09/01/19

2019
State of the Construction & Surety Industries Report

Prepared and Narrated By:

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2019 Executive Summary

Between Q4 of ‘17 and Q3 of ‘18, average U.S. Real GDP growth hovered above the 3% mark, which is considered strong for the U.S. nowadays. Accordingly, the FOMC ticked up the federal funds rate by a quarter point on seven separate occasions between ‘17 and ‘18 and, as a result, the U.S. economy has been in slow-growth mode since Q4 of ‘18. Growth has been further stymied by U.S./China trade wars that started in ‘18 and continue today, and for the foreseeable future for that matter. Global growth is also slowing, which adds fuel to the U.S.’ slow-growth fire. Moreover, the yield curve is near zero and has inverted (intraday) several times of late, which signals a recession is looming. Despite indicators that the historic 10.5-year bull run is nearing an end and a bear market is imminent, unemployment remains at a 50-year low, consumer spending remains strong, and the CPI growth is below 2%, which suggests this historic run might have runway alas. In fact, the U.S. is currently in what I consider a mini-recession, like that of ‘95, ‘98, ‘13, and ‘15, where GDP growth nears 0%, but the economy escapes from a technical recession.

Not surprisingly, the private (and overall) construction industry is compressing for the first time since ‘10. As is typically the case, public construction is doing the opposite and is having its best year since 2008. Even with the pull-back of the larger private marketplace, overall construction unemployment remains below 5%, which is its lowest level on record. This trend causes continued schedule and/or quality concerns for contractors, and it promotes price escalation. In fact, construction costs (both labor and materials), have considerably outpaced the CPI over the past decade, and developers, as a result, are having trouble making proformas work in ‘19. Accordingly, private construction will continue to pull back (or flatten at a minimum) in ‘19/‘20, while public construction booms due to a decade of pent up demand. Things are not all rosy on the public construction front in ‘19, however, as many large-scale AEC companies are currently suffering massive losses on EPC mega-projects. Contractors claim such losses are a result of onerous contract terms within their lump-sum at-risk agreements. The contract surety industry suffered a mild loss cycle after the Great Recession, but loss ratios since ‘15 have been stellar, and this trend will likely continue for the next several years because elevated losses historically don’t mount after a recessionary cycle, unless of course the industry is over-exposed to the noted EPC work. Also, surety premium continues to be on the rise as public construction revenue soars.

All in all, ‘19 represents a pivot point in the construction industry.

Presentation Outline:

Part 1: State of the U.S. Economy (Slide 4)

Part 2: State of the U.S. Construction Industry (Slide 30)

Part 3: State of the Contract Surety Industry (Slide 77)

Part 4: Takeaways (Slide 86)

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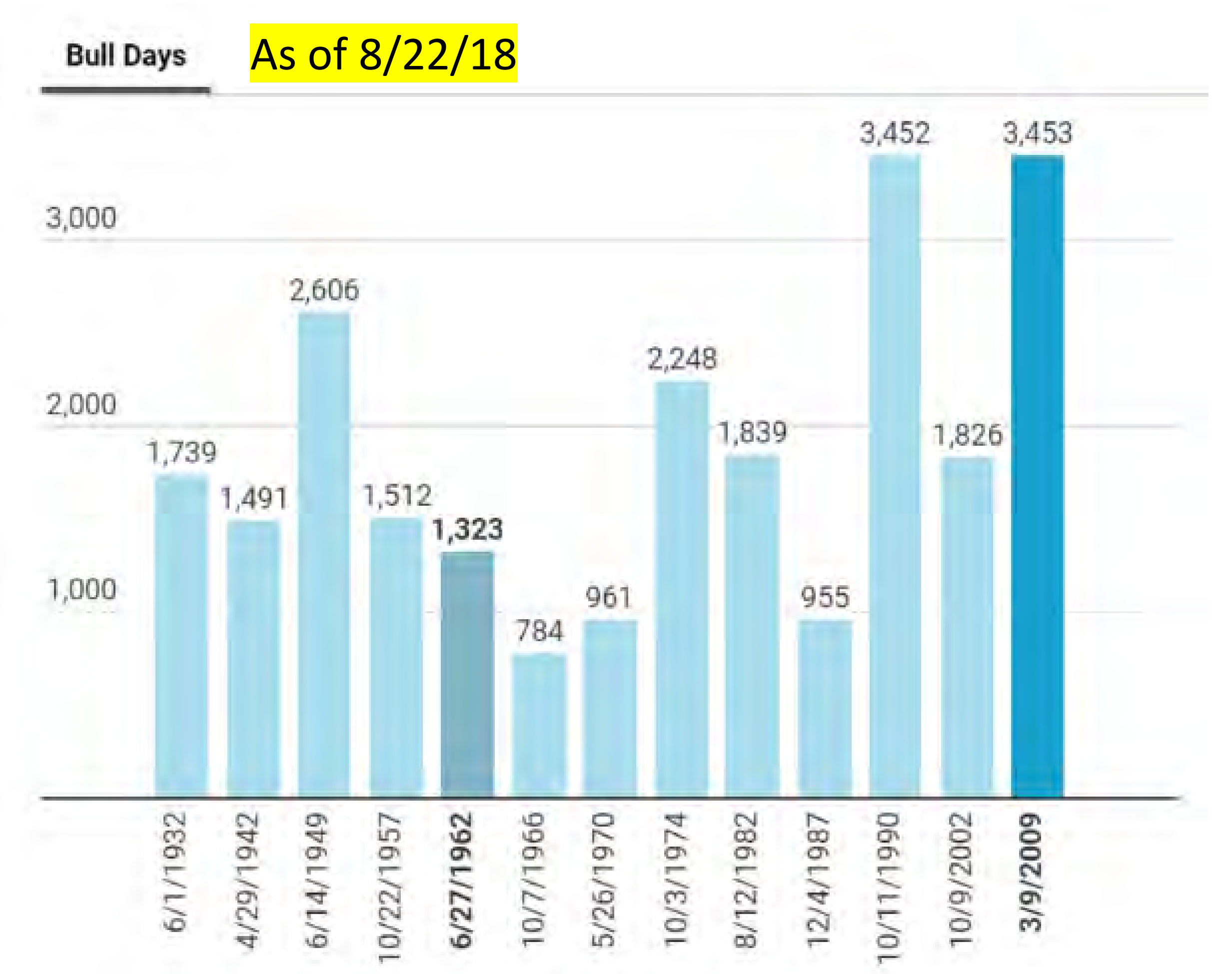
Part 1. State of the U.S. Economy

Unchartered territory.

Longest Time Since Previous Recession:

- **Jun 2009 to Aug 2019 — 10 years, 2 months (and running)**
- Mar 1991 to Mar 2001 — 10 years, 0 months
- Feb 1961 to Dec 1969 — 8 years, 10 months
- Nov 1982 to Jul 1990 — 7 years, 8 months
- Jun 1938 to Feb 1945 — 6 years, 8 months

Note: Since 1950, the average time between recessions is 5.04 years.



Source: https://www.datawrapper.de/_/4KcT2/

03/09/09
<u>08/22/18</u>
3,453 Days

03/09/09
<u>09/01/19</u>
3,828 Days

Longest Bull Run by
375 Days, as of 09/01/19

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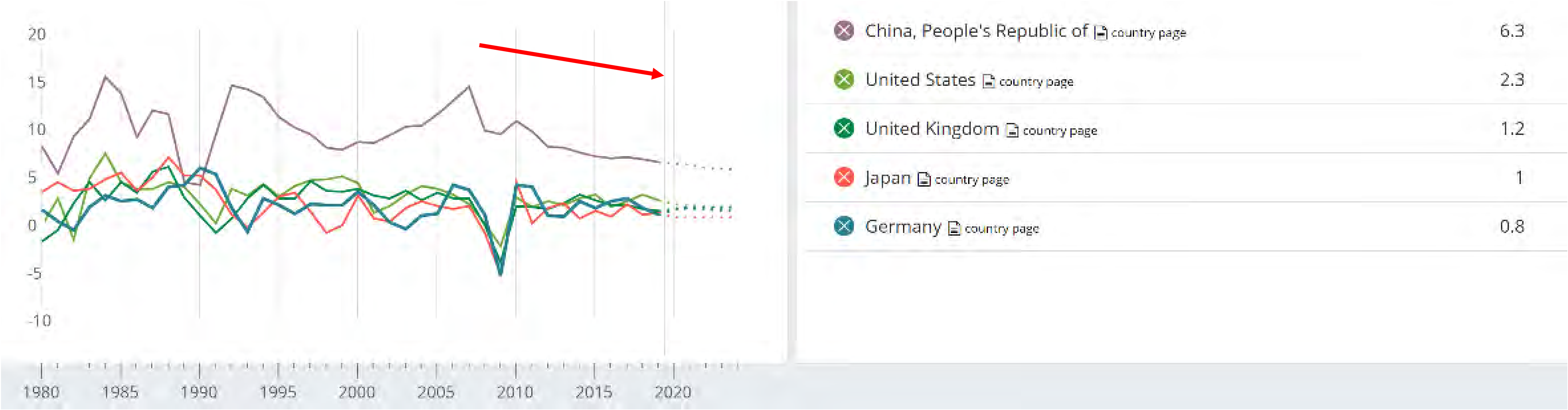
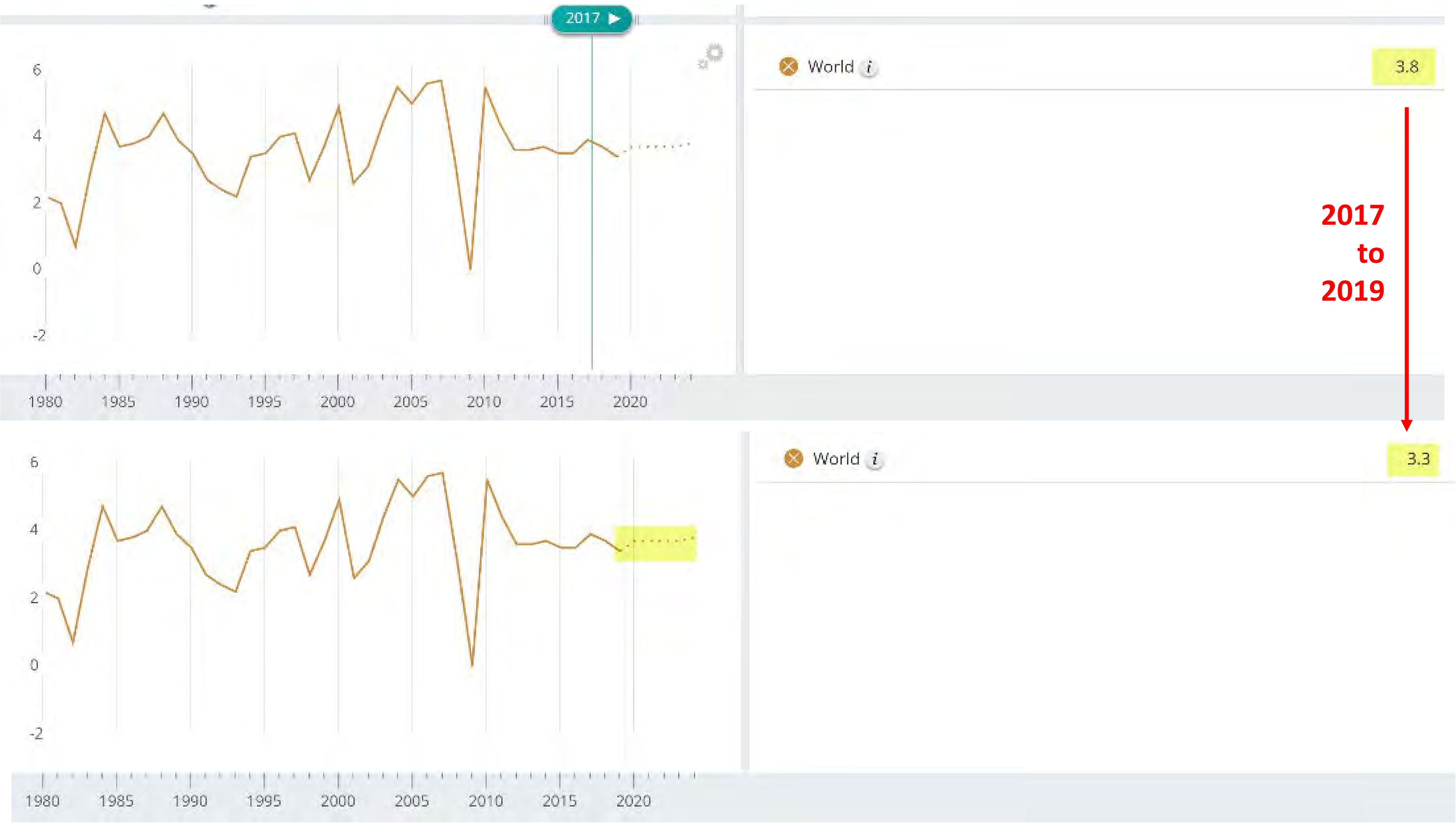
Real GDP growth

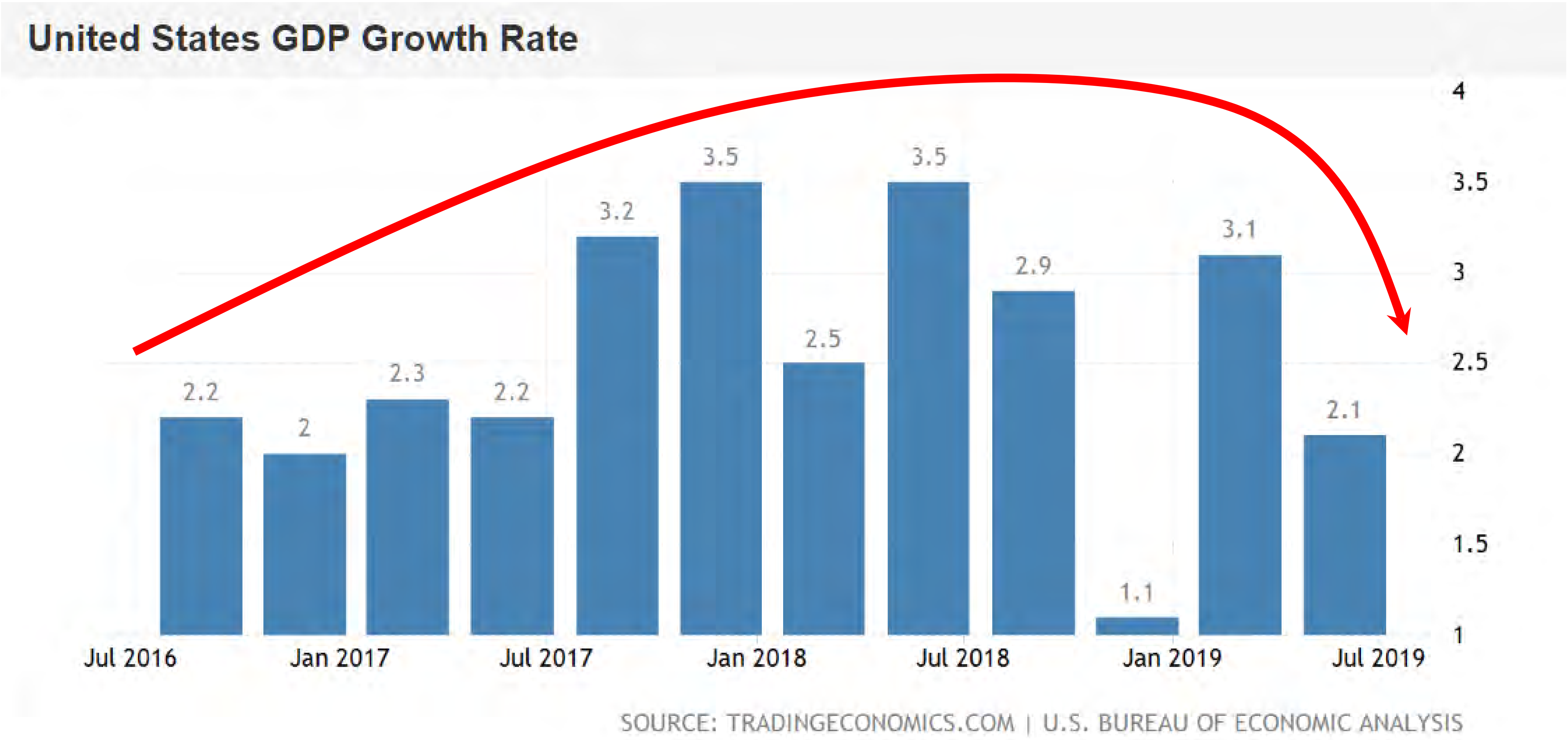
Annual percent change



Source: https://www.imf.org/external/Datamapper/NGDP_RPCH@WEO/CHN/USA/GBR/JPN/DEU



Source: https://www.imf.org/external/Datamapper/NGDP_RPCH@WEO/CHN/USA/GBR/JPN/DEU



United States GDP Growth Rate
2.2
2
2.3
2.2
3.2
3.5
2.5
3.5
2.9
1.1
3.1
2.1
4
3.5
3
2.5
2
1.5
1
Jul 2016
Jan 2017
Jul 2017
Jan 2018
Jul 2018
Jan 2019
Jul 2019
SOURCE: TRADINGECONOMICS.COM | U.S. BUREAU OF ECONOMIC ANALYSIS

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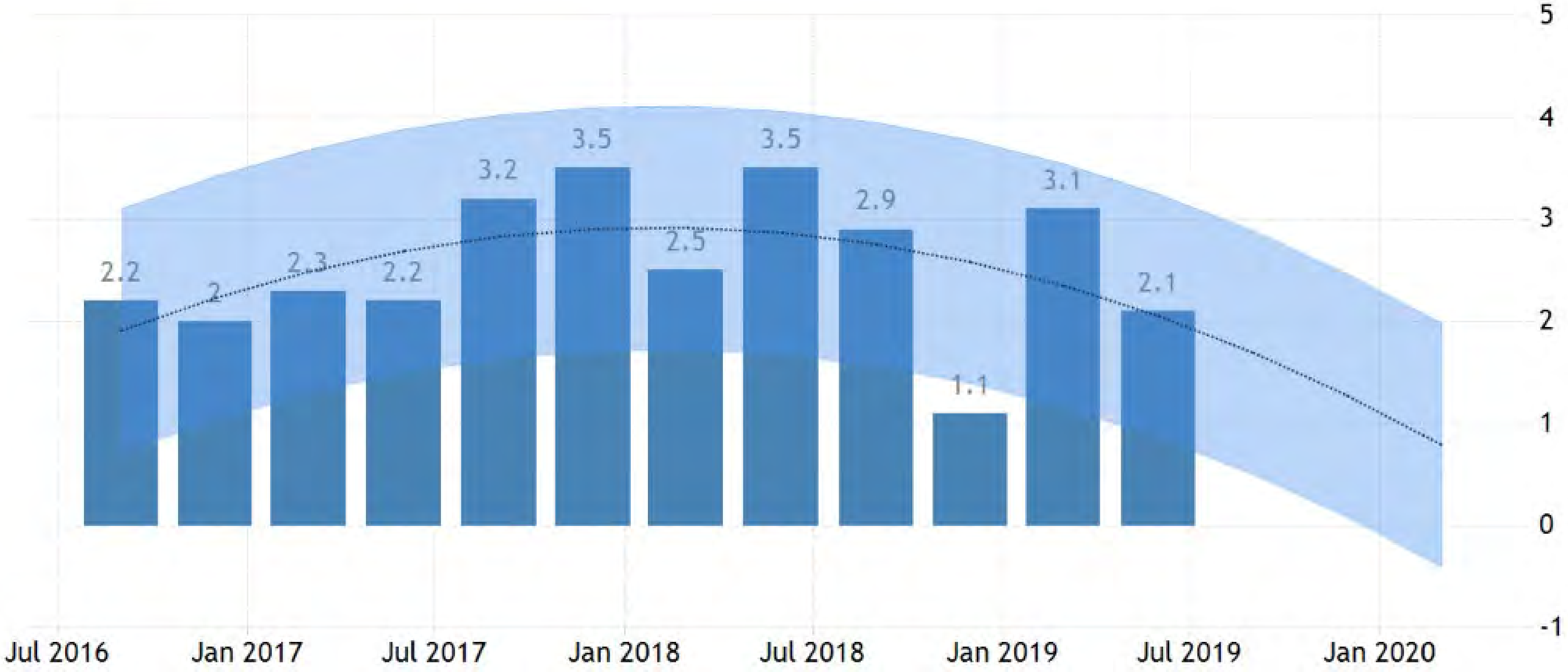
Forecast Data API



SOURCE: TRADINGECONOMICS.COM | U.S. BUREAU OF ECONOMIC ANALYSIS

GDP Growth Rate QoQ Adv Q3 1.9%

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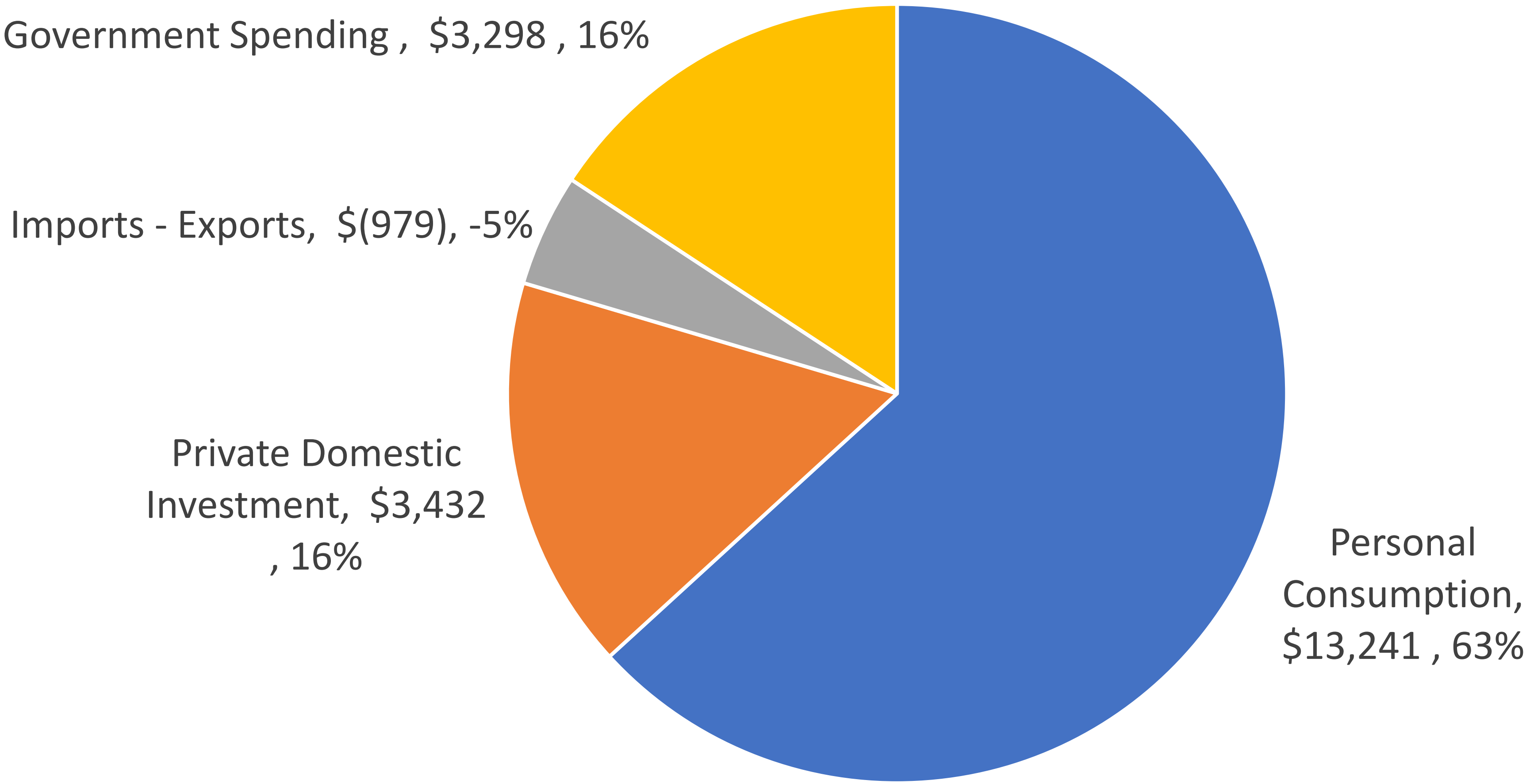
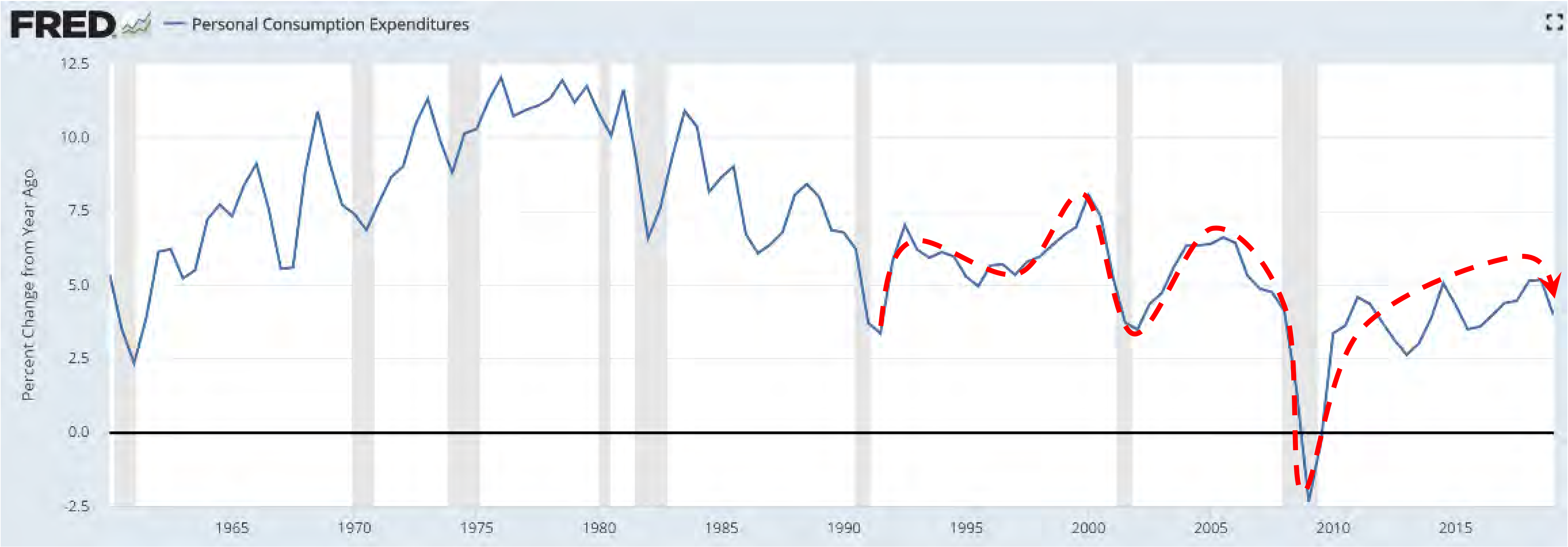
U.S. GDP ($19T) Components (in billions; 2019 Q2)



Source: BEA Data


FRED
Personal Consumption Expenditures
Percent Change from Year Ago
12.5
10.0
7.5
5.0
2.5
0.0
-2.5
1965
1970
1975
1980
1985
1990
1995
2000
2005
2010
2015

Trade Deficit Review

Rank	Countries	1992 Deficit	2018 Deficit	Change 1992-2017	Deficit Drivers
#1	China (WTO)	-$18B	-$413B	-$395B	Telecom equipment (-$156B), Office Machines & ADP Equipment (-$127B), Misc Manufactured Articles (-$99B)
#2	Mexico (FTA)	+$5B	-$81B	-$76B	Vehicles (-$153B), Electronics & Appliances (-$68B) Office Machines & ADP Equipment (-$45B)
#3	Germany (WTO)	-$8B	-$68B	-$60B	Vehicles (-$40B), Medicine (-$26B), General Industrial Machinery (-$18.6B)
#4	Japan (WTO)	-$49B	-$67B	-$18B	Vehicles (-$82.5B), Electronics & Machinery (-$21B), Machinery Specialized (-$16B)
#5	Ireland (WTO)	+$1B	-$47B	-$48B	Medicinal & Pharmaceutical Products (-$44B), Organic Chemicals (-$19.6B), Misc Manufactured Articles (-$8.4B)

Rank	Countries	1992 Deficit	2018 Deficit	Change 1992-2017	Deficit Drivers
#6	Vietnam (WTO)	$0B	-$40B	-$40B	Apparel (-$21B), Telecom Equipment (-$12.7B), Footwear (-$10.5B)
#7	Italy (WTO)	-$4B	-$31B	-$27B	Medicinal & Pharmaceutical Products (-$9.4B), Vehicles (-$9.3B)
#8	Malaysia (WTO)	-$4B	-$26B	-$22B	Electronics & Machinery (-$31B) Telecom Equipment (-$9B)
#9	India (WTO)	-$2B	-$23B	-$21B	Nonmetallic Mineral (-$17.8B), Medicinal & Pharmaceutical Products (-$10.9B), Apparel (-$7B)
#10	Canada (FTA)	+$8B	-$21B	-$29B	Petroleum & Products (-$127B), Vehicles (-$88.3B)

Source:
https://assets.nationbuilder.com/prosperousamerica/pages/4899/attachments/original/1551234774/190128_Top_10_Trade_Deficit_Countries.pdf?1551234774

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U.S. / China Trade War Summary

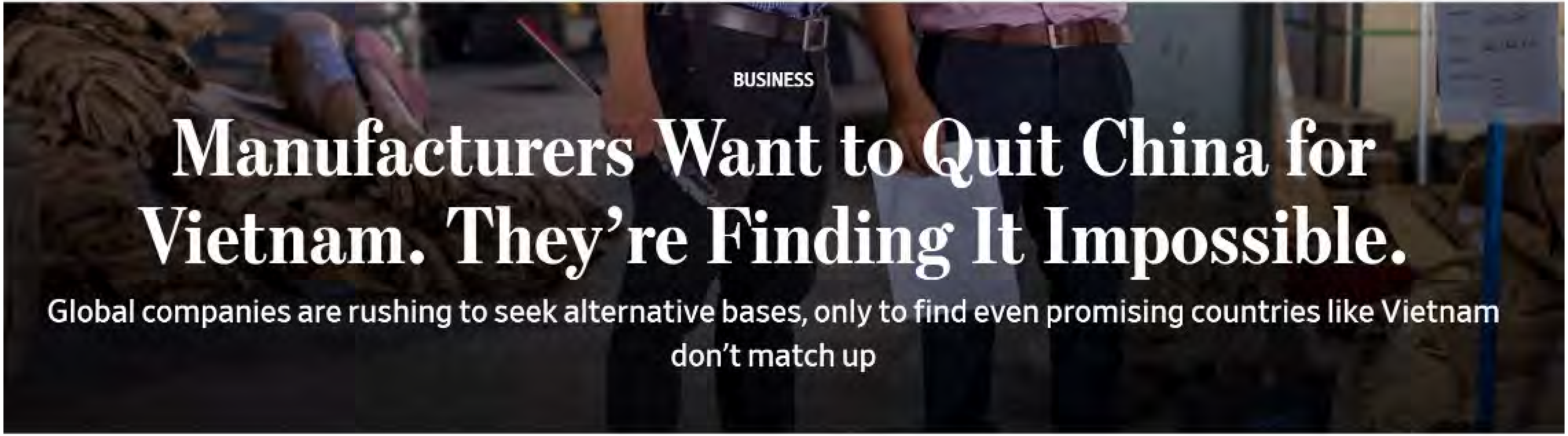
Total U.S. tariffs applied exclusively to Chinese goods:	$250B
Total Chinese tariffs applied exclusively to U.S. goods:	$110B

Source: https://www.china-briefing.com/news/the-us-china-trade-war-a-timeline/

U.S. / CHINA TRADE WAR DETAILS

02/07/18:	U.S. imposed 30% tariff on solar panels (all countries) and 20% tariff on washing machines (all countries); combined it is worth $1.8B in goods.
03/23/18:	U.S. imposes 25% tariff on steel (all counties except Argentina, Australia, Brazil, and South Korea) and a 10% tariff on aluminum (except from Argentina and Australia).
04/02/18:	China imposes tariffs (ranging 15-25%) on 128 products ($3B of goods).
07/06/18:	U.S. imposes 25% tariff on List 1, or 818 imported products ($34B of goods).
08/23/18:	U.S. imposes 25% tariff on List 2, or 279 imported products ($16B of goods). Goods include semiconductors, chemicals, plastics, motorbikes and electric scooters.
08/23/18:	China imposes 25% tariff on 333 products ($16B of goods). Goods include coal, copper scrap, fuel, buses and medical equipment.
09/24/18:	U.S. imposes 10% tariff on List 3, or $200B of goods (total goods up to $250B). 10% will be increased to 25% in the future.
09/24/18:	China imposes 5% to 10% tariff on $60 billion of US goods.
05/10/19:	U.S. increases tariff from 10% to 25% on List 3 goods ($200B).
06/01/19:	China increases tariff percentages on $60 billion of US goods (up from the tariff imposed on 09/24/18). List 1 tariffs go from 10% to 25%; List 2 tariffs go from 10% to 20%; List 3 tariffs go from 5% to 10%; and List 4 remains at 5% tariff.
08/01/19:	Trump threatens 10% tariff on remaining $300B of products starting on 09/01/19.

THE WALL STREET JOURNAL.



BUSINESS

Manufacturers Want to Quit China for Vietnam. They’re Finding It Impossible.

Global companies are rushing to seek alternative bases, only to find even promising countries like Vietnam don’t match up

By Niharika Mandhana | Photographs by Linh Pham for The Wall Street Journal

Aug. 21, 2019 10:33 am ET

Source: https://www.wsj.com/articles/for-manufacturers-in-china-breaking-up-is-hard-to-do-11566397989

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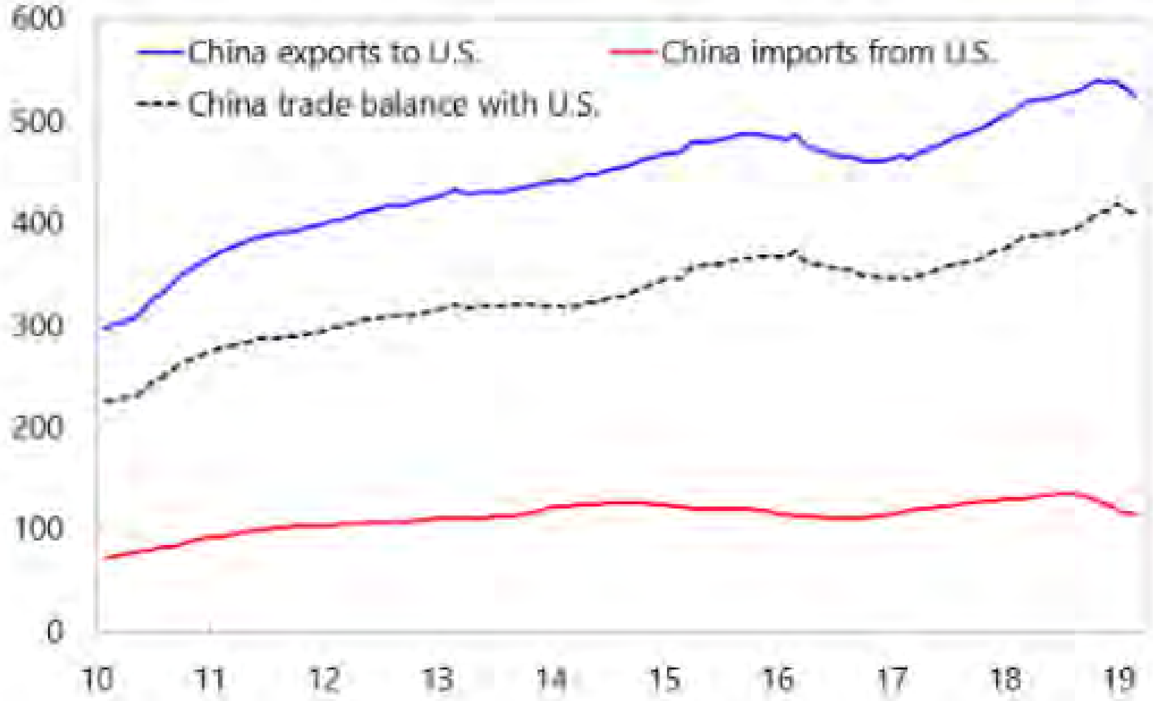
Little impact

Rising tariffs between the United States and China have had a limited effect on the trade balance between both countries.

(China trade balance with US, billions of US dollars, 12-month moving sum)



Sources: US Department of Commerce; and IMF staff calculations.

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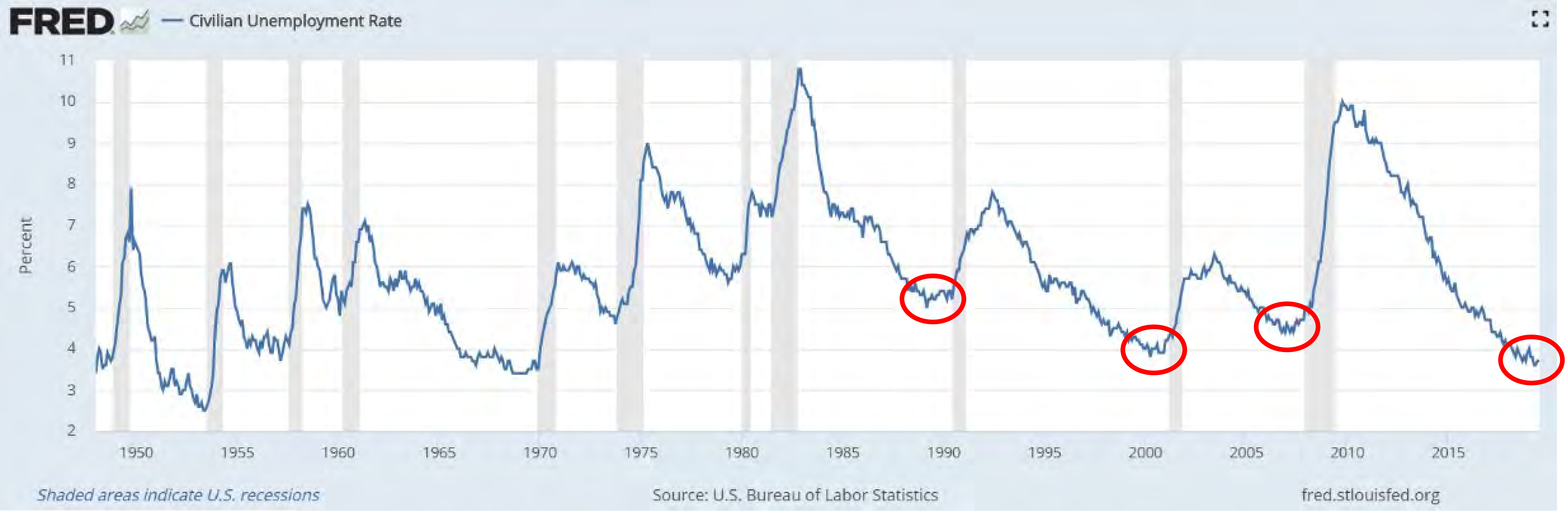
FRED
China / U.S. Foreign Exchange Rate
Weaker Yuan
Reduces Effect of US
Tariffs
Chinese Yuan to One U.S. Dollar
7.10
7.05
7.00
6.95
6.90
6.85
6.80
6.75
6.70
6.65
2018-09
2018-10
2018-11
2018-12
2019-01
2019-02
2019-03
2019-04
2019-05
2019-06
2019-07
2019-08
Shaded areas indicate U.S. recessions
Source: Board of Governors of the Federal Reserve System (US)
fred.stlouisfed.org

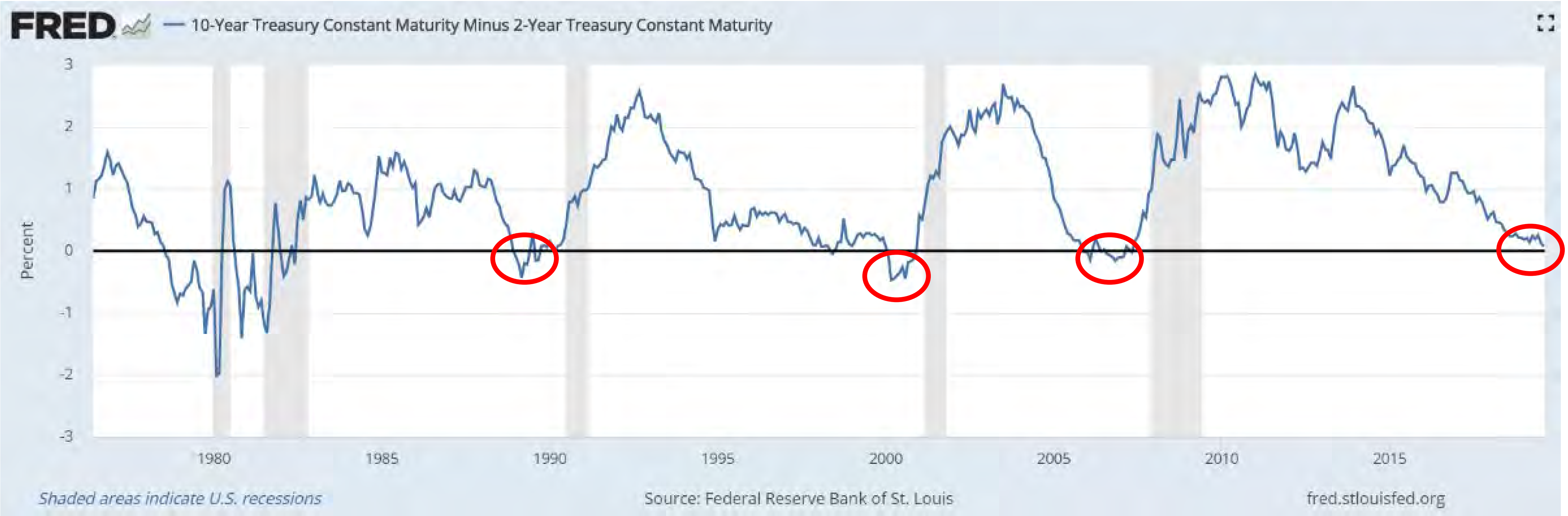


Observation:

Jul 2019: **3.7** (+ more)

Updated: Aug 2, 2019

VERTEX


FRED
10-Year Treasury Constant Maturity Minus 2-Year Treasury Constant Maturity
Percent
3
2
1
0
-1
-2
-3
1980
1985
1990
1995
2000
2005
2010
2015
Shaded areas indicate U.S. recessions
Source: Federal Reserve Bank of St. Louis
fred.stlouisfed.org

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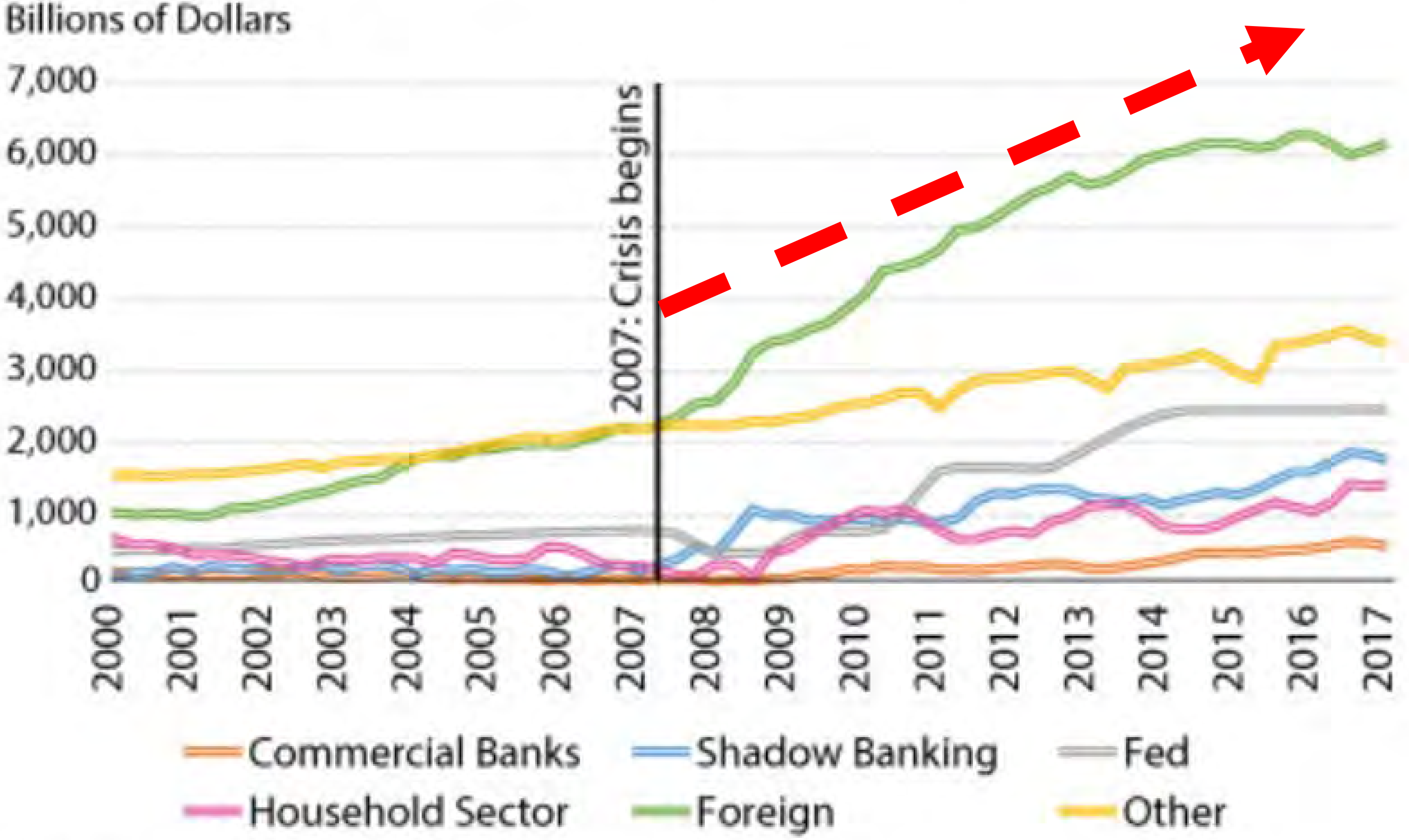
Ownership of U.S. Treasury Securities, 2000-17

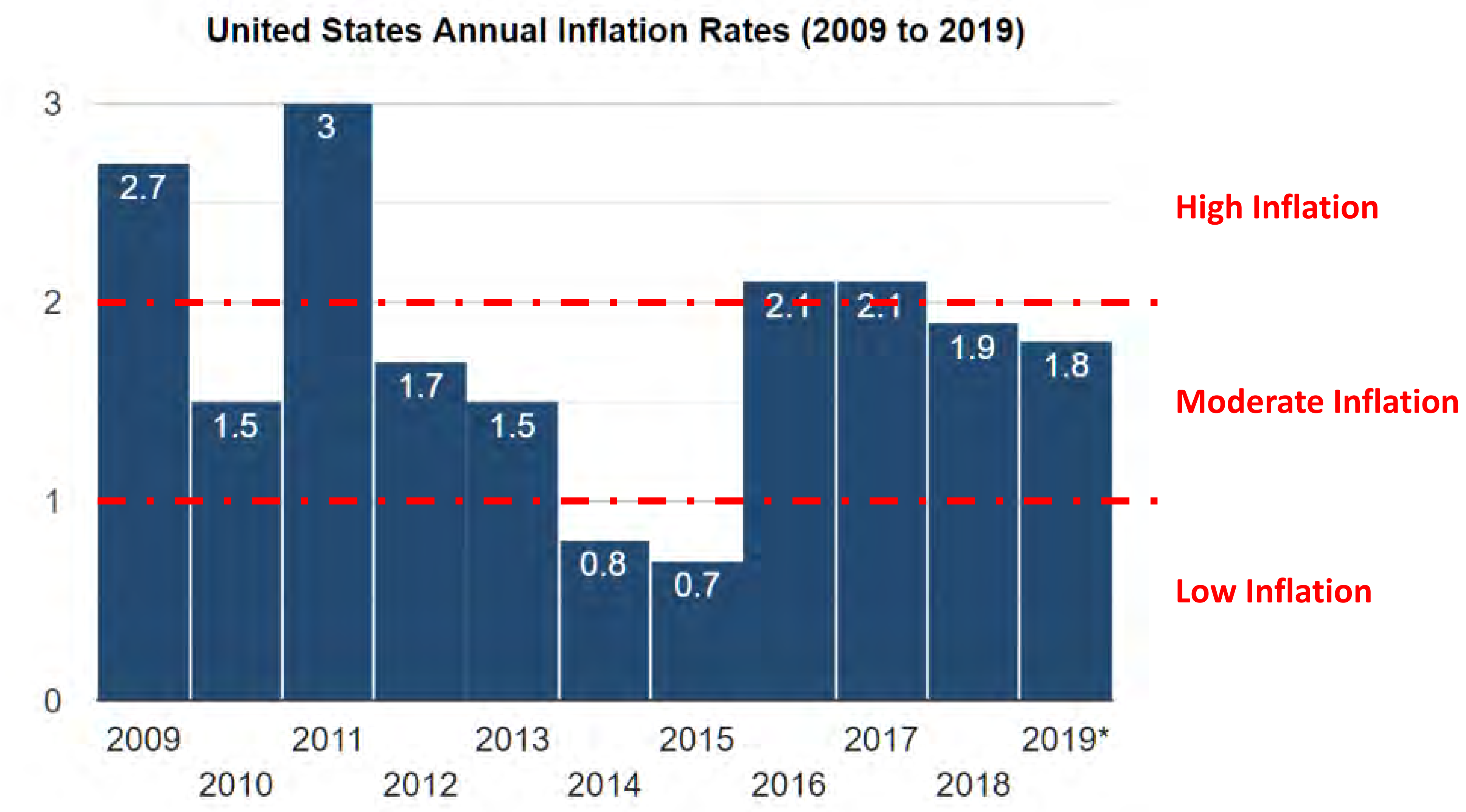


SOURCE: Board of Governors of the Federal Reserve System.

VERTEX


FRED
Effective Federal Funds Rate
Percent
20.0
17.5
15.0
12.5
10.0
7.5
5.0
2.5
0.0
1955
1960
1965
1970
1975
1980
1985
1990
1995
2000
2005
2010
2015
Shaded areas indicate U.S. recessions
Source: Board of Governors of the Federal Reserve System (US)
fred.stlouisfed.org

Date	Fed Funds Rate	
December 16, 2008	0.25%	
December 15, 2015	0.50%	1
December 14, 2016	0.75%	2
March 15, 2017	1.00%	3
June 14, 2017	1.25%	4
December 13, 2017	1.50%	5
March 21, 2018	1.75%	6
June 13, 2018	2.00%	7
September 26, 2018	2.25%	8
December 19, 2018	2.50%	9
July 31, 2019	2.25%	



Source: https://www.usinflationcalculator.com/inflation/current-inflation-rates/

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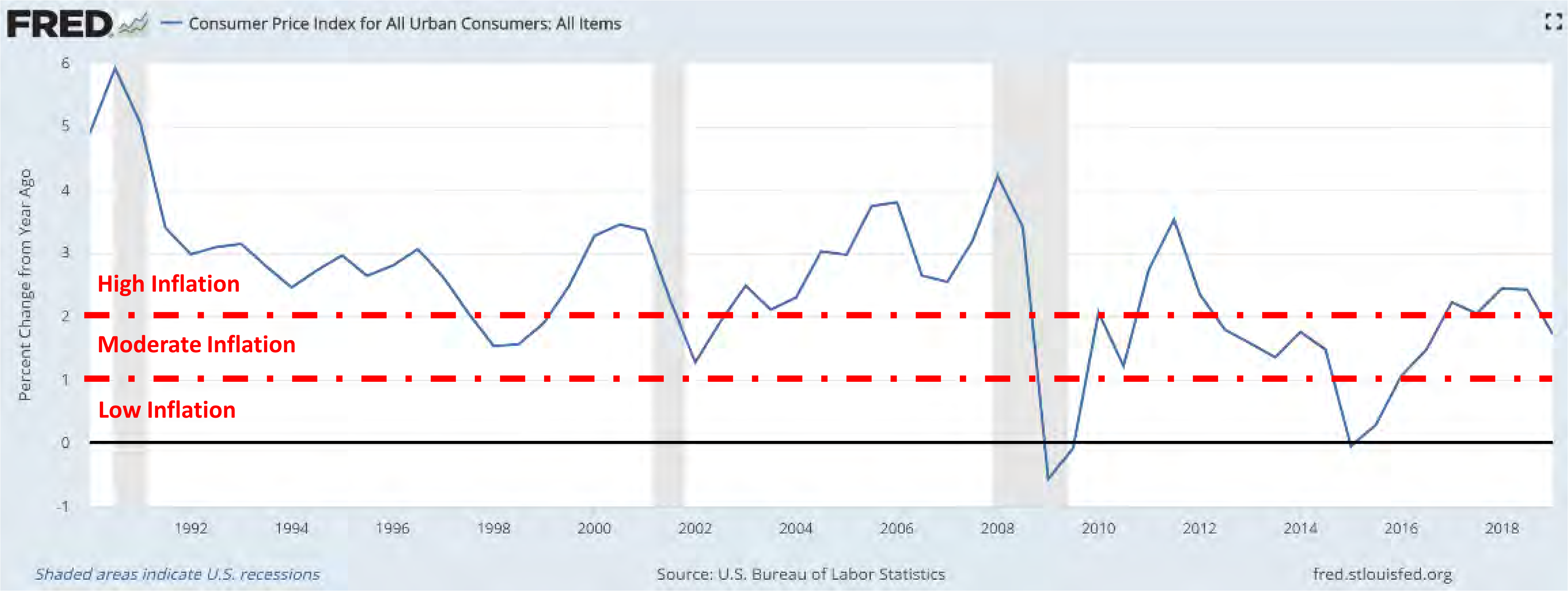
FRED
Consumer Price Index for All Urban Consumers: All Items
Percent Change from Year Ago
6
5
4
3
2
1
0
-1
High Inflation
Moderate Inflation
Low Inflation
1992
1994
1996
1998
2000
2002
2004
2006
2008
2010
2012
2014
2016
2018
Shaded areas indicate U.S. recessions
Source: U.S. Bureau of Labor Statistics
fred.stlouisfed.org

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2. State of the U.S. Construction Industry

Role reversal.

2a. Overall Construction Industry Statistics

Value of Construction Put in Place - Seasonally Adjusted Annual Rate

(Millions of dollars. Details may not add to totals due to rounding.)

Type of Construction:	Jun 2019[p]	May 2019[r]	Apr 2019[r]	Mar 2019	Feb 2019	Jun 2018	Percent change Jun 2019 from - May 2019	Jun 2018
Total Construction	1,286,997	1,303,427	1,310,102	1,298,528	1,297,819	1,314,788	-1.3	-2.1
Total Private Construction[1]	962,943	966,990	969,450	969,684	970,860	1,009,424	-0.4	-4.6
Total Public Construction[2]	324,055	336,437	340,652	328,845	326,959	305,364	-3.7	6.1

Source: https://www.census.gov/construction/c30/pdf/totsa.pdf

Type of Construction:	Jun 2019[p]	May 2019[r]	Apr 2019[r]	Mar 2019	Feb 2019	Jun 2018	Percent change Jun 2019 from - May 2019	Jun 2018
Total Private Construction[1]	962,943	966,990	969,450	969,684	970,860	1,009,424	-0.4	-4.6
Residential	507,231	509,690	509,535	504,780	508,722	551,668	-0.5	-8.1
Nonresidential	455,712	457,300	459,916	464,904	462,138	457,756	-0.3	-0.4
Lodging	33,188	32,603	32,600	33,154	31,709	30,702	1.8	8.1
Office	68,184	67,939	68,362	67,375	66,594	62,728	0.4	8.7
Commercial	78,702	77,723	77,719	79,543	83,711	89,395	1.3	-12.0
Health care	34,300	34,146	34,527	35,639	33,967	32,443	0.5	5.7
Educational	17,709	18,684	19,859	20,366	20,360	20,904	-5.2	-15.3
Religious	2,751	2,832	2,903	2,880	3,116	2,844	-2.9	-3.3
Amusement and recreation	14,597	14,576	14,516	14,385	14,465	14,687	0.1	-0.6
Transportation	18,443	19,505	18,366	18,293	17,609	17,486	-5.4	5.5
Communication	23,060	23,342	23,325	23,627	23,177	24,376	-1.2	-5.4
Power	92,417	94,383	94,444	95,775	94,645	97,134	-2.1	-4.9
Manufacturing	70,906	70,279	71,720	72,256	71,089	64,168	0.9	10.5

Source: https://www.census.gov/construction/c30/pdf/totsa.pdf

Type of Construction:	Jun 2019[p]	May 2019[r]	Apr 2019[r]	Mar 2019	Feb 2019	Jun 2018	Percent change Jun 2019 from - May 2019	Jun 2018
Total Public Construction[2]	324,055	336,437	340,652	328,845	326,959	305,364	-3.7	6.1
Residential	6,013	6,180	6,500	6,270	6,133	6,466	-2.7	-7.0
Nonresidential	318,041	330,257	334,152	322,574	320,827	298,898	-3.7	6.4
Office	10,766	10,307	10,816	10,872	10,393	9,790	4.5	10.0
Commerical	4,362	4,241	4,297	4,313	4,460	3,590	2.9	21.5
Health care	8,491	8,787	9,270	8,517	8,527	9,469	-3.4	-10.3
Educational	72,963	78,328	78,968	78,409	78,497	70,400	-6.8	3.6
Public saftey	9,682	9,834	9,637	9,481	9,766	9,287	-1.5	4.3
Amusement and recreation	13,170	13,069	13,354	12,849	13,190	11,900	0.8	10.7
Transportation	38,344	38,474	36,274	35,053	34,750	35,361	-0.3	8.4
Power	6,013	5,661	5,961	5,817	5,953	6,014	6.2	0.0
Highway and street	101,939	108,874	113,330	107,412	106,750	95,778	-6.4	6.4
Sewage and waste disposal	26,082	26,453	25,483	24,606	23,746	22,166	-1.4	17.7
Water supply	15,826	15,801	16,337	15,137	14,924	15,182	0.2	4.2
Conservation and development	8,932	8,603	8,736	8,629	8,390	8,464	3.8	5.5

Source: https://www.census.gov/construction/c30/pdf/totsa.pdf

Year	Put In Place Construction		
	Overall	Private	Public
2007	-2.3%	-6.1%	10.1%
2008	-3.6%	-7.6%	7.0%
2009	-9.9%	-14.9%	1.3%
2010	-6.4%	-9.8%	-0.3%
2011	4.3%	8.3%	-2.5%
2012	7.8%	15.0%	-5.6%
2013	5.3%	8.0%	-0.7%
2014	2.2%	0.4%	6.7%
2015	8.2%	9.9%	3.9%
2016	4.2%	6.3%	-1.8%
2017	2.6%	2.1%	4.4%
2018	1.6%	0.8%	4.2%
2019	-2.1%	-4.6%	6.1%

First Negative Figures Since '09

2007 very much looks like 2019

Average Growth % from '07 to '19:	1%	1%	3%
Average Growth % from '07 to '10:	-6%	-10%	5%
Average Growth % from '11 to '16:	5%	8%	0%
Average Growth % from '17 to '19:	1%	-1%	5%

Source:
https://www.census.gov/construction/c30/prpdf.html

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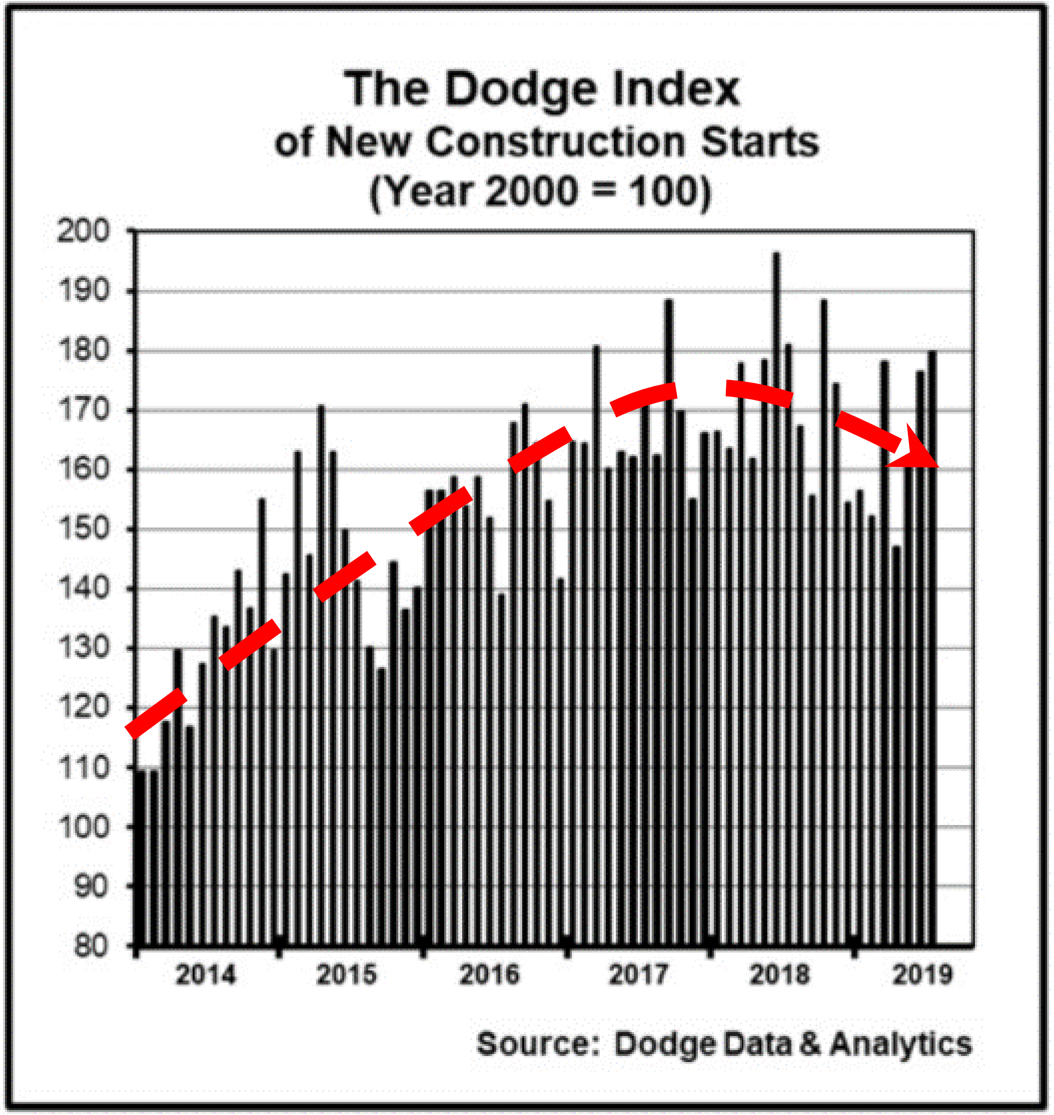

Year-to-Date Construction Starts
Unadjusted Totals, in Millions of Dollars

	7 Mos. 2019	7 Mos. 2018	% Change
Nonresidential Building	$161,101	$177,913	-9
Residential Building	181,495	198,893	-9
Nonbuilding Construction	116,744	114,295	+2
Total Construction	$459,340	$491,101	-6

Source: https://www.construction.com/news/july-construction-starts-increase-2-percent-august-2019

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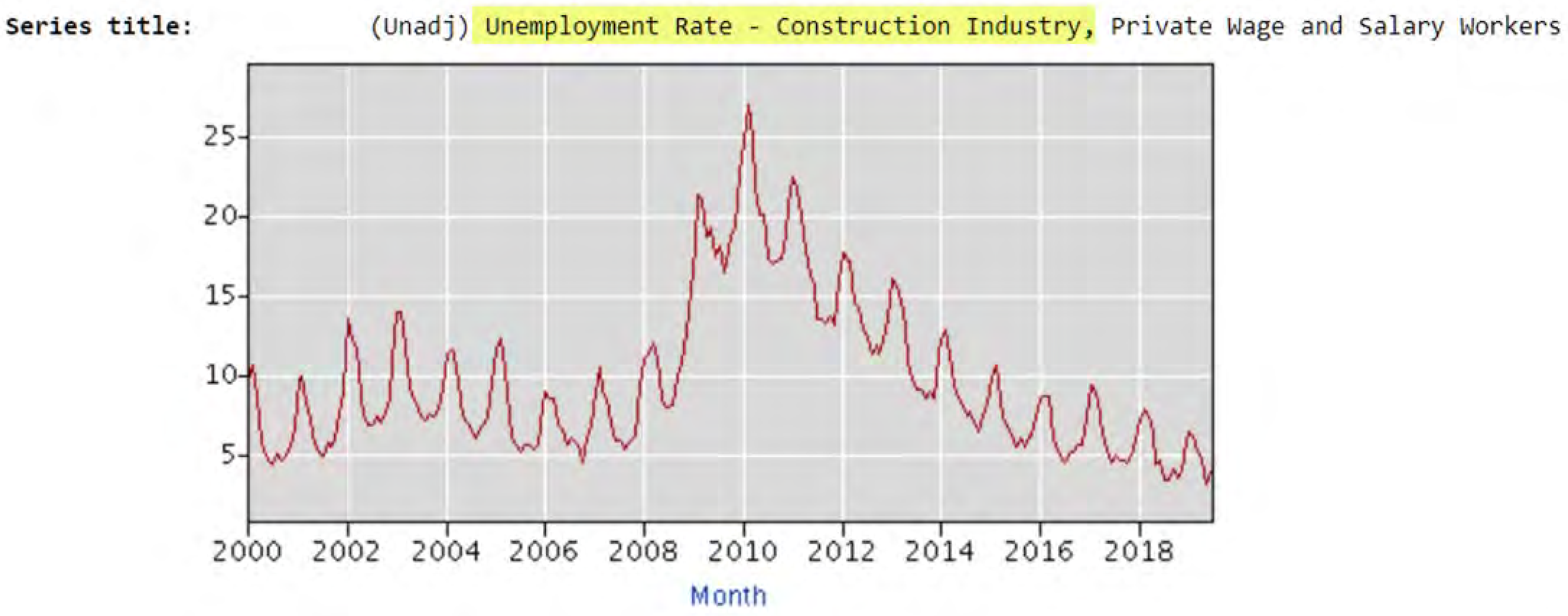
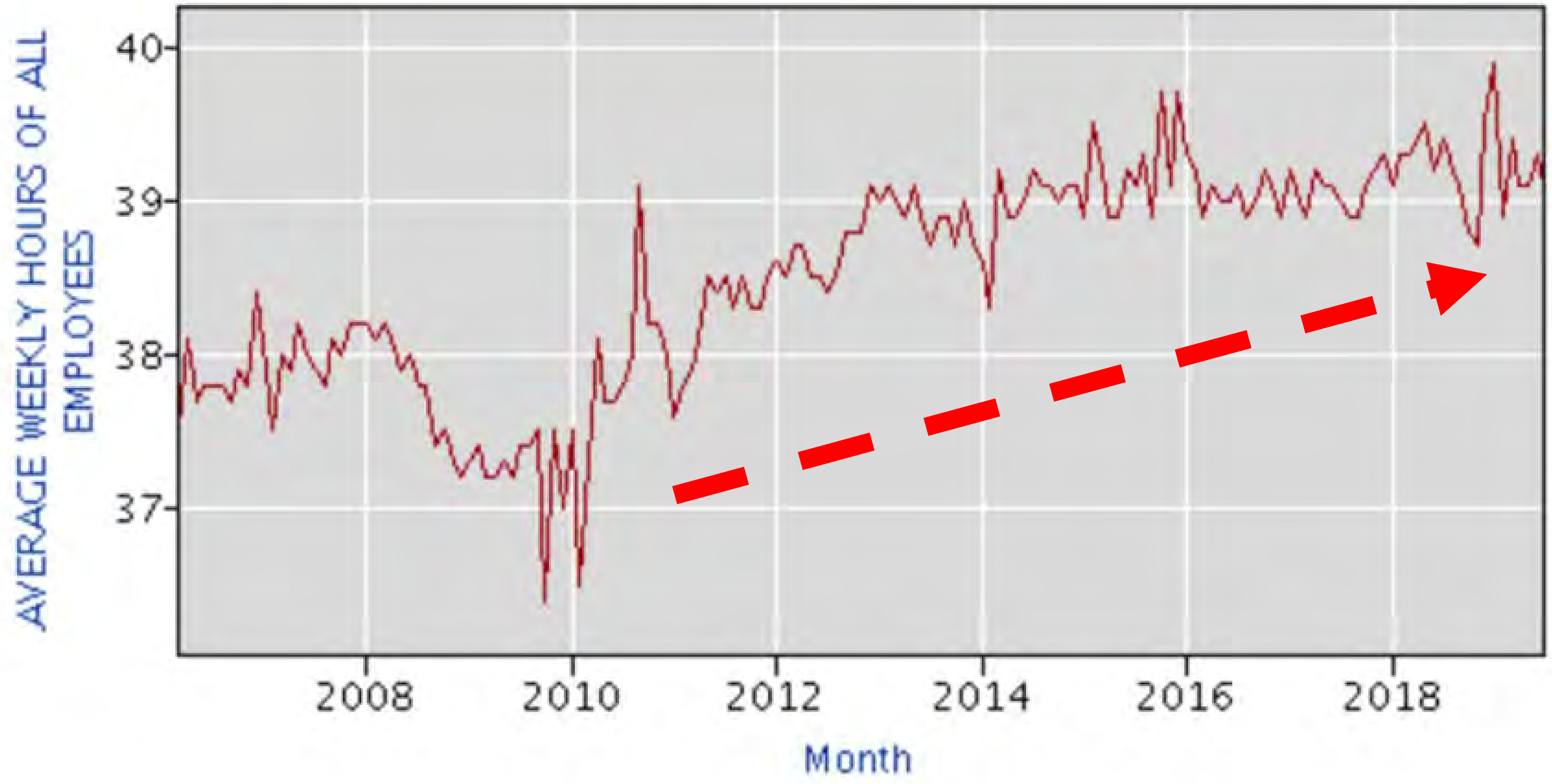


Source: https://www.bls.gov/iag/tgs/iag23.htm

Series Title: Average weekly hours of all employees, construction, seasonally adjusted



Source: https://www.bls.gov/iag/tgs/iag23.htm

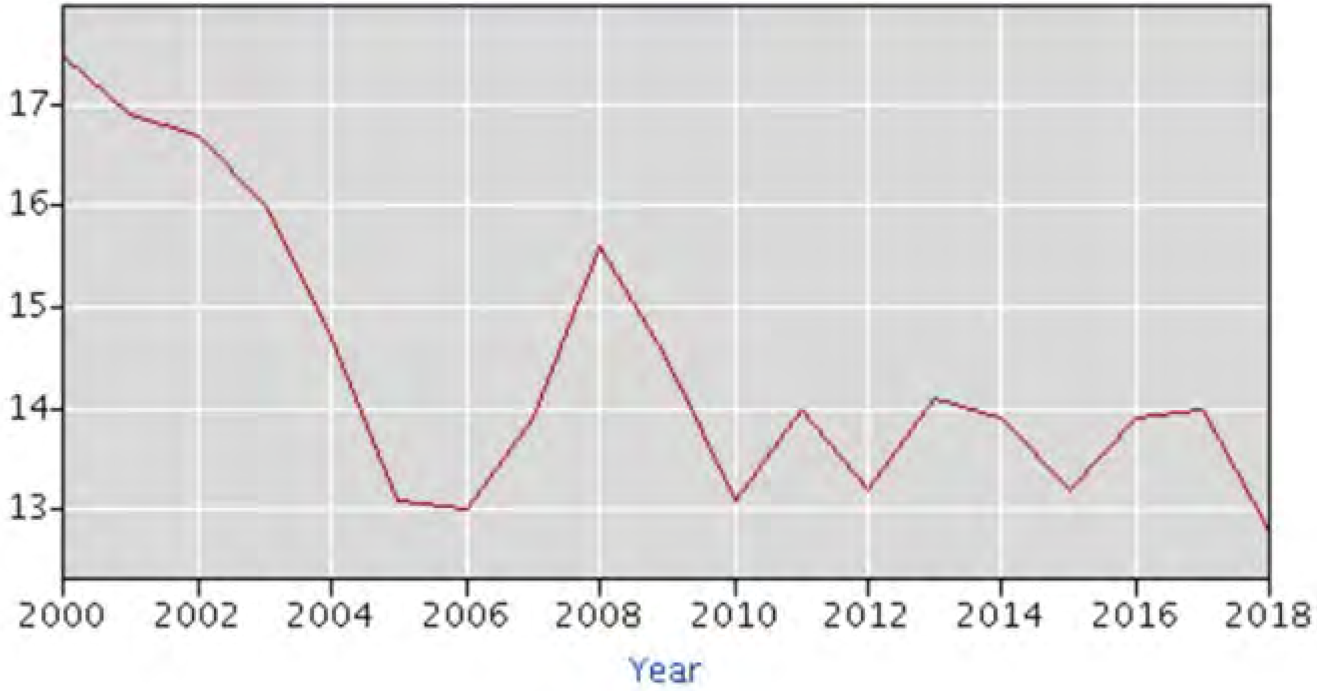
Series Title: All employees, thousands, construction, seasonally adjusted

Source: https://www.bls.gov/iag/tgs/iag23.htm

VERTEX

Series title: (unadj)- Percent of employed, Private wage and salary workers, Members of unions, Construction

Unadjusted series



Source: https://www.bls.gov/iag/tgs/iag23.htm

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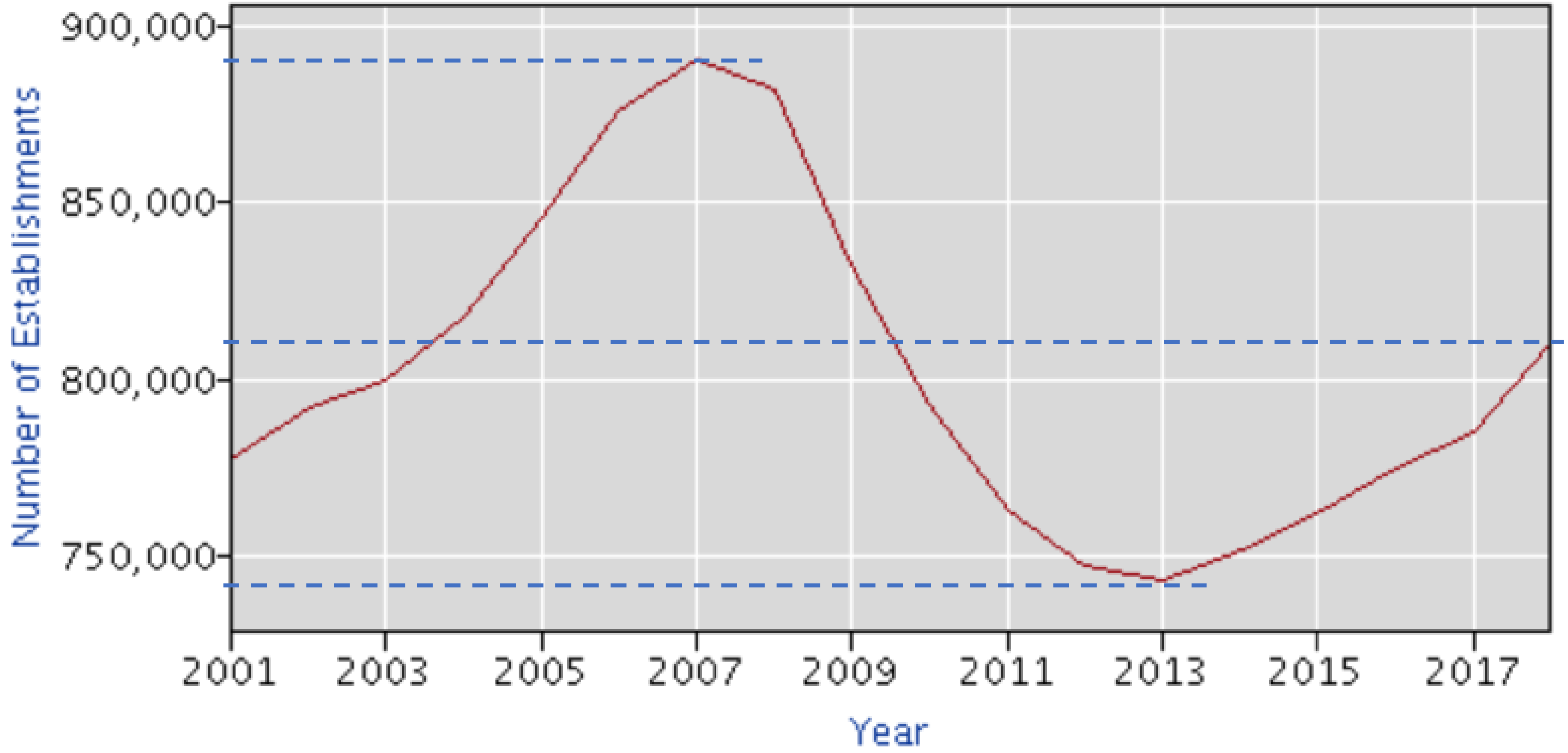
Series Title: Average hourly earnings of all employees, construction, seasonally adjusted

Source: https://www.bls.gov/iag/tgs/iag23.htm

Type: Number of Establishments



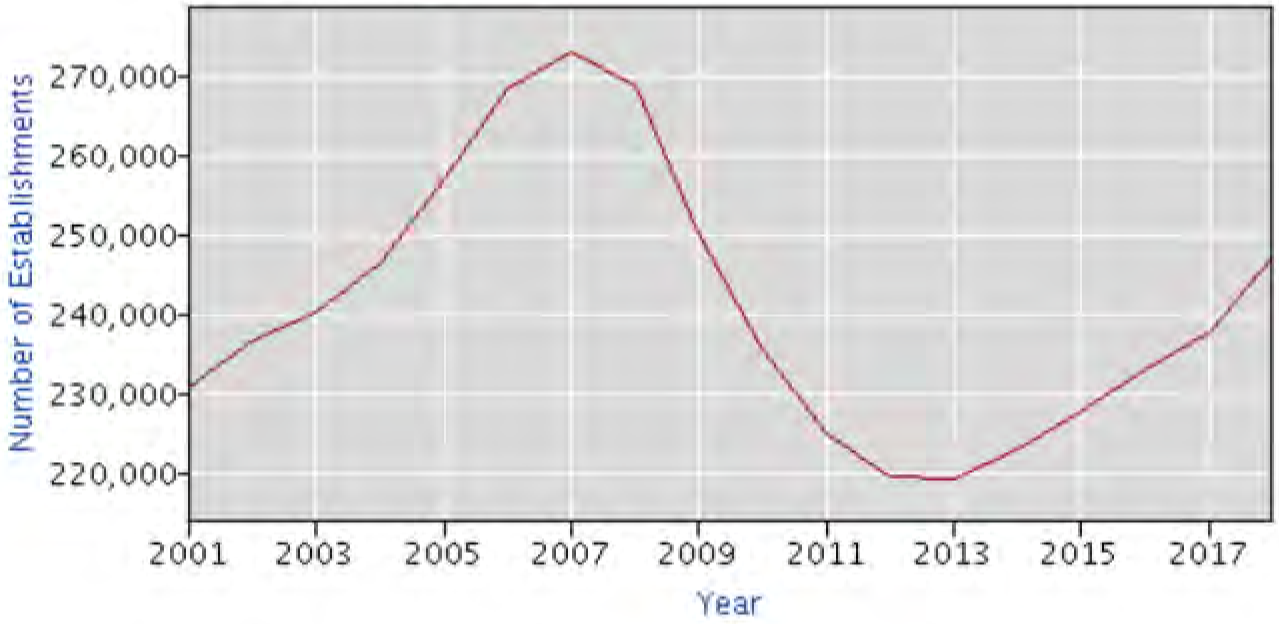
Source: https://www.bls.gov/iag/tgs/iag23.htm

2b. Building Contractors Statistics

Series Id: CES2023600001
Seasonally Adjusted
Series Title: All employees, thousands, construction of buildings, seasonally adjusted
Super Sector: Construction
Industry: Construction of buildings
NAICS Code: 236
Data Type: ALL EMPLOYEES, THOUSANDS

Source: https://www.bls.gov/iag/tgs/iag23.htm

Series Id: ENUUS000205236
Series Title: Number of Establishments in Private NAICS 236 Construction of buildings for All establishment sizes in U.S. TOTAL, NSA
State: U.S. TOTAL
Area: U.S. TOTAL
Industry: NAICS 236 Construction of buildings
Owner: Private
Size: All establishment sizes
Type: Number of Establishments



Source: https://www.bls.gov/iag/tgs/iag23.htm

2c. Heavy Contractors Statistics

Series Id: CES2023700001
Seasonally Adjusted
Series Title: All employees, thousands, heavy and civil engineering construction, seasonally adjusted
Super Sector: Construction
Industry: Heavy and civil engineering construction
NAICS Code: 237
Data Type: ALL EMPLOYEES, THOUSANDS

Source: https://www.bls.gov/iag/tgs/iag23.htm

VERTEX

Series Id:	ENUUS000205237
Series Title:	Number of Establishments in Private NAICS 237 Heavy and civil engineering construction for All establishment sizes in U.S. TOTAL, NSA
State:	U.S. TOTAL
Area:	U.S. TOTAL
Industry:	NAICS 237 Heavy and civil engineering construction
Owner:	Private
Size:	All establishment sizes
Type:	Number of Establishments

Source: https://www.bls.gov/iag/tgs/iag23.htm

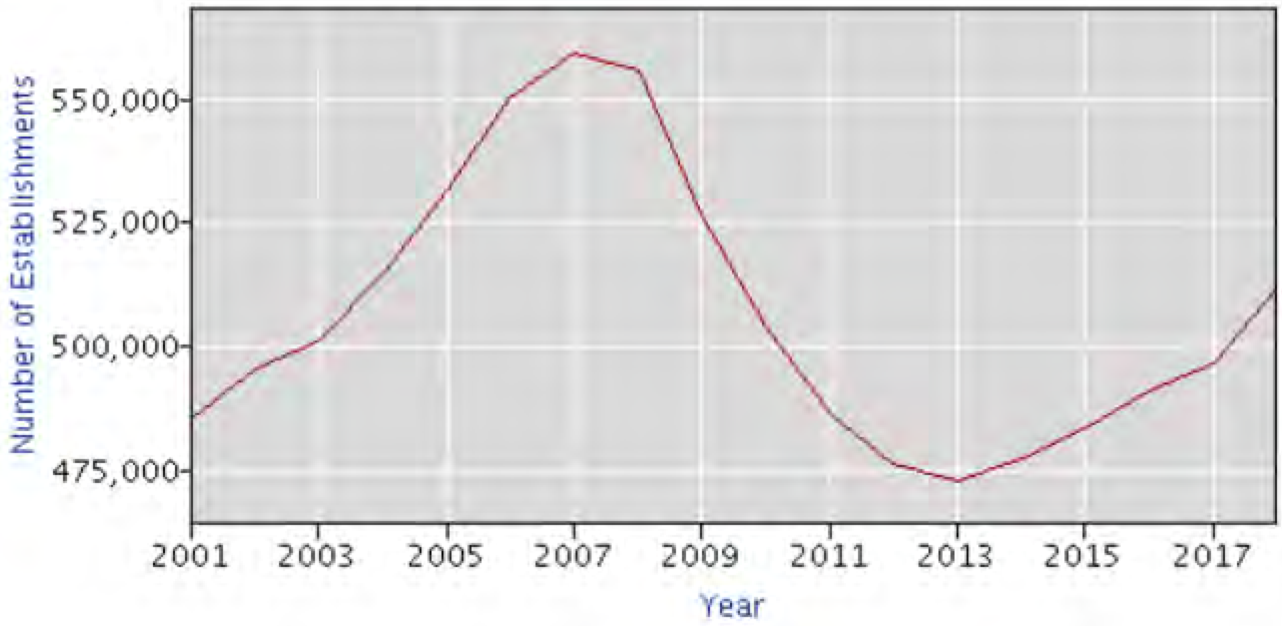
2d. Specialty Contractors Statistics

Series Id: CES2023800001
Seasonally Adjusted
Series Title: All employees, thousands, specialty trade contractors, seasonally adjusted
Super Sector: Construction
Industry: Specialty trade contractors
NAICS Code: 238
Data Type: ALL EMPLOYEES, THOUSANDS

Source: https://www.bls.gov/iag/tgs/iag23.htm

VERTEX®

Series Id: ENUUS000205238
Series Title: Number of Establishments in Private NAICS 238 Specialty trade contractors for All establishment sizes in U.S. TOTAL, NSA
State: U.S. TOTAL
Area: U.S. TOTAL
Industry: NAICS 238 Specialty trade contractors
Owner: Private
Size: All establishment sizes
Type: Number of Establishments



Source: https://www.bls.gov/iag/tgs/iag23.htm

2e. Construction Risk Trends

2019 International Construction Costs: Confronting the rising cost of construction in the U.S.

The latest edition of Arcadis' annual International Construction Costs report details the relative cost of building in 100 of the world's major cities — one of the largest comparisons of its type — and covers every major construction market. Where did the United States land in this year's report? At the very top.

Source: https://www.arcadis.com/en/united-states/arcadis-blog/david-hudd/2019-international-construction-costsconfronting-the-rising-cost-of-construction-in-the-u-s/

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U.S. Construction Costs & Office Development Trends | October 2018

United States > U.S. Research & Reports >

October 29, 2018

As construction costs spike, office development activity plateaus

Recent spikes in key commodity prices for commercial real estate construction have exacerbated cost pressures on developers and project management teams. Rising oil prices have driven up asphalt and diesel prices, and recently imposed tariffs have contributed to price increases for commodities like iron, steel and lumber.

Source: https://www.cbre.us/research-and-reports/U-S--Construction-Costs-and-Office-Development-Trends-October-2018

By: Alex Carrick on September 5th, 2018

Print/Save as PDF

U.S. Construction Costs Are Soaring

ECONOMIC NEWS

The press release issued on the U.S. Producer Price Index (PPI) data calculated by the Bureau of Labor Statistics (BLS) highlights only a small subset of all the series generated. There is a much larger (i.e., 185-page) monthly report that features thousands of entries. Many of them pertain to construction.

Source: https://www.constructconnect.com/blog/economy/u-s-construction-costs-soaring

ENR's Material Price Index

Year	ENR Material Price Index	Percent Increase	CPI
1992	1788		
1993	1995	11.6%	
1994	2029	1.7%	
1995	1974	-2.7%	
1996	2072	5.0%	
1997	2195	5.9%	
1998	2165	-1.4%	
1999	2192	1.2%	
2000	2127	-3.0%	
2001	2056	-3.3%	
2002	1992	-3.1%	
2003	2011	1.0%	
2004	2420	20.3%	
2005	2575	6.4%	
2006	2596	0.8%	
2007	2577	-0.7%	
2008	2775	7.7%	
2009	2620	-5.6%	
2010	2731	4.2%	1.6%
2011	2863	4.8%	3.2%
2012	2889	0.9%	2.1%
2013	2969	2.8%	1.5%
2014	3064	3.2%	1.6%
2015	3041	-0.8%	0.1%
2016	3153	3.7%	1.3%
2017	3271	3.7%	2.1%
2018	3392	3.7%	2.2%
Average: 2010 - 2018		2.9%	1.7%

Source: ENR

ENR's Skilled Labor Index

Year	ENR Material Price Index	Percent Increase	CPI
1992	4653		
1993	4766	2.4%	
1994	4880	2.4%	
1995	5016	2.8%	
1996	5177	3.2%	
1997	5294	2.3%	
1998	5473	3.4%	
1999	5635	3.0%	
2000	5873	4.2%	
2001	6067	3.3%	
2002	6338	4.5%	
2003	6616	4.4%	
2004	6912	4.5%	
2005	7199	4.2%	
2006	7459	3.6%	
2007	7796	4.5%	
2008	8107	4.0%	
2009	8356	3.1%	
2010	8645	3.5%	1.6%
2011	8800	1.8%	3.2%
2012	9010	2.4%	2.1%
2013	9183	1.9%	1.5%
2014	9434	2.7%	1.6%
2015	9715	3.0%	0.1%
2016	10011	3.0%	1.3%
2017	10216	2.0%	2.1%
2018	10411	1.9%	2.2%
Average: 2010 - 2018		2.5%	1.7%

Source: ENR

ENR 2019 Top 250 International Contractors: Global Market Is Risky Business

Strabag and Sacyr (No. 48) are building the Autopista al Mar 1 toll road between Medellín and Santa Fe de Antioquia in Colombia.

PHOTO COURTESY OF STRABAG SE

August 21, 2019

Gary J. Tulacz and Peter Reina

Source: https://www.enr.com/articles/47380-enr-2019-top-250-international-contractors-global-market-is-risky-business

“Owners around the world have seen large contractors fighting for work and have used this desperation to impose increasingly tough conditions in contracts, ***<u>pushing more risk onto companies</u>***.” (emphasis added)

Recent International Mega-Failures per ENR:

- Carillion (U.K.)
- Isolux Corsan (Spain; #121 international contractor in ‘17)
- Joannou & Paraskevaides Overseas (Cyprus; #60 international contractor in ‘17)
- Trevi-Finanziaria Industriale SpA (Italy)
- Condotte d’Acqua SpA (Italy)
- C.M.C. di Ravenna (Italy; #113 international contractor in ‘17)
- Astaldi (Italy; #47 international contractor in ‘17)
- Odebrecht SA (Brazil; #29 international contractor in ‘17)

Source: https://www.enr.com/articles/47380-enr-2019-top-250-international-contractors-global-market-is-risky-business

After Bottom-Line Hits, More Firms Exit Fixed-Price Work

August 7, 2019

Debra K. Rubin and
Mary B. Powers

Source: https://www.enr.com/articles/47380-enr-2019-top-250-international-contractors-global-market-is-risky-business

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Analysts Point to Contract Terms To Cut E&C Investment Risks

June 20, 2019

Debra K. Rubin

Source: https://www.enr.com/articles/47098-analysts-point-to-contract-terms-to-cut-ec-investment-risks

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June 20, 2019

Debra K. Rubin

Analysts Point to Contract Terms To Cut E&C Investment Risks

With recent project execution issues, quarter results surprises and share price falloffs among some publicly traded engineering and construction firms, sector analysts are questioning traditional industry business models and are calling for strategy changes to keep investors from fleeing industry stocks.

In a "deep dive" assessment earlier this month, investment bank Credit Suisse analyzed metrics among large firms it tracks, with recommendations for needed change to eliminate or reduce high-risk profiles—some companies have addressed or are in process.

"Bottom line, cost overruns associated with construction represent a huge repeatable industry issue," says Jamie Cook, lead research analyst in the early June report.

Cook notes the continuing "self-help" moves by some firms, through sell-offs of higher-risk businesses and transition into sectors with growth potential and more stable earnings.

She and other analysts point to moves by AECOM, Jacobs Engineering Group and KBR, for example, that have shed or reduced potentially higher-margin but risk-prone heavy construction markets, or are in process, in favor of more stable IT consulting or government services.

AECOM has completed a $225-million restructuring, s set to divest by year end its hard bid-at-risk construction businesses and fixed price power sector building in 30 countries.

Source: https://www.enr.com/articles/47380-enr-2019-top-250-international-contractors-global-market-is-risky-business

ENRMountain States

Stantec Completes Its Acquisition of MWH Global

May 30, 2016

Stantec Inc. has completed its acquisition of MWH Global Inc., a 6,800-person wet-infrastructure consulting firm based in Broomfield, Colo. The acquisition expands Canada-

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M&A in consulting

Loss-making water specialist MWH Constructors to be sold by Stantec

29 October 2018 | Consultancy.uk

After just two years of ownership, Stantec has decided to divest itself from MWH Constructors, following a period of poor results. The 1,900-person engineering and construction management firm focuses on water and natural resources for the built infrastructure and the environment.

Global consultant Stantec first struck a deal to buy MWH Constructors in 2016, as part of a deal for international consulting brand MWH Global. In a release at the time, Stantec highlighted MWH Global's 200 year history, succession of lucrative UK clients – including Anglian, Southern Water, Thames and Severn Trent and Scottish Water – and award winning pedigree as reasons for the purchase, however, the prestige of the broader company does not seem to have translated into the Constructors wing of the former entity.

Recently, this led to Stantec announcing a strategic review of its construction services last April to deliver improved prospects for employees, clients, and shareholders. It is understood that MWH Constructors was found to be making a loss, and earmarked for a swift re-sale. Now, Stantec has struck a deal to offload its loss-making MWH Constructors operation just two years after buying the business.

Stantec markets services locations ideas about careers investors global | eng

Stantec finalizes divestiture of MWH Constructors

11/02/2018 EDMONTON, AB; NEW YORK, NY TSX, NYSE:STN

Global design firm Stantec today announced it has finalized the divestiture of its construction services division, MWH Constructors, to funds managed by Oaktree Capital Management, L.P. ("Oaktree"). Gross proceeds from the sale were approximately $103 million, net cash proceeds are estimated to be $46 million after transaction costs and working capital adjustments.

November 2, 2018

BRIEF

Fluor re-evaluates risk, project selection amid $555M Q2 loss

(Credit: Robert Shaw Manufacturing)

AUTHOR
Joe Beeton

PUBLISHED
Aug. 7, 2019

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Dive Brief:

- Fluor Corp. reported a net loss of $555 million in its second quarter, compared to $115 million in earnings recorded for the same period last year. The second-largest contractor by revenue, according to Engineering News Record's Top 400 Contractors list, scored $4.1 billion in revenue for the quarter ended June 30, a 16% dip from the prior year's $4.9 billion. The firm's backlog landed at $35.5 billion, up from $29.3 billion last year.
- The loss was due to $714 million in pre-tax charges, the firm said during its earnings conference call last week, which were incurred as a result of meeting with clients, subcontractors and suppliers during the quarter to address ongoing disputes, pending change orders, schedule extensions and outstanding receivables and claims.
- Amid former CEO David Seaton stepping down in May, Fluor instituted several major changes to the amount of risk it takes on through its selection of projects, CEO and Director Carlos Hernandez said. Going forward, Fluor will only pursue fixed-price energy work that meets strict criteria, narrow focus on infrastructure work to five key states, and will no longer pursue most lump-sum projects in the government sector — echoing an industry trend.

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On $97M quarterly loss, Granite Construction shifts to smaller projects

(Credit: Jim Henderson/Wikimedia Commons)

AUTHOR
Jenn Goodman

PUBLISHED
Aug. 3, 2019

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TWEET

Granite Construction, one of the country's largest contractors, reported a net loss of $97.8 million for the second quarter of 2019. Granite is No. 4 on ENR's list of top domestic heavy contractors in the U.S. and No. 24 overall.

In an earnings call on Friday, CEO James Roberts attributed some of the downturn to delivery methods that put too much risk on recent megaprojects and said that the firm is changing the way it does business.

The decline was caused by a combination of increased project costs due to weather delays and by the execution of disputed work in the firm's heavy civil sector that resulted in before-tax charges of $143.7 million, according to a company release. These issues brought the full amount of revenue reduction to more than $114.2 million in the second quarter, causing the company to revise its full year expectations for 2019, Roberts said during the call.

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CANADA August 2, 2019 12:17 pm Updated: August 2, 2019 12:18 pm

SNC Lavalin cuts dividend by 80% amid $2B net loss and record low stock price

By Christopher Reynolds The Canadian Press

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Last month, Edwards announced the company is quitting the field of so-called lump-sum turnkey projects _ “the root cause of the company’s underperformance,” he said Thursday _ and pivoting to a more stable business model that revolves around engineering services, steering clear of the cost overruns absorbed by fixed-price bidders.

Edwards also reiterated his aim of “exploring all options” for SNC’s resources segment, including selling its flagging oil and gas business _ which accounted for one quarter of overall company revenues last year, down from 44 per cent in 2016.

SNC-Lavalin remains saddled with a $4.6-billion backlog on fixed-price resource and infrastructure contracts, its “biggest stumbling block,” said analyst Maxim Sytchev of National Bank of Canada.

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REUTERS Business Markets World Politics TV More

MAY 2, 2019 / 5:58 AM / 3 MONTHS AGO

SNC-Lavalin to exit 15 countries; main unit posts surprise loss

Shanti S Nair, Nelson Wyatt

3 MIN READ

(Reuters) - SNC-Lavalin Group Inc is exiting operations in 15 countries, the Canadian company said on Thursday, after posting a surprise quarterly loss in its engineering and construction unit that pushed its shares to a decade low.

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AECOM

ABOUT MARKETS SERVICES PROJECTS

News Release

AECOM announces intent to spin off its industry-leading government services business

LOS ANGELES--(BUSINESS WIRE)--Jun. 17, 2019-- AECOM (NYSE:ACM), a premier, fully integrated global infrastructure firm, today announced that its Board of Directors has unanimously approved a plan to pursue a spin-off of the Company's Management Services segment into a leading, standalone government services company. The transaction is currently expected to be completed in the second half of fiscal 2020.

Download PDF

This transformational initiative builds upon the strategic actions AECOM has taken and continues to take to maximize shareholder value, including the already-executed $225 million G&A reduction, the anticipated exit of hard-bid at-risk construction, the exit of non-core Oil & Gas and fixed-price combined-cycle gas power plant construction, the planned exit from more than 30 countries and the decision to no longer pursue international at-risk construction opportunities. As a result of the proposed spin-off and these ongoing strategic actions, AECOM will benefit from a honed focus on its high-returning professional services businesses with leading market share, strong cash flow and on attractive financial return profile to foster continued growth, return of capital to shareholders, and debt reduction under the Company's existing capital allocation policy.

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BRIEF

AECOM records strong Q3 amid ongoing changes

(Credit: Raysonho / Wikimedia Commons)

VERTEX®

AUTHOR
Joe Beeton

PUBLISHED
Aug. 8, 2019

CEO and Chairman Michael S. Burke said the positive results were due in part to the actions the company announced late last year, such as "de-risking" its portfolio by focusing on lower-risk construction management work. The plan, as the contractor laid out in its earnings presentation, also includes extracting its involvement in all at-risk, self-perform construction, all non-core oil and gas and international development work, and more related to its capital services business.

In its Design and Consulting Services segment, the firm said it is witnessing its strongest growth in several years in the Middle East and is actively positioning for post-Brexit growth opportunities in the U.K. However, the firm is also reportedly actualizing its plan to exit more than 30 countries, with 76% of its business in the U.S., 11% in Europe, Middle-East and Africa, 8% in Asia-Pacific and 5% in Canada, in terms of trailing 12-month revenue.

Changes AECOM announced in the prior period seem to already be paying off, so the trend may be that large contractors will continue taking on less risk, or at least re-evaluate the way they view risk. That's playing out currently, with Granite, Fluor and other major contractors also announcing major shifts in focus at the conclusion of their respective second quarters so far this month.

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MARKETS BUSINESS INVESTING TECH POLITICS CNBC TV

ENERGY

Australia's WorleyParsons to buy Jacobs Engineering's energy and resources arm for $3.3 billion

PUBLISHED MON, OCT 22 2018 · 8:11 AM EDT | UPDATED MON, OCT 22 2018 · 8:19 AM EDT

Jacobs, the largest service provider to the NASA space program, said it would now focus on higher growth, higher margin lines of business including aerospace, technology and nuclear projects as well as buildings and infrastructure.

"For Jacobs, this transaction marks an inflection point in our portfolio transformation focused on more consistent, higher-margin growth as a leader solving the world's critical challenges," Jacobs Chairman and Chief Executive Steve Demetriou said in a statement.

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Part 3. State of the Contract Surety Industry

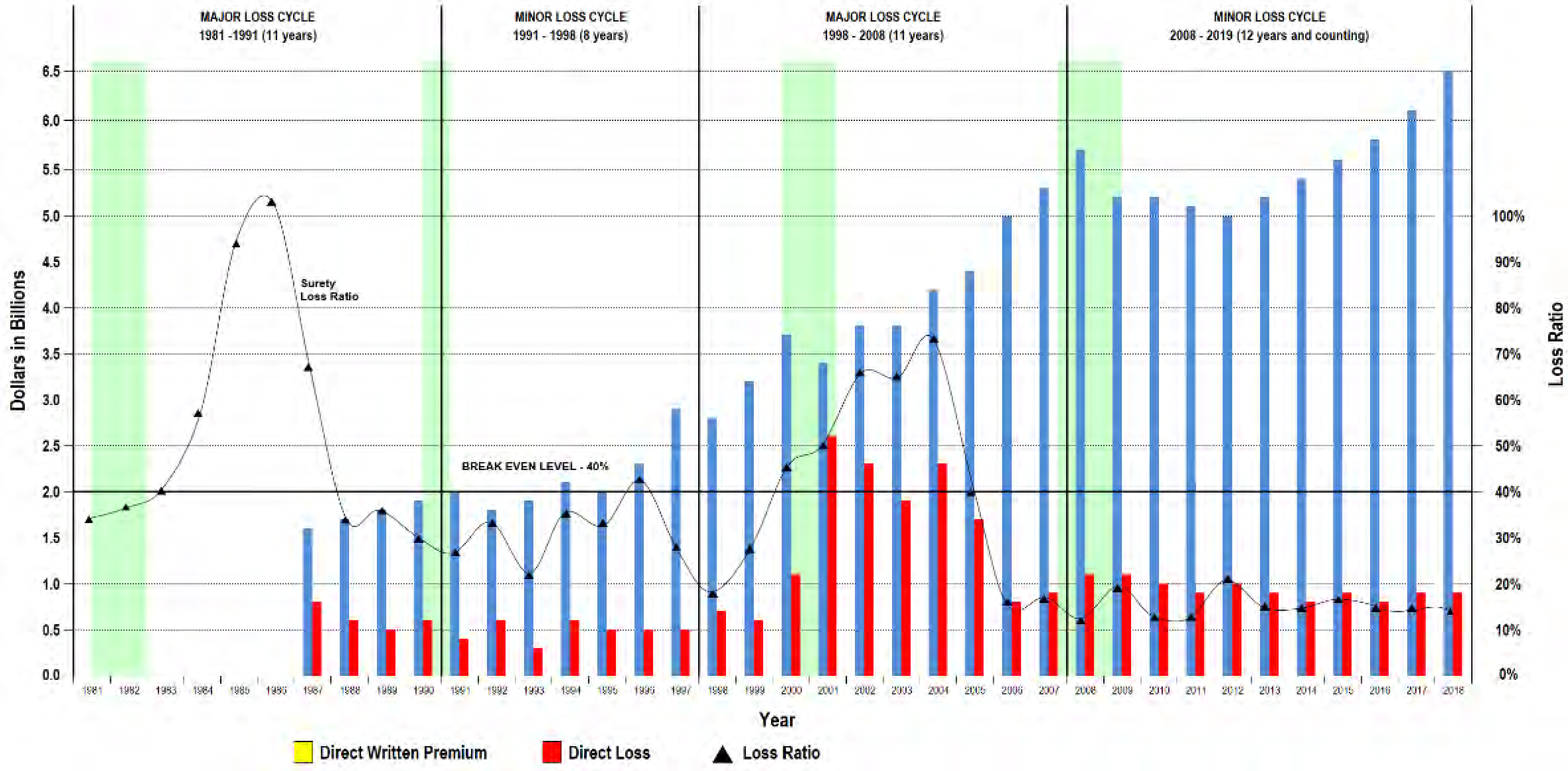
Two thumbs up.

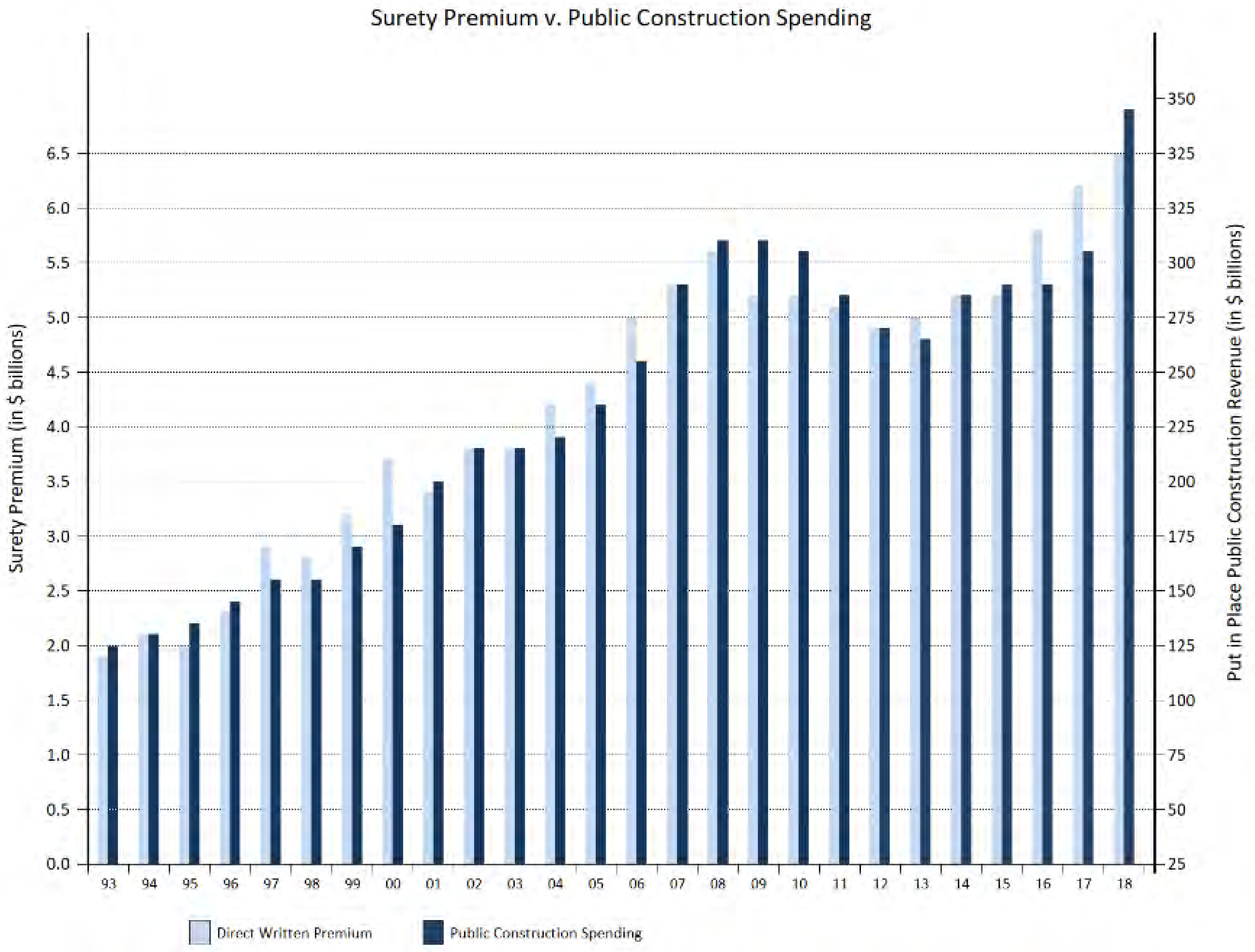
2018 Preliminary Overall Surety Results (SFAA)

Direct Written Premium	$	6,552,232,631
Direct Premium Earned	$	6,303,048,932
Direct Losses Incurred	$	818,175,014
Direct Loss Ratio		13%

Source: SFAA

Surety Loss Cycles





Surety Premium v. Public Construction Spending
Surety Premium (in $ billions)
0.0
0.5
1.0
1.5
2.0
2.5
3.0
3.5
4.0
4.5
5.0
5.5
6.0
6.5
Put in Place Public Construction Revenue (in $ billions)
25
50
75
100
125
150
175
200
225
250
275
300
325
325
350
93
94
95
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Direct Written Premium
Public Construction Spending

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Contract Surety Results

Year	Direct Premium Written	Direct Premium Earned	Direct Losses	Loss Ratio
2006	$ 3,223,980,595	$ 2,831,159,171	$ 312,155,253	11.0%
2007	$ 3,477,071,867	$ 3,145,594,236	$ 422,346,066	13.4%
2008	$ 3,286,788,842	$ 3,145,407,781	$ 189,249,655	6.0%
2009	$ 3,245,353,995	$ 3,189,383,088	$ 441,311,658	13.8%
2010	$ 3,181,470,683	$ 3,066,587,859	$ 563,473,047	18.4%
2011	$ 3,076,150,729	$ 2,973,692,924	$ 735,152,410	24.7%
2012	$ 2,960,101,496	$ 2,919,429,977	$ 1,080,881,076	37.0%
2013	$ 3,052,180,345	$ 2,878,413,510	$ 648,704,836	22.5%
2014	$ 3,155,672,451	$ 2,923,904,749	$ 854,449,063	29.2%
2015	$ 3,201,695,033	$ 3,053,047,521	$ 402,555,934	13.2%
2016	$ 3,335,936,244	$ 3,110,282,512	$ 445,775,571	14.3%
2017	$ 3,535,981,862	$ 3,229,923,928	$ 523,568,524	16.2%
Totals	$ 38,732,384,142	$ 36,466,827,256	$ 6,619,623,093	18.2%

Source: SFAA

Market Share of the Top 10 Surety Providers:

1980:	21%
1990:	42%
2004:	67%
2008:	68%
2014:	63%
2016:	62%
2017:	61%
2018:	**60% (~$4B out of ~$6.5B)**

The market share of the Top 10 surety providers has not been this low for approximately 20 years.

Surety Guarantees

Report: Bonds on Big Projects Often Fall Short of Full Contract Value

Construction work on the Bethesda shaft of the Maryland Purple Line Light Rail project. *Photo courtesy of the Maryland Dept. of Transportation*

16 • ENR • August 5/12, 2019 enr.com

Source: http://digital.bnpmedia.com/publication/?i=608071&p=72?oly_enc_id=6022G7651790F6A#{%22page%22:18,%22issue_id%22:608071}

As public-private infrastructure projects across the U.S. grow ever larger, surety bond requirements have ballooned, effectively pricing out potential bidders.

In order to ensure competition for everything from new bridges and highways to light-rail lines, some states have resorted to cutting surety bond requirements from the traditional 100% coverage down, in some cases, to just a quarter or third of a project's cost.

If not implemented correctly, this strategy also has the potential to backfire, as was the case with Indiana's I-69 highway project, where the state's financing authority wound up on the hook more than $100 million after the developer defaulted, notes Montreal-based WSP Global, a big player in the P3 sector, in a recent white paper on the issue.

Source: http://digital.bnpmedia.com/publication/?i=608071&p=72?oly_enc_id=6022G7651790F6A#{%22page%22:18,%22issue_id%22:608071}

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Part 4. Takeaways

Proceed with caution.

Top Risks that Face Contractors and Contract Surety Providers in 2019:

1. Labor Shortage = Safety / Quality / Schedule Issues; this trend will continue so long as construction unemployment remains under 5%
2. Lack of growth in private construction markets will shrink margins over time unless contractors take "right-sizing" measures
3. Larges losses in EPC work due to excessive risk profile
4. Construction labor and material continue to outpace the CPI
5. Looming recession fears will shrink private construction spending

Top Risks that Face Contractors and Contract Surety Providers in 2018:

1. Labor Shortage = Safety / Quality / Schedule Issues; this trend will continue so long as construction unemployment remains under 5%
2. Lack of growth in public construction over the past decade
3. Inflationary pressures due to increased costs for labor and material

End

About the Author:

William J. McConnell, PE, JD, MSCE
Chief Executive Officer
THE VERTEX COMPANIES, INC.

This is Mr. McConnell's 15th State of the Industry presentation, and his first attempt at a voice-over-PowerPoint. He hopes you will find this information interesting and useful. Mr. McConnell has presented on this topic at many construction and surety conferences over the years, including AGC, ABA, ASCE, and NBCA events. If you are a surety provider, large AEC company, or construction organization, and would like Mr. McConnell to present to your company, please contact Vertex's Brenna Stuhlman at bstuhlman@vertexeng.com or 303.623.9116.

Bill McConnell is a co-founder and the CEO of The Vertex Companies, Inc. Vertex is an AEC firm that offers Forensic, Engineering, Construction, Environmental, and Digital solutions throughout its 27 offices in North America. Bill has a BS in Civil Engineering from the University of Maine, a JD degree from the University of Denver, a MS degree from Columbia University, and he is working towards his PhD in Civil Engineering from the University of Colorado (anticipated graduation in '20). Bill also completed a part-time three-year business program at MIT. When Bill is not performing his CEO duties (or going to school), he serves as a top expert witness for construction disputes. He has testified over 160 times, most notably for cost, schedule, and/or standard of care opinions.