NRMCA Concrete Design Center: How to Get the Conversation Started

Frank Gordon, NRMCA Senior Director Building Innovations

Thursday, June 18th at 1:30 p.m.
Thompson Research Group

TN Concrete Association

Non-res & Infrastructure: Managing A Post COVID Environment

June 11, 2020

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Overview

- Commercial Construction End Market
  - Early Expectations (Pre-COVID-19): Construction was robust with strong current activity, huge backlogs, and significant pipelines of work bid on.

- Public Construction End Market
  - Early Expectations (Pre-COVID-19): Construction was strong and steady as infrastructure and public projects through DOT lettings provided the biggest momentum into 2020.

- Wrapping it all up
Commercial End Market
Assessing the Landscape
Non-res PIP Growth Slows from COVID-19

About Non-res PIP: Data represents a seasonally adjusted annual rate of construction put-in-place expressed in nominal dollars.

Recent Results:
- Most recent results in April +0.9% YOY.
- Sectors with the highest growth rates (% basis) in April include public safety, power, and water supply.
- Sectors with the largest rates of decline (% basis) in April include lodging, amusement & recreation, and religious.

Non-res PIP By Sector

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<tbody>
<tr>
<td>Total Non Res</td>
<td>3.9%</td>
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<td>Lodging</td>
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<tr>
<td>Office</td>
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<td>Commercial</td>
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<td>Health care</td>
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<td>Power</td>
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<td>Highway &amp; Street</td>
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<td>Sewage and waste disposal</td>
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<td>Water supply</td>
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<td>Conservation and development</td>
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<td>Manufacturing</td>
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Source: Census Bureau; TRG Research
About the ABI:

- The ABI is a leading indicator for non-res construction. The AIA conducts a monthly survey of architectural firms asking whether billings in the previous month significantly increased, remained about the same, or significantly decreased. The ABI is a diffusion index and scores above 50 represent an increase in billings.

Recent Results (April 2020):

- Total billings = 29.5
  - January and February 2020 were the highest levels since January 2019, before March and April dropped below 50 due to COVID-19.
- Commercial/Industrial billings = 27.8
  - Five months of 2019 were below below the 50.0 threshold, with Oct’9 to Jan’20 above the 50.0 level.
Q1’20 Trends & Takeaways

Q1 had two stories, the first ten weeks and the last two weeks:

- Non-res construction was strong during the first ten weeks, with some offset due to wet weather in parts of the country.
- The last two weeks of March downshifted as projects were halted or slowed meaningfully due to government orders.

Demand drifted down and stabilized in mid-late April, with improvement off the trough:

- Many companies appear to have found a bottom in demand in the mid-to-late April timeframe, with improvement since. Many demand patterns look like the charts below.
- Notable, Whirlpool anticipates a “U-type” recovery and in the company’s recent quarterly slides compares the trend of new COVID-19 case to industry sell-out trends, which shows an inverse relationship for China and Italy, and expects the U.S. may follow that pattern broadly.

MLM: Sales were down at the end of March and early April, with an uptrend by mid-April

United Rentals: OEC-on-rent declined following COVID-19 lockdown, but stabilized from ~April 8 trough

Source: Company Filings; TRG Research
Where Do We Go From Here?

**Where do we go from here? Various drivers and potential timeline:**

- We have heard of few cancellations of projects.
- BUT there are delays of current projects due to work sites being either paused or progressing more slowly as there are less workers allowed on a specific job site.

**What other non-res/commercial-focused companies are saying:**

- Equipment rental companies have seen improvement off the lows in April – United Rentals, Herc, H&E
- Building products companies (FERG, TILE, AWI) reported improving trends off the April lows but remained cautious to call for a sharp rebound as non-res activity will likely be slower to come back than resi work – Ferguson (plumbing), Interface (commercial flooring), Armstrong World (commercial ceiling systems)

**Feedback from the Field:**

- “Lots of data center, distribution, anything large public utility – these are strong. Resi is slowing a little bit, and commercial slowing more than most.” – Private Southeastern aggregate producer
- “Day to day tenant improvement has come to a stop. Healthcare remains strong. We have also been busy redoing and modifying Target stores – all COVID related.” – West Coast Commercial Flooring Installer
- “We have seen a few jobs post-poned here and there on the non-res sector…I would say that if you looked at the heavy non-res, and which is some of what has slowed the lighter nonres, which we talked about, data centers, distribution centers, warehouses, health care, education, online commerce has very much picked up.” – Vulcan Materials investor call
- “Haven’t seen a lot of cancelations, choppy by market on delays and timing of restarts.” – U.S. Concrete investor call
Public Construction
How to Think About A Post-COVID Landscape
Q1 Public Construction was strength:
- Public construction was strong and steady as infrastructure and public projects through DOT lettings provided the biggest momentum into 2020.

Public Construction bucked the trend:
- Public construction deem “essential” allowing work to continue. Light traffic volume allowed DOTs to accelerate projects by extending work hours and lane closures.

Where do we go from here? Various drivers and potential timeline:
- Public end market activity remains strong as DOT’s continue work, and in select cases accelerate jobs as there is less traffic on the road.
- Heavy materials companies reported little to no impact on infrastructure related work.
- A drop in state revenue collections, however, could pose problems down the road and is an area TRG follows closely through our quarterly State Revenue Report.
- Some DOTs are reporting bids now coming in below estimates.

What does this mean for Tennessee DOT?
COVID-19 Impact to state revenues and budget

- Budget shortfall of up to $1.5B through FY’21.
- State has cut expenditures by $681MM in FY’20 & ‘21.
- Governor request FY’21 budget reduction of 12%.

May economic impact:

- Unemployment rate jumped to 14.3% from 3.3%.
- Non-farm payrolls fell to 2.7MM from 3.1MM.

Department of Transportation

- No impact to lettings in FY’20.
- Key DOT revenues for May:
  - Gasoline tax collections down 38% YOY.
  - Vehicle registration tax collections down 35% YOY.
- No guidance yet on FY’21 letting schedule.

Re-opening Phase

- Governor announced state reopen plans on April 24.
  - Nashville lagging rest of state in reopening plans.
- Statewide traffic volumes dropped up to 40%+ in April.
- June traffic volumes turned positive YOY vs. national average of -15%.

Source: St. Louis Federal Reserve, MS2, TRG Research
What Now?

Predictions For a Post COVID-19 World
Population Migration to Southeast & Southwest/West Will Continue

What is Happening

- Of the top 20 counties with the largest % population shift since 2010
  - South = 14 counties
  - West = 5
  - Midwest/Plains = 1

- Of the top 15 states with the largest numeric population changes between 2010-18
  - South = 5
  - West = 5
  - Northwest = 4
  - Midwest = 1

Shift from Snowbelt to Sunbelt

- Tax and business friendly states
- Favorable labor laws
- Lower cost of living
- Warmer and coastal areas
- Older population migration

Source: U.S. Census Bureau, TRG Research
## Wrapping It All Up

<table>
<thead>
<tr>
<th>Theme</th>
<th>Commentary</th>
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<tbody>
<tr>
<td><strong>Infrastructure/Public Construction</strong></td>
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<tr>
<td>Infrastructure to help re-shore a bruised U.S. economy</td>
<td>Infrastructure construction is one item that both political parties can agree on and can keep people employed.</td>
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<tr>
<td>Aggregates better positioned than other materials</td>
<td>Aggregates pricing to hold up better than concrete and cement pricing, similar to dynamics in the Great Recession.</td>
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<tr>
<td>Infrastructure bill a catalyst to already strong trends</td>
<td>Any potential Federal infrastructure bill would provide further funding for public work.</td>
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<tr>
<td>Public Construction Essential</td>
<td>Not only have industry participants continued to work throughout the COVID-19 outbreak, but DOT have accelerated projects taking advantage of lighter traffic volumes allowing significantly more work completion.</td>
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<tr>
<td><strong>Residential</strong></td>
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<tr>
<td>Exodus from large cities</td>
<td>A broader secular trend we see post COVID-19 is an exodus from major cities, further pushing population trends to the SE/SW.</td>
</tr>
<tr>
<td>“Easy” residential renovation growth spurred</td>
<td>People stuck at home are keeping busy with light R&amp;R work such as painting, landscaping, and décor remodels.</td>
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<tr>
<td>“Home office” fundamentally changing</td>
<td>With “forced” nesting, companies have had to adapt to remote working environments.</td>
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<tr>
<td>Supply/Demand dynamics remain</td>
<td>After medium-term adjustments to coronavirus, the fundamentals of supply not meeting demand is likely to remain intact.</td>
</tr>
<tr>
<td>Greater longer-term focus on the home</td>
<td>The near-term for residential construction looks pretty tough, but the longer-term outlook we think will be very strong. We see a greater focus on resi home construction and resi renovation in a way we have not seen in 10-15 years.</td>
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<tr>
<td><strong>Commercial</strong></td>
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<td>Large projects underway mostly continuing</td>
<td>TRG industry contacts confirm large-scale construction projects (airport expansions, stadium buildouts, etc.) are continuing.</td>
</tr>
<tr>
<td>Commercial R&amp;R seeing a slowdown</td>
<td>Companies are reducing capex to only maintenance capex and saving cash for getting through the crisis.</td>
</tr>
<tr>
<td><strong>What else matters</strong></td>
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<tr>
<td>Size matters</td>
<td>Larger cap companies will outperform relative to smaller cap names.</td>
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<tr>
<td>Geographic focus matters</td>
<td>Southeast/southwest focused companies will relatively outperform because of population growth trends.</td>
</tr>
<tr>
<td>Capital structure matters</td>
<td>Companies with superior capital positions (low to no debt) and strong liquidity/access to alternative forms of cash/liquidity.</td>
</tr>
<tr>
<td>Revenue generation matters</td>
<td>Companies able to continue revenues in some capacity vs. a complete shut down of sales are better positioned.</td>
</tr>
<tr>
<td>Pick up in M&amp;A activity post COVID-19</td>
<td>TRG also expects to see an uptick in M&amp;A activity when the dust settles across a wide variety of industries in construction. Companies that were waiting to time the peak are getting a strong dose of reality today with COVID-19. While most deals are sidelined in the current environment, we expect that to change in coming months. The challenge now is how are companies valued in this environment. As one conference participant noted last week, COVID-19 likely “has reminded smaller independents/companies that this is a cyclical business.”</td>
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