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BUSINESS VALUATION & FINANCIAL ADVISORY SERVICES

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VALUE FOCUS

Construction & Building Materials

Fourth Quarter 2019 | Segment Focus: Nonresidential Construction

Executive Industry Trends

- Residential construction rebounded after declining through the second half of 2018. Mortgage rates declined to multi-year lows.
- State and local governments increased spending on much-needed infrastructure projects but are beginning to face budgetary constraints and the expiration of FAST Act funding.
- The Fed cut the federal funds rate in July, September, and October, the first series of cuts since 2008, as the 10-year treasury yield has continued to decline.
- Nonresidential construction spending increased in 2019 led by public infrastructure, office, and transportation spending.

In This Issue

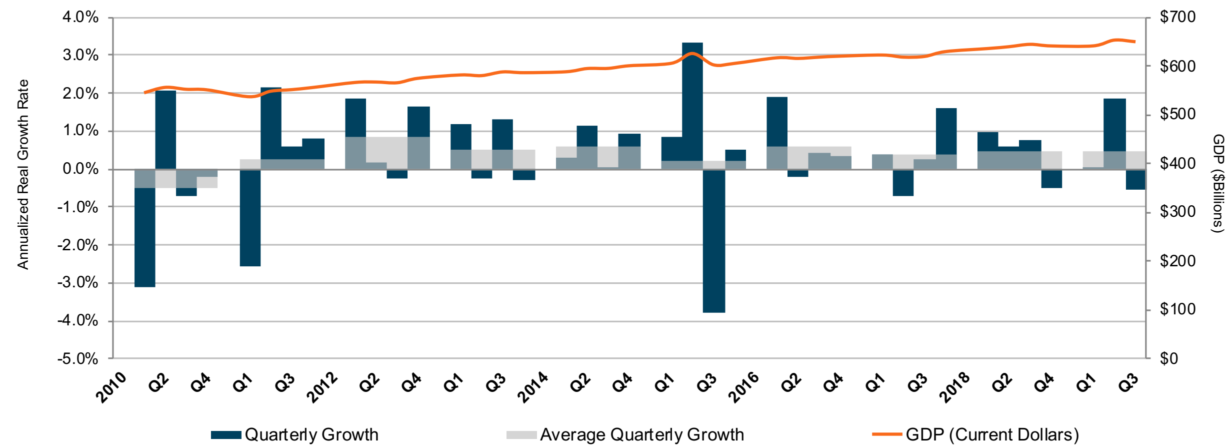
Construction Overview	1
Segment Focus: Nonresidential Construction	4
Sector Round-up	8
Bellwether Stocks & Industry Participants	12
About Mercer Capital	16

Construction Overview

Construction & National GDP

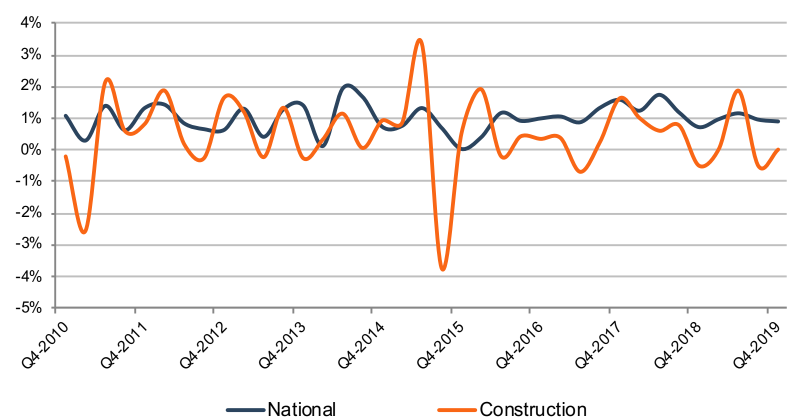
National GDP rose 4.1% (nominal basis) during 2019, in line with recent periods but decelerating from the pace set in 2018. Since 2009, construction averaged 3.4% of national GDP, and accounted for 3.0% of GDP during 3Q 2019 (4Q19 construction GDP not yet available). Construction has steadily recovered since the decline precipitated by the 2008 financial crisis, experiencing growth consistent with that of the national GDP. Fluctuations in construction GDP have now stabilized, with most quarterly growth rates lying in the plus or minus 0-2 percent range since 2012. Year-over-year construction GDP has increased 0.8%. The deceleration in construction GDP growth over the second half of 2018 was primarily due to declining residential construction activity. Despite improved residential construction performance, political and trade tensions are weighing on the outlook for industry growth as well as concerns over the length of the current credit cycle.

Construction Gross Domestic Product



Source: Bureau of Economic Analysis

% Change in GDP



Source: tradingeconomics.com | U.S.Bureau of Economic Analysis

Construction GDP	
Period	**% Change**
Q-o-Q	-0.5%
Y-o-Y	0.8%

National GDP	
Period	**% Change**
Q-o-Q	0.9%
Y-o-Y	4.0%

*Based on 3Q19 Date

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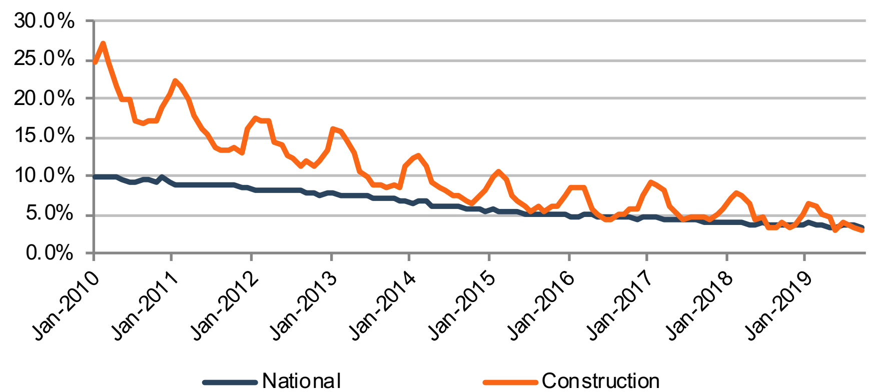
Construction Overview

Construction & National Unemployment

The Federal Reserve generally views a healthy economy as having an unemployment rate between 4.5% and 6.0%. The current level of 3.5% falls below this range, indicative of a tight labor market. The December unemployment rate matches period lows of recent months.

The unemployment rate in the construction industry is typically more volatile because it is a cyclical and seasonal industry. The major contributing factor to the seasonal nature of the industry is weather. Production of materials and projects generally decrease during the colder, winter months. December construction unemployment was at 5.0%, comparable to the level of 5.1% at the same time last year. The construction unemployment rate hit period lows of 3.2% in May and September 2019. A lack of skilled laborers has become an industry wide issue and has contributed to wage growth and increased costs for builders.

Unemployment Rate



Source: U.S. Bureau of Labor Statistics

Note: In the above graph, the national unemployment rate is seasonally adjusted, but the construction unemployment rate is not in order to show seasonality and recent trends.

Construction Overview

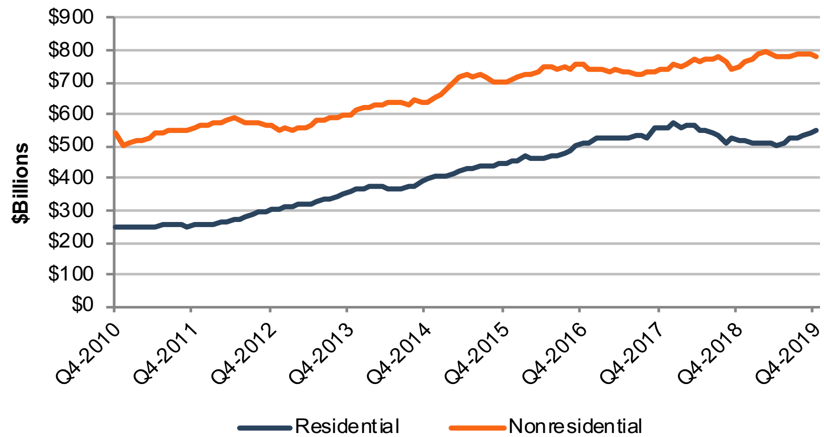
Value of Construction Put-in-Place

The value of construction put-in-place is the total value of construction work done in the U.S. for a particular period. The U.S. Census Bureau tracks this data and reports the total monthly. This value includes, but is not limited to, building materials costs, labor costs, profit, engineering costs, interest, and taxes.

Year-over-year put-in-place construction has increased by 5.8% for residential and increased by 4.4% for nonresidential. Nonresidential construction decreased by 0.8% quarter-over-quarter through December 2019. After declining in 2018, put-in-place residential construction increased in the fourth quarter of 2019 as the sharp rise in mortgage rates in late 2018 reversed course throughout 2019 although concerns about affordability and availability remain.

Nonresidential construction was supported by increased spending at the local and state government level on public infrastructure over the past year due to a large backlog of deferred maintenance. However, public spending on infrastructure softened in the second half of 2019. A decline in commercial-related construction spending also weighed on nonresidential construction in 2019.

Value of Construction Put-in-Place



Source: U.S. Census Bureau

Residential	
Period	**% Change**
Q-o-Q	3.5%
Y-o-Y	5.8%

Nonresidential	
Period	**% Change**
Q-o-Q	-0.8%
Y-o-Y	4.4%

Sector Focus

Nonresidential Construction

After years of recovery and economic expansion, total construction spending was flat in 2019 as political and trade tensions are weighed on the outlook for industry growth as well as concerns over the length of the current credit cycle. According to the **2020 FMI Overview**, total construction and engineering spending is projected to increase by a mere 1% in 2020.

Leading construction spending segments of public infrastructure and various other nonresidential sectors were offset by lackluster residential spending in 2019. Construction spending in public infrastructure segments of power, highway and street, sewage and waste disposal, water supply, and conservation and development all increased by more than 5% in 2019. Other leading segments included lodging, office, and transportation construction spending. Residential segments (-4.6%) as well as commercial (-10.7%) construction spending all declined in 2019.

Lodging construction spending in 2019 was aided by low unemployment and a stable economy. However, projected spending is expected to decelerate due to the significant increase in supply as well as heightened uncertainty regarding future GDP growth and the 2020 presidential election. Office construction spending has been supported by historically low unemployment rates and strong demand in large metro markets as well as niche segments such as technology, data centers, and life sciences. Transportation spending is expected to continue to enjoy strong demand from large airport investments and transit and light rail megaprojects expected to get started over the coming years in various states (including Florida, Texas, California, and Massachusetts). Construction spending on commercial space such as shopping centers and malls has continued to be adversely affected by the shift in spending habits towards e-commerce. Additionally, declining global trade has reduced demand for larger warehouse units. Pockets of high demand in commercial construction spending are focused on well-positioned hybrid spaces that combine retail and entertainment experiences. Construction spending has become increasingly concentrated in fewer, large markets due to increasing urbanization.

State and local governments have increased much-needed spending on infrastructure projects as the prospects of the administration's infrastructure plan have continuously diminished. After a period of fiscal restraint, state and local governments have begun to work through a backlog of deferred maintenance with growth being led by several of the largest states such as California's SB1 Bill. However, analysts are concerned the current trend is unsustainable and other fixes such as more public-private partnerships (3Ps), infrastructure funds, and improving the tax system are in order. While prospects of a grand infrastructure plan may be revived in the 2020 election cycle, the Fixing America's Surface Transportation (FAST) Act is set to expire in 2020 and funds will need to be reauthorized.

Nonresidential Construction

Trade-Weighted Index and Yield on 10-Year Treasury

The **Trade-Weighted Index** measures the relative strength of the U.S. Dollar in comparison to foreign currencies, putting an emphasized weight on the most common trade partners and largest economies. When the Dollar is strong, imports become cheaper and exports become more expensive. The Dollar is near its strongest level in the last ten years, which increases the cost for other countries to purchase U.S. building materials and decreases sales volume. The TWI increased throughout 2018 after a decline in 2017. Divergence in monetary policy between the U.S. and the international community boosted the dollar's appreciation as the Fed increased rates in 2018.

The **yield on 10-Year Treasury Bonds** can indirectly affect the road contracting industry. Higher interest rates make construction projects more expensive to undertake but they may also signify increased optimism about economic growth. As seen on the chart on page 6, the 10-year yield experienced an upward trend for much of 2017 and 2018 as the Fed raised short term interest rates. The 10-year yield has decreased by 97 basis points over the past year due to a shift in the Fed's stance on interest rates over concerns of the flattening yield curve. The Fed lowered the federal funds rate in July, September, and October, the first rate reductions since 2008.

One interest rate measure to watch is the spread between 10-year and 2-year treasury yields. A spread approaching zero or an inversion has historically preceded a recession and potentially signals that the Fed has tightened rates too much. After dipping into negative territory in August 2019, the spread pulled back in September as the Fed continued to cut the federal funds rate which has a greater impact on 2-year yields. The market appears to be signaling increased odds of further short-term rate reductions.

Nonresidential Construction

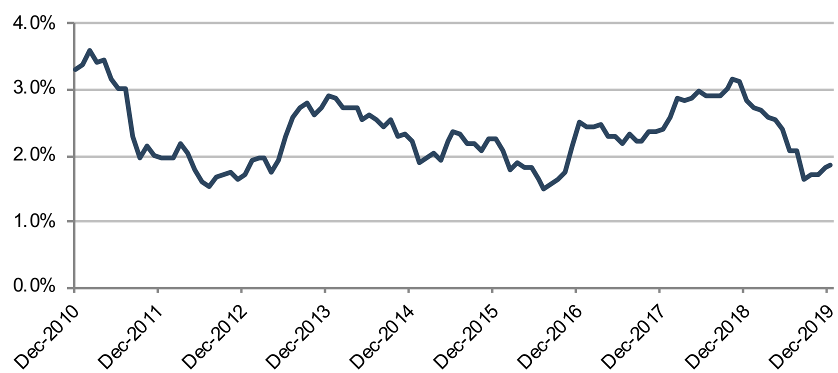
Trade-Weighted Index and Yield on 10-Year Treasury

Trade-Weighted Index

Source: St. Louis Fed | Board of Governors of the Federal Reserve (US)

Trade-Weighted Index	
Period	**% Change**
Q-o-Q	-1.1%
Y-o-Y	0.7%

Yield on 10-Year Treasury



Source: St. Louis Fed

Yield on 10-Year Treasury	
Period	**% Change**
Q-o-Q	16 BPS
Y-o-Y	-97 BPS

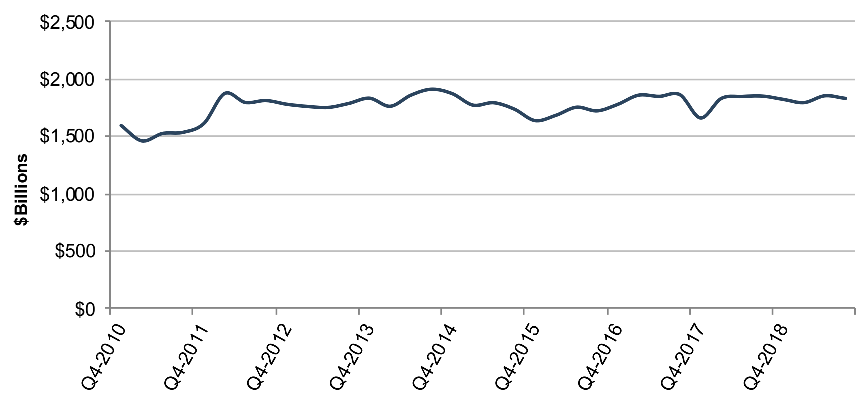
Nonresidential Construction

Corporate Profit and Office Rental Vacancy

Corporate profit is essential for companies not only to survive, but to grow and expand. When corporate profit increases, companies are more willing and able to open new branches and divisions. These additions lead to more commercial construction. As seen in the chart below, corporate profit has flattened in recent periods (4Q19 data not available). The U.S. Tax Cuts and Jobs Act of 2017 lowered the corporate tax rate from 35% to 21%. The dip in the fourth quarter of 2017 is partially due to one-time deferred tax asset write-downs incurred by companies owing to the new tax rate. Uncertainty regarding the global trade outlook given ongoing tensions between the United States and China may weigh on future business investment.

Office rental vacancy can also be a signal for new commercial construction demand. Low vacancy rates indicate a need for more space for companies to conduct business, which is a boon for the nonresidential construction industry. Both suburban and downtown vacancy rates have remained stable at cycle lows for the previous couple of years as strong demand has absorbed supply as it has become available. New construction has been predominantly concentrated in a small number of metro markets such as Manhattan, Washington D.C., and San Francisco. According to **CBRE**, the metro areas with the higher 2019 absorption totals were San Jose, Washington D.C., Dallas, Phoenix, and Chicago – a regionally diverse group. Labor constraints and slowing employment growth may slow future spending on office real estate.

Corporate Profit



Source: St. Louis Fed

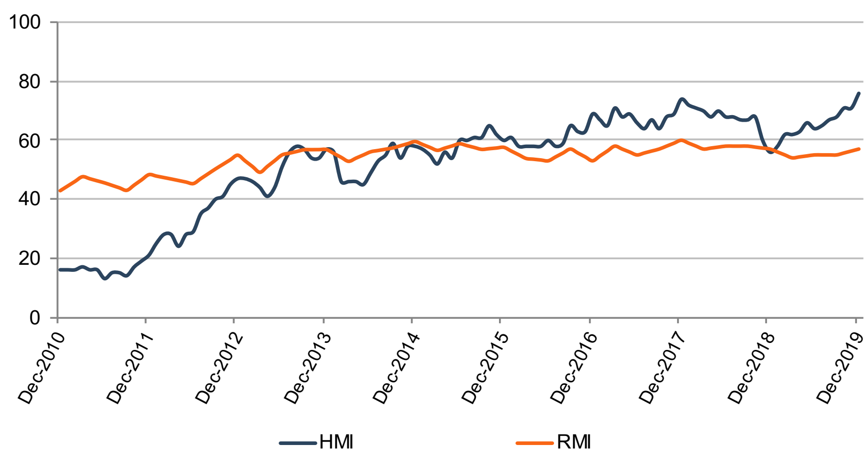
Corporate Profit	
Period	**% Change**
Q-o-Q	-1.2%
Y-o-Y	-1.1%

Sector Round-up

Residential Construction

The National Association of Home Builders conducts two separate surveys, the Housing Market Index ("HMI") and the Remodeling Market Index ("RMI"), to measure confidence in the home building industry. Respondents rate their activity on a scale from 1-100 with 50 being average. The HMI is produced monthly and asks respondents to rate market conditions both at present and looking forward six months. The monthly index has remained above 50 since July 2014 and reached a ten-year high of 76 in December 2019. The HMI recovered in the first half of 2019 after housing market activity had softened in late 2018. Additionally, American homebuilders are less exposed to ongoing trade disputes with China and the European Union. The RMI is produced quarterly and asks respondents to rate their work volume as either higher or lower than the previous quarter. The quarterly index has fluctuated between 50 and 60 since the second quarter of 2013.

National Association of Home Builders HMI and RMI



NAHB HMI	
Period	**% Change**
Q-o-Q	11.8%
Y-o-Y	35.7%

NAHB RMI	
Period	**% Change**
Q-o-Q	0.0%
Y-o-Y	-3.5%

Source: National Association of Home Builders

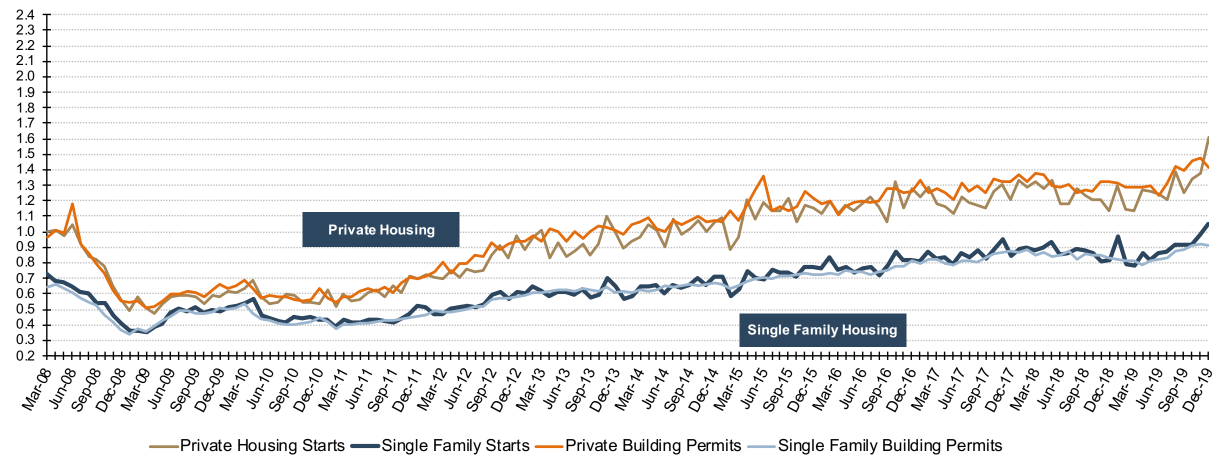
Note: RMI is measured quarterly and approximated for a monthly basis using a straight-line approach

Sector Round-up

Residential Construction (continued)

Building permits and housing starts are two important indicators for the home building industry. Both reflect demand, consumer confidence, and the feasibility of financing construction projects. Building permits can be issued and then shelved by builders; therefore, housing starts are a better focused measure of current activity within the industry. After declining nearly 75% during from Q1 2006 to Q1 2009 as the housing bubble unwound, housing permits and starts have steadily recovered but are unlikely to reach pre-recession highs. After mixed performance throughout most of 2018, housing starts have improved throughout 2019 as demand for new homes increased in response to declining mortgage rates.

Seasonally Adjusted Annualized Rates of New Housing Starts and Building Permits (Millions of Units)



Source: U.S. Census Bureau
Note: Permits at a given date are generally a leading indicator of future starts. Beginning with January 2004, building permit data reflects the change to the 20,000 place series.

Private Housing Starts	
Period	**% Change**
Q-o-Q	28.0%
Y-o-Y	41.1%

Single Family Starts	
Period	**% Change**
Q-o-Q	14.9%
Y-o-Y	29.6%

Private Building Permits	
Period	**% Change**
Q-o-Q	1.8%
Y-o-Y	6.8%

Single Family Building Permits	
Period	**% Change**
Q-o-Q	4.0%
Y-o-Y	10.5%

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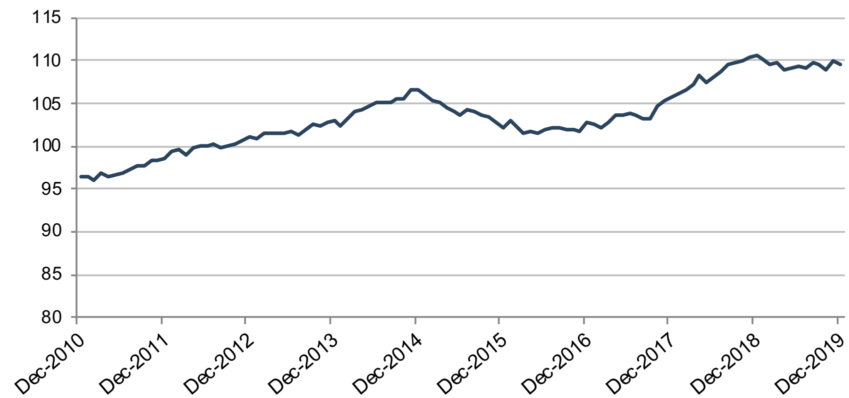
Sector Round-up

Building Materials

The Industrial Production Index ("IPI") is an indicator of economic activity that measures real production output of the manufacturing, mining, and utilities industries. It acts as a barometer for the level of demand for industrial products and manufacturing activity. After oscillating for a couple of years, IPI steadily increased for most of 2017 and 2018. In December 2018, IPI reached its highest level of the examined period but has experienced limited growth during 2019.

Cement and ready-mix concrete are used in most construction projects involving the utilities subsector such as transportation, energy, gas, water, and sewage. There will always be a need for such infrastructure, so building materials companies can rely on this revenue stream even though the growth rate of new projects fluctuates. The value of utilities construction has increased 10.2% year-over-year. Increased renovation and safety requirements have driven an increase in power construction spending as well as a focus on natural gas and renewable energy sources. Spending on water supply construction is expected to increase as most of the country's pipeline system was installed in the mid-20th century.

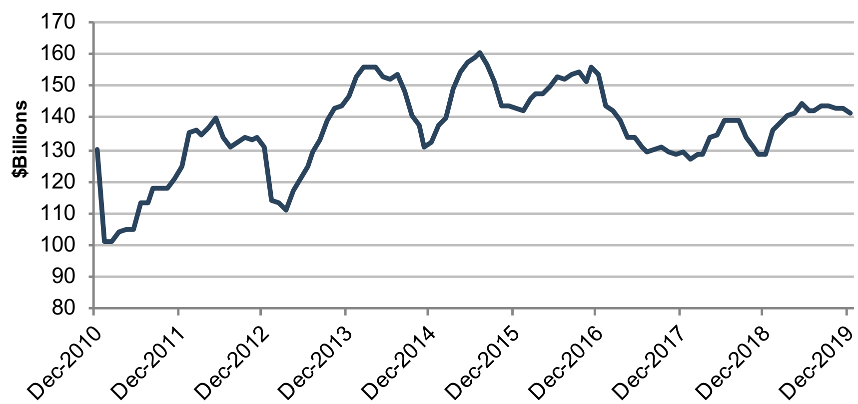
Industrial Production Index



Source: St. Louis Fed

Industrial Production Index	
Period	**% Change**
Q-o-Q	0.1%
Y-o-Y	-0.9%

Value of Utilities Construction



Source: U.S. Census Bureau

Value of Utilities Construction	
Period	**% Change**
Q-o-Q	-1.5%
Y-o-Y	10.2%

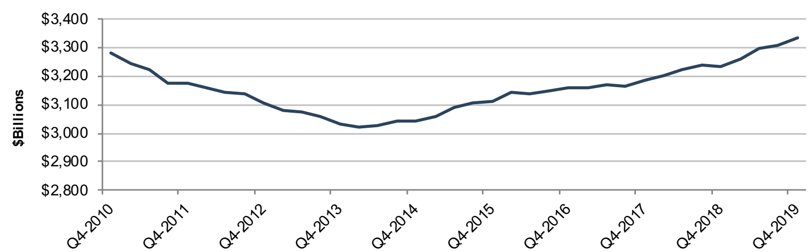
Sector Round-up

Roads, Bridges, and Highways

Building materials are a crucial input to construction projects. Without funding, however, construction projects cannot be completed. Much of this funding comes from public resources, so the industry is typically concerned with the level of government spending on construction activity. Government consumption expenditures and gross investments ("GCI") reached high levels during the recession to boost the economy and declined significantly in the years following. After stagnating for much of 2016 and 2017, GCI grew throughout 2018 and 2019 reaching the highest levels since 2010. The growth in GCI was boosted by increased military spending as well as increased public infrastructure investment at the state and local level.

The value of road and highway construction increased 14.1% year-over-year as state and local governments increased spending on infrastructure in place of increased federal spending. However, road and highway construction has declined after peaking in April. As state and local governments come under more budgetary pressures, alternative sources of funding need to be tapped. Increased political uncertainty has clouded the future of road and highway construction as the FAST Act will expire in 2020 amidst the 2020 presidential election.

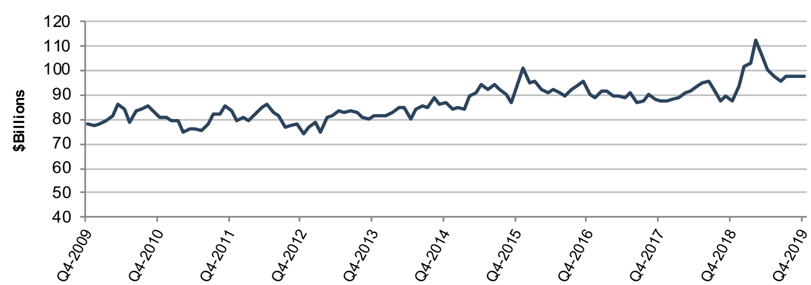
Government Consumption and Investment



Source: St. Louis Fed

Government Consumption and Investment	
Period	**% Change**
Q-o-Q	0.7%
Y-o-Y	3.0%

Value of Highway and Street Construction



Source: U.S. Census Bureau

Value of Highway and Street Construction	
Period	**% Change**
Q-o-Q	2.8%
Y-o-Y	14.1%

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Bellwether Stocks & Industry Participants

	Ticker	Price at 12/31/19	52-Week Perf.	LTM Revenue	Enterprise Value	Debt / MVTC	EBITDA Margin	EV / EBITDA (x)	TEV / Next Yr EBITDA (x)	Price / LTM Earnings
Residential										
Beazer Homes USA, Inc.	NYSE: BZH	14.13	49.1%	2,104	1,495	74.3%	3.5%	20.32	7.68	NM
D.R. Horton, Inc.	NYSE: DHI	52.75	52.2%	18,095	21,679	16.4%	12.7%	9.43	8.35	11.10
KB Home	NYSE: KBH	34.27	79.4%	4,553	4,706	36.6%	8.8%	11.80	7.96	11.29
Lennar Corporation	NYSE: LEN	55.79	42.5%	22,260	26,861	35.6%	11.6%	10.41	9.09	9.69
LGI Homes, Inc.	NasdaqGS: LGIH	70.65	56.2%	1,658	2,341	31.8%	12.3%	11.52	8.56	10.40
M.D.C. Holdings, Inc.	NYSE: MDC	38.16	46.6%	3,293	3,231	33.2%	9.9%	9.92	7.19	9.93
NVR, Inc.	NYSE: NVR	3,808.41	56.3%	7,426	13,693	4.7%	14.4%	12.79	12.27	15.78
PulteGroup, Inc.	NYSE: PHM	38.80	49.3%	10,213	12,856	23.5%	13.8%	9.13	7.96	10.58
Taylor Morrison Home Corporation	NYSE: TMHC	21.86	37.5%	4,762	4,253	46.2%	8.8%	10.18	9.85	9.18
Meritage Homes Corporation	NYSE: MTH	61.11	66.4%	3,667	3,229	31.0%	9.3%	9.42	7.51	9.33
TRI Pointe Group, Inc.	NYSE: TPH	15.58	42.5%	3,083	3,530	38.2%	10.3%	11.12	10.22	10.59
Median - Residential			**49%**	**4,553**	**4,253**	**33.2%**	**10.3%**	**10.41**	**8.35**	**10.49**

All figures reported in millions, except per share data

Source: Capital IQ

Bellwether Stocks & Industry Participants

	Ticker	Price at 12/31/19	52-Week Perf.	LTM Revenue	Enterprise Value	Debt / MVTC	EBITDA Margin	EV / EBITDA (x)	TEV / Next Yr EBITDA (x)	Price / LTM Earnings
Building Materials										
Eagle Materials Inc.	NYSE: EXP	90.66	48.5%	1,420	4,755	20.8%	26.8%	12.48	10.39	NM
Martin Marietta Materials, Inc.	NYSE: MLM	279.64	62.7%	4,422	20,852	15.8%	28.3%	16.67	14.88	28.60
Summit Materials, Inc.	NYSE: SUM	23.90	92.7%	2,222	4,466	42.1%	19.7%	10.18	9.10	45.40
U.S. Concrete, Inc.	NasdaqGS: USCR	41.66	18.1%	1,480	1,459	53.3%	11.0%	8.95	7.06	52.64
Vulcan Materials Company	NYSE: VMC	143.99	45.7%	4,929	22,172	14.3%	25.1%	17.96	15.50	30.60
CEMEX, S.A.B. de C.V.	BMV: CEMEX CPO	0.38	-22.3%	13,130	18,077	66.7%	15.6%	8.80	7.35	100.64
CRH plc	ISE: CRG	40.03	51.3%	31,933	43,780	29.7%	12.8%	10.73	9.23	17.86
HeidelbergCement AG	DB: HEI	73.10	20.1%	20,764	27,182	48.7%	16.0%	8.18	6.60	13.17
LafargeHolcim Ltd	SWX: LHN	55.45	34.7%	27,929	49,647	32.5%	21.2%	8.37	7.31	14.76
Median - Building Materials			**46%**	**4,929**	**20,852**	**32.5%**	**19.7%**	**10.18**	**9.10**	**29.60**
Roads, Bridges, and Highways										
Granite Construction Incorporated	NYSE: GVA	27.67	-31%	3,390	1,350	27.7%	0.3%	135.45	5.63	NM
Sterling Construction Company, Inc.	NasdaqGS: STRL	14.08	29.3%	1,035	406	18.6%	4.4%	9.01	2.85	16.08
Construction Partners, Inc.	NasdaqGS: ROAD	16.87	91.1%	804	843	7.1%	11.1%	9.47	8.54	19.98
Tutor Perini Corporation	NYSE: TPC	12.86	-19.5%	4,456	1,301	57.7%	5.8%	5.05	4.05	NM
Median - Roads, Bridges, and Highways			**5%**	**2,212**	**1,072**	**23.2%**	**5.1%**	**9.24**	**4.84**	**18.03**

All figures reported in millions, except per share data
Source: Capital IQ

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Bellwether Stocks & Industry Participants

	Ticker	Price at 12/31/19	52-Week Perf.	LTM Revenue	Enterprise Value	Debt / MVTC	EBITDA Margin	EV / EBITDA (x)	TEV / Next Yr EBITDA (x)	Price / LTM Earnings
Nonresidential										
AECOM	NYSE: ACM	43.13	63%	20,053	9,306	39.3%	4.7%	9.80	12.38	NM
Dycom Industries, Inc.	NYSE: DY	47.15	-13%	3,351	2,522	41.7%	9.0%	8.36	7.56	26.32
EMCOR Group, Inc.	NYSE: EME	86.30	44.6%	9,000	4,990	9.5%	6.0%	9.24	8.65	15.34
Fluor Corporation	NYSE: FLR	18.88	-41%	18,520	2,879	42.6%	-0.6%	(24.17)	5.69	NM
Jacobs Engineering Group Inc.	NYSE: J	89.83	53.7%	13,014	12,794	17.8%	7.5%	13.09	11.49	30.13
MasTec, Inc.	NYSE: MTZ	64.16	58%	7,392	6,345	24.4%	10.9%	7.88	7.27	14.98
Quanta Services, Inc.	NYSE: PWR	40.71	35.2%	12,112	7,894	27.3%	7.4%	8.79	7.34	17.52
Median - Nonresidential			**45%**	**12,112**	**6,345**	**27.3%**	**7.4%**	**8.79**	**7.56**	**17.52**

All figures reported in millions, except per share data

Source: Capital IQ

Mercer Capital

Construction &
Building Materials
Industry Services

Mercer Capital provides valuation and transaction advisory services to the construction and building materials industries.

Industry Segments

Mercer Capital serves construction industry segments from to commercial and civil to residential. We also serve the building materials sector from aluminum and steel to brick, glass, and lumber.

Mercer Capital Experience

- Family and management succession planning
- Buy-side and sell-side transaction advisory assistance
- Conflict resolution and litigation support
- Trust and estate planning
- Buy-sell agreement valuation, design, and funding advisory

Contact a Mercer Capital professional to discuss your needs in confidence.

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