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the building product advisor

A PUBLICATION FOCUSED ON MERGERS, ACQUISITIONS, & CORPORATE FINANCE IN THE BUILDING PRODUCT INDUSTRY

Toward a New Distribution Model

One can't help but notice that the production builders are increasing their market share. Currently estimated near 24%, the top ten builders are projected to account for 35-40% of new home construction within a decade. The Lennar's and Pulte's of the world have many advantages over smaller builders: increased buying power lowers material costs, large-scale building leads to greater efficiency, and access to cheap long-term capital allows them to tie up large amounts of land.

What may be less noticed is the secondary effect this consolidation has been having on the supply chain. Old relationships are changing, and new ones are being formed as building product manufacturers, distributors, dealers and subcontractors are all scrambling to align themselves with the production builders. This is causing a shift in how products are sold, stored, and delivered to the jobsite. And it is causing befuddlement in the market, as the traditional lines of competition are blurred.

National Buying Contracts

More and more, the production builders are negotiating directly with building product manufacturers on a national basis. The manufacturer is then often told which local dealer to use to get the product to the job site. The sales function is removed from the dealer, and the value added profits that go along with it. The dealers have essentially been turned into logistics arms of the manufacturers. They charge the customer what is essentially a handling fee to stock and deliver products to the job site, and deal with the paperwork. Not an attractive or highly profitable endeavor.

In some local markets, builders are even establishing their own centralized distribution warehouses. These warehouses accept deliveries directly from the manufacturer, and then deliver to the job site when needed. Though currently not widespread, builders are actively experimenting with this distribution model in selected markets.

The Rise of the SuperSub

Plumbing, electrical, and brickwork have long been subcontracted trades. Increasingly however, traditional in-house tasks such as framing and exterior siding are contracted out to specialists. The production builders

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Trailer Envy

Post Katrina disaster assessments indicate that between 250,000 and 500,000 housing units were destroyed (deemed uninhabitable and beyond repair) in the storm. FEMA is still evaluating needs, but estimates peg the number of manufactured homes needed to house the displaced to be at least 150,000 units. This exceeds recent industry-wide annual production capacity of 140,000 units, and represents almost 10% of the 1.6 million single-family housing starts annually in the country.

Immediately following the storm, FEMA began purchasing large quantities of travel trailers, RVs and mobile homes from retail stock. The amount spent at dealerships nationwide exceeds $236 million thus far, and continues to climb.

In addition, FEMA awarded contracts directly with US manufacturers. A huge boon for a cyclical industry beset with overcapacity, the largest of these contracts are outlined below.

COMPANY	CONTRACT	VALUE
Gulf Stream Coach	50,000 cavalier travel trailers	$571MM
Morgan Buildings & Spas	Travel trailers & portable bldgs	$372MM
CMH Manufacturing / Clayton Homes	3 contracts for mobile homes	$190MM
Fleetwood Enterprises	7,500 travel trailers and 3,000 single section mobile homes	$170MM
Cavalier Homes	2,380 singlewide mobile homes	$69-75MM
Champion Homes	2,000 singlewide mobile homes	$60-80MM
Stewart Park Homes	3 contracts for travel trailers and ADA homes	$41MM
Southern Energy Homes	2 contracts for mobile homes	$36MM

Also benefiting have been the component suppliers. Companies like Drew, Patrick, LaSalle Bristol, Kinro, Elixir and others that specialize in the manufactured housing and RV markets are all seeing unprecedented demand. Drew Industries, for example, instituted second and third shifts at certain factories, and expects revenues for the December quarter to be up 30%.

in this issue

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have been particularly aggressive in their use of subcontractors. The result is that many of these subcontractors have grown quite large, as they service the production builders in multiple regions across multiple states.

Subs are also being asked more often to supply labor and materials, rather than just workers. With the volume to strike national contracts directly with manufacturers, these large subcontractors have become de facto distributors in their own right, with warehousing and delivery capabilities. The result is that the traditional dealer network is often completely bypassed.

In addition to convenience, these large subcontractors can offer smaller builders the benefits of their factory direct relationship – better pricing and reliable supply.

Dealer Installed Sales

For some time, dealers have been augmenting their business with value-added services such as framing and roof trusses. More recently, door hanging, siding, roofing and other tasks are have been added and are all performed by dealers' installed sales divisions. These divisions compete directly with many of their traditional material customers. BMHC has been particularly aggressive in this area. The company recently purchased plumbing and electrical contractors in their key Las Vegas market to capture more of a home's construction value.

Two-Stepping Down

All of these changes in the market are putting a great deal of pressure on two-step distributors. Already, their margins are razor thin. And they are seeing the country's largest customers bypass them completely, as the big builders buy more product direct. These businesses require a large amount of capital – in working capital, warehouses and truck fleets, and it is hard to justify the investment when the returns are less than stellar.

Two-step distributors will not disappear. Some will serve the shrinking market of smaller builders and dealers, others will migrate into manufacturing and private label their own brands, and others will transform themselves into pure logistics companies, with no sales function.

What's in Store

For many, the production builders are too important to say no to. As many saw the balance shift to Home Depot in the recent past, so too will the balance of power be in the hands of the largest builders. Many learned that one can survive and even prosper without Home Depot, and so will it be with the production builders. You just must do so in a shrinking market.

Where all of this is heading is still uncertain. The landscape is in flux, with builders becoming distributors, dealers becoming subcontractors, and subcontractors becoming distributors. What is certain is that somebody will have to manufacturer the products, somebody will have to deliver those products to the job site, and somebody will have to build the house.

ABOUT CAPSTONE:

Capstone Financial Group is an investment banking firm that specializes in assisting owners of middle market companies with their financial needs:

- Mergers and acquisitions
- Recapitalizations
- Private placements

Capstone is backed by a knowledgeable team of senior professionals. Managing Director, Porter Wiley has extensive experience focusing exclusively on the building products sector, both with Capstone and a major Wall Street firm. He has completed transactions for companies in a wide variety of businesses:

- Bath & Plumbing
- Windows & Doors
- Building Products Distribution
- Cabinets & Millwork
- Concrete & Aggregates
- Roofing & Waterproofing
- Lighting & Electrical
- HVAC
- Tile & Flooring

It is unclear just now which companies will perform the majority of those tasks in the future.

M&A Implications

These developments have extremely positive implications for mergers & acquisitions activity in the building products sector over the next several years. A certain level of consolidation would be expected to naturally follow the consolidation of the home building industry. But it will be more than that.

The changing dynamics in the industry are causing many to rethink their strategies, especially those in the middle of the distribution chain. Many see the need to diversify or vertically integrate, and will often do so through acquisition. With the traditional boundary lines shifting, and vertical integration blurring the distinctions between product manufacturers, distributors and subcontractors, the field of potential buyers for any building product related company increases. That's a positive development for sellers.

Building product distributors have long grown through acquiring additional stores. What has changed is that the large distributors are now vertically integrating at a faster pace. They are more aggressive buyers of subcontracting businesses, and millwork, truss and other manufactured product businesses.

Another positive development is the rise of the *"supersub"*. Finding a good exit for a contracting business has often been difficult in the past, as there were few competitors with the capital resources to make significant acquisitions. Now, there is a growing group of larger, well-capitalized contractors with the desire and ability to make acquisitions as they seek to enter new geographic markets.

Building Product Transactions 2005—4th Quarter

Announce Date	Target	Target Description	Acquirer	Firm Value	Revenue FV / Rev.	EBITDA FV / EBITDA
12/31/2005	Bowlings, Inc. / White Sulpher Glass	WV glass and hardware company	O.C. Cluss Lumber Co.	-	-	-
12/30/2005	14 SD/MN ready mixed plants	Consolidated Ready Mix, Henrich & Sons, Huron Steel, and B&B Concrete	Grupo Cementos de Chihuahua	$31.2	$30.0 *1.0x*	- -
12/22/2005	American Fire Protection Group	recapitalization - group of fire protection / safety prod mfrs	Golub Capital	-	-	-
12/22/2005	Pacific Sales Kitchen & Bath Centers, Inc.	14 CA retail showroom home improvement locations	Best Buy	-	$320.0	-
12/21/2005	Pacific Stair Products	CA mfr of stair rail products	P&F Industries, Inc.	-	$5.0	-
12/21/2005	Gallatin Plumbing Supply	PA plumbing supply house	O.C. Cluss Lumber Co.	-	-	-
12/13/2005	assets of Iowa Paint Mfg	42 Midwest service centers and Iowa/Sterling brands	PPG Industries	-	-	-
12/9/2005	Zenith Products	DE mfr of bathroom storage products - sold by Masco	Charlesbank Capital Partners	-	-	-
12/8/2005	Dormont Manufacturing Co.	PA mfr of flexible steel connectors for propane gas	Watts Water Technologies, Inc.	$94.5	$56.5 *1.7x*	- -
12/6/2005	Yardbirds Home Center	10 San Francisco area DIY centers	Home Depot	-	-	-
12/5/2005	assets of Go-Crete and South Loop Development Corp	Dallas/Fort Worth area ready mixed company	U.S. Concrete, Inc.	$29.3	$50.0 *.6x*	- -
12/2/2005	Nybron Flooring International	Swiss mfr of pre-engineered wood flooring	Vestar Capital Partners	-	-	-
12/1/2005	FrameSaver	TX mfr of rot-resistant moisture-proof wood door frames	Endura Products, Inc.	-	$33.0	-
11/30/2005	Easton Wholesale, Inc.	MD distributor of residential building products	Beacon Roofing Supply, Inc.		$9.3	-
11/30/2005	Metals USA	deals in steel and other metals for the building prod market	Apollo Management	$566.4	$1,644.9	$113.9
11/30/2005	Dietrich Metal Framing Canada	mfr of steel framing products - acquired remaining 40%	Dietrich Metal Framing		*.3x*	*5.0x*
11/28/2005	Contech Construction Products	produces precast concrete bridge structures and retaining walls - sold by Butler Capital Corp	Apax Partners	>$1B	-	-
11/25/2005	Orchard Supply Hardware Stores Corp	CA operator of 84 hardware stores - Ares bought 19.9% ownership from Sears	Ares Management	$58.7	-	-
11/20/2005	British Plaster Board (BPB, Plc)	Worldwide gypsum wallboard and ceiling tile mfr, incl. ProRoc gypsum wallboard and Celotex ceiling systems	Saint-Gobain	£3,890.0	£2,317.0 *1.7x*	£408.8 *9.5x*
11/17/2005	Edge Flooring LLC	GA mfr of engineered tile flooring systems	Hunt Special Situations Group	-	-	-
11/14/2005	Georgia-Pacific Corp	mfr of paper, packaging, building products, and chemicals	Koch Industries	$2,100.0	$1,863.2 *1.1x*	$238.7 *8.8x*
11/14/2005	DecKorators	MO importer of decorative balusters	Universal Forest Products	-	-	-
11/10/2005	Hubbardton Forge	designer and mfr of lighting products	Lineage Capital	-	-	-
11/9/2005	Home Lumber	3 Houston area lumberyards	BMC West	-	-	-
11/9/2005	Canyon Drive Lumber	TX lumber yard	Stock Building Supply	-	-	-
11/7/2005	Armortec* business of Lee Brick and Block LLC	provider of concrete erosion control systems	CONTECH Construction Products	-	-	-
11/4/2005	Scott's, Inc.	2 location NC dist of plumbing, lighting, heating equip.	Cregger Co.	-	-	-
11/4/2005	Able Distribution	WI and AZ plumbing wholesale locations	Hajoca Corp	-	-	-
11/2/2005	Seigle's Inc.	11 location Chicago area distributor and contractor	Stock Building Supply	-	-	-
11/2/2005	City Concrete / City Transports	5 Memphis area ready mixed operations	U.S. Concrete	$14.3	$23.5 *.6x*	- -
11/1/2005	W.L. Plastics Corp	WY mfr of high desnsity polyethylene pressure piping	Sequel Holdings and others	-	-	-
11/1/2005	Southern Star Concrete	TX ready mixed concrete company	Cia. De Cemento Argos SA	$245.0	-	-
10/31/2005	John Frischkorn Jr., Inc.	17 location Southern dist. Of plumbing products	Ferguson	-	$100.0	-
10/18/2005	HnR Framing Systems, Inc. & Home Building Components	San Diego area framing and building components co.	Building Materials Holding Corporation (BMHC)	-	$140.0	-
10/15/2005	Embassy Manufacturing	mfr of hydronic heating equipment	Mestek	$8.0	-	-
10/11/2005	Highland Manufacturing Company	recapitalization - mfr of HUD-code and modular homes	Norwest Equity Partners	-	-	-
10/10/2005	Max Manufacturing & Roofing, LLC	MI mfr of synthetic roofing tiles	Tapco International Corp.	-	-	-
10/4/2005	American Wilcon Plastics	mfr of custom plastic-injection molded products	Gibraltar Industries, Inc.	-	$16.0	-
9/30/2005	Economy Plumbing & Heating Supply	Philadelphia WD of plumbing and heating equipment	Ferguson		$26.1	-
9/30/2005	Endries, Inc.	intl provider of vendor mgmt inventory programs	Ferguson	-	$149.5	-
9/30/2005	Contractors Field Products, Inc. (CFP)	Charlotte, NC geotechnical and environmental sitework	Ferguson	-	$13.2	-
9/30/2005	Concrete Express, Inc.	GA ready mixed producer	Compania de Cemento Argos S.A.	-	-	-
9/28/2005	Vangaurd Piping Systems / Midtec	KS mfrs of PEX water distribution systems and components	Viega, Inc.	-	-	-

Public Equity Trading Valuations

	Current share price	Market value	Total firm value	LTM revenue	LTM EBITDA	LTM EBIT	LTM EBITDA margin	LTM net income	12 mo Forward EPS	Book value	Total debt / EBITDA
LARGE CAP											
BUILDING PRODUCTS											
Masco	$30.19	$12,794.5	$15,958.5	$12,711.0	$1,770.0	$1,523.0	13.9%	$856.0	$2.53	$4,997.0	*2.7x*
				1.3x	*9.0x*	*10.5x*		*14.9x*	*11.9x*	*2.6x*	
American Standard	39.95	8,395.1	9,688.3	10,071.7	1,165.2	899.4	11.6%	405.0	2.85	1,006.1	*1.4x*
				1.0x	*8.3x*	*10.8x*		*20.7x*	*14.0x*	*8.3x*	
Black & Decker	86.96	6,818.5	7,726.1	6,519.1	967.3	814.7	14.8%	575.9	7.49	1,565.1	*1.2x*
				1.2x	*8.0x*	*9.5x*		*11.8x*	*11.6x*	*4.4x*	
Sherwin Williams	45.42	6,218.5	7,154.3	6,979.8	853.2	709.9	12.2%	470.6	3.60	1,753.1	*1.1x*
				1.0x	*8.4x*	*10.1x*		*13.2x*	*12.6x*	*3.5x*	
Mohawk (1)	86.98	5,818.1	9,186.8	7,278.6	1,052.5	873.5	14.5%	385.0	6.70	2,941.8	*3.2x*
				1.3x	*8.7x*	*10.5x*		*15.1x*	*13.0x*	*2.0x*	
Stanley Works (2)	48.04	4,016.6	4,357.2	3,114.9	514.5	420.5	16.5%	251.9	3.62	1,378.2	*1.3x*
				1.4x	*8.5x*	*10.4x*		*15.9x*	*13.3x*	*2.9x*	
James Hardie (3)	32.47	3,000.9	2,977.4	1,339.4	302.1	261.2	22.6%	170.3	2.47	712.7	*.5x*
				2.2x	*9.9x*	*11.4x*		*17.6x*	*13.1x*	*4.2x*	
RPM (4)	17.37	2,045.0	2,698.9	2,555.7	343.1	277.1	13.4%	156.0	1.49	1,046.5	*2.4x*
				1.1x	*7.9x*	*9.7x*		*13.1x*	*11.7x*	*2.0x*	
			MEAN	*1.3x*	*8.6x*	*10.4x*	14.9%	*15.3x*	*12.7x*	*3.7x*	*1.7x*
			MEDIAN	*1.2x*	*8.4x*	*10.4x*	14.2%	*15.0x*	*12.8x*	*3.2x*	*1.4x*
MID CAP											
BUILDING PRODUCTS											
Lennox International	$28.20	$1,999.1	$2,059.0	$3,237.0	$252.7	$214.6	7.8%	$120.9	$2.00	$633.9	*.9x*
				.6x	*8.1x*	*9.6x*		*16.5x*	*14.1x*	*3.2x*	
Genlyte Group	53.57	1,494.6	1,626.0	1,240.4	174.7	146.1	14.1%	82.0	3.36	520.1	*1.0x*
				1.3x	*9.3x*	*11.1x*		*18.2x*	*15.9x*	*2.9x*	
Royal Group Technologies	C$ 10.53	984.0	1,533.7	1,875.9	138.3	(3.0)	7.4%	(34.8)	0.70	1,346.3	*3.9x*
				.8x	*11.1x*	*NM*		*NM*	*15.0x*	*.7x*	
Jacuzzi (5)	8.40	647.5	944.3	1,133.9	132.8	105.4	11.7%	53.0	0.45	285.2	*3.1x*
				.8x	*7.1x*	*9.0x*		*12.2x*	*18.7x*	*2.3x*	
Elkcorp (6)	33.66	687.0	828.0	814.6	107.2	83.1	13.2%	45.6	2.50	283.3	*1.9x*
				1.0x	*7.7x*	*10.0x*		*15.1x*	*13.5x*	*2.4x*	
American Woodmark	24.79	408.3	400.3	820.4	82.6	45.9	10.1%	28.2	1.80	229.9	*.4x*
				.5x	*4.8x*	*8.7x*		*14.5x*	*13.8x*	*1.8x*	
International Aluminum	40.25	172.7	153.4	251.6	27.1	20.8	10.8%	12.9	-	123.7	*.0x*
				.6x	*5.7x*	*7.4x*		*13.3x*	-	*1.4x*	
			MEAN	*.8x*	*7.7x*	*9.3x*	10.7%	*15.0x*	*15.2x*	*2.1x*	*1.6x*
			MEDIAN	*.8x*	*7.7x*	*9.3x*	10.8%	*14.8x*	*14.6x*	*2.3x*	*1.0x*
HEAVY BUILDING MATERIALS											
Vulcan Materials	67.75	6,899.0	7,242.8	2,508.2	627.6	469.6	25.0%	316.7	3.75	2,163.9	*1.0x*
				2.9x	*11.5x*	*15.4x*		*21.8x*	*18.1x*	*3.2x*	
LaFarge N. America, Inc.	55.02	3,947.1	4,191.9	4,171.8	758.2	518.3	18.2%	265.0	4.86	3,240.0	*.7x*
				1.0x	*5.5x*	*8.1x*		*14.9x*	*11.3x*	*1.2x*	
Martin Marietta Materials	76.72	3,556.7	4,169.5	1,935.0	426.4	290.0	22.0%	179.3	4.51	1,201.5	*1.7x*
				2.2x	*9.8x*	*14.4x*		*19.8x*	*17.0x*	*3.0x*	
Florida Rock Industries	49.06	3,215.9	3,166.9	1,153.5	314.0	249.5	27.2%	157.7	2.90	747.9	*.1x*
				2.7x	*10.1x*	*12.7x*		*20.4x*	*16.9x*	*4.3x*	
Eagle Materials	122.36	2,171.9	2,254.0	729.7	234.2	197.1	32.1%	131.6	8.50	511.4	*.4x*
				3.1x	*9.6x*	*11.4x*		*16.5x*	*14.4x*	*4.2x*	
Texas Industries (7)	49.84	1,146.4	1,461.7	867.6	171.0	126.8	19.7%	108.3	-	368.3	*2.6x*
				1.7x	*8.5x*	*11.5x*		*10.6x*	-	*3.1x*	
U.S. Concrete, Inc.	9.48	280.3	432.3	541.4	42.3	29.2	7.8%	8.6	0.64	178.8	*4.7x*
				.8x	*10.2x*	*14.8x*		*32.7x*	*14.8x*	*1.6x*	
			MEAN	*2.1x*	*9.3x*	*12.6x*	21.7%	*19.5x*	*15.4x*	*2.9x*	*1.6x*
			MEDIAN	*2.2x*	*9.8x*	*12.7x*	22.0%	*19.8x*	*15.9x*	*3.1x*	*1.0x*

Share price as of 12/30/2005

(1) Mohawk is pro forma for acquisition of Unilin Holding NV

(2) Stanley Works is not pro forma for acquisition of National Hardware nor Facom Tools

(3) James Hardie is not pro forma for $29.5MM in 'Special Commission of Inquiry' related expenses; primarily legal expenditures concerning asbestos

(4) RPM is not pro forma for the acquisition of Illbruck. $78MM related to asbestos charges added back to EBIT and EBITDA. $51MM added back to net income for after tax effects of asbestos reserve charges.

(5) Jacuzzi is pro forma for the divestitures of Rexair and Eljer Plumbingware

(6) Elk is not pro forma for the acquisition RGM Products and the divestiture of Ortloff Engineers

(7) Texas Industries is pro forma for spin-off of Chaparral, including $112MM added back to EBIT and EBITDA for loss on debt retirements and spin-off charges. $64MM added back to net income for after tax effects

All figures in millions except Share Price and EPS

NM is Not Meaningful, and is not included in the calculation of Mean

Firm Value = Market Cap + Debt + Minority Interest + Preferred Stock - Cash & Equivalents