FMI Capital Advisors

2021

Construction Materials Market Outlook

Spring 2021

FMI Capital Advisors

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OVER **100** TRANSACTIONS

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Products	Concrete | Asphalt | Cement
Construction	Asphalt Paving | Road Construction

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NAPA – National Asphalt Pavement Association

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Pit & Quarry

Recent Transactions

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Is Now The Right Time To Sell?

As the nation moves beyond the distress of 2020, the economy and government have turned their attention back towards growth and development. With a renewed focus on infrastructure, all eyes are on the Construction Materials ("CM") sector in early 2021. There are a number of significant factors that are setting up the CM space to have a robust year operationally along with an extremely active M&A market. First, the pandemic has induced a white-hot residential market as home buyers demand more space for "work-from-home" lifestyles and have access to record-low mortgage rates. Second, the market has renewed optimism in state and federal funding sources: The Continuing Resolution of the FAST Act passed in December 2020, the potential reauthorization of the federal highway bill due by the end of September of 2021, and President Biden's *American Jobs Plan* has brought a one-time infrastructure investment to the forefront of political discussion. With all of the positive activity surrounding Construction Materials, the public markets have given a favorable view to the stock prices of the publicly traded CM companies.

Key Takeaways:

- Extremely Active M&A Market
- Strong Public Company Performance
- Optimism Surrounding Infrastructure Funding
- White-hot Residential Market
- Expected Increase in Capital Gains Tax

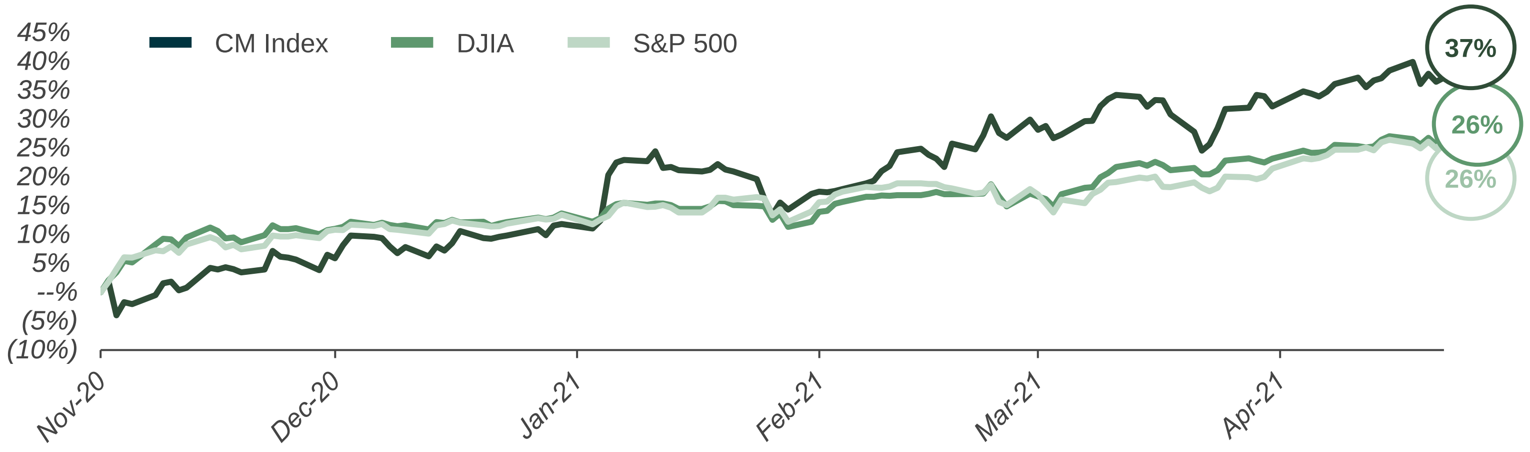
Since the November elections, FMI's Construction Materials Index ("CMI"), a proprietary composite of 17 publicly traded CM companies, has outperformed the broader indexes. As sentiment and stock price are the "currencies" in which public companies trade, this recent increase has positioned the large public companies to be highly acquisitive. Armed with strong balance sheets, and a "war chest" of cash accumulated during the pandemic, CM buyers are hungry for acquisitions that align with their strategic plans. In conjunction, sellers are watching for potential increases in capital gains tax rates, adding new motivation to sell. In the last 6 months, FMI has seen more Construction Materials acquisitions announced than any other similar time frame since 2018. The stars are aligned for the Construction Materials sector to have a banner year for M&A.

Public CM Company Performance

Public markets have viewed the CM sector favorably ever since the President emphasized infrastructure as being vital to "jump start" the economy. As seen in exhibit 1, the CMI has outperformed both the Dow Jones Industrial Average and the S&P 500 by ~11%. The individual companies that make up the CMI have all had positive performance in their stock price (see Table 1). This is important for merger and acquisition activity for two reasons. First, it gives C-Suite executives the confidence to undertake more ambitious projects.

Exhibit 1 - CMI vs. Major Indexes Last 6 Months

FMI's Construction Materials Index (CMI) is a proprietary index 17 public companies operating in the Construction Materials space



The CM index includes: Buzzi (BIT: BZU); Cementos Argos (BVC: CEMARGOS); Cemex (BMV: CEMEX CPO); Colas SA (ENXTPA: RE); CPI (NasdaqGS: ROAD); CRH (ISE: CRG); Eagle Materials (NYSE: EXP); GCC (BMV: GCC); Granite Construction (NYSE: GVA); Heidelberg Cement (DB: HEI); LafargeHolcim (SWX: LHN); Martin Marietta (NYSE: MLM); The Monarch Cement Company (OTCPK: MCEM); Summit Materials (NYSE: SUM); Titan Cement (ATSE: TITK); U.S. Concrete (NasdaqCM: USCR); Vulcan Materials (NYSE: VMC)

Public CM Company Performance (continued)

Second, it signifies that investors have expectations of positive financial performance in the future, lowering the risk on investing in growth initiatives. Both of these factors present the ideal situation for driving up buyer interest. In addition to the increased demand for acquisitions, buyers are also well-positioned to pay for their top targets. The 2020 pandemic forced companies to bolster their balance sheets to weather the unprecedented period of uncertainty. CM companies tapped into low-cost financing to strengthen their cash position, whether it be through the debt markets, equity markets, or federal programs such as the PPP program. Additionally, many companies focused on core operations, and paused all ambitious capital projects. Now, many buyers find themselves with abnormally large cash balances and manageable debt positions (see Exhibits 2 and 3). Jan Jenisch, CEO of LafargeHolcim, highlighted on the company's fourth quarter earnings call how the company's net debt leverage improved to 1.4x which "is also a record low and… gives [them] a lot of room and space to do meaningful investments". Martin Marietta ended the year with a debt-to-EBITDA ratio of 1.9 times, which will allow the company "flexibility to pursue accretive investment opportunities". "When you look at our balance sheet, we have the firepower to do about anything we'd like to do," said Suzanne Wood, SVP & CFO of Vulcan Materials. The majority of CMI companies now find themselves with a war chest and they are ready to deploy it.

Table 1 - CMI Company Stock Price Performance (Nov. 2020 – Apr. 2021)

Company	Stock Performance
Granite Construction Incorporated	**90.3%**
The Monarch Cement Company	**86.5%**
U.S. Concrete, Inc.	**76.2%**
CEMEX, S.A.B. de C.V.	**75.2%**
Summit Materials, Inc.	**60.5%**
Eagle Materials Inc.	**54.2%**
Titan Cement International S.A.	**51.2%**
HeidelbergCement AG	**49.5%**
Grupo Cementos de Chihuahua	**40.8%**
Construction Partners, Inc.	**35.6%**
LafargeHolcim Ltd	**33.4%**
Martin Marietta Materials, Inc.	**27.4%**
CRH plc	**23.4%**
Cementos Argos S.A.	**22.4%**
Colas SA	**19.6%**
Vulcan Materials Company	**18.1%**
Buzzi Unicem S.p.A.	**15.0%**

Exhibit 2 – CMI Composite Debt Analysis

Many companies ended 2020 with a "war chest" of cash

($) in Billions

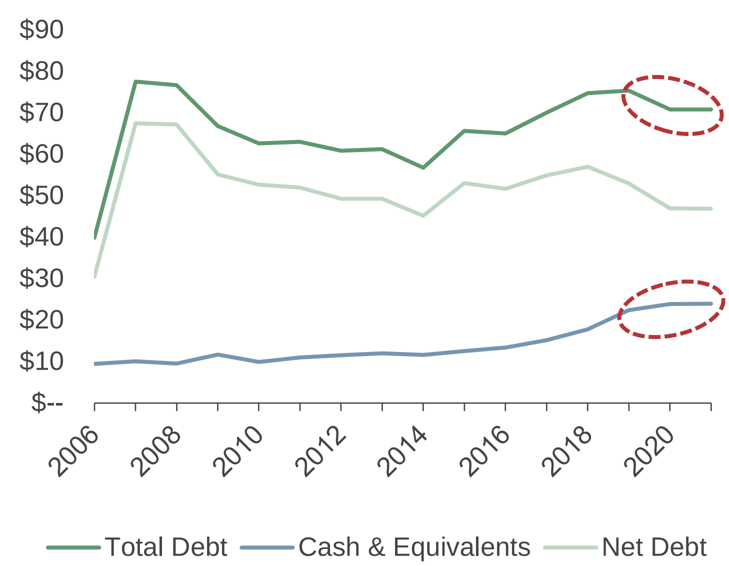
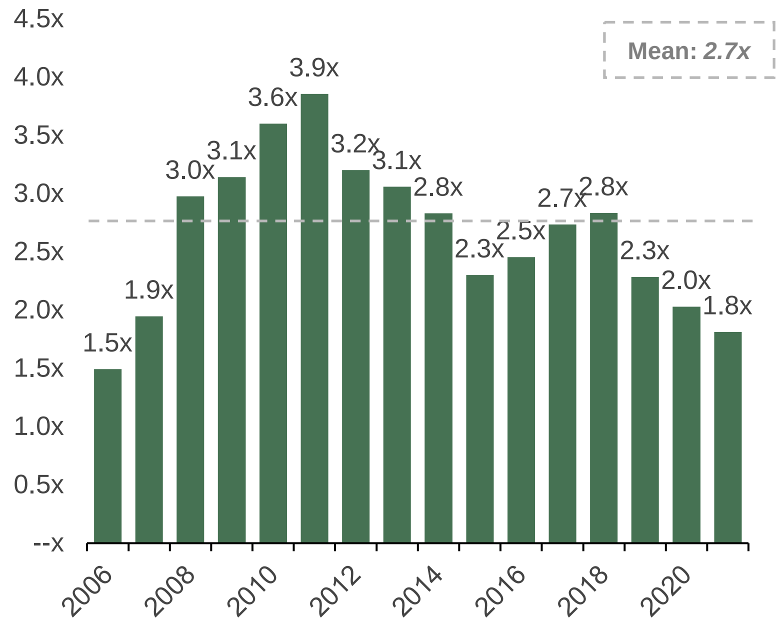


Exhibit 3 – CMI Median Net Debt/EBITDA

Debt positions have been reduced to manageable levels



Source: CapIQ

Merger & Acquisition Activity

Strong buyer positions led to a surge of M&A coming out of 2020. This can be seen both globally and in the CM space. Exhibit 4 demonstrates how there were nearly three times as many CM acquisitions announced in the second half of 2020 than in the first half of the year. Exhibit 5 shows the total acquisition activity in the U.S. has picked up 61% in the last six months. The dearth of acquisitions in the first half of 2020 led to pent up demand in the latter half of the year. In the last six months, the CM sector has had ~37 announced deals. This level of activity had not been achieved since 2018. “In 2020, nothing happened, and you would expect it to come roaring back in 2021, and it's busy,” said Tom Hill, Chairman, President & CEO of Vulcan Materials. Buyers are eager to pursue deals that align with there strategic goals, which often focus on increased vertical integration. A strong trend that FMI is seeing in the market is the disciplined strategies of buyers. Buyers are not pursuing every opportunity, but when a deal makes sense for their strategy and position – they are pursuing vigorously with aggressive pricing. “With the strongest balance sheet we have ever had in our history… discipline will be maintained, but our appetite is strong for M&A and our pipeline is good,” said CRH CEO, Albert Manifold. A caveat to 2021 when comparing the year to recent history is that CM buyers are open to all types of targets. “We're going to be looking at…bolt-on acquisitions in markets that we currently exist. But equally, we will look at potential platform acquisitions in markets in which we would like to grow,” said Ward Nye, President & CEO of Martin Marietta.

Exhibit 4 – CM Deals 2017 – 2021 by Half

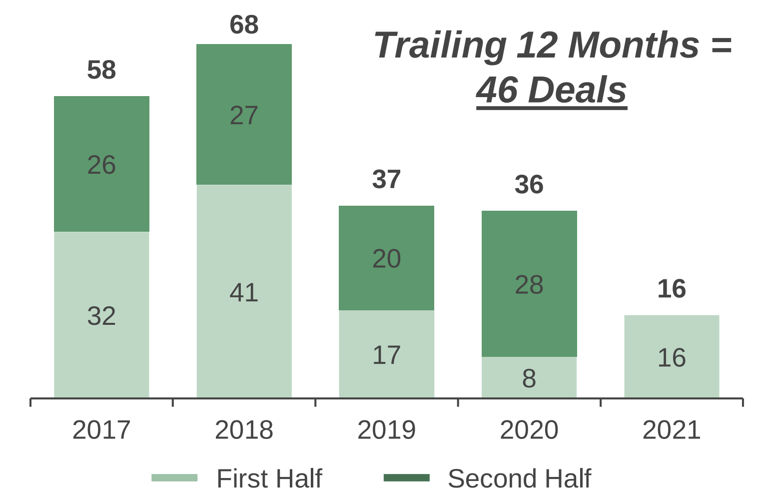
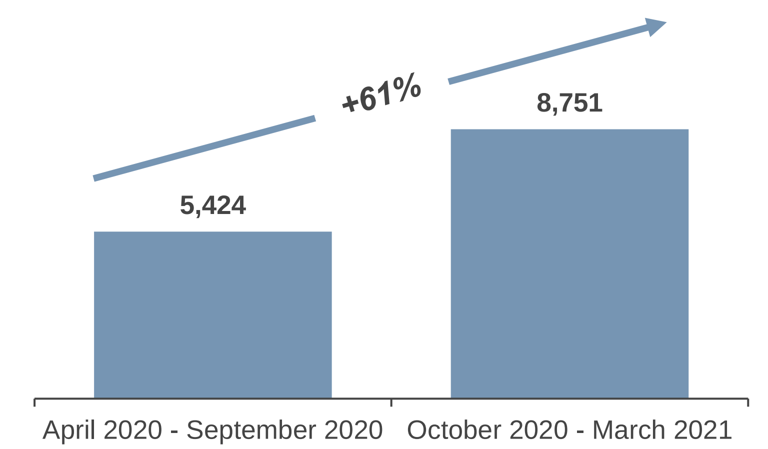


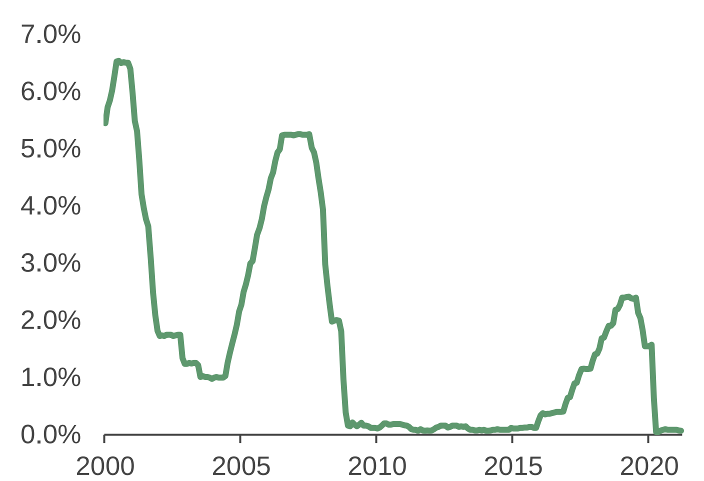
Exhibit 5 – U.S. M&A Deal Volume (# of Deals)



Robust Residential Market

The 2021 residential market continues to ride the wave of momentum from the previous year. Homebuyers have access to cheap financing due to low interest rates (see Exhibit 6). The pool of homebuyers has also increased as Millennials have begun to enter their prime earning years and have flooded the market. Compounding to the problem is that the inventory of available homes is at an all time low. “Newbuild construction was robust in the U.S. Demand for new housing is really at multiyear high, supported by low interest rates, low inventory levels and a continuation of the migration pattern we have seen to the western and southern portions of the U.S.,” said Randy Lake, CRH’s Group Executive for Strategic Operations. With new residential construction commencing, this should greatly benefit aggregates and ready-mixed concrete producers.

Exhibit 6 – Federal Funds Rate



Infrastructure Funding

American Jobs Act Infrastructure: $621B

Highways, bridges and roads $115B	Public transit $85B	Passenger and freight rail $80B
Electric vehicles $174B		
Airports, water transit and ports $42B		
Transportation inequities $45B		
Infrastructure resilience $50B		
Other $30B		

The Construction Materials sector gained a boost with the announcement of President Biden's American Jobs Plan. In it, the President is calling for $2.25 trillion in infrastructure funding to be spent over the next decade. For transportation infrastructure, there is an allotment of $621 billion, and of that value, $115 billion is to be spent on "[modernizing] bridges, roads, and main streets that are in most critical need of repair." The proposal comes as a double-edged sword for CM producers, as President Biden is calling for an increase in corporate taxes from 21% to 28% to finance the bill. Additionally, although not mentioned in this version of the bill, the Wall Street Journal reports that, "taxes on high-income individuals' income, capital gains, estates, and noncorporate businesses are expected in a future segment of the President's agenda". This increase in tax rate could be a strong motivator for potential sellers who want to capitalize on proceeds from a transaction before an increase in capital gains tax becomes a reality.

Conclusion

The fundamental difference between the 2020 CM market and 2021 is: **certainty**. There is an undeniably robust residential market, an increasing likelihood of an infrastructure bill, and strong momentum towards a reauthorization of the FAST act. The statistics show that there is pent up demand in the M&A market, with buyers visibly signaling the desire to pursue growth through acquisition. With the possibility of tax changes looming and the frothiness of the market, it might a good opportunity for privately owned CM producers to consider next steps.

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