September 2000

News & Views

Construction Materials Industry Investment Banking

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The Big Get Bigger

The consolidation trend in the construction materials industry shows little, if any, sign of diminishing as the big keep getting bigger. Two prime examples of this consolidation trend are **Hanson**'s acquisition of **Pioneer** and **CSR**'s several recent acquisitions.

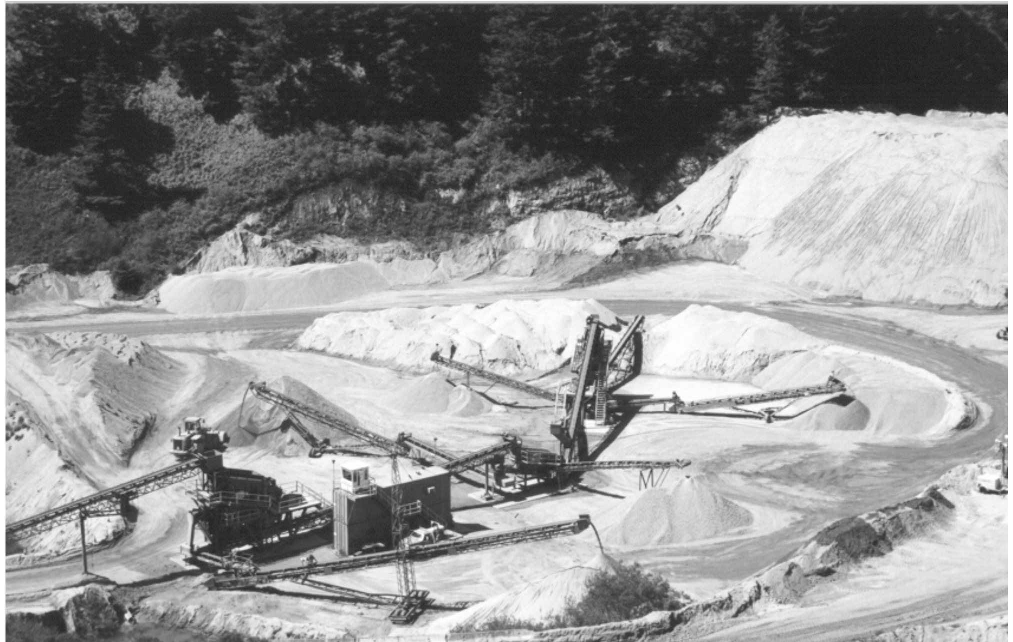
Acquisition of Australia-based Pioneer for $2.5 billion makes British-based Hanson the largest aggregates producer in the world (still third in the U.S.) and second largest ready-mix producer in the world, behind only RMC. Hanson also continues to gobble-up smaller companies, acquiring a total of 12 businesses in North America in 1999. Australia-based CSR has also been busy purchasing construction materials companies in the U.S. For example, they recently purchased American Limestone for $211 million, Florida Crushed Stone for $348 million and a couple concrete pipe producers for another $84 million.

These transactions, plus numerous smaller acquisitions show that the big are definitely continuing to get bigger. And as the big get bigger (and richer), they become increasingly formidable competitors. Much of the industry's consolidation is driven by the increasing need for automation and other efficiency improvements, plus increasing capital and overhead costs of regulatory compliance. Many small and medium sized companies do not have the financial or management clout to keep up with their bigger competitors and decide that selling might be a good idea.

Happily, prices for quality companies are still very high, with multiple purchasers vying for each transaction. Company owners, especially owners of small and medium sized companies concerned about competing with the economies of scale of the big companies, should consider the opportunities presented by today's market. Eaton Capital can help owners evaluate their competitive position and the potential benefits of selling in this very favorable environment.

Thoughts on the "Death Tax"

With the recent passage of an estate tax repeal by Congress, President Clinton's veto of the measure, and the importance of estate taxes to family-owned companies, estate taxes seemed an appropriate subject for this newsletter. Estate taxes, popularly called "Death Taxes", are the government's last chance to grab more of your hard-earned money. Not only do you pay taxes as you earn income while you are alive, but the IRS hammers you again after you die by claiming up to 55% of the value of your taxable assets. Individuals can exempt $675,000 of their estates ($1.35 million for couples), with the exemption scheduled to rise to $1 million in 2006. As I describe below, the estate tax is bad tax policy for



several reasons, and I applaud the Congress for its attempt at repeal. The estate tax is unfair because it taxes income that has already been heavily taxed. It is complex and imposes high compliance and avoidance costs. It discourage work and savings, and be-

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The Biggest of the Big

Here's the most recent list of the largest aggregate producers in the U.S., ranked by volume Note that there have been some significant changes in the rankings since last year.

2000 Ranking	Producer	1999 Ranking
1	Vulcan	1
2	Martin Marietta	2
3	Hanson	3
4	Oldcastle	4
5	Lafarge	5
6	Aggregate Industries	10
7	Florida Rock	7
8	CSR	8
9	Rogers Group	9
10	Southdown	11
11	Tarmac	12
12	Meridian Aggregates	13
13	RMC	22
14	Ashland Oil/APAC	16
15	General Dynamics	17
16	Blue Circle	15
17	U.S. Aggregates	14
18	Peter Kiewit & Sons	25
19	Luck Stone	19
20	TXI	18
21	National Lime & Stone	20
22	Mathy Construction	—
23	New Enterprise Stone	24
24	Michigan Limestone	21
25	Irving Materials	—

Source: US Geological Survey

Death Taxes

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cause of these negative incentives, probably causes a net decrease in total federal tax revenue.

Double and Triple Taxation

The combined effect of income and estate taxes can produce remarkably high marginal tax rates. For example, let's assume there are no taxes and a person earns $1,000 and invests it in a bond paying 7% interest. If he dies in 30 years, his estate would include $7,612 from this investment. Unfortunately, in the real world, income and estate taxes would cut this amount to only $1,618, which is a marginal tax rate of over 78%! Here's how the government grabs so much. First, the combination of a 31% marginal income tax rate and 2.9% Medicare taxes cuts the original $1,000 of income down to only $661 to be invested. Then, the 7% interest is cut by those same income tax rates to only 4.6%, so the original $661 only grows to $2,568 after 30 years. Thus, the two levels of income taxes (one on the original income, the second on the income from the investment) reduce the estate by about 66%. Then, the person dies and the government grabs a third handful of taxes. If the total estate is $1 million, the marginal estate tax rate is 37% (55% if the estate is $3 million), leaving only $1,618. Thus, three levels of taxes have eaten up over 78% of the estate (85% for larger estates)!!

Compliance and Avoidance Costs

Naturally, these outrageous tax rates encourage tax-planning activities designed to reduce the government's tax bite. American families have paid accountants and attorneys for millions of hours of work developing a menagerie of tax avoidance techniques. For the estate tax alone, the average of economists' compliance-cost studies indicates that the cost of compliance (the sum of what taxpayers spend complying and the IRS spends collecting) is about 30% of the amount of the estate tax paid. And this cost does not include the previously mentioned millions of hours of legal and accounting skill wasted trying to avoid the tax altogether. Unfortunately, even the best tax planning cannot always avoid these taxes, and in some cases families are forced to sell their businesses just to pay the estate taxes, a high compliance cost indeed.

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Negative Incentives

These high tax rates are not only unfair, but they actually reduce the incentive to work and save. A taxpayer might ask why not just consume the extra $1,000 of earnings instead of saving that amount to pass on to heirs when taxes will eat up 78% or more? And even if you are planning to leave your money to your heirs, why make the extra effort to continue building your estate when so little of it actually makes it past the government's greedy hands? While there may be some who like their work well enough to not care about marginal compensation, many workers are encouraged by the combination of high income taxes and high estate taxes to work less or retire earlier, wasting their talents and depriving others of the benefit of their efforts, skills and entrepreneurship.

In fact, when the negative incentive effect of taxes is taken into account, the net impact of the estate tax is probably to reduce the government's overall tax revenues. For example, the estate tax may induce wealthy individuals to make large charitable gifts, both before death and as bequests. These gifts are tax deductible, so tax revenue is reduced. A gift of appreciated stock or personal property also avoids capital gains taxes, further reducing tax revenues. Also, charitable gifts shift income generated from these assets from taxable income to tax-exempt income, again reducing tax revenue. Plus, the estate tax often induces individuals to give some of their assets to their children and grandchildren before dying. In many cases, this shifts income to lower tax bracket individuals, further reducing tax revenue. These losses of tax revenue can easily exceed the revenue collected by the estate tax itself, so eliminating the tax would probably increase total tax revenue.

Estate Tax "Elimination"

In July, Congress passed a bill which would have "eliminated" (eventually) the estate tax, although President Clinton vetoed the bill later in the summer. The bill passed by Congress was a mixed blessing. Rather that just eliminating the estate tax (good), the bill phased it out over ten years (less good). And, unfortunately, the bill included a change to the rules which increased taxes once inherited assets are sold (bad). Unhappily, in order to get the bill approved, the Republicans felt they had to agree to the phase-out period, plus they gave in to the Democrats regarding the "carry-over basis" rule. Under current law, inherited assets are given a tax basis equal to fair market value at the time of inheritance. But the bill required that inherited assets "carry-over" the almost always lower tax basis of the deceased, thus substantially increasing the tax due once the asset is sold.

Family-Owned Companies

So what does all this mean for the family-owned construction materials company? First, the estate tax is definitely not gone. Second, beware of the "carry-

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Death Taxes

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over basis" problem, which may appear again in future repeal bills and raises taxes for heirs. Third, even if the estate tax is eliminated, the need for careful financial and estate planning is definitely not eliminated. Owners still may need to have wills, insurance, trusts to protect and control assets, gift-giving mechanisms, and techniques for avoiding income taxes before and after death.

At Eaton Capital, we specialize in representing family-owned construction material companies, and we understand the tax, liquidity, succession, competition, management and other issues which may cause owners to consider selling their companies. We understand that making a decision to sell a family-owned business can be very difficult. For many family members who have invested their lives building a company, selling the business is a serious matter, indeed. The company may be so much a part of their lives and personal identities that sale of the company can be a very difficult and emotional decision. We can help guide company owners through many of these issues, and if selling is the right choice, we have the experience, technical expertise and market knowledge to maximize the benefits of the transaction. C.E.

Current Engagements

Eaton Capital is currently representing the owners of four construction materials companies in various stages of selling their companies, an aggregate producer, two block manufacturers and a ready mix producer. One of these transactions is expected to close late this or early next month, two later this year, and the fourth early next year. If you have been wondering if the time is right to consider selling your company, please give us a call.

Attention Recipients

If you have received this newsletter, you are in our construction materials industry database. We would very much like to have other senior managers, and especially the owners of your company, see this newsletter, too, so please pass it on. And if you are not the right person in your company to receive our newsletter, please call or write to tell us to whom in your organization we should send future newsletters. Thanks.