

Construction Partners Inc.

More visibility on the ROAD as inflationary pressures take a back seat

Maintain Rating: BUY | PO: 52.00 USD | Price: 46.81 USD

Strong start to the year – reaffirms FY 2024 outlook

Construction Partners (ROAD) reported a strong start to the year: FQ1 EBITDA up 50% YoY on a 16% sales gain. EBITDA margin of 10.3% expanded 235bps YoY. EBITDA came in 8% ahead of consensus. In our view, ROAD shares fell 7% (vs SPX +1%) given the reaffirming of the FY24 outlook (i.e., no raise): sales \$1.75-\$1.825bn (+13-17% YoY), EBITDA \$197-\$219mn (+17-27% YoY). That said, ROAD typically does not raise guidance after Q1 (seasonally low quarter) and does not see any specific headwinds holding back growth or margin expansion as we move through 2024.

Record backlog: infrastructure construction still positive

Backlog of \$1.62bn was up 10% YoY and 1% QoQ with strong bidding activity seen across all of ROAD's six states. Specifically, ROAD's backlog has increased for 13 consecutive quarters as of FQ1 – which the company noted is atypical given that it historically tends to go down during the busy season (Spring-Summer) when it burns most of their backlog. According to ROAD, this is largely due to the robust demand backdrop: public infrastructure is robust (DoT budgets, stimulus) & private construction supported by positive demographic trends to the Southeast helping offset higher rates.

Price v cost remains healthy as inflationary pressures ease

ROAD cited the completion of its pre-inflationary backlog entering FY24 along with the rolling over of costs (raw mats, labor, etc.) relative to prior quarters. As a result, margins expanded 235bps YoY in FQ1. Additionally, third-party sale of aggregates and HMA (10-12% of revenue) was accretive to margins. We sense a slight tailwind from the lower diesel and liquid asphalt in FY24 if price levels hold. The bidding environment (pricing) remains healthy given strong backlogs across the industry in the Southeast.

Buy: mindful of valuation yet FCF coming through

We raise our estimates post a strong FQ1 and raise our PO to \$52 (\$45) based on 13.5x 2024e EBITDA as we believe the strong FCF generation warrants a higher multiple (vs 12.5x prior). We are cognizant that ROAD's multiple is expanding and approaching aggregates (VMC, MLM 15-16x). In our view, valuation upside is likely to be underpinned by strong growth, margin expansion, and cash flow starting to flow through. For example, cash from ops in Q1 was a positive \$60mn, up 110% YoY. We maintain our Buy-rating given strong tailwinds from infrastructure, Southeast demographics, and positive price vs cost dynamics over the next 12 months.

Estimates (Sep) (US\$)	2022A	2023A	2024E	2025E	2026E
EPS	0.41	0.94	1.38	1.67	2.01
EPS Change (YoY)	5.1%	129.3%	46.8%	21.0%	20.4%
Consensus EPS (Bloomberg)			1.27	1.68	NA
DPS	0	0	0	0	0
Valuation (Sep)					
P/E	114.2x	49.8x	33.9x	28.0x	23.3x
EV / EBITDA*	21.0x	13.5x	10.7x	9.3x	8.2x
Free Cash Flow Yield*	-2.6%	2.9%	5.4%	5.8%	7.6%

* For full definitions of *IQmethod*SM measures, see page 4.

09 February 2024

Equity

Key Changes

(US\$)	Previous	Current
Price Obj.	45.00	52.00
2024E Rev (m)	1,798.1	1,820.8
2025E Rev (m)	2,031.8	2,039.2
2026E Rev (m)	2,255.3	2,243.2
2024E EPS	1.25	1.38
2025E EPS	1.70	1.67
2026E EPS	2.10	2.01

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Stock Data

Price	46.81 USD
Price Objective	52.00 USD
Date Established	9-Feb-2024
Investment Opinion	B-1-9
52-Week Range	24.12 USD - 50.70 USD
Mkt Val (mn) / Shares Out (mn)	2,052 USD / 43.8
Free Float	96.9%
Average Daily Value (mn)	13.04 USD
BofA Ticker / Exchange	ROAD / NAS
Bloomberg / Reuters	ROAD US / ROAD.OQ
ROE (2024E)	13.0%
Net Dbt to Eqty (Sep-2023A)	63.2%
ESGMeter TM	Medium

ESGMeter is not indicative of a company's future stock price performance and is not an investment recommendation or rating. ESGMeter is independent of BofA Global Research's equity investment rating, volatility risk rating, income rating, and price objective for that company. For full details, refer to "BofA ESGMeter Methodology".

DoT = Department of Transportation

HMA = Hot Mix Asphalt

MLM = Martin Marietta Mate

VMC = Vulcan Materials

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Timestamp: 09 February 2024 08:07PM EST

iQprofileSM Construction Partners Inc.

iQmethodSM – Bus Performance*

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Return on Capital Employed	3.5%	6.7%	8.6%	9.4%	10.1%
Return on Equity	4.9%	10.1%	13.0%	13.8%	14.4%
Operating Margin	2.7%	3.6%	6.2%	6.6%	7.0%
Free Cash Flow	(52)	59	111	118	155

iQmethodSM – Quality of Earnings*

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Cash Realization Ratio	0.8x	3.2x	2.8x	2.4x	2.3x
Asset Replacement Ratio	1.0x	1.2x	1.0x	0.9x	0.8x
Tax Rate	24.4%	25.1%	25.0%	25.0%	25.0%
Net Debt-to-Equity Ratio	74.6%	63.2%	36.7%	14.5%	-7.4%
Interest Cover	4.6x	4.7x	6.3x	7.5x	9.2x

Income Statement Data (Sep)

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Sales	1,302	1,564	1,821	2,039	2,243
% Change	42.9%	20.1%	16.5%	12.0%	10.0%
Gross Profit	139	196	259	298	336
% Change	16.1%	41.0%	31.7%	15.2%	13.0%
EBITDA	111	173	218	250	285
% Change	22.7%	55.3%	26.1%	14.9%	14.1%
Net Interest & Other Income	(7)	(16)	(18)	(18)	(17)
Net Income (Adjusted)	21	49	72	87	105
% Change	5.9%	129.2%	46.7%	21.6%	20.1%

Free Cash Flow Data (Sep)

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Net Income from Cont Operations (GAAP)	21	49	72	87	105
Depreciation & Amortization	66	79	92	103	115
Change in Working Capital	(80)	19	41	17	26
Deferred Taxation Charge	6	11	0	0	0
Other Adjustments, Net	3	(1)	0	0	0
Capital Expenditure	(69)	(98)	(94)	(90)	(90)
Free Cash Flow	-52	59	111	118	155
% Change	-568.4%	NM	86.9%	6.4%	31.7%
Share / Issue Repurchase	0	0	0	0	0
Cost of Dividends Paid	0	0	0	0	0
Change in Debt	159	0	0	0	0

Balance Sheet Data (Sep)

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Cash & Equivalents	36	49	160	278	434
Trade Receivables	265	304	190	184	184
Other Current Assets	116	121	122	137	115
Property, Plant & Equipment	481	505	507	493	469
Other Non-Current Assets	197	241	247	254	262
Total Assets	1,096	1,220	1,226	1,347	1,463
Short-Term Debt	13	15	15	15	15
Other Current Liabilities	214	264	198	232	243
Long-Term Debt	363	361	361	361	361
Other Non-Current Liabilities	50	63	63	63	63
Total Liabilities	640	703	637	671	682
Total Equity	456	517	588	676	781
Total Equity & Liabilities	1,096	1,220	1,226	1,347	1,463

* For full definitions of iQmethodSM measures, see page 4.

Company Sector

Engineering & Construction

Company Description

Construction Partners Inc. (ROAD) is a leading road building and maintenance services firm in the Southeast. ROAD primarily serves government entities, with state DOT's making up the majority of their customer base. ROAD is a large player regionally, and continues to expand into new territories within the five states in which they operate: Alabama, Georgia, Florida, North Carolina and South Carolina.

Investment Rationale

We believe ROAD is an interesting play on rising infrastructure spending. Its balance sheet and vertical integration strategy allow ROAD to be a 'big fish in a small pond' - expanding in size and scale in an underfollowed market (i.e., road maintenance services). We expect ROAD to re-establish credibility following a challenged 2021 by expanding margin and improving FCF generation as the company burns off old backlog (typical project 6-9 months), mix shifts to public work, and integrates M&A.

Stock Data

Average Daily Volume 278,620

Quarterly Earnings Estimates

	2023	2024
Q1	0.04A	0.19A
Q2	-0.11A	-0.03E
Q3	0.41A	0.53E
Q4	0.59A	0.70E

Price objective basis & risk

Construction Partners Inc. (ROAD)

Our \$52 PO is based on 13.5.0x 2024E EV/EBITDA, broadly the midpoint of its historical range. In our view, the improving multi-year outlook and growth prospects from Infrastructure are somewhat offset by inflationary pressure. Our target multiple puts ROAD at a slight discount to Aggregates that share similar business models and exposure to public infrastructure markets.

Risks to our PO are: 1) Labor and supply chain issues constrain project timing. 2) Weaker than expected infrastructure spending. 30% of revenue is tied to private construction which can be cyclical. 3) Vertical integration risks: operating a liquid asphalt terminal and wide network of hot mixed asphalt plants can bring a different level of complexity, 4) Pricing struggles to offset rising costs (labor, liquid asphalt, transportation).

Analyst Certification

I, Michael Feniger, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject securities and issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or view expressed in this research report.

US - Machinery Coverage Cluster

Investment rating	Company	BofA Ticker	Bloomberg symbol	Analyst
BUY				
	AECOM	ACM	ACM US	Michael Feniger
	Blue Bird Corp	BLBD	BLBD US	Sherif El-Sabbahy
	Caterpillar Inc	CAT	CAT US	Michael Feniger
	CNH Industrial NV	CNHI	CNHI US	Michael Feniger
	Construction Partners Inc.	ROAD	ROAD US	Michael Feniger
	ESAB Corp	ESAB	ESAB US	Sherif El-Sabbahy
	Finning International Inc.	YFTT	FTT CN	Sherif El-Sabbahy
	H&E Equipment Services Inc	HEES	HEES US	Sherif El-Sabbahy
	Knife River Corp	KNF	KNF US	Sherif El-Sabbahy
	Republic Services	RSG	RSG US	Michael Feniger
	Techtronic Industries Co Ltd	TTNDF	669 HK	Michael Feniger
	Techtronic Industries Co Ltd	TTNDY	TTNDY US	Michael Feniger
	United Rentals Inc	URI	URI US	Michael Feniger
	Vulcan Materials	VMC	VMC US	Michael Feniger
	Waste Connections Inc	WCN	WCN US	Michael Feniger
	WillScot Mobile Mini	WSC	WSC US	Sherif El-Sabbahy
NEUTRAL				
	AGCO Corp	AGCO	AGCO US	Michael Feniger
	Deere & Co	DE	DE US	Michael Feniger
	Fluor	FLR	FLR US	Michael Feniger
	GFL Environmental Inc	GFL	GFL US	Michael Feniger
	GFL Environmental Inc	YGFL	GFL CN	Michael Feniger
	Jacobs Eng.	J	J US	Michael Feniger
	Kennametal Inc.	KMT	KMT US	Michael Feniger
	Martin Marietta Materials	MLM	MLM US	Michael Feniger
	NV5 Global Inc.	NVEE	NVEE US	Michael Feniger
	PACCAR Inc	PCAR	PCAR US	Michael Feniger
	RB Global, Inc	RBA	RBA US	Michael Feniger
	Waste Management	WM	WM US	Michael Feniger
UNDERPERFORM				
	Allison Transmission Holdings Inc.	ALSN	ALSN US	Sherif El-Sabbahy
	Casella	CWST	CWST US	Michael Feniger
	Cummins Inc	CMI	CMI US	Michael Feniger
	Herc Holdings Inc	HRI	HRI US	Sherif El-Sabbahy
	IPG Photonics	IPGP	IPGP US	Michael Feniger
	Oshkosh Corp.	OSK	OSK US	Michael Feniger



US - Machinery Coverage Cluster

Investment rating	Company	BofA Ticker	Bloomberg symbol	Analyst
	Terex Corp.	TEX	TEX US	Michael Feniger
	Timken Company	TKR	TKR US	Michael Feniger

iQmethodSM Measures Definitions**Business Performance**

Return On Capital Employed

Return On Equity

Operating Margin

Earnings Growth

Free Cash Flow

Quality of Earnings

Cash Realization Ratio

Asset Replacement Ratio

Tax Rate

Net Debt-To-Equity Ratio

Interest Cover

Valuation Toolkit

Price / Earnings Ratio

Price / Book Value

Dividend Yield

Free Cash Flow Yield

Enterprise Value / Sales

EV / EBITDA

Numerator

NOPAT = (EBIT + Interest Income) × (1 – Tax Rate) + Goodwill Amortization

Net Income

Operating Profit

Expected 5 Year CAGR From Latest Actual

Cash Flow From Operations – Total Capex

Numerator

Cash Flow From Operations

Capex

Tax Charge

Net Debt = Total Debt – Cash & Equivalents

EBIT

Numerator

Current Share Price

Current Share Price

Annualised Declared Cash Dividend

Cash Flow From Operations – Total Capex

EV = Current Share Price × Current Shares + Minority Equity + Net Debt +

Other LT Liabilities

Enterprise Value

Denominator

Total Assets – Current Liabilities + ST Debt + Accumulated Goodwill

Amortization

Shareholders' Equity

Sales

N/A

N/A

Denominator

Net Income

Depreciation

Pre-Tax Income

Total Equity

Interest Expense

Denominator

Diluted Earnings Per Share (Basis As Specified)

Shareholders' Equity / Current Basic Shares

Current Share Price

Market Cap = Current Share Price × Current Basic Shares

Sales

Basic EBIT + Depreciation + Amortization

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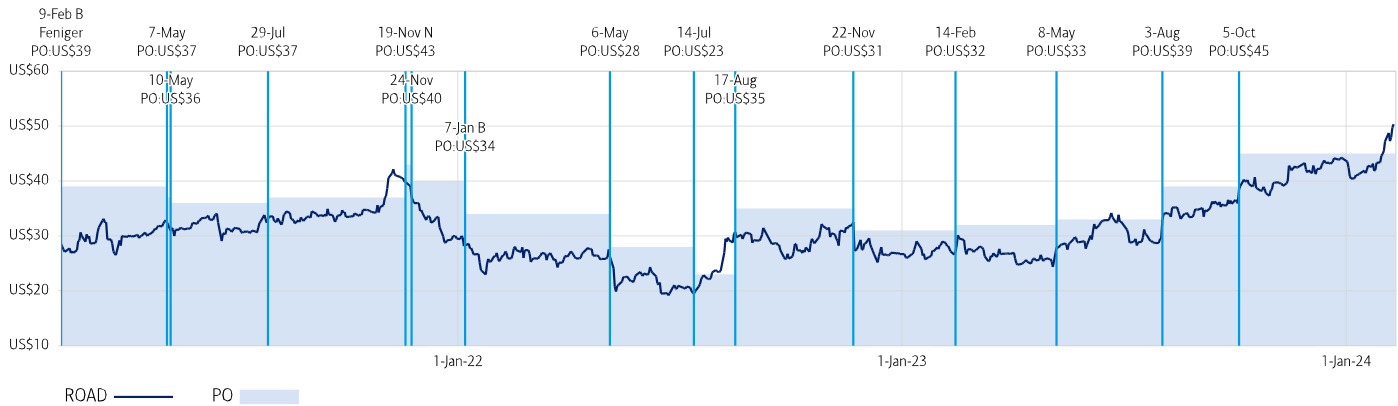
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Construction Partner (ROAD) Price Chart



B: Buy, N: Neutral, U: Underperform, PO: Price Objective, NA: No longer valid, NR: No Rating

The Investment Opinion System is contained at the end of the report under the heading "Fundamental Equity Opinion Key". Dark grey shading indicates the security is restricted with the opinion suspended. Medium grey shading indicates the security is under review with the opinion withdrawn. Light grey shading indicates the security is not covered. Chart is current as of a date no more than one trading day prior to the date of the report.

Equity Investment Rating Distribution: Engineering & Construction Group (as of 31 Dec 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships ^{R1}	Count	Percent
Buy	9	42.86%	Buy	5	55.56%
Hold	7	33.33%	Hold	3	42.86%
Sell	5	23.81%	Sell	3	60.00%

Equity Investment Rating Distribution: Global Group (as of 31 Dec 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships ^{R1}	Count	Percent
Buy	1895	53.62%	Buy	1083	57.15%
Hold	832	23.54%	Hold	454	54.57%
Sell	807	22.84%	Sell	383	47.46%

^{R1} Issuers that were investment banking clients of BofA Securities or one of its affiliates within the past 12 months. For purposes of this Investment Rating Distribution, the coverage universe includes only stocks. A stock rated Neutral is included as a Hold, and a stock rated Underperform is included as a Sell.

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Buy	≥ 10%	≤ 70%
Neutral	≥ 0%	≤ 30%
Underperform	N/A	≥ 20%

^{R2} Ratings dispersions may vary from time to time where BofA Global Research believes it better reflects the investment prospects of stocks in a Coverage Cluster.

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