AlphaSense

Key Predictions for Energy and Industrials in 2024

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Executive Summary

This report presents 2024 predictions for the energy and industrials sector by leveraging firsthand perspectives from industry experts through AlphaSense Expert Insights. Our experts, found within the AlphaSense expert transcript library, identified key trends and implications for the construction, renewables, and agriculture equipment segments.

In construction, experts at AlphaSense predict bifurcated residential performance with strong results at the entry- and luxury-levels but disappointing sales at the mid-level. In commercial construction, experts expect performance coatings to outpace the overall market.

In renewables, experts believe financial discipline at oil majors will stagnate material adoption in hydrogen and carbon sequestration deployments. However, they also argue that renewable diesel could be a segment of success due to declining transport costs.

Finally, in agricultural equipment, experts assert that market participants have become excessively pessimistic and low farmer delinquencies, stable farmer income, and replacement demand will mitigate a cycle downturn.

Construction Markets

The Federal Reserve System's 11 interest rate hikes over the last two years have reduced home affordability and slowed residential construction markets. Given potential interest rate cuts in 2024, industry watchers ponder the extent of a potential recovery. AlphaSense experts foresee a patchy recovery in residential construction, with some segments benefiting more than others. In commercial construction, they project performance coatings to outperform the segment.

Residential Construction

Overoptimism on Construction Recovery

Bullish industry players forecast that federal interest rate reductions in 2024 will lead to 10-15% growth in single-family starts through 2025. However, the forecasts of AlphaSense experts are less optimistic.

> "The rates would have to get down to 4.5% [for the market to achieve 10-15% growth]. Seven to eight percent growth over the next two years [is more credible]."
>
> **– Vice President, Sherwin Williams (Prior) | Expert Transcript**

Bifurcated Residential Performance is Likely

Experts also expect bifurcated residential market performance in 2024. While they forecast strength at the entry level and the luxury segment, they expect continued weakness in the mid-market.

> "For me, I think that we're really going to see two markets succeed. It's going to be the value-engineered, low-end pricing and then the luxury. Everything in the middle is probably going to move at a much slower pace. That's going to be our everyday working professional, head of household, that market is going to slow down."
>
> **– Divisional Director, PulteGroup (Prior) | Expert Transcript**

Buyers Demand for Home Customization

Homebuyers in 2024 have a growing interest for their homes to look unique, which is difficult to achieve with home-construction packages. AlphaSense experts expect option-heavy builders to prevail over builders who focus on packages.

> "What I'm seeing is people are looking for more options, less packages. They're going for the grays or the blue cabinets, white cabinets, etc. They're looking for a little more luxurious finish, but they also don't want every single home to look the same. When you go to packages, that does make it definitely very hard to make each home look unique."

– Divisional Director, PulteGroup (Prior) | Expert Transcript

Buyer Fatigue with Value Engineering

Experts predict that value-engineering is one of the biggest risks to the home building market in 2024, rather than interest rates. While value engineering succeeds at the entry-level, buyers are tiring of it in the middle segment. If builders push value engineering too far, buyers will reject middle market new builds and renovate existing properties instead.

> "As we value engineer the middle segment, if builders continue to reduce things out, I think what we're going to see is home buyers are going to pause on new builds and start to renovate older homes, the current home that they're in because the quality of the finishes will be far greater for the square footage that they're receiving."
>
> **– Divisional Director, PulteGroup (Prior) | Expert Transcript**

Private Builders at Risk

Experts assert that the most challenging participants within the home building segment will be smaller, private builders. Experts expect smaller home builders to lose market share to the large national builders due to their difficulty securing labor in a tight labor market.

> "The private home builder, it's very difficult for them to compete right now against the cost and the labor pool from the larger builders. Right now, I think that we're going to see a lot of trends that go over to production national builders that are in all large markets and all product lines."
>
> **– Divisional Director, PulteGroup (Prior) | Expert Transcript**

Commercial Construction

Strong Sales in Performance Coatings

One expert believes that performance coatings will buoy the building materials market in 2024 and that the resinous flooring segment will likely be one of the strongest within commercial construction segments. Commercial clients prefer resinous flooring to conventional VCT tile because it's easier to install and maintain.

> "That market is growing double digits compared to everything else in commercial."
>
> **– Vice President, Sherwin Williams (Prior) | Expert Transcript**

AlphaSense experts also believe the acrylic roof coating segment will likely experience above sector growth. Owners of older industrial buildings are opting to utilize roof coatings more frequently to reduce leaks and maintenance expenses.

> "When they choose to spend their investment dollars to rehab a roof, they're going with really good systems that are going to last 30-50 years. Northeast, Midwest has just an abundance of huge old manufactured buildings that constantly need that."
>
> **– Vice President, Sherwin Williams (Prior) | Expert Transcript**

Global Performance Coating Forecast 2022-2032

Source: Fact.MR

Pricing Remains Firm for Coatings

On pricing, AlphaSense experts anticipate positive but moderating pricing momentum in the coatings industry. They also expect slower price hikes than in 2023.

> "You'll see some continued impact from pricing coming into 2024."
>
> **– Vice President, Sherwin Williams (Prior) | Expert Transcript**

New Multi-family Construction Will Slow

On the weaker side, experts assert the new multi-family build segment may see a decline after years of strong growth. Despite high occupancy at apartment complexes, new build activity for these structures is slowing down quickly.

> "I suspect the fourth quarter will be negative when it comes to new multifamily build, and I think because of the comps 2024 faces, it's probably going to be negative. Now, the new build side only represents 4%-5% of the total multifamily market, but that's enough of a drag to keep multifamily flat or maybe negative for the year."
>
> **– Vice President, Sherwin Williams (Prior) | Expert Transcript**

Renewable Energy

Renewables Adoption

Oil Major Capital Discipline Slows Adoption

Historically, industry participants have predicted that hydrogen and carbon capture will serve as technologies that fossil fuel firms use to transition away from carbon fuel. However, the adoption of hydrogen and carbon capture has been disappointing. Experts believe that investor pressure for higher returns on capital and capital discipline is to blame for slow renewable energy adoption.

Despite capital discipline priorities, experts predict renewable diesel may see higher adoption in 2024 due to lower transport costs. Experts predict pilot project announcements outside of renewable diesel in hydrogen and carbon capture rather than industrial scale projects.

> “Oil companies are under enormous pressure for capital discipline right now. There are a lot of shareholder activists that are basically wanting seats on the board to control what they see is undisciplined CapEx. I think you'll find in oil companies that they'll make announcements. They'll maybe pilot projects. Do I think that they're going to scale that type of stuff? No."
>
> **– Director, Phillips 66 (Prior) | Expert Transcript**

Hydrogen

Lack of Scalability Impairs Industrial Scale Adoption

Experts blame performance issues with hydrogen for its slow adoption at oil majors. A former director at Phillips 66 asserts that green hydrogen lacks scalability at the industrial level. Additionally, he doubts its ability to provide uninterrupted power.

> “We're producing 40,000 barrels a day of renewable diesel and another 10,000 barrels of SAF. The hydrogen required for that type of process, electrolysis doesn't even begin. It's like trying to empty the ocean with a thimble cap."
>
> **– Director, Phillips 66 (Prior) | Expert Transcript**

Regulatory Confusion Impairs Adoption

A former director at Phillips 66 argues that regulatory confusion surrounding the IRA tax credits is slowing hydrogen adoption. While the initial IRA tax credits appeared quite generous, the IRS subsequently made rules stricter for accessing the credits.

> “Within the IRA, you have basically two credits. You have what's called 45V and 45Q. When you start looking at that, basically, depending on whether you're blue or green, the

> credits range anywhere from 60 ¢/kg-$3/kg. That's again the new hydrogen rules that have come out. Remember that the regulation is still very murky with hydrogen. A lot of the stuff is not clearly defined, and then the IRS made the rules much stricter, and they're more complex."
>
> **– Director, Phillips 66 (Prior) | Expert Transcript**

Carbon Capture

Pilot Scale Announcements Outpace Industrial Scale Projects

Experts argue that carbon capture technology will not see greater adoption in 2024 due to expensive, ineffective technology. They argue that the technology lacks scalability for industrial use.

> "The ability to capture that, whether you're recycling or capturing just volumes of air or you put on scrubbers to capture emissions coming off the emission stacks on these plants, the technology, I think, is not as advanced as we would like. It's really not scalable. The second thing is the cost of doing this. I've heard quotes of over $1,000 a ton to remove carbon. There'll be a lot of propaganda and greenwashing going on, but I don't see it happening in a commercial sense. Unless two things happen: 1) The credit values are enhanced and 2) that the technology improves. It's just not there yet."
>
> **– Director, Phillips 66 (Prior) | Expert Transcript**

Carbon Capture Infrastructure Continues to Lag

Experts also argue that carbon capture infrastructure is not in place for industrial-scale projects. In the name of capital discipline, oil majors are pursuing pilot-scale projects rather than industrial-scale ones.

> "There is a lot of infrastructure hurdles that the downstream space would have to overcome to make carbon capture a viable alternative. Not saying this is not being done, and we are doing some of it. Phillips 66 is doing some of it. I think, again, you've got to look at and ask yourself, is it more on a pilot scale or a large commercial scale? Most of it today it's like pilot-type generation."
>
> **– Director, Phillips 66 (Prior) | Expert Transcript**

Renewable Diesel

Renewable Diesel Withstands Financial Scrutiny

One segment of low carbon fuel that can stand up to financial scrutiny is renewable diesel. Renewable diesel is a drop-in fuel that does not require vehicle or infrastructure upgrades thereby making it cheaper to implement than hydrogen.

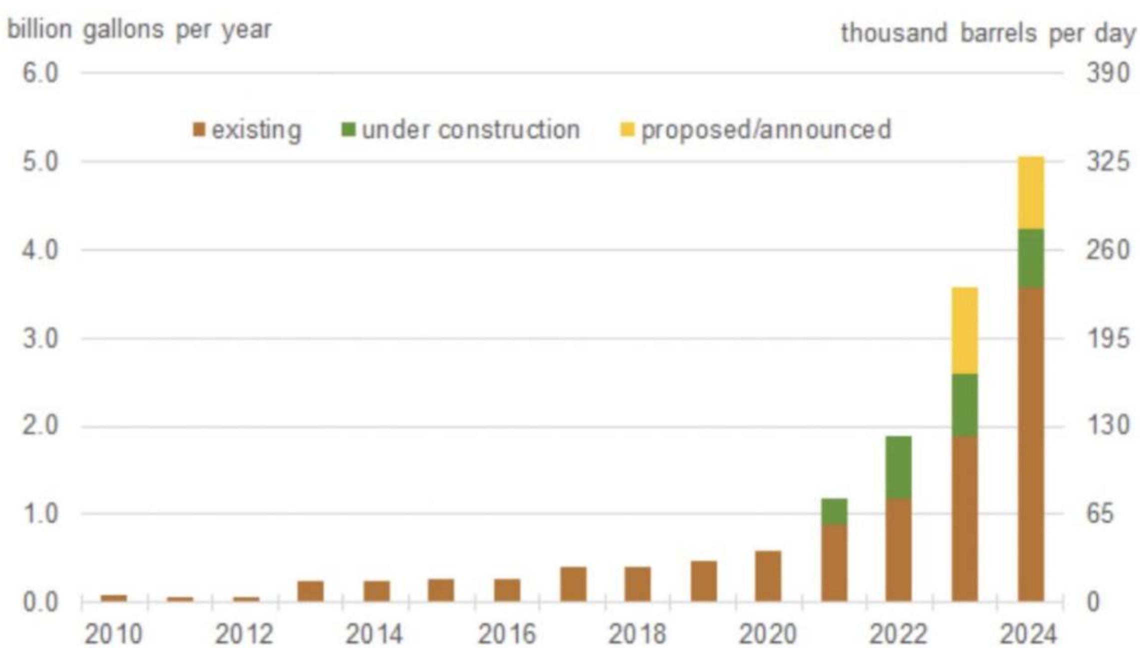
> "Renewable diesel, you can see it already when you look at the cost of the LCFS credits in renewable diesel. Renewable diesel is superior to fossil diesel. The renewable diesel is seen as a drop-in fuel. In other words, there are no modifications to storage, to infrastructure, to fuel systems, to injectors, or to the engine."
>
> **– Director, Phillips 66 (Prior) | Expert Transcript**

New Pipelines Reduce Transport Costs

Additionally, experts anticipate that new pipelines in 2024 will reduce renewable diesel transport costs which have historically been high. The lower transport costs and ease of implementation will contribute to a strong adoption year.

> "Pipeline is the way to go, and now what you're seeing is Kinder Morgan, which is the primary pipeline operator in California, is allowing renewable diesel on the pipeline, which allows it to get into the terminals at the most efficient price. You're going to find that the winners are going to be those with the access to infrastructure that delivers that barrel in at the cheapest cost. All the diesel prior to 2023, renewable diesel is delivered by truck and rail."
>
> **– Director, Phillips 66 (Prior) | Expert Transcript**

US Renewable Diesel Production Capacity



Source: US EIA and Commodity Research Group

Agriculture Equipment

Equipment Downcycle

After Deere's disappointing earnings guidance in the fall of 2023, industry watchers question whether the shift towards autonomous farming and replacement demand can mitigate the downcycle.

Uncertainty surrounds the depth and duration of the agricultural equipment slowdown. One expert believes that low farmer delinquencies, stable farmer income, and replacement demand could shorten the agricultural equipment downcycle.

> "Delinquencies across the COVID time period to now, delinquencies of 2.5%, 3% are now under 1%. Farm balance sheets are in pretty good shape. I have a reason to believe 2024 farm income will be equal to 2023. I think there's too many pessimists."
>
> **– Director, AGCO Corporation (Prior) | Expert Transcript**

Looking Ahead

In residential construction, the best-placed firms are those with less exposure to the middle tier and more exposure to the entry and luxury levels, given these are the tiers that experts expect to perform well. This could include firms such as Toll Brothers and KB Home. In commercial construction, the best-placed firms could consist of firms with significant exposure to performance coatings such as RPM International and PPG.

In renewables, companies with renewable diesel exposure could benefit from improving fundamentals. These firms could include Chevron, Marathon, Phillips 66, and Neste.

In agricultural equipment, company fundamentals could prove less negative than expectations. Firms such as Deere, AGCO, and CNH Industrial could stand to benefit.

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