

CONSTRUCTION PARTNERS, INC. | ROAD

BUY

Starts FY'24 with a Solid Beat, Backlog +10% Yr/Yr, Target to \$55

PRICE \$46.81

PRICE TARGET \$55.00

KEY TAKEAWAY

ROAD reported an 8% EBITDA beat for Q1'24 (\$41M vs. consensus of \$38M), primarily driven by higher margins. The company generated an EBITDA margin of 10.3% in Q1, which was 70 bps above our forecast. Free cash flow was the biggest positive surprise to us in Q1'24 (\$36M vs. our \$3M). ROAD has completed four acquisitions in FY'24, and we expect M&A to continue. We are tweaking our FY'24 EBITDA forecast higher (from \$206M to \$207M) and raising our 12-month price target from \$50 to \$55. Management expects strong public-sector bidding in the coming months, which could support robust H2'24 results, in our view.

KEY POINTS

Reports Q1'24 beat. Construction Partners reported Q1'24 adjusted EBITDA of \$41M (+48% yr/yr) versus our estimate of \$39M and consensus of \$38M. The beat versus our model was driven by higher margins. Total revenue came in at \$397M (+16% yr/yr) versus our estimate of \$409M and consensus of \$394M. ROAD generated an adjusted EBITDA margin of 10.3%, which was 70 bps above our forecast and up 220 bps yr/yr.

Sequential backlog growth continues. ROAD finished Q1'24 with a total backlog of \$1.6B, up 10% yr/yr and 1% sequentially. This represented the 13th consecutive quarter of sequential backlog growth. The company appeared upbeat about state DOT bidding in the coming months, in our view.

Some sectors within private construction, such as office and retail, slowed in FY'23. Our sense is that there has been no incremental weakness in private construction demand in FY'24. Like others, ROAD management noted that heavy nonresidential construction demand remains elevated.

Cash flow beats; four acquisitions YTD. ROAD generated free cash flow of \$36M in Q1'24, which was well above our \$3M forecast. We are increasing our FY'24 free cash flow forecast from \$78M to \$110M to reflect the beat.

ROAD completed three acquisitions during Q1'24 and ended the quarter with net debt of \$372M (1.8x our FY'24 EBITDA forecast). So far, the company has completed one acquisition during Q2'24, and we believe M&A discussions remain active. ROAD reiterated its leverage target of 1.5x–2.5x.

Guidance reiterated, tweaking estimates higher. Management maintained the midpoint of its FY'24 EBITDA guidance at \$208M, which is slightly below consensus of \$210M. We are increasing our FY'24 forecast from \$206M to \$207M to reflect the Q1 beat, partially offset by more conservative Q2 assumptions. We are maintaining our FY'25 EBITDA forecast of \$235M (+13% yr/yr).

Stock weakness on Friday due to strong YTD performance; raising our price target to \$55. ROAD shares sold off on Friday (–7.0% vs. the S&P 500 Index +0.6%). We believe that the underperformance was due to the stock's strong YTD performance heading into the Q1'24 report. Even after Friday's selloff, shares are +7.6% YTD versus the S&P 500 +5.5%. We continue to view ROAD as an attractive small cap growth opportunity. Our 12-month price target goes from \$50 to \$55.

Engineering & Construction

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COMPANY STATISTICS

52-Week Range	\$24.12-\$50.70
Market Capitalization (M)	\$2,454
Average Daily Volume (000s)	294
Debt/Total Cap	46%
Dividend	NA
Shares Outstanding (M) fd	52.4
Estimated 3-yr EPS Growth	54%
Enterprise Value (M)	\$2,827
Float (M)	50.8

FINANCIALS

FYE Sept	2022A	2023A	2024E	2025E
P/E Ratio	113.7x	50.1x	37.6x	31.1x
EV/EBITDA	25.4x	16.2x	13.7x	12.0x
Revenue (M)	\$1,302	\$1,564	\$1,765	\$1,930
Op Inc (M)	\$35	\$82	\$106	\$127
EBITDA (M)	\$111	\$174	\$207	\$235
EPS				
Q1	\$0.11	\$0.04	\$0.19A	\$0.21
Q2	(\$0.18)	(\$0.11)	(\$0.11)	(\$0.10)
Q3	\$0.23	\$0.41	\$0.53	\$0.66
Q4	\$0.25	\$0.59	\$0.63	\$0.73
Total	\$0.41	\$0.93	\$1.24	\$1.51
Consensus	—	—	\$1.36	\$1.86

Consensus estimates from Visible Alpha Insights

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Valuation. Over the past two years, ROAD has traded at 11.7x forward EV/EBITDA, on average. Currently, shares are trading at 13.7x our FY'24 EV/EBITDA. Our \$55 price target is based on 14.0x our FY'25 EV/EBITDA forecast, thus assuming slight multiple expansion. ROAD's multiple is elevated, but we are encouraged by the prospect for strong EBITDA growth over the forecast period, and we expect M&A to continue (i.e., we view ROAD as an attractive long-term growth story).

Risks. Primary risks to ROAD's share price and to the achievement of our price target include: (1) macroeconomic conditions; (2) productivity disruptions, such as weather and other factors; (3) uncertainty related to state DOT budgets in AL, FL, GA, NC, SC, and TN; and (4) inflation. Lastly, the potential exists that ROAD's recent acquisitions will be harder to integrate than anticipated. ROAD plans to remain acquisitive, we believe, and acquired companies could negatively impact the company's consolidated performance.

Construction Partners
Earnings Model

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(\$ millions)	2023A					2024E					2025E				
	Dec	Mar	June	Sept	Sept	Dec	Mar	June	Sept	Sept	Dec	Mar	June	Sept	Sept
	Q1	Q2	Q3	Q4	Year	Q1A	Q2	Q3	Q4	Year	Q1	Q2	Q3	Q4	Year
Revenue	\$341.8	\$324.9	\$421.9	\$475.0	\$1,563.5	\$396.5	\$359.0	\$488.5	\$521.0	\$1,765.0	\$425.0	\$380.0	\$550.0	\$575.0	\$1,930.0
Cost of revenue	311.3	298.6	357.8	399.5	1,367.2	344.6	326.7	410.3	433.7	1,515.4	368.7	345.8	460.6	477.3	1,652.4
Gross profit	30.5	26.3	64.1	75.5	196.4	51.9	32.3	78.2	87.3	249.6	56.3	34.2	89.4	97.8	277.6
G&A expenses	(29.7)	(32.0)	(32.2)	(33.0)	(126.9)	(36.0)	(36.0)	(36.0)	(38.0)	(146.0)	(37.0)	(37.0)	(38.0)	(41.0)	(153.0)
Settlement income	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Gain on sale of equipment, net	5.6	3.2	1.5	2.2	12.4	0.8	0.5	0.5	0.5	2.3	0.5	0.5	0.5	0.5	2.0
Operating income	6.3	(2.6)	33.3	44.8	81.9	16.7	(3.2)	42.7	49.8	106.0	19.8	(2.3)	51.9	57.3	126.6
Interest expense, net	(4.0)	(5.1)	(5.0)	(3.5)	(17.6)	(3.7)	(5.0)	(5.0)	(5.0)	(18.7)	(5.0)	(5.0)	(5.0)	(5.0)	(20.0)
Other income (expense), net	0.0	0.4	0.5	(0.1)	0.9	(0.0)	0.0	0.0	0.0	(0.0)	0.0	0.0	0.0	0.0	0.0
Pre-tax income	2.4	(7.3)	28.8	41.2	65.1	13.0	(8.2)	37.7	44.8	87.2	14.8	(7.3)	46.9	52.3	106.6
Income taxes	0.5	(1.5)	7.1	10.3	16.4	3.1	(2.1)	9.6	11.4	22.0	3.8	(1.9)	12.0	13.3	27.2
Earnings from JV	0.0	0.0	0.0	0.0	0.0	0.0	0.1	0.1	0.1	0.3	0.1	0.1	0.1	0.1	0.4
Net income	1.9	(5.8)	21.7	30.9	48.7	9.8	(6.0)	28.2	33.5	65.4	11.1	(5.3)	35.0	39.0	79.8
Adjusted EPS	\$0.04	(\$0.11)	\$0.41	\$0.59	\$0.93	\$0.19	(\$0.11)	\$0.53	\$0.63	\$1.24	\$0.21	(\$0.10)	\$0.66	\$0.73	\$1.51
Shares outstanding (diluted)	52.1	51.8	52.3	52.4	52.2	52.4	52.5	52.6	52.7	52.6	52.8	52.9	53.0	53.1	53.0
DD&A	\$18.4	\$19.9	\$19.5	\$21.3	\$79.1	\$21.1	\$22.1	\$22.6	\$23.1	\$89.0	\$23.4	\$23.6	\$23.9	\$24.1	\$95.0
Equity-based comp	2.5	2.7	2.7	2.9	10.8	3.0	2.9	2.9	3.0	11.8	3.3	3.0	3.0	3.5	12.8
Management fees and other	0.4	0.4	0.4	0.4	1.5	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Adjusted EBITDA	\$27.6	\$20.8	\$56.5	\$69.3	\$174.1	\$40.9	\$21.9	\$68.3	\$76.0	\$207.1	\$46.5	\$24.4	\$78.8	\$85.0	\$234.8
Percent of Sales:															
Gross margin	8.9%	8.1%	15.2%	15.9%	12.6%	13.1%	9.0%	16.0%	16.8%	14.1%	13.3%	9.0%	16.3%	17.0%	14.4%
Adjusted EBITDA margin	8.1%	6.4%	13.4%	14.6%	11.1%	10.3%	6.1%	14.0%	14.6%	11.7%	10.9%	6.4%	14.3%	14.8%	12.2%
Operating margin	1.9%	(0.8%)	7.9%	9.4%	5.2%	4.2%	(0.9%)	8.7%	9.6%	6.0%	4.7%	(0.6%)	9.4%	10.0%	6.6%
Pre-tax margin	0.7%	(2.2%)	6.8%	8.7%	4.2%	3.3%	(2.3%)	7.7%	8.6%	4.9%	3.5%	(1.9%)	8.5%	9.1%	5.5%
Net margin	0.6%	(1.8%)	5.1%	6.5%	3.1%	2.5%	(1.7%)	5.8%	6.4%	3.7%	2.6%	(1.4%)	6.4%	6.8%	4.1%
SG&A as a % of sales	8.7%	9.8%	7.6%	6.9%	8.1%	9.1%	10.0%	7.4%	7.3%	8.3%	8.7%	9.7%	6.9%	7.1%	7.9%
Tax rate	21.2%	20.3%	24.7%	24.9%	25.2%	24.1%	25.5%	25.5%	25.5%	25.3%	25.5%	25.5%	25.5%	25.5%	25.5%
Yr/Yr Change:															
Revenues	19.9%	33.5%	10.9%	20.9%	20.1%	16.0%	10.5%	15.8%	9.7%	12.9%	7.2%	5.8%	12.6%	10.4%	9.3%
Gross profit	(7.5%)	110.3%	44.8%	52.3%	41.0%	70.1%	22.9%	22.0%	15.5%	27.1%	8.5%	5.8%	14.3%	12.0%	11.2%
SG&A	19.2%	28.0%	21.2%	6.3%	18.0%	21.0%	12.5%	11.7%	15.1%	15.0%	2.8%	2.8%	5.6%	7.9%	4.8%
Adjusted EBITDA	4.7%	165.3%	50.1%	76.0%	56.6%	48.2%	5.7%	20.9%	9.7%	18.9%	13.8%	11.4%	15.5%	11.8%	13.4%
Operating income	(25.2%)	NM	85.2%	118.9%	131.2%	164.5%	NM	28.0%	11.2%	29.4%	18.4%	NM	21.6%	15.0%	19.5%
Net income	(65.7%)	NM	78.1%	135.7%	127.8%	420.2%	NM	29.9%	8.2%	34.4%	13.1%	NM	24.4%	16.7%	22.0%
EPS	(65.8%)	NM	76.8%	134.0%	126.8%	417.2%	NM	29.1%	7.5%	33.3%	12.3%	NM	23.4%	15.8%	21.1%

Source: Company reports and Thompson Davis & Co. estimates

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Buy: Company/Industry has strong fundamentals, attractive valuation; outperforms the relevant indices in over the next 12–18 months

Hold: Stock is fairly valued; no compelling reason to buy or sell stock today; cautious about prospects over the next 6–12 months for industry or company; neutral performance relative to the relevant indices.

Sell: Fundamentals of industry or company are deteriorating; company not expected to have consistent earnings growth over next 12–18 months or business model is questionable; underperforms the relevant indices in the next 12–18 months.

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Price targets, when established, represent our best estimate of the market price of a stock in 12 months. A 12-month price target is highly subjective and the result of numerous assumptions, including company, industry, and market fundamentals, both on an absolute and relative basis, as well as investor sentiment, which can be highly volatile.

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Thompson Davis & Co., Inc., rating distribution by percentage (as of February 12, 2024):

	#	%
BUY	24	96
SELL	0	0
HOLD	1	4
TOTAL	25	100.0%

Rating and Price Target History for Construction Partners, Inc. (ROAD) as of December 29, 2023

Date	Rating	Price	Target
2/5/2021	Buy	\$29.51	\$33
5/10/2021	Buy	\$30.95	\$35
11/18/2021	Buy	\$39.83	\$42
1/13/2022	Buy	\$27.24	\$35
5/6/2022	Buy	\$24.63	\$30
8/5/2022	Buy	\$26.64	\$32
2/13/2023	Buy	\$26.59	\$34
5/8/2023	Buy	\$27.86	\$36
8/2/2023	Buy	\$31.97	\$40
10/5/2023	Buy	\$39.07	\$46
11/29/2023	Buy	\$41.05	\$50

