Fundamentals of Growth in the Construction Materials Industry & Virginia Construction Outlook

Presented by Sidney Mays
Vulcan Materials Company
March 7, 2013
Important Understanding  
“Safe Harbor”

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WELCOME to March Madness

Sequestration
Automatic Cuts
Job Loss

Continuing Resolution Deadline
Partial Government Shut-Down

Potential Downgrade by Rating Agencies Higher Debt Cost
Discussion Points

1. The “TRAP”
   – The “trap” impacts our point of view

2. Early Stages of the Construction Cycle
   – What Can We Expect?
   – What Indicators Should I Watch?

3. “Partial Recovery”
   – We need … to get a “True Recovery”

4. VMC’s Construction Outlook
   – Yes, Virginia there is a Recovery (sort of)
What Do I Mean By The TRAP?

The **Trap** is how our current view is impacted by the past.
# The Personal Impact

**Trap — letting the past permanently change your point of view**

- **VA Construction Employment declined -29%**

<table>
<thead>
<tr>
<th>Sector</th>
<th>% Change 2006 to 2012</th>
</tr>
</thead>
<tbody>
<tr>
<td>Education and Health Services</td>
<td>19.3%</td>
</tr>
<tr>
<td>Professional and Business Services</td>
<td>6.3%</td>
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<tr>
<td>Government</td>
<td>5.9%</td>
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<tr>
<td>Leisure and Hospitality</td>
<td>4.7%</td>
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<tr>
<td>Other Services</td>
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<tr>
<td><strong>TOTAL NONFARM</strong></td>
<td><strong>-0.1%</strong></td>
</tr>
<tr>
<td>Financial Activities</td>
<td>-2.2%</td>
</tr>
<tr>
<td>Trade, Transportation, and Utilities</td>
<td>-4.2%</td>
</tr>
<tr>
<td>Information</td>
<td>-20.6%</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>-21.0%</td>
</tr>
<tr>
<td>Construction</td>
<td>-28.7%</td>
</tr>
</tbody>
</table>
Early Stages of Construction Cycle – What Can We Expect?

• Uneven Geographic Impact

• Unbalanced Demand

• 1st Half of 2013 Disappointments – 2nd Half Encouragement
Location, Location, Location…

- If you are lucky enough to be located near work…
- Early part of a recovery looks very different in each market
- Don’t forget that it looks different in each sector of the economy
- Some sectors of economy are strong – many are still struggling

**Feeling pretty good or better**

- Housing – *Financing / Real Estate Portions*
- Automobile industry
- Energy sector
- Health care
- Rail and Water Transportation

**Still waiting on recovery**

- Construction
- Light Industrial Manufacturing
- Regional Banking
- Professional & Technical Services

VA is much higher than the US average in percentage of the economy tied to Professional and Technical Services
Demand Is Not What It Used To Be

VA Construction History
40 years of balance

PUBLIC: Roads Sewers Airports Gov. Bldgs

50% 50%

PRIVATE: Offices Stores Hospitals Mfg. Plants

35% 65%

Will private be strong enough in 2013?

Public Construction Stabilizes
Private Begins Recovery (from very low level)
Tough Comparison in 1st Half of Year

• First quarter of 2012 was good – compared to 2011

• Most markets saw significant increases in 1st Qtr 2012
  – Housing starts, employment, Government spending
  – Shipments of concrete

• First quarter of 2013 could be very rough
  – Federal and state policy – March Madness
    • Military spending
    • Highway spending
  – Nervous private investment
  – Bad weather in first two months

• Don’t give up on the year! - 2nd Half will be better
Planning Next Few Years – What Indicators Should I Watch?

• Housing Recovery Downstream Impact

• Employment Recovery

• Pent Up Demand to Address Need for Infrastructure
Watch for Impact of Housing – *Leads to Broader Economic Growth*

**Housing Starts**

- **Growth Leads to Demand for Private Investment $**
- **Initial and Ongoing Source of Tax Revenue $**

**Non-residential Buildings**
- Retail
- Office
- Health Care
- Restaurants

**Private Support Infrastructure**
- Power
- Utility
- Communication

**Locally Funded Buildings**
- Schools
- Municipal
- Public Services

**Locally Funded Infrastructure**
- Roads
- Sewer
- Water
- Recreation

*Private Sector Construction Activity Examples*

*Public Sector Construction Activity Examples*
Watch for Employment Growth - Key to Commercial Building Construction

- Employment declines always signal reduction in private investment

- Many economic factors impact commercial building decisions, but employment is the main driver

- **KEY:** Watch for employment growth in your market and …

### Prior 5 Employment Recessions

Parallels Private Non-Residential Construction Recessions

Change indexed to Employment and Private Non-Residential Construction peak in cycle
Watch for Employment Growth - Key to Commercial Building Construction

VA Change in Employment and Private Non-Residential Construction

- The prior 4 recoveries in VA employment led to growth in private investment
- Last recovery did not create enough commercial space to get back to trend

Currently...
- VA has experienced 9 quarters of employment growth...
- which has lead to 7 quarters of non-residential construction award growth

Will there be enough employment growth in 2013?
Planning Next Few Years –
What Indicators Should I Watch?

- *Housing Recovery Downstream Impact*

- *Employment Recovery*

- *Pent Up Demand to Address Need for Infrastructure*
Watch for Infrastructure Needs to Expand

- **Location of Growth**
  - **GEOGRAPHY**

- **Continued Growth in**
  - **DEMOGRAPHICS**

- **NEED for Supporting**
  - **INFRASTRUCTURE**

- **NEED for SPACE**
  - Housing and Buildings
One Example of NEED FOR BUILDINGS

Demographics as a Predictor of Schools Construction

44% Decline in School Construction in 3 years

Did children stop going to school?

What about this decline?
One Example of NEED FOR BUILDINGS

Demographics as a Predictor of Schools Construction

It’s all about NEED!

Gap

9 & 10 years old “student bubble”
One Example of NEED FOR BUILDINGS

Demographics as a Predictor of Schools Construction

- VA has a similar bubble
- 5 to 9 yrs old students added
- 2000 to 2010 = 20,000
- 2010 to 2020 = 80,000

The needs are real.
When will pent-up needs create demand?
Infrastructure Investment

Public Construction as a % of GSP for Virginia

1950’s thru 1970’s
3 Decades of Investment

70’s
2.5%

1980 thru 2010
3 Decades of Maintenance

80’s
1.4%

90’s
1.2%

00’s
1.2%

3 year moving average
Source: Commerce Department - BEA & FW Dodge
Infrastructure Investment -
Growth in highway capacity has lagged growth in demand

VA Driving Intensity Index

Source: USDOT Federal Highway Statistics.

Use of roads

Capacity of roads

Investment Gap

% Change 1990 to 2011
Fuel Consumed 37%
Vehicle Miles Traveled 35%
Lane Miles 11%

2 Million People Added

Source: USDOT Federal Highway Statistics.
Marketing Support Services

Early Stages of Construction Cycle – What Can We Expect?

• Uneven Geographic Impact
• Unbalanced Demand
• 1st Half of 2013 Disappointments – 2nd Half Encouragement

Planning Next Few Years – What Indicators Should I Watch?

• Housing Recovery Downstream Impact
• Employment Recovery
• Pent Up Demand to Address Need for Infrastructure
Construction Outlook

Public Construction Stabilizing
Private Begins Recovery
“Partial Recovery”

We need true employment growth and balance across multiple sectors of the economy.
Current Real GSP Recovery

VA Real Gross State Product: Percent Change From Preceding Period
Seasonally Adjusted at Annual Rates

Source: Moody’s Economy.com
Current Real GSP Recovery

VA Real Gross State Product: Percent Change From Preceding Period
Seasonally Adjusted at Annual Rates

Past Recoveries have averaged 4.6%
Current Recovery is averaging 2.7%

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Virginia Current Employment Recovery

Employment: Total Nonagricultural, (Mil., SA)
Percent Change from Preceeding Quarter - Annual Rates

Past Recoveries have averaged 2.8%
Current Recovery is averaging 1.3%

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What about Virginia Construction?

*Caution Sign about forecast*

- Does Not include impact of spending cuts caused by Sequestration
- Does Not include benefits in 2013 of any new highway funding
Sequestration: **Milestones**

- **March 1 Agencies budgets are cut.** Agencies will begin notifying employees, contractors, and states that spending will contract over the next seven months.
- **Early to mid March Furlough notices will begin** - warning that unpaid leave could begin in 30 more days.
- **March 27 Continuing Resolution Expires** - funding for some federal programs and agencies expires. If an agreement isn't reached, a partial government shutdown could ensue.
- **Early to mid April unpaid leave will begin** - If a shutdown is averted, many agencies will begin unpaid leave for employees, typically one day per week or one day every other week. The cuts' impact may become more visible, possibly affecting places like airports.
- **Sept. 30 The federal budget year ends**, meaning the cuts have to be accounted for by this time
- **Oct. 1 The next federal budget year begins**, triggering a second year of sequester cuts.

Source: WSJ – 02/28/2013 -
http://online.wsj.com/article/SB10001424127887323478304578332543799317924.html
The longer it takes to compromise the deeper the cuts

- Some obligations that are already in place – will take time to reduce
- If Congress finds a solution in the first 30 days – impact will be very limited
- If they find the solution in 60 days or next year – VA will be impacted
If Sequestration Happens – Construction Reduced

The forecast that will be presented does not include automatic cuts (sequestration)

If we get Sequestration and Spending Cuts…

• Impacts construction directly in VA
  – Military Construction would be cut -13%
  – Military Housing spending reduced -11%
  – Federal Transit spending down -7%
  – Dept. of Agriculture reduced -8%
  – Corp. of Engineers cut by -10% to -15%
  – Non-defense grants reduced -2%

• Loss of 200k jobs,
• $11B of income and
• $21B of GSP
If Sequestration Happens – Construction Reduced

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• Loss of 200k jobs, $11B of income and $21B of GSP

Pew Research - Impact Study

<table>
<thead>
<tr>
<th>Virginia Impact from Cuts in Federal Spending</th>
<th>US</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>VA</td>
</tr>
<tr>
<td>Federal Grants % of State Revenue</td>
<td>6%</td>
</tr>
<tr>
<td>Federal Spending Total Procurement, Salaries and Wages as % of State GSP</td>
<td>20%</td>
</tr>
<tr>
<td>Federal Defense Spending as % of State GSP</td>
<td>10%</td>
</tr>
<tr>
<td>Federal Non-Defense Spending as a % of State GSP</td>
<td>10%</td>
</tr>
<tr>
<td>Federal Non-Defense Work Force as % of Total Employment</td>
<td>4%</td>
</tr>
</tbody>
</table>

Source: Pew Trust Research

Based on Sept 2012 & Feb 2013 information from CBO & AGC
Virginia Areas
## Construction Award Momentum

**Northern Virginia**

<table>
<thead>
<tr>
<th>Public Construction</th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Highways</td>
<td>Yes</td>
<td></td>
</tr>
<tr>
<td>Infrastructure</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Public Non-Residential</td>
<td>Yes</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Private Construction</th>
<th></th>
<th>Long-Term</th>
</tr>
</thead>
<tbody>
<tr>
<td>Single Family</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Multi Family</td>
<td>Yes</td>
<td>Yes</td>
</tr>
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<td>Yes</td>
<td>Yes</td>
</tr>
</tbody>
</table>

**Positive Award Momentum**

**Short-Term**

- Potential
- Turn

**Long-Term**

- Established
- Trend
### Short-term Construction Material Demand Forecast

#### 2012 – Improvement but concentrated in several large projects
- Highway awards declined -30% before strong lettings late in year
- Infrastructure declines as large power, sewer, water and dam projects are not replaced
- Housing growth similar to 2011
- Weakness in office space drove buildings down

#### 2013 - Optimistic
- Highway up – driven by large projects
- Limited replacement projects in Infrastructure
- Housing growth continues (*both sf & mf*)
- Institutional and retail space awards grew in 2nd half of 2012
- Gov. building awards are up for first time in several years

<table>
<thead>
<tr>
<th>Northern Virginia</th>
<th>% Chg. YOY</th>
<th>2011 to 2012</th>
<th>2012 to 2013</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Enduse</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Highways</td>
<td>% Chg</td>
<td>expanding</td>
<td></td>
</tr>
<tr>
<td>Infrastr.</td>
<td>0% to -2%</td>
<td>expanding</td>
<td></td>
</tr>
<tr>
<td></td>
<td>10% to 15%</td>
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<td>Total Aggr.</td>
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<td>3% to 6%</td>
<td></td>
</tr>
<tr>
<td><strong>RMC Yds</strong></td>
<td></td>
<td>5% to 10%</td>
<td>0% to 5%</td>
</tr>
<tr>
<td><strong>HMA Tons</strong></td>
<td></td>
<td>0% to -5%</td>
<td>4% to 8%</td>
</tr>
</tbody>
</table>
# Construction Award Momentum

<table>
<thead>
<tr>
<th>Richmond Area</th>
<th>Postitive Award Momentum</th>
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<tr>
<td><strong>Public Construction</strong></td>
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<tr>
<td>Highways</td>
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<tr>
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<td>Turn</td>
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## Short-term Construction Material Demand Forecast

### Richmond Virginia

<table>
<thead>
<tr>
<th>Enduse</th>
<th>% Chg. YOY 2011 to 2012</th>
<th>% Chg 2012 to 2013</th>
</tr>
</thead>
<tbody>
<tr>
<td>Highways</td>
<td>-5% to -7%</td>
<td>declining</td>
</tr>
<tr>
<td>Infrastr.</td>
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</tr>
<tr>
<td>Housing</td>
<td>5% to 10%</td>
<td>expanding</td>
</tr>
<tr>
<td>Buildings</td>
<td>20% to 25%</td>
<td>flat to up</td>
</tr>
<tr>
<td>Total Aggr.</td>
<td>0% to -5%</td>
<td>flat</td>
</tr>
<tr>
<td>RMC Yds</td>
<td>5% to 10%</td>
<td>flat</td>
</tr>
<tr>
<td>HMA Tons</td>
<td>-2% to -7%</td>
<td>-1% to -3%</td>
</tr>
</tbody>
</table>

### 2012 – Housing & Distribution Centers

- Highway & infrastructure decline after awards fall -30% to -35%
- Housing finally starts to grow
- Retail growth driven by Amazon and a few other large projects

### 2013 – Flat to Slightly Down

- Highway and infrastructure continue weakness
- Single family housing grows faster than 2012; multi-family growth unclear?
- Commercial building spill over from 2012 – no replacement for large projects
- Gov. building awards grew in 2nd half of 2012 – this could provide upside in 2013
## Short-term Construction Material Demand Forecast

**Virginia Beach VA**

<table>
<thead>
<tr>
<th>Enduse</th>
<th>2011 to 2012</th>
<th>2012 to 2013</th>
</tr>
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<tbody>
<tr>
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<td>Total Aggr.</td>
<td>4% to 8%</td>
<td>3% to 6%</td>
</tr>
</tbody>
</table>

- **2012 – Highways & Single Family**
  - Strong awards in 1st half of 2012 drove highways
  - Weak awards in 2012 – some growth in sewers
  - Single family housing growth - 28%
  - Non-residential stops double digit declines (reached bottom - maybe)

- **2013 – Optimism based on Private Investment Growth**
  - Highway awards started to decline 2nd half of 2012
  - Sewers only positive as other infrastructure projects decline
  - Single family continues growth
  - Office and retail space weak, but institutional and government building awards grew in 2nd half of 2012

### % Chg. YOY & % Chg. 2012 to 2013

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<td>15% to 20%</td>
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<td>Total Aggr.</td>
<td>0% to -2%</td>
<td>-2% to 1%</td>
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</table>

**Central Virginia**

- **2012 – Retail Space & Infrastructure**
  - Highway projects concentrated in early 2012
  - Single family still looking for the bottom
  - Non-residential stops double digit declines with retail space work

- **2013 – Still Looking for the Bottom**
  - Highway and infrastructure – no big projects to turn it around
  - Single-family still looks weak, multi-family almost non-existent
  - Retail and institutional work may lead to a better in 2nd half of 2013
# Short-term Construction Material Demand Forecast

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## 2012 – Pipeline of Work Dried Up
- Highway awards decline 30% in 2012
- Infrastructure weakness caused by 70% decline in awards in 2011
- Housing has second year of decline
- Non-residential awards declined 68% in 2011

## 2013 – Pipeline is Still Weak
- Highway award weakness in 2nd half of 2012 continues
- Infrastructure awards late in 2012 may be enough to stop the fall
- Housing will turn, but add very little volume
- Private high school projects encouraging, but public buildings are the only other projects in the pipeline

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Early Stages of Recovery Can Be Tough

External Influences

Changing Market Conditions

VA Construction History
40 years of balance

Current Imbalance

Potential for Upside – Private Investment
Private Begins Recovery (from very low level)

Will private be strong enough in 2013?