MERCER CAPITAL

BUSINESS VALUATION &
FINANCIAL ADVISORY SERVICES

VALUE FOCUS
Construction & Building Materials

First Quarter 2018

SEGMENT FOCUS
Residential Construction

EXECUTIVE
INDUSTRY TRENDS

- Favorable macroeconomic environment leads to increased residential construction activity and new home sales in the midst of existing home inventory shortages
- 30-year mortgage rates and 10-year Treasury yields increased 24 and 36 BPS year-over-year
- The Fed's raising of rates has caused a negative shift in investor sentiment to homebuilders in particular in the face of continued growth and a favorable macroeconomic environment

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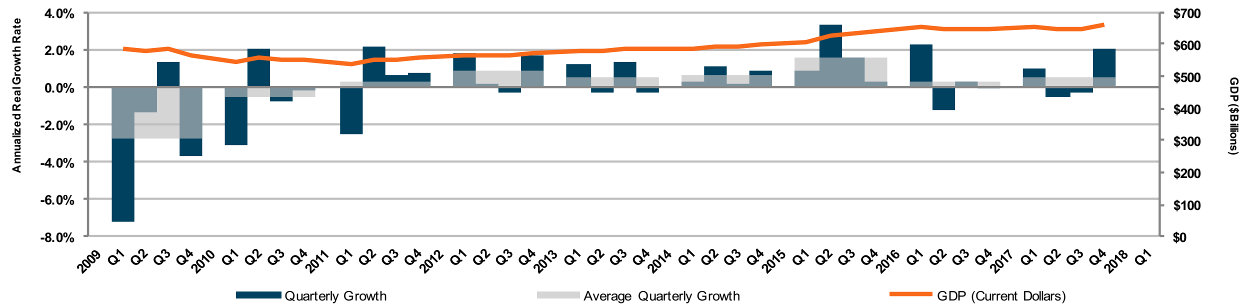
Construction Overview

Construction & National GDP

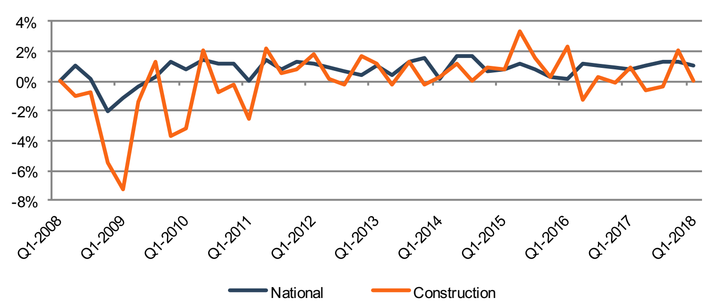
GDP rose 4.7% over the past the past twelve months through the first quarter of 2018, which is slightly above the ideal range of 2% to 4%. Since 2008, construction has averaged 3.7% of national GDP, and it accounted for 3.3% of GDP over 4Q17. Construction has steadily recovered since 2008 financial crisis, seeing 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 2.1%, and plans for increased infrastructure spending as well as inventory constraints in the existing home market should allow for continued industry growth.

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	2.0%
Y-o-Y	2.1%

National GDP	
Period	**% Change**
Q-o-Q	1.0%
Y-o-Y	4.7%

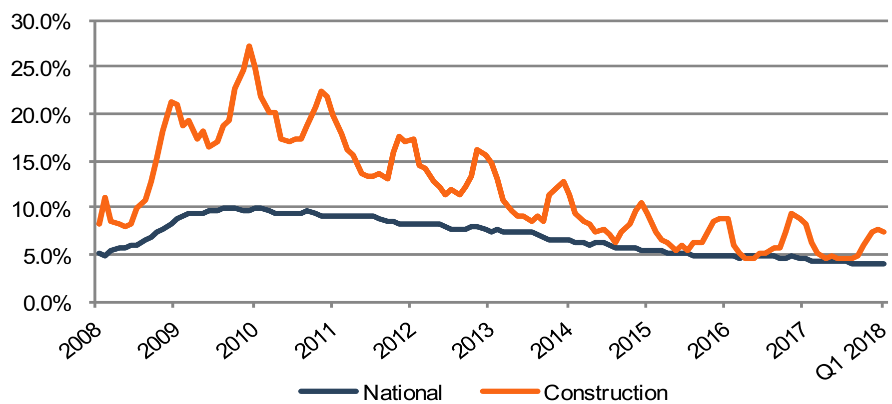
Construction Overview

Construction & National Unemployment

The Federal Reserve believes a healthy economy typically has an unemployment rate between 4.5% and 6.0%. The current level of 4.1% falls slightly below this range indicating strong economic conditions.

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 the weather. Production of materials and projects generally decrease during the colder, winter months. Construction unemployment is currently at 7.4%, down significantly from 8.4% a year ago, but slightly higher than the 5.9% level at the end of 2017. This number will likely decrease as construction activity accelerates in the spring and summer months. Lower unemployment rates suggest an increase of activity within the industry.

Unemployment Rate



Source: U.S. Bureau of Labor Statistics

Note: The national unemployment rate is seasonally adjusted, but the construction unemployment rate is not to show seasonality and recent trends.

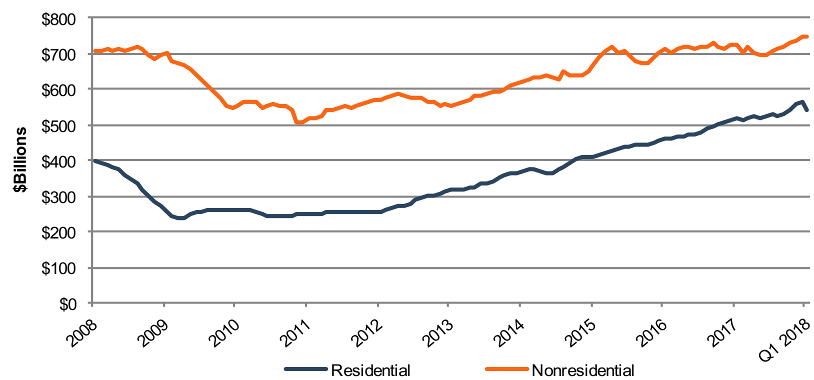
Construction Overview

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, the building materials, labor, profit, engineering, interest, and taxes.

Year-over-year put-in-place construction has increased by 4.5% for residential and by 3.3% for nonresidential. Nonresidential construction grew by 1.9% quarter-over-quarter through March 2018. The increase in non-residential construction comes in the midst of delays for Donald Trump's $1 trillion worth of infrastructure projects due to financing issues. Progress in these plans would create significant public work projects and could accelerate nonresidential growth. Growth in residential construction has slowed in comparison to a year ago, but the industry has further room for expansion going forward.

Value of Construction Put-in-Place



Source: U.S. Census Bureau

Residential	
Period	**% Change**
Q-o-Q	0.0%
Y-o-Y	4.5%

Nonresidential	
Period	**% Change**
Q-o-Q	1.9%
Y-o-Y	3.3%

Sector Focus

Residential Construction

The current macroeconomic conditions are providing a strong foundation for continued growth in the residential construction market in 2018. While the industry has seen continued growth, rising interest rate concerns have placed downward pressure on U.S. homebuilder stock prices. For 1Q18 the members of our comparable public company group all saw decreases in their stock prices when compared to 4Q17, ranging between 5% and 20%.

High consumer confidence, wage growth, and strong job creation lead the way in terms of growth factors for residential construction. Single-family housing starts seem to be the driving group as it saw growth of 10.3% year-over-year. Furthermore, the new home market is expected to see single digit growth over 2018. The MBA predicts that housing starts could increase as high as 20% by 2020 from where they were at the end of 2017. However, in the existing home market, lack of inventory and rising interest rates are likely to limit growth. Resale inventories have been declining for the last two years which has resulted in a month's supply significantly lower than historical averages, while rising interest rates will most likely deter many current homeowners who already have a below market mortgage rate.

Rising input costs in land, labor, and materials have become a concern for homebuilders. Land, labor, and material costs currently make up 80% of the average selling price on a new single family home, and increases in these costs could present a 400 bps headwind to gross margins in 2018. Currently, aggregate cost of materials is up 3% in 2018 and up 11% since 2016. Lumber in particular has experienced a significant increase in price. Lumber costs are up 26% in comparison to the average over the same period a year ago. Furthermore, a lack of skilled laborers has become an industry wide issue, evidenced by the percentage of builders reporting a shortage of subcontractors increasing to 63% as of mid-2017. This shortage has pushed the cost of labor up by an average of about 6% annually. While land costs have stabilized since the large increases seen in 2012-2013, they still have continued to be a major headwind to builder's gross margins over the last several years and could present a 50-100 bps headwind in 2018. However, limited inventory supply should help builders offset costs and stabilize margins by allowing them to increase their average selling price. Builder's focus on SG&A costs should allow builders to generate improved operating leverage.

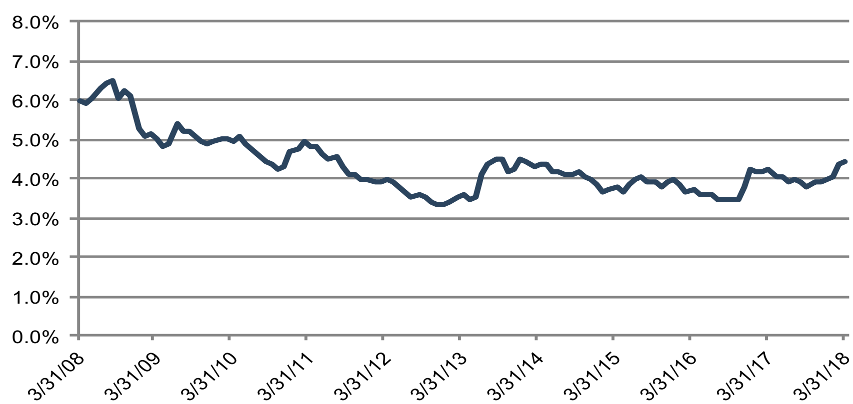
Rising interest rates have caused worry among many investors in the homebuilders market. They have caused valuation multiples to decrease as investors are less willing to pay for interest rate sensitive stocks. Mortgage rates are currently at 4.44% at the end of the quarter, which is higher than the 4.2% seen at the end of 2017. Among industry leaders, Lennar Corporation stock is only down 7% due to the anticipated growth outlook stemming from their acquisition of CalAtlantic Group which was completed during February 2018.

Residential Construction

30-Year Mortgage Rate

The 30-year mortgage rate is the most common financing tool home buyers use in the U.S. Rising mortgage rates mean more overall cost to consumers, and therefore, a decrease in the demand for homes. Mortgage rates have increased by 24 basis points over the past year due to an increase in Treasury yields after a downward trend over 2017. Mortgage rates have been rising over 4Q17 and 1Q18, which has raised concerns for investors. 10-year Treasury yields are up 36 bps year-over-year and are projected to continue to rise to over 3% in 2018, indicating a further increase in mortgage rates.

30-Year Mortgage Rate



Source: Freddie Mac

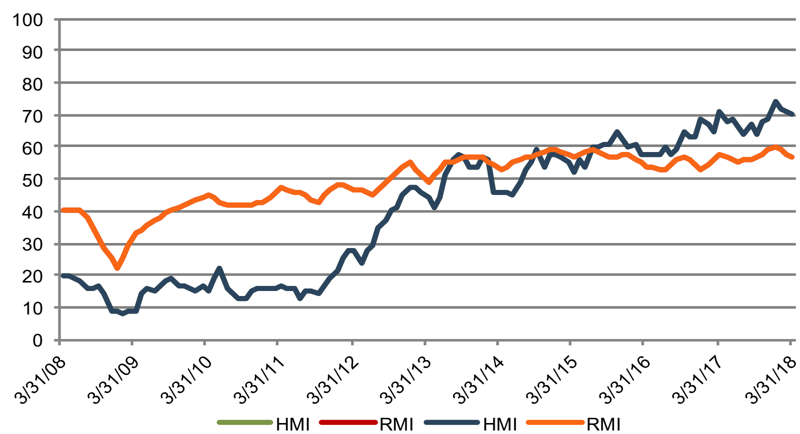
30-Year Mortgage Rate	
Period	**Change**
Q-o-Q	49 BPS
Y-o-Y	24 BPS

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 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. HMI is down 1.4% year-over-year even though there has been stable growth in the homebuilding market. While HMI is slightly down, new homes have seen solid growth over the past year reaching a new 10-year high of 74 during December 2017. 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 55 and 60 since the beginning of 2017.

NAHB Housing Market and Remodeling Market Indices



NAHB HMI	
Period	**% Change**
Q-o-Q	-5.4%
Y-o-Y	-1.4%

NAHB RMI	
Period	**% Change**
Q-o-Q	-5.0%
Y-o-Y	-1.7%

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

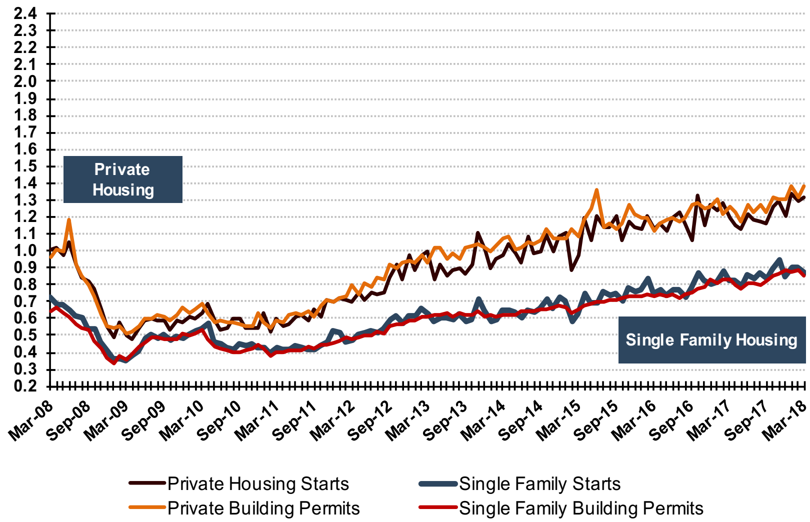
Residential Construction

Housing Starts & Permits

Two important indicators for the home building industry are housing starts and building permits because they reflect demand, consumer confidence, and the feasibility of financing construction projects. Housing starts are generally a clearer measure of activity in the industry, due to the fact that building permits can be issued and then shelved by builders. 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 2018 for both private housing and single family housing, and should continue to grow due to inventory constraints in the existing home market.

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	6.2%
Y-o-Y	8.3%

Single Family Starts	
Period	**% Change**
Q-o-Q	1.4%
Y-o-Y	10.3%

Private Building Permits	
Period	**% Change**
Q-o-Q	4.6%
Y-o-Y	5.9%

Single Family Building Permits	
Period	**% Change**
Q-o-Q	3.2%
Y-o-Y	8.8%

Residential Construction

Housing Starts & Permits (continued)

Housing starts generally increased from 2016 to 2017. The largest increase came from the Western region of the U.S. as housing starts here were up 7.7%. Housing starts decreased in the Northeast by about 4% and in the Midwest by 1.5% after both regions saw major increases in years prior. The South remains the area with the most starts; there were more than 598,000 housing starts in the South, while housing starts in the West increased from more than 290,000 in 2016 to more than 313,000 in 2017.

Single family housing starts increased across the board. The Northeast saw the slowest growth at 3.2%, and the West had the largest increase year-over-year with 13.7%. 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. Single family housing will be able to drive residential construction growth while multi-family construction growth begins to stagnate.

Regional Housing Starts

Period	Y-o-Y % Change
Midwest	-1.5%
Northeast	-4.0%
South	2.4%
West	7.7%

Regional Housing Starts Single Family

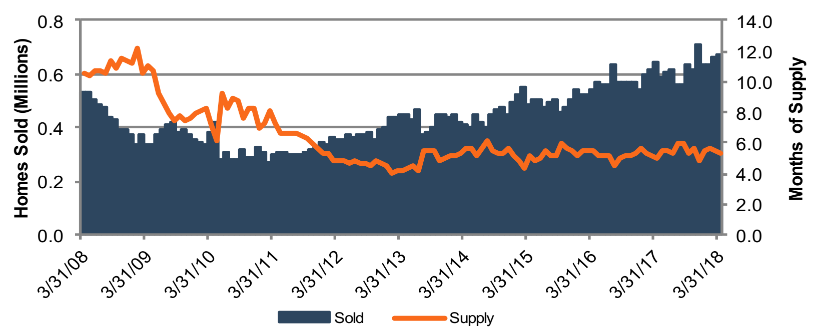
Period	Y-o-Y % Change
Midwest	7.7%
Northeast	3.2%
South	7.6%
West	13.7%

Residential Construction

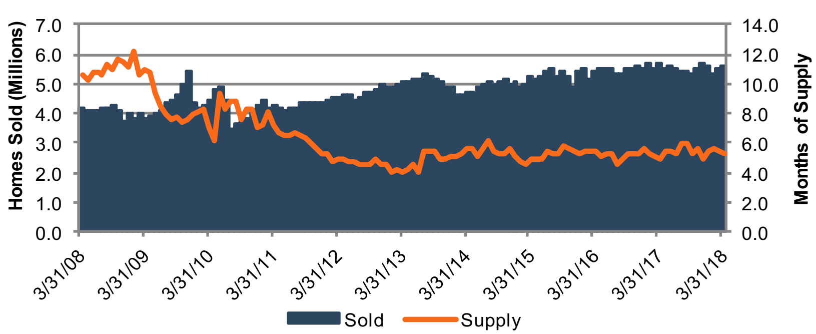
New and Existing Home Sales & Months of Supply

New and existing home sales give a sense of the market demand for 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. It is alternatively known as the absorption rate. Six months is considered average and lower levels signify a pricing advantage for sellers and vice versa. Supply has dropped back below pre-recession levels, while new homes sold continue to increase and are up 4.5% year-over-year. Inventory shortages in the existing home market have caused sales to drop 1.9% year-over-year and have limited room for volume growth in the market.

New Homes Sold and Months of Supply



Existing Homes Sold and Months of Supply



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

New Homes Sold	
Period	**% Change**
Y-o-Y	4.5%

Existing Homes Sold	
Period	**% Change**
Y-o-Y	-1.9%

Months of Supply	
Period	**% Change**
Y-o-Y	6.0%

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 seen a slight increase of 1.1% year-over-year after remaining pretty stagnant during 2017. Expectations of significant infrastructure projects totaling $1-1.5 trillion have hit delays due to financing issues. Progress in these plans could lead to major growth in the building materials sector and the construction industry as a whole. One possible solution is the use of public and private partnerships (PPP) which Trump and members of his staff have supported. These partnerships would limit the amount of tax payer money needed to finance infrastructure projects.

Government Consumption and Investment

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

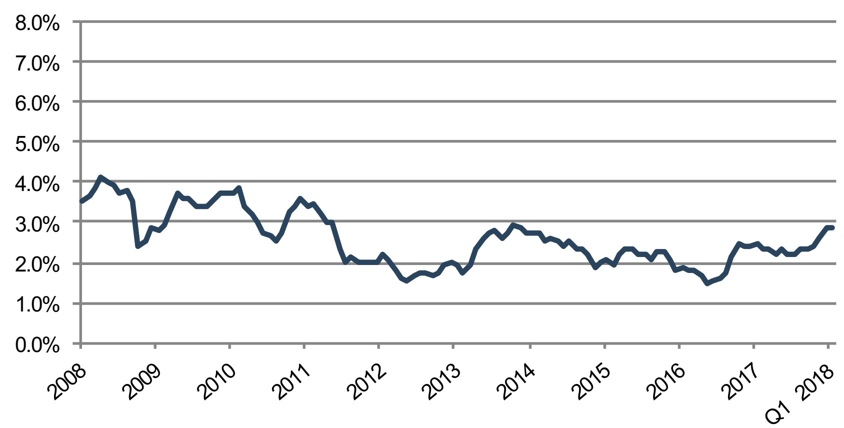
Government Consumption and Investment	
Period	**% Change**
Q-o-Q	0.3%
Y-o-Y	1.1%

Sector Round-up

Roads, Bridges & Highways

The yield on 10-Year Treasury bonds can indirectly affect the road contracting industry. Construction projects are more expensive to undertake when interest rates are higher. 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. However, the 10-year yield has increased by 36 basis points over the past year due to expected rate hikes by the Fed, and the 10-year yield is expected to break 3% at some point this year. Rising interest rates create higher borrowing costs and create a potential headwind for the industry.

Yield on 10-Year Treasury



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

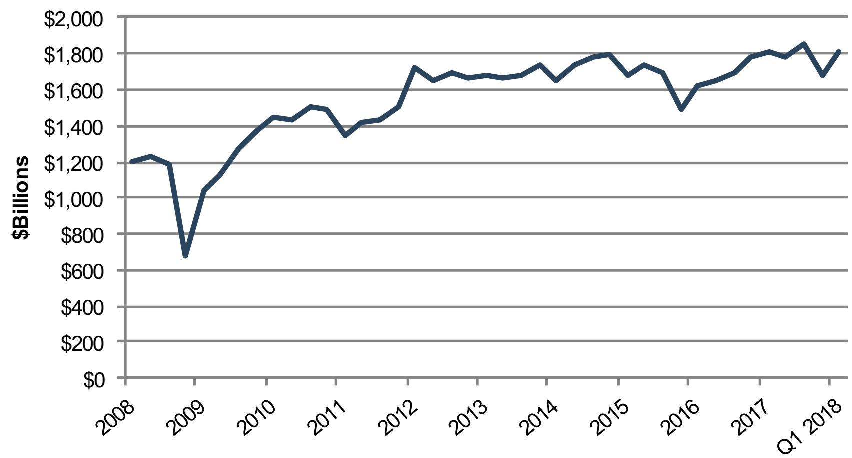
Yield on 10-Year Treasury	
Period	**% Change**
Q-o-Q	-1 BPS
Y-o-Y	36 BPS

Sector Round-up

Nonresidential Construction

Corporate profit is essential for companies not only to survive but to grow and expand. Increases in corporate profit allow for companies to be more able and willing to open new branches and divisions of business. These expansions lead to an increase in commercial construction due to needs for larger offices, new locations, larger warehouses, etc. According to the chart below, corporate profit fluctuated during the 2017 fiscal year hitting a low for the year during 4Q17; however, profits are up in 1Q18 to a similar level as the same period of 2017.

Corporate Profit



Source: St. Louis Federal Reserve

Corporate Profit	
Period	**% Change**
Q-o-Q	7.9%
Y-o-Y	0.1%

Mergers and Acquisitions

Lennar Corporation completed their merger with CalAtlantic Group in February and now CalAtlantic is a wholly owned subsidiary of Lennar Corporation. The $9.3 billion dollar deal was the largest ever in the industry. The deal gave Lennar a top three position in 24 out of the top 30 major homebuilding markets, and Lennar now expects free cash flows to reach $1 billion in 2019 compared to the $885 million at year end 2017. This merger allows for Lennar to join with DR Horton Inc. as the only homebuilders with a significant national presence. DR Horton's home closings for the past twelve months as of March 2018 are now around 47,000 while Lennar's closings for the same period are now around 44,000, but both are more than double the closing of PulteGroup which is the third largest homebuilder in the industry.

Bellwether Stocks & Industry Participants

	Ticker	Exchange	Price at 3/31/18	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	15.95	31.5%	1,979	1,659	72.1%	4.8%	17.29	16.10	NM
D.R. Horton, Inc.	DHI	NYSE	43.84	31.6%	15,063	19,016	16.4%	12.2%	10.36	8.57	14.41
KB Home	KBH	NYSE:	28.45	43.1%	4,422	4,276	48.8%	7.5%	12.86	8.98	26.13
Lennar Corporation	LEN	NYSE	58.94	17.4%	13,290	24,291	38.2%	10.8%	16.87	8.50	15.81
LGI Homes, Inc.	LGIH	NasdaqGS	70.57	108.1%	1,374	1,984	26.6%	13.5%	10.69	9.31	11.95
M.D.C. Holdings, Inc.	MDC	NYSE	27.92	0.3%	2,623	2,161	41.0%	7.6%	10.78	8.12	9.88
NVR, Inc.	NVR	NYSE	2,800.00	32.9%	6,574	10,213	5.5%	14.5%	10.74	9.59	17.37
PulteGroup, Inc.	PHM	NYSE	29.49	25.2%	8,913	11,679	28.3%	14.1%	9.26	8.16	16.83
Taylor Morrison Home Corporation	TMHC	NYSE	23.28	9.2%	3,869	4,262	35.2%	9.3%	11.86	8.22	14.79
Meritage Homes Corporation	MTH	NYSE	45.25	23.0%	3,311	2,952	41.6%	8.3%	10.69	9.02	11.17
TRI Pointe Group, Inc.	TPH	NYSE	16.43	31.0%	3,001	3,676	37.2%	13.6%	9.03	8.63	11.28
Median				**31%**	**3,869**	**4,262**	**37.2%**	**10.8%**	**10.74**	**8.63**	**14.60**

All figures reported in millions, except per share data

Source: Capital IQ

Bellwether Stocks & Industry Participants

	Ticker	Exchange	Price at 3/31/18	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	103.05	6.1%	1,387	5,559	11.0%	29.7%	13.51	10.26	19.33
Martin Marietta Materials, Inc.	MLM	NYSE	207.30	-5.0%	3,682	14,603	18.9%	26.3%	15.08	12.97	19.21
Summit Materials, Inc.	SUM	NYSE	30.28	24.3%	1,963	4,849	35.3%	20.6%	11.97	9.64	27.55
U.S. Concrete, Inc.	USCR	NasdaqCM	60.40	-6.4%	1,365	1,708	42.7%	11.7%	10.74	7.10	63.80
Vulcan Materials Company	VMC	NYSE	114.17	-5.2%	3,957	17,823	16.5%	24.5%	18.39	14.87	25.08
CEMEX, S.A.B. de C.V.	CPO	BMV	0.66	-23.5%	14,227	23,388	52.4%	16.9%	9.70	8.38	21.26
CRH plc	CRG	ISE	33.97	-3.9%	30,283	36,392	25.1%	12.5%	9.64	8.26	13.22
HeidelbergCement AG	HEI	DB	98.21	4.7%	21,091	32,043	42.1%	16.2%	9.36	7.64	15.48
LafargeHolcim Ltd	LHN	SWX	54.85	-7.3%	26,811	51,207	36.8%	5.7%	33.43	8.00	NM
Median				**-5%**	**3,957**	**17,823**	**35.3%**	**16.9%**	**11.97**	**8.38**	**20.30**
Roads, Bridges, and Highways											
Granite Construction Incorporated	GVA	NYSE	55.86	11%	3,085	1,950	9.1%	6.2%	10.20	7.67	27.33
Sterling Construction Company, Inc.	STRL	NasdaqGS	11.46	23.9%	1,027	321	21.8%	4.2%	7.36	5.59	18.72
Tutor Perini Corporation	TPC	NYSE	22.05	-30.7%	4,668	1,633	42.7%	3.9%	8.94	5.70	8.96
Median				**11%**	**3,085**	**1,633**	**21.8%**	**4.2%**	**8.94**	**5.70**	**18.72**

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 3/31/18	52-Week Perf.	LTM Revenue	Enterprise Value	Debt / MVTC	EBITDA Margin	EV / EBITDA (x)	TEV / Next Yr EBITDA (x)	Price / LTM Earnings
Nonresidential											
AECOM	ACM	NYSE	35.63	0%	19,120	8,987	41.0%	3.9%	12.10	9.16	30.97
Dycom Industries, Inc.	DY	NYSE	107.63	16%	2,823	4,020	18.5%	10.3%	13.87	8.58	24.28
EMCOR Group, Inc.	EME	NYSE	77.93	23.8%	7,696	4,393	6.3%	6.1%	9.31	9.43	19.94
Fluor Corporation	FLR	NYSE	57.22	9%	19,509	7,810	17.0%	2.9%	13.75	8.05	70.74
Jacobs Engineering Group Inc.	JEC	NYSE	59.15	7.0%	11,854	10,006	23.1%	6.8%	12.41	9.33	32.16
MasTec, Inc.	MTZ	NYSE	47.05	17%	6,846	5,138	27.3%	8.2%	9.16	7.46	11.45
Quanta Services, Inc.	PWR	NYSE	34.35	-7.4%	9,706	5,836	14.3%	6.9%	8.71	7.17	17.66
Median				**9%**	**9,706**	**5,836**	**18.5%**	**6.8%**	**12.10**	**8.58**	**24.28**

All figures reported in millions, except per share data

Source: Capital IQ

MERCER CAPITAL
BUSINESS VALUATION & FINANCIAL ADVISORY SERVICES

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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