Investment Research & Analytics

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US to Reignite Growth with Infrastructure Push

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Overview

- The **COVID-19 pandemic** has already affected the lives of many; it pushed the US and other developed countries into recession in 2020. The economic impact of the pandemic is staggering and long-lasting, with every sector of the economy feeling the brunt.
- **Jobless claims** skyrocketed as companies across the US laid off employees to survive the pandemic. To address this, the Democrats and Republicans proposed stimulus packages, in the form of an infrastructure bill. This is in addition to the USD 2.2 trillion stimulus package released to fight the impact of the COVID-19 pandemic on the US economy.

- **Infrastructure** is the lifeline of a country, providing connectivity to citizens within and outside the country. Surface transportation, waterways, railroads, and suitable Internet connectivity are all crucial to the import and export of finished products. These also aid in creating employment opportunities.
- During the past three decades, the infrastructure sector in the US has been largely **underfunded**, with shortfalls acting as a hurdle in the maintenance of existing assets. This is also posing headwinds to creating a globally competitive system. Therefore, closing the infrastructure investment gap is essential to jump-starting the economy.

- **Closing the investment gap** would boost employment opportunities and help in developing an efficient transportation network to connect households across metropolitan cities.
- Although infrastructure investments are slow tools to fight recessions, federal infrastructure aid could **stimulate short-term demand** in times of uncertainty.
- We believe infrastructure investments could help **rebuild the US economy**, making it resilient to such shocks, and boost growth after this unprecedented economic fallout. These investments can be considered as much-needed short-term measures to mitigate the impact of the pandemic.

- As per the American Society of Civil Engineers (ASCE), it is crucial to close the investment gap in the US infrastructure sector by 2039; otherwise, the US economy would lose more than USD 10 trillion in GDP.
- In this report, we have compared the existing and projected investment requirements in the infrastructure sector to the current funding trends in different sectors, such as surface transportation, water, and wastewater.
- We have identified the key sectors that would benefit the most from the infrastructure bill. We have also shortlisted a few companies that are expected to outperform; our analysis is based on each of these companies' fundamentals and how well the company is placed relative to its peers.

Key developments related to infrastructure bill

August 2016
Trump proposed a plan to spend USD 800 billion to USD 1 trillion to improve the US infrastructure.

February 2018
Trump unveiled a USD 1.5 trillion plan to spur infrastructure investment.

February 2019
Trump proposed an infrastructure plan during the State of the Union address.

April 2019
Republicans and Democrats agreed to pursue a USD 2 trillion infrastructure plan.

June 2020
House Democrats unveiled their USD 1.5 trillion infrastructure plan.

December 2020
Democrats won the US 2020 elections. As they control the Senate, the USD 1.5 trillion infrastructure bill could become a reality. Democrats hold majority in both houses of Congress.

Democrats' infrastructure bill more comprehensive than Republicans' bill

Democrats' Bill of USD 1.5 Trillion

Five-Year Surface Transportation Plan Focusing on Roads, Bridges, and Railways
Nearly USD 500 billion for a five-year surface transportation plan

School Infrastructure
USD 130 billion for school infrastructure

Internet Access
Over USD 100 billion to expand Internet access to rural areas

Affordable Homes
USD 100 billion to create or preserve at least 1.8 million affordable homes

Childcare Facilities
USD 25 billion (state-controlled revolving fund) to upgrade childcare facilities and provide access to safe drinking water

Postal Service Infrastructure
USD 25 billion to modernize Postal Service's operations and infrastructure, including a fleet of electric vehicles

Republicans' Bill of USD 1.0 Trillion

Highway Infrastructure – USD 602 Billion

Building Infrastructure Great Grants Program – USD 60 Billion

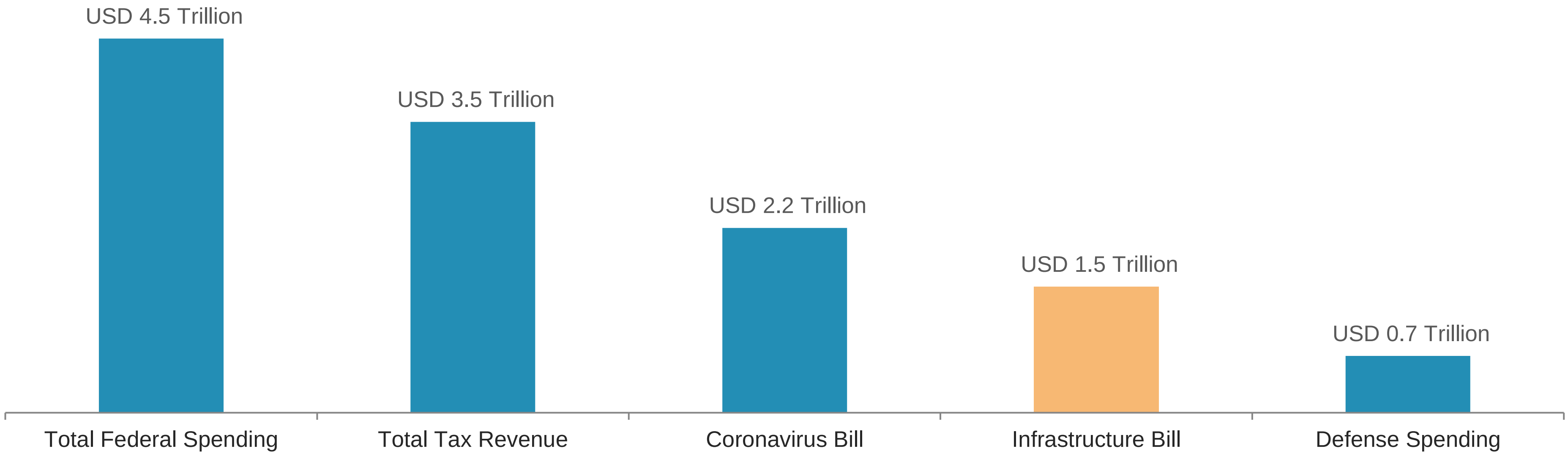
Moving America's Freight Safely and Efficiently Program – USD 50 Billion

Rail Infrastructure – USD 17 Billion

Traffic and Motor Carrier Safety – USD 20 Billion

Transportation Infrastructure Finance – USD 16 Billion

Size of US infrastructure bill



Note: *Data as of 2019*

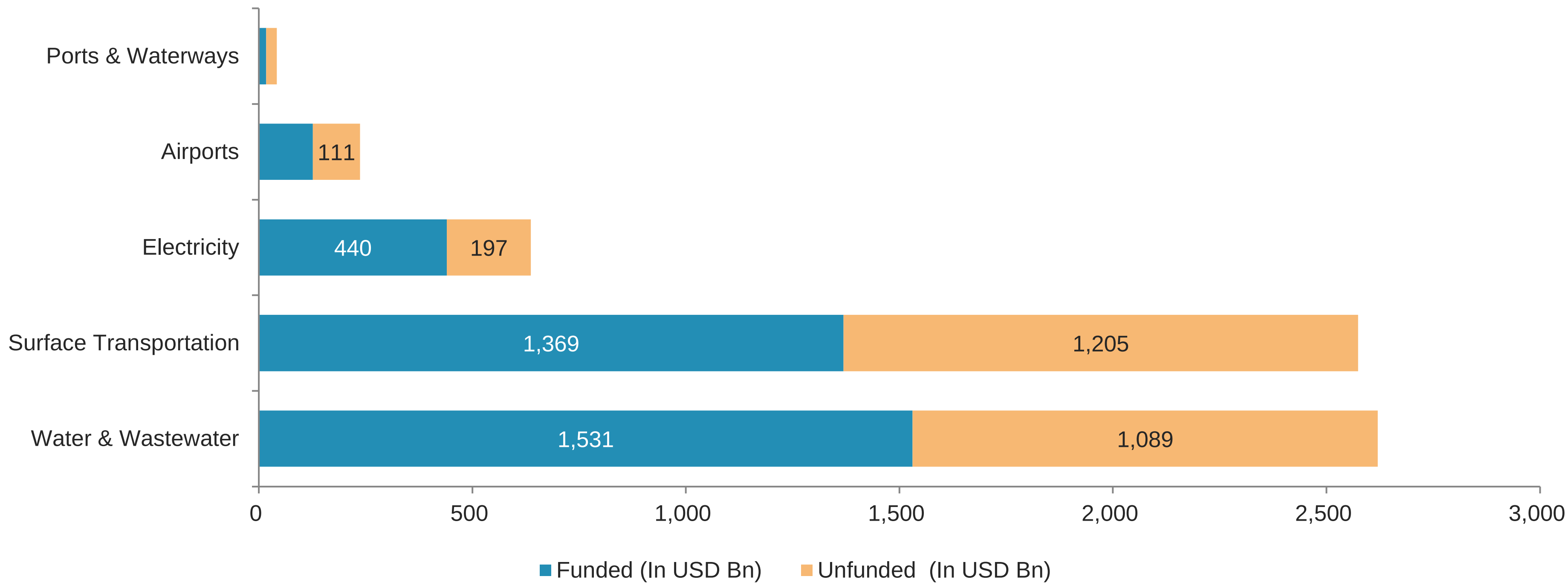
- Infrastructure investment is vital to growth of any economy. However, optimal utilization of funds is essential to achieving the anticipated growth. The USD 1.5 trillion infrastructure bill accounts for around 33.3% of the total federal spending and for 4.5% of 2019 GDP.
- Of the USD 1.5 trillion investment, nearly USD 500 billion would be used for surface transportation, USD 130 billion for school infrastructure, USD 70 billion for electric grid infrastructure, USD 100 billion each for housing and broadband Internet expansion, and about USD 30 billion for healthcare facilities.
- The state as well as local governments should contribute large amounts to infrastructure funding, which would be used to rebuild roads, bridges, waterways, energy plants, rural infrastructure, public properties, etc.

Source: *ASCE, Aranca Analysis*

Of total USD 6.1 trillion required to meet needs through 2029, only USD 3.5 trillion (approximately 57%) available

Funding Needs of Major Infrastructure Sectors in the US (2020–29)

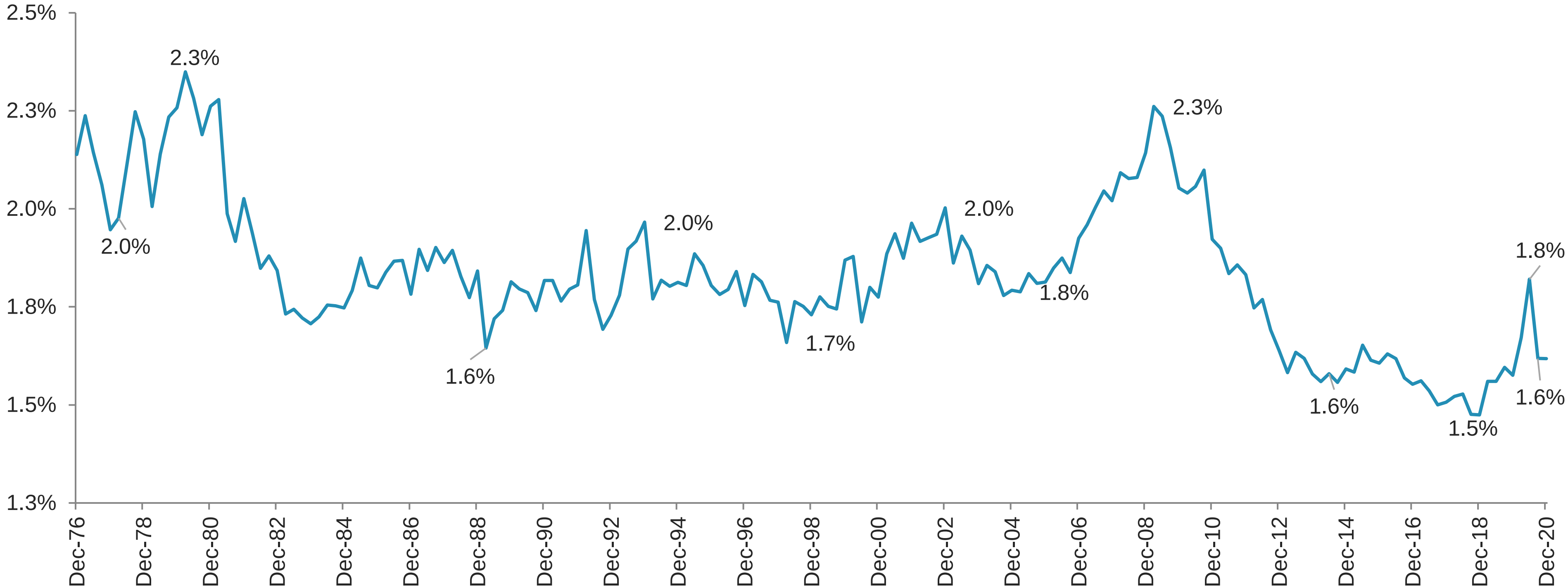
Water transportation and surface transportation, including roads and railways, are the largest sectors that require funding. Even after receiving an estimated USD 2.9 trillion, both the sectors would have a funding gap of over USD 2.2 trillion. In terms of funding gap, these sectors are followed by electricity sector, which includes electric grids; the sector would require an additional funding of USD 197 billion. According to the ASCE, an estimated USD 6.1 trillion is required to fund the cumulative needs of various sectors (mentioned below) through 2029; the amount required is expected to increase to USD 13.1 trillion by 2039. Consequently, the funding gap would amount to a whopping USD 2.6 trillion by 2029; the gap is expected to rise to USD 5.6 trillion by 2039.



Source: *ASCE*

Public construction spending fails to revert to earlier levels

Public Construction as Percentage of GDP



Between 2016 and 2018, the US economy lost some momentum due to sluggish growth, trade tensions between the US and China, and slowdown of global economies. This led to further decline in domestic infrastructure spending. The above graph depicts the public construction spending as a percentage of GDP; the spending continued to trend downward from early 2011 and reached 1.6% of GDP in December 2020.

Source: *US Census Bureau, Bloomberg*

Infrastructure investments to boost lagging US economy

Infrastructure investments form a significant part of several economic stimulus packages developed by countries across the world to boost economic activities and respond to global recession. Despite using all monetary tools, the US Fed could not avert a recession. Hence, stimulating the lagging infrastructure sector would be the best approach to revive growth. Overall, we expect the infrastructure investments could strengthen the lagging economy by generating employment opportunities and boosting economic competitiveness in the near term and long term, respectively.

Employment

- Increased infrastructure spending could significantly boost employment and economic activities, as demand for construction activities would increase with rising need to build new transport and energy networks and upgrade the existing networks.
- According to the US Associated Builders and Contractors (ABC), a national trade association, the proposed USD 1.5 trillion infrastructure plan could create an estimated 2.6 million construction jobs.

Competitiveness

- Investing in new infrastructure and maintaining the existing one would increase efficiency and reliability, besides lowering transportation costs, in the long term.
- Meanwhile, infrastructure investment could boost labor demand, which may lead to tighter labor markets in the short term. This could help in quickly restoring productivity. The aforesaid factors would boost US' competitiveness globally.

Source: *Research Reports, ASCE, ABC, Aranca Analysis*

Sectors likely to benefit most from infrastructure bill

- We have identified key sectors such as materials and industrials that are likely to benefit from the proposed infrastructure bill. We have shortlisted a few companies under these sectors which are well placed in terms of geographical location and could benefit the most from the bill.
- We are positive about a few companies in the list: U.S. Concrete, CRH, Fluor Corp, and Caterpillar. Based on our analysis, we believe stocks of these companies could outperform the market, as they are the major producers of raw materials, engineering and construction materials, and construction equipment. Furthermore, these companies' attractive valuation and sustainable growth profiles make them our preferred bets.

Key Sectors

- **Materials**
  - U.S. Concrete, Inc.
  - Vulcan Materials
  - CRH
  - Nucor
  - Heidelberg Cement
- **Industrial**
  - United Rentals
  - Fastenal
  - Fluor Corp.
  - Dycom Industries
  - Caterpillar, Inc.

Recommendation

- Materials: U.S. Concrete, Inc.; CRH
- Industrial: Fluor Corp.; Caterpillar, Inc.

Material stocks set to gain from proposed infrastructure bill

	U.S. Concrete, Inc.	Vulcan Materials	CRH	Nucor	Heidelberg Cement
Company Description	▪ Manufactures and markets ready-mix concrete, aggregates, and concrete-related products and services	▪ Produces, distributes, and sells construction materials	▪ Dublin-based building materials giant that generates 55% of revenue from the US; the biggest roadbuilder in the market	▪ North America's most diversified steel products maker and the country's largest recycler	▪ Multinational building materials company headquartered in Heidelberg, Germany
Key Catalysts	▪ Although the Congress is yet to pass an infrastructure bill, the company is well placed to benefit from such a bill due to its recent acquisition of a concrete plant in the San Francisco Bay Area. ▪ As the company produces a variety of products, we expect it to play a key role in highway development projects.	▪ The low mortgage rates would benefit the company. ▪ Vulcan has a strong hold in states such as California, Texas, and Georgia which contributed 61% to its 2019 revenue. ▪ Stock price doubled recently from the March lows, driven by the expected release of the infrastructure bill.	▪ Its stock rallied almost 140% from the March lows, negating the losses generated during the initial phase of the pandemic outbreak across Europe and North America ▪ We expect the infrastructure bill to be favorable for the building and construction segment, amid the COVID-19-related challenges.	▪ The country's tough stance on illegal, cheap steel imports could spur domestic demand; this is expected to fuel Nucor's growth further.	▪ Its strong profitability, along with a diversified portfolio, is the key catalyst for the stock. ▪ Cash savings from its COPE cost-cutting program stood at EUR 354 million at the end of June 2020. The company had set a target of EUR 1.0 billion in savings for the full year 2020.

Source: *Reuters; Aranca Analysis*

Industrial stocks on track to gain momentum

	United Rentals	Fastenal	Fluor Corp.	Dycom Industries	Caterpillar, Inc.
Company Description					
	▪ Operates in the equipment rental business, serving different institutions	▪ Sells fasteners, safety supplies, and tools, in addition to hydraulics equipment and electrical/welding equipment	▪ Global engineering and construction firm with offices on six continents	▪ Provides specialty contracting services	▪ Manufactures construction equipment
Key Catalysts					
	▪ Over the past decade, construction spending per capita has fallen; however, the equipment rental market continues to grow. This has helped United Rental gain market share over the past few years.	▪ The infrastructure bill is expected to re-accelerate the business as growth is expected to resume from 2021. ▪ Over three-years, its sales growth rate has advanced to 11%.	▪ The management expects that an increase in economic activity would bring in greater project opportunities. ▪ The stock has performed well recently, surging 200% from its low in March 2020, driven by further stimulus measures.	▪ The stock hit a new 52-week high of USD 57.61 in August 2020. Since then, it has witnessed a tremendous 47% growth; this is attributed to the rising demand in the telecom industry amid the pandemic. ▪ Steady contracts, coupled with the proposed infrastructure bill, are promising opportunities for the company.	▪ The stock was impacted by heightened trade tensions between the US and China; however, it is gaining strength, driven by the expected release of an additional stimulus package. ▪ Robust operating margins, strong brand image, and a recent USD 1.25 billion stock buyback program could be positives for the stock.

Source: *Reuters; Aranca Analysis*

U.S. Concrete, Inc. – Materials Sector

Best bet given its recent acquisitions, along with decent valuation

Company Overview

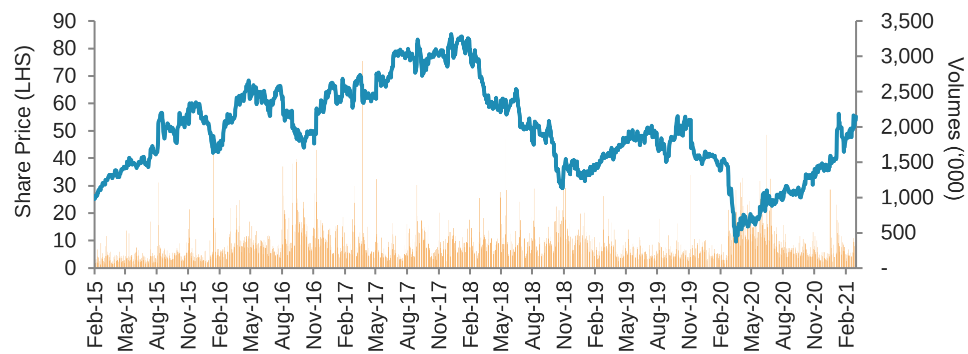
U.S. Concrete, Inc. sells ready-mix concrete (RMC) in several major markets in the US. The company operates through two main business segments: RMC and Aggregate Products.

- RMC: This segment produces and delivers RMC to customers in several markets.
- Aggregate Products: This segment produces crushed stone, sand, and gravel from aggregate facilities situated countrywide.
- The company sold 8.2 million cubic yards of RMC during 2019 and 12.6 million tons of aggregates.

Thesis

- As higher prices and more efficient logistics are key catalysts for major expansion in margins, we expect the margin trend to be sustainable. The company targets a 2% to 5% Y/Y increase in Adjusted EBITDA for 2021.
- Although the pandemic caused some disruption in construction activity across the country, we believe the company's aggregates business is strong.
- The recent acquisition of a concrete plant in the San Francisco Bay Area would help the company to gain the most from such an infrastructure bill.
- Solid momentum in residential activity, supported by large industrial commercial projects, and robust activity in the infrastructure sector, including the construction of freeways and roads, are expected to support the firm's top line through 2021.

Share Price Performance (USD)



Financial Performance (USD Million)

	2019A	2020A	2021E
Sales	1,479	1,366	1,399
EBITDA	158	175	195
Net Income	16	25	36
Net Debt	647	691	559

Market Valuations

Valuation Metrics	2019A	2020A	2021E
P/E (x)	45.85	26.02	18.94
P/B (x)	2.17	1.89	1.49
EV/Revenue (x)	0.96	1.05	0.99
EV/EBIT (x)	21.80	18.90	15.47
EV/EBITDA (x)	8.96	8.16	7.11

Note: *Data as on 4th March 2021*

Source: *Thomson Reuters Eikon, Research Reports*

CRH PLC – Materials Sector

Offers inexpensive growth

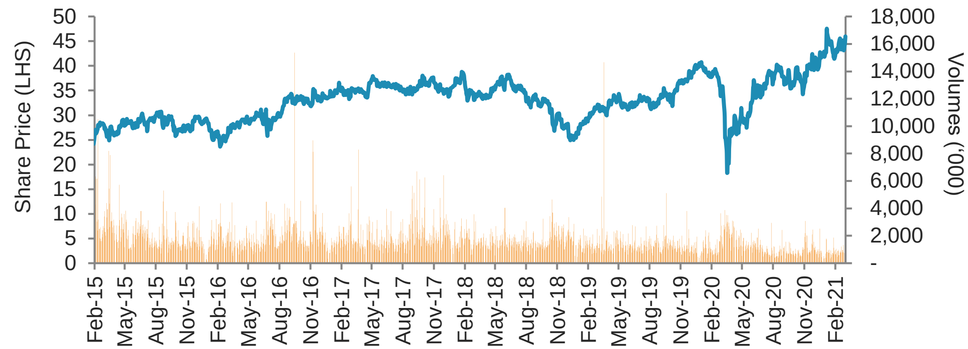
Company Overview

CRH PLC operates in the building materials business. It produces and supplies a range of building material products for the construction and maintenance of infrastructure, housing, and commercial projects. It conducts business through segments in Europe, the Americas, and Asia. CRH is headquartered in Rathfarnham, Ireland.

Thesis

- Underinvestment in the US infrastructure provides a runway for CRH's products.
- CRH enjoys one of the strongest balance sheets in the sector. A healthy balance sheet ensures that dividend payout remains intact.
- The management has a proven record of delivering steady margin improvement and superior returns via well-executed portfolio turnover.
- In Europe, continued recovery and adequate capacity would further support the French market ahead of the 2022 presidential elections.
- CRH's commitment to continue with a progressive dividend approach and its view on buybacks are encouraging.
- M&A would remain a strategic priority for CRH. We expect an uptick in construction activity, with the pipeline being strong and the uncertainty regarding the pandemic receding.
- We expect CRH to benefit from its significant exposure to downstream building materials. Robust repair and maintenance projects have benefited this segment.

Share Price Performance (USD)



Financial Performance (USD Million)

	2019A	2020A	2021E
Sales	31,536	33,692	31,061
EBITDA	5,143	5,655	5,138
Net Income	1,846	1,423	2,150
Net Debt	8,526	7,485	4,969

Market Valuations

Valuation Metrics	2019A	2020A	2021E
P/E (x)	17.85	24.14	16.36
P/B (x)	1.48	1.37	1.68
EV/Revenue (x)	1.30	1.22	NA
EV/EBIT (x)	13.02	11.48	NA
EV/EBITDA (x)	7.95	7.28	NA

Note: *Data as on 4th March 2021*

Source: *Thomson Reuters Eikon, Research Reports*

Fluor Corporation – Industrial Sector

Strong end-market prospects, solid backlog levels to drive growth

Company Overview

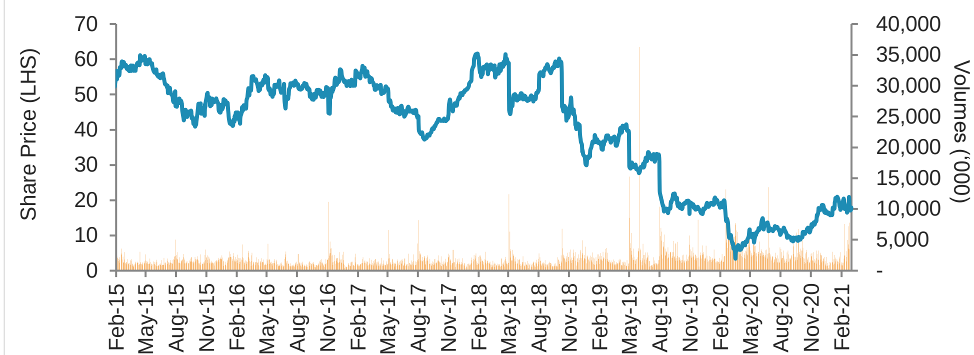
Fluor Corporation is a holding company. The company operates via four segments.

- Energy & Chemicals: This segment focuses on upstream, midstream, downstream, chemical, and petrochemical markets.
- Industrial, Mining, Infrastructure & Power: This segment provides design; engineering, procurement, and construction (EPC); and project management services to various sectors.
- Diversified Services: This segment provides asset integrity services, including staffing.
- Government: This segment provides engineering, construction, and logistics services to the US government.

Thesis

- We are optimistic about its end markets, including mining, as capital spending and land capacity utilization are improving in several regions and industries, signalling higher future capex.
- It has a strong record of receiving awards and the management expects this trend to continue. This is expected to drive the company's growth.
- Market diversity is a key strength, helping the company mitigate the cyclicality of the markets it operates in.
- It continues to focus on enhancing its competitive position in the market through various initiatives and strategic acquisitions.
- On February 18, 2020, the company halted the sale of its Government segment as it stood poised to benefit from the segment's strong liquidity position and robust cash-flow-generating capacity.

Share Price Performance (USD)



Financial Performance (USD Million)

	2019A	2020A	2021E
Sales	17,317	15,668	13,841
EBITDA	-212	250	291
Net Income	-1,557	-226	93
Net Debt	-314	-487	-220

Market Valuations

Valuation Metrics	2019A	2020A	2021E
P/E (x)	NA	NA	33.99
P/B (x)	1.78	2.18	1.60
EV/Revenue (x)	0.14	0.13	0.15
EV/EBIT (x)	NA	13.79	9.43
EV/EBITDA (x)	NA	7.97	6.99

Note: *Data as on 4th March 2021*

Source: *Thomson Reuters Eikon, Research Reports*

Caterpillar, Inc. – Industrial Sector

Stands to gain from strong balance sheet, low-interest-rate environment

Company Overview

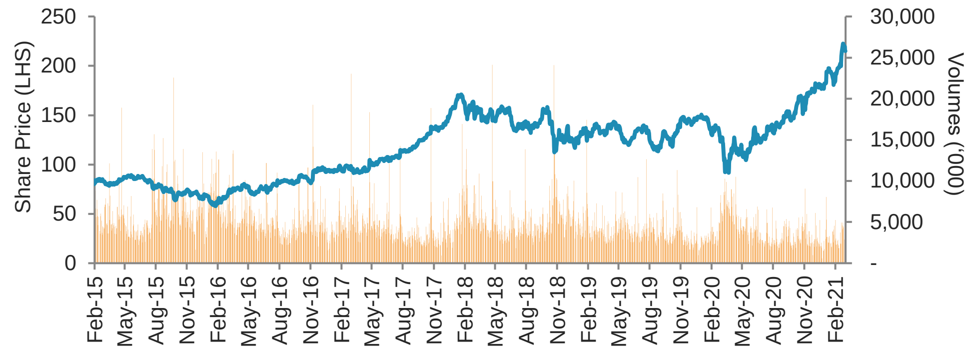
Caterpillar is a global manufacturer of construction and mining equipment. It also produces natural gas and diesel engines, diesel electric locomotives, and industrial gas turbines. It operates through the following three segments.

- Construction Industries: This segment supports infrastructure, forestry, and building construction projects.
- Resource Industries and Energy & Transportation: This segment caters to customers using machinery in quarrying, mining, material-handling, and waste-handling applications. The Energy & Transportation division supports the oil and gas, and power generation industries.
- Financial Products: This segment provides financing and related services.

Thesis

- A robust balance sheet and healthy margin performance have been the company's steady features over the past few years.
- The current low-interest-rate environment and the Federal Reserve (Fed)'s accommodative policy could lead to a bull run in asset prices which would benefit Caterpillar.
- We believe the company's focus on increasing its service revenue would help increase sales, besides providing a path to cyclical recovery.
- Caterpillar's superior dealer network of 165 dealers serving 191 countries and its strong brand image are added advantages.
- We expect the stock price to rise further in 2021, with the pandemic-related uncertainties receding and demand increasing in recent months.

Share Price Performance (USD)



Financial Performance (USD Million)

	2019A	2020A	2021E
Sales	53,800	41,748	46,263
EBITDA	11,887	7,929	8,475
Net Income	5,888	2,909	4,332
Net Debt	29,373	27,811	15,416

Market Valuations

Valuation Metrics	2019A	2020A	2021E
P/E (x)	14.17	34.22	22.56
P/B (x)	5.57	6.47	6.98
EV/Revenue (x)	2.06	3.04	2.78
EV/EBIT (x)	11.89	23.13	21.42
EV/EBITDA (x)	9.31	16.03	15.12

***Note:** Data as on 4th March 2021*

***Source:** Thomson Reuters Eikon, Research Reports*

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