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VALUE FOCUS

Construction & Building Materials

Second Quarter 2020 | Sector Focus: Building Materials

Executive Industry Trends

- Strong economic fundamentals entering 2020 were overshadowed by the spread of COVID-19. Government actions taken to counteract the virus dramatically lowered economic activity as the country suffered the largest annualized GDP decline in U.S. history in the second quarter of 2020.
- Construction designated as an "essential" sector throughout most of the country, allowing construction companies to continue to work although in the face of a multitude of disruptions.
- Signs of economic fallout started to appear in late 1Q20 data but 2Q20 demonstrated a more comprehensive picture of the effects of the virus on economic barometers. Most metrics suffered their steepest declines in April and showed some improvement through June.

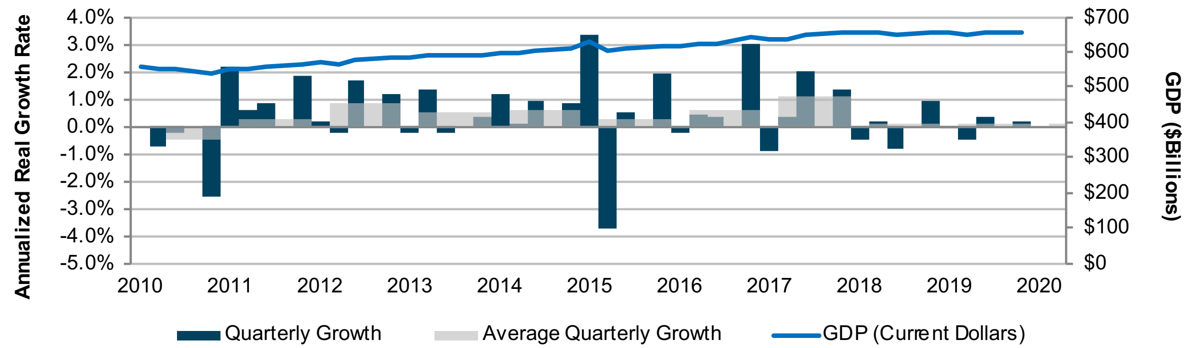
In This Issue

Construction Overview

Construction & National GDP

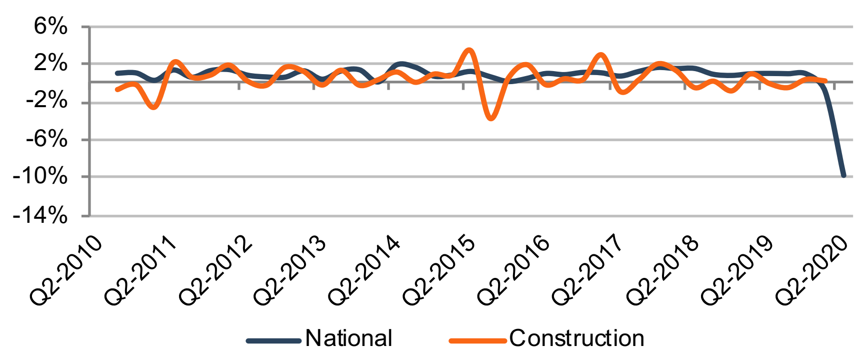
U.S. GDP contracted 9.6% quarter-over-quarter in the second quarter of 2020, the second consecutive quarterly decline after twenty-two previous quarters of growth. The decline is due to the spread of COVID-19, which was declared a global pandemic by the World Health Organization on March 11, 2020. As governments responded by issuing "stay-at-home" orders, economic activity and demand plummeted. Many employers shifted to remote work or postponed operations which has led to a spike in unemployment. Economic growth is expected to be negatively affected for an indeterminate period. Year-over-year construction GDP growth was flat through the first quarter of 2020. The deceleration in construction GDP growth over the second half of 2018 was primarily due to declining residential construction activity which recovered strongly through the end of 2019. Despite entering 2020 with strong fundamentals, construction activity and demand will likely suffer with the broader economy from the fallout of COVID-19. Backlog execution and pipeline projects may benefit from lower interest rates.

Construction Gross Domestic Product



Source: Trading Economics

% Change in GDP



Construction GDP	
Period	**% Change**
Q-o-Q	-6.4%
Y-o-Y	-6.0%

National GDP	
Period	**% Change**
Q-o-Q	-9.6%
Y-o-Y	-8.6%

Source: Trading Economics, U.S. Bureau of Economic Analysis

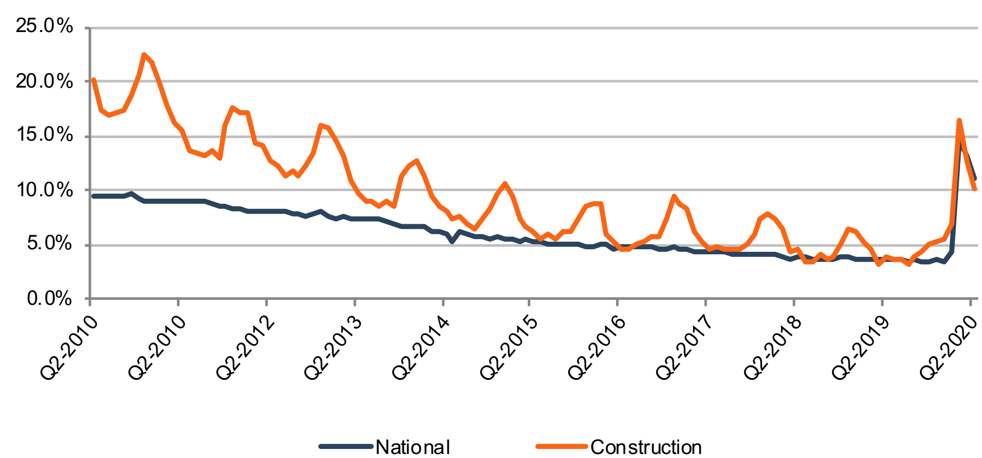
Construction Overview

Construction & National Unemployment

The Federal Reserve historically gauges a healthy economy as sustaining an unemployment rate between 4.5% and 6.0%. The increase from 3.5% in February 2020 to 14.7% in April 2020 reflects the initial impact of COVID-19 as economic activity plummeted. The unemployment rate improved from its peak in April to 11.1% in June 2020, which is still significantly above pre-COVID levels.

The unemployment rate in the construction industry is typically more volatile due to the cyclical and seasonal nature of the industry. The major contributing factor to the seasonal nature of the industry is the weather. Production of materials and projects generally decrease during the colder, winter months. Construction unemployment peaked in at April at 16.6% before improving to 10.1% in June 2020. The construction unemployment rate hit period lows of 3.2% in May and September 2019. Many construction activities have been designated as "essential" throughout most of the country, which may partially mitigate the decline in construction employment relative to the broader economy.

Unemployment Rate



Source: U.S. Bureau of Labor Statistics

Construction Overview

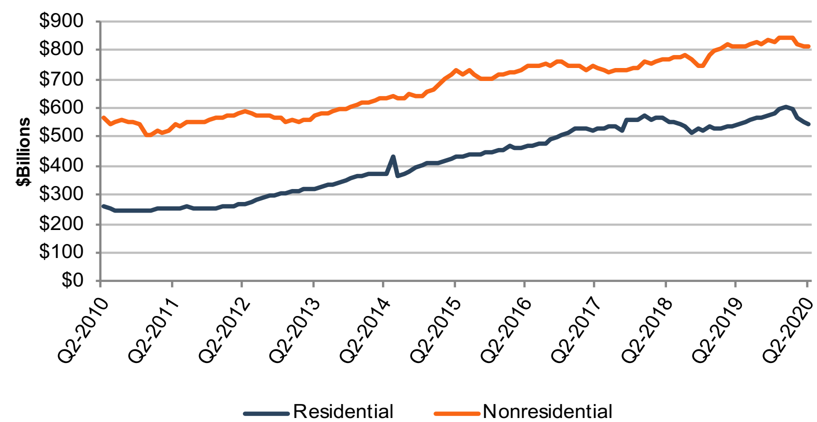
Value of Construction Put-in-Place

The value of construction put-in-place is the total value of construction work performed in the U.S. during a specified period. The U.S. Census Bureau tracks this data and reports the monthly results. 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 increased by 0.4% for nonresidential and declined by 0.2% for residential. After declining in 2018, put-in-place residential construction continued to increase in 1Q20 as the sharp rise in mortgage rates in late 2018 reversed course throughout 2019. The decline in housing starts in March due to COVID- 19 has weighed on residential construction in the second quarter as increased unemployment and uncertainty has reduced demand. Low mortgage rates helped mitigate the downturn as eligible buyers sought new homes from a somewhat limited inventory.

Nonresidential construction has been 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. Nonresidential construction will be disrupted going forward due to the negative economic fallout from COVID-19. Sectors that are expected to be particularly affected include the oil and gas due to the collapse in oil prices, retail, office, lodging, and transportation.

Value of Construction Put-in-Place



Source: U.S. Census Bureau

Residential	
Period	**% Change**
Q-o-Q	-8.8%
Y-o-Y	-0.2%

Nonresidential	
Period	**% Change**
Q-o-Q	-3.3%
Y-o-Y	0.4%

Sector Focus

Building Materials

The global economy was affected by a pandemic declared by the World Health Organization ("WHO") as of March 11, 2020. COVID-19 is considered highly dangerous, particularly for the elderly and/or those with pre-existing conditions and chronic ailments that compromise the human immune system. Since its discovery, COVID-19 has spread throughout the globe. Incidence of infection and mortality persisted through the first half of 2020. Governmental authorities in the U.S. and abroad have mandated limits on social gatherings and recommended that civilian populations take measures to isolate themselves to curtail further spread of the disease. All manner of public and private events have been canceled throughout the world, and travel and border restrictions have been enacted by the U.S. and many other nations. These restrictions are expected to negatively affect economic growth for an indeterminate period. As locales ease limits on social gatherings over different timetables, economic activity may accelerate, albeit, with the chance that infections may escalate again.

The evolution of the pandemic, the extent of its economic and cultural consequences, and the results of steps taken and yet to be taken by governments and financial institutions are fluid and evolving in real-time. U.S. GDP suffered a historic decline in the second quarter of 2020 due to COVID-19. The decline in GDP in the second quarter translated to an annualized 33% decline, the steepest recorded decline in U.S. economic history.

The U.S. Federal Reserve's responses to the deepening COVID-19 crisis have included emergency cuts to the Fed Funds Rate of 50 and 100 basis points on March 6th and March 16th, respectively. The federal government passed three significant acts intended to respond to the medical crisis and mitigate its economic effects, culminating in the Coronavirus Aid, Relief, and Economic Security Act (the "CARES Act") on March 27, 2020. The Federal Reserve also launched several programs and initiatives to alleviate funding strains and illiquidity in various markets, leveraging many programs created in response to the 2008 to 2009 financial crisis. Additional legislative, executive, and agency-level actions may occur as policymakers seek to minimize the economic downside of the pandemic and to promote economic recovery.

The construction industry has been designated as "essential" throughout much of the country. Accordingly, some builders are able to execute current backlog. However, contractors will contend with an increasingly disruptive operating environment as municipalities are slow to clear paperwork while labor constraints and supply disruptions complicate the work site. Despite the acute downturn evidenced by the 2Q-20 economic data, publicly traded building materials companies reported steady to record earnings in the second quarter driven by strong current backlogs and continued construction in key markets (including North Texas, Colorado, Utah, and Virginia). However, most management teams hesitated to provide guidance for future earnings due to the current level of heightened uncertainty surrounding employment trends, additional federal stimulus, and the state of federal and local funding.

Sector Focus

Building Materials (cont.)

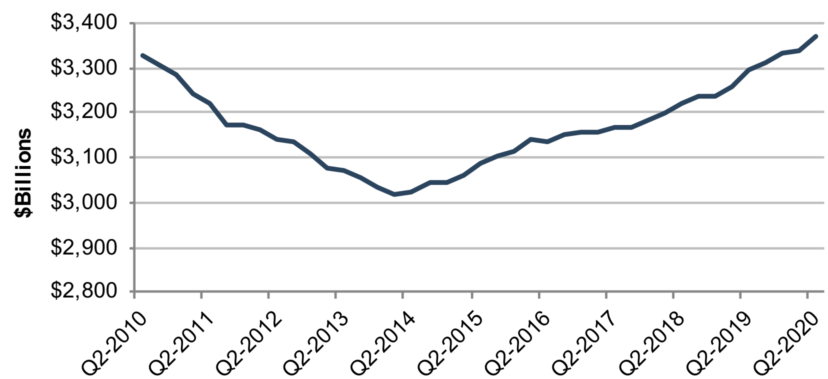
The outlook for building materials end-markets remains mixed. The residential market showed signs of improvement towards the end of the second quarter as starts and confidence indices increased from their April floors while mortgage rates remain at historic lows. Non-residential construction demand depends on the extent to which the end-market has been affected by COVID-19. Lodging, retail, airport, and office demand are expected to remain under pressure from COVID-19. State funding sources for road and highway spending may become strained due to budgetary pressures, especially due to responses to COVID-19. Additionally, the Fixing America's Surface Transportation (FAST) Act is set to expire in September 2020 and its successor will be a political issue during the upcoming elections.

Building Materials

Government Consumption and Investment

Most of the funding for transportation infrastructure comes from public resources. Accordingly, activity in the contracting and building materials industries is typically correlated to level of government spending on construction activity. To bolster the economy during the great recession, government consumption expenditures and gross investments increased but declined significantly in the years following. After stagnating for much of 2013 to 2016, GCI increased 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. As COVID-19 weighs on various construction sectors, public construction spending may prove to be a stable source of demand especially if fiscal stimulus accelerates. There is some risk that state-level funding capacity could be adversely affected by the significant decline in motor fuel purchases during the COVID-19 crisis. Accordingly, backlog and pipeline projects that normally lessen down-cycle declines in infrastructural construction could be delayed and/ or reduced.

Government Consumption and Investment



Government Consumption and Investment	
Period	**% Change**
Q-o-Q	1.0%
Y-o-Y	2.2%

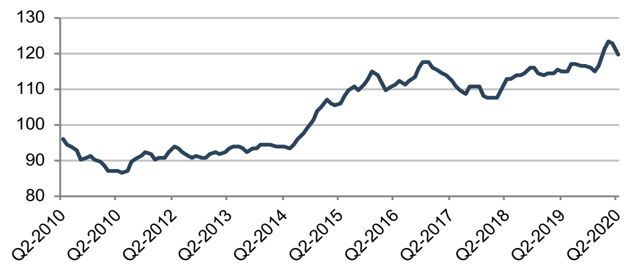
Source: St. Louis Fed | U.S. Bureau of Economic Analysis

Building Materials

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. Halfway through 2020, the Dollar remains at its strongest level in the last 10 years, which increases the cost for other countries to purchase U.S. building materials and decreases sales volume. The TWI increased throughout 2018 and remained steady in 2019. Divergence in monetary policy between the U.S. and the international community boosted the Dollar's appreciation in 2018 as the Fed raised short-term interest rates and began the process of shrinking its balance sheet. The Fed began to lower rates in the second half of 2019 before eventually employing emergency rate cuts to combat COVID-19.

Trade-Weighted Index

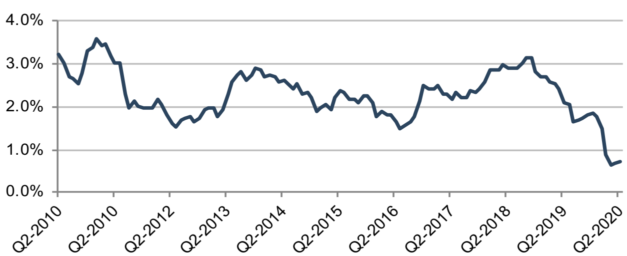


Source: St. Louis Fed | Board of Governors of the Federal Reserve (US)

Trade-Weighted Index	
Period	**% Change**
Q-o-Q	-1.0%
Y-o-Y	4.0%

The yield on 10-Year Treasury Bonds acts as a proxy for how expensive it is to finance construction projects. An increase in yields raises the cost of investment, but it can also signify increasing optimism about future economic growth, which leads to more spending in the construction industry. The 10-year yield peaked in the fourth quarter of 2018 but has since declined due the Fed's rate cuts.

Yield on 10-Year-Treasury Bonds



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

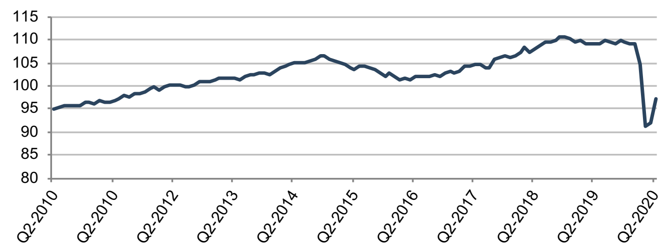
Yield on 10-Year-Treasury Bonds	
Period	**% Change**
Q-o-Q	-14 BPS
Y-o-Y	-134 BPS

Building Materials

Industrial Production Index and Value of Utilities Construction

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 experienced limited growth over 2019. IPI plummeted in April and May 2020 as part of the overall decline in economic activity and manufacturers' preference for drawing down inventories before pivoting back to production. Aerospace and automobile manufacturers will be particularly affected by the decline in traffic and air travel, while other manufacturers will be reliant on an increase in consumer demand in order to resume production

Industrial Production Index

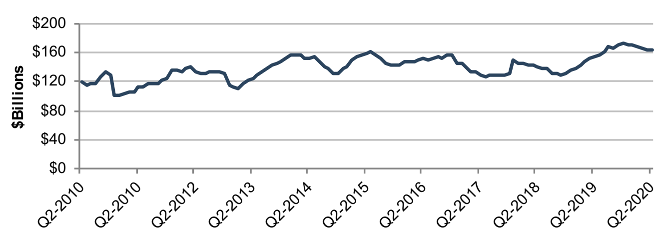


Source: St. Louis Fed | Board of Governors of the Federal Reserve (US)

Industrial Production Index	
Period	**% Change**
Q-o-Q	-7.1%
Y-o-Y	-11.0%

Ready-mix concrete is used in most construction projects involving the utilities subsector such as transportation, energy, gas, water, and sewage. Building materials companies can generally rely on utility maintenance and repair activity when new project activity wanes. The value of utilities construction has increased 6.7% year-over-year. Increased renovation and safety requirements have driven an increase in power construction investment as well as the shift from legacy fossils fuels to natural gas and renewable energy sources. Spending on water supply and purification construction is expected to increase as most of the country's pipeline system was installed in the mid-20th century and will require augmentation and/or replacement to address demand and/or water quality concerns.

Value of Utilities Construction



Source: U.S. Census Bureau

Value of Utilities Construction	
Period	**% Change**
Q-o-Q	-2.0%
Y-o-Y	6.7%

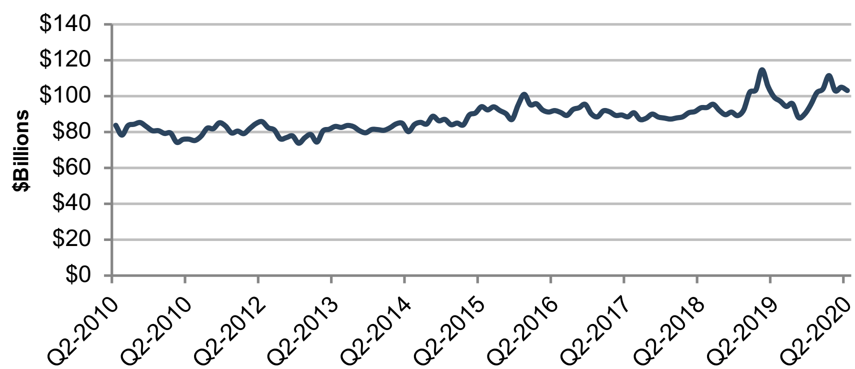
Sector Round-up

Roads, Bridges, and Highways

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. The 10-year yield peaked in the fourth quarter of 2018 after a period of short-term interest rate hikes but has since declined to cyclical lows as discussed previously.

The value of road and highway construction increased 3.6% year-over-year as state and local governments increased spending on infrastructure in place of increased federal spending. After declining from its peak in April 2019, road and highway construction spending increased appreciably through 4Q19 and 1Q20. As state and local governments come under more budgetary pressures, especially due to COVID-19, 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.

Value of Highway and Street Construction



Source: U.S. Census Bureau

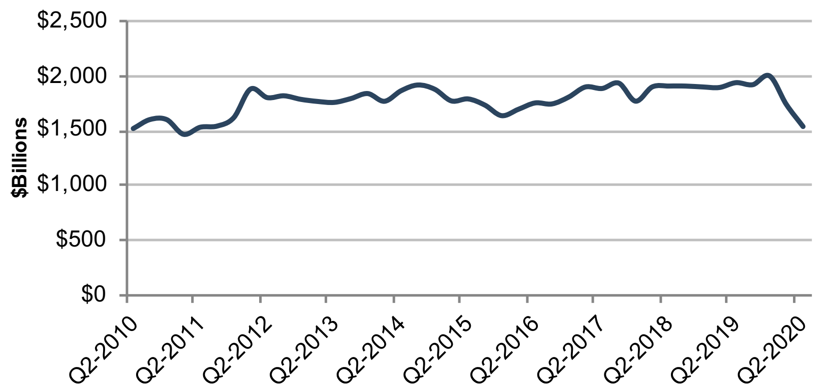
Value of Highway and Street Construction	
Period	**% Change**
Q-o-Q	-7.4%
Y-o-Y	3.6%

Nonresidential Construction

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 following chart, corporate profit 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. Corporate profits have suffered significantly from the fall-off in economic activity due to COVID-19 and are expected to remain under pressure for the balance of 2020. Significant uncertainty exists over the length and extent of the virus's effect on economic activity going forward.

Office and retail 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 driver for the nonresidential construction industry. Both office and retail vacancy could experience increases due to "stay-at-home" orders and reduced foot traffic once current leases expire. COVID-19 may accelerate long-term structural changes that could fundamentally disrupt demand for office and retail space due to expansions in work-from-home technology, evolution of corporate culture, and accelerated e-commerce penetration.

Corporate Profit



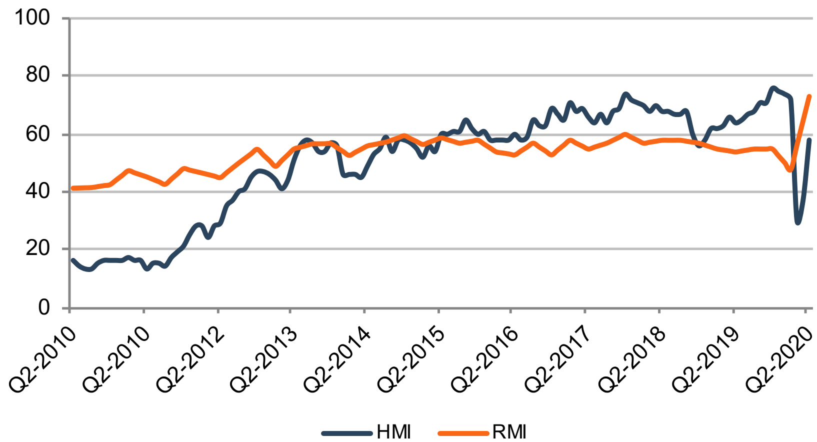
Source: St. Louis Federal Reserve

Corporate Profit	
Period	**% Change**
Q-o-Q	-11.7%
Y-o-Y	-20.8%

Residential Construction

The National Association of Home Builders (NAHB) conducts two separate surveys, the Housing Market Index (HMI) and the Remodeling Market Index (RMI), which 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 remained above 50 from July 2014 through the first quarter of 2020 and reached a ten year high of 76 in December 2019. The HMI plummeted to 30 in April 2020 due to increased uncertainty over the effect of COVID-19 on residential construction demand but recovered to 58 by the end of June 2020. 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 fluctuated between 50 and 60 since the second quarter of 2013 before declining to 48 in the first quarter of 2020. However, the RMI increased to 73 in the second quarter, a higher level over the examined period.

NAHB HMI and RMI



Source: National Association of Home Builders
Note: RMI is measured quarterly and approximated for a monthly basis using a straight-line approach.

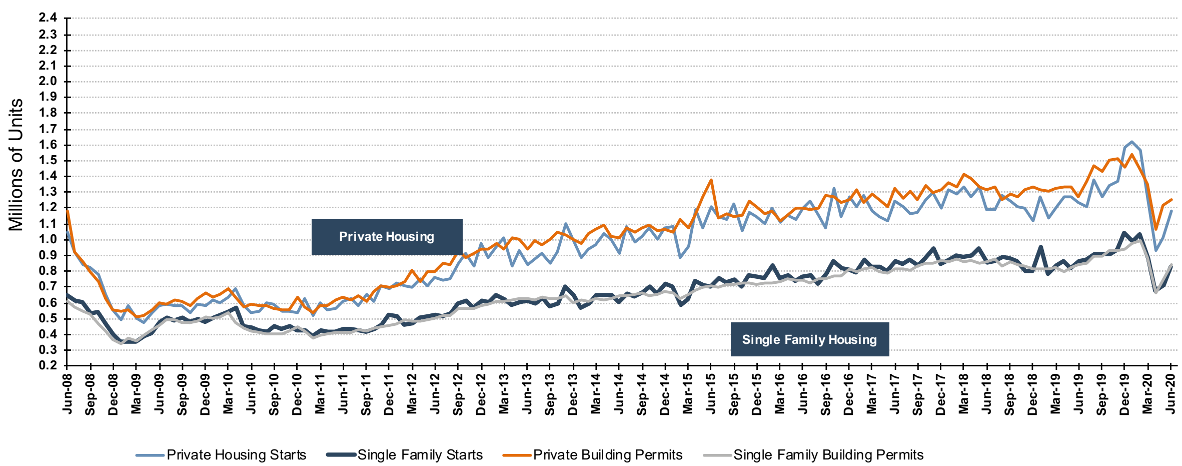
NAHB HMI	
Period	**% Change**
Q-o-Q	-19.4%
Y-o-Y	-9.4%

NAHB RMI	
Period	**% Change**
Q-o-Q	52.1%
Y-o-Y	35.2%

Residential Construction
(cont.)

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 more focused measure of current activity in the industry. After declining nearly 75% during from Q1 2006 to Q1 2009 as the housing boom decayed, housing permits and starts have steadily recovered but are unlikely to reach pre-great recession highs. Both private and single family starts dramatically declined in the first half of 2020 as COVID-19 negatively affected demand for new homes. Housing starts bottomed out in April 2020 and recovered partially through June 2020.

Seasonally Adjusted Annualized Rates of New Housing Starts and Building Permits



Private Housing Stats	
Period	% Change
Q-o-Q	-6.5%
Y-o-Y	-4.0%

Single Family Stats	
Period	% Change
Q-o-Q	-5.6%
Y-o-Y	-3.9%

Private Building Permits	
Period	% Change
Q-o-Q	-7.2%
Y-o-Y	-1.2%

Single Family Building Permits	
Period	% Change
Q-o-Q	-5.0%
Y-o-Y	-0.4%

Bellwether Stocks & Industry Participants

	Ticker	Price at 6/30/20	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	10.07	4.8%	2,222	1,450	80.0%	4.4%	14.72	11.95	9.61
D.R. Horton, Inc.	NYSE: DHI	55.45	28.6%	18,950	23,387	17.8%	13.8%	8.91	10.44	9.93
KB Home	NYSE: KBH	30.68	19.2%	4,709	4,733	33.7%	9.4%	10.66	9.72	9.11
Lennar Corporation	NYSE: LEN	61.62	27.2%	22,621	24,843	32.4%	12.4%	8.89	9.04	9.26
LGI Homes, Inc.	NasdaqGS: LGIH	88.03	23.2%	2,025	2,839	21.2%	13.5%	10.36	11.44	10.09
M.D.C. Holdings, Inc.	NYSE: MDC	35.70	8.9%	3,516	3,058	35.2%	10.3%	8.48	10.26	8.48
NVR, Inc.	NYSE: NVR	3,258.75	-3.3%	7,136	11,598	9.6%	14.3%	11.36	13.78	14.60
PulteGroup, Inc.	NYSE: PHM	34.03	7.6%	10,616	11,118	25.5%	15.4%	6.80	8.87	8.00
Taylor Morrison Home Corporation	NYSE: TMHC	19.29	-8.0%	5,444	5,898	60.7%	8.5%	12.70	12.98	14.31
Meritage Homes Corporation	NYSE: MTH	76.12	48.3%	4,029	3,616	26.8%	11.0%	8.15	10.42	8.62
TRI Pointe Group, Inc.	NYSE: TPH	14.69	22.7%	3,257	3,129	43.5%	12.7%	7.57	13.04	7.42
Median - Residential			**19.2%**	**4,709**	**4,733**	**32.4%**	**12.4%**	**8.91**	**10.44**	**9.26**

All figures reported in millions, except per share data

Source: Capital IQ

Bellwether Stocks & Industry Participants

	Ticker	Price at 6/30/20	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	70.22	-24.3%	1,508	4,441	34.6%	28.9%	10.20	10.40	23.11
Martin Marietta Materials, Inc.	NYSE: MLM	206.57	-10.2%	4,428	16,182	20.1%	29.0%	12.61	13.63	20.69
Summit Materials, Inc.	NYSE: SUM	16.08	-16.5%	2,287	3,598	51.5%	20.8%	7.58	8.87	17.58
U.S. Concrete, Inc.	NasdaqGS: USCR	24.80	-50.1%	1,435	1,270	67.1%	11.8%	7.48	8.50	20.06
Vulcan Materials Company	NYSE: VMC	115.85	-15.6%	4,977	18,440	19.5%	25.8%	14.36	15.25	24.30
CEMEX, S.A.B. de C.V.	BMV: CEMEX CPO	0.28	-33.3%	12,632	15,712	76.1%	15.6%	7.95	8.17	180.06
CRH plc	ISE: CRG	34.32	5.1%	27,647	35,179	40.2%	15.2%	8.34	8.95	16.18
HeidelbergCement AG	DB: HEI	53.59	-33.3%	20,203	21,854	55.1%	16.1%	6.73	6.37	NM
LafargeHolcim Ltd	SWX: LHN	43.83	-10.3%	25,717	40,701	36.2%	19.7%	8.02	7.01	16.27
Median - Building Materials			**-16.5%**	**4,977**	**16,182**	**40.2%**	**19.7%**	**8.02**	**8.87**	**20.37**
Roads, Bridges, and Highways										
Granite Construction Incorporated	NYSE: GVA	19.14	-60.3%	3,390	952	35.6%	0.3%	95.52	4.47	NM
Sterling Construction Company, Inc.	NasdaqGS: STRL	10.47	-22.0%	1,335	704	60.5%	7.6%	6.90	5.95	5.56
Construction Partners, Inc.	NasdaqGS: ROAD	17.76	18.2%	798	942	7.6%	11.2%	10.49	10.24	23.26
Tutor Perini Corporation	NYSE: TPC	12.18	-12.2%	4,894	1,347	58.7%	5.6%	4.93	3.92	NM
Median - Roads, Bridges, and Highways			**-17.1%**	**2,362**	**947**	**47.1%**	**6.6%**	**8.70**	**5.21**	**14.41**

All figures reported in millions, except per share data

Source: Capital IQ

Note: CX, CRG, HEI, and LHN report in foreign currency. Margin and multiples unaffected and shown for analysis.

Bellwether Stocks & Industry Participants

	Ticker	Price at 6/30/20	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	37.58	-0.7%	19,715	8,053	33.1%	4.9%	8.26	11.14	NM
Dycom Industries, Inc.	NYSE: DY	40.89	-30.5%	3,320	2,092	53.0%	9.0%	6.97	6.66	122.60
EMCOR Group, Inc.	NYSE: EME	66.14	-24.9%	9,006	4,037	13.4%	6.2%	7.19	9.95	22.98
Fluor Corporation	NYSE: FLR	12.08	-64.1%	18,520	1,926	53.7%	-0.6%	NM	4.34	NM
Jacobs Engineering Group Inc.	NYSE: J	84.80	0.5%	13,440	13,295	21.9%	8.4%	11.84	12.78	36.73
MasTec, Inc.	NYSE: MTZ	44.87	-12.9%	6,712	4,806	31.0%	10.3%	6.94	6.00	10.33
Quanta Services, Inc.	NYSE: PWR	39.23	2.7%	11,736	6,982	23.6%	7.4%	8.06	7.67	15.40
Primoris Services Corporation	NasdaqGS: PRIM	17.76	-15.1%	3,306	1,375	41.4%	7.1%	5.88	6.94	9.59
Median - Nonresidential			**-14.0%**	**10,371**	**4,421**	**32.1%**	**7.2%**	**7.19**	**7.30**	**19.19**

All figures reported in millions, except per share data

Source: Capital IQ

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Construction & Building Materials Industry Services

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

Industry Segments

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- 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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