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Moody's 2019 Outlooks

Homebuilding and Building Materials – North America

2019 Outlook

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Homebuilding – US

Homebuilding - US outlook stable

Outlook parameters

NEGATIVE

What could change the outlook to negative

- Sector's revenues will decline by more than 10% year-over-year over the next 12-18 months
- Weighted industry gross margins will fall below 15% over the next 12-18 months

STABLE

Drivers of the stable outlook

- Sector's revenue will grow within a range of -10% to +10% year-over-year during the next 12-18 months
- Weighted industry gross margins will range from 15% to 20% over the next 12-18 months

POSITIVE

What could change the outlook to positive

- US homebuilding sector's revenues will grow by more than 10% year-over-year over the next 12-18 months
- Weighted industry gross margins will exceed 20% over the next 12-18 months

Industry outlooks reflect our view of fundamental business conditions for an industry over the next 12-18 months. Since outlooks represent our forward-looking view on business conditions that factor into our ratings, a negative (positive) outlook suggests that negative (positive) rating actions are more likely on average. However, the industry outlook does not represent a sum of upgrades, downgrades or ratings under review, or an average of the rating outlooks of issuers in the industry, but rather our assessment of the main direction of business fundamentals within the overall industry.

Stable view reflects rising mortgage rates, inventories

Key Credit Themes

- We expect that homebuilders' revenues will grow in the 6% to 8% range in the next 12 to 18 months, in line with a stable outlook
  - the industry's growth will continue to diminish, with slowing new orders and prices
- Rising mortgage rates and increasing home prices continue to eat into affordability, which has declined for 5 straight quarters
- Inventory of new unsold homes is now the highest in 7 years
- Gross margins, our second outlook parameter, should hover around the 20% mark

Slowing new order growth

Revenue growth will follow suit

Y-O-Y homebuilding revenue growth

	Q1 2017	Q2 2017	Q3 2017	Q4 2017	Q1 2018	Q2 2018	Q3 2018
Median	16%	13%	7%	10%	16%	17%	14%
Average	15%	13%	10%	13%	17%	19%	17%

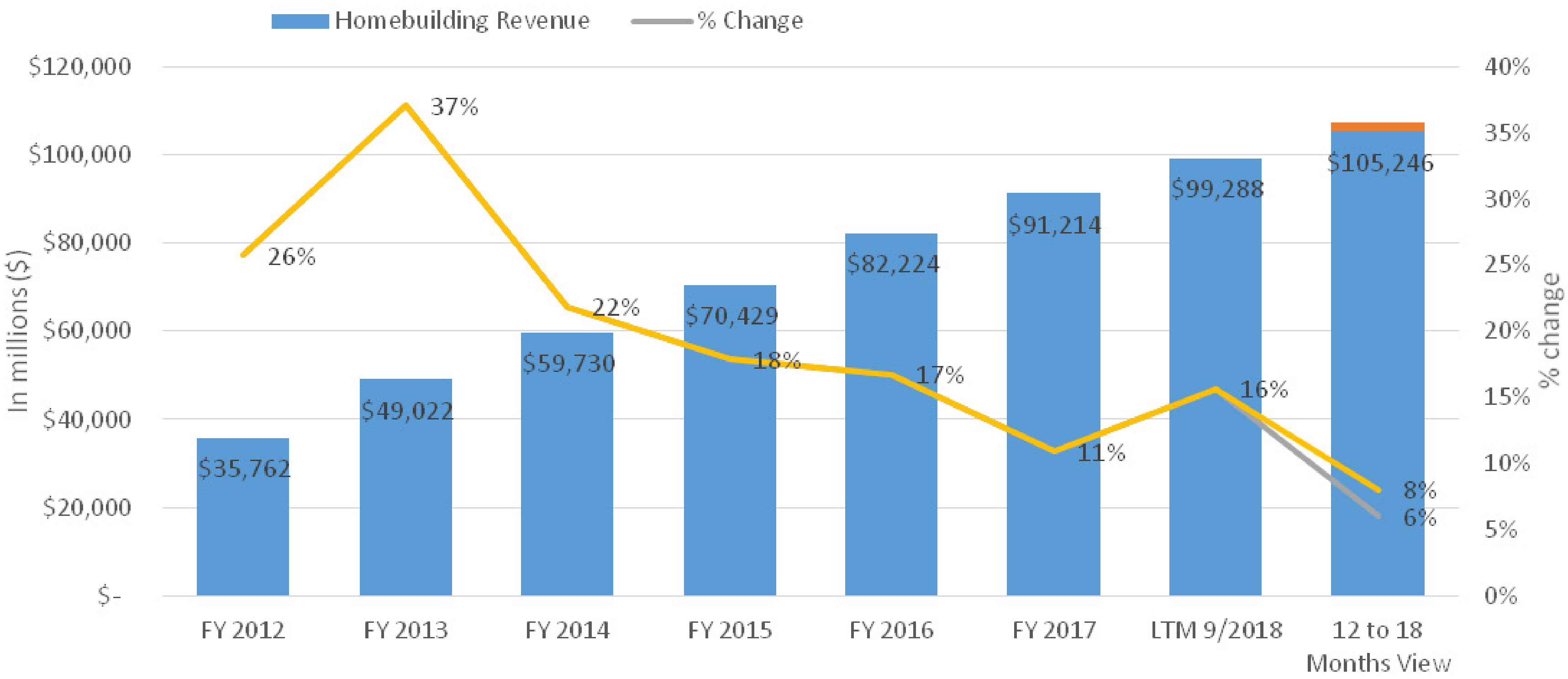
Y-O-Y homebuilding new order growth

	Q1 2017	Q2 2017	Q3 2017	Q4 2017	Q1 2018	Q2 2018	Q3 2018
Median	12%	9%	9%	18%	11%	5%	3%
Average	15%	10%	9%	18%	12%	10%	7%

Sources: Moody's Financial Metrics, Moody’s Investors Service

Homebuilder revenue to grow 6%-8% in 2019

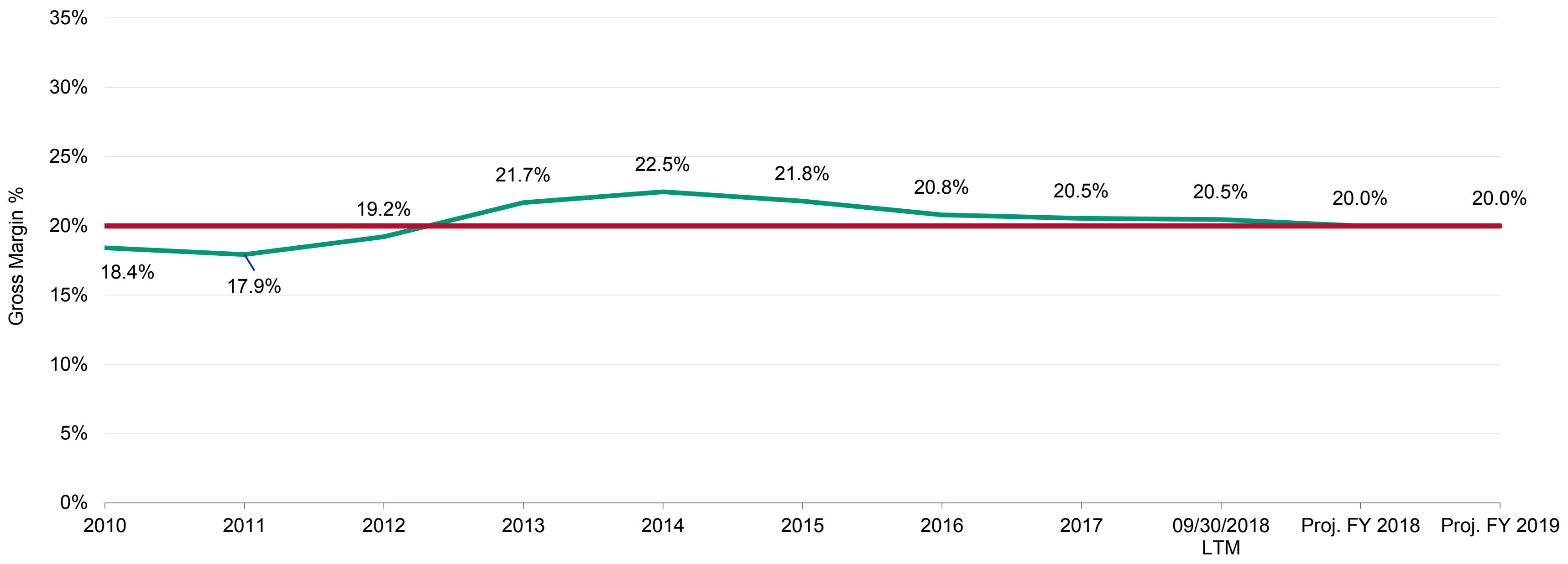
Slowing year over year growth



Aggregate revenue of rated homebuilders
Sources: Moody's Financial Metrics, Moody's Projections

Homebuilding gross margin hovers around 20%

Reflective of cost increases and decelerating pricing power



All figures are calculated using Moody's estimates and standard adjustments
Sources: Moody’s Financial Metrics, Moody’s Projections

Outlook stable, but homebuilders face concerns

FINANCIAL STABILITY

- Interest rates, and therefore mortgage rates, have risen making the all-in cost of owning a home (mortgage, tax, maintenance) less affordable

TRADE TENSIONS

- Raw-material cost increases exacerbated by tariffs, particularly on steel, aluminum and lumber

POLITICAL RISKS

- Tighter immigration policies have worsened skilled labor shortages, causing longer construction times and higher costs for homebuilders
- Negative impact on market's luxury segment from tax-law changes

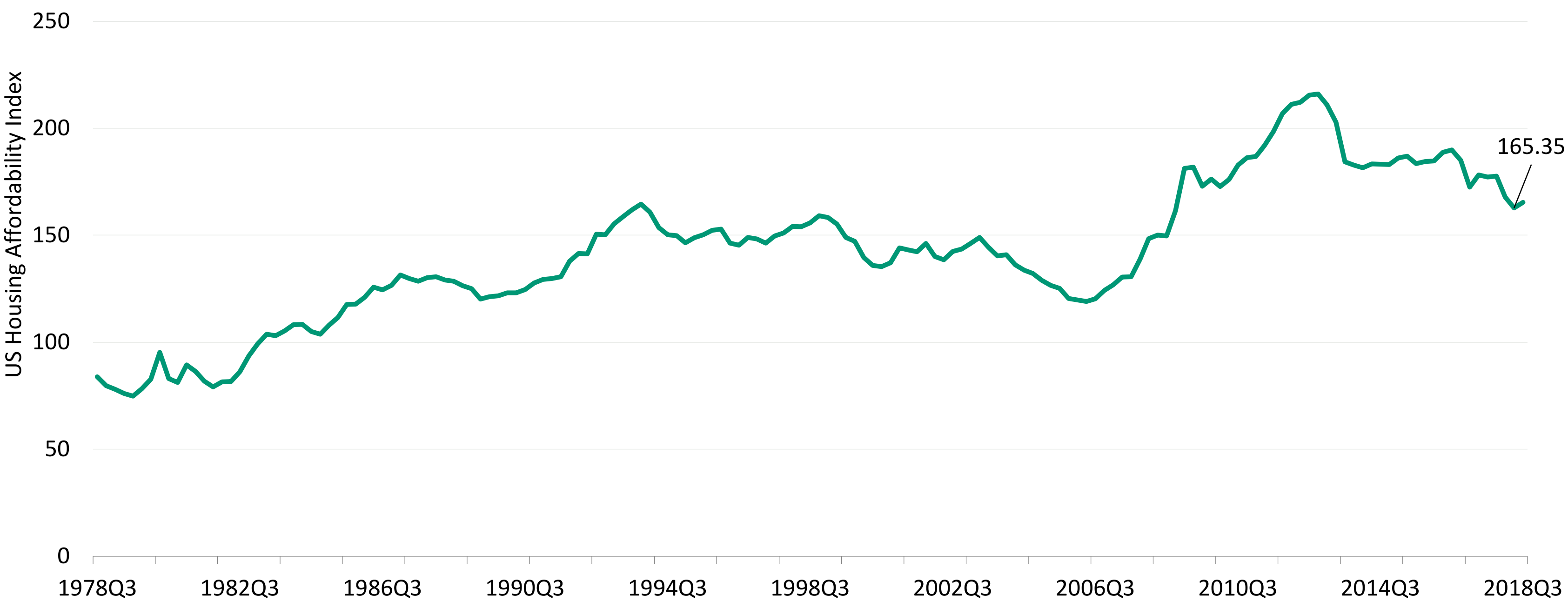
Concerns facing homebuilders

- Interest rates, and therefore mortgage rates, expected to rise further
  - Cost of owning a home (mortgage, tax, maintenance) is less affordable
  - Recent declines in single-family new home sales, existing home sales
- Land prices, raw-material costs rising, the latter exacerbated by tariffs
- Skilled labor shortages remain, causing longer construction times and higher cost to homebuilders
- Shortages of developed land persist
- New home inventory supply expanding
  - Home buying traffic is reported to be slowing, homes unsold for longer
- Negative impact on luxury segment from tax law changes
- Budget deficits expanding, despite the robust economic growth
- Cost comparisons increasingly favor renting over buying

Affordability is declining

Affordability reading has weakened in 5 straight quarters

Housing Affordability Index, US*

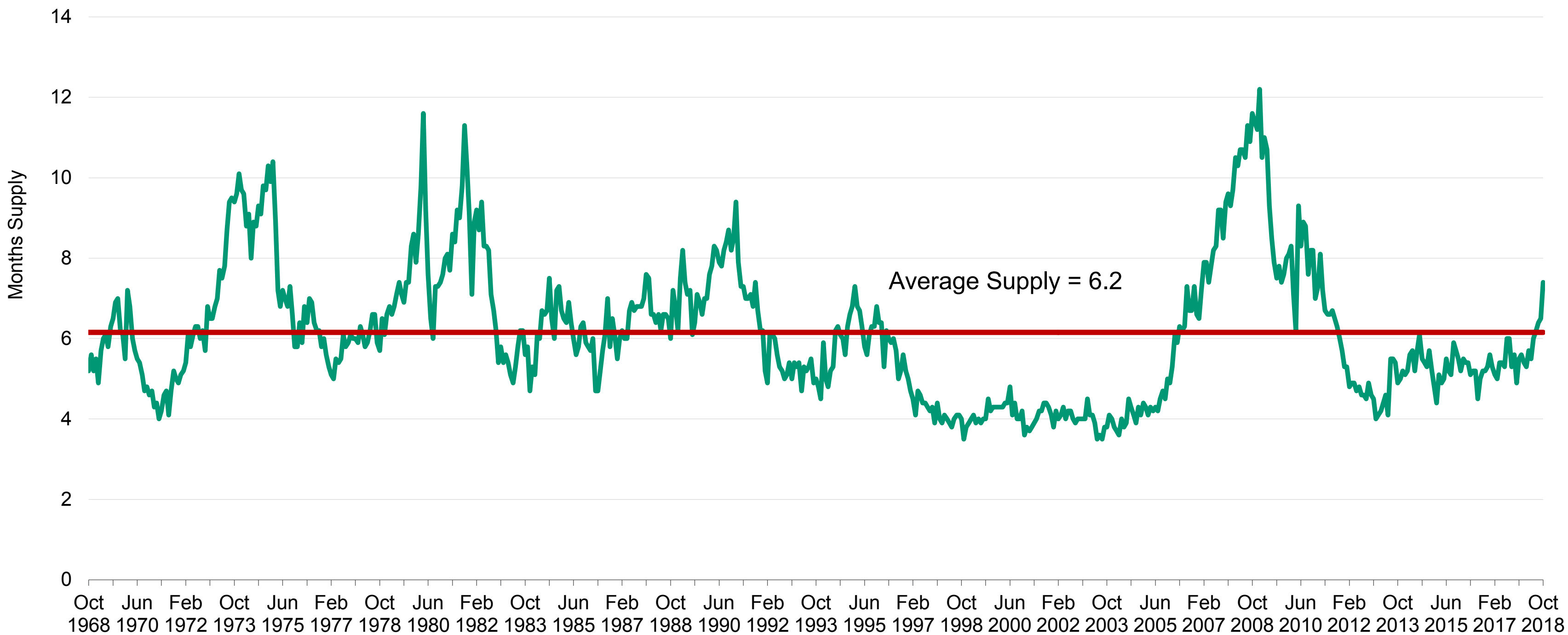


Sources: National Association of Realtors (NAR): Real Estate Outlook; US Census Bureau (BOC); US Bureau of Economic Analysis (BEA); Moody's Analytics Estimates
*An index value of 100 means that a family with the median income has exactly enough income to qualify for a mortgage on a median-priced home.

Home supply is building up

Inventory of new unsold homes reached 7 months, first time since 2011
Six-month supply is considered a norm for a stable housing market

Months Supply at Current Sales Rate



Sources: U.S. Census Bureau, Moody's Analytics

Underlying fundamentals remain strong

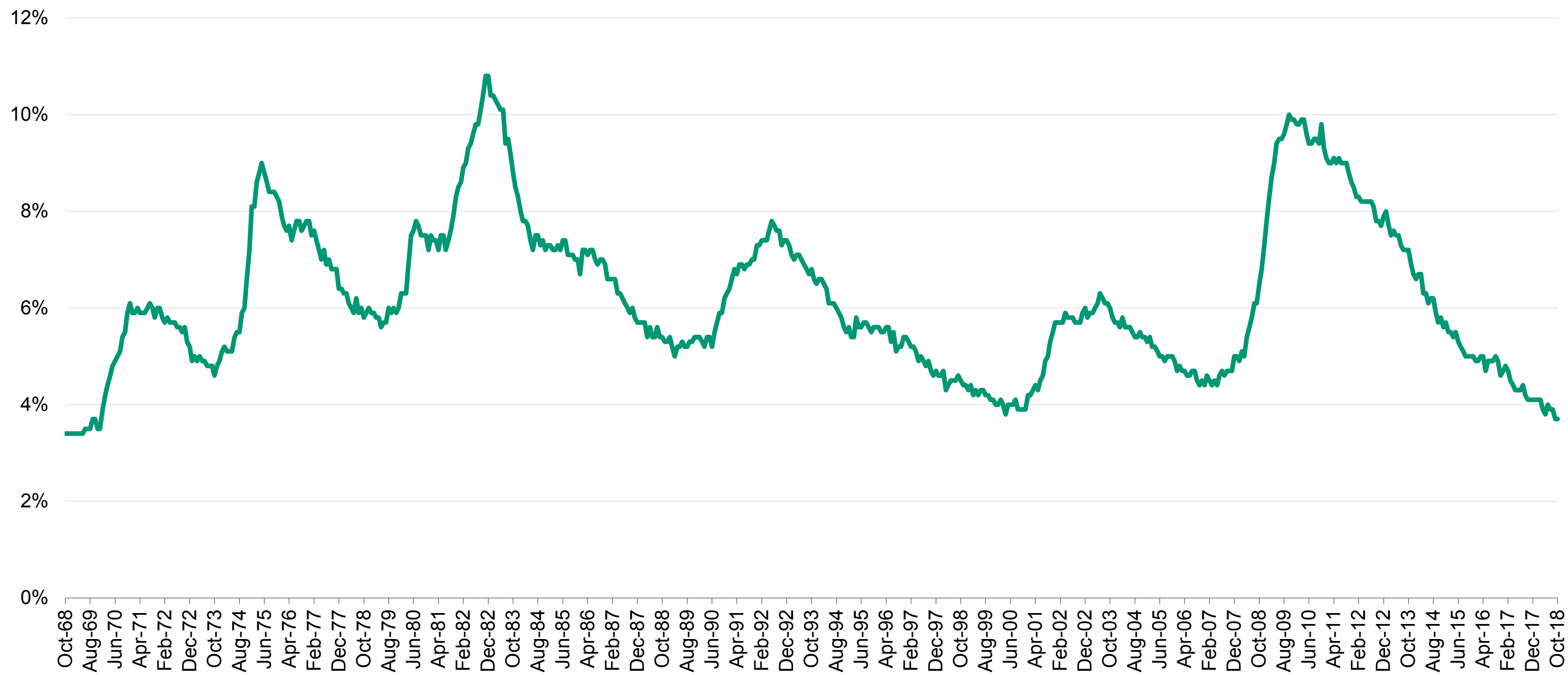
Despite the moderation in growth

- Unemployment claims at 49-year low, unemployment rate lowest in 20 years
- Nearly 20-year high consumer confidence
- Wage and household income growth gaining traction
- GDP growth vigorous
- Millennial demand to remain significant source of growth over next 20 years
- Many homebuilders focusing on construction of affordable, entry-level homes
- Cancellations remain at acceptable levels
- Order backlogs robust
- Housing starts, new home sales still trending below long-term averages, indicating an absence of excess, or froth
- Homebuilders' performance trends exceed macro statistics because they take share from smaller builders, are more efficient, and have better capital access and land-buying opportunities

Strong employment environment

Unemployment rate at 20 year low
Recent unemployment claims at 49-year low

Unemployment rate

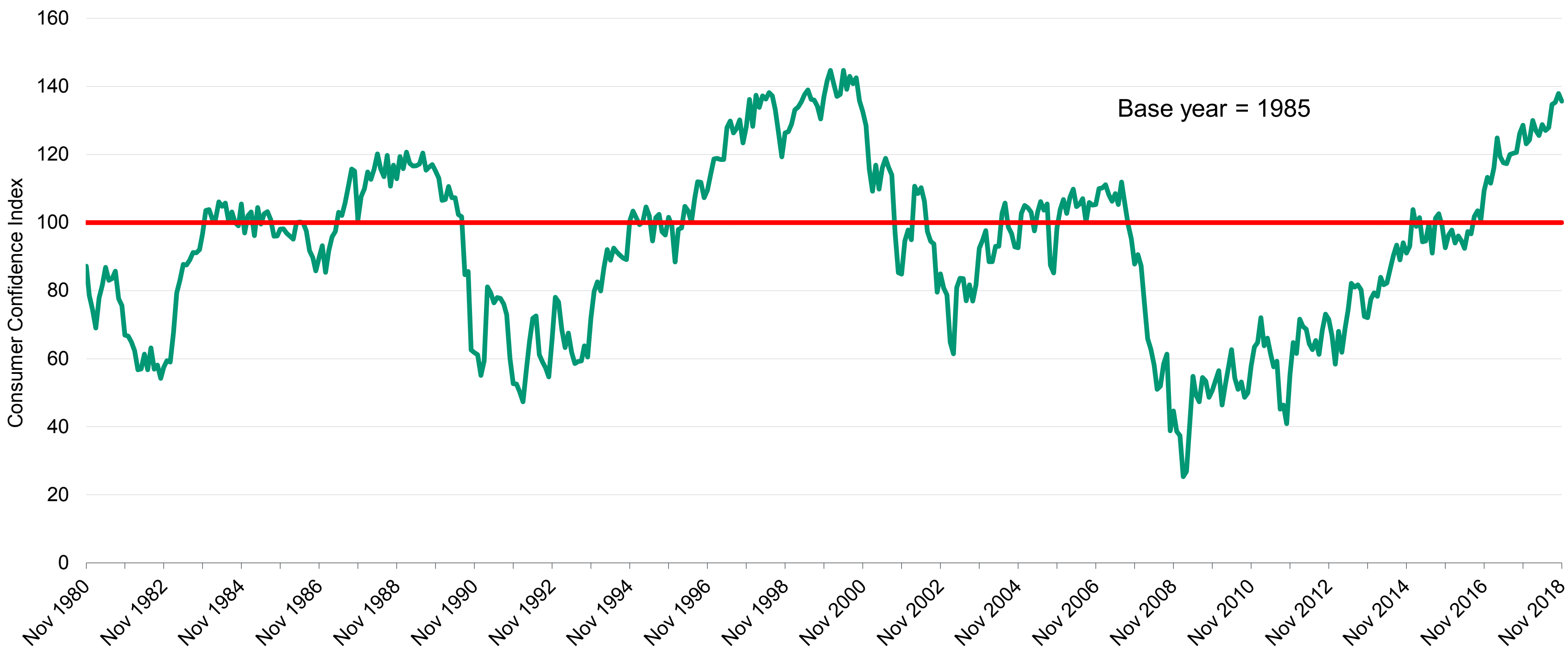


Sources: U.S. Bureau of Labor Statistics (BLS): Current Population Survey, Moody's Analytics

Solid Consumer Confidence

Strongest level in nearly 20 years

Consumer Confidence Index



Sources: The Conference Board, Moody's Analytics

Macro Housing Data and Forecast

Slower growth projected ahead

Housing starts, new home sales, prices - moderating increases

In 000's	2013A	2014A	2015A	2016A	2017A	2018P	2019P
Total Housing Starts	925	1,003	1,112	1,174	1,203	1,268	1,305
% YOY Change		**8.4%**	**10.9%**	**5.6%**	**2.5%**	**5.4%**	**2.9%**
Single-Family Housing Starts	618	648	715	782	849	887	915
% YOY Change		**4.9%**	**10.3%**	**9.4%**	**8.6%**	**4.5%**	**3.2%**
Multi-Family Housing Starts	307	355	397	392	354	381	390
% YOY Change		**15.6%**	**11.8%**	**-1.3%**	**-9.7%**	**7.6%**	**2.4%**
New Home Sales (defined as single-family)	429	437	501	561	614	625	640
% YOY Change		**1.9%**	**14.6%**	**12.0%**	**9.4%**	**1.8%**	**2.4%**
New Home Price Gains (median)	9.5%	6.9%	5.0%	4.6%	5.3%	1.0%	1.0%
Existing Home Sales (defined as both single- and multi-family)	5,090	4,940	5,250	5,450	5,510	5,400	5,450
% YOY Change		**-2.9%**	**6.3%**	**3.8%**	**1.1%**	**-2.0%**	**0.9%**
Existing Home Price Gains (median)	11.5%	5.7%	6.8%	5.1%	5.7%	4.2%	3.0%

Sources: U.S. Census Bureau, National Association of Realtors, Moody's Projections

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Building Materials

Building Materials – US: Outlook stable

Outlook Parameters

NEGATIVE

What could change outlook to negative

» Operating income expected to contract by 3% or more over the next 12 – 18 months

» Momentum in end markets reverses

» Reversal of broader economic indicators pointing to recessionary conditions

STABLE

Drivers of the stable outlook

» Operating income change expected to be between minus 3% to plus 7% over the next 12 – 18 months

» Modest, but stable momentum in public, private residential and private non-residential construction

POSITIVE

What could change outlook to positive

» Operating income expected to grow by more than 7% over the next 12 – 18 months

» Solid momentum in public, private residential and private non-residential construction continues

» Stable federal highway spending

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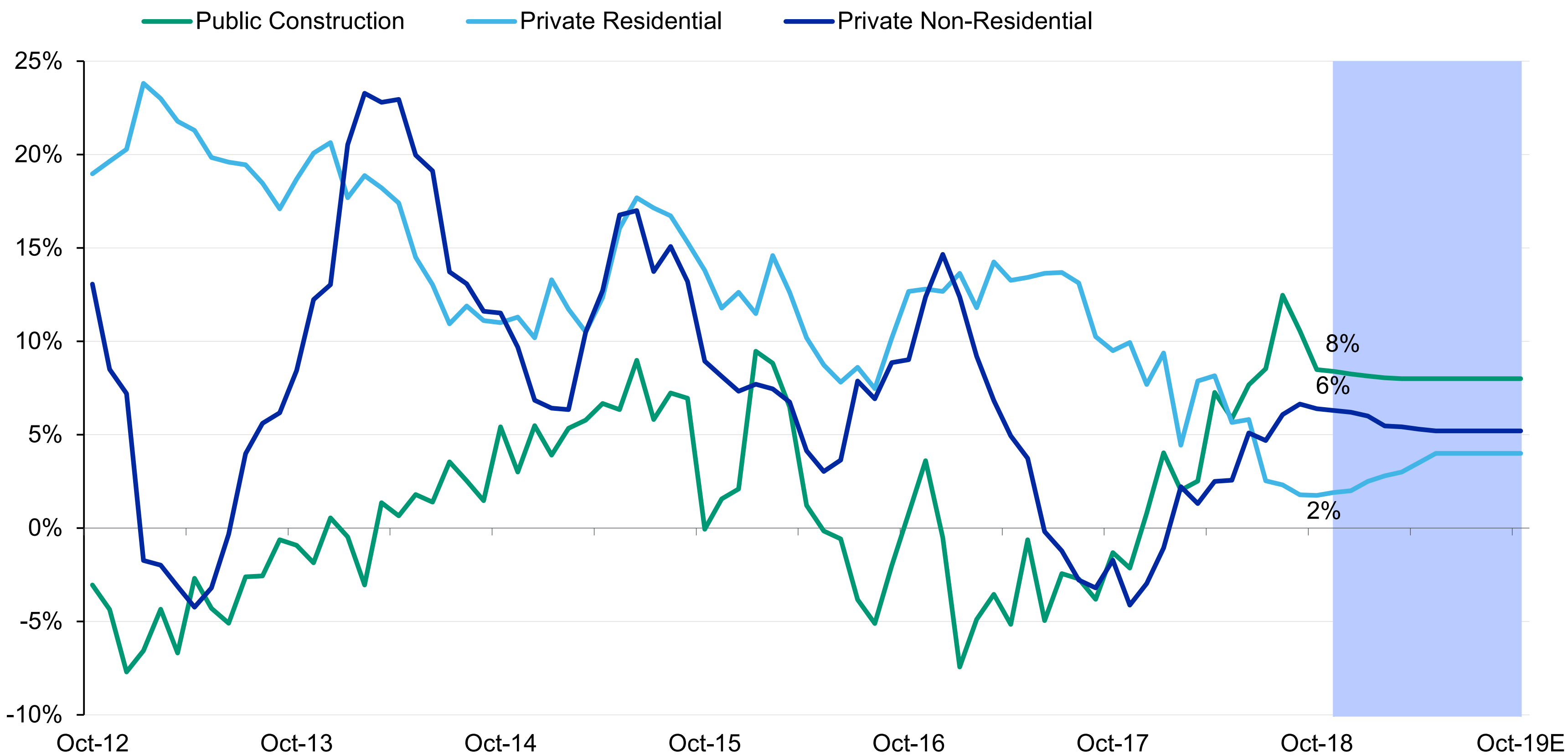
Stable outlook reflects maturing construction cycle

Key credit themes

- We expect organic operating income growth to moderate coming in at or slightly below 7% in 2019, which is at the high end of the growth range for a stable outlook
- Private construction growth is decelerating, with several key factors pointing to a slowdown (rising mortgage rates, decline in housing affordability, labor constraints, high materials cost)
- Public infrastructure spending remains robust, particularly at the state level
- Price increases have largely moderated, but remain positive

Construction put in place

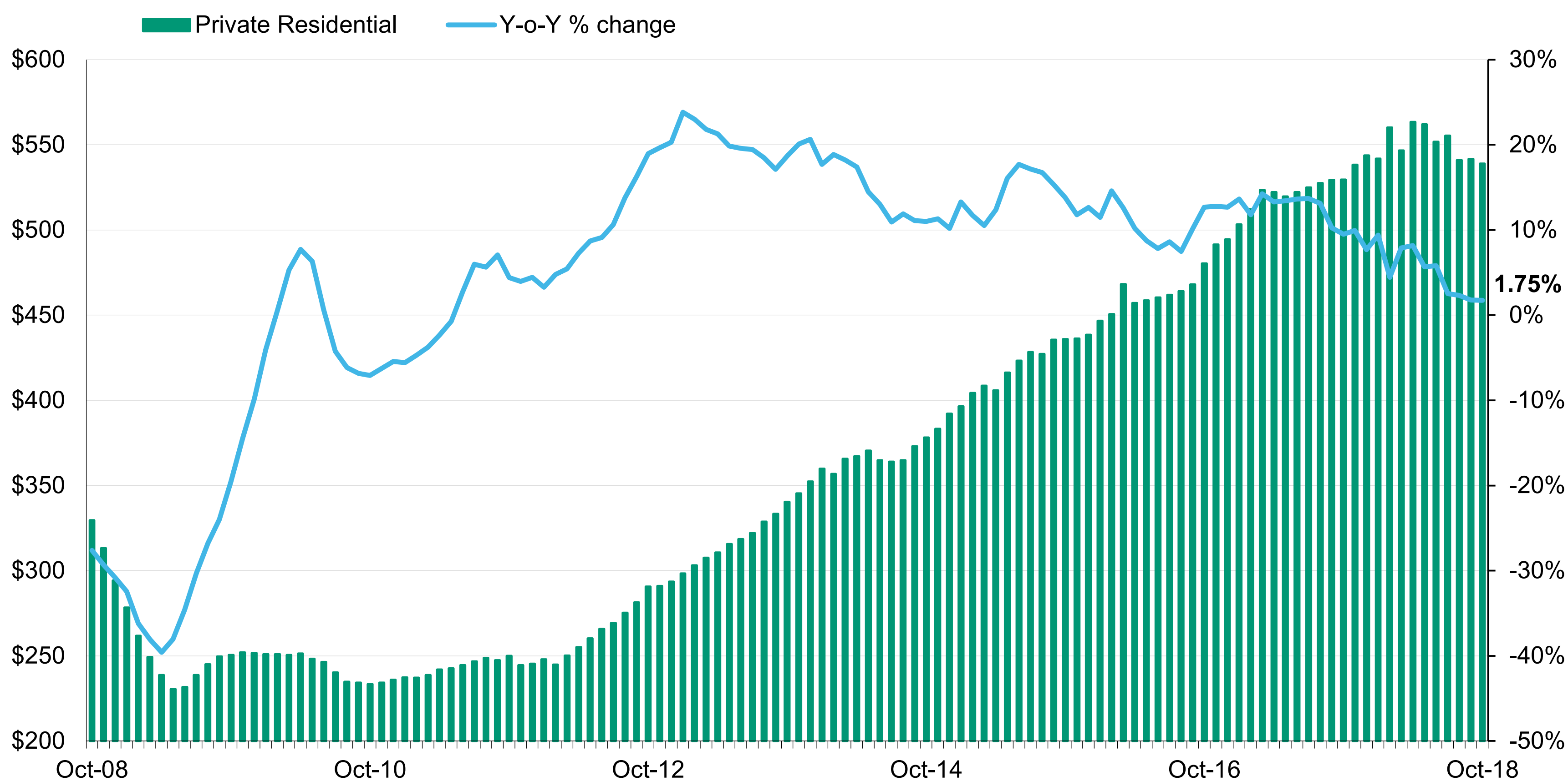
Percent change in construction put in place, year-over-year



Sources: Based on seasonally adjusted data from the U.S. Census Bureau, Moody's Analytics; Figures 11.2018 – 10.2019 are Moody's Analytics Forecasted

Private residential construction

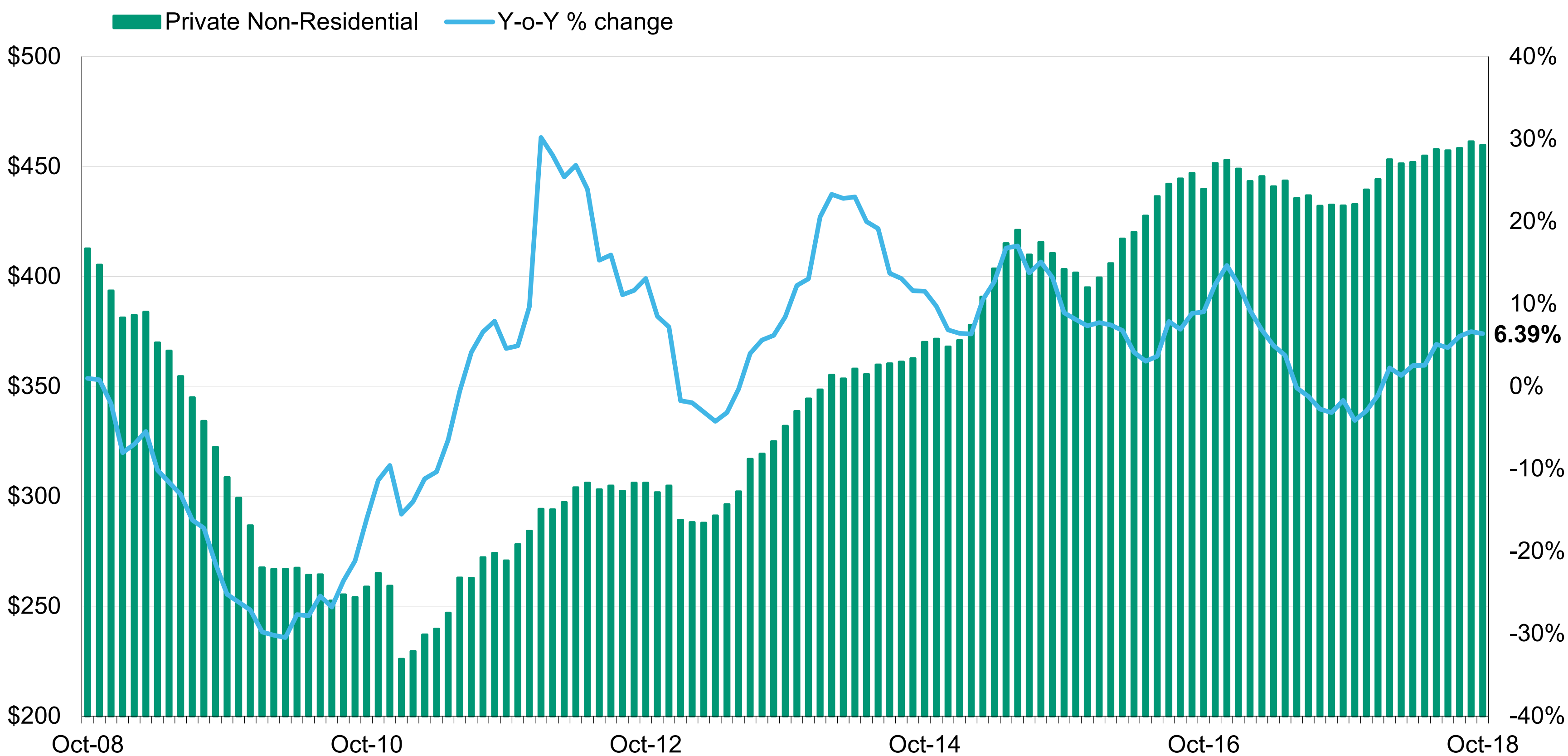
Growth in spending is slowing



Sources: Based on seasonally adjusted data from the U.S. Census Bureau

Private non-residential construction

Spending growth to slow to low single-digit % in 2019

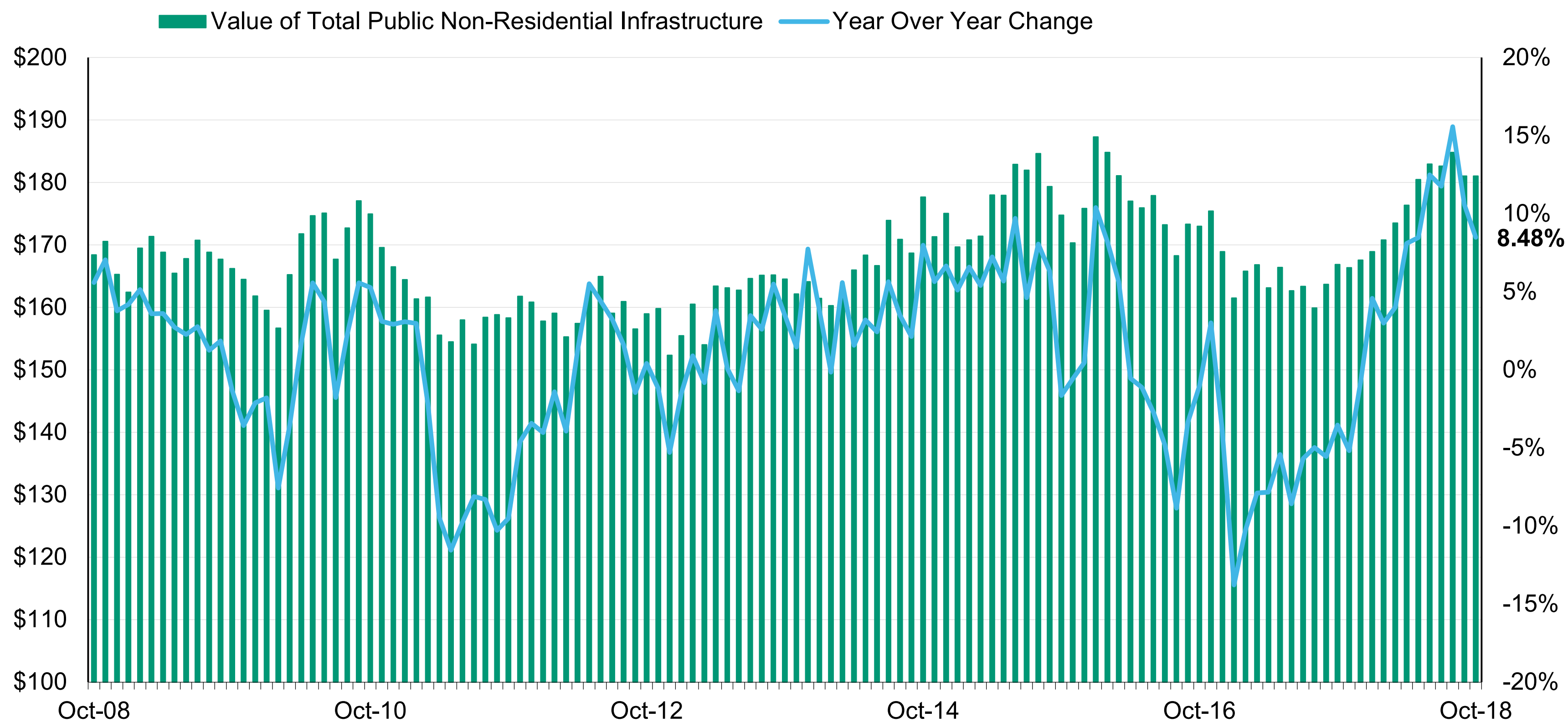


Sources: Based on seasonally adjusted data from the U.S. Census Bureau

Public Construction

Total infrastructure construction spending remains robust

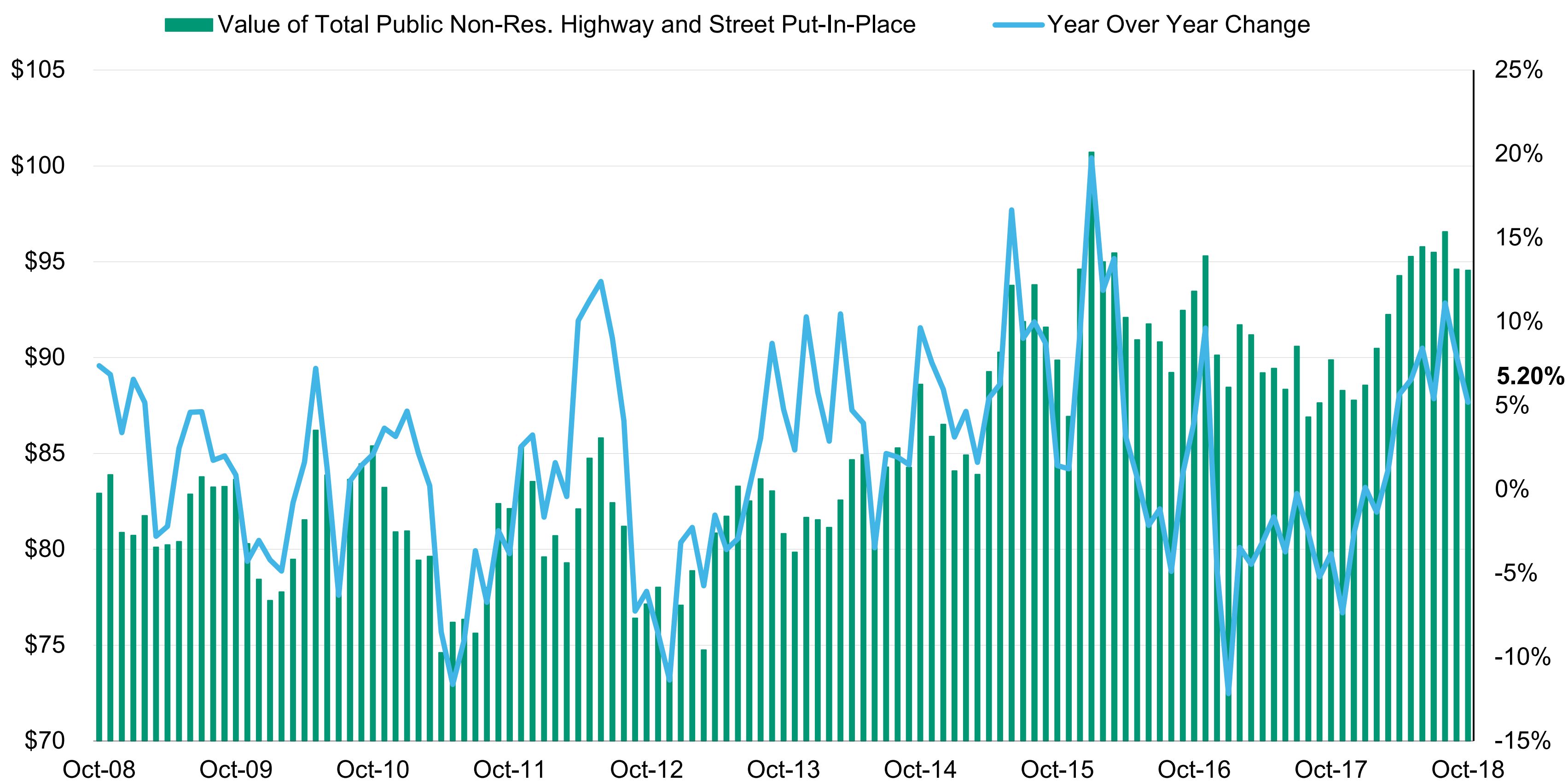
» State government spending on roads drives continued growth



Sources: Based on seasonally adjusted data from the U.S. Census Bureau

Public Construction

Highway/street construction grew for the past 8 months



Source: Based on seasonally adjusted data from the U.S. Census Bureau

Solid metrics for building material companies

Ratings likely to hold steady

- Liquidity strong for rated companies, minimal near-term maturities, high levels of cash and credit line availability
- Free cash flow generation will be used for growth, debt repayment and share buybacks
- Price continues to increase but at more moderate pace
- Product mix continues to shift towards aggregates
- Approval of a federal infrastructure plan would support longer-term stability of sector, but timing is unclear
- Tight labor supply and increasing material costs will temper growth

Building Materials - US

Issuers of Interest

- **Martin Marietta Materials, Inc.** (Baa3 negative) was placed on negative outlook following announcement of a 2017 acquisition that increased adjusted debt-to-EBITDA to 3.4x at YE17 from 2.3x at YE16. Leverage remains at 3.4x for the 12 months ended 9/30/18, with severe weather in 2018 delaying projects. We expect the company to de-lever through adjusted EBITDA growth and moderate balance sheet debt reduction in 2019
  - The company is more vulnerable to any setback in market conditions.
- **New Enterprise Stone & Lime Co.** (B3 positive) was placed on positive outlook in February 2018 as a result of improvement in the company's construction end markets and key credit metrics
  - Adjusted debt-to-EBITDA should decline to below 5.0x over the next few years, primarily through EBITDA growth balance sheet debt paydowns.

Moody's related publications

Homebuilding and Building Materials

Industry Outlook:

» Homebuilding – US: Slower growth, increasing headwinds, prompt outlook cut to stable from positive

» Building Materials – US: Revising outlook to stable amid maturing construction cycle

Sector Comments:

» Homebuilding – US: Regional effects on homebuilding from Hurricane Florence, but no expectation of significant damage to operating results

» Building Materials – US: Hurricane Florence likely to have limited impact on second-half operating results

Methodology:

» Homebuilding and Property Development Rating Methodology

» Building Materials Industry Rating Methodology

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