

THE BUILDING PRODUCT ADVISOR

CAPSTONE
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IN THE BUILDING PRODUCTS INDUSTRY*

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STRONG HIGH YIELD MARKET INCREASING VALUATIONS

The first quarter of 2004 saw continued strength in high yield market new issues. And the availability of relatively cheap long-term capital has had a positive effect on M&A valuations. Private equity firms can afford to pay more for

acquisitions and still make their targeted returns because lenders are willing to finance at higher leverage multiples.

One bond issue illustrative of recent market conditions is the \$200 million subordinated note priced on March 26, 2004 by

U.S. Concrete. U.S. Concrete is a producer of ready-mixed concrete and related concrete products in select U.S. markets. While not associated with an LBO, it does offer an excellent yardstick for comparison. Originally planned

(Continued on page 2, see "High Yield")

WHEN IS THE RIGHT TIME TO SELL?

When is the right time to sell? The short answer is simple: when you have a buyer.

However, the timing of the sale of a company is a critical consideration often overlooked by most company owners. Many times, these owners wait too long (e.g., until the company is embroiled in an operational bind). Alternatively, they may try to sell prematurely.

As a result, sale price and value to the owner are not maximized, and time and effort are wasted. Consulting an investment banker is the best way to understand how to prepare your company for sale and how to know when to sell.

The right time to sell a

business is when the sale price can be maximized. Of course, this is easier said than done. However, there are some rough rules of thumb to follow.

For example, companies below a certain size can be very difficult to sell because most buyers are not interested in companies that have limited profitability or no critical mass. Generally speaking, middle market Private Equity Groups do not consider companies with less than \$2 million in EBITDA and 10% EBITDA margins.

For larger companies, a favorable break point occurs at \$10 million in EBITDA due to the increased availability of cash flow financing. This type of lending effectively increases the multiples that buyers can

pay for companies because leverage has a positive effect on equity returns.

Beyond size and profitability issues, certain macroeconomic and business-specific factors need to be considered.

Answers to the following questions highlight some of the more important factors:

What is the overall M&A climate?

Where is your segment heading?

Where is your business heading?

Are there personal issues or other intangibles at play?

How prepared is your business for sale?

One of the "biggest" hits at the 2004 KBIS in Chicago was this toilet from The Great John Toilet Company, designed for the supersized customer.

Also on display at KBIS was this new whirlpool bath from Jacuzzi, with a built-in large screen LCD display and floating remote. The only thing missing is a drink holder.

RECENTLY ANNOUNCED BUILDING PRODUCT TRANSACTIONS

Announce Date	Target	Target Description	Acquirer	Cons.	Firm Value	FV / Rev.	FV / EBITDA
4/1/2004	The Concrete Co.	Sells ready-mix concrete and related aggregates	Lafarge S.A.	NA	--	--	--
3/30/2004	Ecoloc N.V./ Lock-Tile Belgium N.V. and Compakta/Pactan	Manufactures industrial tile flooring/Manufactures specialty silicone-based adhesives, joint filler, and sealers	RPM International Inc.	Cash	--	--	--
3/16/2004	Carolina Brick and Block	Manufactures masonry products	General Shale Brick (Wienerberger AG)	NA	--	--	--
3/12/2004	Georgia-Pacific Building Materials Distribution	Distributes structural products used in construction	Cerberus Capital	Cash	810.0	0.2x	7.0x
3/11/2004	MAAX Inc.	Manufactures bathroom products and spas	J.W. Childs Associates, Borealis Capital Corp., and Ontario Municipal Employees Retirement System	Cash	640.0	1.0x	6.5x
3/1/2004	Athens Brick Company, Inc.	Manufactures facing brick for residential and commercial construction	Hanson PLC	Cash	40.4	2.7x	6.2x
2/15/2004	Butler Manufacturing Company	Manufactures pre-engineered steel building systems	BlueScope Steel Limited	Cash	138.1	0.2x	10.7x
2/6/2004	ABC Window Co.	Manufacturer of vinyl and aluminum windows and patio doors	William Blair Capital	Cash	38.0	0.8x	4.8x
1/22/2004	Republic Builders Products Co.	Manufactures commercial steel doors and frames	Desco Capital Partners	NA	13.0	--	--
1/22/2004	Windsor Door Inc.	Manufactures doors	Desco Capital Partners	NA	27.0	--	--
1/15/2004	PGT Industries	Manufacturer of windows, doors, sunrooms and patio rooms	JLL Partners	Cash	--	--	--
1/6/2004	Renown Specialties Company Ltd.	Manufactures structural connectors used to join wood to wood, wood to concrete, and wood to masonry	Gibraltar Steel Corp.	NA	5.8	0.6x	--
1/6/2004	Creative Touch Interiors, Inc.	Turnkey design center provider for major homebuilders	The Home Depot	NA	--	--	--
NA	Custom Surfaces, Inc.	Fabricator and installer of solid surface and granite countertops	Oldcastle APG South/CRH plc	NA	--	--	--
1/2/2004	Morris Ginsberg & Son, Inc.	Distributor of roofing and building materials, equipment, and supplies	Red Diamond Capital	NA	--	--	--
1/1/2004	Superior Engineered Products Corporation	Manufacturer of windows and other building materials	Atrium Companies, Inc.	Cash/ Stock	52.5	--	--

High Yield *(Continued from page 1)*

for \$150 million, strong demand led to the issue being upped to \$200 million at a coupon rate of 8.375%.

Compare that to the company's November 10, 2000 private placement of \$95 million, which the new issue replaced. Pricing on the old issue was 12%, and total leverage was lower than the 2004 issue. Even allowing for some price concession due to a lack of liquidity on the private placement, the large pricing spread between the two issues demonstrates why companies –

and private equity firms - are so eager to raise high yield capital now.

The frothy high yield market has had a spillover effect on the mezzanine financing market – which is the market more relevant for middle market companies. While it is more difficult to compare pricing in the mezzanine market, one can measure total leverage multiples. Rising leverage multiples in LBO transactions demonstrate an increased willingness to lend. And the middle market has seen recent LBOs approaching 5x total leverage.

U.S. Concrete Subordinated Note Comparison

	11/10/99	3/26/04
Date	11/10/99	3/26/04
Amount	95 million	200 million
Coupon	12.0%	8.375%
Term	10 years	10 years
EBITDA	52.6	43.7
Net Debt	157.1	155
Leverage	3.0x	3.5x

Selected Public Company Capitalization and Operating Figures
(\$ in millions, except per share data)

Company	Enterprise Value					Last Twelve Months (LTM)			
	Price as of 4/6/04	Market Cap	Debt	Cash	Enterprise Value (1)	LTM Date	Revenue	EBITDA	Net Income
Masco Corporation	\$29.80	\$13,483.3	\$4,182.0	\$795.0	\$17,053.6	12/31/03	\$10,936.0	\$1,738.0	\$782.7
American Standard Companies Inc.	114.97	8,303.8	1,679.1	111.7	10,256.1	12/31/03	8,567.6	923.6	405.2
Mohawk Industries, Inc.	82.09	5,470.4	1,012.4	0.0	6,576.4	12/31/03	5,005.1	648.6	310.1
Masonite International Corporation	28.38	1,515.8	489.4	129.7	1,981.4	12/31/03	1,777.2	234.9	107.7
Royal Group Technologies Limited	11.67	901.9	679.1	151.5	1,440.7	12/31/03	1,433.3	83.9	(53.7)
Lennox International Inc.	18.75	1,102.9	372.8	64.4	1,411.3	9/30/03	3,012.5	181.4	66.8
Jacuzzi Brands, Inc.	9.42	707.6	493.6	29.6	1,179.8	1/3/04	1,230.5	128.7	13.0
ELKCORP	27.09	531.9	148.4	31.1	661.6	12/31/03	571.1	71.8	29.3
American Woodmark Corporation	69.19	563.0	19.0	27.8	587.8	1/31/04	631.5	78.7	30.9
OMNOVA Solutions Inc.	5.03	202.1	203.0	14.1	392.1	2/29/04	689.1	32.1	(45.6)

Selected Public Company Multiples and Operating Statistics

Company	Enterprise Value /					P / E Ratio	Margins		
	Revenue	EBIT	EBITDA	Free Cash Flow (2)	Net Income		Gross Margins	EBITDA Margins	Net Margins
Masco Corporation	1.6x	11.4x	9.8x	11.6x	21.8x	17.2	30.6%	15.9%	7.2%
American Standard Companies Inc.	1.2x	15.2x	11.1x	13.6x	25.3x	20.5	23.8%	10.8%	4.7%
Mohawk Industries, Inc.	1.3x	12.1x	10.1x	12.3x	21.2x	17.6	27.2%	13.0%	6.2%
Masonite International Corporation	1.1x	10.6x	8.4x	10.7x	18.4x	14.1	19.6%	13.2%	6.1%
Royal Group Technologies Limited	1.0x	NM	17.2x	72.6x	NM	NM	5.9%	5.9%	NM
Lennox International Inc.	0.5x	10.5x	7.8x	9.0x	21.1x	16.5	32.8%	6.0%	2.2%
Jacuzzi Brands, Inc.	1.0x	11.3x	9.2x	10.9x	90.5x	54.3	30.0%	10.5%	1.1%
ELKCORP	1.2x	12.5x	9.2x	79.8x	22.6x	18.2	20.5%	12.6%	5.1%
American Woodmark Corporation	0.9x	11.5x	7.5x	9.2x	19.0x	18.2	21.1%	12.5%	4.9%
OMNOVA Solutions Inc.	0.6x	NM	12.2x	16.5x	NM	NM	19.5%	4.7%	NM
Mean	1.0x	11.9x	10.3x	24.6x	30.0x	22.1x	23.1%	10.5%	4.7%
Median	1.1x	11.4x	9.5x	12.0x	21.5x	17.9x	22.5%	11.6%	5.0%

(1) Enterprise Value equals market cap, plus debt, minus cash

(2) Free Cash Flow equals EBITDA less capital expenditure

"NM" is not meaningful

DEALS IN THE PIPELINE

Following is a short list of building products companies that are publicly known to be "on the market." One can expect a number of the larger building products companies to explore the M&A market right now, as the frothy high yield market is increasing transaction multiples.

Kawneer Architectural Products division of Alcoa

The division is a manufacturer of aluminum building products for commercial construction - entrances, framing systems, windows and curtain wall systems. Alcoa has recently sold it foil manufacturing units, specialty chemical business and packaging equipment business as part of its stated goal to raise \$750 to \$850 million through divestitures. Kawneer is next, and the company expects to close a transaction by July.

Tools division of Pentair, including Porter-Cable, Delta and Devilbiss

This deal has been expected for a number of years. In 2000, the company had severe problems with a new distribution facility. Pentair compounded the problem by offering price concessions to its many angry customers. The company has yet to fully recover, but the \$1.1 billion business has been stabilized. Combined with Pentair's recent \$850 million acquisition of Wicor and \$217 million acquisition of Everpure, the company is closer to its stated goal of becoming a more focused water products company.

Grohe Holding GmbH

Grohe is a world-leading supplier of premium quality sanitary products and systems, with an estimated more than 10% world-wide market share. The company was purchased in 1999 by private equity firm BC Partners for a reported \$1.4 billion - the largest LBO in German history at the time.

Bids are expected in the 2 billion Euro range, and CVC, Bain Capital, Texas Pacific Group, and Fortune Brands are said to be among the likely bidders. The sale process has been going since September 2003, and BC Partners has stated that it may explore an IPO depending upon the bid levels.

International Aluminum Corporation

The company announced February 18, 2004 that it had retained investment bankers to explore a possible sale of the company. The company has a current market cap around \$125 million, annual revenues of \$200 million and is debt free.

International Aluminum is an integrated manufacturer of diversified lines of aluminum and vinyl building products. It operates in three segments of the building products industry, Commercial Products, Residential Products and Aluminum Extrusions.

Historical and Forecasted Construction Spending

McGraw Hill Construction Forecast (Dollars in Billions)							
	1998	1999	2000	2001	2002	2003	2004
Total Construction	405.6	447.2	473.1	495.9	501.7	505.6	508.9
% Change		10%	6%	5%	1%	1%	1%
Single-Family Housing	152.3	164.3	177.0	186.9	214.2	230.5	226.0
% Change		8%	8%	6%	15%	8%	-2%
Public Works	67.9	74.1	77.8	83.5	87.6	78.9	80.5
% Change		9%	5%	7%	5%	-10%	2%
Electric Utilities	3.4	9.4	13.5	23.6	12.0	9.3	7.5
% Change		176%	44%	75%	-49%	-23%	-19%
Income Properties	101.6	107.9	112.3	103.1	92.9	92.9	100.9
% Change		6%	4%	-8%	-10%	0%	9%
Institutional Buildings	68.3	80.1	83.6	90.7	89.7	88.6	88.1
% Change		17%	4%	8%	-1%	-1%	-1%
Manufacturing Buildings	12.1	11.3	8.9	8.1	5.3	5.5	6.0
% Change		-7%	-21%	-9%	-35%	4%	9%

Source: McGraw Hill Construction

Business Valuation 101: What's Your Business Worth?

Business valuation is best understood within the context of an M&A transaction because what someone is willing to pay for a business is usually the most practical and reliable indication of its value.

When it comes to buying businesses, buyers typically take the perspective that they are buying the cash flow a business generates. This cash flow is measured via several benchmarks, beginning with EBIT (earning before interest and taxes), the measurement which best represents the cash flow "reward" to an owner from the company's day-to-day operations. Next, depreciation and amortization are added to EBIT because they are non-cash expenses. The end result, of course, is EBITDA, the most commonly used and widely accepted proxy for cash flow in the context of business valuation.

EBITDA must be "normalized" before it can be used for valuation purposes. When calculating a company's normalized EBITDA, there are certain items that need to be added or subtracted in order to capture the "true" cash flow a business generates. Examples of items that should be added back to EBITDA include:

- Extraordinary, non-recurring, non-operating or non-business expenses such as moving expenses, litigation, conversion from FIFO to LIFO, fire losses, and theft.
- Owner's salary in excess of the market rate of compensation.
- Shareholder perks like life insurance, bonuses, cars, financial counseling, excess travel and entertainment, and any other expense that will disappear after the sale of the company.

Because buyers buy the future cash flow of a business rather than the cash flow that was generated in the past, a capitalization multiple must be applied to a business's normalized EBITDA in order to determine the present value of all its future anticipated cash flow.

Capitalization multiples approximate the present value of all the future cash flow of a business by discounting them into today's dollars using a buyer's cost of capital, which is also called the "discount rate."

A capitalization multiple is the mathematical inverse of its discount rate. For example, a 20% discount rate implies a multiple of five because its inverse, one divided by 0.20, equals five.

Multiplying normalized EBITDA by a relevant capitalization multiple yields what is known as "enterprise value." Subtracting the company's

debt from this enterprise value and adding the company's cash balances yields the market value of the shareholders' equity.

EBITDA multiples vary significantly depending on a variety of market-, industry-, and company-specific factors. Core ranges of EBITDA multiples for automotive aftermarket businesses are between four and six, but can be as much as eight or more. Some of the more important company specific valuation criteria are:

- Revenue levels;
- Amount and sustainability of Gross Margins;
- Number and type of distribution channels;
- Growth potential;
- Management strength;
- Brand equity; and
- Competition.