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# News & Views

## Construction Materials Industry Investment Banking

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## Is Now a Good Time to Sell?

(and won't taxes kill me if I do?) by Chuck Eaton

Owners of companies are always interested in knowing the value of their companies, but determining that value is not always easy. If you own stock in a public company, you can simply look up the price on line or call your broker. But if you own stock in a private company, there is no regular buying and selling of your stock, so there is no easily discernible price. The value of a privately-held company can be accurately estimated by a knowledgeable investment banker, based on similar recent transactions and current market conditions. No two companies are exactly alike, so no two companies will be valued in exactly the same way, but there are certain market conditions which affect the value of companies generally. When these market conditions are favorable companies will sell for higher prices than when they are not favorable. As described below, general market conditions are favorable right now, and recent increases in acquisition activity reflects those favorable conditions.

**With 15+ acquisitions this year, including several over $100 million, the pace of consolidation in the construction materials industry is picking up. The just-announced acquisition of Bluegrass Materials by Martin Marietta for $1.6 billion is grabbing the latest headlines.**

### General Prosperity

The general economy continues to be reasonably strong, despite the disruptive threats of terrorism and nuclear proliferation. The stock market, generally an excellent leading indicator, keeps hitting new highs. Construction spending is growing in many parts of the country, and some raw material prices are increasing. In most markets, demand has been strong enough that producers have been able to pass on these raw material price increases to consumers. While not a universal result for all geographic areas or companies, this economic well-being has had two beneficial effects for potential sellers. First, the sellers' companies are doing well financially, with strong cash flows and excellent prospects for the future. Second, companies which are potential acquirers are also doing well financially, so the pool of potential acquirers is broad and deep, with many potential purchasers looking for acquisitions, and those purchasers have substantial resources to use buying companies.

### Supply and Demand

This general level of prosperity has produced strong earnings and cash flow for many of the largest companies in the industry. These large companies, both foreign and domestic, need to grow to keep their earnings up and their owners satisfied. However, internal growth in our industry can be difficult to achieve, given the difficulty of permitting aggregate reserves and operating locations in most areas of the country. Additionally, it is usually expensive to capture market share from other producers through price competition, especially in a commodity business in which margins are already pretty thin. Therefore, most of these large companies prefer to grow through acquisitions rather than suffer the potential economic losses of competing for market share.

Industry consolidation over the past couple decades has significantly reduced the number of viable acquisition candidates. There are simply fewer companies for potential purchasers to consider. This combination of many potential purchasers and fewer potential sellers has a very beneficial result for sellers. Basic economics tells us that if demand is large and supply is small, prices will increase, and this has clearly been happening in the construction materials industry.

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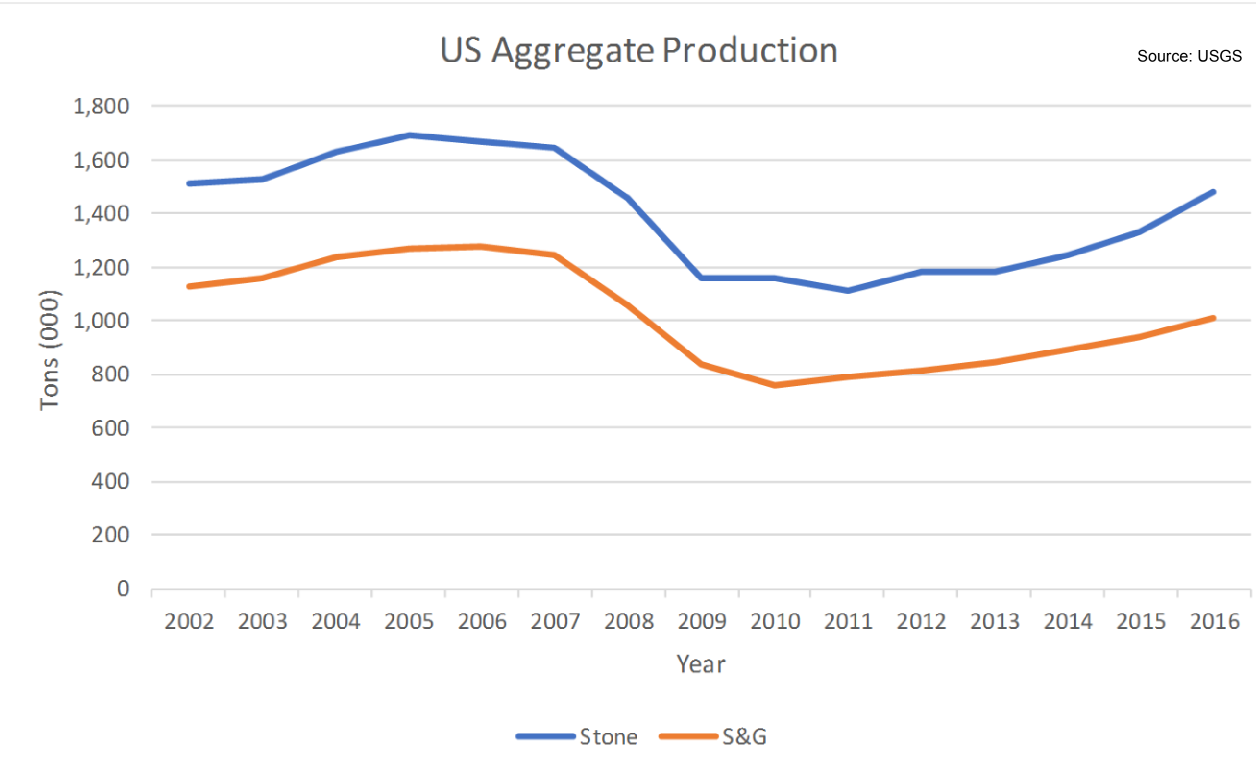
# The Top 25 Crushed Stone Producers

Shown below is the most recent (2015) list of the largest crushed stone producers in the U.S.

| Top 25 Crushed Stone Producers in 2015 | | | Source: USGS |
|---|---|---|---|
| Rank | Company | Rank | Company |
| 1 | Vulcan Materials | 13 | Summit Materials |
| 2 | Martin Marietta Aggregates | 14 | Ash Grove Cement |
| 3 | Oldcastle | 15 | Dolese Bros. |
| 4 | Lehigh Hanson | 16 | Bluegrass Materials |
| 5 | Cemex | 17 | National Lime & Stone |
| 6 | Lafarge North America | 18 | Vecellio & Grogan |
| 7 | Rogers Group | 19 | Buzzi Unicem USA |
| 8 | Carmeuse Lime & Stone | 20 | Mulzer Crushed Stone |
| 9 | Holcim Group | 21 | Eagle Materials |
| 10 | Lhoist North America | 22 | Eucon |
| 11 | New Enterprise Stone & Lime | 23 | H&K Group |
| 12 | Luck Stone | 24 | Fred Weber |
| | | 25 | Texas Crushed Stone |

# Historic Crushed Stone and Sand & Gravel Production

The graph below shows past production volume for both crushed stone and sand & gravel. Note the substantial drop from 2007 thru 2010, and that the recovery has not yet returned volumes to what they were in 2006.



# North Florida Rock

The Assets
of
## North Florida Rock, Ltd.
Marianna, FL

have been acquired by

### ACG Materials, Inc

**The undersigned initiated and managed this transaction while representing North Florida Rock**

The Little Rock and Grand Mound
Sand & Gravel Operations
of
## Quality Rock Products, Inc.
Rochester, WA

have been acquired by

### Black Lake Quarry, LLC

**The undersigned initiated and managed this transaction while representing Quality Rock Products**

*(Continued from page 1)*

### Interest Rates

The general level of interest rates also helps determine the value of companies. While interest rates have increased above their lows of a few years ago, they are still relatively low, so purchasers' cost of financing their acquisitions is still relatively low. These low interest rates, together with strong internal cash flow, cause purchasers to use low discount rates to value companies, and these low discount rates lead directly to high values. But this favorable interest rate environment may be changing. Predicting the future course of interest rates is always tricky, but many observers believe that a strengthening economy, along with hints of rising inflation, may cause interest rates to resume their upward trend, which will tend to depress acquisition prices.

### Won't Taxes Kill Me if I Sell?

Unfortunately, the old saying about the certainty of (death and) taxes applies to selling companies, but fortunately there may be some ways to at least minimize the taxes a seller must pay. Owners should consult with their own tax advisors about their specific situations, but here are some thoughts that might be helpful. A seller's tax result may be quite different if they sell stock than if they sell assets. In general, if owners sell stock, the sale price will be taxed only once, at the owner level, based on the sale of the stock. But if owners sell assets, the sale price may be taxed twice, once at the corporate level as the sale of assets, then a second time at the owner level when the sale proceeds are distributed. This double taxation will occur if the company is a regular C corporation, but if the company is an S corporation or a LLC, selling assets may produce about the same tax result as selling stock, depending on the Accumulated Adjustments Account. Additionally, there may be some pre- and post-closing actions owners can take to minimize their tax bills, such as moving assets (especially real estate assets) between companies, gifts to family members or charities, etc., but owners should check with their own tax advisors before taking any of these steps.

The double taxation on sale of assets can be a particularly vexing problem for owners of C corporations. This is especially true because most purchasers prefer to purchase assets instead of stock for two reasons. The first reason is that by purchasing assets, the buyer avoids any unknown liabilities they would assume if they purchase stock of the company. The second reason is that if the buyer purchases assets, they should be able to write-up the value of the assets to current fair market value, thus increasing tax depreciation deductions in future years. In fact, this write-up of asset value may allow the asset purchaser to pay a higher price for the assets than for the stock, all other things being equal. Unfortunately, this price increase is usually smaller than the tax increase the sellers face when they sell assets, so some otherwise acceptable transactions can fail due to the seller's taxes.

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Mergers can be great way to defer taxes on sale, but usually only work with certain purchasers. Since the sellers are trading their company stock for the purchaser's stock, the purchaser's stock must be acceptable to the sellers. Securities laws (and possibly the purchaser) impose holding period restrictions (e.g., sellers cannot sell the purchaser's stock for a certain number of years), so sellers are in effect trading an investment in their old company for an investment in the purchasing company. This may be acceptable, but may not work for all potential purchasers. However, if a merger is acceptable to sellers, the gain on sale is not realized by the sellers until they sell the purchaser's stock. This can be very beneficial, allowing sellers to defer taxes almost indefinitely, and can provide significant estate planning opportunities. Unfortunately, mergers can be complicated, and the transaction costs (e.g., legal bills) can be large, so it can be difficult to execute a merger on small transactions.

## Conclusions

Is this a good time to sell? We think the answer is YES! Most companies in our industry are doing very well financially, making them attractive acquisition candidates. Prices being offered for companies are high due to the supply and demand characteristics of the market and moderate interest rates. Capital gains tax rates are low, so sellers can keep more of the sale proceeds, and careful transaction structuring can significantly defer or reduce taxes on sale. These factors are rarely in synch like they are today, so right now is an excellent time for company owners to explore possible sale of their company. **Call us if you would like to discuss how these issues could affect your company.**

*Charles E. Eaton is President of Eaton Capital Corporation, a strategic advisory and investment banking firm specializing in the construction materials industry.*