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Q2 2002 Martin Marietta Materials Earnings Conference Call

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CONFERENCE CALL PARTICIPANTS

Stephen Zelnak
John Riley
Steven Ken
David Weaver
Robert Marshall
Jack Kasprzac
Armando Lopez
Bob Bridges
Stephen Zelnek

PRESENTATION

Operator

Good day and welcome to this Martin Marietta Materials, Inc. conference call. Today's call is being recorded. At this time for opening remarks and introductions, I would like to turn the call over to the President and Chief Executive Officer, Mr. Stephen Zelnak. Please go ahead.

Stephen Zelnak

Thanks for joining us this afternoon. I have with me Janice Henry, our CFO, Ann Lloyd, our Chief Accounting Officer and Roselyn Bar, our General Counsel.

Second quarter was a very positive one for us as we achieved the highest operating profit for any quarter in our history. For the quarter, net sales increased 1% to $425 million while operating earnings increased 27% to $82 million. The operating margin for the total company improved 400 basis points to 19.3% from 15.3% in the prior year period. Other income for the quarter was $13.7 million, as compared to $7.9 million in the prior year period.

The other income this year is primarily the result of our divestiture of two quarries in Virginia and six quarries in the Columbus, Ohio area. In the prior year period, the other income was attributable to the sale of our refractory business.

Interest expense was down $2.1 million this quarter based on lower rates and reduced debt. Net earnings for the quarter of $1.09 per diluted share compare favourably to $0.82 per share recorded in the prior year period.

For the first half, net sales increased 5%, to $715 million, while operating earnings increased 15% to $77 million. Other income of $13.9 million is $4.7 million greater than the prior year. Earnings per diluted share is $0.88, as compared to the prior year's $0.72.

For the quarter, net sales per aggregates increased 3% to %405 million with pricing at heritage locations up about 2%. Aggregates shipments at our heritage locations increased 1%, with strong performance in the southwest and midwest regions. Total aggregates shipments inclusive of acquisitions and divestitures increased 1% for the quarter.

Operating earnings increased 27% from the prior year period to $81 million, a record for any quarter. The operating margin of 19.9% was up 380 basis points with improvement in the aggregates, asphalt and ready mix concrete product lines.

Year-to-date net sales of $676 million are up 8% compared to the prior year period. Operating profits of $74 million is 12% higher than the prior year. Magnesia Specialties had second quarter sales to $20 million, which was down 25% from the prior year period - based on the sale of the refractory business. Operating earnings of $1.4 million compared favourably to $1 million in the prior year period. Year-to-date net sales of $38 million is down 33%, while operating earnings were $2.9 million, as compared to $780,000 in the prior year period.

We were pleased with the performance of both our aggregates and Magnesia Specialties businesses in the second quarter. Margin increase in aggregates reflects reduced energy cost, along with similar cost reduction benefits of our plants and process improvement projects.

Also, in the prior year period, we were negatively impacted by some unusual events, including the 500-year flood in Houston, and a union work stop at Indianapolis

Our highway business continues to be positive for the company as a whole, with particular strength in South Georgia, Iowa, and the Cincinnati areas. Residential construction remains solid, although with a slightly downward trend. A major point of concern is commercial construction, which continues to weaken.

During the quarter, we completed two important acquisition and divestiture deals. We sold two quarries located in Northern Virginia, near Fredericksburg and Culpeper to Luck Stone company. In turn, we acquired a quarry near Haw River, North Carolina, from Luck Stone.

As a larger transaction, we purchased four quarries in Alabama from Oldcastle Materials, quarries that have been originally filed out of US aggregates. We sold six quarries in Colombus, Ohio, to Oldcastle. The net result of these transactions is that we have improved our strategic position in the areas of focus, and we expect to have a higher return on capital employed with the opportunity for higher profitability versus the assets divested. We expect to continue to selectively acquire as well as divest additional, non-strategic operations.

We were particularly pleased with the performance of the Meridian quarries for the quarter. Earnings from these operations more than doubled from the prior year period based on operational improvements and reduced overhead.

We have been very successful in reducing debt, which is a stated objective. After netting out cash, and cash held in escrow, pending life count [?] exchanges, our debt level at the end of the quarter was approximately $781 million. We are ahead of schedule on debt reduction, which in turn should provide us with the option of buying back our shares at a meaningful level at an earlier time, if we deem that as the appropriate choice.

At this time, I will be pleased to take any questions that you may have.

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Operator

Today's question and answer session will be conducted electronically. If you would like to ask a question, you may do so by pressing the star key followed by the digit '1' on you touchtone phone. Again, that is star, 1, if you would like to ask a question. We will pause a moment to assemble our roster.

We will go first to Arnie Ernstner, CJS Securities.

John Riley

This is John Riley for Arnie Ernstner. Could you give us volume and pricing by region for the quarter?

Stephen Zelnak

I will give you volume, but not pricing. Mideast, which is Virginia, West Virginia and Maryland for us - flat; Carolina, North Carolina - up about 1.5%; the southeast, which is South Carolina, Georgia, Alabama, Florida, Mississippi and Tennessee - up about 0.5%; southwest is very strong - up about 7%; mid America, which is Indiana and Ohio, was down by 14% - heavily affected by rainfall during the quarter and also softening demand in Indiana; midwest was up about 8%; the central division, which is primarily our waterborne, was up about 2.5%; and you heard it increase just a little less than 1%. As you net out the best of your acquisitions, it comes out as the same 1%.

John Riley

Thank you. How has the current weather in Texas impacted the current quarter?

Stephen Zelnak

Weather in Texas, I am sure you have seen and read that it is miserable in south Texas and not particularly good in North Texas either. Dallas was impacted in the second quarter and has continued to be impacted.

The major impact was in the San Antonio area. We were fortunate in that we did not lose any of our major quarry operations to flooding. We had one, small base plant that was impacted. But bigger disruption really is in terms of shipments and inability to produce for a couple of weeks.

It will have a detrimental effect to the third quarter. Expectation is that we will make up a good portion of that volume in the third and fourth quarter. But we have been trying to be pretty cautious in looking at that in respect to the third quarter forecast we laid out.

John Riley

Are any of your primary states experiencing substantial budget deficits?

Stephen Zelnak

How many would you like to discuss? States are, obviously, this way. Last time I looked at some data, you had 45 states that had budgetary issues out of balance. North Carolina, which is obviously important to us, has a budget deficit of about $1.5 billion, and at the same time, the North Carolina highway programme is pretty good as it has expropriated some extra money that was in surplus for this year, and additional money is available for the next two years.

We are not sure what is going to happen here with respect to the budget. It is quite possible that the legislature in North Carolina will go home without passing one, and by law, the governor must back in and balance the budget.

He started that process last week by declaring a reduction of 2,600 jobs, and like you do in politics, 2,400 of them were unoccupied. However, it does have an impact because the departments use those monies, they allocate the monies.

At the end of the day, with highway programme, we think we are going to have a very solid highway programme in North Carolina and the state recognises that as a priority. But things are very tight, and we get fractured legislature down here politically and the house is having difficulty in getting it together. That is the biggest problem out there, but there are a lot of states and virtually all of the states have some degree of problem.

John Riley

Got you. One last question - on the process [?] of operating margins for the quarter, is this sustainable going forward? Could we expect margins in excess of 19%?

Stephen Zelnak

I am going to be reluctant to say, 'count on it.' But is the trend line positive? Yes, I think we are on course, where we are going to get the benefit and the yield out of what we have been working at for the last year or so. We have put in place, say, quite a few projects that are efficiency improvement projects. We have some others that we are currently working on; and I think, particularly given the age of the assets we have acquired, that we are remodelling, we are getting some impressive results in terms of production rates, for the capital we are employing and with that, variable cost reductions.

So I would just say to you that my belief is we are on the positive trend line. Whether it is a straight line - it has never happened in my career. It will bounce up and down.

John Riley

Thank you.

Stephen Zelnak

Sure.

Operator

We go next to Armando Lopez, Morgan Stanley. Mr Lopez, please check your mute button.

Stephen Zelnak

Looks like we have lost him.

Operator

We will go on to Steven Ken, Salomon Smith Barney.

Steven Ken

Thanks very much. A good quarter, guys.

Stephen Zelnak

Thank you.

Steven Ken

The first question I have is related to other income, if you could be a little bit more specific about the profit contribution from the various activities. Was pretty much all the profit recorded in the other income related to the divestiture of those assets, or were there some other things in there?

Stephen Zelnak

No, it was related to the divestiture.

Steven Ken

Ok. Secondly, Bahamas was certainly an issue that we talked a lot about.

Stephen Zelnak

Let me back up on those statements and get back to the fact...

Steven Ken

Sure.

Stephen Zelnak

We do have other income and other expense on a recurring basis. We have net out other income and expenses for this particular quarter. The other income we have recorded in this quarter relates to the divestitures.

You have to go back and look at the history. We always look at some other income.

Steven Ken

Right. Ok. The Bahamas facility, which we have certainly talked a lot about over the last several months, and I was wondering if you could give us a little bit of update on that. I know the last time we talked, it was starting to look better and going according to plan, but can you sort of give us an update on how that actually performed in the quarter?

Stephen Zelnak

Improvement certainly is still not where we expect it to be. It does not go forward. Production rates - we had two months during the quarter where we wrapped up 400,000 tons of production, which was the target. So we are getting production out of there now at much higher rates.

We are still trying to put together stockpiles of dry materials. That is going slower than we had hoped, primarily because we are still doing some digging in the ship channel basin down there - more than we would really like to be doing. But the trend line is positive there.

I think we are over the hump.

The key issue there is the market for base material. We have got very good markets for concrete stone. With the general softening of the economy, the market for base material was sort of governing factors to what we would be able of producing down there.

So I think for the next, probably the next six to 12 months, that would be the key issue, and we will get our stockpile of what we call 'surge material' - the sharp rock that we will stack up and let it grind, and dry material to process. So we expect the costs to continue to come down in the remainder of this year and as we go into 2003, certainly they should come down more. Some positive trend line there too.

Steven Ken

OK. But relative to your expectations, Bahamas pretty much came in as you expected this quarter?

Stephen Zelnak

Well, a little bit below, relative to my expectations.

Steven Ken

Ok. Thirdly, fuel - if you could quantify the impact of fuel that had on you this quarter.

Stephen Zelnak

Sure. You have a couple of components to that. Perhaps it is better to talk about the overall petroleum energy costs and I will break it up for you.

The diesel fuel component of it, a little over $2 million worth of cost reduction versus Q2 prior year and in other things, we are using petroleum based liquid asphalt, natural gas, roughly measuring a cost reduction there. So if you add it up, you are in the $3.8 - $3.9 million range.

Steven Ken

And how have you seen that turning out so far this quarter? Similar?

Stephen Zelnak

Diesel fuel continues to bounce around. It was higher in the second quarter, continues to be higher than it was in the first quarter. But certainly relative to the big spike we had last year and the year before it is well behaved.

Liquid asphalt prices have gone up, but seemed to have stabilised and backed off slightly in the last 60 days or so.

Steven Ken

Great. Thanks very much.

Stephen Zelnak

Sure.

Operator

We go next to David Weaver, Lake Mason.

David Weaver

Good afternoon. In terms of the quarries that you acquired and sold, did they pretty much wash in terms of volume, or did you pick up or lose what you would call capacity for the full year?

Stephen Zelnak

Actually we gave up some volume in...I will take you through the equation there because I tried to explain it in my remarks, but it is very difficult to do in short remarks.

If you take the Virginia quarries, we gave up two quarries, which were not strategic to us. In turn, we acquired a North Carolina quarry. The difference in volume there is that we gave up roughly three quarters of a million tons

With respect to the Alabama quarries purchase versus the Columbus, Ohio quarries sold - on a full year basis, remember, we are doing this sort of in the mid year in Virginia, numbers before year two - on a full year basis, we would give up some where in the neighbourhood of 1.5 million to 2 million tons.

And the other part of that is the expectation is that we will make somewhere, or better profits on less than half capital employed and significantly strengthen our strategic position in the areas where we have considerable interest.

David Weaver

Ok.

Stephen Zelnak

We are very pleased with the deals, and hopefully the people on the other end are.

David Weaver

Ok. Several of the homebuilders have indicated that mid last year, they slowed down their residential development process. That is where a lot of the stone goes, but it re-accelerated this year. Did you happen to see that trend in your business?

Stephen Zelnak

We are seeing some more subdivision development, which we have talked about before. For a while they were living off the inventory, and it does appear that we are at a point where their inventories have diminished. As I am sure you would have noticed, mortgage rates are at a very low level, that is 6.25% on a 30-year mortgage rate. So with those kinds of rates, you would expect home building would continue to be pretty strong.

So I think we have got some possibility of some positive in the demand there, although the dollar figures for home building are tapering slightly. We may get the backside of that opportunity for our aggregate, and we may see a little bit more demand than the dollar figures would indicate as they develop in subdivision. So, could be a plus. We do not know yet.

David Weaver

One last thing - if you go us a free cash flow of the year?

Stephen Zelnak

Sure. We are somewhere between $80 and $100 million after taking everything out, including dividends; and on top of that, we have got the cash flow coming in from the Daouzeska [?] operations, which is going to add another $70 million or so. So, we will be very positive in that regard.

Our term debt, if you recall, is at $700 million dollars and we are going to be pushing down on that very quickly. One of our objectives is to get down to the term debt level. At that point in time, we have all our options open and even possibly before that, depending on what we think is appropriate. We are on a very good pathway with respect to debt reduction, very strong and positive free cash flow.

David Weaver

I take it from your comments that you have not been active in buying back shares.

Stephen Zelnak

Not as this point, but certainly watching it very carefully.

David Weaver

Ok, that is all I have, thanks.

Stephen Zelnak

Sure.

Operator

We go next to Robert Marshall, [Warco VS].

Robert Marshall

Could you give us a little more detail on how exactly you picked up 380 basis points on relatively flat volume? Was it a wind down of the capacity expansion projects?

Stephen Zelnak

First of all, let us just deal with the non-amortised goodwill so that everyone has got that. That was $6.0 million for us. Beyond that I have already cited the energy savings, which were about $3.7 million to $3.8 million - a nice piece of it. We are getting the benefit of process improvement and of capital deployed, and I have cited the benefit of the Meridian acquisition in the second quarter. I indicated in the prepared remarks that we had more than doubled profits in Meridian - so one nice piece of it is in fact the Meridian piece, which was very solidly accreted.

Robert Marshall

Ok. Second question: you mentioned in [tandem] with your guidance for the full year that it is inclusive of other income. Do you anticipate..., or are there any other sales build on to that guidance in the second half of the year?

Stephen Zelnak

No.

Robert Marshall

Ok. All right, thank you very much.

Stephen Zelnak

Sure.

Operator

We will go next to Tripp [?] Rogers, UBS Warburg.

[Tripp] Rogers: Hi, good quarter.

Stephen Zelnak

Thank you.

[Tripp] Rogers: Stephen, it looks like the highway award numbers that come out of North Carolina is down quite a bit to the first half. I know that it has a bit of a tough competition [?]. Is there anything you have seen in the first half that suggests that the second half awards in the state might be slightly sluggish?

Stephen Zelnak

I think this is basically based on the overall financial situation of the state. But, there is quite a hefty backlog out there with major projects. If you go back one year and look at the prior year and remember that these project deploy [?] out, the big ones over a 24 to 36 month period typically, there is a pretty good-sized backlog. Most of the contractors we deal with have nice [?] backlogs. Their problem is that they do not have the commercial backlogs, which is where the real softness is. North Carolina has been a very robust commercial builder, as has all of the Southeast. So, I do not think that is the bigger point of concern right now. A lot of award work is taken place in areas where we are quite active and have strong positions. There is a significant amount of work in central North Carolina in the Greensboro area and down towards Charlotte, and that really plays to our strength. If you recall, there was research work lead by the state in special lettings at the end of last year with about $170 million dollars of additional monies put out. That has pumped up the highway sector, and is work that will be done this year. That will make the second half better than it otherwise would have been. So I feel reasonably good about North Carolina at this point.

[Tripp] Rogers: Last quarter you were also pretty optimistic about Texas and Georgia. Does the same hold true today?

Stephen Zelnak

I think Texas is going to do fine. The concern there, again, is the commercial sector. The concrete [?] people in Texas are certainly seeing diminishment in commercial backlogs. If you read the reports you can see that Dallas has a very high vacancy rate. They have been impacted by the demise of telecom; I guess that is the way to put it. That is going to continue, and Dallas will not be as robust as it was last year. Overall, we are going to have a very good year in Texas.

We are presently adding capacity in South Georgia. I just signed off on two new portable plants yesterday to go to that area and supplement capacity, and also signed off on another portable plant two weeks ago to go down there, as well as on a major capacity expansion - a new secondary plant in one of large quarries. So, we are adding capacity just as quickly as we can in order to meet the demand, which is going to go on in South Georgia for the next three years, clearly. What is happening there is that with all the problems in Atlanta money is getting shifted to other parts of the state, which historically have not received their fair share. That plays to our strength, and it is where we have a very strong position. It also plays to our long-haul strategy, where we have positions in both transportation and materials likewise.

[Tripp] Rogers: Ok, thanks a lot.

Stephen Zelnak

Sure.

Operator

We go next to Jack Kasprzac, BBNT Capital Markets.

Jack Kasprzac

Thanks. Hi Steve. On the SG&A line, could you give us a bogey as a percentage of sales where you think that might be for the full year this year?

Stephen Zelnak

Probably around 7%-ish, or a little bit higher. We are going to be up a little this year based on the overhang. Remember that we did not buy Meridian until the second quarter of last year. We also have some impact on SG&A from items we have discussed relating to the benefits side of the equation. I will tell you that one of the key reasons for the performance of Meridian, additional to the operational improvement, was a significant overhead reduction quarter-on-quarter of about 40% compared to the second quarter of last year. I think we have that done that job pretty well.

Jack Kasprzac

On a more normalised basis, looking out to 2003, what would you think SG&A dollar amount would increase by[?]?

Stephen Zelnak

I do not know the dollar amount yet. We will have to see what our sales forecast looks like, which will have some impact on how we handle the SG&A. Still, the expectation would be that we would keep in the 7-percentage range. That, I think, is a reasonable level for a company like ours, and certainly is quite competitive with other all-up numbers that companies in our industry have, particularly if you grab it from all the lines where they have SG&A since people account for it in different ways.

Jack Kasprzac

Sure, ok. On the US Aggregates operations that you acquired - that was a company that was in some financial distress, as we all know. Could you talk about whether there is a lot of investment to do there to upgrade them, as well as opportunities in the long term, as far as cost reduction and production enhancement is concerned, in those operations in particular?

Stephen Zelnak

We will have very little capital investment to make there. I will just simply leave it at that, as we have a number of things going on that are [product] to the bankruptcy proceeding, and which enable us to position ourselves so that we are going to need very little capital investment. We are going to be set up to run very well and very efficiently on those locations. The expectation is that we have some cost reduction opportunities at those locations. We would therefore expect to improve them over where they are. I will also say to you that the Alabama market is fairly soft. It will probably be 2003 before we see any drift [?] in demand, but when the volumes pick up we should benefit greatly due to the positioning we have. The key to that acquisition was that we had one strategic gap in our system - by rail, from North Carolina all the way to Texas. It was that gap right down the centre of Alabama. We now have the capability of running unit trains on CSX down to south Alabama. One goes down into the panhandle area of Florida. It has improved our position significantly. It yields cost reduction, and as things turn up, I think we are in a great position.

Jack Kasprzac

Ok, thanks a lot.

Stephen Zelnak

Sure.

Operator

We go next to Armando Lopez, Morgan Stanley.

Armando Lopez

Just a quick question. You did a solid job of improving the margins in the Aggregates business. Based on the way in which I read the press releases it sounds like you are looking for aggregate volume to be flat to up, maybe modestly, for the duration of the year. So, if you have up margins and EBIT flattish volumes, is there something else offsetting that, which results in flat EPS in the third quarter?

Stephen Zelnak

Texas. I do not know if you were on the call at that point, but our caution [?] in the third quarter more than anything else is related to the flood impact and heavy rain in Texas. It is not so much flood impact, but a couple of weeks of shutdown of the business, relatively low volumes and very little production, along with one small location that we did loose to the flooding and had to restore. I also mentioned the Dallas market, which has been impacted by rain. Dallas has softened up considerably with commercial markets. The real risk and reason why we are cautious is summed up in commercial construction.

Armando Lopez

Based on what you are seeing, what are you expecting for, say, highway construction for the year?

Stephen Zelnak

Well, we think it is going to be up modestly - low single-digit figures.

Armando Lopez

You are not seeing any improvement on the commercial side? Would you expect to see some improvement there, and when would be the earliest you would expect to see such improvement?

Stephen Zelnak

In my personal view I do not think you will see improvement in commercial construction this year. I believe that the earliest time we will see that is in 2003. It could be in the first half or it could be in the second half. There is a lot of overhang out there right now, and it is really unusual in the way that it has happened, since, if you go back a couple of years, things were pretty much in balance. What has happened is that the demand side of the equation has dropped sharply with dot.com and telecom not needing the space they once did. It is therefore quite hard to determine how long it is going to take to work off that overhang. We talk to our concrete customers, who are probably quite a good judge on that, and most of our major concrete companies are off this year 10-20% in terms of volume. In terms of the backlogs that they have these have not stabilised, and are still tapering. Our view is that we are not out of the bottom yet on commercial. Hopefully we will get there in the next few months.

Armando Lopez

All right, thank you.

Stephen Zelnak

Sure.

Operator

We will go next to Bob Bridges, Sterling Capital Management.

Bob Bridges

Stephen, can you give us an update, from what you are hearing from your industry contacts and others, on how things are progressing in Washington with your replacement TEA-21 legislation? I thought I saw a headline that said that a Senate subcommittee might be voting today or tomorrow on preparations. Can you comment on that?

Stephen Zelnak

The Senate Transportation Committee came out with a full restoration up to last year's level of $31.8 billion. You probably know that the House of Representatives has been towing the line with President Bush, which was $27.7 billion. I think it is $27.6 billion as they have sought to cut funds across the board. The debate will come between the House and the Senate. The Senate Appropriations Committee has to pass the bill. We are not quite sure what they are going to do. Senator Byrd is certainly a strong advocate for infrastructure and highway construction. We think his numbers are on the higher side rather than on lower. My guess and personal view is that the final numbers will wind up somewhere between $28 billion and $29 billion. Anything over $29 billion will be a huge plus. But, at that level, if you take the flow of spending that goes with that, which is about 25% of the money spent in the first, roughly 47% in the second year, and then the rest of it in years three to seven, you would have positive spending in the financial year 2003 at the $27.6 billion to $27.7 billion level and probably be up by two to three percent. It looks like positive spending is pretty much locked in at this point. The question is: can it go up some more?

Bob Bridges

Ok, that is very helpful. Thank you.

Stephen Zelnak

Sure.

Bob Bridges

Also, I think you made a comment in last quarter's conference - or it might have been at the Bahamas presentation, I cannot quite recall where you said it - talking about the infrastructure build-out for the long haul network and how that is substantially complete. I just wanted to have a comment on the right way to think about capital spending over the medium term, looking three to five years out, and how that is going to relate to what the spend is going to be over the three to five years. Do you see it accelerating or attaining levels relative to sales or any other metric you want to use?

Stephen Zelnak

We do actually run it and look at it relative to sales, EBIT and EBITDA projections. If you were comparing it to any of those over a five-year plan, the expectation is that it is coming down as a percentage of.... Obviously, we do not know exactly where the earnings numbers are going to be for sales, but the expectation is that we are going to spend considerably less capital than we have in the last five years, relative to the size of our business. We have indicated that we have gone through a process of putting in place a network that we think is pretty powerful. There are some people who disagree with us. We will find out. I would suggest to you the fact that we have up volume in the second quarter, and the other people I have looked at had pretty substantial down volumes in most cases. There might be an element of that in it, based on transportation choices and also product type options. We think there is some real power in it.

Capex last year was, as I recall, $194 million. We are looking at capex this year, excluding newly acquired properties, in the $125 million to $130 million range. For the next five-year period I do not see any particular reason why it is going to be different relative to what we have today. We think we are going to be much more of a significant cash generator. We put a lot in place, and as the economy picks up we are going to have capacity in places where we will have impact. We are going to have very efficient capacity in those impact spots, and we expect to do some harvesting and reap the benefits there.

Bob Bridges

Not different in absolute dollars or in relative percentage of those metrics?

Stephen Zelnak

It is absolute dollars we are talking about. If you go through the last two years, we were at $171 million and $194 million. We are talking about capex over the next five years that is in the $125 million to $135 million range based on what we see today.

Bob Bridges

Great. Great quarter. Appreciate it, thank you.

Stephen Zelnak

Sure.

Operator

It appears that there are no further questions. At this time I would like to turn the call back over to Mr Zelnik for any closing remarks.

Stephen Zelnek

Ok. Thanks for joining us. As I said, we were pleased with the quarter. We think we are on a very positive trend line with respect to our operations and the efficiencies we are putting in place. Again, I would suggest to you that we have put a lot of time and effort into the transportation and product type options. We are beginning to see some shipping of customers related to that in the direction of Martin Marietta. We would expect to be able to offer those customers some additional value going forward based on what we put in place.

So, we thank you for joining us and look forward to talking to you a little bit later.

Operator

Thank you for joining today's conference. You may disconnect at this time.

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Dennis Scinnel *Ruth Ed Captial*

PRESENTATION

Operator

Good day and welcome to this Martin Marietta Materials Incorporated conference call.

Today's call is being recorded.

At this time, for opening remarks and introductions, I would like to turn the conference over to the President and Chief Executive Officer, Mr. Stephen Zelnak. Please go ahead, sir.

Steven Zelnack, Jr. ***Martin Marietta Materials, Inc. - Chairman, President, Chief Executive Officer***

Thanks for joining us this afternoon.

I have with me Janice Henry, Chief Financial Officer and Ann Lloyd, our Chief Accounting Officer.

The third quarter was a sharp contrast to the record results we posted in the second quarter.

Demand for our aggregates products was well below our expectations with a resulting shipments volume decline of 1% for the quarter for our Heritage locations.

During the quarter, we experienced a notable decline in commercial construction demand. We also saw a slowdown in highway construction as the state struggled with budget shortfalls. In addition, the 11 hurricanes and tropical storms during the quarter negatively effected shipments in operations.

For the quarter, sales for the company were $429 million, a 2% decline from the prior year period. While earnings from operations were $68.7 million was down $11 million.

Earnings per share was 80 cents as compared to 95 cents in the prior year period. Reduced shipments in production coupled with very wet operating conditions accounted for the variance .

Year to date sales of $1.14 billion were 2% above the prior year period while operating earnings of $146 million was essentially the same.

Year to date other income is $5.4 million positive, all related to the sale of Ohio and Virginia quarries in the second quarter. Interest expense decreased $2.4 million or 7% primarily as a result of debt reduction. Year to date net earnings are $81.7 million, or $1.67 per share. As compared to $80.3 million or $1.68 per share in the prior year period.

For the third quarter, aggregate sales of $411 million were down 1% from the prior year period while earnings from operations were $67 million compared with $79 million. The decline in earnings is a result of the weak demand in our Southeast markets. Specifically North Carolina, South Carolina and parts of Georgia, where we typically generate above-average margins. We also produced less than optimum levels to control inventory based on the decline in demand.

After a strong performance in the second quarter, the Meridian locations performed below expectation, primarily as a result of a significant decline in demand in Dallas/Ft. Worth, coupled with wet weather in the area. Reduced demand from our Minnesota and Wyoming operations also effected Meridian's results.

In addition, the 11 major storms that hit the U.S. in the third quarter reduced operating efficiency. Year to date sales for aggregates of $1.1 billion exceeded the prior year period by 4%, primarily due to acquisitions, while operating earnings of $141 million were down 2%.

For the quarter, the average selling price at Heritage aggregates operations increased about 2% while shipments volume was down 1%. Inclusive of acquisitions and divestitures, the average selling price increased 3% while shipments volume decreased 4%.

Year to date, the average selling price for Heritage locations is up 2% while volume is down about 1/2 of 1%. Our scaled down Magnesia Specialties business performed well even in a tough economy.

For the quarter, sales of $18 million were down 19% compared to the prior year period. While earnings from operations of $1.3 million were up significantly from the $800,000 recorded last year. Year to date sales of $56 million decreased 29%, primarily due to the sale of refractory assets in 2001. Earnings from operations of $4.2 million are more than doubled the prior year period.

During the quarter, we continue to focus on debt reduction. When taking into account our positive net cash position and like kind exchange funds and escrow accounts, our effective debt to capitalization ratio is down to 41% from a high of 52% following the purchase of Meridian in April of 2001. We expect to continue to reduce debt and the debt to capitalization ratio.

We continue to put in place significant investments in processing improvement at our plants. Through plant productivity improvement projects and right-sizing of mobile equipment for optimum efficiency.

The reduced production mode in the third quarter, coupled with the significant weather impediments, masked the improvements which were more visible in our second quarter results.

We plan to continue in this process improvement mode to improve the productivity and in most cases increase the capacity potential of our plants.

We have made significant progress in recent months in acquiring new customers for our offshore operations at our recapitalized Bahamas plant and Nova Scotia quarry.

Newly acquired customers are expected to purchase over 2 million tons of our high quality offshore granite and limestone products in Florida, other southeastern and gulf coast states and the Caribbean. We expect to continue to add business to these locations in 2003.

During the quarter, we acquired an asphalt plant that serves the western sector of San Antonio. This is an excellent strategic fit with our aggregates in asphalt operations in the area. We also purchased a small sand and gravel facility at Courville, Texas, which is northeast of San Antonio. These acquisitions further increase our presence in Texas.

Results from aggregates operations acquired in Alabama and North Carolina during the second quarter have been very positive. We have improved productivity and lowered costs at all of the acquired plants in these areas.

For the full year 2003, we expect these locations to earn more than the divested locations in Ohio and Virginia on less than 50% of the invested capital.

During the quarter, we sold several small rural quarries in Iowa which did not meet our investment criteria. Year to date, we have sold for over $100 million marginally performing assets which were not strategic to our business.

We also moved ahead on the development of our structural composites business during the quarter. We bid on approximately $10 million in composite rail car components and expect to compete regularly in this product period going forward.

We view this as a significant business opportunity for our structural composites business. Also, we're seeing increasing interest in our composite bridge deck products both in the U.S. and worldwide.

We continue testing on the United States version of composite trailer, our specialty all-composite truck trailer, which is currently on the road in Europe. The testing has gone well. We currently expect to introduce our first line of specialty truck trailers in the first half of 2003. These units will be imported from Belgium.

We are finalizing an assembly location contract in North Carolina and expect to be assembling specialty truck trailers in the U.S. in 2004. We expect our structural composites business to be a meaningful component of our company in 2004 and beyond.

The outlook for the remainder of 2002 remains soft with no expected improvement in industry demand. This weakness coupled with the adverse weather conditions experienced in the fourth quarter to date will effect sales and operating efficiencies.

While we currently expect net earnings for 2002 to range from $2 to $2.15 per share, continued industry weakness and adverse weather will likely result in earnings at the lower end of this range.

At this time, I would be pleased to take any questions you may have.

QUESTIONS AND ANSWERS

Operator

Thank you.

Today's Q&A session will be conducted electronically.

If you do wish to ask a question, please press the star key followed by the digit 1 on your touch-tone phone. Once again, that's star 1 on your touch-tone phone to signal for a question.

If you're using a speaker phone today, please pick up the handset while posing your question and be sure your mute function is turned off to allow your signal to reach our equipment.

We will pause for a moment to assemble our roster.

Our first question today comes from Armando Lopez with Morgan Stanley Dean Witter.

Armando Lopez *Morgan Stanley Dean Witter*

Yeah, hi, good afternoon.

Steven Zelnack, Jr. *Martin Marietta Materials, Inc. - Chairman, President, Chief Executive Officer*

Hi.

Armando Lopez *Morgan Stanley Dean Witter*

Just a couple of quick questions one it seems like you guys continue to get pricing despite the weak environment. When -- when does that -- I mean how sustainable is that if demand remains weak. I mean do you eventually expect pricing may moderate here some?

Steven Zelnack, Jr. ***Martin Marietta Materials, Inc. - Chairman, President, Chief Executive Officer***

Well, actually pricing is already moderated, Armando, if you go back over the last five years, coming into this year, we had averaged about 4%.

Armando Lopez ***Morgan Stanley Dean Witter***

Right.

Steven Zelnack, Jr. ***Martin Marietta Materials, Inc. - Chairman, President, Chief Executive Officer***

So you're looking at last year being down around 2.5, you're looking at this year, year to date, being right around 2. So, it's already come down.

It's a split market, I say that from the standpoint of the customer base. The ready mix business is in dire straits based very poor demand out of commercial construction.

It is extremely difficult to get price increase in the ready mix side of the business and, in fact, more apt to see some price decrease.

However, in the asphalt side of the business, based on the pressure related to, you know, even what is a little bit less robust highway program than we expected, there still is some supply pressure there related to asphalt-size stone and the price increases in that area have been much better. So that's what's carrying it. You have one side that's extremely soft and the other side is stronger.

Armando Lopez ***Morgan Stanley Dean Witter***

Okay, so like going into the fourth quarter, would you expect like to continue to see like a similar trend that we saw in the third quarter?

Steven Zelnack, Jr. ***Martin Marietta Materials, Inc. - Chairman, President, Chief Executive Officer***

I would.

Armando Lopez ***Morgan Stanley Dean Witter***

Okay.

And in terms of like the highway, it seems like highway demand has softened up more than people would have expected a few months ago. Are these projects -- are they just being delayed or are people starting to take projects off the table? Could you just provide a little more color on that?

Steven Zelnack, Jr. ***Martin Marietta Materials, Inc. - Chairman, President, Chief Executive Officer***

It's -- it's a variety of those kinds of things. You can go to Virginia as an extreme where they literally stopped construction projects in progress and shut down jobs because of cash flow problems. That -- that is one extreme.

In some cases, you have states proceeding along at what I call a normal clip. The more likely scenario, what is taking place in most of the states that we do business in; that they're looking at the fact that their revenues have slowed down, they're in deficit, so, in virtually every case, they have taken advantage of the federal matching money and they're using state funds to do that.

Armando Lopez ***Morgan Stanley Dean Witter***

Uh-huh.

Steven Zelnack, Jr. ***Martin Marietta Materials, Inc. - Chairman, President, Chief Executive Officer***

But they're slowing down and in some cases, you know, deferring for substantial periods of time the 100% paid state maintenance. You know, that the state has to do itself on secondary roads and other state roads.

Armando Lopez ***Morgan Stanley Dean Witter***

Right.

Steven Zelnack, Jr. ***Martin Marietta Materials, Inc. - Chairman, President, Chief Executive Officer***

So, they're shifting money toward the federal side and with that, they seem to be operating at a somewhat slower pace as far as the build-out of those projects. However, I will tell you, that is part state, part contractor because some of that relates to contractors' backlogs which are not as robust as they were a year ago.

Armando Lopez ***Morgan Stanley Dean Witter***

Uh-huh.

Steven Zelnack, Jr. ***Martin Marietta Materials, Inc. - Chairman, President, Chief Executive Officer***

And a lot of these jobs have long time frames on them, so, the contractors are trying to make sure that they've got adequate work to keep their people employed so they're not pushing in most cases.

Armando Lopez ***Morgan Stanley Dean Witter***

Okay.

Steven Zelnack, Jr. ***Martin Marietta Materials, Inc. - Chairman, President, Chief Executive Officer***

So, it's all of that together.

Armando Lopez ***Morgan Stanley Dean Witter***

Okay.

Steven Zelnack, Jr. ***Martin Marietta Materials, Inc. - Chairman, President, Chief Executive Officer***

That causes deferral. And deferral is the correct word, I think. You know, the funds on the federal side are out there. The states will ultimately match in almost every case.

Armando Lopez ***Morgan Stanley Dean Witter***

Right. Uh-huh. Okay. Thank you.

Steven Zelnack, Jr. ***Martin Marietta Materials, Inc. - Chairman, President, Chief Executive Officer***

Sure.

Operator

We will take our next question from Arnold Ersner with CJS Securities.

John Riley ***CJS Securities***

This is John Riley for Arnie Ersner. First, can you give us a volume and pricing trends by region?

Steven Zelnack, Jr. ***Martin Marietta Materials, Inc. - Chairman, President, Chief Executive Officer***

I will give you volume trends.

John Riley ***CJS Securities***

Sure.

Steven Zelnack, Jr. ***Martin Marietta Materials, Inc. - Chairman, President, Chief Executive Officer***

Mideast for us, which is Virginia, Maryland, West Virginia, the volume was up about 13%. But that's really skewed to the upside by a new location that we opened up in West Virginia. In North Carolina, volume was down 3%. This is for the quarter.

John Riley ***CJS Securities***

Right.

Steven Zelnack, Jr. ***Martin Marietta Materials, Inc. - Chairman, President, Chief Executive Officer***

In the southeast, which is South Carolina, Georgia, Alabama, Mississippi, Florida, volume was down 5%. In the southwest, which is Texas, Oklahoma, volume was up 1% but I need to split that for you because it's a dichotomy and San Antonio, Houston and south Texas, volume was very strong. In North Texas, Dallas Fort Worth it was extremely weak. In mid-America, which is Indiana, Ohio, Northern Kentucky, down 2%. The midwest, which is Iowa and the rest of the farm belt, down 3%. And our central division, which is the Waterborne plus Arkansas, up 4%. And that adds up to a negative 1% for our Heritage locations.

John Riley ***CJS Securities***

Okay. Looks like your CAP-X year to date is a little more than $100 million. Can you tell us what to expect in Q4 and 2003?

Steven Zelnack, Jr. ***Martin Marietta Materials, Inc. - Chairman, President, Chief Executive Officer***

For Q4 -- I will give it to you for the year. We expect to wind up the year at between $135, $140 million of CAP-X.

John Riley ***CJS Securities***

Right.

Steven Zelnack, Jr. ***Martin Marietta Materials, Inc. - Chairman, President, Chief Executive Officer***

And our depreciation just as a comparison will be in the range of about $140 million. With respect to 2003, capital expenditures will be in a similar range.

John Riley ***CJS Securities***

Okay, so you're not going to cut CAP-X?

Steven Zelnack, Jr. ***Martin Marietta Materials, Inc. - Chairman, President, Chief Executive Officer***

We're probably going to take it down slightly, but, you know, no major cuts. We've got a lot of very good high return internal productivity improvement projects that we want to move along on.

John Riley ***CJS Securities***

Okay. And last question, what are you hearing from your sources on the state of the reauthorization bill in Washington?

Steven Zelnack, Jr. ***Martin Marietta Materials, Inc. - Chairman, President, Chief Executive Officer***

I wish I could find someone who truly knew! [Laughter] It's about as confusing as I've ever seen it.

You know, we are operating right now under continuing resolutions since October 1. It will likely be March/April before there is a true number set.

You know, the feedback we're getting is that if -- if the economic woes continue there is going to be more interest in a higher number with respect to generating jobs in the economy. So, if we have a weak economy, which it certainly appears that way in the fourth quarter and in the first quarter, then that would tend to make you believe that they will come back at the higher end of the range as opposed to -- you're at 27-7 on the administration side right now. $27.7 billion.

John Riley ***CJS Securities***

Right.

Steven Zelnack, Jr. ***Martin Marietta Materials, Inc. - Chairman, President, Chief Executive Officer***

Senate Appropriations Committee at $31.8 billion, which is last year's number. So, a weak economy would lead you more to the $31.8. The fixed problem we've got is the states don't know right now. And if -- if the number worked to be lower, they're really not in a position to do anything but work with the low-end numbers until they know.

John Riley ***CJS Securities***

All right. Okay. Thank you very much.

Steven Zelnack, Jr. ***Martin Marietta Materials, Inc. - Chairman, President, Chief Executive Officer***

Sure.

Operator

Steven Ken with Salomon Smith Barney.

Jed Baron ***Salomon Smith Barney***

Hi, it is Jed Baron for Steve Ken.

I wanted to drill down a little bit on your fourth quarter guidance.

First of all, on -- on the volume side, looking at your Heritage volumes in the fourth quarter, I know you're up against somewhat of a difficult comparison and given the weather conditions that you referenced that you've seen in October so far, what do you think the chances are that we might be talking about, you know, a mid- to high single digit decline in Heritage volumes in 4Q.

Steven Zelnack, Jr. ***Martin Marietta Materials, Inc. - Chairman, President, Chief Executive Officer***

I would be surprised if we had a high single digit decline. The real issue is October.

Jed Baron ***Salomon Smith Barney***

Okay.

Steven Zelnack, Jr. ***Martin Marietta Materials, Inc. - Chairman, President, Chief Executive Officer***

And I think you've heard that from other producers.

October is normally the driest month of the year and normally the highest shipping month. It has 23 shipping days typically. And the fact is that October has been incredibly wet.

We haven't gotten out from under it yet and the key to the fourth quarter will be whether or not we actually get some drying out and some decent weather to work in November. You know, even with the less than robust economy, contractors do have work to do and if they can get an opening to do it before the year-end in November, you know, the possibility of getting some better numbers. But, you know, we -- we advise you that October weather conditions are just horrendous, so, November will be the key.

Jed Baron ***Salomon Smith Barney***

Okay. And last thing: In terms of the tax rate, what might be a fair estimate here in the fourth quarter? I think you said in your press release you were thinking of averaging 35 for the year? Is that correct?

Janice Henry ***Martin Marietta Materials, Inc. - Senior Vice President, Chief Financial Officer***

Jed, the tax rate that we're estimating for the year is the tax rate that's used year to date in the third quarter, it is 35%. That's our estimate for the year, also.

Jed Baron ***Salomon Smith Barney***

Okay. Okay. Great. Thanks very much.

Steven Zelnack, Jr. ***Martin Marietta Materials, Inc. - Chairman, President, Chief Executive Officer***

Sure.

Operator

Once again, as a reminder to our audience, if you do wish to ask a question, please press the star key followed by the digit 1 on your touch-tone phone at this time. We will go next to David Weaver with Legg Mason.

David Weaver ***Legg Mason***

Good afternoon.

Steven Zelnack, Jr. ***Martin Marietta Materials, Inc. - Chairman, President, Chief Executive Officer***

Hi, Dave.

David Weaver ***Legg Mason***

On the North Carolina market, at the beginning of the year that was one of the few markets that looked like it was going to be very healthy on the public side and you cited that as one that's getting a sharp decline. Is it more on the commercial side, are you also seeing the public spending soften up quite a bit in North Carolina?

Steven Zelnack, Jr. ***Martin Marietta Materials, Inc. - Chairman, President, Chief Executive Officer***

Actually, the public side is quite good.

I had mentioned earlier in the year that North Carolina had appropriated some additional monies for resurfacing and that money has come out, jobs being done and in some cases it's put a lot of pressure on us for asphalt sizes.

The issue in North Carolina is commercial construction, which has been a very, very robust market in the last five or six years and I'll just give you a couple of data points here in Raleigh-Durham, you know, that research triangle has been exceptional. If you go back two years ago and look at office construction statistics and you look at what's under construction to date, it is a 77% decline. If you take distribution warehouses, two years ago there was roughly 675,000 square feet under construction. Today, that number is 0.

So, that gives you some idea of what's going on commercially. That's where the issue is. Home going has been pretty good, as it has in most places, based on low interest rates. Even though North Carolina has run, you know, had financial difficulties in balancing its budget, the highway program has been a good one. It continues to be.

David Weaver ***Legg Mason***

Okay. On Texas, is there -- to what extent are you able to discern between what's been a reaction to the weather versus actually slowing demand?

Steven Zelnack, Jr. ***Martin Marietta Materials, Inc. - Chairman, President, Chief Executive Officer***

It's difficult to do. I -- I think it actually masked it, the weather masked it in the second quarter when Dallas/Ft. Worth got hit pretty hard weather wise then, too.

I think our view and most people's view was that, you know, it was more weather than demand, certainly in the third quarter it was both, clearly demand has dropped pretty sharply up there. And that, again, is driven by commercial.

You know, you're back to the composition of the economy and Dallas/Ft. Worth, like a Raleigh-Durham has a very high technology component and we know the state of finance of those kinds of people.

David Weaver ***Legg Mason***

Okay. And one last thing, could you -- could you note any areas of strength that you're seeing in the country?

Steven Zelnack, Jr. ***Martin Marietta Materials, Inc. - Chairman, President, Chief Executive Officer***

It's -- it's pretty easy to sort out and get to the areas of strength because they are few.

You know, Florida market, which we are not a large participant in, but an increasing participant, continues to be overall pretty strong. You know, it's more residential-driven. And, you know, very positive there.

South Georgia continues to be a very strong market for us, it's an area of strength in road construction and it is an area where we have a very strong market position from Augusta, Macon, toward Columbus, all the way down to the Florida border. Savannah is very strong. Those are the areas where we're seeing significant strength. San Antonio and Houston are pretty good. And south Texas is pretty good. Beyond that, you know, weakness.

David Weaver ***Legg Mason***

Okay. Thank you very much.

Steven Zelnack, Jr. ***Martin Marietta Materials, Inc. - Chairman, President, Chief Executive Officer***

Sure.

Operator

Operator: We'll go now to Mark Alta with CS First Boston.

Mark Alta ***CS First Boston***

Hi, thank you. Where do you hope to get that leverage down and over what time frame?

Steven Zelnack, Jr. ***Martin Marietta Materials, Inc. - Chairman, President, Chief Executive Officer***

Debt leverage for us, you know, down about 35% is a very, very comfortable number and I think with the course that we're on right now, you know, we've got an opportunity to push down toward that, maybe get to it by the end of 2003.

Mark Alta ***CS First Boston***

But that's a net debt leverage number that you're using, right?

Steven Zelnack, Jr. ***Martin Marietta Materials, Inc. - Chairman, President, Chief Executive Officer***

Yes.

Mark Alta ***CS First Boston***

Okay. Thank you.

Operator

We will take a follow-up from Armando Lopez with Morgan Stanley.

Armando Lopez ***Morgan Stanley Dean Witter***

Hi, just another quick question. With respect to the -- the guidance that you provided for the full year, like the -- the low end of the range, the $2. Does that assume further -- like what type of additional deterioration does that assume in the markets? Or does that assume things kind of level off in like November and December?

Steven Zelnack, Jr. ***Martin Marietta Materials, Inc. - Chairman, President, Chief Executive Officer***

The assumption is that October is what it is, which is pretty raunchy.

Armando Lopez ***Morgan Stanley Dean Witter***

Uh-huh.

Steven Zelnack, Jr. ***Martin Marietta Materials, Inc. - Chairman, President, Chief Executive Officer***

That November is a normal November, which means you get about 2 to 3 weeks of decent operating weather and along about Thanksgiving week you're beginning to shut down, things are coming down seasonally.

Typical December and late onto that is the fact that, you know, the economy is weak, you know, we think that's going to continue. You know, I don't think it's going to fall off of a cliff --

Armando Lopez ***Morgan Stanley Dean Witter***

Right.

Steven Zelnack, Jr. ***Martin Marietta Materials, Inc. - Chairman, President, Chief Executive Officer***

-- compared to where we are, but it's going to continue to exhibit weakness. I think the seasonal patterns are going to be more of a determinant as I indicated. Really November is the key.

Armando Lopez ***Morgan Stanley Dean Witter***

Okay. Okay. Thank you.

Steven Zelnack, Jr. ***Martin Marietta Materials, Inc. - Chairman, President, Chief Executive Officer***

Sure.

Operator

Our next question today will come from Jack Kasparzac with BB&T Capital Markets.

Jack Kasparzac ***BB&T Capital Markets***

Thanks, hi, Steve.

Steven Zelnack, Jr. ***Martin Marietta Materials, Inc. - Chairman, President, Chief Executive Officer***

They've had more trouble with your name, Jack than mine.

Jack Kasparzac ***BB&T Capital Markets***

10 years of this now! [Laughter] You mentioned you got some new customers for the gulf coast area, just wondered if you could give us an update on the Bahamas operation in the third quarter, how did it run versus expectations?

Steven Zelnack, Jr. ***Martin Marietta Materials, Inc. - Chairman, President, Chief Executive Officer***

We're running much, much better in the Bahamas. What we're trying to do now is, you know, just kind of fine-tune there.

We're trying to build a customer base, which is what I, you know, commented on and if you recall, we were doing about 2.5 million tons in the Bahamas prior to the measured capital project. And we have capacity to go to 6 to 8 million tons. We could get to 8 with a small additional capital investment.

So, the trick now is to build volume levels and I would have to tell you that we're -- we're quite pleased because, you know, reality is we are in the midst of a difficult economy. But we've been able to add significant new customer base to both the Bahamas and Nova Scotia based on the quality and the delivered costs coming out of those operations. So, I'm quite please we did that.

It is Southeast, it's a number of Florida destinations and gulf coast primarily, a little bit into the Caribbean. And based on the selling effort in the feedback we're getting from other potential customers, you know, we certainly expect that to continue into next year. Even on a tough comp. So, at this point I'm reasonably pleased with it.

Jack Kasparzac ***BB&T Capital Markets***

Okay. On commercial construction, it's -- it's very weak and getting weaker, I guess through the third -- through the third quarter. Any thoughts on where you think it might bottom out if it -- maybe it's already bottomed out or is there just no visibility on that at this point?

Steven Zelnack, Jr. ***Martin Marietta Materials, Inc. - Chairman, President, Chief Executive Officer***

You know, I can put on my economist hat and speculate like all of those folks do, our view is that it's probably unlikely that we're going to get a turn in commercial construction until the second half of 2003 at the earliest. It's not too difficult to make a case that says that it's

'04.

You start looking at office construction in particular and, you know, I cited the declines in the Raleigh-Durham area. That's pretty severe.

But you start looking at vacancy rates in a lot of the major markets and then you go off into a side study on how much space is really in the market, based on sublet space added to the formal vacancy rate. It's going to take time to clear that out and get back to market equilibrium. I'm not particularly optimistic about that.

I'm more optimistic about, you know, some freeing up of road money in 2003 and going in to '04, '04 is an election year and I've never known politicians not to cut loose in an election year. Roads are built in all of the congressional districts. And housing continues to hold up, you know, beyond your expectations.

Jack Kasparzac ***BB&T Capital Markets***

Right.

Steven Zelnack, Jr. ***Martin Marietta Materials, Inc. - Chairman, President, Chief Executive Officer***

With the low interest rates.

And the other thing I would say to you is that, you know, we're -- we feel good about the internal efforts that we have under way with respect to productivity improvement. We've made it a lot of progress with a lot of the acquired facilities, you know, I specifically cited Alabama and North Carolina, but there is much more than that. You've got screened and will get screened with low volumes, but as we get volume uptick, you know, I think we're very well positioned.

Jack Kasparzac ***BB&T Capital Markets***

Great. Thanks a lot, Steve.

Steven Zelnack, Jr. ***Martin Marietta Materials, Inc. - Chairman, President, Chief Executive Officer***

Sure.

Operator

We will take your final question from Dennis Scinnel with Ruth Ed Capital.

Dennis Scinnel ***Ruth Ed Captial***

Yes, hi, Steven and Janice, just a couple of quick questions.

Steve, you mentioned I think it was $100 million of asset sales year to date, are you -- are you done kind of calling auto your under performing properties or -- or could there be more looking out over the next few quarters?

Steven Zelnack, Jr. ***Martin Marietta Materials, Inc. - Chairman, President, Chief Executive Officer***

We've got a little bit more to do, expectation is that we will complete that and have our system baseline where we want it in 2004. I do not expect to see anything of the magnitude that we've done, you know, as we've repositioned our investment in the past year.

Dennis Scinnel ***Ruth Ed Captial***

Yep, yep. Gotcha.

And then, how about on the acquisition front, you know, debt has come down a little bit, maybe not at your target level, but obviously you all aren't the only ones feeling the softness in the market. Does that make it more likely that some high quality properties that you might be interested in would be coming to market at reasonable multiples, less likely, kind of any insight over the next 12, 18 months?

Steven Zelnack, Jr. ***Martin Marietta Materials, Inc. - Chairman, President, Chief Executive Officer***

Well, I can tell you what we're seeing right now, there are a lot of people out there that still value their properties rather dearly. They're valuing them based what things were three years ago. And those numbers just don't compute for us and probably not for most people based on the low level of acquisitions. We have only a very small number of acquisition prospects that I consider real and possible right now.

Dennis Scinnel ***Ruth Ed Captial***

Yep.

Steven Zelnack, Jr. ***Martin Marietta Materials, Inc. - Chairman, President, Chief Executive Officer***

And we're just going to be very cautious with that. We are -- we are much more focused on taking our investment capital and putting it into process improvement modernization and capacity expansion of the existing facilities that we've accumulated over the last five and a fraction years, because that's where the power is. And the returns on those projects are incredibly high. You're looking at projects that typically are north of 30%. Sometimes north of 50%, internal rate of return, versus an acquisition that's going to be 15 to 18%, typically.

Dennis Scinnel ***Ruth Ed Captial***

Yep, yep. Well that sounds pretty attractive.

And along those lines, you know, if -- if we continue to see for, you know, several quarters, you know, some pretty tough comparisons at least on the volume side, you know, I understand that you've got this productivity, you know, program -- productivity enhancement program under way.

Again, if things get really bleak over the next 12 months, are there other actions that you all would take? Are there other big cost chunks that you could take out of the system, again, if things get really bad?

Steven Zelnack, Jr. ***Martin Marietta Materials, Inc. - Chairman, President, Chief Executive Officer***

Well, if we were to go to, you know, some type of close to depression scenario, what you will begin to do is you will begin to shut down plants and consolidate production in areas where you have multiple plant locations and, I mean that's something that's very logical to do.

Dennis Scinnel ***Ruth Ed Captial***

Yep. Yep.

Steven Zelnack, Jr. ***Martin Marietta Materials, Inc. - Chairman, President, Chief Executive Officer***

We're in a position to do that if we had to. We have already pulled back operating hours very sharply and at many locations are operating on minimal schedules, which for us is, you know, 40, 45 hours a week with the load-out. We load out more hours typically than we operate.

Dennis Scinnel ***Ruth Ed Captial***

Yep.

Steven Zelnack, Jr. ***Martin Marietta Materials, Inc. - Chairman, President, Chief Executive Officer***

So, we're doing that.

Dennis Scinnel ***Ruth Ed Captial***

Gotcha.

And then, you know, you mentioned the end markets vis-a-vis, you know, I thought of you guys in terms of public spending versus commercial, versus the small piece that's residential. But how would you estimate your aggregate end market split between asphalt versus ready mix versus other? Is there kind of an easy rule of thumb for us to think of that?

Steven Zelnack, Jr. ***Martin Marietta Materials, Inc. - Chairman, President, Chief Executive Officer***

Yeah, I can give you a rough cut. You know, to asphalt plants would typically be somewhere in the 20, 25% range. Ready mix plants, fairly similar. And then the rest of it is going to go into base or projects, it's going to go into septic stone, all kinds of miscellaneous uses.

Dennis Scinnel ***Ruth Ed Captial***

Gotcha. And okay, not to leave out Janice, what -- could you talk a little bit about the pension fund, kind of what your expectations are for '03 in terms of what we might see coming through on the income statement and whether or not there will be any cash funding requirements?

Janice Henry ***Martin Marietta Materials, Inc. - Senior Vice President, Chief Financial Officer***

Well, Dennis, we're really not going to get into a lot of details on '03 until January.

We have said, however, that, you know, given the state of the market and the returns on assets in the market, that we would expect to see an increase in -- in pension expense for next year. We would also expect to see some level of cash funding for next year. None of that -- neither of those will be what I consider to be material at this time, but it will be in the first quarter of next year that we actually detail that for you.

Dennis Scinnel ***Ruth Ed Captial***

Okay. Okay. So -- so, we wouldn't be able to get that at the fourth quarter probably sometime during the first quarter --

Janice Henry ***Martin Marietta Materials, Inc. - Senior Vice President, Chief Financial Officer***

Excuse me, I'm sorry?

Dennis Scinnel ***Ruth Ed Captial***

We wouldn't be able to get that kind of guidance after you report the fourth quarter?

Janice Henry ***Martin Marietta Materials, Inc. - Senior Vice President, Chief Financial Officer***

Yes, yes, when we report the fourth quarter.

Dennis Scinnel ***Ruth Ed Captial***

Gotcha. Yep.

Steven Zelnack, Jr. ***Martin Marietta Materials, Inc. - Chairman, President, Chief Executive Officer***

In January, when we do the call again we will try to give you some specifics.

Dennis Scinnel ***Ruth Ed Captial***

Yep, great. And one final one, maybe an update on how the ERP system is working and all of that kind of good stuff?

Steven Zelnack, Jr. ***Martin Marietta Materials, Inc. - Chairman, President, Chief Executive Officer***

Well, I'll brag a little bit on that one because we've got some people I think have done an incredible job.

We have one of the few ERP projects that's essentially on time, on budget. And it's been managed well, I think, by the folks that have done that.

There's been extensive senior management involvement, there's been extensive involvement at the operating divisions and at this point, we -- we're pretty well along, we will be doing the tail end of the project next year and possibly a little bit into '04, but the bulk of the expenditure has been made in what we're doing right now is making sure we can get report mechanisms that pull out data in all kinds of different ways that help us with management analysis, really makes it a tool -- much more of a tool. We're focused on outputs now.

Dennis Scinnel ***Ruth Ed Captial***

So, it's up and running now?

Steven Zelnack, Jr. ***Martin Marietta Materials, Inc. - Chairman, President, Chief Executive Officer***

Yes.

Janice Henry ***Martin Marietta Materials, Inc. - Senior Vice President, Chief Financial Officer***

Oh, yes!

Dennis Scinnel ***Ruth Ed Captial***

Terrific, that's it! Thanks.

Operator

At this time, we have no further questions standing by in our question roster. I'd like to turn the conference back to our speaker for additional or closing comments.

Steven Zelnack, Jr. ***Martin Marietta Materials, Inc. - Chairman, President, Chief Executive Officer***

Okay. Thank you for joining us. We will report back to you in January.

Operator

Thank you for your participation on today's conference call. You may disconnect at this time.

THOMSON REUTERS

PLACEHOLDER TRANSCRIPT

Q4 2002 Martin Marietta Materials Earnings Conference Call

EVENT DATE/TIME: JANUARY 30, 2003 / 7:00PM GMT

CORPORATE PARTICIPANTS

Stephen P. Zelnack Jr. *Martin Marietta Materials - Chairman and President and CEO*
Janice Henry *Martin Marietta Materials - Senior Vice President and Chief Financial Officer and Treasurer*

CONFERENCE CALL PARTICIPANTS

John H. Reilly III *CJS Securities - Analyst*
Jack L. Kelly *Goldman Sachs and Company - Analyst*
David D. Weaver *Legg Mason Wood and Walker - Analyst*
Armando Lopez *Morgan Stanley - Analyst*
John Fox *Fenomore - Analyst*
Barry Hanes *Sage Asset Management - Analyst*
Stephen S. Kim *Salomon Smith Barney - Analyst*
Keith Hanson *Ohio State Teachers Retirement System - Analyst*

Transcript

Operator

Please stand by. We're about to begin. Good day everyone and welcome to this Martin Marietta Materials' conference call. Today's conference is being recorded. At this time for opening remarks and introductions, I would like to turn the call over to the president and Chief Executive Officer, Mr. Stephen P. Zelnack. Go ahead sir.

Stephen P. Zelnack Jr. ***Martin Marietta Materials - Chairman and President and CEO***

Thank you for being with us this afternoon. I have with me, Janice Henry, Chief Financial Officer, Ann Lloyd, of our Controller and Chief Accounting Officer and Roselyn Bar, General Counsel . The fourth quarter was significantly affected with bad weather particularly in the Southeast and Southwest. Aggregate shipments in our Southeastern states including North Carolina were down about 16% while shipments from in the Southwest declined 12% from the prior year period. Although the economy remains soft with commercial construction at low levels, the decline in shipments was more affected by weather during the quarter.

For the quarter, sales of $353m dollars were 8% below the prior year period. While operating earnings were $29m as compared to $51m in the prior year. Earnings per share for the quarter were $.33 per diluted share, versus $.52 in the prior year period.

For the full year 2002, net sales of $1.5b was down about .5%. Earnings from operations was $175m as compared to the prior year of $197m. Other income was about $6m higher than prior year, due primarily to the divestiture of plants in the Columbus, Ohio and Fredericksburg, Virginia areas in the second quarter.

The company recorded a charge of $11.5m related to the impairment of goodwill at our road paving operations in connection with the adoption of FAS 142 concerning goodwill and other intangible assets. Net sales for the aggregate segment for the fourth quarter was $335m, down 8% from the prior year period. Our Heritage aggregates operations experienced a 10% decline in shipments and an 11% decline in production. As noted earlier, the Southeast and Southwest have significantly higher reductions based on poor weather conditions.

On a positive note, in our central division, which is predominantly our water transport quarries, we recorded a shipments increase of 4% as we continue to broaden our markets and distribution opportunities from our offshore operations in the Bahamas and Nova Scotia at our river quarries. Pricing for the quarter was up 4% compared to the prior period favorably influenced by product mix. Inclusive of acquisitions and divestitures, shipment volume declined 12%.

The low production rate for the quarter caused an absorption of fixed cost. In addition to the weather issues demand continued to be soft based on further decline in commercial construction along with the uncertainty associated with the federal transportation program. Congress is still not passed a budget for fiscal year 2003. However, the positive news is that it appears that both Houses and the administration are prepared to move ahead, in passing a transportation bill at the $31.8b level. If passed at this level, this should be a positive beginning in the second half of 2003. For the full year 2002, net sales the aggregates segments were $1.423b which is 1% above the prior year all due to acquisitions. Earnings from operations is $170m as compared to $194m in the prior year.

During the year, we completed six acquisitions, with a two most significant being the four U.S. Aggregates Plants south of Birmingham, Alabama and the Lucstone(ph) Quarry near Burlington, North Carolina. Performance at these locations exceeded our expectations during 2002. During the fourth quarter, we brought on line a major new plant facility near Hot Springs, Arkansas. When we purchased this location in 1998, shipments were about 1.2m tons annually. Over the past two years, we have more than doubled shipments by expanding the rail business in Texas and Louisiana. In order to meet the increased demand we have been operating with a small permanent plant supplemented by two small portable plants. The new plant will eliminate all three of the other plants and provide a major reduction in production cost. In addition, we are consolidating the rail serve business from a recently closed high-cost quarry near Little Rock. Expected result is well over 3m tons of annual shipments with significant cost reduction and profit improvement. This is a good example of the types of projects that we have been working on.

Our Magnesia Specialties business reported fourth quarter sales of $18m which is a 10% decline from the prior year period. Operating earnings for the quarter was $600,000 versus $1.6m. For the full year, sales of $74m decreased 25% primarily due to sales of certain refractory assets in 2001. Operating earnings were $4.8m an increase of $1.6m over prior year. During the quarter, we completed a long term agreement with Dow Chemical whereby they will purchase the waste brine from our Manistein(ph), Michigan for use as feed stock in making calcium chloride products at their Letting, Michigan plant. This will be a positive to income beginning in 2003, with full impact in 2004. Based on a number of factors, we expect in 2003, a ramp-up in our shipments of our Flow-Mag product and our CellGuard product for use in paper production.

During the quarter we made some significant strides with our new structural composites business. We secured a 185,000 square foot factory location in Sparta, North Carolina which will be use used for assembly of composite products. Also, we signed a licensing agreement, relating to proprietary composite sandwich technology, which will be used in a variety of flat-panel applications. The Sparta facility will be used for assembly of our composite bridge decks and for assembly of our all composites truck-trailer, called composite trailer. We are also quoting a variety of composite products into the rail car industry and other transportation and construction applications. 2003 will be a ramp-up year with 2004 being our first full year of business. Our objective beginning in 2004 is to grow this business to $300m to $500m in revenue with a 15% EBIT margin over the next five to seven year period. We believe this business offers positive opportunity based on the potential for a high organic growth rate, low capital intensity and a non-cyclical revenue and profit source based on diverse product lines and the opportunities for substitution for existing structural materials.

During 2002, we focused on paying down debt. We reduced our debt by $67m, and reduced our debt to capitalization ratio from 44% down to 41%. After adjusting for funds in escrow for tax free exchanges, and the impact of interest rates swaps on the debt calculation, the true ratio is 40%. We expect to continue debt reduction in 2003.

The outlook for 2003 remains uncertain. The final appropriation level in the federal transportation bill, the situation with Iraq, including its impact on energy prices, and the general economy being major variables. We expect aggregates volume to be flat with pricing up about 2%. Given current knowledge, we expect our earnings in 2003 to range between $1.95 a share to $2.25 per share. With the possibility of war and its impact potential on consumer confidence and energy prices, our view is that there is likely more down side risk than upside opportunity in 2003.

At this time I'd be pleased to take any questions you may have.

QUESTIONS AND ANSWERS

Operator

Thank you sir. Today's question and answer session will be conducted electronically. To ask a question press star followed by the digit one. If you are listening on a speakerphone, you may want to disengage the mute to allow your signal to reach our equipment.

First question with John Reilly with CJS Securities. Go ahead.

John H. Reilly III ***CJS Securities - Analyst***

Good afternoon. Regarding your plant in the Bahamas, what can you say about volume and profitability in the quarter and are there any additional steps needed to get the plant to full production?

Stephen P. Zelnack Jr. ***Martin Marietta Materials - Chairman and President and CEO***

Volume and profitability in the quarter were certainly an improvement over where we've been. The volume side of the equation is coming along very well. In fact, we had announced in the third quarter that we had picked up significant new business for that facility. And the objective is to continue to grow that, and I think we're in a position to do it. So I'm less concerned about volume. The production cost side of it, we're still not totally there. We've got -- still have some issues related to deposit problems, trying to make sure that we're mining in the most cost effective way. But the cost structure is much improved. And we're on a course to get, you know, get to where we set out to be. So we're still not there but much improved over where we've been.

John H. Reilly III ***CJS Securities - Analyst***

Okay. Next question focusing on your capital expenditure budgets. What was Capex in the quarter and given your outlook for demand in 2003, where can we expect Capex in 2003?

Stephen P. Zelnack Jr. ***Martin Marietta Materials - Chairman and President and CEO***

Okay. Janice will pull up, you got the quarterly number? $43m in the quarter. And that was more than we had anticipated. What's happening is that unlike the last couple of years, where all the projects we're doing lag and drag, because of lack of personnel available or a company's busy, nobody's busy out there right now so we had the opportunity to move projects much quicker, got a lot of attention, and we completed some projects at a faster clip than we expected, therefore, the higher capital expenditure level than we anticipated. As we go into 2003, it's a year where we're looking at expenditure in the DD&A level, somewhere in the $135m to $140m range as we're looking at in our capital plan. And depending what conditions are as we go forward, we're going to play it pretty cautiously. That could be pulled in, you know, if the environment were to get a little worse than we think. We're not going to start off the year by expending all the capital plan.

John H. Reilly III ***CJS Securities - Analyst***

Thank you.

Stephen P. Zelnack Jr. ***Martin Marietta Materials - Chairman and President and CEO***

Sure.

Operator

Next question comes from Jack L. Kelly with Goldman Sachs. Please go ahead.

Jack L. Kelly ***Goldman Sachs and Company - Analyst***

Good afternoon.

Stephen P. Zelnack Jr. ***Martin Marietta Materials - Chairman and President and CEO***

Hi, Jack.

Jack L. Kelly ***Goldman Sachs and Company - Analyst***

Two questions, one on the Heritage volume outlook for '03, the flat number. Can you give us an idea, you know, how maybe the T-21 number affects that? I know it's tough to figure out where all the stone goes, but you know, let's assume 40% or 50% kind of go into roads, half of that is state, half of that is T-21, how you are figuring out the end market that end up with a flat number for the year and secondly, just on the composite business in terms of what you might be investing there over the next two years or so to kind of generate that $300m to $500m, you know, out three or four years.

Jack L. Kelly ***Goldman Sachs and Company - Analyst***

Okay, good questions. If you take the highway segment in total, it's about 40% of our business. And roughly half, it's a little bit more than half at the state level, little bit less than half from federal moneys. Our expectation is that we are going to see an increase. We know we're going to see an increase or confident we're going to see an increase in '03. The question is how much of an increase. And that's going to be determined by the Omnibus Conference Bill that they're in the midst of right now. They just did as I understand another continuing resolution. That takes it out to February the 7th. We are told that we should expect another continuing resolution beyond that. You probably are looking at the middle of February before the omnibus bill is put together, and ready to go forward to the President. And that's probably most optimistic timetable. So we'll know a little bit more, you know, when they finish that up we'll know a lot more. We're looking for a positive there. We would expect that the commercial construction side is not going to drift down much more. It probably drifts down, drifts down a little bit more in the first half, hopefully by the second half we see a trough, a clear trough, and perhaps just a little bit of pickup. And the residential side looks like, you know, it's fairly flat, at a good level. You know, some possibility of a slight decline there. But that's how we're getting there coupled with the fact that based on projects undertaken and positions expanded we are in fact picking up additional market opportunities.

Jack L. Kelly ***Goldman Sachs and Company - Analyst***

Steve, on the 40% that is kind of related to roads, half of that is touched by T-21 so that should be up. What about the 20% touched by the states and localities, that would seem like that would have to be down.

Stephen P. Zelnack Jr. ***Martin Marietta Materials - Chairman and President and CEO***

I think the federal part of it is going to be a much prettier picture than the stateside of it. There are some states that are in deep, deep trouble. Actually I read a state by state synopsis yesterday, and probably the two that stuck out the most are Virginia, which according to the numbers I saw, you know, they're looking at a $6b deficit. They're the only state that did not take advantage of federal allocation under T-21 in this recent year, this past fiscal year. They left some money on the table. And they actually stopped construction projects underway, which is rare. So they have a deep problem based on the magnitude of the deficit in California, certainly appears that that problem is pretty severe. Those are the two that kind of pop out. But virtually every state's dealing with it. You know, the states that we are in, I would expect to see a slight negative, Jack. But the positive for us is that the work in the areas, the big areas that we're in, in key states, looks pretty good.

So you know, a lot of times it comes back to specific metro location, where you have your plants, and you know, overall I think we're positioned pretty well for the coming year. On -- does that answer that question?

Jack L. Kelly ***Goldman Sachs and Company - Analyst***

Yeah, fine, thanks.

Stephen P. Zelnack Jr. ***Martin Marietta Materials - Chairman and President and CEO***

Okay. On composites, you know kind of an interesting opportunity. We've talked about it a little bit in the past but two things have happened that trigger more disclosure and you know, we'll put it on your screen and we'll be talking about it more as we go forward.

First of all, we did take down the factory location in the fourth quarter and we put out a public release on that so we physically made that move. Secondly, we did acquire the additional proprietary technology in the fourth quarter, and frankly, that's something we've been waiting on because panel technology to go with our bridge deck support technology is a very important component of what we're working with.

The capital intensity of composites is very low. And we structured it that way particularly in the early years. As you might imagine in looking for a factory site, your choices are many, and your pursuers are few. We actually had 84 buildings to look at on the first cut in western North Carolina and by the time we got through, we wound up with a lease arrangement on that building which is extremely attractive with an option to buy. So it will be several years out before we actually make the capital component of the investment. We will be setting-up equipment in the facility for assembly lines. When you look at that, in working capital in the first couple of years, say, after 2004, it's tough to see us having, you know, more than $10m or so invested in that business at that point. The growth in investment as we go forward is, you know, as we see it at this point is going to be, you know, purely incremental related to particular product lines and supporting the working capital necessary to finance the business. This is not a capital intensive business which is one of the very appealing parts of it. We're going to be doing limited. manufacturing which means we don't have big, complex production lines with high investment. It's predominantly assembly, with the rope manufacturing done by other companies that we have relationships with. So we'll be buying shapes, components, on most of the structural part of it. And then we'll be manufacturing the panel side of it at our Sparta location. So hopefully that gives you an idea.

Jack L. Kelly ***Goldman Sachs and Company - Analyst***

Thanks.

Stephen P. Zelnack Jr. ***Martin Marietta Materials - Chairman and President and CEO***

Sure.

Operator

We'll go to David D. Weaver at Legg Mason.

David D. Weaver ***Legg Mason Wood and Walker - Analyst***

Will you give us an idea of the pricing on volume and market?

Stephen P. Zelnack Jr. ***Martin Marietta Materials - Chairman and President and CEO***

I'll give you the volume. Virginia/Maryland area down about 6%. North Carolina down 17%. And I can assure you that wasn't driven by the soft economy, a small portion. That was weather. Southeast, the rest of the Southeast down 15.5%, same issue. In this part of the country, we just skipped fall, went straight from summer to winter. In the southwest which we got off to a very good start in the southwest the first half of the year, they got hammered, same issue in the fourth quarter. Volume's down 12%. Mid-America area, Indiana, Ohio, down 6%. Midwest with Iowa being the key state, surrounding states, down 8%, and central, the water born area which is coastal southeast coast, Gulf Coast predominantly and the river markets, up 4%.

David D. Weaver ***Legg Mason Wood and Walker - Analyst***

Okay. Could you give us a little color on the Texas market? I know that's probably your largest market but as you go sort of region by region there what you were seeing?

Stephen P. Zelnack Jr. ***Martin Marietta Materials - Chairman and President and CEO***

Sure. The two strong areas in Texas have been, and we think will continue to be, the south Texas NAFTA corridor down in the Corpus Christi, Brownsville, Laredo area. We had a very good year this past year and we expect we're going to see further improvement and positive demand in that area, driven truly by NAFTA. San Antonio market looks positive and we're on course, we started out with a very, very good year there and again we got hammered by the weather conditions which I hate to talk about but it's just a fact. And as we look at '03 in San Antonio, we think we're going to have a good year there. Houston market is a little more problematic. We think it's going to be an okay year there, okay meaning that it's going to be somewhat similar to '02, could be up a little, could be down a little.

And then the big question mark is Dallas, Fort Worth and our Oklahoma locations which are smaller areas. Dallas, Fort Worth, there is some significant transportation work in Dallas, Fort Worth in '03. That will be the primary plus in the market. The commercial market will probably drop a little bit more. That's a very, very soft commercial market. So all in all, I would expect that that area probably hits the trough this year. And hopefully, begins to rebuild with transportation offsetting the building construction side. Does that help?

David D. Weaver ***Legg Mason Wood and Walker - Analyst***

Yes, that helps. One final question. Could you talk about any potential pension fund contributions that you might have to make this year?

Stephen P. Zelnack Jr. ***Martin Marietta Materials - Chairman and President and CEO***

Sure. I'll ask Janice to do that.

Janice Henry ***Martin Marietta Materials - Senior Vice President and Chief Financial Officer and Treasurer***

Dave, we would expect to see some pension fund contribution this year. The exact extent of that is still being worked. As I look at the numbers right now, we think it would be fairly insignificant to our cash flow, probably in the neighborhood of $15m.

David D. Weaver ***Legg Mason Wood and Walker - Analyst***

Okay. Thank you.

Stephen P. Zelnack Jr. ***Martin Marietta Materials - Chairman and President and CEO***

Sure.

Operator

We have a question from Armando Lopez with Morgan Stanley. Go ahead please.

Armando Lopez ***Morgan Stanley - Analyst***

Good afternoon everyone.

Stephen P. Zelnack Jr. ***Martin Marietta Materials - Chairman and President and CEO***

Hi.

Armando Lopez ***Morgan Stanley - Analyst***

Couple of questions. I was wondering if you could talk a little bit about the tax rate in the quarter. It came in much lower than we had expected. What's driving that?

Stephen P. Zelnack Jr. ***Martin Marietta Materials - Chairman and President and CEO***

I'll give you a quick answer and Janice can give you the explanation. You can get a lesson in depletion allowance which is one of the most important things in our industry and she'll tell you about the difference between tax deductible and non-tax deductible goodwill.

Janice Henry ***Martin Marietta Materials - Senior Vice President and Chief Financial Officer and Treasurer***

I'm going to try to do that anyway.

Armando, the tax for the year is an estimate. We begin the year with our estimate of what our earnings are going to be and do an estimate on taxes based on those earnings. Throughout the year, we will change our tax rate as facts and circumstances change. Now, as it turns out, 2002 was a fairly unusual year for us from a tax perspective. In the second quarter, we had the sale of a number of assets, primarily the Columbus location. Associated with the Columbus locations, we wrote off fairly significant amount of goodwill. That goodwill was not tax deductible. Obviously, that wasn't something that we had forecasted originally, so when the sale occurred in the second quarter, we adjusted our tax rate to allow for this non-deductibility of goodwill which in fact increased our tax.

In the third quarter, third quarter is the time of the year where we actually complete our taxes, our tax packages, and submit it to the IRS for the prior year. So in the third quarter we take a look at what we actually pay to the IRS compared to what we thought we were going to pay to the IRS when we did our final year estimate and we basically recorded the difference between the estimate and the actual. When we did that in the third quarter, our statutory depletion deduction was higher than we had estimated and as our practice, we take any difference between the estimate and the actual through the rate. We did that in the third quarter.

In the fourth quarter, coming to the fourth quarter, fourth quarter is when we make our final estimate. And again, it is still an estimate until we actually pay the taxes next year. We've made our final estimate for the fourth quarter. Earnings were actually below our expectations. But when we looked at our statutory depletion deduction, we found that the depletion deduction that we had anticipated was really close to being right about on where our current estimate is. And that's really because, while we did reduce earnings, that earnings reduction was not in areas that affected our depletion deduction. So we were able to get the depletion deduction in spite of the fact that earnings went down. Those two counterbalanced one another causing the rate to go down below where we had estimated in the third quarter.

Armando Lopez ***Morgan Stanley - Analyst***

Okay. So essentially, when you calculate depletion deduction, I mean the state -- the earnings overall came in lower than expected. But the, let's say the activity in those states where you were forecasting a depletion deduction was about in line?

Janice Henry ***Martin Marietta Materials - Senior Vice President and Chief Financial Officer and Treasurer***

That's correct. That's right.

Stephen P. Zelnack Jr. ***Martin Marietta Materials - Chairman and President and CEO***

And another way to look at the whole equation is that if we'd had anything like reasonable shipping conditions of the Southeast and Southwest we would have been well above what we're talking about now. You know, up at the top of the range, maybe even beyond the top of the range.

Armando Lopez ***Morgan Stanley - Analyst***

Okay. Okay. And then second question, on the -- I guess there was about $20m in one-time gains this year. So I'm just wanting to get some more clarity on the guidance going forward. I mean, if you look at, you know, the results for this year, you generated about $144m in pretax income. If you back out the $20m one-time gain you get to $124m. And then if you assume say 2% pricing that gives you an incremental $25m which, you know, say that's offset of some higher costs of 1%, so that gives you like an incremental $11m in cost, which brings you down to about $138m in pretax income. So I guess my question is, you still need to make up $6m somewhere and then to get to the high end of the range you would even need to make up more than that. Where would that come from?

Stephen P. Zelnack Jr. ***Martin Marietta Materials - Chairman and President and CEO***

Okay, let me give it to you in a couple of pieces. You know, first of all, we got hit -- the timing of divestitures in '02 hurt our earnings, because we sold the Columbus quarries after accumulating the winter losses but before accumulating the earnings during the year. We sold them about the worst time so that goes away. We don't have the Columbus losses we ate. We don't have the startup costs associated with the Bahamas. In addition to that, we have closed 12 facilities during the year and you kind of zero all that out and baseline, there's about $10m there very quickly.

Armando Lopez ***Morgan Stanley - Analyst***

Okay.

Armando Lopez ***Morgan Stanley - Analyst***

Actually more than $10m. And then, we began to take the improvement projects that we have, and began to take a look at what the yield is. I cited one of them, the Jones Mill project, I didn't site that just because I wanted to pick a plant. I cited it because I think it's going to make a important contribution to earnings in '03. It has been a high-cost plant, high cost three plants, that we're now consolidated one highly efficient plant. It's going to be driven by cost reduction in many different ways. Some of which, good portion of which has already been accomplish. So we'll get the benefit of having that run through our income statement in '03. So that's where we're coming from.

Armando Lopez ***Morgan Stanley - Analyst***

Okay. As you consolidated that plant, like where do -- like how shall we think about that? Where do most of the cost savings come from in that scenario? I mean --

Stephen P. Zelnack Jr. ***Martin Marietta Materials - Chairman and President and CEO***

Well, I can give it to you in -- let me think about it. You run three small plants, first of all your headcount, personnel cost is exorbitant. The personnel cost is roughly double what we would have in an efficient plant. So you're going to take that down to a very efficient personnel cost so that's a starting point. You're also expending the energy cost, supply cost, energy in feeding and hauling from three plants. You're expending the energy costs associated with operating three plants. If the plant itself with power consumption, the supply cost in terms of supply and repair costs associated with three plants, two of which are very old plants, it was extremely high.

Armando Lopez ***Morgan Stanley - Analyst***

Okay.

Stephen P. Zelnack Jr. ***Martin Marietta Materials - Chairman and President and CEO***

So you take those out, and what we put in is a very well-designed, highly efficient modular plant that has more capacity than the three plants combined. That's why you get in front of it. So you have a significant variable cost reduction. When I say significant, I mean very significant. And then, on the fixed cost side, what you're going to do is you're going to run more tons through that than you were running through the three plants. We expect the tonnage is going to be up 20%, 25% versus what we're running the three plants. So that's where it comes from.

Armando Lopez ***Morgan Stanley - Analyst***

Great. One last one, in terms of your forecast, what are you guys expecting for like diesel cost and natural gas prices?

Stephen P. Zelnack Jr. ***Martin Marietta Materials - Chairman and President and CEO***

I don't know. Maybe you could tell us. It's a confounding equation. I can tell you that in '02, we were very positive obviously in the first half of the year as diesel went down. And the second half of the year we were negative and in the fourth quarter we had roughly in terms of total energy cost, natural gas, adjustments on the water for fuel escalators, you know, diesel and such, we were about $2.5m negative. As we go into the first half of '03, we're going to have a negative compare, because diesel is up in the $.90 range now. Last year in the first quarter it was in the $.60s. So we'll have a negative compare there. The offset to that is we're also -- we're dropping out some places that we are consuming a disproportionate amount of diesel. We have renewed a lot of mobile equipment where the consumption is less and that's a positive. But we do expecting to be negative in the first two quarters. From the middle of the year on to the back two quarters we'll compare against higher diesel prices, and you tell me what's happening in Iraq and the Middle East, certainly you can make a positive case that if things go well, we're not sitting here coping with $33, $34 a barrel oil prices. It is not just the Middle East right now. Venezuela is a real problem based on its leading supply position to the U.S. but not just in terms of the diesel gasoline side of the equation. Venezuela is the measured supplier of liquid asphalt to the U.S. through CITGO. And particularly to the eastern sector of the country. And I just listen to one of the major energy company CEOs comment on that. We were on the platform of a convention together. And he said 30 to 45 days, and it's a real problem on the supply side. So hopefully, Venezuela is going to get solved, and you know, Iraq gets solved quickly but you know, who knows.

Armando Lopez ***Morgan Stanley - Analyst***

Okay, all right, well, thanks a lot.

Stephen P. Zelnack Jr. ***Martin Marietta Materials - Chairman and President and CEO***

Sure.

Operator

Next question, John Fox with Fenomore(ph). Please go ahead.

John Fox ***Fenomore - Analyst***

Hi everyone. Most of my questions have been answered but I have two left. Why not tax rate for '03?

Janice Henry ***Martin Marietta Materials - Senior Vice President and Chief Financial Officer and Treasurer***

Based on the current estimates of earnings for next year, I'd expect it to be right about where it wound up this year. Should not be a significant differential.

John Fox ***Fenomore - Analyst***

For the full year, huh?

Janice Henry ***Martin Marietta Materials - Senior Vice President and Chief Financial Officer and Treasurer***

Yes.

John Fox ***Fenomore - Analyst***

And on the debt reduction, I assume that the only debt to repay is the commercial paper, is that -- do you have any other debt you can repay or --

Janice Henry ***Martin Marietta Materials - Senior Vice President and Chief Financial Officer and Treasurer***

Nothing significant, John. There are some other small pieces, but the commercial paper is the major piece.

John Fox ***Fenomore - Analyst***

What would that outstanding balance be at this point?

Janice Henry ***Martin Marietta Materials - Senior Vice President and Chief Financial Officer and Treasurer***

It was about $35m the end of the year.

Stephen P. Zelnack Jr. ***Martin Marietta Materials - Chairman and President and CEO***

The objective is to get that paid down and have a little positive cash so we reduce net debt below our $700m term debt number and bring the debt to cap down into toward mid 30s.

John Fox ***Fenomore - Analyst***

Net debt below $700m?

Stephen P. Zelnack Jr. ***Martin Marietta Materials - Chairman and President and CEO***

That's the objective.

John Fox ***Fenomore - Analyst***

The objective. Okay. Is there any buy-back in that equation also?

Stephen P. Zelnack Jr. ***Martin Marietta Materials - Chairman and President and CEO***

No.

John Fox ***Fenomore - Analyst***

Okay. Thank you.

Stephen P. Zelnack Jr. ***Martin Marietta Materials - Chairman and President and CEO***

Uh-huh.

Operator

We'll take our next question from Barry Hanes with Sage Asset Management. Go ahead.

Barry Hanes ***Sage Asset Management - Analyst***

Good afternoon. Had a question just trying to understand the quarters a little bit. The midpoint of your new range is I guess $2.10 which is not that different from what '02 was. But as we think of the progression on the quarters, is the first half likely to be meaningfully weaker than first half '02 and you make it back second half or is there weather makeup in the first quarter that will help out? How should we look at the quarterly progression? Thanks.

Stephen P. Zelnack Jr. ***Martin Marietta Materials - Chairman and President and CEO***

I'll give you qualitative comments on that and that's about the best I can do at this point. We had a miserable first quarter last year. And that was powered, we had Bahamas startup losses which were significant. We had Meridian repair cost, it was the first winter shut-down period we had with Meridian. And we will not have those kinds of things coming at us this year. So if we have something called normal, and I'm beginning to wonder if I even know what it is in terms of seasonal patterns, certainly an expectation that we will have a positive first quarter compared to last year. When you get to the second quarter, we had a report second quarter. We just knocked the socks off.

We had good weather, seasonal pattern was very nice, volume was relatively good, costs, we ran our business the way we'd like to run it. We also in the second quarter had significant gain on sale from the divestitures, that will not be repeating. And I would say to you that it will be tough to match up to the operating performance that we had last year, given the environment we're in. You know, volume is going to be tough to come by. So that would be those two quarters. One probably positive, the other probably negative.

You get to the back half of the year, and if we have passage of the federal transportation bill at 31.8 and we get that done pretty quickly, it's likely going to free up some money, you're going to have more workout there, give the states' confidence that they've got their federal component, and I see that as probably getting us just a little bit more stimulus in the back half. And if you look at the relative comparisons, you have third quarter was not a really bad quarter. It was okay. Hopefully, we have -- we match up or maybe have a little positive. Fourth quarter was a miserable quarter, back to, you know, the weather pattern coupled with bad economy. I hope we have positive compare there so that's qualitative in terms of float.

Barry Hanes *Sage Asset Management - Analyst*

Thanks very much. That helps. Appreciate it.

Stephen P. Zelnack Jr. *Martin Marietta Materials - Chairman and President and CEO*

Sure.

Operator

We will now go to Stephen Kim with Salomon Smith Barney. Go ahead.

Stephen S. Kim *Salomon Smith Barney - Analyst*

Most of my questions have been asked but I have a few left. Specifically, following on a previous question, share repurchase, you indicated that really wasn't in the mix. Can you give us an idea, is there a price at which point you would find the balance leaning more towards share repurchase instead of debt pay down and how you think about that?

Stephen P. Zelnack Jr. *Martin Marietta Materials - Chairman and President and CEO*

The way we think about it is from our standpoint, we certainly think our stock is cheap. I mean, I'll say that very pointedly. I can also tell you that the management group believes that because we've committed close to $1m for share purchase within the officer group. And you'll see some Form 4s showing up including a pretty significant portion for me. With respect to the company itself, you know, we have said to the people who have loaned us money that we're going to make sure that we are a worthy company to make loans to. Because in the future, we may want to borrow some more money, if the appropriate opportunity comes up. So we're going to stick to the knitting on that. We're going to pay the debt down to get back in the debt cap ratio and other ratios that credit agencies look at and make sure we are where we ought to be, need to be. And then at that point we're in a position to consider and certainly will consider what we do with that free cash flow to the benefit of our shareholders.

Stephen S. Kim *Salomon Smith Barney - Analyst*

Okay. Those share purchases internally occurred in this past quarter, you said the $1m?

Stephen P. Zelnack Jr. *Martin Marietta Materials - Chairman and President and CEO*

You're talking about this month and if you haven't you'll see some Form 4s.

Stephen S. Kim *Salomon Smith Barney - Analyst*

Got it. With respect to the acquisition pipeline, can you give us an indication as to whether you're still seeing or basically the trends you are seeing in the acquisition pipeline?

Stephen P. Zelnack Jr. *Martin Marietta Materials - Chairman and President and CEO*

We don't see a lot that is attractive. Probably the lowest level of things we have an interest in, we've seen in the last six, seven years, we do have some active deals that we're working on. We always do. We also have some active divestitures that we're working on. And I've said before we've got a few more things that we want to divest of. Example, we have a couple of plants up in Columbus that we did not sell to Old Castle. We've indicated publicly that we're going to divest those so you should expect that. We've got a couple of other pieces that we'll probably deal with that way. Not big dollars, you know, not nearly as much as we did in '02. And at that point you know, we'll be pretty much baseline. So we'll continue to look at acquisitions, we'll continue to sort out things that we don't want to go forward with for the long term. And I would expect to have all that divestiture done that we've got on the screen right now, by the end of '02. That's the target, that's what we want to accomplish.

Stephen S. Kim ***Salomon Smith Barney - Analyst***

By the end of '03, you mean?

Stephen P. Zelnack Jr. ***Martin Marietta Materials - Chairman and President and CEO***

'03, yeah.

Stephen S. Kim ***Salomon Smith Barney - Analyst***

Third question, with respect to the clarity for federal funding, were you referring to the reauthorization bill or were you referring to the end of just the continued -- the continuations that we have been seeing here month to month? Because the reauthorizations look like it could, you might not get clarity on that until really pretty close to the end of the year. Just wanted to sort of get clarity on that.

Stephen P. Zelnack Jr. ***Martin Marietta Materials - Chairman and President and CEO***

Yeah, reauthorization is -- the current T-21 expires September 30, 2003. And then we will have a follow-on. History says that Congress will not pass that prior to September 30. It typically goes over into the first quarter of the following year. So I would expect, you know, Q1 ‘04, we've got a new bill. In the meantime, we still don't have a budget for the year that began October 1, '02. And that is what I was commented in the short term the $31.8b.

Stephen S. Kim ***Salomon Smith Barney - Analyst***

That's what I was addressing, are we really going to get clarity such that people are going to feel comfortable allocating you know planning for future expenditures until the reauthorization is actually passed, you know, whenever that occurs?

Stephen P. Zelnack Jr. ***Martin Marietta Materials - Chairman and President and CEO***

I really don't think that there's going to be any clarity, Steve. There are so many different views of it, what is likely to happen is that the administration is going to toss a number out there. They'll submit their budget here in February. And I would expect that they will toss a very low number out for transportation, just like they did for '03. Remember, they tossed out a $23b number as opposed to $27.7b that they eventually went to and $31.8b that the Senate is at and we think the consensus will be. So you'll see the President toss out something, I would tell you that our view and the view of Congress based on the people we've talked to, that that will be dead on arrival. And then they will begin to debate what the true amount is going to be. And that's going to be complicated based on looking at revenue sources. It is not that the needs aren't there. The question is, you know, where do you get the revenue to support a program you want to put in place.

Stephen S. Kim ***Salomon Smith Barney - Analyst***

I mean you're going to need to pass a gas tax, it sounds like.

Stephen P. Zelnack Jr. ***Martin Marietta Materials - Chairman and President and CEO***

You're going to need revenue enhancement of different types. Lot of ideas as to how to do that, including some bonding. I don't know where that will go but certainly it's up on the screen.

Stephen S. Kim ***Salomon Smith Barney - Analyst***

Okay. And I had one last housekeeping question. Janice, could you give us the actual Heritage volume, Heritage shipments in the quarter?

Janice Henry ***Martin Marietta Materials - Senior Vice President and Chief Financial Officer and Treasurer***

Similar --

Stephen S. Kim ***Salomon Smith Barney - Analyst***

I know they were down 10% but do you have the actual number?

Janice Henry ***Martin Marietta Materials - Senior Vice President and Chief Financial Officer and Treasurer***

35,864.

Stephen S. Kim ***Salomon Smith Barney - Analyst***

Great thanks very much.

Operator

Star, one for questions.

And we will now go to Keith Hanson, Ohio State Teachers Retirement System.

Keith Hanson ***Ohio State Teachers Retirement System - Analyst***

Good afternoon. I have a quick question on barge traffic. Do you think your business will be impacted by low water levels anywhere?

Stephen P. Zelnack Jr. ***Martin Marietta Materials - Chairman and President and CEO***

It would be a rare year where it wasn't, either by low or high water. That's the nature of the barge business. We see it both ways.

Keith Hanson ***Ohio State Teachers Retirement System - Analyst***

Okay.

Stephen P. Zelnack Jr. ***Martin Marietta Materials - Chairman and President and CEO***

One of the things you have to do, if you're going to be in the barging business, is that you've got to have a very good distribution network with space to hold inventory. Because as you're alluding to the ability to move barges can be problematic based on weather. So one of our strengths is that we do in fact have a well established, well located distribution yard network. So we'll keep some inventory on those yards. It would be rare that we would miss any sales. It would also be rare that we didn't have some barges stacked up at some point of year because of low water or high water.

Keith Hanson ***Ohio State Teachers Retirement System - Analyst***

Okay great, thank you.

Operator

There are no further questions in the queue so I'll turn the call back over to the speakers for additional or closing remarks.

Stephen P. Zelnack Jr. ***Martin Marietta Materials - Chairman and President and CEO***

At this point, I'd like to thank you for joining in obviously a very difficult scenario to forecast. We've tried to give you as much information as we possibly can and hopefully it's been helpful to you, and we'll talk to you again at the end of the first quarter. Thank you.

Operator

Thank you again. That does conclude today's conference call. We appreciate your participation and you may now disconnect.