

Building Products Market Update

Industry Consulting Team | Q2 2023

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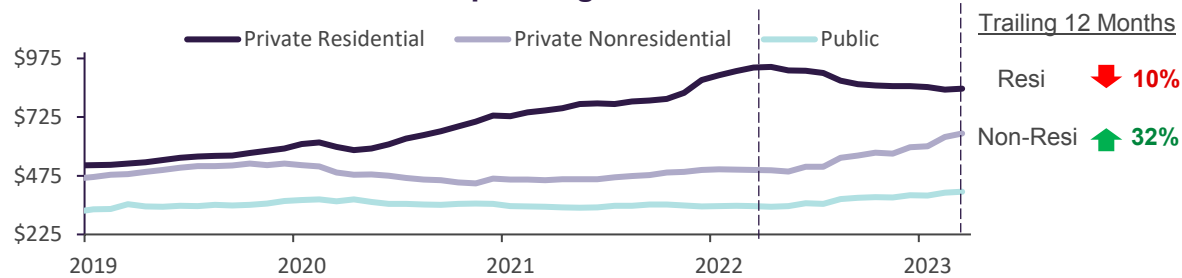
Highlights

- Fed signals nearly done raising interest rates
- New residential starts begin to increase
- Existing home sale values remain flat
- Strong non-residential spending
- Margins ease, but still higher than pre-pandemic levels
- Infrastructure spending is slow to ramp up, but gaining momentum

New Construction Spending Overview:

- **Residential** is trying to shake off the effects of the worst housing correction since the great recession. New residential homes sales jumped 15% year over year to 763K. Single family (SF) builders believe the market has found a floor and the worst is now behind us.
- **Non-residential** remains up but is expected to slow down in 2024. Not all components of non-residential spending will contract at the same pace. Lighter commercial property types connected to suburban expansion, typically lag a residential cycle, so weakness in this category makes sense given the recent residential correction. Other property types such as industrial, data centers, and life science buildings still have large pipelines and may not experience much slow down at all.
- **Public Infrastructure** is expected to grow steadily as we are still in the beginning phases of generational increase in spending primarily stemming from Infrastructure Investment and Jobs Act (IIJA).

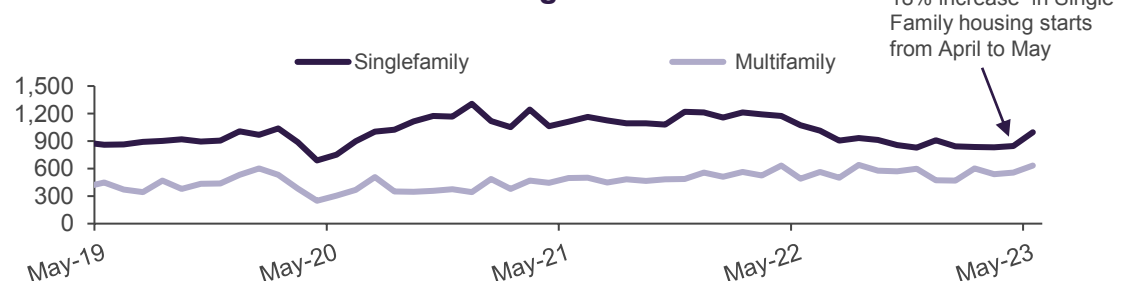
Construction Spending Trends (in billions)



Residential Starts Rebound:

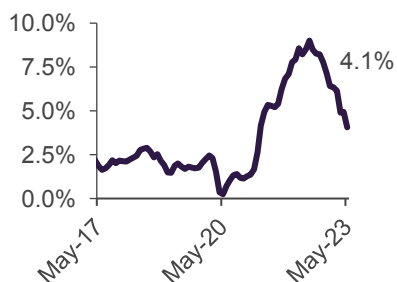
- Total housing starts were 1.63MM units in May which came in significantly above consensus of 1.4MM.
- SF starts increased 14% to 997K and expectations going forward call for production rates to flatten out at a healthy pace.
- Multifamily (MF) continues to outperform assumptions with 634K starts vs. typical annual pace of 510K. The strength in MF spending has been a nice offset as SF slowed down.
- Looking forward to 2H23 and 2024, it is likely the balance will swing back to SF leading the recovery as MF production slows.

Housing Starts



| | Current Rate | 90 Day Low | 90 Day High |
|---------------|--------------|------------|-------------|
| 30yr Mortgage | 7.05% | 6.70% | 7.19% |
| 10yr Treasury | 3.72% | 3.31% | 3.82% |
| 30 Day SOFR | 5.09% | 4.79% | 5.17% |

Inflation (YoY CPI % Change)



Sources: FRED, Bloomberg, U.S. Census Bureau, U.S. Dept. of Housing and Urban Development, Truist Securities

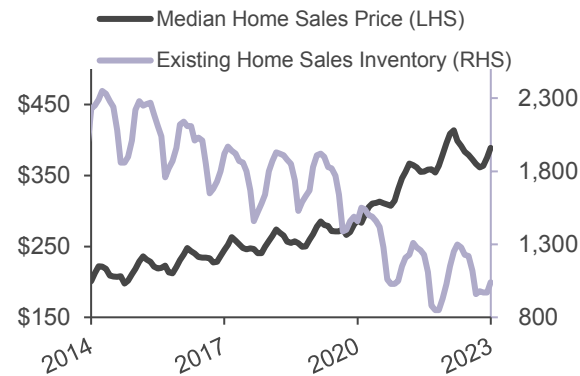
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Slowing Existing Home Sales and Flat Home Values:

- Existing home sales in May were down 18.2% year over year and but the declines are not nearly as dramatic as seen in the last 9 months.
- Home sales are clearly sluggish, but this trend shows that consumers could be adjusting to the new normal for interest rates.
- For sale inventory remains very low with less than 3 months of supply available which has propped up home values.
- Home values are only down 4.3% from the peak levels in June of 2022 and the month-to-month values increased 1.9%.
- This dynamic remains constructive for home building activity for 2H23 and 2024.

Home Prices & Inventories



Infrastructure Spending:

- Infrastructure Investment and Jobs Act (IIJA) is still in the early stages of funding, but it will continue to ramp up in the 2H23.
- So far, Texas is the first state to see significant increases with Q1 2023 infrastructure spending up 32% year over year.
- Most states have not yet seen the boost in spending, and some are growing frustrated with the lack of progress.
- These large-scale funding projects come with a lot of red tape making the approval process challenging and slow. This adds pressure to the contractors who bid for the work since material costs continues to change, heavy equipment is not easy to find, and finding enough skilled labor to meet the scope of work is very challenging.
- The good news is bidding is steadily picking up and the IIJA will provide a long-term tailwind for those involved.

Infrastructure Bill Allocations

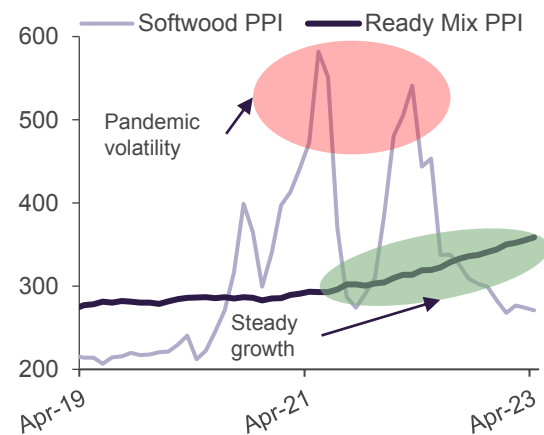
(estimates in billions)



Less Volatility in Heavy Materials:

- The strongest performers right now are the rock-based product companies such as those dealing in aggregates or cement manufacturing.
- Historically price increases come out annually at a predictable rate, but over the past few years we have seen many increases which are now adding up in a big way.
- In general, these companies have a similar story with volume levels being flat or down, but the price increases outweigh those in other building product segments giving them much better revenue performance.
- Demand drivers for this group are more durable than wood products since they can sell high volumes into all three construction spending channels; residential, non-residential, and public infrastructure spending.
- The adjacent chart shows the comparison of percentage increases between the more volatile lumber prices compared to ready mix prices over the past few years.
- Martin Marietta (MLM) led the way with a 10% increase revenue and a sizable 9.6% increase in EBIT margins. See scorecard chart on the next page.

Ready Mix vs Softwood Volatility



*Producer Price Index (PPI) is a program measuring the average change over time in selling prices



Sources: Truist Securities, U.S. Census Bureau, Bureau of Labor Statistics, Board of Governors of the Federal Reserve System (US), Bloomberg

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Financial Performance:

- Q1 2023 financial performance was expected to come in below Q1 2022 numbers and for the most part that was the case. Performance varies greatly depending on which segment of products you operate, but most companies continue to outperform forecasts due to sticky pricing power and better than expected margins.
- Publicly traded and highly diversified residential focused distributors like Beacon Building Products (BECN), realized a slight increase in revenue despite SF starts declining over 20% and a cooling repair and renovation market (R&R). Their core product unit volume was down -9.2%, but pricing increased 8% which helped balance out revenue loss.
- Jeld Wen's (JELD) North American business, is another example, with volume down 3%, price up 10%, and revenue increase of 6.3%.
- The more volatile world of lumber related products realized a more dramatic change. Builders First Source (BLDR) saw volume drop -14.5% and price drop -11.8% which sharply lowered revenue by -31.6%. The good news here is lumber tends to be first in and first out of housing cycles so expect the negative comparison data to burn off in 2H23.

| 1Q23A Earnings Scorecard | Year-Over-Year | | | |
|------------------------------------|----------------|---------------|---------------|-----------------|
| | Unit % Δ | Price % Δ | Revenue % Δ | EBIT Margin Δ |
| Beacon Roofing (BECN) | | | 2.7% | -200 bps |
| Residential Roofing Products | -9.2% | 8.0% | 0.4% | |
| Non-Residential Roofing Products | | | -7.8% | |
| Complementary Products | | | 22.7% | |
| Builders FirstSource (BLDR) | -14.5% | -11.8% | -31.6% | -200 bps |
| JELD-WEN (JELD) | | | 4.4% | 260 bps |
| North America | -3.0% | 10.0% | 6.3% | |
| Martin Marrietta (MLM) | | | 10.0% | 960 bps |
| Aggregates | -0.8% | 22.6% | 20.5% | |
| Cement | -6.8% | 32.2% | 21.9% | |
| Ready-Mix Concrete | -37.1% | 20.2% | -24.4% | |
| Asphalt | -25.1% | 9.9% | 2.1% | |
| Magnesia Specialties | | | 18.0% | |

Margins & Lower Input Costs Looking Forward:

- Overall margins remain better than pre-pandemic levels but are off from more recent highs.
- Year-to-date, non-commodity finished good selling prices remain elevated which balances the decrease in unit volume.
- Manufacturers are having to compete again to maintain market share, but so far that has not resulted in widespread deflation.
- Certain raw material and production costs are trending lower such as freight, natural gas, petrochemicals, steel scrap, lumber, and roofing asphalt. These categories may see a slight increase in margin 2H23.

Big Box Losing Share of Pro Market to Distributors Following Pandemic:

- According to Zonda (Private), big-box retailers are beginning to see a pullback in market share versus pro distributors.
- The company noted that initially during the pandemic, big box gained share of pro contractors due to homeowners wanting contractors to take any mean possible to get the jobs done and big box became a consistent source of building products inventory.
- In addition, Zonda referenced the pushback ratio as the measure of the number of homeowners pushing back on certain contractor proposals, with a growing number of proposals seeing some form of resistance over accepted bids.
- Higher pushback ratios are now forcing some contractors to shop around different channels other than big box, including specialty distributors.

