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Summit Materials

Third Quarter 2019 Earnings Conference Call

October 30, 2019

C O R P O R A T E P A R T I C I P A N T S

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Paul Rogers, *Exane BNP Paribas*

Jerry Revich, *Goldman Sachs*

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P R E S E N T A T I O N

Operator:

Greetings, and welcome to Summit Materials Third 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, zero on your telephone keypad. As a reminder, this conference is being recorded.

I would now like to turn the conference over to your host, Karli Anderson, Vice President of Investor Relations. Please go ahead.

Karli Anderson:

Welcome to Summit Materials Third Quarter 2019 Results Conference Call. We issued a press release this morning detailing our third quarter results. This call is accompanied by our third quarter 2019 investor presentation and an updated supplemental workbook highlighting key financial and operating data, both of which are posted on the Investors section of our website.

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.

You can find reconciliations of the historical non-GAAP financial measures discussed in today's call in our press release.

Today's call will begin with remarks from Tom Hill, who will provide an update on our business, and then Brian Harris 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 W. Hill:

Good morning, everyone, and thank you for joining our call. Turning to Slide 4 of the presentation, today Summit is reporting higher organic price increases and higher volumes in all lines of business on solid demand and improved weather conditions. The third quarter is typically the strongest of the year, and we set records with the highest quarterly net revenue, operating income and Adjusted EBITDA in the Company's history. Furthermore, I'd like to draw your attention to the record free cash flow of $119 million, which is more than double what we generated a year ago.

Net revenue grew 6.5% in the third quarter, and 4.1% year-to-date, as a result of both organic and acquisition-related growths from deals completed in 2018. Adjusted EBITDA grew 12.4% in the third quarter, and 8.8% year-to-date, supported by organic price and volume growth, as well as more favorable weather conditions than a year-ago. Our aggregates business continues to excel with 11.4% organic volume growth in Q3, and 7.7% year-to-date, driven in part by contributions from our Missouri, Kansas and Texas operations.

Cement volumes increased 3.8% in Q3, and 2.9% year-to-date, despite unprecedented flooding on the Mississippi River. Continued strong performance is expected through the remainder of 2019, and as a result, we've narrowed the 2019 Adjusted EBITDA guidance range to $440 million to $460 million.

Turning to Slide 5, record Q3 results were anchored by the aggregates business where there was double-digit volume growth over the last year. In Kansas, the growth was driven by summer road repair and strength in the residential market. In Missouri, we shipped significant aggregate volumes associated with flood related levee repairs. In Texas, entry level residential demand and public infrastructure work remained strong.

Third quarter organic aggregates pricing increased 6.9% over the year ago quarter. This is a function of the robust demand environment as well as a catch-up to offset industry-wide cost increases that occurred in 2018. Based on prior experience, this is typical, after the industry suffered sudden cost increases and margin contraction. Our aggregates gross margin of 69% is steady from a year ago and higher sequentially from the prior period.

Turning next to the Cement segment on Slide 6. There has only recently been a return to normal shipping conditions on the Mississippi River. When the river reopened in late June, many of the barges were already full. It took some time for barges to become available, and for us to be able to build inventory. Cost continued to be incurred until this overhang cleared. The cement Adjusted EBITDA shortfall for the full year, should however be mitigated by the once off flood-related levee work.

Turning to Slide 7, you'll see an image of one of our greenfield aggregates sites where we recently commissioned a new crushing plant in Georgia. Aggregate Greenfields provide an avenue for Summit to enhance its position in high growth markets, add reserves, and generate higher returns in areas where there are limited acquisition opportunities. We continue to target attractive markets that enhance our geographic footprint in the Southeast and Western U.S. We currently have eight projects either completed or in development. It is estimated that these projects will add 450 million tons of reserves, and on an annualized basis, generate shipments of 7 million tons, approximately $45 million of Adjusted EBITDA and mid-teens free cash yield by 2024.

Spending on greenfields since 2014 has been $90 million, and we expect to spend an additional $130 million on these projects over the next few years. This total expenditure of $220 million represents less than six times EBITDA for these pure play aggregates operations.

Turning to Slide 8, adjusted cash gross profit margins rebounded in the products and services lines of business in the third quarter due to better weather and more working days than the same period in 2018. On the product side, organic prices increased 2.7% and 7.2% in our ready-mix and asphalt businesses, respectively. Ready-mix pricing was higher, particularly in Utah, Texas and Missouri. Higher volumes drove better operating efficiencies and resulted in a margin expansion of 190 basis points over third quarter 2018.

Services experienced a 150-basis-point expansion in gross margin. More selective bidding resulted in improved job mix, which helped boost margins for the quarter.

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

Brian J. Harris:

Thank you, Tom. Turning to Slide 10, we have our quarterly revenue bridge, comparing the third quarter of 2019 to the same period in 2018. Net revenue increased 6.5%, and was led by our aggregates business, which contributed 25.5% more net revenue than in the third quarter of 2018. Geographically, the East segment drove the improved year-over-year revenue, contributing an incremental $33.7 million from the third quarter of 2018, much of which can be attributed to levee repair work in Missouri.

In the West segment, organic net revenue increased by $12.1 million, but was offset by the sale of a non-core business in the third quarter of 2018 of roughly the same proportion. There was also a $5 million incremental net revenue contribution from cement-related to a 3.8% increase in organic volume.

Turning to Slide 11, you will see the year-to-date Adjusted EBITDA bridge. It's up 8.8% for the first nine months of 2018. The increase was driven primarily by price, and to a lesser extent by volume. The higher prices have more than offset increases in variable costs.

Turning to Slide 12, you will see the key GAAP financial metrics. Net revenue increased 6.5% on higher volume and price in all lines of business with aggregates being the largest incremental contributor. Operating income increased 21% to $130.9 million in the third quarter of 2019 as compared to $108.2 million in the third quarter of 2018 as revenue gains outpaced the cost of revenue. Our G&A expenses increased in the third quarter of 2019 relative to Q3 2018, as incentive compensation in the third quarter of 2018 was reduced to reflect lower levels of earnings.

Reported net income attributable to Summit, Inc. was $55.8 million or $0.50 per basic share in Q3 2019, which was lower than our Q3 2018 net income of $71.3 million or $0.64 per share. Net income declined due to an increase in income tax expense related to proposed U.S. tax reform regulations that limit interest deductibility.

Turning to Slide 13. We've presented several non-GAAP financial metrics. Adjusted cash gross profit margin for the third quarter improved by 170 basis points to 37.4% in Q3 2019, compared to 35.7% in Q3 2018, as we operated under more favorable weather conditions and our average selling prices and volumes expanded in all lines of business. Adjusted EBITDA margin was 29% in Q3 2019, which is a two year high on better overall weather, pricing and volume and is a 150-basis-point improvement over the year ago quarter.

Turning to Slide 14, you will notice that our year-to-date average selling prices in the aggregates line of business improved 7.3% organically relative to the same period in 2018, and increased 7.9%, including acquisitions. On the last earnings call in August, we told you that as the mix of our business shifted towards the northern markets in the second half of 2019, we expected some upward movement on average cement selling price, and on a full-year basis, we are still expecting pricing to improve over the prior year. That upward movement has occurred to some extent as Q3 2019 cement price increased 1.4% relative to the same period last year. However, cement pricing continues to reflect a competitive environment.

In our products lines of business, we reported volume declines in ready-mix of 3.7%, reflecting wet conditions in Texas at the end of Q3. Asphalt volume grew 2% over the prior year period, despite more competitive bidding in Utah. Organic average selling price increases were both positive at plus 2.2% on ready-mix, and plus 6.8% on asphalt.

Turning to Slide 15, on the August earnings call, we told you that as we move into our peak selling season, we were encouraged by positive volume and pricing trends, which we believed would drive margin expansion in the second half of the year. Although we have seen a quarter-on-quarter sequential improvement in margins in all lines of business, we remain below historical highs and believe that there is scope for further margin expansion. In aggregates, our costs in Q3 were elevated due in part to the loss of the dredge, which was reported in Q2, and delays in commissioning on a number of large aggregate projects. We believe these productivity issues are behind us.

In cement, the higher cost of shipping was the main factor. As anticipated, the leverage ratio decreased in Q3 to 4.2 times compared to 4.7 times at the end of Q2. Due to the very strong operating cash flow, we reduced our leverage by half a turn. At the midpoint of our Adjusted EBITDA guidance, we continue to expect our net leverage at the end of the year to be below four 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 and local cash taxes and no US federal income taxes. Our effective tax rate should be modeled in the high 40s.

Finally, with regards to total equity interest outstanding, as of September 28, 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.

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

Thomas W. Hill:

Thanks, Brian. Turning to Slide 17, and the outlook for our end markets. Our view on the U.S. construction cycle and anticipated demand across all end markets remains relatively unchanged from our August update, as we continue to be encouraged by underlying demand trends. On the residential side, we see slow and steady growth in our markets, supported by high employment, low interest rates and reasonable affordability.

We are positive on the residential markets in Houston and Salt Lake City, which continued to exhibit good entry level demand. These two markets, which represent two-thirds of our ready-mix volume are underpinned by low unemployment and net in-migration. Nationally, at 12.6 million units, we're still below the long-term average of 1.4 million to 1.5 million units. We believe most of Summit's markets are still mid-cycle, whereas other U.S. markets appear to be later in the cycle.

In non-residential markets, we primarily participate in low-rise commercial, which follows residential by 12 to 24 months. This includes distribution centers, schools, movie theaters and strip malls, and most of our markets are still reporting solid activity in these segments. We don't participate in the more volatile segments such as office, high rise and large industrial. With respect to overall non-res demand, the growth of the last few years has continued into 2019, as expected. Over the longer term, FMI forecast growth of 2.3% per annum through 2023.

On the public side, we continue to expect to see mufti-year growth in highway construction, funded at both the federal and state level. We remain optimistic that the FAST Act will be expanded or replaced prior to its October 2020 expiration, and are encouraged that the Bipartisan Americas Transportation Infrastructure Act was unanimously voted through the Senate Committee on Environmental and Public Works to the Senate floor in August. This proposed legislation would authorize $287 billion in highway funding, 28% above FAST levels between Fiscal Years, 2021 and 2025.

Several states have implemented their own funding mechanisms during the last few years, allowing them to significantly increase their DOT budgets. For example, Kansas highway funding is expected to increase approximately 30% year-over-year in 2020. The 2020 Unified Transportation Program was approved by the Texas Transportation Commission in September 2019 at $77 billion to fund transportation projects from 2020 through 2029. This is an increase from $71 billion in 2018, and $75 billion in 2019. Looking ahead, the American Road and Transportation Builders Association forecasts U.S. highway bridge and tunnel construction spend to grow at a 2.4% CAGR through 2023, without any additional help from Washington.

So wrapping up, on Slide 18, we expect 2019 Adjusted EBITDA to be in line with the original outlook. With two months remaining in our fiscal year we are narrowing our full year 2019 Adjusted EBITDA guidance to $440 million to $460 million. We estimate that approximately 70% of our full year Adjusted EBITDA will be derived from materials. We've also narrowed our cap ex guidance to $160 million to $170 million, bringing down the original top of the range, which was previously $175 million. An additional $20 million of possible greenfield project that may happen before the end of the 2019, is not included in cap ex guidance because the timing is uncertain.

We continue to allocate capital carefully and are focused on reducing leverage at year-end to be below four times. Efforts to expand our business through greenfield development activity continue. The M&A pipeline is also very active, and we continue to evaluate opportunities where the rate of return makes sense for our shareholders.

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

Operator:

Thank you. At this time we'll be conducting a question-and-answer session. If you would like to ask a question please press star, one on your telephone keypad. A confirmation tone will indicate your line is in the question queue. Please ask one question and one follow-up question and then requeue for any additional questions. You may also 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 before pressing the star keys. One moment please while we poll for questions.

Our first question today comes from Rohit Seth of SunTrust. Please go ahead.

Rohit Seth:

Hey, thanks for taking my question. On the cement business, it looks like that most of the Mississippi River issue is behind you. What's the reasonable time-frame you think you can get the unit profitability back up to where it has been historically. I guess you guys go back to 2017, as like the most normal year, is that fair to say—is it fair to use '17 is like—as the bar, as opposed to what happened over the last couple of years?

Thomas W. Hill:

Yes, certainly. I mean, I think, that we should be able to get back to '17 levels. Brian do you –

Brian J. Harris:

Yes. If you look at the—in the last two quarters, 45.8% and 46%, those are the ones that were really impacted by 3% to 4%. That $3 million or $4 million that we talked about last time on the—for the extra shipping costs. Had it not been for those, we would have been back at closer to 50%, which is where we were in 3Q of '18, and then there is further opportunity for a little bit more expansion there as selling prices improve. So I think so.

Rohit Seth:

Okay, and then, on ASPs, you had really good ASP traction this year, coming off a tough year with cost inflation, last year, what is sort of the expectation in 2020? Do you think that momentum will continue or we'll see some deceleration back to normal trend next year?

Thomas W. Hill:

Yes, Rohit, we do focus on the mix adjusted number, which year-to-date is about 4.5%. So far, we have started our 2020 pricing process, and so far, it's going quite well, very similar to last year. So we would think that the trend would be at least where we are today and perhaps better.

Rohit Seth:

Okay, and if I can just squeeze one last one in, on one of the prior conference calls, we heard reports that contractors are talking about advancing projects into the third quarter, in anticipation of an early shutdown to the season, in the northern markets. Is that something you guys are hearing as well?

Thomas W. Hill:

No, in fact, probably, the only sort of change in quarterly shipments would be on our levee work in Missouri, where actually the Missouri River, I think, twice in the last few weeks has—in September, excuse me, actually flooded again, and actually pushed some of those volumes that we would have expected in Q3 into Q4.

Rohit Seth:

Okay. So Q4 is just going as a normal—with the normal seasonality?

Thomas W. Hill:

Correct.

Rohit Seth:

Okay. All right. That's all I have. Thank you.

Operator:

The next question is from Trey Grooms of Stephens. Please go ahead.

Trey Grooms:

Hey, good morning.

Thomas W. Hill:

Hi, Trey.

Trey Grooms:

I guess on the, kind of looking at the aggregates business here on the incremental, I mean, you guys put up pretty strong incrementals here in the quarter. As we're looking into next year, and Tom you mentioned, kind of the outlook for price there, it's good in this year, if not, maybe a little better. How are you thinking about the profitability on that side of the business as we look into 2020, again, putting up very nice incrementals in the third quarter?

Thomas W. Hill:

Well, with pricing, stay at the same, if not better than this year. We did have some, we believe to be, once-off cost issues in 2019. We had the dredge that we mentioned last quarter that sank in the Red River in Texas, and then, we've also had a number of large cap ex projects that have been delayed, and that did increase our cost this year. So we would actually see our costs actually improving next year. So we have good price, good cost, and we believe underlying demand is going to be steady, then our incremental should certainly improve.

Trey Grooms:

Got it, okay, and then, you mentioned still a fairly competitive environment in cement pricing, and I think you've got a price increase announced in the market for next spring. What are you guys hearing in the market around that increased competitive response, customer feedback? I know, it's early, but anything kind of initial thoughts around that?

Thomas W. Hill:

Yes, cement pricing, basically, in our market, the industry is out with an $8 a ton price increase, effective April 1. So far, so good. Trey, it is, awfully early to tell. It's really—you need to get into the first quarter of 2020 before you really get a feel. But we are guardedly optimistic. We think our primary competitors are getting close to capacity, and that should make for a positive pricing environment. But we're coming off of two years of disappointing pricing in that market. So like I say, we're guardedly optimistic.

Trey Grooms:

Understood. Thanks for taking my questions. I'll pass it on. Thank you.

Thomas W. Hill:

Okay. Thanks, Trey.

Operator:

The next question is from Kathryn Thompson of Thompson Research Group. Please go ahead.

Kathryn Thompson:

Hi, thank you for taking my questions today. First is just a follow-up on cement, and a clarification from your prepared commentary. Do you feel like you are where you need to be today with logistics in the river system. I know that you built some inventory just as you're dealing with some of the flooding issues from earlier this year. If you could just give some color on where cement inventory is, and if you feel okay with this level. Thank you.

Thomas W. Hill:

Yes, the river is basically back to normal, Kathryn. It took a little longer than we thought, most certainly. As far as inventory levels, our plants are running quite well. I think we're going to end the year with what we think is a reasonable level of inventory. It's not too low, and again, not going to be too high. Sometimes the weather in the last—in December, can make a big difference in what your inventory levels are. But we have enough flexibility in our system between rail and barge terminals that we can even things out if we do have a poor December, weather wise. But I don't see any problems in our cement inventory levels.

Kathryn Thompson:

Okay, great, and then, following up on aggregates, and helpful detail that you gave on your greenfield investments, when you think more strategically, not just into 2020, but say, over the next two to three years, how do you—how should we think about putting in buckets your capital spend towards targeting greenfield opportunities versus acquisitions in the aggregates space, in particular? Thank you.

Thomas W. Hill:

One thing, the greenfields are so unpredictable, they're probably even less predictable than acquisitions just because they rely on permitting and zoning and some things that are completely out of your control. We do have a number of greenfields that have been permitted and are in process, as we've said in our prepared remarks, and we have a number of other opportunities that we're working on. So I could see greenfield spending in the $30 million to $40 million range, but that's really, Kathryn, a true guess, but it will be a part of our capital allocation going forward. We would like to get back into the acquisitions also, and the activity is quite strong, right at the moment, on the M&A side.

Kathryn Thompson:

Okay. Thank you very much.

Operator:

The next question is from Stanley Elliott of Stifel. Please go ahead.

Stanley Elliott:

Hey, good morning, everyone. Thank you all for taking the question. Brian, you mentioned a little bit about kind of the cost environment setting up into next year. You also have your hedge program on diesel, if I remember correctly. Is there a way to kind of ballpark or bucket, kind of what sort of cost savings you might be getting from all of the things you all mentioned into next year?

Brian J. Harris:

Thanks, Stanley. Yes, we do actually have a hedging program for at least forward purchasing for diesel. At the moment, we're expecting to see the cost of diesel to be a slight tailwind in 2020 compared to the actual cost of diesel this year based on the 60% or so that we have hedged at this point. So that should be a slight tailwind.

Other major cost elements we think of is labor, is probably going to run in the 3% to 4% inflation range. There will probably be a little bit of price increase on utilities as normal. We noticed that natural gas is actually, although not a huge spend for us, natural gas is actually up a little bit more than normal this year. So we would expect there to be just kind of more of the same in terms of underlying cost inflation.

Then what we talked about was those capital projects that we've had, which have been a little bit delayed this year for one reason or another. We should see some cost reduction from those capital projects. I think most of the commissioning issues are now behind us, and we should be getting the full benefit of those in 2020. But little early to give you hard numbers on that.

Stanley Elliott:

Understood, and could you remind us, again kind of the benefit that you're seeing from this levee work? Does that continue through next year or just kind of ballpark to help us with the volume cadence as we're looking ahead?

Brian J. Harris:

It's very hard to estimate going forward. We've—we had good volumes in over the last three or four months, it's continuing into Q4. We believe it will, at least, carry forward to some extent into 2020. It's not just in levees, it's—there's hundreds of miles of roads that have been washed away, and also, in that part of the world, railroads tend to run next to the Missouri River. So there is miles and miles of rail that needs to be repaired, that takes ballast material. So I am optimistic that it will continue at least into 2020, but it's very hard to sort of give you a quantity or any financial metrics around that.

Stanley Elliott:

Understood. Thank you very much for the time. Best of luck.

Operator:

The next question is from Paul Rogers of Exane BNP Paribas. Please go ahead.

Paul Rogers:

Yes. Good morning everyone, thanks for taking the call. So first question then, so one of your competitors yesterday was giving a relatively detailed preliminary review of Q1 2020, expecting aggregates volumes to be up sort of low to mid-single digits and price in the mid-single digit range. Are you able to comment, I mean, is that something that you would be in agreement with? Or do you think slightly differently?

Thomas W. Hill:

Yes, I mean, I think, that's roughly where we'd be. I mean it's awfully early in my opinion to be giving detailed guidance for next year. Certainly, when I look at next year—certainly, on the volume side, 2019 was flattered by extremely easy comps, because of the weather we had in our markets in 2018. Then on the levee work, which we were just discussing, it's unclear how much of that levee and flood work will carry forward into the prior year, or in the next year. So it's—on the volume side, we're pretty bullish on all of our markets; res, non-res and highways, we think are going to be steady. The only real forward-looking information we have is in our backlog, which—these backlogs are at the end of September compared to the prior year. Our ags backlog is up 8%, our asphalt backlog is actually up 46%, and our RMC, our ready-mix concrete, backlog is up 80%, and our paving construction backlog is up 30%.

So good strong backlogs, really good underlying economy, a bit offset by some of the things I mentioned as far as easy comps, and the levee work in Missouri. But overall, we're very optimistic on volumes. On price, we do focus on our mix-adjusted number, and we're about 4.5% year-to-date, and we see no reason why that shouldn't continue, and perhaps, a little bit of upside. So overall, when you mix all that up, it's not that much different than what you heard yesterday, but it's still awfully early.

Paul Rogers:

Yes, that's fair enough. Also, just a follow-up then, particularly on the pricing environments in Texas, am I right to think there's has been a bit of a trend change recently. I know the pricing has got quite a bit better across the different product lines. If that is the case, what is actually driving that, and do you see that continue into 2020?

Thomas W. Hill:

Ready-mix concrete in Houston, we've gotten a good price increase, and that's usually led by cement. Everything I hear about cement in Texas is that they should get a decent price increase, and that should result in good real price increases in ready-mix concrete. On the asphalt and paving side, we have a great business that stretches from Texarkana in Northeast Texas out to Amarillo in Northwest Texas, and they're basically in ags and asphalt and paving business, and they are basically sold out next year. Their backlog is that strong.

So when you're sold out, your margins tend to be pretty good. So we are very optimistic about that business. So yes, I'd say the answer is yes, overall, that the prices seem to be firming in Texas as demand continues to be quite strong.

Paul Rogers:

That's great. Thank you for your time. Thanks for taking my questions.

Thomas W. Hill:

Yes. Thanks, Paul.

Operator:

The next question is from Jerry Revich of Goldman Sachs. Please go ahead.

Jerry Revich:

Yes, hi, good morning, everyone. Tom, I'm wondering if you could expand on your comments, in your prepared remarks about some markets in the U.S. getting past mid-cycle. Which markets are those? It gives—it's interesting, residential's obviously not at terribly high levels nationwide, and infrastructure is only now starting to find its legs. So I wonder if you could just expand on those comments, and share your views. Thanks.

Thomas W. Hill:

Well, anecdotally, our headquarters is here in Denver. Denver is a really strong market. It's been a fantastic market for four, five, six years. I suspect that it's probably further along in the cycle than say Salt Lake, or the Western Slope of Colorado, which really only started recovering a couple of years ago. We are in the Austin market, and we don't really participate in residential. We do it to a very to a small extent. But that market, I think, again has been fantastic for a number of years, but I do think it is fairly late in the cycle.

Then, you get into sort of the more stable, less growthy markets in Kansas and Missouri and Kentucky, where we are, and we think that they are all in mid-cycle, are way below their prior peak. So it's really when I look at our markets compared to some of the other markets whether it's Denver, California, whatever, I just think we have more of a runway as in total, we're certainly earlier in the cycle.

Jerry Revich:

In terms of the greenfield plants, thank you for sharing the details, I'm wondering if you could talk about what's your location versus your biggest competitors in those markets. Typically we see greenfields that are at a transportation disadvantage versus existing market participants. Can you flesh that out and talk about do you need the market to grow substantially to absorb your volumes? Or is there a natural reserve erosion in the appropriate markets? Thanks.

Thomas W. Hill:

Yes, I mean we've had a couple of greenfields earlier a few years ago in Texas, specifically, outside of Houston, and they have been very successful, and they were in an area where reserves were depleting. We just have a new greenfield, actually a brownfield site that we have outside of Kansas City, which is fully permitted. We're putting a plant in there, as we speak. We think that's a great market, very well structured market.

But the growth markets that we were talking about in the prepared remarks, in Georgia, we think this is—it's a great market. We have one quarry near Athens that we just commissioned. We have another plant being built right at the moment near Atlanta. That should be online later this year, and then we have one other site near Atlanta that will be online in the first half of 2021. Then one other greenfield, which is permitted, which we are going to be building a plant next year, and probably be commissioned in 2021. That's on Coastal Carolinas.

So in Georgia, and the Carolinas, those are very, very well structured markets, and we think we will be very competitive. We're going to have many decades of reserves at each one of those sites, and we think will be very competitive, and they are good markets.

Jerry Revich:

Okay, and lastly, Brian, in the press release discussion around interest expense flexibility, can you just talk about any headwind that we need to keep in mind in terms of operating cash flow over the next couple of years as a result, or are you able to offset that limit? Thanks.

Brian J. Harris:

Yes, it's certainly not a headwind for us, Jerry. The limitation is based around interest deductively, the way the rules are proposed, and this is still proposed legislation, which was put into place in the fourth quarter of 2018, when we began to reflect it in our financial statements. But it's a 30% maximum of tax EBITDA is the criteria, and so depreciation which goes through cost of goods sold, it doesn't get added back. When you look at those limitations, in our calculations, we come up with this higher interest expense, the tax expense. It has no effect on our cash flow.

We still have no federal cash taxes for the foreseeable future. So in many ways for us it's something of a non-event. Obviously, we do have to reflect it until such time as that is either reversed or, as we expect it under GAAP rules, this is a probability we have to account for it. So we don't expect it though to have any impact on our cash flow.

Jerry Revich:

Okay. I appreciate it. Thanks.

Operator:

The next question is from Garik Shmois of Longbow Research. Please go ahead.

Garik Shmois:

Hi, thank you. I wanted to ask on a comment on the slide deck around a return to full plant utilization in cement. Just to clarify, did that mean to imply that you are sold out in cement? As a follow-up, how are you thinking about the need to increase imports to your terminals into 2020?

Thomas W. Hill:

Yes, we are essentially sold out of the cement we produced at Hannibal and Davenport, but we do have the ability to import. We will probably import some cement this year. One of the interesting things in our cement business is the weather in '18 and '19 has just been abysmal, and really up and down in Mississippi, not just flooding, but it has just rained everywhere. Minneapolis, which is actually our best cement market, and our biggest cement market, I think has had the worst record—worst weather on record.

So for us, we see if we can get a year of anything that resembles normal weather that we should have some catch-up volume. So if we do, we'll import cement or buy domestic cement that's available. It's lower margin, but there is no investment involved in, basically, in selling that. So it's still very profitable.

Garik Shmois:

Okay, thanks. Just wanted to clarify on the implied fourth quarter guidance. If I'm doing the math right, implies 18% EBITDA growth, which would outpace what you've been doing year-to-date. So I'm just kind of wondering what gives you confidence, in that type of acceleration, towards the midpoint of the guidance. If there is any offset, maybe some lingering cost issues that impacted the fourth quarter of 2018, or anything that might help the comparability?

Thomas W. Hill:

The biggest element was just horrific weather last year, in October, and early onset of winter. So that's probably the biggest element there. We have good backlogs, pricing is set. If we get a decent amount of warm sunny days, we believe we'll be in that guidance.

Garik Shmois:

Great. Thanks again.

Operator:

The next question is from Phil Ng of Jefferies. Please go ahead.

Phil Ng:

Hey guys, you're well on track to bring the leverage below four times by year-end. When you look at capital deployment going forward, how should we think about debt pay down versus more growth initiatives like M&A, I think, Tom, your tone around M&A in the pipeline was certainly much more upbeat today versus the past few quarters?

Thomas W. Hill:

Yes, it's gotten very busy. That's all I can say, I can never predict the pipeline, but it's extremely busy right now. We'll see if any of them get to the finish line. But I think, we're doing a good job on generating cash right now. So, Brian?

Brian J. Harris:

Yes, no, the plan, Phil, is to keep our cash on the balance sheet for the time being, and, obviously that reduces our net debt. But we don't have any immediate plans to deploy that cash for actual debt pay down.

Phil Ng:

Got it, and then just one more around this M&A component. I know, previously, Tom, you had some concerns just on the valuation front. Has that come in a little more favorably, recently? When you think about on these acquisitions, potentially in the pipeline, are they more geared towards bolt-on or more platform deals?

Thomas W. Hill:

Probably more towards bolt-ons. It's still competitive out there. So on the deal side, so we will see. I'll probably know better in 90 days as far as where valuations are. Like I say, the deal flow has just picked up in the last couple of months. So we haven't gotten to the end of any of them at this point.

Phil Ng:

Got it. Just one last one from me. On the margin front, this result, in general, the aggregate segment was quite strong in 3Q. But from a margin standpoint it's down year-over-year. I think, you called out mix being a headwind and some one-off costs. Can you help quantify that, and when you think about fourth quarter, do those headwinds reverse where you can actually see margins kind of step back?

Brian J. Harris:

Yes, Phil. So the ongoing issues from the sunken dredge that we reported in Q2 were a headwind to us, and then some of those start-up issues with our larger aggregates projects, probably all told, we maybe had a headwind of about $5 million.

Phil Ng:

Okay. Does that all go away next quarter, or it's going to linger a little bit?

Thomas W. Hill:

For the most part. Maybe a little bit of lingering, but for the most part, it's behind us.

Brian J. Harris:

Our new dredge just got delivered actually this week. It will take a couple of weeks to float it and get it in operation. So you might have a little bit of lingering effect in Q4, but nothing major.

Phil Ng:

Okay, great. Thanks a lot.

Operator:

The next question is from Adam Thalhimer of Thompson Davis. Please go ahead.

Adam Thalhimer:

Hey, good morning guys. Can you quantify the levee repairs, how much that added to aggregates' volumes the past couple of quarters?

Thomas W. Hill:

It's hard—it's probably, somewhere—if it's strictly levees, it's $300,000 to $500,000 in the quarter. But there are other flood-related work, that's hard to separate out from day-to-day work. But it's, we are continuing into the end of the fourth quarter. If the weather holds, it could be significant in Q4 also.

Adam Thalhimer:

Okay, I was really thinking about it from a standpoint of Q3, or Q2 and Q3 of next year, where do you think you can have growth off of this year without the repairs?

Thomas W. Hill:

First off, I think there will be some flood-related work that goes through 2020. The extent of that, I can't comment on. But I think, for sure that there'll be repair in Northwest Missouri, near the river, for a few years. It's just unpredictable.

Adam Thalhimer:

Okay, and the other one I had was just on Imelda, how much ready-mix volumes you might have lost in Houston from that?

Brian J. Harris:

Yes, it's hard to—yes, probably, cost us a week. The week volumes are something like—we do 40,000 in a week, so 40,000 to 50,000 yards of concrete. But it's also—the other thing that you just don't—we pay our drivers 40 hours. So it's also a hit on costs also. So you just can't do the volume, and also you have to pay your drivers. So it was a—on the east side of Houston, I mean, there are areas that got more rain than they did in Harvey. That was a pretty dramatic event.

Adam Thalhimer:

That's a pretty big hit. I mean you might have had 5% volume growth in ready-mix, ex-Imelda.

Thomas W. Hill:

Yes, I mean, it definitely was a hit, for sure. The other thing, I think, that is with a tight labor market, it's also in ready-mix, it probably has the least amount of elasticity of supply. It's hard to catch up. The only real day you can catch-up is Saturday, because you have limitations on number of drivers, you have limitation on hours. So it's probably the product line that we have the hardest time catching up in.

Adam Thalhimer:

Great. Okay. Thanks, Tom.

Thomas W. Hill:

Okay.

Operator:

The next question is from Adrian Huerta of JPMorgan. Please go ahead.

Adrian Huerta:

Hi, good morning. Thank you everyone for taking my question. My question has to do on working capital investments that have come down so far in the first nine months of the year. If you can just give us an explanation where is this coming from? If we could expect a reversal of working capital in the 4Q, similar to what we have seen in the prior two years, in the fourth quarter, which was somewhere around closer to $100 million? Thanks.

Thomas W. Hill:

Yes. Adrian, thanks for your question. What we have in our business is typically a working capital build during the first half of the year. As we build inventory, and the industry gets geared up for the start of the season, working capital generally builds at that time, and then we see, again, typically a rapidly declining working capital as we move towards the end of the season.

So the sales that we've made in September-October, we turn those receivables into cash. Inventories are generally speaking at relatively low levels, if we see a normal weather pattern. In 2018, we didn't have that normal weather pattern. So we still had inventory in the system, which we had expected to sell in September and October, and because it was so wet, we didn't manage to convert that. So this year, assuming normal weather patterns, we will have lower receivables and lower inventory as we get towards the year-end.

Adrian Huerta:

Understood. Thank you.

Operator:

The next question is from Brent Thielman of DA Davidson. Please go ahead.

Brent Thielman:

Great, thanks. Tom or Brian, can you elaborate on the more competitive bidding environment, you talked about in Utah, kind of what you're seeing there, and what you're doing to counteract that?

Thomas W. Hill:

I think, first off, we have a really first-class asphalt and paving business there. But we have had a couple of new plants come into the market, new asphalt plants, so it is more competitive, and—it's a big market and a growing market, so it will adjust. But it is more competitive. What we're working on is just making sure that we focus on the right type of job in the right place. That sounds simple, but when you're bidding hundreds of jobs, almost every month in that area, it's really—you need to focus on what we do well close to your plant. So we're just continuing to fine tune that business as we go forward.

Brent Thielman:

Okay, and then, I think, you made the comment that ready-mix backlog overall is up to around 80%. I guess, is that predominantly Houston? Is, I guess, the second part of it, how is the Permian area business? Is it still going pretty strong?

Thomas W. Hill:

It's strong. It's—we're having—that's an area where we have a heck of a time getting drivers and keeping them because of the oil field being so close. We don't do any energy work. We basically service the private market that basically serves the energy. But we just have a heck of a time keeping drivers there. The demand is quite strong. We do have a couple of wind farms in the middle part of the country, which, has certainly has added to the backlog, but, overall, it's sort of a general strength on the ready-mix side.

Brent Thielman:

Okay, thank you.

Operator:

The next question is from Mike Dahl of RBC Capital Markets. Please go ahead.

Mike Dahl:

Hi, thanks for fitting me in. Just a couple of quick follow-ups. I wanted to follow-up on an answer to or—an answer to Phil's question earlier, which I think was specifically around the fourth quarter margins, and just ask again, in terms of both aggregates and cement, do you expect margins to inflect positively year-on-year in each of those segments?

Brian J. Harris:

Yes, providing the volumes hold up through the fourth quarter, then the answer to that would be typically be yes. With the shipping costs returning to normal or near normal in the fourth quarter for cement, and production levels remaining high, then yes, we would expect to see margins creep up a little bit. Likewise on aggregates, if the volumes are there, we know we've got the prices and some of the cost issues behind us, so should see a little bit of margin expansion there as well.

Thomas W. Hill:

Yes, whenever you talk about fourth quarter, it is—it's weather. So far, in the fourth quarter, the weather has continued the same pattern as it was in the third. It's not normal—it's not as good as normal weather, but it's better than the prior year. That has continued.

Mike Dahl:

Okay, got it. So far, the volume's there, it's really just a question of November and December?

Brian J. Harris:

Correct.

Thomas W. Hill:

Correct.

Mike Dahl:

Okay. Second question, and not to get too bogged down on the tax issue, Brian, but just another question there. In theory, that sounds like it could be a cash impact. So I guess the lack of cash impact for Summit, is that just because it hasn't actually been implemented yet, or is it because you will just burn through NOLs more quickly? Or is there something else that I'm missing there?

Brian J. Harris:

No, it's not. We have significant NOLs and other tax attributes from accelerated depreciation, step-ups from acquisitions that we've done in the past. So those will be the things that will drive the lack of a cash—cash tax payment for the foreseeable future.

Mike Dahl:

Okay, makes sense. Thank you.

Thomas W. Hill:

Thank you, Operator, and thank you all for joining us. That concludes our call.

Operator:

This concludes today's conference. You may now disconnect your lines at this time. Thank you for your participation.