Asset Analysis Focus

Summer 2011

	Price on 9/13/11	Price on 9/14/12	% Change
Equifax	31.01	47.35	53%
Mohawk Industries	44.04	78.92	79%
Watsco	57.25	78.59	37%
Whirlpool	53.27	83.34	56%
Average Performance for Companies in the 2011 Summer Issue			**56%**
S&P 500	1,172.87	1,465.77	25%

**Past performance is no guarantee of future success*

September 13, 2011
Volume XXXVII, Issue VII & VIII

Boyar
asset analysis focus

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September 13, 2011
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Introduction

Background

Although approaching the subject from a slightly different angle, we have decided to re-visit a familiar topic for this year's summer issue: the domestic housing market. In our January 2007 edition of Asset Analysis Focus, we profiled the homebuilding industry as a short. In that issue, we outlined our thesis as to why we thought the shares of many of the publicly traded homebuilders were vulnerable despite sporting deceptively low trading multiples. We supported our case by highlighting a number of worrisome signs that the run-up in home prices was poised to crack, reflecting reduced affordability, increasing prevalence of subprime and exotic mortgages and a growing supply of housing inventory. The following table summarizes the percentage decline in the homebuilder stocks that we felt were overvalued in 2007, including the iShares Dow Jones U.S. Home Construction Fund (Ticker: ITB), which at the time was a "pure play" on the publicly traded homebuilders:

Homebuilder Price Decline from January 2007

Company Name	Ticker	Price 1/31/07 Issue	Current Price 9/13/11	% Change 1/31/07-9/13/11	Price 12/18/08 Issue	% Change 1/31/07-12/18/08
Dow Jones U.S. Home Construction Index Fund	**ITB**	$42.66	$9.34	-78.1%	$11.50	-73.0%
KB Home	**KB**	$54.22	$5.67	-89.5%	$14.83	-72.6%
Lennar Corp.	**LEN**	$54.38	$13.33	-75.5%	$10.12	-81.4%
M.D.C. Holdings	**MDC**	$58.27	$17.20	-70.5%	$32.55	-44.1%
NVR Inc.	**NVR**	$692.52	$616.50	-11.0%	$484.21	-30.1%
WCI Communities *	**WCI**	$21.65	$0.00	-100.0%	$0.00	-100.0%
Average Return				**-70.8%**		**-66.9%**

* WCI filed for bankruptcy on 8/4/08

In December 2008, we formally reversed our "short" call on housing within our 2009 Forgotten Forty publication when we featured the iShares Dow Jones U.S. Home Construction Fund as a long. At that time, ITB was trading at $11.50 per share, down 73% from when we featured the fund as a short nearly two years earlier. Just as we had been early with our prior housing warnings, our view in December 2008 that homebuilders were attractively priced has proved to be premature. Most homebuilding related stocks have yet to experience a meaningful recovery as new home construction continues to hover at historically depressed levels. We believe the absence of a sustained housing recovery to date is attributable to a number of factors including the unprecedented supply overhang created during the recent housing bubble, the stubbornly high unemployment rate in the wake of the housing/financial/credit crisis, tighter credit conditions, consumer balance sheet deleveraging, and depressed consumer sentiment levels. To add insult to injury, and in what can be described as a classic case of "closing the barn door after the horse has run out," overly restrictive government regulations have been introduced dealing a further blow to the housing industry's future prospects. We recognize that these factors may mean a robust real estate upturn is still years away. In turn, this could threaten cash flow problems for many homebuilders that still have overleveraged balance sheets and uncertain access to reasonably-priced funding. Additionally, it has become increasingly evident that homebuilders are still plagued by the remnants of bubble-era excesses, including a glut of difficult-to-value land & development inventory, opaque off-balance sheet arrangements, and in some cases, even substantial representation and warranty liabilities stemming from mortgage originations.

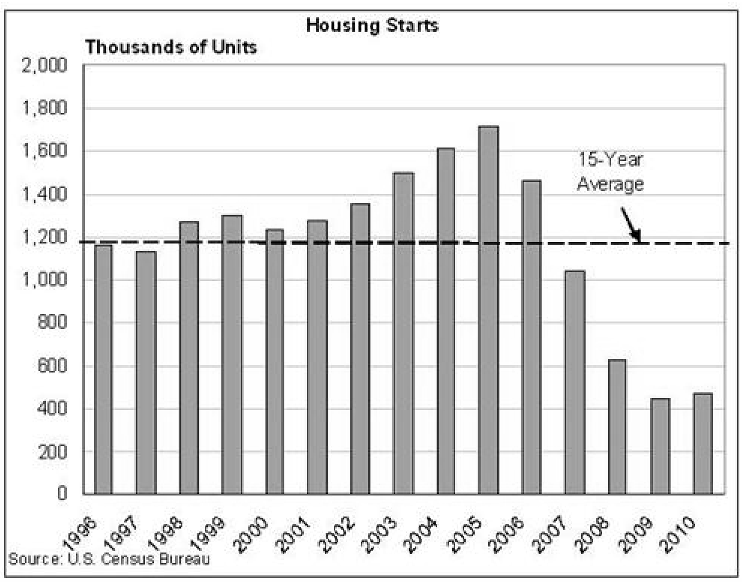
However, as we reassess the housing industry some 5 years after the peak in real estate prices, it is impossible to ignore the contrast between sentiment (both investor and consumer), which is again approaching 2008-2009 lows, and the much-improved underlying housing fundamentals. Interest rates are at record lows, affordability measures are at multi-decade highs, homeownership rates are down markedly, and new construction levels are far below normalized household formation rates. In extending our search beyond homebuilders to other businesses closely linked to the housing market (appliances, textiles, credit information, etc.) we have come across many companies that weathered the bubble's collapse only to come out in stronger financial and competitive positions, that currently trade at attractive valuations, and have tremendous upside from a healthy housing environment. In our view, the market is affording an opportunity to make long-term investments in companies that will see outsized benefits when the housing recovery inevitably emerges, yet are well positioned to withstand a protracted extension of the currently stagnant environment.

> *"A housing recovery will probably begin within a year or so. In any event, it is certain to occur at some point."*
>
> – Warren Buffett, 2010 Letter to Shareholders, February 26, 2011

Current Market Conditions – "Fear Sells"

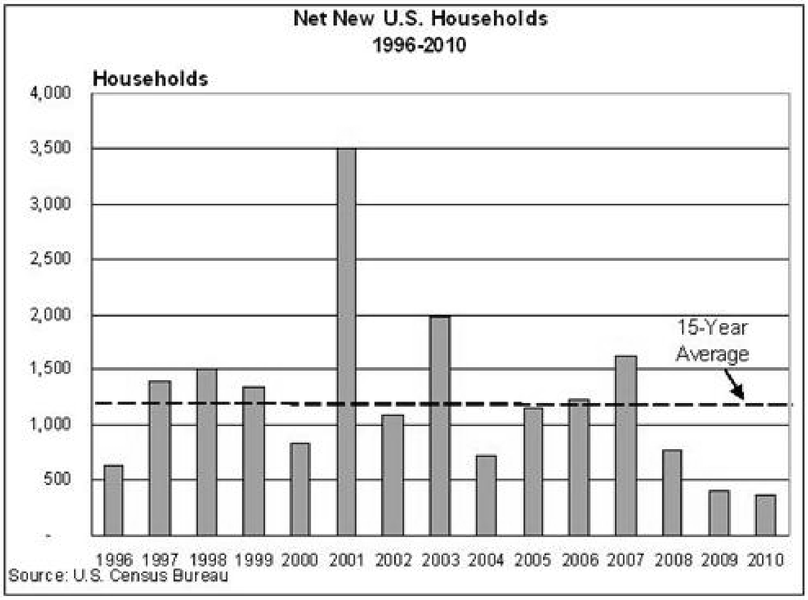
If you believe the headlines of major news outlets, you would be convinced that there is absolutely no potential for a housing recovery on the horizon. Clearly, the current housing supply is elevated, especially when you factor in the so-called shadow inventory, which includes borrowers that are seriously delinquent, homeowners that are in some stage of foreclosure and properties that have already been repossessed (REO). According to the National Association of Realtors, the current supply (end of July) of homes on the market stands at 9.4 months, but factoring in the shadow inventory (an additional 1.7 million units or an additional 5 months according to CoreLogic) the total housing supply stands at ~14 months. With approximately 22.5% of all U.S. mortgages currently underwater (note: this is a potential source of new housing supply that is not factored into the shadow inventory), the shadow inventory will likely remain elevated for a few more years. Nevertheless, it should be noted that the shadow inventory peaked in January 2010 at 2 million units or 8.5 months of supply. Absent a long term secular decline in home prices, the shadow inventory represents a finite supply of inventory that should be worked off in an orderly manner over the near/intermediate term.

While the headline grabbing news agencies like to instill fear in their readers by focusing on one component of housing supply, it is worth noting that a traditional source of housing supply (new home construction) has contracted meaningfully. New housing starts were just 447,000 in 2010, only slightly above 2009 levels, which were the lowest levels since the Commerce Department began keeping records in 1959. It should be noted that housing starts have been well below longer-term averages (1.2 million starts annually) over the past 3 years.



Source: bankstocks.com, "It's Not Just Banks' Inventory Overhang That Will Drive Housing Prices", 8/4/2011

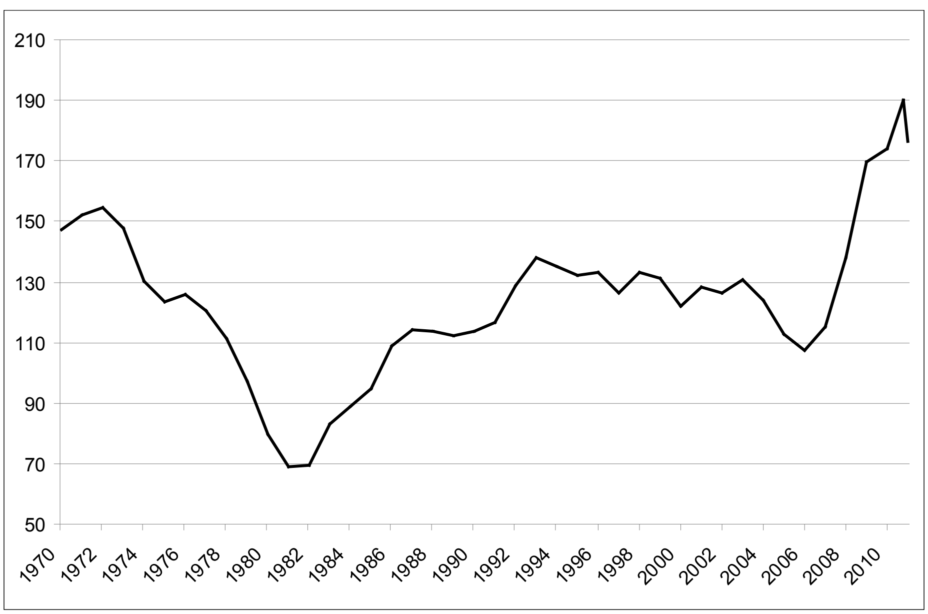
Although weak economic conditions have negatively impacted the demand side of the housing equation, we believe that housing demand will likely pivot from a housing headwind to a tailwind in the not too distant future. Specifically, household formation (or net new U.S. households as depicted in the following chart) has been impacted in recent years by the economic malaise, but will likely spur an enormous demand for housing in the coming years. Primary sources of increased household formation may include (1) The 20 million adult children currently living with their parents, in large part due to the current economic/employment environment; and (2) A reversal of recent declines in immigration as economic growth in the U.S. improves and attracts more job-seekers.



Source: bankstocks.com, "It's Not Just Banks' Inventory Overhang That Will Drive Housing Prices", 8/4/2011

In our view, robust demand will help not only to absorb the current excess supply, but also to drive future housing growth. Home affordability levels also give us optimism that healthier levels of demand will re-emerge in the not-too-distant future. During the housing boom, housing became unaffordable, but the correction in prices coupled with record low interest rates has dramatically powered home affordability levels up to record highs.

NAR Housing Affordability Index



Source: National Association of Realtors

A weak U.S. dollar coupled with attractive prices is already beginning to attract foreign investors to the U.S. housing market. We note that a number of markets have experienced an inflow of foreign ownership, including Miami, which was among the hardest hit housing markets. Finally, we believe the aging baby boom generation with their rising pool of discretionary income will help absorb a large amount of the excess supply as they purchase second homes for their retirement. While the baby boomers were certainly not immune to the hits taken to real estate and investment portfolio values during the last decade, we would note that the most affordable housing markets today are located in traditionally attractive retirement areas (Florida, Arizona, Southern California, Las Vegas, etc.). Although we would expect boomers to remain in their current residences for a number of years given lifestyle factors (healthier generation, desire to be closer to grandchildren, etc.) we would not be surprised if they began to absorb a significant amount of the excess supply in the hard hit markets that would initially be utilized as second homes.

A Closer Look at the Multiple Catalysts that Should Produce a Robust Housing Recovery

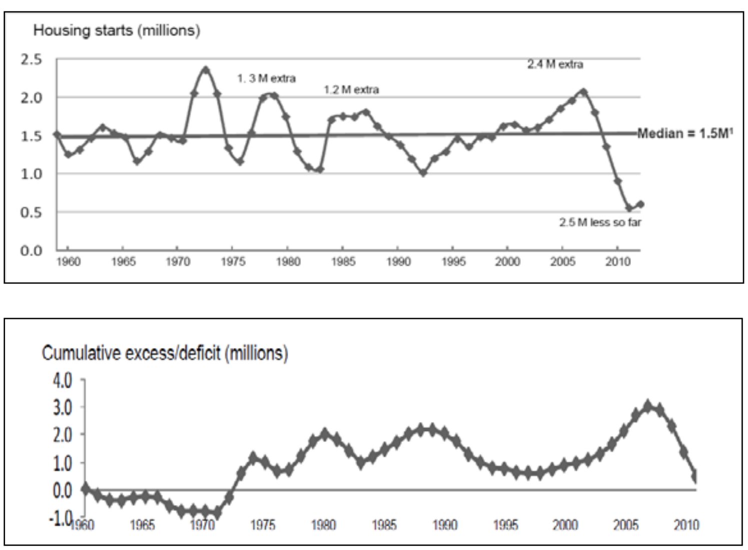
Below we provide a detailed review of the current housing supply/demand conditions and address what we see as the powerful demand drivers for housing.

New Housing – Favorable Supply/Demand Conditions

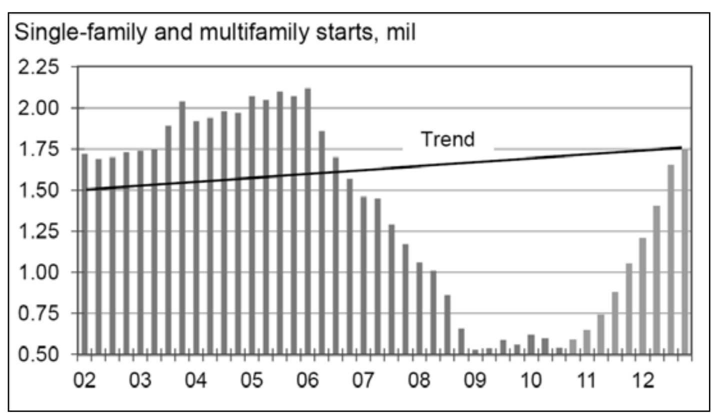
Just as the pendulum swung from an equilibrium of housing starts in the early 2000s to a surplus in 2004 and 2005, we believe the pendulum has swung to the other extreme and there will be a shortage of supply when housing demand normalizes. Using housing permits as a proxy for housing starts/construction (since this data is widely available and has closely tracked new housing construction), median housing starts totaled approximately 1.5 million homes per year since 1960. This figure is more or less in line with long term housing demand which is estimated to be roughly 1.35 million per year, consisting of household formations (750,000), obsolescence (400,000), and second homes (200,000).

As a result of the bursting of the stock market bubble in March 2000, the subsequent lowering of interest rates by the Federal Reserve (Fed Funds rate decreased from 6.5% in May 2000 to 3.0% in May 2005), the growth of creative financing (no down payment, liar loans, interest-only loans, negative amortization), and the public's disenchantment with the stock market, individuals and investors (speculators or flippers) alike shifted an enormous amount of capital to real estate. Between 2000 and 2006, sales of new and existing homes increased by 14% and 26%, respectively. Home builders responded in kind and actually overshot demand with increased production, to the tune of a cumulative 2.4 million homes built in excess of estimated long-term demand between 2004 and 2006.

Excess Supply Being Reduced Through 4 Years of Significant Under-Building



Source: U.S. Census Bureau; NAHB via PulteGroup, Inc., Investor Presentation, June 2011



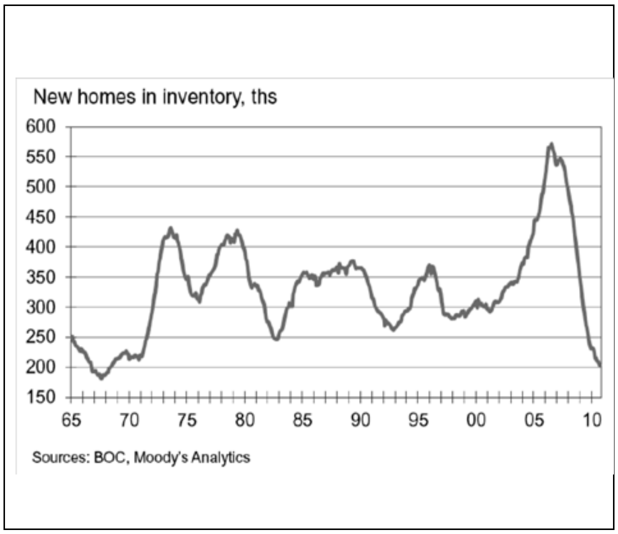
Source: Moody's Analytics, "Housing Hits Bottom in 2011"

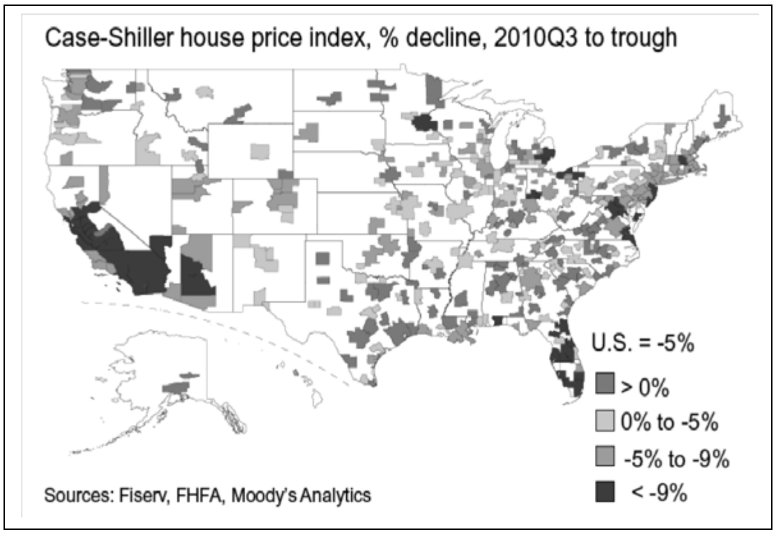
The Federal Reserve began to raise interest rates in June 2004, effectively putting in motion the end of the housing bubble. As interest rates on adjustable rate mortgages reset at higher rates, homeowners increasingly began to default on their mortgages due to higher mortgage payments, spurring increased bank foreclosure activity.

As the supply of foreclosed homes for sale increased, home prices dropped and created a negative cycle. This compelled homebuilders to ratchet down home production to balance supply with demand. Accordingly, single family housing permits dropped to under 1.4 million by 2006 and continued to freefall thereafter, reaching the historic low of roughly 440,000 units in 2009. Since 2007, a cumulative 2.5 million fewer homes were built relative to long term demand (i.e. versus a steady 1.35 million per year rate)—essentially offsetting the preceding over-construction. In 2010, annual new home construction was just 600,000, consisting of 450,000 single family homes, 100,000 multifamily and 50,000 manufactured homes. At present, the deficit in new home construction exists primarily due to depressed new household formation rates (which we will discuss later). Finally, as the preceding chart shows, we would note that cumulative excess housing builds (relative to estimated long-term demand) are currently near lows not seen since the late 1960s. If history is any guide, we expect housing construction to snap back fairly quickly, as it did in the early 1970s, when demand normalizes.

Existing Homes and Shadow Inventory

Meanwhile, we believe that existing housing inventories have peaked and excess inventory is becoming manageable. There are currently nine months of supply of unsold homes in the market. Much of the excess is regionally concentrated in areas such as Arizona, the central valley of California, Florida, Georgia and parts of the Midwest.

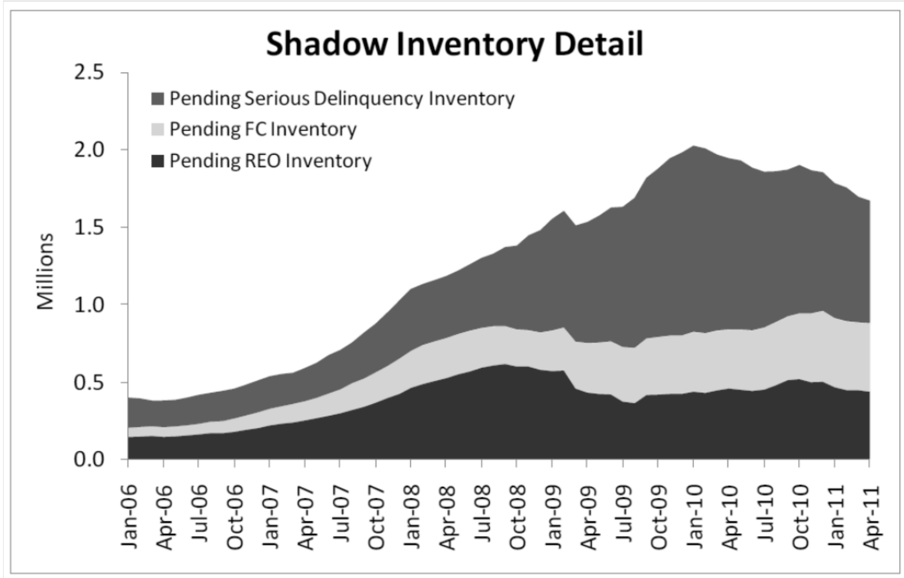




Source: Moody's Analytics, "Housing Hits Bottom in 2011"

Not coincidentally, these regions also rank in the top 10 areas for foreclosures. Therefore, it is encouraging that RealtyTrac reported that foreclosure activity is off 29% for the first half of 2011. During the 2Q 2011, foreclosures totaled 608,000, down 11% compared to 1Q 2011 and down 32% from 2Q 2010. This is the lowest quarterly total since 4Q 2007 and June 2011 was the ninth straight month where foreclosure activity decreased on a year over year basis. We acknowledge that a portion of the decline in foreclosures is attributable to processing and procedural delays due to the banks' questionable foreclosure process, otherwise known as robo-signings. RealtyTrac estimates that approximately one million foreclosure actions that should have taken place in 2011 will now occur in 2012 or later.

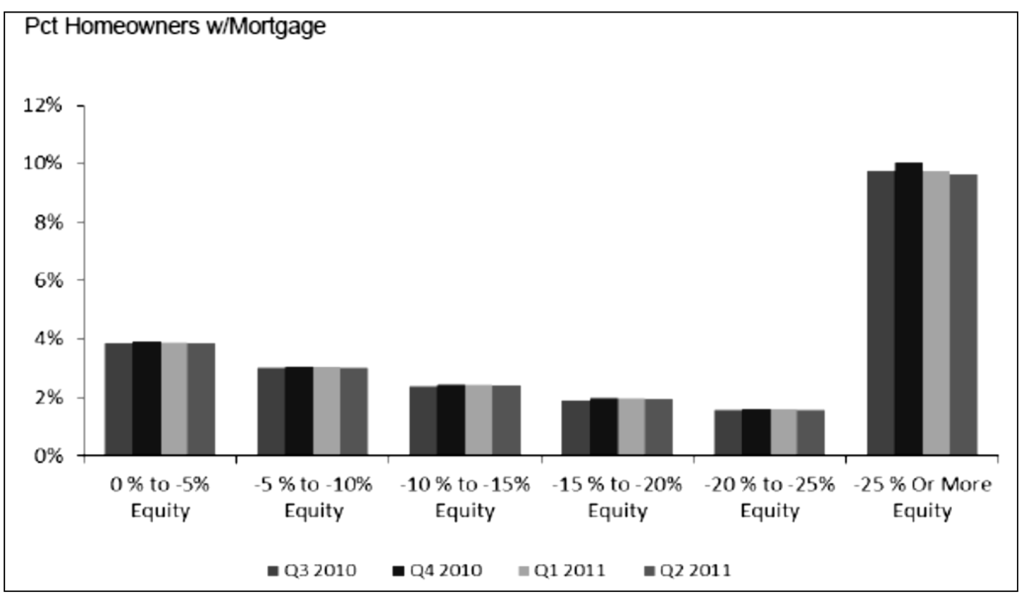
One cannot overlook that there also exists an additional supply of unsold homes known as "shadow inventory." Shadow inventory consists of distressed properties not currently listed on multiple listing services that are seriously delinquent (90 days or more), in foreclosure, or owned by lenders. According to CoreLogic, the shadow inventory of residential properties as of April 2011 stood at 1.7 million units. While this may seem like a lot of supply, it has declined from a peak of 2 million units and 8.5 months of supply and now represents a more manageable 5 months of supply at the current sales pace.



Source: CoreLogic, June 7, 2011

As we noted above, growth in existing home inventory has been constrained by processing/procedural delays associated with the foreclosure process. In addition, we would also highlight the potential for new supply of shadow inventory from homeowners who are not currently delinquent on their mortgage, but whose mortgages are currently underwater. According to CoreLogic data, as of 2Q 2011, 22.5% of tracked mortgaged homes or 10.9 million homes have a mortgage that is above the current value of the property, including close to 10% of homes with greater than 25% negative equity.

Distribution of Home Equity

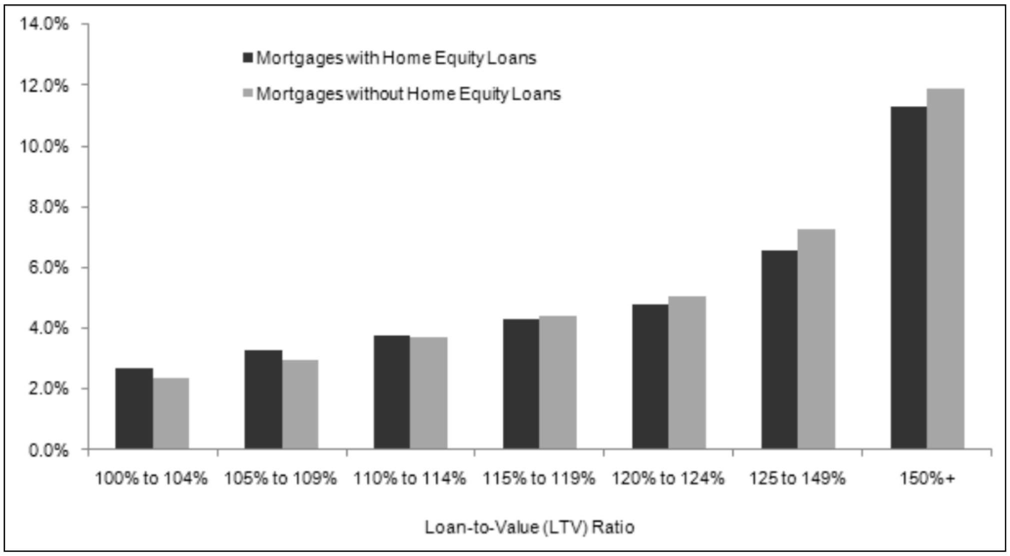


Source: CoreLogic, September 13, 2011

In theory, it would appear to make financial sense for individuals to walk away from their underwater mortgages, but in practice this is not always the case for a number of reasons. First, there may not be a comparable residence to rent/purchase in an individual's desired geographic area. Second, walking away from a mortgage has a number of negative long term implications including the inability to access credit in the future.

Third, we would note that while appraisals were likely elevated during the housing boom, they're likely overly conservative at current levels. Accordingly, it may be difficult for a homeowner to purchase a home in a desired location at the "appraisal" value. Additionally, it may still make financial sense to pay down an underwater mortgage if the home value is expected to appreciate sufficiently over time. Finally, we would not entirely dismiss emotional factors such as strong ties to the home as a place of memories and/or moral qualms with walking away from a contractual debt.

Default Rate for Homes by Home Equity Status



Source: CoreLogic, June 7, 2011

Reflecting these factors, historical default rates for underwater mortgages are actually relatively modest. As illustrated in the preceding chart, according to CoreLogic, default rates have averaged between 2% and 12% depending on the level of negative equity. Nonetheless, we would note that even an extreme scenario in which 50% of the mortgages that are more than 25% upside down on their mortgages eventually become part of the shadow inventory, we estimate this would still represent a relatively modest 7 month overhang of additional inventory.

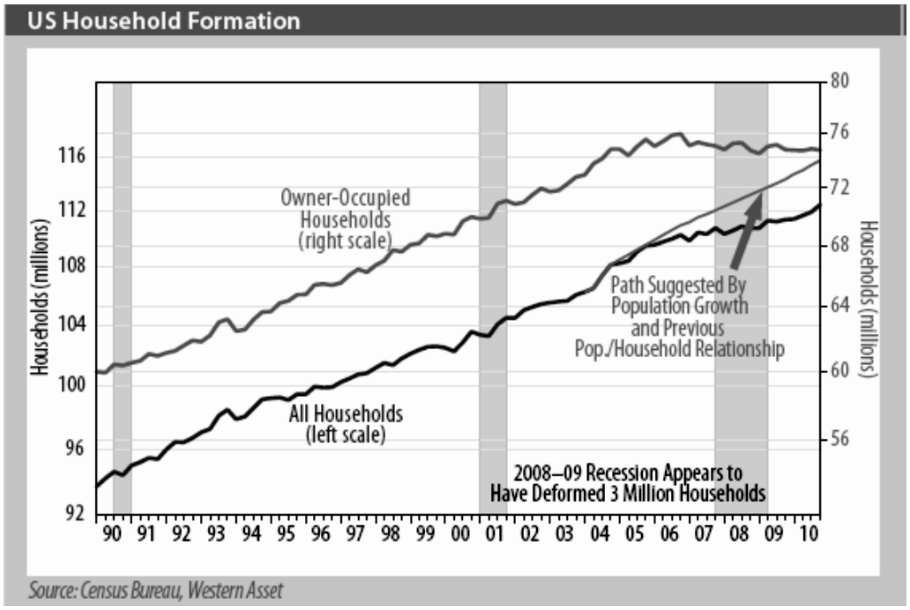
Potential Policy Countermeasures

Although still in an exploratory phase, the Obama administration is examining ways to pull foreclosed properties off the market and rent them instead. This should help alleviate some of this excess supply of foreclosed homes and stabilize housing prices. HUD owned about 69,000 homes at the end of April, while Fannie Mae and Freddie Mac owned an additional 218,000 homes at the end of March. Combined, these homes represent about 47% of 2Q 2011 foreclosed supply.

In addition to measures to pull foreclosed homes off the market, the Obama administration is also looking to broaden U.S. homeowners' ability to refinance their mortgages. The administration has said said the plan could potentially free up more than $2,000 a year for each family refinancing. While the plan is not without its challenges, it has the potential to result in the refinancing of 2.9 million mortgages in its first year and avoid ~110,000 defaults, according to the Congressional Budget Office.

Household Formation

Household formation is a key driver of demand for residential real estate. Simply stated, households are residential units that shelter one or more individuals which are typically created via marriage, divorce, immigration, second home/vacation home purchases, or children leaving the home. Prior to the economic downturn in 2008, household formation had increased at a fairly steady rate. Since the 1970's, households had typically increased by approximately 1%-2% per year. However this growth was significantly curtailed by the economic dislocation experienced in 2008 (see following chart). According to the 2009 Annual Social and Economic Supplement to the Current Population Survey (CPS), total U.S. households increased by only 398,000 (up 0.3%) between March 2008 and March 2009. This represented the smallest increase since 1983, and the second lowest increase since the inception of the survey in 1947**. <u>Importantly, greater than all of the increase was driven by new households aged 65 years old and older (up 721,000)</u>**, while all other age groups reported varying levels of decline for the period. This trend has been a clear negative for residential housing demand, and this lack of household growth has been driven by several key factors.

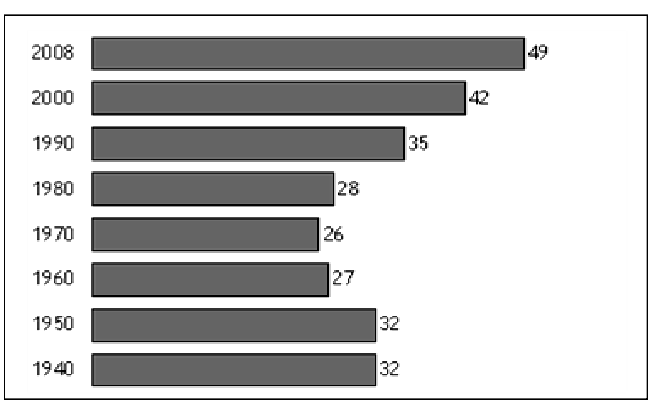


Source: Western Asset Management Company, 2011

Among the drivers of weak household formation is a significant increase in adult children who elect or are economically forced to reside with parents or older relatives. Many young adults (typically within the 20s-30s age range) are among the most impacted by the uncertain economic environment. Certainly, recent college graduates face a challenging employment environment, and may find it financially unfeasible to purchase a home. Among those able to secure employment, the general lack of stability and confidence within the marketplace makes such a large financial transaction a less desirable option. Accordingly, the U.S. is now experiencing a historic resurgence in "Multi-Generational Households." According to Pew Research, 20% of adults aged 25-34 lived in a multi-generational household in 2008, up from a low of 11% in 1980. However, it should be noted that there already had been an increasing trend toward multi-generational households prior to the 2008 recession (see chart).

<u>U.S. Population Living in Multi-Generational Family Households, 1940-2008</u>

<u>(millions)</u>



Source: Pew Research Center

Another contributing factor to sluggish household growth has been a deceleration in U.S. marriages. Clearly, the trend of individuals waiting longer to marry was already apparent prior to the economic slowdown. On average, U.S. males and females currently marry at the ages of 28 and 26, respectively (Pew Research). For both genders this represents an increase of about 5 years since the 1970s. However, the poor market environment served to reinforce the trend toward delaying marriage. According to a CDC (Center for Disease Control) study, U.S. marriages totaled 2.08 million in 2009, a 9% decline from 2004 levels, despite a 4.5% increase in overall U.S. population during that same period. This translated to a marriage rate of 6.8 per thousand, down from 7.8 in 2004 (a 13% drop on a per thousand basis).

The economic uncertainty has also caused many to delay potential divorce proceedings, further limiting formation of new U.S. households. According to the CDC, divorces and annulments per thousand stood at 3.5 in 2009, down from a 5-year average of 3.7 prior to the recession. In a 2011 survey by the National Marriage Project at the University of Virginia, 38% of people considering a divorce elected to delay further proceedings due to the recession. At this stage, we would conclude that this is a temporary obstacle to near-term household formation, and does not necessarily reflect a secular change in the divorce rate from historical averages.

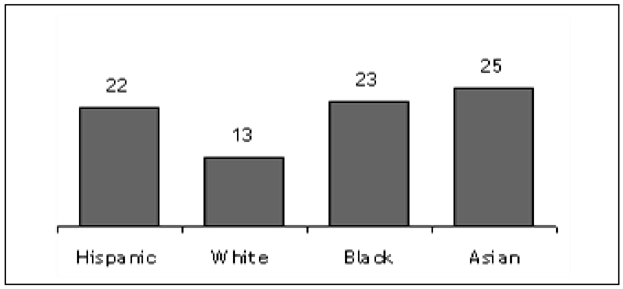
Another key driver of U.S. household formation is immigration. During the 1980s, immigration accounted for 16% of new household formation, and that figure nearly doubled by the 1990s. Like other groups, immigrants typically view home ownership as a desirable goal that signifies both wealth and financial security. Immigrants tend to have lower ownership rates relative to the native population, but that gap typically narrows over time, and second generation Americans actually have above average home ownership rates (source: Fannie Mae). By 2007, over 10% of U.S home owners were foreign born. However, economic uncertainty has also impacted this group as well, curtailing both new immigration and home ownership by existing immigrants. According to a report from the Pew Hispanic Center, the average annual inflow of unauthorized immigrants into the U.S. has declined by over 60% during the past decade. Although this may partially reflect enhanced border security, the reduced economic prospects in the U.S. likely represent a root cause as well. Despite this recent reduction, immigrants are expected to remain a key driver of household growth over the long-term, and we would expect immigration rates to regain momentum once the U.S. returns to a more robust growth trajectory.

All of the previously mentioned factors are clear near-term negatives for both household formation and overall demand for residential real estate. However, we believe many of these issues are temporary in nature, and household formation trends should regain momentum once U.S. economic fundamentals improve. The recent rate of household formation is likely at an artificial low, creating the potential for a significant “snap-back” as pent-up household formation recovers to more normalized levels. According to Harvard’s Joint Center for Housing Studies, an estimated 12.5 million households are expected to be created over the next decade. This forecast implies 1.25 million new households per year, more than triple the levels achieved in 2009. Assuming such a forecast is remotely feasible, demand for residential real estate should eventually be poised for a significant recovery.

However, it is worth noting that at least part of the previously mentioned trend toward multi-generational households may represent a long-term secular trend. In particular, this trend will likely be supported by growth among Hispanic and Asian citizens as a percentage of the overall country. According to Pew Research, 22% of Hispanics and 25% of Asians reside in multi-generational households, compared to a rate of only 13% for White households (see following chart). In addition, multi-generational households could increase as the baby boomer generation reaches more advanced age, and seniors consider residing with younger relatives. Overall, we regard this issue as a minor headwind for household formation and housing demand, but do not consider it a significant obstacle to the long-term fundamental outlook for improved household formation and housing demand.

Share of Population in Multi-Generational Family Household

by Race/Ethnicity, 2008 (%)



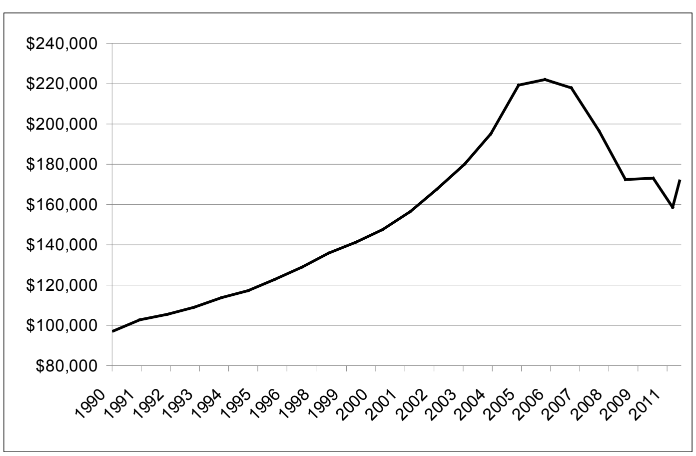
Source: Pew Research Center

Affordability

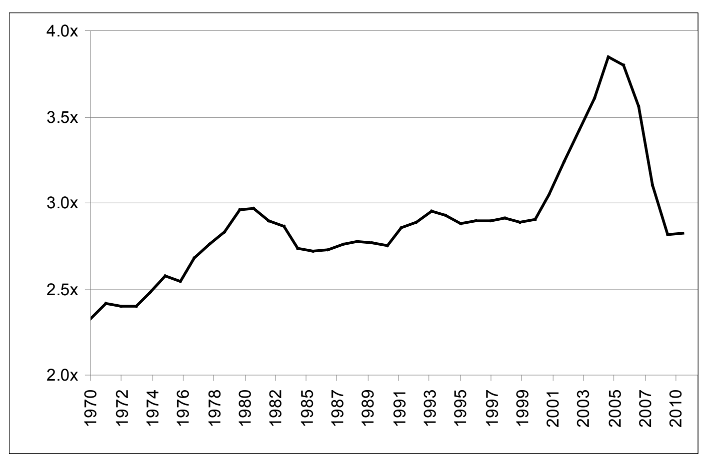
Beyond the various classic signs of bubble formation, the most basic observation that compelled *Asset Analysis Focus* to voice our negative outlook on the housing industry (homebuilders) in January 2007 was that housing had simply become unaffordable. The national median home price reached $247K in 4Q 2006, up 54% from 2002 levels.[1] The NAHB/Wells Fargo Housing Opportunity Index stood at just 41.6 in 4Q 2006, versus a previous low of 53.9 at the time of the HOI's inception in 1Q 1992. Based on median home prices and mortgage rates in 2006, a home purchase would cost 23% of pretax income in monthly mortgage payments for the median income household. This implied almost *half* of purchasers would be taking on monthly mortgage payments above the maximum safe or 'qualifying' level (25% of pretax income).

Of course, these payment obligations estimates assumed borrowers were taking out 30-year fixed rate, 80% loan-to-value mortgages. However, in reality, all kinds of nonstandard loans were being issued featuring low-to-no-down payments, negative amortizations, 'teaser' low initial rate ARMs, etc. These gimmicks reduced mortgage payments in the short run, but only deferred the inevitable costs and created unsustainably large mortgage obligations for borrowers down the road. Rising home prices sustained this housing bubble for even longer than we expected and many home 'flippers' were able to capture a quick profit along the way. However, by January 2007 we recognized the stable long-term, buy and hold-based housing demand needed to sustain the real estate market was being rapidly priced out of existence.

Median U.S. Existing Home Prices, 1990-2011



Median Home Price to Income Ratio, 1970-2011

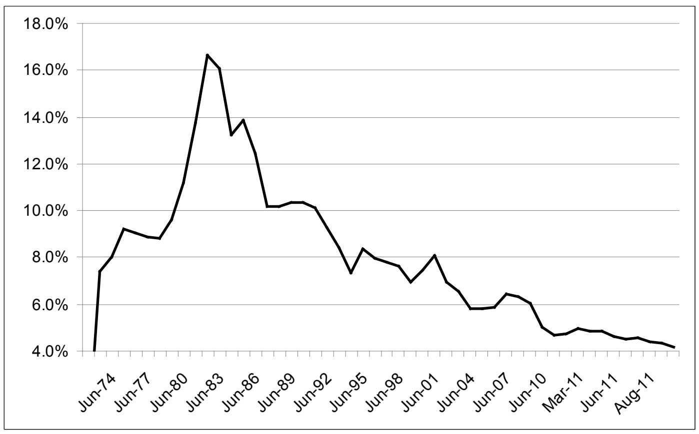


Source: National Association of Realtors http://www.realtor.org/research.nsf/pages/HousingInx

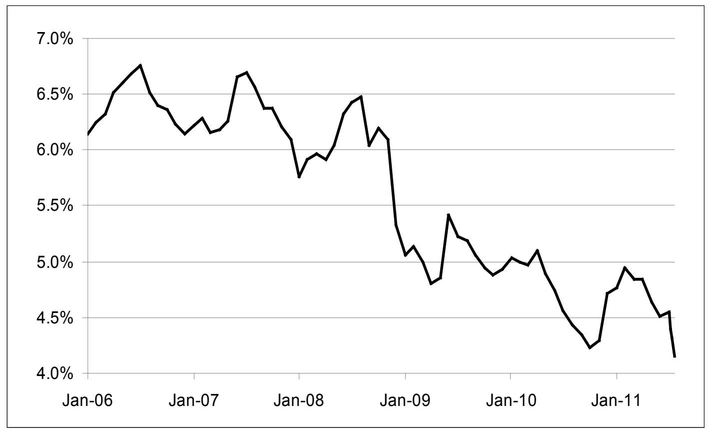
[1] NAHB Economics & Housing Policy Group

Today, the housing picture looks almost like the complete opposite of what we witnessed just a few years ago. According to the National Association of Home Builders (NAHB), median national home prices have declined 32% from the 2005 peak to $172K in 2Q 2011—essentially back to 2002 price levels. In real terms (adjusted for inflation ex-shelter), home prices have actually declined all the way back to 1999-2000 levels. The NAHB median price also represents only 2.8x the current median family income versus 3.8x in 2006. While the current price-to-income ratio is only slightly below the long-term historical average of 2.9x looking back to 1970, housing affordability is further supported by the current ultra-low interest rates. According to Freddie Mac's survey, 30-year fixed rate mortgages averaged 4.12% as of September 8, 2011. This represents a decline of 228 bps from the average rate in 2006 and is a record low dating back to the survey's inception in 1971.

<u>40-Year Interest Rate Trends</u>



<u>5-Year Interest Rate Trends</u>



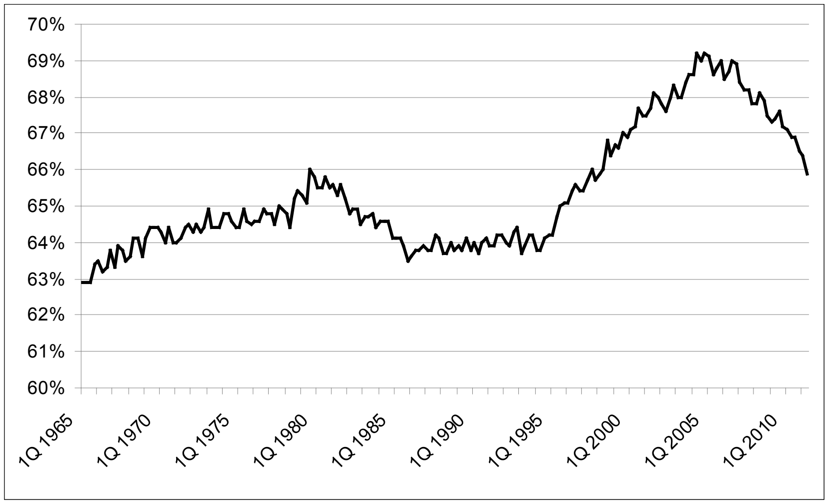
Source: Freddie Mac

This combination of lower housing prices and historically low interest rates has produced record housing affordability levels. Based on the average home price and 30 year mortgage rates (80% LTV), monthly mortgage payments represented only 13.5% of median family income in 2Q 2011 versus the aforementioned 23% average in 2006. The National Association of Realtors' (NAR) Housing Affordability Index, which measures this ratio, climbed from 107.6 in 2006 to reach an all-time high (dating to 1970) of 190 in 1Q 2011 and currently stands at 176.9. The previous annual high was 154.8 in 1972. While a marked rise in interest rates would reduce affordability, Fed Chairman Bernanke's recent indication that short-term interest rates will be held at near-zero levels through at least mid-2013 appear to minimize this risk over the medium term.

<u>Home Ownership vs. Rental</u>

Not surprisingly, the bursting of the housing bubble and the recent recession made renting an increasingly popular alternative to owning a home. Rationales including wealth destruction, efforts to de-leverage and reduce risk, low access to credit, foreclosure/rent-back activity, individuals' generally negative outlook toward a rebound in home prices, etc. have all pushed individuals toward renting. As a result, homeownership rates have declined from a peak of over 69% in 2006 to 65.9% in 2Q 2011, according to Fannie Mae. This is the lowest rate observed since 1Q 1998. Homeownership rates are still somewhat elevated versus longer-term (pre-1995) historical levels, although underlying structural changes such as the outsized impact of the aging baby boomer generation and greater governmental support for owning a home can explain much of the longer-term shift toward higher homeownership rates.

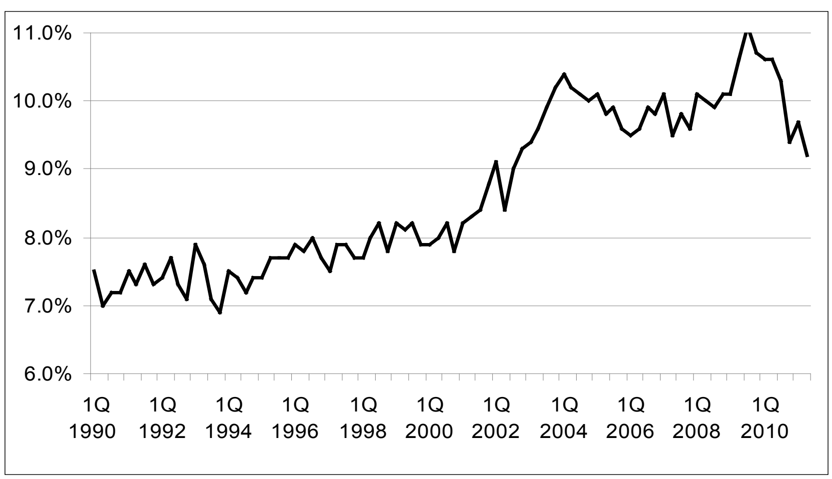
Historical Homeownership Rate, 1965-2011



Source: Current Population Survey/Housing Vacancy Survey, Series H-111 Reports, Bureau of the Census

The corollary to increased rental preference is that, as the rental market heats up, homeownership becomes an increasingly affordable alternative on a relative basis. The recent trend toward renting has eaten into supply, with rental vacancy rates declining from a pre-recession peak near 14% to 9.2% in 2Q 2011, the lowest level observed since 2002 according to the U.S. Census Bureau. Data from 82 markets collected by Reis Services suggests a similarly rapid decline, with the measured apartment vacancy rate at 6.0% in the second quarter versus 7.8% a year ago.[2] At the same time, the weak economic environment has kept new apartment supply at depressed levels. According to Reis, approximately 8,700 new apartment units opened during the second quarter—the second lowest total since Reis began tracking the data in 1999.

Quarterly Vacancy Rate, 1990-2010



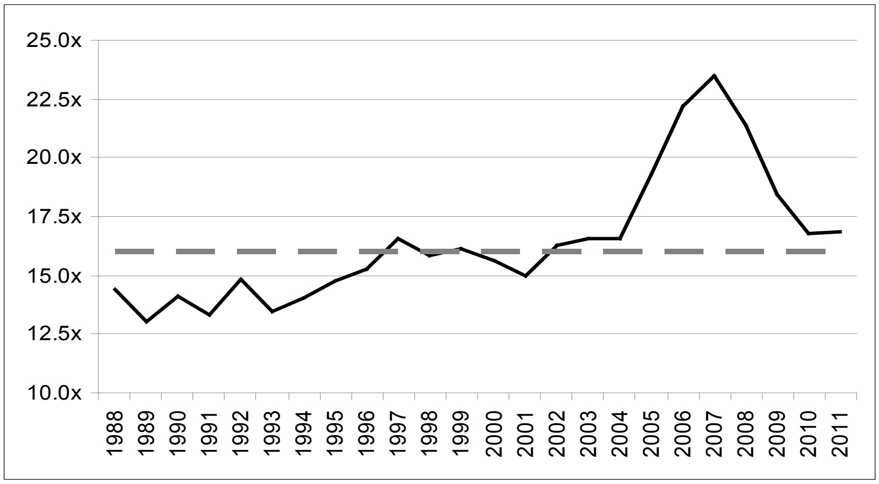
Source: U.S. Bureau of the Census

These supply/demand dynamics have begun to translate into higher rental prices. Moody's Analytics estimates national average rents increased by approximately 3% in 2010. Reis also reported that average effective rents across its covered markets increased 2.4% year-over-year in the second quarter. Data from the U.S. Census is more mixed, with median asking rent for vacant units down 1.4% YoY in the second quarter. However, we would note that second quarter numbers still represent a 9.4% increase from 5 years earlier. Viewed in combination with

[2] http://online.wsj.com/article/SB10001424052702304793504576430201720587490.html

the concurrent decline in housing prices and historically low interest rates, buying a home looks increasingly compelling versus renting. By our calculations, the national average price-to-rental ratio has declined from greater than 25x in 2007 to approximately 17x, roughly in line with historical average levels.

Median Existing Home Sale Price to Median Asking Rent



Source: U.S. Bureau of the Census

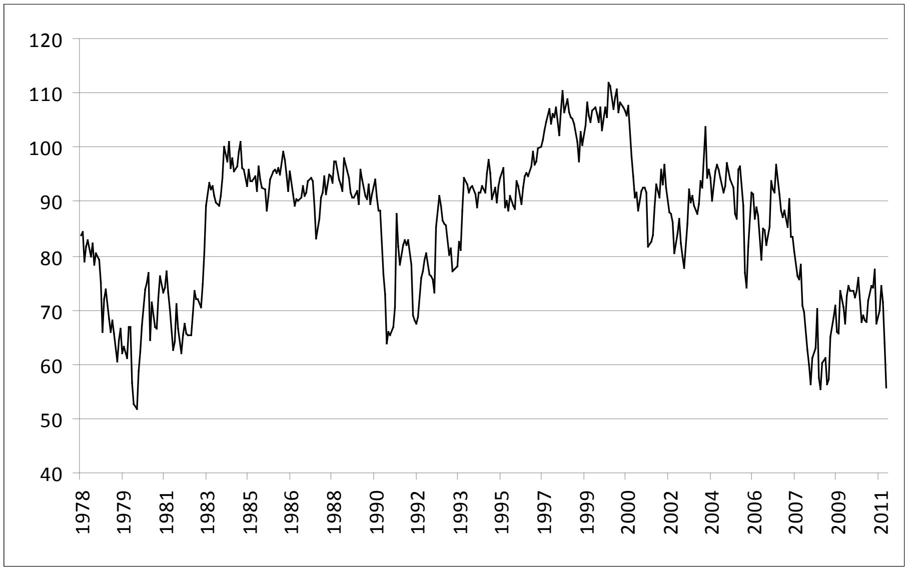
Fundamentals Imply Attractive Housing Market for Long-Term Investors

Of course, we may still be years away from a full recovery in the U.S. residential real estate market. Housing supply/demand imbalances (detailed further on pages above) have not yet been fully resolved. Apartment vacancy rates are still above longer-term historical levels, and conversion of excess single family home inventory into rental homes could also increase supply. An improved labor market, regulatory clarity regarding the home mortgage lending system, and the return of a healthy private mortgage lending business are also needed to support a sustained housing recovery. However, home affordability has reached unprecedented levels. Only 23% of single-home renters and 29% of multifamily home renters say renting makes more sense than buying, according to the latest Fannie Mae household survey. Precisely predicting the timing of this recovery is probably futile, but as long-term, fundamentally driven value investors we believe the current housing market fundamentals suggest this is an attractive point to make a long-term play on a recovery in the housing market.

Consumer Confidence May Be Bottoming

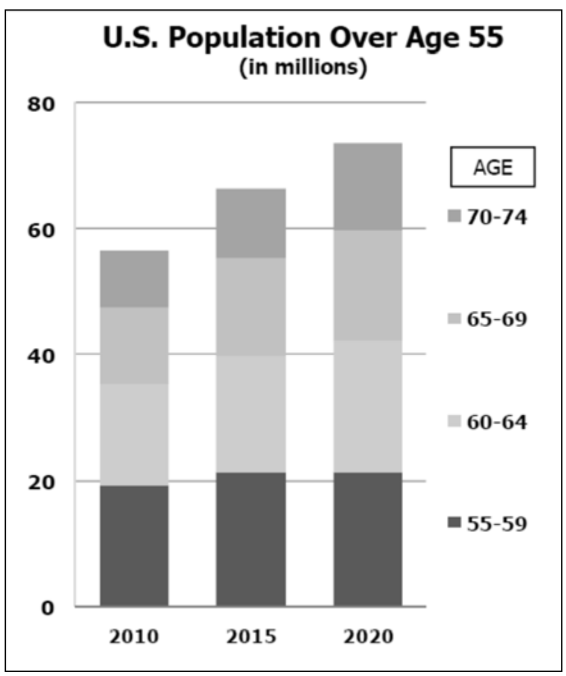
Broadly negative consumer sentiment continues to act as a major headwind to a housing recovery despite the improving fundamentals. Consumer sentiment has deteriorated in recent months amid the signs of a slowing economic recovery and increased concerns over a double-dip recession. The recent re-emergence of extreme volatility in the financial markets and further flaring up of the European sovereign debt crisis have also spooked individual investors. Reflecting these concerns, the Reuters/University of Michigan Consumer Sentiment Index plummeted to 55.7 in August—an extreme low previously breached only by November 2008's 55.3 reading and two sub-55 months in the spring of 1980. The expectations index was even more dreadful in August, coming in at 47.4. We recognize that the aforementioned concerns are very real and significant downside risk to the macro economy remains. However, consumer sentiment is typically a lagging, backward-looking indicator and in our view much of this risk is already reflected in current consumer (and market) sentiment. Should these risks ease, healthier consumer sentiment may provide the spark to homeownership demand necessary to ignite a housing recovery given the increasingly attractive underlying affordability fundamentals.

Reuters/University of Michigan Consumer Sentiment Index



Source: Thomson Reuters/University of Michigan, Copyright, 2011, Survey Research Center

Demographic Drivers – Baby Boom Generation



Source: PulteGroup, Inc., Investor Presentation, June 2011

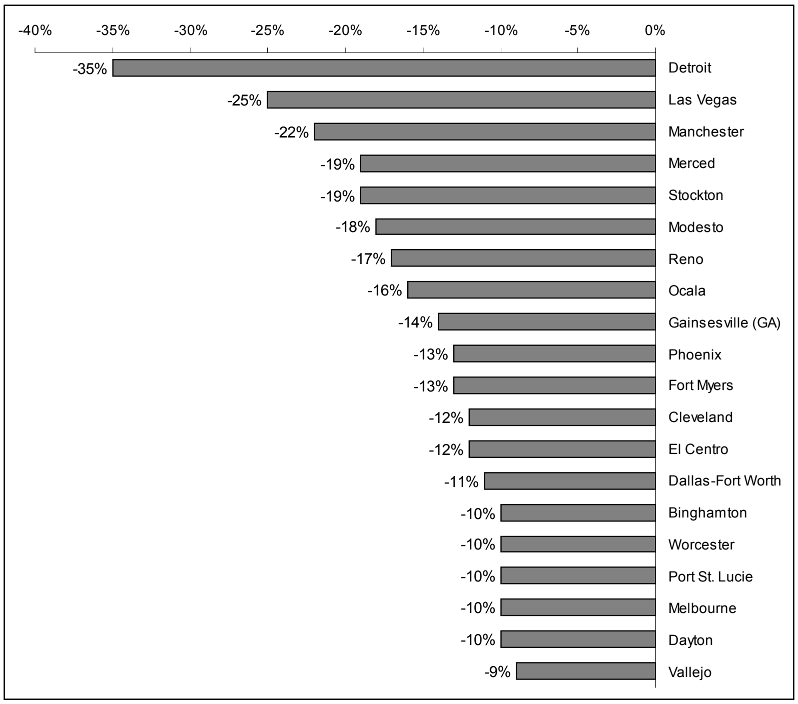
The very first generation of baby boomers, which includes ~ 78 million individuals who were born between 1946 and 1964, turned 65 this past January (January 2011). According to the U.S. Census Bureau's national population projections released in 2009, the number of Americans 65 years old or older will grow by an impressive 36% from 40 million to 54.6 million by 2020. The baby boom generation is generally healthier than their parents' generation so they'll likely be able to delay the move to retirement communities. Further, while baby boomers were not immune from the financial crisis, they still represent the largest and wealthiest demographic. In our view, this has two important implications:

(1) This should provide a boost to home improvement retailers, especially given boomers' preference to remain in their current residences.

(2) This should bolster demand for second homes. Notably, many of the areas hardest hit by the housing decline and still suffering from the highest percentage of underwater mortgages (Southern California, Florida, Las Vegas, etc.) are also very popular retirement or second home locations. Accordingly, although baby boomers were not immune from the economic/real estate downturn either, attractive housing values in these areas could spur baby boomers to absorb much of the excess supply in coming years.

Current Price-to-Income Ratio Compared to Historical Average

Lowest 20



Source: Zillow via *Wall Street Journal* online, "Linkage in Income, Home Prices Shifts," online.wsj.com; August 17, 2011

Although there is the potential for a fair amount of supply to emerge from the baby boom generation, we believe that there is plenty of potential for this supply to be absorbed, especially via new household formation as discussed above. In particular, we believe that the "echo boom" generation will soon be positioned to absorb the supply generated by the baby boom generation in the coming years. The echo boom generation is comprised of 80 million people (slightly larger than the baby boom generation) that were born between 1982 and 1995. The bulk of this generation has already entered the work force. We would reiterate that 20 million adult children (primarily echo boomers) are currently living at home with their parents. In our view, as economic conditions improve and new job creation gains traction there will be an enormous pent-up demand for housing from this generation as they begin to feel more confident in their financial situation.

Homebuilding and Job Creation

Since 1970, private residential investment – which includes construction of new single family and multifamily structures, residential remodeling, production of manufactured homes, and brokers' fees – has ranged between 5% and 6% of gross domestic product. This peaked at 6.1% in 2005 and dropped to 2.5% in 2010.

Housing's Contribution to GDP

	1970	1975	1980	1985	1990	1995	2000	2005	2010
Constant Dollars (2005, Billions)									
Gross Domestic Product	$4,270	$4,880	$5,839	$6,849	$8,034	$9,094	$11,226	$12,638	$13,248
Gross private domestic investment	475	504	718	943	994	1,259	1,970	2,172	1,775
Residential Fixed Investment	248	256	310	384	386	456	580	775	333
Personal Consumption Expenditures	2,740	3,214	3,766	4,540	5,316	6,079	7,608	8,819	9,314
Housing Services	537	673	800	912	1,044	1,199	1,384	1,567	1,674
Residential Fixed Investment + Housing Services	$785	$929	$1,110	$1,296	$1,430	$1,656	$1,964	$2,342	$2,007
Percentage of Real GDP									
Residential Fixed Investment	5.8%	5.2%	5.3%	5.6%	4.8%	5.0%	5.2%	6.1%	2.5%
Housing Services	12.6%	13.8%	13.7%	13.3%	13.0%	13.2%	12.3%	12.4%	12.6%
Residential Fixed Investment + Housing Services	18.4%	19.0%	19.0%	18.9%	17.8%	18.2%	17.5%	18.5%	15.1%

Residential investment is an important driver of overall employment growth. According to the National Association of Home Builders (NAHB), three jobs are created for every new single family home constructed. About 1½ jobs are created in construction, while the rest are created in other housing related industries such as lumber, concrete, lighting, fixtures, heating and cooling equipment, and other products used to build a home. Additional jobs are created when real estate agents, lawyers and brokers provide services to home builders and home buyers. According to the Bureau of Labor and Statistics, it is estimated that between 2000 and 2006, approximately 40% of the job growth in the financial sector occurred in businesses directly related to the selling and buying of homes. For instance, from 2001 to 2006, total mortgage industry employment surged by 83%, to nearly 500,000 positions and the number of realtors jumped by 66%, to roughly 1.3 million. However, between April 2006 and December 2010, housing related financial industries lost 348,000 jobs and employment fell to its lowest level since January 1998.

Sales of new and existing homes peaked between mid 2005 and early 2006, and the peak in employment in construction and several housing related financial industries followed soon after. During the peak, it is estimated that housing related industry payroll employment accounted for approximately 5% of total nonfarm payrolls and about 6% of private nonfarm payrolls, or about 7 million payroll jobs. Residential construction employment peaked in April 2006 at 3.5 million jobs, following approximately 5 years of rapid growth. As a result of the recession and the deflating of the housing bubble, the U.S. Bureau of Labor Statistics estimates that this figure currently stands near 2.0 million, which represents a nearly 45% decrease.

Housing Recovery has Wide-Ranging Implications – Beneficiaries of a Housing Recovery

While our homebuilders short report back in 2007 proved correct, we could have featured a number of other sectors/industries that would have produced equally spectacular results. The housing bubble of the previous decade provided fuel to a broad list of companies from investment banks to cable companies to mortgage insurers. Just as the housing crash had several beneficiaries, we believe that there are a number of industries that will benefit as housing conditions improve. In the table below we have included a list of a few traditional and non-traditional companies that could receive a boost from a housing recovery.

Construction Materials

Company	Ticker
Vulcan Materials	VMC
Martin Marietta Materials	MLM
Texas Industries	TXI

Home Furnishings

Company	Ticker
Bed Bath & Beyond	BBBY
Ethan Allen	ETH
Leggett & Platt	LEG

Alarm/Security Companies

Company	Ticker
Ascent Media	ASCMA
Tyco International	TYC

Cable

Company	Ticker
Comcast	CMCSK
Time Warner Cable	TWC

Obviously the homebuilders would be a direct beneficiary of a housing recovery, especially a recovery in new home construction. We view cable companies as beneficiaries as household formation (discussed previously) will likely prove to be a powerful tailwind (more broadband and video subscriptions, etc.). While construction aggregates companies such as Vulcan Materials, Texas Industries and Martin Marietta Materials derive a large portion of revenue from public works projects, their fortunes should be lifted by increased new home construction in the coming years (more roads, bridges and sidewalks, etc.). We believe that security companies such as Ascent and Tyco will get a boost from new household formation as these new homeowners will likely consider installing an alarm service. Finally, traditional home furnishing companies should benefit as homeowners look to furnish their new purchases.

Positioning for a Housing Recovery

Over the past 1-2 years, prominent investors have targeted the housing industry as an attractive investment opportunity. In Berkshire's 2011 letter to shareholders, Warren Buffett noted that Berkshire-owned MiTeck (supplier of engineered products for the building components industry) recently made five bolt-on acquisitions in recent months. In addition, Berkshire has boosted its housing exposure through the acquisition of Acme, an Alabama brick maker. Meanwhile, prominent hedge fund manager Bill Ackman of Pershing Square delivered a presentation in November 2010 discussing the merits of investing in single family housing.

As we noted above, there are a number of industries that are poised to benefit from a rebound in housing. While homebuilders would clearly be a direct beneficiary of a rebound in new home construction, we would note that today's publicly traded homebuilders are not your father's homebuilder stocks. Specifically, we believe that a number of homebuilders contain significant risks ranging from loan origination risks (retained loans as well as representations and warranties) to off-balance sheet land development arrangements. Further, while new home construction is likely to rebound at some point in the future, the exact timing of a recovery is uncertain and will depend on a number of variables including the amount of time it takes to work off the current inventory and shadow inventory. **Accordingly, we believe this introduces additional balance sheet risk for homebuilders and could present meaningful liquidity issues should a recovery in new construction be delayed.**

The Asset Analysis Focus Approach to Benefiting From a Housing Recovery

Our preferred method to profit from a housing recovery is to focus on companies that will benefit from an improved housing market, but are not necessarily dependent on a rebound in new home construction. In searching for names to feature in this year's issue, we specifically focused on identifying companies that would be aided regardless of what course a recovery takes. For example, if a housing recovery is aided by investors snatching up the current/future supply given the potential for a robust rental market, we want to be able to benefit from this trend. We could see this trend primarily benefiting home material companies (floors, carpets, appliances) or their distributors as well as demand for credit checks. Conversely, if the industry growth comes from outsized demand from new household formation spurring demand for existing inventory, the aforementioned trends would still hold – more home renovation, new floors, air conditioners, etc. For all of the names that we selected for our in-depth reports, the return of new home construction to more normalized levels would provide an additional catalyst/growth opportunity, but the turnover/absorption of housing returning to more normalized levels would be the primary driver. We also concentrated on companies that were able to maintain profitability through the recent crisis and emerge in an even stronger position. We believe this will provide protection should the real estate recovery take longer than expected to develop or if the economy were to suffer a double-dip recession. Other favorable characteristics of the names we have selected include:

- Strong replacement oriented/recurring revenue business models
- Favorable competitive environment
- Robust free cash flow generation
- Good international growth prospects
- High barriers to entry

We have identified four companies that we believe will participate in a housing recovery and have provided an in-depth report on each company. A summary of these companies is provided below:

Equifax Inc. (Ticker: EFX $31.01)

Equifax is one of only three large global players in the credit reporting and credit information businesses and currently boasts a number one or number two market share in most of its major markets. A housing recovery bodes particularly well for Equifax given its direct mortgage exposure (15% in 2010) and implication for job growth, which should translate into increased consumer credit demand. Further, institutions are demanding more advanced analytics about consumers' ability to pay in response to the recent downturn, which should increase demand for the Company's proprietary databases and analytical services. While a housing recovery will likely provide a nice boost for Equifax, we believe that there are a multiple number of growth drivers that could favorably impact future results. Among the Company's promising growth opportunities include strong new product development, recent investments/acquisitions in unique data assets and the growing demand for credit and risk information outside of the traditional finance/mortgage industries.

Mohawk Industries, Inc. (Ticker: MHK $44.04)

Founded in 1878, Mohawk Industries is the oldest and largest flooring company. We believe the Company will be one of the prime beneficiaries of an eventual recovery in new residential housing construction. In the meantime, the Company is focusing on the replacement and remodeling end markets and international channels to weather the housing recession. Mohawk maintains strong competitive advantages, including a leading distribution network, low-cost manufacturing, and a broad line of product offerings. At current levels, the Company is trading at 7.0x depressed LTM EBITDA. We believe Mohawk warrants a higher valuation multiple due to its competitive advantages, favorable business mix, international growth prospects, well regarded management team and ability to generate strong free cash flow.

Watsco, Inc. (Ticker: WSO $57.25)

Watsco, Inc. is an independent distributor of heating, ventilation, air conditioning, and light commercial refrigeration (HVAC/R) equipment and supplies in the U.S. Watsco is the largest competitor in an otherwise fragmented industry characterized by strong barriers to entry, rational competition and local monopolies, relatively steady pass-through margins, a growing install base offering strong long-term recurring revenue sources (75% of Watsco's revenue), and positive long-term pricing and margin implications from the trend toward more energy efficient units. Due to the recent housing market collapse and restricted consumer spending, industry-wide unitary equipment shipments have plummeted to levels not seen since 1995. An eventual drawdown from historic levels of pent-up replacement demand and a recovery in new home construction offer tremendous incremental revenue opportunities for the industry. In the meantime, Watsco remains on pace for record profitability in 2011 due to strong expense controls and the Company's recently-established (at bargain purchase prices) joint ventures with Carrier Corp—which we believe reflect both the Company's operating skills and the absence of competing bidders given its unique position.

Whirlpool Corporation (Ticker: WHR $53.27)

Whirlpool Corporation is a well established and recognized Company within the major home appliance market (#1 share of worldwide major appliances), and portable appliance market. Several negative forces (weak housing fundamentals, low consumer confidence, etc.) have been meaningful headwinds for WHR sales and profits. In our view, WHR management has taken several important steps to mitigate the difficult fundamentals of the current marketplace and position itself for long-term success. Assuming housing market fundamentals eventually improve to a more normalized level, we would regard WHR as an attractively valued means of participating in a potential recovery. The Company's leading market share position, globally recognized brands, and strong distribution capabilities should ensure that WHR retains a solid competitive position over the long-term. Moreover, growth opportunities associated with potential market share gains, extension of product lines, and increasing exposure to emerging markets should serve to further bolster WHR's potential cash flow generation and earnings power.

In addition to the in-depth reports on these four companies, we have provided snapshots of three companies (including 2 new ideas) that we believe will also receive a significant boost from a recovering housing/real estate markets. Home Depot and Wells Fargo fit our preferred housing recovery theme, while The Howard Hughes Corporation is a unique asset play where the bulk of the Company's current book value is tied to new home construction. In our view, HHC represents a lower risk way to play new home construction (vs. the homebuilders) with a multiple number of attractive future growth opportunities.

The Home Depot, Inc.

Ticker: HD $32.66

Background:

- HD is the world's largest home improvement retailer and second largest retailer in the United States based on net sales. The Company operates 2,245 Home Depot stores located throughout the U.S., Canada, Mexico and China. The Company sells a wide assortment of building materials, home improvement and lawn and garden products, and provides a number of services to three primary customer groups: Do-It-Yourself Customers (DIY); Do-It-For-Me Customers (DIFM); and Professional Customers (Pros). In fiscal 2010, HD had net sales of $68.0 billion and net income of $3.3 billion.

Recent Developments:

- HD reported better than expected results for fiscal 2Q. EPS was $0.86 for the period, 4 cents above consensus projections and up 19% year over year. Same store sales increased 4.3%, driven by a recovery in seasonal business, storm-related demand, and overall strength across its core businesses. Importantly, positive comparisons were reported in depressed markets such as California, Florida, and Arizona. In conjunction with the 2Q report, management increased its forecast for full year FY 2011 EPS to $2.34 (16% growth).

Strategic Position:

- Since becoming CEO four years ago, Frank Blake has enacted several key strategic changes. Blake has foregone new store openings and acquisitions in favor of focusing on existing store operations. In addition, management has embarked on a number of initiatives including bolstering the Company's supply chain, improving customer service, and focusing on innovation and values. The Company believes it can achieve a 10% operating profit margin and 15% return on invested capital (ROIC) by the end of fiscal 2013.
- Although housing market conditions have been challenging, HD should be well positioned for any recovery. As overall home sales rebound, we believe Home Depot will benefit from the investment new homeowners make to maintain and upgrade their homes. There is also pent up demand for building materials and supplies as a result of the record amount of foreclosed homes. Interestingly, approximately 37% of Home Depot's store base is located in the nation's top ten foreclosure markets, which include Arizona, California, Michigan and Nevada.

Financial Position:

- Over the last five years, HD cumulatively generated over $17.5 billion in free cash flow, or about $11 per share. The Company has used part of the free cash generated to strengthen its balance sheet. From its peak at the end of fiscal 2007, adjusted net debt (defined as total debt plus operating leases less cash) declined from approximately $20 billion to under $15 billion. In addition, HD returns excess cash flow though a $1.00 annual dividend (a yield of about 3%), and the Company plans to repurchase $2.5 billion of stock during 2011.

Valuation:

- HD shares have provided a total return of over 10% during the past 12 months, but the stock is down about 10% over the past 5 years. We estimate the Company can earn approximately $3.00 per share in 2014. Applying a 15.0x multiple to this level of earnings, we derive an intrinsic value of about $45 for Home Depot, representing a total return potential of over 30%. Meanwhile, the Company owns a vast real estate portfolio, which we conservatively estimate to be worth $26.3 billion or $16.50 per share, providing investors with downside protection.

The Howard Hughes Corporation

Ticker: HHC $47.61

Background:

- The Howard Hughes Corporation was spun off from General Growth Properties (GGP) on November 9, 2011 when GGP emerged from bankruptcy. HHC, which was created from a subset of 34 assets previously owned by General Growth, currently owns, manages and develops commercial, residential and mixed-use real estate throughout the country. The board of General Growth Properties chose to create HHC because the REIT structure is less than ideal for the type of assets HHC owns, whose current cash flows are not reflective of their long-term potential.

Key Assets:

- The Company owns four master planned communities (MPC), which contain approximately 14,000 saleable acres of residential and commercial lots, representing the bulk of the Company's book value. At June 30, 2011, these MPC's were carried on the Company's balance sheet at $1.3 billion ($33 per share), representing 63% of the Company's book value ($52 per share).

Redevelopment Opportunities:

- HHC currently has significant development/redevelopment opportunities for trophy assets in its portfolio including Ward Center in Hawaii, South Street Seaport in New York City and the right to acquire, for nominal consideration, an 80% ownership interest in the air rights above portions of the Fashion Show Mall located on the Las Vegas Strip.

Strategy:

- The Company's stated goal is to convert each of its non or modestly income producing assets into an income generating property, while selectively monetizing assets when the Company believes a sale will generate more value for HHC on a present value basis than holding the asset for the long-term. While the development of the Company's strategic development assets will require large amounts of capital, the Company intends to raise outside capital and/or joint venture many of its properties with other investors, operators, and/or developers. HHC believes this approach is a prudent way to manage risk and increase return on invested capital.

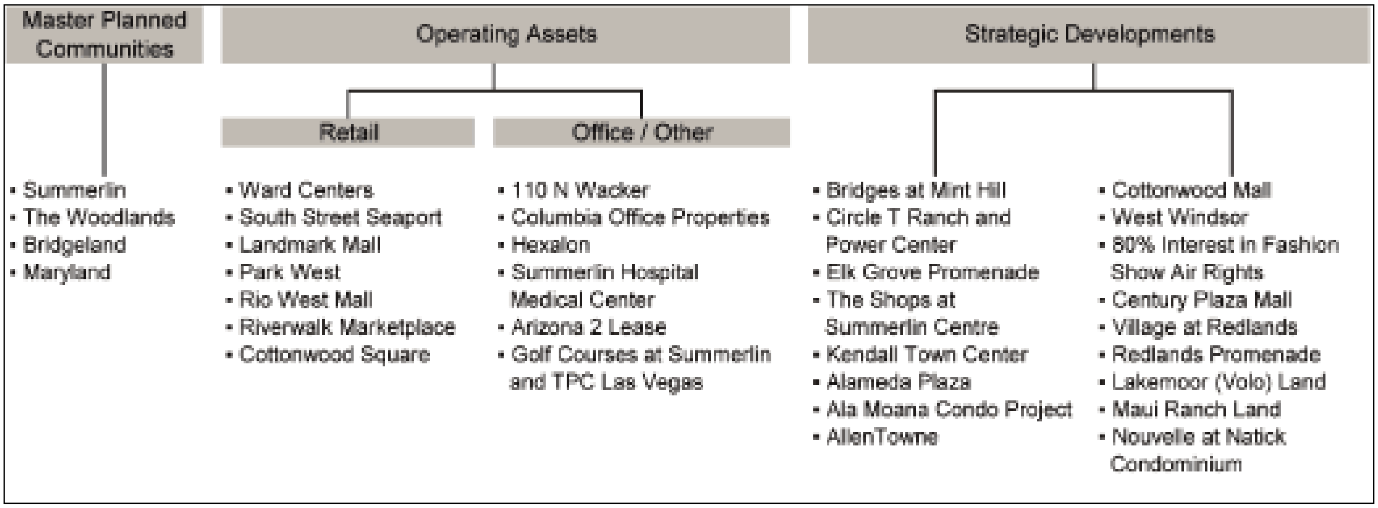
Management Team Heavily Incentivized to Unlock Shareholder Value:

- We believe that management's interests are tightly aligned with shareholders. The directors and senior management have invested a combined $260 million of capital and currently own 43.5% (~50% factoring in warrants etc.) of the Company. Notably, in November 2011, HHC CEO David Weinreb and President Grant Herlitz each purchased a warrant to acquire shares in HHC. Mr. Weinreb invested $15 million to purchase a warrant to acquire 2.4 million HHC shares while Grant Herlitz purchased his warrant for $2 million entitling him to acquire 316,000 shares. These warrants have an exercise price of $42.23 a share, became fully vested at the time of purchase, and generally become exercisable (except in the case of change in control) in November 2016 and expire in November 2017.

Housing Recovery Participation and Estimate of Intrinsic Value:

- A housing recovery should allow HHC to aggressively pursue its strategy as it sells its vast land holdings and deploys funds toward redevelopment. It should be noted that HHC does not contain many of the issues currently plaguing the public homebuilders (reps & warranties, off-balance sheet exposure etc.)
- HHC's long-term value creation will likely occur as the Company converts/redevelops its assets into operating assets. We view HHC as the "Liberty Media" of real estate. Over the years, Liberty Media has employed a similar approach to its hodgepodge of media assets and investors have been amply rewarded.
- At current levels, HHC trades at ~10% discount to its stated book value. In our view, the Company's book value substantially understates the intrinsic value of the Company's assets. Given management's goal (and equity incentive) to convert its assets to a higher and better use through development/redevelopment, we believe the shares should command a premium to current book value. Applying a 1.5x multiple to the HHC's book value, we estimate the Company's intrinsic value to be $78 per share.

Segment Assets



Source: HHC 10-Q, June 30, 2011

The following table summarizes HHC's master planned communities as of December 31, 2010:

Community	Location	Ownership (%)	Total Gross Acres [a]	People Living in Community (Approx. No.)	Remaining Saleable Acres [b] Residential[c]	Commercial[d]	Total	Other Acres	Projected Community Sell-Out Date
Summerlin	Las Vegas, NV	100.0	22,500	100,000	5,995	906	6,901	—	2039
Bridgeland	Houston, TX	100.0	11,400	3,750	3,863	1,226	5,089	—	2036
Maryland									
Columbia									
Town Center	Howard County	100.0	14,200	100,000	—	—	—	40 [e]	2020 [g]
Gateway	Howard County	100.0	630	—	—	121	121	—	2017
Emerson	Howard County	100.0	520	2,000	9	68	77	—	2017
Fairwood	Prince George's Cty	100.0	1,100	2,300	—	11	11	24	2013
The Woodlands	Houston, TX	52.5 [f]	28,400	97,000	1,013	973	1,986	—	2022
Total			78,750	305,050	10,880	3,305	14,185	64	

(a) Encompasses all of the land located within the borders of the master planned community, including parcels already sold, saleable parcels and non-saleable areas, such as roads, parks and recreation and conservation areas.
(b) Includes only parcels that are intended for sale or joint venture. The mix of intended use, as well as the amount of remaining saleable acres, are primarily based on assumptions regarding entitlements and zoning of the remaining project and are likely to change overtime as the master plan is refined. Remaining saleable acres are estimates.
(c) Includes standard, custom and high density residential land parcels. Standard residential lots are designed for detached and attached single- and multi-family homes, of a broad range, from entry-level to luxury homes. At Summerlin, HHC has designated certain residential parcels as custom lots as their premium price reflects their larger size and other distinguishing features - such as being within a gated community, having golf course access, or being located at higher elevations. High density residential includes townhomes, apartments and condominiums.
(d) Designated for retail, office, resort, services and other for-profit activities, as well as those parcels allocated for use by government, schools, houses of worship and other not-for-profit entities.
(e) Reflects the number of net developable acres in raw land and subdivided land parcel available for new development, but which the Company currently intends to hold.
(f) Reflects HHC's current economic interest. Our ownership interest is 42.5% and we make decisions with our joint venture partner.
(g) Reflects the projected redevelopment completion date.

Source: HHC 10-K, December 31, 2010

The following table summarizes HHC's retail operating assets as of December 31, 2010:

Asset	Location	Existing Gross Leasable Area	Size (Acres)	Net Book Value (Millions)	Acquisition Year
Ward Centers	Honolulu, HI	1,000,817[a]	60	$336.3	2002
South Street Seaport	New York, NY	298,759[b]	11	3.1	2004
Landmark Mall	Alexandria, VA	440,325[c]	22	23.5	2004
Park West	Peoria, AZ	249,168	48	82.0	2006
Rio West Mall	Gallup, NM	333,077[b][d]	50	11.4	1981 [e]
Riverwalk Marketplace	New Orleans, LA	194,452[b]	11	11.7	2004
Cottonwood Square	Salt Lake City, UT	77,079[b]	21	5.2	2002
Total		2,593,677	223	$473.2	

(a) Excludes 153,928 SF related to ground leases of which HHC is the lessor.
(b) All of the project is on a ground lease where HHC is the ground lessee.
(c) Excludes 438,937 SF in project that is owned and occupied by Sears and Macy's.
(d) Excludes 180,946 SF of outparcel improvements in project currently owned by tenant.
(e) Reflects the year that Rio West Mall opened.

Source: HHC 10-K, December 31, 2010

The following table summarizes HHC's strategic development projects as of December 31, 2010:

Asset	Location	GLA	Size (Acres)	Net Book Value (Millions)	Acquisition Year
Bridges at Mint Hill	Charlotte, NC	—	162	$ 12.4	2007
Circle T Ranch and Power Center [a]	Dallas/Ft. Worth, TX	—	279	9.0	2005
Elk Grove Promenade	Elk Grove, CA	—	100	10.7	2003
The Shops at Summerlin Centre	Las Vegas, NV	—	106	35.6	2004
Ala Moana Condo Project	Honolulu, HI	—	—	22.8	2002 [c]
AllenTowne	Allen, TX	—	238	25.4	2006
Cottonwood Mall	Holladay, UT	6,600	54	20.3	2002
Kendall Town Center	Kendall, FL	—	91	18.6	2004
West Windsor	Princeton, NJ	—	658	20.6	2004
Fashion Show Air Rights	Las Vegas, NV	—	—	—	2004
Alameda Plaza	Pocatello, ID	190,341	22	2.4	2002
Century Plaza	Birmingham, AL	169,072 [b]	63	4.5	1997
Village at Redlands	Redlands, CA	—	5	6.9	2004
Redlands Promenade	Redlands, CA	—	10	2.8	2004
Lakemoor (Volo) Land	Lakemoor, IL	—	40	0.3	1995
Maui Ranch Land	Maui, HI	—	10	—	2002
Nouvelle at Natick	Natick, MA	—	—	13.4	2007 [c]
Total		366,013	1,838	$ 205.7	

(a) Represents HHC's 50% interest in these two development projects.
(b) Operating tenant space totals 16,706 square feet.
(c) Represents date of initial construction.

Source: HHC 10-K, December 31, 2010

Two Examples of Why HHC's Book Value May Not Be a Good Indicator of The Company's Intrinsic Value:

- Ward Centers (Honolulu, HI)

Ward Centers is comprised of approximately 60 acres situated along Ala Moana Beach Park and is within one mile of Waikiki and downtown Honolulu. It is also a ten minute walk from Ala Moana Center. Ward Centers currently includes a 550,000 square foot shopping district containing six specialty centers and over 135 unique shops, a variety of restaurants and an entertainment center which includes a 16 screen movie theater. HHC is nearing completion of construction of a 732 stall parking deck that is expected to facilitate the leasing of additional space at Ward Centers. In January 2009, the Hawaii Community Development Authority approved a 15-year master plan, which entitles a mixed-use development encompassing a maximum of 9.3 million square feet, including up to 7.6 million square feet of residential (4,300 units), five million square feet of retail and four million square feet of office, commercial and other uses. Commenting on the residential opportunity of Ward Centers in a 2011 letter to shareholders, CEO Weinreb stated, *"It also presents an opportunity to develop thousands of residential units with unobstructed ocean views in one of the market's most desirable residential locations."* In August 2011, HHC announced that it is partnering with the MacNaughton Group and Kayashi Group to evaluate the development of a luxury tower at Ala Moana Center.

As of December 31, 2010, the net book value of Ward Centers was $336.3 million. It should be noted that land adjacent to the Ward Centers sold for $18 million an acre during 2007. Obviously, 2007 was a different environment, but assuming a 50% haircut to that valuation still values the Ward Centers $200 million above its book value.

- South Street Seaport (New York, NY)

The South Street Seaport is comprised of three historic buildings and one pavilion shopping mall, which is located at Pier 17 on the East River in lower Manhattan. The property is subject to two ground leases with the city of New York. The property includes 298,759 square feet of retail space. Cobblestone streets, gas lamps, sailing ships and a museum make the South Street Seaport a unique experience in New York City. The Company's redevelopment plan for South Street Seaport may ultimately include hotels, residential units, retail space and restaurants. The implementation of any redevelopment plan would require numerous permits and approvals, including the approval of HHC's ground lessor, the City of New York.

While South Street Seaport represents one of HHC's more valuable assets, its "book value" as of 12/31/10 was just $3.1 million. Last year, the South Street Seaport asset generated more than $5 million in cash net operating income, and management believes that this substantially understates the potential future cash generating potential of the property. According to Chairman Ackman in his April 2011 letter to shareholders, *"Even using the $5 million NOI number, one can get to values approaching $100 million using cap rates appropriate for New York City retail assets, and we would likely leave a lot of money on the table if we sold it for this price."*

Wells Fargo & Company

Ticker: WFC $24.36

Background:

- WFC provides retail, commercial, and corporate banking throughout the United States. The company's net income is derived from 3 segments: Community Banking (48%), Wholesale Banking (44%), and Wealth, Brokerage and Retirement (8%). The firm is one of the nation's largest banks with over $1.2 trillion in assets. WFC's branch network has a national footprint, bolstered by the 2009 acquisition of Wachovia.
- WFC has considerable exposure to the U.S housing market. The company is the nation's largest mortgage originator (it originates 25% of all residential mortgages). As of the most recent quarter, it held $317 billion in residential mortgage loans on its balance sheet, representing 42% of the overall loan portfolio. We would expect the beaten-down California market to be among the primary beneficiaries of a national housing recovery. California continues to be WFC's largest geographic market in terms of both loans and deposits.

Recent Developments:

- WFC's 2Q earnings report showed several encouraging signs. EPS of $0.70 was $0.01 above expectations and up 27% on a year over year basis. Importantly, credits metrics such as NPAs and NCOs were improved on both a year over year and sequential basis. The firm's ROA of 1.27% represented a new high for the past 3 years. In addition, WFC announced a plan to cut another $1.5 billion in costs by the end of 2012.

Strategic Position:

- WFC has established itself as a top tier bank with a superior track record and management team. WFC achieved an average net interest margin of 4.9% during the 2001-2010 period, 150 basis points above the peer average. A key aspect of WFC's profitability over the years stems from the Company's strong sales culture. This culture has translated to superior levels of deposit growth and cross-selling. Importantly, this record has been achieved while maintaining a relatively conservative lending profile.
- The Company's acquisition of Wachovia should yield both strategic and financial benefits. In addition to expanding its geographic footprint, the deal should create meaningful revenue synergies as Wells Fargo integrates its sales culture within the Wachovia system. This deal, combined with smaller M&A, have allowed WFC to bolster its market share position during the economic downturn.
- Assuming the housing market recovers to more normalized levels, WFC earnings should be poised for meaningful growth. WFC profits would likely benefit from key factors such as loan growth and reduced charge-offs.

Financial Position:

- As of the most recent quarter, the firm's tier 1 capital ratio was 9.2% (well capitalized under Basel 1 standards). During 2Q, the company repurchased 35 million shares and redeemed $3.4 billion in trust preferred securities.
- During 1Q, WFC announced an increase in the annual dividend from $0.20 to $0.48 per share, and an increase to its share repurchase authorization by 200 million shares (4% of shares outstanding). These measures were part of a capital management plan submitted to the Federal Reserve, and further underscored the firm's capital adequacy from a regulatory perspective.

Valuation:

- Applying bottom of the range valuation multiples (12x EPS, 1.5x tangible book value), produces a fair value of approximately $40 per share, implying a potential total return of over 60%. From a longer-term perspective, potential appreciation could be even more substantial as housing fundamentals improve, and the company continues to build its book value and earnings power.

September 13, 2011
Volume XXXVII, Issue VII & VIII

Equifax Inc.

(NYSE: EFX)

Dow Jones Indus:	**11,105.85**
S&P 500:	**1,172.87**
Russell 2000:	**691.74**
Index Component:	**S&P 500**

Trigger: No
Type of Situation: Consumer Franchise, Business Value

Price:	**$ 31.01**
Total Shares Outstanding (MM):	**122.8**
Fully Diluted (MM) (% Increase):	**124.6 (1.5%)**
Average Daily Volume (MM):	**1.1**
Market Cap (MM):	**$ 3,866**
Enterprise Value (MM):	**$ 4,739**
Percentage Closely Held:	**Officers/Directors 4.6%**
52-Week High/Low:	**$ 39.81/28.79**
5-Year High/Low:	**$ 46.26/19.79**
Trailing Twelve Months	
Price/Earnings:	**17.6x**
Price/Stated Book Value:	**2.1x**
Long-Term Debt (MM):	**$ 982**
Implied Upside to Estimate of Intrinsic Value:	**41%**
Dividend:	**$0.64**
Payout:	**37%**
Yield:	**2.1%**
Revenue Per Share:	
TTM*:	**$ 15.37**
2010:	**$ 14.70**
2009:	**$ 13.42**
2008:	**$ 13.91**
Earnings Per Share:	
TTM:	**$ 1.73**
2010:	**$ 1.86**
2009:	**$ 1.70**
2008:	**$ 1.91**
Fiscal Year Ends:	**December 31**
Company Address:	**1550 Peachtree Street, N.W. Atlanta, GA**
Telephone:	**(404) 885-8000**
Chairman/CEO:	**Richard F. Smith**

Clients of Boyar Asset Management, Inc. do not own shares of Equifax, Inc. common stock.

Analysts employed by Boyar's Intrinsic Value Research LLC do not own shares of Equifax, Inc. common stock.

Introduction

Equifax ("EFX" or "the Company") is a leading provider of information solutions, employment and income verifications and human resources business processing outsourcing. During 2010, nearly 90% of the Company's revenues were derived from services provided to businesses including consumer and business credit intelligence, credit portfolio management, decisioning technology, marketing tools and HR related services. Equifax leverages its large commercial and consumer databases, advanced analytics and proprietary technology to enable its customers to make better decisions and therefore help them grow profitably.

Products marketed to individual consumers represented 10% of the Company's 2010 revenues. The Company's direct to consumer products allow individuals to make financial decisions, monitor their credit and credit score, and protect their identity. These products are sold on either a transaction or subscription basis and are delivered to customers electronically via the Internet.

In our view, the Company operates an extremely attractive business model characterized by repeatable revenues streams, high barriers to entry, minimal capital requirements and high margins thanks to significant operating leverage. In addition, the competitive environment is extremely favorable as there are only two other large scale global competitors in the consumer credit and information management industry.

Equifax's results have been negatively impacted by consumer deleveraging and tighter bank lending standards in response to the 2008/2009 credit crisis. These factors have pressured Equifax's U.S Consumer Information Services (USCIS) business segment (40% of 2010 revenue; 63% of operating profit) the largest of the Company's five operating segments. Revenues in the segment were 3% lower in 2010 vs. 2008 while operating margins have contracted by 260 basis points over that same time period. We believe the headwinds associated with the challenging economic environment will soon pivot to a tailwind given our view of an upcoming housing recovery (see our Summer 2011 introduction "Stocks set for a lift from a housing recovery"). A housing recovery bodes particularly well for Equifax given its direct mortgage exposure (15% in 2010) and implication for job growth, which should translate into increased consumer credit demand. Further, institutions are demanding more advanced analytics about consumers' ability to pay in response to the recent downturn, which should increase demand for the Company's services.

While a housing recovery will likely provide a nice boost for Equifax, we believe that there are a multiple number of growth drivers that could favorably impact future results. Among the Company's promising growth opportunities include strong new product development (137 new products introduced over the past 2 years), recent investments/acquisitions in unique data assets and the growing demand for credit and risk information outside of the traditional finance/mortgage industries. Further, the Company has exposure to a number of high growth emerging markets including Russia, India and South America. The middle class population is exploding in these regions and the use of financing by consumers in these countries for property and vehicle purchases is expected to increase significantly.

The significant operating leverage inherent in the Company's database business model enables Equifax to generate an enormous amount of free cash flow. While the Company's capital allocation has balanced share repurchases ($378 million since 2008), debt reduction ($238 million decrease), and acquisitions ($337 million since 2008) since the 2008/2009 credit crisis, we believe that a disproportionate amount of free cash flow going forward will be deployed for share repurchases. It should be noted that the Company's leverage (debt/EBITDA) has declined meaningfully over the last 3 years and now stands at 1.6x down from 2.3x at the end of 2007. Further, we believe share repurchases represent an excellent use of capital with the shares trading at just 6.6x our 2012E EBITDA.

At current levels, Equifax shares trade 22% below their 52 week high and are little changed over the past 6 years. In our view, the Company's current valuation is inconsistent with the Company's attractive business model (EBITDA margins ~32%) and strong growth prospects. Reinforcing our view of Equifax's outlook and business prospects is the Company's recent decision to boost its quarterly dividend by a whopping four fold to $0.16 a share from $0.04 a share (current yield: 2.1%). Applying a 9.0x multiple (on par with the 8.5x-9.0x multiple paid by Madison Dearborn in 2010 to acquire a 51% stake in peer TransUnion from the Pritzker Family) to our projection of the Company's 2012E EBITDA, we estimate the Company's intrinsic value to be $44 a share, representing 41% upside from current levels.

Business Overview

Equifax manages its operations through five reportable segments. The following provides a summary of the annual operating results by segment over the past three years.

Operating Revenues

	2008	2009	2010	6 Mos. 2010	6 Mos. 2011
U.S. Consumer Information Services	$768.7	$712.2	$743.0	$357.7	$375.0
International	$505.7	$438.6	$482.8	$234.4	$258.0
TALX	$305.1	$346.4	$395.6	$194.3	$195.7
North Am. Personal Solutions	$162.6	$149.0	$157.6	$80.0	$89.6
North Am. Commercial Sol.	$71.5	$69.8	$80.5	$37.3	$41.4
Total Operating Revenue:	$1,813.6	$1,716.0	$1,859.5	$903.7	$959.7

Operating Income

	2008	2009	2010	6 Mos. 2010	6 Mos. 2011
U.S. Consumer Information Services	$298.9	$259.4	$269.8	$128.4	$132.5
International	$149.9	$118.9	$119.4	$58.8	$64.0
TALX	$53.1	$75.4	$92.1	$44.5	$42.5
North Am. Personal Solutions	$46.3	$34.3	$44.6	$20.2	$25.2
North Am. Commercial Sol.	$13.6	$15.1	$19.5	$8.1	$9.5
General Corporate Expense	($122.8)	($121.3)	($115.4)	($49.9)	($50.0)
Total Operating Income:	$439.0	$381.8	$430.0	$210.1	$223.7

Segment Operating Margins	2008	2009	2010	6 Mos. 2010	6 Mos. 2011
U.S. Consumer Information Services	38.9%	36.4%	36.3%	35.9%	35.3%
International	29.6%	27.1%	24.7%	25.1%	24.8%
TALX	17.4%	21.8%	23.3%	22.9%	21.7%
North America Personal Solutions	28.5%	23.0%	28.3%	25.3%	28.1%
North America Commercial Solutions	19.0%	21.6%	24.2%	21.7%	22.9%
Total Operating Margin:	24.2%	22.2%	23.1%	23.2%	23.3%

While we will provide a detailed review of each of the Company's business segments in the following sections, below is a brief description of the Company's products and services by business segment:

U.S. Consumer Information Solutions (40% of 2010 Revenues; 63% of Operating Income)

Provides data on consumers to businesses (such as credit information and credit scoring, credit modeling services, locate services, fraud detection and prevention services, identity verification services and other consulting services; mortgage loan origination information, appraisal, title and closing services; consumer financial marketing services; and multi-factor authentication solutions. There are multiple industries that purchase products/data from this segment including:

- Utility/phone companies to evaluate the approval of a new customer
- Investors to evaluate a securitized loan portfolio
- Credit card companies to determine how much credit to extend a customer

International (26% of 2010 Revenues; 28% of Operating Income)

Provides consumer and commercial credit services (including credit scoring and credit modeling services), credit and other marketing products and services, and products and services sold directly to consumers.

TALX (21% of 2010 Revenues; 21% of Operating Income

Services includes employment, income and social security number verification (known as The Work Number) and employment tax and talent management services. Mortgage companies are the largest user of The Work Number and utilize the Work Number to verify an individual's employment/income. Consumers with verified employment on the Work Number are more collectable (~32% higher collections) than those that are not. Other customers of the Work Number database include social service providers (approval of low income grants), consumer lenders, and auto companies, among others.

North America Personal Solutions (9% of 2010 Revenues; 10% of Operating Income)

Includes products that are sold directly to the consumers via the Internet and various hard-copy formats including credit information, credit monitoring and identity theft protection. Equifax's most popular Personal Solutions product is a subscription based product (monthly fee) that allows consumers to monitor key changes to their credit files from the three national credit bureaus (Equifax, Experian and TransUnion), unlimited access to their Equifax credit score and provides $25,000 in identity theft protection.

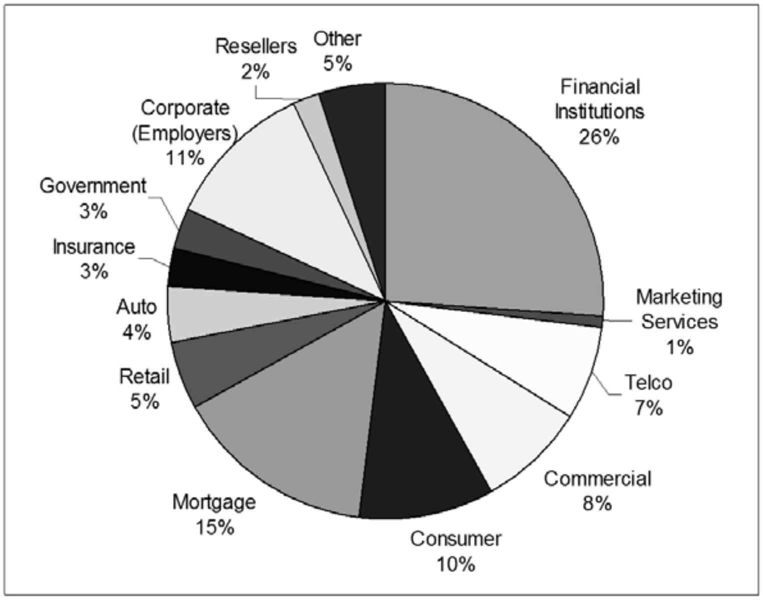
North America Commercial Solutions (4% of Operating Revenue; 5% of Operating Income)

Commercial Solutions provides products that contain information on businesses including credit and demographic information, credit scores and portfolio analytics (decisioning tools), which are derived from databases of business credit, financial and demographic information. While there are a wide range of uses for the Company's Commercial Solutions information, one application of the Company's data would be to help organizations understand how many of their divisions have separate relationships with the same supplier. The organization could then use the information to understand if they are properly leveraging their buying power.

Customer Mix

Equifax's products and services serve clients across a wide range of industries, including financial services, mortgage, human resources, telecommunications, healthcare and insurance industries, as well as state and federal governments. The Company also serves consumers directly offering a suite of products including credit monitoring, debt management and identity theft protection. EFX's revenue stream is highly diversified with the Company's largest customer providing only 3% of total revenue. The following chart summarizes the various end-user markets that Equifax serves:

Customer Mix

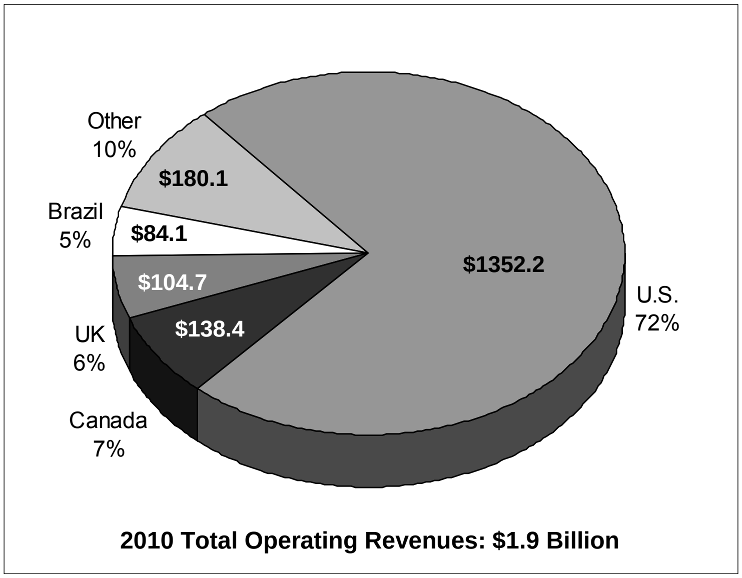


Source: Company presentation, August 2011

Geographic Exposure

The U.S. (73% of 2010 operating revenues) is clearly the Company's largest market as no other region currently makes up more than 10% of operating revenues. Outside of the U.S., Canada (7%) and the U.K. (6%) are the next biggest exposures. Equifax also has operations in Spain, Portugal, and Latin America (Argentina, Chile, Ecuador, El Salvador, Honduras, Paraguay, Peru and Uruguay).

Equifax Geographic Mix ($MM)

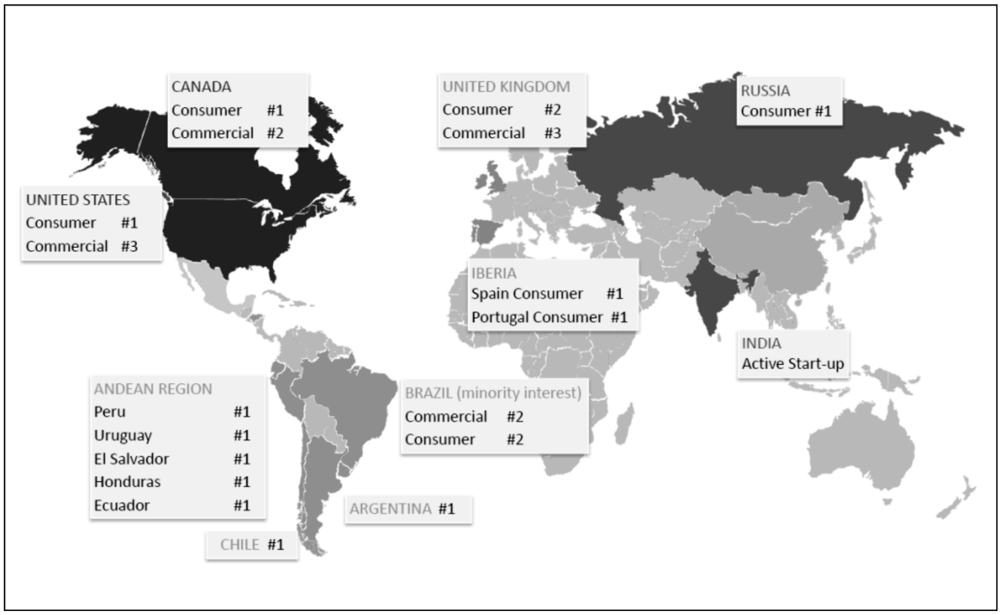


In addition to the Company's operations in the aforementioned countries, Equifax has equity interests in credit information businesses in Brazil (15%), Russia (33%) and India (49%). These investments should further diversify the Company's exposure away from the U.S. and allow it to benefit from the growth of middle class populations in these emerging markets.

Industry Overview - Competitive Advantages and Market Overview and Potential

Equifax is one of only three large global players (Experian and TransUnion are the primary competitors) in the credit reporting and credit information businesses and currently boasts a number one or number two market share in most of its major markets.

Equifax - Global Market Share



Source: Company presentation, August 2011

Competitive Advantages and Industry Overview

In our view, Equifax's competitive advantages reside in the Company's 100+ year history of building, maintaining and analyzing large databases of credit information. It would be virtually impossible to replicate many of the Company's databases as well as the proprietary analytical tools utilized to create customized insights, decision-making solutions and processing services for businesses. Although the Company licenses credit related algorithms from Fair Isaac Corporation (FICO) and the FICO score remains well recognized in the industry, the number of online transactions that include an Equifax analytical component continues to increase. During the 2Q11, 39 % of EFX's online transaction volume within the OCIS business unit included an analytical component from an Equifax model vs. 32% in 2Q10 and up from 23% in 1Q08. While Equifax generally obtains the data for its databases on favorable terms (in some cases free) and the data is typically not provided on an exclusive basis, we believe barriers to entry for the business are extremely high. Institutions that provide Equifax credit and wealth data need to be assured that they are handing over the data to a Company that has the infrastructure in place to keep the data secure.

Equifax derives the bulk of its revenue from its U.S. operations where there are just three major national players (Experian and TransUnion are the other two). We believe this bodes well for a rational pricing environment given the oligopoly type industry composition. Further, we would also note that peer TransUnion has become heavily levered (~5x debt to EBITDA) in conjunction with Madison Dearborn's investment. While TransUnion's leverage may be reduced if the Company completes its pending IPO, TransUnion's leverage would still likely be at elevated levels.

U.S. Credit Information - Market and Growth Potential

Although the U.S. is generally considered a mature/developed market, the market for business information services is large and growing. According to recent data from industry researcher Veronis Suhler Stevenson (VSH), spending on business information in the U.S. was $51.6 billion in 2009 of which $11 billion was attributed to spending on credit and risk information. VSH expects that credit and risk information spending will grow at a 6.4% CAGR between 2009 and 2014.

Emerging Markets Overview

Emerging markets should present good growth opportunities for the Company. A recent report (April 2011) by the International Monetary fund projects that in 2012 the average GDP of emerging markets is projected to grow at 2.5x the rate of developed markets. As emerging markets continue to develop and mature, these economies should experience favorable socio-economic trends including an expanding middle class that increasingly makes use of financial products and services. We believe that Equifax is well positioned with a presence in a number of high growth emerging markets.

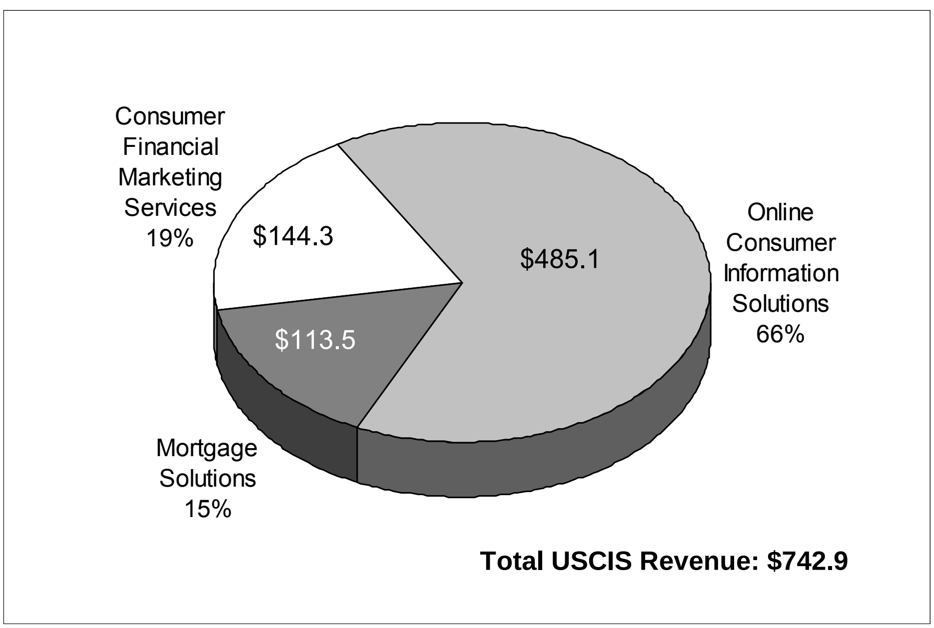
Personal Solutions Overview and Outlook

Equifax currently derives just 10% of its business from consumers globally (9% in the U.S.). The direct to consumer market is a relatively new market for the industry with Equifax releasing its first consumer product in the early 2000s. The advancement of the Internet has allowed companies to target and deliver products to this market more efficiently and cost effectively. According to credit industry researcher Javelin Strategy and Research, the market for online credit monitoring and identity theft protection services is $2.4 billion. With identity theft ranking as the top consumer complaint received by the FTC during 2010, coupled with financial institutions' reluctance to lend and stricter lending standards, individuals have become more interested in understanding their credit profile. Accordingly, consumers are increasingly accessing their credit reports and purchasing credit monitoring services. Equifax currently boasts the number 1 consumer market share in the U.S., Canada, and in a number of markets in Latin America.

U.S. Consumer Information Solutions (USCIS)

The U.S. Consumer Information Solutions Segment (USCIS) is the Company's largest segment and consists of three product and service lines. The following illustrates USCIS revenue by product and service line:

USCIS - Revenue by Business Unit ($MM)



OCIS and Mortgage Solutions revenue is principally transaction-based and derived from sales of products such as consumer credit reporting and scoring, mortgage settlement services, identity verification, fraud detection and modeling services. Meanwhile, Consumer Financial Marketing revenue is primarily project and subscription based and is derived from sales of batch credit, consumer wealth or demographic information.

Online Consumer Information Solutions (OCIS) (66% of USCIS Revenues)

The OCIS unit is the most profitable of the three USCIS business units. Products within this unit are developed from the Company's large databases of consumer information. Equifax offers other data, analytical and predictive services based on information in its databases to help further mitigate the risk of granting credit by verifying the identity of the consumer seeking credit, predicting the risk of consumer bankruptcy, or indicating the credit applicant's risk potential for account delinquency.

Mortgage Solutions (15% of USCIS Revenues)

The Company's mortgage solutions products consist of specialized reports that combine the reports of the three major credit consumer credit reporting agencies (Equifax, Experian, and TransUnion) in a single report (known a tri-merge) provided in an online format. Mortgage lenders use the tri-merge reports to make underwriting decisions. Equifax also offers ancillary mortgage services (appraisal, title, closing etc.), some of which are provided by third parties.

Consumer Financial Marketing Services (CFMS) (19% of USCIS revenues)

Equifax's CFMS products apply consumer financial information (credit, income, asset, liquidity, etc.) to help companies target new customers efficiently and effectively and cross sell new services. Customers for these products primarily include companies in the banking, brokerage, insurance, mortgage and marketing (digital/interactive).

Recent Results – USCIS

U.S. Consumer Information Solutions

	2008	2009	2010	% Change 2009 vs. 2008	% Change 2010 vs. 2009	6 Mos. 2010	6 Mos. 2011	% Change
Operating Revenues:								
Online Consumer Information Solutions	$566.5	$501.4	$485.2	-11.5%	-3.2%	$240.0	$247.8	3.3%
Mortgage Solutions	$70.2	$99.5	$113.5	41.7%	14.1%	$52.0	$54.2	4.2%
Consumer Financial Marketing Services	$132.0	$111.3	$144.3	-15.7%	29.6%	$65.7	$73.0	11.1%
U.S. CIS Operating Revenue:	$768.7	$712.2	$743.0	-7.4%	4.3%	$357.7	$375.0	4.8%
U.S. CIS Operating Income	$298.9	$259.4	$269.8	-13.2%	4.0%	$128.4	$132.5	3.2%
U.S. CIS Operating Margin	*38.9%*	*36.4%*	*36.3%*			*35.9%*	*35.3%*	

While the results in OCIS unit have been impacted by the downturn in lending, prospects for the business are looking up. Through June, volume growth in online information services provided by OCIS has improved sequentially for 6 straight quarters from -15% in 1Q10 to +11% in 2Q11 as financial institutions are beginning to grow, albeit modestly, their lending portfolios. For the first half of 2011, revenues in OCIS increased by 3% reflecting a 9% increase in core credit decision transaction volume partially offset by lower average price per transaction. It should be noted that a portion of the Company's revenue growth was aided by the fourth quarter 2010 acquisition of IXI Corporation (we will provide additional detail on IXI later).

The Mortgage Solutions business showed good revenue growth during 2010 (+14%) reflecting low interest rates (more refinancing) and a boost from the government incentives for housing purchases (expired May 2010). While revenue increased 4% during the first six months of 2011, revenue growth declined by 6% during the second quarter due to decreased mortgage application and refinancing activity. Equifax has stated that the mortgage business will face difficult comps during the second half of 2011.

Revenue growth in the Consumer Financial Marketing Services (CFMS) business was strong, increasing by 11% in both the first quarter and first half of 2011 on a year over year basis. Results were driven by strong market penetration of wealth-based consumer information services as well as continued growth in credit-based pre-screen and portfolio management revenue. In our view, the continued growth in pre-screen activity in CFMS bodes well for future lending activity, which should provide a boost to the OCIS business unit.

Margins in the USCIS segment have been impacted by the combination of weak lending and investments in new products to drive future growth. Equifax expects segment margins to continue to expand in the second half of 2011 and during 2012 as well.

International

The International operating segment includes Equifax's consumer business in Canada as well as the Europe and Latin America business units. These business units offer products that are similar to those available in the USCIS Operating segment, although data sources tend to rely more heavily on government agencies than in the U.S.

Recent Results – International

International

				% Change				
	2008	**2009**	**2010**	**2009 vs. 2008**	**2010 vs. 2009**	**6 Mos. 2010**	**6 Mos. 2011**	**% Change**
Operating Revenues:								
Latin America	$219.9	$200.4	$231.3	-8.9%	15.4%	$111.8	$119.2	6.6%
Europe	$175.0	$138.4	$137.6	-20.9%	-0.6%	$66.4	$76.3	14.9%
Canada Consumer	$110.8	$99.8	$113.9	-9.9%	14.1%	$56.2	$62.5	11.2%
International Operating Revenue:	$505.7	$438.6	$482.8	-13.3%	10.1%	$234.4	$258.0	10.1%
International Operating Income	$149.9	$118.9	$119.4	-20.7%	0.4%	$58.8	$64.0	8.8%
International Operating Margin	*29.6%*	*27.1%*	*24.7%*			*25.1%*	*24.8%*	

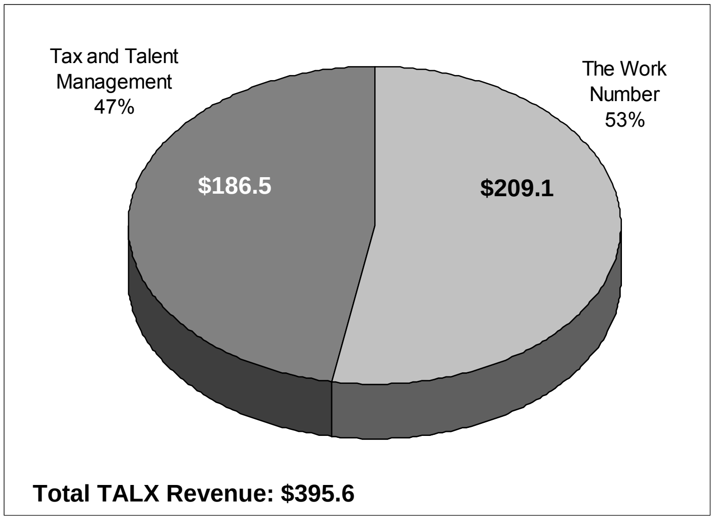
Operating margins within the Company's international business have been impacted as Equifax has invested heavily in sales, marketing and product management to strengthen its franchises in Brazil and the U.K. In addition, operations in Brazil have adversely impacted results though the Company has recently addressed its poor performance in that market. In May 2011, Equifax reached an agreement to combine its operations in Brazil with Boa Vista Services in exchange for a 15% equity interest in the business. We will provide more detail on this transaction below in a later section, but the agreement looks attractive on a number of fronts. Specifically, the combined entity now represents a formidable competitor in Brazil, diversifies the Company's operations away from the commercial business in that country and is structured in a way that Equifax is able to increase its stake in the business over time.

With the new entity structured as an equity investment, the Company's operations in Brazil will no longer be consolidated with Equifax's financials (accounted for under the cost method). As a result, Equifax expects overall Company margins to be aided by ~100 basis points with the Brazil business no longer included in the Company's International segment results (the business was generating ~$80 million in annual revenue, but was not generating an operating profit). Margins in the international segment expanded by 70 basis points during the second quarter reflecting rapid growth in the Company's higher margin country operations and the exclusion of Brazil (subsequent to May 2011).

TALX

TALX, which was acquired in 2007, operates in two business segments including The Work Number (TWN Services) and Tax and Talent Management Services. The following chart illustrates the revenue breakdown by TALX's two business units:

TALX Revenue by Business Unit ($MM)

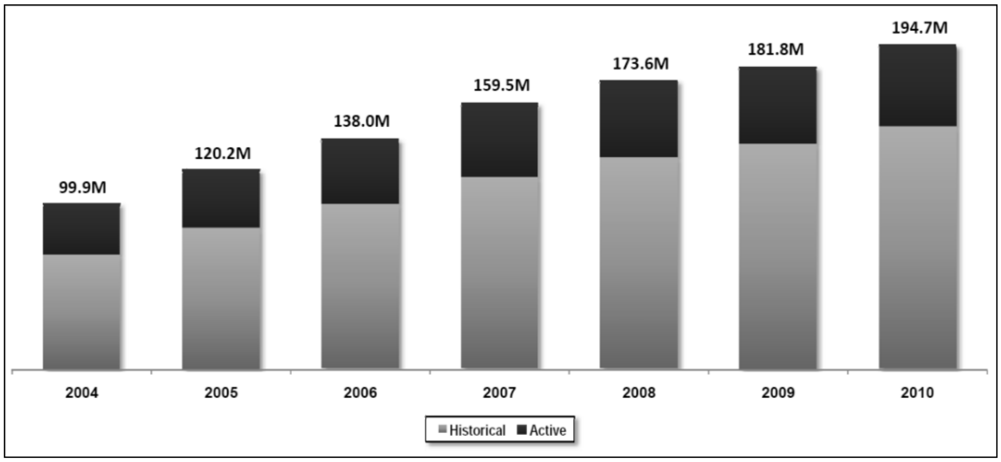


The Work Number (TWN Services) (53% of TALX Revenues)

TWN Services include employment, income and social security number verification services and complementary services which include W-2 management services (initial, reissue and correction of W2 forms). Other services include paperless pay and paperless new hire services. TWN Services also provide I-9 management services designed to help clients electronically comply with the immigration laws that require employers to complete an I-9 form for each new hire.

The Work Number is the Crown jewel of the TALX segment thanks to the Work Number Database (TWN Database) that contained approximately 220 million current and historic employment records as of December 31, 2010. The TWN Database receives its data from over 2,400 organizations including over half of Fortune 500 companies that regularly update the database. The data is used to provide employment verifications to third party verifiers who are charged a fee on a per transaction basis. The Company has not experienced significant turnover in the employer contributors to the TWN database because Equifax's verification service frees them from the administrative burden and expense of responding to third party employment verification results. The TWN database has expanded by 50% over the past 4 years and contains 49 million active records used for employment and income verification that no other competitor comes close to matching. The following chart illustrates the growth of the Work Number database.

Continuous, Strong Growth of the Work Number Database



Source: Company presentation, August 2011

Tax and Talent Management Services (47% of TALX Revenues)

The tax and talent management provide a broad range of human resource related services including unemployment tax management and services associated with recruiting and onboarding new employees of corporate and government agencies.

Recent Results – TALX

TALX

				% Change				
	2008	**2009**	**2010**	**2009 vs. 2008**	**2010 vs. 2009**	**6 Mos. 2010**	**6 Mos. 2011**	**% Change**
Operating Revenues:								
The Work Number	$131.9	$158.2	$209.1	19.9%	32.2%	$99.7	$103.5	3.8%
Tax and Talent Management	$173.2	$188.2	$186.5	8.7%	-0.9%	$94.6	$92.2	-2.5%
TALX Operating Revenue:	$305.1	$346.4	$395.6	13.5%	14.2%	$194.3	$195.7	0.7%
TALX Operating Income	$53.1	$75.4	$92.1	42.0%	22.1%	$44.5	$42.5	-4.5%
TALX Operating Margin	*17.4%*	*21.8%*	*23.3%*			*22.9%*	*21.7%*	

Revenue growth in The Work Number increased by 4% during the first half of 2011 as double-digit growth in the Company's traditional employment-based verification services and complementary services was partially offset by weakness in government-based tax transcript verifications. Meanwhile, revenue growth in Tax and Talent Management declined by 3% during the first half of 2011. The lower revenue was attributed to declines in the Talent Management services business reflecting decreased government hiring at the Transportation Security Administration (TSA) and reduced licensing revenue, partially offset by modest revenue growth in the Tax Management Business. Segment operating margins were adversely impacted during the first half of 2011 by 120 basis points reflecting declines within Talent Management and higher personnel related expenses.

North America Personal Solutions (PSOL)

The Company's personal solutions products give consumers information to make financial decisions and monitor credit, credit score and identity information through Equifax Complete, ID Patrol, Credit Watch and Score Watch monitoring products. The Company's products are available to consumers directly and through their relationships with business partners who distribute products or provide these services to their employees or customers. The PSOL segment now generates ~75% of its revenues from subscription-based products, up from 27% in 2005.

PSOL – Recent Results

North America Personal Solutions

	2008	2009	2010	% Change 2009 vs. 2008	% Change 2010 vs. 2009	6 Mos. 2010	6 Mos. 2011	% Change
PSOL Operating Revenues	$162.6	$149.0	$157.6	-8.4%	5.8%	$80.0	$89.6	12.0%
PSOL Operating Income	$46.3	$34.3	$44.6	-25.9%	30.0%	$20.2	$25.2	24.8%
PSOL Operating Margin	*28.5%*	*23.0%*	*28.3%*			*25.3%*	*28.1%*	

Through June 30, 2011, Equifax has increased its already market leading share in the U.S. consumer business for 6 consecutive quarters. During the first half of 2011, revenue increased by 12% reflecting a 12% increase in Equifax-branded subscription revenue versus the first six months of 2010. The strong results thus far in 2011 follow on the heels of good growth experienced during 2010 (+6%). Recent results have been aided by a successful new advertising campaign surrounding Equifax Complete, a new product that has been well received by the market and contains high value features such as information from all three national credit bureau services. The product is priced at a premium to its other offerings and has helped boost the segment's revenue per subscriber metrics. While margins have expanded nicely within this segment (28.2% in first half 2011 vs. 25.3% in first half 2010 and up from 12% in 2005), management believes that the normalized long term PSOL margins are in the mid 20s percentage range.

North America Commercial Solutions (NACS)

Commercial Solutions products are derived from databases of credit, financial and marketing information regarding businesses in the U.S. and Canada. The business records included in the U.S. credit database have been developed in part from the Small Business Financial Exchange. SBFE members including a number of commercial lending financial institutions, contribute their data to the member-owned SBFE database that is exclusively managed by Equifax.

In addition, the Company maintains other databases that it has compiled from loan, credit card, public records and leasing history data, trade accounts receivable and SEC registration information. The Company also offers scoring and analytical services that provide additional information to help mitigate the credit risk assumed by its customers. Finally, the Company has a marketing database that hosts approximately 47 million commercial demographic data records from around the world helping companies identify corporate family structures for enterprise visibility of customers and suppliers.

NACS – Recent Results

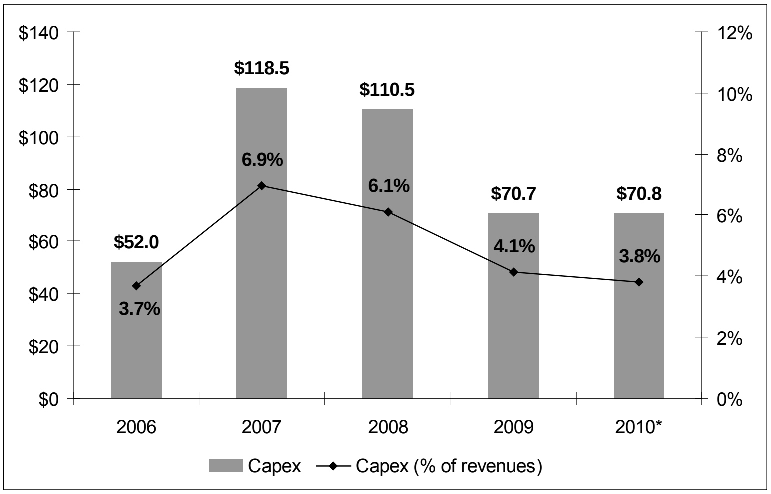
North America Commercial Solutions

				% Change				
	2008	2009	2010	2009 vs. 2008	2010 vs. 2009	6 Mos. 2010	6 Mos. 2011	% Change
NACS Operating Revenues	$71.5	$69.8	$80.5	-2.4%	15.3%	$37.3	$41.4	11.0%
NACS Operating Income	$13.6	$15.1	$19.5	11.0%	29.1%	$8.1	$9.5	17.3%
NACS Operating Margin	*19.0%*	*21.6%*	*24.2%*			*21.7%*	*22.9%*	

During the first half of 2011, NACS revenue increased by 11% (9% on a local currency basis). The revenue increase on a local currency basis was primarily due to increases in U.S. risk and marketing service revenue and revenue from the Company's data management products. Notably, the second quarter of 2011 represented the 7th consecutive quarter of double-digit revenue growth for this segment.

Investment in New Products/Database Integrations Driving Growth

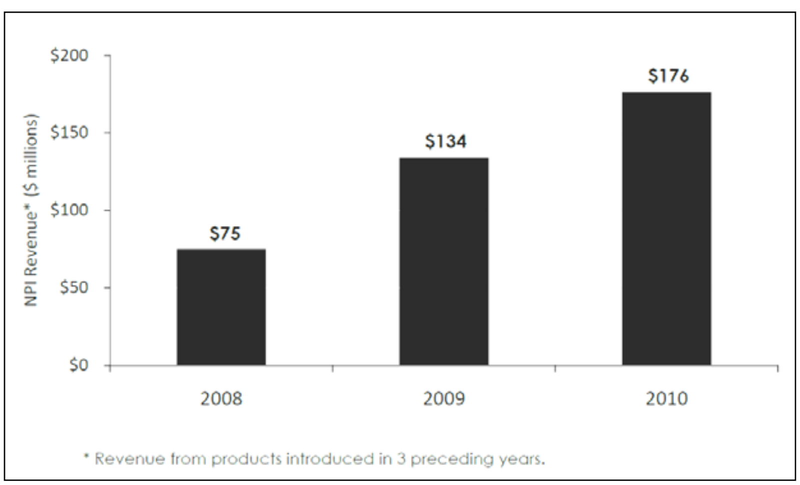
CAPEX 2006 to 2010 ($MM)



*Note: 2010 Capex excludes $29 million payment for purchase of Atlanta headquarters buildings

Equifax has significantly boosted its spending on new products in recent years. While a significant amount of the capex increase in 2008 reflected data center infrastructure improvements, a large amount of the Company's annual capex is utilized for new product development. EFX launched 72 new products in 2010 and generated $176 million in revenue during the year from products introduced between 2007 and 2009, representing a 31% increase. Equifax's stated goal is to generate 10% of the Company's revenue within each of its segments from products introduced in the prior three years. During the Company's 2Q11 earnings conference call, Equifax said that new products introduced in the previous 3 years are generating 2-3 percentage points of incremental revenue growth for the Company. EFX has recently indicated that it is ahead of its revenue targets for new products and it has a couple of products that could soon become very large revenue contributors.

Growth Driver – New Product Innovation



Source: Company presentation, March 2011

Two of the Company's more promising new products that launched in 2010 include Undisclosed Debt Monitoring and Equifax Complete. Undisclosed Debt Monitoring is the industry's first platform to monitor and notify lenders of new account activity from the time a borrower applies for a mortgage until it is closed, while Equifax Complete is a three in one credit report that contains 24/7 access to credit scores from the three major reporting agencies.

As part of the Company's Decision 360 initiatives, Equifax has also been investing heavily to link all of its databases (IXI, the Work Number, NCTUE+, credit etc.) with the goal of gaining further insight on its customers (assessing a consumers' willingness, ability and capacity to pay). Importantly, EFX believes that linking all of the databases will allow the Company to develop more products faster and more cost effectively than it was able to do historically. As of June 30, 2011 management said that it is generating revenue from 13 different product offerings that were built leveraging the Company's multiple data assets.

Investment in Unique Data Sources – Opportunity to Further Leverage EFX Databases

A key component of Equifax's growth strategy is to invest in and acquire sources of credit and non-credit information to enhance the variety and quality of the Company's services while increasing customers' confidence in information-based business decisions. Areas of focus for investment in new sources of data include, among others, positive payment data, real estate data and new commercial business data. The following reviews recent investments/acquisitions to further the Company's unique data sources strategy:

Acquisitions - IXI Corporation and Workload

During 2009, EFX paid $124 million to acquire IXI Corporation, a company with U.S. consumer data related to employment and financial assets, which broadens types of services EFX offers its customers. At the time of the acquisition, IXI sourced its data from more than 95 leading banks, brokerage firms and other financial entities. The Company's IXI database is the most comprehensive database of invested and deposited consumer wealth in the U.S. IXI directly measures data on more than $10 trillion in U.S. consumer assets and investments, representing more than 42 percent of all U.S. consumer invested assets.

During the second quarter of 2011, Equifax paid $31 million to acquire Workload Financial Business Consultants, a U.K. company that has a database of consumer deposit, savings and investment information. The transaction puts the Company in a stronger position by offering customers better insights on ability to pay, a major focus of customers and UK regulators. Data providers include life insurance companies, fund managers, pension providers and retail banks (data is similar to the IXI database but at the product level vs. the individual account). The data are updated quarterly and are aggregated at the postal code level. Equifax intends to utilize the workload data to develop a suite of products similar to what IXI has developed in the U.S. To accomplish its ambitions, Equifax has re-located a key executive from IXI to the U.K.

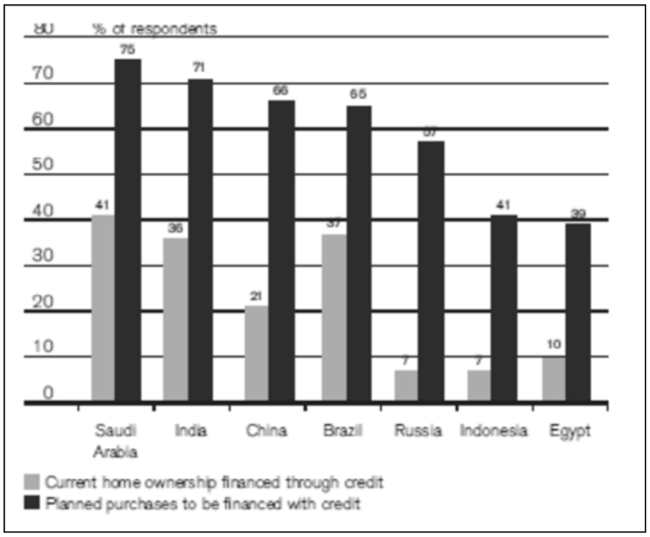
National Consumer Telecommunications Utilities Exchange NCTUE+ Database

Equifax recently built a positive payment database to complement its existing negative payment database, which dates to the mid 1990s. While a typical credit database contains only negative data (missed or late payments etc.) a positive database provides information about those consumers that have a history of paying their bills on times. Having a positive payment database is strategically important for Equifax as it includes data on a large group of consumers that are not included in the negative database. In early 2011, Equifax stated that its positive database had over 1 billion positive data records on 140 million unique consumers. Notably, 20% of consumers in the NCTUE+ database are not included in the consumer credit database or have insufficient credit to develop a credit score. Equifax's NCTUE+ database is the only significant positive non-financial database in the U.S. giving the Company a significant competitive advantage in our view. The NCTUE+ database was launched in early 2011 and the Company recently stated that it is generating very strong customer demand and that installations and commitments were ahead of the Company's expectations.

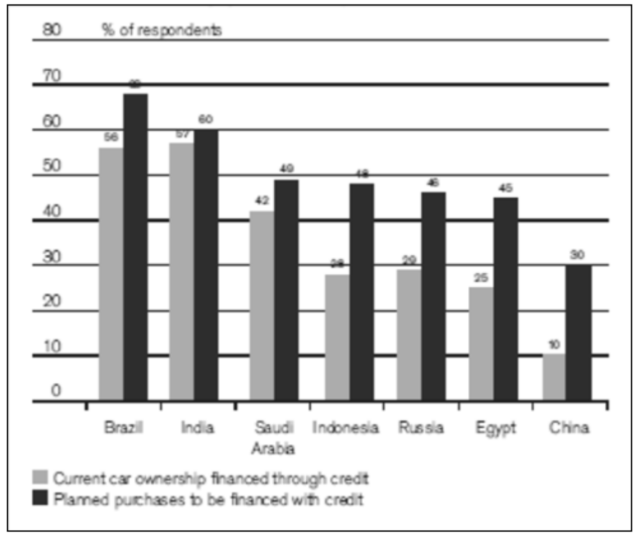
Emerging Markets Hold Significant Potential – Opportunity to Increase Exposure

In our view, Equifax is positioned well in emerging market countries that are poised to experience an expanding middle class. At present, the Company has attractive equity interests in Brazil, Russia and India. We believe the growing middle class populations in these countries will be increasingly utilizing financial products and services. According to the chart below, consumers in Russia, Brazil and India plan to significantly increase their use of financing for future property and vehicle purchases.

Property Financing and Plans for Financing



Vehicle Financing and Plans for Financing



Source: Credit Suisse Emerging Consumer Survey, January 2011

Importantly, the Company should be able to boost its equity interests in Brazil and Russia over time, potentially taking a controlling stake in these businesses in those countries down the road. The following summarizes the Company's investments in Brazil, Russia and India:

Brazil

As we noted above, in May 2011, Equifax combined its credit operations in Brazil with Boa Vista Services (BVS) in exchange for a 15% equity interest. We view the transaction favorably as the combined entity is now a formidable competitor in that country with a number 2 position in both commercial and consumer credit operations (prior to the merger Equifax was a distant number 3 in the consumer business and held a number 2 market share in the commercial business). Importantly, Equifax will have the opportunity to increase its stake in BVS in a couple of ways. First, Equifax's ownership of BVS could expand if it provides funding to BVS to make acquisitions, which it has committed to do as part of the transaction. The Company could also increase its interest by buying out BVS' other owners. Equifax has the right of first refusal to buy its partners' stakes if they decide to sell. It should be noted that ~21% of BVS is owned by a Brazilian private equity firm (TMG Partners) while the remaining interests are split among four Brazilian based organizations with Associacao Comercial de Sao Paulo (ACSP) being the largest with a ~59% stake.

Russia

On June 30, 2008, as a part of the Company's long-term growth strategy of entering new geographies, Equifax acquired a 28 percent (increased to 33% in 2Q11) equity interest in Global Payments Credit Services LLC, or GPCS, a credit information company in Russia. The Company paid $4.4 million for its stake GPCS, which is now doing business as Equifax Credit Services, LLC in Russia. Under the shareholders' agreement, Equifax has the option to acquire up to an additional 22 percent interest in GPCS between 2011 and 2013.

India

On December 23, 2009, Equifax formed a joint venture, Equifax Credit Information Services Private Limited, or ECIS, to provide a broad range of credit data and information solutions in India. According to the terms of the transaction, EFX acquired a 49% equity interest in ECIS for $5.2 million. India boasts the world's fastest growing middle class economy presenting the Company with an attractive future growth opportunity.

Additional Growth Drivers/Opportunities

In addition to new product introductions, strategic acquisitions/investments of unique data assets and emerging markets growth we would highlight a couple of other drivers that are likely to benefit Equifax in the coming years.

Key Client Program

During 2010, Equifax launched its "Key Client Program" initiative, which entails employees from the Company's multiple divisions working closely with its large financial services clients to provide an array of solutions. Through the initiative, EFX leveraged its unique current wealth and Income Data from IXI and TALX into the development of the industry's first set of "ability-to-pay" solutions based on actual income and asset data. These solutions were adopted by three of the top four credit card companies during 2010. For a majority of its key clients, over 50% of the revenue is from product offerings that are unique to Equifax when compared to its primary credit reporting competitors. We believe this demonstrates the Company's solid competitive position and gives credence to the Company's strategy of integrating its unique data assets and capabilities in helping its customers solve new problems while allowing EFX to pursue new growth opportunities.

Increased Demand from Non-Traditional User of Credit Data

While Equifax's data has traditionally helped companies make decisions directly related to credit in the financial sector, we believe that the Company's data will be increasingly used by companies outside of the traditional financial lending sector. Healthcare companies are utilizing credit data in today's high deductible and high uninsured environment. Meanwhile, investors are using credit data to evaluate securitized loan portfolios and for profit education companies are able to use the data to help them reduce loan defaults.

Equifax's recent partnership with Internet data provider comScore highlights another potential non-traditional user of credit data. As part of the partnership, comScore will be using EFX's data (IXI Database) and technology to develop new co-branded solutions designed to optimize ad placement for the financial services sector to more effectively reach their targeted audiences based on estimated income, assets, discretionary spending or ability to pay. We believe that the Company's databases could become increasingly valuable for online advertising/media companies providing a new revenue stream for the Company.

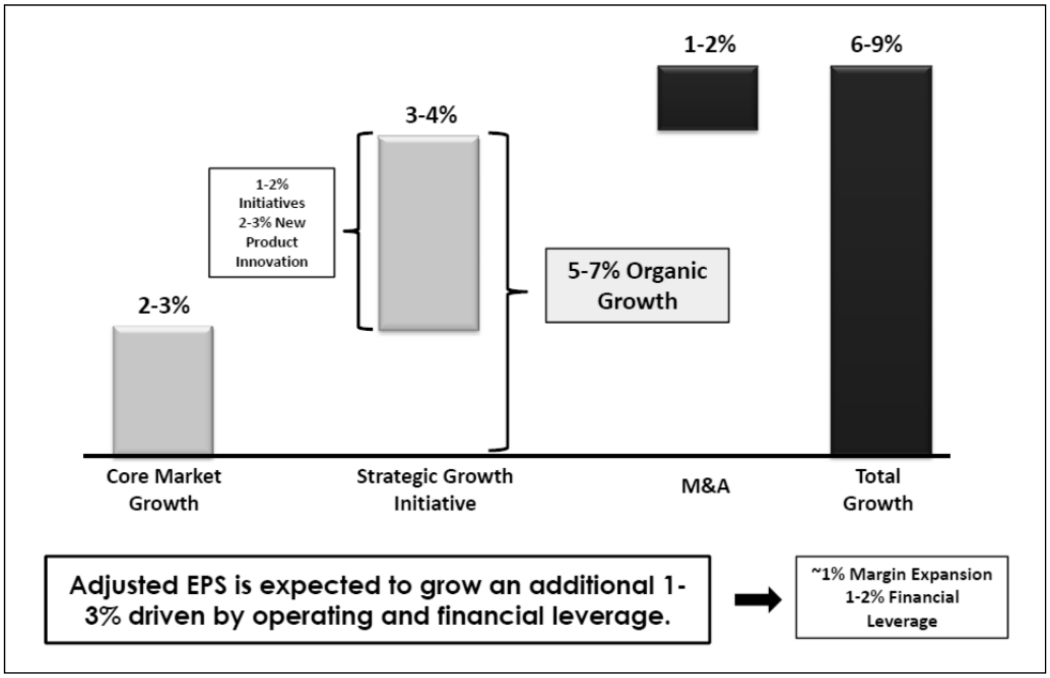
Expansion into Adjacent Markets - Leveraging the Company's Credit Database

In October 2010, Equifax acquired Anakam, a global leader in multi-factor authentication, identity proofing and verification technologies, for $64.3 million. In our view, the Anakam acquisition provides Equifax with the opportunity to develop new sources of authentication solutions that leverage the Company's credit and income databases. Anakam has developed unique authentication tools that eliminate the need for costly hard tokens or the downloading of software. The combination of the Company's databases with Anakam's technology could take the authentication process to another level by including data unique to an individual's credit file and include questions such as "What was the make/model of the last car you purchased or leased?". We believe the transaction could help further diversify the Company's revenue outside of the financial services industry given Anakam's large exposure to the Healthcare and Government industries.

Outlook

Equifax's long-term goal for revenue growth is in the 6% to 9% range. The following chart illustrates the components of the Company's revenue growth expectations.

Equifax Long Term Financial Model



Source: Company presentation, September 2011

The Company expects operating margins to be between 25% and 27%. It should be noted that the prior outlook for margins were in the 24%-26% range, but this assumed consolidation of the Brazil operations. With the recent merger of its Brazil business, which resulted in the Company receiving an equity stake, the Company expects to receive a ~100 bps margin improvement going forward. Equifax believes that margins will reach the lower end of its range during the fourth quarter of 2011. In terms of earnings per share growth, the Company expects that adjusted EPS should to grow 1%-3% faster than its sale growth reflecting operating and financial leverage. Further, dividends are expected to add 1% to 2% annually to shareholder return.

Second Half 2001 Outlook

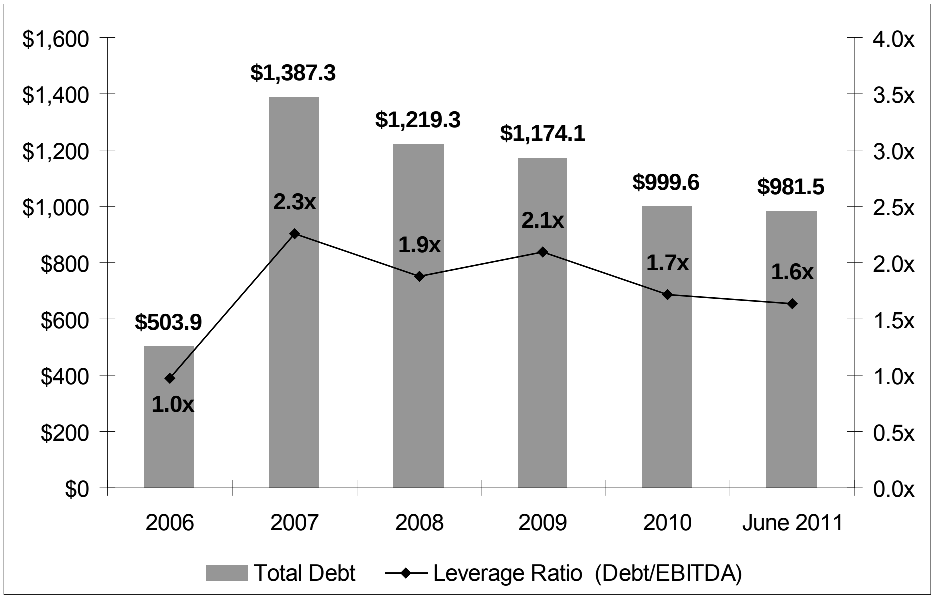
Equifax stated on its 2Q11 quarterly earnings call that it is confident in 6%-9% revenue growth for the remainder of the year, despite challenges posed by the U.S. economy. In addition, the Company faces difficult comps in its mortgage business in the second half, suggesting strong underlying improvement in the core business (non-mortgage related). At the same time, overall Company margins are expected to expand driven by improvement in USCIS, which is expected to show margin improvement beginning in the 2nd half of 2011.

In a rare move during the Company's 2Q11 earnings call, the Company issued an outlook for its fourth quarter stating that it expects 4Q11 revenue growth to be in the upper half of its 6%-9% range. In addition, Equifax said that margins will expand to 25.0%-25.5% range in 4Q11 (4Q10 margins were 22.8%).

Balance Sheet and Financial Strength – Debt Reduction and Liquidity

Equifax's $1.4 billion acquisition of TALX in 2007 (75% stock; 25% cash; + assumption of ~$200 million of debt) increased the Company's debt load by ~$500 million. In addition, Equifax instituted a major share buyback in conjunction with the TALX acquisition and repurchased 17.9 million shares for $718 million in 2007 at an average cost of ~$40 a share. Since the TALX acquisition, EFX's total debt has declined by $406 million while the Company's leverage ratio has declined to 1.63x as of June 2011 from 2.3x in 2007.

Equifax Total Debt & Leverage Ratio



In February 2011, EFX extended the maturity date and reduced the borrowing limits of its existing unsecured revolving credit facility (senior credit facility). The maturity date of the facility was extended to February 2015 (from July 2011) while the size of the facility was reduced to $500 million (from $850 million). EFX indicated that the changes were made in line with its liquidity needs and reflecting credit market conditions, including higher upfront fees and fees for unused borrowing availability. It should be noted that the new facility has an accordion feature allowing the Company to request an increase in the total commitment to $750 million if it chooses to. At June 30, 2011, there were no borrowings under the senior credit facility with borrowing capacity of $498.4 million.

At June 30, 2011, approximately 70% of the company's debt was fixed rate debt while 30% was effectively variable rate debt. The Company's variable debt includes 5 year notes due 2014 (EFX has executed interest rate swaps to convert interest expense from fixed rate to floating rates), and generally bears interest at a specified margin plus a base rate (LIBOR). Equifax has just $320 million (out of a total of $963.9 million) of debt maturing prior to 2014, with most of the debt maturing after 2017 including $125 million maturing in 2028 and $250 million maturing in 2037.

Free Cash Flow – Minimal Capex Allows Company to Generate Strong Free Cash Flow

Over the past 3 years, the Company has generated an average of $326 million in free cash flow. While free cash flow declined in 2010 vs. 2009, we would note that capex included $29 million for the purchase of the Company's headquarters building in Atlanta. In addition, the Company made an additional $35 million in pension contributions (pension plans were underfunded by $10 million) vs. 2009 and paid $42 million in taxes in connection with the sale of two businesses (DMS and APPRO). Excluding these items, EFX's free cash flow would have been ~$10 million higher versus 2009 levels.

Free Cash Flow Summary ($MM)

	2008	2009	2010 *
Cash Flow From Operations	488.1	418.4	352.6
Capital Expenditures	110.5	70.7	99.8
Free Cash Flow	377.6	347.7	252.8

* 2010 Capex Includes $29.0 million for purchase of Headquarters Building

Equifax expects its annual capex requirements to be in the $70 to $90 million (~4% of revenues) range going forward with most of that amount spent on new product development. Based on our projection, we believe the Company could generate $325-$350 million in free cash flow during 2011 (free cash flow yield: 9%) and a total of $1.1 billion over the next three years (2011-2013), representing nearly 30% of the Company's current market cap.

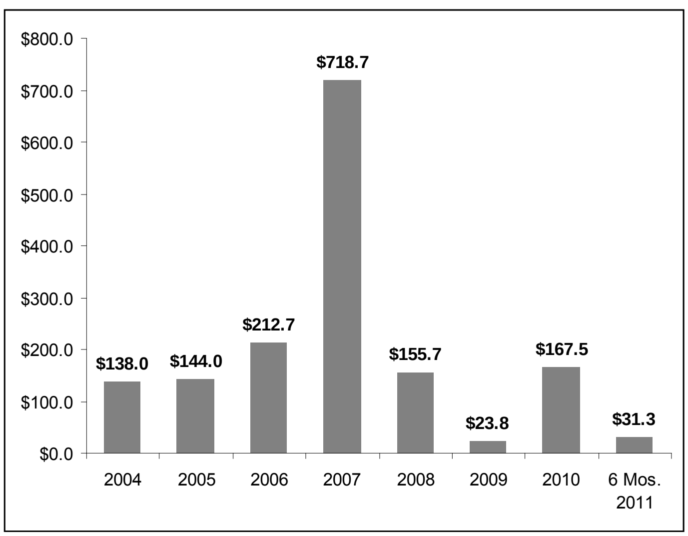
Computer Sciences Put Could Require Debt/Capital Raise

EFX has an agreement with Computer Sciences Corporation (CSC) under which CSC-owned credit reporting agencies utilize EFX's computerized credit database services. CSC retains ownership of its credit files and the revenues generated by its credit reporting activities. EFX receives a processing fee for maintaining the database and for each report supplied. The agreement with CSC expires in 2018 and is renewable at the option of CSC for 10-year periods. EFX has the option to purchase the business from CSC if CSC does not elect to renew or if there is a change in control of CSC while the agreement is in effect. In addition, CSC has an option to sell its credit reporting business to Equifax at any time through August 2013. EFX estimates that if the option was exercised in December 2010 the value would have been $625 to $700 million. The estimate is based on EFX's internal analysis of the business and a number of other factors.

Dividends and Share Repurchases – Accelerating Returns to Shareholders

Equifax's improved financial position and confidence in its business and growth prospects prompted the Company to significantly increase its quarterly payout. In November 2010, Equifax boosted its quarterly payout by a whopping 4-fold to $0.16 a share from $0.04 a share, representing a 2.1% dividend yield at current prices. The dividend boost was the first increase in the Company's payout since 2005. Going forward, Equifax stated that it intends to pay out 25% to 35% of its net income in the form of dividends.

Share Repurchases 2006 to 2011 ($MM)



As we noted above, the Company's leverage has come down meaningfully in recent years as debt reduction has been a capital allocation priority post the credit/financial crisis. With leverage at low levels, and despite the prospect for future bolt on acquisitions in unique data assets, we believe that share repurchases will likely play a large role in the Company's future capital allocation. While Equifax has repurchased just $31.3 million or 0.8 million shares (at an average cost of $37.32) during the first half of 2011, we would expect share repurchases to accelerate during the second half of the year. We would note that the current share price is 20% below the average share price realized for share repurchases during first half of 2011. In addition, the Company's leverage (Debt/EBITDA) now stands at just 1.6x, a level at which the Company has stated that it intends to be more aggressive with repurchases (more repurchase when leverage is below 1.75x; more debt reduction with leverage above 2.0x, subject to market conditions). At June 30, 2011, Equifax had $223.2 million remaining under its authorization after having increased its share authorization by $150 million in May 2011.

Valuation – 2010 Investment in TransUnion by Madison Dearborn Provides Glimpse of Equifax Value

We believe the pending IPO of TransUnion could help bring U.S. investors' attention to credit information companies, providing a boost for Equifax's valuation. Although Experian, Equifax's other main global competitor is publicly traded, its shares trade on the LSE. The recent S-1 filing by TransUnion, which has been filed in advance of a potential TransUnion IPO, allows investors to construct a good comp as Madison Dearborn acquired a 51% stake in TransUnion during 2010 from the Pritzker Family. We estimate that Madison Dearborn paid ~8.5x-9.0x EBITDA for its 51% stake in TransUnion.

Experian, whose shares sell on the LSE, currently trades at 9.5x trailing EBITDA, which is at a premium to Equifax's current valuation of 8.0x trailing EBITDA. In our view, Equifax's discounted multiple is curious given the Company's strong cash flow generation. In addition, the Company's EBITDA margins (low 30s%) are on par with both Experian and TransUnion.

Applying a 9.0x multiple to our estimate of Equifax's 2012E EBITDA, our estimate of the Company's intrinsic value is $44 a share, representing 41% upside from current levels. We believe that additional upside is possible with a better than anticipated housing/economic recovery. In addition, our valuation does not assign any value for the Company's promising emerging market equity interests, which could become a significant value creator for Equifax over time.

Equifax Valuation Summary

	Value ($MM)
EFX @ 9x 2012E EBITDA	$6,059
2012E Net Debt	($675)
Underfunded Pension and Other Benefits*	($123)
Equity Value	$5,261
2012E Shares Outstanding	120.3
Estimate of Instrinsic Value (Per Share)	**$43.74**
Implied Upside to Intrinsic Value Estimate	41.0%

**As of 12/31/10*

Amortization Expense Obscures Company's True Earnings Power

It is worth highlighting that Equifax's earnings per share includes significant amortization expense (due to acquisitions) related to definite lived purchased intangible assets. For example, during 2010 the Company recorded $90 million (~$80 million in each of 2008 and 2009) in amortization expense related to purchased intangible assets. Accordingly, the Company's diluted EPS from continuing operations of $1.86 would have been $~2.30-$2.35 if you were to exclude this amortization expense, a large amount of which is due to the 2007 TALX acquisition. Investors looking at EFX on a reported EPS basis should be aware of the outsized amortization expense that is embedded in the Company's reported results.

The following summarizes EFX's estimated future amortization expense related to definite-lived purchased intangible assets at December 31, 2010:

Future Amortization Expense at December 31, 2010

Years ending December 31,	Amount (in millions)
2011	$ 94.8
2012	84.7
2013	60.0
2014	46.8
2015	43.1
Thereafter	264.5
	$ 593.9

Conclusion

In our view, it would be virtually impossible to replicate Equifax's proprietary databases, many of which have been built over multiple decades if not centuries. The Company's data assets include over 200 million U.S. credit files, The Work Number database that contains over 200 million employment related records, $10 trillion in consumer wealth data from the IXI database, the National Consumer Telecom & Utilities Exchange (positive and negative databases) and nearly 30 million files of small business information. In our view, Equifax is well positioned as a provider of solutions in today's stricter lending environment with its broad sources of consumer and business information.

While tighter lending standards and a challenging economic environment have pressured results recently, we believe Equifax will be a prime beneficiary when a housing recovery takes hold. During the downturn, Equifax has continued to invest in its business to drive profitable long-term growth. The Company has introduced a total of 137 new products over the past two years, a number of which are playing a large role in the Company's growth.

We believe that Equifax is well positioned to benefit from growth in emerging markets in the coming years. The middle class population is exploding in emerging markets, which should boost lending activity and drive demand for credit based information tools and analytics. Equifax currently has operations and equity interests in a number of emerging markets with attractive growth opportunities including Russia, India and Brazil.

The competitive environment that Equifax operates in is extremely favorable, as the industry is characterized by high barriers to entry and dominated by just three global players. In addition, Equifax operates an attractive business model that generates a high amount of recurring/repeatable revenue streams, produces high margins and throws off a significant amount of free cash flow. As a testament to the Company's business outlook and future growth prospects, Equifax recently boosted its dividend by four-fold to $0.16 on a quarterly basis from $0.04. We believe that share repurchases will also become a priority for the Company given the Company's current valuation (6.6x 2012E EBITDA), and multi-year low leverage levels (current Debt/EBITDA: 1.6x).

Applying an 9.0x multiple to our estimate of the Company's 2012E EBITDA, we estimate Equifax's intrinsic value to be $44 a share, representing 41% upside from current levels. We believe additional upside is possible with a faster than anticipated economic/housing recovery and/or faster than anticipated contribution from investments in emerging markets.

Risks:

Risks that Equifax may not achieve our estimate of the Company's intrinsic value include, but are not limited to, an adverse impact from financial regulation, inability to access consumer data including credit, income, employment an wealth data, and further decline in consumers' appetite for credit.

Analyst Certification:

Asset Analysis Focus certifies that the views expressed in this report accurately reflect the personal views of our analysts about the subject securities and issuers mentioned. We also certify that no part of our analysts' compensation was, is, or will be, directly or indirectly, related to the specific views expressed in this report.

EQUIFAX INC.
CONSOLIDATED BALANCE SHEETS
(In millions, except par values)

ASSETS	June 30, 2011 *(Unaudited)*	Dec. 31, 2010
Current assets:		
Cash and cash equivalents	$ 108.7	$ 119.4
Trade accounts receivable, net	273.0	262.6
Prepaid expenses	33.1	26.1
Other current assets	21.7	21.1
Total current assets	436.5	429.2
Property and equipment:		
Capitalized internal-use software and system costs	321.2	315.9
Data processing equipment and furniture	176.6	181.0
Land, buildings and improvements	176.0	169.5
Total property and equipment	673.8	666.4
Less accumulated depreciation and amortization	(372.9	(368.0
Total property and equipment, net	300.9	298.4
Goodwill	1,919.1	1,914.7
Indefinite-lived intangible assets	95.7	95.6
Purchased intangible assets, net	559.8	593.9
Other assets, net	177.3	101.8
TOTAL ASSETS	**$ 3,489.3**	**$ 3,433.6**

LIABILITIES AND EQUITY		
Current liabilities:		
Short-term debt and current maturities	$ 17.6	$ 20.7
Accounts payable	26.7	24.6
Accrued expenses	62.3	61.9
Accrued salaries and bonuses	38.1	71.9
Deferred revenue	52.6	58.7
Other current liabilities	101.4	81.7
Total current liabilities	298.7	319.5
Long-term debt	963.9	978.9
Deferred income tax liabilities, net	252.5	244.2
Long-term pension and other postretirement benefit liabilities	113.3	129.0
Other long-term liabilities	58.3	53.6
TOTAL LIABILITIES	1,686.7	1,725.2
Equifax shareholders' equity:		
Preferred stock, $0.01 par value	-	-
Common stock, $1.25 par value	236.6	236.6
Paid-in capital	1,110.6	1,105.8
Retained earnings	2,777.6	2,725.7
Accumulated other comprehensive loss	(295.9)	(344.5)
Treasury stock, at cost	(2,003.4)	(1,991.0)
Stock held by employee benefits trusts, at cost	(41.2)	(41.2)
TOTAL EQUIFAX SHAREHOLDERS' EQUITY	1,784.3	1,691.4
Noncontrolling interests	18.3	17.0
TOTAL EQUITY	1,802.6	1,708.4
TOTAL LIABILITIES AND EQUITY	**$ 3,489.3**	**$ 3,433.6**

September 13, 2011
Volume XXXVII, Issue VII & VIII

Mohawk Industries, Inc.

(NYSE: MHK)

Dow Jones Indus:	**11,105.85**
S&P 500:	**1,172.87**
Russell 2000:	**691.74**
Index Component:	**S&P MidCap 400**

Trigger: No
Type of Situation: Consumer Franchise, Business Value

Price:	**$ 44.04**
Shares Outstanding (MM):	**68.8**
Fully Diluted (MM) (% Increase):	**69.0 (0.3%)**
Average Daily Volume (MM):	**0.8**
Market Cap (MM):	**$ 3,028.1**
Enterprise Value (MM):	**$ 4,400.1**
Percentage Closely Held: Jeffrey Lorberbaum ~16%	
52-Week High/Low:	**$ 68.86/41.66**
5-Year High/Low:	**$ 103.32/17.11**
Trailing Twelve Months	
Price/Earnings:	**16.0x**
Price/Stated Book Value:	**0.9x**
Long-Term Debt (MM):	**$ 1,625.1**
Implied Upside to Estimate of Intrinsic Value:	**62.0%**
Dividend:	
Payout	**N/A**
Yield	**Nil**
Net Revenue Per Share:	
LTM:	**$ 78.6**
2010:	**$ 77.6**
2009:	**$ 78.1**
2008:	**$ 99.8**
Earnings Per Share:	
LTM:	**$ 2.76**
2010:	**$ 2.51**
2009:	**$ 2.24**
2008:	**$ 3.67**
Fiscal Year Ends:	**December 31st**
Company Address:	**160 S. Industrial Blvd. Calhoun, GA 30701**
Telephone:	**706-629-7721**
Chairman/CEO:	**Jeffrey Lorberbaum**

Clients of Boyar Asset Management, Inc. do not own shares of Mohawk Industries, Inc. common stock.

Analysts employed by Boyar's Intrinsic Value Research LLC do not own shares of Mohawk Industries, Inc. common stock.

Overview

Mohawk Industries ("Mohawk," "MHK," or "the Company"), founded in 1878, is the oldest and second largest carpet and rug manufacturer in the U.S. It is also one of the largest manufacturers of ceramic tile, natural stone and hardwood flooring and a leading producer of laminate flooring in the U.S. and Europe. The Company's well-known brands include Mohawk, Karastan, Bigelow, Dal-Tile, American Olean and UniClic.

U.S. wholesale flooring market sales totaled approximately $17.1 billion in 2010, up 3.3% from 2009. Catalina Research forecasts flooring sales to increase 2.1% in 2011. While the industry has experienced a slight rebound, flooring sales in 2010 still represented a marked 32% decline from the peak of $25.7 billion recorded in 2006 prior to the housing recession.

In our view, there are a number of items that will favorably impact Mohawk's future results including international growth, the eventual rebound in new residential housing construction, pent up demand for home remodeling and the aging of the nation's housing stock. The tile market in Mexico is similar to the U.S. in size but is growing 5%-6% per year, while the China tile market is 30 times the size of the U.S. and is growing 10%-12% per year. The laminate market in Russia is driven by a rapidly expanding middle class and rising personal income. MHK is well positioned in these markets with their own manufacturing and distribution facilities in both Mexico and Russia, and a strong equity partner in China.

Not only was new housing construction in the U.S. near all-time lows in 2010, but there also has been a cumulative 2.5 million fewer homes built relative to long term demand since 2006. Therefore, we believe new housing construction in the U.S. is poised to rebound as industry conditions begin to normalize. Finally, the BuildFax Remodeling Index stands at its highest level since August 2004, reflecting pent up demand from homeowners seeking to update their homes. Mohawk should be a prime beneficiary of these remodeling dynamics with ~50% of sales derived from the residential home remodel and replacement end market.

The Company enjoys various competitive advantages, which include its distribution network, product differentiation and low cost manufacturing. It owns an unrivaled distribution system that would be costly for new and smaller competitors to duplicate, thus serving as a significant barrier to entry. Meanwhile, the Company differentiates its products with innovative features such as easy installation, unique images and new materials, and provides unmatched retailer support. As a result of its position as the largest flooring company, Mohawk possesses a scale advantage relative to its smaller competitors, giving it leverage against its suppliers and lower unit cost as expenses are amortized over a large sales base.

In the challenging housing environment of the past few years, Mohawk has been unable to offset declining operating profit due to lower sales, the deleveraging of the Company's fixed cost structure and higher raw material costs. As a result, 2009 operating profit margin and ROE fell to 4.5% and 5.8%, respectively, from 9.9% and 17.0%, respectively, just two years earlier. Management's goal is to return to 8%-10% margin over the longer term. Based on the Company's current capital structure, asset turnover level and a normalized tax rate, if management reaches its targeted 9% operating profit margin, we estimate the Company can generate ~12% ROE, which translates close to $6.00 per share in normalized earnings power. In the meantime, over the next five years, we project the Company would be able to generate approximately $1.8 billion cumulatively in free cash flow, or over $26 per share. While management's top priority for free cash flow deployment is acquisitions, the Company is likely to continue to repay debt or repurchase stock if it is unable to find attractively priced strategic acquisitions.

At current levels, the Company is trading at 7.0x depressed LTM EBITDA. We believe Mohawk deserves to trade at a higher multiple due to its competitive advantages, favorable business mix, international growth prospects, well regarded management team and proven ability to generate strong free cash flow. Nevertheless, assuming no multiple expansion and valuing MHK at 7.0x our estimated 2013 EBITDA of $755.0 million, our estimate of the Company's intrinsic value is $71 a share, representing 62% upside from current price levels.

Company Description

Mohawk Industries, based in Calhoun, Georgia is the largest manufacturer and distributor of floor covering products. Among the Company's well known brands are Mohawk, Karastan, Bigelow, Durkan, Dal-Tile, American Olean, Columbian Flooring, Smartstrand and UniClic. In carpets and rugs, the Company owns a 25% market share in the U.S., second only to Shaw Industries (31%), which is owned by Berkshire Hathaway. However, MHK has a 34% share in the ceramic tiles (which accounts for 25% of the Company's 2010 total sales), five times larger than the next competitor. Looking at all flooring products, MHK is the market share leader with a 22% share, slightly ahead of Shaw Industries' 21% share. The top ten competitors in the industry combined have an almost 70% share of the flooring market, with the top four players representing over 50% of the market.

2010 U.S. Flooring Manufacturers

Dollars In Billions	Carpet and Rugs		Total Flooring	
	Dollars	% Total	Dollars	% Total
Mohawk	**$2.4**	**25%**	**$3.5**	**22%**
Shaw	$3.0	31%	$3.3	21%
Armstrong			$1.0	6%
Beaulieu	$0.9	9%	$0.9	6%
Tarkett			$0.6	4%
Mannington	$0.2	3%	$0.6	3%
Interface	$0.5	5%	$0.5	3%
Pfleiderer			$0.3	2%
Marazzi			$0.2	1%
The Dixie Group	$0.2	2%	$0.2	1%
Total Top Ten	$7.3	75%	$11.1	69%
Total Industry	$9.7		$16.0	

Source: Floor Focus via Company presentation, August 2011

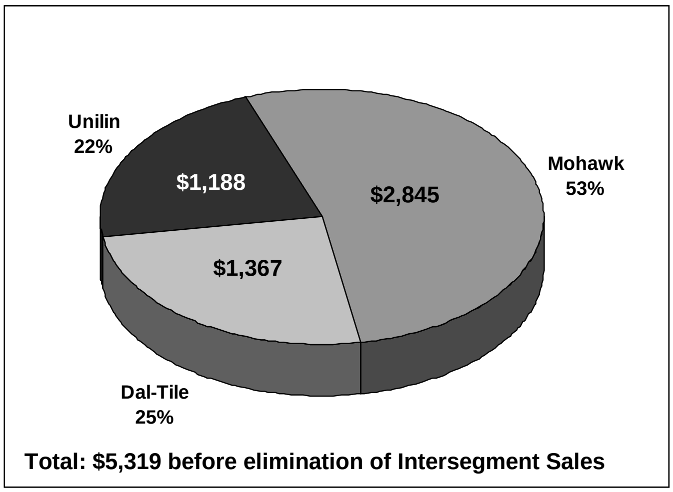
The Company operates in three operating segments: Mohawk (53% of total sales and 35% of total segment EBITDA); Dal-Tile (25% of total sales and 23% of total EBITDA) and Unilin (22% of total sales and 42% of total EBITDA).

The Mohawk segment designs, manufactures, distributes and markets its floor covering product lines for residential and commercial applications in both new construction and remodeling. Its lines include carpet, Mohawk-branded ceramic tile, laminate, rugs, carpet pad, hardwood flooring and resilient flooring, in a broad range of colors, textures and patterns. About 90% of this segment's sales are carpet related and the remaining 10% are Mohawk branded hard surfaces flooring. Approximately 75% of the segment's sales are to residential customers, of which about 75% are for residential replacement and ~25% are to residential new construction. The remaining 25% of the segment's sales are attributed to the commercial construction end market (of which 70% is for replacement needs and 30% is for new construction).

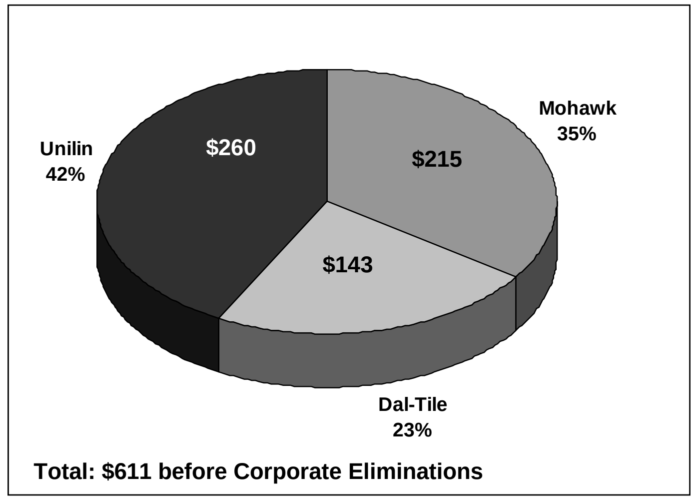
MHK's Dal-Tile segment designs, manufactures, sources, distributes and markets a broad line of ceramic tile, porcelain tile, natural stone and other products used in the residential and commercial markets for both new construction and remodeling. Commercial construction accounts for approximately 40% of the segment's sales. Mohawk purchased Dal-Tile in March 2002 for $1.8 billion. At the time of purchase, Dal-Tile had a little over $1.0 billion in sales and a 25% market share in the tiles category, which is four times its nearest competitor. Under Mohawk's ownership, Dal-Tile's sales have increased over 30% and market share now stands at 34%, which is five times its nearest competitor. Dal-Tile also has leading market positions in stone flooring and countertops. The stone business is a distribution business where Dal-Tile leverages its customer base through its existing sales and service centers. Management estimates, that in just a few years, they have grown the business from zero to approximately 15%-20% market share while becoming one of the major distributors of stone slabs.

Finally, Unilin is one of the leaders in laminate flooring technology and is one of the largest vertically integrated laminate flooring manufacturers in the U.S., producing both laminate flooring and related high density fiberboard. About 75% of the segment's sales are non-U.S., primarily Europe, and 25% are U.S. Unilin products are positioned on the mid to high end of the marketplace and are primarily sold to the residential replacement market through retailers, independent distributors and home centers in Europe and North America under the Quick-Step, Columbia Floor, Century Flooring and Universal Flooring brands. Unilin commercialized direct pressure laminate technology (DPL), a process now used across the industry. The Company is also known for developing the UNICLIC glueless system, beveled edges, and new designs/textures for laminate and hardwood flooring. After having steadily increased distribution within Eastern Europe and Russia, the Company added a manufacturing facility in Russia that will be operational in 3Q 2011. In addition, Mohawk has expanded Unilin's Western European business into the hardwood category with products manufactured from Malaysia and through the acquisition of a large hard surface wholesaler in the U.K. and Ireland. Finally, Unilin recently expanded its product lines to include roofing systems, insulation panels and other wood products. Non-flooring products now account for one-third of overall segment sales.

2010 Sales ($MM)



2010 EBITDA ($MM)



Source: Company reports

History of the Company

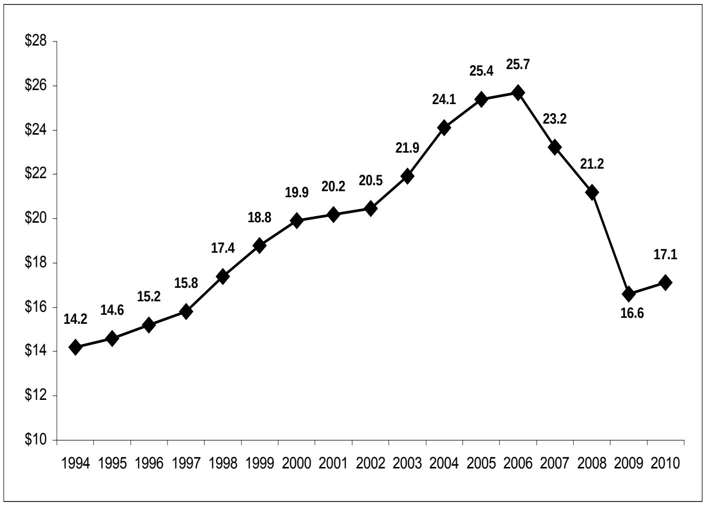
The Company was founded in 1878 by four Shuttleworth brothers who shipped 14 second-hand Wilton looms from Great Britain to Amsterdam, New York (which at the time was a major textile center) to launch their carpet mill. The Company was incorporated in 1902 under the name Shuttleworth Brothers Company. Three generations of Shuttleworths ran the Company's first century, and in 1920, the company began the first of what would become many mergers and acquisitions when it combined with carpet makers McCleary, William and Crouse to become a market leader in the then fragmented industry. After the merger, the combined company was renamed Mohawk Carpet Mills. In 1956, Mohawk merged with Alexander Smith Inc., which was the largest carpet manufacturer in the world at that time, to form Mohasco Industries. Aspiring to build a home furnishing empire, Mohasco acquired nine furniture manufacturers over the next 15 years. By 1972, Mohasco was the number two player in the overall home furnishing market, behind Bassett Furniture, and its carpet business only accounted about a quarter of total sales. Mohasco's carpet business incurred operating losses throughout the late 1970s and 1980s as the industry was burdened with overcapacity and fierce competition. David Kolb was hired as President of Mohasco's carpet division in 1980 and was charged with improving profitability. Over the next five years, he upgraded manufacturing facilities, emphasized high margin carpet products and sold directly to floor covering retailers. Kolb led a management buyout of the division in 1988, but MHK reemerged as a public company in 1992.

In 1994, Mohawk merged with highly profitable and privately held Aladdin Mills. Because Aladdin was more profitable than Mohawk, the privately held company's owners, the Lorberbaum family, ended up with a controlling 39 percent stake in Mohawk. After the merger, Aladdin contributed 40 percent of MHK's sales and 50 percent of net income. In 1995, Jeffrey Lorberbaum, son of Aladdin founder Alan Lorberbaum, was appointed President and Chief Operating Officer. He continued the Company's acquisition strategy to consolidate the industry with the purchase of Galaxy Carpet Mills in 1995, Diamond Rug and Carpet Mills in 1997, and Newmark & James, America Weavers, and World Carpets in 1998. In 1999, Mohawk acquired Image carpet and Durkan Patterned Carpets, Crown Crafts' woven division. In 2001, MHK paid $1.7 billion for

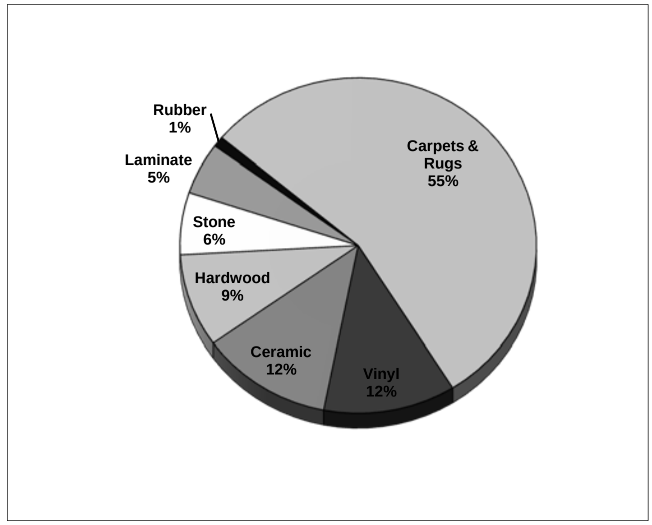
Dal-Tile. The acquisition was the Company's 14th since 1992 and added close to $1 billion to MHK's already substantial $3.3 billion in 2002 sales. In 2005, the Company acquired Unilin for almost $2.6 billion. Over the last 15 or so years, MHK added $4.5 billion in sales through acquisitions.

Overview of the Flooring Industry

U.S. Flooring Sales 1994-2010 ($MM)



2010 U.S Flooring Industry - $17.1 Billion



Source: Floor Covering Weekly, July 18/25, 2011

In 2010, U.S. floor covering sales approximated $17.1 billion consisting of carpet and area rugs (54.7% of total sales), vinyl, linoleum and cork (12.1%), ceramic (11.6%), hardwood (9.4%), stone (6.2%), laminates (5.1%) and rubber (0.9%). Over a ten year period from 1995 to 2005, the Industry grew at a compound annual growth rate of 5.7%. Between 2006 and 2010, the U.S. flooring sales declined 33.2%. Sales in 2010 increased 3.3% due to inventory restocking, depleted inventories at distribution channels, and higher housing sales driven by the homebuyer tax credit. The increase was encouraging given that new home construction was under 500,000 units in 2010, for the second consecutive year, and the homes built were about six percent smaller on average. Catalina Research forecasts flooring sales to increase 2.1% in 2011. Overall industry sales are typically driven by residential replacement and remodeling, which accounts for about 56% of total sales while residential new construction and commercial make up 8% and 36%, respectively.

Carpet and rug sales approximated $9.4 billion in 2010, up 1.1% from 2009's level, while square footage approximated 10.7 million square feet, up 0.8%. Residential replacement and new construction accounted for 65% and 3%, respectively, of total carpet sales. For commercial construction, replacement sales accounted for 21% of total category sales, while new construction makes up 4%. Carpet and area rugs have been losing market share to ceramic tiles, hardwood floor and laminate flooring. Over the last five years, total carpet and area rug sales have declined 36.5% from $14.7 billion in 2006, while overall square footage declined 37.2% from 17.0 billion square feet. During this same period, carpet and area rugs share of the overall flooring market declined from 63.8% to 59.9% (as measured in square footage).

In the hardwood flooring category, sales increased 8.5% from $1.5 billion in 2009 to $1.6 billion in 2010 due to higher pricing (from manufacturers passing through higher lumber prices) and pent up demand from home remodelers. Square foot sales were up 3.2% in 2010 to 829.0 million from 803.4 million in 2009. About 77% of 2010's $1.6 billion hardwood sales are consumed in residential housing (58.3% is replacement and 18.5% new construction). Hardwood flooring share (as measured in square feet) of the overall flooring market increased from 4.1% in 2006 to 4.6% in 2010. Hardwood is now increasingly desired by consumers and should benefit from a healthier consumer spending environment as they remodel their existing homes or purchase a new house. In our view, hardwood flooring should correlate with home sales going forward.

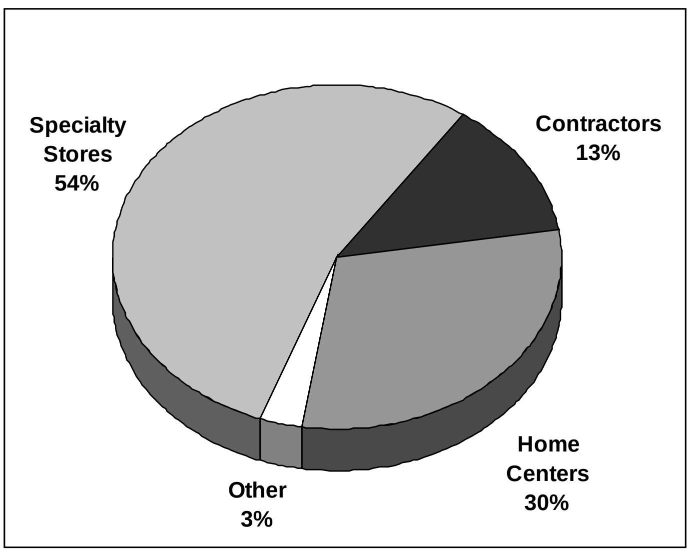
Industry sales of ceramic floor and wall tiles increased 9.2% in 2010 to $2.0 billion from $1.8 billion in 2009. Residential remodel and repair accounted for 40% of this category and new residential construction accounted for another 16%. This category accounted for 11.2% of total flooring industry square footage sales in 2010, down from 12.4% in 2006. This decline has been primarily driven by the fall off in new residential construction. Lately, this category has seen an increase in technology and capabilities of digital inkjet software and printing technology, allowing for the flawless, completely life-like transfer of images and graphics to each and every tile for a highly improved look.

Laminates sales in 2010 declined 2.2% to $881 million from $901 million in 2009. However, industry square footage increased almost 5%. Residential replacement accounts for 80.5% of the laminate market while commercial construction accounts for 11.6%. Over the last five years, laminate flooring square footage has increased from 4.6% of total industry square footage sales to 5.4%. Laminate flooring is growing in popularity with a consumer base looking for value.

Customer Analysis

Over half of the industry's flooring sales are driven by specialty flooring stores, while a little less than one-third of the sales are driven by home centers such as Home Depot and Lowe's.

Floorcovering Retailers – 2010 U.S. Industry



Source: *Floor Covering Weekly*, and Catalina Research via Company presentation, August 2011

For Mohawk, no single customer accounted for more than 5% of total sales and its top ten customers represented for less than 20% of total sales. As a result, a loss of one major customer would not have a big impact on the Company's valuation.

Mohawk Enjoys Various Competitive Advantages

Mohawk maintains strong competitive advantages such as the leading distribution network, low-cost manufacturing, leading dealer focus, and a broad line of product offerings. Below we provide further detail on these competitive advantages:

Barriers to Entry – Leading Distribution System

The Company maintains an unrivaled distribution system that is not only difficult for smaller competitors to replicate, but also serves as a barrier to entry against new competitors. This leading distribution network is a critical factor in maintaining fill-rates, expansive geographic reach, and high customer service levels. The Company operates an efficient hub and spoke operation network of ten regional distribution center (300 distribution points), owns a fleet of approximately 700 trucks and approximately 1,500 sales representatives. In particular, on the Mohawk side of business, the Company has 40 warehouses across the country and it pushes product through its network of trucks and salespeople out to the specialty retailers with the consumers coming to the retailers to make their selections and purchases. On the Dal-Tile side, the Company has about 250 distribution points across the country. Each one of these has a small showroom and a small warehouse. The consumers come into the service center, and make their selections at the showroom. These service centers enable MHK to have a decentralized customer service operation that keeps the Company close to its customers. The importance of this was reinforced by CEO Jeffrey Lorberbaum on two different occasions:

> *"… our distribution has provided Mohawk customers with a higher service level than our competitors can provide. This has allowed us to continue improving customer loyalty for our products. In addition, it has created the foundation for moving from a carpet supplier to a total flooring company. As others in our industry retracted to centralized warehousing, we offered higher service levels, which reduce our customers' inventories and improves their sales."*[1]

> *"… the distribution system that we have really provided dramatic market advantages and has allowed us to have as large a market share as we have…"*[2]

Low Cost Manufacturer

As a result of its position as the largest flooring company, Mohawk possesses a scale advantage relative to its smaller competitors. One of the more obvious scale advantages is its purchasing of raw materials. Many of MHK's raw materials are derived from oil and natural gas such as various fibers, latex, dyes, and colors. Given that these raw materials are volatile and gross profit margin are only in the 20% range, the Company's purchasing scale gives the Company leverage against chemical manufacturers to push back on higher prices or extract more favorable pricing such as volume discounts, relative to its smaller competitors. Also, the Company's scale enables it to amortize its spending on R&D, marketing and distribution over greater units, resulting in lower cost per unit.

MHK also enjoys scale in its operating activities, especially in research and development spending, and marketing. For example, new product development has been a key growth driver for the company, and has produced such innovative products as SmartStrand Triexta, Reveal Imaging and Uniclic. As a result of the Company's scale, it is able to monetize these large expenses over larger quantity of units, resulting in lower cost per unit.

In addition, MHK's manufacturing operations are highly efficient. Mohawk's carpet and rug operations are vertically integrated from the extrusion of resins to the conversion of resins into fiber, and the manufacturer and distribution of finished product. Dal-Tile's operations are vertically integrated from the production of frit (a basic glassy substance that has been fused in a special fusing oven to make porcelain) to the manufacture and distribution of ceramic tile. Vertical integration not only enables the Company to lower costs, but allows it to control quality and service levels. The Company also employs state of the art management information systems to provide managers with real time information to control labor, quality and yield from the shop floor to the sales floor.

Finally, the Company's aforementioned distribution provides it with another cost advantage. Shipping heavy flooring inventory across the country can be costly, especially during periods of elevated energy prices (gas and diesel) such as those currently being experienced. The Company's expansive distribution system with its own truck fleet enables the Mohawk to realize lower transportation costs (shorter travel distance, no fuel surcharges, etc.).

Differentiation

Mohawk differentiates itself in the marketplace through innovative products, a broad product portfolio and unrivaled retail support. One of the reasons MHK has been able to outperform the flooring industry through the recent downturn is its intense focus on product development and innovation. Among some of the new

[1] *Textile World*, April 2003
[2] 4Q 2009 earnings conference call transcript

products recently introduced by the Company are Smartstrand Triexta in carpeting, Reveal Imaging for tiles and UniClic in the Unilin segment. Smartstrand fiber is based on a new material manufactured with DuPont Sorona fiber, a new polyester fiber. Currently, Triexta is exclusively offered by MHK. The material offers better durability, stain protection and softness compared to other polyester fibers. The Company is able to manufacture the product cost effectively because it is made with corn, which requires less energy. From the consumers' perspective, Smartstrand reduces the life cycle costs of the product due to his superior durability and stain resistance. MHK's reflective imaging for ceramic tiles brings the latest in digital imaging technology and one of the most sophisticated design application processes in the industry by produce the most natural, realistic tile. The technique creates a three dimensional appearance with intricate visual detail and unmatched color definition. Finally, in the Unilin business, in addition to new finishes and species, the engineered products in Mohawk's wood introduction also feature a new glueless installation system based on UniClic technology, recognized as the installer's favorite click system for laminate. This patented method allows for fast, easy angled or sliding installing on the sides of the panels.

Another point of differentiation for Mohawk is the scope of products it offers retailers to attract customers into their stores. MHK owns a broad portfolio of high quality, well known products at various price points, allowing different brands to go under different market places as well as strategies of how to use those brands and to keep them differentiated in the marketplace, without cannibalizing each other. With a broad product portfolio, MHK is able to segment the marketplace, both geographically as well as within various channels, and also use different products from channel to channel. For example, within the Company's carpet business, the Karastan brand is positioned at the high end while the Aladdin brand is on the low end. Over the course of the business cycle, Mohawk is able to participate as consumer either trade down or up.

Finally, MHK also provides retailer support to help the retailers sell flooring products. As CEO Lorberbaum described in a recent interview,

> *"We offer total store concepts, boutiques and individual product collections to meet the needs of different retailers. These offerings also include store design, coordinated merchandising, comprehensive selling systems, consumer benefits, geographic exclusivity, unique products, retail and sales training, co-branding, promotion and advertising, to name a few."*[3]

Approximately half of the industry's sales are made by floor covering stores, which are generally smaller and do not have the scale to merchandise the products cost effectively. As a result, MHK's retail support can be crucial to these stores' success.

Balance Sheet Continues to Improve and Robust Free Cash Flow Generation

Mohawk generates robust free cash flow. Over the last 10 years, the Company has generated close to $3.8 billion in free cash flow, or $54 per share, which is greater than the Company's current market capitalization.

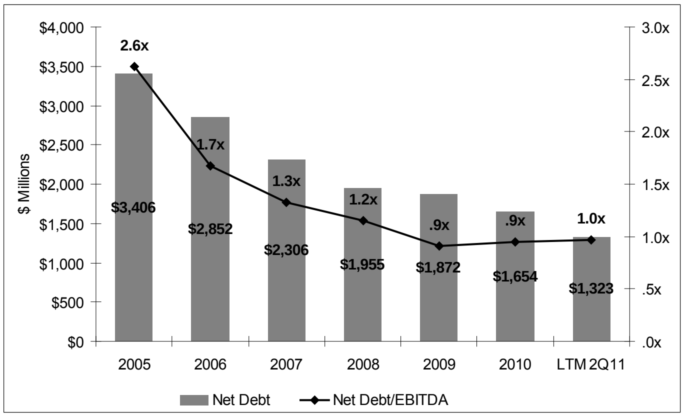
	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
CFFO	331.2	549.5	309.4	242.8	561.5	782.0	880.4	576.1	672.2	319.7
Capex	(52.9)	(111.9)	(114.6)	(106.6)	(247.3)	(165.8)	(163.1)	(217.8)	(108.9)	(156.2)
FCF	278.3	437.6	194.8	136.2	314.2	616.2	717.3	358.3	563.3	163.5

Source: Company reports

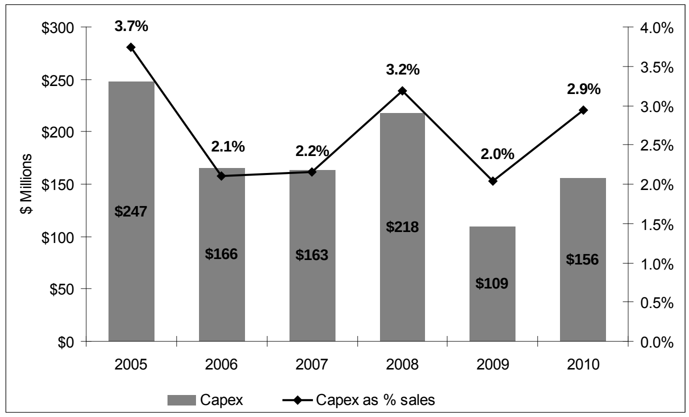
This has allowed the Company to repay close to $2.0 billion of debt since 2005, or $27 per share. As a result, net debt has declined from a peak of $3.3 billion at the end of 2005 to just $1.3 billon at July 2, 2011. In addition, the Company has invested about $1.5 billion in capital expenditures to upgrade its facilities, improve the efficiency of its manufacturing processes and increase manufacturing capacity in low cost regions (Mexico and Russia).

[3] *Textile World*, April 2003

Net Debt



Capex



Source: Company reports

Much of the Company's free cash generated is due to excess depreciation and amortization expense relative to capital expenditure requirements. Over the last ten years, MHK has averaged $59.2 million in excess depreciation and amortization. This excess D&A is derived from the acquisitions the Company has made since 1992, with the largest being Dal-Tile in 2002 and Unilin in 2005. For 2011, D&A is expected to be near $300 million and capex is expected to approximate $280 million. 2011 capex is elevated due to three large projects, totaling $120 million, MHK is undertaking to support future growth.

	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
D&A	84.2	101.9	106.6	123.1	150.7	275.0	306.4	295.1	298.7	296.0
Capex	(52.9)	(111.9)	(114.6)	(106.6)	(247.3)	(165.8)	(163.1)	(217.8)	(108.9)	(156.2)
Excess D&A	31.3	(10.0)	(8.0)	16.5	(96.6)	109.2	143.3	77.3	189.8	139.8

Source: Company reports

Over the next five years, we project Mohawk can generate approximately $1.8 billion cumulatively in free cash flow, or about $26 per share. Management's top priority for cash generated is acquisitions, which includes tuck-in acquisitions in markets it is currently in (both geographically and product lines), and new geographies in high-growth world marketplaces that it currently does not participate in. However, management also stated that if it is unable to find the right acquisition at the right price, it will continue to repay debt or buyback stock. At the end of 2010, the Company had 3.5 million shares left on its share repurchase authorization. Since the Board of Directors authorized a 15 million stock repurchase program in 1999, MHK has repurchased approximately 11.5 million shares for about $334.7 million, or $29.10 per share. These repurchases helped offset share dilution issued for acquisitions. Since the $2.6 billion of Unilin in 2005, the Company has not repurchased any shares.. With the Company's stock price trading below 6.5x our estimated 2011 EBITDA and leverage near historic lows, we would not be surprised to see the Company repurchase shares on the open market.

Operating Performance and ROIC

When Jeff Lorberbaum was appointed President and COO in 1995, Mohawk generated low to mid single digit operating profit margin it had been focused more on acquisitions than it did on operations. Lorberbaum quickly improved profitability by rationalizing manufacturing capacity, closing several mills and consolidating operations at the most efficient plants. He also expanded Aladdin's warehousing and distribution system to service all of Mohawk's operations, and launched a more relevant marketing campaign that emphasized the strength of the Company's core brands. Lorberbaum's restructuring efforts paid off as Mohawk profitability steadily improved each year under the early part of his tenure and consistently maintained 9%-11%

operating profit margin since 2001. However, since the onset of the housing recession that began in 2006, the Company has been unable to offset declining operating profit due to lower sales, the deleveraging of the Company's fixed cost structure and higher raw material costs. As a result, the Company's operating margin fell to 4.5% in 2009 from 9.9% in 2007. Management moved quickly to align MHK's infrastructure with current market demand, such as closing inefficient facilities, redesigning and automating processes, and upgrading information systems and reporting tools. Also, the Company focused on managing working capital and limiting capital expenditure to projects with immediate paybacks. All these actions have helped improved profitability as operating profit margin improved 130 bps to 5.8% in 2010 and the Company generated robust free cash flow as previously mentioned. Operating profit continued to improve in 2011 as first half 2011 operating profit increased to 6.9%, up 50 bps from 6.4% in the same period last year. Management believes the Company can eventually return to 8%-10% operating profit margin.

From 2001 when Lorberbaum was appointed CEO through the start of the housing recession in 2006, the Company's return on equity (ROE) ranged between 11.9% and 19.9%, and averaged 14.4%, while return on invested capital (ROIC) ranged between 8.0% and 15.8%, and averaged 11.7%. As a result of lower sales volume and higher raw material costs over the last few years, the Company's ROE dropped to an embarrassingly low 5.8% in 2010 and ROIC was a dismal 3.8%. We believe ROE and ROIC were negatively impacted during 2010 reflecting lower sales volume (which we believe are cyclical rather than secular issues) and higher raw material costs (which are a temporary mismatch between price and cost). Based on the Company's current capital structure, asset turnover level and a normalized tax rate, if management reaches its targeted 9% operating profit margin, we estimate the Company can generate ~12% ROE, which translates to approximately $6.00 per share in normalized earnings power.

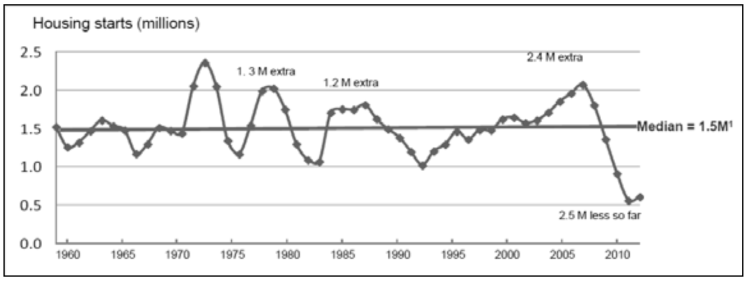
Given this level of mediocre ROE and ROIC, one may question whether the Company is competitively advantaged. However, the Company's return on tangible invested capital has ranged between high teens to high 20% range. We believe ROTIC is more reflective of the Company's business model since ROE and ROIC are diluted by management's capital allocation and other temporary business conditions.

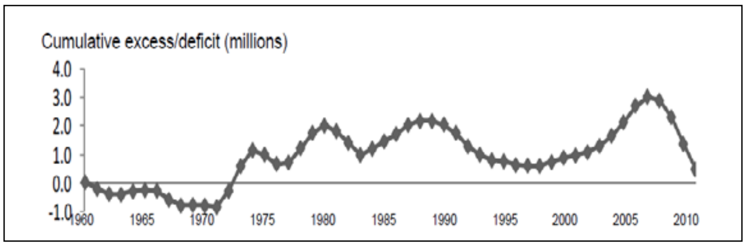
Growth Drivers and Catalysts

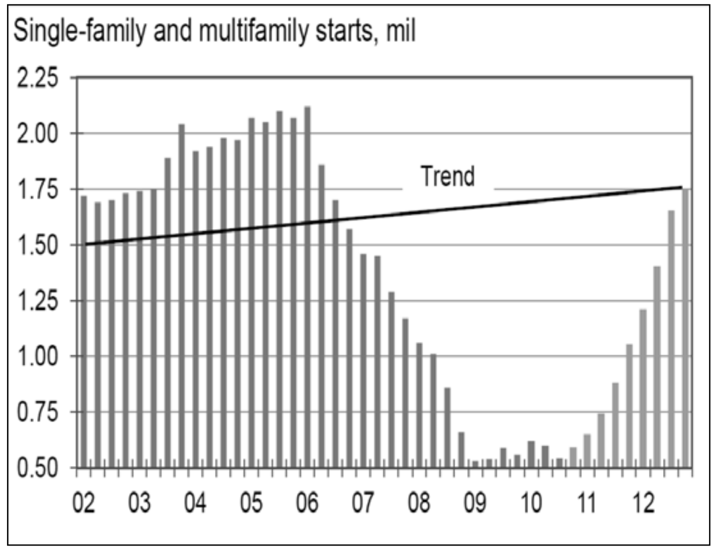
We believe Mohawk will be a prime beneficiary of a few favorable trends: the eventual recovery of the new residential housing construction market, an aging housing stock, pent up demand for remodeling, and international expansion.

Rebound in New Residential Housing Construction

As we mentioned in the introduction of our 2011 summer double Issue, *Stocks Set For a Lift From a Housing Recovery*, new housing construction is currently near an all time low. Using housing permits as a proxy for housing starts/construction (since this data is widely available and has closely tracked construction), median housing starts totaled approximately 1.5 million homes per year since 1960. This figure is more or less in-line with long term housing demand which is around 1.35 million per year. Between 2000 and 2006, sales of new and existing homes increased by 14% and 26%, respectively. Home builders responded in kind and increased production to meet demand, resulting in a cumulative 2.4 million new homes being over built relative to long term demand between 2004 and 2006. At the onset of the recent housing recession, housing permits dropped to under 1.4 million by 2006 and continued to decline thereafter, reaching the historic low point of roughly 440,000 units in 2009. Since the overbuilding ended in 2006 and the ensuing decline in production, there has been a cumulative 2.5 million fewer homes built relative to long term demand. This amount of under building helped offset the accumulated 2.4 million surplus homes and has left the single family housing market in an under-built state. In 2010, annual new home construction was just 600,000 consisting of 450,000 single family homes, 100,000 multifamily and 50,000 manufactured homes.







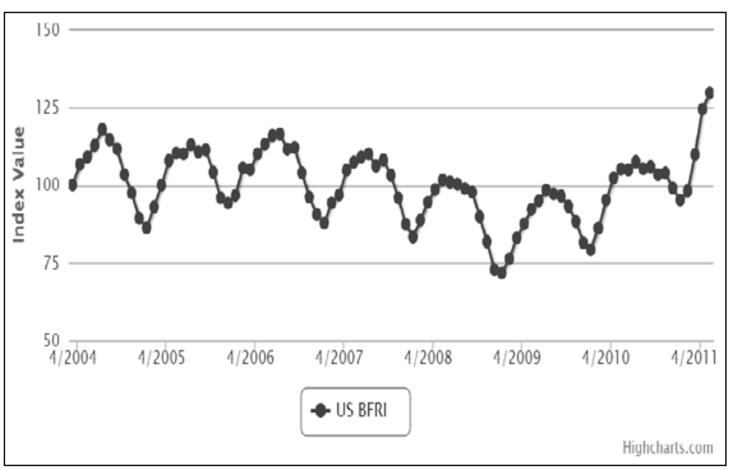
Source: U.S. Census Bureau; NAHB via PulteGroup, Inc., Investor Presentation, June 2011

Source: Moody's Analytics, "Housing Hits Bottom in 2011"

Home Replacement and Remodeling

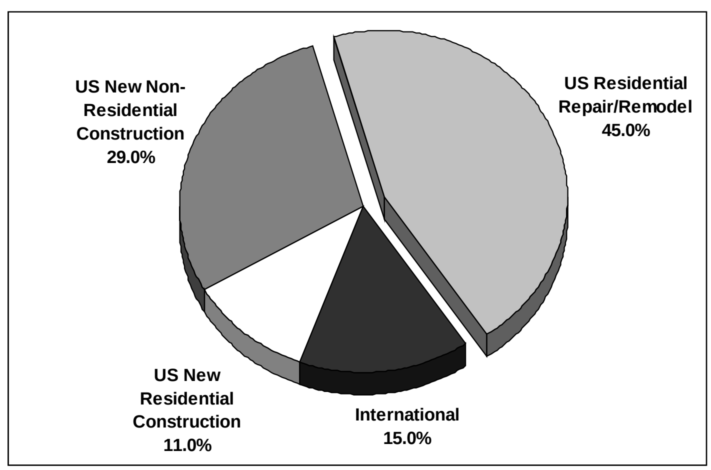
The average carpet or laminate wood floor lasts approximately seven to ten years. One of the more popular items homeowners like to remodel is their floor, either replace due to wear and tear or to get an updated look of the room. According to The National Association of Home Builders (NAHB), Americans spent $116 billion on improvements to owner-occupied units in 2010, down from a peak of $146 billion in 2006. However, housing expenditures are expected to increase steadily as the broader housing market recovers through 2011 and 2012, reaching $119 billion and $131 billion, respectively. Indeed, according to a recent industry report, the Residential BuildFax Remodeling Index was up for the twentieth straight month in June 2011 and now stands at the highest point since August 2004. This trend bodes well for MHK since close to half of the Company's business is derived from the residential home remodeling and replacement end market.

BuildFax Remodeling Index



Source: Buildfax.com

Mohawk Sales by End Markets



Source: Company reports

Aging U.S. Housing Stock

The age of owner-occupied housing stock has been trending upwards over the last ten years. In 1997, the median age of the average American home was 29 years, but it crept up to 32 years by 2007. In fact, according to the latest American Housing Survey, over 50% of the U.S. housing stock is 40 years or older, which bodes well for future flooring/remodeling expenditures .

U.S. Housing Stock

Year Structure Was Built	Total Housing Units	% of Total
2005 to 2009	7,324	5.6%
2000 to 2004	9,158	7.0%
1995 to 1999	8,821	6.8%
1990 to 1994	7,060	5.4%
1985 to 1989	8,804	6.8%
1980 to 1984	7,478	5.7%
1975 to 1979	13,731	10.6%
1970 to 1974	11,068	8.5%
1960 to 1969	15,261	11.7%
1950 to 1959	13,222	10.2%
1940 to 1949	7,945	6.1%
1930 to 1939	5,840	4.5%
1920 to 1929	5,164	4.0%
1919 or earlier	9,235	7.1%
	130,111	100.0%

Source: American Housing Survey for the United States, 2009

International Growth

Approximately 15%-20% of the Mohawk's total sales are generated outside of the U.S. Currently, the Company is focused on the developing countries, in particular, Mexico, Russia and China.

International Growth Opportunities

Sq. Ft. in Millions	2005	2006	2007	2008	2009
China					
TILE	33,100	40,400	47,600	54,700	59,200
Russia					
LAMINATE	395	409	527	656	592
Mexico					
TILE	1,732	1,765	1,861	1,894	1,754

Source: Ceramic World, Frost & Sullivan, China Construction Ceramics Association and management estimates via Company presentation

The Mexico tile market is equivalent to the U.S. market in terms of market size and unit volume, and growing 5%-6% per year. The Company's Dal-Tile business unit has manufactured ceramic tiles in Mexico (at its Monterrey facility) since 1955, primarily for export to the United States. Sales in the Mexican market was primarily on the higher end segment of the market and MHK achieved less than a 10% market share of the entire market. However, the lower end of the segment comprises the largest market segment. Now, Mexico is one of the focal points of MHK's growth strategy. To gain a larger share of this market, the Company recently constructed a new plant in Salamanca, near Mexico City, to expand production, broaden the product offerings to encompass value price points and increase market penetration through distributors. This new plant is targeted to begin production in mid-2012. According to Lorberbaum,

> *"The Mexican marketplace this year [2010] grew 3%, it's anticipated to grow about 6% next year. So we believe it's a good market to be in. We have management talent there that understands how to operate the plants, and understands the customer base. And we will invest this year [2011], broadening our distribution, and in some cases, selling the products that we have into the marketplace and they'll be replaced by new ones when the [new] plant [comes on-line]…."* [4]

MHK started distributing tiles to the Russian marketplace during 2008. In 2009, total flooring market in this country was approximately 4.1 billion square feet, with laminate and hardwood flooring accounting for 9% and 5%, respectively, of the total market. Russia's market growth is driven by a rapidly expanding middle class and rising personal income. Until recently, the Company primarily imported ceramic and laminates into the Russian market from its European plants. However, importing is difficult as it is not only costly, but it is difficult to get products across the borders, which negatively impacts customer service levels. In 2009, MHK built a distribution center in Russia in order to improve customer service and enable it to broaden out its sales base. In 2010, the Company began construction of a manufacturing plant in the country, which will be partly operational in 2011. This new facility will be able to support $100 million worth of sales and should be operational in 3Q 2011. As in Europe, the Company aims to compete in the mid- to high-end with differentiated products in the Russian laminate market.

The Chinese flooring market is estimated to be approximately 60 billion square feet, or 30 times the size of the U.S. market, and it is expected to grow 10%-12% per year. The market is highly fragmented with the largest player having no more than a 3% or 4% market share. Mohawk recently entered the Chinese market with an $80 million investment for a 34% interest in Sanfi, one of the country's top ten ceramic tile manufacturers. This investment not only allows the Company to participate in the world's largest and fastest growing tile market, but it also provides MHK with a source of low cost value-added products for the North American market and a gateway to neighboring Asian markets. According to Lorberbaum,

> *"We've put significant capacity in that marketplace. We are developing the customers, broadening our distribution. We are, in China, we brought together glazed floor tile technology, which the first line has already been started up in China. We're helping them develop products. We're helping them improve their merchandising and marketing, and the combination of those pieces; we believe that we can grow our share, both from an internal standpoint. And then longer-term, it would give us the base to possibly start consolidating the market over time and put us in a position to significantly participate in the market over time."* [5]

Valuation

At current levels, Mohawk is trading at 7.0x LTM EBITDA, which we believe represents depressed profitability. Over the last 10 years, TEV/LTM EBITDA ranged between 4.9x and 12.5x, and averaged 8.7x. Comparable companies in our universe that supply building products to the home construction and remodel industry are currently trading at ~10.0x LTM EBITDA.

From a strategic acquirer perspective, Berkshire Hathaway acquired Shaw Industries at ~7.0x LTM EBITDA in 2001. However, we believe margins were more normalized in 2001 than is currently the case. At the time of Berkshire's acquisition, Shaw's had operating profit margin of 9.4%, which was similar to MHK's profitability at the same time and much higher than the Company's operating profit margin of 5.8% in 2010. Furthermore, the majority of Shaw's business is carpeting, which has slower growth and a lower operating profit margin. More recently, in August 2009, private equity group, TPG Capital, acquired a 12% interest in another of MHK's competitors, Armstrong World Industries, for about $156 million, implying a valuation of approximately 5.0x LTM EBITDA. It should be noted that TPG did not acquire the shares directly from

[4] 4Q 2010 earnings call transcript
[5] Ibid

Armstrong World Industries. Instead, TPG acquired the shares from The Armstrong World Industries Asbestos Personal Injury Settlement Trust (which is a separate legal entity formed 2006 as part of Armstrong World's emergence from bankruptcy to handle Armstrong World's asbestos liabilities and currently owns ~52% of Armstrong World Industries stock). We believe the Trust is being forced to sell shares at such a low valuation in order to fund liability settlements.

Building Products Companies Valuation Comparison

	TEV	LTM EBITDA	TEV / LTM EBTDA
Mohawk Industries	4,400.1	628.6	7.0
Armstrong World Industries	2,732.6	353.5	7.7
Interface Inc.	1,086.5	134.8	8.1
Beacon Roofing Supply	1,058.8	112.6	9.4
Trex Company	354.9	30.3	11.7
Masco Corporation	5,220.4	421.0	12.4
Average			**9.4**
Average excluding Mohawk			**9.9**

Source: Capital IQ

In our view, MHK warrants a premium valuation due to its competitive advantages, better business mix, favorable international growth prospects, well regarded management team and ability to generate strong free cash flow. Nevertheless, assuming that there is no expansion in the valuation multiple and valuing MHK at 7.5x our estimated 2013 EBITDA of $755.0 million, estimate the Company's intrinsic value to be $71 per share for the Company, representing ~62% upside from current price levels. In deriving our EBITDA estimate, we assumed sales growth of only 3.0% per year over the next two years. Our sales assumptions incorporates no improvement in the new residential construction market from 2010's depressed levels, continued slow growth for both commercial and residential remodeling activities and price increases initiated by the Company to catch up on recovering higher raw material costs. Also, we assumed gradual improvement in the Company's profitability level due to price increases the Company has taken to recover higher raw materials and cost savings initiatives. Management has restructured all three businesses to improve efficiencies, reduce manufacturing costs, enhance materials yields (through increased production speeds and innovative product engineering), and utilize alternative materials. Accordingly, we assumed operating profit margin to increase from 5.8% at the end of 2010 to 8.0% by the end of 2013. We would note that this level of operating profitability is at the lower end management's targeted goal of 8%-10% operating profit margin. In addition, any improvement in the new construction market will provide meaningful upside to our operating profit assumption. Finally, we assumed all the free cash flow generated by the Company is used to repay debt.

MHK Estimate of Intrinsic Value

2013E EBITDA	$754.8
Valuation Multiple	7.0x
Total Enterprise Value	5,283.8
Less: 2013E Net Debt	360.5
Intrinsic Equity Value	4,923.3
Shares Outstanding	69.0
Intrinsic Value per share	$71
% Upside From Current Levels	61%

Share Ownership

We believe management's interests are tightly aligned with shareholders. As a result of the merger of Mohawk and Aladdin Mills in 1994, the Lorberbaum family (led by the Company's CEO Jeffrey Lorberbaum, age 56) owns 10.8 million shares or approximately 16% of the Company's shares outstanding. As mentioned previously, Mr. Lorberbaum joined the Company in 1995 and has been Mohawk's CEO since 2001.

Conclusion

Mohawk Industries is an out of favor stock. However, as the world's largest flooring company, MHK is one of the prime beneficiaries of an eventual recovery in new residential housing construction. In the meantime, as it waits for that end market to turn around, half of the Company's sales come from the replacement and remodeling end markets and another 15%-20% come from international channels, particularly Mexico, Russia and China. These additional end markets should help MHK weather the recent housing recession. In the meantime, the Company is focused on generating free cash flow by managing its cost structure, capital expenditures and working capital in order to pay down debt. Mohawk maintains various competitive advantages, which helped it outperform the flooring industry through the recent downturn. The Company maintains a distribution system that is not only difficult for smaller competitors to replicate, but it serves as a barrier to entry against new competitors. This leading distribution network is a critical factor in maintaining fill-rates, expanding its geographic reach, and generating high customer service levels. MHK's innovation machine continue to develop products that lead and move the industry to a new level, such as creating a new class of materials in carpeting, easy to install laminate wood floors and unique images in tiles. Finally, as a result of its position as the largest flooring company, Mohawk possesses a scale advantage relative to its smaller competitors, giving it leverage against its suppliers and also, lower unit cost as expenses are amortized over a large sales base.

At the current share price, Mohawk is trading about 7.0x LTM EBITDA, which we believe likely represents a depressed profitability level. We also believe MHK warrants a premium valuation due to its competitive advantages, better business mix, favorable international growth prospects, well regarded management team and strong ability to generate robust free cash flow. Nevertheless, assuming no multiple expansion and valuing Mohawk at 7.0x our 2013E EBITDA of $755 million, we derive a value of $71 for the Company, representing ~62% upside from current price levels.

Risks

Risks that Mohawk Industries may not achieve our estimate of the Company's intrinsic value include, but are not limited to, higher raw material costs, inability to pass through pricing to recover margins, a slower than expected recovery in the new residential housing construction market, slowdown in residential home remodeling, inability to expand internationally, increased competitive pressures, changes in the regulatory environment, and failure to properly integrate future acquisitions.

Analyst Certification

Asset Analysis Focus certifies that the views expressed in this report accurately reflect the personal views of our analysts about the subject securities and issuers mentioned. We also certify that no part of our analysts' compensation was, is, or will be, directly or indirectly, related to the specific views expressed in this report.

MOHAWK INDUSTRIES, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS
(In thousands)
(Unaudited)

ASSETS	July 2, 2011	Dec. 31, 2010
Current assets:		
Cash and cash equivalents	$ 285,422	$ 354,217
Restricted cash	—	27,954
Receivables, net	797,893	614,473
Inventories	1,102,769	1,007,503
Prepaid expenses	103,518	91,731
Deferred income taxes	135,338	133,304
Other current assets	22,297	19,431
Total current assets	2,447,237	2,248,613
Property, plant and equipment, at cost	3,649,881	3,518,392
Less accumulated depreciation and amortization	1,918,967	1,831,268
Property, plant and equipment, net	1,730,914	1,687,124
Goodwill	1,418,830	1,369,394
Tradenames	481,351	456,890
Other intangible assets, net	199,827	220,237
Deferred income taxes and other non-current assets	110,841	116,668
TOTAL ASSETS	$ 6,389,000	$ 6,098,926

LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Current portion of long-term debt	$ 453,185	$ 350,588
Accounts payable and accrued expenses	771,297	698,326
Total current liabilities	1,224,482	1,048,914
Deferred income taxes	366,610	346,503
Long-term debt, less current portion	1,155,150	1,302,994
Other long-term liabilities	93,499	93,518
TOTAL LIABILITIES	2,839,741	2,791,929
Redeemable noncontrolling interest	32,300	35,441
Stockholders' equity:		
Preferred stock, $.01 par value	—	—
Common stock, $.01 par value	798	797
Additional paid-in capital	1,242,963	1,235,445
Retained earnings	2,265,188	2,180,843
Accumulated other comprehensive income, net	331,558	178,097
	3,840,507	3,595,182
Less treasury stock at cost	(323,548)	(323,626)
TOTAL STOCKHOLDERS' EQUITY	3,516,959	3,271,556
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$ 6,389,000	$ 6,098,926

September 13, 2011
Volume XXXVII, Issue VII & VIII

Watsco, Inc.

(NYSE: WSO)

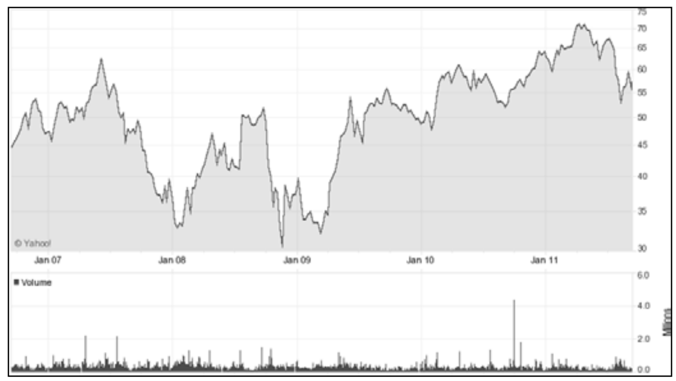
Dow Jones Indus:	**11,105.85**
S&P 500:	**1,172.87**
Russell 2000:	**691.74**
Index Component:	**S&P 400**

Trigger: No
Type of Situation: Consumer Franchise, Business Value

Price:	**$ 57.25**
Shares Outstanding (MM):	**30.7**
Fully Diluted (MM) (% Increase):	**30.8 (0.3%)**
Average Daily Volume (MM):	**0.310**
Market Cap (B):	**$ 1.79**
Enterprise Value (B):	**$ 1.81**
Percentage Closely Held:	**Officers/Directors 16% economic/ 58% voting**
52-Week High/Low:	**$ 72.76/52.12**
5-Year High/Low:	**$ 72.76/30.62**
Trailing Twelve Months Price/Earnings:	**21.9x**
Price/Stated Book Value:	**2.3x**
Long-Term Debt (MM):	**$ 65**
Upside to Estimate of Intrinsic Value:	**31%**
Dividend:	**$ 2.28**
Payout	**87%**
Yield	**4.0%**
Revenues Per Share:	
2010:	**$ 93.02**
2009:	**$ 70.19**
2008:	**$ 62.92**
2007:	**$ 64.78**
Earnings Per Share:	
2010:	**$ 2.49**
2009:	**$ 1.40**
2008:	**$ 2.09**
2007:	**$ 2.34**
Fiscal Year Ends:	**December 31**
Company Address:	**2665 South Bayshore Drive Coconut Grove, FL 33133**
Telephone:	**305-714-4100**
Chairman/CEO:	**Albert H. Nahmad**

Clients of Boyar Asset Management, Inc. do not own shares of Watsco, Inc. common stock.

Analysts employed by Boyar's Intrinsic Value Research LLC do not own shares of Watsco, Inc. common stock.



Overview

Watsco, Incorporated ("Watsco," "WSO" or "the Company") is a distributor of heating, ventilation, and air conditioning (HVAC) equipment and supplies for residential and light commercial buildings. Watsco is the largest independent distributor in the United States in an otherwise fragmented industry characterized by strong barriers to entry, rational competition and local monopolies, relatively steady pass-through margins, a growing install base offering strong long-term recurring revenue sources (75% of Watsco's revenue), and positive long-term pricing and margin implications from the trend toward more energy efficient units.

As the only independent U.S. distributor of national scale, Watsco looks ideally positioned to take advantage of these conditions. The Company has historically grown through a very cautious but steady acquisition strategy, integrating well-run family businesses when the situation presents itself while eschewing leveraged transactions. We believe Watsco's three recently established joint ventures with United Technologies to take over most of the distribution centers of its leading HVAC equipment business (Carrier) exemplify the Company's market leadership and strong operational skills. Watsco has already expanded operating margins by close to 400 basis points two years into the first-established JV. Watsco also completed the transactions at bargain multiples of 0.2x-0.4x sales and as low as 4x forward earnings based on our estimates—which we believe reflects both the Company's operating skills and the absence of competing bidders given its unique position.

Going forward, we believe additional operating improvements from the Carrier JVs, which expand Watsco's revenue base by >60%, as well as the exercise of options to increase the Company's ownership in the Carrier Sunbelt JV, should drive outsized earnings growth. Additionally, unitary equipment sales are currently at historic lows but should see a boost from the run-down of pent-up replacement demand and/or a recovery in new home construction levels. Even while discounting a full recovery by 2014 in our forecasts, we estimate Watsco's intrinsic value at $75 per share based on 9x 2014E EV/EBITDA. Watsco also offers an unleveraged balance sheet ($65 million in seasonal borrowing) and strong free cash flow generation with an emphasis on returning cash to shareholders via dividends. The Company has increased its dividend rate for 10 consecutive years, most recently by 10% to $2.28/share in February, offering an attractive 4.0% yield at the current share price.

Industry Background

The domestic residential and light commercial heating, ventilation, and air conditioning (HVAC) business is in many ways little changed looking back over the past fifty-plus years. On the supply side, while some low-cost Asian manufacturers have made modest headway into pockets of the industry, the HVAC equipment market is still dominated by a small number of original equipment manufacturers (OEMs) including: Trane (acquired by Ingersoll Rand in 2008), Carrier (United Technologies), York (Johnson Controls), Rheem (Paloma Industries), Lennox International, and Goodman Holding. The HVAC parts and supplies manufacturing business is more competitive, with hundreds of companies manufacturing various products. While several of the HVAC OEMs have company-owned distribution facilities, they represent a minority of industry sales. Several factors have kept factory-owned distribution centers to a minimum including the lack of specialized retailing/local customer relationship skills, capital allocation priorities, and the inability to offer a competitive/full slate of equipment, parts and supplies. Instead, the HVAC distribution business features greater than 1,300 separate independent distributors throughout the country.

HVAC distributors sell to a wide, unconsolidated base of over 100,000 contractors. As a result, local relationships with individual contractors are key business drivers for distributors. Additionally, OEMs typically grant exclusive or semi-exclusive, often perpetual licenses to distributors on a regional or state-by-state basis. These licenses are typically not transferrable without the approval of the OEM and serve to control quality as well as to create a more rational pricing environment. As a result, many of the HVAC distributors are small local businesses that have been run by the same families for decades. These factors also serve as a barrier of sorts from the major do-it-yourself or big box retailers entering the business, while also making it more difficult for private equity money to quickly roll-up the distribution industry.

Watsco History

Watsco is the leading distributor of heating, ventilation, air conditioning, and refrigeration (HVAC/R) equipment and supplies in the United States. Watsco was founded in 1947 as a manufacturer of parts and supplies for heating, ventilation, and air conditioning systems. The Company went public in 1962 and in 1973 came under the leadership of current Chairman, President and CEO and controlling shareholder Mr. Albert Nahmad (age 70). Watsco transitioned toward the distribution side of the HVAC/R business in 1989. Seeing a highly fragmented distribution business, over the next 20+ years, CEO Nahmad headed the acquisition of 57 separate HVAC/R companies, primarily independent 'mom and pop' distributors. In 2009, Watsco established a transformational joint venture with leading HVAC equipment manufacturer Carrier Corp. (a subsidiary of United Technologies) to take over Carrier's 95 distribution centers in the U.S. Sunbelt region. This year the joint venture was extended to Carrier's Northeastern U.S. and Mexico operations. Under Mr. Nahmad's leadership, Watsco has grown from approximately $25 million in annual sales in 1988 to a current run rate of roughly $3 billion across 526 distribution centers in 37 states. Watsco's leading position in the industry still represents a modest ~10% market share and was built up through a very slow, methodical expansion and strategy of acquiring well-run local businesses over the past 20+ years.

Watsco's Competitive Advantages

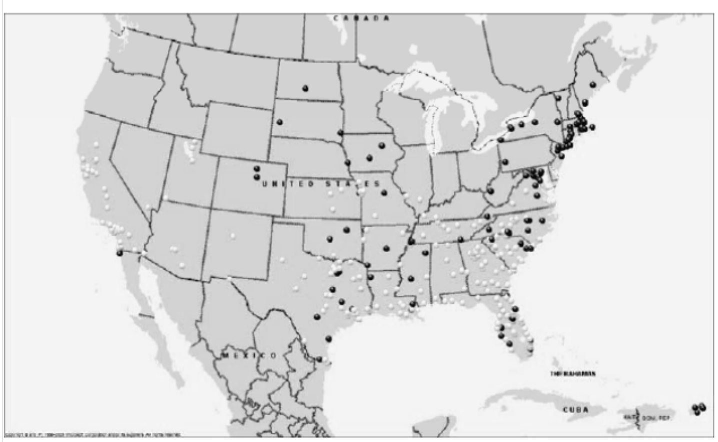
Given the aforementioned industry dynamics, we believe HVAC/R distribution offers a relatively stable business for existing competitors with a limited threat from new entrants. In addition, we believe Watsco offers particular competitive advantages that should insulate it from significant market share erosion from fringe competitors:

- Exclusive distribution agreements—Watsco holds exclusive distribution agreements in various regions with top OEMs such as Carrier and Rheem. This makes Watsco the only option for contractors looking for particular high-end products.
- Market Share—Although the Company's leading market share still accounts for only approximately 10% of the $30 billion domestic market, management has noted that Watsco maintains 20%-30% or greater market share in many of its top regions. Watsco's scale and market share also provide it with an advantage in negotiation power with suppliers compared to smaller independents.
- Customer relationships—Watsco supplies to over 50,000 contractors. A very local customer base and Watsco's focus on retaining long-tenured store managers and counter people creates a sense of loyalty. Watsco also offers customers assistance with local advertising, market development and strategy, which few competitors match.
- Balance Sheet Size & Strength—Watsco is by far the largest HVAC/R distributor, and also sports a healthy balance sheet (net debt to EBITDA only 0.2x). When smaller family distributors are looking to exit the business, Watsco is the best-capitalized, and sometimes the only, potential buyer. This has historically allowed the Company to acquire profitable, well-run businesses at attractive valuations. Watsco's balance sheet also enables the Company to extend credit to its customers, which may help win business from competitors. According to the Company, the average customer has roughly $5,000 in credit. Allowance for doubtful accounts were still modest at $6.3 million at year-end 2010.

Watsco Business Description & Recent Performance

Watsco operates 526 distribution facilities across 37 states and Puerto Rico. The Company has historically concentrated on gaining scale in the 'Sunbelt' region across the southern U.S., where central air condition is more often seen as a necessity and seasonality in the business is minimized. The Sunbelt still accounts for close to 90% of the Company's revenue, including close to 30% from Florida and between 15%-20% from Texas, with the Carolinas accounting for the third-greatest share. With the recent Carrier Enterprise joint ventures (described in greater detail on pages 68), Watsco is also expanding its reach in the Northeast as well as Latin America and the Caribbean.

Current Footprint



Product Mix

Equipment	
Split systems	28%
Air handlers & coils	12%
Packaged units	10%
Furnaces	4%
Other	5%
Total equipment	59%
Parts & supplies	34%
Commercial refrigeration	7%
Total	100%

Note: Watsco locations in white, Carrier Enterprise locations in black

Source: Company presentation, August 2011

Watsco derives approximately 59% of revenue from HVAC equipment such as furnaces, split systems, air handlers, and evaporator coils. Parts and supplies account for another 34% of revenue, and consist of over 50,000 SKUs. Watsco's goods are sold to a highly fragmented customer base of over 50,000 contractors, with end-users primarily residential units as well as some light-commercial buildings. Watsco also derives approximately 7% of revenue from commercial refrigeration products. This includes light commercial refrigerators and ice making equipment and related parts sold to grocery stores, restaurants, hotels, etc. Watsco only significantly entered the light commercial refrigeration business around 10 years ago but has experienced solid growth from both market share gains and favorable regulatory (energy efficiency and pollution regulation) tailwinds. In terms of suppliers, in 2010, Watsco purchased approximately 72% of products from its top 4 suppliers including 52% from Carrier. Prior to the Carrier Enterprise joint ventures, Watsco purchased approximately 48% of goods from its top 4 suppliers including 13% from Carrier in 2008.

Historical Performance

Looking back over the past 10-plus years, Watsco has consistently posted impressive operational performance. The Company increased annual revenue at an 8% compound annual growth rate (CAGR) between 2000-2010, while EPS increased at an even stronger 14% CAGR. Favorable industry dynamics including a growing install base, regulatory/energy efficiency guidelines, and new home construction helped fuel this growth, as did solid expense controls and opportunistic acquisitions. Despite the concentrated equipment supply chain, Watsco has consistently maintained gross margins around the 24%-26% range, indicative of the Company's strong ability to pass through OEM and other supply cost increases. Watsco also maintains a lean corporate structure; there are still only ~20 employees at its Miami headquarters. The Company relies on 9 regional managers to oversee operations in various store clusters, with the managers' compensation heavily based on performance incentives. Given the nature of the business, Watsco's advertising and marketing costs are also minimal; advertising expense totaled only $26.6 million or 0.9% of sales in 2010 and $12.1 million or 0.6% of revenue in 2009. Total SG&A expenses averaged a relatively modest 17.9% of sales in 2010.

Historical Operating Performance ($thousands)

	1H 2011	1H 2010	2010	2009	2008	2007	2006	2005	2004
Revenue	$1,417,887	$1,374,560	$2,844,595	$2,001,815	$1,700,237	$1,758,022	$1,771,214	$1,658,249	$1,294,715
Gross Margin %	24.56%	23.55%	23.67%	24.02%	26.00%	25.43%	25.82%	25.24%	25.77%
Operating Profit	$92,239	$79,784	$165,572	$81,060	$98,608	$111,154	$135,394	$117,283	$84,094
Operating Margin %	6.51%	5.80%	5.82%	4.05%	5.80%	6.32%	7.64%	7.07%	6.50%
Diluted EPS	$1.33	$1.20	$2.49	$1.41	$2.09	$2.27	$2.86	$2.52	$1.79

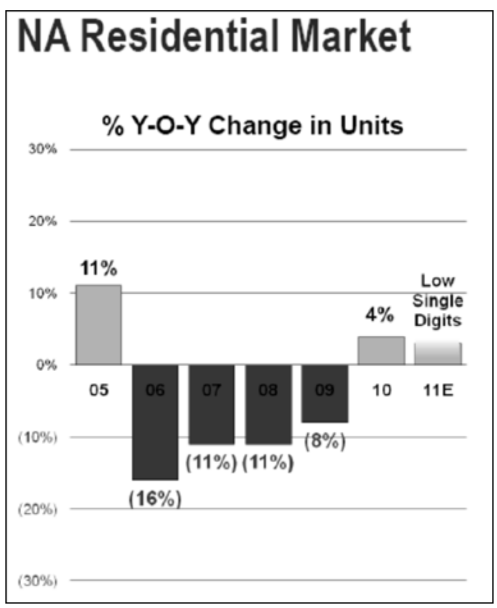
Recovery from Recession

Watsco suffered 17% and 10% declines in same store sales in 2008 and 2009, respectively, due to a combination of the drastic decline in new home construction and deferral of HVAC repairs/replacement by retrenching consumers. Operating income (EBIT) declined to $81 million in 2009 from a peak of $135 million in 2006. However, in our view the Company has prudently managed the decline. While EBIT margins declined from a peak of 7.7% in 2006 to 4.0% in 2009, Watsco remained profitable due to the Company's relatively low fixed cost structure. Cost savings initiatives implemented over the past four years cut approximately $120 million in SG&A expenses, which declined to 17.9% of revenue from 19.1% in 2007. Same store sales rebounded 11% in 2010 including a 16% increase in HVAC equipment sales, driven by pent up demand for replacement heating and air conditioning units, including higher-priced more energy efficient units. While same store revenues have increased only 1% in 1H11, the Company expects to achieve record EPS this year, driven by margin expansion and the Carrier Enterprise acquisitions. Management is targeting improvement in EBIT margins (which are still depressed by the recent addition of below-average margin Carrier Enterprise businesses, as described on pages 68) to 10%, although this may require a recovery in same store revenues to around the prior peak—roughly 10%-15% above current levels. As detailed below, we believe pent-up demand and a recovery in new home construction could support this revenue growth over the next few years.

Attractive Recurring Revenue Business Model

We are attracted by the solid underlying demand and recurring revenue nature of Watsco's primary business. There are roughly 120 million homes in the U.S. with existing central air and/or heating, and this HVAC install base has consistently grown year in and year out. Growth from new home construction has been enhanced by increased penetration rates for central air conditioning and heating; for example central air is now installed in ~90% of new U.S. residences versus under 80% 25 years ago. Increased penetration of existing homes as well as home renovations or expansions (which may require the addition of a second HVAC unit) also offer additional unit growth. This growing install base provides Watsco with a relatively stable source of revenue from repairs and replacements. Watsco currently generates approximately 75% of revenue from the repair and replacement of existing HVAC systems. The Company estimates replacement unit sales have increased at an approximate 3%-4% average growth rate per year (*prior* to price increases) over the past 15-plus years.

Not surprisingly, Watsco has observed unprecedented belt-tightening among existing install base customers since the housing downturn and recession struck. Residential consumers have tended toward repairs and more minor replacements over full unit replacements at unusually elevated levels. For example, customers have increasingly elected to replace HVAC compressors rather than replacing entire condensers or the full HVAC systems. According to industry data, unitary system sales to the residential market declined by between 8%-16% annually from 2006 through 2009 (2006 includes an unusual decline related to the expiration of SEER 10/13 upgrade mandates). Although this is primarily attributable to plummeting new home construction, nonetheless replacement sales are estimated to have declined by approximately 15% between 2007-2009.



Source: Lennox International presentation, August 2011

On the plus side, Watsco has not seen a huge decline in overall revenue from the HVAC install base as deferred replacement demand has migrated toward greater parts and supplies sales. Importantly, these repairs also generally represent temporary patchwork and the full replacement of aging units can be delayed, but not deferred indefinitely. Some recovery of pent-up replacement demand is already kicking in. Industry-wide unit sales rebounded approximately 4% in 2010, according to Lennox International. According to Air Conditioning and Refrigeration Institute (AHRI) data, residential central air conditioners and heat pump shipments are up 11% year-to-date through July (final sales are likely to significantly lag shipments as depleted inventory is being rebuilt). Nonetheless, an estimated 1-2 years or more of pent-up replacement demand remains outstanding. Watsco estimates a whopping 74 million units are at least 10 years old. With the estimated average useful life of these units at approximately 12-14 years, these units will increasingly require significant repair or replacement.

Historical U.S. Air Conditioner & Heat Pump Sales

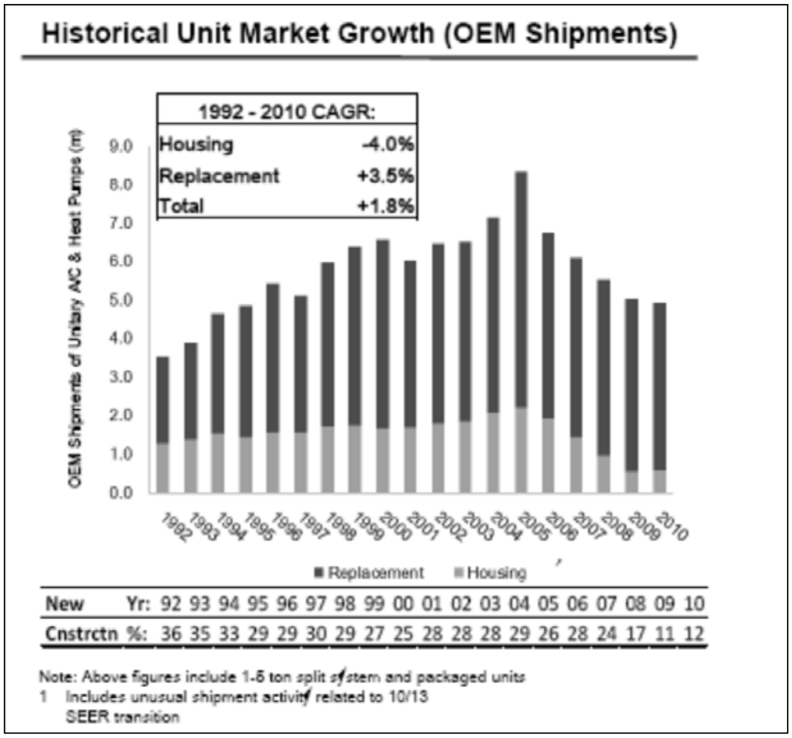
	Unitary Air Conditioners	Air-Source Heat Pumps	Total
1991	3,006,296	764,067	3,770,363
1992	2,914,470	798,930	3,713,400
1993	3,187,966	882,341	4,070,307
1994	3,887,820	1,008,072	4,895,892
1995	4,063,176	1,024,885	5,088,061
1996	4,522,837	1,147,828	5,670,665
1997	4,229,140	1,130,718	5,359,858
1998	4,980,283	1,259,695	6,239,978
1999	5,353,676	1,293,395	6,647,071
2000	5,346,046	1,339,435	6,685,481
2001	4,839,088	1,442,355	6,281,443
2002	5,262,727	1,483,599	6,746,326
2003	5,180,897	1,626,365	6,807,262
2004	5,514,967	1,886,100	7,401,067
2005	6,470,976	2,136,525	8,607,501
2006	4,950,827	2,118,469	7,069,296
2007	4,507,692	1,898,905	6,406,597
2008	3,968,044	1,865,310	5,833,354
2009	3,515,648	1,642,064	5,157,712
2010	3,419,290	1,747,920	5,167,210

Source: Air-Conditioning, Heating, and Refrigeration Institute

If the macro economy and employment environment continue to stagnate, consumers may continue to delay complete replacement. Nonetheless, compressors typically only last 3-4 years, so this will create steady repair demand. On average, parts and supplies sales are also higher margin for Watsco (although obviously lower ticket price) than unitary equipment. We would also note that compressors typically run at around $1,000/unit, plus additional labor and parts/supplies costs for the end-consumer, versus $3,000/$4,000 to replace the full system. Thus it is often in consumers' economic interest to undertake a complete replacement. Given these dynamics, and especially if we see any substantial macroeconomic improvement in the interim, we believe a fairly strong pickup in full unit replacement demand over the next 2-5 years is a good bet.

Upside from New Housing Recovery

While the HVAC replace/repair market held up fairly well through the recent recession all things considered, demand from new home construction has been an entirely different story. Domestic new home construction plummeted from a rate of greater than 2 million homes/year in early 2006 to a current run rate of only approximately 600,000. As a result, the share of HVAC unit sales attributable to new home construction has also plummeted to approximately 10% today from a historical average of 25-30% in the decade preceding the recent downturn. Similarly, industry-wide shipments of unitary air conditioning and heat pumps have declined at the equivalent of a (4.0%) CAGR from 1992 levels to 2010 levels.



Source: Air Conditioning and Refrigeration Institute (AHRI)

As further detailed in our introduction to this summer's *Asset Analysis Focus* Double Issue, we estimate the longer-term run rate for new home construction to keep pace with new household formation is approximately 1.4 million homes annually. Numerous factors may keep new housing construction below this level for the next several years depending on macroeconomic developments, but we believe this represents a tremendous upside opportunity for Watsco. The Company estimates it generates an average of roughly $3,000 in revenue per new home at above-average margins. A recovery to normalized home construction implies an incremental annual revenue opportunity of approximately $240 million or 9% incremental revenue for Watsco, assuming the Company's current market share holds steady. The bottom-line impact should be significantly higher given the SG&A leveraging, and of course, every new home also has the long-term benefit of increasing the installed based and bringing on the associated repair/replacement revenue.

Carrier JVs and Margin Expansion Potential

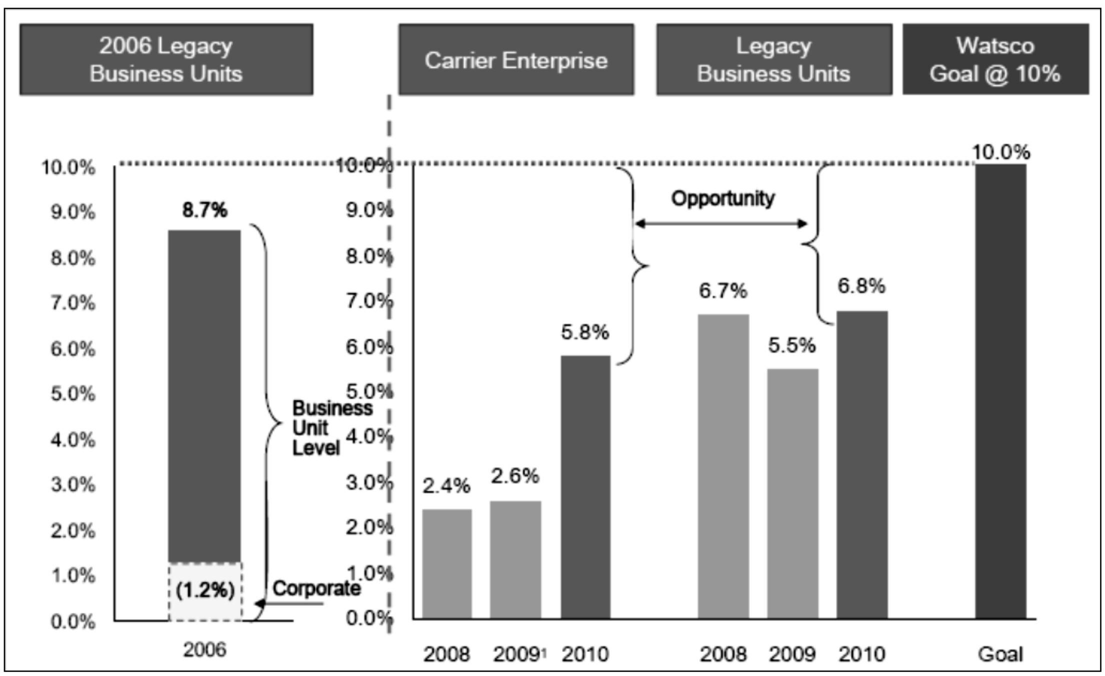
After performing a strategic review that began in 2008, United Technologies Corp. ('UTC') decided to bring in an independent operator for the distribution centers of its HVAC OEM business, Carrier Corp. According to Watsco management, the Company had initiated discussions with Carrier about the possibility of a joint venture for 10-15 years prior to the idea taking hold in 2009. Watsco already maintained a good relationship with Carrier as its largest independent distributor. As the only independent distributor with sufficient scale as well as a solid long-term operational track record, Watsco was a natural partner. In July 2009, Watsco completed the first of a series of acquisitions/joint ventures, incorporated as Carrier Enterprise, with Watsco to take over the management of Carrier's distribution centers in the Sunbelt region. The Company recently completed two additional joint ventures covering Carrier's Northeast and Mexico distribution centers. Based on our analysis, the deals represent extremely attractive investments with modest purchase prices combined with the potential for very significant improvements in operational profitability, as already being exhibited in the Sunbelt JV.

Carrier Enterprise Sunbelt

Watsco completed the first joint venture with Carrier in July 2009. The JV was structured with Watsco taking a 60% controlling ownership and UTC retaining a 40% interest. Watsco also received the option to purchase additional 10% stakes in July 2012 and July 2014. In association with the JV, Carrier contributed 95 distribution stores across 12 states in the U.S. Sunbelt and Puerto Rico. The stores also include a small Miami-based export business that exports to Latin America and the Caribbean. Watsco also contributed 15 of its existing stores that primarily sold Carrier products in the Midwest. The combined business added approximately $1.2 billion in revenue, increasing Watsco's pro forma 2009 revenue base by roughly 81% (prior to backing out UTC's retained interest).

Drastic Operational Improvements

Under UTC, the Carrier Enterprise stores' performance were most likely limited by lack of management focus, given their modest contribution to the $57 billion/year conglomerate's bottom line; most of UTC's Carrier distribution businesses were labeled 'non-core' following the 2008 strategic review. At the time the JV was formed, the businesses were operating with gross margins below 20% and EBIT margins of only ~2.8%. Watsco management has aggressively moved to improve operating performance, setting goals to bring the business in line with historical WSO gross margins at ~25% and EBIT margins up to ~10%. While the turnaround plan is still in the earlier stages, given we are only ~2 years in, nonetheless material improvements in operating performance under Watsco's leadership are already evident at Carrier Enterprise Sunbelt. EBIT margins have expanded roughly 370 bps to 6.5% in 2Q 2011, despite the still challenging macro environment.



Source: Company presentation, August 2011

The major aspects of Watsco's strategy for improving the Carrier Enterprise business include:

- Aligning Management Incentives—According to Watsco management, under UTC, store/regional managers were not sufficiency incentivized to maximize operational performance. Incentive pay was focused on revenues rather than profits, a policy which Watsco has reversed. This change combined with greater oversight, introduction of best practices at the store level, and a higher portion of incentive-based pay have already had a meaningful impact on gross margins and profitability.

- Expanded Product Offerings—Performance at the legacy Carrier stores was significant impaired by limited product offerings, primarily consisting of equipment under Carrier's brands. According to Watsco, the contributed stores averaged approximately 90% equipment sales mix versus 10% from parts and supplies. Watsco has focused on expanding the stores' parts and supplies business, which offers a huge opportunity for incremental revenue—most of which also sells at higher-than-average gross margins. The Company has made good progress to date, bringing the mix down to 72% equipment versus 24% parts and 4% supplies. Attractive opportunities for additional gains remain, and management believes they can get supplies to a 15%-20+% share and equipment closer to 50% of sales.
- Additional Revenue Synergies—Leveraging existing contractor client relationships across the expanded product lines for both legacy Carrier and Watsco stores.
- General and administrative expense leveraging.

Attractive Acquisition Price

The initial Carrier Enterprise acquisition significantly increased Watsco's scale in the attractive Sunbelt region and brought Watsco economically and strategically valuable exclusive distribution agreements with the premier Carrier brands. Importantly, the acquisition was also transacted at what we view as extremely attractive valuation multiples. Watsco's purchase of the 60% interest in the joint venture was valued at approximately $181 million, including the issuance of 3.1 million shares (~11.5% dilution) with a then-current market value of $151 million plus the contribution of 15 stores valued at $23 million and $7 million in working capital adjustments. Carrier stores generated approximately $1.2 billion in revenue in 2009, implying a purchase price of only 0.25x sales after backing out UTC's 40% retained interest. Based on full Carrier Enterprise operating margins of 2.4% in 2008, Watsco paid a relatively modest 10x operating income. However, the real economics of the deal become evidence once factoring in the performance improvements Watsco has been able to generate from the acquisition. Based on Carrier Enterprise's 2010 net income, Watsco paid a bargain-basement 4.0x forward earnings (net income) for the acquisition. Carrier Enterprise's margins are already up to 6.5% and as Watsco continues to execute the strategic initiatives, we are optimistic the Company can continue to grow Carrier Enterprise revenue and approach if not achieve its 10% EBIT margin goals—especially if we see any material uptick in replacement demand and/or home construction.

Carrier Enterprise Sunbelt Transaction Analysis

Acquisition Cost:	
3,080,469 WSO shares @ $49.05	$ 151,097
+ 40% in 15 Watsco Stores @ book value	$ 23,217
+ Working Capital Adjustments	$ 7,201
	$ 181,515
Transaction Multiples:	
2008 Revenue, Contributed Carrier Stores	$ 1,233,425
Price/Sales multiple, 60% Interest	0.25x
2008E Operating Income @ 2.4% margins	$ 29,602
Price/Operating Income multiple, 60% Interest	10.22x
2010 Actual Net Income	$ 77,405
Price/ 2010 Earnings, 60% interest	3.91x

Not surprisingly, we would have preferred to see Watsco pay UTC in cash rather than diluting shareholders at <$50 per share—although according to Watsco's management, UTC requested stock-based payment (UTC still held 3.0 million shares as of April 2011 according to Watsco's latest proxy statement). It should also be noted that additional accretion should come from the exercise of Watsco's option to increase its stake in the JV to 70% in July 2012 and 80% in July 2014. The upcoming July 2012 option has an exercise price estimated at approximately $50 million payable in cash or WSO shares at the Company's discretion, while the July 2014 option should come at a modestly higher price tag based on performance-linked adjustments. Given the JV's current profitability and performance trends, we anticipate Watsco will exercise these options at similarly attractive valuations as the initial deal.

Carrier Enterprise Northeast

Watsco completed a second 60/40 joint venture with Carrier on April 29, 2011 covering Carrier's Northeast distribution centers. Carrier contributed 28 Northeast centers, while Watsco contributed $35.7 million in cash plus the Company's 14 Northeast locations valued at $14.7 million. The contributed Carrier Northeast stores had approximately $210 million in annual sales and EBIT margins <5%. This implies a purchase price for Watsco's interest of only 0.4x sales or 9x trailing EBIT. As Watsco initiates similar strategic initiatives in this business as the Carrier Enterprise Sunbelt operation, this acquisition price should look increasingly attractive.

Carrier Enterprise Mexico

Most recently, on August 1, 2011 Watsco announced the completion of a third 60/40 joint venture with Carrier covering Carrier's 6 distribution centers in Mexico. The stores generated approximately $80 million in revenue over the trailing twelve months ended June 30, 2011, while profitability statistics have not yet been released. Watsco paid $9 million in cash, or only approximately 0.2x revenue for its share in the JV. Watsco plans to expand parts and supplies sales at these locations as well as to add additional stores in Mexico in the coming years. The Company estimates this is a $2 billion addressable market, and although the business has been hit by the recession in recent years, Carrier remains the #1 HVAC brand in Mexico.

Additional Long-Term Growth Drivers

In addition to the Carrier Enterprise acquisitions, pent-up replacement demand, and new home construction, we believe Watsco is well-positioned to capitalize on several additional long-term opportunities, both industry-wide and Company-specific.

Sunbelt Exposure

Prior to accounting for the recently-completed additional Carrier JVs, Watsco derives approximately 90% of revenues from the Sunbelt region, including close to 50% of sales from Florida and Texas. Historically, the Company concentrated on expanding in these regions due to numerous favorable characteristics including strong immigration trends from retirees as well as Hispanics; a longer hot season reducing seasonality and increasing demand for air conditioning systems; higher repair/replace demand given more frequent running of air conditioning systems; and additional demand from 2nd home construction given the region's vacation attractiveness. Alongside California, Florida was probably the most overbuilt state during the housing bubble, which should keep demand from new construction and home expansion/remodeling depressed through the medium term. On the other hand, Texas has suffered relatively modestly in recent years and continues to see strong positive benefits from migration and the more recent oil and gas boom locally. Regardless, in the longer term the aforementioned factors should continue to make the entire Sunbelt region a particularly attractive operating region. For example, the U.S. Census Bureau estimates Florida and Texas will experience the #3 and #4 population growth rates, respectively, among all states between 2000-2030.

Energy/Environmental Efficiency Mandates

Environmental and energy efficiency regulations add an additional layer of complexity to the domestic HVAC industry, generally to Watsco's benefit. Heating and cooling accounts for approximately 56% of the energy consumed in a typical home, which is leading to increased focus on HVAC energy conservation by regulators. The U.S. Department of Energy has developed 'SEER' (seasonal energy efficiency ratio) energy efficiency standards for central air conditioners and heat pumps. As of 2006, all new and replacement systems must meet at least the 13 SEER standards, which are 30% more energy efficient than the previous SEER 10 standards. The federal government has also recently offered additional tax credits for higher energy efficiency purchases. Federal tax credits offered have included up to $1,500 in 2010 and $500 in 2011 for replacement of HVAC systems/parts with SEER ratings of 15-16 or higher depending on the specific item. Watsco estimates approximately 50% of the central air market is now at 13 SEER, 30% at 14 SEER ('Energy Star'), and a small but nicely-growing portion at the ultra-premium 16+ SEER. Additional regulations include the phasing-out of

R-22 'freon' refrigerants (high in ozone-depleting CFCs) commonly used in residential air conditioning systems and heat pumps.

Not surprisingly, premium energy efficiency products command premium prices—to Watsco's benefits. However, federal government and/or utility subsidies, plus energy savings, typically make upgrades an economic choice for consumers. Watsco estimates higher pricing associated with improved products has historically contributed a very meaningful 2%-3% to annual sales. Given the increased focus on environmental and energy efficiency concerns of late, as well as unusually high energy price inflation, we anticipate Watsco will continue to benefit materially from these issues going forward.

International Growth

Watsco has historically been an almost exclusively domestic distributor. Prior to the Carrier Enterprise acquisitions, the Company owned no distribution centers outside of the continental U.S. However (in addition to the Carrier Mexico acquisition), the Company acquired via Carrier Sunbelt an approximately $200 million/year business exporting HVAC equipment and supplies from Miami to various countries in the Caribbean and Latin America. Watsco estimates this is a ~$3 billion addressable market, so plenty of room for additional growth from expanded product lines and market share gain is available.

Cash Flow and Balance Sheet

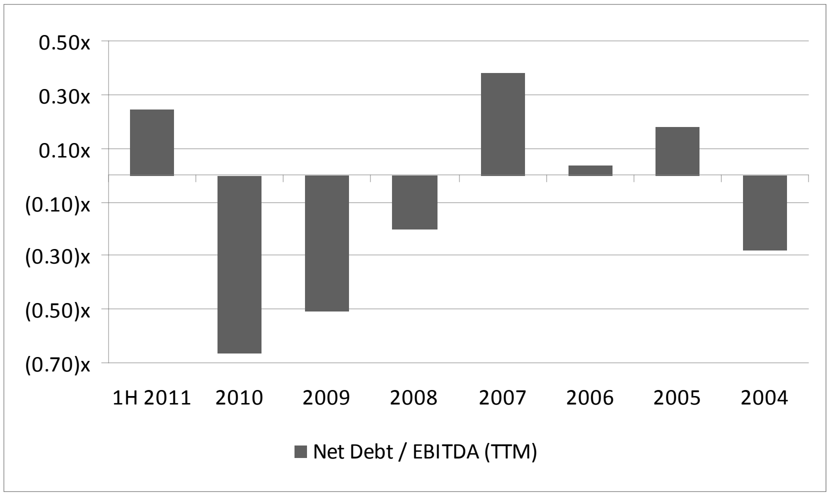
CEO Nahmad and Watsco's management have historically run the business with a strong focus on cash flow. Watsco generated $851 million in operating cash flow between 2000-2010 versus $602 million in net income. Watsco generated $144 million in free cash flow in 2010, or an 8.5% free cash flow yield at the current share price. The strong cash flow has been driven by a focus on working capital in recent years. Inventory turns were up to 5.6x in 2010 versus 4.6 x in 2009 and 4.7x in 2008. Inventory lead times have been managed down to 7-14 days. Additionally, maintenance capex needs are very low for Watsco's business—roughly $5 million per year historically and between $5-$10 million per year after the addition of the Carrier Enterprise joint ventures. Top management's focus on cash flow has also been distilled down throughout the organization; for example, the Company's recently-issued incentive based compensation plans for its 9 regional managers included a clause that operating cash flow must exceed net income.

Cash Flow Summary ($ millions)

	2010	2009	2008	2007	2006	2005
Cash Flow from Operations	$153	$88	$113	$108	$68	$36
Capital Expenditures	$8	$6	$4	$6	$10	$7
Free Cash Flow	$144	$82	$110	$102	$58	$29
Avg. Diluted Shares	30.6	28.5	27.0	27.1	27.2	27.8
FCF/Share	$4.72	$2.89	$4.05	$3.76	$2.16	$1.03
Dividends	$66	$57	$49	$37	$26	$17
Distributions to Non-Controlling Interests	$14	$5	–	–	–	–
Share Repurchases	–	–	$5	$9	$15	$18
Net Cash Acquisition Costs	$4	$10	$0	$109	$10	$49

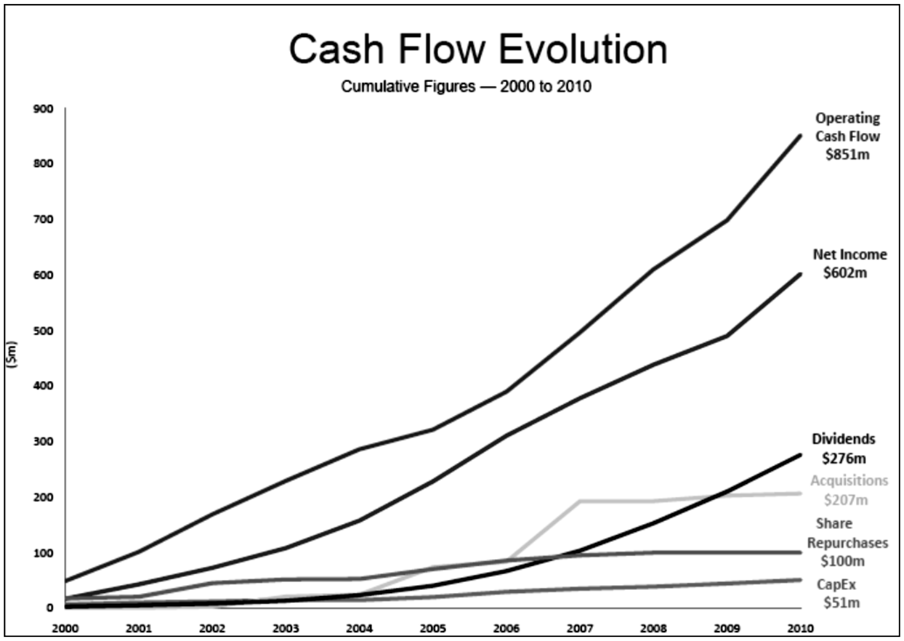
As illustrated in the following chart, Watsco has also historically maintained a conservative balance sheet, operating with minimal or no net leverage. The Company currently has $46.4 million in net debt outstanding, or 0.25x EBITDA. In our view, if anything, the Company has historically been underleveraged given the consistent free cash flow generation and we would not object to seeing the Company take on moderate debt levels during low interest rate environments like today's and/or to repurchase shares during periods of market dislocation. Nonetheless, we view the Company's conservative capital structure as a positive buffer in this still-uncertain economic environment as well as an indication of the Company's conservative approach to M&A considering its history as a 'roll up' of sorts, as detailed below.

Historical Year-End Leverage Ratios



Prudent Cash Deployment

Not only is Watsco a consistent free cash flow generator, but in our view management have historically been prudent stewards of capital. As illustrated in the following chart, between 2000-2010 Watsco returned the greatest portion of operating cash flow (32%) to shareholders via dividends. The Company also spent $100 million (12% of OCF) on share repurchases, primarily prior to 2006. Management has downplayed their inclination toward share repurchases in recent years, while emphasizing that a large dividend payout is 'fundamental' to the Company. While the Company is inclined toward executing accretive acquisitions, Watsco put a relatively modest $207 million or 24% of OCF toward acquisitions between 2000-2010—which, again, we believe reflects the Company's conservative approach to M&A.



Source: Company presentation, August 2011

Attractive Dividend Looks Sustainable

Watsco has an impressive record of returning cash to shareholders via common dividends. Watsco initiated a dividend policy in 1997 and the Company has raised the dividend rate 13 times since 2003 to the current annual rate of $2.28 per share (4.0% yield). The dividend rate has grown at an impressive 31% CAGR since 2000. The current dividend rate represents a payout ratio of approximately 87% of TTM diluted EPS, which may make some investors fear it is unsustainable. However, we would note that this represents a more modest 80% forward ratio based on the baseline of management's forecast that 2011 EPS will exceed 2006's record of $2.86, and represents only 49% of 2010 free cash flow (before accounting for cash earnings attributable to UTC). Furthermore, we anticipate Watsco's low-capex model, minimal debt levels, and the incremental cash generation which should flow from the additional Carrier Enterprise ventures will provide ample support for the current dividend payout and future increases going forward. Management has also expressed their continuing commitment to the dividend and we would speculate that Mr. Nahmad, who is 70 years old and appears to have the lion's share of his wealth tied to Watsco stock, is likely very keen to keep those big dividend checks flowing every quarter.

Cautious Acquisition Strategy Likely to Continue

CEO Nahmad and Watsco management have expressed continued interest in executing acquisitions within the HVAC/R distribution industry. While we are typically cautious investors when it comes to 'roll up' strategies, several aspects of Watsco's strategy help us to get comfortable with the execution risk. First of all, as illustrated above, the Company has historically been operated with minimal leverage and only allocated ~24% of OCF toward acquisitions. Management has expressed their continued disinclination to take on a significant debt load in order to fund acquisitions. For example:

> *"We've always [built the Company] on a conservative balance sheet. I don't expect that's going to change…we know [Watsco] is underleveraged, we like it that way…"*
>
> – CEO Albert Nahmad, 2Q 2011 earnings conference call, July 26, 2011

Additionally, Watsco's market-leading position combined with the industry's highly deconsolidated nature (~1,300 primarily small, local, independent 'mom and pop' distributors) virtually eliminate the possibility of a single large-scale, transformative acquisition. Even the initial 2009 Carrier Enterprise joint venture, which was far and away the Company's largest transaction and an acquired business which we believe was larger than any remaining North American competitors, was completed at a relatively modest $181 million price tag for Watsco. The deal was also structured for Watsco to contribute Company shares and distribution centers rather than cash/debt (although we would have rather seen some use of debt given the share price).

Management has also expressed interest in only acquiring 'top 50' type distribution companies rather than bottom-tier companies. The Company's extensive track record and dealmaking procedure also give us confidence in their due diligence process. Under the stewardship of Mr. Nahmad, the Company has completed 57 acquisitions with no major stumbles along the road. Notably, the Company has never entered a bidding war or hired investment bankers in connection with acquisitions (including the Carrier transactions). Instead, management tries to wait patiently to find well-run operations where the families are looking to exit at a reasonable price.

> *We built the Company over the last 22 years through what we call a buy and build growth strategy. We bought a lot of companies, a lot of family businesses. It takes a long time to buy a family business, sometimes 10, 15 years to get a family oriented to selling, then waiting to sell, then having a price to sell that is comfortable and a price that we are willing to pay that is comfortable. A very long process. We have done it very successfully, never hired a banker, never paid a fee, never been in an auction; just simply had a lot of good relationships with people that own these businesses.*
>
> – Barry Logan, Watsco. Inc. Senior VP, JPMorgan HVAC Conference, June 06, 2011

We are also attracted by the potential for Watsco to acquire additional manufacturer-owned store networks a la the Carrier Enterprise joint ventures. According to management, the Company spent over a decade trying to persuade United Technologies to sell the business until they finally agreed after a strategic review in 2009. As detailed earlier, the results of the JV to date are excellent and Watsco was also able to obtain a very attractive price given the acquired operations' struggles, 'non core' status to UTC, and lack of potential strategic bidders with sufficient scale apart from Watsco. Several other OEMs have company-owned store networks, and according to management, Watsco is now using the evidence of Carrier Enterprise's success to more vocally make the case for divesture of distribution centers to these OEMs. While it is difficult to gauge how likely Watsco is to successfully convince the OEMs to divest, in our estimation the extensive synergies and operational improvements executed at Carrier Enterprises would be replicable across other OEM stores and such acquisitions would most likely represent very attractive investment of capital.

Key Man & Corporate Governance Issues

Dual Class Shares

As long-time *Asset Analysis Focus* subscribers may remember, we have previously discussed the pitfalls as well as potential opportunities associated with dual class shares (including in our summer 2005 double issue). In Watsco's case, longtime Chairman and CEO Mr. Albert Nahmad owns an approximately 13% economic interest in Watsco but a controlling 55% voting interest through the holding of Class B supervoting shares, which also include the right to nominate 75% of the Board of Directors. Mr. Nahmad is 70 years old and has directed the Company all the way through its transition into the leading domestic HVAC distributor. Although all indications are that CEO Nahmad remains very actively involved in Watsco's operations and has no plans for anything otherwise, nonetheless this creates a major key man risk. In terms of succession, Watsco's Senior Vice President and Secretary, Mr. Barry Logan (age 48; 1% economic ownership), who has served various key roles with the Company since 1992, appears to be very active in daily operations (including key relationships) and would be an obvious replacement. On the other hand, CEO Nahmad's 29 year old son Aaron Nahmad has served as Director of Global Business Development since 2005 and was recently promoted to Vice President of Strategy and Innovation in 2010. Alternatively, as we have frequently highlighted in the past, succession/control issues associated with dual class shares and aging patriarchs often create catalysts for unlocking shareholder value.

Corporate Governance Issues

Mr. Nahmad's control of Watsco extends to the Board of Directors, the members of which appear to have questionable independence and oversight capacity. The Lead Director, Mr. Paul Manley (age 74), was elected to the Board in 1984 and has been retired since 1991. He previously served as Vice President of Planning at Sensomatic Electronics from 1982-1987 and Executive Director of the law firm Holland & Knight from 1987-1991. Mr. Manley also serves as Chairman of the Compensation Committee and Co-Chairman of the Audit Committee—roles for which he received $52,250 in fees in 2010. Mr. Manley and the Board have authorized an incentive compensation plan for Chairman/CEO Nahmad which we view as outrageously structured. In addition to an annual salary of around $1 million, Mr. Nahmad has a performance-based plan linked to annual increases in WSO share price and EPS, *without* a highwater mark.

	Salary	Incentive Award per $0.01 EPS Increase	Incentive Award per $0.01/Share Annual Stock Price Increase (0%-15%)	Incentive Award per $0.01/Share Annual Stock Price Increase (+15%)*	Restricted Stock Awards (Shares)	Grant Date Fair Value of Stock Awards	Estimated Share Dilution
2010	$1,045,000	$65,250	$1,200	$1,800	301,052	$19,300,500	1.0%
2009	$ 990,000	$65,250	$1,200	$1,800	76,635	$3,808,760	0.3%
2008	$1,100,000	$65,250	$1,200	$1,800	–	–	

* Threshold was 20% in 2008

Note: Mr. Nahmad entitled to receive incentive awards in cash or 2x cash value in long-term restricted Class B stock (vesting length and some additional restrictions vary by period)

Last year's plan called for a $65,250 bonus for every $0.01 increase in EPS versus the prior year, which Mr. Nahmad may elect to convert to double the value in Class B, 12-year restricted stock (doubled to supposedly account for discounting associated with the 12 year vesting period). Although EPS would not be our preferred performance measure, in a typical year this plan would produce not entirely unreasonable compensation levels by market standards. Mr. Nahmad received no bonus in 2008 due to the declines in WSO stock price and EPS, while he received $3.8 million in performance pay in 2009 based on the increase in WSO's share price during the year. However, as a result of the sharp drop in EPS to $1.40 in 2009 followed by the rebound to $2.49 last year, in 2010 Mr. Nahmad was granted approximately 301,000 shares of restricted stock with a market value of $19.3 million (undiscounted)—equivalent to roughly 17% of the entire Company's net income in 2010. While we believe this is an exorbitant level of compensation, we are as much or more dismayed by the overall structure of the compensation plan. The plan not only measures performance based on an unreasonably short window and using less than preferable metrics, but the plan essentially rewards earnings volatility and allows Mr. Nahmad to earn compensation on the same earnings gain multiple times.

The Board composition and incentive pay structure are serious corporate governance issues which we would argue are deserving of vocal resistance from Watsco shareholders. Nonetheless, we have highlighted attractive investment opportunities in significantly more dubious management situations in the past (e.g. Cablevision, Dow Jones, Playboy, etc.). While we would like to see unfair dual class share structures abolished and always must approach such situations with caution, in many cases we have also observed over-penalization by the market creating attractive long-term investment opportunities. In the case of Watsco, we would note that Mr. Nahmad has an impressive three-decade history of conservatively managing the Company and generating outsized returns for all shareholders, including returning plenty of cash to shareholders via dividends. Of course, we would like to see meaningful Board oversight and view the performance metrics used in calculating performance pay as seriously flawed. Nonetheless we would note that even in the most egregious case in 2010, Mr. Nahmad's payout still represented approximately 1% shareholder dilution, which, viewed in combination with minimal additional corporate expenses/stock-based compensation, is actually less than the levels observed at a large percentage of public companies. The use of 12-year restricted stock as currency also further aligns Mr. Nahmad's interest with long-term shareholders.

Valuation

Watsco has recorded tremendous operational performance over the past decade, increasing EPS at a remarkable 14% CAGR and free cash flow at a 13% CAGR between 2000-2010 in the face of what was essentially a 'lost decade' in the stock market and only marginally better from a macroeconomic perspective.

Watsco shareholders have certainly been beneficiaries of this performance, with WSO shares up 388% over the past 10 years in addition to the 33% CAGR on the common dividend since 2000. Despite the historical outperformance, we believe Watsco shares still offer a compelling long-term investment value. In our view Watsco shares have long traded at a discount to intrinsic value due to some combination of a general lack of investor familiarity with the name; investor misunderstanding of Watsco's leading position and competitive moat in a seemingly undifferentiated business; lack of recognition of the attractiveness of the recent Carrier Enterprise joint ventures; a generally negative outlook toward stocks linked to the domestic housing market; and corporate governance issues associated with Chairman/CEO Nahmad's controlling interest in the Company.

Watsco shares currently trade at approximately 9x EV/TTM EBITDA (closer to 11x after backing out our estimate of the contribution from UTC's interest in the Carrier Enterprise JV), at the lower end of the Company's historical trading multiple range of 9-12x EV/EBITDA. However, we would note that shares look much cheaper on a free cash flow basis (13.5x 2010 free cash flow) given the low capex requirements, excess amortization of intangibles, and a focus on working capital improvements. Additionally, in our view several extremely attractive opportunities are not imbedded in the near term trading multiples: (1) Additional upside from further integration of the Carrier Enterprise Sunbelt JV, which continues to post impressive margin expansion. (2) Exercise of Watsco's options to increase its Carrier Enterprise Sunbelt stake by 10% in each of 2012 and 2014 at what should be highly accretive cost bases. (3) The Carrier Northeast and Mexico JVs, just completed in late April and September, respectively. (4) Possibility of additional accretive acquisitions/JVs with Carrier and/or other OEMs as well as the acquisition of smaller competitors. And last but not least, (5) Historic pent up demand for HVAC replacements as well as an estimated 8%-12% upside to annual revenue from a recovery in new housing construction to long-term normalized levels.

These dynamics could drive significant EBITDA and free cash flow growth for Watsco over the next few years even without assuming a full recovery in new home construction or pent-up replacement demand. In our base case scenario, we assume Watsco's legacy (non-Carrier Enterprise) business sales grow at a tepid 1% rate in 2011 and 2.5% in 2012 before a modest benefit from an improved housing/economic environment leads to 5% growth by 2013 and 8% in 2014, while the Carrier Sunbelt business exhibits stronger growth over the next 18 months from continuing product mix improvement. We also conservatively estimate base business EBIT margins expand only approximately 130 basis points over the next 3 years to 7% (~8% pre-corporate expense), well below the 8.6% levels achieved in 2006 and management's target of 10% operating margins. Even in this scenario, we estimate Watsco can generate EBITDA greater than $290 million, or $257 million after deconsolidating UTC's interest, by 2014. Applying a 9x EV/EBITDA multiple, we estimate Watsco's intrinsic value at approximately $75 per share—implying approximately 31% upside from current levels. In the meantime, we estimate Watsco could increase the dividend over the next three years to $2.88/share (5.0% yield at the current share price) by 2014 while still paying out less than 55% of 2014E free cash flow.

Watsco Valuation

	Value ($MM)
2014E EBITDA (unconsolidated)	$257
Assumed Multiple	9.0x
Enterprise Value	$2,310
Less 2014E Net Debt	$30
Equity Value	$2,339
2014E Diluted Shares Outstanding	31.3
Estimated Intrinsic Value Per Share	**$74.74**
Implied Upside to Intrinsic Value	31%

The upside from a fuller, more timely recovery in new home construction and consumer spending/pent-up replacement demand is compelling. As noted earlier, a recovery in new home construction to normalized levels could translate into an 8-10% boost to annual sales for Watsco. We estimate the impact of a run-down in pent-up HVAC replacement demand would be of similar magnitude. The contribution margin from these incremental sales should also be above-average given the opportunity for operating leverage. If such a scenario were to unfold by 2013, we model core revenue growth (ex-Carrier Mexico and Northeast) increasing up to 8% in each of 2013 and 2014 and core operating margins expanding to 8.5% by 2014. Under this scenario, we estimate Watsco could generate close to $305 million in EBITDA by 2014, which implies an estimated intrinsic value upwards of $90 per share based on the same 9x EV/EBITDA multiple. Notably, Watsco management has targeted significantly higher (10%) operating margins under a similar (actually somewhat more modest) revenue growth scenario. Additionally, we would not be surprised to see multiple expansion in such a scenario. Of course, we would be very pleasantly surprised to see such a scenario fully unfold by 2014 given the current macroeconomic picture. Nonetheless, we believe a recovery in home construction and consumer confidence is inevitable, and Watsco should ultimately see an outsized benefit whenever this eventually takes form.

Investment Rationale

Watsco is the largest independent distributor of residential and light commercial HVAC equipment, parts and supplies in the U.S. We view Watsco as a top operator and the only independent distributor of scale in an otherwise highly fragmented industry (1,300+ independents) with attractive barriers to entry. Although Watsco still only has ~10% market share (which we view as an opportunity), the Company has 20%-30% market share in its top regions, which are also concentrated in attractive HVAC markets in states like Florida and Texas. The HVAC distribution business is also characterized by regional or state-wide, non-transferrable, often exclusive, distribution agreements with the various HVAC manufacturers (6 of whom have long dominated the industry). With a customer base of 100,000+ independent contractors, this business is also closely tied to longstanding local relationships while offering minimal customer concentration pressures.

The domestic HVAC install base has consistently grown over the years to more than 120 million units, which offers an attractive recurring-type revenue source from repair and replacement sales. Annual industry-wide replacement unit shipments have grown at a ~3.5% rate over the past 20 years. Upgrades related to more energy efficient units has also contributed ~2-3% to annual sales growth for Watsco via higher pricing and should continue to be a long-term tailwind given higher energy prices and increasing government focus (including mandates and/or incentives/rebates) on energy efficiency programs. These dynamics combined with selective acquisitions have enabled Watsco to slowly but steadily increase its scale and earnings power over the years, with the Company recording annualized revenue growth of 8% and EPS growth of 14% between 2000-2010. While the housing downturn affected Watsco, the Company remained solidly profitable due to a combination of resilient underlying repair/replacement demand, the pass-through nature of the business, a minimal corporate structure and meaningful SG&A expense reductions. In fact, management expects to post record EPS (previous high was $2.85/share in 2006) in 2011.

Watsco currently trades at 9x EV/TTM EBITDA (we estimate 10.5x-11x after backing out consolidated JVs) and 20x consensus 2011E EPS, which may not look particularly compelling on the surface. However, we believe the underlying valuation is significantly more compelling. Watsco's low-capex (<0.5% of sales) business model and management's prioritization of working capital improvements and strong free cash flow have produced 13% annualized growth in free cash flow over the past decade, and WSO currently trades at a more modest 13.5x 2010 free cash flow. Additionally, we see several huge tailwinds for Watsco going forward. Over the past 2 years the Company completed several 60/40 joint ventures with United Technologies to take over HVAC distribution centers for its leading manufacturer, Carrier Corp. This should contribute ~$1.3 billion in additional revenue in 2011 and based on early results from the initial 2009 JV covering Sunbelt region stores (operating margins already up 370 bps to date), a combination of Watsco's superior operational practices, cost savings, and the introduction of a vastly expanded line of product offerings should drive substantial profitability improvements. The Carrier transactions were completed at extremely attractive multiples of only <0.2x-0.4x sales, including options for WSO to increase its stake in the largest Sunbelt JV to 80% by 2014. Watsco also has the potential to see tremendous operational upside over the next few years from the unwinding of pent-up replacement demand and a recovery in new housing construction—the latter of which historically accounted for

25-30% of industry unit sales versus ~10% today. Even discounting a full recovery, we estimate Watsco has an intrinsic value of at least $75/share based on 9x 2014E EV/EBITDA.

We would also note that longtime Chairman/CEO Mr. Nahmad's controlling interest via class B shares presents some risk, but historically he has proved to be an excellent steward of capital. The Company is run with a conservative balance sheet (minimal to no leverage) and although acquisitions have been very successful, they accounted for the deployment of a fairly modest 24% of operating cash flow over the past decade. Watsco has consistently returned its free cash flow to shareholders via dividends to the tune of a 37% CAGR in the annual rate since 2001, including a 10% increase in February 2011 to $2.28/share offering an attractive 4.0% yield.

Risks:

Risks that Watsco may not achieve our estimate of the Company's intrinsic value include, but are not limited, to an economic slowdown; extended deferral of the replacement cycle; lack of recovery in new home construction; failure to successfully integrate acquisitions; unfavorable supply disruptions or renegotiations; loss of key management personnel; and corporate governance issues associated with the dual-class share structure.

Analyst Certification:

Asset Analysis Focus certifies that the views expressed in this report accurately reflect the personal views of our analysts about the subject securities and issuers mentioned. We also certify that no part of our analysts' compensation was, is, or will be, directly or indirectly, related to the specific views expressed in this report.

WATSCO, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS
(in thousands)

ASSETS	June 30, 2011 (Unaudited)	Dec. 31, 2010
Current assets:		
Cash and cash equivalents	$ 18,627	$ 126,498
Accounts receivable, net	435,016	305,088
Inventories	612,736	391,925
Other current assets	16,300	14,493
Total current assets	1,082,679	838,004
Property and equipment, net	36,178	31,221
Goodwill	316,060	303,703
Intangible assets, net	76,155	56,627
Other assets	6,820	7,672
TOTAL ASSETS	**$ 1,517,892**	**$ 1,237,227**

LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Current portion of long-term obligations	$ 41	$ 72
Accounts payable	349,350	182,185
Accrued expenses and other current liabilities	95,955	83,748
Total current liabilities	445,346	266,005
Long-term obligations:		
Borrowings under revolving credit agreements	65,000	10,000
Other long-term obligations, net of current portion	16	16
Total long-term obligations	65,016	10,016
Deferred income taxes and other liabilities	36,159	32,310
Watsco, Inc. shareholders' equity:		
Common stock, $0.50 par value	17,303	17,223
Class B common stock, $0.50 par value	2,354	2,187
Preferred stock, $0.50 par value	—	—
Paid-in capital	488,209	472,883
Accumulated other comprehensive loss, net of tax	(446)	(593)
Retained earnings	395,002	387,186
Treasury stock, at cost	(114,425)	(114,425)
Total Watsco, Inc. shareholders' equity	787,997	764,461
Noncontrolling interest	183,374	164,435
TOTAL SHAREHOLDERS' EQUITY	971,371	928,896
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	**$ 1,517,892**	**$ 1,237,227**

September 13, 2011
Volume XXXVII, Issue VII & VIII

Whirlpool Corporation

(NYSE: WHR)

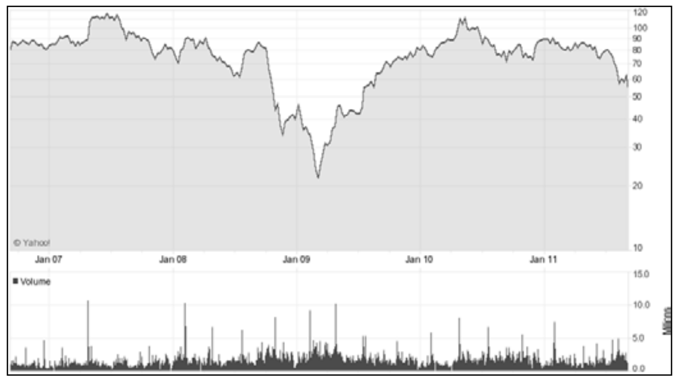
Dow Jones Indus:	**11,105.85**
S&P 500:	**1,172.87**
Russell 2000:	**697.74**
Index Component:	**S&P 500**

Trigger: No
Type of Situation: Business Value, Consumer Franchise

Price:	**$ 53.27**
Shares Outstanding (MM):	**76.8**
Fully Diluted (MM) (% Increase):	**76.8**
Average Daily Volume (MM):	**1.9**
Market Cap (B):	**$ 4.09**
Enterprise Value (B):	**$ 5.75**
Percentage Closely Held:	**Insiders: 1.0%**
52-Week High/Low:	**$ 92.28/50.92**
5-Year High/Low:	**$ 116.85/19.39**
Trailing Twelve Months	
Price/Earnings:	**16.2x**
Price/Stated Book Value:	**0.92x**
Long-Term Debt (B):	**$ 2.1**
Implied Upside to Estimate of Intrinsic Value:	**58%**
Dividend:	**$ 2.00**
Payout	**23%**
Yield	**3.8%**
Net Revenue Per Share:	
TTM	**$ 245.05**
2010	**$ 236.67**
2009	**$ 226.18**
2008	**$ 248.78**
Earnings Per Share:	
TTM	**$ 3.29**
2010	**$ 9.19**
2009	**$ 4.34**
2008	**$ 3.17**
Fiscal Year Ends:	**December 31**
Company Address:	**200 North M-63, Benton Harbor, MI 49022**
Telephone:	**269-923-2641**
President/CEO:	**Jeff M. Fettig**

Clients of Boyar Asset Management, Inc. do not own shares of Whirlpool Corporation common stock.

Analysts employed by Boyar's Intrinsic Value Research LLC do not own shares of Whirlpool Corporation common stock.



Overview

Whirlpool Corporation ("WHR," "Whirlpool," or "the Company") is a well established and recognized Company within the major home appliance market (#1 share of worldwide major appliances), and portable appliance market. Over its long history, Whirlpool has built a strong presence in several key product categories, and it has extended its reach to become a global player across the majority of the world's markets. The Company's product line consists of laundry appliances, refrigerators, dishwashers, cooking appliances, mixers and other small household appliances. Its reportable geographic segments span the globe: North America, Latin America, EMEA (Europe, Middle East, Africa), and Asia. WHR currently is composed of 6 brands that each generate at least $1 billion in annual revenue (Whirlpool, Maytag, KitchenAid, Brastemp, Embraco, Consul), and its portfolio also includes other significant brands which are more modest contributors (JENN-AIR, Amana, Bauknecht, and Gladiator).

The overall Company generates over $18 billion in revenue, and it sells its products in over 130 countries. The Company has a long history of solid profitability and cash flow generation. Importantly, these profits and cash flows remained positive throughout the challenging economic environment of recent years. However, Whirlpool has certainly felt the impact of the market downturn. Several negative forces (weak housing fundamentals, low consumer confidence, etc.) have been meaningful headwinds for WHR sales and profits. In addition, historic increases in raw material costs have served to exacerbate the downward pressure on profits (key raw materials include steel, oil, plastic resins, and base metals such as aluminum, copper, nickel, and zinc). Not surprisingly, WHR shares have fallen out of favor as investors have adjusted to this new reality (stock is down about 50% from its pre-recession highs).

In our view, WHR management has taken several important steps to mitigate the difficult fundamentals of the current marketplace and position itself for long-term success. The Company has maintained its solid market share position throughout its key product categories and markets. Moreover, WHR has retained an investment grade balance sheet, and enacted several programs to improve its overall efficiency and cost structure. Although these initiatives have shown substantial progress, a return to more normalized conditions for the housing market and economy remain essential to Whirlpool realizing its true earnings potential. Assuming such a recovery is attainable during the coming years, WHR should be well positioned for significant sales growth, margin expansion, and share appreciation.

History

WHR's history of being a high quality provider of appliances in the U.S. and abroad is a key aspect of its brand identity and competitive position. The Company was founded in 1911 in St. Joseph, Michigan, and has roots that date back to the late 19th century. Lou Upton, and his uncle Emory Upton, founded Upton Machine company, acquired the patent for electric wringer washers (an early form of laundry washing machine), and began manufacturing these washers on a mass scale. The washers were well received by the marketplace, and the Company was soon filling orders for hundreds of washers. By 1916, the Company became a provider of washers to Sears Roebuck, and Company.

Innovation continued to play a key role within the Company's growth and culture as Whirlpool created increasingly diverse and sophisticated lines of appliances throughout the 20th century. The Company officially changed its name to Whirlpool Corporation in 1949, and built its market presence through both organic means and acquisitions. In 1958, WHR made its first foray into foreign markets via a joint venture with Brazil's Basmotor. Among the most noteworthy acquisitions are WHR's purchase of KitchenAid in 1986, and its 2006 purchase of Maytag. One century after its founding, WHR now holds the top global position within the major home appliance market, with a manufacturing presence in 12 countries and nearly a worldwide sales presence.

WHR's current management team is led by CEO Jeff Fettig (age 54), a 30-year veteran of Whirlpool (appointed CEO in 2004). As the following table shows, the WHR executive team consists of many seasoned executives with substantial industry experience. It is important to note that CFO Roy Templin recently announced his retirement (scheduled for April 2012). Templin will be succeeded by Larry Venturelli, who currently holds the positions of senior vice president, corporate controller, chief accounting officer, and CFO of WHR International. Venturelli has been with the Company since 2002.

Name	Position	Years on Management Team
Jeff Fettig	Chairman & CEO	17 years
Michael Todman	President, WHR International	10 years
Marc Bitzer	President, WHR North America	5 years
Bracken Darrell	Exec. V.P. & President, WHR Europe	2 years
Jose Drummond	Exec. V.P. & President, WHR Latin America	3 years
David Szczupak	Exec. V.P., Global Product Organization	3 years
Roy Templin	Exec. V.P. & CFO	7 years

Financial Results Illustrate Current Challenges

WHR reported 2Q 2011 results that were largely in line with expectations. Revenue increased 4% year over year to $4.7 billion, while EPS totaled $2.76 excluding non-recurring items, down 2% from 2Q 2010. However, the business challenges being faced by WHR and the rest of the industry remained apparent. Revenue trends continue to be sluggish in most of the Company's markets, reflecting weak consumer activity, and difficult conditions within both the housing market and the overall economy. These conditions were particularly evident within North America, as sales declined by 7%. Similar weakness was also reported within other mature markets within Europe. Favorable sales comparisons within the emerging markets remained the main source of growth for WHR. In particular, sales derived from Latin America increased 16% (excluding currency effects).

Not surprisingly, this demand weakness has had an adverse impact on margins and profitability, and is being exacerbated by strong cost pressures from raw materials and crude oil. The Company's overall gross margin was 14.1% for the quarter, a 270 basis point decline compared to 2Q 2010. Management indicated that material costs have been increasing at historic rates, and prices are nearly double WHR's projection from the beginning of the year. The Company has implemented price increases to help mitigate the cost impact on margins, and additional price increases are scheduled for later in the year. These price increases, combined with WHR's cost reduction and efficiency initiatives, are expected to produce positive sequential gross margin comparisons during the second half of 2011.

Despite the headwinds experienced during the second quarter, management did not change guidance for full-year EPS and free cash flow. EPS is expected to be $12.00-$13.00 in 2011, and free cash flow is projected to total $400-$500 million (excluding legal settlement costs). It is important to note that EPS guidance includes a total beneficial impact of at least $7.00 in EPS derived from tax credits in the U.S. and Brazil. In addition, the free cash flow guidance includes the negative impact of a $300 million contribution to the U.S. pension plan. However, full year sales guidance for WHR has been reduced for 2011 as a result of challenging market fundamentals (Latin America is the only exception).

Region	Previous Forecast	Updated Forecast
North America	+2%-3%	(1)%-(2)%
Europe & MENA	+2%-4%	+1%-2%
Latin America	+5%-10%	+5%-10%
Asia	+6%-8%	+4%-6%

It is clear that financial results for WHR will likely remain "noisy" during the coming quarters given the various factors that are impacting results. The earnings quality associated with tax credit benefits is far from ideal. WHR had earned tax credits in Brazil as part of a past government program to incentivize exports (the credits helped to mitigate other taxes incurred by exporters). WHR recognized $225 million in tax credits from this program in 2010, and a combined $238 million in credits during the 2008-2009 period. However, less than $500 million in credits remain, and its beneficial impact on WHR results will likely dissipate during the coming years. The Company also earns tax credits from the U.S. government stemming from the sale of energy efficient appliances ($225 million recognized in 2010, and another $300 million is projected for 2011). However, it is unclear whether these U.S. tax incentives will remain in place over the long-term.

Yet, there are many negative headwinds also impacting profits that investors could classify as somewhat anomalous from a long-term perspective. Certainly, historically poor housing market fundamentals and extremely weak consumer sentiment paired with historic hikes in commodity prices are factors that may prove to be transitory from a multi-year perspective. In our view, the many moving parts in near term results are clouding the long-term EPS power of WHR's underlying businesses, and are likely contributing to the negative investor sentiment for the stock.

Updates on Various Legal Matters

Brazilian Settlement with Banco Safra

On June 22nd, WHR announced a legal settlement with Brazilian bank Banco Safra. The long-standing dispute related to a former employee of Embraco (now part of WHR's Brazilian operations) who entered the Company into an unauthorized loan with Banco Safra in 1989. After 22 years of litigation, management elected to settle the matter for approximately $600 million. The payment will be made in two installments over the next 6 months. WHR recorded an additional charge of $439 million, and will pay the settlement from the Company's existing cash balance. The total after-tax impact for WHR is $290 million, or approximately $3.70 per share. Management has updated its financial guidance for 2011 to reflect the financial impact of the settlement.

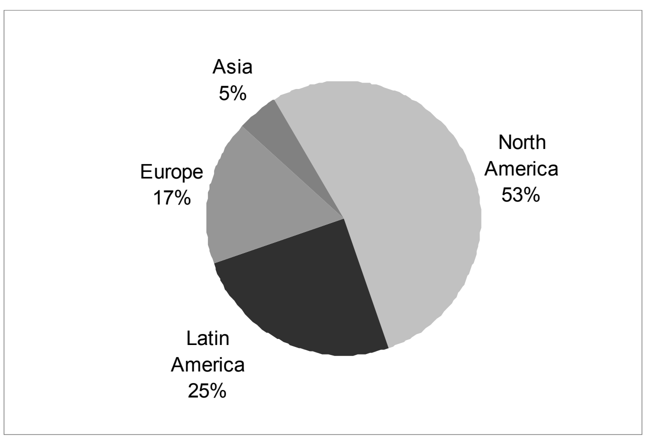
Embraco Anti-Trust Investigation

Beginning in 2009, various competition authorities (Brazil, United States, and Europe) requested documents from WHR as part of several anti-trust investigations involving the global compressor industry (pertaining to Embraco and its competitors). The Company has reached settlements with government authorities in Brazil and the United States, but several investigations remain ongoing (including the European Commission). The final value of WHR's liability is not precisely quantifiable, but management believes it can estimate the total costs related to this matter. As of the end of the second quarter, the Company had taken $306 million in total charges for this issue.

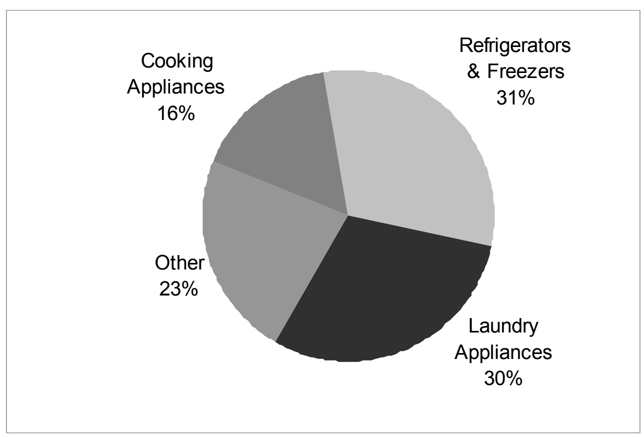
Business

WHR's strong market share helps to illustrate the Company's solid competitive position. Within the global appliance market, WHR holds the #1 market share position. The Company's 15% share of the worldwide market is 50% larger than its nearest competitor, Electrolux. The Company has the #1 market position in North America and Latin America, the #3 position in Europe, and the #2 position in the growing India market. As the charts below illustrate, the Company has a relatively diverse sales mix in term of both products and regions. During 2010, 31% of WHR's total revenue was derived from refrigerators and freezers, followed by laundry appliances (30%), other (23%), and cooking appliances (16%). Whirlpool has approximately 71,000 employees, and roughly 60% of WHR employees are unionized.

Whirlpool 2010 Sales by Region



Whirlpool 2010 Sales by Product



In terms of geographic exposure, North America (53%) is still WHR's largest source of sales, followed by Latin America (25%), Europe (17%), and Asia (5%). The Company does utilize currency options, swaps and forward contracts in order to manage its currency risk. During past periods, WHR has been able to achieve ROE and Return on Capital levels in excess of 20%, but recent market conditions have made that less attainable. Whirlpool does not break out profitability by product. However, the Company does disclose its gross margins by region. The following table depicts each market's average gross margin for the past 3 years (2008-2010).

Region	Gross Margin (2008-2010 Average)
North America	11.6%
Latin America	19.9%
Europe	12.9%
Asia	18.2%
Consolidated	14.0%

Whirlpool's Foundation for Success

The Company's formidable competitive position has been gradually built over many decades. In our view, it would be very challenging for industry peers or new entrants to replicate the Company's strong standing within the global appliance marketplace. However, maintaining this competitive position is an ongoing challenge that requires significant investment and management execution. The executives at WHR cite scale, brands, and distribution as the "foundation" for its competitive position. These factors, combined with several meaningful growth opportunities represent management's key priorities for long-term value creation.

Whirlpool's scale is a key aspect of its competitive position. The Company has a global presence in terms of both its sales reach and manufacturing capabilities. A combination of both organic growth and selective acquisition has enabled the Company to sell its products in over 130 countries worldwide. WHR also has 35 manufacturing facilities in 12 countries, allowing for a greater proximity between its production and end users. Importantly, the Company's manufacturing facilities possess leading capabilities and scale relative to the facilities of industry peers. In North America for example, management has indicated that its factories are 70% larger than the average factory of its competition. It is important to note that WHR has maintained this scale position while improving the efficiency of its manufacturing operations. Total global manufacturing centers now total 35, down from 45 in 2006. In total, WHR occupies about 70 million total square feet of space for manufacturing, service, sales, and administrative purposes (roughly 50/50 split between owned and leased space).

WHR's well established portfolio of brands is another source of competitive strength. The appliance market is a relatively segmented landscape, characterized by numerous customer groups, end markets, and price points. In the view of management, having a diverse group of brands enhances WHR's ability to effectively monetize these opportunities (WHR brands reach over 85% of consumers according to company data). WHR possesses 10 brands, and 6 of these brands generate at least $1 billion in annual revenue. These brands hold relatively high levels of recognition and favorability among most appliance consumers. In addition, the value of the brands has been reinforced by various media sources that evaluate the appliance industry and products (favorable reports for WHR products from sources such as *Consumer Reports* in the U.S. and *Epoca Negocios* in Brazil). The following provides a more detailed description of WHR's brand portfolio, and the respective identity and positioning of each brand:

The Billion Dollar Brands (Annual Sales of at least $1 billion):

- ***Whirlpool***: Whirlpool is a well-established brand, present in the North American market since the 1950s. Whirlpool products are now available on a global basis, and largely consist of laundry and kitchen appliances designed for the middle market. According to management, the Whirlpool brand has the greatest global reach within its portfolio.
- ***Maytag***: The Maytag brand has existed since the early 1900s, and became part of WHR after the 2006 acquisition. Like Whirlpool, Maytag products largely consist of laundry and kitchen appliances designed for the middle market.
- ***KitchenAid***: KitchenAid has been a prominent provider of kitchen appliances and products since the early 1900s. The company was acquired by WHR in 1986, and provides a diverse range of appliances

and related products for kitchen use. The products are designed for a somewhat higher-end consumer who has a greater appreciation for professional grade characteristics.

- ***Brastemp***: Brastemp has been a provider of kitchen appliances in Brazil for over 60 years. It started a partnership with Whirlpool in 1957 and became a part of the Company in 1997. The brand holds a market-leading position among Brazilian consumers in terms of awareness, preference, and loyalty. Brastemp seeks to differentiate itself through cutting edge technology and design.
- ***Embraco***: Embraco is a leading manufacturer of compressors (a key component for refrigerators), typically utilized for both household and commercial purposes. Embraco is headquartered in Brazil, but it has a manufacturing and sales presence throughout the world.
- ***Consul***: Consul appliances have been a part of the Brazilian market since the 1950s, and are now found in nearly 60% of Brazilian households. The Consul brand had historically been associated with relatively simple ovens and refrigerators. However, the product line has expanded to include portable appliances such as microwaves, vacuums, and water purifiers.

<u>The Other Brands:</u>

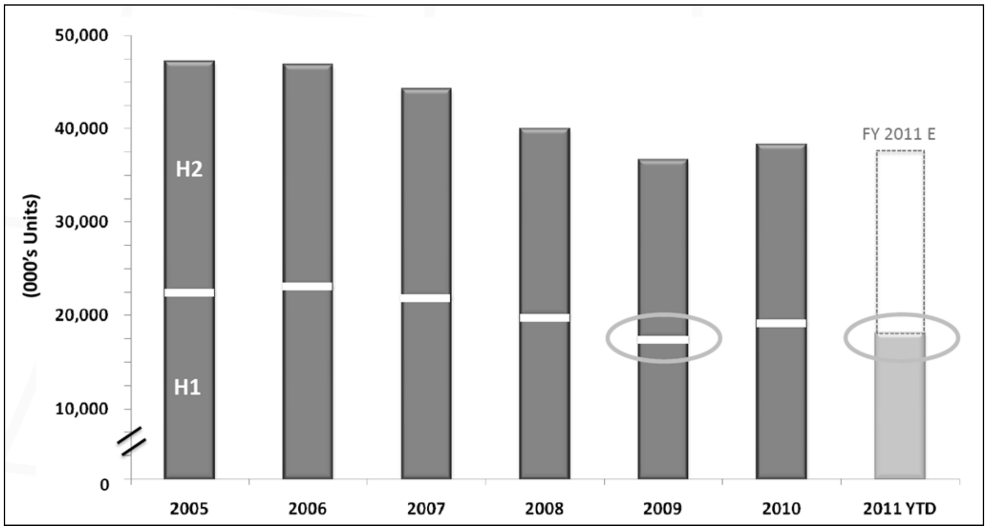
- ***Jenn-Air:*** Jenn-Air was founded in 1947, and was acquired by Whirlpool in 2006 (it was owned by Maytag at the time). The Jenn-Air products are kitchen products, differentiated through industry-leading design and technology. This brand targets a more high-end, style-conscious buyer relative to the other parts of the Whirlpool portfolio.
- ***Amana***: Amana was founded in the 1930s, and has extended its operations to include both kitchen and laundry appliances. Amana was acquired by Whirlpool as part of the Maytag acquisition in 2006. Amana products are designed to be simple, and relatively lower cost.
- ***Bauknecht***: Bauknecht was founded in the mid-20th century in Germany, and became part of Whirlpool in 1989. This brand is focused on providing kitchen and laundry appliances that are distinguished by their technology and modern design. This brand's primary presence is in Central and Northern Europe.
- ***Gladiator***: The Gladiator GarageWorks brand was launched by Whirlpool in 2003. The brand is focused on garage organization and storage products. Management launched this category in response to customer feedback, and perceived growth opportunities for both domestic and overseas markets. Gladiator is expected to have a presence in 10 countries by the end of 2011.

The Company's global distribution capability further differentiates WHR from its industry peers. The Company has long-established relationships with major retailers that sell home appliances (Lowe's, Home Depot, Sears, etc.). Importantly, WHR holds relationships with major local retailers throughout its global footprint. Lowe's represents WHR's largest retail relationship, accounting for 10% of total sales in 2010. WHR typically holds the #1 or #2 share of appliance sales among retailers that distribute its products. In our view, the Company's scale, innovation, and brand recognition should ensure that consumers will continue to seek WHR products when visiting their local retailer. However, it should be noted that the majority of WHR contracts with retailers are short-term in nature; these trade customers have meaningful leverage with WHR and other appliance providers and can adjust orders and shelf space as market conditions warrant.

<u>Navigating the Current Challenges</u>

Demand for WHR's products is sensitive to several factors including housing fundamentals and overall consumer confidence. Although conditions in several emerging markets remain favorable, the Company still relies on the developed markets of North America and Europe for the majority of its revenue. Roughly 50% of appliance purchases in the United States stem from replacement of existing units, 27% are classified as discretionary, and the remaining 23% are driven by sales of new and existing homes. Clearly, the weak fundamentals for U.S. real estate and overall consumer sentiment represent key near-term challenges. Industry data regarding U.S. appliance shipments remain weak. During the most recent quarter, industry shipments declined 10% year-over-year, reverting to 2009 levels (see chart).

U.S. Industry T7 Unit Shipments

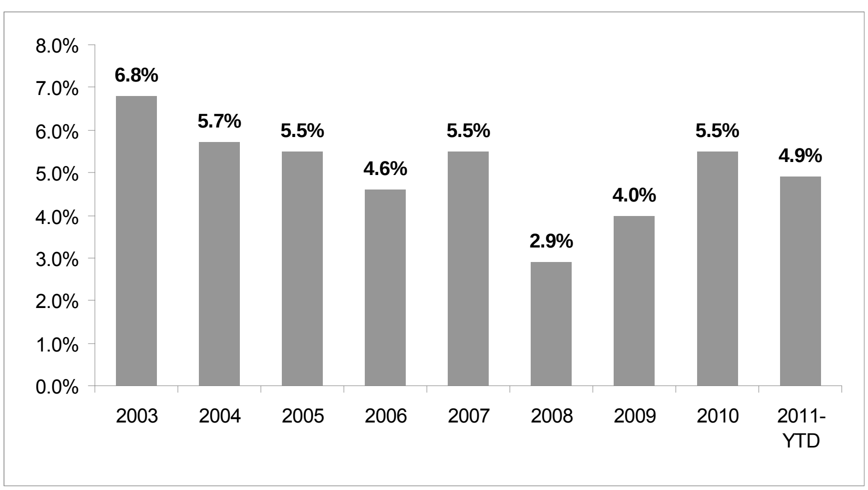


Source: Company presentation, July 21, 2011

As a result of weak sales trends and increasing raw material costs, WHR's margins have come under significant pressure. Management has taken several steps to mitigate these margin pressures, and create a more profitable Company for the long-term. Since the economic downturn, WHR has pursued several initiatives that address the Company's overall efficiency and cost structure. WHR has reduced its total number of manufacturing centers by over 20% since 2006. SG&A levels have also been well controlled, SG&A as a percent of sales was 8.7% in 2010, down from a pre-recession level of 9.4% (Even more impressive when considering the weakening sales trends). In addition, the Company has implemented several price increases to offset cost pressures from raw materials. These collective measures, combined with reduced promotional activity are expected to yield sequential improvements in margins during the second half of 2011.

Although near-term margins may show some stabilization and improvement, overall profitability will still be depressed when evaluating financial results from a longer-term perspective. The following chart helps to illustrate the level of recent profitability relative to historical ranges.

WHR Operating Margins



Long-term Objectives

In our view, the difficult near-term outlook does not reflect the long-term term fundamentals for WHR or its industry. Clearly, a recovery to more normalized conditions and profitability could require a multi-year time frame. However, the negative sentiment and weak results mask the true underlying earnings power and cash flow generation potential for this business. Moreover, management has taken several previously mentioned steps (cost reduction, manufacturing efficiency improvements, etc.) that should position the Company for profitability that could potentially exceed historical levels.

Management has outlined the following benchmarks for long-term creation of shareholder value. In addition, the Company has also set specific goals for WHR to achieve by 2014. Although the timing of a recovery is never certain, we believe these goals represent reasonable long-term objectives in a normalized environment. However, it is important to note that our valuation of the stock incorporates more modest assumptions.

2014 Objectives	Long-term Benchmarks
$24 billion in revenue	5%-7% annual revenue growth
8% operating margin	10%-15% annual EPS growth
EPS of at least $15.00	4%-5% free cash flow: sales ratio

Assuming the above objectives are attainable in a more favorable market environment, they would imply annual EBITDA of about $2.2 billion and approximately $1 billion in free cash flow per year. This free cash flow projection is well above the $400-$500 million expected in 2011, and would imply a free cash flow yield over 20% based on Whirlpool's current market capitalization.

Long-term Growth Drivers

In our view, there are several significant drivers of profit growth for WHR over the long-term. The most obvious growth driver should remain a return to normalized conditions in the housing market and overall economy in North America (still representing over 50% of total Company revenue). Absent such a recovery, WHR's long-term financial objectives would be difficult to achieve, and the Company's true earnings power would likely remain unrealized. However, we believe some normalization in housing market conditions is likely to occur during the coming years.

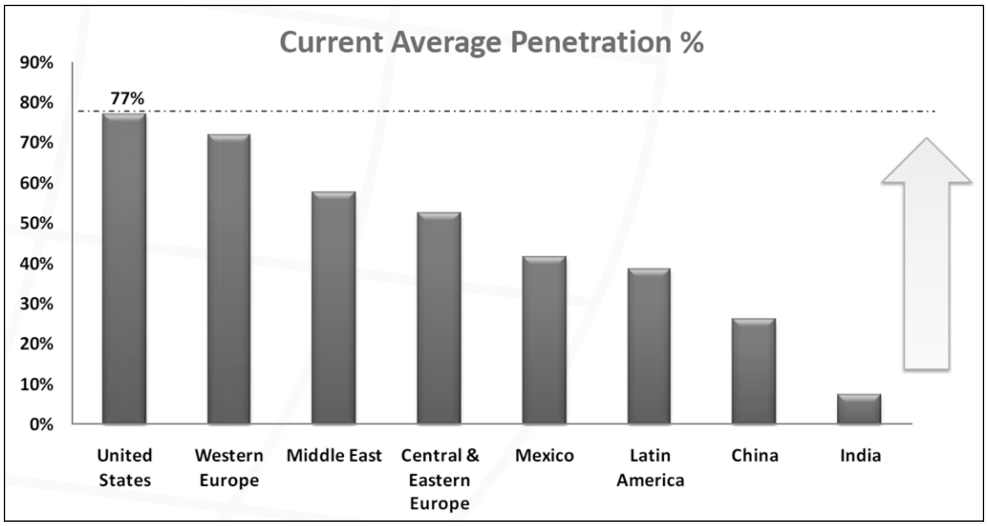
An additional potential driver of long-term growth is Company efforts to increase share and extend product lines into adjacent businesses. For example, WHR's market share position within laundry appliances currently stands at over 50%, but kitchen appliance share is below 40%, and management sees meaningful opportunities to close that gap (through products such as microwaves and freezers). In addition, an extension into adjacent categories (portable appliances, parts & service, water purifiers, etc.) also represents a potential source of new sales. Management believes the combined effect of a market recovery paired with market share gains represents a $1 billion revenue opportunity (over a 5% boost from current sales levels).

From our perspective, this opportunity for $1 billion in additional revenue should be attainable. During the coming years, issues such as household formation, population growth, and the drastic reduction in housing starts argue for a more normalized market environment in North America. In addition, WHR's disciplined capital investment throughout the cycle should position the Company for market share gains (capital expenditures have remained above $500 million since 2006). This level of Company investment should ensure that WHR products continue to differentiate themselves through their technology and innovation. Moreover, investments in its manufacturing, and its focus on overall efficiency should enhance WHR's competitiveness from a cost perspective.

The growth and importance of WHR's emerging markets presence is another key growth driver. Within the next 5 years, international markets are expected to represent at least half of overall Company sales (up from 47% in 2010). Importantly, nearly 70% of that international business will likely be derived from emerging markets (WHR has #1 market share in Latin America and #2 share in India). According to a U.S. State Department report, there are now more than 50 million Indians who are classified as "middle class," and the

Indian middle class is projected to increase ten-fold by 2025. Within Latin America, WHR's primary exposure is through Brazil. Within Brazil, the middle class population increased by 24% during the 2005-2009 period alone (source: Brazil Census Bureau), and the growth of the middle class is expected to remain robust for the foreseeable future.

The growth of middle class populations within emerging markets should bode well for appliance demand, and sales of WHR products. The worldwide appliance market is current valued at approximately $120 billion. This market should enjoy a healthy growth profile as utilization of appliances within emerging markets grows and begins to approach levels currently seen in developed markets such as the United States and Western Europe (see chart below).



Source: Company presentation, March 9, 2011

Balance Sheet and Financial Position

Despite facing a challenging market environment, WHR has successfully maintained profitability and relatively healthy cash flow throughout recent years. During this period of weakness, WHR has made significant progress with its cost structure and has maintained a solid balance sheet. During 2010 alone, WHR paid down $400 million in debt. As of the most recent quarter, Whirlpool had a net debt: capital ratio of 27% and total debt of about $2.5 billion. Although near-term results are weak, the current level of interest expense (approximately $220 million) should be comfortably covered by company cash flow (We expect WHR to generate over $1 billion in EBITDA during 2011). However, it should be noted that WHR's bond ratings have been downgraded in recent years in response to the difficult industry conditions. WHR continues to have investment grade bond ratings from the major agencies (S&P BBB-, Moody's Baa3), and these ratings were reaffirmed following the recently announced $600 million settlement with Banco Safra. Management has listed improved bond ratings as among its top financial priorities during the coming years.

Given WHR's relatively resilient cash flow, the Company has been able to address its funding needs throughout the downturn. Whirlpool has maintained a fairly steady investment in capital spending throughout the economic cycle. During 2010 the Company had $593 million in capital expenditures and $516 million in R&D, and capital spending has remained above $500 million since 2006. In addition, the Company has allocated some of its excess cash flow to addressing its pension obligations (a $300 million contribution has been budgeted for 2011). Going into 2011, WHR's overall pension obligations were underfunded by $1.5 billion.

WHR's dividend has been maintained throughout the downturn, and was actually increased 16% earlier this year to an annual payment of $2.00 per share (a dividend yield of over 3%). Based on EPS expectations for the next 1-2 years, this represents a dividend payout ratio of less than 25%, and further underscores the security of future dividends. In terms of future free cash flow priorities, management ranks its priorities as follows: 1) fund the business (Capital Expenditures and Pension Funding), 2) maintain the dividend, and 3) repay debt. Once those issues are sufficiently addressed management may also consider share repurchase, selective M&A, and a potential dividend increase. WHR's board of directors authorized a $500 million share repurchase program in 2008, but it has not been utilized for over 2 years. The unused portion of the share repurchase authorization stands at $350 million.

Corporate Governance

WHR has made several meaningful improvements to its corporate governance practices during recent years. The Company has eliminated its poison pill, supermajority voting provisions in its certificate of incorporation, and classified board structure. Currently, of the 14 board members, 12 are independent (non-employees). CEO Jeff Fettig has held the Chairman of the Board position since 2004. The overall level of insider ownership is low (under 1%), however we are encouraged by several insider purchases of the stock, serving to underscore the stock's attractive valuation. During August of 2011 alone, three Company officers invested a combined $438,000 in WHR shares (at an average price of $58.48). Like most firms, WHR utilizes stock options are part of its incentive compensation. During 2010, WHR recorded $29 million in share-based compensation expense. As of the end of last year, there was $44 million in unrecognized compensation related to non-vested stock options and stock unit awards.

Valuation

WHR shares have come under significant pressure during recent years, reflecting the multiple challenges impacting the Company's fundamental outlook. Certainly, overall market and industry considerations related to issues such as weak housing conditions and cost pressures from raw material costs have served to negatively impact financial results, valuation, and overall investor sentiment. Taking these factors into consideration, it should create little surprise that stock performance has been very disappointing. WHR shares have declined approximately 40% just since the beginning of 2011, the stock is down nearly 50% from highs achieved as recently as Spring-2010, and there is roughly a 14% short interest. Investors who exclusively focus on the near-term challenges will likely conclude that WHR's valuation and share performance are warranted. However, we believe the stock presents a very attractive opportunity for patient investors with a longer-term time horizon.

Assuming that conditions for the economy and the housing market can approach a more normalized state during the next 2-3 years, WHR should be well positioned to achieve a meaningful recovery in terms of both profitability and stock performance. In addition to having improved housing fundamentals and improved consumer sentiment as positive catalysts for product demand, WHR should also realize meaningful cost benefits from multiple sources. Company restructuring and cost reduction initiatives have already achieved meaningful progress, and should have positive long-term ramifications for margins. Moreover, near-term profits have been pressured by historic increases in raw materials costs, which we believe may prove to be unsustainable from a multi-year perspective. Importantly, we would also highlight that WHR has continued to invest in its businesses throughout the downturn, while maintaining its healthy dividend (yield over 3%), and an investment grade balance sheet.

For the purposes of estimating intrinsic value, our valuation utilizes an EV/EBITDA methodology. In our view, this represents a more reliable means of valuation relative to earnings, especially given the uncertain impact of tax credits on WHR's future net income. As previously mentioned, management has outlined fairly ambitious financial benchmarks for the 2014 time period, which could represent a potentially achievable scenario during a more favorable market environment (see Long-term Objectives section). However, we prefer to utilize a more conservative set of assumptions in order to value WHR shares.

In order to estimate an intrinsic value for WHR in 2-3 years, we have assumed WHR can trade at 5.0x EV/EBITDA, a multiple that is toward the lower end of the stock's historical trading range. For the purposes of valuation, our intrinsic value estimate also assumes WHR can achieve about $21.5 billion in revenue and a 6% operating margin (implying EBITDA of about $1.9 billion, and free cash flow of roughly

$900 million) by 2014. This level of revenue assumes a 10% shortfall relative to management's 2014 objective, and assumes only a 10% improvement from very depressed 2011 sales levels. Moreover, our operating margin implies a 200 basis point shortfall relative to WHR's 2014 goal, and assumes only a modest improvement from pre-recession levels of profitability. Overall, these multiple and profit assumptions produce an intrinsic value of $84 for WHR shares, and this may prove to be conservative. This intrinsic value, combined with the current dividend yield of over 3%, implies total return potential of over 60% from the current price. Importantly, we have assumed no additional pension contributions beyond 2011, implying a $1.2 billion pension shortfall (See below for breakdown).

Whirlpool Valuation Summary

	Value ($MM)
WHR @ 5x 2014 EBITDA	$ 9,325
Net Debt	(1,661)
Underfunded Pension*	(1,200)
Equity Value	$ 6,464
Shares Outstanding	76.8
Estimate of Intrinsic Value (Per Share)	**$84.17**

* reflects 2011 contribution only

Higher levels of growth and profitability (at or closer to WHR's objectives) could yield a fair value for WHR that would be over 40% higher than our estimate of intrinsic value (see matrix below for sensitivity analysis). Moreover, the 5.0 EV/EBITDA multiple could also prove to be conservative given that it is toward the lower end of historical ranges (WHR has traded at 6.0x EV/EBITDA or higher at certain times in the past).

Intrinsic Value Matrix

Assumed EV/EBITDA 5.0x

Operating Margin / **Sales**	**20,000**	**20,500**	**21,000**	**21,500**	**22,000**	**22,500**	**23,000**	**23,500**	**24,000**
4.5%	$58.78	$60.24	$61.71	$63.17	$64.64	$ 66.10	$67.57	$69.03	$ 70.49
5.0%	$65.29	$66.91	$68.54	$70.17	$71.80	$ 73.42	$75.05	$76.68	$ 78.31
5.5%	$71.80	$73.59	$75.38	$77.17	$78.96	$ 80.75	$82.54	$84.33	$ 86.12
6.0%	$78.31	$80.26	$82.21	**$84.17**	$86.12	$ 88.07	$90.03	$91.98	$ 93.93
6.5%	$84.82	$86.93	$89.05	$91.17	$93.28	$ 95.40	$97.51	$99.63	$101.74
7.0%	$91.33	$93.61	$95.89	$98.16	$100.44	$102.72	$105.00	$107.28	$109.56
7.5%	$97.84	$100.28	$102.72	$105.16	$107.60	$110.05	$112.49	$114.93	$117.37
8.0%	$104.35	$106.95	$109.56	$112.16	$114.77	$117.37	$119.97	$122.58	$125.18

In our view, WHR shares represent a compelling opportunity for patient long-term investors to participate in a recovery in the housing market. Our price target utilizes relatively modest assumptions, and evaluates the Company on an independent, stand-alone basis. However, additional upside from other sources also warrants mention. From our perspective, WHR could eventually attract the attention of private equity investors given its strong brands, steady cash flow, and solid balance sheet. Appliance makers have been the focus of such investors in the past. Prior to WHR's acquisition of Maytag in 2006, Maytag had attracted the interest of multiple private equity firms (In addition to the WHR bid, 2 private equity groups made formal bids for

Maytag). After multiple bids for Maytag from several sources, WHR ultimately purchased the firm for $21 per share (equating to about 8.0x on an EV/EBITDA basis). We would also highlight Bain Capital's 2007 purchase of American Standard's bath and kitchen unit as another illustration of past investor interest in this industry (purchased for over 0.70x sales). These past transactions would suggest a fair value of approximately $150 per share for an acquisition of WHR, but we regard such multiples as unrealistic for the foreseeable future given current market fundamentals.

Conclusion

In summary, we regard WHR as an attractively valued means of participating in a future housing market recovery. The Company's leading market share position, globally recognized brands, and strong distribution capabilities should ensure that Whirlpool retains a solid competitive position over the long-term. Moreover, growth opportunities associated with potential market share gains, extension of product lines, and increasing exposure to emerging markets should serve to further bolster WHR's potential cash flow generation and earnings power. Consistent investment in R&D throughout the downturn should continue to support product quality and innovation. Additionally, management's initiatives related to cost reduction and manufacturing efficiency during the downturn should translate to higher margins and profits as market conditions improve.

We believe WHR's valuation and potential recovery in profitability offers compelling long-term upside. Our $84 estimate of intrinsic value, combined with a dividend yield of over 3%, implies a total return of over 60% during the next 2-3 years. This valuation utilizes relatively modest assumptions from a long-term perspective, and these assumptions could prove conservative. Our investment thesis is solely based on WHR remaining an independent, stand-alone entity. However, WHR's overall strategic and financial profile could attract the attention of private equity investors at some point in the future. Ultimately, WHR is an out-of-favor stock in an out-of-favor industry. Although near-term results may remain challenging, we believe the stock's depressed valuation and poor sentiment translates to an attractive investment opportunity for patient investors with a multi-year time horizon.

Risks:

Risks that Whirlpool may not achieve our estimate of the Company's intrinsic value include, but are not limited to, a lack of recovery in housing fundamentals, a persistent increase in materials costs, a substantial slowdown in growth within emerging markets, and a general failure by management to maintain and improve the Company's strategic and financial position.

Analyst Certification:

Asset Analysis Focus certifies that the views expressed in this report accurately reflect the personal views of our analysts about the subject securities and issuers mentioned. We also certify that no part of our analysts' compensation was, is, or will be, directly or indirectly, related to the specific views expressed in this report.

WHIRLPOOL CORPORATION
CONSOLIDATED BALANCE SHEETS
(in millions)

ASSETS	(Unaudited) June 30, 2011	December 31, 2010
Current assets		
Cash and equivalents	$ 845	$ 1,368
Accounts receivable, net	2,455	2,278
Inventories	3,071	2,792
Deferred income taxes	182	204
Prepaid and other current assets	662	673
Total current assets	7,215	7,315
Property, net of accumulated depreciation	3,213	3,134
Goodwill	1,729	1,731
Other intangibles, net of accumulated amortization	1,780	1,789
Deferred income taxes	1,633	1,305
Other noncurrent assets	344	310
TOTAL ASSETS	**$ 15,914**	**$ 15,584**

LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities		
Accounts payable	$ 3,827	$ 3,660
Accrued expenses	1,262	671
Accrued advertising and promotions	312	426
Employee compensation	386	467
Notes payable	15	2
Current maturities of long-term debt	363	312
Other current liabilities	704	611
Total current liabilities	6,869	6,149
Noncurrent liabilities		
Long-term debt	2,143	2,195
Pension benefits	1,312	1,519
Postretirement benefits	465	610
Other noncurrent liabilities	626	791
Total noncurrent liabilities	4,546	5,115
Stockholders' equity		
Common stock, $1 par value	106	106
Additional paid-in capital	2,184	2,156
Retained earnings	4,617	4,680
Accumulated other comprehensive loss	(687)	(893)
Treasury stock	(1,822)	(1,823)
Total Whirlpool stockholders' equity	4,398	4,226
Noncontrolling interests	101	94
TOTAL STOCKHOLDERS' EQUITY	4,499	4,320
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	**$ 15,914**	**$ 15,584**

DISCLAIMERS

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