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Vulcan Materials

NYSE: VMC

Buy

April 3, 2002

S&P Sector – Basic Materials

Industry – Construction

MARKET DATA

Price	52-Wk Range	Price Target	Shares Out.	Market Cap.	Beta	Book Value	P/S	P/E
4-2-02 close	low on 9-21-01	Valuation Result	(million)	(billion)	Yahoo!	per share	(ttm)	(ttm)
\$47.70	\$37.50 - \$55.30	\$53.29	101.4	\$4.82	0.60	\$15.82	1.77	21.89

COMPANY OVERVIEW – FROM YAHOO! FINANCE

Vulcan Materials Company and its subsidiaries are principally engaged in the production, distribution and sale of construction materials and industrial and specialty chemicals. The company's construction materials business consists of the production and sale of construction aggregates and other construction materials and related services. Construction aggregates include crushed stone, sand and gravel, rock asphalt, re-crushed concrete and crushed slag (a by-product of blast iron and steel production), and are employed in virtually all types of construction, including highway construction and maintenance and in the production of asphaltic and portland cement concrete mixes. The chemicals segment is organized into two business units, the Chloralkali Business Unit, which manages the company's line of chloralkali products and related businesses, and the Performance Chemicals Business Unit, which manages the company's specialty chemicals and services business.

INVESTMENT RECOMMENDATION

- ☐ Buy 100 shares of VMC.

SUMMARY

- ☐ VMC seems to be undervalued by approximately 12%. Our 2-stage growth model indicates that fair value is around \$53.00 a share. This target was calculated using the following CAPM assumptions: beta of 0.60, risk-free rate equal to 5.80%, and a market risk premium of 5.50%.
- ☐ Federal highway spending will likely be robust for 2002 - 2003, which should translate into strong earnings for the company's aggregate business. Following 2003, we assume a level of spending similar to that under the expiring TEA-21 program will be renewed by Congress.
- ☐ The Chemicals business holds the potential to bolster earnings as demand for its products strengthens along with domestic manufacturing activity.
- ☐ Vulcan's stock price has been flat over the past twelve months. We believe this fact, coupled with its conservative P/E multiple of just under 22 times earnings, points to a stock with more upside than downside potential; further, we believe it sets the stage for a breakout of its current range to occur sooner rather than later.

INDUSTRY INSIGHT

News & Trends The cement and aggregates industry is driven largely by construction activity. While private construction spending in 2002 will depend on the strength of the economic recovery, public spending should remain strong at least through the end of next year. TEA-21, a massive federal highway construction spending program currently underway, is the reason for the robust public spending forecast. This program expires after 2003, however, and some uncertainty exists regarding the level of spending Congress will renew. Given the fairly tight fiscal atmosphere of Washington these days, there is little hope for a significant increase in federal highway spending. However, the nation's highway system historically has received favorable treatment by politicians, so the consensus seems to call for a program similar in size to TEA-21 (\$160 Billion over six years) to be pushed through next year.

In general, the aggregates industry continues to see consolidations, such as VMC's acquisition of CalMat and Tarmac over the past two years. The industry is highly fragmented, offering abundant opportunity for a continuation of this trend, particularly as economies of scale become increasingly critical. Shipping cost and reserve quality are two important issues in this business, so proximity to customers, and the ability to offer high quality product give firms an advantage. On both of these fronts, VMC is well-positioned.

Regarding the chemicals business, which comprises 25% of Vulcan's revenues, the future looks bright. After enduring two years of high energy costs and lackluster demand, the industry seems to be turning a corner. Demand is poised to recover as the manufacturing sector continues to improve. Specialty chemicals, in particular, should add to Vulcan's performance, given its ability to tailor products for customer's unique requirements, and the pricing power inherent in the specialty chemicals market versus bulk chemicals.

INVESTMENT HIGHLIGHTS**Effect on the
Wright Fund**

The basic materials sector of the fund contains only one holding at this time, Phelps Dodge, so the sector is underweight the index. As a result, we are looking to bolster our holding in this sector. Purchasing 100 shares of VMC will bring the portfolio's exposure to materials from 1.3% to 2.0% of assets under management.

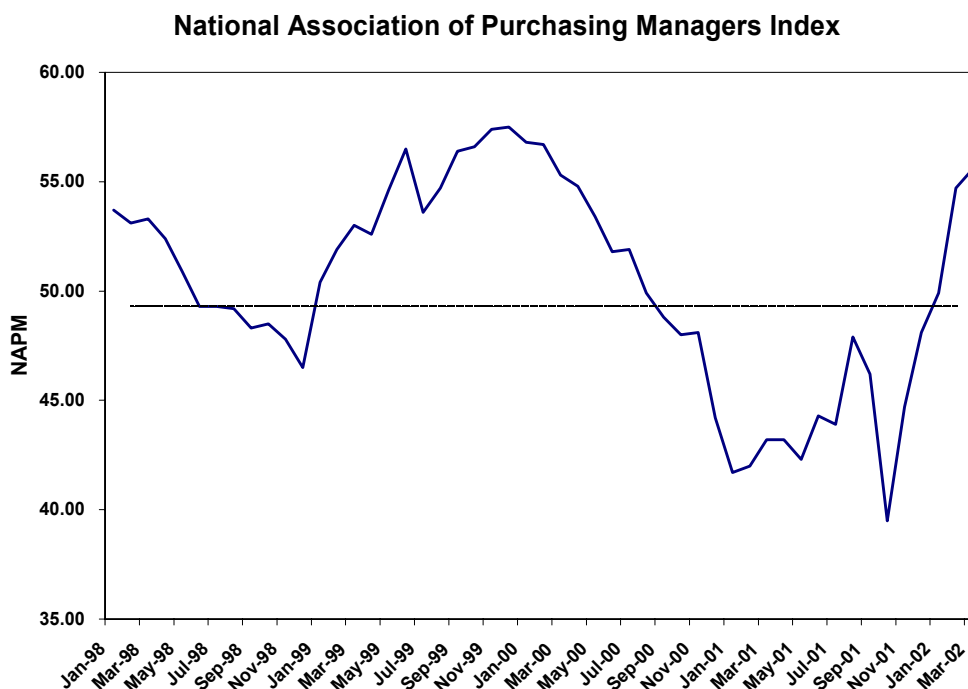
Holding VMC should also generate current income for the fund, as its dividend yield is close to 2%. With a conservative beta of 0.60, this stock should help smooth volatility in this segment of the portfolio as well.

Investment Thesis The market seems to be uncomfortable with the uncertain outlook for road-building and overall construction activity, which explains Vulcan's conservative price. However, given the robust construction spending in February (+1.1%) and consistently strong home sale figures released over the past several months, private construction appears healthy. Public spending also looks to be stable going forward. While Congress may not renew TEA-21 at quite the level it was previously, spending will certainly continue on maintaining and expanding the country's transportation infrastructure.

Vulcan is poised to benefit from these trends. Its geographic concentration is in the South and Southwest, where the strongest construction spending exists, and which represents a region that has historically benefited from heavy state and federal highway outlays. Furthermore, as the largest producer of aggregates in the US, Vulcan enjoys immense economies of scale, making it the lowest-cost producer.

Vulcan's chemicals business, too, should benefit nicely from any recovery in the economy. On this front, signs are encouraging—for the third straight month, the PMI was up in March, placing the index squarely into growth territory (see chart below). As the manufacturing sector picks up steam, the chemicals business should trail right along.

Trading at just under 22 times earnings, VMC is a nice value play in our opinion. Vulcan's stock price has been flat so far this year, while the basic materials sector has gained a modest 9.2%. Currently priced in the middle of its 52-week range, VMC has upside potential and very little downside risk in our view. Vulcan appears to be out of favor at the moment, but once the outlook clears, we believe VMC has appreciation potential.



Comparables

Among other aggregate and cement players, Vulcan is one of the most attractive in our view. It boasts one of the highest ROEs in its group, a solid profit margin, and a nice dividend yield. On the surface, FRK (Florida Rock Industries) seems better on several measures; in reality, however, this company is highly concentrated in Florida, deriving over 80% of its revenues from sales in this state. In our opinion, the market has priced in this over-exposure via its low p/e ratio. Furthermore, FRK is more dependent on private construction and state highway spending, versus VMC's greater reliance on federal highway funds and a more diversified geographic presence.

	VMC	FRK	LAF	MLM	CXP	TXI
P/E	22.07	15.20	13.45	19.24	21.85	30.62
Debt/Equity	0.60	0.29	0.53	0.78	0.49	0.71
Profit Margin	8.10%	10.30%	7.00%	6.10%	7.00%	2.41%
% Float Short	2.20%	1.50%	0.90%	1.70%	2.40%	4.90%
Divd Yield	1.96%	0.86%	1.40%	1.34%	0.52%	0.71%
ROA	6.58%	10.42%	5.90%	4.92%	4.80%	1.72%
ROE	14.62%	17.66%	12.54%	11.20%	8.13%	4.41%

Risks

The primary risk associated with Vulcan is that construction activity slows dramatically, either in the private or public sector. However, given the apparent economic recovery underway, this risk is limited. VMC has a history of strong performance through both up and down economic cycles, and no evidence exists to suggest this cycle will be any different. With a low debt load, Vulcan is positioned to sustain a lull in construction activity if one should occur.

Along these lines, Vulcan's earnings might suffer should interest rates rise dramatically. Such an event could choke off private sector construction spending, such as that related to home and office building activity. Government spending on highway and other infrastructure projects, however, would mediate this since it is less sensitive to interest rate changes.

Finally, Vulcan is exposed to potentially rising energy costs, particularly its chemical business which uses natural gas to process feedstocks into chemicals. The aggregates business, to a lesser extent, is also exposed to energy vis-à-vis diesel fuel, which is the primary source of energy used to deliver aggregates to customers.

Valuation

Our two-stage growth model assumes a five-year average revenue growth rate of 14%, followed by terminal growth of 3%. This level of growth is on par with historical levels, and we believe achievable in an environment of economic improvement.

The discount rate used in our model incorporates a risk-free rate of 5.8%, a market risk premium of 5.5%, and a beta of 0.60. This yields a target price of \$53 per share, which we believe could even be on the conservative side.

**Other
Considerations**

- ❑ Management has indicated its intent to continue acquiring competitors as opportunities arise. In our view this strategy is prudent, given most of the likely targets are local, poorly capitalized operations which Vulcan can easily upgrade and make more efficient.
- ❑ Vulcan recently completed a string of capital spending programs to upgrade recently acquired sites. One result we may see is a growing cash position which the company could use to pay down debt, or make share repurchases.

Sources:

Bloomberg
Yahoo! Finance
MSN Money
Vulcan Materials Company website
Morgan Stanley Vulcan Materials report dated March 5, 2002
Salomon Smith Barney Eastman Chemical report dated March 15, 2002
Salomon Smith Barney Vulcan Materials report dated January 23, 2002
UBS Warburg Vulcan Materials report dated January 23, 2002
Deutsche Bank Vulcan Materials report dated January 30, 2002
Legg Mason Florida Rock report dated November 8, 2001
Value Line – Investment Survey, January 11, 2002

Vulcan Materials Company: Recent Annual Financials (from MSN Money)

Annual Income Statement (Values in Millions)	12/2001	12/2000	12/1999	12/1998	12/1997
Sales	3,020.0	2,491.7	2,355.8	1,776.4	1,678.6
Cost of Sales	2,092.3	1,701.9	1,584.9	1,096.9	1,084.0
Gross Operating Profit	927.7	789.8	770.9	679.5	594.6
Selling, General & Admin. Expense	279.0	217.0	205.6	199.0	190.4
Other Taxes	0.0	0.0	0.0	0.0	0.0
EBITDA	648.7	572.8	565.3	480.5	404.2
Depreciation & Amortization	278.2	232.4	207.1	137.8	120.6
EBIT	370.5	340.4	358.2	342.7	283.6
Other Income, Net	6.4	12.0	42.0	38.8	23.8
Total Income Avail for Interest Exp.	376.9	352.4	400.2	381.5	307.4
Interest Expense	61.3	48.1	48.6	6.8	6.9
Minority Interest	-8.5	-7.8	0.0	0.0	0.0
Pre-tax Income	315.6	304.3	351.6	374.7	300.5
Income Taxes	101.4	92.3	111.9	118.9	91.4
Special Income/Charges	0.0	0.0	0.0	0.0	0.0
Net Income from Cont. Operations	222.7	219.9	239.7	255.9	209.1
Net Income from Discont. Ops.	0.0	0.0	0.0	0.0	0.0
Net Income from Total Operations	222.7	219.9	239.7	255.9	209.1
Normalized Income	222.7	219.9	239.7	255.9	209.1
Extraordinary Income	0.0	0.0	0.0	0.0	0.0
Income from Cum. Eff. of Acct. Chg.	0.0	0.0	0.0	0.0	0.0
Income from Tax Loss Carryforward	0.0	0.0	0.0	0.0	0.0
Other Gains (Losses)	0.0	0.0	0.0	0.0	0.0
Total Net Income	222.7	219.9	239.7	255.9	209.1
Dividends Paid per Share	0.90	0.84	0.78	0.69	0.63
Preferred Dividends	0.00	0.00	0.00	0.00	0.00
Basic EPS from Cont. Operations	2.20	2.18	2.38	2.54	2.06
Basic EPS from Discont. Operations	0.00	0.00	0.00	0.00	0.00
Basic EPS from Total Operations	2.20	2.18	2.38	2.54	2.06
Diluted EPS from Cont. Operations	2.17	2.16	2.35	2.50	2.03
Diluted EPS from Discont. Operations	0.00	0.00	0.00	0.00	0.00
Diluted EPS from Total Operations	2.17	2.16	2.35	2.50	2.03

Annual Balance Sheet (Values in Millions)	12/2001	12/2000	12/1999	12/1998	12/1997
Assets					
Current Assets					
Cash and Equivalents	100.8	55.3	52.8	180.6	128.6
Receivables	340.1	381.9	329.7	221.3	199.8
Inventories	228.4	199.0	178.7	143.7	132.4
Other Current Assets	60.6	58.3	63.5	30.8	26.5
Total Current Assets	730.0	694.5	624.7	576.4	487.1
Non-Current Assets					
Property, Plant & Equipment, Gross	3,943.9	3,496.2	3,149.9	2,280.8	2,120.2
Accum. Depreciation & Depletion	1,943.9	1,647.6	1,510.2	1,385.0	1,311.8
Property, Plant & Equipment, Net	2,000.0	1,848.6	1,639.7	895.8	808.4
Intangibles	588.6	562.0	454.8	0.0	0.0
Other Non-Current Assets	79.7	123.4	120.3	186.4	153.7
Total Non-Current Assets	2,668.3	2,534.0	2,214.8	1,082.2	962.1
Total Assets	3,398.2	3,228.6	2,839.5	1,658.6	1,449.2
Liabilities & Shareholder's Equity					
Current Liabilities					
Accounts Payable	153.6	181.3	136.1	107.4	112.5
Short Term Debt	61.2	277.1	107.9	7.8	9.1
Other Current Liabilities	129.7	113.8	142.6	96.4	86.1
Total Current Liabilities	344.5	572.2	386.6	211.5	207.7
Non-Current liabilities					
Long Term Debt	906.3	685.4	698.9	76.5	81.9
Deferred Income Taxes	318.5	268.8	250.8	98.5	88.7
Other Non-Current Liabilities	129.5	127.1	179.5	118.5	79.4
Minority Interest	95.1	103.6	0.0	0.0	0.0
Total Non-Current Liabilities	1,449.4	1,184.9	1,129.2	293.5	250.0
Total Liabilities	1,793.9	1,757.1	1,515.8	505.1	457.7
Shareholder's Equity					
Preferred Stock Equity	0.0	0.0	0.0	0.0	0.0

Common Stock Equity	1,604.3	1,471.5	1,323.7	1,153.7	991.5
Total Equity	1,604.3	1,471.5	1,323.7	1,153.7	991.5
Total Liabilities & Stock Equity	3,398.2	3,228.6	2,839.5	1,658.8	1,449.2
Total Common Shares Outstanding	101.3 Mil	101.1 Mil	100.7 Mil	100.6 Mil	101.2 Mil
Preferred Shares	0.0	0.0	0.0	0.0	0.0
Treasury Shares	38.4 Mil	39.0 Mil	39.0 Mil	39.1 Mil	38.7 Mil

Annual Cash Flow (in Millions)	12/2001	12/2000	12/1999	12/1998	12/1997
Cash Flow from Operating Activities					
Net Income (Loss)	222.7	219.9	239.7	255.9	209.1
Depreciation and Amortization	278.2	232.4	207.1	137.8	120.6
Deferred Income Taxes	34.9	8.3	-28.0	6.3	3.9
Operating (Gains) Losses	0.0	0.0	0.0	6.8	0.0
Extraordinary (Gains) Losses	0.0	0.0	0.0	0.0	0.0
Change in Working Capital					
(Increase) Decr. in Receivables	43.2	-31.8	33.0	-20.4	-14.2
(Increase) Decr. in Inventories	-15.6	-8.4	-11.5	-8.8	-3.8
(Increase) Decr. in Other Curr. Assets	-10.5	-23.7	-27.9	-0.9	0.6
(Decrease) Incr. in Payables	-41.1	13.4	-32.2	-4.4	-2.1
(Decrease) Incr. in Other Curr. Liabs.	3.8	8.1	25.6	-9.7	9.6
Other Non-Cash Items	-5.2	0.0	-2.8	0.0	22.0
Net Cash from Cont. Operations	510.3	418.2	403.0	362.6	345.8
Net Cash from Discont. Operations	0.0	0.0	0.0	0.0	0.0
Net Cash from Operating Activities	510.3	418.2	403.0	362.6	345.8
Cash Flow from Investing Activities					
Cash Flow Provided by:					
Sale of Property, Plant, Equipment	39.0	62.3	103.1	27.1	16.4
Sale of Short Term Investments	0.0	0.0	0.0	0.0	0.0
Cash Used by:					
Purchase of Property, Plant, Equipmt.	-425.7	-605.5	-1,095.1	-203.3	-173.3
Purchase of Short Term Investments	0.0	0.0	0.0	0.0	0.2
Other Investing Changes Net	0.0	13.2	16.1	-24.6	0.0
Net Cash from Investing Activities	-386.7	-529.9	-975.9	-200.8	-156.7
Cash Flow from Financing Activities					
Cash Flow Provided by:					
Issuance of Debt	238.6	168.6	588.2	0.0	0.4
Issuance of Capital Stock	0.0	0.0	0.0	0.0	0.0
Cash Used for:					

Repayment of Debt	-233.2	-14.1	-97.5	-6.7	-5.0
Repurchase of Capital Stock	0.0	0.0	-12.5	-65.0	-43.1
Payment of Cash Dividends	-91.1	-84.8	-78.7	-70.0	-63.6
Other Financing Charges, Net	7.7	44.4	45.7	31.9	0.0
Net Cash from Financing Activities	-78.1	114.2	445.2	-109.8	-111.3
Effect of Exchange Rate Changes	0.0	0.0	0.0	0.0	0.0
Net Change in Cash & Cash Equivalents	45.5	2.4	-127.7	52.0	77.8
Cash at Beginning of Period	55.3	52.8	180.6	128.6	50.8
Free Cash Flow	-6.5	-272.1	-770.8	89.3	108.9

CHARTS / TECHNICAL

VMC Daily Stock Chart (source: Yahoo! 4/1/02)



VMC Discounted Cash Flow Valuation Model

Assumptions

		1997	1998	1999	2000	2001	Average
Growth Rate of Sales	13.7%		5.8%	32.6%	5.8%	10.6%	13.7%
Steady State (g)	3.0%						
Current Assets/Sales	28.5%	29%	32%	27%	28%	26%	28.5%
COGS/SALES	84.4%	82%	79%	85%	87%	88%	84.4%
Terminal Capital Expenditures							
Depreciation/CA	30.4%	27%	24%	33%	33%	38%	31.0%
Capex Growth Rate	18.3%		26.1%	54.8%	8.2%	-15.7%	18.3%

Exogenous Parameters

Tax rate	31.0%	30.4%	31.7%	31.8%	29.6%	31.3%	31.0%
Cost of Equity	9.10%						
WACC	7.22%						
Shares Outstanding	101,400						

Results

Value of Equity	5,403,420
Share Price	53.29

Cashflow Model

	-4	-3	-2	-1	0	1	2	3	4	5	6
	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
Revenues	1,678,581	1,776,434	2,355,778	2,491,744	2,755,291	3,132,766	3,561,955	4,049,943	4,604,785	5,235,640	5,952,923
Total Costs and Expenses	1,378,080	1,401,590	2,004,217	2,179,506	2,431,238	2,644,054	3,006,290	3,418,152	3,886,438	4,418,880	5,024,267
Pre-Tax Income (EBIT)	300,501	374,844	351,561	312,238	324,053	488,711	555,665	631,791	718,346	816,760	928,656
Taxes	91,356	118,936	111,868	92,345	101,373	151,501	172,256	195,855	222,687	253,196	287,883
Net Income	209,145	255,908	239,693	219,893	222,680	337,211	383,409	435,936	495,659	563,564	640,773
Depreciation & Amortization	129,217	137,792	207,108	232,265	278,209	271,423	308,608	350,887	398,959	453,616	515,761
Capital Expenditures	161,238	203,258	314,650	340,409	286,854	339,348	349,529	360,015	370,815	381,939	393,398
Current Assets	487,132	576,373	624,724	694,504	729,952	892,838	1,015,157	1,154,234	1,312,364	1,492,157	1,696,583
Current Liabilities (Non-interest Bearing)	207,697	211,462	386,642	572,231	344,495	535,703	609,094	692,540	787,418	895,294	1,017,950
Interest Expense	6,914	6,782	48,576	48,087	61,280						
Working Capital	279,435	364,911	238,082	122,273	385,457	357,135	406,063	461,693	524,945	596,863	678,633
Change in Working Capital		85,476	(126,829)	(115,809)	263,184	(28,322)	48,928	55,631	63,252	71,918	81,770
Free Cash Flows to Equity (before principal)	170,210	98,184	210,404	179,471	(110,429)	297,607	293,560	371,178	460,551	563,323	681,366
Less Principal Repayments						17,264	41,205	256,220	3,237	272,623	272,624
Free Cash Flows to Equity						280,343	252,355	114,958	457,314	290,700	408,742
Discounted CFs						256,960	212,013	88,525	322,786	188,071	6,700,688
Terminal Value											
PV of Terminal Value						4,335,065					
PV (FCFE)						5,403,420					