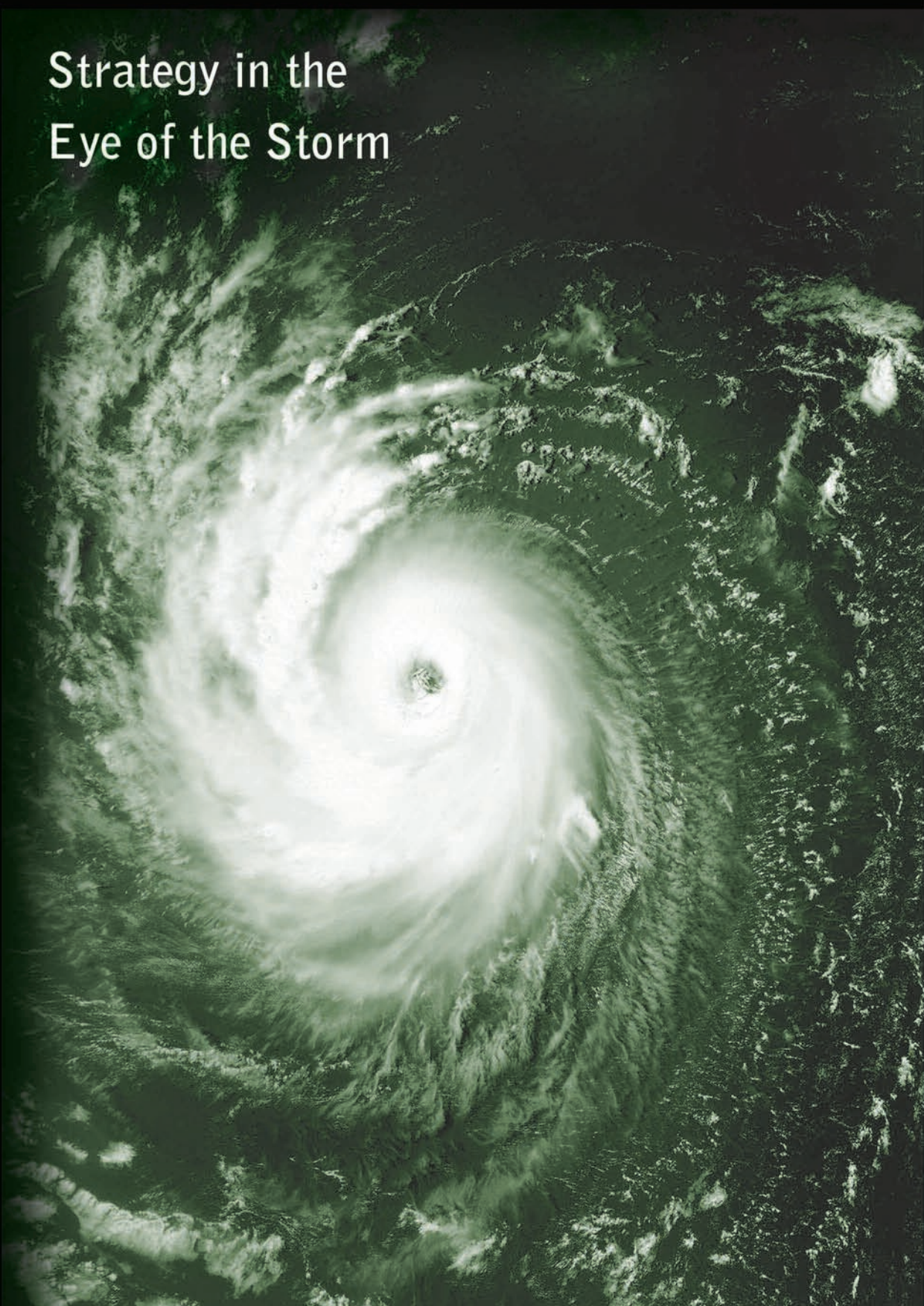


Strategy in the Eye of the Storm



MANAGEMENT CONSULTING • INVESTMENT BANKING
for the CONSTRUCTION INDUSTRY



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Strategy in the Eye of the Storm

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EXECUTIVE SUMMARY

Stocks have fallen, banks have failed, projects are being delayed and cancelled at an unprecedented rate, bailouts have come – but are they enough? The headlines continue to report bad news, raising the alarm of declining confidence and reminding us of the need to think strategically. However, once it sinks in that this global crisis exists and is unavoidable, it is often a good idea to shut off the alarms, find a quiet corner and contemplate how to adapt the business. In crisis, there is opportunity. Now is not the time to panic. It is time to take advantage of a rare chance to refine your business model and develop a winning strategy for the future.

Most sectors of the construction industry are facing their most severe downturn in more than 25 years. Having enjoyed an extended period of economic prosperity, many industry executives have been closely monitoring the bell-weather indicators in order to better understand what a deep recession will mean to their companies.

FMI launched its 2009 Construction Industry Strategy Survey in February of this year to gauge exactly how executives of the industry's leading firms were preparing for a rapidly changing landscape. Another critical objective of the survey was to provide insight into the depth of strategic thinking among industry participants and how they were positioning their businesses for both the short and long term. The feedback provided a comprehensive look at how construction firms are approaching strategy and preparing for a world that will look much different in the future than it did in 2007 and 2008.

Our field of 230 survey participants was comprised of some of the most influential executives in the U.S. construction industry. We benefited from great participation from firms with annual revenues greater than \$250 million and had good representation from general contractors, construction managers, large specialty trade and heavy civil contractors.

What were some of our more-interesting findings?

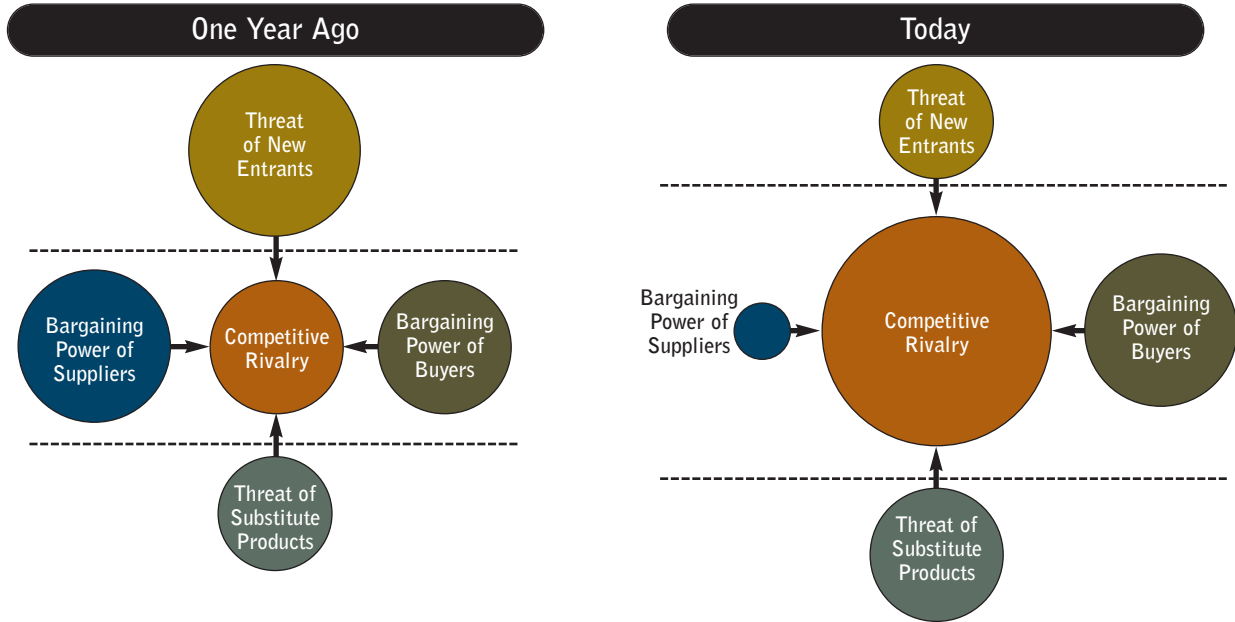
- Participants are analyzing their macro-climate, customers and markets, competitors and their own companies with varying degrees of rigor.
- Many firms do not feel adequately prepared for the uncertainty that lies ahead.
- Firms in the middle market, especially with annual revenues from \$500 million – \$999 million, are anticipating the most uncertainty and are the least prepared.
- The lack of in-depth planning is preventing some firms from developing a strategy that aligns with the shifting industry context (a more detailed explanation is provided later in this report).

It is clear that the world is changing, and participants in this year's survey were asked to rate just how much the competitive environment had intensified over the last 12 months. The questions were structured using Michael Porter's seminal work on the competitive dynamics that shape an industry. As you can see, the forces at work in the construction industry¹ have dramatically shifted.



EXHIBIT 1 Porter's Five Forces Model

Threat of New Entrants:	Bargaining Power of Suppliers:	Threat of Substitute Products / Services:	Bargaining Power of Buyers:	Competitive Rivalry
Decreasing...	Decreasing...	Increasing...	Increasing...	Increasing...



Key

Threat of New Entrants = Attractiveness or incentive for new competitors to enter the industry.

Bargaining Power of Suppliers = Ability of contractors to put pressure on customers.

Threat of Substitute Products = Availability of alternative suppliers of construction services.

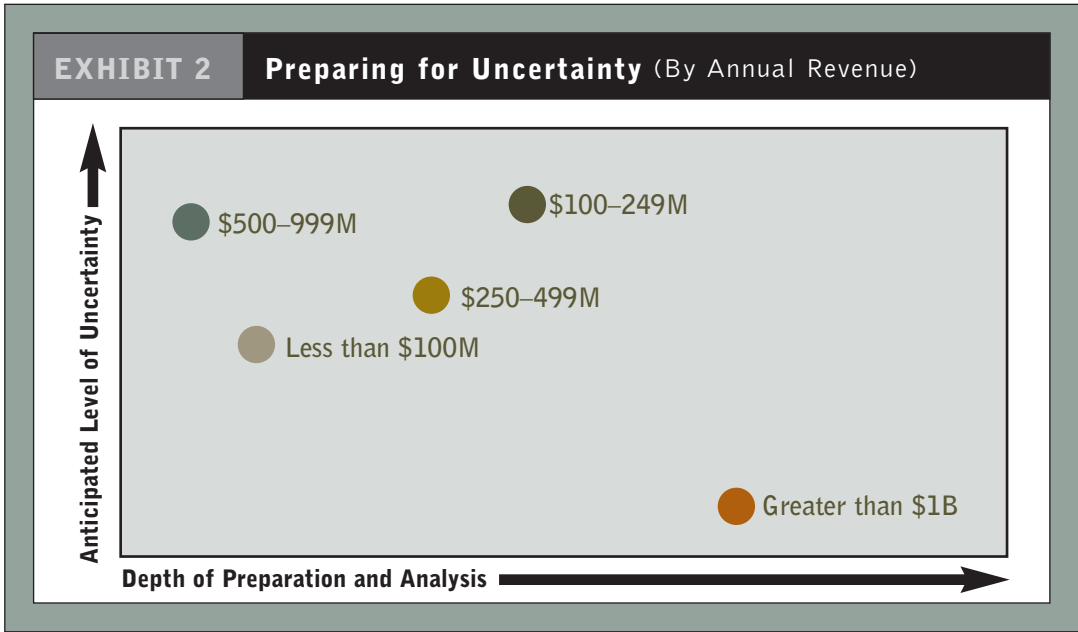
Bargaining Power of Buyers = Ability of customers to put pressure on contractors.

Competitive Rivalry = Ferocity of competition.

The changing dynamic among contractors, competitors and customers is the most stark indicator (i.e., the middle band), signaling the waning of the previous market expansion and suggesting that a new modus operandi will be required to remain viable going forward.

Drastic change in the competitive environment breeds uncertainty for every company, and this year's survey attempted to find out the degree of uncertainty firms were anticipating and how deep were their levels of preparation.

¹ "How Competitive Forces Shape Strategy" Harvard Business Review 57, March - April 1979, pages 86-93

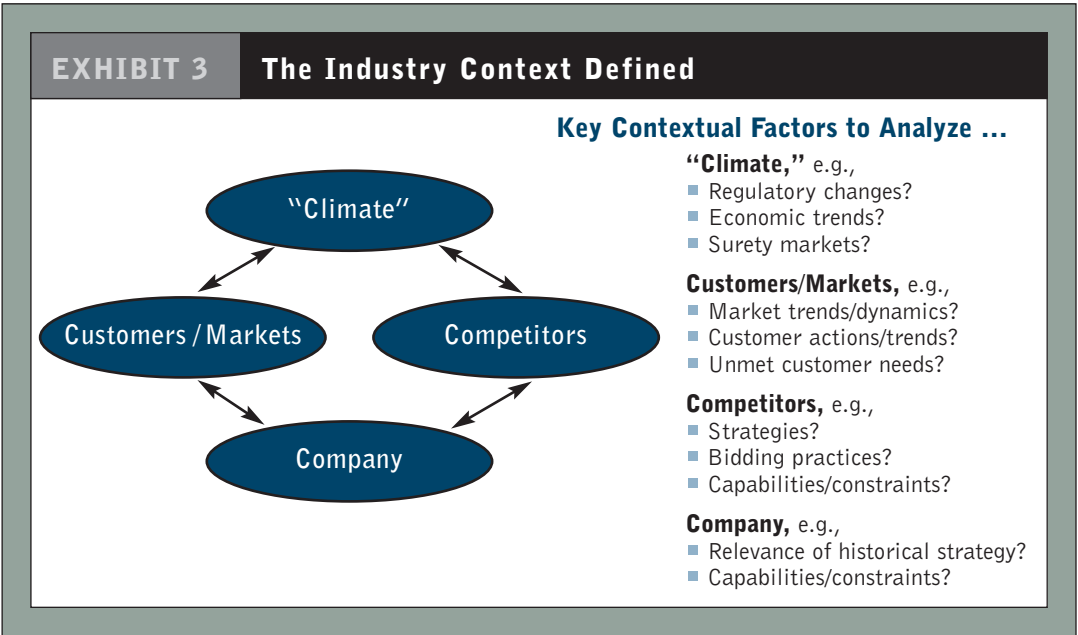


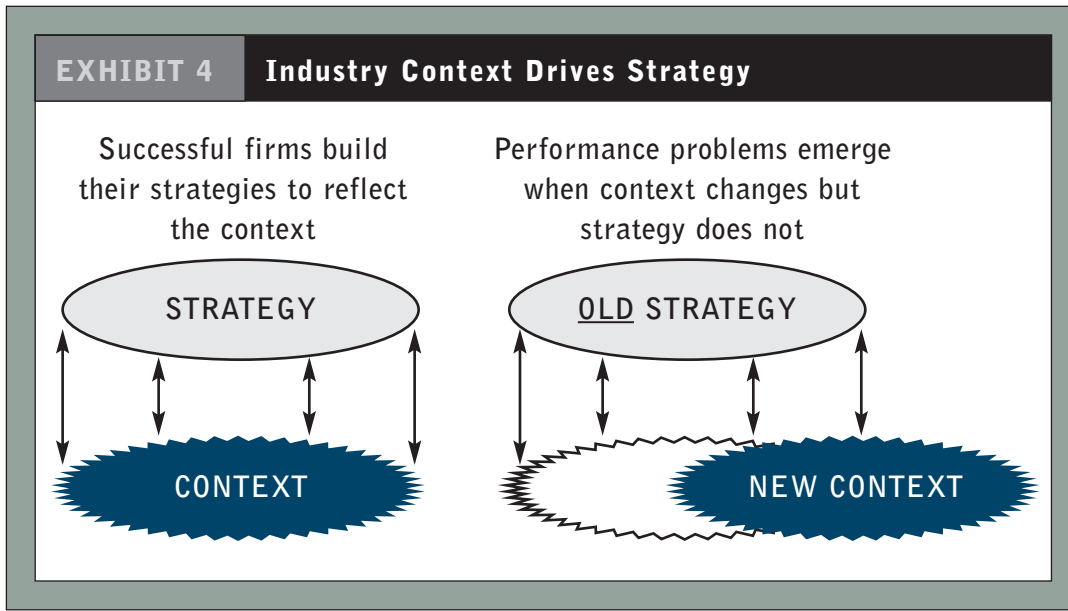
The findings suggest that while most companies anticipate a high degree of future uncertainty, they have not adapted the way they develop strategy. As uncertainty increases, so too should the level of preparation and depth of analysis that is used to determine a go-forward direction. This theme resonates throughout the survey findings and indicates that far too many contractors have yet to adapt to the changing context.

INTRODUCTION TO THE INDUSTRY CONTEXT

When there is a significant shift in the industry context, firms must adapt their strategies to remain viable. At this point in our description of the survey results, FMI would like to take the opportunity to define what we mean when we refer to the 'industry context' and why a detailed understanding of this context is critical to strategy development.

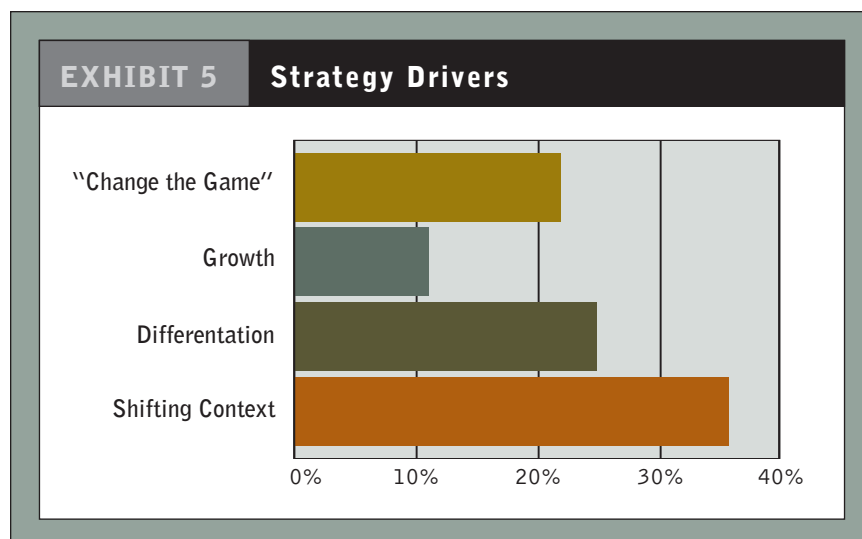
The industry context in which your firm operates is defined by the macro-climate, your customers and markets, your competitors as well as the capabilities, constraints and value drivers of your own company.





Understanding that the context was only beginning to change in early 2009, we asked our participants several questions to reveal the challenges they were facing in developing their strategy. The results fell into four primary categories, but the shifting industry context was the main impetus driving companies to revisit their current strategy.

The key findings from this year's survey are organized to align with the components of the industry context. This methodology provides insight into how firms are assessing all of these factors and what resultant primary strategies are being developed to prepare for challenging times ahead in the construction industry.

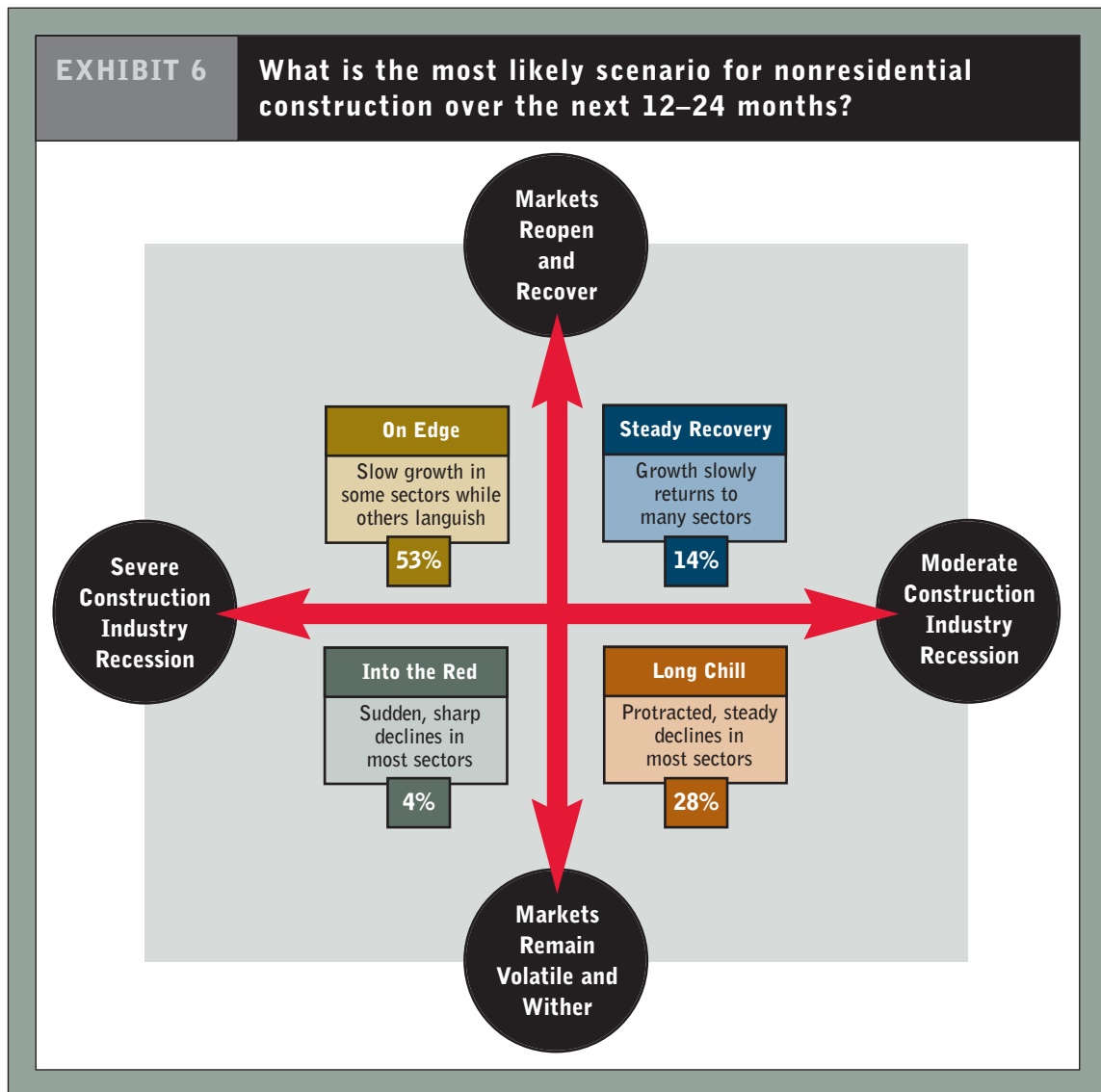


SURVEY FINDINGS – THE INDUSTRY CONTEXT

The “Climate”

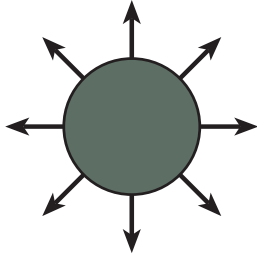
We surveyed industry executives to get their thoughts on what was happening in the broader economic environment. Their feedback was incredibly informative and a few highlights are noted below:

- More than 50 percent felt that the most likely economic scenario facing the industry was one we called “On Edge,” which referred to the possibility of slow growth in a few sectors while others languish. Only 14 percent anticipate a near-term recovery of any sort.

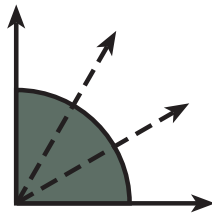


- Ninety-one percent expect increased uncertainty, but opinions differ as to whether the chosen potential scenarios may come to fruition. Fifty-three percent are anticipating a range of possible futures, but are unsure as to the ultimate outcome².

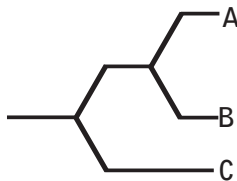
² Source of framework: “20/20 Foresight: Crafting Strategy in an Uncertain World.” Hugh Courtney. Harvard Business School Press.

EXHIBIT 7**How would you describe the level of uncertainty for which you are preparing?****Level 4: True Uncertainty**

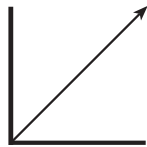
Not even an anticipated range of possible future outcomes

4%**Level 3: Range of Futures**

Wider range of possible future outcomes, unsure of ultimate outcome

53%**Level 2: Alternative Futures**

Limited set of outcomes, of which one will occur

38%**Level 1: Clear Enough Future**

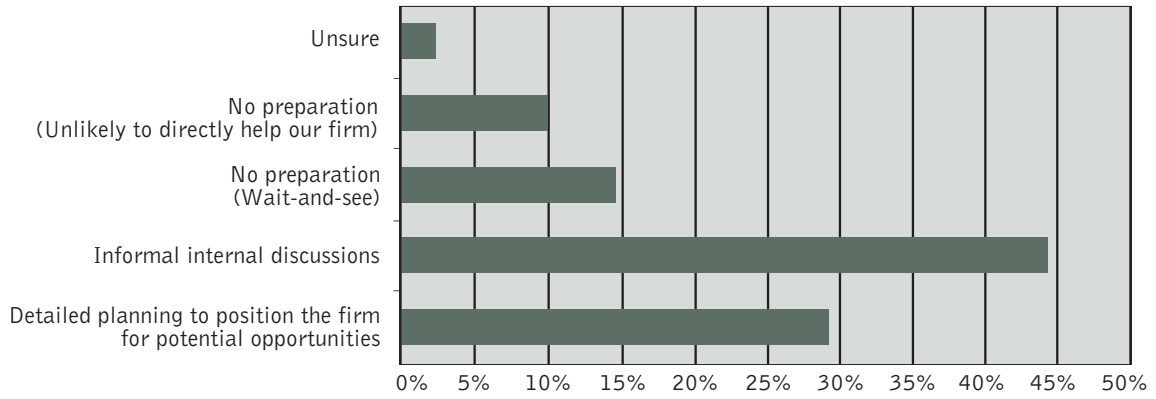
Singular view of the future, certain of what's to come

5%

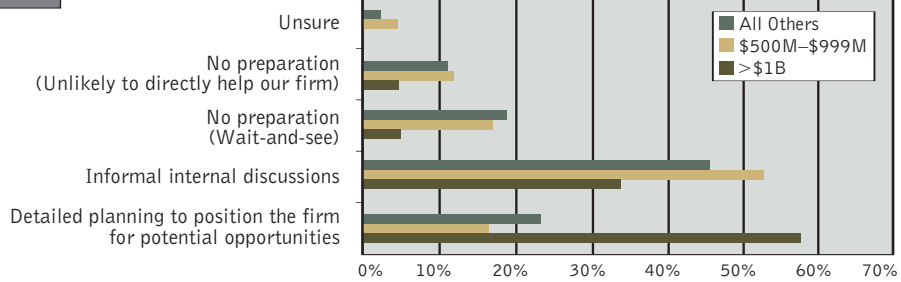
- With all of the initial talk surrounding the federal stimulus bill and the early perception within the industry that it would provide a panacea of opportunity, the survey results surprisingly revealed how few respondents were formally preparing for the release of these funds. It is noteworthy that most firms with annual revenues greater than \$1 billion were conducting detailed planning relative to stimulus funding, while the results among smaller companies were more diverse. Part of the hesitation is likely due to the fact that most firms now recognize the minimal impact the stimulus bill will have on their businesses and that at best, government intervention will only replace lost demand, not stimulate a building boom.

EXHIBIT 8

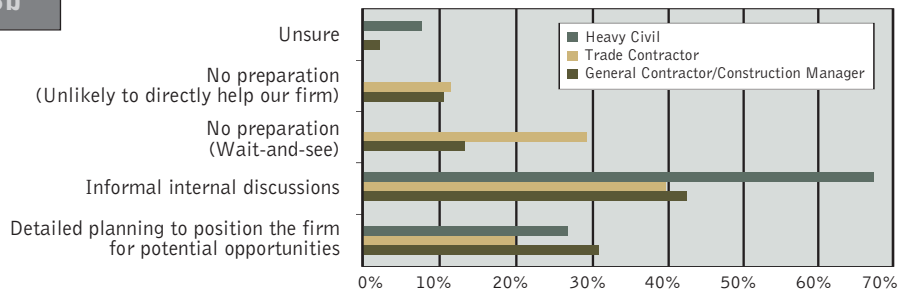
How are you preparing for possible government stimulus measures?



8a



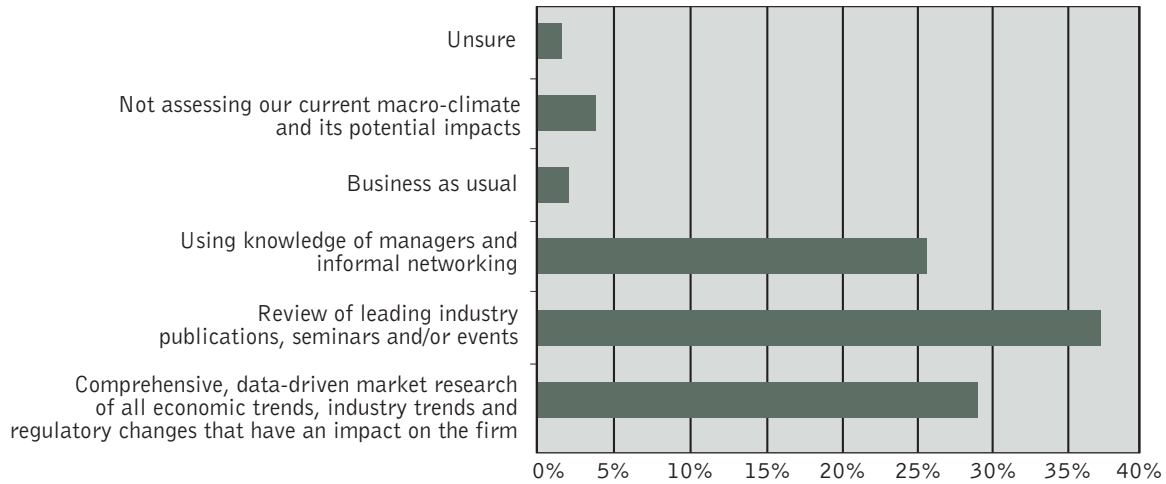
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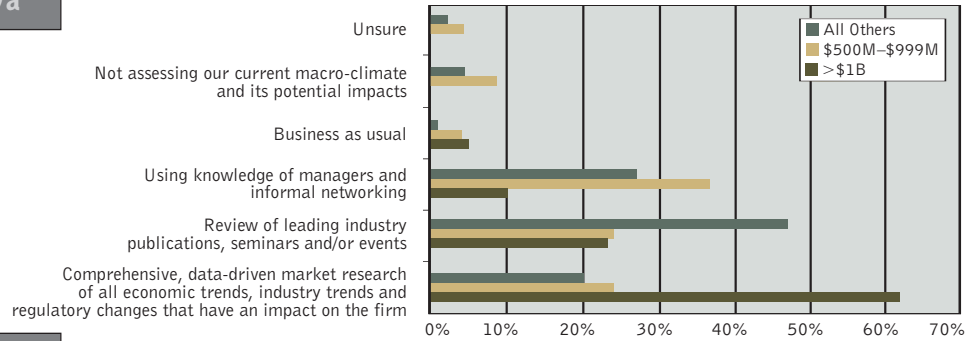
- Executives were also asked about how their firms were evaluating potential economic scenarios and outcomes. In terms of the four major components of the industry context, the analytical depth with which firms are assessing the macro-climate ranks first. Sixty-seven percent of our respondents are formally evaluating the macro-climate via a rigorous process.

EXHIBIT 9

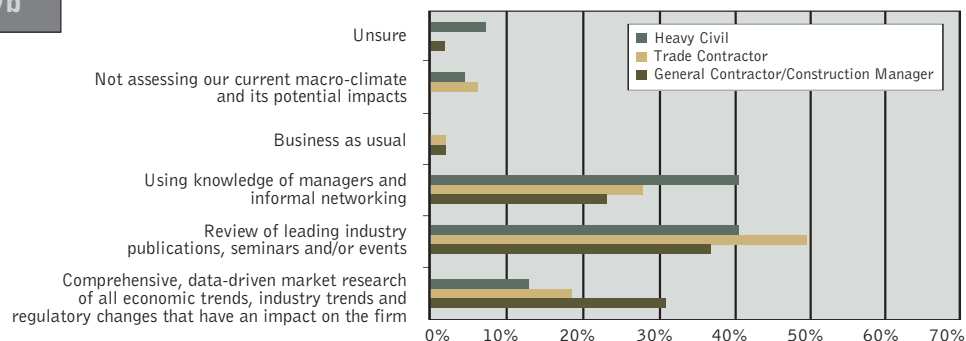
How is your firm evaluating potential economic scenarios and outcomes?



9a



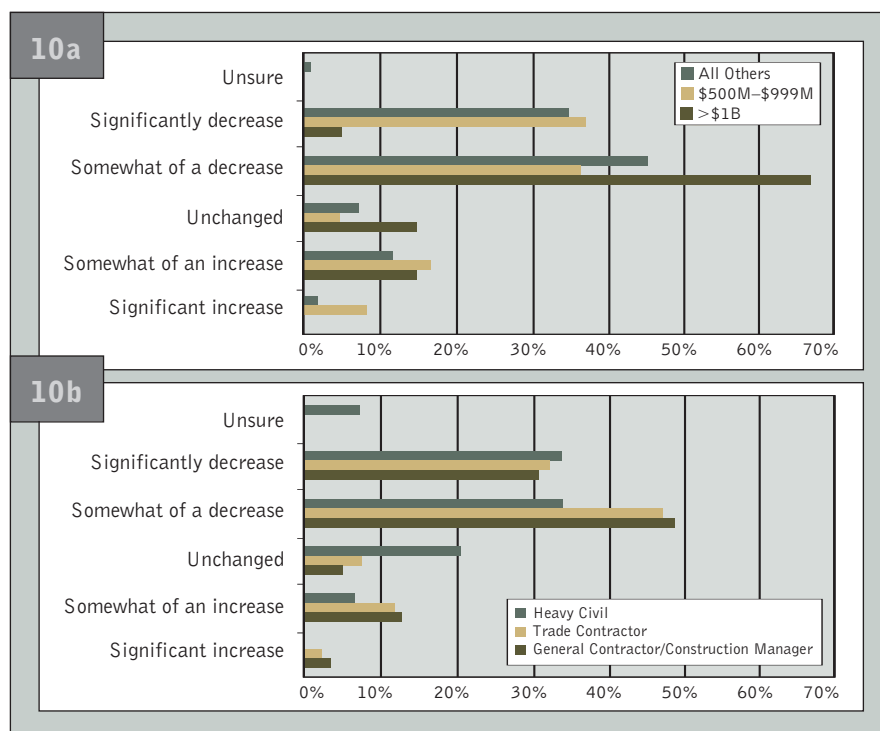
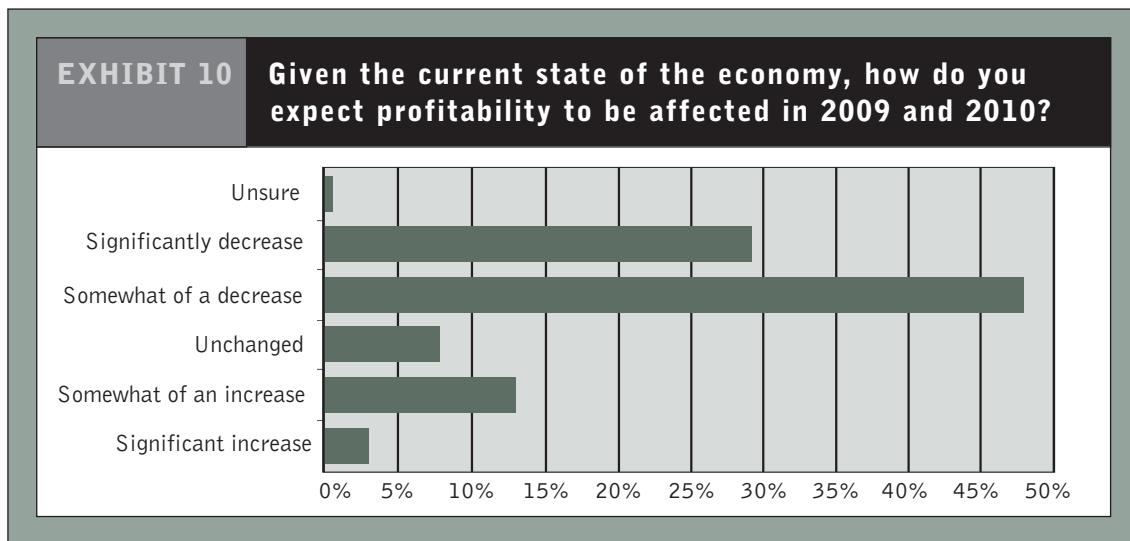
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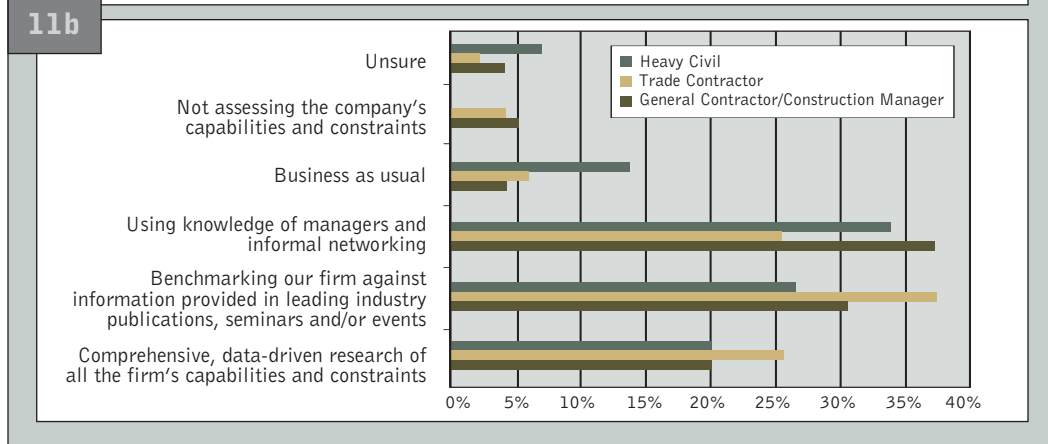
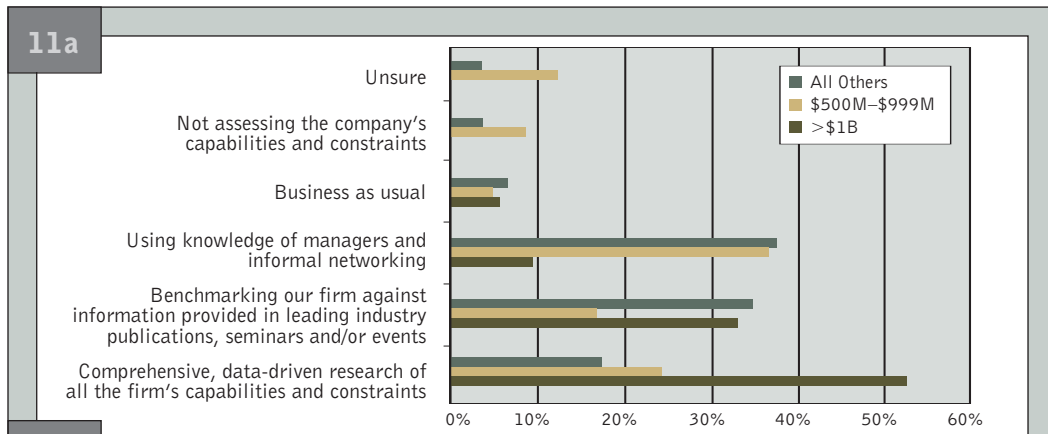
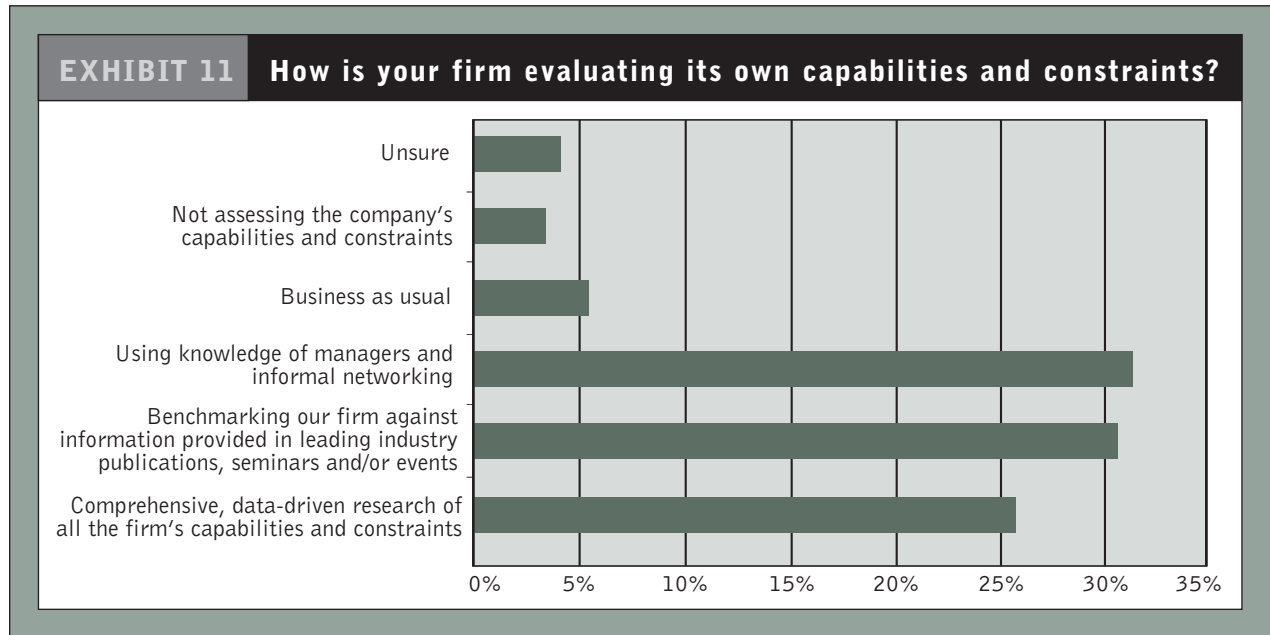
The Company

We invited our participants to answer a series of questions to ascertain what impact they thought the current and anticipated market conditions would have on their companies. Some of the key findings are noted below:

- More than 73 percent of participants anticipate a decrease in the size of their workforce in 2009 and 2010, while only 11 percent anticipate any sort of increase.
- Seventy-four percent have increased their business development efforts in the last six months.
- Fifty-seven percent of firms are only *somewhat* confident in their strategy, while 10 percent are experiencing a deeper lack of confidence.
- Another ominous, and unfortunately unsurprising, signal that our respondents provided was the anticipated impact of the economic meltdown on their firms' profitability in 2009 and 2010. Seventy-seven percent anticipate a decrease in profitability.



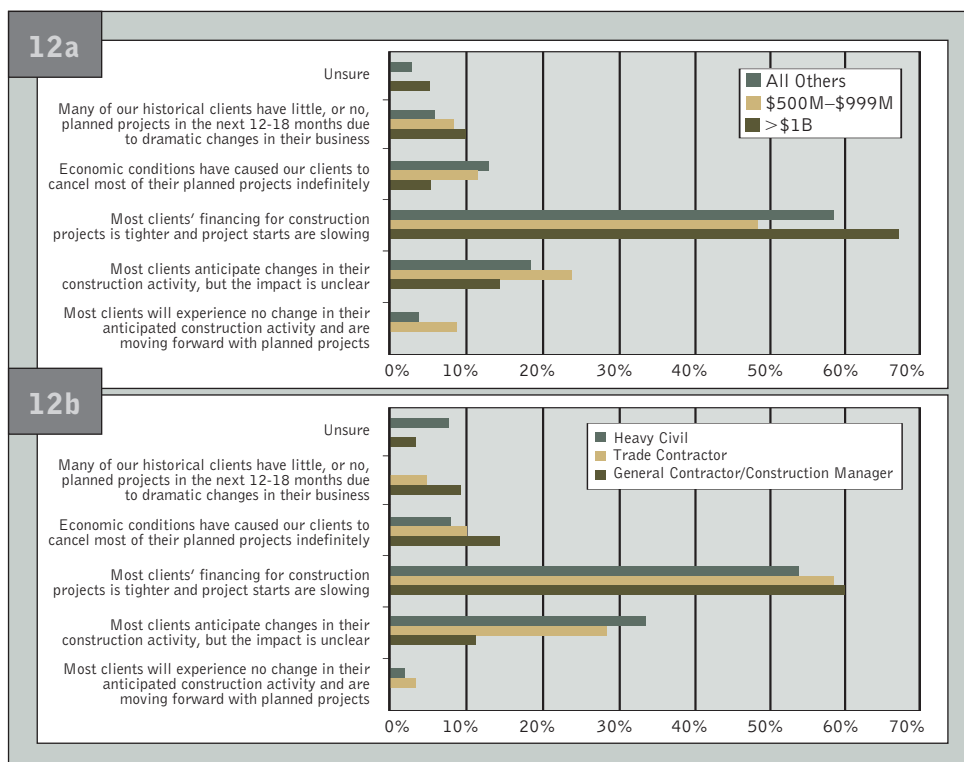
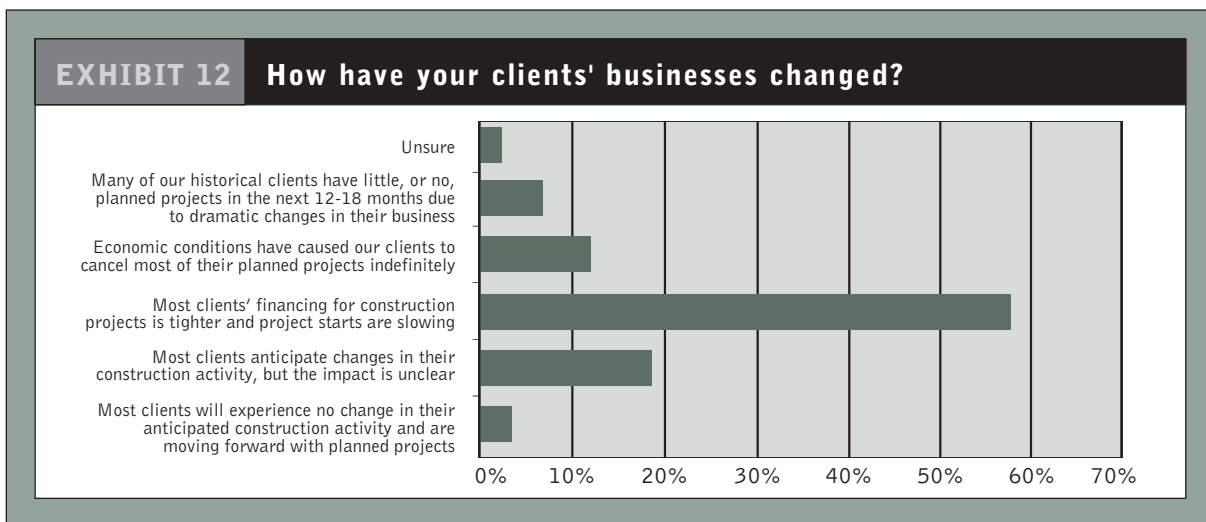
- FMI also asked executives how their firms were evaluating their own internal capabilities and constraints. Only 56 percent of our respondents are formally evaluating their companies via a rigorous process.



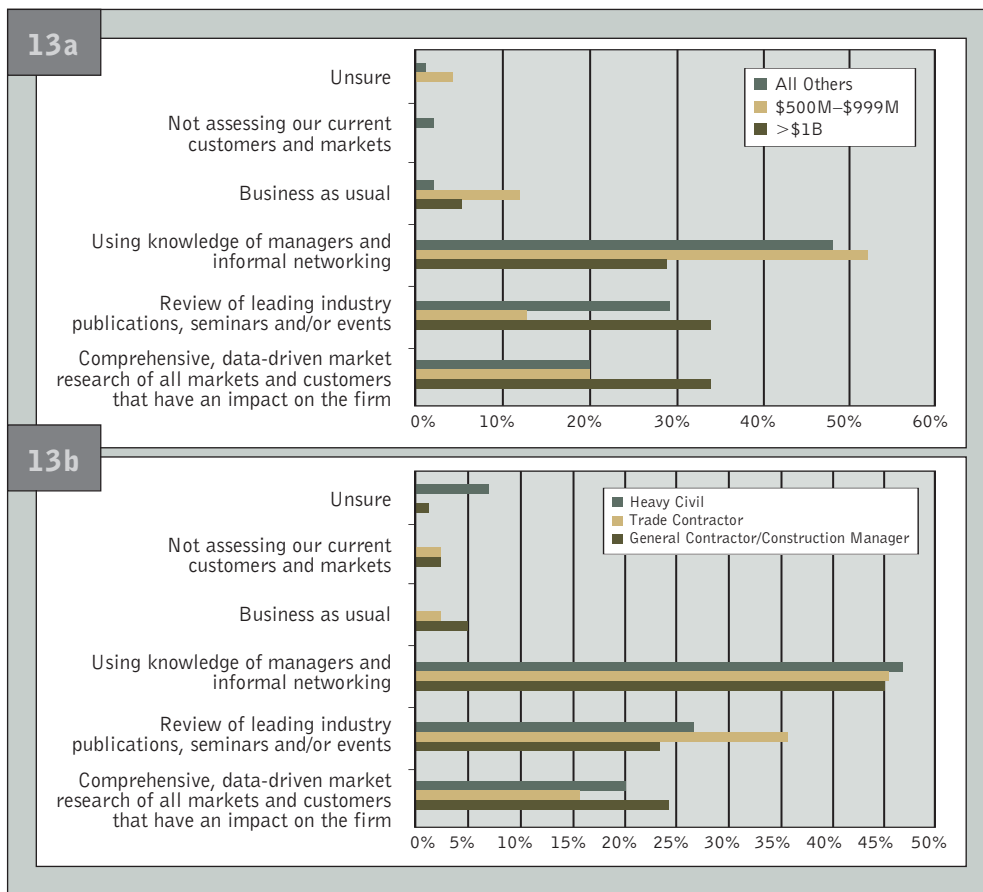
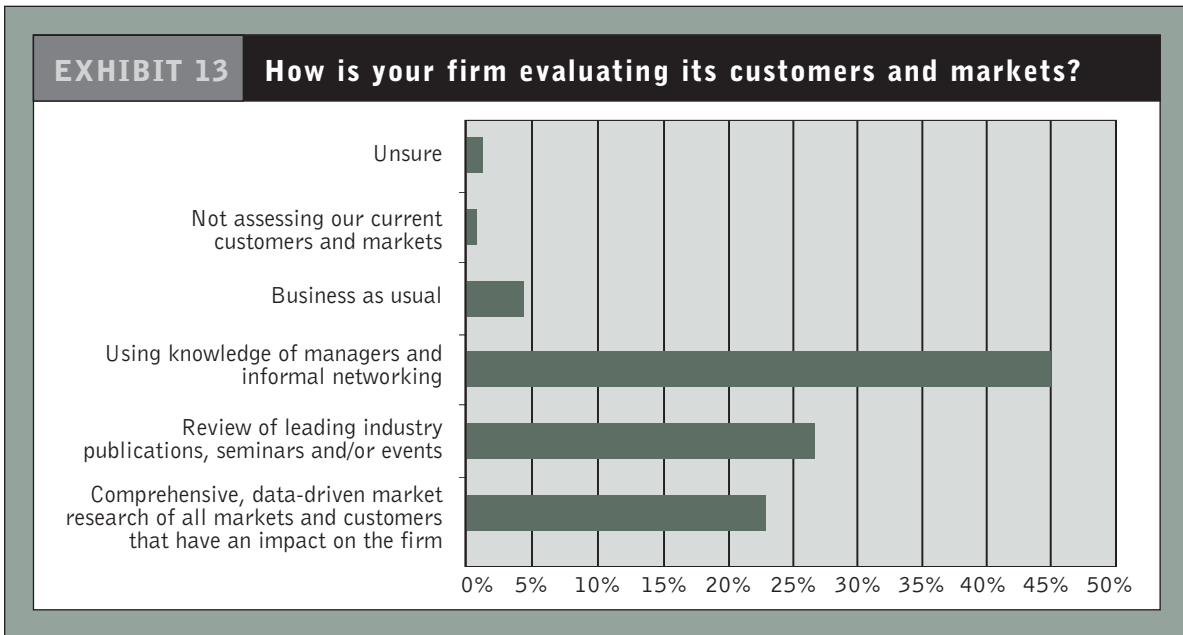
Customers and Markets

In uncertain times, a steady finger on the pulse of key customers and markets is essential for survival and for ensuring future growth. The results of our analysis in this area range from ‘mildly surprising’ to ‘expected’ given the current economic malaise. A few highlights:

- Seventy-one percent of firms indicated that they are still able to sell on value, although it is becoming more challenging.
- When asked about the anticipated impact on their target markets in the next 12-24 months, 67 percent responded that they expected a decline. A brave 20 percent projected *somewhat* of an improvement, but no one stepped out on a limb to forecast a *significant* improvement.
- The question, “How have your clients’ businesses changed?” elicited a variety of responses. While the majority sees their customers’ businesses changing, as evidenced by tighter financing and slowing project starts, only 3 percent feel that their clients will experience little change in anticipated construction activity.



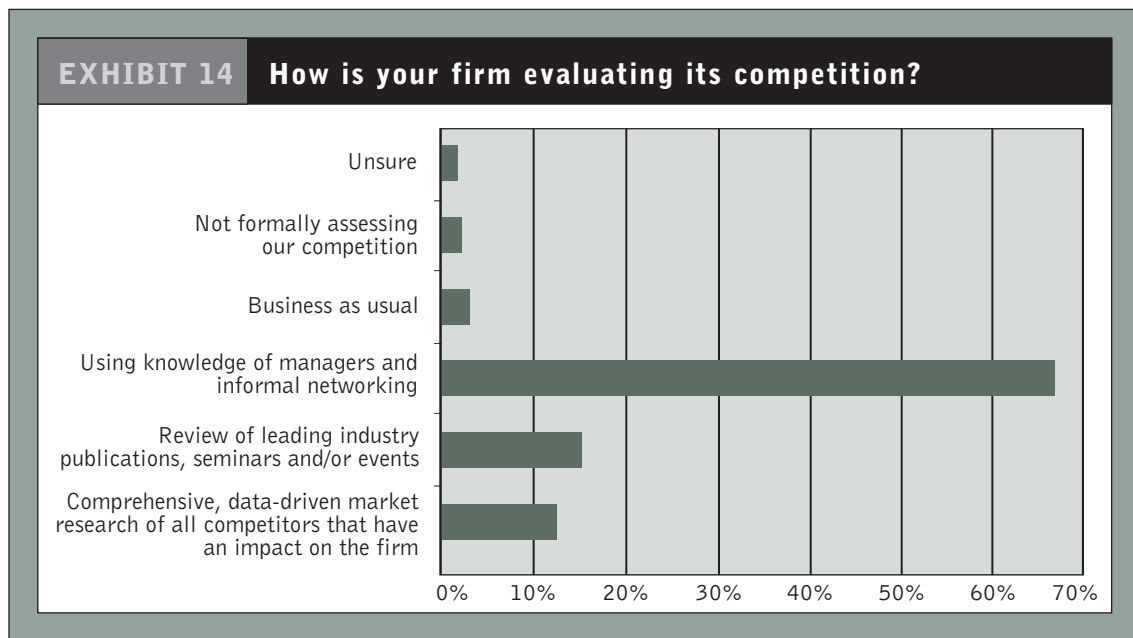
- Survey respondents are evaluating their customers and markets, albeit to differing degrees. While some firms were paying close attention to this aspect of the industry context, it is noteworthy that less than 50 percent are engaged in any type of formal evaluation.



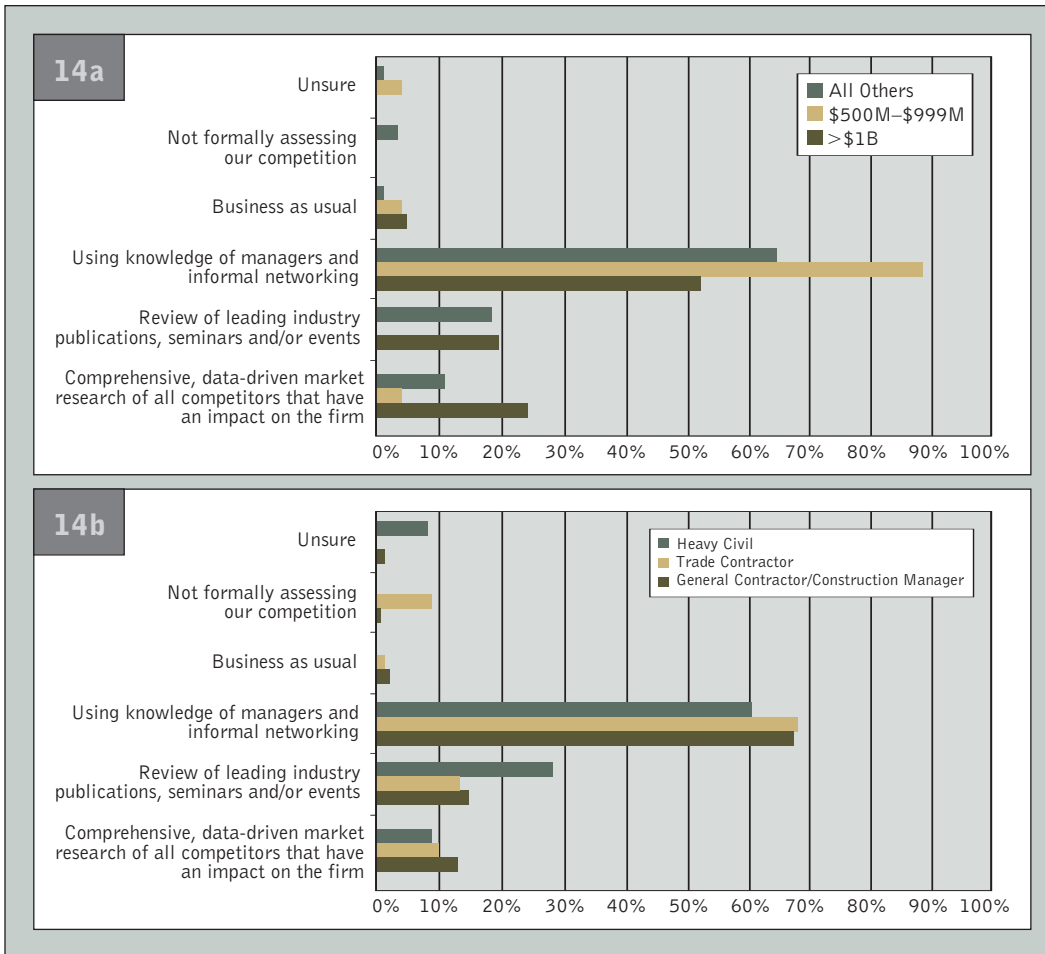
Competitors

Truly knowing your competitors, both current and up-and-comers, remains a vital aspect of strategy development. Information about the competition can often be difficult to obtain, but a proactive assessment and evaluation process prevents firms from being blind-sided and can keep a company abreast of potential gaps, or opportunities, in the marketplace. Some highlights:

- Eighty-four percent cited an increase in competition in their primary markets.
- Lower pricing was identified by more than 80 percent as the competition's primary response to current market conditions.
- Only 30 percent have a detailed understanding of their competitors' strategies and competitive advantages.
- Respondents seem to be assessing their competitors less formally than other areas of the industry context. Only 29 percent of firms are actively evaluating and assessing the competition.



Truly knowing your competitors, both current and up-and-comers, remains a vital aspect of strategy development.



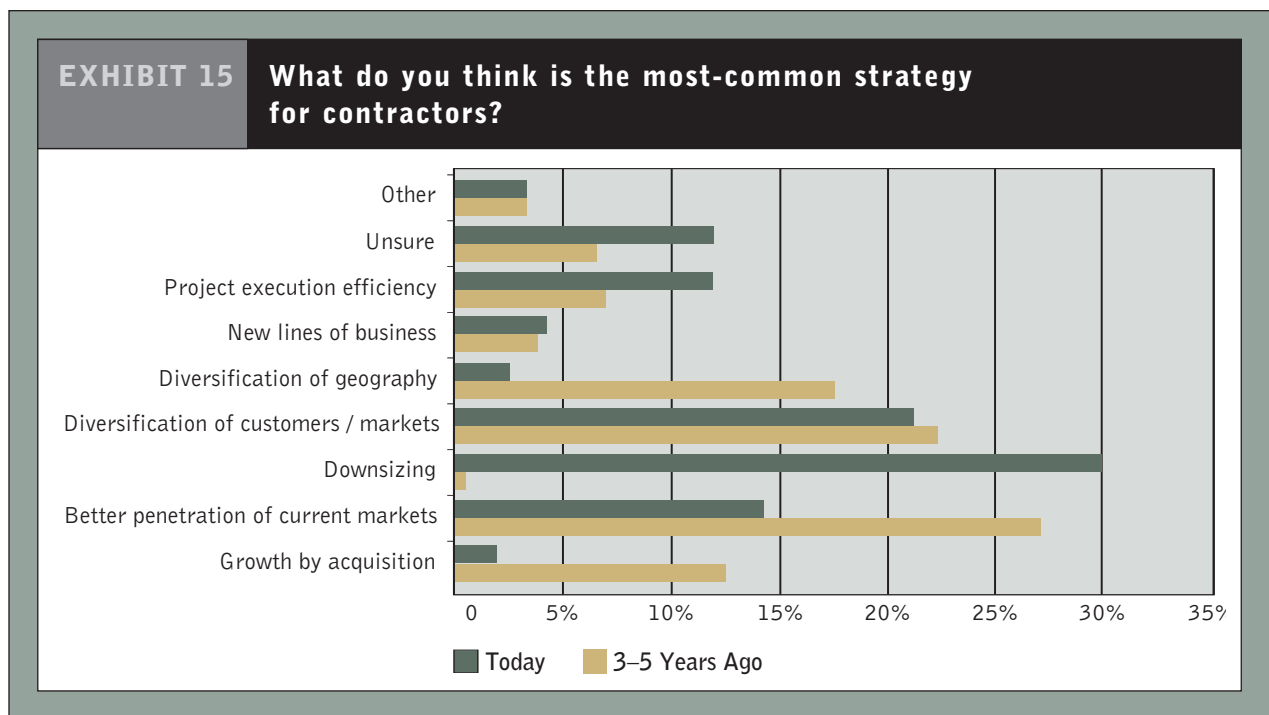
As you can see from the above survey results, having a comprehensive understanding of the industry context is imperative to strategy development. In support of our questions about the context, we also inquired about some primary strategies firms are developing to mitigate uncertainty, respond to competitive pressures and ultimately chart a path toward the future.

PRIMARY STRATEGIES

Beyond the assessment of the industry context, we felt it important to gain an understanding of how our respondents thought about specific industry strategies. We asked a series of questions to understand which common strategies were the most prevalent both now and 3-5 years ago.

We gave executives a few choices and had them pick the single “most-common” strategy for contractors both today and 3-5 years ago. This question was designed to elicit responses about what our participants thought were *general industry strategies* being utilized, not necessarily their own firms’.

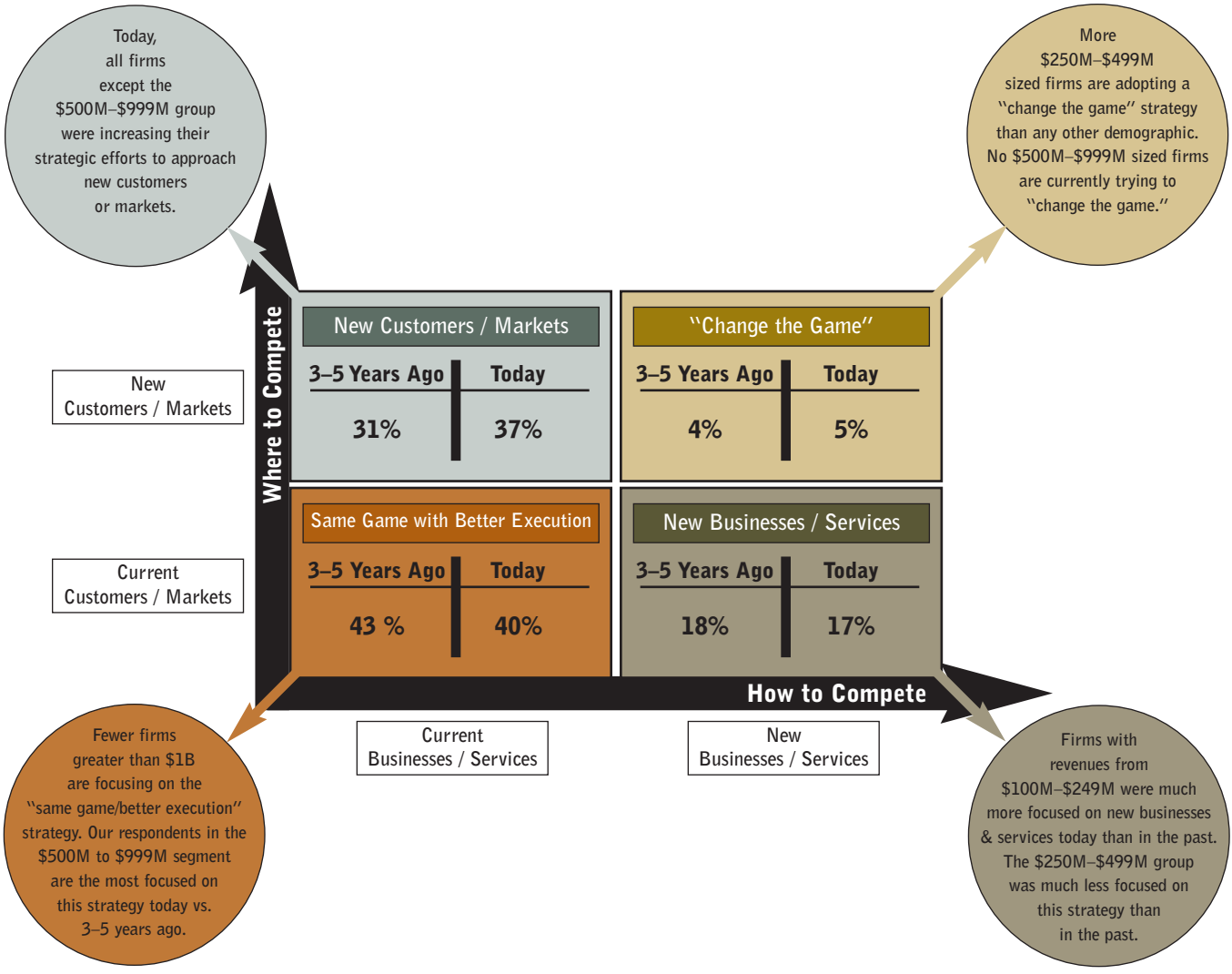
The results revealed that the most-common *prior* strategy was ‘better penetration of current markets’. ‘Geographic and customer/market diversification’ were also common responses. *Today*, our respondents feel that downsizing (more of a tactical response than a strategy) is the most-prevalent strategy while ‘diversification of customers/markets’ and ‘better penetration of current markets’ remain at the top of the list.



The results above are quite consistent with our next line of questioning, which was structured to assess how participants thought of *their own strategy*, both today and 3-5 years ago. The “How to Compete / Where to Compete” matrix is a simple, yet powerful, means by which to assess strategy and strategic options. The results generated in this year’s survey were quite compelling.

The findings revealed that the most-common strategy (past and present) is to remain focused on delivering current services to current customers, an approach we termed ‘same game with better execution.’ Geographic and customer/market diversification were also common, although less prevalent.

EXHIBIT 16 Which best describes your strategy?

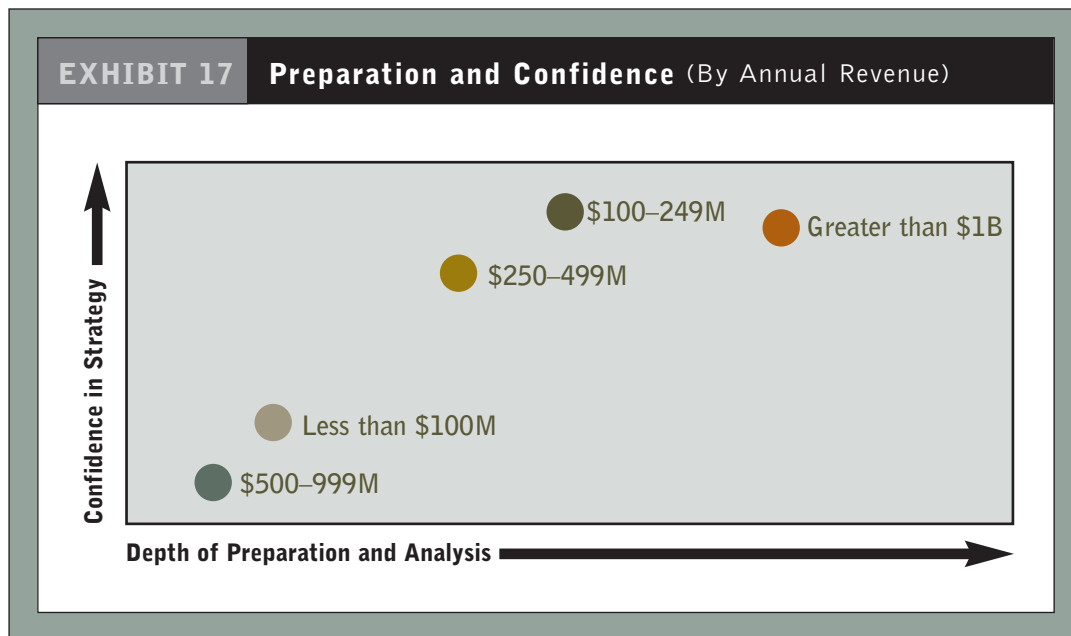


Our readers will note that overall, participants were primarily holding onto the same strategy today as that of the recent past, although subtle shifts are occurring. Fewer companies are engaging in strategies characterized as 'same game with better execution,' while more are branching out into 'new customers and markets.' It is also interesting that a few more firms are looking for that 'game-changing' idea and fewer are looking into starting new businesses or services.

CONCLUDING THOUGHTS

This survey marked the first time that FMI has formally polled the industry's leading firms about their approach to strategy. As we have seen in the above survey results, we can only be certain of uncertainty in the near term. Firms are analyzing their macro-climate, customers and markets, competitors and themselves with varying degrees of rigor. The findings indicate that since most contractors are not deeply assessing all aspects of the industry context in preparation for challenging times ahead, they find themselves holding on to the strategy used during the glory days of the most-recent market expansion.

However, the firms approaching strategy development with the most-detailed analysis and preparation are, not surprisingly, the most confident that they have the right strategy for the current economic environment.



As our readers will note, there appears to be a direct correlation between the depth of preparation and overall confidence in the resultant strategy. For our respondents with annual revenues in the \$500 million – \$999 million range, we were particularly concerned in light of their low confidence in the current strategy, their high degree of anticipated uncertainty (Exhibit 2) and their less-detailed preparation. Based on FMI's 50-plus years in the industry, the hardest-hit firms are usually those stuck in the middle of the market as larger firms increase competition from the top and smaller companies become more aggressive from the bottom.

The final section of this year's survey allowed participants to provide written commentary in response to the question: "How have the events of the last six months changed the way you think about your firm's strategy?" The responses ranged from A to Z, but the undertones contained within varied primarily between opportunistic and concerned, proactive and reactive. Below, we have listed some of the more-revealing comments:

- "Nobody has a clue what the future holds, so we need to be ready for anything."
- "We are looking farther away geographically...with JV firms that are local, substantial and have experienced personnel to contribute."
- "We will also look at strategic growth through acquisition to enter new markets."
- "[Engaged in] Intense visioning and strategy sessions to examine all products and services offered, cost position and customer requirements."
- "I don't think you do anything 'differently' in tough economic times; you simply do 'better' what you should already be doing."
- "I am more concerned with survival than growth."
- "Our strategy is wait-and-see while we continue to invest in training and management succession."
- "Business as usual; 'hoping' things will get better soon."

Unfortunately, as we learned in our previous study of business failures, contractors are not too big to fail (unlike Bear Stearns, Fannie Mae or Freddie Mac). At the same time, many of the successful contractors we surveyed have been in business through many economic cycles and have done more than just survive – they have created cultures and business models that are resilient and sustainable.

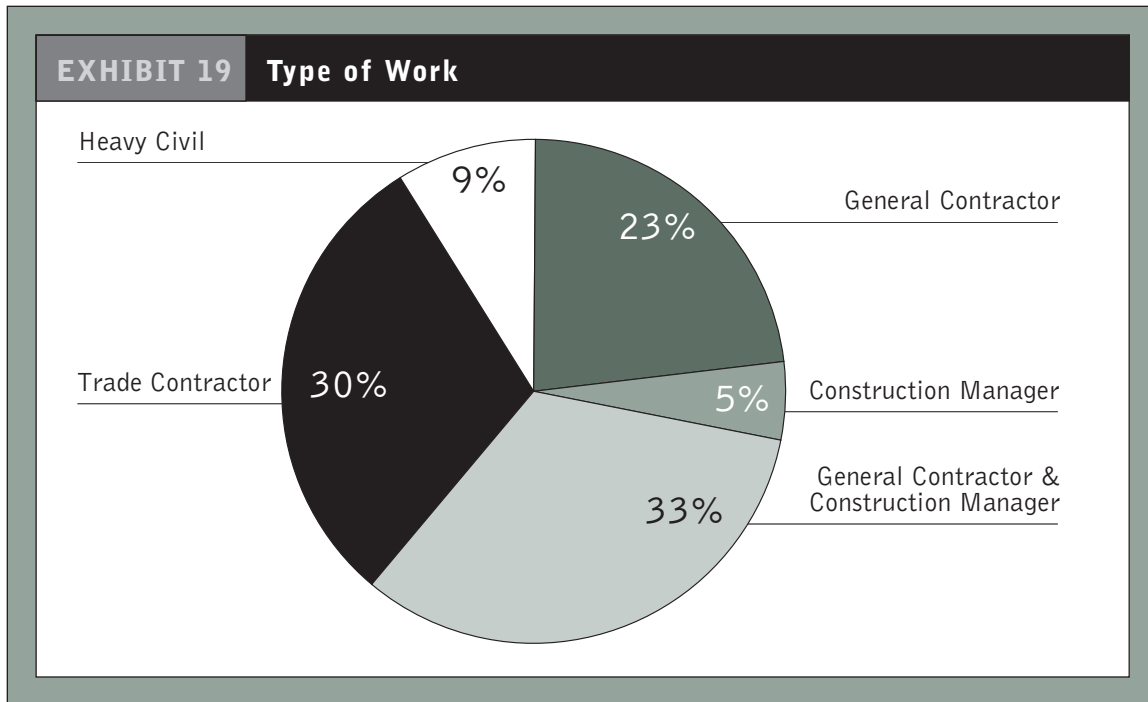
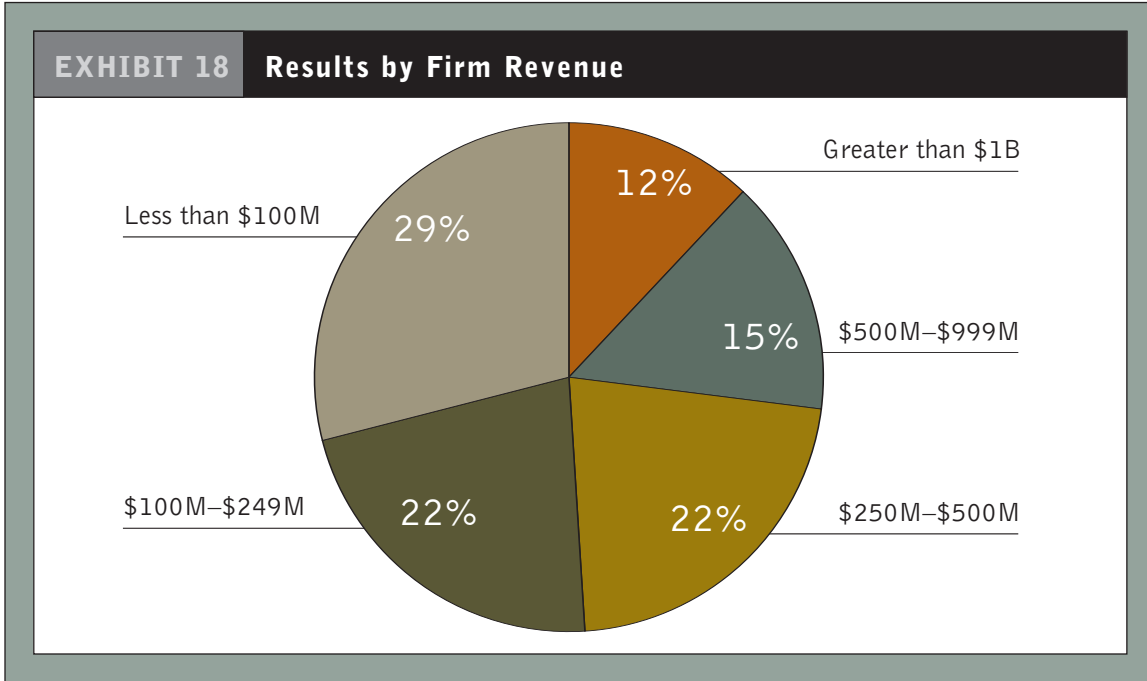
No one can doubt that the construction markets have been severely disrupted by the global financial crisis, but the sky has not fallen. Contractors have made money in the past during similar times of uncertainty. Successful contractors will use this time to refocus the business, examine strategic opportunities and right-size their operations. The latest storm will leave a world of opportunities in its wake, but the next boom is unlikely to mirror the last. There are many possible futures facing the industry, and those firms preparing and adapting their strategies now will be there to win big when the market recovers.

No one can doubt that the construction markets have been severely disrupted by the global financial crisis, but the sky has not fallen. Contractors have made money in the past during similar times of uncertainty.

APPENDIX

Survey Demographics

Our field of 230 survey participants was comprised of some of the most influential executives in the U.S. construction industry.



The survey benefitted from great participation by firms with annual revenues greater than \$250 million and had good representation from large specialty trade contractors.

ABOUT FMI

Founded in 1953 by Dr. Emol A. Fails, FMI provides management consulting and investment banking for the worldwide construction industry.

FMI delivers innovative, customized solutions to facility owners; contractors; construction materials producers; manufacturers and suppliers of building materials and construction equipment; property managers and developers; engineers and architects; surety companies; and industry trade associations.

FMI's experienced professionals assist owners with the development of sourcing strategy, assessing design and construction unit performance and support for management skill development. Services provided to other construction industry businesses include strategy, leader and organizational development, business development, research, mergers and acquisitions, peer groups, private equity placement, project execution, and training.

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