Acquisitions in the Construction Industry

FMI, a leading financial advisor to the Engineering and Construction industry, presents
Relatively Few Transactions in the E&C Sector

The Traditional Reasons

• Low barriers to entry
• Absence of economies of scale
• Multiples are low
• Owners want to preserve their legacy
FMI’s Nonresidential Construction Index

NRCI Scores Since Inception—Q4 2010 to Q1 2017
(Scores above 50 indicate expansion, below 50 contraction.)

Source: FMI Nonresidential Construction Index Q4 2016
Contractor Profit Before Tax

Recession Periods Are Shaded Orange
Surety Industry Results

Direct Loss Ratio

Source: Surety & Fidelity Association of America (S&FAA)
Construction as a Percentage of GDP

Construction Put in Place and GDP

* FMI Forecast
U.S. Construction Forecast

Construction Put in Place

Millions of Current Dollars

- 100,000
- 200,000
- 300,000
- 400,000
- 500,000
- 600,000
- 700,000

Recession
Residential
Nonresidential Buildings
Nonbuilding Structures

* FMI Forecast
Dallas – Fort Worth, TX MSA Construction Put in Place

The Dallas-Fort Worth, TX MSA includes Dallas County, Tarrant County, Collin County, Denton County, Johnson County, Ellis County, Parker County, Kaufman County, Hunt County, Rockwall County, Wise County and Delta County.

Source: Building permits. Construction Put in Place and trade sources. This report is based on multiple sources, prepared and believed accurate by FMI, but accuracy is not guaranteed by FMI nor by its employees.
### Dallas – Fort Worth, TX MSA Construction Put in Place

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Millions of current dollars, Q1 2017</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Single Family</td>
<td>6,574</td>
<td>7,197</td>
<td>8,024</td>
<td>8,628</td>
<td>9,110</td>
<td>9,752</td>
<td>10,474</td>
</tr>
<tr>
<td>Multi Family</td>
<td>1,411</td>
<td>1,442</td>
<td>1,313</td>
<td>1,139</td>
<td>1,164</td>
<td>1,207</td>
<td>1,268</td>
</tr>
<tr>
<td>Improvements*</td>
<td>3,451</td>
<td>3,518</td>
<td>3,544</td>
<td>3,519</td>
<td>3,498</td>
<td>3,537</td>
<td>3,601</td>
</tr>
<tr>
<td><strong>Total Residential</strong></td>
<td>11,436</td>
<td>12,157</td>
<td>12,882</td>
<td>13,286</td>
<td>13,772</td>
<td>14,496</td>
<td>15,343</td>
</tr>
<tr>
<td><strong>Percent Change YoY</strong></td>
<td>22%</td>
<td>6%</td>
<td>6%</td>
<td>3%</td>
<td>4%</td>
<td>5%</td>
<td>6%</td>
</tr>
<tr>
<td>Lodging</td>
<td>589</td>
<td>670</td>
<td>700</td>
<td>637</td>
<td>601</td>
<td>612</td>
<td>641</td>
</tr>
<tr>
<td>Office</td>
<td>1,107</td>
<td>1,217</td>
<td>1,416</td>
<td>1,528</td>
<td>1,461</td>
<td>1,508</td>
<td>1,570</td>
</tr>
<tr>
<td>Commercial</td>
<td>1,435</td>
<td>1,618</td>
<td>1,770</td>
<td>1,784</td>
<td>1,653</td>
<td>1,578</td>
<td>1,605</td>
</tr>
<tr>
<td>Health Care</td>
<td>1,141</td>
<td>1,044</td>
<td>1,026</td>
<td>1,066</td>
<td>1,185</td>
<td>1,306</td>
<td>1,406</td>
</tr>
<tr>
<td>Educational</td>
<td>2,015</td>
<td>2,078</td>
<td>2,134</td>
<td>2,202</td>
<td>2,255</td>
<td>2,326</td>
<td>2,442</td>
</tr>
<tr>
<td>Religious</td>
<td>93</td>
<td>95</td>
<td>99</td>
<td>103</td>
<td>108</td>
<td>115</td>
<td>118</td>
</tr>
<tr>
<td>Public Safety</td>
<td>206</td>
<td>209</td>
<td>216</td>
<td>227</td>
<td>236</td>
<td>249</td>
<td>259</td>
</tr>
<tr>
<td>Amusement and Recreation</td>
<td>441</td>
<td>478</td>
<td>542</td>
<td>637</td>
<td>589</td>
<td>563</td>
<td>574</td>
</tr>
<tr>
<td>Transportation</td>
<td>1,192</td>
<td>1,274</td>
<td>1,391</td>
<td>1,579</td>
<td>1,843</td>
<td>2,208</td>
<td>2,280</td>
</tr>
<tr>
<td>Communication</td>
<td>399</td>
<td>455</td>
<td>512</td>
<td>548</td>
<td>588</td>
<td>635</td>
<td>659</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>1,072</td>
<td>1,217</td>
<td>1,303</td>
<td>1,175</td>
<td>1,125</td>
<td>1,200</td>
<td>1,264</td>
</tr>
<tr>
<td><strong>Total Nonresidential Buildings</strong></td>
<td>9,689</td>
<td>10,354</td>
<td>11,109</td>
<td>11,487</td>
<td>11,643</td>
<td>12,298</td>
<td>12,817</td>
</tr>
<tr>
<td><strong>Percent Change YoY</strong></td>
<td>6%</td>
<td>7%</td>
<td>7%</td>
<td>3%</td>
<td>1%</td>
<td>6%</td>
<td>4%</td>
</tr>
<tr>
<td>Power</td>
<td>2,611</td>
<td>2,570</td>
<td>2,593</td>
<td>2,703</td>
<td>2,836</td>
<td>3,002</td>
<td>3,139</td>
</tr>
<tr>
<td>Highway and Street</td>
<td>2,545</td>
<td>2,626</td>
<td>2,672</td>
<td>2,674</td>
<td>2,711</td>
<td>2,775</td>
<td>2,836</td>
</tr>
<tr>
<td>Sewage and Waste Disposal</td>
<td>722</td>
<td>770</td>
<td>818</td>
<td>844</td>
<td>810</td>
<td>765</td>
<td>773</td>
</tr>
<tr>
<td>Water Supply</td>
<td>413</td>
<td>431</td>
<td>461</td>
<td>500</td>
<td>531</td>
<td>570</td>
<td>596</td>
</tr>
<tr>
<td>Conservation and Development</td>
<td>253</td>
<td>271</td>
<td>302</td>
<td>341</td>
<td>371</td>
<td>413</td>
<td>436</td>
</tr>
<tr>
<td><strong>Total Nonbuilding Structures</strong></td>
<td>6,544</td>
<td>6,670</td>
<td>6,847</td>
<td>7,061</td>
<td>7,259</td>
<td>7,524</td>
<td>7,781</td>
</tr>
<tr>
<td><strong>Percent Change YoY</strong></td>
<td>4%</td>
<td>2%</td>
<td>3%</td>
<td>3%</td>
<td>3%</td>
<td>4%</td>
<td>3%</td>
</tr>
<tr>
<td><strong>Total Put in Place</strong></td>
<td>$27,668</td>
<td>$29,181</td>
<td>$30,838</td>
<td>$31,834</td>
<td>$32,674</td>
<td>$34,318</td>
<td>$35,941</td>
</tr>
<tr>
<td><strong>Percent Change YoY</strong></td>
<td>11%</td>
<td>5%</td>
<td>6%</td>
<td>3%</td>
<td>3%</td>
<td>5%</td>
<td>5%</td>
</tr>
</tbody>
</table>

*Improvements include additions, alterations and major replacements. It does not include maintenance and repairs.

Source: Building permits, Construction Put in Place and trade sources.
This report is based on multiple sources, prepared and believed accurate by FMI, but accuracy is not guaranteed by FMI nor by its employees.
Construction Market Trends

Current / Short Term: 1 – 2 years

• General building construction has recovered

• Contractors are continuing to strategically expand their business through selective acquisitions

• Bright spots within the general building market include healthcare, education (esp. higher ed.) and multifamily, although high-end multifamily may have peaked

• Infrastructure, power and industrial maintenance/service remain the most attractive segments of the U.S. Construction market.
Construction Market Trends

Current / Mid-Term: 2 – 5 years

• Manufacturing renaissance in U.S. will continue to drive industrial construction

• State and local budgets will remain constrained

• Surety markets will remain tight; continued personal guarantees and stricter ratios

• Single-family housing will improve but never return to bubble levels

• Relative to the rest of the world, the U.S. offers compelling construction opportunities
Current Acquisition Trends

• Private equity
• Strategic buyers are distracted with thin staffs and high volume of work
• Significant international interest in the U.S.
• Buyers are increasingly open to seller retention of equity
• Union contractor pension liabilities have become a significant issue
Acquisitions Drivers: Buyer

• Access to capital
• Growing industry sector
• Geographic expansion
• Need for people
• Favorable price/structure
• Diversification
• Enter market niche
Acquisition Drivers: Buyer

- Financial constraints
- People shortage
- Right timing / right price
- Retirement / succession
- Personal risk
Buyers' Market

- Small to mid-size general contractors
- Highway
- Heavy/civil
- Mechanical/electrical subcontractors
- Union firms
Sellers' Market

• Large regional general contractor
• Service-oriented building sectors
• Industrial maintenance
• Energy-related construction and maintenance
• Infrastructure
• Niche companies of any type
• National players of virtually any type
Building Contractor Acquisitions

• For BUYER
  • Seller expectations getting more reasonable
  • Establish local presence
  • Provide people
  • Enter a new niche

• For SELLER
  • Provides capital and resources
  • Takes money off the table
Building Contractor Acquisitions

- Establish local “partner”
- Develop a specialty
- Low profit + low investment = high returns
- Ongoing dilemma – acquire or greenfield?
Building Contractor Acquisitions

- Renovation/retrofit markets attractive

- Foreign interest due to:
  - Ratio of purchase price to volume is low
  - With established bonding capacity, little capital is required
  - Delivery mechanism for PPP
Specialty Contractor Acquisitions

• Acquisition market is strong for service-oriented specialties

• Mechanical/electrical giants mature

• Industrial contractors have attracted significant interest

• Mechanical contractors continue to attract interest

• Labor shortage has rekindled interest in trade subcontractors
Heavy Highway Contractor Acquisitions

- State budget deficits have constrained spending
- Federal funding remains a question
- Most projects are being awarded below budget
- Valuations not compelling for sellers
Industrial Contractor Acquisitions

- Industrial maintenance is attractive
  - Specialized work force
  - Valuable relationships
  - Good cash flow
  - No bonding
  - Continued focus and automation of the factory floor
  - National presence is sought
International Acquisition Trends

- Strong in large, specialized heavy/civil and large general contractor markets
- U.S. firms expand abroad slowly
- Joint ventures are popular
- Foreign firms seek more privatization opportunities
Private Equity Investment

- Trend investors who generally don’t understand construction
- Successful contractors seeking new exit alternatives
- Private equity
  - Investment must provide the investor an opportunity for a high return
  - Investor must have exit strategies
  - Typically coupled with senior debt
  - Tend to overpay in our sector
Private Equity Investment

• **Uses:**

  • Acquisition
  • Management buyout
  • Partial liquidity
  • Other

• **Trend investors** – was residential, now energy and infrastructure
TRENDS

• Ownership by key management employees will accelerate
• Breadth of ownership will increase
• ESOPs will continue to be terminated as frequently as they are created
• The family business is an ownership model that will persist in the industry
• Retiring baby boomers face lack of key second-tier management
• Outside buyers must compete and sellers struggle with:
  • Preserving a firm’s legacy
  • Valuation
• With recent poor economy, transitions have been postponed and there is considerable pent-up demand
Landon Funsten is a senior managing director with FMI Capital Advisors, Inc., FMI Corporation’s registered Investment Banking subsidiary. He works extensively with contractors throughout the country, focusing on stock valuations, buyer and seller representations and business continuity.

Prior to his tenure in the Investment Banking group, Landon spent several years in FMI's Management Consulting practice. This experience gives him a unique understanding of the difficult organizational, operational and strategic issues facing an owner in the process of ownership transition, whether it be to a third party or an internal buyer. In addition, Landon's financial background gives him a thorough understanding of transaction structures and valuation issues.

Landon has authored numerous articles on topics, including mergers and acquisitions, valuations and ownership transition, that have appeared in a number of industry publications. In addition, Landon speaks extensively to national and regional construction-industry groups, such as the AGC, ABC, CFMA and MCA, about mergers and acquisitions, ownership transfer issues and overall industry trends. Landon holds a bachelor of arts in economics from the University of Virginia and a master of business administration from the University of North Carolina at Chapel Hill. Landon also holds a General Securities Representative license (Series 7) from the Securities and Exchange Commission and FINRA.