

AFTER A RECORD YEAR IN 2006, C&E FIRMS LOOK TO STAY ON TRACK IN 2007 AND BEYOND

In the annual CEO survey conducted by the Environmental Financial Consulting Group (New York, N.Y.; www.efcg.com), the executives of environmental and infrastructure consulting and engineering (C&E) firms have had a frequent tendency to project 10% growth for the year to come, even when more cautious assessments would project closer to 5% growth—and even when 5% is what the number turns out to be.

For the last couple of years, the outcome has been very different. CEOs surveyed in 2005 projected 9.3% internal growth for 2006, and they came back in late 2006 and adjusted the estimate back to the familiar 10% level (the executives are surveyed in July and August of each year, and year over year, a large number of the same firms are represented). The upward adjustment appeared justified as the robust 2006 market rolled on—and again, their projection proved to be conservative. Looking back on 2006, the executives responding to EFCG's 2007 CEO survey, representing 194 environmental and infrastructure C&E firms, indicated that actual internal growth averaged an impressive 12.9% for 2006.

If 2007 shows any kind of fall-off from 2006, as of the middle of the fourth quarter, it didn't look like it would be very much of a fall. There have been scattered reports to the effect that the credit crunch emerging during the summer of 2007 may have already begun to have an impact on those C&E businesses with skin in the land development and residential/commercial real estate games, but other sectors—oil & gas, electric utility, infrastructure of all kinds—are propping up the business nicely. "It's been a great year," noted EFCG President Paul Zofnass during EFCG's annual CEO Conference in New York City in October. "An unbelievably great year."

The C&E sector is healthy, and it looks like outside parties of some import—notably Wall Street—are taking notice. Perhaps the most striking pieces of data from EFCG's 2007 CEO conference hosted by Zofnass are those reflecting the valuations of C&E firms. For the 22 firms in EFCG's index of public companies, for example, the average price to earnings (P/E) ratio is in the neigh-

borhood of 27-28X, a 60% premium over the S&P 500's 17X. Valuations have increased by a factor of five over the past five years, and the market capitalization of EFCG index firms increased by an eye-popping \$50 billion, or 170%, during 2007 through September 30. Compare that with a \$20 billion increase in value from 2003 through 2006. The period of increase coincides with a period of revenue and profit growth as illustrated in Zofnass' 'happines quotient' chart, but 2007 looks likely to be remembered for both its remarkable stock performance and its likely peak in the HQ chart.

PRIVATE EQUITY ON THE PROWL

Just as remarkable as 2007's valuations—and no doubt a related phenomenon—is the elevated interest that private equity has been taking in environmental and infrastructure C&E firms. Nine of the 194 firms represented in EFCG's 2007 survey indicated that at least some of their stock was owned by private equity, but 59 said that they had been approached recently by private-equity interests. One respondent commented wryly that "we're an answering service for private-equity solicitation calls."

Those firms actually considering the influx of private equity identified the access to increased capital and the enhanced ability to finance acquisitions and general growth as key reasons for doing so. Others remarked that the addition of private equity could help facilitate ownership transition—a major issue for C&E firms, especially for the non-public and employee-owned concerns. Still other respondents remarked that it "couldn't hurt to listen."

The overwhelming majority of respondents noted that they are not currently considering private equity, claiming in many cases that they are already well-capitalized, that they have a solid business model in place, and that bank debt is adequate to serve near-term needs. A good number also expressed "culture" concerns, reflecting either a strong desire to remain employee-owned or simply an aversion to outside influence or, rightly or wrongly, to "vulture" capital.

So the C&E industry is riding high and may continue to do so for a while. EFCG's Zofnass believes with some confidence that

this good fortune derives from something more than just good revenue growth and good profitability. Striking a powerful theme at the recent CEO conference, he noted that environmental and infrastructure C&E firms stand at a critical crossroads between unprecedented global economic growth, fueled in no small measure by China, India and other emerging economies, and a rapidly increasing understanding on the part of the public and private "engines" of this growth that continued good fortune must be achieved in the context of significant resource constraints. To achieve these robust growth targets while pursuing "sustainability" agendas and affirming environmental and social goals as part of the corporate brand, the world's industrial companies must turn to their environmental C&E firms for solutions—and the investment community is coming to understand this point very well. "We're entering the decade of the environmental and infrastructure engineering and consulting firm," Zofnass declared.

In post-conference interview with EBJ, Zofnass commented that his reflections had received an overwhelmingly positive response from the CEOs in attendance, and that his own belief in the rising importance of the C&E industry was very much affirmed. "You can't read the newspapers over the last year without thinking that we have real problems, and if anybody is in the pathway of the solutions, it's this industry." CEOs at C&E firms should take a moment to sit back and enjoy this elevated position, then, before the problems of growth, profitability, business development, leadership development and transition, rising costs and professional recruitment and retention intrude.... Okay, break's over.

IT'S WAR OUT THERE

During a panel session at the EFCG conference in October 2007, the CEOs of several large C&E firms commented on the biggest issues that their firms face in today's market and turned first to the so-called "war for talent." Year after year, the challenge of recruiting and retaining professionals is at or near the top of CEO issues, and it's no less true this year. Yet while there's "obviously a shortage" of professionals, observed Robert Uhler, CEO of MWH Global, the situation doesn't amount to a crisis. "The work's getting done, and done more efficiently," he said, adding that no one is calling up his company to say, "I can't get this work done—will you do it?"

Strategic Information for a Changing Industry

Earth Tech CEO Alan Krusi described the war for talent as real and observed that the costs of retention in particular are rising. He was quick to point out, however, that these changes in the landscape are healthy, leading, for one thing, to better selectivity on projects. AECOM CEO John Dionisio observed that his firm spends millions of dollars on recruiters when it should be spending the same amount on engagement with those talented people who are already in the profession. "The key is encouraging people to come into the industry and stay," he stressed. Lee McIntire, president at CH2M HILL, agreed that retention is a big issue and offered that, of 1,000 people lost to the company in any given year, 800 might be "keepers," and "I'd like to keep half of those people."

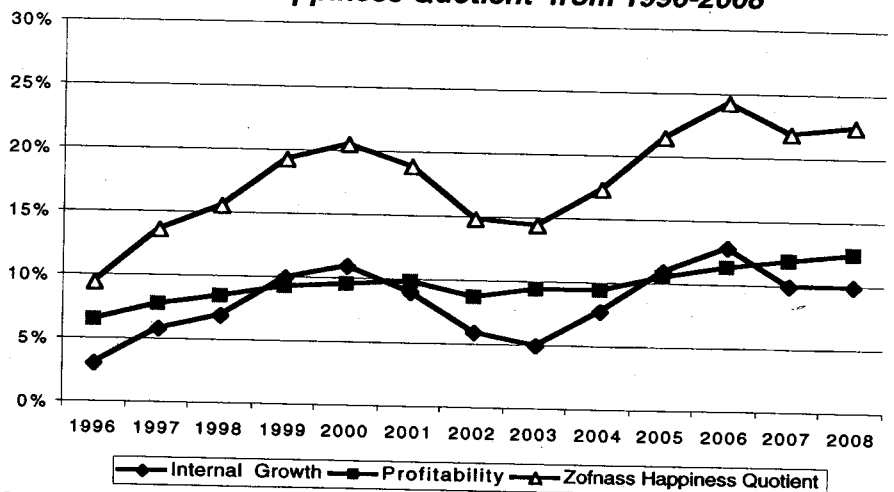
Pilferage and other practices of dubious integrity certainly take place, although incidents of raiding are down, according to Dan Batrack, CEO at Tetra Tech. Firms will see senior-level people hired away for big compensation packages, more often by small firms that are building new practices and are counting on a good number of the senior-level hire's staff to come along. This practice isn't proper, Batrack asserted, and the only winners are the attorneys.

The five executives claimed to have felt little impact from the credit crunch, although MWH's Uhler said that some building permits for municipal water and wastewater facilities are on hold. CH2M HILL's McIntire did warn that this economic slippage was "something to watch," particularly in terms of the impacts on the costs of materials for construction projects. Tetra Tech's Batrack reflected that the credit situation has actually presented opportunity by "washing out" smaller firms that can't access credit.

Asked to comment on the C&E industry's critical and high-profile position at the crossroads of global growth and environmental constraint, Earth Tech's Krusi pointed out that this has been the industry's traditional role, but he affirmed that the technical challenges are certainly greater today. Dan Batrack echoed that perspective, noting that the industry no longer serves in a one-dimensional capacity by simply cleaning up a contaminated site or building a treatment plant. "We have to come up with innovative solutions, in green building, or in zero-discharge operation," he noted by way of example. "We have to be very multidisciplinary."

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EFCG 'Happiness Quotient' from 1996-2008



Source: EFCG annual CEO surveys; profit margin is defined as EBIT/Net Revs or earnings before interest, bonus and taxes; HQ is the sum of profit margin and growth rate; 2007 is estimated as of October 2007 and 2008 is projected.

MWH's Uhler pointed out that climate change is the over-arching theme to this growing awareness of environmental constraints, leading the world's nations to address major infrastructure issues that will draw upon "compassionate funding." AECOM's Dionisio mused that engineers have often been taken for granted, and that perhaps those days are coming to an end. "We make a difference."

ADVANTAGE, PUBLIC FIRMS?

One of the key themes in characterizing the state of the environmental and infrastructure C&E industry today is the rise in aura of the publicly traded firms. This may present something of a puzzle, considering the relative disaffection with the engineering industry that Wall Street held just a few short years ago.

Consider the issue from the perspective of a CEO and owner, or part-owner, of a privately held firm that's interested in selling. That CEO may be no more interested in being acquired by a publicly traded firm than by a private-equity firm, but times have changed. When several C&E and remediation firms—EA Engineering, Science and Technology, Severson Environmental Services, Weston Solutions and GZA GeoEnvironmental among them (EBJ, Vol. XIV, No. 1/2, 2002)—left the public markets through various avenues in the earlier part of the decade, part of the reason was Wall Street's disaffection with the industry. Another reason was perhaps a combination of pragmatism and culture. Internal management meant shedding those quarterly reporting obligations, not having to live up to

the expectations of outside owners (i.e., shareholders), and generally having greater control of one's own destiny.

The cultural perspectives and preferences are still largely in place. "I don't think the culture factor has changed," EFCG's Zofnass told EBJ. "Most employees would probably say they would rather work for private companies, which tend to get the awards for being popular places to work."

The financial picture has turned around, however. As noted earlier, the stocks of public C&E firms are trading at 28X after-tax earnings, or 16X pre-tax earnings, according to Zofnass. With privately held firms valuing themselves at book value or perhaps a little more—in the neighborhood of 2X pre-tax earnings—the public firm has a clear advantage on the merger and acquisition stage.

"It's virtually impossible for a private company to make an acquisition and pay anywhere near the value that public companies can pay," noted Zofnass. Thus, when a potential seller comes to EFCG with a preference for a private company—for culture reasons, etc.—"we have to point out that the public companies can pay substantially more."

Publicly traded C&E firms also appear to have an advantage in terms of financing the cost of growth and the cost of retirement. The faster you grow, the more capital you need to reinvest in your firm, and so the cost of growth can be greater than after-tax profits, Zofnass pointed out. "If operating margins are 10% of revenues, you can't grow at more than 7% per year without borrowing

from a bank," he explained. "Or you have to sell out, or bring in a private-equity investor."

As for the cost of retirement, employees reaching retirement age obviously pull their capital out of the company, and the big question is, where does that capital come from? At private companies, of course, it comes from the company itself, whereas a public company, whose stock is bought and sold on the open market, "doesn't have to finance the retirement of its owners," Zofnass observed. "The private company has to come up with the cash to pay out retirees, and that's a significant number.

"I think these trends will have an impact on the entire industry, in terms of forcing the private companies to be as efficient, or more so, as the public companies," Zofnass concluded. "Everyone will have to be far more efficient and far more focused. If you are a private company and want to stay that way, okay, but recognize what you're up against."

Whether it's a matter of the private firms keeping pace with the public firms, or the public firms keeping up with rapidly growing global economy, all C&E firms must avoid what Zofnass refers to as "dysfunctional decision-making syndrome" (DDS). The label may be new, he affirms; the phenomenon is not. The principal assets of professional services firms like those in C&E are people, and very smart, opinionated people at that, and many voices contribute to the process of setting a firm's direction.

What is new, or why DDS has special urgency now, Zofnass noted, is the dizzying pace of change in today's world. "All firms have to be able to react to changes in the economic and competitive environment faster," he remarked. "Firms without a decision-making culture are going to be at a disadvantage.... Today, change is happening fast, and you have to make a decision without dawdling for a year. And it's difficult for our firms, because they are in partnership mode. They are hamstrung by their own internal decision-making culture. They keep putting off and tabling decisions, and they don't change." Zofnass added that, after he made these remarks at the conference, "It's interesting how many people came up to me after and said, 'boy, you sure know our firm.'"

NO REST IN M&A

With the public firms apparently hold-

ing the above-mentioned advantages, one might expect that they would account for the bulk of the merger and acquisition activity over the past year. Indeed, that's what appears to have happened—and what a flurry of activity that was.

According to respondents' estimates from the 2007 EFCEG survey, when 2007 closes, 71 firms expect to have completed a total of 148 acquisitions. That's up from 60 firms doing 131 deals in 2006, and in fact, both the number of deals and the number of companies doing deals have trended upward at least since 2002, when 28 firms completed 60 acquisitions.

Perhaps no firm was more active than AECOM—and in this firm we have the quintessential example of what the public markets can do for growth. AECOM had initiated an effort to go public several years ago, but could not close the deal. CEO John Dionisio recalled being told by Wall Street

that his firm had a better chance for success by going public as a "management consultant" rather than as an engineering/construction (E/C) firm.

Now, "E/C is okay," he remarked at the EFCEG conference. In May 2007, AECOM netted proceeds of \$472.3 million through an initial public offering (IPO) of more than 40.4-million shares of common stock, priced initially at \$20 per share. In the first half of November 2007, the price was in the low 30s (the high had been \$38.25 in mid-October).

Before and after the IPO, AECOM was wheeling and dealing at a good clip and picking up new operations of some considerable size. In January, the firm bought Hayes, Seay, Mattern & Mattern (HSMM; Roanoke, VA), a multidisciplinary architectural and engineering firm with more than 650 employees at 20-plus offices in the United States. HSMM consists of five oper-

Environmental C&E Firms: Selected Deals of 2007

Month	Buyer	Seller
January	Tetra Tech	Vector Colorado LLC
	AECOM	HSMM
	AECOM (ENSR)	RETEC Group
February	Tetra Tech	Soil Testing Engineers
	HDR	Quest Engineers
March	Mott MacDonald	Euroconsult
	CH2M HILL	Wade & Associates
	Jacobs Engineering	Edwards and Kelcey
April	AECOM	STS Consultants
	HMM	Paragon Engineering
	Tetra Tech	The Delaney Group
May	HDR	Hawaii Pacific Engineers
	GZA GeoEnv'l	Baystate Environmental
	ATC	Lincoln Environmental
June	Kennedy/Jenks	Meurer & Associates
	AECOM (ENSR)	HLA-Envirosciences
	ARCADIS	Alkyon
August	AMEC	AGRARO Consult
	ARCADIS	APS Group Companies
	ENVIRON	Boelter Associates
	AECOM	KMK Consulting
September	ICF International	Energy and Env'l Analysis
	CH2M HILL	VECO
	Tetra Tech	ARD
October	AECOM	Gartner Lee
	ARCADIS	Vectra Group Ltd.*
November	Jacobs Engineering	Carter & Burgess

* Agreement announced

ating units: HSMM Buildings, HSMM Civil & Environmental, HSMM Transportation, Watershed Concepts, and CTM Communications.

AECOM followed quickly with the purchase of **The RETEC Group, Inc.** (Concord, Mass.), a 400-employee environmental consulting and engineering firm with particular strength in remediation engineering and technology. According to Todd Schwendeman, vice president in charge of the remediation business at AECOM's ENSR unit, RETEC delivered added scale and "cutting-edge" technology to ENSR's remediation practice, and in particular technologies for evaluating light nonaqueous phase liquid (LNAPL) mobility and polyaromatic hydrocarbon (PAH) bioavailability in sediments (EBJ, Vol. XX, No. 7/8, 2007).

March brought the addition of **STS Consultants** (Vernon Hills, IL), a 550-person firm specializing in complex foundations, construction services, site development, facilities support and transportation engineering. In June came another addition to the ENSR team—**HLA-Envirosciences** (HLA), an Australian environmental, health and safety consulting and engineering firm that gives ENSR significant added strength in the very hot Australia/New Zealand market.

KMK Consulting Ltd., an Ontario-based firm specializing in water and wastewater engineering, came on board in August, boosting AECOM's presence in the Canadian infrastructure market to more than 1,300 professionals. In late October, AECOM dipped into Canada again, acquiring **Gartner Lee Ltd.** (Markham, Ont.), a 1,600-person environmental science, planning, economics and engineering firm with 16 offices in Canada and an international office Doha, Qatar.

Also engaging in multiple deals were **Jacobs Engineering Group** and **Tetra Tech**, the latter picking up three small U.S. firms and then taking the first step in its new strategic initiative to boost its international business by acquiring **ARD, Inc.** (Burlington, VT), a consulting and technical services firm with a focus on supporting international aid agencies and other government entities. ARD has about 760 employees working at more than 25 global offices and generated about \$65 million in net revenues over the 12 months prior to the acquisition in September.

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In March, Jacobs Engineering acquired **Edwards and Kelcey**, a 61-year-old, New Jersey-based engineering and consulting firm with operations in the East, Midwest, and Southeast and strong revenue and profitability growth over the last several years. In November, Jacobs Engineering announced that it has acquired **Carter & Burgess** (Fort Worth, TX), a 3,200-person architecture, engineering, design and planning firm serving the transportation, water/wastewater, general building and land development markets.

The respondents to the EFCG survey indicated that 2008 would see even more merger and acquisition activity, with 80 firms projecting that they will make upwards of 150 acquisitions. Is this rising deal flow sustainable? Are the incredible valuations of public C&E firms sustainable? In response to the former question, EFCG Principal Andre Avelini noted when he spoke to EBJ in late October that his firm was working on 30 transactions at the time, where normally the number is 10. He pointed out that there are thousands of C&E firms out there. "This pace should be sustainable for the foreseeable future. We don't think we'll run out of firms in 10 years' time."

As for valuations, there's more of a historical, "what goes up must come down" concern, Avelini reflected. "We're starting to see that the private-equity investors, which have been adding fuel to the fire for the last couple of years, are no longer able to pay as much, because of the credit crunch, and they can't borrow at previous levels. So they might be at a disadvantage to the strategic buyers. Like any other market, when you take buying power away, that tilts the balance more towards buyers than sellers." He added that, "on the other hand, if the industry continues to perform, even if valuations come down a bit, there's that valuation arbitrage. You've P/E ratios of 27X after tax, which is probably 16X pre-tax for the EBIT multiple. If you are public and you are trading at 16X EBIT, you can buy at 10X, so you've got some room."

Of course, there are variables—the direction of the overall economy a big one—that make all predictions contingent. Even projections of continued high deal flow should be taken with a note of caution, Avelini stressed. "There are many cogs keeping this activity in place, and if one of those cogs goes away..." As we said, enjoy the good times, but don't become complacent. ■

HAZARDOUS WASTE RECOVERING SLOWLY

Imagine you're a Wall Street analyst covering the hazardous waste management segment of the environmental industry, and you're about to run through your daily update of how the publicly traded companies in this segment did on the market yesterday. Done yet?

It shouldn't have taken you long. The number of hazardous waste management companies whose stock is still trading on the public markets has shrunk considerably over recent years. Today, EBJ tracks four such companies in its hazardous waste management index, and one of those, **Stericycle, Inc.** (Lake Forest, Ill.; www.stericycle.com), is exclusively ensconced as the big dog in the medical waste management sector, while the other, **Perma-Fix Environmental Services, Inc.** (Atlanta, Ga.; www.perma-fix.com), is exiting the industrial waste business and is focusing on radioactive waste management and related nuclear services.

Take a look at the other two public companies—**Clean Harbors, Inc.** (Norwell, Mass.) and **American Ecology, Inc.** (Boise, Id.)—and you'd think hazardous waste management was the modern version of finding the golden fleece. For the third quarter of 2007, Clean Harbors reported another in an impressive series of quarterly financial results, adding again to top-line growth while recording solid profitability. Meanwhile, American Ecology recorded a whopping 47% increase in revenues during 2006 compared with the previous year, and that pace of growth has continued into 2007, with third-quarter revenues up 44% over the same quarter of 2006.

In fact, although the \$9-billion hazardous waste management industry is not growing at the pace of other environmental industry segments, its commercial industrial waster subsegment is not doing all that badly compared with its own recent history. There has been better balance between existing capacity and demand over the past couple of years, and diversification into new business lines has provided innovators with ways to prosper in a challenging market.

One indicator of what appears to be an ongoing turnaround in the hazardous waste management sector is the renewed attention being directed towards the industry by investors. Indeed, if you are a Wall Street ana-