

Lincoln International's U.S. Building & Construction Market Update

While 2008 was a very difficult year for the building and construction market, there were three key themes that emerged. Two of these themes relate to long-term trends that are affecting the building and construction industry: the influence of environmental sustainability ("green construction") and the impact of virtual design on future construction activities. The third theme explores the influence that President Obama's policies will have in the industry in the near-term.

Green Construction

Over the last several years, the construction industry has seen a steady rise in "green construction." One of the factors that has contributed to this rise has been the set of guidelines provided by the LEED certification process, which has allowed owners, building managers and contractors to agree on a set of benchmarks for new buildings and existing buildings undergoing renovations to be certified as environmentally friendly. The LEED certification has gone through several iterations over the last five years and a new standard will be published this year. The new standard will address many current issues and streamline the LEED certification process. Currently, modifying building plans to pursue the LEED certification only adds an average of 1.1% to the total construction cost and the savings and benefits usually far outweigh the increased initial investment. Reduced management costs usually make investing in green features financially attractive over the life of the building. Green construction is still in its early stages. Architects and contractors are expecting this trend to become the standard in new building construction in the future.

Building Information Modeling ("BIM")

BIM is a new process for generating and managing building data during its life cycle. The process uses three-dimensional, real-time, dynamic building modeling software to increase productivity in building design and construction, promising to bring to the construction industry the benefits that Computer-Aided Design ("CAD") brought to engineering. One of the benefits of BIM is that it allows architects to be more efficient with their time, reducing the design lead-time. But BIM's impact is broader than that. In fact, BIM is improving the overall construction process by helping to reduce labor and materials costs, acting as a check

for the architect by alerting them if there is an issue with the design, and allowing contractors to collaborate early on in the project and provide feedback on design features that might present complications at the time of building. The detailed designs created with BIM allow the contractor to prefabricate materials offsite, thus minimizing improvisation on the job site. As the standard continues to evolve and gains wider acceptance in the industry, BIM will have a larger impact on both construction companies and development companies to help reduce new construction costs.

Even as these two trends change the landscape of the construction industry, the current outlook for construction activity occupies everybody's mind. The next two years are expected to be a very challenging time for the building and construction industry. Overall construction spending is expected to have been down 12% in 2008 and an additional 7% in 2009, according to McGraw-Hill. Commercial building construction will be one of the hardest hit with a projected decline of over 10% in 2009. The commercial construction market is not expected to suffer the same decline as residential, but it will still decline with the economic cycle. However, unlike previous boom-and-bust commercial construction cycles, the current cycle did not experience an over build, so the downturn is expected to be more moderate than in the past. The historical cyclicity of the construction market is shown in Chart A.

Political Landscape

The current state of the economy has put President Obama's policies in the spotlight.

Inside this issue

- U.S. Building & Construction Market Update
- European Building & Construction Market Update
- Sector Update: Getting to Green M&A

One of the main focal points of the recently passed stimulus package was the amount of money allocated to bringing the nation's infrastructure up to code. The stimulus plan allocates \$90 billion to modernize roads, bridges, transit and waterways and another \$355 billion in infrastructure related projects such as IT upgrades and energy efficiency improvements. The Federal Highway Administration has declared that approximately 13% of the highway bridges are structurally deficient. This does not include the 14% of bridges that are considered functionally obsolete, meaning they do not meet current design standards.


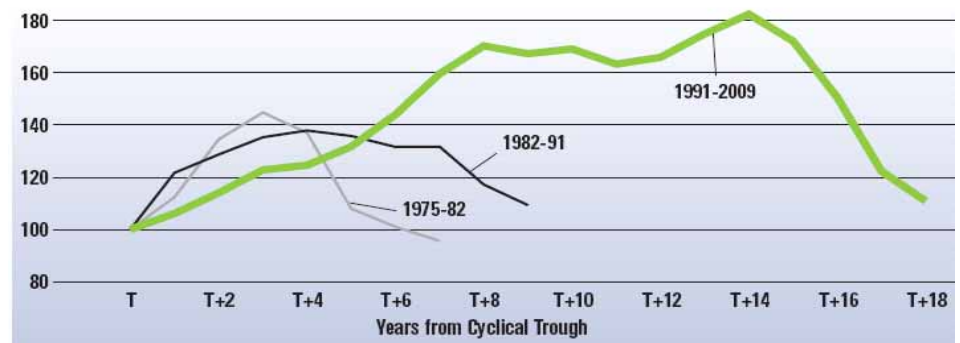
While the building and construction industry is currently experiencing a downturn, there are several positive trends seen within the industry. There has been a huge drop in commodity prices over the last several months, which has translated into lower input and materials costs for the industry. The U.S. still has the highest population growth rate of any industrialized nation. This trend points to a strong housing market in the coming decade. Lastly, the U.S. has an aging infrastructure that will need to be replaced in the coming years. 

Chart A: Total Construction Activity by Cycle (Cycle Trough (T) = 100, Based on Constant 2000 Dollars)



Source: McGraw-Hill Construction

European Building & Construction Market Update

The financial turmoil that began during 2007 in the U.S. has spread around the world, creating an uncertain economic environment in most countries. Given this unprecedented change in the economic climate, and the building and construction sector's central role in this crisis, we felt it important to provide an update on current trends in some of the major European economies.

Together, the level of total new construction in the German, UK, French and Spanish markets are expected to have finished 2008 with a decline, offsetting gains in 2007. Residential construction is expected to be the segment with the steepest decline in 2008 and 2009, dragging down overall construction levels in the region. This decline is largely the result of the high levels of unsold homes built during the last expansion, limited credit availability and a lack of confidence by builders to enter the market to build new developments.

German Construction Market Update

The German construction market is expected to have had some of the strongest growth of the four European countries profiled in this issue. The total sales volume of the construction sector in Germany is expected to have been EUR 84.3 billion in 2008, up approximately 4.5% compared to 2007. This trend is mainly a result of a large order backlog that was accumulated up until the first half of the year. Total sales volume for the German construction sector is expected to increase 2.7% to EUR 86.6 billion in 2009.

While larger, more diversified and more international construction companies realize solid profits and take advantage of the high demand for non-residential property construction and civil engineering projects worldwide, medium to small companies that are largely focused on domestic residential property construction have been severely impacted by the decline in housing starts. According to the IfO-Institut, an institute for economic research, the total number of finished units of residential buildings dropped 6.5% from 184,000 units in 2007 to 172,000 units in 2008. Average residential and non-residential property building permits per month declined 26% between 2006 and 2007, and an additional 3% in the first nine months of 2008.

For 2008, sales in Germany's non-residential construction segment are expected to have increased 7.5% compared to 2007. From 2008-2010 total spending for non-residential construction is expected to grow at an average rate of 2.3%. Primary growth drivers include the construction of industrial and agricultural buildings and buildings for the health and education sectors.

Civil engineering project demand grew 9.5% in the first half of 2008 as a result of increasing demand from state and local governments for new buildings and facilities.

UK Construction Market Update

The UK new construction market is expected to experience a decline in the mid single digits from 2008 to 2010. Investment into the residential segment in the UK is expected to continue its decline in 2009, as the UK's largest homebuilders continue to struggle financially, cut headcount and reduce new housing starts. A recovery in the residential segment is not expected until 2011 or when buying activity increases and homebuilders feel comfortable enough to invest in new developments.

The non-residential new construction market had posted strong growth in recent years, but is expected to have started contracting in 2008 and to continue the contraction through 2009. However, declines in the private sector will be offset by public investment in facilities needed for the 2012 Olympic Games and continued expansion of educational facilities.

Civil engineering is expected to have continued the strong growth that began in 2007. To date, this segment has remained largely unaffected by the credit turmoil. Over the next two years, many high value projects are scheduled to begin, including large rail projects, new power plants and port expansions. This combination of factors makes growth expectations for the UK's civil engineering segment one of the strongest segments of any country in our subset from 2008 through 2010.

French Construction Market Update

2008 represented the fifth consecutive year of sustained growth across all segments for the French construction market. The market for new housing, however, has reached its peak with a record number of construction starts. Within the next two years the residential market is expected to fall due to weak market demand caused by marked declines in home prices, an increase in the inventory of unsold homes, a reduction in the availability of credit and tightening loan requirements.

A slowdown in the level of growth in the non-residential market is also anticipated, caused by lower investment levels and a contraction in local government expenditures following the municipal elections. Nevertheless, this segment is projected to experience growth in new investment in the low single digits over the next two years.

Historical data has shown that capital spending at the local government level reaches a low point in the year following elections. This drop in spending will not only affect the non-residential market as mentioned above, but it will also slow the recent growth in the civil engineering segment, extending the decline in roadwork investment.

To combat these expected declines, the French government recently announced a plan to inject up to EUR 26.5 billion into the economy, with a significant portion of the proceeds being allocated to the building and construction industry. This new investment plan will include a reported EUR 1.1 billion allocated for building and renovating public housing and another EUR 870 million to be injected into the transportation industry.

Spanish Construction Market Update

The Spanish construction market has been seriously impacted by the uncertain economic environment, having experienced this past September the steepest decline in activity for all countries in the European Union after posting a 24% contraction compared to the year before.

After experiencing an unprecedented boom in construction, which many characterized as a bubble, the Spanish residential construction market is expected to continue the steep decline that began in 2008 through 2009. Now that the market has turned, it is suffering from the high level of unsold homes on the market, including a large number of investment properties bought at the height of the cycle which are being listed for sale. During 2008, residential market activity decreased by 28% as compared to 2007. Those companies that have the financial strength to survive the downturn are looking into rehabilitation and subsidized housing as market niches within the residential segment where growth for 2009 and 2010 is forecasted to be 11% and 16%, respectively. Another diversification measure taken by Spanish companies in recent years has been entering the residential markets in Eastern Europe and South America, a trend expected to continue in the next few years.

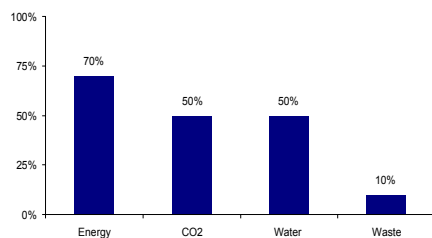
Non-residential new construction is expected to experience mild declines in 2009 and growth in 2010. While commercial construction is suffering from the current economic environment, which is slowing down the completion schedules of multiple urban projects, the new amount of commercial space available for lease opened in 2008 slightly surpassed 2007 levels. Commercial space for lease will reach 14.2 million square meters in 2009, including a total of 620 commercial malls, representing substantial growth over prior years. The outlook for office construction in the short-term remains strong.

The Spanish construction sector's bright spot will be the civil engineering segment, which is expected to continue to post moderate growth based on numerous long-term infrastructure projects undertaken as part of the government's national plans. The budget for the National Infrastructure Plan for transportation for the period 2005-2020 amounts to EUR 250 billion and the new National Plan of Water Quality for 2007-2015 guarantees a total investment of EUR 19 billion, which will be partially financed by the Ministry of Environment and the European funds. Both of these government programs will compensate for the decrease in residential construction. Overall, the civil works market is expected to grow at a rate between 4.1% and 6.8% per year between 2006-2012.

Sector Update: Getting to Green M&A

Green construction products and services continue to experience increasing demand. Factors including higher energy costs (see Chart B), health benefits, government tax incentives and environmental awareness. As the availability of green products increases and the industry matures, it is becoming more clear that green construction is not a passing fad but a trend that is here to stay. So far, growth in the green construction segment has been notable and is expected to continue, according to the latest McGraw-Hill Construction Survey and a study

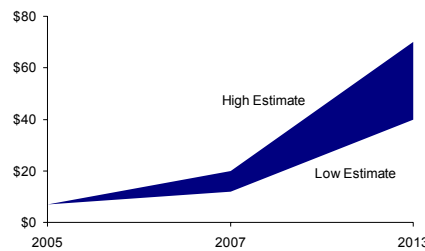
Chart B: Potential Savings for Average Building by Cost Type



Source: U.S. Green Building Council

conducted by IBISWorld. In their forecasts, the consolidated residential construction market is expected to expand 27% between 2007 and 2013, while green residential construction is expected to grow in the range of 233% and 483% during the same period (see Chart C). Green commercial construction and building renovations are expected to follow a similar trend, expanding 186% to 329% and 85% respectively between 2007 and 2013.

Chart C: Residential Green Building Market (\$ in billions)



Source: McGraw-Hill Construction

The growth in green construction, however, has been slow to translate into M&A activity thus far. According to a survey conducted by MergerMarket, the main impediments to more M&A activity in the sector are the uncertainties surrounding the definition of green products, the benefits these products offer and their profitability. In light of the overall weakness of the building and construction market, these factors make it difficult to evaluate acquisition opportunities and are significant deterrents for the development of M&A activity.

Several projects have already been put into place by the private and public sectors to address the definition of green and its benefits. For instance, the LEED program has become the industry standard for green construction and the most important program for promoting environmentally friendly products. In addition, the U.S. Department of Energy has started to certify brokers who attend seminars on the benefits and standards governing green products and services. In fact, Government intervention in this segment will increase. President Obama's stimulus package contemplates \$4.5 billion to improve energy efficiency in federal buildings and another \$6 billion to start building projects in college campuses. Additionally, it establishes tax credits for new purchases of certain building products. Similar initiatives will continue to materialize in the future.

The profitability of environmentally friendly construction projects is harder to gauge given the lack of publicly available data. The government has tried to help by establishing multiple targeted tax credits and rebates to improve the competitiveness of several green products.

Together with the underlying trends in the market, these incentives are transforming green products into a more appealing investment opportunity. In part, this explains why many companies offering a wide range of green building products have already attracted venture capital to fund their growth. One area that has attracted significant interest from venture capitalists is solar technology. For example, Soliant Energy, a developer of solar panels for commercial rooftops, recently received \$21 million from a venture capital group led by GE Financial Services. Larger players in the market have also attracted significant attention. Solyndra, Inc., which is a competitor of Soliant Energy, claims to have raised \$600 million from a group of financial institutions after having secured a \$1.2 billion multi-year sales contract with both European and American clients.

Other innovative companies seeking to reduce the environmental impact of the construction industry have also attracted funding. Serious Materials, a green building products manufacturer that offers high-performance insulated windows and glass, has received over \$50 million in funding over the last two and a half years. As part of their growth plan, on January 20th the company acquired the assets of the former Kensington Windows, whose parent, Jancor Cos lost its financing and filed for bankruptcy protection last year. Additionally, the company is waiting for approval to acquire the Chicago plant of Republic Windows and Doors from the administrators of Republic's bankruptcy filing.

As these companies demonstrate their ability to generate a significant market presence and grow profitably, M&A activity in green products is expected to increase significantly. For example, LED lighting for residential use has already resulted in M&A transactions, the most recent being Cree, Inc.'s \$42 million acquisition of LED Light Fixtures. Overall, companies that develop environmentally friendly products and that can also demonstrate an attractive cost saving potential will likely emerge as leaders in the future. Manufacturers of green building products that can compete with traditional materials on cost and performance will benefit from consumer trends that increasingly take environmental impact as a factor in building decisions.

Even with current industry conditions, there is little evidence to date suggesting a decrease in demand for green products. Once the construction industry cycle turns, increasing demand will set the stage for a wave of consolidation within the segment.

Lincoln International's Global Footprint

More than 70 professionals in the U.S.

More than 55 professionals plus a 19-person advisory board in Europe

Office in Japan and strategic partnerships in China and India

★ Indicates Lincoln International office

★ Indicates strategic partnership and/or Lincoln International personnel

About Lincoln International

Lincoln International specializes in merger and acquisition services, debt advisory services, UK pensions advisory and providing fairness opinions and valuations for leading organizations involved in mid-market transactions. With offices in Chicago, Frankfurt, London, Los Angeles, New York, Madrid, Paris, Tokyo and Vienna and strategic partnerships with China Everbright and other partner firms in Asia, Lincoln International has strong local knowledge and contacts in the key global economies. The organization provides clients with senior-level attention, in-depth industry expertise and integrated resources. By being focused and independent, Lincoln International serves its clients without conflicts of interest. More information about Lincoln International can be obtained at www.lincolninternational.com.

Industry Groups

Lincoln International dedicates teams headed by senior professionals in each of its global offices to the following industries:

- Aerospace and Defense
- Automotive and Truck
- Building and Construction
- Business Services
- Chemicals
- Consumer
- Electronics
- Food and Beverage
- Industrials
- Packaging
- Technology
- Transportation and Logistics

Officer Contacts

NORTH AMERICA

Andrew Bohutinsky
Managing Director
& Group Head
(Chicago)
abohutinsky@lincolninternational.com
+1-312-580-2805

Jim Lawson
Managing Director
& Co-Chairman
(Chicago)
jlawson@lincolninternational.com
+1-312-580-8326

Robert Crawford
Director
(New York)
rcrawford@lincolninternational.com
+1-212-277-8104

Jeff Corum
Vice President
(Chicago)
jcorum@lincolninternational.com
+1-312-580-6282

Carlos Galvez
Associate
(Chicago)
cgalvez@lincolninternational.com
+1-312-506-2738

EUROPE AND ASIA

FRANKFURT
Stefan Wilhelm
Managing Director
s.wilhelm@lincolninternational.de
+49-69-97-10-54-15

FRANKFURT
Frank Winter
Managing Director
f.winter@lincolninternational.de
+49-69-97-10-54-54

LONDON
Darren Redmayne
Managing Director
& UK CEO
dredmayne@lincolninternational.com
+44-20-7022-9880

MADRID
Ramón Vecino
President and CEO
r.vecino@lincolninternational.es
+34-91-781-9460

PARIS
Jean-Rene Hartpence
Managing Director
jr.hartpence@lincolninternational.fr
+33-1-53-53-18-21

TOKYO
Tetsuya Fujii
Managing Director &
President of Japan
tfujii@lincolninternational.com
+813-4360-9160



CHICAGO | FRANKFURT | LONDON | LOS ANGELES
MADRID | NEW YORK | PARIS | TOKYO | VIENNA

Contributors
Greg T. Hicks, Analyst, ghicks@lincolninternational.com
Nick McGann, Analyst, nmcgann@lincolninternational.com
G. Adolfo Aponte, Analyst, aaponte@lincolninternational.com

© 2009 Lincoln International