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VALUATION observations

What is the Value of Your AEC Firm? Make Sure to Nail Down These Points

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Many architectural, engineering and construction ("AEC") firms will have the need to transition ownership in the next decade. Oftentimes, these firms are led by baby boomers who have succession planning needs, a desire to transfer the business to their children, or perhaps no longer have the stomach for the ups and downs of the industry. Due to these factors, we have seen a surge in requests for valuations of AEC firms in recent years. The following are industry-specific factors that we pay special attention to when valuing AEC firms.

Consider the cyclicality of the industry.
By their very nature, AEC firms operate in a cyclical industry. It is not uncommon to see AEC firms enjoy high profits during strong economic periods and struggle to meet payroll during weaker economic periods. In our experience, management's projections are often too optimistic in the good times and too pessimistic in the bad times. Projections should have a long-term perspective and not get too "caught up in the moment". Likewise, valuations should be based on the firm's "normal" level of performance, so as to account for all stages of the economic cycle.

What is the firm's mix of public vs. private work?
The AEC firm's mix of public vs. private work can influence the firm's volatility of performance. During downturns, most AEC firms will suffer, but those with a higher mix of public work will often take less of a hit than their counterparts who focus on private work. Even during the "Great Recession" when private work nearly came to a halt, most levels of government (i.e., public works) continued to spend as part of stimulus funding. As such, having a mix of public work often decreases a firm's risk through decreased volatility.

Does the firm have any recurring work or are all projects won "bid" basis?
Firms that have a higher mix of recurring revenue tend to be less volatile (and therefore more valuable) compared to those firms which have to continually bid for work. For example, we often find that AEC firms providing maintenance or service contracts transact at higher multiples than firms with less stable sources of revenue. As such, an appraiser should analyze what revenue can accurately be considered recurring.

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Does the firm have "key-man" risk?
Many AEC firms are owned by one or two individuals who started the business and are the "glue" that holds the business together. These individuals are often the main contact for clients, are the firm's primary salespeople, and have extensive experience in estimating jobs (which can be essential to profitability). Most firms make efforts to train younger staff in estimating jobs and managing client relationships, but this is not a quick process. As such, firms with deeper management teams are more valuable than their counterparts with one or two key executives.

Is cash required to be held for bonding purposes?
Particularly for those firms that do public work, bonding may be required to prove that the firm has the financial stability to remain solvent throughout the project. Bonding typically requires the firm to maintain certain levels of equity or working capital. Therefore, while a firm may have significant cash on its balance sheet, this is often an asset that must stay in the business and is not available for distribution. Oftentimes, valuators view cash as an "excess asset", but in the case of an AEC firm, the valuation professional must take care to adequately consider bonding requirements.

Does the firm have any pent-up capital expenditure requirements?
It is not uncommon to see management's projections ignore delayed maintenance capital expenditures or growth investments that need to be made. These delayed expenditures represent a future outlay of cash and therefore decrease the value of a firm. Firms that are current on all capital expenditures are more valuable, all else equal.

Has the appraiser considered and appropriately applied normalization adjustments?
Reported earnings often include nonrecurring, non-cash, and other unusual or discretionary items that distort the cash flows that would otherwise be available to the subject firm and its shareholders. These items should be adjusted so that reported results reflect the firm's normalized, ongoing operating performance.

Is the valuation based on <u>future</u> performance potential?
Valuation analysis is a forward-looking exercise, as a prospective investor in a firm will benefit only from the firm's future performance (more specifically, its ability to generate cash flow). Therefore, valuation methods should only utilize historical performance metrics (e.g., latest twelve month or five-year weighted average EBITDA) to the extent that those metrics reflect future performance potential. Take for example if an AEC firm generated $20 million of EBITDA in one year due to a large one-time project, but $10 million of EBITDA is a more

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"normal" level of EBITDA; basing the valuation on $20 million instead of $10 million would drastically over-value the firm.

Have transaction multiples been sufficiently analyzed?

Transactions involving AEC firms have varied over the years, notably increasing during stronger economic periods and decreasing during weaker economic periods. Additionally, multiples can vary considerably based on the type of firm being valued, the size of the firm, and various other factors. As such, the valuation professional should perform a rigorous review and analysis to determine the appropriate multiples to apply—there is no "one size fits all" multiple that is appropriate for all AEC firms.

GBQ Consulting's business valuation group has significant experience in the valuation of AEC firms, in addition to a robust audit and tax focus in the industry. The authors of this article can be reached using the contact information provided herein.

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Select AEC Valuation Experience

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Commissioning Agents, Inc.

ESOP Consulting and Transaction Advisory for ESOP Formation

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Triad Engineering, Inc.

ESOP Transaction Advisory and Consulting

berardi+

Berardi+Partners, Inc.

Valuation of Equity

CTL ENGINEERING INC.

CTL Engineering, Inc.

ESOP Valuation

BURGESS & NIPLE
Engineers ■ Architects ■ Planners

Burgess & Niple, Inc.

Has acquired

GSWW

GSWW, Inc.

Purchase Price Allocation

Stantec

Stantec
(TSE: STN and NYSE: STN)

Has acquired

R.D. Zande & Associates

R.D. Zande & Associates

Fairness Opinion

BOWEN
RICHARD L. BOWEN + ASSOCIATES, INC.

Richard L. Bowen + Associates, Inc. and Subsidiary

ESOP Valuation

Paul J. Ford and Company

ESOP Valuation

Varo Engineers, Inc.

Varo Engineers, Inc.

Valuation of Equity

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Select AEC Valuation Experience (continued)

R.W. SETTERLIN BUILDING COMPANY

R.W. Setterlin Building Company

Valuation of Equity

Ruscilli CONSTRUCTION CO., INC.

Ruscilli Construction Co., Inc. and Subsidiaries

Valuation of Equity

NICOLOZAKES TRUCKING & CONSTRUCTION, INC.

Nicolozakes Realty Company, LLC

Valuation of Equity

MID-CITY Electric / Technologies

Mid-City Electric Company, Inc.

Valuation of Equity

RESOURCE INTERNATIONAL Rii

Resource International, Inc.

Valuation of Equity

DYNOTEC

Dynotec, Inc.

Valuation of Equity

IGEL Since 1911

George J. Igel & Co., Inc.

Valuation of Equity

BMWC

BMWC Group, Inc.

Valuation of Equity

ACCURATE ELECTRIC CONSTRUCTION

Accurate Electric Construction

ESOP Consulting and Transaction Advisory for ESOP Formation

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GBQ Consulting is a national valuation practice with offices in New York (NY), Philadelphia (PA), Columbus (OH), Cincinnati (OH), and Indianapolis (IN). Our valuation professionals have extensive experience in the valuation of businesses, business interests, and intangible assets of both privately held and publicly traded companies in a broad range of contexts, including:

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