

The Outlook for U.S. Utility Infrastructure Construction

While the broader construction industry struggles through the worst recession in everyone's lifetime, executives of utility infrastructure firms have much for which to be thankful. Utility construction firms have been spared the severity of the industry decline that has many E&C firms fighting to stay in business.

How severe has the industry downturn been?

Residential construction declined 78 percent from 2007 through 2010. Total nonresidential building construction spending declined 28 percent over the past two years. Total construction put in place in the United States has declined from a high of \$1.2 trillion in 2006 to \$840 billion in 2010, a decline of approximately \$360 billion or 30 percent. That equals a decline greater than the individual annual economic output (GDP) of 36 states.

How do utility infrastructure sectors compare?

Power infrastructure spending increased 89 percent from 2007 through 2009 and then declined a mere 1 percent in 2010. Highway and street construction (includes significant utility infrastructure) has increased 15 percent, water/waste water is up 11 percent and water supply is up 8 percent during the same period. Telecom infrastructure spending is up over 10 percent and is poised to explode in 2011.

In addition to holding serve during depths of the downturn, the outlook for each of the main utility infrastructure segments is quite positive based on market specific growth drivers. Likewise, there are a number of challenges facing the construction industry that can adversely affect utility contractors over the next couple of years.

Growth Drivers for Water/Wastewater

The EPA estimates approximately 7 billion gallons of clean drinking water are lost to leaking pipes daily. The total estimated cost to replace aged and inefficient water supply infrastructure over the next 20 years is approximately \$390 billion. Annual water supply construction has grown from \$8.6 billion in 2000 to \$16 billion in 2010, but is far short of what is needed to address the problem. In the short-term, the economic recession has led to flat spending as municipal governments face revenue shortfalls and tight credit markets. However, by 2014, water supply construction is anticipated to grow to \$20 billion annually.

Wastewater construction tripled from \$3.3 billion in 1999 to \$10.3 billion in 2009. Wastewater infrastructure spending will continue to grow as thousands of municipalities are under pressure to increase spending to upgrade wastewater infrastructure to meet these new standards.

Challenges Facing Utility Contractors New Competitors

The relative strength of the utility infrastructure markets has not gone unnoticed by complementary trades in the heavy civil sectors. As a result, various segments such as, high voltage transmission, substation, solar, wind and water/wastewater are seeing new or return competitors enter the market. It is typical for underground contractors to see 15 or more bidders in markets where traditionally there were only three to four participants.

Irrational Pricing

Increased competition, often from new market entrants responding to shrinking backlogs, can lead to irrational pricing. Having a firm handle on costs, adjusting overhead to reduced gross mar-

gins, and most importantly, retaining pricing discipline is key to weathering periods of irrational pricing.

Unsympathetic Banks

The United States' economy may technically be out of recession, but the banking crisis is far from over. In 2010, 157 commercial banks failed, up 19 percent from 2009. Unfortunately, many banks are restricting their lending to contractors. It is common for a bank to call a contractor's loan or refuse to renew its line of credit, thus precipitating a financial crisis for the contractor. If the bank fails and is taken over, all bets are off for the contractor. In response, utility contractors must have frank conversations with their local bank and take proactive measures to ensure they have alternate lenders to turn to in case of emergency.

Nervous Sureties

Sureties are holding their collective breath as the industry moves through the bottom of a prolonged downturn. In response, bonding agents are taking a hard look at contractor backlogs, bidding practices and balance sheets. Some contractors are finding their bonding capacity curtailed or even dropped. Do not be surprised if personal indemnification is required to renew existing lines. For aging baby boomers, expect your surety provider to ask very specific questions about succession planning at your firm.

Municipal Budget Shortfalls

By far the biggest immediate threat to sustaining the health of the water/wastewater market are the budget deficits of states and municipalities. Municipalities are slashing spending in face of severe revenue shortfalls and are often unable to fund capital projects through traditional bond offerings. Public-private partnerships (P3) offer one way to fund critical new infrastructure projects; however, many states lack the appropriate legislation to allow state and municipalities to structure P3 deals. Until the economy shows sustained expansion and the unemployment rate declines, municipal funding for new utility infrastructure projects will be under threat.

Jobless Recovery

The unemployment rate in the United States continues to hover around 9 percent. Many economists place the true unemployment rate at closer to 15 percent by taking into account discouraged workers who are no longer seeking employment. Without real job growth, the housing market will continue to languish, commercial, office and retail construction will remain depressed and utility construction associated with these projects will remain flat.

The above challenges represent real and immediate threats to individual contractors competing in specific markets throughout the country. Fortunately, recessions do not last forever and there are realistic signs the economy is on the mend. General economic recovery can only bolster what is otherwise a very positive outlook for all segments of utility infrastructure construction.

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