2016 Market Overview

Rusty Sherwood
Position for Growth

Optimize Performance

Build Capacity

Transition Successfully
The Numbers

Trends shaping construction

Leading through both
Macro Conditions: “steady as it goes...for now”

<table>
<thead>
<tr>
<th>Positives</th>
<th>Negatives</th>
</tr>
</thead>
<tbody>
<tr>
<td>▪ For-sale housing demand looking stronger</td>
<td>▪ But housing starts at half of peak levels</td>
</tr>
<tr>
<td>▪ Household formation finally at normal levels</td>
<td>▪ So where’s the wage growth?</td>
</tr>
<tr>
<td>▪ Unemployment at 5.0% and falling</td>
<td>▪ Wasn't overleverage part of our problem?</td>
</tr>
<tr>
<td>▪ US bank loans up</td>
<td>▪ Mismatch between job openings and job seekers</td>
</tr>
<tr>
<td>▪ Despite layoffs, jobless claims really low</td>
<td>▪ But strong dollar hurts manufacturing/trade</td>
</tr>
<tr>
<td>▪ Stimulus from other central banks should help US by stabilizing global growth</td>
<td>▪ However, growth hindered in specific metros</td>
</tr>
<tr>
<td>▪ Low commodity prices broadly positive for US households and businesses</td>
<td>▪ But global economic backdrop too shaky, particularly in Europe and Japan</td>
</tr>
<tr>
<td>▪ Low levels of inflation in US should allow Fed to tighten</td>
<td></td>
</tr>
</tbody>
</table>

**US economic expansion will continue**

**Downside risks remain**
Jobs and Unemployment

Construction Unemployment vs. National Unemployment

Construction added 259,000 jobs over the past year.

Source: U.S. Department of Labor, AGC of America
<table>
<thead>
<tr>
<th></th>
<th>2010</th>
<th>2011</th>
<th>2012</th>
<th>2013</th>
<th>2014</th>
<th>2015-16</th>
</tr>
</thead>
<tbody>
<tr>
<td>Real GDP</td>
<td>2.6</td>
<td>2.5</td>
<td>2.0</td>
<td>2.8</td>
<td>2.4</td>
<td>2.0</td>
</tr>
<tr>
<td>CPI</td>
<td>1.5</td>
<td>3.0</td>
<td>1.7</td>
<td>1.6</td>
<td>1.7</td>
<td>0.4</td>
</tr>
<tr>
<td>Unemployment Rate</td>
<td>10.0</td>
<td>8.5</td>
<td>7.8</td>
<td>6.7</td>
<td>5.8</td>
<td>5.0</td>
</tr>
<tr>
<td>3-mo. Treasury (latest 1/4/16)</td>
<td>0.2</td>
<td>0.1</td>
<td>0.1</td>
<td>0.05</td>
<td>0</td>
<td>0.23</td>
</tr>
<tr>
<td>10-yr. Treasury (latest 1/4/16)</td>
<td>3.8</td>
<td>1.9</td>
<td>1.72</td>
<td>2.68</td>
<td>2.26</td>
<td>2.25</td>
</tr>
<tr>
<td>Housing Starts (mm)</td>
<td>0.76</td>
<td>0.57</td>
<td>0.76</td>
<td>0.91</td>
<td>1.04</td>
<td>1.17</td>
</tr>
<tr>
<td>Oil (U.S. $/Barrel) (latest 1/6/16)</td>
<td>77.6</td>
<td>86.9</td>
<td>89.7</td>
<td>99.7</td>
<td>66.15</td>
<td>34.23</td>
</tr>
</tbody>
</table>
Ten megapolitan areas will have populations of at least 10 million each by 2040.

Source: Metropolitan Institute at Virginia Tech

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“Opportunity will be ample, industry capacity to push it through the pipe as quickly as needed will be the challenge.”
Construction Spending

Construction Put in Place

* FMI Forecast

© 2016 FMI Corporation
Construction Spending

West North Central Region

* FMI Forecast
Total Residential Construction

- We expect solid growth of 10% for 2016 and for 6% to 7% growth through 2019.
- Multifamily construction continues double-digit growth through 2019, according to our forecast.
- Factors impacting residential activity:
  - Foreclosure rates slowing
  - Currently demand outpaces supply
  - Affordability is high
  - Low mortgage rates
  - Changing demographics
  - Low household formation rate
  - Improving job rate
  - Multifamily rents are up; vacancy rates lower
Multifamily Housing Construction

• Construction put in place rose 24% in 2015 and will rise another 11% in 2016 to $70.1 billion.

• Rents rising as population shifts to the city and forgoes homeownership for now.

• Market drivers:
  – Children of baby boomers forming fewer households
  – Immigration
  – Foreclosure trending down
  – Potential homebuyers deferring purchasing decisions
  – Hard to get credit even for highly creditworthy borrowers
  – Vacancies remain around 4.1% with most new capacity being absorbed

© 2016 FMI Corporation

Source: FMI Fourth Quarter Outlook 2015
Lodging Construction

- Our latest forecast expects growth to slow to 17%, after reaching 23% in 2015.

- Baby boomers are the largest group of nonbusiness travelers.

- Room starts are increasing

- Occupancy rates and RevPar are up

- Hotel profits up for six consecutive years (HospitalityNet.com)

- In 2016, PwC expects “RevPAR to grow 5.7 percent, driven by ADR.” (November 12, 2015)

<table>
<thead>
<tr>
<th>West North Central</th>
<th>CPIP 2016</th>
<th>CPIP 2017</th>
</tr>
</thead>
<tbody>
<tr>
<td>$’s billions</td>
<td>1.84</td>
<td>1.99</td>
</tr>
<tr>
<td>% change</td>
<td>8.0%</td>
<td>8.0%</td>
</tr>
</tbody>
</table>

Source: FMI Fourth Quarter Outlook 2015
Office Construction

- Office construction grew 19% in 2015, but the current rate of growth will slow to 9% in 2016 and lower through 2019.

- New office space is being absorbed at a faster rate than existing office space, with rent increases falling back somewhat.

- Continued growth in the technical sector and in larger metropolitan areas like Chicago will keep rents and absorption of new space high.

<table>
<thead>
<tr>
<th>Year</th>
<th>West North Central CPIP 2016</th>
<th>West North Central CPIP 2017</th>
</tr>
</thead>
<tbody>
<tr>
<td>$’s billions</td>
<td>4.7</td>
<td>4.83</td>
</tr>
<tr>
<td>% change</td>
<td>0.0%</td>
<td>3.0%</td>
</tr>
</tbody>
</table>

Source: FMI Fourth Quarter Outlook 2015
• Commercial construction is expected to end 2015 with growth of 7% and edge up to 8% growth for 2016.

• The Internet of Things (IoT) will be increasingly disruptive for commercial business, presenting both opportunities for new businesses and threats to traditional brick and mortar markets.

• Closings of well-known chain stores like Macy’s, Sears, JCPenney and RadioS signal a change in consumer shopping habits as well as an example of traditional brands’ inability to move with the trends.
Healthcare Construction

- Health care construction should end up at $41.2 billion for 2015 and grow to $43.2 billion in 2016.

- Trending toward more ambulatory care centers.

- Trend toward rebuilding existing facilities to use modern hospital design and allow for greater use of technology.

### West North Central CPIP

<table>
<thead>
<tr>
<th></th>
<th>2016</th>
<th>2017</th>
</tr>
</thead>
<tbody>
<tr>
<td>$’s billions</td>
<td>3.59</td>
<td>3.76</td>
</tr>
<tr>
<td>% change</td>
<td>3.0%</td>
<td>5.0%</td>
</tr>
</tbody>
</table>

Source: FMI Fourth Quarter Outlook 2015
Educational Construction

- Education construction is growing again, reaching a respectable growth rate of 6% for 2015 and an expected 5% for 2016.

- New trends include increased green building practices, an emphasis on security considerations and increased federal funding.

- New designs for schools will be more flexible for changing classrooms and greater use of natural light. Expect more use of modular building designs.

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**West North Central CPIP**

<table>
<thead>
<tr>
<th></th>
<th>2016</th>
<th>2017</th>
</tr>
</thead>
<tbody>
<tr>
<td>$’s billions</td>
<td>7.87</td>
<td>8.08</td>
</tr>
<tr>
<td>% change</td>
<td>4.0%</td>
<td>3.0%</td>
</tr>
</tbody>
</table>

Source: FMI Fourth Quarter Outlook 2015
West North Central: Non-Residential Construction Change

- Change from previous year – current dollar basis
- 4th Quarter 2015 Forecast, Based on 3rd Quarter 2015 Actuals

Source: FMI Fourth Quarter Outlook 2015
Transportation Construction

- Transportation construction achieved a solid 9% growth in 2015, and it is expected to match that growth rate for 2016.

- Growth in container ports is recovering from the recession.

- Intermodal transportation will be the focus of new projects.

<table>
<thead>
<tr>
<th>Year</th>
<th>West $'s (Billions)</th>
<th>North $'s (Billions)</th>
<th>Central $'s (Billions)</th>
<th>CPIP $'s (Billions)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2005</td>
<td>24.3</td>
<td>21.0</td>
<td>15.2</td>
<td>10.8</td>
</tr>
<tr>
<td>2006</td>
<td>27.5</td>
<td>24.2</td>
<td>18.0</td>
<td>12.3</td>
</tr>
<tr>
<td>2007</td>
<td>29.5</td>
<td>26.5</td>
<td>20.0</td>
<td>14.3</td>
</tr>
<tr>
<td>2008</td>
<td>31.7</td>
<td>28.5</td>
<td>22.0</td>
<td>16.4</td>
</tr>
<tr>
<td>2009</td>
<td>33.9</td>
<td>30.5</td>
<td>24.0</td>
<td>18.5</td>
</tr>
<tr>
<td>2010</td>
<td>36.1</td>
<td>32.5</td>
<td>26.0</td>
<td>20.6</td>
</tr>
<tr>
<td>2011</td>
<td>38.4</td>
<td>34.5</td>
<td>28.0</td>
<td>22.7</td>
</tr>
<tr>
<td>2012</td>
<td>40.7</td>
<td>36.5</td>
<td>30.0</td>
<td>24.8</td>
</tr>
<tr>
<td>2013</td>
<td>43.0</td>
<td>38.5</td>
<td>32.0</td>
<td>26.9</td>
</tr>
<tr>
<td>2014</td>
<td>45.3</td>
<td>40.5</td>
<td>34.0</td>
<td>29.0</td>
</tr>
<tr>
<td>2015</td>
<td>47.6</td>
<td>42.5</td>
<td>36.0</td>
<td>31.1</td>
</tr>
<tr>
<td>2016</td>
<td>49.9</td>
<td>44.5</td>
<td>38.0</td>
<td>33.2</td>
</tr>
<tr>
<td>2017</td>
<td>52.2</td>
<td>46.5</td>
<td>40.0</td>
<td>35.3</td>
</tr>
</tbody>
</table>

Source: FMI Fourth Quarter Outlook 2015
Manufacturing Construction

- Manufacturing is currently the fastest-growing construction sector at 25% for 2015. However, we expect that rate to simmer in 2016 to 11%.

- The strong dollar may delay more manufacturers from relocating to the U.S. for now.

- Capacity utilization rates were 76.4% of capacity in October 2015, which has been consistent for the year. (Federal Reserve)

- Lower natural gas prices will help manufacturing energy inputs.

### Table: West North Central CPIP 2016 vs. 2017

<table>
<thead>
<tr>
<th></th>
<th>2016</th>
<th>2017</th>
</tr>
</thead>
<tbody>
<tr>
<td>$’s billions</td>
<td>5.88</td>
<td>6.20</td>
</tr>
<tr>
<td>% change</td>
<td>0.0%</td>
<td>5.0%</td>
</tr>
</tbody>
</table>

Source: FMI Fourth Quarter Outlook 2015
Power Construction

- Power construction has slipped 11% in 2015 and is expected to regain 2% of that drop in 2016 to $91.2 billion.

- The power industry is in flux due to changing fuel supplies using more natural gas and less coal as well as variable rates of growth in alternative energy sources like solar and wind.

- Managing distributed generation sources is a growing challenge as more power is generated by solar and wind power and sent back to the power distribution facility.
Even though the passing of the Fixing America's Surface Transportation (FAST) Act for highway and transportation funding for the next five years removes much uncertainty for highway funding, we don’t expect a significant jump in spending over current rates in 2016 through our forecast horizon of 2019.

“About $163 billion is needed annually over a six-year period for highways, bridges and transit systems, yet only about $105 billion is being invested, according to a December report from the American Association of State Highway and Transportation Officials and the American Public Transportation Association.” (finance-commerce.com/2015/04)
Obstacles or Opportunities?:

Industry-shaping trends
2016 Trends in the Construction Industry:
Growth concerns due to talent availability

- Availability of labor at all levels is a major concern
  - Recession
  - Baby boomers
  - Young people entering the industry
  - Slowdown in U.S. immigration

- As a result:
  - Need for leadership development
  - Caution in project selection
  - Diversity

61% believe the lack of skilled labor will impact competitiveness and/or slow ability to grow.
2016 Trends in the Construction Industry:
Production gains happening through accelerated technology, lean process adoption

- Technology impacting the industry:
  - Building Information Modeling (BIM)
  - 3D Laser Scanning Technology

- Additional technological advancements:
  - Drones for surveying
  - 3D printing
  - Smart Transportation Systems (STS)
  - Smart helmets
  - Anti-collision software
  - Transparent solar panels
2016 Trends in the Construction Industry:
Expect more “building manufacturing” through prefabrication

- Use of prefabricated building components on the rise:
  - Higher quality
  - Improved job-site performance
  - Ideal for repetitive sections
  - Architectural style NOT compromised

- Implications:
  - Less skilled labor on jobsites required
  - Changing playing field: who will be contracting the work?
  - Competencies in manufacturing process required
  - Heightened ability to collaborate across trades
## 2016 Trends in the Construction Industry: Disruption Accelerating

<table>
<thead>
<tr>
<th>Trend</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mobile Internet</td>
<td>Increasingly inexpensive and capable mobile computing devices and Internet connectivity.</td>
</tr>
<tr>
<td>Automation of knowledge work</td>
<td>Intelligent software systems that can perform knowledge work tasks involving unstructured commands and subtle judgments.</td>
</tr>
<tr>
<td>The Internet of Things</td>
<td>Networks of low-cost sensors and actuators for data collection, monitoring, decision making, and process optimization.</td>
</tr>
<tr>
<td>Cloud technology</td>
<td>Use of computer hardware and software resources delivered over a network or the Internet, often as a service.</td>
</tr>
<tr>
<td>Advanced robotics</td>
<td>Increasingly capable robots with enhanced senses, dexterity, and intelligence used to automate tasks or augment humans.</td>
</tr>
<tr>
<td>Autonomous and near-autonomous vehicles</td>
<td>Vehicles that can navigate and operate with reduced or no human intervention.</td>
</tr>
</tbody>
</table>

**Source:** McKinsey Global Institute analysis
2016 Trends in the Construction Industry:
Bifurcation and business reinvention continues

Bifurcation:
Convergence underway in design and construction

- Seventeen (17) of the top twenty-five (25) engineering firms are in the contracting business
  - This number will only increase in the coming years
- Growth of design-build and construction management
- Battle for dominance – designers versus contractors
- Designing for productivity and efficiency

Bifurcation:
ENR 400 Share is Growing of Total Construction Put in Place
2016 Trends in the Construction Industry:
Smart Buildings = Green 2.0

- Renewable energy has implications for the construction industry:
  - Opportunities: growth & diversification
  - Consumption

- Renewable energy implementation in the construction industry:
  - Design
  - Materials
  - Updated standards
2016 Trends in the Construction Industry: Leadership succession intensifying

• Majority of senior leaders will be retiring in the next 5 to 8 years
  – Identification of future leaders and owners typically requires more time than planned
  – Succession planning requires selection and development with the future in mind

• Implications
  – Formalizing management succession and building leaders for the future is the number one long-term priority for current leaders
  – Lack of bench strength will undermine near term performance and long-term valuations
And, if the pace of change wasn’t enough, we’re now operating in a VUCA world

Volatile
Uncertain
Complex
Ambiguous

Global is now your backyard
If the rate of change on the outside exceeds the rate of change on the inside, the end is near.

Jack Welch
How the leading leaders will be leading
Strategic leaders

finding balance between long-term foundations & short-term performance gains

Success = V(ision) * T(alent) * Culture
Strategic leaders

finding balance between long-term foundations & short-term performance gains

Success = \text{V(ision)} \times \text{T(alent)} \times \text{Culture}
Strategic leaders are clear on their **why**

The Golden Circle

By

Simon Sinek

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But why?
Strategic leaders are clarifying vision, and diversifying

© FMI’s Center for Strategic Leadership
Strategic leaders

finding balance between long-term foundations & short-term performance gains

Success = V(ision) * T(alent) * Culture
“People are our greatest asset.”

“Are we truly living this out?”
If people are truly our greatest asset, we are...

Building 3G succession plans

Building competencies

Recruiting the BEST who align

Developing “HI-POs”
By 2030, Millennials will out number Boomers by 22 million.
Talent essential... agile problem solvers

Think Strategically

- Decision Making
- Mental Flexibility
- Intellectual Curiosity
- Creativity
- Personal Values and Attitudes
- Intuition
- Information Gathering
- Analysis
- Systems Thinking

World View
Talent essential... high-trust collaborators
Strategic leaders

finding balance between long-term foundations & short-term performance gains

Success = V(ision) * T(alent) * Culture
“Culture eats strategy for breakfast.”

- P. Drucker
“The way we do things around here.”
Construction culture for the times...

Discipline

+ Adaptability

Performance
Construction culture for the times

Discipline + Adaptability

New Markets

Process
Key Takeaways...

- **Recovery** holding
- **Portfolio** construction is key
- **Demographic** trends and locational shifts are keys to hedging risk
- **Trends** are creating opportunities or obstacles depending on understanding and ability to adapt
- **Strategic Leaders** focus on creating profitable growth through clear vision, building a strategic thinking organization, retaining top talent and encouraging adaptability
About FMI

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• Strategy Development
• Market Research and Business Development
• Leadership and Talent Development
• Project and Process Improvement
• Mergers, Acquisitions and Financial Consulting

Founded by Dr. Emol A. Fails in 1953, FMI has professionals in offices across the U.S. FMI delivers innovative, customized solutions to contractors; construction materials producers; manufacturers and suppliers of building materials and equipment; owners and developers; engineers and architects; utilities; and construction industry trade associations. FMI is an advisor you can count on to build and maintain a successful business, from your leadership to your site managers.

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