CONFERENCE REPORT

2012 BUILDING AND INFRASTRUCTURE CONFERENCE

The Recovery Has Started

October 4, 2012 ■ New York Athletic Club

PRESENTED BY:

Lincoln INTERNATIONAL

L.E.K.

Contents

Executive Summary

At the Lincoln International and L.E.K. Consulting Building and Infrastructure Conference held in New York on October 4th, "The Recovery Has Started" was a common theme from speakers and panelists for an audience that featured prominent executives from across the building and construction industry, including product manufacturers, distributors, investment professionals, industry analysts and economists. Attendees at the conference gained fresh insights regarding the underlying drivers of the recovery, growth opportunities and potential caution areas.

Chris Kenney, Vice President and Head of the North America Building Materials & Industrial Products Practice of L.E.K. Consulting, opened the conference by welcoming all attendees and speakers to the New York Athletic Club for the afternoon's sessions. Mr. Kenney said that the title of this year's conference, "The Recovery Has Started", is certainly noteworthy and indicates that the industry is finally headed in the right direction.

Jim Lawson, Chairman of Lincoln International, introduced the keynote speaker, John Burns of John Burns Real Estate Consulting. Mr. Lawson noted that Mr. Burns spoke at the first Building and Infrastructure Conference in 2007 and at that conference correctly called the severity of the approaching cyclical downturn in residential construction. Mr. Lawson said that Mr. Burns then spoke at the Building and Infrastructure Conference last year in March 2011 and at that conference accurately predicted that a recovery in residential construction would begin soon.

In his keynote address, Mr. Burns said that the recovery in residential construction was underway. He noted that the stock prices of public companies in the industry had risen significantly, indicating that investors are expecting a recovery. He said that the recovery is being driven by job growth, the depletion of excess housing units, a rise in residential sales, a growing population and attractive house price affordability.

During the first panel discussion of the day, Near Term M&A Outlook, attendees heard that the M&A environment for building products companies was more active in 2012, with an even higher level of transaction activity expected in 2013. Panelists agreed that some buyers were stretching on valuation at this early stage in the cycle. Panelists also noted that lending markets were becoming very hot for building products companies, especially for larger transactions.

The second panel, Growth Priorities and Challenges, discussed the fact that energy efficient products are driving growth in many different product categories, and that this trend was accelerating. Panelists spoke about online channels and the impact those channels are having on different market participants. Panelists also discussed consolidation in distribution channels.

Before conference attendees broke for cocktails and networking, endnote speaker Bernard Markstein, U.S. Chief Economist for Reed Construction Data, discussed the recovery that is beginning in commercial construction. Dr. Markstein indicated that the recovery in residential construction is benefitting nonresidential construction as different facilities are built such as schools, medical facilities and parking garages, among others, to support new residential development.

Keynote Address

John Burns, President and CEO of John Burns Real Estate Consulting

The Housing Market Recovery

In his keynote address, Mr. Burns said that the long-awaited housing recovery has started in many regions in the United States. Fundamentals are improving, with excess housing units falling, sales rising, the population growing, and home affordability the best it has been in generations. Construction and new home sales have a long way to go to get back to normal, but job growth and low mortgage rates are helping to push the market in the right direction. The Federal Reserve is a key driver, as it will continue buying mortgages in an effort to reduce mortgage rates. Mortgage delinquencies and foreclosures are declining, but are still at high levels. From this point in the cycle, residential construction will double, transactions will increase and prices will rise which gives all industry participants hope for the future.

Mr. Burns stated that during the 2011 conference he believed that the residential construction outlook was very good in the long term, with the recovery just starting to gain momentum. In the current market the recovery is underway, with the public equity markets up big in almost all verticals in the building products industry, including big gains for homebuilders who are seeing better business conditions.

Mr. Burns pointed out that in the last year in the United States demand for housing units has significantly exceeded supply, as measured by the amount of new jobs created compared to the annual pace of residential construction. Market fundamentals are looking very attractive, as months of supply is currently low and affordability is very good. As the excesses of the building boom are cleared away housing will take off.

Tracking growth

Mr. Burns noted that almost every region in the country is growing housing demand much faster than supply, led by Northern and Southern California. Part of this demand is represented by the approximately 5.9 million 25- to 34- year-olds who are living with their parents, representing significant near and medium term demand for both rental units and owned housing. The Burns Home Value Index shows that in 19 of the top 20 markets home prices have appreciated in the last six months, and land values are also rising after falling to 2003 levels.

Mr. Burns said that construction starts bottomed in April 2009 at 478,000 starts, with our current level of starts at 746,000. Mr. Burns expects the normalized rate of residential construction to be 1.5 million starts, with the rate of growth back to this level an unknown. "How many industries can you point to where that industry is at 50% of normal levels of production yet is trending up to those normal levels," said Burns. Existing home sales bottomed at 3.3 million, with the current level at 4.47 million. The normalized level of existing home sales would be 4.9 million, so the market is 73% of the way back to normal. And lastly, according to the John Burns Real Estate Consulting Affordability Index, housing is very affordable today with prices needing to rise 32% at current interest rate levels to return to normal.

Job growth and mortgage rates

Mr. Burns noted that job growth and mortgage rates are critical factors in forecasting housing markets. Mr. Burns expects that mortgage rates will stay very low in 2013 at 3.4% while gradually increasing to 4.5% by 2016. For job growth, Mr. Burns expects 0.7% job growth in 2013 in an economy that is recovering at an anemic rate, with job growth slowly increasing to 1.6% by 2016. The key factors that are slowing the United States recovery are the coming fiscal cliff, budgetary problems with the federal government and the grim situation in Europe. Mr. Burns said that the problems in Europe are especially affecting the Northeast and Midwest, which is leading to significant regional differences in economic growth in the United States that are causing similarly big regional differences in the housing market. The good news is that the Federal Reserve led by Ben Bernanke is committed to using housing to boost the economy. The Federal Reserve is currently buying $40 billion of mortgage securities each month to boost housing, and this support will eventually help lift home prices.

Rental market shifts

Mr. Burns said that the rental market is poised to grow significantly in the next five years as the number of total renter households is expected to rise by 8.2 million from 2010 to 2015, while at the

same time the number of homeowners will decline by 1.2 million. Many of these renters have lost their homes due to foreclosures, but this population of renters will likely buy homes in the future when they are able. The single family renter portion of the total is 4.5 million, which is abnormally high. Most borrowers that are more than 90 days delinquent on their loans will become renters. Mr. Burns thinks that the homeownership rate will bottom at approximately 63% in 2014, before eventually recovering to approximately 66%.

Mr. Burns noted that the number of homes entering the foreclosure process is declining, although still quite high. The distressed sales volume of homes should peak this year and remain elevated through 2015. One good piece of news is that investors have begun to bid aggressively for these properties, which will help to clear out this inventory. Mr. Burns said that right now the move up market is slow, as many families with children are stuck in their current homes.

Phase 2 of the recovery

Mr. Burns said that we are in "Phase 2" of a supply-constrained housing recovery. Phase 1 is that job growth occurs, which has been happening for years. Phase 2 is price appreciation among low-priced foreclosures, which is driving up resale prices to the point that new homes are a great value; this phase has been going on for months. Phase 3 is strong demand with no supply that will lead to good price appreciation in land constrained markets. This phase is ahead of us as residential construction will double, the number of transactions will increase, and prices will rise as residential construction returns to normal levels of activity.

Impact of potential changes in mortgage interest deduction

A member of the audience asked how potential changes in the mortgage interest rate deduction would affect the housing market recovery. Mr. Burns said that one potential scenario is that the deduction for a second home will be eliminated, in addition to a reduction in the deductible mortgage debt amount from $1,000,000 to $500,000. These changes would hurt upper income homeowners with second homes or large mortgages, but would only raise an estimated $5 billion in additional tax revenue. Mr. Burns noted that the complete elimination of the mortgage deduction might not hurt the housing market as much as you might think, given that most people in the United States are not itemizing their mortgage interest since it doesn't reach their standard deduction which is currently $11,600.

Panel 1

Panel 1 (l-r): Uzair Dossani, Principal, Warburg Pincus; L.T. Gibson, President and Chief Executive Officer, US LBM Holdings; Jeff Corum, Director and Co-Head Building and Infrastructure, Lincoln International; Ira Starr, Founding Partner, Long Point Capital, Andrew Prete, Vice President - Business Development, Nortek, Inc.

Near Term M&A Outlook

Panelists in the first session agreed that the housing recovery is underway with residential construction levels expected to continue to increase in 2013. Participants talked about higher levels of merger and acquisition activity in 2012, with more deals anticipated in 2013 as the cycle advances. For the good deals that have come to market this year, some buyers have stretched on purchase price, and this is especially true for more cyclical companies. The panelists noted that lending markets for building products companies are currently quite healthy, with lending levels for larger opportunities becoming very aggressive.

PANELISTS: Uzair Dossani, Principal, Warburg Pincus
L.T. Gibson, President and Chief Executive Officer, US LBM Holdings
Andrew Prete, Vice President - Business Development, Nortek, Inc.
Ira Starr, Founding Partner, Long Point Capital

MODERATOR: Jeff Corum, Director and Co-Head Building and Infrastructure, Lincoln International

Market forecast

Jeff Corum of Lincoln International began by asking the panelists about their outlook for residential construction in 2013 and beyond. L.T. Gibson of US LBM said there was increased activity in all of their core markets in 2012, and that there is continued optimism from single family homebuilders and remodelers about 2013. Mr. Gibson expects single family new home construction to increase in 2013 by 15% to 20% in the markets that US LBM supplies. Ira Starr of Long Point agrees that the housing market is improving, with a key factor being that home prices are stabilizing. Mr. Starr does not think the housing market will rebound as quickly, but thinks that the recovery will be a steady one.

2013 deal activity

Mr. Corum then asked the panelists if the healthier M&A market for building and infrastructure companies would continue in 2013 with more companies for sale. Andrew Prete of Nortek said that deal activity was heavy this past summer, with some deals driven by potential tax increases. He expects 2013 to be a robust year, as financing markets continue to support deal activity. Uzair Dossani of Warburg Pincus believes that there will be more activity in 2013, driven primarily by higher levels of residential construction which will make it easier for sellers and buyers to agree on transactions. Mr. Gibson thinks that buyers will be aggressively looking for acquisitions at this stage of the cycle due to a belief that the recovery is real, and he expects that sellers will be more likely to sell if they cannot capitalize on the potential upside. Mr. Starr said that potential sellers that are more exposed to new construction may wait for several years to sell if they believe that single family home construction will double from this point in the cycle. Mr. Starr also noted that these parties could recapitalize their businesses while they wait for starts to advance.

Current market trends

Mr. Corum then asked what multiples panelists were currently seeing in the market, and also whether panelists would give any credit to potential target companies for future increases in profits. Mr. Starr said that with regards to multiples, some buyers are stretching but there have not been a lot of data points from good companies being sold in the market. Mr. Starr noted that the public markets are valuing industry participants quite highly as stock prices have risen due to expectations of future growth, while the private market is somewhat constrained by the leverage that is available based on trailing EBITDA levels. Mr. Dossani said that cyclical businesses may currently trade at a higher than normal multiple at this stage of the cycle, but that buyers should realize that any multiple compression as the cycle advances will hurt returns for an investment. Mr. Prete said that there is significant interest from buyers right now in the market, and he thinks that buyers are stretching by up to a multiple point for attractive targets.

Financing

Mr. Corum then asked the panel about their current view on financing markets for building products companies. Mr. Dossani said that lending markets are hot right now, with a very attractive high-yield environment and an active private market offering high leverage multiples for private deals. Mr. Dossani noted that investors are very comfortable with the credit story for most companies given where we are in the cycle. Mr. Starr said that while the last couple years have been very tough, lenders feel much better about building products companies today and are more comfortable with the industry. Mr. Starr believes that the market for larger transactions is very hot, while the market for smaller transactions is more normal. Mr. Gibson said that US LBM just completed a refinancing and found that lenders were interested again, which was a difference from several years ago.

Prices going up?

Lastly, Mr. Corum asked where product prices were headed in 2013. Mr. Gibson said that commodity prices were very volatile in 2012 with increasing prices, and that although there will be some softness at the end of this year during the winter, there are expectations for more price increases in early 2013. For finished goods such as windows, doors and roofing products, Mr. Gibson expects prices to rise substantially as demand increases for different product categories. Mr. Starr also expects pricing pressure in 2013 as demand increases, which will strain suppliers that have taken significant capacity out of the market.

Nonresidential and remodeling activity

A member of the audience asked how the panel thought nonresidential construction would recover. Mr. Starr believes that the commercial cycle will trail the residential cycle by a year or two, with infrastructure construction recovering somewhat in 2013 as governmental spending increases. He thinks that assets in the nonresidential sector could be attractive investments currently, but Mr. Starr has seen very few assets for sale. Mr. Dossani said that nonresidential products typically are higher margin which are positives for potential acquirers, but there is less clarity currently as to when the nonresidential market will recover.

Another member of the audience asked about remodeling activity. Mr. Gibson said that the remodeling market grew by 5% to 7% in US LBM's core markets in 2012, and they expect similar growth in 2013. Mr. Prete said that he also believes that remodeling is growing in the middle single digits. Mr. Starr said that it can be difficult to determine if products are sold into the new construction or remodeling markets, but his view is that growth in remodeling has been slow for several reasons, including the lack of available financing for homeowners.

Panel 2

Panel 2 (l-r): Greg Henry, Corporate Vice President and Chief Financial Officer, Rheem Manufacturing Company; Richard McPhail, Vice President of Strategic Business Development, The Home Depot; Brendan Deely, President and Chief Executive Officer, L&W Supply; Senior Vice President, USG Corporation; Robert Rourke, Vice President, Head of L.E.K.'s Chicago Office, L.E.K. Consulting

Growth Priorities and Challenges

Panelists agreed that residential construction is rebounding, and that nonresidential construction is also recovering. They discussed different avenues of growth and the risks associated with pursuing those growth strategies. Panelists noted that energy efficiency has become more important in different product categories and the drivers of this important trend were discussed. Panelists also addressed how online channels are affecting their businesses, and lastly commented on consolidation in distribution channels.

PANELISTS: Brendan Deely, President and Chief Executive Officer, L&W Supply;
Senior Vice President, USG Corporation
Greg Henry, Corporate Vice President and Chief Financial Officer
Rheem Manufacturing Company
Richard McPhail, Vice President of Strategic Business Development, The Home Depot

MODERATOR: Robert Rourke, Vice President, Head of L.E.K.'s Chicago Office, L.E.K. Consulting

2013 outlook

Rob Rourke of L.E.K. Consulting began by asking the panelists about their outlook for 2013 and their view on residential construction. Richard McPhail of The Home Depot said that they have seen good growth with their professional contractor customers and recent trends in housing seem to indicate the recovery is underway. Brendan Deely of L&W Supply said that while the recovery has started, we are still at approximately half of normal levels of construction activity. Mr. Deely thinks that multiunit construction in particular has increased. Greg Henry of Rheem Manufacturing said that residential construction has bottomed and will start to grow, but expect to see slow growth in the next several years as the market recovers.

Growth opportunities

Mr. Rourke asked where the sources of growth are in the market today, now that companies have taken cost out of their businesses and are now more focused on growth. Mr. Deely said that over the last four years they have taken a tremendous amount of cost out of their business, which will provide significant operating leverage going forward. They have focused on specific segments and product categories to drive targeted growth. Mr. McPhail said that Home Depot is focused on growing different competencies internally by hiring the right people and creating the best possible customer experience both in their stores and online.

Mr. Henry said that market participants are having to work harder to find growth; replacement business has been easier to find but more competitors have entered their space as new construction slowed. Mr. Deely believes that different verticals will rebound at different rates of growth, and he believes that replacement products will grow more quickly than products for new construction. Mr. Deely said that job growth and interest rates are the biggest risks to the industry; he also believes that access to credit is critical since the building products industry is powered by leverage.

Mr. Rourke asked the panelists for their views on commercial construction in 2013 and beyond. Mr. Deely said that they expect commercial construction to increase by approximately 17% in both 2013 and 2014; in addition, approximately 60% of commercial floor space in the United States is 30 years old or older, which will provide significant opportunities for projects. "Residential is coming back a little quicker, but commercial is moving in the right direction," noted Mr. Deely. Mr. Henry said that they are actually seeing more growth in commercial than residential, primarily driven by retrofits that emphasize energy efficiency as business owners are more aware of energy savings than homeowners tend to be.

Channel shifts

Mr. Rourke then asked about online channels, including the impact that Amazon Supply may have on the

industry. Mr. McPhail said that while only about 2% of their sales go through homedepot.com, they think that about 50% of their sales are influenced by the website. Mr. Henry said that Rheem is redeploying marketing spending into their website, which they view as the best way to reach their ultimate customers. Mr. Henry believes that companies are moving away from big trade shows and are instead investing more in website marketing. Mr. Deely said that they have redesigned their website to allow their customers to get job quotes, credit applications, do online video training and obtain more information about products. The goal is to provide more tools to their approximately 30,000 customers.

Mr. Rourke also asked about consolidation in the marketplace for one- and two-step distributors. Mr. Deely said that there is interest in the professional distribution market now that the industry has consolidated through branch closures. He also said that for distributors their balance sheet matters now more than ever as volumes return, and that as commodity inflation occurs in a broad market recovery companies will need working capital to grow.

Gauging demand for energy efficiency

Lastly, Mr. Rourke asked about energy efficiency and if it is a megatrend that will shape the building products industry for many years to come. Mr. Henry said that governmental standards are a critical factor for their vertical in pushing customers into high efficiency products through rebates; once rebates expire though products may not move. On the commercial side there is a lot of interest in high efficiency products that reduce energy costs and provide a nice return on investment. Mr. Deely said that as governmental authorities mandate that buildings become more efficient it will lead to significant opportunities to provide products that promote energy efficiency. Mr. McPhail said that during the downturn consumers focused more on short term cost, while in this recovering market energy efficient products are showing growth.

An audience member asked if inventory levels will rise in proportion with volume in a recovery, or will remain lean. Mr. Henry said that they will invest in inventory to support growth, but that Rheem became very good at managing working capital during the downturn and that he expects this discipline to continue.

Endnote Address

Bernard Markstein, P.h.D., U.S. Chief Economist, Reed Construction Data

Outlook for Commercial Construction

In his endnote address Dr. Markstein of Reed Construction Data spoke about construction activity in the United States, with a particular focus on commercial construction. Dr. Markstein said that residential construction is improving, although the difficulty in obtaining financing is slowing the recovery. The residential recovery is benefitting commercial construction, which has also begun to recover. Infrastructure in the United States is in need of repair, and the federal legislation passed last summer will support increased spending levels in 2013 and 2014.

Dr. Markstein began by saying that the economy and employment are growing, but not at a fast enough rate. There are significant near-term economic risks, including the situation in Europe and the pending fiscal cliff in the United States. The federal debt ceiling is approaching again, and the possibility of rising energy prices also remain a risk.

Dr. Markstein said that the residential construction market will improve from today's low levels. In 2005 over half of the $1.1 trillion in construction spending was residential construction driven by overbuilding in this sector, while today total construction is $800 billion and residential is a third of the total. The demand for housing in the long run should range from

a low estimate of 1.5 million starts to a high estimate of 1.8 million starts, with both figures significantly higher than today. While the market is improving, several factors are slowing the recovery, including the fact that banks are extremely cautious in their lending which is hurting some potential homeowners.

Apartment construction has been growing rapidly, and Dr. Markstein noted that the falling homeownership rate is a bad sign for single family housing, but a good sign for potentially increasing rental demand. In addition, the rental vacancy rate has dropped, which will support rents. There has been some overbuilding that is occurring in certain markets, but multiunit construction should continue to recover strongly.

Nonresidential construction projections

Dr. Markstein said that nonresidential construction will continue to strengthen throughout 2012 and 2013. He noted that the improvement in residential construction is benefitting nonresidential construction, and we are seeing the most improvement in office, commercial, education and manufacturing construction. Manufacturing has benefitted from low natural gas prices which are encouraging companies to bring production back to the United States.

Dr. Markstein said that heavy engineering construction has held up better than residential or nonresidential construction, but has been adversely affected by both federal government and local government spending. Different forms of infrastructure in the United States are in need of repair, including highways and water and sewer infrastructure. In July 2012, the federal government passed legislation to renew funding for highways in a $120 billion transportation bill that extends federal contributions to projects until October 2014. The bill is a step in the right direction but falls short of the long term solution that is needed.

A member of the audience noted that we are seeing some negative trends in construction in the last couple of months and asked if these trends continued at what point should we become concerned that the recovery is stalling. Dr. Markstein replied that he would need to see three or four more months of negative monthly trends which stretch into 2013, as the year over year comparisons have been very positive. In addition, government revisions have been upward recently which indicate that these trends may not be as negative as they first appear.

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