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Summit Materials

Second Quarter 2019 Earnings Conference Call

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PRESENTATION

Operator:

Greetings, and welcome to Summit Materials Second Quarter 2019 Earnings Conference Call. At this time all participants are in a listen only mode. A question and answer session will follow the formal presentation. If anyone should require Operator assistance during the conference, please press star, one on your telephone keypad.

As a reminder, this conference is being recorded. I would now like to turn the conference over to your host, Mr. Brian Harris. You may start.

Brian Harris:

Good morning. This is Brian Harris, and I would like to welcome you to Summit Materials Second Quarter 2019 Results Conference Call. We issued a press release before the market opened this morning, detailing our second quarter results. This call will be accompanied by our second quarter 2019 investor presentation and an updated supplemental workbook highlighting key financial and operating data, both of which can be found in the Investors section of our website.

I would like to remind you that Management's commentary and responses to questions on today's call may include forward-looking statements, which by their nature are uncertain and outside of Summit Materials' control. Although these forward-looking statements are based on Management's current expectations and beliefs, actual results may differ in a material way. For a discussion of some of the factors that could cause actual results to differ, please see the Risk Factors section of Summit Materials' latest Annual Report on Form 10-K, which is filed with the SEC. Additionally, you can find reconciliations of the historical non-GAAP financial measures discussed in today's call in this morning's press release.

Today's call will begin with remarks from Tom Hill, who will provide an update on our business, and I will provide a financial review and Tom will finish with an update on our Management outlook. At the conclusion of these remarks, we will open the line for questions.

With that, I'll turn the call over to Tom.

Thomas Hill:

Good morning, everyone, and thank you for joining our call. Turning to Slide 4 of the presentation. Net revenue grew 0.6% in the second quarter and 2.3% in the first half, supported by both organic and acquisition growth from deals completed in 2018. Our aggregates business, in particular, continued to deliver strong performance through the first half, with mid-single-digit organic volume increases and mid to high single-digit organic price improvement versus the prior year period.

Adjusted EBITDA grew 3.8% in the second quarter and 4.4% in the first half, supported by top line growth and stabilizing cost. Excluding the impact of acquisitions, Adjusted EBITDA increased 1.4% in the second quarter and 1.0% in the first half as a strength of our diversified vertically integrated business model, offset the negative impacts of the record precipitation in most of our markets and the catastrophic Mississippi River flooding.

Given the extremely challenging River environment during the first half, we are especially pleased with the resilience, performance of our Cement business. We remain focused on prudent capital allocation, which over time will reduce our leverage. Organically, our aggregates Greenfields quarries, which we will discuss in more detail later, are progressing and are expected to generate superior returns. Although the pace of acquisitions has slowed relative to recent years, our pipeline remains active, and we continue to evaluate compelling transactions where we believe we can add meaningful value.

Turning to Slide 5. Our strong aggregates performance through the first half has more than offset the cement shortfall. Severe flooding impacted both our cement business, where barge shipments were halted for several months, and our Oklahoma aggregates operation where our dredge sank due to high water levels. If you adjust for these two impacts, we realized significant real price growth in the first half. This pricing momentum is expected to continue through the remainder of the year and in conjunction with pent-up demand across our markets, drive meaningful incremental earnings.

The foundation of our business is materials, aggregates and cement, which comprise the majority of our adjusted cash gross profit. These businesses have high barriers to entry with strong underlying pricing momentum and the long-term reserves underwrite future value appreciation. It's like prepaying for 99 years of inventory where the value of the inventory keeps going up.

In our vertically integrated model, we supply aggregates for the production of our downstream products, ready-mix and asphalt, and supply aggregates and asphalt to our paving business. This model, in well-structured aggregates markets, extracts greater value for our shareholders. Our downstream products and services allow us to achieve market rate margins along the entire value chain and expand our overall profitability per ton of materials sold, while also providing increased avenues for growth within our markets, both organically and by acquisition.

Turning to Slide 7. U.S. aggregate consumption remains well below peak levels. High barriers to entry, diversified end use and strong pricing dynamics are contributing to the positive outlook for this industry. Since our IPO, we have expanded and improved our aggregates business. As a result, between 2014 and 2018, we grew our adjusted cash gross profit at a 26% CAGR, and increased our adjusted cash gross profit per ton by 35%.

Our aggregates business now represents 39% of our total adjusted cash gross profit, a 40% increase in contribution versus 2014. Considering the growth and magnitude of our aggregates adjusted gross profit, $222 million in 2018, we believe that the value of our aggregates business remains at a significant discount to our peer group.

Turning to Slide 8. Our aggregates business has benefited from volume growth, pricing momentum and stabilizing cost. The volume growth has been steady across all end markets, particularly the public segment. This trend should continue with rising DOT funding levels, the significant flood-related levee repairs required in Missouri and the increase in wind farm activities throughout the Midwest. Organic pricing growth through the first half has been robust at 7.4%. We anticipate strong real price increases to continue through the second half and into the next year and expect meaningful expansion in our margins.

Further, with several new aggregates capital projects coming online this year, we expect to see additional cost reductions going forward.

Turning to Slide 9. Over the past few years, we've increased our Greenfield quarry development efforts in light of the limited availability of pure play aggregates acquisition opportunities and increase in valuations. Although Greenfields can take years to develop and are capital intensive upfront, they provide access to high-growth markets and offer higher returns than many acquisitions. Our primary geographic focus has been the Southeastern U.S., which has multiple well-structured, high-growth markets, but limited acquisition opportunities.

Targeting locations in this geography also complements our existing geographic footprint across Virginia, the Carolinas and Georgia. Today, we have seven projects completed or under development with committed capital and several more in diligence. With the seven completed or under development projects, our reserve base has increased by approximately 390 million tons, and we estimate that these projects will generate shipments of over 6 million tons, $40 million of Adjusted EBITDA and mid-teens free cash yield by 2024. Since 2014, we have spent $78 million and expect to spend additional $128 million over the next few years.

While timing is uncertain, we could spend up to a quarter of the remaining investment in our second half capital expenditures, which would be incremental to our guidance range. Greenfield development has been an important part of our capital allocation strategy to date, and we expect this to continue in the future.

Turning to Slide 10. We operate the two most northern cement plants on the Mississippi River, both of which are modern and highly profitable with run rate EBITDA margins in the low 40% range. With over 500 million tons of reserves and a distribution network of nine terminals that runs the length of the Mississippi River, we believe our cement segment will generate significant long-term value, particularly in light of the industry's high barriers to entry, U.S. consumption remaining well below peak levels and U.S. pricing having grown well in excess of inflation historically.

Turning to Slide 11. Flooding on the Mississippi River as a result of the wettest January to June period on record in the U.S., created significant challenges for our cement business. In Davenport, the River was above flood stage for a record 95 consecutive days, double the prior record. While in Hannibal, the River was above flood stage for a record 106 consecutive days.

As a result of this extensive flooding and the issues previously highlighted in Q1, our cement business was negatively impacted by approximately $8 million through the first half. Further, with the shortened River shipping season, decreased barge availability and increased traffic upon the River opening, we expect to incur an additional $3 million to $5 million of flood-related impact in the second half. Despite a very challenging first half, our plants are running well, alternative fuels are exceeding expectations and underlying demand remains robust.

For the year, it is unlikely that cement will be able to recover the estimated $12 million Adjusted EBITDA impact, but we do expect it to be offset by our strong aggregates performance and the anticipated acceleration of products margins in the second half.

Turning to Slide 12. As I mentioned earlier, our products and services lines of business generate incremental earnings throughout the heavy side construction materials value chain. We focus our downstream business on select well-structured aggregates markets in which Summit is a top supplier. The attractiveness of these businesses is their ability to support stable aggregates demand, produce a higher relative return on invested capital and expand our acquisition target universe.

With that, I'll turn the call over to Brian for a discussion of our financial results.

Brian Harris:

Thank you, Tom. Turning to Slide 14. I would like to start with the quarterly revenue bridge. In the West segment, net revenue declined by $20.4 million primarily resulting from the sale of a noncore business in the third quarter of 2018 and unfavorable weather in Texas and Utah, which delayed the start of the season and negatively impacted ready-mix volumes. This was partially offset by increases in organic aggregates volumes and average selling prices. In the east segment, net revenue increased by $21 million, primarily due to strength in both organic aggregates volumes and average selling prices.

There was a slight increase in net revenue from cement due to a 2.2% increase in organic volume despite the weather challenges that Tom described.

Turning to Slide 15. Here we show the key GAAP financial metrics. We reported a basic net income per share of $0.32, which was the same as the prior year. Operating income improved by about $3 million in Q2 over the prior year, but remains about $3 million below the prior year-to-date. We reported a positive net income attributable to Summit Inc. of $36.4 million in Q2 2019, which was slightly ahead of the prior year.

Turning to Slide 16. Our adjusted cash gross profit margin for the second quarter improved slightly, but is still slightly behind the prior year-to-date. As Tom mentioned earlier, our gross margins were negatively impacted by the elevated costs associated with flooding in the period.

Adjusted EBITDA margin was above 25% in Q2, indicating a positive upward trend as we enter our busiest period of the year.

Turning to Slide 17. You will notice that average selling prices in our aggregates line of business showed a significant improvement over the prior year, both organically at plus 7.4% and in total at plus 8.5%. Cement prices were flat with the prior year, reflecting a complex customer mix caused by the flood disruption and the ongoing competitive environment. As the mix of our business shifts towards the northern markets in the second half, we expect some upward movement on average selling price, and on a full year basis we still expect pricing to improve over the prior year. Despite the disruption caused by river flooding, we were able to service our customers' needs.

In our products lines of business, we reported a volume decline in ready-mix of 5.9%, reflecting the wet conditions in Texas and the slow start to the season in Utah. Asphalt volume grew 2.9% over the prior year period, and average selling price increases were both positive at plus 1.9% on ready-mix and plus 5.9% on asphalt.

Turning to Slide 18. Although consolidated gross margins remain slightly lower year-on-year, this was largely due to the cost associated with flooding. As we move into our peak selling season, we are encouraged by the positive volume and pricing trends, which we believe will drive margin expansion in the second half of the year.

As anticipated, our leverage ratio decreased only slightly during Q2, reflecting the higher level of capital expenditure, which occurred during the first half. Our cash balance increased slightly to $67.7 million, resulting in a leverage ratio of 4.7 times compared to 4.8 times at the end of Q1. At the midpoint of our Adjusted EBITDA guidance, we expect our net leverage at the end of the year to be below 4 times.

For quarterly modeling purposes in the remainder of 2019, SG&A should be in a range of $65 million to $68 million, DD&A should be in a range of $53 million to $55 million, and interest expense should be in a range of $28 million to $30 million. We anticipate paying minimal state in local cash taxes and no U.S. federal income taxes.

Finally, with regards to total equity interest outstanding as of June 29, we had a weighted average of 112.1 million Class A shares outstanding, and 3.4 million LP units held by investors, resulting in total equity interest outstanding of 115.5 million and this is the share count that should be used in calculating the adjusted diluted earnings per share.

And with that, I'll turn the call back to Tom for his closing remarks.

Thomas Hill:

Thanks, Brian. Turning to Slide 20. Our view on the U.S. construction cycle and anticipated demand across all end markets remains unchanged from our May update, as we continue to be encouraged by local market dynamics. On the residential side, we see slow and steady growth in our markets supported by high employment, low interest rates and reasonable affordability.

With respect to non-residential demand, the growth of the last few years has continued into 2019 as expected. In the near term, AIA forecasts growth of 3.8% and 2.4% in 2019 and 2020. Over the longer term, FMI forecast growth of 2.9% per annum through 2023. Importantly, we do not see any overbuilding in the markets we serve.

On the public side, both the federal and state level funding outlooks remain positive with the fundamentals in place for strong multiyear growth in highway construction. At the federal level, we are optimistic that the FAST Act will be expanded or replaced prior to its October 2020 expiration.

Just this week, the Bipartisan Americas Transportation Infrastructure Act was unanimously voted through the Senate Committee on Environment and Public Works to the Senate floor. This proposed legislation would authorize $287 billion in highway funding, 28% above FAST levels between Fiscal Year 2021 and 2025.

Locally, the majority of states have implemented their own self-funding mechanisms during the last few years, allowing them to significantly increase their DOT budgets. In particular, Kansas' highway funding is finally improving as Fiscal Year 2020 funding is expected to increase approximately 30% year-over-year, and be more than double Fiscal Year 2017.

As a result of increasing funding, public construction put in place is up 11% year-over-year through May and the lettings in several of our key states continue to hit record levels in 2019. Additionally, we are continuing to see pent-up demand from weather-related maintenance following the harsh winter in several of our states, all of which are reflected in our improved asphalt and paving backlogs.

Looking ahead, ARTBA forecast the U.S. highway, bridge and tunnel construction spend to grow at a 2.4% CAGR through 2023, without any additional help from Washington.

Turning to Slide 21. In closing, we see stable underlying U.S. economic growth continuing to underpin broad-based demand across all our end markets. The vast majority of our 2019 price increases have held especially in aggregates, which were up 8% organically in the second quarter. We are seeing strong cement demand with moderate pricing growth in what has been a very challenging river market year-to-date.

Further, with an acceleration of volumes within our product lines of business following a slower start to the season and continued cost recovery through price, we expect incremental margin expansion across all lines of business in the second half. As such, we are reaffirming our full year 2019 financial guidance with Adjusted EBITDA of $430 million to $470 million.

In addition, we estimate that approximately 65% to 70% of our full year Adjusted EBITDA will be derived from materials.

With that, I'd like to turn it over to the operator for questions. Operator?

Operator:

Thank you. At this time we will be conducting a question and answer session. If you would like to ask a question please press star, one on your telephone keypad. We ask that you limit it to one question and one follow-up. A confirmation tone will indicate your line is in the question queue. You may press star, two if you would like to remove your question from the queue. For participants using speaker equipment it may be necessary to pick up your handset. One moment please while we poll for questions.

Our first question comes from Kathryn Thompson with Thompson Research. Please proceed with your question.

Kathryn Thompson:

Hi. Thank you for taking my questions today. On the aggregates segment, very nice pricing in the quarter, and also just a sequential momentum that we saw from the prior quarter. On that pricing, how much was impacted by just pure pricing actions versus mix, and that would be the product and geography. And then, also in particular, when we look at the remediation and recovery efforts on the Mississippi River, how much—maybe a clarification on how aggregates participated that, not only from a volume but from a pricing standpoint?

Thomas Hill:

Yes. Good morning, Kathryn, on the mix issue, if you adjust both for geography and product, it's—we're right around 5%. And in the first half, the levee work in the Midwest really didn't have that much of an impact. We do believe that in the second half, it will have a significant impact on our results. There's—the amount of damage done to county roads, to levees, so forth, especially in Northwest Missouri is pretty stunning. In fact, I was out there last week and was really shocked at the amount of damage, but that will be a lot of incremental work for us and especially in the second half.

Kathryn Thompson:

Okay. And then just follow-up on cement, appreciated the color you had on the impact of flooding, and what this has meant for your business particularly in the first half and as we look into the second half. But maybe help us better understand the cadence of—we would have expected maybe a little bit better cadence in the second half, but help us connect the dots in understanding what we should expect in the second half. Also, just assuming, confirming that some of that business isn't necessarily lost, it's just kicked down—the can has kicked down the road, and hoping to understand that in terms of volumes, too.

Thomas Hill:

Yes. Kathryn, as far as cadence goes, the—I think our team did a remarkable job of servicing our customers, albeit at a higher cost as we had to use rail and truck versus barge. So in fact, we really didn't lose much volume, if any. So we would expect some real catch-up volume in the second half. So we're very optimistic about volume. On the other hand, pricing is sort of set and we'll do a little better than last year, but nowhere near where we had hoped. So real strong volumes and a continuation of the same pricing pattern in the second half.

Kathryn Thompson:

Okay. Thank you.

Thomas Hill:

Thanks, Kat.

Operator:

Our next question comes from Jerry Revich with Goldman Sachs. Please proceed with your question.

Jerry Revich:

Yes. Hi. This is Jerry Revich, Goldman Sachs. Good morning. I'm wondering if you could talk about what really clicked for your aggregates business. This year, I know you've been focused a lot on rolling out pricing tools to the individual business. Can you just expand on that? Correct me if I'm wrong, but I believe these are record pricing gains for a lot of your markets. And can you talk about the—how the discussions are going to be shaping up this year from a timing standpoint for 2020 as well? When do you expect to go out to the field for 2020 price increases too?

Thomas Hill:

Yes. Good morning, Jerry. We have certainly implemented a very disciplined process over the last several years in our pricing. I think, also, you have to remember that it's typical for this industry after a year like we had in 2018 where we had an increase in cost, margins were a bit down. The industry tends to recover that over the next few years. So I think it's—the record price increases are a result of a very disciplined positive process, and also just industry dynamics where there's a bit of catch up from last year. We have actually already begun our process to implement 2020 price increases, and we would expect the pricing momentum to certainly continue, if not improve into 2020.

Jerry Revich:

And Tom, just so we're on the same page, when you say pricing momentum improve, are—is your point that price increases on a percentage basis could be higher in 2020 than what we've seen to date?

Thomas Hill:

Yes.

Jerry Revich:

And in terms of how— broad-based is that, are there a number of markets that are disproportionate drivers? Or is that across your footprint that you're seeing this level of increase?

Thomas Hill:

It's pretty much across the footprint. It does vary in—from local market to local market. But in general, it's across-the-board. I would be very optimistic in some of our Midwest markets now with the levee and repair work going on that there will probably be a shortage of aggregates in certain markets, and that will be positive for pricing. So I think—but overall, we're very pleased with what I consider to be a broad-based increase in ag pricing.

Jerry Revich:

Okay. And lastly, in prior cycles when we've seen aggregates pricing move sharply higher like we're seeing now, we've seen downstream and asphalt, specifically pricing and margins moved sharply higher as well. Is that how we should be thinking about this cycle unfolding? Or are there any competitive dynamics we should keep in mind?

Thomas Hill:

In the downstream, we're seeing really positive signs on the ready-mix side. Asphalt side is not really about price, it's about margin. We have extremely good backlogs, and we would expect to make some progress on asphalt. I actually don't recall, Jerry, in prior cycles that there was an acceleration in the downstream when we had aggregate pricing going up, but I'll go back and take a look at that. But we're optimistic across all our LOBs for pricing and margin going forward.

Jerry Revich:

Okay. Terrific. Thank you.

Thomas Hill:

Okay, Jerry. Cheers.

Operator:

Our next question comes from Phil Ng with Jefferies. Please proceed with your question.

Philip Ng:

Hey, guys. Good to see you reiterate your guidance for the full year, but some of these cost still lingering in the back half. Just curious, how confident are you kind of shaking out towards the midpoint? Or should we just, kind of, track closer to the low end? And what are some sort of the big drivers for that acceleration in the back half?

Thomas Hill:

Well, we feel we're in really the exact same spot we were when we set our guidance, and it's really around weather. If we get really good weather, we'll be towards the top of it. If we get weather like we had last year, we'll be towards the bottom of it. On the puts and takes, as far as our guidance goes, I mean, certainly cement has faced pretty serious tailwinds on the River, still unprecedented tailwinds. And I think offsetting that has been aggregates, both pricing and volume. So really that takes us back to where we started, which we think it's all about weather in the second half.

Philip Ng:

Got it. And in the 6 million tons of organic projects, you got it highlighted to ramp it by 2024, it sounds really promising. How should we think about the ramp up curve and the potential contribution as early as next year?

Thomas Hill:

It's a—a few of them are going quite strongly and they've been in their second and third year of contribution. We have one right now in Northeast Georgia that's starting up. We have a couple more that are committed capital. I'm not sure if I have that off the top of my head, Phil, as far as it—but you would certainly think that we would have at least half of it in place by next year.

Philip Ng:

Okay, great. Thanks a lot.

Operator:

Our next question comes from Trey Grooms with Stephens. Please proceed with your question.

Trey Grooms:

Hey. Good morning. So the—I guess, first would be a follow-up to the last question. Just on the timing on the spend itself. I think you mentioned, Brian, 30%—well, 25% of the $128 million happening in the back half of this year. So $32 million or so. Is that kind of the cadence on capital spend for these projects we should expecting as well? Kind of, so two years or so on the spend?

Thomas Hill:

Trey, let me—I'll just start off and then hand it over to Brian. Unfortunately, these—the Greenfields we're dealing with local government agencies, and I can tell you it is completely unpredictable and tends to be longer rather than shorter. But it is—the reason we don't have it in our guidance is because it's so unpredictable. And Brian?

Brian Harris:

Yes. No, I'll just add to that, but, however, we did want to just flag to people that there's a possibility that it could happen and obviously, we've highlighted an amount there that will spend over the next several years but as Tom said, the timing is uncertain. And obviously, we will report back on that as things develop.

Trey Grooms:

Understood. Well, maybe I could ask it this way or this might help it for detail anyway. How much of the 6 million incremental annual tons you're talking about? How much of that is currently permitted now and how much is still on the come as far as getting the permit. It's like you said it is...

Thomas Hill:

So we don't commit capital without a permit. So the full 6 million tons is permitted. But you still have to get building permits and other things, but we would never commit capital without the actual permit being in place. It just takes a long time. Some of them we have to buy additional buffer property. There's all sorts of other regulatory hoops, which are not in doubt, it's just the timing is in doubt.

Trey Grooms:

Understood. And then, I guess, the next one would be clearly the ready-mix business was impacted from the Texas weather you guys talked about. Is there any way to parse out of the organic ready-mix volume decline, how much was Texas-specific in that decline? And then, kind of, with that, obviously Texas weather has been pretty good in July. It seems like it's been pretty dry and favorable. If you can talk about any—what you're seeing since the weather started to cooperate there?

Thomas Hill:

The one thing on the ready-mix side, Trey, is that we have probably a bigger impact on Utah weather. I think they had the wettest May on record and very late to this—to the late start to the season in Utah. And Utah is almost as big as our Texas operations. I don't know any specifics. Weather has definitely improved in July. July is always a bit funky just because you've got July 4, and I think it was on a Wednesday this year. But certainly, the weather has improved and that's certainly helped.

Trey Grooms:

All right. Thanks a lot. I will pass it up.

Thomas Hill:

Okay. Cheers, Trey.

Operator:

Our next question is from Mike Dahl with RBC Capital Markets. Please proceed with your question.

Michael Dahl:

Good morning, thanks for taking my questions. Tom, I wanted to ask a question about ags margins, all things considered across-the-board, really nice set of results in light of some of the challenges from a weather standpoint. I think in ags, specifically, you also called out basically loss of equipment and some stripping costs as being contributors to margin headwinds on the aggregate side.

Could you just give us a little more detail and quantification of what that meant in terms of EBITDA headwinds? And with respect to then the stripping, was this just kind of a timing issue in terms of when you normally do the work? Or how else would you characterize it?

Thomas Hill:

Yes. I mean, the biggest headwind we had was certainly in Texas and that was weather overall. We had a dredge capsize in our sand and gravel pit north of Dallas on the Red River. That was from very high water levels. And then we just had really poor productivity around Texas due to a very wet spring. That's especially true in Central Texas where you're dealing with limestone deposits that have a fair amount of fines in them so when it rains, it basically turns to glue.

So if you look at it, if you take our aggregates business and you exclude Texas, our ag incrementals were right around 60%, and we would expect overall for our business to get back to that level by year-end.

Michael Dahl:

Okay. That's helpful. And then, my second question was just relating to clarification on a pricing comment. I think you said that price x mix was up 5%. I want to make sure I heard that correctly and it wasn't actually that the mix impact itself was 5%. And then related to that, when you talk about potential for greater pricing power into 2020, is that related to the mix adjusted price, i.e. the 5% that you can do better than? Or is it from the 8% or so run rate that you're at in the first half?

Thomas Hill:

Yes. The 5% is the mix in geographic—product mix and geographic mix adjusted number. And that's the number we focus on. So when I say momentum, it's on the mix adjusted number.

Michael Dahl:

Okay, great. Thank you.

Operator:

Our next question is from Garik Shmois with Longbow Research. Please proceed with your question.

Garik Shmois:

Hi. Thanks. I wanted to ask just on cement and cement pricing. Was there any mix impact from selling third-party cements to meet your customer needs? And if so, is it possible that cement pricing moves sequentially higher in the second half of the year as some of the potentially mix impact subside?

Thomas Hill:

Yes. Not really, unfortunately, Garik. Sort of the price is what it is. When you buy third-party cement, you still sell it at the price you would've sold your manufactured cement. So we are certainly disappointed with our actual price realization in cement in the last couple of years, and it's primarily been due to the actions of one large competitor who has focused on share, and we really continue to believe that the—that this pattern will change in 2020 and get back to a more rational basis.

Garik Shmois:

Okay. That makes sense. My follow-up is on the capital allocation program moving forward. You're highlighting Greenfields a bit more today than, I think what we've heard previously, which makes sense, but also recognizing that your target is still to get your net leverage down below 4 times by the end of the year. So I'm just trying to understand if you look out over the next several years, should we continue to expect Greenfields as being a greater focus? Or is there a possibility that M&A comes back into the fold?

Thomas Hill:

I think there's a possibility of that. But right now, when you get later in the cycle, valuations go up. And regardless of our leverage, I mean, our deal—our acquisition spend would probably have come down because we just are very disciplined, and we don't chase expensive deals. I think, on the Greenfields, we're just—we've—since we started Summit, we have been working on Greenfields and it just—they just take forever to come to fruition. So we're just starting to see it and we're starting to spend some money. So we really wanted to highlight that to everyone.

We think it's a very exciting prospect that gets us into high-price, high-growth markets that you can't enter by acquisition. The returns are superior and it's—to me, it's a very exciting part of the Summit story.

Garik Shmois:

Okay. Thank you. Best of luck.

Thomas Hill:

Okay. Thanks, Garik.

Operator:

Our next question comes from Scott Schrier with Citi. Please proceed with your question.

Scott Schrier:

Hi. Good morning. Nice quarter. I wanted to ask one more on the ags Greenfield. Are you looking to vertically integrate these assets over time and create typical Summit-type platforms? Or do they bolt on to existing platforms? Are you going to structure these at stone-only plays?

Thomas Hill:

As always, Scott, it really depends on the local market. A lot of the southeast is an aggregates-only market, and we probably would keep it that way because most of our customers would be the downstream and it doesn't normally work to compete with your customers. But we also look at each market individually and see if it's worthwhile to be in the downstream. So—but I would say, just thinking through the seven we have out there, probably five of them we would not look at going downstream but a couple of them, we would consider it. So it really—it just—it's—this is such a local business where the product shifts 40 or 50 miles and each of those local markets has different supply/demand characteristics, and we make the decision locally whether we go downstream or not. But we certainly don't start with the idea that we have to go downstream.

Scott Schrier:

Got it, thanks for that, Tom. And secondly, Brian, it looks like the SG&A looked lower than the typical run rate and then what you've guided to in the—for the balance of the year. Just curious if there's anything to highlight there?

Brian Harris:

Nothing major, Scott. We had a slightly lower run rate on our healthcare worker comp cost this time and we've obviously had some—a little bit lower headcount in our fixed overhead in certain areas of the business, which has brought the run rate down a little bit. But nothing other than that.

Thomas Hill:

Yes. And I would highlight there, Scott, that we have made great progress on our safety program. We have a real passion for safety and keeping our employees safe at Summit and a result of that is a lower workman's comp number. So we're pretty proud of that.

Brian Harris:

That sounds great. Thanks a lot for the questions and best of luck.

Thomas Hill:

Thanks a lot.

Operator:

Our next question comes from Adam Thalhimer with Thompson Davis. Please proceed with your question.

Adam Thalhimer:

First...

Thomas Hill:

Adam, are you there?

Adam Thalhimer:

Sorry. I was hoping you could give some additional color on the asphalt and paving backlogs.

Thomas Hill:

Let's see. I believe our asphalt backlogs are up 17% and our paving backlog is up 12%, and that's pretty much—Texas, obviously with the DOT spend there is way up. We're actually a bit down in Utah and all our other markets are up a bit. So I think it looks very strong for the back half of the year.

Adam Thalhimer:

And then, Tom, what are your expectations for ready-mix volumes in H2?

Thomas Hill:

They will be quite good, whether they are very weather dependent, probably that and asphalt are pretty weather dependent. We should have good volumes in Houston and good volumes in Utah. Utah, it's interesting. With the wet spring, they will not catch up by the end of the year but the volumes in the second half should be pretty good. While there's just not enough days left to catch up what they lost in April and May and the first little bit of June, but overall, I would think that we should see very good volumes on the ready-mix side.

Adam Thalhimer:

And Houston and then some other players have characterized Houston as like early-stage market, again very strong.

Thomas Hill:

I've been saying that for three years, Adam. So I'm trying to be optimistic, but not—I'd like to see some volumes. Our volumes have been quite good recently there, but it is just—rain has just been very difficult there over—since late '17. So I'd like to see some volumes there. Certainly, our backlogs are good, our customers are saying all the right things, and I do really believe that Houston is early stage in all the segments.

I mean, highways are very, very strong. The non-res that we participate in, the low rise, strip malls, and so forth that follow residential are quite strong. And residential, all the stats are pretty good there. So we're hopeful.

Adam Thalhimer:

Got it. Thank you, Tom.

Thomas Hill:

Okay.

Operator:

Our next question comes from Stanley Elliott with Stifel. Please proceed with your question.

Stanley Elliott:

Good morning, guys. Thank you for taking the question. I apologize if I missed it. Can you tell us what sort of EBITDA contribution you're expecting from the additional, kind of, levee work in the back half of the year?

Thomas Hill:

We're not going to quote a number because it's in flux right now. It's—a lot of it is not bid work, it's just, they call it, the core says, "Hey, I need material." So it should be pretty significant, but it's hard to put a number on it.

Stanley Elliott:

And as we're looking at that market, it sounds like cement pricing will be up a couple of dollars maybe, and with the chance of additional volumes on the River and around the River, does it feel like that the cement pricing is actually going to be maybe a little bit better as we start into thinking about into next year?

Thomas Hill:

Yes, but we've been disappointed for two years. So we're pretty careful in what we say there. It's a—it should get back into the mid-single digits, but yes, I would have said that coming into this year. I think capacity utilization is getting higher and there's no reason in my mind that we shouldn't be getting mid-single-digit price increases, realized price increases. We went up. In the '18, we were up. We announced $8 this year. We announced $10, and we just had been unsuccessful in realizing that. And as I said earlier, it's really been the actions of one large competitor that has kept that down. We certainly hope that, that corrects itself in 2020.

Stanley Elliott:

Yes. And on the Greenfield, of the seven that you guys are working on, is there a split between sand or more kind of granite limestone sort of assets that you could share?

Thomas Hill:

Let me think about that. I think they're all hard rock. I can't tell you which ones are granite and which ones are limestone, but they're all—yes, the majority of them are hard rock.

Stanley Elliott:

Yes. That was fine. I was really more looking for the delineation. And then, lastly, I think—could you help us with the cadence of the EBITDA contribution coming from those? I think you started to answer one of the questions and my phone kind of cut out a little bit and so I didn't—it didn't quite hear what the answer was.

Maybe around the $40 million of EBITDA contribution. Just trying to get a runway, and I understand that the permitting process and project cost can differ but is it more ratable? Or is it kind of more back-end loaded?

Thomas Hill:

It's more back-end loaded, about a third of it is in our numbers for this year and it should, so you can rate it right through 2024 pretty much on an even basis.

Stanley Elliott:

Perfect. Thank you for the time and congratulations on navigating that—another weathered quarter.

Thomas Hill:

Thanks, Stanley.

Operator:

Our next question comes from Brent Thielman with D. A. Davidson. Please proceed with your question.

Brent Thielman:

Thanks. Good morning. A clarification on the product side. You're tracking below—in terms of profit contribution, it's tracking below last year to this first half. I guess beyond whatever weather occurs, are you thinking that's going to reverse in the second half? There's anything else on the cost side that should hold you back there?

Thomas Hill:

No. There really isn't. We should see that improve through the third and fourth quarters. I mean, pricing is quite good where—we've—costs are certainly much more stable than they were last year. So we should see an acceleration of products margins through the rest of the year.

Brent Thielman:

Okay. And Tom, when you look at the split of the business today between kind of private, public, two-thirds, one-third, given where you see the markets growing or funding coming from, do you think you could see a fifty-fifty split in the business in the next few years? Are you just structurally different and that you wouldn't see that?

Thomas Hill:

I think it would be hard given our existing business to get to fifty-fifty. Could we get to 40% public, yes. But 50% is a stretch. The only way we can get there is by acquisition, I would think.

Brent Thielman:

Okay. Thank you.

Operator:

Our next question comes from Fernando Mendez with JPMorgan. Please proceed with your question.

Fernando Mendez:

Hello, guys. Thank you so much for taking the question. Going back to the cement margins, could you give me a little bit more color on how much of the $8 million impact from flooding came from market share losses, how much came from buying third-party product and how much from higher freight costs?

Thomas Hill:

It's pretty hard to break that out, very little to market share loss. Like, as I said earlier, our team did a remarkable job of taking care of our customers. The $8 million would be additional freight expense and also a little bit more purchase cement. I don't—do you have that split, Brian?

Brian Harris:

Yes. Well, if you look at the chart that we have on the slide deck there, you'll see that of the $8 million in the first half, about $4 million of it was attributed to the extended winter shutdown. We talked before about the failure of one of the major components, and that cost us a number of extra days and then about $4 million was flood related and the vast majority of that would have been freight costs and logistics caused by the disruption and the—forced to use rail and road significantly.

Fernando Mendez:

Great. And if I could follow up. In terms of energy prices, are you seeing better comps in second half? Any specific boost for margins coming from lower energy prices in the second half?

Thomas Hill:

Not really. And if it's—so it will be pretty limited. We're seeing—we do hedge our diesel for instance, so that was already in place months ago. And we might see it on the—a bit on the liquid asphalt side, although liquid has dipped a little, but not dramatically. We might still see a little gain on the asphalt side due to lower liquid asphalt. But in general, I would say it will be relatively immaterial either way.

Fernando Mendez:

Perfect. Thank you guys.

Thomas Hill:

Thank you.

Operator:

As a reminder if you would like to ask a question please press star, one on your telephone keypad. One moment please while we pull for questions.

There are no further questions. At this time, I'd like to turn call back over to Tom Hill for final closing remarks.

Thomas Hill:

Thank you, Operator, and thanks, everyone, for joining us. That concludes our call. Have a good day.

Operator:

This concludes today's conference call. You may disconnect your lines at this time, and we thank you for your participation.