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Vulcan Materials Co (VMC) CEO James Hill on Q3 2019 Results - Earnings Call Transcript

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Q3: 11-06-19 Earnings Summary

Press Release SEC *10-Q*

EPS of $1.68 misses by $-0.04 | Revenue of $1.42B (14.40% Y/Y) beats by $45M

Earning Call Audio

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Vulcan Materials Co (NYSE:VMC) Q3 2019 Earnings Conference Call November 6, 2019 11:00 AM ET

Company Participants

Mark Warren - VP, IR

James Hill - Chairman, President & CEO

Suzanne Wood - SVP, CFO & Company Secretary

Conference Call Participants

Stanley Elliott - Stifel, Nicolaus & Company

Kathryn Thompson - Thompson Research Group

Michael Dahl - RBC Capital Markets

Jerry Revich - Goldman Sachs Group

Trey Grooms - Stephens Inc.

Michael Wood - Nomura Securities

Paul Roger - Exane BNP Paribas

Rohit Seth - SunTrust Robinson Humphrey

Garik Shmois - Longbow Research

Timna Tanners - Bank of America Merrill Lynch

Adam Thalhimer - Thompson, Davis & Company, Inc.

Philip Ng - Jefferies

Operator

Good morning, ladies and gentlemen, and welcome to Vulcan Materials Company's Third Quarter Earnings Conference Call. My name is Jake, and I will be your conference call coordinator today. As a reminder, today's call is being recorded. [Operator Instructions].

Now I will like to turn the call over to your host, Mr. Mark Warren, Vice President of Investor Relations for Vulcan Materials. Mr. Warren, you may begin.

Mark Warren

Good morning, everyone, and thank you for joining our third quarter earnings call. With me today are Tom Hill, Chairman and CEO; and Suzanne Wood, Senior Vice President and Chief Financial Officer.

Before we begin, I'd like to call your attention to our quarterly supplemental materials posted at our website, vulcanmaterials.com. Additionally, a recording of this call will be available for replay at our website later today. Please be reminded that comments regarding the company's results and projections may include forward-looking statements, which are subject to risks and uncertainties. These risks, along with other legal disclaimers, are described in detail in the company's earnings release and in other filings with the Securities and Exchange Commission. Finally, you can find a reconciliation of non-GAAP financial measures and other related information in both our earnings release and at the end of our supplemental presentation. Now I'd like to turn the call over to Tom.

James Hill

Thank you, Mark, and thanks to everyone for joining the call today. We appreciate your interest in Vulcan Materials. Our third quarter results reflected another strong performance, with adjusted EBITDA improving 15% as compared to last year. This was driven primarily by the Aggregates segment, which experienced higher shipments, better pricing and improved unit margins. For the quarter, aggregate shipments increased by 8%, both on a reported and same-store basis. But remember, the quarter did include an extra day. If we normalize the number of shipping days, same-store volume increased by 6%, in line with expectations.

This growth in volume reflects the solid underlying demand fundamentals in our markets. The fundamentals, which include growth in population and households and in jobs, are 2 to 3x the growth of other markets over the next 10 years. Shipments in certain markets in the Southeast, Mid-Atlantic and Texas were particularly strong. Shipments in California were also better than last year due to the strength in Southern and Central California. Freight-adjusted sales prices rose by 5.6%, and importantly, the increases were widespread. On a mix-adjusted basis, prices improved by 5%. Both product mix and geographic mix were slightly favorable. Gross profit per ton grew by 9% in the quarter to $5.87.

We are pleased with the progression of our unit profitability. In fact, this quarter represented the fifth straight quarter of high single-digit or low double-digit year-over-year improvement. The four strategic initiatives reviewed at our recent Investor Day contributed to this outcome and offer further opportunities for margin enhancement.

On a trailing 12-month basis, the aggregate same-store incremental flow-through rate was 60%, which is in line with our long-term guidance. Through the first nine months of the year, aggregate shipments have exceeded the upper end of our expectations. Pricing has increased in line with our expectations, and we had delivered good incremental earnings. This improved Aggregates performance will partially be offset by lower non-Aggregates gross profit. Our non-Aggregates gross profit is now expected to be below original expectations, but in line with the prior year. That said, we are well positioned to deliver another year of double-digit earnings growth and should carry good momentum into 2020 in all product lines. We expect full year 2019 adjusted EBITDA of between $1.25 billion and $1.33 billion, on track with our expectations at the beginning of the year.

Looking ahead to next year, we expect another year of strong earnings growth. Based on early successes of our four strategic initiatives, we are confident that our margin expansion will continue. With respect to 2020 aggregate shipments, we anticipate low- to mid-single-digit growth at this time. Vulcan-served markets should continue to benefit from public construction demand led by highways. State and local level transportation funding has increased significantly in our key states, and it will be a multiyear contributor to our future results. Most of the approved funding is firewalled and can be only used for transportation. Therefore, it's not a matter of if, but when. The demand visibility is there but the timing of shipments is not precise, given the number of state and local transportation agencies involved and the relative complexity of large projects.

On the private side, which accounts for the other half of our aggregate shipments. We continue to have solid shipment momentum in most of our markets. It is important to remember that over the medium to long term, the underlying demand fundamentals, including population employment growth, remain firmly in place and underpin long-term growth in residential and nonresidential construction. And we are in the best position with our geographic footprint to capitalize on this trend.

Now turning to price. We expect a positive environment again next year. The visibility of public demand should help drive sales price increases similar to 2019 mid-single-digit range. Together with disciplined capital allocation priorities, the compounding effect of price and unit margin improvement will position us to grow our discretionary cash flows and improve our return profiles in 2020. We will report out our final 2020 guidance in February. Now I'll turn the call over to Suzanne for some additional comments on the results. Suzanne?

Suzanne Wood

Thanks, Tom, and good morning to everyone. Clearly, the third quarter represented another quarter of strong earnings growth for our Aggregates business, but we also made progress in our non-Aggregates segments. Asphalt segment gross profit was $28 million, an increase of $4 million or 16% as compared to the prior year. Asphalt mix shipments increased by 18% and average selling prices rose by 3%. The significant volume increase related to a number of projects across our footprint. The average unit cost for liquid asphalt was 6% higher this quarter compared to the same period last year. This compares favorably to the second quarter when our liquid asphalt costs were 16% higher year-over-year. We expect liquid costs to remain stable throughout the remainder of the year. As a result, asphalt material unit margins were slightly lower than the prior year, and therefore, the gross profit improvement was driven by volume.

Concrete segment gross profit was $15 million or 3% higher than the prior year quarter. Both volume and average selling prices improved. As Tom said, for the full year, we now expect our gross profit from the non-Aggregates segment to be in line with the 2018 level. This change in our outlook is due mostly to the timing of shipments in our Asphalt business.

With respect to SAG costs, our trailing 12-month expense, as a percentage of revenue, declined by 40 basis points. Similar to last quarter, we incurred higher compensation-related expense, including incentives that are tied to earnings expectations and the share price. We also continue to make investments to accelerate the benefits derived from our sales and operational initiatives. For the full year, we remain on track with our expectations and will focus on further leveraging these costs in 2020.

Turning to the balance sheet. Our leverage position and debt structure provide us with significant flexibility as we continue to execute our business plan. Our leverage ratio at September 30 was 2.2x, well within our target range. The weighted average maturity of our debt is 14 years, and our weighted average interest rate is 4.4%.

On Page 8 of the supplemental slides, you'll find information on our discretionary cash flow expectation of $825 million for the full year. As a reminder, we define discretionary cash flow as mid-range adjusted EBITDA guidance, less working capital change, interest, taxes and operating and maintenance capital.

During the quarter, we closed no acquisitions, but we did invest to $3 million in share repurchases. For the full year, we reiterate our expectation of spending approximately $250 million on operating and maintenance CapEx and approximately $200 million on internal growth projects, which will further strengthen the footprint and generate future earnings.

Our return on investment continued on its positive trajectory. For the trailing 12 months ended September 30, our ROI was 13.8% on an adjusted-EBITDA basis. This compares to 12.6% for the 2018 fiscal year.

Now before I hand over to Tom, I'll make one comment on our guidance. With a quarter to go, we remain on track with our full year expectations, the midpoint of which has remained unchanged at $1.29 billion. When we gave our initial 2019 annual guidance, we tried to be thoughtful about it. That approach served us well because we have consistently performed within those parameters and, therefore, expect to deliver another year of double-digit earnings growth. And now I'll turn the call back over to Tom for some closing remarks.

James Hill

Thanks, Suzanne. Before we go to Q&A, I want to take this opportunity to thank the men and women of Vulcan, for their hard work and dedication. They have taken good care of our customers and have improved our business processes and disciplines. Importantly, they have promoted our strong safety culture and are responsible for delivering our industry-leading safety metrics.

As we move forward, we'll continue to capitalize on our strengths, our aggregates-focused business, our outstanding geographic footprint and local execution capabilities, particularly around those things we can control. Our four strategic initiatives will ensure continued improvement in unit margins. Now we'll be happy to take your questions.

Question-and-Answer Session

Operator

[Operator Instructions]. We will start with Stanley Elliott with Stifel.

Stanley Elliott

Can you comment on what you're seeing on the cost side? I know you like to talk about the incrementals on more of a trailing basis as opposed from quarter-to-quarter. Were there any one-off stripping costs or anything else that might have popped up? Just curious.

James Hill

Yes. On the third quarter, the cost increase were really based in two areas. One was planned, higher repair and maintenance on stationary equipment, particularly some big crusher repairs that we did or rebuilds that we did. And also, we took one of our big drag lines down in Florida and made some major repairs on it. The second area was extra blue water shipping costs as we took our older ship into dry dock and we're using contract ships at much higher cost.

That ship is back in the fleet at this point. So that's behind us. And as you pointed out, year-to-date, we've also - not so much in the quarter, but year-to-date, we experienced some higher stripping costs in preparation for higher volumes from highway demand. If you think about all these costs are planned long-term investments in anticipation of improving volumes. But again, as you had talked about - if you look at what we always guided you through the trailing 12-month same-store flow-through was at 60%, which is where we would guide you to be.

Suzanne Wood

And just picking up on Tom's point, I'd also add that, as he said, we always guide toward 60% on a trailing 12-month basis. And if you look at, just pick the last eight quarters, we've got quarters ranging with flow-throughs in the specific quarter ranging from 41% to just over 100%. So it's really difficult to look at a particular quarter when you've got 350 mines and lots of different things going on. That's why we always guide to the trailing 12 months to smooth some of those things out, Stanley.

Stanley Elliott

Perfect. Understood. And then just as a second question, kind of looking out to 2020 on the low- to mid-single-digit volume growth. I know you don't want to give too much color here, but maybe a couple of states that maybe you're most excited about looking at the upcoming year?

James Hill

Yes. I would point you to the - really pretty much across footprint, but the Mid-Atlantic, Southeast will be strong. Parts of Texas will be strong. California with SB 1 kicking in, should be good. As you said, it's - we're actually right in the middle of the planning for 2020. So it's early. On the private side, we still see growth in shipments to res and nonres sectors, and they've been strong, particularly strong in '19.

If you kind of said, what are you - there's some watches there, which we called out San Francisco, Dallas, Miami and Chicago. But we had talked about Nashville, but Nashville, we actually think has gotten a second win and is doing quite well on the private side. We've got most of our markets shipping really strong on private. Highway demand and shipments, as we talked about, is going to be very good, and will continue to grow, not just 2020, but years to - a number of years to come. We have tried to be thoughtful in that low to mid-single-digit in '23 because it's really early in the process. And we'll obviously give you a much better look at this in February.

Operator

[Operator Instructions]. I'll now move to the next question, Kathryn Thompson with Thompson Research Group.

Kathryn Thompson

Shifting to California, know that SB 1 has been great. Would love to get an update on progress. And give any color of what is the impact of fires have had on construction projects.

James Hill

Yes. SB 1 continues to be well. We saw it double and up through from where it was passed in '17 through this year. Then next year, they'll add another $1 billion to it. As you know, we got a slow start this year because we just got rained out in the first five months. But now we're shipping strong both with aggregates and asphalt. So things are picking up in California.

On the fires, we've recently seen some delays from fires. And I think we'll have those, and we will have those, but as you know, the work doesn't go away, and we will be there. Most importantly, our people are all okay and their homes are all okay. We - as far as power outages, which is another part of that, we've not seen any to our aggregates operations. We've seen a little bit to our ready-mix operations, but no impact from that at this point.

Kathryn Thompson

Okay, great then. And really, this is more a broad downstream question for you. Just a little bit more color in terms of the regional market impacted with the asphalt timing and with Concrete gross profit. We had great volume and pricing, but the gross profit, as a percentage of sales, was off year-over-year. Maybe a little color on that.

James Hill

Yes. As we talked about with Asphalt, we would have thought it would have done a little bit better this year. We actually had a good quarter and that the gross profit was up 60%, really driven by volume. The - what we would tell you where we - the shortfall in Asphalt would have been volume in California just because of the rains in the first part of the year, but the demand is there, and that will flow into 2020. We were a little slower on catch up on unit margins than we would have anticipated. But I think what we saw - the good news is we saw, in the second and third quarter, that unit margins were virtually flat.

So price has - liquid costs as we look forward to 2020, we would see based on backlogs and booking pace, our prices in hot mix going up. And we would expect, at worst case, liquid cost to be flat. So I think as we look forward to 2020, really good news for this product line. The highway demand will drive volumes up in Asphalt. And I think that now that liquid has stabilized, we'll see unit margin start to improve. So I look forward to this product line in 2020.

Operator

Now we'll take a question from Mike Dahl with RBC Capital.

Michael Dahl

First question I had, and I might not have heard properly, but just around the costs and margins in the quarter in aggs. It sounds like they were a bit lower than your internal plans, but then, Tom, the comments you made around planned maintenance and added Blue Water shipping. I wasn't clear if those were increases that you had contemplated in your plan or if those were the reasons for the increased cost versus your internal expectations or just any additional puts and takes there that you may not have contemplated.

James Hill

Yes. Both of those - well, all of that was planned, but it was an increase over prior year, but it was planned. I think as you kind of look at, to Suzanne's point, if you look at the cost profile in the Aggregates business, it's going to be lumpy quarter-to-quarter. It's just the nature of the beast. You have 350 facilities. You have to do the right thing at the right time in each of those, whether that's stripping or whether that's a big repair on a crusher or as we did pulling out dragline down. And if you - if in you - the - so the timing always is in big flux because you - all three of those 50 may or may not hit at once, it may hit at different times. And you can't really procrastinate those things. You need to do it when you need to do it or they'll cost you more.

It'll lead to downtime, it'll lead to failures. So for the long-term nature of the business, you inspect it and fix it when it needs to be fixed or you strip when it needs to be stripped. We talked about that a lot in Tampa with inspecting and maintenance and timely owned equipment. But if I step back and look at it and put my operator's hat on, I am very confident in our ability to pull through that 60% on a regular basis for the long haul, but you won't do it quarterly.

And if you look at trailing 12 months, we've done that. I mean, that's our track record. And that's what we'll always guide you to. But quarterly, because of the nature or the long-term nature of the beast and just doing what you got to do in each one of those individual mines, it's going to be lumpy by nature.

Michael Dahl

Okay, understood. Second question is just around the guidance. And Suzanne, I appreciate the thoughtfulness throughout the year. I guess, just to press on the implied 4Q guide a bit. The low end of the implied guide would have you down year-on-year on EBITDA. So I guess, just to be - to just want some clarification of whether it doesn't seem from the outside that there's anything that would produce that type of outcome, given volume and price, but is there anything you're seeing there? Or is it really just you've had this annual guide out how - and you may be tracking towards the midpoint or better, but just didn't feel the urgency to take up the low end?

James Hill

I think I'll comment on the market and then let Suzanne comment on the financials. The works there, I think we feel good about our backlogs and our booking pace and we support our outlook, both for the full year and for 2020. But as always, in the fourth quarter, it's just a matter of how many shipping days you're going to have before the year is out. I think you saw that last year. We actually ran out of time when we pull work into the first quarter of 2019. So it's first in - first - fourth quarter and first quarter are always just iffy because of the time of year it is. But the underlying fundamentals, the pricing, the demand, all those fundamentals are there, and we feel very good about it.

Suzanne Wood

Yes. And I would just add on to that, that's the guide that's been in place all year. We're still comfortable within that range, as you indicated. Hopefully, at the - at/or around the midpoint of the range, but it depends on the number of shipping days. So I wouldn't - I would not read anything into the fact that we didn't raise the lower end of the range. We just decided to leave it in place, but nothing in our outlook for the year has changed. And indeed, if you look at the results that we have produced year-to-date, I mean, we are on a good pathway to achieve that.

Operator

Now moving to a question from Jerry Revich with Goldman Sachs.

Jerry Revich

So I'm wondering if you could talk about the pricing announcements that you've made for 2020. What's the breadth of pricing actions? Or is it more or less mid-single digits across the board? Or is there more of a variability by market? And in terms of the pricing actions that you're taking, are they more significant than what we've seen in those comparable markets in '18 in areas where you're pushing pricing above the company average for '20?

James Hill

As always, they're going to be - there'll be variability, and that's just because different markets have different cadences of you push price for a while and then you let it catch up and then you push price for a while. So those will all be a little different. I think that the pricing dynamics in all markets is good. I believe we'll see price - real price increases in the vast majority, if not all, of our markets. Our backlog, our booking pace would support that mid-single. Our conversations with our fixed-plant customers, I think, would support that.

Again, we're still - we're in the middle of this, and we're still early in the process. That's our best thoughtful guide at this point. We'll give you a more educated view of this in - as we have a volume in February. But the very strong shipments on the private side, coupled with the visibility of the dramatically growing highway work, really support pricing throughout the sector, not just aggregates, but I think all construction materials and construction. We'll end this year strong, and I think we'll start into 2020 with very good momentum.

Jerry Revich

And Tom, I'm wondering if you could expand on your prior comments you had made in your prepared remarks on infrastructure project cadence. So clearly, the backlog is healthy. We've seen some lumpy awards activity. California, in particular, comes to mind. Can you just talk about over what time frame would we see a - would we need to see a re-acceleration in lettings to have a steady project cadence and avoid holes in the schedule, if you will?

James Hill

It's really hard to predict holes in the schedule. I think that if you look at starts, for example, which is - has been - if you look at starts, which looks kind of like they would be down a little bit. You got to remember that the value of those starts is up to 20% over two years ago. So we're - number one, we're playing at a much higher level.

And then you've also seen, with these big increases, massive increases in funding, you're seeing much larger projects. So the starts metric is now very lumpy, where shipments, those big projects, will ship over a number of years. So the nature of that leading indicator has changed a little bit. Let me give you an example. If you look at the job that we're shipping today, which is I-66 in Northern Virginia, it dropped into the starts in April of 2018 at $2.3 billion. So it just skewed the value of the starts, as we compare it to April, year-over-year, but that job is shipping, and it'll ship for four years.

So that - the big projects have made that a little bit lumpy. I think if you look at, overall, you just look at the value of what's going on in the states. And I'll just run through 8 and 9 for you, Florida. The - it will be up - lettings will be up 25% this year. Georgia lettings will more than double over the next 2 years from $1.4 billion to $3 billion. Texas' budget goes from $26 billion to over $31 billion. Virginia DoT and regional authorities goes from $4.5 billion to $5.5 billion from a budget perspective. Highway lettings and how we're spending in South Carolina will be up 10%. Tennessee is up 40% over a two year time frame. And California, as I said earlier, it's up since 2017, $1.7 billion, it increased another $1 billion in 2020. So there's a lot of work out there and a lot of work to come. Timing, we'll just have to see what happens. But it's - again, as I said in my prepared remarks, it's not if, it's when.

Operator

And now we'll hear from Trey Grooms with Stephens Inc.

Trey Grooms

So just looking at the elevated cost or for planned cost that occurred in Q3, is there any - is there anything we should be aware of as we're looking into 4Q when it comes to any of these costs that might be occurring in that time?

James Hill

Not dramatic. I think it's - again, it's the timing of when those fall in individual plants, but I wouldn't - nothing's changed in our fundamental cost structure. Again, it's going to be lumpy. It's going to be lumpy by a quarter. But - and I'm actually pleased with the disciplines that we're instilling for the long term of what happens in operating efficiencies. I mean, you got to rebuild crushers, you got to rebuild drag lines, and those are going to come at different times. But the underlying fundamentals that really drive the cost of efficiencies of tons per man-hour, tons per hour downtime, those kind of things, I think we've continually pushed the ball forward and improved on it.

Trey Grooms

Okay. And with the Asphalt business, unit margins taking the - margins improved, I guess, but it was on volume. Just - and it sounded like most of the downside to your guide on that side of the business was due to volume and timing there. So - I didn't understand that correctly.

James Hill

Yes. So let me see if I can explain it to you. The - there's a mixed bag in the shortfall of guidance was volume and volume in California. We just got a - we just shortened the year with the rain in the first five months. So that was one piece of it. The other piece of it is, we thought we would start improving unit margins faster than we have, and that's really price of hot mix catching the cost of liquid. I think - well, the good news of that is what we saw in Q2 and Q3 was we caught it. We're virtually flat.

Now as we look into 2020, we know that based on our backlogs, that our prices are up. We believe that, in a worst case, liquid will probably be around flat. So you should start seeing units. So as you look into 2020, we think we'll see unit margin expansion. Because we don't - we're not chasing at all anymore, and we've continued to be able to raise prices on a hot - on the hot mix side. If you look at demand going into 2020, it's pretty simple. We know what's happening with lettings and highway spending, and that's a big driver of asphalt volumes. So again, we're doing the plan right now. We can't give you guidance, but we'll be clear on that when we talk to you in February.

Trey Grooms

Okay. It sounds like improvement nonetheless.

James Hill

Yes.

Trey Grooms

And last one for me, just on the FAST Act expiring next year. What's your expectation for, I guess, right now, any update on your kind of thought of how it shakes out and what the response is from the Fed? And then at this point, I guess? And then do you expect states to hit the pause button at all as we move closer to that expiration date?

James Hill

I'll take the second part of that first, and the answer is absolutely not. The states will move forward. They have a substantial amount of funding, and they will have political pressure to spend that funding and improve their roads, improve their infrastructure because their voters said, we've voted on this to make our roads better. So they'll make sure that happens. Again, timing, we will see. If you look at the highway bill, the simple part of that is the funding is not going to go down if we don't get a bill, which I don't think we will. In election year, then they'll - we'll have extensions. If you look - and so I don't - I have faith and that, that spending will continue, and infrastructure will be supported.

If you look a little further out to the Highway Bill. You've heard me say this, the House is actually working on a bill right now. Policymakers are working on the reauthorization package as we speak. The Environmental Public Works Committee is working on a bill, which would increase funding by roughly 28%.

Again, we'll see what happens. But the feds are not going to let it go down and our states' funding in our states is up $20 billion a year. So - and that is now flowing into shipments. So I think demand is going to continue to grow over the next 7 or 8 years, but what we know right now. Now, and I believe we'll, right up to the election, there'll be a drive to get another federal build on.

Operator

And our next question will come from Michael Wood with Nomura Instinet.

Michael Wood

I appreciate the comments that you made in the Q&A session here on Asphalt and non-Aggregates. But I'm curious with - you're essentially flat in the non-Ag businesses year-to-date. And curious why we wouldn't start to see an improving trend in fourth quarter. Does that give you any concern at all for the ability to grow those non-aggregates into 2020?

James Hill

Well, fourth quarter is just tough to predict on asphalt. And again, it's - remember asphalt, you've got to lay it at 45 degrees in rising. So you just don't know when in different markets we're in, when you got to stop laying asphalt. I think the fundamentals - so that's kind of why I look forward to 2020. I think that the fundamentals for 2020 are very good, and we don't give quarterly guidance. But the fourth quarter is just hard to call anyway, particularly with asphalt because of the temperature sensitivity of the product line.

Suzanne Wood

That's right. And if you go back to when we had some similar discussions around this in the first quarter on asphalt, we would have said exactly the same thing, Michael. It's just Q4 and Q1 are just iffy because of the temperatures.

Michael Wood

Understood. And as a follow-up, the aggregates freight-adjusted selling price, there's not a lot of movement quarter-over-quarter. Curious if there's any mix impacts that you didn't call out besides the geographic. Because I would think as projects roll off, given your success with prior price increases, you would see at least a steady upward drift.

James Hill

So I think we did have a little bit of mix, and it was 5.6%, up $0.75, but mix was - mix-adjusted went up 5%. It was about half product in that geographic. The product was, well, clean stone sizes, particularly asphalt sizes, again driven by the highway demand. And then the geographic mix was higher volumes in Mid-Atlantic and the Southeast. I think if you look at our backlogs, booking pace, again, it would support that mid-single digit. And I think that's - is - not all markets are created equal and the timing of those is different. But again, early to tell. We got work to do on that. We'll give you a lot clearer guidance in February.

Operator

Now moving to Paul Roger with Exane BNP.

Paul Roger

Nice to be on the call today. I'll just move away from the trading, if I may, and focus a little bit on capital allocation. Obviously, your balance sheet is in quite a nice position now. Actually, some of your competitors have also talked started increasing the sort of M&A pipeline. Is that the type of thing you're seeing and how you want to look out for deals over the next [indiscernible].

Suzanne Wood

Yes, we will - I mean, our capital allocation policy is unchanged. We've talked about that a number of times, so I'll just speak specifically to the M&A part of your question. I mean, look, we certainly like and prefer same-store growth. It's the most profitable and the least risky, but deals come along. We look at those all the time. We've looked at a number of them this year, but we are very picky about those we do. They have to hit a certain very specific set of criteria. They have to fit well in terms of geography product to move us forward. We have specific returns characteristics so we continue to look, and we pass on a fair number because they don't hit those very high hurdle rates, but there are a few in the pipeline, and we will see which ones get to the finish line.

Paul Roger

Okay. That's very clear. And then just going back to the Asphalt business. I mean, you've obviously given some color on your expectations for 2020 anyway. I'm just wondering, is there any sort of structural reason why this can't be a sort of mid- to high-teens margin business again? And also, do you expect any impact from IMO 2020 in terms of deflation on the cost side?

James Hill

I think as far as the unit margins, that may be a little bit aggressive. Obviously, I agree with you, I'd love to have that, but it maybe a little aggressive on double-digit margin improvement, it - without help from liquid. Now if you get help from liquid, it's a different story. As far as IMO 2020. I think, again, we're early in the planning. I think we would be the mindset that, right now, liquid, at worst case, is flat to slightly up at worst case. But again, I don't know that we have clear enough visibility in 2020 at this point to make a call on liquid.

Operator

And now we will hear from Rohit Seth with SunTrust.

Rohit Seth

We talked a lot about the public. But on the housing side, builders are benefiting from lower rates. Their orders have been really strong. Just curious if you've seen a pickup on the housing side for your business and maybe what you could share what growth was like across the footprint during the quarter.

James Hill

Yes. For the year, shipments to residential market have been high single-digit. We're carrying really strong shipment momentum into 2020. Most recently, if you look at the trailing three month permits and starts and our markets are up. As you said, the fundamental drivers for housing are still very good, population growth, employment growth, low interest rates on houses and low inventories of houses. I mean, there's - most of our markets, there's just not much inventory or at an all-time low. So if you look at residential demand, we should a pretty good momentum - at this point, we believe we'll carry a pretty good momentum into 2020.

Rohit Seth

Okay. And maybe you can talk about what you - where the shipment growth was this quarter by geography.

James Hill

Yes. It was actually pretty good throughout our footprint, particularly strong in Mid-Atlantic, Southeast. Coastal Texas was very strong. South Texas was strong. Southern and Central California were strong. Tennessee was - East Tennessee was very good.

Suzanne Wood

And although you didn't ask, I'll offer that on the pricing side, very widespread virtual - well, every one of the key markets experienced year-over-year price increases. So that was nice to see as well.

Rohit Seth

Okay. And then last one, if I can here. At the Analyst Day, you talked about gross profit - unit profits rising to about mid-8s. And then we saw like incrementals come in here that reminds us that the best incremental margins, I mean, for us to model is about 60%. There was no intention there to suggest that maybe incrementals would be better as we go forward into - over the next few years. Is that right?

James Hill

I think we would take you right back to 60% over the long haul. And again, in any quarter, you're going to have quarters that will be much above 60%, you'd have quarters where we will be way below 60, but on a long - and I talked about that because of the lumpy nature of the cost and the timing of that is you have to do it when you need - you need to do it when you need to do it for the good of the business and the long-term profitability of the business, but I think we'd always bring you back to 60%.

Operator

And our next question will now come from Garik Shmois with Longbow Research.

Garik Shmois

A competitor of yours talked about the shifts in the mix of business moving towards large-scale highway work and less away from bridge work at this point in the cycle. So just curious if you're seeing that? And if so, how does that impact your outlook from an aggregates intensity standpoint for volumes and potentially from a price/mix standpoint moving forward?

James Hill

I think you're going to see more. What you'll see is capacity in these large projects. And even in smaller projects, I think they're going to be a lot aimed at just laying capacity because we're so constrained. Obviously, there'll be maintenance in there, but that is very good news for us because laying capacity is the most intensive demand used for aggregates of any we have, including just within highway. So as we look forward, I think we would see improved maintenance, but most importantly, and most of the money is going to be with laying capacity, which is the most aggregate-intensive.

Garik Shmois

Okay. And just a quick one. There were some concerns around Hurricane Dorian impacting the timing of volumes in the quarter. I was wondering if you ended up seeing any of that and if that delay in Florida and in the Southeast might end up being shifting some project work into the fourth quarter.

James Hill

We didn't see a lot of that. And if you'd noticed, this is - we've not used the W word once in this call. So we're pleased with that. But I don't know that we saw a lot of impact from Dorian. If it was, it was fairly brief, but it didn't really hit our radar.

Operator

Timna Tanners with Bank of America will have the next question.

Timna Tanners

I was wondering if you could discuss a little bit some of the other cost trends like labor in particular and any other freight costs just for starters. If you could discuss that and any other major components we should be thinking out about.

James Hill

I think the buckets I would put cost in was - fuel was slightly down. Labor cost, as far as cost per hour, I wouldn't - not a big change. Minor, but not a big change. The shipping cost we talked about was we had one of our ships in Blue Water, and that's behind us and that our - the Vulcan ship is back in service. But the primary cost driver for us in the quarter, as far as the delta, was the higher planned repair and maintenance on stationary equipment. That was the big one besides the ships.

Timna Tanners

Okay. Sorry, I didn't mean to make you repeat that. I was thinking more going forward.

James Hill

No, it's okay. No, no.

Timna Tanners

Like your labor or your cost going forward, a big issue? Or do you think that's been contained? Because I know that's something that you've been talking about for a while.

James Hill

I think there's pressures on labor cost going forward. I think what we're focused on is the disciplines and efficiencies to mitigate labor cost, and those are how we run those plants and how we best utilize our men and women who run the quarries.

Timna Tanners

Okay, super. And then circling back on the capital allocation discussion. You may have had a nice step change in returns and just trying to think about what are your priorities in terms of organic growth. I know you talked about M&A already, but organic growth versus repurchases, you did a few, and also dividends.

James Hill

I think our biggest growth engine, well, as always, will be our organic growth and the change of high single-digit to double - low double-digit to our unit margins and those four strategic initiatives where we are actively trying to improve those and with a lot of discipline and process. Obviously, we're going to look for M&A. As Suzanne said, we're going to be disciplined about it. We look at a lot of those. And they have to fit our profile. They have to fit what we want. And the key there is to be disciplined. And so - but again, the key here is improving that unit margin day in and day out.

Suzanne Wood

And I think you mentioned dividends. I mean, we look at the dividend as a progressive one. Our - it's clearly a board decision, but our view is that we should, particularly with our cash generation, which, as you'll note, we raised our discretionary cash flow guidance by about $10 million for the year versus last quarter. We'll continue to look at the dividend and the plan would be to generally raise it in line with our earnings growth to a level that we're absolutely certain we can maintain throughout the cycle.

Operator

Now we'll hear from Adam Thalhimer with Thompson Davis.

Adam Thalhimer

I wanted to ask first on the - what are you hearing from your Washington group on the risk of rescission? It looks like Texas might have to repay the federal government $600 million next year. I mean, do you think that actually happens? Or do you think somebody, they step in and fix them?

James Hill

No. I think the threat of the FAST Act rescission going to effect is slim to none. I think what this will do is help Congress find a way to pass a repeal of the session. The feds are not going to cut funding.

Adam Thalhimer

Good. I was hoping you would say that. And then as it relates to incremental margins, we've had a couple of years here where it's kind of trended below 60%. I'm just curious, for a model - modeling purposes out to 2020, I mean, would you like us to stick in 60%? Or is it better to stick in 50% and work it higher as the year goes on?

James Hill

We would guide you to 60%. Now in any given quarter. Obviously, I've just talked about, it's going to be quite volatile. In any given year, you're going to be plus or minus, something around 60%, but you're always going to come back over time to that 60% number, and that's how we guide you.

Suzanne Wood

Well, as an example, for the full year 2018, it was 64%. We would still - we'd still guide you back to 60%.

James Hill

Yes, the year before that was a little below 60%, right. Right now, we're at 60%, so we'll guide you back to 60%.

Adam Thalhimer

Okay. I mean, to get to 60% for this year, it implies that margins up in Q4 in aggs? So I just - that's kind of why I wanted to focus on 2020 because I'm just not sure margins can go up in aggs in Q4.

James Hill

Well, I think that we're always trying to drive margin ups on aggs once in a quarter over the year, that's fundamentally what we're doing. And that is the thing that we can control there is improvement in unit margins, and that's what we're focused on as well as servicing our customers, so we are not sure we're up for the volume.

Operator

We'll now hear from Phil Ng with Jefferies.

Philip Ng

It sounds like your conversations with your customers on pricing have been pretty constructive, and I know it's early. Are there any pockets or markets where you could see like a midyear increase in 2020?

James Hill

I would - it's way too early, Phil, that, we're not even through the plan of 2020 and beginning-of-the-year price increases. Usually, there will be - normally when you have rising demand, you will have a few markets where you're able to - the whole market can accept midyear price increases, and that's not just in aggregates that kind of flow-through. It just depends. But I think - so from - if you just step back and look at what happens in over the last 5 or 6 years, there'll be - there's usually that - the vast majority of time, there's a few markets where will take midyear price increases.

But you got to remember, we're talking about the fixed-plant pricing on, which is 40% of the business. The 6% of bid work is you're pricing dozens of quotes day in and day out. And in those markets - and those things, we're always trying to push price forward. And that's part of our commercial excellence and what we work hard on is to earn that - to earn - to serve our customers where we earn those price increases. But that happens day in and day out.

Philip Ng

Got it. That's helpful color. I know it's really early, and I appreciate you giving us some color for 2020. Your volume outlook seems very reasonable to me, but it's also reflecting some modest deceleration from the last few years. With housing reaccelerating and pretty healthy backlogs in public, just curious what's driving some of that deceleration. And are there any end markets that are a little less strong from your perspective?

James Hill

I think I would describe that this way. I think we're just trying to be thoughtful because it's very early, and we don't have our plans. This is our best estimate at this time. So it's not trying - we're not trying to signal, at all, any deceleration. I think what we're trying to do is just be thoughtful because we don't have the plan yet.

Operator

And ladies and gentlemen, that concludes our question-and-answer session. I'll turn the call back over to Tom Hill for closing comments.

James Hill

Thank you. I thank all of you for your time and your interest in Vulcan Materials. As you can see, the business continues to operate well, and we look forward to discussing this with you throughout the quarter. Thank you.

Operator

Ladies and gentlemen, this will conclude your conference for today. We do thank you for your participation, and you may now disconnect.