FMI for the Built Environment

Steady Sailing Through Uncharted Waters

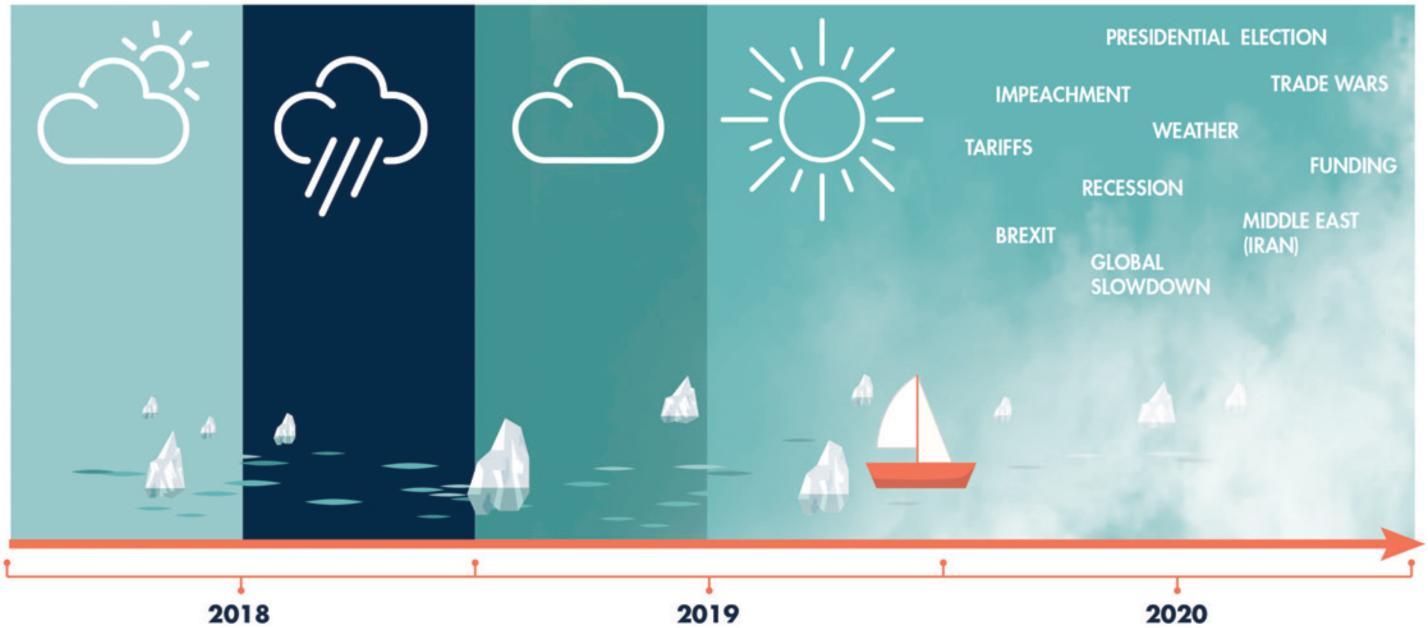
A look at 2019, 2020 and the M&A Landscape for the **Construction Materials Industry**

by George Reddin and Scott Duncan

Executive Summary

2019 was a "Steady Sailing" year for the construction materials (CM) market, with many industry participants achieving robust volumes and revenues. Broadly speaking, last year's performance was driven by improved weather, strong backlogs and state-level infrastructure funding. These improvements benefited both public and private CM producers. Despite the strong operating performance, M&A started the year off slowly, as anticipated by FMI in our previous annual review titled "Understanding the Balance". After grappling with 2018 stock declines and recession concerns, buyers needed to see a return to stability before they resumed investing in acquisitions. The solid performance of 2019 eventually led to positive stock price appreciation for CM buyers and created favorable tailwinds for the M&A market. By the end of the year, M&A had returned to a more normal pace, with optimism continuing into 2020. CM buyers generally enter 2020 with capital availability, positive state infrastructure spending and reasonable stock valuations (relative to historic EV/EBITDA metrics). Accordingly, FMI projects a rebound in M&A activity, despite some concerns about economic uncertainty looming in the future.

While the CM Industry faced a stormy 2018, 2019 performance proved robust. FMI expects continued momentum, with limited visibility into the distant future.

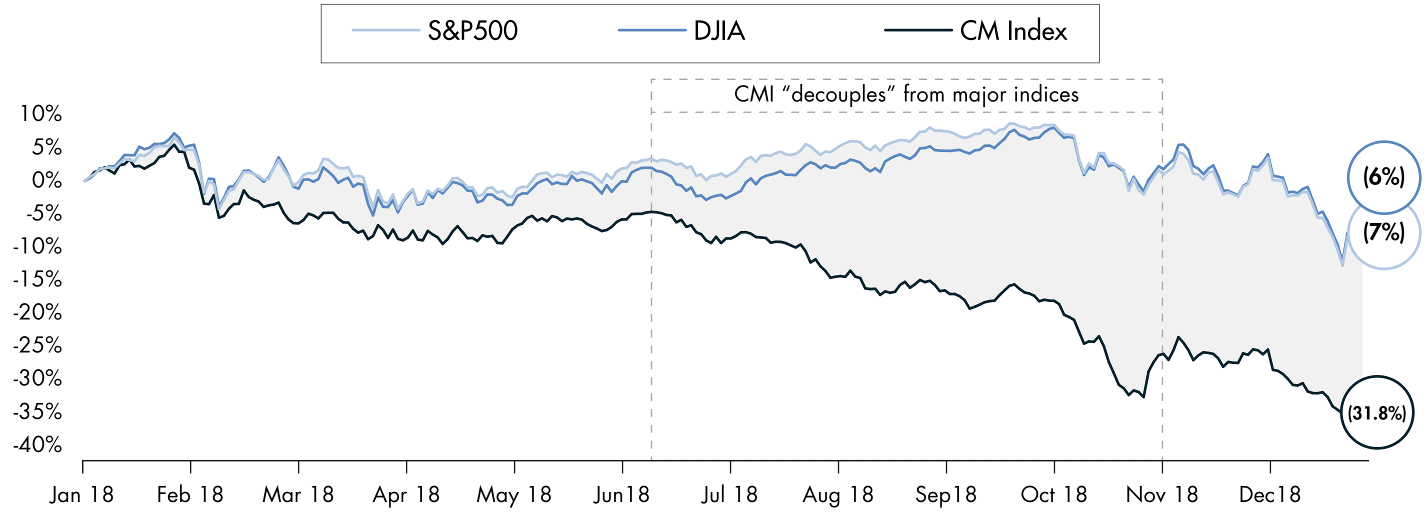


Steady Sailing – The 2019 Construction Marterials Market

Last January, FMI dubbed 2019 the "Show Me" year for public CM companies, as analysts and investors were expected to closely watch industry performance for signs of recovery from the negative developments of late 2018. From June-November 2018, FMI's Construction Materials Index (CMI), consisting of 17 major CM stocks, "decoupled" from the major indices, and suffered a collective loss of almost **$50 billion** or ~32% of their collective market capitalization.[1] Bad weather and global uncertainty created a lull in public CM company performance and led to a reset of stock value.

Exhibit 1: 2018 CMI and Stock Market Performance

The CMI decouples from the broader indices mid-2018



Although public valuations struggled, many private CM firms experienced solid performance during this time frame. Despite inclement weather, several private companies reported 2018 as one of their best years ever (although admittedly not as good as initially expected). However, the effects of public company performance did have a significant impact on M&A as buyer pullback conflicted with seller enthusiasm. This tension posed a potentially challenging road ahead for M&A.

Exhibit 2: 2019 Materials Consumption

Increased consumption yielded banner earnings

Metric	Source	2019 Growth
Cement Consumption	Portland Cement Association	+2.3%
Crushed Stone Production	U.S. Geological Survey	+7.4%
Sand & Gravel Production	U.S. Geological Survey	+3.4%

1 S&P Capital IQ database

In 2019 CM producers were able to overcome prior year hurdles and, in many cases, achieve record results. The strong rebound was driven largely by weather improvements, backlog capitalization and improved infrastructure funding for multiple states. Industry barometers such as the U.S. Geological Survey (USGS) and the Portland Cement Association reported increased materials consumption in 2019 (See Exhibit 2). Increased consumption yielded banner earnings that exceeded stock analyst expectations for many public firms, as summarized in Exhibit 3. The categories Exceed/Hit (✔) Miss (✖) are relative to the consensus estimates of stock analysts.[2] FMI observed similar earnings trends among private materials producers.

Exhibit 3: CMI Company – Annual Performance Review

Only two of the 17 CMI companies missed Q3 EBITDA as weather returned to normal

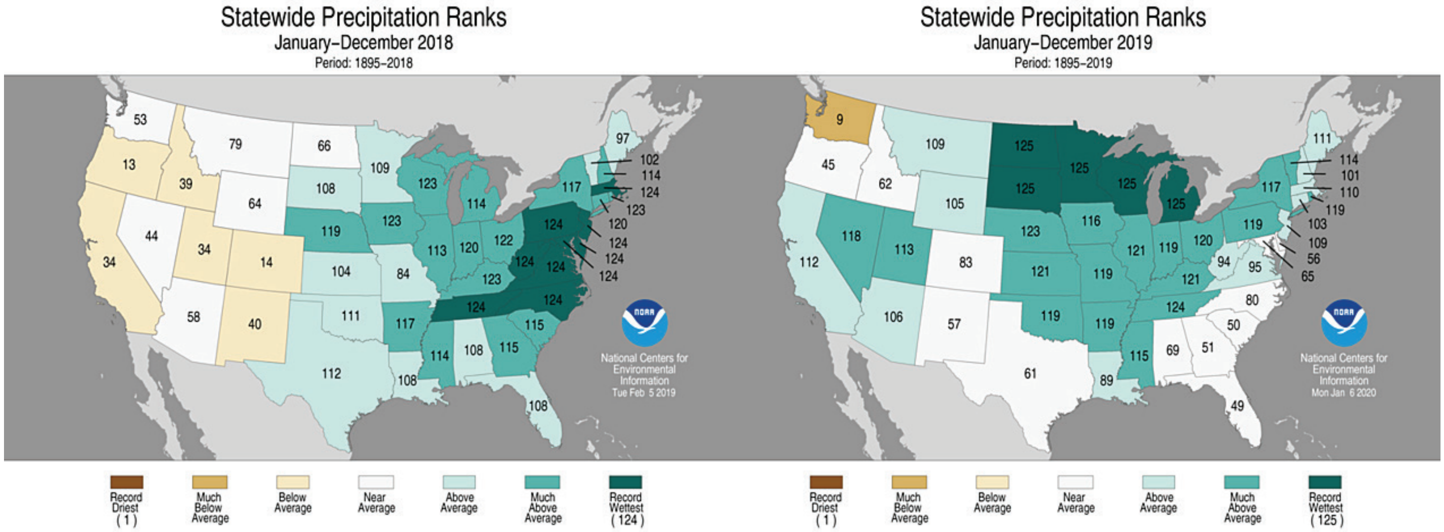
Company	Q1 Revenue Expectations	Q1 EBITDA Expectations	Q2 Revenue Expectations	Q2 EBITDA Expectations	Q3 Revenue Expectations	Q3 EBITDA Expectations
Buzzi Unicem S.p.A.	N/A	N/A	✔	✔	N/A	N/A
Cementos Argos S.A.	✔	✔	✔	✔	✔	✔
CEMEX, S.A.B de C.V.	✔	✔	✖	✔	✔	✔
Colas SA	N/A	N/A	N/A	N/A	N/A	N/A
Construction Partners, Inc.	✔	✔	✔	✔	✖	✔
CRH plc	N/A	N/A	✔	✔	N/A	N/A
Eagle Materials Inc.	✔	✔	✔	✖	✔	✖
Granite Construction Incorporated	✔	✖	✔	✖	✖	✖
Grupo Cementos de Chihuahua	✔	✖	✔	✔	✔	✔
HeidelbergCement AG	✔	✔	✔	✔	✔	✔
LafargeHolcim Ltd	✔	✔	✔	✔	✔	✔
Martin Marietta Materials, Inc.	✔	✔	✔	✔	✔	✔
The Monarch Cement Company	N/A	N/A	N/A	N/A	N/A	N/A
Summit Materials, Inc.	✔	✖	✖	✔	✔	✔
Titan Cement International, S.A.	✔	✖	✔	✔	✔	✔
U.S. Concrete, Inc.	✔	✖	✖	✖	✖	✔
Vulcan Materials Company	✔	✔	✔	✔	✔	✔

2 Hit rates reflect 5% sensitivity around consensus expectations. Anything lower than 95% was classified as a "Miss," while anything above was "Exceed/Hit." N/A means that not enough industry experts produced a quarterly estimate to generate a meaningful consensus estimate.

2019 Operational Driver #1: Weather Impacts

Although extreme levels of precipitation hindered construction activity in both of the last two years, construction materials producers generally fared better in 2019. For historical perspective, the National Oceanic and Atmospheric Administration (NOAA) reported record precipitation in many parts of the country in each of the last two years. In fact, across NOAA's 125-year database of U.S. precipitation since 1895, 13 states experienced their wettest single year in either 2018 or 2019 (See Exhibit 4).

Exhibit 4: NOAA Weather Maps[3]



As suggested by the NOAA maps, the population density of weather-affected areas was a strong driver behind the construction materials improved performance in 2019. In 2018 the Mid-Atlantic region, the Southeast and Texas were hit hardest with wet conditions. These regions represent some of the largest and fastest-growing CM geographies. Some areas continued to experience outlier weather, while many others (Texas, Florida, Georgia, Virginia, the Carolinas) experienced weather improvement in 2019. In Texas, the nation's top crushed stone-producing state, volumes rebounded noticeably. According to USGS, Texas crushed stone production rose 8.5% through the first three quarters of 2019, with sand and gravel production likewise rising 10.2%. The moderation in the more populous and fast-growing areas allowed CM producers to capitalize on high demand. Accordingly, many public and private producers reported record volumes and revenue for 2019.

This story of improved weather, however, was not uniform, as some producers faced weather obstacles beyond their control in back-to-back years. It should be noted that for some areas, 2019 weather was as bad or worse than 2018, especially in the Midwest region. Precipitation in the Midwest caused flooding so severe that multiple governors were forced to declare a state of emergency. Many producers in these regions did not necessarily see the bounce back experienced by their peers in other states.

> **"The extreme bad weather we experienced was and is a short-term disruption."**
>
> – Vulcan Materials, Nov. 2018

> **"On the volume side, 2019 was flattered by extremely easy comps because of the weather we had in our markets in 2018."**
>
> – Summit Materials, Nov. 2019

3 Source: https://www.ncdc.noaa.gov/temp-and-precip/us-maps/

2019 Operational Driver #2: Backlog Capitalization

Many construction material producers entered 2019 carrying record backlogs with strong margin projections. Leading CMI member firms cited backlogs as a reason for strong earnings.

GCC

"The increase in [U.S.] cement sales volumes was primarily due to robust demand and to the strong backlog in all of GCC's market segments."[4]

Vulcan Materials

"Positive trends in backlogged project work, along with demand visibility and customer confidence, support our expectations for continued price improvement throughout the remainder of 2019."[5]

Public earnings commentary mirrors the story that FMI has seen in private markets as well. Like their publicly traded counterparts, private sector CM producers generally capitalized on their strong backlogs as pent-up 2018 demand carried into 2019. Public and private results did, however, vary to some degree based on geography. Public companies benefit from geographic diversity, while private companies are more operationally constrained to their local market concentration. Private producers in areas with less rain in 2019 tended to produce record results, while producers in rain-drenched/flooded areas often lagged budgets and projections.

2019 Operational Driver #3: Infrastructure Funding Dynamics

Much of the growth in the mature CM industry is driven by infrastructure funding. The Fixing America's Surface Transportation (FAST) Act, signed into law in December 2015, provided funding that helped drive organic growth over the past few years, but at a modest rate. To subsidize the reserved growth provided by the FAST Act, states and counties developed transportation funding mechanisms of their own. In fact, since the Fast Act was passed, 31 states have passed funding initiatives. The FAST Act was never viewed by producers as a permanent solution to U.S. infrastructure funding, leaving producers more and more reliant on state and local funding in the absence of a comprehensive federal infrastructure bill.

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4 GCC Third Quarter Earnings Report, October 2019, https://www.gcc.com/wp-content/uploads/2019/10/GCC-3Q2019.pdf

5 Vulcan Second Quarter Earnings Release, July 2019, https://www.sec.gov/Archives/edgar/data/1396009/000114420419035868/tv525852_ex99-1.htm

> “States and local governments are now paying larger portions for public infrastructure, about 80% of all projects, as federal investment has decreased over the years.”
>
> – Wall Street Journal, Jan. 2020

> “States collectively face a backlog of $873 billion worth of repairs for infrastructure projects such as roads and highways.”
>
> – Wall Street Journal, Jan. 2020

Industry participants entered 2019 with hopes for substantial progress on federal infrastructure funding, given that the FAST Act is set to expire by the end of fiscal year 2020 (Sept. 30, 2020). The FAST Act passed with strong support from both parties (359-65 in the House; 83-16 in the Senate), indicating at least a chance that both sides would come to the table.

In the summer of 2019, industry hopes were raised by the announcement of a $259 billion bill for roads and bridges, known as the America's Transportation Infrastructure Act (ATIC). Unfortunately, the ATIC was stalled and quietly dashed in the Senate. The hyperpolarized political climate in Washington continued to cloud the future of infrastructure spending. As summer turned to fall and winter, infrastructure receded into the background as other political crises claimed the spotlight (tariffs, trade wars, impeachment, Iran, et al.). However, political support for infrastructure funding has historically been bipartisan, justifying optimism for 2020's outlook. Many sources continue to push for collaborative efforts to create a substantial infrastructure funding bill.

As mentioned, states have devoted significant legislative energy to compensate for the uncertainties of federal infrastructure funding in recent years. From 2014-2019, state transportation spending increased by an average of **4.2%** annually.[6] This growth far exceeds the average U.S. inflation rate of ~1.5% seen during that same time frame and is much higher than the previous state transportation spending growth rate of **1.4%** seen from 2008-2013. 2019 was a very active year, as spending increased by **4.6%**.[7] According to the Transportation Investment Advocacy Center, 15 states passed recurring revenue bills for transportation funding in 2019, including five permanent gas tax increases.[8] Legislative urgency around transportation funding appears to be shared by the voting public as well, with 270 of 305 (89%) of transportation ballot initiatives approved by voters during the 2019 election cycle.[9] The increasing demand for state-level funding was also recently highlighted in *The Wall Street Journal*.

6 https://www.usgovernmentspending.com/compare_state_spending_2014b60a

7 Ibid

8 https://transportationinvestment.org/wp-content/uploads/2019/11/201910-State-Transportation-Funding-Legislation-Report.pdf

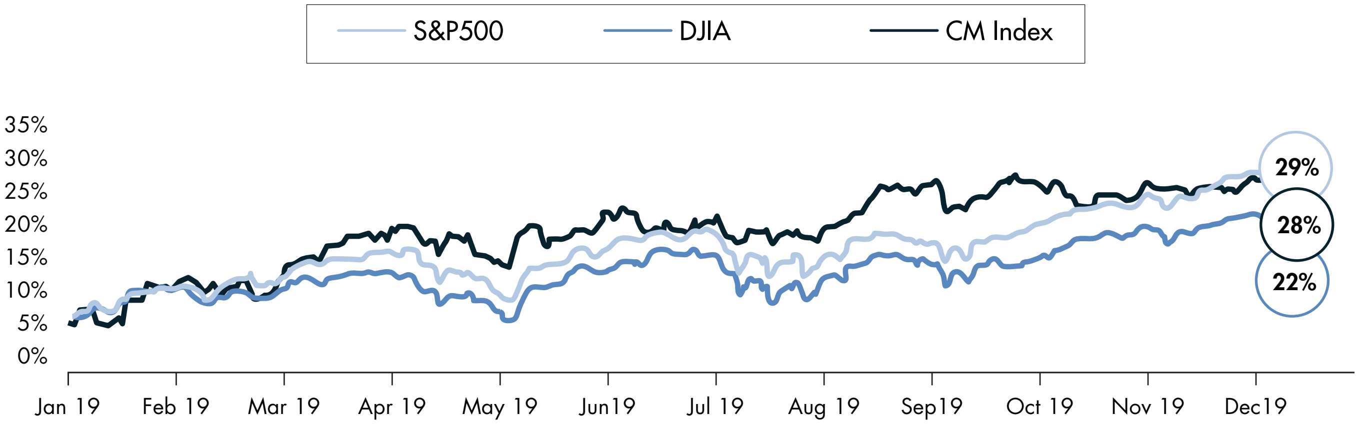
9 https://transportationinvestment.org/research/election-reports/ballot-measures/

2019 Results: Stock Market Appreciation

Despite a global environment replete with macroeconomic and geopolitical uncertainty, CMI stocks had an outstanding year due to the aforementioned operational strength. Slow, steady improvements in weather, backlogs and state funding yielded stock appreciation for publicly traded construction materials firms.[10]

Exhibit 5: CMI vs. Major Indices – 2019

In 2019, the CMI performed in-line with the S&P500 and outperformed the Dow Jones



As noted, the CMI diverged from the major stock indices for part of 2018, due to an accumulation of disappointments reaching crescendo during the third quarter. Throughout 2019, however, the CMI has traded directionally consistent with the major indices, performing in line with the S&P 500 and outperforming the Dow Jones (See Exhibit 5). The CMI gained 28.4% versus 22.3% for the Dow Jones and 28.9% for the S&P500. However, it should be noted that despite the significant rise, the CMI remains down -12.5% over a two-year period. Compared to the two-year gains of 15.0% and 19.8% for the Dow and S&P500 respectively, the CMI is still clearly amid a recovery.[11] Additionally, approximately half of CMI firms underwent stock buyback initiatives in 2019, indicating that they believe their stock is still undervalued.

10 S&P Capital IQ database

11 Ibid

Exhibit 6: CMI Top Performers of 2019

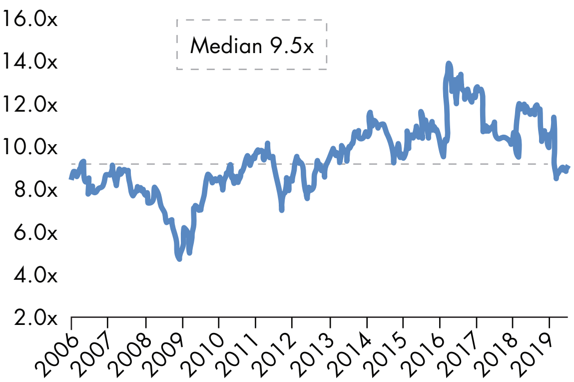
7 of 17 CMI Member Firms rose By 45% or more in 2019

Company	Jan. 1 Price	Dec. 31 Price	2019 Stock Performance
Summit Materials, Inc.	$12.40	$23.90	92.7%
Construction Partners, Inc.	$8.83	$16.87	91.1%
Martin Marietta Materials, Inc.	$171.87	$279.64	62.7%
CRH plc	$26.45	$40.03	51.3%
Eagle Materials Inc.	$61.03	$90.66	48.5%
Buzzi Unicem S.p.A.	$17.20	$25.18	46.4%
Vulcan Materials Company	$98.80	$143.99	45.7%
CMI Index			28.4%
S&P 500			28.9%
Dow Jones Industrial			22.3%

In 2019 the current bull market officially became the longest stock rally in U.S. history. Although asset inflation tends to arise during extended bull markets, current CM valuations do not appear speculative per historic valuation metrics (as seen in Exhibit 7). While the bull stock market highlights the expansion of the U.S. economy, annual growth rates during the past decade have averaged a meager 2.3%, with no single year exceeding 3.0%. Since the Great Recession, dynamic expansion has seemingly been replaced by "smooth sailing."

Exhibit 7: CMI TEV/EBITDA

CMI companies are trading at close to historic levels

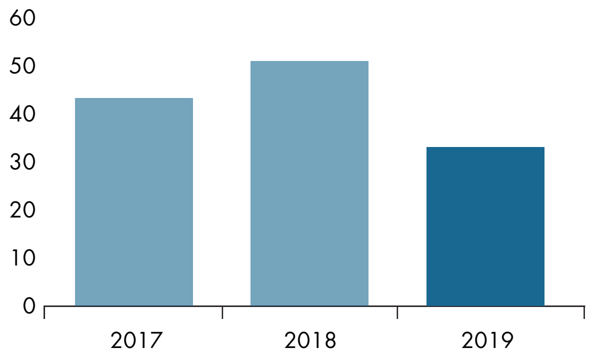


Navigating the Tides – The Construction Materials M&A Market

As anticipated, M&A activity for the construction materials market started off slowly in 2019. This was in contrast to the 2018 CM acquisition market, which carried strong momentum coming off robust 2017 performance. Driven by strong operations, predictable earnings and projected growth, 2018 was poised to be a record-setting year for transactions. While the first half lived up to expectations, M&A experienced a midyear pause, as various negative developments weighed down the sector (as discussed in "Understanding the Balance"). Despite these developments, 2018 ended up as an active M&A year, albeit tempered from what could have been.

Exhibit 8: CM M&A Deal Count

There were noticeably fewer CM transactions announced in 2019 than in 2017 or 2018



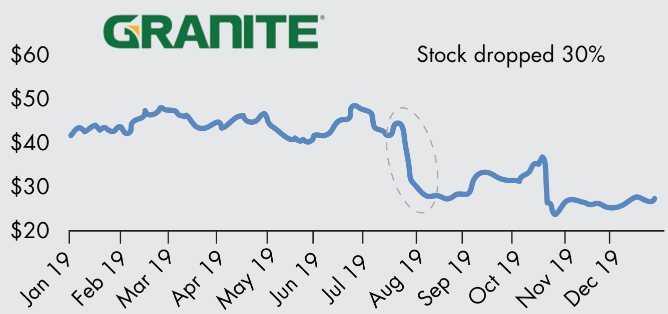
Looking at 2019 from this perspective, the decline seen in transaction volumes looks strongly pronounced (See Exhibit 8). FMI estimates ~30 CM deals were announced in 2019, as compared to more than 50 transactions in 2018.[13] As expected, many CM companies became more selective and cautious with transaction pricing, waiting to ensure a "return to normal" operations and weather. Once performance was proven "normal," buyers were still cautious to quickly invest capital due to potential economic uncertainty. However, by the end of 2019, concerns receded, as both buyers and sellers returned to an active market. FMI expects 2020 to begin with a strong rebound in the CM M&A market, as there appear to be more potential transactions in market than in recent memory.

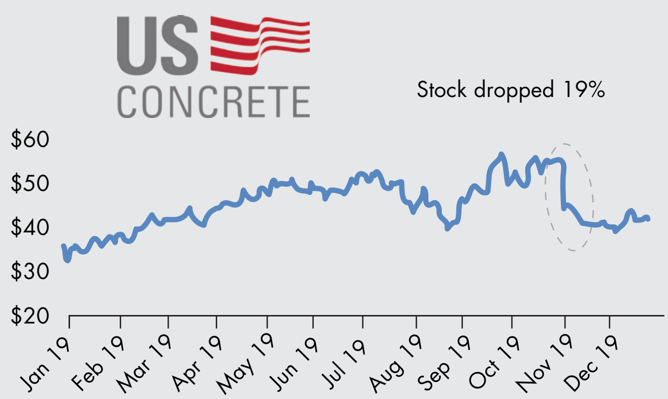
12 S&P Capital IQ database

13 S&P Capital IQ database, Wall Street research, proprietary FMI database

Market Spotlight

Public markets can penalize companies for missed earning expectations, as witnessed by Granite (NYSE: GVA) and U.S. Concrete (Nasdaq: USCR) in 2019. GVA fell 30% during the week of July 29, based on its preliminary second quarter loss estimates (released 7/29) and second quarter earnings release (released 8/2). Granite's second quarter losses stemmed from write-downs of four legacy joint venture projects that were not Construction Materials related. GVA ended 2019 down 31%. USCR rose 31%, yet could have finished the year much higher. USCR fell 19% in a single day (Nov. 8) when the company announced a third quarter earning miss. The public reaction to these two stock prices vividly illustrates the severity of CM earnings misses and helps explain the continual appetite for some level of M&A.[12]





The 2019 M&A Market in Review

Public companies and other large buyers entered the first quarter of 2019 with hesitancy, eager to put the 2018 end-of-year downturn in the "rear-view mirror" before expending substantial capital. After a record drop in market valuations, CMI companies needed to regain their footing.

First and second quarter earnings reports from major players showed most companies hitting market expectations for volumes and revenues; however, profitability results were mixed. Accordingly, the market saw little significant M&A activity as buyers remained selective in their targets. Buyers could afford to be selective, as they were typically favored by supply and demand dynamics in the first half of 2019.

Throughout the summer and fall, earnings reports remained strong and generally hit analyst expectations. Not only did revenue and volumes remain strong, but a reprieve from bad weather began to align profits with market expectations later in the year. Inspired by this "return to normal" operations, buyers became hungry to make up lost ground on growth targets. As expected, acquisitions seemed to once again become a relevant part of growth strategies for many large CM firms. At the same time, some CMI companies were beginning to factor in the risks associated with a potential recession, clouding M&A momentum. Throughout 2019, CM buyers were forced to carefully assess the benefits of capital allocation with the potential risks. Coupling industry confidence with macroeconomic uncertainty created a complex market for construction materials M&A. Lower future visibility drove buyers toward "safe," synergy-driven, often bolt-on transactions.

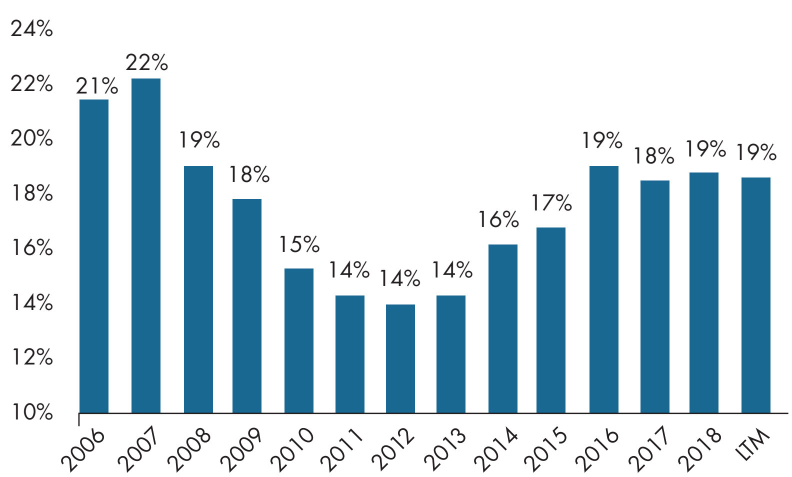
1. M&A Seller Perspective

M&A seller motivations in 2019 were driven by three essential considerations: succession planning, capturing maximum value, and a potential future slowdown.

Privately held businesses without a clear succession plan weighed current market values in contemplation with an exit from the industry. Producers who benefited from robust growth in the past decade did not want to "miss their window" to exit at a maximum value. The experience from 2008 lingered in the minds of operators as they considered their options. Bolstered by recent strong performance, many owners sought to capture the value of what may be perceived as "peak earnings" through a transaction. Some ownership teams felt that they could capture their full value in the current market climate without needing to endure another downturn. FMI noted more seller activity in the market in late 2019 than in recent memory. At this point in the economic cycle, CM industry participants are hearing "a lot of talk" about a possible downturn, but not necessarily feeling any effects.

Exhibit 9: CMI Average EBITDA Margin

Stable, robust margins illustrate the strength of current CM operations[14]



14 S&P Capital IQ database

2. M&A Buyer Perspective

Despite an M&A lull in the first half of 2019, buyers were actively pursuing targets as the year progressed. Almost all public buyers were in the market for the "right" kinds of deals. Growth remained vital for public companies, as investors and Wall Street analysts continually demanded quarterly gains. For a mature industry like CM, organic growth is often insufficient to meet investor demands and must be complimented with acquisitions.

Capital availability was an important theme for CM buyers as 2019 progressed, both for traditional strategic buyers and private equity participants in the industry. Traditional CM buyers, including CRH, Eagle Materials, Buzzi Unicem, Cemex and Cementos Argos, publicly announced asset divestures as management teams pivoted their respective portfolios.

Exhibit 10: CMI Historic Net Debt/EBITDA

Net Debt to EBITDA ratios suggest leverage below long-term averages

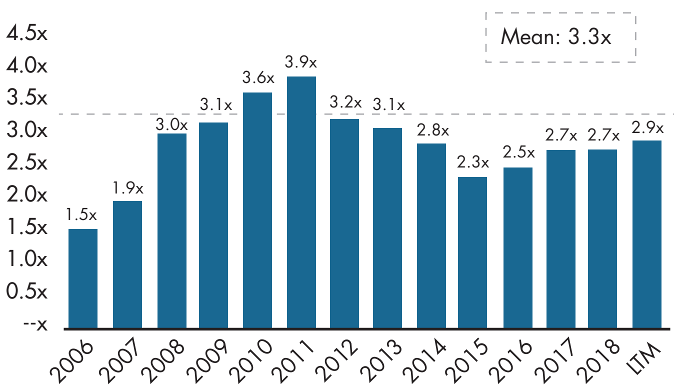
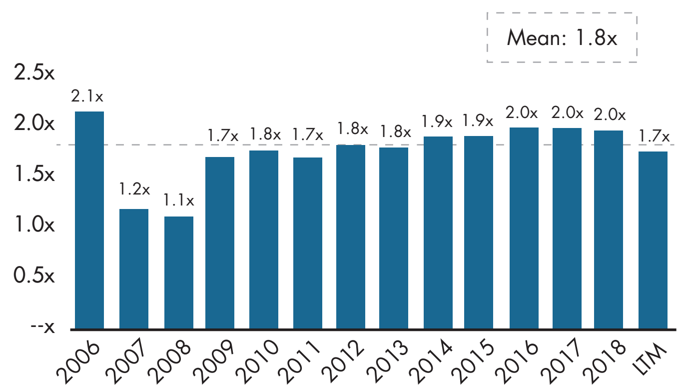


Exhibit 11: CMI Historic Equity/Net Debt

Equity to Net Debt Ratios have remained well above crisis levels since 2009

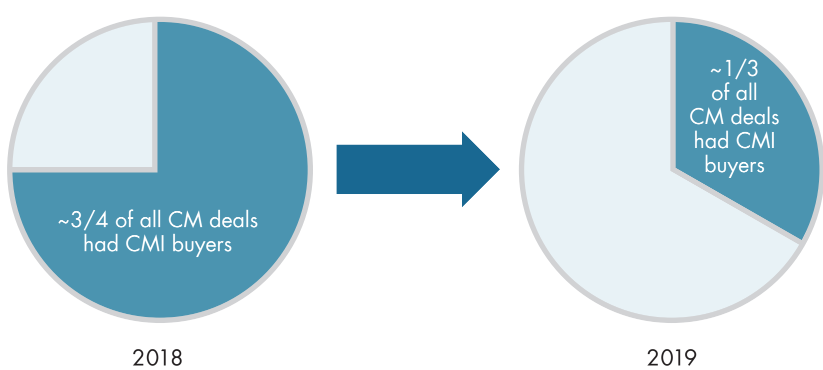


From the perspective of leverage, net debt/EBITDA ratios remained below historical averages for 2019. Additional metrics (such as equity/net debt) also suggested that CMI companies ended the year with moderate leverage by historic standards. Such data suggests that buyers have additional capacity for acquisitions. CMI companies closed the year with capital availability and board mandates for M&A.

A noteworthy wrinkle in 2019 M&A dynamics was an uptick in private buyer interest. Historically, CM buyers have been predominantly public entities. With CMI member firms largely sidelined from M&A early in the year, large private buyers partially filled a void in the transaction market. In 2018 public company buyers closed approximately three-quarters of the announced deals, while in 2019 they only accounted for approximately one-third of deals (See Exhibit 12). FMI anticipates public buyer activity to again dominant CM deals in 2020.

Exhibit 12: Shift in the Buyer Pool[15]

Private buyers account for the majority of announced CM transactions in 2019



15 S&P Capital IQ database and Wall Street Analyst reports

Public buyer interest was renewed in late 2019 as companies sought not only revenue growth but also margin improvement from deals. The twin pressures of revenue growth and margin improvement made bolt-on deals appealing, given the rapid speed of integration and readily achievable synergies.

Construction Partners, Inc.
CEO Charles Owens, "We like the bolt-on acquisitions"[16]

LafargeHolcim
CEO Jan Jenish, "I think for the future… we can do around 10 bolt-ons every year" [17]

FMI sees this trend carrying into 2020. Buyer preferences for easily digestible deals tends to be evergreen and should persist regardless of macroeconomic cycles.

3. M&A Valuation

In 2019 favorable industry earnings combined with attractive EV/EBITDA multiples to create healthy, "normal" valuations for public CM companies. Operating performance has proven robust for both the public and private CM sectors throughout the year. Accordingly, sellers expect businesses to be valued on current, strong performance. Industry leaders generally project a strong 2020, with many markets expecting both price and volume increases.

The potential future volatility of the global economy, however, adds a layer of complication with respect to individual transaction pricing. Buyers tend to burden valuations with risks associated with acquiring targets at possible "peak earnings." Sellers, on the other hand, with good backlogs and funding initiatives are bullish about the future. This dichotomy between buyer and seller expectations can create valuation tension. This tension is not a deal-breaker for companies that can show clear visibility into future earnings, but has led buyers to be increasingly selective, and to focus on small to midsized transactions with strong backlogs. As evidence of this trend, FMI notes that in 2017, there were six deals announced over $250 million, yet only three in 2018 and two in late 2019 (Eagle Materials' acquisition of the Cemex Kosmos cement plant in Kentucky; Arcosa's announced acquisition of Cherry Industries). FMI generally expects the trends toward compelling, strategic deals to continue in 2020.

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16 Transcripts, SA. "Construction Partners, Inc. (ROAD) CEO Charles Owens on Q3 2019 Results - Earnings Call Transcript." Seeking Alpha, Seeking Alpha, 10 Aug. 2019, seekingalpha.com/article/4284221-construction-partners-inc-road-ceo-charles-owens-on-q3-2019-results-earnings-call-transcript?part=single.

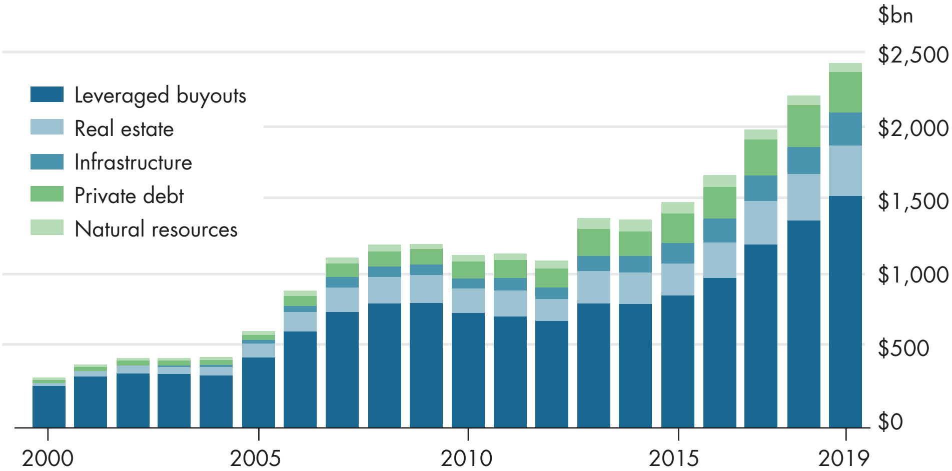
17 Transcripts, SA. "LafargeHolcim Ltd (HCMLY) CEO Jan Jenisch on Q3 2019 Results - Earnings Call Transcript." Seeking Alpha, Seeking Alpha, 25 Oct. 2019, seekingalpha.com/article/4299237-lafargeholcim-ltd-hcmly-ceo-jan-jenisch-on-q3-2019-results-earnings-call-transcript?part=single.

4. Private Equity

Private equity capital was relatively more active in the construction materials space in 2019 than in recent years. StonePoint Materials and its affiliate private equity investor, Sun Capital Partners, continued to assemble an industry player throughout the year. StonePoint acquired Standard Gravel Company (Mississippi) in September and Road Builders, LLC (Kentucky) in December and has publicly communicated an appetite for additional acquisitions moving forward.

Exhibit 13: Historic Levels of Private Equity Investment Capital[18]

PE groups have record levels of "dry powder" available



The private equity trend could become increasingly relevant in the CM space for 2020. In most construction materials transactions, PE firms cannot capture the same operational synergies as strategic buyers and therefore are generally less competitive with deal pricing. However, as more and more investment capital becomes active in the global M&A market, competition for traditional PE purchases increases. As a result, PE firms could be forced to look for new industries to invest in that provide mature, steady cash flows. The construction materials space has the potential to become a destination for PE funding.

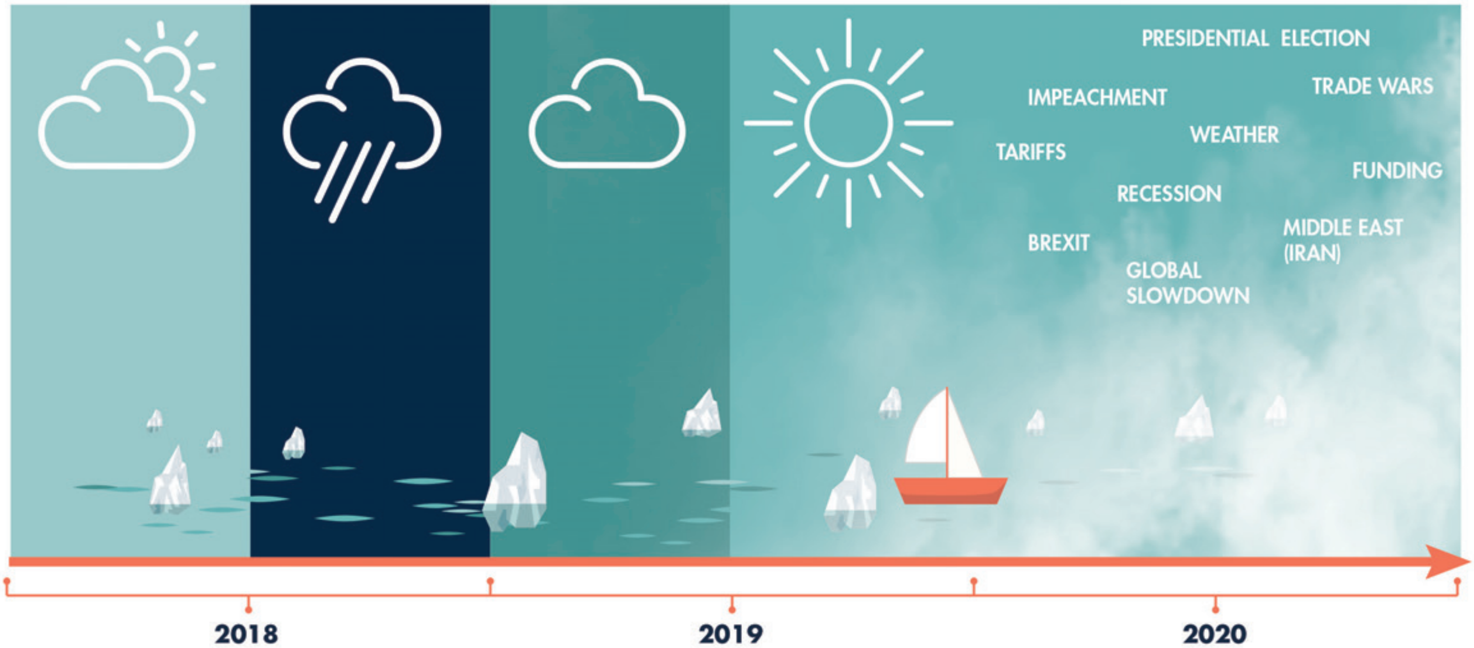
So-called PE "dry powder" (undeployed capital) closed 2019 at an all-time high, which could drive up pricing and expand traditional investment markets. As seen in Exhibit 13, Preqin currently estimates global dry powder at nearly $2.5 trillion.[19] Following StonePoint's lead, private equity deals could ramp up in 2020 as financiers hunt for steady, predictable cash flows in fragmented markets. If CMI buyers are sidelined, private equity could serve as a backstop buyer for CM transactions.

Private equity companies have "…never had more capital at [their] disposal, and it will take years for dry powder reserves to be processed."[20]

18 Source: Preqin, Financial Times

19 https://www.ft.com/content/2f777656-9854-11e9-9573-ee5cbb98ed36

20 "2020 Global Private Equity Outlook." Mergermarket and Dechert LLP. Page 34. 24 October 2019.

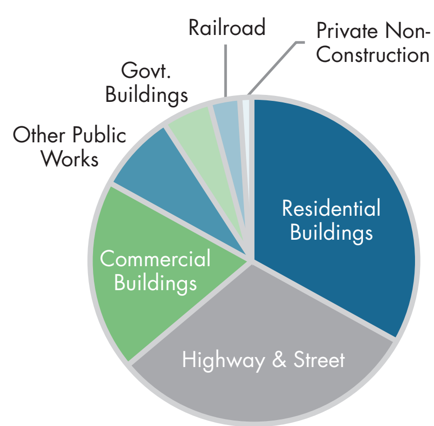


Open Waters and Uncharted Seas – The 2020 CM Industry

It is challenging to predict how 2020 will unfold for construction materials firms. While there are several bridges to cross in 2020 (seen above), materials producers are cautiously optimistic about the operating environment. CMI companies were correctly positive about 2019 earnings based on late 2018 backlogs. A parallel narrative has emerged for 2020 earnings based on late 2019 backlogs.

Residential and public infrastructure construction are traditionally the primary end-use drivers of U.S. aggregates consumption, with commercial building serving as an additional outlet (See Exhibit 14)[21, 22]. Looking ahead to 2020, FMI expects healthy growth in the highway and street construction segment, driven by public spending. Residential and commercial sectors are projected to stabilize at lower growth rates as the private sector shows slower movement. If these forecasts materialize as projected, then 2020 should be another year of positive aggregate consumption trends. Additionally, the public sector's aggregates consumption creates a recession buffer for CM producers, as public construction trends tend to be less volatile than the private sector.

Exhibit 14: Aggregates End Uses[22]



21 FMI Research

22 National Stone, Sand, and Gravel Association

Construction Partners, Inc.

9/30/2019 project backlog of $531 million versus 9/30/2018 backlog of $594 million. CPI comments, "Backlog is expected to build again through the first half of the current year for the current year [fiscal year 2020]."[23]

Knife River

"Record third quarter backlog of $747 million, up 27% from $590 million in 2018."[24]

Summitt Materials

"The only real forward-looking information we have is in our backlogs, …But overall, we're very optimistic on volume."[25]

Granite Construction

9/30/2019 total contract backlog of $3.6 billion versus 9/30/2018 backlog of $3.2 billion.[26]

Aggregates consumption and construction put-in-place projections could receive additional stimulus from funding improvements in 2020. The pending expiration of the FAST Act in September 2020 could prompt Congress to move quickly to redress funding. Notably, 79% of Americans affirmed that increasing spending on roads, bridges and airports should be an "extremely important priority" to Congress.[27] Polling data was virtually identical among Democrats, Republicans and independent voters.[28] Congressional officials may need a "quick win" in the upcoming election years. Against the backdrop of public support, there is always a chance of swift legislative action. Regardless of federal legislative activity, states and counties will likely continue the multiyear trend of creative, self-funding for infrastructure.

Infrastructure funding improvements would also spur M&A activity onward in 2020. State transportation funding is currently projected to grow 4.4% this year.[29] This growth could be compounded further by a systemic boost from federal spending. Reauthorization of the FAST Act would substantiate optimistic performance projections from sellers and help buyers gain confidence in projections. Until we see confirmed action on this front, FMI expects that buyers will continue to primarily pursue bolt-on acquisitions over platform deals, as easily integrated companies with obtainable synergies are always in vogue.

Exhibit 15: Construction Put-in-Place Outlook

	Actuals				Forecast
(% Annual Change)	2016	2017	2018	2019*	2020
Residential	10%	12%	3%	(4%)	1%
Non-Residential	9%	4%	5%	2%	3%
Non-Building	5%	(8%)	1%	6%	5%
Subsector: Highway & Street	3%	(4%)	2%	6%	5%
Total Put-in-Place	**8.8%**	**4.5%**	**3.3%**	**0.4%**	**2.4%**

** Actuals through Q3 2019*

The backdrop of U.S. macroeconomic stability bodes well for construction materials markets in 2020. In December 2019, the Federal Reserve opted to maintain its key interest rate target between 1.5% and 1.75%. The Federal Open Market Committee (FOMC) noted, "The Committee judges that the current stance of monetary policy is appropriate to support sustained expansion of economic activity, strong labor market conditions and inflation near the Committee's symmetric 2% objective."[30] With no interest rate changes projected in the near-term, construction markets are likely to experience relative stability as both cost inflation and interest expenses remain tame in 2020.

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23 Construction Partners Inc., Fiscal 2019 Fourth Quarter and Year-End Results, December 2019, http://ir.constructionpartners.net/news-releases/news-release-details/construction-partners-inc-announces-fiscal-2019-fourth-quarter

24 MDU Resources Third Quarter Earnings Report, October 2019, https://www.mdu.com/Cache/1500124721.PDF?O=PDF&T=&Y=&D=&FID=1500124721&iid=4010692

25 Transcripts, SA. "Summit Materials, Inc. (SUM) CEO Thomas Hill on Q3 2019 Results - Earnings Call Transcript." Seeking Alpha, Seeking Alpha, 31 Oct. 2019, seekingalpha.com/article/4300754-summit-materials-inc-sum-ceo-thomas-hill-on-q3-2019-results-earnings-call-transcript?part=single.

26 Granite Construction Third Quarter Earnings Report, October 2019, https://investor.graniteconstruction.com/press-releases/2019/10-25-2019-115358604

27 "Americans' Priorities for the New Congress in 2019," Politico & Harvard, Dec. 2018. https://www.politico.com/f/?id=00000168-1450-da94-ad6d-1ffa86630001

28 Ibid

29 https://www.usgovernmentspending.com/compare_state_spending_2020b60a

30 Federal Reserve, "Federal Reserve issues FOMC statement," December 11, 2019, https://www.federalreserve.gov/newsevents/pressreleases/monetary20191211a.htm

Dangerous Waters – The Potential of a Recession

Amid otherwise calm economic indicators, early recession signals point toward the potential for a correction. In the third quarter of 2019, the New York Federal Reserve calculated a 38% chance of recession within 12 months. This was the highest level since just before the 2008 financial crisis. However, in the fourth quarter of 2019, the same indicator read as a 25% chance of recession, showing a declining trend. When recession comes – whether in 2020 or later – the odds are strong that the severity and length of the recession will be modest compared to the Great Recession. Countervailing macroeconomic factors working against a protracted recession include: strong labor market, gains in private sector productivity, better capitalized banks, and rational residential real estate prices in most of the country. Accordingly, market watchers generally predict a softer correction than 2008-2009 for those key reasons.

While the next stock market correction will inevitably lead to CMI price adjustments, we are encouraged that CMI stock performance appears grounded in improved operations. Although the Great Recession was incredibly painful, materials producers generally emerged as more efficient operators. Over the past decade, both public and private producers have focused on throughput efficiency, bidding discipline, tech investment, safety improvement and control of overhead costs. These investments have made producers better prepared to endure a traditional downturn. When correction comes, FMI does not anticipate anything as drastic as 2008. Although the water may become choppy in the intermediate future, industry captains should remain confident in their ability to steer their organizations to open seas.

Promising Skies Ahead

2020 looks like a promising atmosphere for closing M&A transactions in the construction materials market. The strength of seller backlogs justifies revenue optimism for 2020 and 2021, based upon revenue visibility. These backlogs can help bridge the gap between buyer and seller expectations by de-risking revenue projections. The 2019 slowdown of transactions seems to have created an "M&A backlog" of deals that could potentially close in 2020. Any progress on long-term federal infrastructure funding could substantially boost the pace and pricing of M&A activity in 2020.

FMI anticipates the M&A behavior from the end of 2019 to continue – as buyers focus on compelling, strategic bolt-on acquisitions with achievable synergies. Companies with healthy backlogs in well-structured markets will continue to be highly sought-after targets, as revenue visibility and predictability of earnings are key drivers for M&A.

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We are sell-side M&A advisors with expertise in the Construction Materials industry. We have built a strong reputation advising clients in this industry on matters ranging from implementing and structuring exit strategies to business valuation.

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OVER ONE HUNDRED TRANSACTIONS **100**

Construction Materials Recent Transactions

John S. Lane & Son, Inc. (Trap Lane Rock) has been acquired by Peckham Industries, Inc.
The undersigned served as the exclusive financial advisor to John S. Lane & Son, Inc. in this transaction
FMI Capital Advisors

JSL Asphalt Inc. has been acquired by Peckham Industries, Inc.
The undersigned served as the exclusive financial advisor to JSL Asphalt, Inc. in this transaction
FMI Capital Advisors

Myrl & Roy's Paving, Inc. has been acquired by L. G. Everist, Inc.
The undersigned served as the exclusive financial advisor to Myrl and Roy's Paving, Inc. in this transaction
FMI Capital Advisors

Ace Ready Mix has been acquired by L. G. Everist, Inc.
The undersigned served as the exclusive financial advisor to Ace Ready Mix, Inc. in this transaction
FMI Capital Advisors

Windsor Rock Products has been acquired by RiverBend Materials, A CRH Company
The undersigned served as the exclusive financial advisor to Windsor Rock Products in this transaction
FMI Capital Advisors

Walker Sand + Gravel, Est. 1972 has been acquired by Summit Materials
The undersigned served as exclusive financial advisor to Walker Sand & Gravel in this transaction
FMI Capital Advisors

Palmer Paving Corp has been acquired by Peckham Industries, Inc.
The undersigned served as the exclusive financial advisor to Palmer Paving Corporation in this transaction
FMI Capital Advisors

Midwest Minerals "Rock Solid Since 1947" has been acquired by Summit Materials
The undersigned served as the exclusive financial advisor to Midwest Minerals in this transaction
FMI Capital Advisors

Vulcan Materials Company has acquired McCartney Construction Co. Inc.
The undersigned served as the exclusive financial advisor to McCartney Construction in this transaction
FMI Capital Advisors

Upstone Materials (A Colas USA Company) Colas has acquired the assets of Graymont
The undersigned served as the exclusive financial advisor to Graymont in this transaction
FMI Capital Advisors

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