

2009 BUILDING AND INFRASTRUCTURE CONFERENCE

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Outlook and Opportunities in the Building and Infrastructure Industry



CONFERENCE REPORT

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Executive Summary

Industry professionals that attended Lincoln International's third annual Building and Infrastructure Conference in November heard that the residential construction market is on the way out of its prolonged slump and may even recover more quickly than expected. By contrast, the commercial building market is still deteriorating.

Andrew Bohutinsky, Managing Director and Global Head of Building and Infrastructure at Lincoln International, thanked L.E.K Consulting for co-sponsoring the event, and welcomed the 250 customers, suppliers, buyers, sellers and investors that had gathered in New York to hear industry perspectives from economists, corporate leaders, private equity professionals and entrepreneurs. "My team and I live and breathe every day the ups and downs of the building and construction cycle," he said. "There are certainly downs right now, as we all know, but we believe that there are very significant opportunities that remain in the space."

In his keynote address, Peter Linneman, Founding Chairman of Real Estate Development at the Wharton School of Business, said that awful as it was, the current recession was no worse than several previous recessions over the last few decades, where a panic-induced slump had been followed by massive rebounds. "It was panic that caused the economy to go down and, as the sun came out and people realized that the world hadn't come to an end, the economy rebounded," he said. "Psychology is more important than we believe."

He predicted that the economy would add another nine million jobs by 2013 and said that there was already equilibrium to moderate excess demand for residential housing in most of the country. However, he warned that, even with a robust recovery, the supply and demand fundamentals that existed in August 2008 for commercial property were unlikely to return until 2013.

The first panelist discussion of the day tackled the outlook for the industry. Participants agreed that while the residential market was picking up, the commercial market still had a long way to fall. They emphasized the need for innovation to survive in today's changed competitive landscape. As Ted Hathaway, Chief Executive of Oldcastle Glass, put it, "When you come out of this, if you don't have a new business model, you won't have a business."

During the second panel, panelists related first-hand accounts of what it was like to buy and sell building and infrastructure companies during the current industry environment. One of the panelists was Dan Sansone, Senior Vice President and Chief Financial Officer of Vulcan Materials Company, a company which, following a large 2007 acquisition, had to shore up its balance sheet with an investor loan and equity capital to stay viable. "Berkshire Hathaway asked if they could invest with us. We placed \$400 million of seven and ten-year notes with Warren Buffet in about 48 hours," he said. "Now we are in good shape, but keeping your balance sheet pristine if you have a meaningful level debt is a serious challenge."

Before the conference ended with a cocktail and networking session, the last panel of the day addressed how strategic companies and private equity firms made portfolio allocation decisions, from evaluating the strength of their existing platforms to deciding when to buy new platforms and when to divest. Panelists had mixed views on whether today's markets presented a good buying opportunity, but all agreed that it was important to focus on the core business before buying for growth.

Strategic companies and private equity investors alike have been proactive about building sustainable businesses that have so far survived the worst downturn industry professionals can remember, but both groups believe there is still some major consolidation left to come. As Michael Brady, Executive Vice President and Head of Corporate Development at Summit Materials, pointed out, "I think there will be some surprising shake ups and divestitures over the next few years that will further change the landscape of the industry."



Dr. Peter Linnemann gives the keynote address

Keynote Address

Is There Light at the End of the Tunnel?

In his keynote address, Dr. Peter Linneman said that while economic conditions during the current recession were extremely painful, they were no worse than those experienced during several other recessions in recent decades. Some metrics, such as individual net worth and the availability of capital, are considerably better. He said that the bottom of the recession was already behind us and that the economic rebound would start slowly and then grow exponentially, in line with previous panic-driven recessions. He predicted the economy would add nine million jobs between April 2010 and April 2013 and that there was now moderate to excess demand for residential housing in the U.S. However, he warned that the supply and demand fundamentals that existed in August 2008 for commercial property were unlikely to return until 2013, even with a robust recovery.

Dr. Linneman began his address by discussing some of the data from the current U.S. recession and comparing it to other recessions since 1969. "This is a miserable recession, but those of you who are old enough will realize that 1973 through 1975 was basically as bad, and 1982 was almost equally bad," he said. He pointed out that in 1973 to 1975, the Watergate scandal led to the Vice President and

President resigning in disgrace, the availability of capital for small business was half of what it is today, consumer confidence was low and housing sales and construction starts had fallen significantly.

Linneman said that in 1982, unemployment was higher than today, underemployment was even higher and the mechanism for financing 95% of all



housing was gone. "I'm not going to lie to you and say things are really good today because they are not," he said. However, he pointed out that two years after these recessions were officially over, consumer confidence had doubled, unemployment had fallen 250 basis points to 350 basis points, auto sales had recovered, housing starts had doubled, construction had picked up and capital market indices had massively improved. "Is today's housing finance system broke? Of course it is broke. Is the commercial mortgage system broke? Of course it is. Is the government a disaster? Of course, but there's nothing new in any of this."

Linneman explained that the last two times that the country had seen a recession plus a panic, this had been followed by massive rebounds. "It was panic that caused the economy to go down, and as the sun came out and people realized that the world hadn't come to an end, the economy rebounded," he said. "Psychology is more important than we believe." He predicted that five years from now, the discussion will focus not on how difficult conditions are in the capital markets, but whether they are getting out of control. "If you don't believe that, you haven't studied history," he said. "There will be a rebound."

Improved demand for housing

Dr. Linneman said the housing starts data from the last 50 years indicated that the bigger the drop, the bigger the rebound, and explained that the U.S. needed to add 1.8 million homes a year to deal with population growth and the destruction of existing housing. In his opinion, the excess supply of two and a half years ago has been run down. "Now there's equilibrium to moderate excess demand for housing in most of the country," he said. "Why did home prices start rising in most of the country in April, May, June and July? Because, actually, we got to a stage where we were not even replacing units that were being destroyed, much less building units for new households."

He added that the drop in house prices had not affected all homeowners equally. "Homeowners have seen a 5% to 10% drop in house prices, which on a leveraged asset is substantial. But one third of Americans who own their home have no mortgage, and another third has a mortgage under 50% of the value." He added that as prices go up, so too will homeowner confidence.

However, Linnemans warned that commercial and industrial construction contracts are at the lowest they have been in 50 years because companies



cannot obtain financing. He added that the supply and demand fundamentals that existed in August 2008 for commercial property were unlikely to return until 2013, even with a robust economic recovery.

Confidence trick

Dr. Linneman said that it was a lack of confidence, not the fundamentals, that brought the economy crashing down in 2008. "Until August of last year, we had a standard recession. Then, one Friday in September, one week after Lehman Brothers went out of business, Hank Paulson and Ben Bernanke told us that the world was coming to an end. We went from having lost approximately two million jobs to a recession that became panic-driven, and now we've lost 8.5 million jobs."

He told the audience about a phone call he had received from his 82-year-old Aunt Betty that weekend, when she asked whether she should take all the money out of her bank. "You guys think you're so sophisticated. You wouldn't put your money under the mattress like Aunt Betty did," he said. "Instead, you took money out of banks and jammed them into treasuries to the point that you got a negative return. At least Aunt Betty got 0% yield."

However, he pointed out that things are improving, with the U.S. and Western Europe coming back to 2% to 3% growth and India, China and Brazil growing dramatically. He predicted that the U.S. economy will continue to turn positive and that companies will no longer be reluctant to hire despite improved profitability. He explained that, at the moment, even good firms in solid industries have not replaced employees who have died, retired, gone to study or had a child. As he put it, "You don't need systemic or sectoral growth in the economy to get a massive job rebound. All you need is for firms to start replacing that person who died six months ago."

Dr. Linneman pointed out that the healthcare, government and education sectors are already adding jobs. He predicted that the economy would reach 0% job growth by January 2010, before a very strong rebound by April 2010, which could create nine million new jobs over the next three years. "Two years from now, my guess is that we will still have high unemployment, but instead of 10.5%, it will be closer to 7.5%," he said.



The inflationary risk

However, in his address Linneman said that he was concerned about inflation. "In five months, the U.S. has created more 'high powered' money—so called because it can be lent against 7.5 times by law—than in the last 50 years combined." He explained that this amounted to a 100% increase in the potential money supply, compared to five months ago, but inflation is not high because the banks are not lending that money.

"The government's response was to keep buying billions of bank bonds, but the money has still not been lent. The question is, when banks do start lending, will there be a sudden spike in inflation?" He said that the government's answer to that scenario would be to sell bonds, but that a sudden surge in supply will increase interest rates. "How many of you who are living on Libor are prepared for a spike?" he asked. He said that to cope with its double-digit deficit, the government was also likely to print money, so now was a good time to be a long-term fixed-rate borrower.

"This recovery will stun people when it occurs," he concluded, conceding that the recovery relied on the return of consumer confidence, but that the country has higher wealth and higher income now

than during the two previous panic-driven recessions. "The argument goes that we don't need anything more as consumers, but we haven't really needed anything we have bought since about 1950. How many of you five years ago would have dreamed you needed a TV as big as this wall? There is the great opportunity that arises out of this crazy exuberance, but not if you panic."

Dr. Linneman ended by taking a few questions from the audience, including one about what he thought would happen to residential mortgage resets. He said that property flippers, not ARM resets, were the main problem. "They bought houses with non-conforming mortgages because they couldn't satisfy the standard that they did not already own property. There were 700,000 of such homes. I'm not saying every foreclosed home was empty beforehand, but many of them were." He said that, in his view, the run up in house prices was more about banks lending to flippers than it was about advancing too much debt to people in general. "I once called this 'idiots lending to idiots', but in the cycle of life, you have to thin the herd."



Panel 1 (l-r): Kevin O'Meara, Operating Partner, Golden Gate Capital; Edwin B. Hathaway, Chief Executive, Oldcastle Glass; Peter Linneman, Ph.D., Linneman Associates; Fareed A. Khan, Vice President, USG Corporation and President, Building Systems; Robert A. Newbold, Managing Principal, Graham Partners

Panel 1

What the Future Holds: Major Trends in the Building and Infrastructure Industry

The panel of private equity professionals and corporate executives discussed the outlook for the residential and commercial construction markets. While most agreed that the residential market was picking up, they felt that the commercial market still had quite a long way to fall. They discussed the point at which it made sense to scale up or scale down during the downturn and stressed the need for innovation to survive in today's changed competitive landscape. Some predicted that without developing a new business model, or at the very least, a new customer offering, many firms would not survive at all and that there would be a lot more consolidation to come.

PANELISTS: Edwin B. Hathaway, Chief Executive, Oldcastle Glass
Fareed A. Khan, Vice President, USG Corporation and President, Building Systems
Robert A. Newbold, Managing Principal, Graham Partners
Kevin O'Meara, Operating Partner, Golden Gate Capital

MODERATOR: Dr. Peter Linneman



Kevin O'Meara, Golden Gate Capital



Edwin B. Hathaway, Oldcastle Glass

Dr. Linneman, who stayed on the platform to moderate the next panel, asked panelists what those in the commercial construction business should do for the next year or so while they were waiting for the recovery. Fareed Khan of USG Corporation said that if companies were not thinking about how to get their businesses sustainable through this difficult period, they would be in trouble next year. "Get sustainable and right-size your business, even if you are not profitable," he said. Kevin O'Meara of Golden Gate Capital thought that it was a question of capacity. "If you pull your capacity down too quickly, you lose customers and market share. You have to do a very good job of balancing your capacity with what's going on in the markets."

Linneman then asked the panel whether they were focused on best practices and efficiencies or just concentrating on survival. Ted Hathaway of Oldcastle Glass responded that the competitive landscape had changed completely in building products. "This time last year I was talking about customer intimacy. This year, I can't even find a customer," he joked. "I think this is a time for innovation and revolution. I don't think this is a cyclical downturn, I think it's a structural downturn." He pointed out that Oldcastle had a great business model that previously posted exceptional returns, but the recession had been a

draconian stress test for any business. "When you come out of this, if you don't have a new business model, you won't have a business," he said.

The case for innovation

Discussing whether innovation was a necessity in this environment, Mr. Khan said that it was very important. "The commercial downturn is very serious but it will come back. I keep looking for scale. I think we will look back and think we could have done more to scale up the business." He said that the challenge for building materials manufacturers is that they tend to be vertically integrated. "If you can find a way to make those verticals more efficient, there's a big opportunity there. You need to get back to higher utilization rates to get to the point where the fundamentals make sense."

Robert Newbold of Graham Partners said that his buyout fund was targeting very specialized types of add-on acquisitions that have synergies with existing portfolio companies. "We've got a couple of building products and water management businesses that have been successful at taking out their number one or number two competitor," he said. "We have also had some good success with firms that have a good



brand name and distribution channel.” Mr. Hathaway said that the industry was in a massive depression in building products. “If you look at European building product companies, there are not ten of everything, there are three. There has to be a period of economic darwinism here, where only the strong survive.”

Dr. Linneman asked the panel what they thought about retaining talent through the downturn. Mr. Hathaway said that head count at Oldcastle Glass was already down 33%, saying, “You reach a point where you can’t cut your way to prosperity.” However, he added that now was a great opportunity to find talent. “We’ve hired a lot of people in digital engineering from GM. There is so little technology being leveraged in our industry, no matter what the product is. Digital engineering of cars and planes is ubiquitous. In the building and construction industry, it is the latest new thing.”

Mr. Khan added that fragmentation was a challenge to technology adoption and Mr. O’Meara commented that companies normally innovate for one of two reasons: either to lower costs or improve the product. “The problem in building on the residential side is that homeowners and builders aren’t prepared to pay any more for the product,” he said. “The other problem with innovation is that you take risks with product liability that are unforeseeable.” Mr. Newbold

agreed that contractors are inherently risk adverse. He gave the example of one of his businesses that makes plastic units for on-site septic systems. “It has been gradually gaining market share for 20 years to a point where it has half the market. If this were the cell phone industry, it would have taken six months,” he said.

Bright spots on the horizon

Asked whether there were any bright spots in the industry in the next 10 to 12 months, Mr. Khan said he thought that repair and remodeling could be the sector that pulls building materials companies out of trouble on the residential side. Mr. Newbold said that, from a private equity standpoint, the next 12 months will be a good time to buy residential building products companies, and Mr. O’Meara was optimistic about the fact that many companies had already done a lot to restructure themselves and their cost structure. “Even without significant improvement in revenue, the bottom line of many companies is going to be better,” O’Meara said. “If they can keep their newly variable costs fixed, then they’ll have a lot of operating leverage going forward.”



Robert A. Newbold, Graham Partners



Fareed A. Khan USG Corporation

A member of the audience asked the panel whether U.S. households were willing to pay for energy savings, to which Mr. Khan responded that this was a growing trend, but that it was still more relevant in the commercial sector, where a lot of the green movement is about risk aversion. "If your building is not LEED silver or gold certified, it could be difficult to rent your space down the road. Developers pay a 1% to 2% premium for that," Khan said. "On the residential side, there aren't the same specifications, so it's tough to find a framework to explain how consumers can get the economics from products."

Another conference participant asked the panel what was going to surprise the audience the most in the next 12 months. Mr. Hathaway said he was worried about hyper inflation. "I don't think there's enough aggregate demand on the non-residential side to be able to raise prices and not get squeezed ourselves." Mr. O'Meara thought that 12 months was too short a time period to present many surprises. "If you go out 24 to 36 months, though, there will be a sharper recovery than people anticipated," he said. Mr. Newbold's view of the situation was mixed. He said that while the commercial downturn will likely be worse than anticipated, the residential uptick will be better than people expect. Mr. Kahn agreed that the commercial sector will take a significant hit. "If

you lose one key customer, that goes back to the stockist, the dealer and to the manufacturer very quickly," he said. "That's going to happen over the next two to three quarters."



Panel 2 (l-r): Dan Sansone, Senior Vice President and Chief Financial Officer, Vulcan Materials Company; Adam Gottlieb, Managing Director, Industrial Opportunity Partners; Michael Brady, Executive Vice President, Head of Corporate Development, Summit Materials; Joe Appelman, President and CEO, Stock Building Supply

Panel 2

Lessons Learned from the Trenches: Buying and Selling Building and Infrastructure Companies in Today's Environment

Delegates heard first hand from Joe Appelman of Stock Building Supply, the distributor recently sold by Wolseley to The Gores Group, and from Dan Sansone of Vulcan Materials, a company which had to shore up its balance sheet with an investor loan and equity capital to stay viable. All the panelists discussed buying opportunities in this market, the sort of valuations acquired companies were receiving and different approaches to bridge the gap between buyers and sellers. They also discussed the differences between having a private equity owner and a strategic one.

PANELISTS: Joe Appelman, President and CEO, Stock Building Supply
Michael Brady, Executive Vice President, Head of Corporate Development, Summit Materials
Adam Gottlieb, Managing Director, Industrial Opportunity Partners
Dan Sansone, Senior Vice President and Chief Financial Officer, Vulcan Materials Company

MODERATOR: Andrew Bohutinsky, Managing Director and Global Head, Building and Infrastructure
Lincoln International



Joe Appellmann, Stock Building Supply



Dan Sansone, Vulcan Materials Company

Mr. Bohutinsky began the discussion by asking Joe Appellmann of Stock Building Supply what it had been like selling the company during the downturn. Mr. Appellmann replied that the company's prior parent company, UK-based Wolseley PLC, made the decision to get out of U.S. residential construction and exit the business in March 2008. "We were very close to a deal with one strategic in the industry, but that fell apart last September as the credit markets dried up," he said. "This March, we decided that we had to find a deal in the next 60 days or we would lose revenue, customers and associates, so it was important to get a deal done quickly with a private equity company." He said that, as a leading consolidator in the building materials distribution space, this recession was the first time in 14 years that the company had not grown. "We really had to change our mindset and try to get on top of how quickly our business was falling away."

Mr. Bohutinsky asked Dan Sansone of Vulcan Materials how his company had adapted during the last year. Mr. Sansone replied that the company has continued to draw operating rates down, because inventories were still growing faster than demand, and that headcount was down about 19% from September last year. He also explained that in February 2007, the company had announced that it was buying aggregate and cement business Florida Rock for \$4.5 billion in stock. "Because of a protracted process with the Department of Justice, we didn't close the transaction

until November 2007, so the organization was in limbo for the better part of a year," he said. "By the time we came to finance the deal, what was originally seen as a simple \$2 billion term bond financing ended up being a series of bond transactions." Earnings had continued to shrink as demand softened, so the company still had some liquidity issues. "Berkshire Hathaway asked if they could invest with us. We placed \$400 million of seven and ten-year notes with Warren Buffet in about 48 hours. Our earnings continued to weaken, so we've also raised new equity capital. Now we are in good shape, but keeping your balance sheet pristine if you have a meaningful level of debt is a serious challenge."

Buying in the recession

Mr. Bohutinsky asked the panel how they viewed acquisitions at this point in the cycle. Michael Brady of Summit Materials thought there were a lot of opportunities, as long as people were careful in selecting targets. "We messed up once when we bought a company that was a poor strategic fit with a weak team. The good companies are always going to command a premium and it doesn't really matter if you are a bit before or a bit after the market as long as you've selected your target correctly," he said. "You also have to institutionalize operational rigor immediately."



Mr. Bohutinsky then asked Mr. Brady how he bridged the gap between the expectations of the buyer and the seller in this market. "Today, sellers are saying 'here is my track record, look at how good it is,'" Brady responded. "The buyers are saying 'that's great, but what about the future?' It's a very different environment today and that can be a problem, so we have looked at risk-reward sharing mechanisms, such as contingent payments, deferred payments and minority ownership for the seller."

Adam Gottlieb of Industrial Opportunity Partners pointed out that a lot of companies would not be selling in this market if they were not forced by their lenders or other constituents. "You are either negotiating against a company's liquidation value or what is offered by other buyers." He said that his private equity firm still encountered competition when trying to buy. "A lot of money has been raised to focus on distressed debt investing or, in our case, acquiring operationally challenged and financially distressed companies. You always run up against a group of folks in every transaction. There's really no such thing as a proprietary distressed sale."

The panelists were then asked about how they got a reasonable valuation when selling their businesses in today's market. Mr. Gottlieb argued that, while building products had been a taboo sector for 12 to 18 months and it had been very difficult to get full

value for any residential-related businesses, now the fire sales were over. However, he thought that the downturn in commercial construction was probably going to be more severe than the consensus estimate. "Lenders are going to need to see some performance improvement before they increase lending to the commercial sector," he said.

A new approach

Mr. Appelmann was asked how his life has changed now that Stock Building Supply is owned by a private equity firm instead of a publicly traded company. Whereas being inside a publicly traded company had meant that the company did not have to worry about writing checks, he said, "Now we have to manage cash in the business." However, he said that The Gores Group had turned the company around. "We needed an owner that would understand the space and that this is a cyclical business. An owner that would help us through our Chapter 11 filing, to get our balance sheet in order and to carve out of our 23-year relationship with Wolseley. Gores have been great. We used to be losing \$1 million a day. Now every month we are getting better EBITDA performance."

Mr. Bohutinsky asked Mr. Brady of Summit Materials whether he has found the pace of life different working with a private equity company. He responded



Michael Brady, Summit Materials



Adam Gottlieb, Industrial Opportunity Partners

that when you are working in the context of a public company, cash is one of several metrics to consider. Now that he is working at a private equity owned company, cash is the only metric that counts. "I also thought when I worked at Oldcastle that it was a very data-driven company, but Summit is even more so. It's all about the numbers," he said. He added that another difference is that every hypothesis he had taken for granted at a strategic company was challenged now. "In strategic companies, you work with professionals who know the industry. With Blackstone as our primary investor, we've got some very experienced investment professionals, but they don't have the industry knowledge, so we have to justify things," he explained. "It's a good rigor in general, although it is also painful at times."

To conclude the discussion, the panelists were asked what the biggest surprises in building material and building construction M&A would be over the next few years. Mr. Sansone thought that the biggest surprise would come from the big global cement players, who he said had expanded over the last decade through very aggressive cross border M&A. "Many today are in financial distress. Some are now selling assets and are working feverishly to steady their balance sheets. What will our industry look like three years from now? Will they reemerge as aggressive global acquirers?" Sansone said. Mr. Brady agreed that there would be some big changes, given

the tough couple of years predicted for the market. "I think there will be some surprising shake ups and divestitures over the next few years that will further change the landscape," he said.



Panel 3 (l-r): Timothy Meyer, Managing Director, Glendon Partners, a Gores Group affiliate; Philippe Milliet, President and CEO, Consolis SAS; Edwin B. Hathaway, Chief Executive, Oldcastle Glass; Fareed A. Khan, Vice President, USG Corporation and President, Building Systems

Panel 3

Portfolio Strategy: Making Strategic Decisions Regarding Existing Assets and Identifying New Platforms

The panelists discussed their acquisition strategies, whether they thought that now was a good time to buy new platforms and when it made sense to divest businesses. All the panelists agreed that there was little sense in buying new platforms for growth if companies did not focus on their core business first. Some were also concerned that companies were still paying too much for the potential synergies they would glean from acquiring a target, which sometimes never materialize.

PANELISTS: Edwin B. Hathaway, Chief Executive, Oldcastle Glass
Fareed A. Khan, Vice President, USG Corporation and President, Building Systems
Timothy Meyer, Managing Director, Glendon Partners, a Gores Group affiliate
Philippe Milliet, President and CEO, Consolis SAS

MODERATOR: Rob Rourke, Partner and Head of L.E.K Building and Infrastructure North America
L.E.K Consulting



Timothy Meyer, Glendon Partners



Fareed A. Khan, USG Corporation

Rob Rourke of L.E.K Consulting started the session by asking panelists how they monitored existing investments, harvested assets and what they thought about investing for growth.

Timothy Meyer of Glendon Partners, a Gores Group affiliate, explained that The Gores Group is a turnaround firm. "We go after deals that are distressed and make a transformation that often requires a carve out. Monitoring an asset is not in our vernacular. We will go out there and effect pretty rapid change." He added that once the firm thinks that it has added all the operational value possible to a portfolio company and that the business is performing close to its potential, Gores exits that investment.

Meyer said that exits happen much more quickly for companies that are not performing well. "We did a carve out from Tyco Power Systems in 2007 and split that into two companies. We realized after the carve out that the companies were not well positioned in that space. Our immediate priority was to find a follow-on deal to give them an opportunity to perform well," he said. "You have to look at every company and ask whether it is good enough as a standalone asset to create substantial value."

Ted Hathaway of Oldcastle Glass said that the company had spent about 10 years geographically consolidating the glass fabrication industry until

it was forced to look at other platforms that were complementary to its core business. "Bolt-on is a misnomer. I think that often you can buy something thinking it is a bolt-on acquisition, when in fact, it is a break off. As a strategic, you need to see if there is an opportunity to grow it and how it can be integrated and reinforce your business," he said, adding that Oldcastle had not divested anything recently.

Mr. Rourke then asked the panelists at what point they made the determination that organic growth is not enough and that they needed to pursue consolidation. Philippe Milliet of Consolis explained that his company felt the economic situation warranted consolidation and that, as a result, it was getting out of some European countries altogether. "For example, in Germany there are lots of small mom and pop shops. It's going to be very difficult to make money in Germany for the next three to five years, so we are exiting that market." He said there would be more consolidation to come. "In two to three years, we want three or four core companies that can control 70% to 80% of our business."

Focusing on core businesses

Mr. Rourke then asked panelists how they balanced the degree to which the platform might leverage existing strengths versus the fundamental value of



the platform itself. Fareed Khan of USG Corporation said that as the company was coming into the downturn, it had decided to be much more focused on reinvesting in its core business. "That was a long lead time decision and we are riding the cycle, but we also did a number of cornerstone acquisitions to build a big footprint in the distribution market, which we filled in with tuck-in acquisitions."

Mr. Hathaway said that his favorite example of a company that had transformed itself through prudent portfolio management was IBM. "They realized that they had this enormous brand equity with customers and they have built a juggernaut by transitioning to systems applications," he said. "They are still posting double-digit increases in earnings per share even through this downturn. Finding that customer connection has to be the foundation of what you do."

Mr. Meyer pointed out that he was at IBM during that transformation. "The company was very effective at strengthening its core business, which at the time was mainframes, while it looked towards changing its business model," he said. "A lot of people chase new platforms when they have a weak core business, when there might be plenty of growth left in that. As a distressed investor, we evaluate new platforms, but we try not to divert capital, time or resources away from strengthening our existing platform businesses until they are strong."

The case for synergies

The panelists were asked whether the synergies that they expected when doing a deal always materialized. Mr. Hathaway said that while synergies may look good on paper, they involve getting people to overcome cultural and operational differences and to execute change. "We bought a company three years ago because we thought there was a huge opportunity to integrate an architectural glass company with an aluminum glazing systems company, but in reality it's very difficult to get a company that's very metal oriented and one that's very glass oriented to work together."

Mr. Milliet agreed that companies often overestimate synergies, which benefits the seller. However, he said that synergies are possible when buying a family business where the heirs do not want to be involved, because the combined companies can operate with a single management, saving money. He added that other successful strategies included taking out capacity after the deal was completed or taking a product from an acquired company and expanding the distribution. "If you are buying a smaller company, you can take the idea and spread the benefit over many countries," he said.

Mr. Meyer said that synergies are a primary driver for doing deals, but that Glendon Partners does not pay the seller for the synergies that it claims it is going to create. "We are very disciplined about that. It's part of the due diligence that we do," he said, pointing



Philippe Milliet, Consolis SAS



Edwin B. Hathaway, Oldcastle Glass

out that speed it also important in order to get the maximum benefits. "People often don't do the detailed planning about what they will do Day One to integrate the businesses. You've got to be quick."

The M&A risk

Mr. Rourke asked whether buying another company was less of a risk now that assets were cheaper. Mr. Meyer responded that, as the firm had not played much in cyclical industries before, from his perspective, the risk profile in this industry was very high. "The way we got comfortable with this was by taking a flat view of the market for an extended period of time to ensure that we could at least recover our capital," he said.

Mr. Meyer said that the uncertainty about where and when the economy would bottom out had presented some great buying opportunities for Glendon Partners, but that period of uncertainty had now passed. Mr. Milliet said that from a long-term perspective, this was the best time to make an acquisition, but Mr. Hathaway disagreed. "We're not turnaround experts who can fix broken businesses," he said. "So many businesses today are struggling and I don't think you get enough of a discount on the multiple you pay to warrant the risk."

The panelists concluded by discussing about when they thought the recovery would arrive. Mr. Milliet said that contractors had been very astute about

issuing tenders on lots of jobs just to be able to book something on their files. "I will know the recovery is coming when I see less tenders coming to our company," he said. Mr. Meyer argued that too many people had banked on a quick recovery, which had failed to materialize. "Those that were aggressive will do well in 2010, but those that were not will have to continue to cut costs." Mr. Hathaway said he was also worried about a perceived recovery, versus a real recovery. "If we move from 600,000 homes starts to 700,000 homes starts, that is still not enough to feed all the industry players in this room," he cautioned.

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