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Industry Update

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Industry: **CONSTRUCTION MATERIALS**

Coverage:

Ticker	Rating	Price
CRH	NEUTRAL	$21.81
CX	NEUTRAL	$10.99
EXP	NEUTRAL	$67.34
MLM	BUY	$100.35
OC	BUY	$42.79
PNR	BUY	$52.83
SSD	NEUTRAL	$29.79
TXI	NEUTRAL	$59.65
USG	NEUTRAL	$30.05
VMC	NEUTRAL	$54.87
WTS	NEUTRAL	$46.50

Aggregate News

IMPORTANT DISCLOSURES ARE LOCATED IN THE APPENDIX.

COMPANY NEWS

CX: Highlights from Analyst Day - We attended CX's analyst day in NYC this week. The company set a 2016 EBITDA target of $4.7B (vs. $2.6B in FY12) which suggests an average annual increase goal of $600M. Approximately half of the EBITDA growth is dependent on the US recovery. Overall, management was quite bullish on its new "value over volume" pricing strategy and believes that pricing, not volumes is the key driver for hitting its EBITDA targets. If CX can pull this off, it would suggest significant upside to the shares. On $4.7B EBITDA, and an approximate net debt of $14B, we estimate CX would be a $13-16 stock in three years (on a 6-7x multiple, $14B net debt). That said, the near term will still likely be choppy with burgeoning US growth partially offset by a still challenged Europe. However, management sees Europe bottoming in 2013 and turning positive in 2014 while US prices are expected to accelerate more significantly in FY14 due to tighter cement supply/demand conditions. So while it may be too early to be buying CX today, it could be a name to own over the next 1-2 years.

EBITDA Growth Price, US Dependent

- For the EBITDA growth, management expects $1.4B to come from volumes, $2.3B in price with a $1.3B offset from costs. Essentially all of the move from $2.6B EBITDA in FY12 to $4.7B in FY16E will come from price. 80% of the EBITDA growth is expected to come from the Americas. Management expects 10% volume growth in the US, 3% in Mexico, 4.7% in Central & South America, 1.7% in Europe and 4-5% in most other parts of the world it services.

- Management stressed throughout the day its "value before volume" program which decouples the value of the product with the value of the service. Essentially, while cement in the US is treated as a commodity it sees its bulk cement offerings in Latin American and emerging markets as more specialized. CX hopes to transform into a building solutions company that will try to recover both the cost of capital and inflation in pricing. Its "gross minus logic" pricing strategy now prices product based on the total service value provided minus discounts for loyalty, payment, volume discounts etc. As CX's prices have been largely stable globally during the downturn, management sees this as a positive in that the competitive landscape, broadly, is rather price disciplined. It also sees competitors' margins and profits dropping sharply and input costs rising and thinks that the broader cement industry is incentivized to get earnings back to more normal levels sooner than just waiting for volumes to recover (which may be inconsistent given mixed near term global trends).

- We see CX taking leadership on pricing as a positive trend. At least in the US, we are bullish on materials prices over the course of the recovery, and think that in tighter and/or more consolidated markets, a bolder pricing strategy could very well work. Even in Europe, Management expects price increases to stick in FY13 as a) cost inflation has not been recovered over the past several years and this would need to reverse, and b) competitors have been losing money as well and need pricing to improve returns near cost of capital. We've seen some building products sectors have success with price increases despite low utilization rates because competitors have generating unsustainable losses. The same logic could spell success for European price increases.

- Management is targeting $150M in noncore asset sales in FY13 with $400M through FY16. Deleveraging the balance sheet remains a medium term goal. Longer term, beyond FY16, it's not unreasonable to think that CX will again be an aggressive buyer (more so in Latin America and other emerging markets).

- We view CX's comments as a positive read through for other construction materials companies, mainly TXI (given TX and Southern California overlap), MLM (both have ~18-20% of sales in TX), and VMC (strong overlap in TX, CA, FL) both on volumes and pricing. Should CX's pricing leadership translate to other competitors like Lafarge, Heidelberg and Holcim supporting large increases, the domestic companies should benefit from the potential tailwind.

Source: Longbow Research. See note published 2-15-2013.

MLM: Revenues Accelerating, Costs Down, Provides Nice Earnings Runway in 2013 - MLM reported 4Q12 of $0.47 vs. our $0.54 forecast and the Street's $0.48. The company was hurt by $6M higher SG&A costs relative to our forecasts, of which half was restructuring. This more than offset a ~$1.5M benefit from a lower than expected tax rate. Net-net, we estimate the higher restructuring costs minus the lower tax was a $0.03 impact on the quarter. Net sales increased 22% vs. our 7% forecast as MLM benefitted from both higher volumes as well as the earlier than expected start up of its new dolomitic lime kiln in the quarter. Total aggregates volumes increased 5% y/y vs. our flat forecast while pricing was flat (+1% like for like). The West Group outperformed on volume while Southeast was strong on price but overall profits for the group disappointed from a still soft GA market. Total gross margins of 16.7% were 110bp below our forecast as the Southeast group underperformed while the West was in line and the Mideast slightly outperformed. Incremental gross margins in aggregates of 21% were below our 49% forecast. MLM's FY13 guidance was generally in line with our expectations. Its +4-6% volume guidance is somewhat more bullish than our 4% forecast, but we note that the company's volume outlook was generally in line with its informal mid-single-digit outlook offered after 3Q. We see potential upside to our forecast given improvement in all of MLM's key end markets plus strength in key geographies, particularly TX. MLM's pricing guidance is 2-4% and compares to our 4% outlook. However, given a strong pricing theme we are seeing for FY13 in construction materials in general, we would expect pricing to come in towards the upper end of the range. MLM is guiding to a 17% y/y EBIT improvement in Specialty Products in FY13 while its downstream businesses are expected to see a $7-9M y/y profit improvement. Overall, while the quarter was somewhat disappointing from one-off costs and weaker than expected trends in the Southeast, we think the company is set up well for over $1.00/share in EPS growth in FY13 from 4% volume and price growth as well as a benign cost environment. That said, 1Q will likely be weak due to weather but 2Q and beyond should see high single digit volume growth, and the kind of incremental margins management has been promising for the past several years could begin to take shape.
Source: Longbow Research. See note published 2-13-2013.

VMC Reports 4Q12 Results, Slightly Disappointing - VMC reported adjusted EBITDA of $90M vs. our $96M forecast. Aggregates gross profit was $1M below our view despite higher sales. Aggregates volumes fell three percent vs. -5% forecast while pricing was up 4% vs. our +2% expectation. VMC's outlook was generally in line with our expectations. The company expects volumes in FY13E to be up 1-5% but demand growth will be back-end loaded given tough 1H12 comparisons. Prices are expected to up 4% y/y. VMC's in line with our up +3% volume and +4% pricing forecast. Overall, VMC put up a slightly disappointing quarter on margins. The VMC report is consistent with 4Q12 theme of solid revenues but softer than expected profit.
Source: Longbow Research.

SSD: Reports Disappointing 4Q Results - SSD reported 4Q EPS of $0.12. However, excluding a $6.8M tax benefit and $2.3M goodwill impairment, EPS was $0.03/share. Results were weaker than our $0.07 EPS forecast which was in line with consensus. Net sales increased 11% y/y and were 210bp ahead of our forecast. Approximately two-thirds of the sales increase was driven by acquisitions with the rest from organic demand, although sales in France and the UK remain weak. The miss was driven by weaker gross margin. Corporate costs which have weighed on prior quarters, up $3M y/y were flat q/q. Gross margin of 38.2% was below our 40.8% forecast and down from 42% in 4Q12. The company cited a higher mix of lower-margin concrete construction sales (vs higher-margin wood construction products), price competition, higher material costs, factory overhead, and shipping costs as weighing on gross profit. We're concerned that gross margin will continue to decline from negative mix as well as pricing pressure. As the company expects rising input costs in FY13, we have a hard time seeing how pricing at this point will be able to offset. North American sales increased 10% but gross margin fell 380bp to 38.2%. European sales increased 13% y/y but gross profit fell from 31.4% to 21.2% but most of the decline was associated with severance costs and the loss on sale of inventory related to the Liebig plant closure and exit of the mechanical anchor market. While SSD is slowly starting to see the sales benefit associated with the rebound in US construction, it continues to see pricing pressure as well margin pressure from mix and price. It's unclear when the company will start to see stability in these areas.
Source: Longbow Research. See note published 2-11-2013.

European Cement Production in 2012: Review From Companies That Already Reported - Geographically, performances in the Americas and Asia propped up balance sheets. Europe, however, continued to ruin the party in 2012. In its Western and Northern Europe section HeidelbergCement saw a 3.9% decrease in sales of cement and clinker to 21.3Mt from 22.1Mt in 2011. However, this was still higher than the sales in 2010 of 19.7Mt.Cemex's Northern Europe section witnessed a 13% drop in overall net sales to €3.05bn. Its Mediterranean section did worse, with a 15% drop in net sales to €1.08bn. Both declines were similar to the falls in cement volumes in these regions. Italcementi watched its Central Western Europe region plummet by 16.1% to 16Mt. To demonstrate the comparative exposure to Western Europe, 25% of HeidelbergCement's volumes came from Western Europe and 35% of Italcementi's sale volumes came from Western Europe. Cemex hasn't released any figures for sales of cement in its preliminary results but overall in cement, aggregates and concrete, 37% of its sales came from its two European regions. HeidelbergCement noted that demand for construction materials remained stable in Germany and Northern Europe. However it weakened in the UK and the Netherlands. By contrast Cemex noted a decrease in cement volumes for the year in Germany although it became stable by the fourth quarter. For the UK it had the same experience as HeidelbergCement, with a similar downturn in France and Poland. In its Mediterranean region Cemex recorded a whopping 40% decrease in cement volumes. Although light on detail, Italcementi pointed out a 25% drop in cement consumption in Italy and an 8% drop in France and Belgium. In November 2012, the European Commission forecast that gross domestic product (GDP) would fall by 0.3% in the European Union (EU) in 2012. Broadly in line with the national situations reported above, Germany's GDP is forecast to have risen in 2012; the UK's, the Netherlands', Belgium, Italy and Spain's GDPs looks to have fallen in 2012. Curiously though, both France and Poland were forecast to have improving GDPs in 2012. HeidelbergCement and Cemex's experiences suggest that this didn't happen in the French construction industry. *Source: Globalcement.com*

CONSTRUCTION MATERIALS INDUSTRY NEWS

VA Senate Panel Approves Plan To Raise Gasoline Tax - The VA Senate Finance Committee voted 9-6 on Tuesday to approve a plan proposed by Sen. Frank W. Wagner, R-Virginia Beach that would raise the state gasoline tax at the pump and at the wholesale level to raise $4.5 billion over the next five years. The new plan also would give localities across Virginia the option of imposing an additional 1-percent sales tax that in the Richmond area would raise an estimated $821.7 million over five years, and raise vehicle registration fees to pay for mass transit and rail. The Senate also killed two other transportation bills last week, including McDonnell’s plan, but Democrats who voted in a bloc against all of the measures have had a change in heart with a ruling by House Speaker William J. Howell, R-Stafford, that effectively killed a political redistricting plan advanced by Senate Republicans. McDonnell welcomed the committee action as a step toward a final plan for funding transportation, even though he faulted the Senate proposal for diverting too little existing sales tax revenue from the general fund to transportation and continuing to rely on the gas tax to pay for road improvements. The fundamental difference in the plans is that McDonnell’s proposal would replace the gas tax with an increase in the sales tax, while the Senate plan would raise the gas tax by 5 cents per gallon at the pump and 1 percent at the wholesale level. A 1-percent wholesale tax equals 3 cents a gallon at current prices. The wholesale tax would increase an additional 1 percent at the wholesale level if Congress fails to adopt legislation that would allow states to tax Internet sales. Both plans anticipate sales tax revenue from the Marketplace Equity Act that could be used for transportation. Both taxes in the Senate plan would be indexed to rise with inflation, unlike the current gas tax of 17.5 cents per gallon, which hasn’t increased in 25 years. The Senate proposal would raise more than $1 billion a year by 2018, but the money generated by the wholesale tax would be reserved for the localities where the tax was levied to help pay for local road projects. Localities also would have the option of imposing an additional 1 percent sales tax, which would raise $1.7 billion in Northern Virginia over five years and $963 million in Hampton Roads over five years. The Senate plan allows a slight increase in the amount of current sales tax revenue that can be allocated to transportation, raising the percentage from 0.5 percent to 0.55 percent, instead of the 0.75 percent advocated by McDonnell to be phased in over five years. The plan also keeps the governor’s proposal to raise vehicle registration fees by $15, with the revenue to be dedicated to mass transit and rail projects.
Source: Richmond Times-Dispatch

CBO Report Confirms Highway Trust Fund's Dismal Outlook - This week, the Congressional Budget Office (CBO) released its semi-annual estimate of the status of the Highway Trust Fund (HTF) based on revenue flowing in. The CBO also anticipated expenditures based on current law requirements. CBO estimates that the highway account and the transit account will be able to meet obligations through the end of FY 2014, but will not have sufficient revenue to meet all obligations for FY 2015. CBO points out that this estimate does not include any reduction in the amounts transferred from the general fund to the HTF as a result of MAP-21. While the HTF is not directly subject to sequestration on March 1, the general fund revenue that MAP-21 provided for the HTF will be reduced by the sequester. CBO estimates that the highway account will end FY 2013 with balances of more than $5 billion, and the transit account will end the year with balances of just under $3 billion.
Source: Associated General Contractors of America

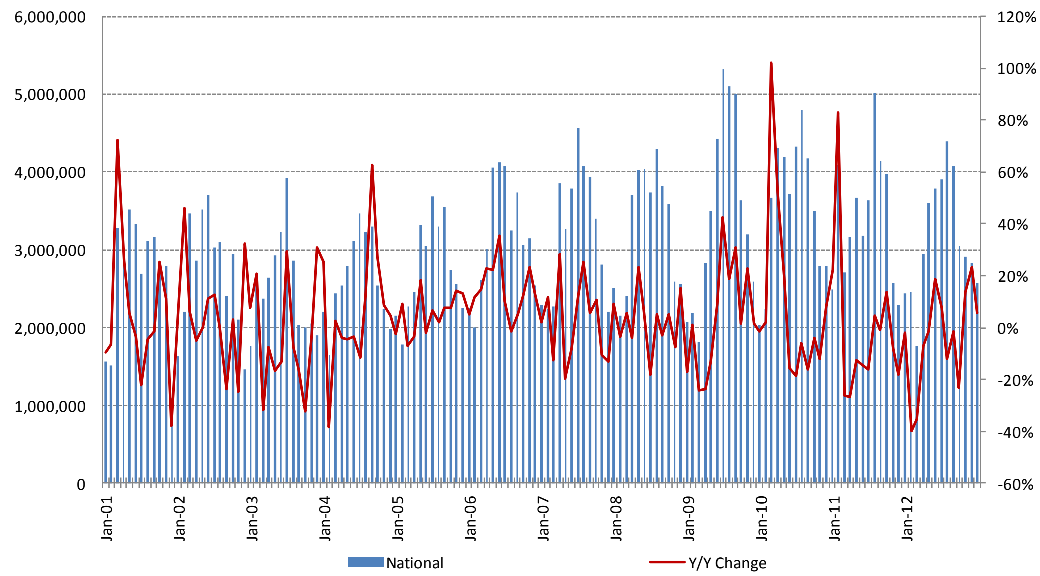
Multifamily Housing Growth Poised to Continue in 2013 - After years of downturn, home building is now solidly contributing to economic growth. An important factor behind that growth has been the expansion of multifamily construction such as apartment buildings and condominiums. As a result of the housing crisis, homeownership is down, particularly among younger households. In addition, the overall number of households—homeowners and renters combined—is down compared to where it should be given the population growth. This trend has translated into a lot of potential in household formation—as many as two million future households according to some estimates, with most of them expected to become renters as economic and labor market conditions improve. The result for the building industry has been an increase in the demand for rental units, which in turn has reduced rental vacancy rates and driven demand for multifamily construction. For example, the number of empty rental units shrunk greatly in the last two years according to the Census Bureau's quarterly Housing Vacancy Survey. Peaking at just over 11 percent, the current measure stands at 8.7 percent as of the end of 2012, comparable to levels seen in early 2002. With fewer units available for a growing number of renters, 2012 marked significant growth in multifamily construction. The graph below charts multifamily units started on a smoothed, three-month moving average. After falling to a low of 75,000 units a year in late 2009 (a greater than 75 percent drop in activity from the peak of the market), new construction now comes in at a 306,000 rate on an annualized basis, a 49 percent improvement year-over-year. And this growth should continue. Survey data of multifamily developers, as reported by the National Association of Home Builders (NAHB) Multifamily Production Index (MPI), suggests more businesses seeing positive market conditions. The most recent reading of the MPI was 52, with any reading above 50 indicating more developers seeing an improving environment. The MPI has been above 50 for three straight quarters as of the third quarter of 2012. The NAHB Economics forecast for multifamily construction projects another strong annual increase in 2013. Multifamily starts should increase another 31 percent over 2012 to 335,000 total units for the year. And like growth in other parts of the housing sector, this additional development activity should add jobs to the construction sector, about 1,110 jobs for every 1,000 multifamily units built according to industry estimates.
Source: US News and World Report

Dodge Momentum Index Continues to Gain in January - The Dodge Momentum Index rose 2.7% in January, according to McGraw-Hill Construction. The Momentum Index is a monthly measure of the first (or initial) report for nonresidential building projects in planning, which have been shown to lead construction spending for nonresidential buildings by a full year. The January increase for the Momentum Index marked its second monthly gain in a row, lifting it to 97.6 – the highest reading since mid-2010. This recent upturn follows a moderate decline for the Momentum Index that took place from August through November, when uncertainty related to the November 2012 elections and the looming fiscal cliff generally dampened investment. With the election results final and the fiscal cliff averted for the time being, plans for nonresidential building projects that may have been deferred are now moving ahead at a quicker pace. January's increase for the Momentum Index relative to December was the result of stronger activity for both its commercial and institutional segments. The 3.1% gain for the institutional segment in January was driven by a surge in new hospital projects entering the planning pipeline. The 2.3% gain for the commercial segment in January reflected an uptick in plans for new offices and stores.
Source: McGraw-Hill Construction

Fourth Quarter Metro Area Home Prices Show Strongest Performance in Seven Years - A growing number of metropolitan areas had higher median home prices in the fourth quarter, with the national price showing the strongest year-over-year increase in seven years, according to the latest quarterly report by the National Association of Realtors. The median existing single-family home price rose in 133 out of 152 metropolitan statistical areas (MSAs) based on closings in the fourth quarter compared with same quarter in 2011, while 19 areas had price declines. In the third quarter 120 areas showed increases from a year earlier, while in the fourth quarter of 2011 only 29 metros were up. The national median existing single-family home price was $178,900 in the fourth quarter, up 10.0 percent from $162,600 in the fourth quarter of 2011, which is the strongest year-over-year price increase since the fourth quarter of 2005 when the median price jumped 13.6 percent. In the third quarter the price rose 8.8 percent from a year earlier. A shrinking market share of lower priced homes continues to account for some of the price growth. Distressed homes - foreclosures and short sales generally sold at deep discounts - accounted for 23 percent of fourth quarter sales, down from 30 percent a year ago. Total existing-home sales, including single-family and condo, rose 5.0 percent to a seasonally adjusted annual rate of 4.90 million in the fourth quarter from 4.66 million in the third quarter, and were 12.1 percent above the 4.37 million pace during the fourth quarter of 2011. Sales in the last quarter were at the highest level since the fourth quarter of 2009 when they reached 4.95 million. At the end of the fourth quarter there were 1.82 million existing homes available for sale, which is 21.6 percent below the close of the fourth quarter of 2011 when 2.32 million homes were on the market. Unsold inventory is at the lowest level since January 2001 when there were 1.78 million homes for sale. NAR's national annual Housing Affordability Index, with breakouts for metropolitan areas, rose to a record high 193.5 in 2012 from 186.4 in 2011. The index is calculated on the relationship between median home price, median family income and average effective mortgage interest rate. The higher the index, the stronger household purchasing power; recordkeeping began in 1970.
Source: NAR

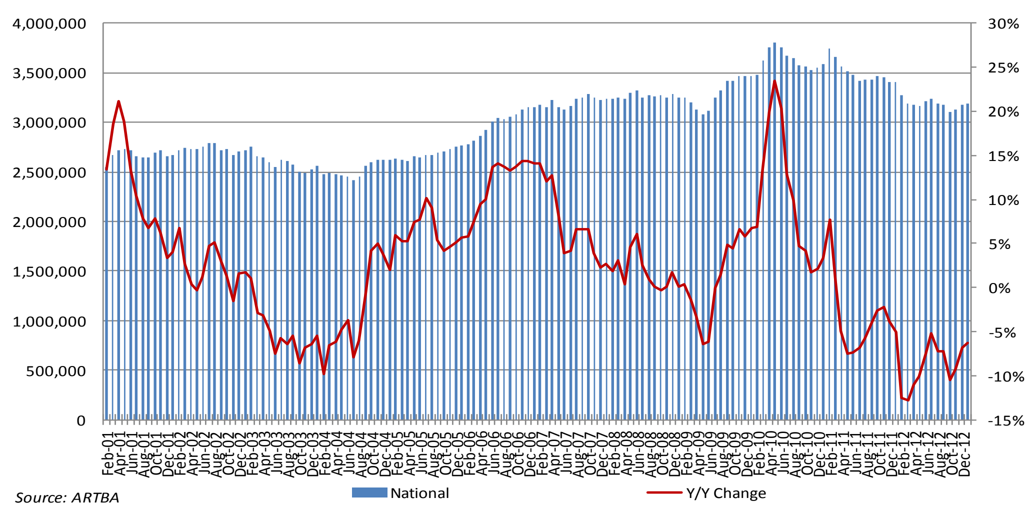
DATA AND GRAPHS

Highway Contract Awards Y/Y Change



Source: ARTBA

Highway Contract Awards-TTM



Source: ARTBA

CONSTRUCTION MATERIALS PEER VALUATION ANALYSIS

Company Name	Ticker	Rating	Price 02/15/13	52-Week Low	52-Week High	Share Count	Market Cap (mm)	Enterprise Value (mm)	Total Assets	Total Liabilities
Cemex	CX	NEUTRAL	$10.99	$4.94	$11.11	1,124	12,353	28,027	39,612	27,384
CRH plc	CRH	NEUTRAL	$21.65	$16.22	$22.31	732	15,848	20,730	29,527	14,916
Eagle Materials	EXP	NEUTRAL	$68.87	$28.77	$67.42	45	3,083	3,292	985	523
Martin Marietta Materials	MLM	BUY	$100.82	$63.64	$101.57	46	4,607	5,671	702	1,784
Owens Corning	OC	BUY	$42.80	$25.70	$42.80	121	5,183	7,349	7,833	4,152
Pentair	PNR	BUY	$53.00	$36.04	$53.36	207	10,971	13,164	11,795	2,635
Simpson Manufacturing	SSD	NEUTRAL	$29.76	$23.22	$35.06	48	1,435	1,248	867	96
Texas Industries	TXI	NEUTRAL	$60.01	$30.10	$59.32	28	1,668	2,267	1,525	857
USG Corp.	USG	NEUTRAL	$30.38	$12.70	$30.60	107	3,262	5,131	3,664	3,542
Vulcan Materials	VMC	NEUTRAL	$54.98	$32.31	$59.48	130	7,125	9,695	8,216	4,470
Watts Water	WTS	NEUTRAL	$46.98	$30.88	$45.57	37	1,729	2,114	1,712	893

Earnings

Company Name	CY Earnings Per Share 2011A	2012E	2013E	Beta	CY EBITDA Per Share 2011A	2012E	2013E	CY 2012E Sales (mm)	Tangible Book Value/Share	Target Price
Cemex	(1.27)	(0.81)	(0.06)	2.4	$2.24	$2.34	$2.65	14,972	$4	-
CRH plc	1.12	0.96	1.21	1.2	$3.17	$2.83	$2.98	23,738	$11	-
Eagle Materials	0.28	1.42	2.80	1.3	$1.87	$3.60	$6.10	600	$7	-
Martin Marietta Materials	2.05	2.30	3.32	1.0	$7.70	$7.99	$9.50	2,038	$16	$113
Owens Corning	2.23	1.13	2.30	2.2	$6.30	$5.30	$7.07	5,205	$12	$54
Pentair	2.41	2.39	3.23	1.1	$4.79	$5.08	$5.66	7,272	$8	$56
Simpson Manufacturing	1.03	0.81	1.31	1.4	$1.96	$1.98	$2.74	704	$13	-
Texas Industries	(2.22)	(1.41)	(0.35)	2.0	$0.98	$2.03	$4.36	639	$25	-
USG Corp.	(3.02)	(1.11)	0.71	2.8	$0.42	$2.37	$4.11	3,280	$1	-
Vulcan Materials	(0.82)	(0.48)	0.28	1.3	$2.67	$3.22	$4.30	2,561	$5	-
Watts Water	2.18	2.16	2.68	1.6	$5.13	$5.49	$6.11	1,455	$3	-

Valuations

Company Name	CY Price to Earnings 2011A	2012E	2013E	Price to Book Value	CY EV/EBITDA 2012E	2013E	EV to Sales	Price to Sales	Dividend Yield	FCF Yield
Cemex	NM	NM	NM	2.6x	10.7x	9.4x	1.9x	0.8x	NA	-0.1%
CRH plc	19.3x	22.6x	17.9x	2.0x	10.0x	9.5x	0.9x	0.7x	4.3%	12.4%
Eagle Materials	246.9x	48.3x	24.6x	9.9x	20.4x	12.1x	5.5x	5.1x	1.1%	0.6%
Martin Marietta Materials	49.3x	43.8x	30.4x	6.3x	15.5x	13.1x	2.8x	2.3x	1.8%	0.0%
Owens Corning	19.2x	38.0x	18.6x	3.5x	11.4x	8.6x	1.4x	1.0x	NA	0.4%
Pentair	22.0x	22.2x	16.4x	6.9x	12.5x	11.2x	1.8x	1.5x	2.2%	5.3%
Simpson Manufacturing	28.8x	36.5x	22.7x	2.2x	13.1x	9.4x	1.8x	2.0x	1.6%	0.9%
Texas Industries	NM	NM	NM	2.4x	40.1x	18.7x	3.5x	2.6x	0.8%	-3.3%
USG Corp.	NM	NM	42.6x	26.7x	20.1x	11.6x	1.6x	1.0x	NA	-0.1%
Vulcan Materials	NM	NM	194.2x	10.8x	23.3x	17.4x	3.8x	2.8x	0.1%	2.4%
Watts Water	21.6x	21.8x	17.5x	15.7x	10.5x	9.4x	1.5x	1.2x	1.1%	2.8%
Average	**58.2x**	**33.3x**	**21.1x**	**8.2x**	**17.1x**	**11.9x**	**2.4x**	**1.9x**	**1.6%**	**1.9%**

Source: Baseline, Longbow Research

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APPENDIX

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Rating Category	Count	Percent
Buy	69	31.4%
Neutral	146	66.4%
Underperform	5	2.3%

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"Buy" means that Longbow Securities expects total return to exceed 20% over a 12-month period.

"Neutral" means that Longbow Securities expects total return to be within a range of plus or minus 20% over a 12-month period.

"Underperform" means that Longbow Securities expects total return to be negative by greater than 20% over a 12-month period.

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