

# Building Products Newsletter – Pockets of Activity

Summer 2010

## Market Update

While the overall U.S. economy continues to stabilize, economic indicators remain volatile month over month. Initial jobless claims for the week ending May 29, 2010 declined to a seasonally adjusted 453,000, representing a 172,000 drop from May 30, 2009. The total number of people collecting unemployment insurance for the week ending May 22, 2010 dropped 2,091,000 from one year ago to 4.7 million. Seasonally adjusted continuing claims hit a low of 4.5 million during February 2010, representing the lowest level since January 2009. The National Association for Business Economics (NABE) predicts the U.S. economy will expand 3.1 percent during 2010. The second estimate of 1Q 2010 GDP released in May 2010 is an advance of 3.0 percent. First quarter 2010 GDP was primarily bolstered by a 3.5 percent annualized increase in personal consumption. Overall, NABE expects technology spending and business

inventory replenishment as key drivers of economic expansion during 2010.<sup>1</sup> Growth in business inventory is an indication of manufacturers' willingness to invest for future orders, an optimistic sign for future growth. On the other hand, the ISM Manufacturing Index and consumer sentiment survey highlight continuing month-to-month economic volatility. The Institute for Supply Management (ISM) Manufacturing Index, which tracks manufacturing activity, declined 0.7 points to 59.7 in May, still exceeding the desired level of 50, which indicates manufacturing growth.<sup>2</sup> The University of Michigan Consumer Sentiment Index, which tracks consumer attitudes on the business climate, personal finance, and spending, rose to 73.6 in May, and is 7.1 percent above the May 2009 level.

Housing data continues to show signs of a stabilizing homebuilding industry. April 2010 seasonally adjusted new home annual sales stood at 504,000, an increase of 14.8 and 47.8 percent from

March 2010 and April 2009, respectively. This is a strong rebound from the 36.4 percent decline between April 2008 and April 2009.<sup>3</sup> April new home inventory stood at 211,000, a 5.0-month supply, and represents the lowest level of new home inventory since December 2005.

Seasonally adjusted existing home annual sales snapped a three-month decline, increasing to 5.77 million in April 2010, an increase of 7.6 and 22.8 percent from March 2010 and April 2009, respectively.<sup>4</sup> Economists polled by *The Wall Street Journal* expect home buyers to continue to step into the market during 2Q 2010 to beat the extended homebuyer tax credit deadline, which covers sales through April 30 that close before July 1.<sup>5</sup>

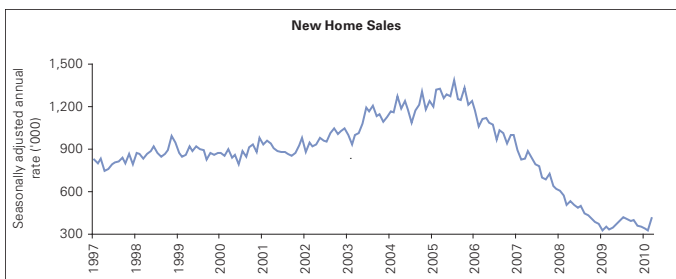
<sup>1</sup> *The Wall Street Journal*, "Economists See Firm Recovery In 2010, Job Creation In 1Q," February 22, 2010.

<sup>2</sup> Institute for Supply Management, May 2010.

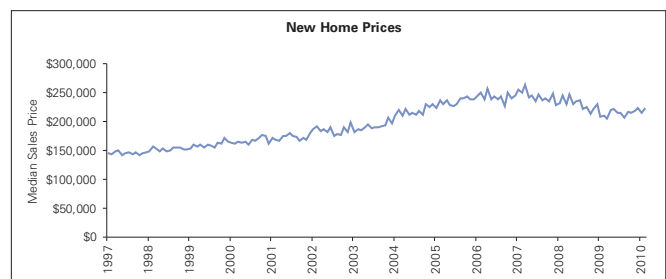
<sup>3</sup> U.S. Department of Housing and Urban Development, May 2010.

<sup>4</sup> National Association of Realtors, May 2010.

<sup>5</sup> *The Wall Street Journal*, "Housing Continues Weak Streak, GDP Firms Up," February 27, 2010.



Source: U.S. Census Bureau



Source: U.S. Census Bureau

March existing home inventory stood at 4.0 million, an 8.4-month supply, and up 2.7 percent from April 2009.

Housing starts in April 2010 for single-family residences increased year over year for the sixth consecutive month to an annual rate of 593,000 homes. This represents an increase of 10.2 and 53.6 percent from March 2010 and April 2009, respectively.

Home prices continue to be volatile evidenced by the median price of a new home declining 9.5 percent from a year ago to US\$198,400 in April 2010. The median price of an existing home was US\$173,100 in April, up 4.0 percent from a year ago. Economists at IHS Global Insight, a provider of economic, financial, and political information, found that the total U.S. housing market was undervalued by 8.9 percent at the end of 2009. Despite being undervalued, economists do not expect home prices to jump in the near term due to broader economic forces, such as job losses, tight credit, and mortgage delinquencies. Weak labor markets continue to suppress personal income gains, which in turn limits the amount people can spend on homes.<sup>6</sup>

**Foreclosure Activity**

Home foreclosures continue to be an industry-wide concern. Properties with foreclosure filings jumped to 2.8 million in 2009, representing an increase of 21.2 percent from 2008. This is still less than the increase of 81.2 percent from 2007 to 2008, when properties with foreclosure filings increased from 1.3 million to 2.3 million. Foreclosures in April 2010 declined 2.4 percent from

April 2009.<sup>7</sup> Regions with the highest foreclosure rates, the West and South regions, also correspond with the highest new and existing home price drops from 2007 to 2009.

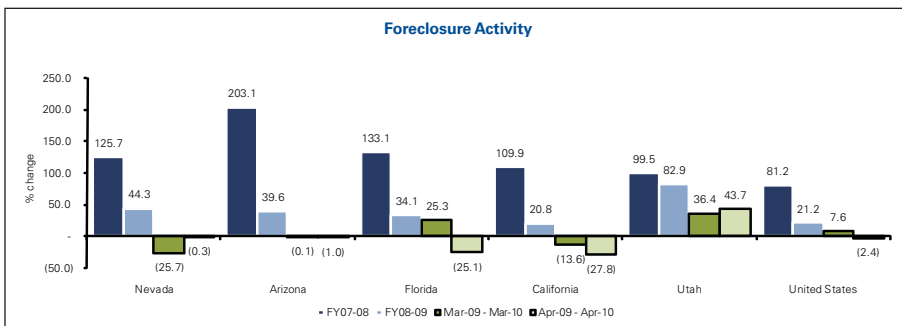
Short sales are a widely used alternative to foreclosure of distressed homes. In a short sale, the lender agrees to discount the amount owed on the mortgage and allow the homeowner to sell the home. This allows both parties to avoid a costly foreclosure, with the homeowner able to reduce the debt and the lender able to get back a portion of what was originally lent. Short sales accounted for 12.0 percent of homes purchased in March 2010, down from approximately 18.0 percent of homes purchased in March 2009.<sup>8</sup> This decline can be attributed to greater competition from buyers resulting in fewer bargain deals. Additionally, buyers and sellers of short sale homes are experiencing long wait times dealing with lenders.<sup>9</sup> Lenders did not expect short sales to continue at an abnormally high pace and have not improved the process or increased staffing to meet these requests. Moving forward, the government’s Home Affordable Foreclosure Alternatives Program, which went into effect in April 2010, sets rules for making the short sale process smoother and faster for all parties involved.

All cash sales have also risen dramatically over the past year, continuing to show that tight credit markets are making it difficult for traditional homebuyers. All cash buyers represented 27.0 percent of home purchases in March 2010, up from

20.0 percent during 4Q 2009 and 7.0 percent in 2008. The rise in all cash purchases shows that sellers are concerned with selling homes faster and reducing the uncertainty of getting a loan. Also, buyers identified as investors are stepping back into the market in hopes of securing bargain deals. In fact, home purchases made by buyers identified as investors was 19.0 percent in March, flat from February, but up from 17.0 percent in January, 15.0 percent in December, and 12.0 percent in November.<sup>10</sup> Investment buyers are able to pay all cash for homes because they typically plan to hold the home for a short period of time, usually making additional investments in homes and flipping them to the next buyer. The rise in purchases by investment buyers is a positive sign for building product companies as these buyers spend money to rehab and remodel homes for future sales.

**Pockets of Activity**

Despite high foreclosure rates and home price declines, there are signs of optimism within the hardest hit states. During the recession, Nevada, Arizona, Florida, California, and Utah were the hardest hit states, expressed by the highest properties in foreclosure at the end of April 2010. However, April foreclosures in California, Florida, and Nevada declined 27.8, 25.1, and 0.3 percent year over year, respectively. Nevada existing home sales increased 60.2 percent from 2008 to 2009, the most of any state. Existing home sales in Florida, Arizona, and California have also posted double digit increases from 2008 to 2009. One of the contributing factors to increased activity in these states is new home inventory trends.



Source: RealtyTrac Foreclosure Trends, January 2007–April 2010

<sup>6</sup> *The Wall Street Journal*, “Home Prices May Be Undervalued,” March 24, 2010.  
<sup>7</sup> RealtyTrac Foreclosure Trends, January 2007 – April 2010.  
<sup>8</sup> National Association of Realtors, Realtors Confidence Index, April 26, 2010.  
<sup>9</sup> MarketWatch.com, “Speeding up short sales,” March 15, 2010.  
<sup>10</sup> National Association of Realtors, Realtors Confidence Index, April 26, 2010.

The months' supply of new home inventory in the West region declined 59.4 percent year over year in April 2010, the twelfth consecutive decline. This is making it harder for homebuyers to find bargain deals, such as in the Las Vegas metro area where despite having the highest U.S. metro foreclosure rate bargains are beginning to disappear.<sup>9,11</sup> The California housing market is showing signs of stabilization with year over year April median home prices increasing 21.7 and 12.2 percent in San Francisco Bay Area and San Diego, respectively.<sup>12</sup> Decreased supply, increasing home prices, and decelerating foreclosure rates suggest positive activity in the hardest hit housing markets.

Along with pockets of activity within the West and South regions are also pockets of continued decline.

Foreclosure rates in the Midwest, West, and Northeast regions continue to accelerate in some states, such as Michigan, Utah, and Maryland. Zillow.com, a Seattle-based firm known for monitoring home values, reported in March that 12 of the 143 metropolitan areas monitored have experienced a double dip in home values. A market is considered to be in a double dip when it has experienced a sustained downturn, then experiences at least five consecutive months of increases in the median home value, followed by at least five consecutive months of decreases in the median home value. At the top of Zillow's list were Augusta, Georgia; Greeley, Colorado; and Boulder, Colorado, which are seeing month over month value declines in excess of 1.0 percent. While Colorado foreclosures flattened, existing home

sales declined 10.0 percent from 2008 to 2009. Additional metropolitan areas in Colorado, Massachusetts, and Florida remain on the Zillow.com double dip watch list in March 2010.<sup>13</sup>

Despite month-to-month volatility in economic indicators, the U.S. economy is stabilizing as evidenced by job creation and GDP growth. Pockets of activity in the hardest hit markets suggest stabilization, although some housing markets continue to deteriorate. Overall, economists still believe the U.S. economy is on course to experience growth in 2010.

<sup>9</sup> MarketWatch.com, "Speeding up short sales," March 15, 2010.

<sup>11</sup> *The Wall Street Journal*, "Vegas House Bargains Dry Up," February 23, 2010.

<sup>12</sup> MDA DataQuick, May 2010.

<sup>13</sup> Zillow.com, "More Markets Head Into Double Dip," March 24, 2010.

## Select building products transactions

April 21, 2010 – **Oak Hill Capital Partners**, a United States-based private equity firm, entered into an agreement to acquire Ohio-based **Hillman Companies, Inc.**, a distributor of fasteners, keys, letters, numbers, and signs, for a transaction value of US\$815 million.

March 22, 2010 – **Smiths Interconnect**, a division of London-based global technology business Smiths Group PLC (LSE: SMIN), entered into an agreement to acquire Kansas City-based **Interconnect Devices, Inc.**, an engineer and manufacturer of spring contact probes, test sockets, and custom interconnect solutions, for an implied enterprise value of US\$185 million.

February 26, 2010 – **Stock Building Supply Holdings LLC**, a portfolio company of private equity firm The Gores Group LLC, entered into an agreement to acquire **National Home Centers, Inc.**, a supplier of building materials to professional builders and do-it-yourself homeowners, for an implied enterprise value of US\$15.0 million.

February 24, 2010 – **H.I.G. Capital, LLC**, a United States-based private equity and venture capital firm, entered into an agreement with management to acquire United Kingdom-based **Synseal Extrusions Ltd.**, a manufacturer of poly vinyl chloride based windows and doors.

January 26, 2010 – **QEP Co. Inc. (OTCPK: QEPC)**, a Boca Raton, Florida-based manufacturer, marketer, and distributor of a line of specialty tools and flooring-related products, entered into an agreement to acquire **ArborCraft, LLC**, a manufacturer of hardwood flooring products, for an implied enterprise value of US\$10.0 million and a valuation of 0.4x revenue.

January 13, 2010 – **Sun Capital Partners, Inc.**, a Boca Raton, Florida-based private equity firm, entered into an agreement to acquire **Arch Aluminum & Glass Co., Inc.**, a fabricator and distributor of architectural glass and aluminum products, in bankruptcy court for an implied enterprise value of US\$63.8 million and a valuation of 0.5x revenue.

December 30, 2009 – Private equity firms **Webster Capital and Sorenson Capital** entered into an agreement to acquire **Re-Bath, LLC**, a manufacturer and remodeler of bathtubs, shower liners, wall surrounds, and bathroom accessories.

December 30, 2009 – **Haddon Windows, LLC**, a Bensalem, Pennsylvania-based manufacturer of replacement windows and doors, entered into an agreement to acquire **Speyer Door & Window Inc.**, a manufacturer of secure windows and doors with keyless access.

December 11, 2009 – **H.I.G. Capital, LLC**, a United States-based private equity and venture capital firm, entered into an agreement with management to acquire Germany-based **Witex Flooring Products GmbH**, a manufacturer and marketer of laminate, parquet, and elastic floorings.

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