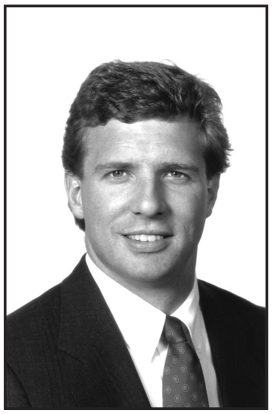
Merger & Acquisition Trends in the Construction Industry for 2004



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The construction merger and acquisition market has been turbulent over the last several years. From the rise and fall of consolidators, major contractor bankruptcies, utility entry and exit, continuing private equity activity and the ebb and flow of foreign interest, the market has been turgid. The following are both emerging and long-term trends that FMI's Investment Banking business expects to have a profound impact on the marketplace.

1. Expect strategic and financial buyer interest in the following key markets:

Pharmaceutical and biotechnology will continue to be sectors that will attract interest. While there has been interest in this sector in the past due to obvious demographic factors, the recent passage of Medicare legislation is expected to increase spending in this market. Engineers, contractors, and maintenance firms in this market sector should expect continued M&A interest.

Water and wastewater engineers and contractors will be desirable as control over scarce water resources will continue to be litigated and highly politicized. Recent court cases involving water rights on the Potomac River as well as the EPA's recent decision to divert water from agricultural uses in California, reiterate the acute need for water conservation and treatment facilities. Although funding will continue to be an issue, this sector should exhibit considerable growth.

Energy infrastructure is a sector that is expected to show dramatic growth in the next decade due to pent up demand. Electric utilities have postponed major additions to their transmission and distribution systems due to capital constraints, and the national grid has become a subject of considerable debate. Likewise, oil and gas infrastructure spending has been paralyzed due to the fall out from Enron and its peers, and, combined with new gas fields opened to drilling and the construction of LNG terminals, will increase dramatically in coming years.

Industrial maintenance is another sector that has had M&A interest over the past several years, which we expect to see continue. Although new plant construction spending has plummeted, firms that offer contract maintenance and shut down services will continue to be in demand since the aging manufacturing infrastructure is in increasing need of repair. This will only be exacerbated by continued increases in factory utilization that are expected as the economy continues to rebound and the dollar slides in value relative to other currencies. New industrial construction, however, is expected to continue to lag due to the broad trend of migration to offshore construction.

Government outsourcing services will continue to grow as military spending increases and there are additional U.S. commitments overseas. Contractors that can successfully navigate the JOC and SABER procurement process, for example, and those that provide facility and base services should find themselves in a seller's market. Likewise, the ability to provide program management services for sprawling government facilities will attract significant buyer interest.

2. The **surety market** will continue to create both motivated buyers and sellers. Over the past year or two, many contractors who historically had no problem getting surety credit have seen it either constrained or eliminated. As a result, some involuntary sellers have emerged, due to a lack of surety credit or a reluctance to pledge personal assets to the business. Likewise, contractors with ample capital and excess credit have been able to opportunistically deploy it through permanent joint ventures and outright acquisitions. The surety credit issue is particularly critical as publicly funded construction comprises an increasingly greater share of the overall non-residential construction market.

3. **Divestitures** will continue for the foreseeable future. Utilities have continued to shed the contractors that they acquired in their attempt to deal with deregulation, which has been stymied. Likewise, many consolidations that were created in the late 1990's continue to unravel. Although many of these divestitures have been sold back to their prior owners or current management, there will continue to be ample possibilities for the opportunistic buyer.

4. The **private equity markets** have begun to rally, with multiples creeping up and the ability to leverage transactions increasing. With financial markets improving and more deals getting funded, this non-traditional source of capital will become increasingly interested in the industry. This interest, however, will continue to be in firms that have unique niches, are high, profitable, have defendable market share through barriers to entry, and little, if any, bonding requirements.

5. For those contractors who chose not to sell to a third party, an increasing number of firms will offer **ownership to a wider group of shareholders**. Emulating large engineering and construction firms, many contractors now, are considering a more widely dispersed ownership model, for both ownership transfer and employee retention purposes. A recent FMI survey of the ownership transfer plans of contractors found that 96% of those that planned an internal succession plan would sell their stock to more than one key employee. Widespread ownership is a profound departure from the sole-proprietor model prevalent in the industry in the not so distant past. With many public companies and consolidations struggling, private firms are developing innovative private ownership structures to provide exit options and employee incentives while preserving financial strength.

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