

## ExportWise - Spring 2008 - Looking Beyond The Housing Market

By Danny Kucharsky

*Despite the current U.S. housing market slump, Canadian exporters are seeing many opportunities in non-residential construction markets, as the United States looks to upgrade its existing infrastructure.*



When the Freedom Tower – the skyscraper that will replace the World Trade Center – is erected in Lower Manhattan in 2011, it will be supported by Canadian expertise.

ADF Group, which produces complex steel structures at its 225-employee plant in Terrebonne, Quebec, has a \$47 million contract (about \$100 million once raw materials are included) to supply some 25,000 tons of steel over a 15-to-18-month period for the 108-storey New York City project, arguably the most-watched and controversial construction site in the world.

All the steel will be shipped by flatbed truck from ADF's Terrebonne plant to the giant site at Ground Zero. ADF will also be building the 409 foot antenna that will adorn the top of the Freedom Tower and give it its symbolic 1,776 feet height – aimed to coincide with 1776, the year of U.S. independence.

"We're fortunate to be part of the Freedom Tower, but let's not forget why we are building this tower," says Louis Potvin, Chief Financial Officer of ADF Group. "We're doing the complicated stuff," he says of the company's involvement in the project. The project's backers "know that we are very seasoned to be able to do the difficult pieces."

ADF is just one of many Canadian exporters in the construction industry who are taking advantage of the non-residential construction and infrastructure market in the United States, one that offers plenty of opportunities to Canadian exporters – despite the fact the residential construction sector in that country has taken a nosedive. The U.S. housing market has had its worst slump in more than two decades, due in large part to a huge increase in mortgage foreclosures.

However, the Annual Economic Forecast by the Associated General Contractors of America predicts the non-residential construction sector in the United States will experience growth this year of 3 to 7 per cent. A renewed emphasis on infrastructure maintenance and upgrades, in the aftermath of last year's bridge collapse in Minneapolis, should help construction projects continue moderate growth, while growth of public-private partnerships also offers potential.

Although overall U.S. construction starts are expected to decline by 2 per cent to USD 614 billion according to the McGraw Hill Construction 2008 Outlook, it is mainly the residential housing segment driving this downturn. When construction starts are combined with ongoing construction, the market totals more than \$1 trillion of new business annually. Other segments such as institutional buildings will grow, presenting continued opportunity for Canadian exporters. The sheer volume of this market provides opportunities for Canadian companies within the U.S. construction and infrastructure market.

As a result, there are growing opportunities for Canadians in non-residential construction in the United States, as our neighbour to the south needs to upgrade existing infrastructure and build new institutional buildings and roads, notes Marie-

Claude Erian, EDC Sector Advisor with the Infrastructure business development team in Ottawa. According to Statistics Canada, 2007 total exports for value-add products and services were about \$17 billion.

**Keystone Pipeline**

**\$150 million**

**1,400 miles of U.S. pipeline**

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What's more, the global demand for various value-added services and goods, such as architectural metals, curtain-walls and architectural services, exceeds the supply for a high number of non-residential construction or infrastructure projects, Erian says. Prospects improve even more once it's considered that new technologies, rising energy prices and the green movement are creating additional pressures for new building standards that reduce waste, energy and water use and create healthy environments, Erian says. She notes that Canada has developed a good reputation in this area and has a number of projects underway that are being built to the U.S. Green Building Council's LEED (Leadership in Energy and Environmental Design) gold and platinum standards. As well, McGraw Hill's U.S. construction outlook for 2008 indicates that by 2010, "green" buildings are expected to comprise 5 to 10 per cent of non-residential building stock, - particularly in publicly-owned structures.

In addition, demographics are changing, as baby boomers age, and this will result in a demand for more health care facilities, Erian says. "Overall, the U.S. market is one that we take for granted in some ways," she says, noting that in the block around Ground Zero alone, USD 20 billion of building and infrastructure will take place between now and 2012. "Our close proximity puts us in a good position to work in the United States."

In fact, Canada's proximity to the large U.S. construction market provides a great opportunity for exporters to sell construction materials without the cultural and physical distance barriers of the overseas market. Therefore, the United States remains by far the most important external market for our construction industry, with 90 per cent of total exports.

Indeed, more than 95 per cent of ADF's business, whose sales reached \$53 million last year, is conducted in the United States, and the company has worked on a number of high profile New York City buildings, including the Bloomberg Tower, Time Warner Center, Random House and new headquarters for Bear Stearns and Goldman Sachs. Although the company has worked on major Canadian projects such as Toronto Pearson International Airport, "there are not many projects up in Canada that require highly complex structural steel," Potvin explains. "We don't do the conventional retail type of buildings."

According to a May 2007 article in Crain's New York Business, Canadian construction entrepreneurs, particularly those from Quebec, are "picking up the slack left by local companies and helping to moderate runaway construction costs during New York's biggest building boom in four decades."

Local firms are unable to keep pace with demand and Quebec participation is helping builders dampen rising costs, the publication says. As well, the New York Building Congress notes that Quebec firms offer lower labour, power and operating costs.

**Promoting Canadian expertise**

This success did not come overnight, however; Quebec's construction industry has been

working for years to build its U.S. relationships. The Association de la construction du Québec, which represents 15,000 firms, started organizing commercial missions to the United States in 2000 to promote the services of its members in industrial, commercial and institutional construction. The trips were a clear contrast to the past, when much of the focus was on export opportunities in residential construction in the United States.

“Once we saw that there was a major emerging market in the United States, we said we’d try to create these missions and create momentum,” says Pierre Hamel, Director of Legal and Government Affairs at the Association de la construction du Québec. “We’ve succeeded to a large extent.”

To date, 12 missions have been conducted to locales such as Washington, Boston, New York, Philadelphia, Miami, Columbus, Cleveland and Chicago. Hamel says that a 2004 Quebec trade mission to Boston led to submissions of about 10 contracts valued at about USD 1 million each and two or three projects for one Quebec firm. “Some firms that have taken part in our missions now do more business in the United States than in Canada,” Hamel says. “Quebec companies are very much in demand.”

Hamel says firms that specialize in pre-cast concrete, curtainwalls, architectural fittings, ornamental iron, infrastructure, ceramics and marble have fared the best in the trade missions. Over the years, the markets most in demand have been Boston with the Big Dig tunnel project and the Ground Zero area in Lower Manhattan.

Canadian firms based outside Quebec are also rising to the export challenge in non-residential and infrastructure work. Take Ontario-based consulting engineering firm Trow.

Trow was awarded the project management of the U.S. portion of the Keystone Pipeline, which will transport up to 591,000 barrels per day of crude oil from Hardisty, Alberta, to Illinois and Oklahoma when completed by the end of 2010. Trow is controlling multi-million dollar budgets for the nearly 1,400 miles of U.S. pipeline. Prior to that, the company was also involved in the Gulfstream Natural Gas Pipeline, which runs across the Gulf of Mexico and through Florida. Trow’s role included engineering, construction, environmental consulting, public relation consultation and legal matters.

The company has developed a prominent position in the pipeline business “because of our unique blend of skills,” says Stan Gonsalves, President of Trow. Trow began its U.S. involvement in 1992. There are few businesses in the pipeline industry and Trow has succeeded in getting involved in large projects that involve major players such as TransCanada Pipelines.

Trow also did logistics work at Toronto Pearson International Airport on security issues, which included the development of alternative methods of collecting and removing waste from the terminal buildings. This, in turn, led to several U.S. contracts. The 1,200-employee company now has a phased contract with Los Angeles International Airport and projects in various stages at airports in Philadelphia, Denver and Texas.

“We’re either approached by the airports because of word of mouth in the industry or articles that we’ve published,” Gonsalves says.

Some 15 per cent of Trow’s business is now in the United States and the goal is for the company’s international business, including the United States, to exceed 25 per cent.

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Trow has made use of EDC services to leverage additional financial capacity in order to meet growing sales. “EDC has been in touch with Trow International to discuss several

of their financial solutions, including bid, performance and warranty bonds that are commonly required in the engineering and consulting industry," notes Richard Ross, EDC Account Manager in Ontario.

ADF has worked with EDC to insure receivables, to issue letters of credit and for bonding. For example, EDC provided bonding insurance for an ADF contract for the new 68-storey headquarters for Goldman Sachs, which is being built near the Freedom Tower.

Trow's Gonsalves plans to expand even further into the country. Despite the rising Canadian dollar, which has hurt in the conversion of sales, there is a silver lining. "With the dollar at par, we can look more at acquisitions."

While firms such as ADF and Trow have prospered in the United States, their executives note that success does not come without overcoming some hurdles.

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"First, you have to make sure that you know the local laws, and ensure terms and conditions are well thought-out," says ADF's Potvin. ADF went through its own pitfalls in the U.S. market about five years ago when a steel project at Ford Field Stadium in Detroit went sour. The client demanded more than 22,000 changes which were not paid for and ADF lost when it went to binding arbitration on the matter. "You've got to read your contracts and make sure that all your change orders are assigned rapidly," says Potvin.

Erian notes the 9/11 terrorist attacks in 2001 greatly increased concern about U.S. domestic security, "and this has significantly affected how exports from Canada and around the world enter the United States."

Security measures continue to evolve and may complicate export business, by slowing traffic across the border or by requiring more preparation and documentation.

Potvin also warns of the large amounts of paperwork that must be properly completed before goods can be shipped to the United States, in order to avoid penalties or, even worse, having them stopped at the border. Exporters also need permits for wide loads. "If you don't do that properly, you might be pulled over by State patrol. And you're stuck not being able to deliver the material to the site."

As well, Canadian firms require additional insurance when they export to the United States. "There's a lot more liability in the United States," Potvin says. While you might be able to operate a business in Canada with a \$5 million general liability risk, in the United States you have to multiply that by at least 10."

"Buy American" policies can also present barriers to Canadian exporters, Erian says. However, Canadians who have established operations in the United States have been able to deal with such issues and could be potential partners for exporters wanting to enter the United States.

Gonsalves adds that the advantages of doing business in the United States outweigh the potential risks.

"Regardless of the current poor news on the stock market and the outlook for the U.S. economy, we're still very bullish on the United States."

A bonus of doing work in the United States is that clients are often willing to pay a premium to come and do business with companies that offer specialized services, like ADF, for which there are limited competitors, notes Potvin.

“Customers come to ADF for our quality workmanship and our on-time deliveries, which are two key components for success in this business. They also come here because there are not a lot of companies who are able to do the difficult work that we’re doing. We’re known in the industry as being able to build anything that is very complicated. That’s our niche and that’s what we’re banking on right now.”

### **Teaming up to win a bid**

Potvin says ADF wins contracts through tenders in which it teams up with another fabricator or erector, who in turn bids to the general contractor or to the developer.

The company tends to shy away from lowest-bid projects, aiming instead for highly complex projects that eliminate a number of potential bidders from the table. “We’ve won contracts recently where we weren’t necessarily the lowest bidder, but the owner and the general contractor were convinced that we were the best team to deliver the product.”

Erian agrees that Canadian firms have to select U.S. projects where they have the most chances of winning. Canadian exporters can increase their odds of expanding to U.S. markets by targeting certain states, or by teaming up with others to bid on larger projects.

Working with a Canadian company with operations in the United States, such as an engineering or architectural firm, is a good way to obtain work in the United States, she says. Canadian suppliers should also strive to become better known by larger U.S. architects, as they can play a role in influencing the procurement of the various - components, systems, materials and structures required in construction projects.

To gain a U.S. foothold quickly, Canadian companies are also taking shortcuts by acquiring smaller firms in the United States, Erian says. That’s the strategy Trow is pursuing. It’s looking for merger or acquisition opportunities “that will give us the people or infrastructure to do well in the United States,” Gonsalves says.

EDC also has several ways of helping Canadian exporters in the U.S. market. “EDC works with surety companies as a re-insurer to add bonding capacity to the market, so that Canadian companies can do more business in the United States and not be constrained by financial capacity,” Erian says. “We also work a lot with banks to help companies with their cash flow by insuring their receivables so that they can discount receivables or access additional working capital with their bank.”

EDC has also developed a Security Compliance Loan program to help Canadian companies finance upgrades required to meet Customs-Trade Partnership against Terrorism (C-TPAT) security standards. The term loans for up to \$150,000 can cover up to 85 per cent of the specific costs.

As well, there’s the EXPORTEExpress-Credit program, in which EDC and Mercantile Finance Services have teamed up to create a new unsecured small business loan program that provides cash to promote companies in new markets, attend trade shows or increase production capacity for a big order. It consists of an unsecured export credit loan designed for companies who wish to expand their export business but have limited access to required capital.



"We're also looking at financing real estate developments – how we can work with banks in the United States to add capacity and match new opportunities for Canadians, which is not something we did in the past," Erian says.

Overall, given its proximity, the United States "is a market we take for granted in some ways," Erian notes. It's in our backyard and EDC has increasingly been focusing on emerging markets and helping diversify Canadian exports. "Nevertheless, we want to reaffirm and solidify our relationship with the United States, in terms of construction and infrastructure."