ALLIANCE RESEARCH

Guarantor Credit Review

Helping the Commercial Real Estate Industry Reduce Financial Risk Since 1989

Johnson Durable Products Inc.

Highlights

Key Positives

- Johnson Durable Products is a leader in the plumbing supply business and since their IPO in mid-2016, the company has generated strong sales growth and profitability, with EBITDA margins recently reaching new highs at ~25%.
- The Company's 2019 acquisition of Quick-Fit Pipes was very positive for the financial profile, as it added significant scale with ~$180 million in revenues, was accretive to EBITDA margins, and was primarily financed with equity, leaving the balance sheet relatively healthy.
- The CFO told us that growth in the U.S. has accelerated since the COVID-19 disruptions began as the home improvement retail channel has remained open and homeowners have pushed up DIY projects.
- Per Management, the Company's net debt is down since the start of the year, with the leverage ratio now at a low ~1.2X.
- Johnson has been able to pause growth CAPEX, halt share buybacks, and execute other cost cuts that should preserve ~$30 million in cash through the end of fiscal 2020, per the CFO.
- The Company has ~$225 million in total liquidity between cash and availability on their credit facility.

Key Negatives/Risks

- The CFO said the Company's APAC business is down ~30-50%, depending on the vendor, and will likely be pressured for the foreseeable future, which will likely drive a year-over-year revenue decline company-wide in the single-digits percentage range.
- There is some concentration risk as Home Depot and Lowe's account for ~15% of total Company sales.
- Johnson operates in a relatively low-growth industry and will likely rely on M&A to accelerate their growth, which increases the execution risk.
- Johnson's stock price is sitting at a 3-year low, which may force them to use debt for any future acquisitions and increase their leverage ratio.
- It is uncertain what the ultimate impact of the COVID-19 business downturn will be.

Financial Highlights

($ 000)	2017	2018	2019	6 mos. 2020
Revenues	$400,212	$516,273	$722,782	$378,212
EBITDA	96,451	124,938	177,082	94,553
Cash & equivalents	14,567	16,782	25,908	21,877
Total assets	395,672	512,431	1,329,312	1,428,910
Long-term debt	163,721	273,521	231,076	197,349
Equity	174,378	172,312	872,223	915,670

Conclusions

Risk Assessment/Credit Quality

Johnson Durable Products generated consistently strong operating results over the periods we reviewed. This has included steady revenue growth, as well as healthy EBITDA margins and free cash flow.

Our rating of the level of tenant risk (see Rating Guide on page 6) in a lease guaranteed by Johnson Durable Products recognizes these positives, as well as the Company's solid balance sheet and liquidity position. While we see the risk profile as somewhat elevated in the near term given the current market backdrop related to the COVID-19 disruptions, we feel that their business model and balance sheet should help them weather the COVID-19 storm relatively well.

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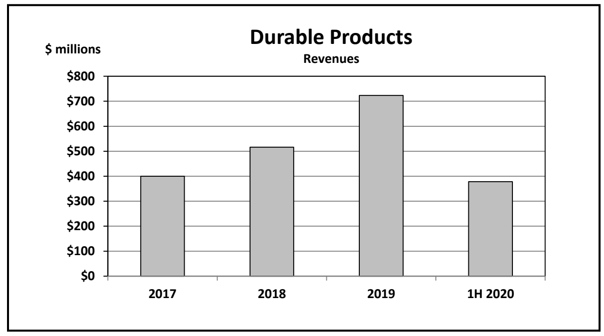
Analyst Notes

Revenues – Johnson Durable Products has shown consistent revenue growth since their IPO in mid-2016, with the Company's top line expanding at rates of 11%, 29%, and 40% in fiscal 2017, 2018, and 2019, respectively. 2018's elevated growth rate was driven in large part by the first-time rollout of product at Lowe's, as well as an acquisition that closed early in the year. In 2019, the acquisition of Quick-Fit added nearly $180 million in sales, accounting for most of that year's growth.



The first half of 2020 grew 3% year-over-year, although this was largely driven by FX impacts and sales were flat on a constant currency basis. When the Company announced their 1H results in late February, they guided full year sales to be up slightly, and a month later, as the COVID-19 pandemic's impacts became clear, they withdrew their guidance. In our conversation with the CFO, he acknowledged that the business had been impacted, especially in Asia, where they are down 30-50% depending on the vendor. However, he noted that they were up >10% in the U.S. since the stay-at-home orders began as their key vendors like Lowe's and Home Depot remained open and homeowners pushed forward home repairs and renovations. The CFO told us full year sales declines would likely be in the single-digit percent range for the Company as a whole.

45% of Johnson's sales come from the U.S., 35% Europe, 11% Australia, and 9% other including Asia and Canada. 45% of their sales come from fittings and pipes, 30% control valves and 25% other plumbing products. In the U.S., 40% of the business is done at Home Depot and Lowe's, with the remainder split across hardware stores like Ace and True Value, wholesalers like Ferguson and regional players, and OEMs that use their valves in water heaters.

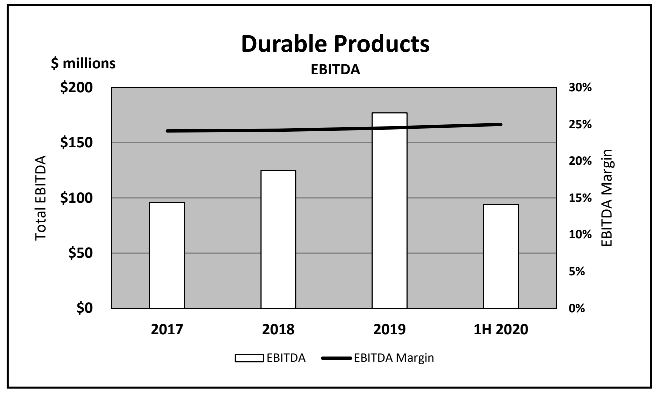
From a company-wide perspective, Home Depot and Lowe's account for a combined ~15% of sales, which does create some concentration risk. The U.S. market is more focused on DIY and 85% of their products go into repair & remodels, while Australia and Asia are more heavily indexed to new construction. Europe is primarily the Quick-Fit business, which sells the majority of their products through wholesalers.

The CFO told us that competition is somewhat limited because they make a high-volume, lower value product with a high capital threshold. He noted their retail business is even more insulated by the fact that Home Depot and Lowe's require high on-time rates that many smaller players cannot fulfill.

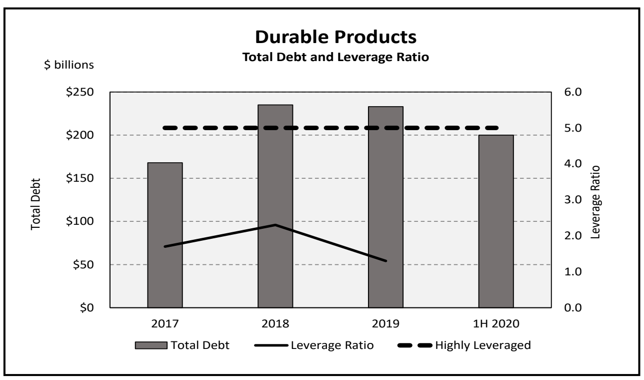
Profitability – Johnson was strongly profitable in the periods we reviewed, with gross margins of ~45% and EBITDA margins between 24-25%, which have improved in each of the past three years. The CFO told us that despite tariffs impacting 20% of their supply that they manufacture in China, they were able to get concessions from suppliers and take pricing actions that allowed gross margins to expand since the tariffs were initiated. The Company told us that they manufacture 20% of their products in China, 30% in Australia, and 50% in the U.S. They noted that their supply chain has not been significantly impacted by the COVID-19 disruptions.

Analyst Notes

EBITDA margins rose 30 basis points in fiscal 2019, primarily due to the Quick-Fit acquisition that was margin accretive as that company generates EBITDA margins of ~27% vs. 22% for legacy Johnson. The Company initially guided 2020 EBITDA to ~$180 million but has since withdrawn this guidance in the wake of the pandemic. EBITDA margins will be pressured in the 2H of 2020 and 1H of 2021 due to the COVID-19 disruptions.

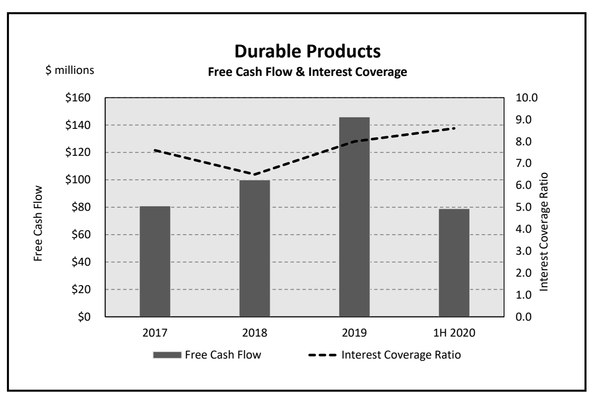


Capitalization – Johnson completed an IPO in 2016 and has since used a combination of debt and equity to fund its growth. Debt has risen from $168 million at the end of fiscal 2017 to a high of $275 million at the end of fiscal 2018, with a portion of that increase going toward funding the Quick-Fit acquisition. Much of the deal, however, was funded with a ~$500 million equity issuance, which helped keep the Company's net debt to EBITDA ratio in a healthy range (we consider a ratio above 5.0 to be "highly leveraged"). The Company has whittled away at their debt since the acquisition, taking it down to ~$200 million as of the end of 1H 2020. The CFO told us that their current net debt situation has improved further as cash has risen more than debt and that their leverage ratio is currently ~1.2X.



The Company's ~$200 million of debt is from their ~$400 million credit facility, which has three equal tranches that each mature at the end of September 2021, 2022, and 2023. The facility has a variable interest rate that is based on a variable base rate plus a margin, which we estimate is currently ~5-6%, based on recent interest expense levels.

Cash Flow/Liquidity – Johnson has generated strong free cash flows over the past few years, due to a combination of strong EBITDA and modest annual CAPEX. With the Company's EBITDA growing from $125 million in 2018 to $175 million in 2019, CAPEX only rose from $25 million to $31 million. The CFO told us that maintenance CAPEX was only $10 million of this (evidenced by their ability to cut ~$20 million of projected CAPEX in response to COVID-19), which suggests they have the ability to preserve cash by limiting growth CAPEX during difficult times.



Analyst Notes

With a free cash flow base of $146 million in fiscal 2019 and a similar yield in the 1H of 2020, the Company easily covers their annual interest expense that is likely to stay in the $18 million range unless the Company takes on more debt. This seems unlikely as the CFO stated that they had continued to be free cash flow positive since the pandemic began, which has increased their total liquidity.

Per the CFO, the Company's cash balance is now greater than the $21 million they had on hand at the end of Q2 2020, and ~$200 million is available from their credit facility. We reiterate that he also stated that cash flow generation has continued to be positive since the COVID-19 disruptions began.

Johnson decided to halt share buybacks, which will save them ~$18 million of cash in the 2H. Combined with the CAPEX pause, furloughs, and other cost reductions and deferments, the CFO estimates that they have preserved as much as $30 million in cash through the end of the fiscal year versus the original plan.

The CFO told us that despite the elevated uncertainty, the Company was constantly looking at potential acquisitions. While their execution on this front has been strong so far, another acquisition would likely elevate the level of execution risk and would be credit negative if financed with debt, something that may be necessary as the Company's stock is sitting at 3-year lows at $10.94 vs. a peak of $35.32 when they issued shares to pay for the Quick-Fit acquisition.

Corporate Profile

Johnson Durable Products Inc. is a leading provider of plumbing and home improvement products in the U.S. (45%), Europe (35%), Australia (11%), and other (9%- Asia, Canada, etc.). 45% of their products are fittings and pipes, 30% control valves, 25% other. In the U.S., they are retail and DIY oriented with ~40% of sales coming from Home Depot and Lowe's and the remainder from hardware stores, wholesalers, and OEMs. In Australia, Asia, and Europe, the Company is more tied to wholesale and distributors with more products going directly to plumbers or being used in new construction. Johnson acquired Quick-Fit, a German-based company, for $600 million in 2019, which gave them a more significant foothold in Europe.

The Company was founded in 1971 by the Johnson family and went public in 2016. The family initially sold 80% of their stake to investors and finally sold the last 20% in a secondary in 2018.

Scope of Analysis

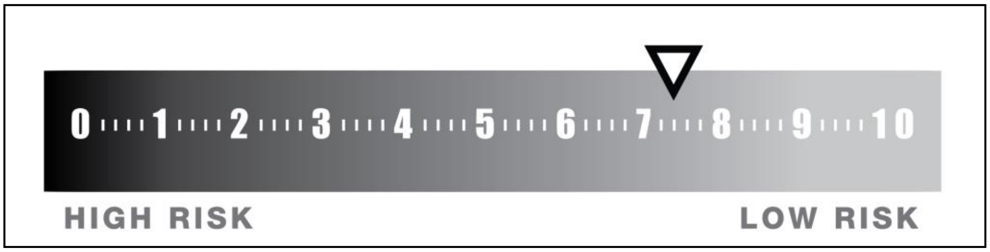
Our analysis of Johnson Durable Products Inc. included (i) a review of the Company's 10Ks for 2017-2019 and their 10Q for the second quarter of 2020; (ii) an online search and review of information about the Company; (iii) a review of business and trade publications about the Company and its industry; and (iv) an interview with the Company's CFO.

Johnson Durable Products Inc.
Financial Spreadsheet

($ in thousands) *Fiscal year ending June 30*	*2017*	*2018*	*2019*	*6 months* *2020*
For the period				
Revenues	$400,212	$516,273	$722,782	$378,212
Year-to-year growth rate	11%	29%	40%	3%
Pre-tax income (as reported)	63,260	67,883	111,328	57,321
EBITDA (adjusted)	96,451	124,938	177,082	94,553
Margins				
Gross margin	44.3%	45.1%	45.2%	45.6%
EBITDA margin	24.1%	24.2%	24.5%	25.0%
Expense ratios (% of revs.)				
Sales & marketing expense	12.1%	13.3%	11.5%	12.7%
G&A expense	7.9%	9.3%	8.7%	9.2%
Cash Flow				
EBITDA	96,451	124,938	177,082	94,553
Capital expenditures	(15,901)	(24,521)	(31,109)	(15,890)
Free cash flow	80,550	100,417	145,973	78,663
Interest expense	(10,549)	(15,439)	(18,342)	(9,128)
Interest coverage	7.6X	6.5X	8.0X	8.6X
From operating activities	50,181	103,133	86,955	112,676
From investing activities	(99,031)	(124,352)	(630,751)	(15,484)
From financing activities	44,321	23,453	552,921	(101,301)
Net change in cash & equiv.	(4,529)	2,234	9,125	(4,109)
At period end[1]				
Assets				
Cash & equivalents	14,567	16,782	25,908	21,877
Accounts receivable	44,575	47,888	125,672	132,905
Inventories	98,543	104,590	141,245	153,803
Total current assets	190,872	203,451	321,376	322,098
Prop., plant & equip. (net)	65,890	135,467	138,921	154,732
Intangible assets	32,109	78,453	175,691	189,337
Goodwill	51,370	90,652	402,347	423,843
Total assets	395,672	512,431	1,329,312	1,428,910
Liabilities/Equity				
Accounts payable	62,662	107,314	84,463	90,083
Current portion of LT debt	1,204	1,543	2,124	2,354
Total current liabilities	74,985	112,341	95,431	94,321
Long-term debt	163,721	273,521	231,076	197,349
Stockholders' equity	174,378	172,312	872,223	915,670
Key financial ratios				
Current ratio	2.5	1.8	3.3	3.4
Quick ratio	1.2	0.9	1.9	1.8
Leverage ratio	1.7	2.3	1.3	N/A
Net debt/EBITDA	1.6	2.1	1.2	----

[1] These are balance sheet highlights. Certain line items have been excluded.

Rating Guide



Tenant Risk[2]/Credit Quality

Rating	Tenant Risk	Credit Quality	Security Recommended
0 – 1	Very high	Deficient	Avoid as tenant
1 – 3	High	Unsafe	Full security
3 – 5	Worrisome	Poor	Full/Partial security
5 – 7	Some concerns	Fair	Partial security
7 – 9	Low	Good	None or partial security
9 – 10	Very low	Excellent	No security

This rating is based on an analysis of a company's key financial documents and business fundamentals, as well as comparative data drawn from the Alliance Group's proprietary Tenant Index of more than 6,000 companies that reside in our research database. In our peer group studies, IndexSearch software is used to categorize and weigh companies by size, industry, risk levels, and other key factors to narrow the peer group and ensure a meaningful group of comparable companies.

Michael F. Calhoun has 25 years of experience in financial analysis, business management and corporate evaluation. He is President of The Alliance Group, a consulting firm specializing in corporate due-diligence studies, acquisition searches, business valuations and investment analysis services. Mr. Calhoun is a former investment analyst for both the Dreyfus Corporation and Oppenheimer Management.

[2] Tenant Risk refers to the possibility that a tenant will default during the life of a lease.