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Takeaways:

- Record increase in home values but new home sales are trending down
- Residential demand has absorbed price increases partially due to lack of inventory available
- Signs indicate expansion for non-residential construction especially for health care and industrial properties
- Balance sheets continue to improve as companies take advantage of increased pricing and healthy margins
- Physical infrastructure spending increases could boost private sector productivity for decades

Construction Spending Trends

Residential

2020 was a record year for many homebuilders in terms of new homes sold, revenue, and margins. 2021 started with the same pace, but presents a more difficult operating environment given the need to manage input cost volatility, delays in supplies, and a slower approval process from municipalities. Additionally, new home sales have fallen from a peak of 993,000 in January to 676,000 in June indicating affordability and supply concerns are real. Home values have skyrocketed and the 2nd quarter average new home sales price was up 17% from the prior year. So far, demand has absorbed the price increases and for-sale inventory remains very low. Consumer's motivations are low interest rates, strong property values, healthy household debt levels, and more permanent levels of remote work environments. Most homebuilders we work with believe it will take 2-3 years to catch up to current demand and the biggest headwind will be lot availability in desirable markets.

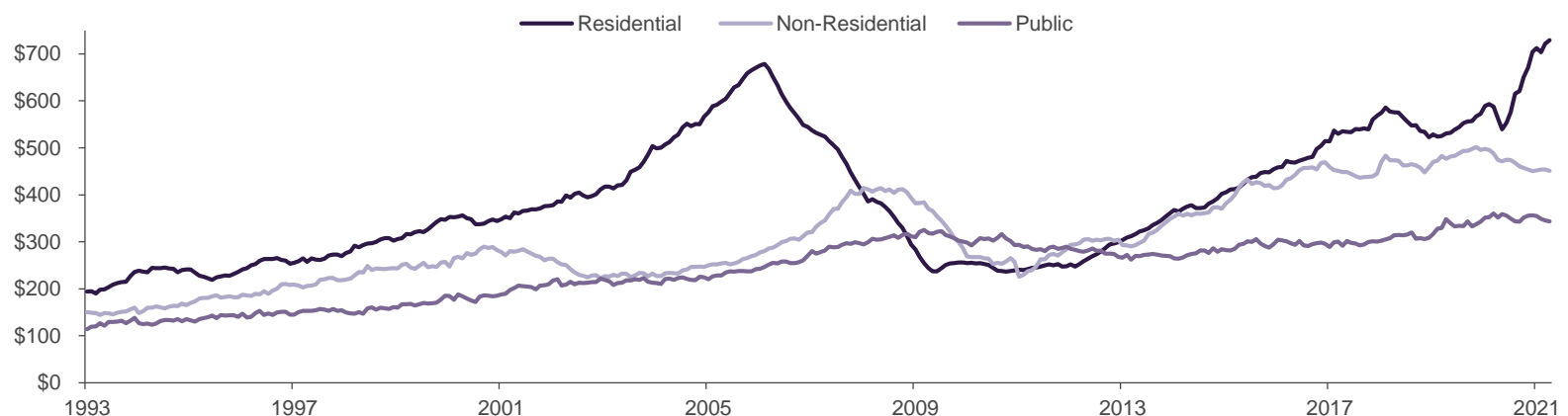
Non-Residential

At a national level, non-residential spending has experienced a very different story than residential. Many construction or renovation projects were put on hold or cancelled all together leading to a decrease in spending almost every month since COVID began. That story is trying to correct itself in the right direction. AIA's Architectural Billings Index (ABI) is a leading indicator for non-homebuilder construction. When the index is above 50 it indicates expansion and ABI returned to 50+ readings in Feb 2021. ABI remains in the mid to high 50's (54.6 July) which predicts non-residential expansion to resume late Q4 2021 and Q1 2022. The most active categories of commercial real estate construction are healthcare and industrial while the least active are hospitality and urban office. Other signs of healthy non-residential demand stem from consistent client feedback that job bidding is back to a pace that exceeds pre-pandemic levels. Headwinds for this space include uncertain staffing and supply chain limits which continue to be a tough byproduct of the pandemic. All in all, the latest non-residential results indicate expansion although the recovery appears to be uneven this cycle.

Public

Anticipation of the details to be included in the highly negotiated federal infrastructure bill has stirred up a lot of activity in the heavy materials industry. The largest suppliers have announced multiple acquisitions and continue to look for ways to gain scale ahead of the federal spending. Public spending on roads already represents 40% of aggregate demand, and funding from the new bill could add another 5-8% per year between 2023-2028. Increased federal spending on highways, bridges, roads, tunnels, railroads, ports and airports will be a welcomed buyer of significant aggregate materials for those established in the industry. For others, it means another increase in project cost is on the way which will be realized in the cost of concrete products, asphalt, roofing, and wallboard among other things.

Construction Spending (in billions)



Sources: US Census Bureau

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Active M&A Environment

Seller Perspectives:

- Robust transaction activity at attractive valuations continues to draw sellers to the market
- Prospect of significant tax increases has motivated sellers to complete transactions during 2021

Buyer Perspectives:

- Strategics are trading at attractive multiples, have significant liquidity and access to very supportive financing markets
- Sponsors seeking new Building Products platforms when they feel they have a differentiated angle to succeed in auction processes

Process Perspectives:

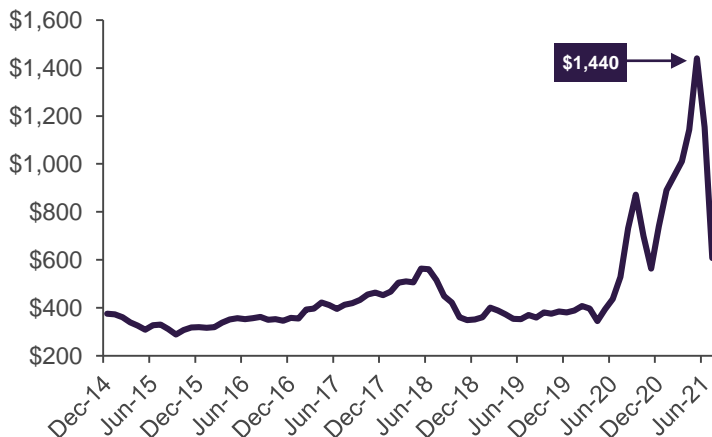
- Record-level public equities, supportive financing markets and competitive processes are driving attractive valuations and terms for sellers

Continued Challenges Around Logistics

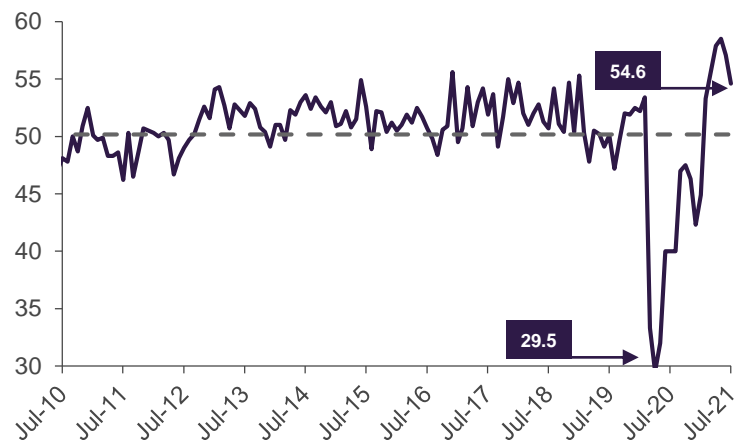
Capacity constraints have pushed up costs for shippers in all industries, including building products. Ongoing driver shortage was exacerbated during the pandemic as driver schools closed, and industry regulations tightened – including a new Federal Drug & Alcohol Clearinghouse that may have taken 200K drivers out of the market. With extremely tight capacity, freight rates increased to record levels across all modes of freight transit. Benchmark rates to ship from China to the US East Coast have been near \$10-15K per 40' container this year, up from \$3,500 on average pre-COVID. Many observers project elevated shipping costs to last past Chinese New Year (Feb 1), and potentially much longer, if the capacity constraints are not addressed.

Key Indices

Random Length Lumber Prices ⁽¹⁾

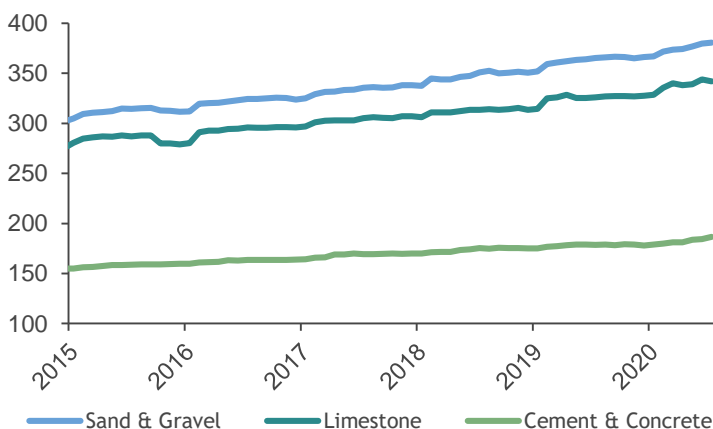


Architectural Billings Index

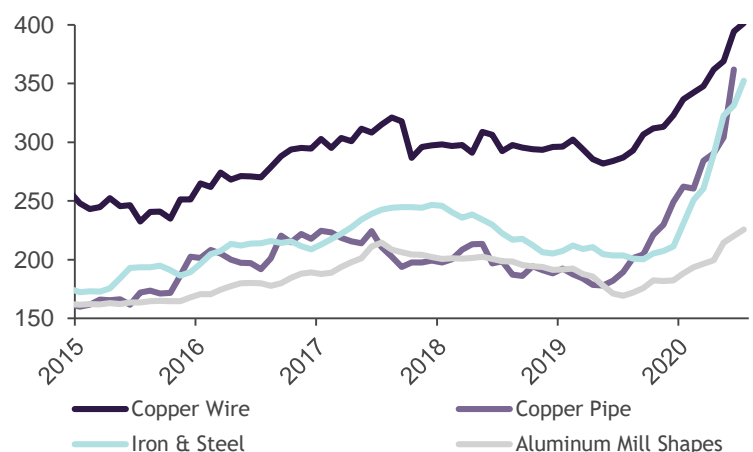


Producer Price Indices ⁽²⁾

Heavy Materials



Metals



(1) RLWORCGZ Index; Random length loading and studs.

(2) PPI is used as an economic indicator. Currently, some PPIs have an index base set at 1982 = 100, while the remainder have an index base that is the month prior to the month that the index was introduced. BLS measures price change in relation to that figure. An index level of 110, for example, means there has been a 10-percent increase in prices since the base period.

Sources: Bloomberg, Random Lengths, US Bureau of Labor Statistics, AIA, ATA