Construction Materials Market Outlook:

Merger and Acquisition Trends

January 2024

EXECUTIVE SUMMARY:

Merger and acquisition (M&A) activity can be fickle, as market cyclicality undulates in a dramatic fashion with economic signals. For the majority of 2023, global transaction volume was in a trough. Battered by headwinds such as inflation, rate hikes, geopolitical tensions and the ever-looming recession, both individuals and businesses prepared for a downturn. Global deal volume shrank to its lowest since 2005 as buyers braced for the worst.[1] However, thanks to strong consumer balance sheets and a resilient labor market, a true recession never seemed to materialize. Sentiment quickly shifted in the fourth quarter as dealmakers and executives became accustomed to the current operating environment. According to Mergermarket, "The fourth quarter had the largest volume of $2B-plus transactions since the second quarter of 2022."[2] Additionally, late in the year, expectations shifted to the Federal Reserve (Fed) cutting rates by early 2024, which may catapult economic growth and fuel more deals in the months ahead.

M&A activity for **construction materials (CM)** followed a similar pattern but managed to fare better overall. Confidence in the CM industry was strengthened throughout the year as public companies reported record (or near-record) financial performance, despite lower sales volumes. Major players were able to use their pricing power to offset concerns about a slowdown, and investors rewarded this behavior with strong valuations and increased share price (see Exhibit 3). Deal volumes for CM companies followed suit, outperforming the broader market (see Exhibits 4 and 5). As expectations for a recession began to recede (indicated by *Wall Street Journal* economist surveys),[3] CM M&A activity was positioned to excel, which was demonstrated in the announcements of several "thunderclap" deals that took place in the fourth quarter.

As we look toward 2024, the operating dynamics for CM companies should support a continued strong M&A market. Bolstered by federal funding packages such as the Infrastructure Investment and Jobs Act (IIJA), Inflation Reduction Act (IRA) and the CHIPS and Science Acts, producers in many markets will continue to benefit from strong backlogs and attractive projects. Guaranteed funding, pricing power, cost mitigation strategies and stable end markets all point to confidence and certainty in the sector. Capitalizing on the current momentum, we expect both buyers and sellers to approach the new year with optimism. Additionally, a Fed reversal on interest rates should unlock capital, resulting in a massive lift to the M&A market.

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[1] "M&A Highlights 2023: Decade Low." Mergermarket. Dec. 19, 2023.

[2] Ibid.

[3] Torry, H. "A Recession Is No Longer the Consensus." The Wall Street Journal. Oct. 15, 2023.

CM Trends and Drivers

Strong Financial Performance

> ***"Volume kills and profit thrills."***
>
> **— FMI Founder, Doc Fails**

CM performance in 2023 is best summarized by these words from FMI founder Emol "Doc" Fails: "Volume kills and profit thrills." As seen in Exhibit 1, U.S. aggregate production was down every quarter compared to the same period in 2022. However, the reporting of these volume decreases was often coupled with excitement around price increases, record revenues and earnings before interest, taxes, depreciation and amortization (EBITDA) (see Exhibit 2). In 2024, CM firms are expected to continue riding the pricing wave, with many having already announced increases for next year. Anne Noonan, CEO of Summit Materials, indicated on the company's third-quarter earnings call that the company has "... shifted to a more dynamic pricing model with customers now expecting at least two price increases a year."[4]

Kyle Larkin, CEO of Granite Construction, expects to "realize further price increases in 2024."[5] The pricing and volume dynamic will be a critical narrative to monitor in 2024, especially with increasing IIJA funding. If performance remains strong, M&A activity should increase or remain strong as well.

Exhibit 1 – Year-Over-Year Percent Change in Total Construction Aggregates Sold or Used in the U.S.

Volume Decline

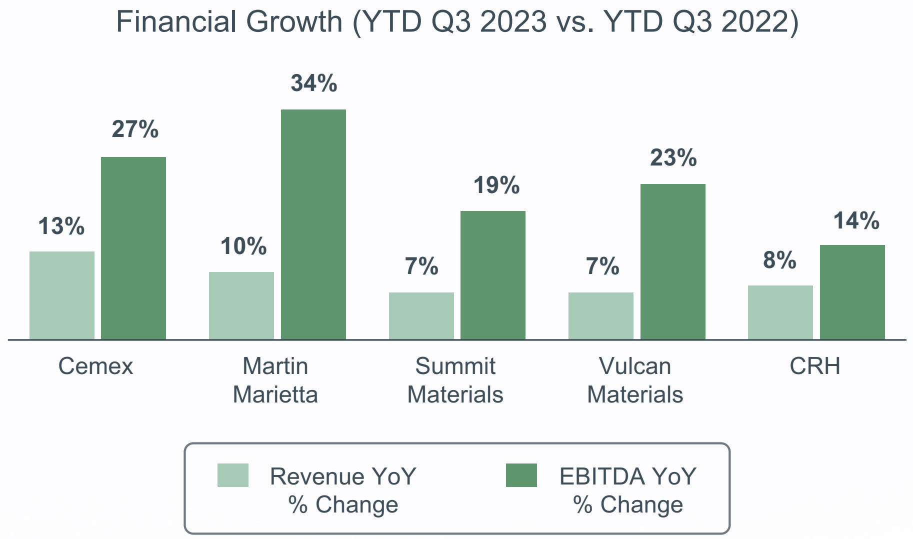
GEOGRAPHY	Q1 2023	Q2 2023	Q3 2023	TRAILING 12 MONTHS
Midwest	18%	6%	-4%	1%
Northeast	8%	-9%	-8%	-4%
South	-2%	0%	-4%	-2%
West	-15%	-6%	0%	-6%
United States	**-2%**	**-2%**	**-3%**	**-3%**

Source: United States Geological Survey

[4] "Summit Materials, Inc. (SUM) Q3 2023 Earnings Call Transcript." Seeking Alpha. Nov. 2, 2023.

[5] "Granite Construction Incorporated (GVA) Q3 2023 Earnings Call Transcript." Seeking Alpha. Oct. 31, 2023.

Exhibit 2 – Select CMI Company Year-Over-Year Revenue and EBITDA Comparison

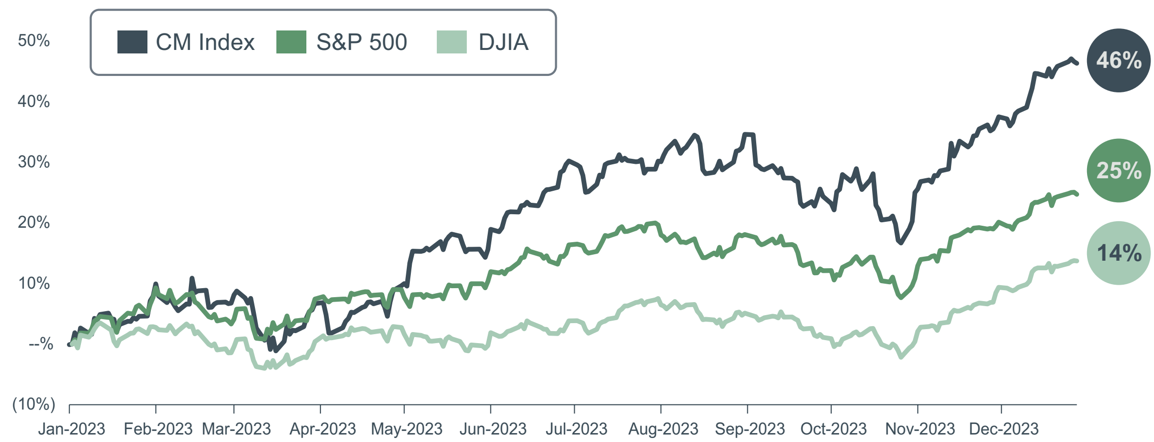


Source: Public Company Filings

Favor on Wall Street

Investors always look for predictability and certainty when deploying capital. Since CM operators benefit from both guaranteed public funding and attractive pricing power, the industry often has a much more transparent path to strong earnings than other market segments. As a result, the Construction Materials Index (CMI), FMI's proprietary index of publicly traded CM firms, significantly outperformed the market in 2023. As seen in Exhibit 3, the CMI outpaced the Dow Jones Industrial Average and the S&P 500 Index by approximately 32% and 21%, respectively. Stock price is the currency in which public companies operate. As stock performance increases in the sector, buyers have more capital to deploy, making acquisitions a very attractive opportunity for growth. Since public buyers make up around 50% of all CM acquisitions, rising stock prices should bode well for M&A activity.

Exhibit 3 – CMI Year-to-Date (12/31/23) Versus Dow Jones Industrial Average and S&P 500



Source: S&P Capital IQ

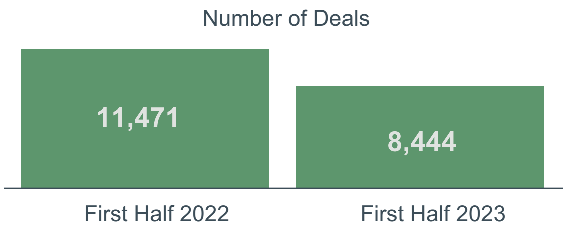
The CM Index includes: Arcosa, Inc. (NYSE: ACA); Buzzi S.p.A. (BIT: BZU); Cementos Argos S.A. (BVC: CEMARGOS); CEMEX, S.A.B. de C.V. (BMV: CEMEX CPO); Construction Partners, Inc. (NasdaqGS: ROAD); CRH plc (NYSE: CRH); Eagle Materials Inc. (NYSE: EXP); GCC, S.A.B. de C.V. (BMV: GCC); Granite Construction Incorporated (NYSE: GVA); Heidelberg Materials AG (DB: HEI); Holcim Ltd (SWX: HOLN); Knife River Corporation (NYSE: KNF); Martin Marietta Materials, Inc. (NYSE: MLM); Summit Materials, Inc. (NYSE: SUM); The Monarch Cement Company (OTCPK: MCEM); Titan Cement International S.A. (ATSE: TITC); Vulcan Materials Company (NYSE: VMC)

Cyclicality

Just like the overall economy, M&A activity is cyclical. There's an uptick in activity when buyers are bullish on the economy and a pullback when there's trepidation. Heading into 2023, the M&A market had seen two years of robust performance, both in terms of deal volume and total acquisition spend. However, the frenzied pace could not last forever, and activity slowed in the first half of 2023. According to S&P Capital IQ, on a deal volume basis, the U.S. and Canada M&A market was down approximately 26.4% for the first half of 2023 compared to the first half of 2022 (see Exhibit 4).[6] Fortunately, for the CM sector, there was less of a decline (around 11%) in the same period (see Exhibit 5).

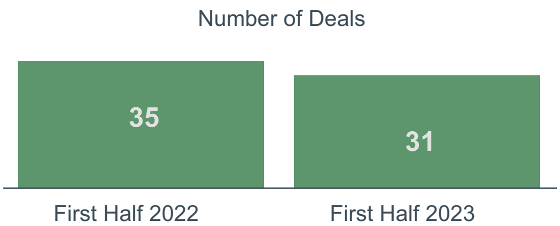
Exhibit 4 – Total U.S. and Canada M&A Activity by Deal Volume

(First Half of 2022 Versus First Half of 2023)



Source: S&P Global Market Intelligence

Exhibit 5 – U.S. Construction Materials M&A Activity by Deal Volume



Source: Mergermarket, S&P Capital IQ, FMI

[6] "High rates extend M&A slump in North America through H1 2023." S&P Global. July 18, 2023.

However, the narrative has shifted as we head into 2024. According to the latest EY CEO Outlook Pulse Survey, 98% of participants plan to pursue a strategic transaction in the next 12 months.[7] On Vulcan Materials Company's third-quarter earnings call, chairman and CEO Tom Hill said, "As I look at the M&A market right now — from, say, six or eight months ago — it's actually picked up. I think over the next several months, over the next several quarters, we should see some strategic bolt-on acquisitions."[8]

Return of "Thunderclap" Deals

The CM sector finished out 2023 with several "thunderclap" transactions — referring to deals that are both sizable in transaction value and have broader market implications. As seen in Exhibit 6, there were at least four major transactions announced in the second half of 2023, further supporting the thesis that sentiments have improved heading into 2024. Thunderclap transactions are cyclical, so it will be interesting to see if more will materialize in 2024, or if these larger transactions have a ripple effect and will catalyze smaller bolt-on transactions in the coming months.

Exhibit 6 – Major "Thunderclap" Transactions in 2023

ANNOUNCE DATE	BUYER	TARGET	DETAILS
September 2023	Summit Materials, Inc.	Cementos Argos S.A.	4 Cement Plants 140 RMC Plants 8 Ports
November 2023	SRM Concrete, LLC	Vulcan Materials Company	82 RMC Plants (TX) 11 Loading Sites (TX)
November 2023	CRH plc	Martin Marietta Materials, Inc.	1 Cement Plant (TX) 20 RMC Plants (TX) Network of Terminals
August 2023	UNACEM Corp S.A.A.	Martin Marietta Materials, Inc.	Cement Plant (CA)

Source: Public Company Filings

[7] Sheynin, N. "M&A Trends and Outlook for 2024." Alpha Sense. Nov. 16, 2023.

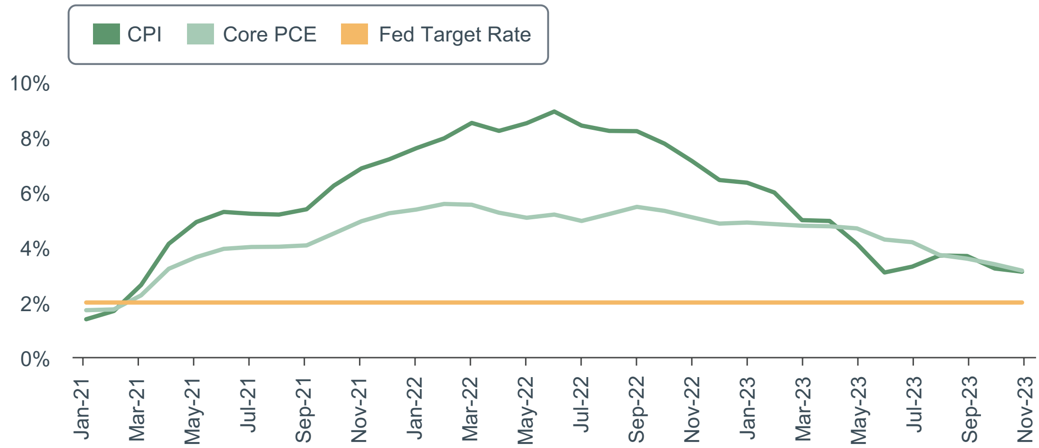
[8] "Vulcan Materials Company (VMC) Q3 2023 Earnings Call Transcript." Seeking Alpha. Oct. 26, 2023.

Economic Trends

Inflation and Interest Rates

One of 2023's big questions was whether the Fed could pull off a soft landing or try to lower inflation without creating a major recession. As we look ahead to 2024, the Fed just might make it happen. In a November *Wall Street Journal* article, Nancy Canden Houten, lead U.S. economist at Oxford Economics, said they were anticipating a soft landing and that "[they] expect the economy to weaken quite a bit, but it does look like we'll avoid an outright contraction."[9] As shown in Exhibit 7, monetary policy is nearing inflation closer to the Fed's 2% target.

Exhibit 7 – Consumer Price Index (CPI) and Core Personal Consumption Expenditures (PCE) Price Index



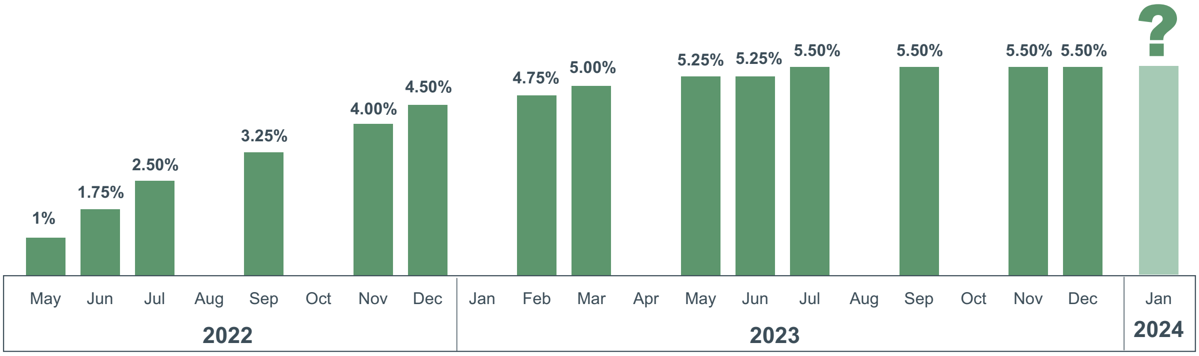
Source: Federal Reserve Bank of St. Louis

[9] Harrison, D. "The Elusive Soft Landing is Coming Into View." The Wall Street Journal. Nov. 15, 2023.

Additionally, as shown in Exhibit 8, the rate hikes have become less pronounced, with Fed officials even electing to hold rates steady in the latter half of the year. Looking to 2024, Jerome Powell and other Fed officials have hinted that rate cuts are on the table. “There is more work to do, and at this point, that work includes not only focusing on bringing inflation down to 2% … but also recognizing that we want to continue to do this gently, with as few disruptions to the labor market as possible,” said San Francisco Fed President Mary Daly.[10] Jerome Powell echoed similar sentiments about the harm that could come with holding rates too high for too long. “We’re aware of the risk[s] [if] we would hang on too long … [and] we’re very focused on not making that mistake.”[11] The market has priced in potential rate hikes for the upcoming year.

Rate cuts (assuming inflation has subsided) would be welcome news for the CM sector, as this would present a major boost to all facets of construction and would help drive M&A activity.

Exhibit 8 – Federal Funds Rate



Source: Federal Reserve Bank of St. Louis

[10] Timiraos, N. “Fed Official Says Rate Cuts Could Be Needed Next Year to Prevent Overtightening.” The Wall Street Journal. Dec. 18, 2023.

[11] Timiraos, N. “Feds Begin Pivot Toward Lowering Rates as Inflation Declines.” The Wall Street Journal. Dec. 13, 2023.

Residential Market

There is a structural problem in the U.S. residential market that goes beyond basic supply-and-demand inefficiencies. Single-family homes have been significantly underbuilt since the decade that followed the 2008 mortgage crisis. As of April 2023, the *Wall Street Journal* estimates that there's a housing shortage of anywhere from 1.7 million to 7.3 million units.[12] Existing home supply has been hampered by higher rates, as homeowners are reluctant to give up low mortgage rates to move to a new home. According to the WSJ, approximately 80% of outstanding U.S. mortgages have an interest rate below 5%.[13] Toward the end of December 2023, mortgage rates dropped below 7% for the first time since August 2023.[14] Despite the headwinds, there have been pockets of opportunity as homebuilders seek to capitalize on the heightened housing demand.

November residential starts beat expectations, increasing 14.8% month over month, with construction of single-family homes increasing to the highest level since April 2022. Additionally, permits for single-family homes increased to their highest levels since May 2022.[15] Stephen Stanley, chief U.S. economist at Santander U.S. Capital Markets, explained to Bloomberg, "Builders are … aware that there is a structural shortage of housing in the U.S., thus, despite rising financing costs, they are likely to want to maintain a certain pace of output regardless of how soft demand gets in the near-term."[16]

Michael Haack, CEO of Eagle Materials, summed up the current housing environment on the company's October earnings call: "Looking longer term, we see the structural underbuild of housing in the U.S. getting worse before it gets better, as rate lock-ins keep people in their current homes for longer, creating a tailwind for our businesses as new homes are built."[17]

[12] Zumbrun, J. "How Severe is the Housing Shortage? It Depends on How You Define 'Shortage.'" The Wall Street Journal. April 14, 2023.

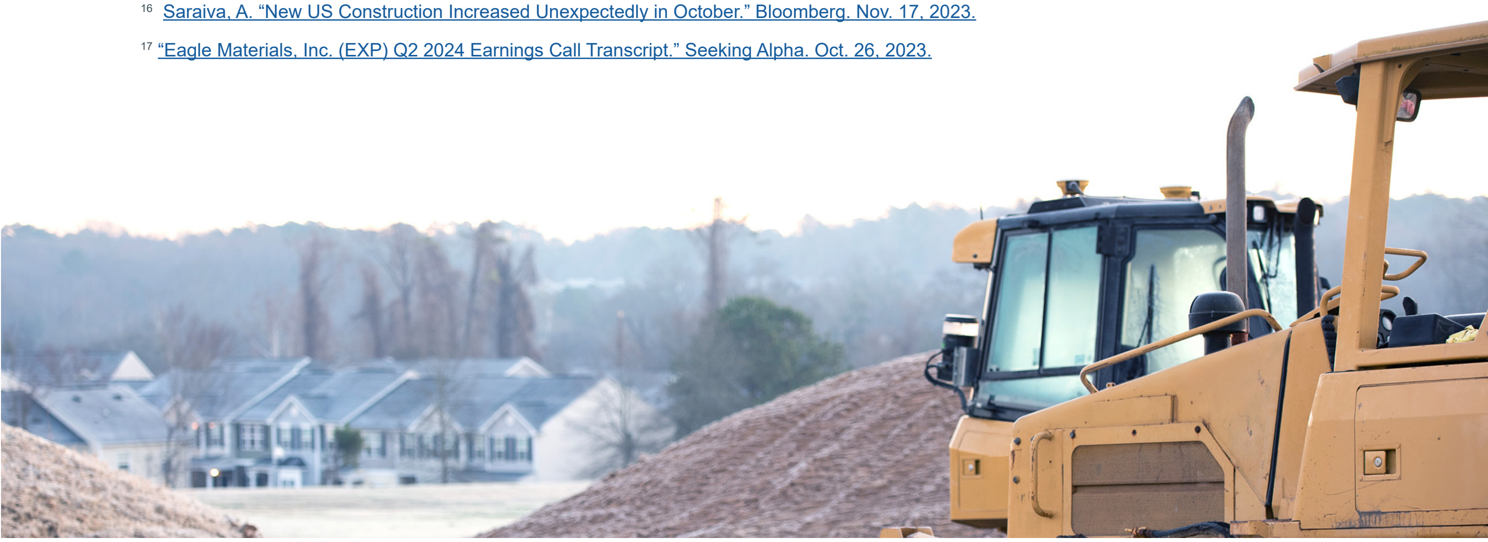
[13] Ryan, C. "There's Never Been a Worse Time to Buy Instead of Rent." The Wall Street Journal. Oct. 22, 2023.

[14] Sasso, M. "US Housing Starts Unexpectedly Rise to a Six-Month High." Bloomberg. Dec. 19, 2023.

[15] Ibid.

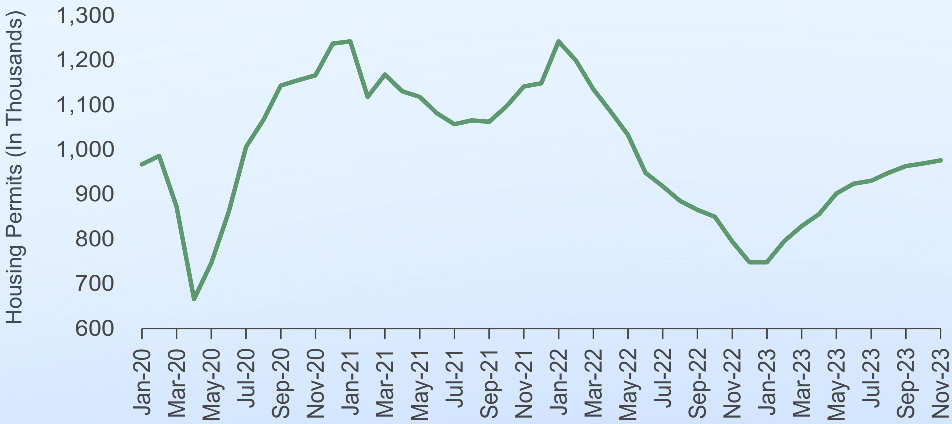
[16] Saraiva, A. "New US Construction Increased Unexpectedly in October." Bloomberg. Nov. 17, 2023.

[17] "Eagle Materials, Inc. (EXP) Q2 2024 Earnings Call Transcript." Seeking Alpha. Oct. 26, 2023.



As seen in Exhibit 9, single-family permits steadily rose over the course of 2023, which is a promising sign for 2024. “I think the interest rates are a big burden for the moment on residential housing in the U.S.,” said Jan Jenisch, CEO of Holcim, on the company’s Q3 earnings call. If the Fed reverses course and reduces rates, this could open the floodgates for the residential market.[18]

Exhibit 9 – U.S. Single-Family Building Permits



Source: U.S. Census Bureau, U.S. Department of Housing and Urban Development

[18] “Holcim Ltd (HCMLF) Q3 2023 Earnings Call Transcript.” Seeking Alpha. Oct. 27, 2023.

Nonresidential Buildings

The nonresidential sector encompasses a broad array of end markets, but there's a clear frontrunner for 2024: manufacturing. According to FMI research, manufacturing and industrial construction is expected to lead year-over-year growth in 2024. This growth will be fueled by CHIPS Act funding, demand from the technology sector (artificial intelligence/AI, cloud computing, chip manufacturing, electric vehicle/EV manufacturing, etc.) and companies looking to bolster their supply chains. There should be a number of manufacturing projects that come online in the near term. On its third-quarter earnings call, CEMEX noted, "Infrastructure activity continued to grow … [and that] our states … remain key beneficiaries from onshoring and clean technology spending."[19]

Heightened demand and funding for nonresidential projects will be a great outlet for cement, aggregates and ready-mixed producers, which should alleviate some concerns surrounding the wildcard residential sector. FMI expects commercial construction to decline in 2024, most notably due to the pullback in warehouse construction (which was white-hot during the pandemic). The ebbs and flows in nonresidential will be another factor to keep an eye on in 2024.

Highways and Streets

This sector is forecasted to remain strong for CM in 2024. The combination of IIJA funding finally flowing into the system, along with reduced cost inflation, should fulfill the 2021 prediction of former National Asphalt Pavement Association's Head of Government Affairs Jay Hansen, which is that asphalt will reach a "supercycle similar to the 1950s."[20]

CM producers are celebrating the positive runway for highways and streets. Ward Nye, CEO of Martin Marietta, said on the company's third-quarter earnings call that "the historic increase in public sector investment from the … IIJA, record state departments of transportation budgets and voter-approved state and local transportation ballot initiatives will provide sustained multiyear demand."[21]

On their November earnings call, executives at Construction Partners, Inc., celebrated their "record backlog of $1.6 billion" and the fact that their backlog has "grown for 12 straight quarters."[22] Greater backlogs combined with upcoming price increases present a clear path to success for materials producers. On Knife River's third-quarter earnings call, CFO Nathan Ring highlighted that the "margins in the backlog improved and overall profitability in dollars is higher."[23] Aggregates and hot-mix asphalt producers may be in the early stages of their product supercycles.

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[19] "CEMEX, S.A.B. de C.V. (CX) Q3 2023 Earnings Call Transcript." Seeking Alpha. Oct. 26, 2023.

[20] National Asphalt Pavement Association. Twitter Post. July 20, 2021. 12:32 PM.

[21] "Martin Marietta Materials, Inc. (MLM) Q3 2023 Earnings Call Transcript." Seeking Alpha. Nov. 1, 2023.

[22] "Construction Partners, Inc. (ROAD) Q4 2023 Earnings Call Transcript." Seeking Alpha. Nov. 29, 2023.

[23] "Knife River Corporation NYSE:KNF FQ3 2023 Earnings Call Transcripts." S&P Global. Nov. 6, 2023.

A Look Ahead

Although deal activity sputtered throughout the majority of 2023, the current sentiment appears to anticipate a strong market going forward. If there's a lesson to be learned from the past year's trials, it's that mergers and acquisitions shy away from uncertainty. The promising news is that there seems to be more clarity now than there was at the start of 2023. Although the risk of recession still lingers, the growing consensus is that the Fed could pull off its targeted soft landing in 2024. If the Fed cuts rates, we should expect to see a jumpstart in many facets of the economy, including M&A. For 2024, the CM sector is poised to capitalize on its current momentum in financial performance, operational performance, funding and deal activity.

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FMI

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FMI Capital Advisors specializes in sell-side mergers and acquisitions for the built environment.

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has been acquired by
Farmer Companies
FMI Capital Advisors
SELL-SIDE ADVISOR

Branscome Incorporated
A COLAS COMPANY
a subsidiary of
COLAS
has been acquired by
Adams Construction Company
FMI Capital Advisors
SELL-SIDE ADVISOR

Syar Industries
has been acquired by
Vulcan Materials Company
FMI Capital Advisors
SELL-SIDE ADVISOR

Razorback Concrete Company
a subsidiary of
Summit Materials
has been acquired by
Farmer Companies
FMI Capital Advisors
SELL-SIDE ADVISOR

SCC materials
a subsidiary of
webber
has been acquired by
Martin Marietta
FMI Capital Advisors
SELL-SIDE ADVISOR

Kuhlman
has been acquired by
The Gerken Companies
FMI Capital Advisors
SELL-SIDE ADVISOR

Barriere Construction
has been acquired by
CRH
FMI Capital Advisors
SELL-SIDE ADVISOR

John S. Lane & Son, Inc.
Trap Lane Rock
has been acquired by
Peckham Industries, Inc.
FMI Capital Advisors
SELL-SIDE ADVISOR

Myr & Roy's Paving, Inc.
has been acquired by
L. G. Everist, Inc.
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