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Sidoti & Company, LLC
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Nonresidential Construction Industry Update

We Expect Nonresidential Construction Will Slow in 2020-2021, Affecting Most Companies Associated With New Construction Builds

Company Name	Ticker	Current Price	Rating	Price Target
AAON, Inc.	AAON	$49.37	NEUTRAL	$52
Comfort Systems USA, Inc.	FIX	$51.10	NEUTRAL	$49
CSW Industrials, Inc.	CSWI	$73.83	NEUTRAL	$64
EMCOR Group, Inc.	EME	$88.93	NEUTRAL	$89

- **After a strong 2016-2019, we expect the U.S. nonresidential construction market will slow in 2020-2021 and may even decline by 2H:20.**
- **Leading indicators such as Dodge Data & Analytics' nonresidential construction starts data and the AIA's Architectural Billings Index, support an outlook for much slower activity in the next 12 months.**
- **Due to the cautious outlook we have on the U.S. nonresidential construction end-market, we maintain NEUTRAL ratings on AAON, FIX, EME and CSWI, which all have significant exposure to this market.**

We think the U.S. nonresidential construction market slows in 2020-2021. According Dodge Data & Analytics, a construction industry provider of analytics, total U.S. construction starts (which include residential, nonresidential and nonbuilding starts) grew 11%-14% annually in the 2012-2015 ,period 7% per annum in 2016-2017 and 3% in 2018. Dodge estimates total starts will be down 1% in 2019 and down 4% in 2020. In the nonresidential construction segment of the market, starts have been much more volatile; however, similar to the overall industry, they have slowed recently. In Exhibit 1, we illustrate the year-over-year growth of nonresidential construction starts (in dollars) from 2012 to 2018, as well as Dodge's estimated growth rates for 2019 and 2020. By end-market, Dodge anticipates starts of commercial buildings to decline 6%, of institutional buildings to remain flat, of manufacturing buildings to decline 2% and of multi-family buildings to decline 13%. Considering the trends in starts, Dodge estimated nonresidential construction spending would grow 3.4% in 2019; in July, this was updated this to 3.8%. According to the Census Bureau, nonresidential construction spending is up 3.6% through October. In the July report, Dodge estimated2019 nonresidential construction spending growth at 2.4%. Considering the trend in starts, we think this estimate could be reduced.

Exhibit 1: Year-Over-Year Growth of Nonresidential Construction Starts

2012	2013	2014	2015	2016	2017	2018	2019E	2020E
-4%	7%	17%	-8%	4%	10%	-1%	-3%	-3%

Source: Dodge Data & Analytics

In addition to Dodge, we follow the American Institute of Architect's Architectural Billings Index (ABI), which is a nine to 12 month leading indicator to nonresidential construction spending. Earlier this year, the trailing three-month average of the ABI fell below 50.0 (indicating a contraction in architectural billings) for seven straight months (April through October), which was the longest period of sub-50.0 since 2011. The index never fell below 48.8 in a single month; so it never indicated a severe decline. That said, it still suggests that construction will slow. After the index fell below 50.0 in April-November 2011, nonresidential construction spending started contracting by mid-2012, according to the Census Burea. Given the ABI did not fall below 50.0 to the degree as we witnessed in 2011, we do not think construction spending declined over a 12 month period; but we do think this also suggests minimal growth in 2020.

Most of the stocks we cover in our universe that are associated with the nonresidential sector are fairly valued, in our view. The four names we highlight are AAON, EME, FIX and CSWI. The first three have about 30%-50% of their revenues associated with new construction; CSWI has about 25% of its revenue associated with the sector. Due to the slowing of these parts of their businesses, we expect a signficant slowdown in growth for these companies in 2020, except for AAON, which had a challenging 2019 due to some internal factors. For EME, we estimate earnings growth declines from an estimated 15% in 2019 to 9% in 2020. For FIX, we estimate earnings are flat in 2020 after growing an estimated 4% in 2019. For CSWI, we estimate earnings will slow from growing an estimated 36% in 2019 to 14% in 2020. Again, AAON has a unique situation in that we

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estimate earnings growth accelerates to 35% in 2020, from an estimated 19% in 2019. As far as valuations, all four stocks are trading above their own historical averages.

EME and FIX. These two companies are two of the largest mechanical and electrical sub-contractors in the industry. Roughly, about 30% and 40% of these companies' respective revenues are associated with the nonresidential construction market. Both companies have realized signficant slowing in their backlog. At the end of 3Q:19, EMCOR's backlog was up 2% year-over-year and Comfort Systems' was up organically 6%; this reflects slowing from double digit growth a year ago. The positive for both companies is that retrofit work and services make up a majority of their businesses, so we continue to expect modest growth. Furthermore, both companies have recently made sizeable acquisitions, which will contribute to EBITDA and FCF growth. Although we like both companies, valuation keeps us NEUTRAL rated on each. For EME, our $89 price target is based on 14x our 2020 EPS estimate of $6.18; this equates to 9.8x our 2020 EBITDA estimate of $529 million. For FIX, our $49 price target continues to be based on 16x our 2020 EPS estimate (of $3.04); this equates to 9.6x our 2020 EBITDA estimate of $211 million.

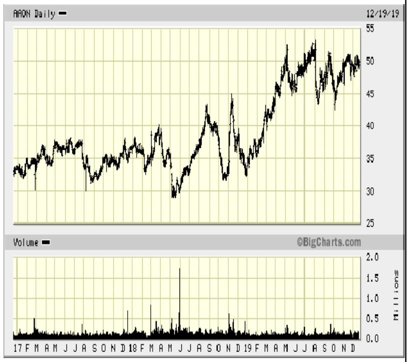
AAON. AAON is a manufacturer of customized HVAC rooftop units, as well as other HVAC equipment for nonresidential buildings. About half the company's sales are associated with new construction; the other half is driven by planned replacement demand. AAON is unique, in that while the end-market can effect the company's performance, we think there are long-term secular trends that will help drive above-market growth. Poor execution weighed on growth in 2018-2019. Now, with many of these issues behind AAON, easy comparisons will result in an acceleration of year-over-year growth in 2020. See our note dated December 11th (in which we raised our price target and estimates following a non-deal road show we hosted) for more detail on our updated thoughts on AAON. However, despite our positive outlook on AAON's prospects, we continue to maintain a NEUTRAL rating based on valaution. Our $52 price target is based on 30x our 2021 EPS estimate of $1.71.

CSWI. CSW Industrials is an industrial conglomerate with several businesses and exposure to many different end-markets. The nonresidential construction market makes up about 26% of total sales; the rest is made up of residential HVAC (36%), general industrial (12%), nonresidential and residential plumbing (10%), energy (8%), rail (5%) and mining (3%). CSW's buildings products business, which makes up the 26% of sales that is associated with nonresidential construction, sells various different products, including indoor and outdoor balcony and walkway railings and smokeguard films installed in elevators in case of a fire. Most of the demand of its building products is driven by new construction. The rest of the business is mixed, in our view. The HVAC business, which we view as its most valuable asset, is trending well as consumers continue to retrofit their homes. The plumbing business also seems to trend well as GDP continues to expand. The rest of the business (30% of revenue) is much more cyclical; we estimate this business will weigh on growth in 2020. We also note, that 2020 will be a tough comparison for the overall company as we estimate 35% earnings growth in 2019. Over the past 12 months, shares of CSWI are up 60%; thus, the earnings growth is certainly being reflected. The multiple also reflected the company's performance, expanding 30% over this time (from an EV/EBITDA multiple of 10x to 13x). In our view, as earnings growth slows signficantly in 2020 (by our estimate), the multiple will not realize much expansion, limiting upside in the stock. Our $64 price target based on 19x our F2021 EPS estimate (of $3.35, down from $3.37); this equates to 11.3x our F2021 EBITDA estimate of $86.8 million.

Required Disclosures

AAON, Inc. (AAON - NEUTRAL)

Action	Date	Px	Rating	PT
PT	5/4/17	37.2		37
PT	8/3/17	33.8		35
PT	4/3/18	37.2		33
PT	5/30/19	46.6		37
PT	7/19/19	50.6		40
PT	12/11/19	48.6		52

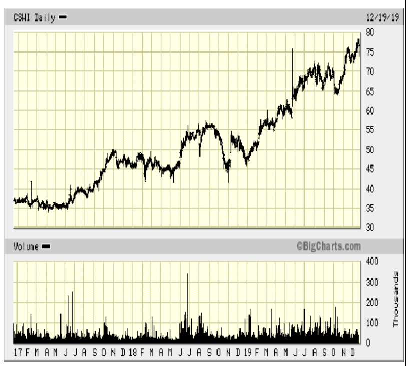


Comfort Systems USA, Inc. (FIX - NEUTRAL)

Action	Date	Px	Rating	PT
PT	2/24/17	32.8		46
PT	5/2/17	37		43
PT	10/27/17	40.5		50
PT	12/8/17	42.6		52
Rating	6/7/18	48.2	Neutral	52
PT	7/27/18	49.1		55
Rating	1/2/19	43.7	Buy	55
PT	2/20/19	51		57
Rating	3/12/19	53.2	Neutral	57
PT	7/26/19	52.4		53
PT	8/7/19	39.6		47
PT	10/25/19	47.1		49

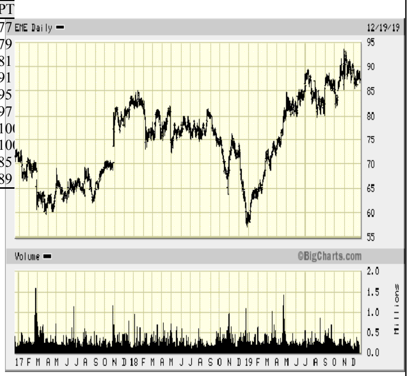
CSW Industrials, Inc. (CSWI - NEUTRAL)

Action	Date	Px	Rating	PT
Initiation	12/20/17	47	Neutral	50
PT	11/7/18	51.2		52
PT	2/5/19	53.8		54
PT	5/22/19	64.1		58
PT	8/8/19	71.5		64



EMCOR Group, Inc. (EME - NEUTRAL)

Action	Date	Px	Rating	PT
PT	3/15/17	62.2		77
PT	4/27/17	68		79
PT	10/26/17	70.3		81
PT	10/30/17	78.9		91
PT	12/8/17	80.2		95
PT	4/27/18	72.5		97
PT	7/9/18	77.6		10[illegible]
Rating	10/4/18	0	Suspended	10[illegible]
Initiation	6/24/19	81	Neutral	85
PT	10/4/19	83.1		89



Appendix
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