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THE BUILDING PRODUCT ADVISOR

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Published by:
Porter Wiley
Managing Director
Building Products Group
Capstone Financial Group
215 East Bay St. Suite 500
Charleston, SC 29401
P) 843-577-3774
F) 843-577-3144
porter@capfg.com
www.capfg.com

We want your feedback. To discuss and receive more information on building products transactions and the capital markets as they relate to the Building Products Industry, please contact Porter Wiley, Managing Director at Capstone.

MARKET LEADER AZEK TRIMBOARDS SOLD

Cellular PVC is Hot, Hot, Hot

CPG/Vycom, manufacturer of market leading Azek Trimboards, was recently sold in a secondary buyout to AEA Investors. Financial details were not disclosed, but the price is thought to be in the 8.5x – 9.0x range on an EBITDA multiple basis – a healthy price. Clearview Capital and JH Whitney purchased CPG/Vycom from The Crane Plastic Group in February 2001, for a total transaction price of $155 million.

Long accepted in the U.K. and Canada as a building material, cellular PVC seems to have finally hit the tipping point in the U.S. market. Manufacturers and distributors are scrambling to keep up with burgeoning demand, as cellular PVC is now being used to make not only trimboards, but columns, fencing, shutters, exterior doors, window components and other products. And builders and manufacturers continue to find new uses for the material as a replacement for wood. While there is no specific market data, industry participants estimate that the use of cellular PVC in building products is increasing over 30% per year, with a huge amount of growth potential.

Domestic suppliers are rushing to meet this demand, with the addition of extrusion lines and new players entering the market. Kommerling is adding capacity at their Alabama facility, and newcomer Kleer Lumber has started up in Massachusetts. Even urethane producer Fypon/Style Solutions is said to be getting into the act with a couple of extrusion lines. Others are seeking suppliers from India and China to meet U.S. demand.

This development is no surprise to Jim Goodman, president of Turnkey Millwork, a millwork shop that has been specializing in working with cellular PVC since 1996. Early on he saw the benefits of cellular PVC as a replacement for wood. "This material is low maintenance, won't rot, resists insects, holds paint well and can be worked with existing tools. You can even bend it."

However, cautions Goodman, "while cellular PVC may be an excellent wood substitute, it takes a good while to master the idiosyncrasies of this material." Over the past few years, Turnkey has developed proprietary tooling modifications and CNC programming specifically for working with cellular PVC. "Anyone looking to get into this must be aware that it takes several years to master this material", says Goodman.

HOUSING MARKET UPDATE

Frank Nitschke – Principal,
Maximus Advisors

After a record-breaking year in 2004, residential construction continued on a torrid pace in January and February 2005.

Single-family housing starts totaled 1.611 million units last year. In January and February of this year, seasonally adjusted annual averages totaled 1.760 million units and 1.775 million units respectively. Can this pace sustain itself?

In the short run, the answer is probably not. While the US economy will likely continue to grow, rising interest rates will likely begin to cool the housing market in latter part of 2005. However, it is demographics that determine longer-term trends, and the US demographic profile is highly favorable for housing over the next decade.

Near-term outlook

Short-term housing demand is tied closely to the economy and movements in interest rates. It is our view that economic growth and income gains will likely help to offset an anticipated rise of interest rates this year. Yet, sales will likely descend slightly from last year's record-breaking pace. Several recent trends are somewhat disconcerting to us, including the growing inventory of new homes available for sale, the increase in the percentage of loans with adjustable rates, and increases in ARM rates.

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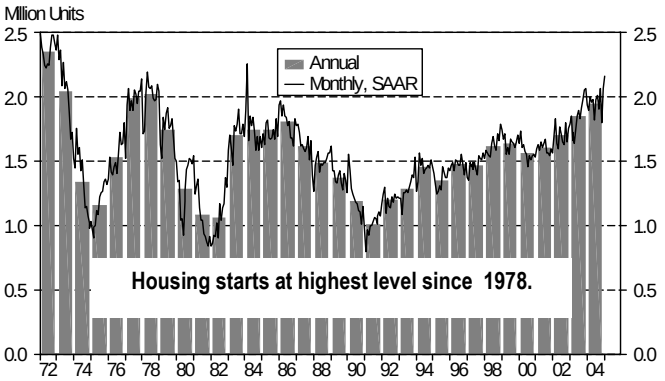
Mortgage interest rates

While the 30-year fixed rate mortgage remains near 6%, adjustable-rate mortgages are moving up as the Federal Reserve hikes up short-term interest rates. If interest rates begin to move up in a stronger way, this year could be a bumpy ride for the housing market - especially in areas that have experienced incredibly robust home price gains.

Another cause of concern is that a significant number of homebuyers have switched to ARMs over the last year, despite the expectation of Federal Reserve increases in short-term interest rates. This suggests that homebuyers may be facing affordability issues and are stretching to keep their monthly payment low enough to qualify for a mortgage. Further interest rate increases could either weaken demand or force home prices lower to maintain sales.

Interest rate sensitivity

The strong increase in home prices in recent years and the interaction of interest rates and home prices on affordability suggest that housing may be more vulnerable to a sudden sharp increase in interest rates today than would have been the case a few years ago.



Sources: Census Bureau, Maximus Advisors

The US housing market may be more vulnerable to interest rate changes today, given the run-up in home prices.

	Monthly mortgage rate	Med-price Single-Fam Home	Princp. & Interest Pmt	Family Income	Composite Affordability Index
1980	12.95	$62,200	$549	$21,023	79.9
1981	15.12	$66,400	$677	$22,388	68.9
1982	15.38	$67,800	$702	$23,433	69.5
1983	12.85	$70,300	$616	$24,580	83.2
1984	12.49	$72,400	$618	$26,433	89.2
1985	11.74	$75,500	$609	$27,735	94.8
1986	10.25	$80,300	$576	$29,458	106.6
1987	9.28	$85,600	$565	$30,853	113.8
1988	9.31	$89,300	$591	$32,100	113.2
1989	10.11	$89,500	$634	$33,600	110.4
1990	10.04	$92,000	$648	$35,353	113.6
1991	9.30	$97,100	$642	$35,939	116.6
1992	8.11	$99,700	$591	$36,812	129.7
1993	7.16	$103,100	$558	$36,959	138.1
1994	7.47	$107,200	$598	$38,782	135.1
1995	7.85	$110,500	$639	$40,611	132.3
1996	7.71	$115,800	$661	$42,300	133.3
1997	7.68	$121,800	$693	$44,568	133.9
1998	7.10	$128,400	$690	$46,737	141.1
1999	7.33	$133,300	$733	$48,950	139.1
2000	8.03	$139,000	$818	$50,890	129.6
2001	7.03	$147,800	$789	$51,407	135.7
2002	6.55	$157,700	$802	$52,692	136.9
2003	5.69	$169,000	$784	$53,166	141.3
2004	5.70	$182,000	$845	$55,505	136.8
+100 bp	6.70	$182,000	$940	$55,505	123.1
+200 bp	7.70	$182,000	$1,038	$55,505	111.4

Sources: NAR, FHFB, Census Bureau, Maximus Advisors

The table at left depicts our analysis of the impact on US housing affordability if composite (fixed and ARM) mortgage interest rates rise 100 bps to 6.7% and 7.7%, holding family income and prices constant at current levels. As the table shows, a 100bp increase would bring affordability back to the level in 1991-92 when interest rates were over 9%. This reflects the rapid home price gains of recent years outpacing income growth.

A 200bp increase in mortgage rates would still place the index level above 100, indicating that the median family could still qualify to purchase a home. This is still well above the affordability levels of the early 1980s that corresponded to a depressed housing market. However, the relative deterioration from the present affordability level would surely have a negative affect on the housing market.

In our next quarterly edition of the Building Product Advisor, we'll discuss the demographics that determine long term trends in housing starts.

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