Investors' Chronicle | Alpha

Alpha Editor: James Norrington
Alpha Production Editor: Sameera Hai Baig

Alpha US shares analysis

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Profit from America's infrastructure boom

Inflation is set to remain a hot topic in the run up to November's presidential election, but the companies benefiting from expansionary fiscal policy are rapidly growing profits, which should interest investors.

Author: **Arthur Sants**

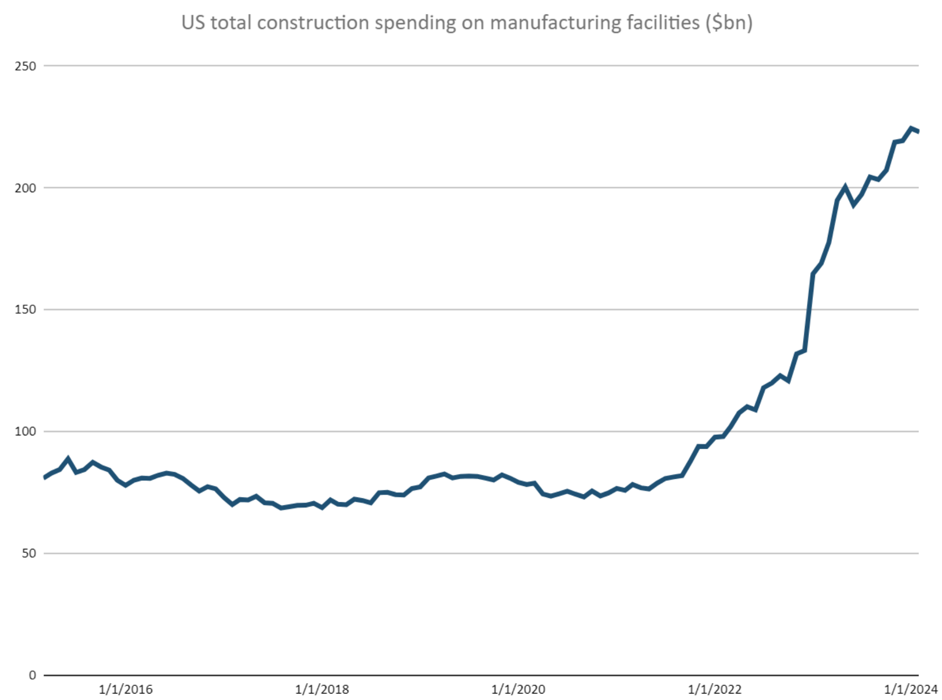
After years of outsourcing to China the United States has decided it needs to invest in its own manufacturing capabilities. The headline stories have focused on the investment in semiconductor plants, but the government has also promised trillions in spending on roads, railways and bridges. This huge fiscal stimulus might contribute to persistently higher inflation, but it is good news for the companies that will be tasked with building the US's bridges, roads, and manufacturing facilities.

In his annual shareholder letter, JP Morgan chief executive Jamie Dimon said he believes the US might have "stickier inflation and higher rates than the market expects". He sees a "growing need for increased spending" to transition the US economy to green energy, as well as restructure its supply chains and boost military expenditure. However, he admits this will all put further upwards pressure on consumer prices, with a forecast that interest rates could hit 8 per cent.

The US government has passed huge infrastructure spending bills. In 2021, the Infrastructure Investment and Jobs Act (IIJA) earmarked $1.2trn to be spent over the next 10 years. Years of underinvestment has left the country with crumbling infrastructure. In the United States one in five miles of highways and major roads and 45,000 bridges are in poor condition, according to the White House's factsheet. On top of this, 30 million Americans live in areas without acceptable broadband.

A lot of the attention has been focused on the Chips and Science Act, which is giving billions of dollars to semiconductor companies like **Intel (US:INTC)**, **Samsung** and **TSMC** to construct plants in the US. However, these plants can't live in isolation. For the US to build out its manufacturing capability it needs to upgrade the infrastructure across the country, including the power grid, highways and railways.

This investment is already having an effect on spending. Construction spending on manufacturing facilities in the US has more than doubled from $97bn annually at the start of 2022 to $220bn at the start of 2024, according to data from the St Louis Fed. In the same period, across every sector annual construction spending has jumped 16 per cent from $1.8trn to $2.1tn. For reference, this is equivalent to two-thirds of the entire UK GDP.



Source: St. Louis Fed

This fiscal stimulus has been driving the US economy forward in the face of interest rate rises. In March, the US added 303,000 jobs which was way ahead of the 200,000 the economists expected. The flipside of this story is that the hot economy is keeping inflation stubbornly above 3 per cent, with annual CPI rising to 3.5 per cent in March.

This is not a good situation for bondholders. However, there are a selection of US manufacturing companies that are already seeing this infrastructure spending boosting their earnings. The *Investors' Chronicle* has ranked the S&P 500 companies by earnings growth and earnings upgrade momentum. This meant that it not only identified businesses with fast growing earnings, but those that were seeing forecasts of their earnings being consistently upgraded by analysts.

Unsurprisingly, at the top of the list was AI chip designer **Nvidia (US:NVDA)**. Amongst the top 30, there were a few other semiconductor companies such as **Broadcom (US:AVGO)**, **Micron (US:MU)** and **Applied Materials (US:AMAT)**, all companies that have been direct beneficiaries of the surge in AI spending.

Another theme to emerge was the earnings momentum of the industrial and construction companies that have been the direct beneficiary of this surge in infrastructure and manufacturing construction. **Vulcan Materials (US:VMC)** and **Martin Marietta Materials (US:MLM)** both produce crushed stone aggregates which are used in all forms of construction and sit near the top of the list.

The companies each own quarries across the US and have relative dominance of an industry that is made up by lots of other smaller players. The areas that aggregates can be mined are subject to zoning and regulatory restrictions, which limits the number of new entrants into the market. In the last year, both have increased their aggregate prices in the double digits. Correspondingly, last year Vulcan Materials' earnings per share rose 59 per cent while Martin Marietta's were up 41 per cent.

The companies are expecting more double-digit price rises in the coming year which has led to a series of earnings forecast upgrades from analysts. Since January last year, Vulcan Materials and Martin Marietta's 2025 analyst consensus earnings forecasts have risen from 15 per cent and 27 per cent, respectively.

Although it is not yet in the S&P 500, **CRH (US:CRH)** is another construction materials company that will benefit from this surge in spending. Last year, the company highlighted $200bn of major projects that were announced. This could be an understatement though, with analysts at Jefferies saying their "analysis shows on-shoring investment budgets could be 3x that level".

In the year to December, CRH's earnings per share rose 34 per cent to $4.65, which was ahead of the $4.50 expected from analysts. And similar to Vulcan Materials and Martin Marietta, its 2025 EPS broker consensus forecast has risen 36 per cent since last January.

Importantly for investors, this government support isn't cyclical, so it gives the business clear vision into the future. "If I look at the United States, our biggest market, we pretty much can underpin till the end of this decade strong construction growth in infrastructure," explained CRH chief executive Albert Manifold on the last earnings call.

This could all be thrown in the air by the election in November. If Donald Trump wins and wants to push through his promised tax cuts, then there will have to be some reduction in federal spending. This shouldn't be too worrying for these businesses though given one of the few bipartisan policies is the need to reduce dependence on China and expand US manufacturing capability. The most likely cuts if Trump wins will be the green energy investment rather than the infrastructure spending.

After the recession that followed the 2008 financial crisis, the US tried to revive its economy through interest rate cuts and quantitative easing. However, although asset prices were inflated, the economy grew slowly, inflation remained low and interest rates were suppressed. This time the government is pursuing a new plan. It is throwing money at construction to jumpstart investment and help the country's manufacturing sector compete with China.

The experts think this plan is going to help stimulate growth. Earlier this month, the International Monetary Fund (IMF) forecast that the US would grow at double the speed of the next G7 country. All of this growth has to accumulate, and there are a handful of companies already starting to benefit.

Martin Marietta Materials

Source: FactSet

Martin Marietta Materials (US:MLM) is an aggregates and concrete business that operates in the US. In short, it specialises in producing crushed rock for construction projects and over the last year has consistently been beating broker forecasts.

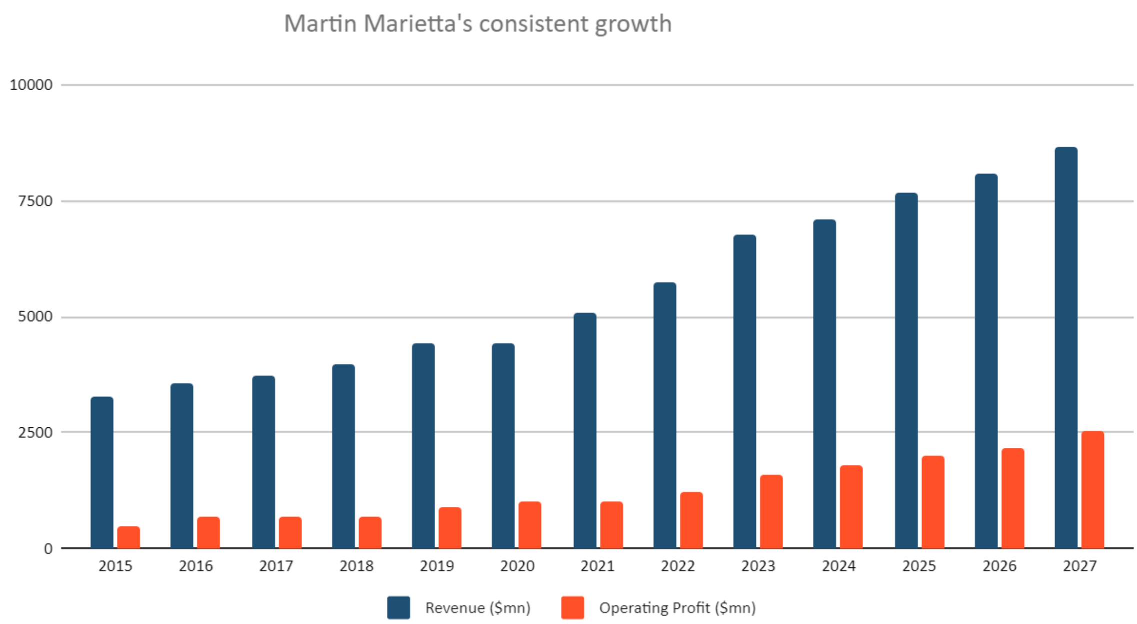
The Martin Marietta Corporation was formed in 1961. Initially, it made aerospace and electronics equipment as well as building materials. However, in 1993 it decided to split the company. The Martin Marietta Materials business focused specifically on aggregates and concrete and was listed on the New York Stock Exchange. Meanwhile, the aerospace business merged with the Lockheed Corporation to form **Lockheed Martin (US:LMT)**.

Since then, Martin Marietta Materials has made several acquisitions to build out its cement and aggregates business. This included the $1.625bn takeover of Bluegrass Materials, the largest private aggregates business in the US at the time. Just recently it completed the acquisition of Albert Frei and Sons, an aggregates producer in Colorado, and Martin Marietta now owns over 300 aggregate quarries across the country as well as several cement plants to create ready-mixed concrete.

The only aggregates business that has a similar scale is **Vulcan Materials (US:VMC)**. The rest of the companies are much smaller, which makes Martin Marietta and Vulcan Materials almost a duopoly. For any business to catch up with them in terms of distribution ability would require significant capital investment. On top of this, there are only a certain number of quarries in the US and they need to be close enough to the customers to make it affordable to deliver the building materials.

This dominance of the market makes it easy for Martin Marietta to pass costs onto customers, with the price of its aggregates rising 15 per cent last year. "We successfully implemented mid-year price increases across the majority of our markets as we endeavour to pass through persistently high-cost inflation," explained chief executive Howard Nye.

However, based on the margin expansions, it seems that Martin Marietta was passing on more than just the high cost of inflation. In the full year, its gross profit rose 42 per cent to $2.02bn while its earnings per share were up 41 per cent. The operating margin of 23.7 per cent was up four percentage points year on year and is exceptionally high for a construction company.



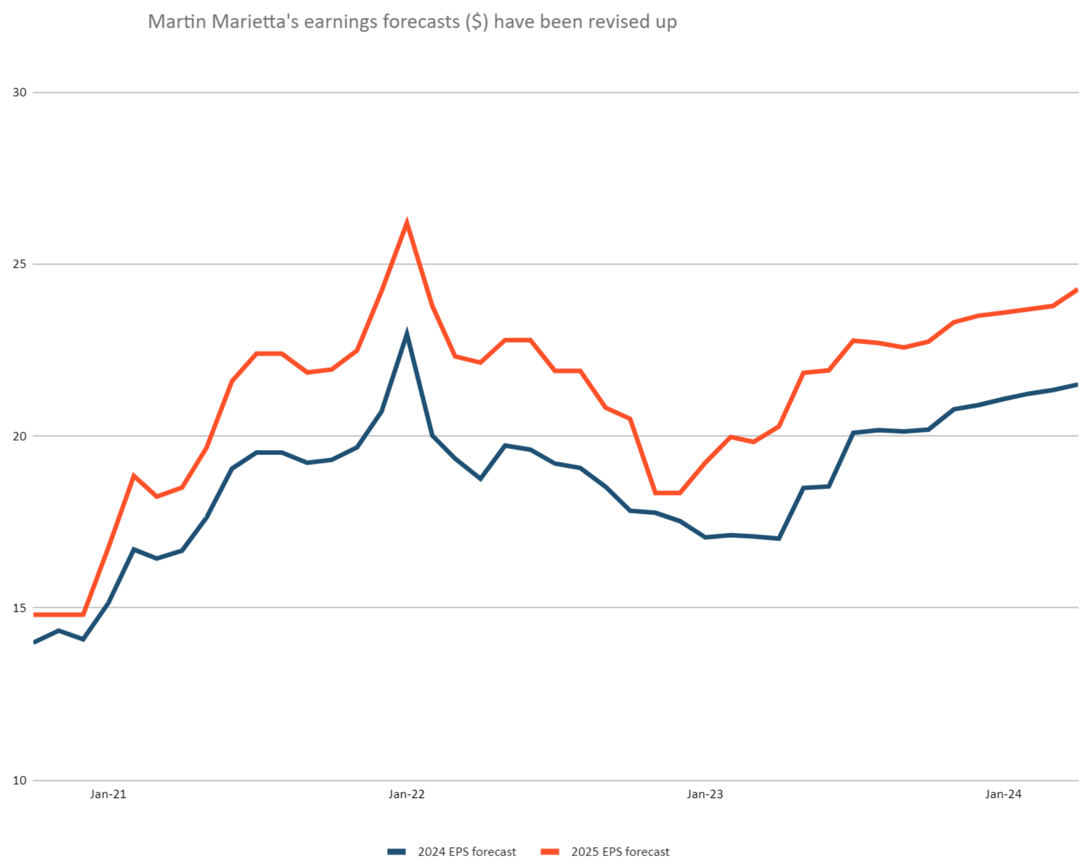
Source: FactSet

Government support

Overall volume was flat, because despite strong demand from infrastructure projects, there has been weakness in the residential sector. Management said that rising mortgage rates have slowed down housing projects. However, there are hopes that an eventual decrease in mortgage rates should "provide tailwinds in residential demand and an uptick in single family home conditions".

As residential growth waits to return, the infrastructure side of the business will benefit from federal government subsidies. The Infrastructure Investment and Jobs Act will distribute more than a trillion dollars over the next 10 years, so this will keep driving demand. State level highway, bridge and tunnel contracts, which are an important leading indicator of future demand, rose 8 per cent to $113bn last year.

Management is aware of the importance of the government spending to its business, so was quick to point out the bipartisan support for the initiative. They cited on the earnings call that during last year's state legislation elections 88 per cent of voters approved of transportation related initiatives. This makes Martin Marietta a counter cyclical business because government support operates independent of the traditional business cycle.



Source: FactSet

This can be seen in the analysts' increasingly bullish forecasts. The FactSet broker consensus is for earnings per share (EPS) to rise to $26.77 in 2026, 39 per cent more than 2023's EPS. Promisingly for investors, this 2025 forecast has risen over 20 per cent since last January.

In the fourth quarter of last year, results were significantly ahead of expectations, with adjusted earnings before interest, tax, depreciation and amortisation (Ebitda) and adjusted EPS from continuing operations of $503mn and $4.74, respectively, versus the consensus forecasts of $488mn and $3.90.

Further price rises

Margins should continue to expand next year as management plans to again increase prices faster than its input costs. Martin Marietta is guiding for its aggregate prices to rise between 10 and 12 per cent, while its cost of goods, including lubricants, diesel and explosives, are forecast to rise 7 per cent. Management sees the double-digit price rises as "trending towards the new normal", which has prompted the analysts at Jefferies to say they expect to see the stock "re-rating higher".

If there is another re-rating, then it would make the stock quite expensive. It's one-year forward price-to-earnings ratio has already risen from 23 times at the start of the year to 26 times, according to FactSet. However, the company is effective at turning its profit into cash meaning its free cash flow yield is close to 3 per cent, which doesn't look overly expensive.

Strong cash generation is essential to the business as it enables it to keep investing in machinery as well as expanding through acquisitions. Its capex spending has consistently exceeded its depreciation which means there won't be any expensive machinery upgrades needed further down the line. Arguably, it is this high level of capital intensity which makes it difficult for competitors to enter the market. The aggregates business only works at this scale, creating a natural monopoly.

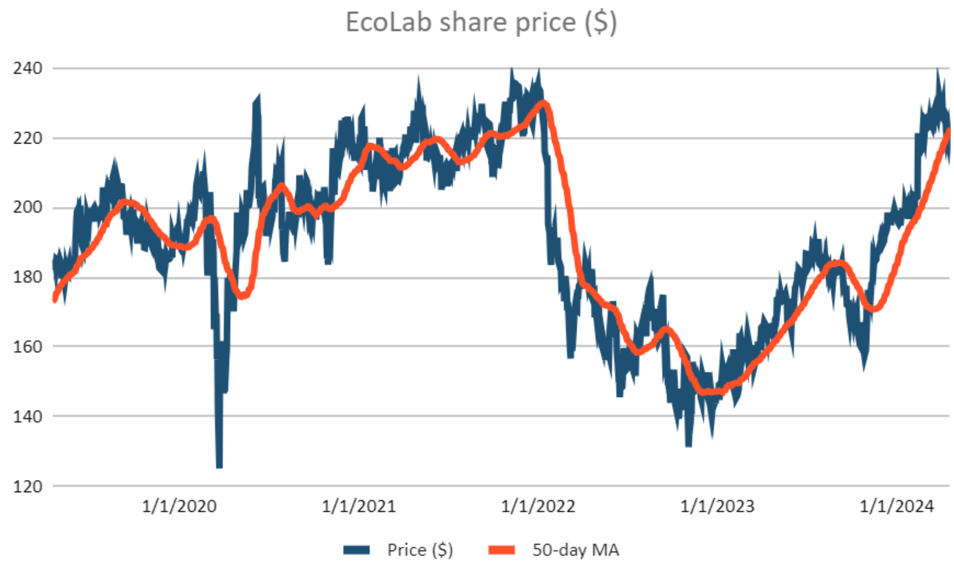
For Martin Marietta's shareholders, this strong market position is incredibly profitable. Rather than complaining about inflation – which is out of most of our control – it's best to own the companies that are benefiting from it.

Martin Marietta Key Information

Company Details	Name	Mkt Cap	Price	52-Wk Hi/Lo
	Martin Marietta Materials, Inc. (MLM)	$35.5bn	$575.89	626.67 / 343.79
Size/Debt	NAV per share*	Net Cash / Debt(-)*	Net Debt / Ebitda	Op Cash/ Ebitda
	13,020c	-$3.64bn	1.5 x	93%
Valuation	Fwd PE (+12mths)	Fwd DY (+12mths)	FCF yld (+12mths)	CAPE
	26	0.5%	3.0%	58.7
Quality/ Growth	EBIT Margin	ROCE	5yr Sales CAGR	5yr EPS CAGR
	23.7%	12.5%	9.8%	21.1%
Forecasts/ Momentum	Fwd EPS grth NTM	Fwd EPS grth STM	3-mth Mom	3-mth Fwd EPS change%
	12%	12%	13.9%	6.0%
Year End 31 Dec	**Sales ($bn)**	**Profit before tax ($bn)**	**EPS (c)**	**DPS (c)**
2021	5.08	0.88	1,228	235
2022	5.73	1.04	1,207	254
2023	6.78	1.49	1,932	280
f'cst 2024	7.09	1.69	2,150	312
f'cst 2025	7.65	1.90	2,427	308
chg (%)	**+8**	**+12**	**+13**	**-1**

Source: FactSet, adjusted PTP and EPS figures; NTM = Next Twelve Months; STM = Second Twelve Months (i.e. one year from now); *Includes intangibles of $4.1bn or 6,622c per share

EcoLab



Source: FactSet

For its infrastructure and construction build out, the US is going to need a lot more filtered and sanitised water. It is not just for the workers to drink, but ultra-purified water is needed for the manufacturing of semiconductors and the cooling down of data centres. It is also important in food and beverage production, as well as cleaning and sanitising hospitals. In short, water is needed everywhere.

EcoLab (US:ECL) purifies water with several different techniques. It can filter water through a media, use disinfectants like chlorine, or use ultraviolet light. It even has a process called reverse osmosis where it uses a semipermeable membrane to remove dissolved ions, molecules and larger particles from the water.

If water has too many minerals then limescale builds up. This isn't too much of a problem with a shower or kitchen tap but can be an issue in an industrial setting. One of EcoLab's fastest growing markets is data centres. These computers get extremely warm and need to be cooled down by running water, but water needs to be treated otherwise it can cause corrosion.

EcoLab's filtration system can remove the minerals from the water, reducing damage, resulting in less downtime for computers and manufacturing equipment. On the way out, EcoLab's filters can also purify the water to make sure the industrial companies are complying with health regulations.

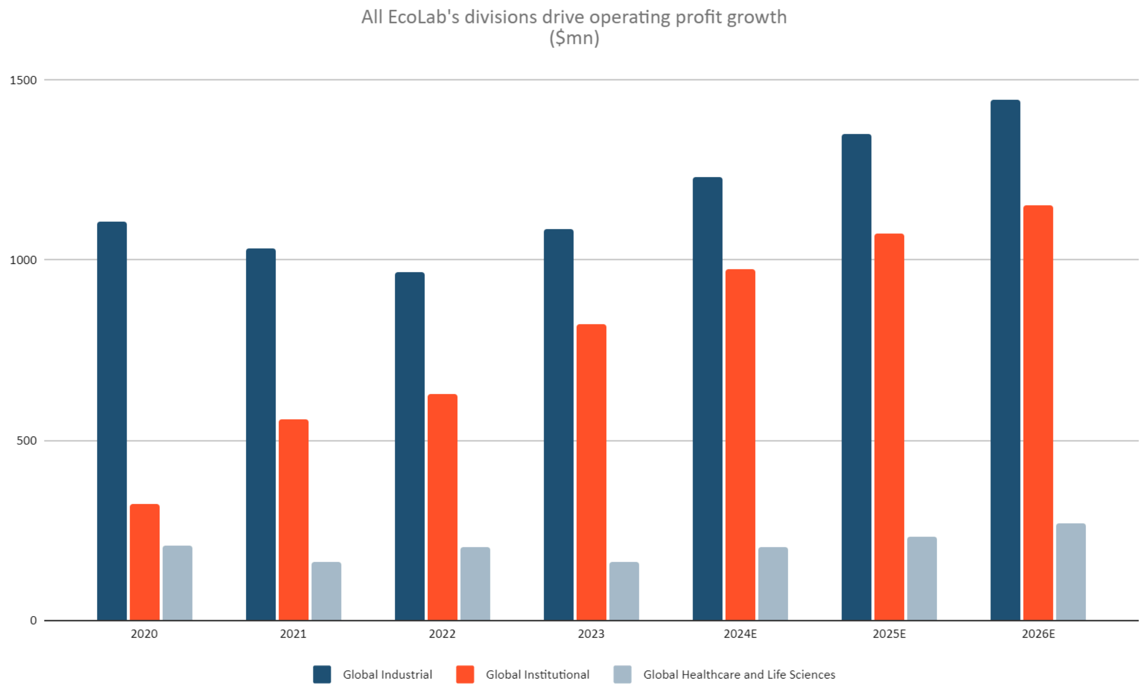
Water in everything

Ultra clean water is essential in the semiconductor manufacturing process. At certain points the wafers need to be cleaned but this needs to be done with extremely pure water. This helped drive EcoLab's industrial revenue growth, with management saying last year it experienced "very strong performance across data centers [sic.] and microelectronics". Since then, Samsung, Intel and TSMC have all announced multi-billion dollar manufacturing plans so it's likely that EcoLab will benefit from further growth in that sector.

EcoLab is an international business and operates across the world, so it is not quite as exposed to the US infrastructure spending boom as Martin Marietta. However, the US is still its biggest market, making up just over 50 per cent of revenue last year. This is followed by Europe, Asia Pacific and Latin America.

In the three months to December, revenue from EcoLab's industrials division grew 3 per cent year on year to $1.87bn, making up 48 per cent of the total revenue. Meanwhile, the institutional and speciality division which includes hotels, schools and government buildings, saw revenue rise 13 per cent to $1.29bn, equivalent to 33 per cent of the total. The remaining 19 per cent of revenue was split between healthcare and 'other' sectors.

The broad range of use for water filtration means EcoLab has a diverse end market, with customers across 40 different industries which means it has less concentration risk. For example, last quarter operating profit from healthcare dropped 25 per cent, but this was more than offset by profit from industrial and institutional rising 18 per cent and 41 per cent, respectively. Overall, group operating profit rose 48 per cent to $590mn.



Source: FactSet

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Price rises and earnings momentum

This profit growth was driven by price increases, with almost double-digit rises in both 2022 and 2023. This meant EcoLab's organic operating margin expanded 200 basis points to 16 per cent last quarter. Management says it expects to reach 20 per cent organic operating margin in the "next few years''. This expansion will feed through into EPS growth, with the company guiding for EPS to rise between 17 per cent and 25 per cent in 2024, off the back of the 16 per cent EPS growth it had in 2023.

The company took a hit during the pandemic with a slowdown in the hospitality sector. In the first quarter of 2021 operating profit dropped 21 per cent. However, up to that point it had consistently outperformed analyst expectations. Now, it is back to outperforming. Every quarter in the last year, EPS earnings came in ahead of consensus expectations and since January last year its 2025 EPS forecast has risen 10 per cent.

EcoLab Key Information

Company Details	Name	Mkt Cap	Price	52-Wk Hi/Lo
	Ecolab Inc. (ECL)	$62.4bn	$218.16	231.86 / 156.72
Size/Debt	NAV per share*	Net Cash / Debt(-)*	Net Debt / Ebitda	Op Cash/ Ebitda
	2,823c	-$7.81bn	2.4 x	99%
Valuation	Fwd PE (+12mths)	Fwd DY (+12mths)	FCF yld (+12mths)	CAPE
	33	1.1%	3.0%	62.3
Quality/ Growth	EBIT Margin	ROCE	5yr Sales CAGR	5yr EPS CAGR
	14.1%	13.1%	0.9%	-0.4%
Forecasts/ Momentum	Fwd EPS grth NTM	Fwd EPS grth STM	3-mth Mom	3-mth Fwd EPS change%
	20%	14%	9.2%	8.0%
Year End 31 Dec	**Sales ($bn)**	**Profit before tax ($bn)**	**EPS (c)**	**DPS (c)**
2021	12.7	1.61	469	196
2022	14.2	1.55	449	208
2023	15.3	1.88	521	213
f'cst 2024	16.0	2.30	641	226
f'cst 2025	16.9	2.59	728	239
chg (%)	**+6**	**+13**	**+14**	**+6**

Source: FactSet, adjusted PTP and EPS figures; NTM = Next Twelve Months; STM = Second Twelve Months (i.e. one year from now); *Includes intangibles of $12bn or 4,072c per share

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