

OUTLOOK

19 November 2018

 Rate this Research

Analyst Contacts

Griselda Bisono +1.212.553.4985
AVP-Analyst
griselda.bisono@moodys.com

Felipe Strieder +1.212.553.4724
Associate Analyst
felipe.strieder@moodys.com

Glenn B. Eckert, CFA +1.212.553.1618
Associate Managing Director
glenn.eckert@moodys.com

CLIENT SERVICES

Americas	1-212-553-1653
Asia Pacific	852-3551-3077
Japan	81-3-5408-4100
EMEA	44-20-7772-5454

Building Materials – US

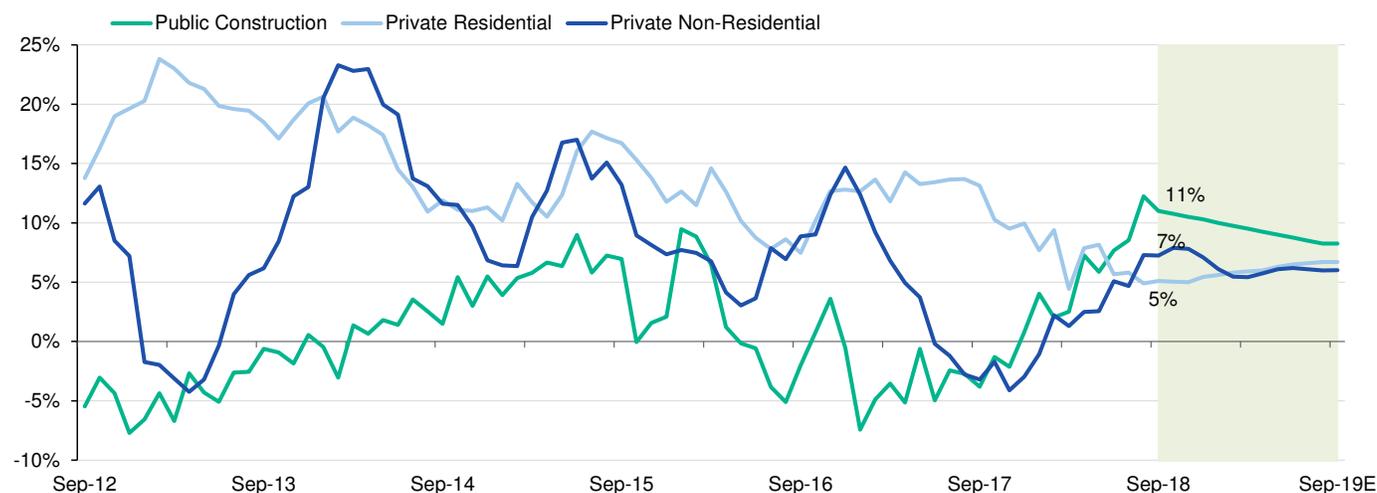
Update: Revising outlook to stable amid maturing construction cycle

- » **We are revising our outlook to stable from positive.** This change to stable reflects our expectations of slower organic operating income growth over the next 18 months due to diminishing demand in private construction. We expect organic operating income growth for the building materials companies that we rate will decelerate in 2019 to an annualized pace below 7%, following four years of strong growth. Our forecast is at the high end of the -3% to +7% operating income growth range for a stable outlook and incorporates more modest, but still growing construction spending.
- » **Private residential construction growth is decelerating, with several key factors pointing to a slowdown.** Rising mortgage rates and a decline in housing affordability have led to a spike in new home inventory and support [Moody's stable homebuilding outlook](#). We expect single-family housing starts to grow 4.5% in 2018 and 3.2% in 2019, compared with 9%-10% average growth from 2015-2017. The inventory of new, unsold homes reached seven months for the first time since 2011. Multifamily rental housing construction has experienced weak growth since 2016, in large part due to reduced capital availability. Multifamily housing starts are expected to grow 7.6% in 2018 and 2.4% in 2019. While that is an improvement from the 11% decline during 2017, those figures are still weak by historical standards. The overall residential construction sector is also facing labor constraints and increasing raw material costs. We expect private residential housing demand to remain stable, supported by solid wage and job growth, low unemployment and millennials' growing need for housing.
- » **Private non-residential construction spending will also see slower growth in 2019.** Non-residential construction should grow 4% in 2019, with the predominance of activity being generated by industrial and institutional construction, according to the American Institute of Architects' consensus construction forecast. This forecast shows slowing commercial building construction and is lower than expectations of 4.7% growth in 2018. Again, labor constraints, as well as the high cost of materials and land, support our stable view for private non-residential construction over the next 12-18 months.

- » **Public infrastructure spending remains robust, particularly at the state level.** Construction spending in the public sector has grown since late 2017 and reached 11% year-over-year growth as of September 2018 (see Exhibit 1). We expect continued, albeit somewhat slower, growth in 2019 of 8% as states continue to pass new long-term legislation supporting highway construction. For example in November 2018 California voters recently rejected a repeal of SB1, a gas tax increase passed in 2017 to help pay for highway infrastructure throughout the state. At the federal level the Fixing America's Surface Transportation (FAST) Act provides funding through 2020 for public infrastructure, close to 75% of which is allocated to the Federal Highway Administration. We remain cautious on public infrastructure spending growth beyond 2020, particularly at the federal level, as other agenda items will likely take priority during an election year.

Exhibit 1

Public construction spending growth expected to outpace private construction spending growth
Total construction put in place (YoY change)



Source: Factset and Moody's Investors Service

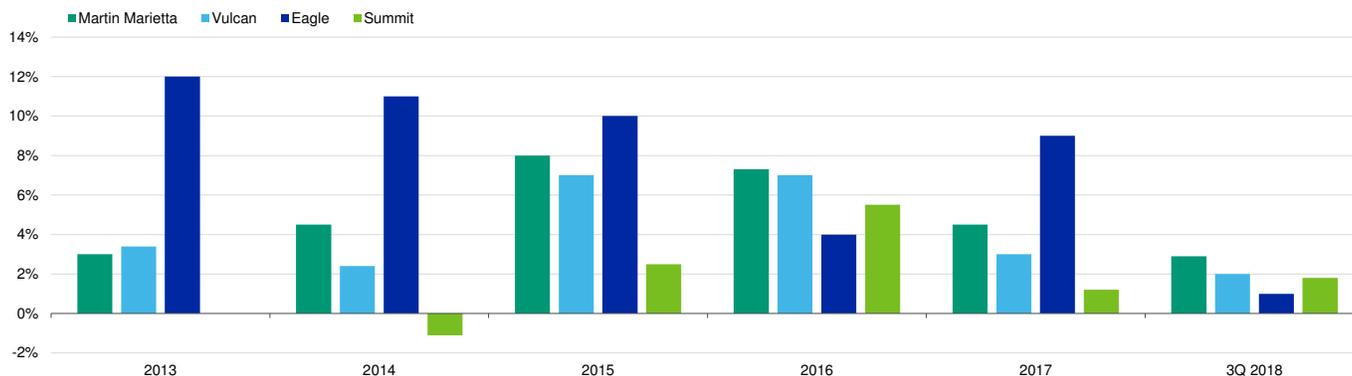
- » **Price increases have largely moderated, but remain positive.** Building material companies' ability to increase prices across all products has diminished in 2018, and is another indicator of tempering in the sector. Aggregates pricing growth is currently in the low single digits (see Exhibit 2). On the positive side, pricing and volume growth is helping to offset labor constraints and higher material costs on margins. In addition, the rated building material companies continue to report strong backlogs, despite weaker earnings in 2017 and 2018 due to the weather.

This publication does not announce a credit rating action. For any credit ratings referenced in this publication, please see the ratings tab on the issuer/entity page on www.moody's.com for the most updated credit rating action information and rating history.

Exhibit 2

Pricing growth has largely moderated, but remains positive

Aggregates YoY change



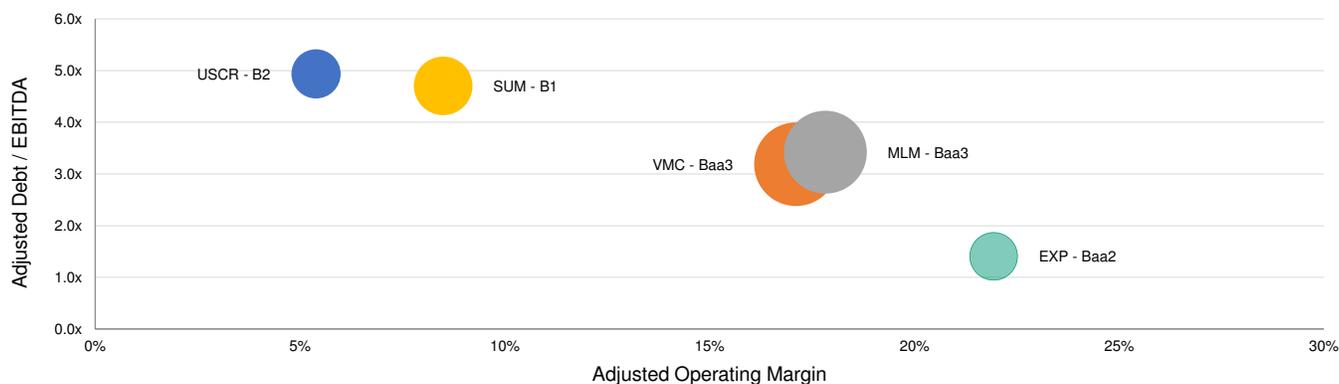
Source: Company filings

- » **Product mix continues to shift towards aggregates.** Several rated building materials companies have either increased their percentage of revenues coming from aggregates or recently made a major acquisitions in the aggregates space, including: [Vulcan Materials Company](#) (Baa3 stable), [Martin Marietta Materials, Inc.](#) (Baa3 negative) and [U.S. Concrete, Inc.](#) (B2 stable). Restrictive permitting processes in most metropolitan areas and high transportation costs makes the aggregates industry very regional in nature and limit competition. Accordingly, aggregates producers benefit from better pricing power through cycles, compared to sellers of cement and ready-mix concrete.
- » **Solid credit metrics and strong liquidity help mitigate volatility in earnings.** The rated US building material companies have good credit profiles, with leverage that has generally trended down over the last decade. Internal liquidity is strong, with minimal near-term maturities, high levels of cash and line availability. Furthermore, the building material companies have strong cash flow generation, with a demonstrated ability to generate positive cash flows during economic downturns.

Exhibit 3

Solid credit profiles support current credit ratings

Moody's adjusted debt/EBITDA and operating margins



Peer comparative includes Eagle Materials Inc. (EXP), Martin Marietta Materials, Inc. (MLM), Summit Materials, LLC (SUM), U.S. Concrete, Inc. (USCR) and Vulcan Materials Company (VMC)

Source: Moody's Investors Service

- » **What could change our outlook?** We could revise our outlook back to positive if the industry's organic operating income growth increases above 7%, coupled with continued solid momentum in public, private residential and private non-residential construction as well as stable federal highway spending. Our outlook could change to negative if the industry's organic operating income contracts by 3% or more, there is a reversal in end market momentum and/or there is a reversal of broader economic indicators pointing to recessionary conditions.

Since outlooks represent our forward-looking view on business conditions that factor into our ratings, a negative (positive) outlook suggests that negative (positive) rating actions are more likely on average. However, the industry outlook does not represent a sum of upgrades, downgrades or ratings under review, or an average of rating outlooks of issuers in the industry, but rather our assessment of the main direction of business fundamentals within the overall industry.

Moody's related publications

- » [Homebuilding - US Outlook: Slower growth, increasing headwinds, prompt outlook cut to stable from positive, November 2018](#)
- » [Building Materials — US: Positive outlook supported by strength in construction spending, producer optimism, June 2018](#)
- » [Building Materials - Global: Energy-intensive cement makers facing rising pressure to lower carbon emissions, July 2018](#)
- » [Cross-Sector - US: Next Congress is unlikely to change direction of US policy, November 2018](#)
- » [State government - US: Four issues that will determine the credit impact of November's elections for states, October 2018](#)

© 2018 Moody's Corporation, Moody's Investors Service, Inc., Moody's Analytics, Inc. and/or their licensors and affiliates (collectively, "MOODY'S"). All rights reserved.

CREDIT RATINGS ISSUED BY MOODY'S INVESTORS SERVICE, INC. AND ITS RATINGS AFFILIATES ("MIS") ARE MOODY'S CURRENT OPINIONS OF THE RELATIVE FUTURE CREDIT RISK OF ENTITIES, CREDIT COMMITMENTS, OR DEBT OR DEBT-LIKE SECURITIES, AND MOODY'S PUBLICATIONS MAY INCLUDE MOODY'S CURRENT OPINIONS OF THE RELATIVE FUTURE CREDIT RISK OF ENTITIES, CREDIT COMMITMENTS, OR DEBT OR DEBT-LIKE SECURITIES. MOODY'S DEFINES CREDIT RISK AS THE RISK THAT AN ENTITY MAY NOT MEET ITS CONTRACTUAL, FINANCIAL OBLIGATIONS AS THEY COME DUE AND ANY ESTIMATED FINANCIAL LOSS IN THE EVENT OF DEFAULT. CREDIT RATINGS DO NOT ADDRESS ANY OTHER RISK, INCLUDING BUT NOT LIMITED TO: LIQUIDITY RISK, MARKET VALUE RISK, OR PRICE VOLATILITY. CREDIT RATINGS AND MOODY'S OPINIONS INCLUDED IN MOODY'S PUBLICATIONS ARE NOT STATEMENTS OF CURRENT OR HISTORICAL FACT. MOODY'S PUBLICATIONS MAY ALSO INCLUDE QUANTITATIVE MODEL-BASED ESTIMATES OF CREDIT RISK AND RELATED OPINIONS OR COMMENTARY PUBLISHED BY MOODY'S ANALYTICS, INC. CREDIT RATINGS AND MOODY'S PUBLICATIONS DO NOT CONSTITUTE OR PROVIDE INVESTMENT OR FINANCIAL ADVICE, AND CREDIT RATINGS AND MOODY'S PUBLICATIONS ARE NOT AND DO NOT PROVIDE RECOMMENDATIONS TO PURCHASE, SELL, OR HOLD PARTICULAR SECURITIES. NEITHER CREDIT RATINGS NOR MOODY'S PUBLICATIONS COMMENT ON THE SUITABILITY OF AN INVESTMENT FOR ANY PARTICULAR INVESTOR. MOODY'S ISSUES ITS CREDIT RATINGS AND PUBLISHES MOODY'S PUBLICATIONS WITH THE EXPECTATION AND UNDERSTANDING THAT EACH INVESTOR WILL, WITH DUE CARE, MAKE ITS OWN STUDY AND EVALUATION OF EACH SECURITY THAT IS UNDER CONSIDERATION FOR PURCHASE, HOLDING, OR SALE.

MOODY'S CREDIT RATINGS AND MOODY'S PUBLICATIONS ARE NOT INTENDED FOR USE BY RETAIL INVESTORS AND IT WOULD BE RECKLESS AND INAPPROPRIATE FOR RETAIL INVESTORS TO USE MOODY'S CREDIT RATINGS OR MOODY'S PUBLICATIONS WHEN MAKING AN INVESTMENT DECISION. IF IN DOUBT YOU SHOULD CONTACT YOUR FINANCIAL OR OTHER PROFESSIONAL ADVISER. ALL INFORMATION CONTAINED HEREIN IS PROTECTED BY LAW, INCLUDING BUT NOT LIMITED TO, COPYRIGHT LAW, AND NONE OF SUCH INFORMATION MAY BE COPIED OR OTHERWISE REPRODUCED, REPACKAGED, FURTHER TRANSMITTED, TRANSFERRED, DISSEMINATED, REDISTRIBUTED OR RESOLD, OR STORED FOR SUBSEQUENT USE FOR ANY SUCH PURPOSE, IN WHOLE OR IN PART, IN ANY FORM OR MANNER OR BY ANY MEANS WHATSOEVER, BY ANY PERSON WITHOUT MOODY'S PRIOR WRITTEN CONSENT.

CREDIT RATINGS AND MOODY'S PUBLICATIONS ARE NOT INTENDED FOR USE BY ANY PERSON AS A BENCHMARK AS THAT TERM IS DEFINED FOR REGULATORY PURPOSES AND MUST NOT BE USED IN ANY WAY THAT COULD RESULT IN THEM BEING CONSIDERED A BENCHMARK.

All information contained herein is obtained by MOODY'S from sources believed by it to be accurate and reliable. Because of the possibility of human or mechanical error as well as other factors, however, all information contained herein is provided "AS IS" without warranty of any kind. MOODY'S adopts all necessary measures so that the information it uses in assigning a credit rating is of sufficient quality and from sources MOODY'S considers to be reliable including, when appropriate, independent third-party sources. However, MOODY'S is not an auditor and cannot in every instance independently verify or validate information received in the rating process or in preparing the Moody's publications.

To the extent permitted by law, MOODY'S and its directors, officers, employees, agents, representatives, licensors and suppliers disclaim liability to any person or entity for any indirect, special, consequential, or incidental losses or damages whatsoever arising from or in connection with the information contained herein or the use of or inability to use any such information, even if MOODY'S or any of its directors, officers, employees, agents, representatives, licensors or suppliers is advised in advance of the possibility of such losses or damages, including but not limited to: (a) any loss of present or prospective profits or (b) any loss or damage arising where the relevant financial instrument is not the subject of a particular credit rating assigned by MOODY'S.

To the extent permitted by law, MOODY'S and its directors, officers, employees, agents, representatives, licensors and suppliers disclaim liability for any direct or compensatory losses or damages caused to any person or entity, including but not limited to by any negligence (but excluding fraud, willful misconduct or any other type of liability that, for the avoidance of doubt, by law cannot be excluded) on the part of, or any contingency within or beyond the control of, MOODY'S or any of its directors, officers, employees, agents, representatives, licensors or suppliers, arising from or in connection with the information contained herein or the use of or inability to use any such information.

NO WARRANTY, EXPRESS OR IMPLIED, AS TO THE ACCURACY, TIMELINESS, COMPLETENESS, MERCHANTABILITY OR FITNESS FOR ANY PARTICULAR PURPOSE OF ANY SUCH RATING OR OTHER OPINION OR INFORMATION IS GIVEN OR MADE BY MOODY'S IN ANY FORM OR MANNER WHATSOEVER.

Moody's Investors Service, Inc., a wholly-owned credit rating agency subsidiary of Moody's Corporation ("MCO"), hereby discloses that most issuers of debt securities (including corporate and municipal bonds, debentures, notes and commercial paper) and preferred stock rated by Moody's Investors Service, Inc. have, prior to assignment of any rating, agreed to pay to Moody's Investors Service, Inc. for appraisal and rating services rendered by it fees ranging from \$1,500 to approximately \$2,500,000. MCO and MIS also maintain policies and procedures to address the independence of MIS's ratings and rating processes. Information regarding certain affiliations that may exist between directors of MCO and rated entities, and between entities who hold ratings from MIS and have also publicly reported to the SEC an ownership interest in MCO of more than 5%, is posted annually at www.moody's.com under the heading "Investor Relations — Corporate Governance — Director and Shareholder Affiliation Policy."

Additional terms for Australia only: Any publication into Australia of this document is pursuant to the Australian Financial Services License of MOODY'S affiliate, Moody's Investors Service Pty Limited ABN 61 003 399 657 AFSL 336969 and/or Moody's Analytics Australia Pty Ltd ABN 94 105 136 972 AFSL 383569 (as applicable). This document is intended to be provided only to "wholesale clients" within the meaning of section 761G of the Corporations Act 2001. By continuing to access this document from within Australia, you represent to MOODY'S that you are, or are accessing the document as a representative of, a "wholesale client" and that neither you nor the entity you represent will directly or indirectly disseminate this document or its contents to "retail clients" within the meaning of section 761G of the Corporations Act 2001. MOODY'S credit rating is an opinion as to the creditworthiness of a debt obligation of the issuer, not on the equity securities of the issuer or any form of security that is available to retail investors. It would be reckless and inappropriate for retail investors to use MOODY'S credit ratings or publications when making an investment decision. If in doubt you should contact your financial or other professional adviser.

Additional terms for Japan only: Moody's Japan K.K. ("MJJK") is a wholly-owned credit rating agency subsidiary of Moody's Group Japan G.K., which is wholly-owned by Moody's Overseas Holdings Inc., a wholly-owned subsidiary of MCO. Moody's SF Japan K.K. ("MSFJ") is a wholly-owned credit rating agency subsidiary of MJJK. MSFJ is not a Nationally Recognized Statistical Rating Organization ("NRSRO"). Therefore, credit ratings assigned by MSFJ are Non-NRSRO Credit Ratings. Non-NRSRO Credit Ratings are assigned by an entity that is not a NRSRO and, consequently, the rated obligation will not qualify for certain types of treatment under U.S. laws. MJJK and MSFJ are credit rating agencies registered with the Japan Financial Services Agency and their registration numbers are FSA Commissioner (Ratings) No. 2 and 3 respectively.

MJJK or MSFJ (as applicable) hereby disclose that most issuers of debt securities (including corporate and municipal bonds, debentures, notes and commercial paper) and preferred stock rated by MJJK or MSFJ (as applicable) have, prior to assignment of any rating, agreed to pay to MJJK or MSFJ (as applicable) for appraisal and rating services rendered by it fees ranging from JPY200,000 to approximately JPY350,000,000.

MJJK and MSFJ also maintain policies and procedures to address Japanese regulatory requirements.

CLIENT SERVICES

Americas	1-212-553-1653
Asia Pacific	852-3551-3077
Japan	81-3-5408-4100
EMEA	44-20-7772-5454