

VALUE FOCUS

Construction & Building Materials

First Quarter 2017

SEGMENT FOCUS

Residential Construction

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EXECUTIVE

INDUSTRY TRENDS

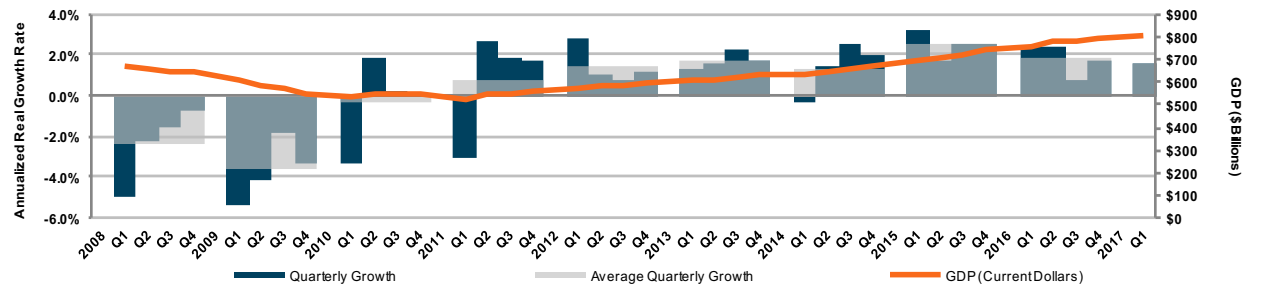
- Favorable macroeconomic environment led to increased residential construction activity and home sales
- 30-Year mortgage rates and 10-Year treasury yields have increased 51 and 59 BPS year-over-year
- The Fed's raising of rates has yet to have a material impact on construction demand as expectations of economic growth outweighed increased borrowing costs

Construction Overview

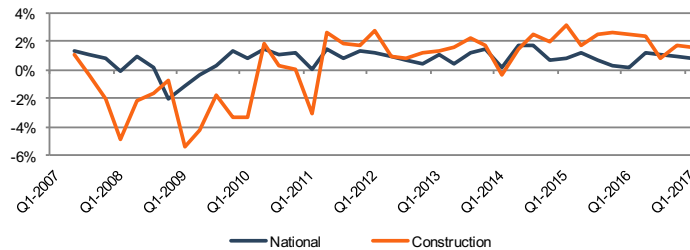
Construction & National GDP

GDP rose 4.0% over the past twelve months through the first quarter of 2017, falling within the traditional target range of 2% to 4%. Over the past ten years, construction has averaged 4.0% of national GDP, and accounted for 4.3% of GDP during 1Q17. Construction lagged behind the rest of the economy, particularly in the years following the decline of 2009, but since then it has steadily recovered. Growth in construction GDP has outpaced growth in the overall economy the past couple of years, marked by a 6.5% year-over-year increase in Construction GDP.

Construction Gross Domestic Product



% Change in GDP



Construction GDP

Period	% Change
Q-o-Q	1.5%
Y-o-Y	6.5%

National GDP

Period	% Change
Q-o-Q	0.8%
Y-o-Y	4.0%

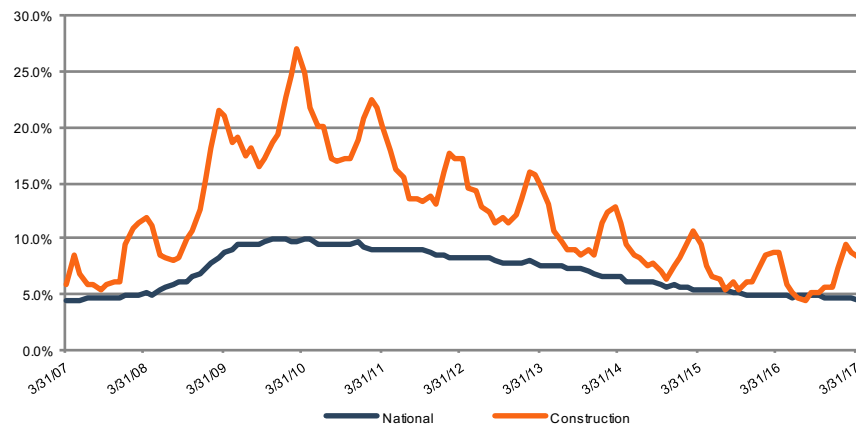
Construction Overview

Construction & National Unemployment

According to the Federal Reserve, a healthy economy typically features an unemployment rate between 4.5% and 6.0%. The current level of 4.5% represents strength in the economy, after decreasing steadily from 5.0% a year ago.

Construction is a cyclical and seasonal industry, so its unemployment rate is more volatile than other industries. The major contributing factor to the seasonal nature of the construction industry is weather. Production of materials and projects generally decrease during the colder, winter months. Construction unemployment is currently 8.4%, down from 8.7% a year ago. This reflects a downward trend in the industry unemployment rate despite the seasonal volatility. This number will likely decrease as construction activity accelerates in the spring months. Lower unemployment rates suggest an increase of activity within the industry.

Unemployment Rate



Note: The national unemployment rate is seasonally adjusted, but the unadjusted construction unemployment rate demonstrates its seasonality and recent trends.

Source: U.S. Bureau of Labor Statistics

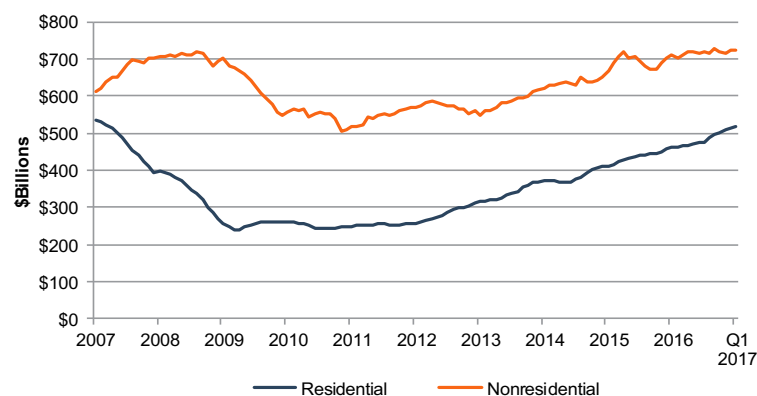
Construction Overview

Value of Construction Put-in-Place

The value of construction put-in-place is the total cost of construction on a job site for a particular period. The U.S. Census Bureau tracks this data and reports the total monthly. These costs include, but are not limited to, building materials, labor, profit, engineering, interest, and taxes.

Year-over-year put-in-place construction has increased by 11.4% for residential and by 1.7% for nonresidential. Nonresidential construction grew by 0.5% quarter-over-quarter through March 2017. Stagnation in nonresidential construction growth is partially due to a decline in public works; expectations of significant infrastructure spending under the new administration have. Growth in residential construction in the most recent quarter was aided by temperate weather conditions in the typically slower winter months.

Value of Construction Put-in-Place



Source: U.S. Census Bureau

Residential	
Period	% Change
Q-o-Q	2.9%
Y-o-Y	11.4%

Nonresidential	
Period	% Change
Q-o-Q	0.5%
Y-o-Y	1.7%

Sector Focus

Residential Construction

The macroeconomic environment is currently favorable for U.S. homebuilders and should provide a sound foundation for an increase in demand for residential construction. New home demand has accelerated through the first quarter of 2017 driven by consumer confidence, favorable demographic trends, and a dwindling supply of existing homes in the resale market. Potential headwinds include rising borrowing costs and a rise in input costs, primarily lumber and land costs.

Strong job growth and wage inflation are helping to drive a rise in consumer confidence. After lagging behind for much of the current economic cycle, the return of wage growth is a positive sign. Employment among the 25-34 year-old group is at a post-recession peak which should boost home sales. Entry-level homes are especially well-positioned to perform well due to improvement in 25-34 year old employment and affordable borrowing costs. Inventories of existing homes are at historical lows after declining consistently since mid-2015, which is also helping stimulate demand for new starts.

Rising interest rates potentially represent a headwind. The effects have been negligible so far as expectations of economic growth have outweighed rising rates. Mortgage rates could reach 4.7% by year-end based on expectations that 10-year treasury yields will increase to 2.9%. The Federal Reserve raised the target federal funds rate range by 25 basis points from 0.75% to 1.0% in March 2017 reaffirming a legacy commitment to metering economic growth and inflation. Increased borrowing costs come at a time of concern regarding the current housing cycle. This is the eighth year of the current cycle after bottoming out in 2009, although housing starts of 1.12 million in 2016 are still below the long-term annual average of 1.44 million units.

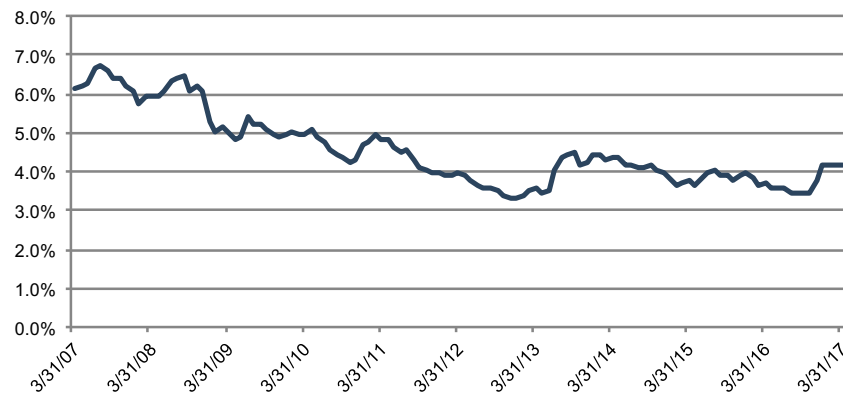
Rising input and land costs could pressure homebuilders' margins without an increase in pricing power. Over the current construction cycle, builders have been able to raise prices commensurately with rising material costs. However, framing lumber, which comprises 15-20% of construction costs, has increased over 10% year-over-year and 4.8% in February 2017. Strong demand and duties on Canadian imports are the main contributors to the increase in lumber prices. In addition to rising input costs, a decline in availability of desirable land is starting to push land costs higher which presents another constraint on margins. The number of vacant developed lots is 35% below their first quarter 2008 peak and has been relatively flat since 2014. Finished lots are up in value 3% so far this year.

Residential Construction

30-Year Mortgage Rate

The 30-year mortgage rate is the most common financing tool home buyers use in the U.S. When mortgage rates decrease, the overall cost to the consumer decreases, so demand for homes increases. Mortgage rates have increased by 51 basis points over the past year due to increased treasury yields. Mortgage rates are projected to continue to rise to 4.7% by year-end based on expectations that the 10-year treasury yield will reach 2.9%. If this trend continues, it may temper the expected rise in housing demand.

30-Year Mortgage Rate



30-Year Mortgage Rate	
Period	Change
Q-o-Q	0 BPS
Y-o-Y	51 BPS

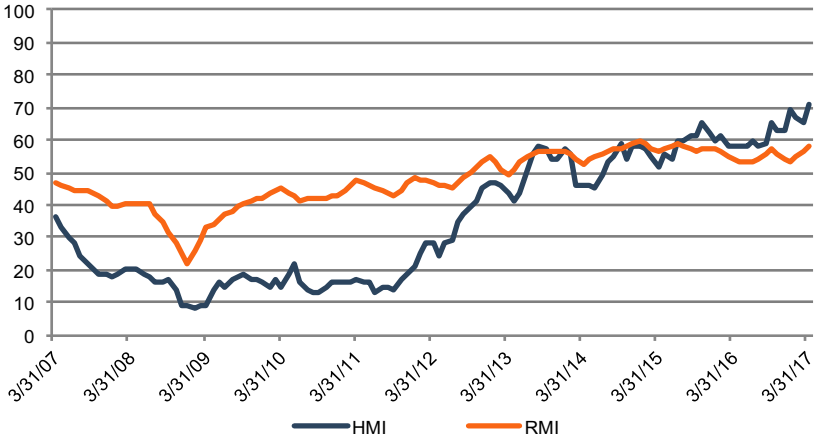
Source: Freddie Mac

Residential Construction

NAHB Indices

The National Association of Home Builders conducts two separate surveys, the Housing Market Index (HMI) and the Remodeling Market Index (RMI), to measure NAHB’s 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 71 in March 2017. The RMI is produced quarterly and asks respondents to rate their work volume as either higher or lower than the previous quarter. The monthly index has fluctuated between 50 and 60 since the second quarter of 2013.

NAHB Housing Market and Remodeling Market Indices



NAHB HMI	
Period	% Change
Q-o-Q	2.9%
Y-o-Y	22.4%

NAHB RMI	
Period	% Change
Q-o-Q	9.4%
Y-o-Y	7.8%

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

Source: National Association of Home Builders

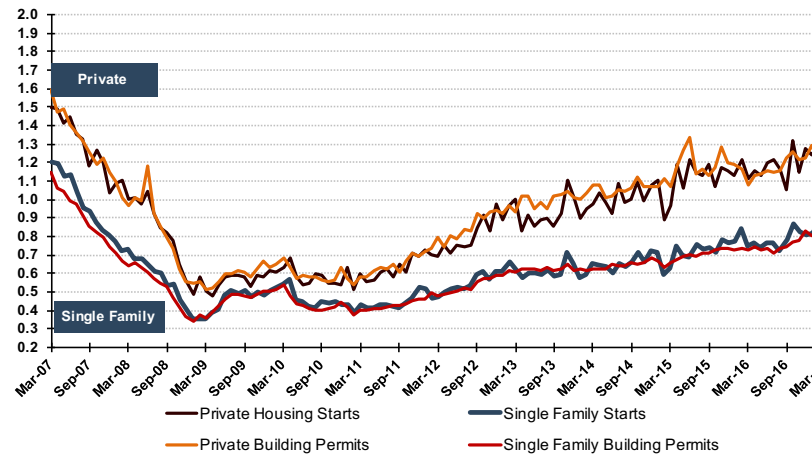
Residential Construction

Housing Starts & Permits

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% from 1Q06 to 1Q09 as the housing bubble unwound, housing permits and starts have steadily recovered but are unlikely to reach pre-recession highs. Starts and permits have continued the upward trend through 2016 for both private housing and single family housing.

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

Private Housing Starts

Period	% Change
Q-o-Q	-4.7%
Y-o-Y	9.2%

Single Family Starts

Period	% Change
Q-o-Q	1.5%
Y-o-Y	9.3%

Private Building Permits

Period	% Change
Q-o-Q	3.2%
Y-o-Y	17.6%

Single Family Building Permits

Period	% Change
Q-o-Q	-0.4%
Y-o-Y	14.1%

Residential Construction

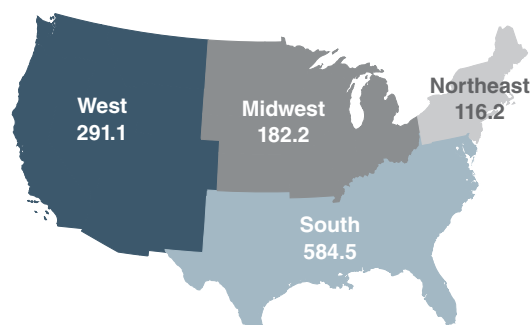
Housing Starts & Permits (continued)

Housing starts increased notably in 2016 compared to 2015. The biggest jump was in the Midwest, which increased by 19.5%. The only region where housing starts decreased was the Northeast which had the largest increase in 2015. The South remains the area with the most starts; there were more than 584,000 housing starts in the South, more than double the next highest, which was the West with over 291,000 starts.

Single family housing starts increased for every region. The West had the slowest growth at 8.6%, and the Midwest had the largest increase year-over-year with 12.7%. The South continues to have the most single family housing starts, but the Midwest maintains the highest percentage of its housing starts devoted to single families.

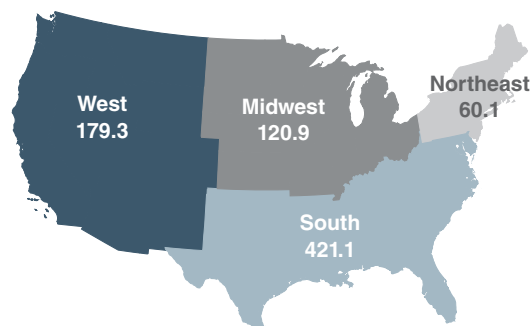
2016 Housing Starts by Census Region

Thousands of Units



2016 Single Family Housing Starts by Census Region

Thousands of Units



Regional Housing Starts	
Period	Y-o-Y % Change
Midwest	19.5%
Northeast	-15.9%
South	5.2%
West	9.7%

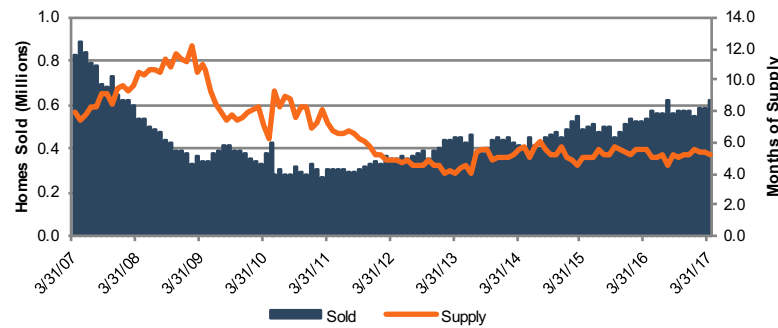
Regional Housing Starts Single Family	
Period	Y-o-Y % Change
Midwest	12.7%
Northeast	9.7%
South	8.8%
West	8.6%

Residential Construction

New and Existing Home Sales & Months of Supply

Home sales, both new and existing, give a sense of the market for people looking to buy houses. Sales track the number of homes actually sold in a month. Months of supply is another measure of the home buying market; it shows how long it would take for all of the homes currently on the market to be purchased at the prevailing pace of sales. It is alternatively known as the absorption rate. Six months is considered average, with lower levels signifying a pricing advantage for sellers and vice versa. While supply has dropped to prerecession levels, home sales, particularly new home sales, have failed to do so.

New Homes Sold and Months of Supply



New Homes Sold

Period	% Change
Y-o-Y	15.6%

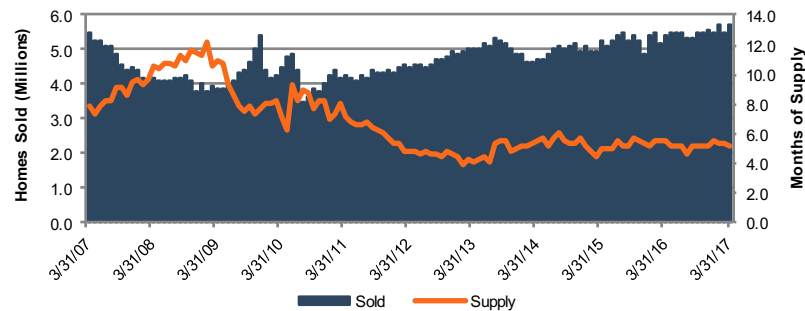
Existing Homes Sold

Period	% Change
Y-o-Y	5.9%

Months of Supply

Period	% Change
Y-o-Y	-5.5%

Existing Homes Sold and Months of Supply



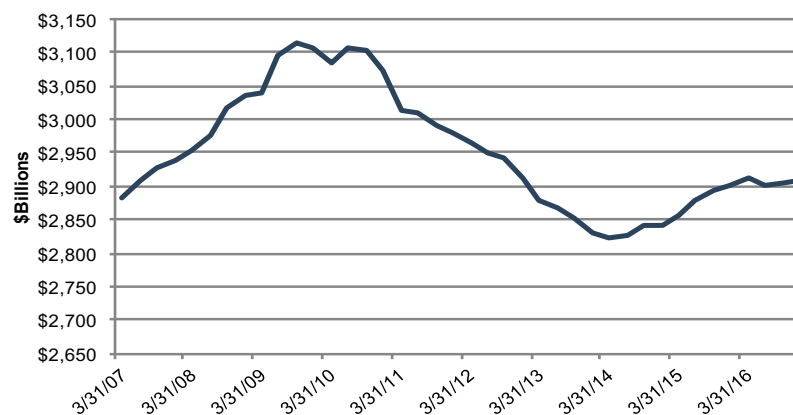
Sources: St. Louis Fed, U.S. Bureau of the Census, National Association of Realtors

Sector Round-up

Building Materials

Construction aggregates, asphalt, cement, and ready-mix concrete are all essential elements to building and maintaining roads and highways. Companies that deal in building materials sell a sizeable amount of their products to publicly funded projects. Therefore, government funding is an important driver for the industry, and companies benefit when public spending increases. According to the chart below, GCI has stagnated this quarter with no growth and only a 0.2% increase over the past year. Expectations of a significant increase in infrastructure investment under the new administrations have diminished.

Government Consumption and Investment



Government Consumption and Investment

Period	% Change
Q-o-Q	0.0%
Y-o-Y	0.2%

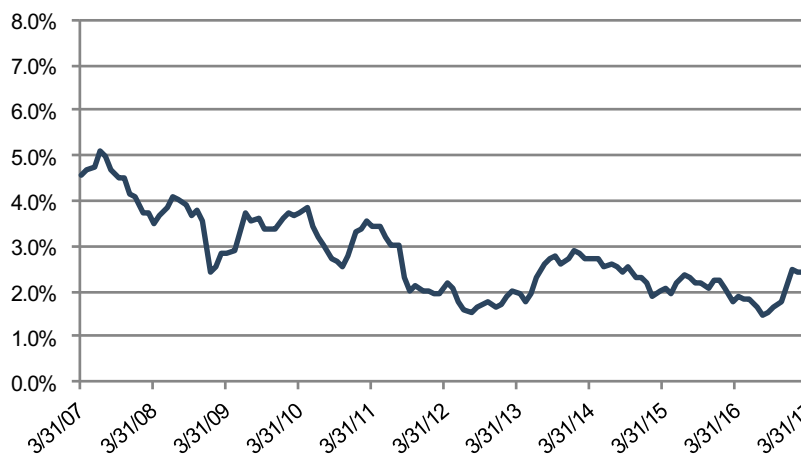
Sources: St. Louis Fed, U.S. Bureau of Economic Analysis

Sector Round-up

Roads, Bridges & 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. When yields on the 10-Year Treasury are low and stable, the construction industry experiences increased investment and volume. As seen in the chart below, the 10-year yield has experienced a downward trend over the past ten years as the Fed attempted to aid the economic recovery by encouraging an increase in investment. The 10-year yield has increased by 59 basis points over the past year due to a shift in the Fed's stance on interest rates and expectations of stronger economic growth and higher inflation. This change could cause higher borrowing costs and create a potential headwind for the construction industry.

Yield on 10-Year Treasury



Yield on 10-Year Treasury	
Period	% Change
Q-o-Q	-1 BPS
Y-o-Y	59 BPS

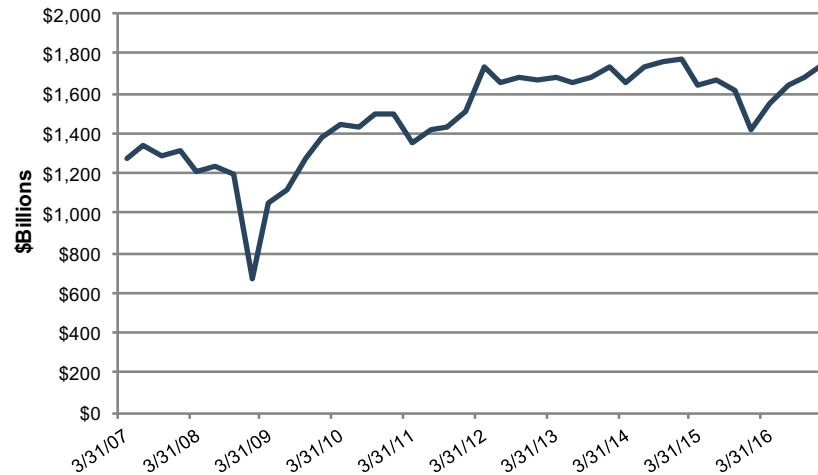
Sources: St. Louis Fed, Board of Governors of the Federal Reserve (US)

Sector Round-up

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 of business. These additions lead to more commercial construction. According to the chart below, corporate profit increased this quarter and has recovered strongly over 2016 after a decline in the fourth quarter of 2015.

Corporate Profit



Corporate Profit	
Period	% Change
Q-o-Q	3.7%
Y-o-Y	22.3%

Source: St. Louis Federal Reserve

Mergers and Acquisitions

Announce Date	Industry Subsector	Target/Issuer	Buyers/Investors	Implied Enterprise Value (\$US mm)	Description
January 5	Building Materials	Everist Materials, LLC & Razorback Concrete Company	Summit Materials, Inc.	\$110.0	Manufacture ready-mix concrete materials
February 23	Nonresidential	BCH Holdings, Inc.	Comfort Systems USA, Inc.	\$100.0	Offers mechanical contract services
March 9	Nonresidential	Tealstone Residential Concrete, Inc. and Tealstone	Sterling Construction Company, Inc.	\$102.3	Provides residential concrete construction services on a contract basis
March 3	Home Building	SAVVY Homes, LLC	AV Homes, Inc.	\$50.0	Designs, customizes, and builds homes for sale in North Carolina and Alabama
March 7	Building Materials	GM&P Consulting and Glazing Contractors, Inc.	Summit Materials, Inc.	\$35.0	Designs and installs building enclosure systems, such as curtain and window walls for buildings through the United States

Source: Capital IQ

Bellwether Stocks & Industry Participants

	Ticker	Exchange	Price at 3/31/17	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.	BZH	NYSE	12.13	39.1%	1,857	1,566	77.5%	3.1%	27.23	9.07	NA
Comstock Holding Companies, Inc.	CHCI	Nasdaq	2.16	20.5%	42	56	85.8%	-8.9%	NA	NA	NA
DR Horton Inc.	DHI	NYSE	33.31	10.2%	13,129	14,541	20.6%	12.0%	9.20	7.97	12.82
Hovnanian Enterprises Inc.	HOV	NYSE	2.27	45.5%	2,729	1,985	83.5%	5.0%	14.47	9.72	25.35
KB Home	KBH	NYSE	19.88	39.2%	3,735	3,844	59.7%	6.0%	17.13	8.65	15.86
Lennar Corporation	LEN	NYSE	51.19	5.9%	11,294	16,964	37.3%	12.0%	12.55	8.75	14.37
LGI Homes, Inc.	LGIH	Nasdaq	33.91	40.1%	839	1,083	36.8%	13.3%	9.71	7.81	9.51
MDC Holdings Inc.	MDC	NYSE	30.05	25.9%	2,501	2,203	37.4%	7.6%	11.61	8.22	13.35
NVR, Inc.	NVR	NYSE	2,106.88	21.6%	5,966	8,025	7.1%	12.3%	10.93	10.02	17.31
PulteGroup, Inc.	PHM	NYSE	23.55	25.9%	7,865	10,320	30.5%	13.4%	9.80	7.99	12.91
Toll Brothers Inc.	TOL	NYSE	36.11	22.4%	5,162	9,136	38.2%	9.4%	18.76	8.73	15.74
Median				26%	3,735	3,844	37.4%	9.4%	12.08	8.69	14.37

All figures reported in millions, except per share data

Source: Capital IQ

Bellwether Stocks & Industry Participants

	Ticker	Exchange	Price at 3/31/17	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.	EXP	NYSE	97.14	38.6%	1,211	4,999	12.7%	30.8%	13.39	10.11	23.49
Martin Marietta Materials, Inc.	MLM	NYSE	218.25	36.8%	3,634	15,403	11.8%	26.1%	16.26	13.89	32.82
MDU Resources Group Inc.	MDU	NYSE	27.37	40.6%	4,207	7,105	24.2%	15.0%	11.29	10.68	22.63
Summit Materials, Inc.	SUM	NYSE	24.71	28.6%	1,626	4,063	37.2%	19.8%	12.64	9.64	46.24
US Concrete, Inc.	USCR	Nasdaq	64.55	8.3%	1,222	1,399	39.1%	13.2%	8.70	7.02	37.32
Vulcan Materials Company	VMC	NYSE	120.48	14.1%	3,625	17,704	12.7%	26.2%	18.67	14.82	37.77
Cemex SAB de CV (ADR)	CX	NYSE	0.87	28.2%	13,680	28,094	45.7%	21.4%	9.59	9.69	15.12
CRH PLC (ADR)	CRH	NYSE	35.36	25.0%	28,612	35,875	21.8%	11.4%	10.96	9.56	22.31
HeidelbergCement	HEI	GR	93.76	9.4%	17,249	30,149	39.8%	16.8%	10.42	8.21	24.60
LafargeHolcim Group	LHN	VTX	59.19	25.4%	26,467	54,572	35.0%	19.0%	10.85	9.18	17.21
Median				27%	3,921	16,554	29.6%	19.4%	11.12	9.66	24.04
Roads, Bridges, and Highways											
Granite Construction Inc.	GVA	NYSE	50.19	5%	2,544	1,768	10.9%	5.0%	13.86	8.40	45.42
Sterling Construction Co	STRL	Nasdaq	9.25	79.6%	717	195	1.8%	2.3%	11.65	7.67	NA
Tutor Perini Corporation	TPC	NYSE	31.80	104.6%	5,005	2,179	33.3%	5.5%	7.94	6.97	16.61
Median				80%	2,544	1,768	10.9%	5.0%	11.65	7.67	31.01

All figures reported in millions, except per share data

Source: Capital IQ

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

Bellwether Stocks & Industry Participants

	Ticker	Exchange	Price at 3/31/17	52-Week Perf.	LTM Revenue	Enterprise Value	Debt / MVTC	EBITDA Margin	EV / EBITDA (x)	TEV / Next Yr EBITDA (x)	Price / LTM Earnings
Nonresidential											
Aecom Technology Corporation	ACM	NYSE	35.59	16%	17,517	9,122	43.2%	4.7%	11.10	9.20	24.63
Chicago Bridge and Iron Company N.V.	CBI	NYSE	30.75	-16.0%	10,372	5,479	43.7%	6.3%	8.37	6.51	NA
Dycom Industries Inc.	DY	NYSE	92.95	44%	2,954	3,651	20.6%	14.1%	8.79	7.48	18.73
EMCOR Group Inc.	EME	NYSE	62.95	29.5%	7,698	3,715	10.1%	5.5%	8.70	8.85	18.68
Fluor Corporation	FLR	NYSE	52.62	-2%	19,449	7,109	17.6%	4.0%	9.06	7.67	30.84
Jacobs Engineering Group Inc.	JEC	NYSE	55.28	26.9%	10,189	6,412	4.8%	6.2%	10.17	9.59	31.80
MasTech, Inc.	MTZ	NYSE	40.05	98%	5,319	4,303	22.4%	10.0%	8.08	7.84	18.43
Quanta Services, Inc.	PWR	NYSE	37.11	64.5%	8,116	5,894	7.0%	7.2%	10.15	9.02	25.46
Median				28%	9,152	5,687	19.1%	6.2%	8.93	8.35	24.63

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 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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