Industry Top Trends Update

Building Materials

Recovery looks choppy after steep decline from COVID-19

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What's changed post-COVID?

Credit quality takes a hit, but business prospects hold up. Negative outlooks have tripled in mid-2020 to more than 50% of the rated portfolio, exposing pockets of high debt and restructuring costs after several years of leveraged buyouts (LBOs), mergers, and acquisitions. Even with the near-term hit to profits, the pandemic could boost at-home spending, while long-term demand prospects remain intact.

April was the cruelest month, but May and June bounced back. A pause by homebuilders, a pullback by consumers, and production problems resulted in big April declines. But homebuilders and consumers quickly resumed construction and DIY projects. Heavy construction/infrastructure looks steady. Repair and remodeling has held up well, particularly for supplies sold through home-improvement centers. Higher-priced, more discretionary (and less socially distant) products (e.g. kitchens and baths) declined sharply and may recover more slowly.

Unlike the Great Recession, issuers reacted quickly. Nearly all issuers cut operating costs by furloughing staff, reduced capital spending and discretionary shareholder returns, and shored up liquidity. These quickly lowered break-even points and better positioned companies for profitability when demand returns.

What is the likely path to recovery?

Barring more lockdowns and restrictions, we expect demand and revenues to improve sequentially through 2021. We expect annual sales for most building materials companies will be down 10%-15% in 2020 because of the very weak second quarter, which likely would drive EBITDA down 15%-25% for the year. We assume an uneven return to 2019 profitability by early 2022.

Homebuilders lead the way, backstopped by repair and remodeling (R&R). With a shortage of available new and resale homes in the U.S. and a spark of interest in suburbs, homebuilding adds to baseline R&R demand for building materials. But the strength of home construction and home reinvestment will be tested by the tug of war between record-low interest rates and record-high job losses. State and local budgets are firm for 2020, but fiscal pressure could affect 2021 spending.

Credit deterioration would accelerate if conditions don't improve in 2021. Our base-case scenario indicates a one-notch downgrade for 10%-15% of issuers in the next year, for a portfolio with a modal rating of 'B/B+'. Credit quality for these issuers will rely heavily on the profit outlook in the spring-summer 2021 selling season to consider refinancing 2022 maturities from 2015-2016 LBOs.

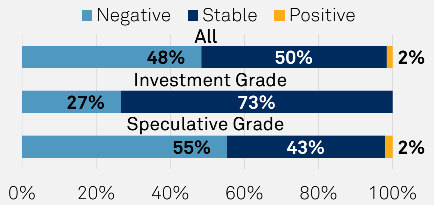
What are the key risks around the baseline?

High unemployment and uncertain benefits. Demand for new projects is bound to decline if most people do not return to work soon and benefits wane, and higher joblessness will push some first-time homebuyers out of the market.

Renewed lockdowns could cause regional dips. COVID-19 cases have spiked in large states such as Texas, Florida, and California. So-called "smile states" across the U.S. South account for an outsize portion of building materials demand given their economic and population growth.

Public infrastructure is a question mark. State income and gasoline tax collections, normally a large source of highway funding, are way down. Without new federal or state infrastructure measures, volumes in heavy materials cement and aggregates producers could decline 10%-20% in 2021.

Outlook Distribution



Ratings Statistics (YTD)

	IG	SG	All
Ratings	15	47	62
Downgrades	1	4	5
Upgrades	1	1	2

Ratings data as of end-June, 2020

COVID-19 Heat Map

Building Materials	
COVID-19, Recession, and O&G Impact	Moderate
Potential Negative Long-Term Industry Disruption	--

2020 Estimates v. 2019

Revenue Decline	EBITDA Decline	Incremental Borrowings
10% to 15%	15% to 25%	No increase

2021 Estimates v. 2019

Revenue Decline	EBITDA Decline
0% to 10%	10% to 20%