

# UHY LLP ANNUAL CONSTRUCTION UPDATE

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**THURSDAY** September 29



An independent member of UHY International



*The next level  
of service*

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***Turbulent Times: “Building” business success in the face of economic challenge***

John A. Moore, PhD, CPA  
Professor and Department Chair: Finance & Economics  
Walsh College

## SOME BACKGROUND ON ME ...

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- My career ...
  - Started in public accounting
  - Chief Financial Officer
  - Academic ... doctorate in economic history
- Worked for ...
  - Taubman
  - R A Demattia
  - Commercial Properties Services
- Lived/worked through ...
  - Stagflation
  - S&L Crisis
  - Panic of 2008



## TODAY'S AGENDA ... FROM A HIGH LEVEL

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What is both the short-term and long-term outlook for the construction (and relatedly, real estate) in The United States (and Michigan)?

Sub question #1: What the heck is going on out there?

Sub question #2: Where are both the threats and opportunities?

## STARTING PREMISE

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- 1. Construction is a “follower” industry ...**
- 2. It reacts to economic and demographic demands ...**

And the ramifications of these facts are that ...

- A. Short-term ... The fortunes of construction and real estate is primarily a function of economic conditions. The industry can be highly cyclical.
- B. Long-term ... It’s all about demographics. Real estate is fixed into place. People, in contrast, are highly mobile.



## THE PLAN ... OUR DETAILED AGENDA FOR TODAY!

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1. Revisit last year's discussion ...
2. An assessment of our current state of affairs
3. Going back to school ...
  - A. Inflation
  - B. Monetary and Fiscal Policy
4. Looking at data
5. Some case studies ...
  - A. 1970s and stagflation
  - B. The S&L Crisis (1991-1992)
6. The Doctor's prognosis

## 1. REVISIT LAST YEAR'S DISCUSSION ... IN 2021

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## LAST YEAR: SOME MICHIGAN THOUGHTS ...

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- Some opportunities ...
  - Office redesigns
  - Distribution
  - Health care
  - Some areas expanding ... Grand Rapids and Traverse City
  
- Some threats
  - National economy is uncertain
  - Interest rates going up ... will slow the economy
  - High national debt ... will slow the economy



## KEY POINTS ...

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- The nature of our industry is cyclical
- Lots of economic uncertainty ... think like your customer!
  - Cost of debt capital going up
  - Cost of construction is going up
  - Growing national debt may crowd out the private sector
- Yet, some reason for optimism
  - Above issues will likely stabilize
  - Long-term GDP trend remains operative
  - Changing life/work patterns will give rise to construction activities
  - Corporate and private America not overleveraged

## CONCLUSIONS

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- **Bottom line ...**
  - **Keep an entrepreneurial mindset ...**
  - **But keep powder dry ...**
  - **Don't take on too much leverage!**
- **We've seen it before ...**
  - **Likely a category 2 storm coming in the next 24 to 36 months ... there will be some fall out ...**
  - **This will separate the best firms from the rest ...**

## 2. AN ASSESSMENT OF OUR CURRENT STATE OF AFFAIRS

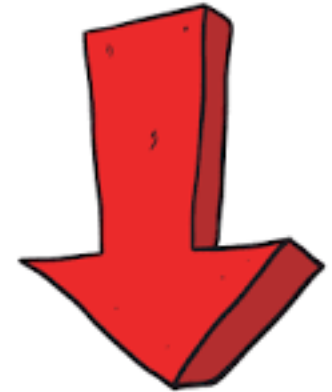
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## HOT OFF THE PRESS!

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- ABC/Washington Post – September 2022
- 74% of Americans believe the economy is not in good shape
- Up from 51% in 2021



## SO ... HOW'S THE ECONOMY GOING?

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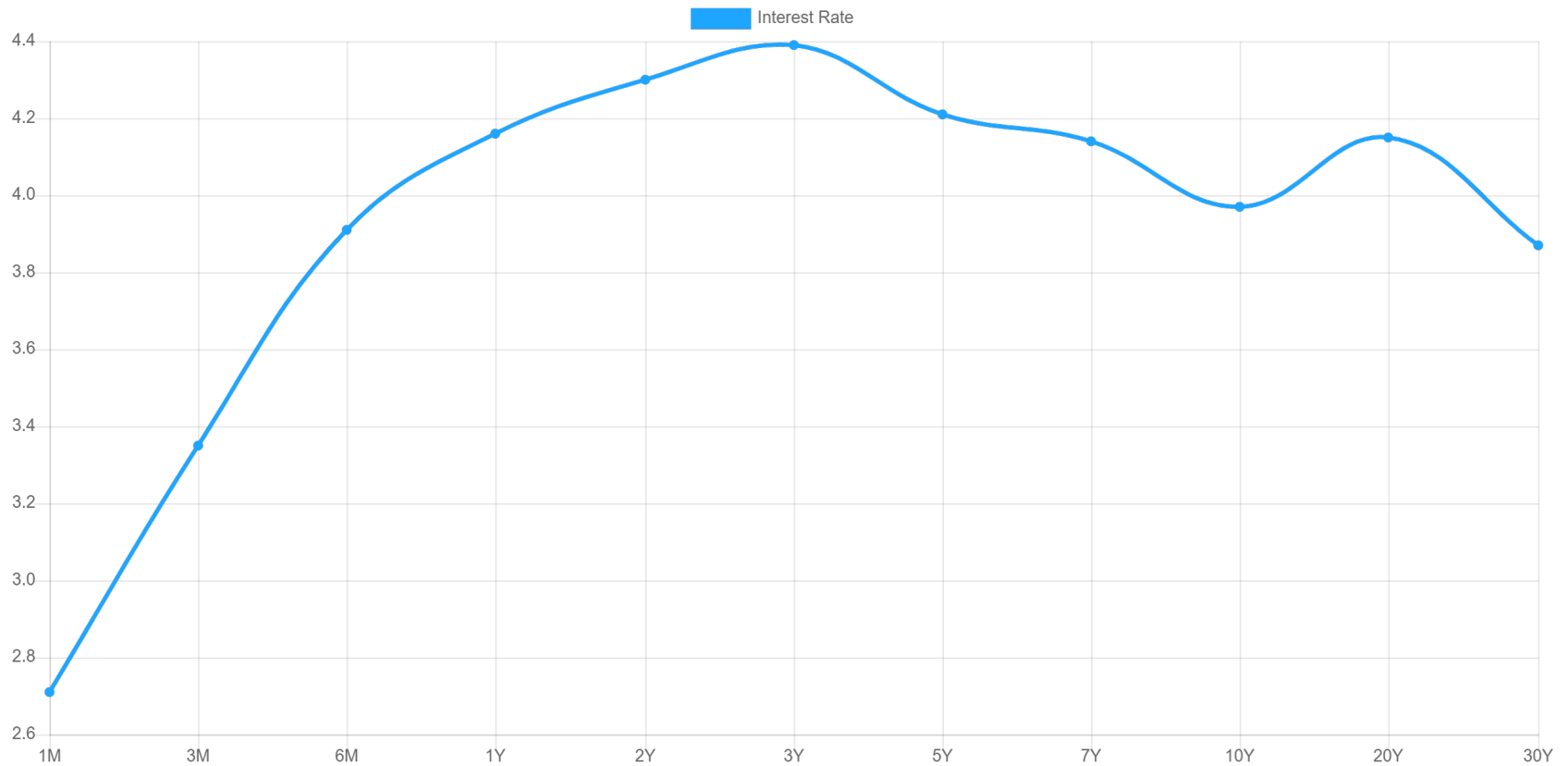
- Production unclear ... maybe a recession?
- Inflation has been persistent for some time now
- Consumers starting to accumulate debt
- Geopolitical considerations
  - Russia/Ukraine
  - China
  - Europe
- Hot political issues ... impacting consumer sentiment ...
- Difficulties finding qualified labor
- Stock market woes ...

## THEORIES OR REALITY?

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- COVID hangover
- Supply chain
- “Transitory”

## THE YIELD CURVE ... SOME WARNING?



### 3. GOING BACK TO SCHOOL!

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## THE MANY VARIABLES OF OUR ECONOMY

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- Growth – real GDP per capita
- National Debt – nominal debt to GDP
- Interest rates – the cost of money
- Inflation – the costs of things
- Money Supply
- Capital Spending – private sector

# INFLATION 101

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## Time Period 1

- Goods produced                    100
- Money                                    50
- **Ratio – cost of a good            0.50**

## Time Period 2

- Goods Produced                    150
- Money                                    100
- **Ratio – cost of a good            0.67**

## GOVERNMENTAL ECONOMIC POLICY

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- Monetary Policy – FED Funds rate
  - Heat up economy ... lower rates
  - Slow down economy ... raise rates
- Fiscal Policy
  - Heat up economy ... spend money
  - Slow down economy ... reduce spending

## RECENT POLICY USES ... SINCE 2000

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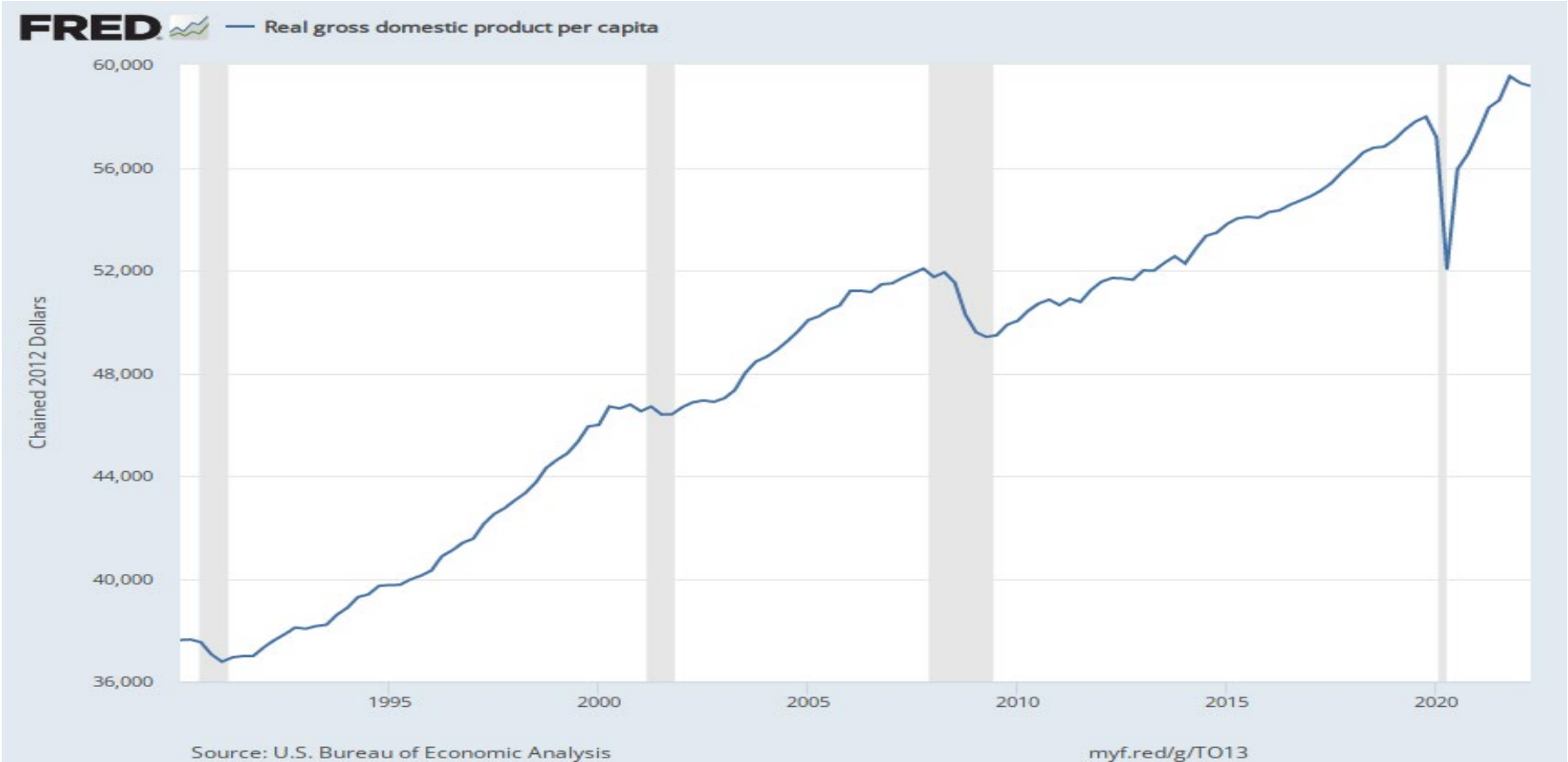
- Monetary policy ... generally a perpetual trend of lowering rates
- Fiscal Policy ... generally a continuous increase in the national debt
- Both policies are expansionary in nature ...

## 4. LET'S LOOK AT THE DATA

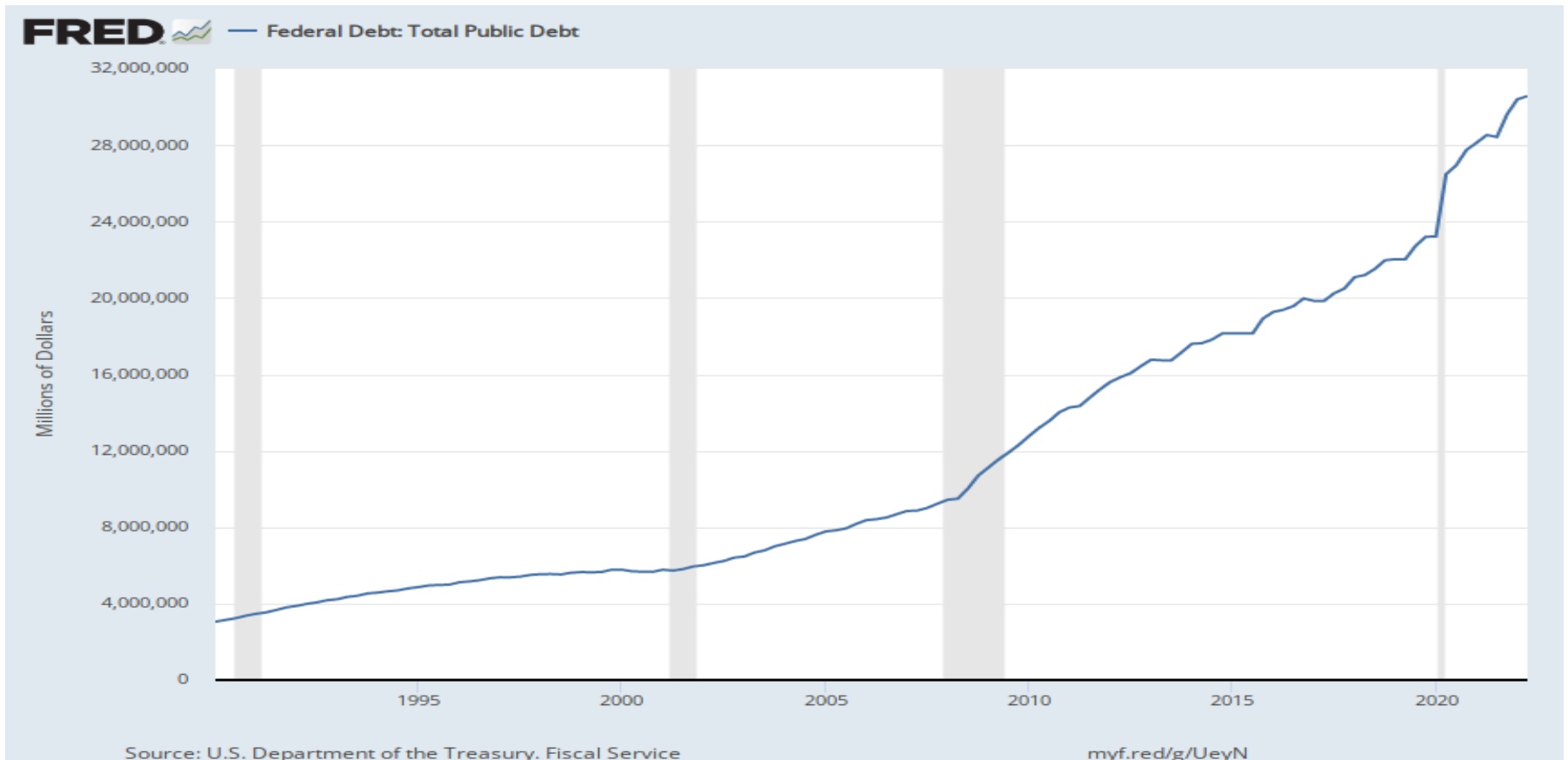
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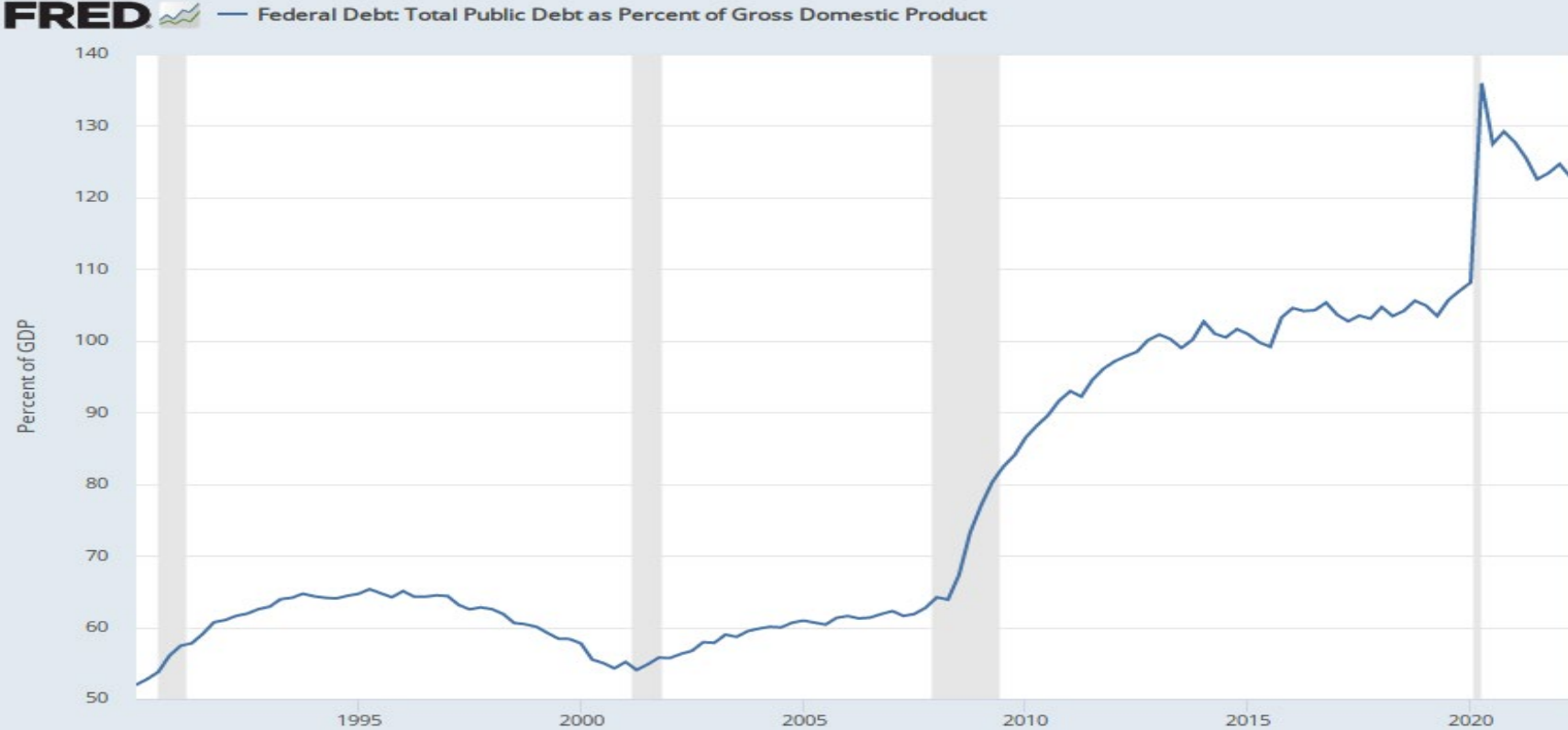
# GROWTH: REAL GDP PER CAPITA – POST WAR ERA



# NATIONAL DEBT: IN NOMINAL DOLLARS



# NATIONAL DEBT: NOMINAL DEBT TO GDP – POST WAR ERA

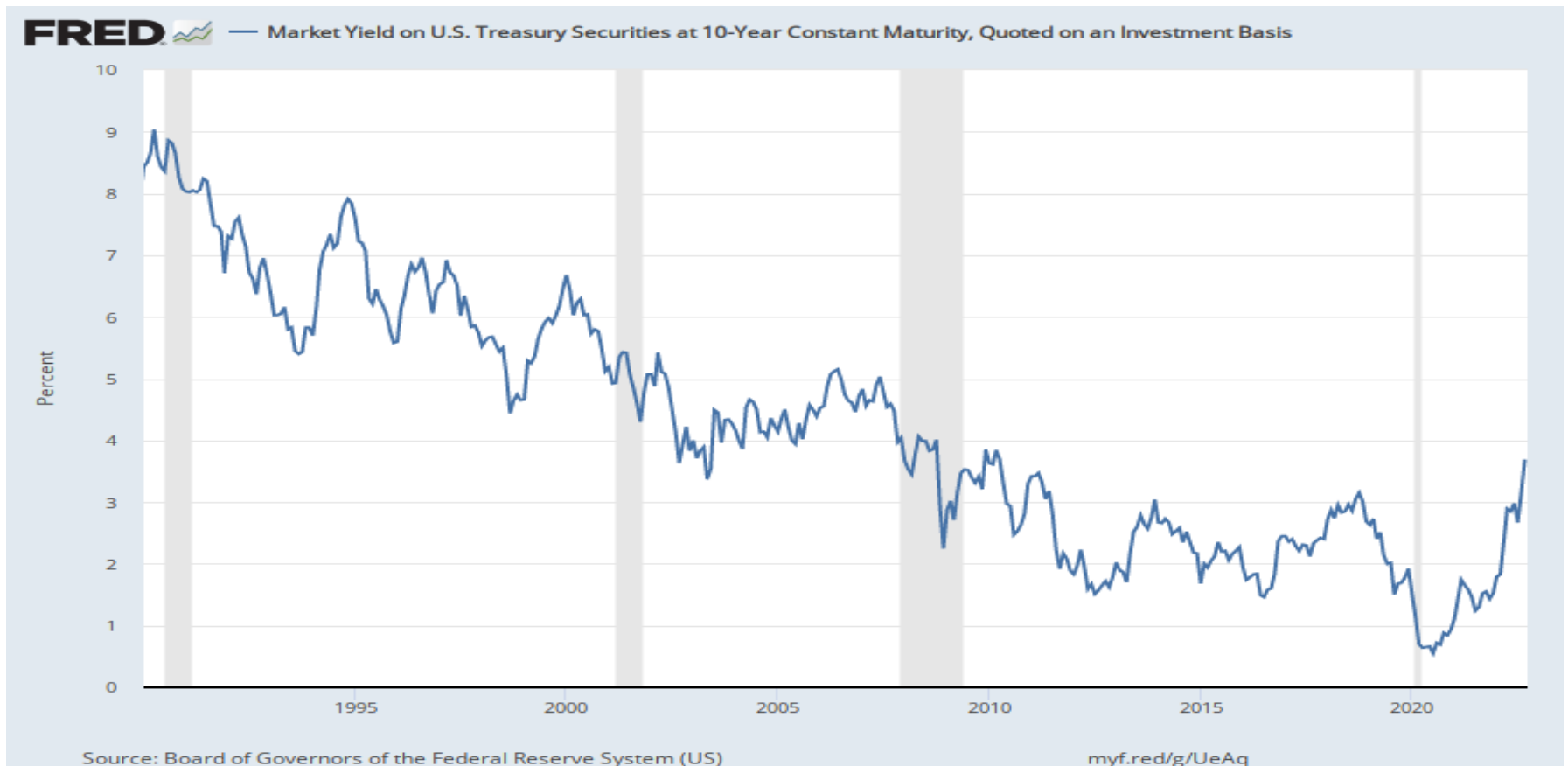


Sources: OMB; St. Louis Fed

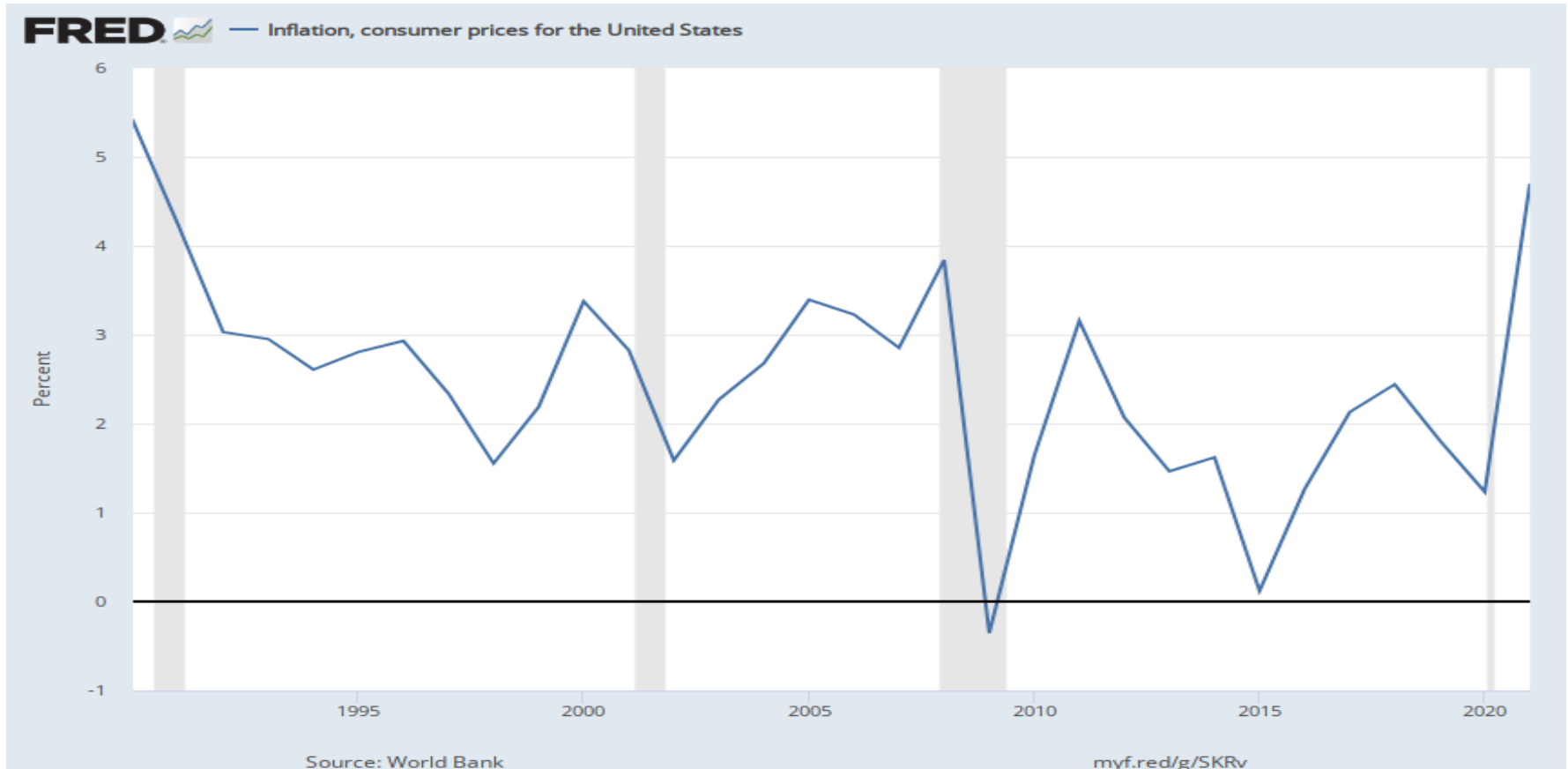
myf.red/g/UezJ



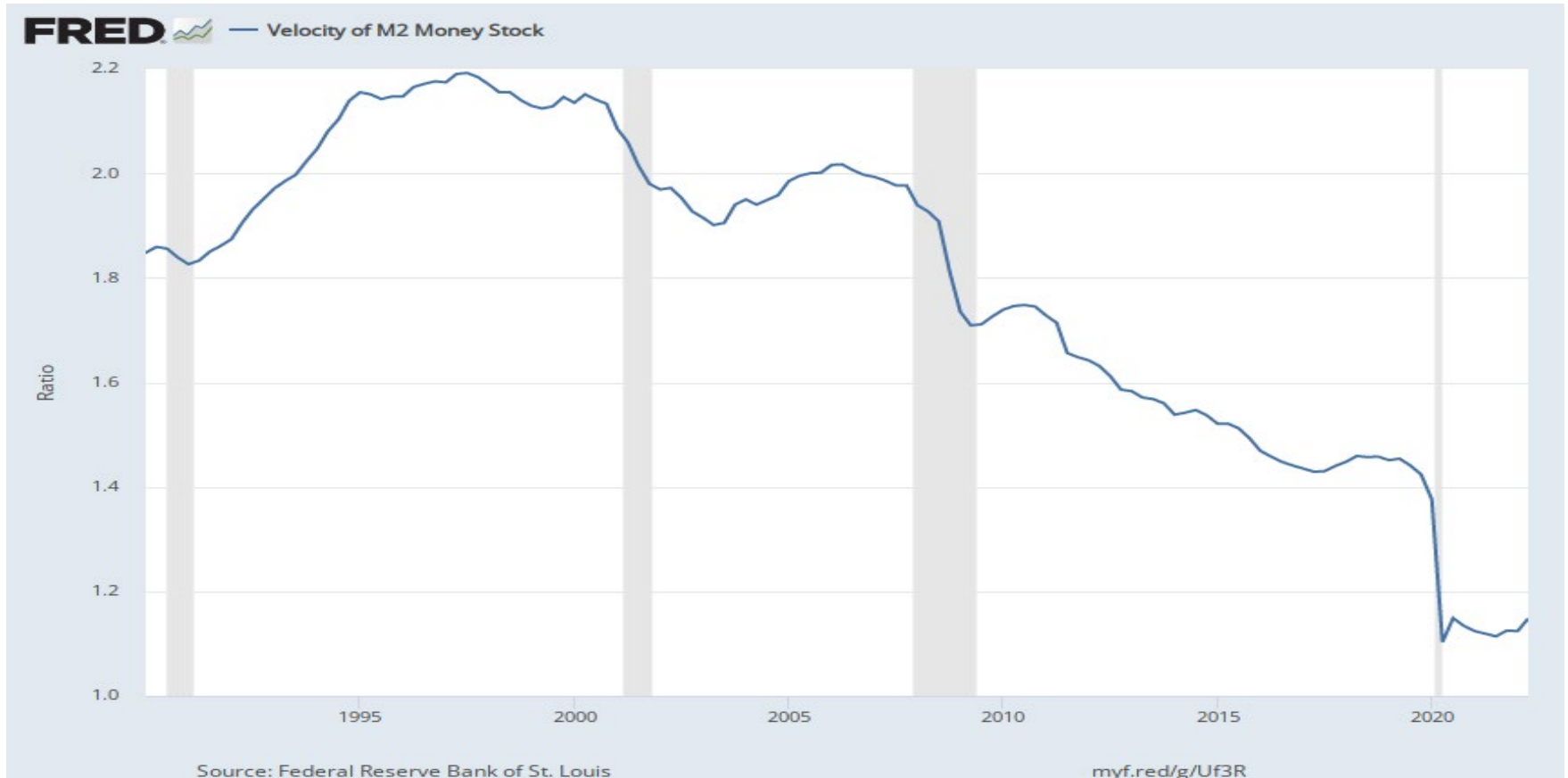
## INTEREST RATES: THE COST OF MONEY – POST WAR ERA



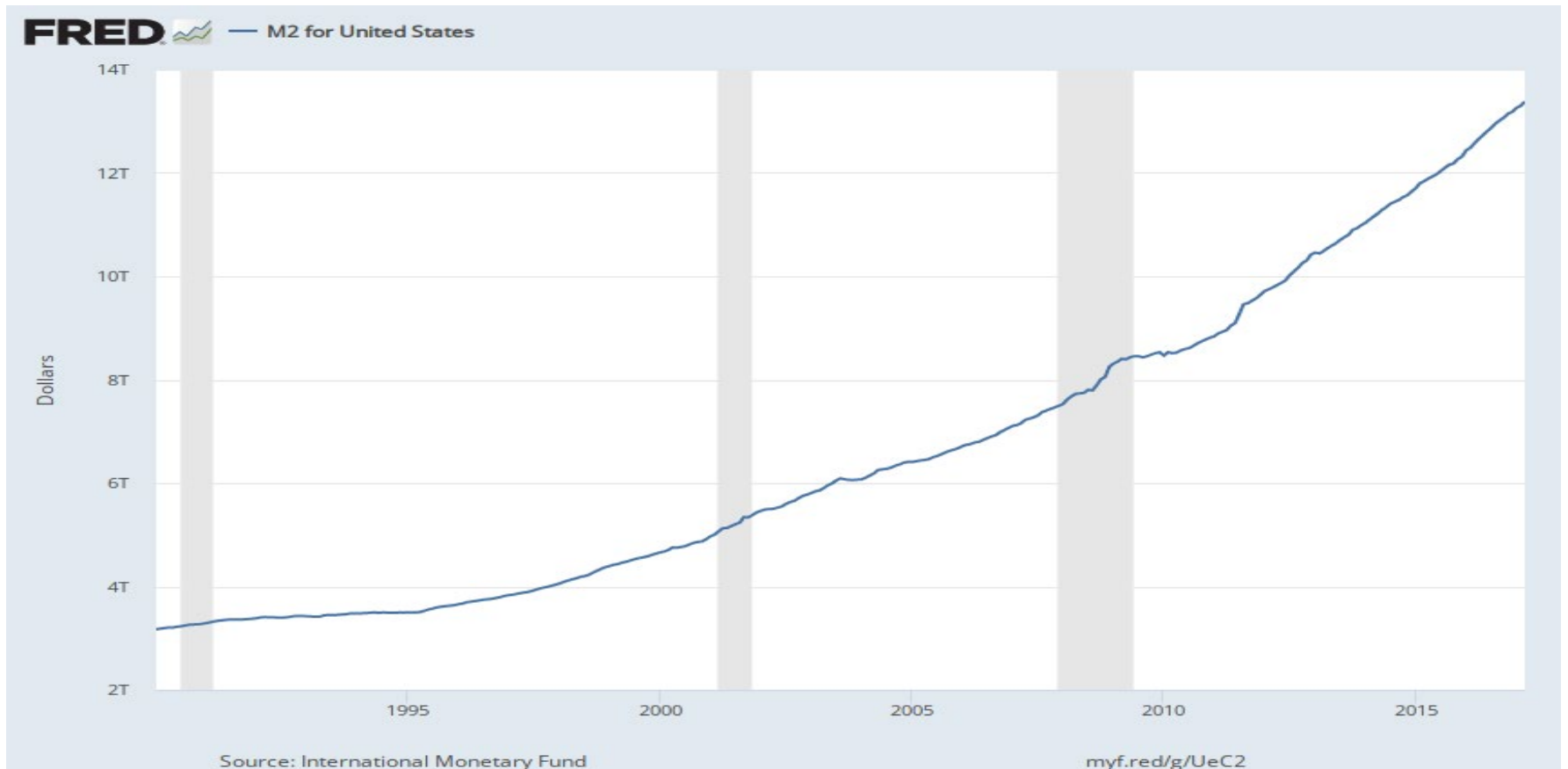
# INFLATION: THE COST OF THINGS – THE POST WAR ERA



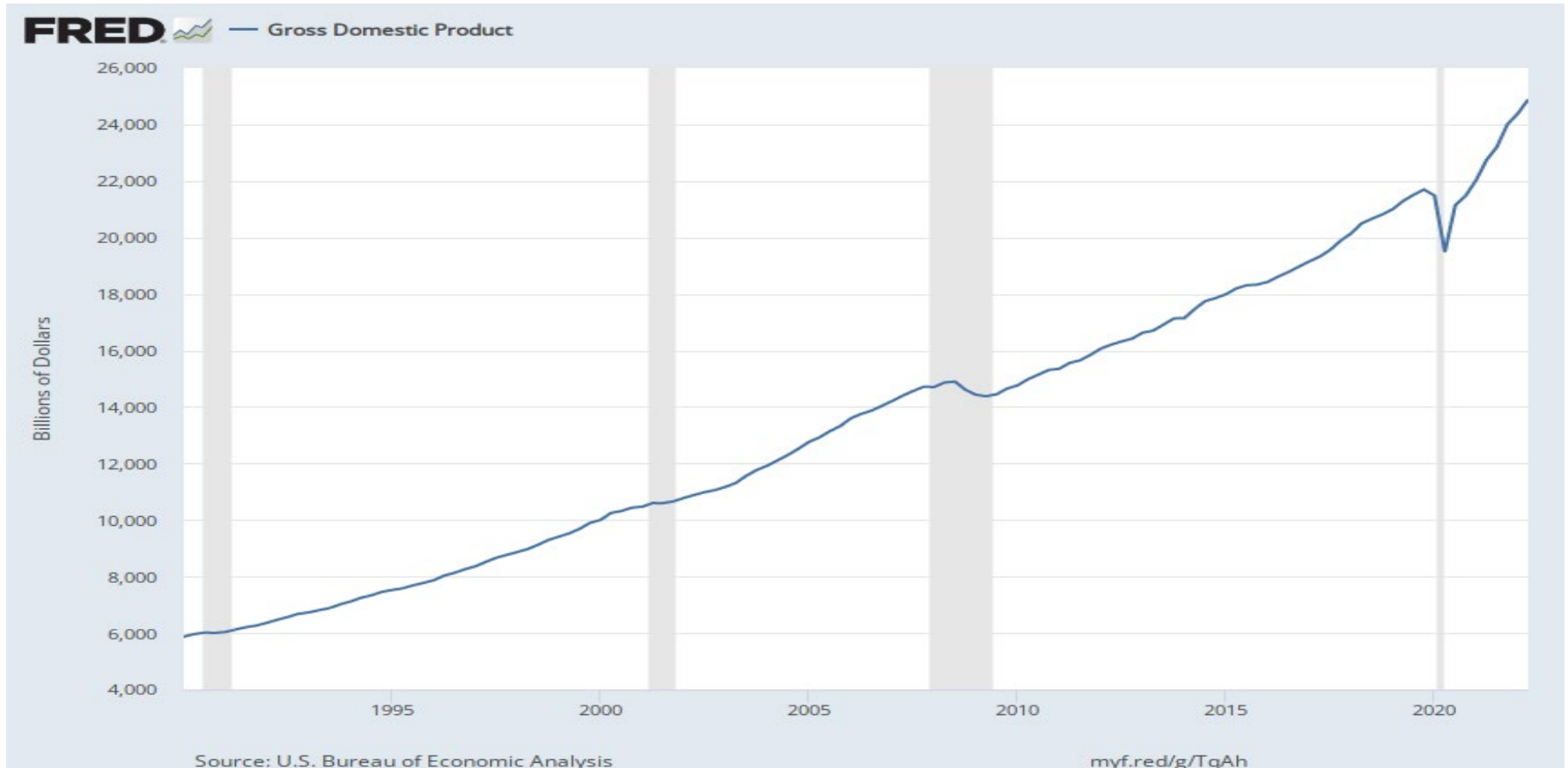
# VELOCITY OF MONEY



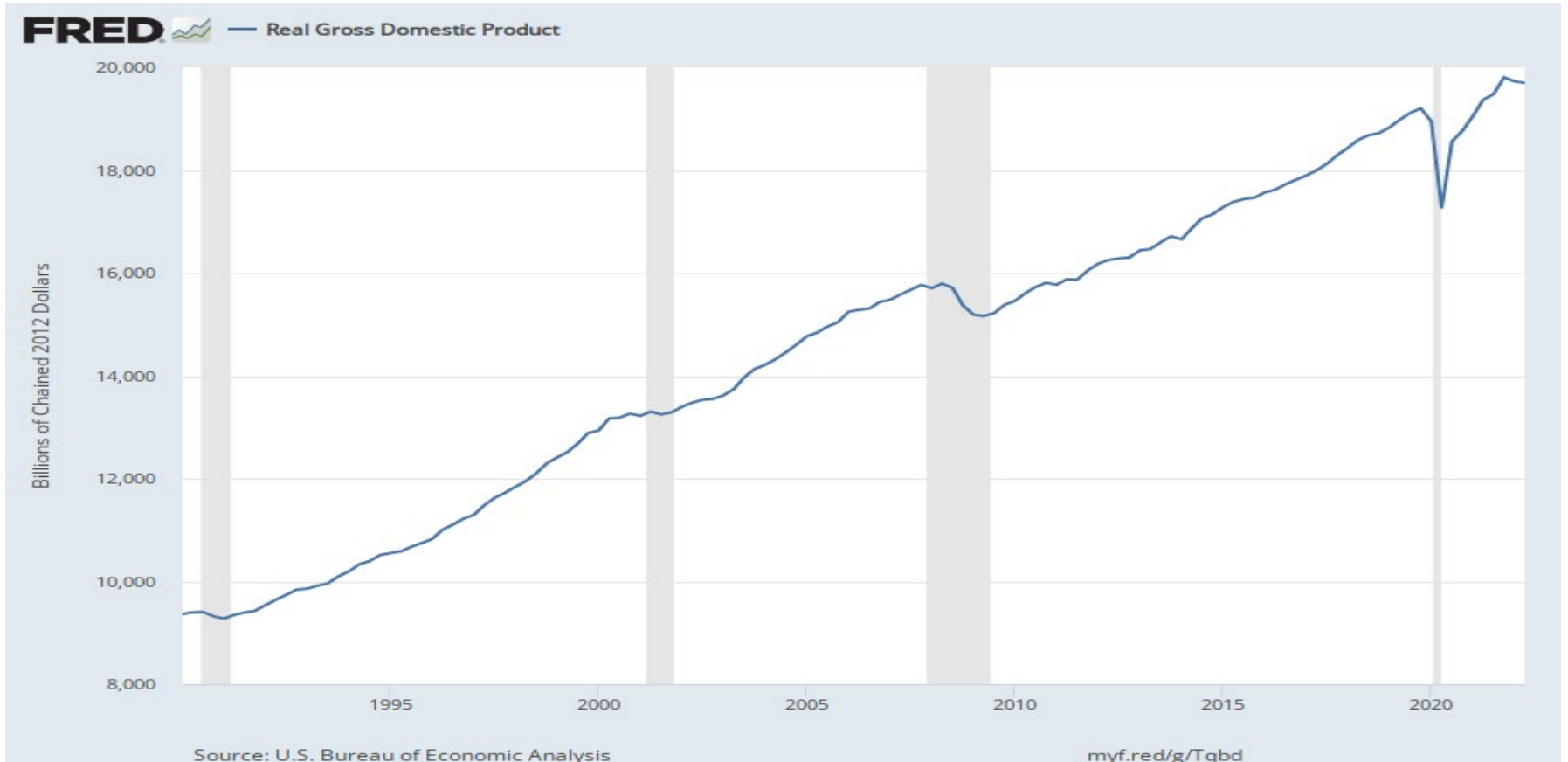
## MONEY SUPPLY



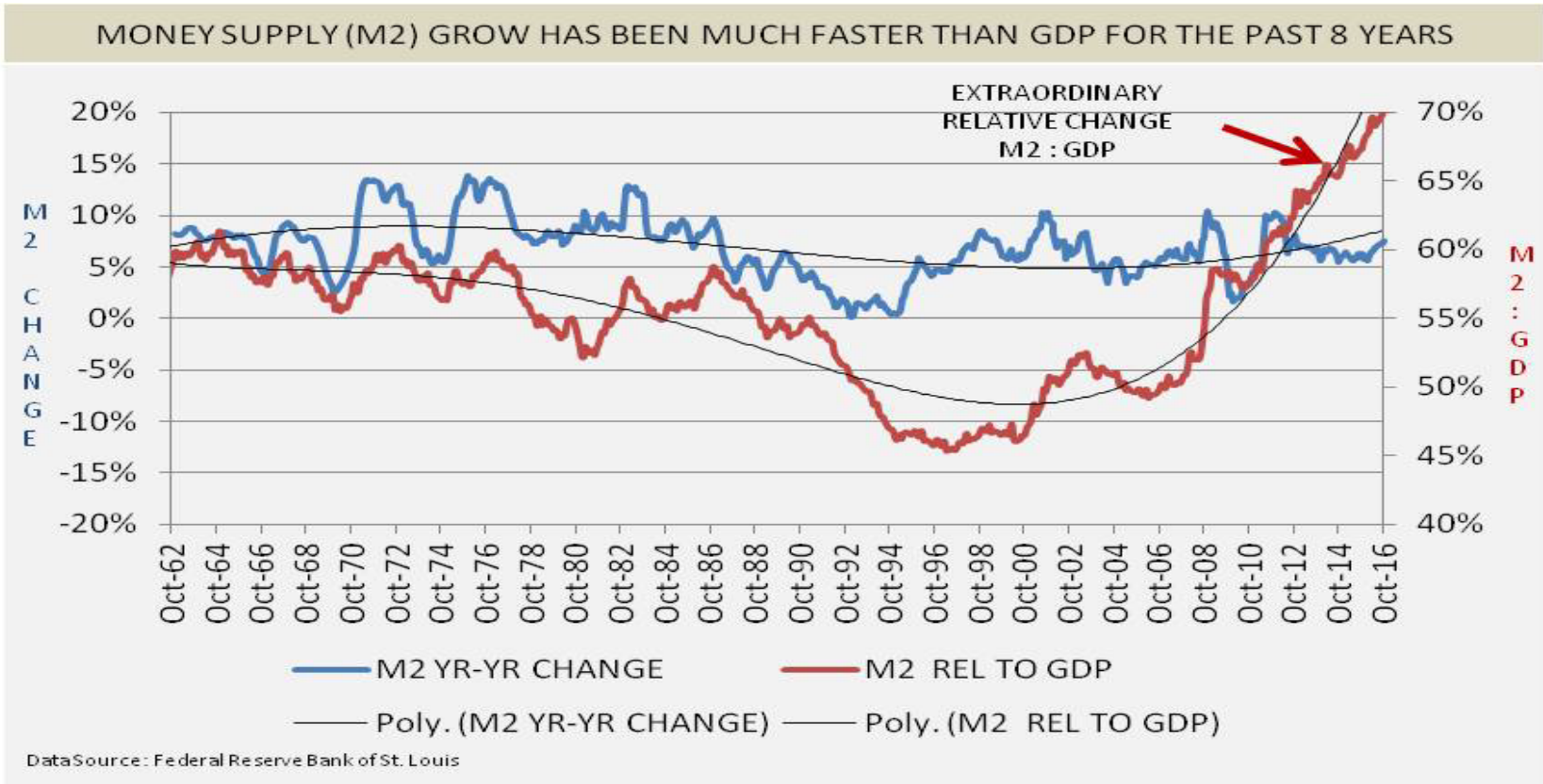
# NOMINAL GDP



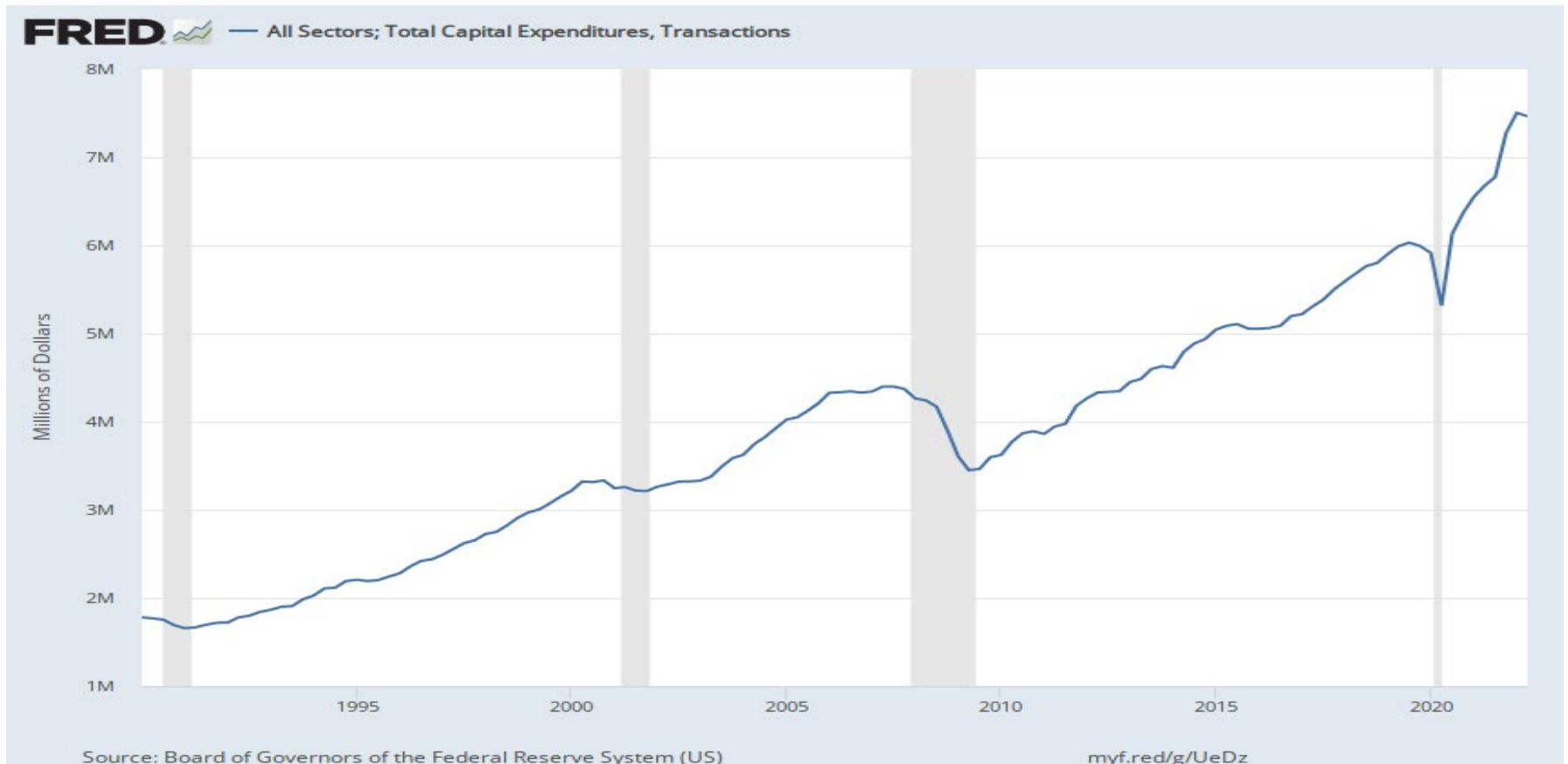
# REAL GDP



# RELATIONSHIPS – GDP AND MONEY

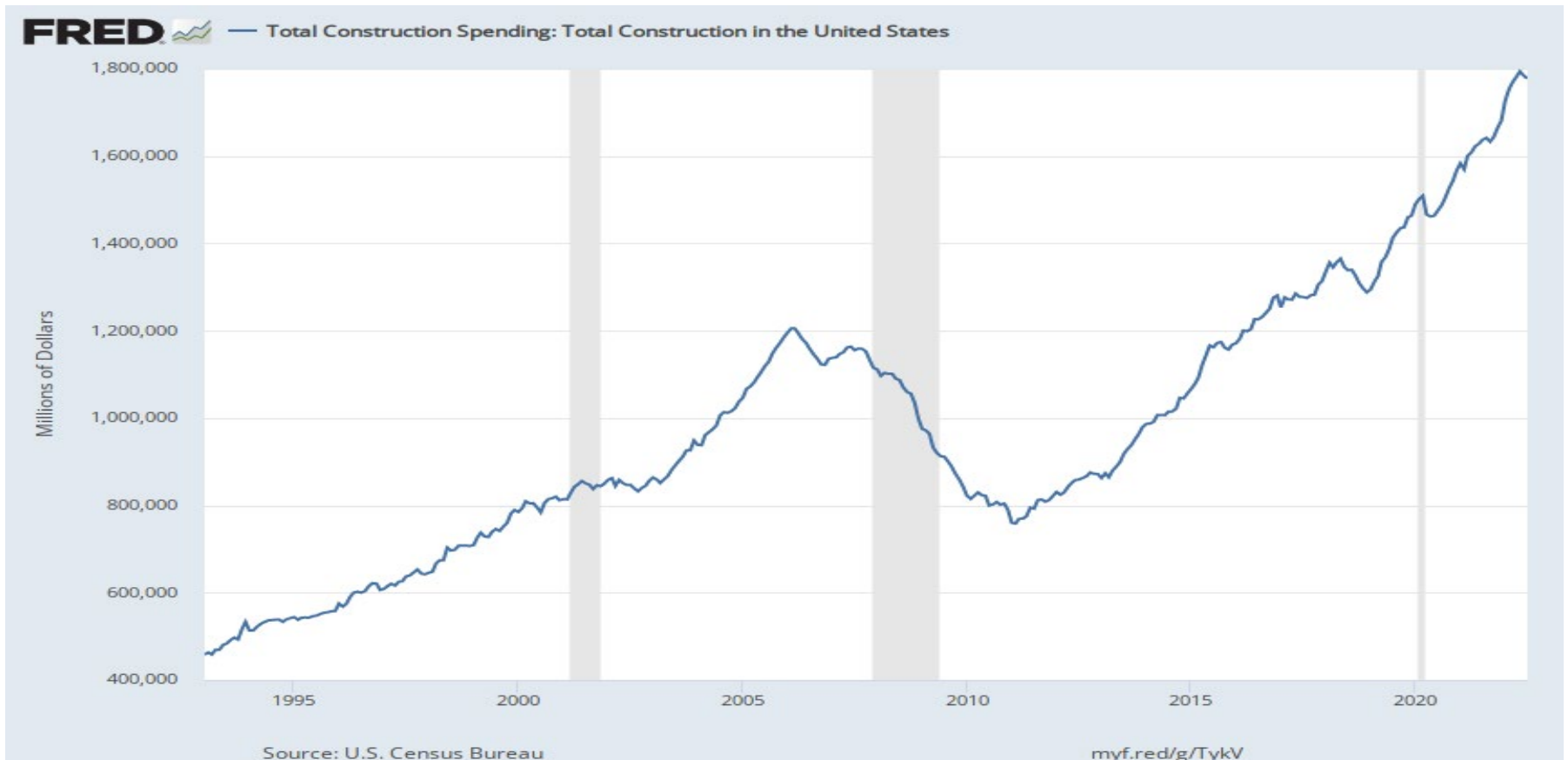


## TOTAL CAPITAL SPENDING:

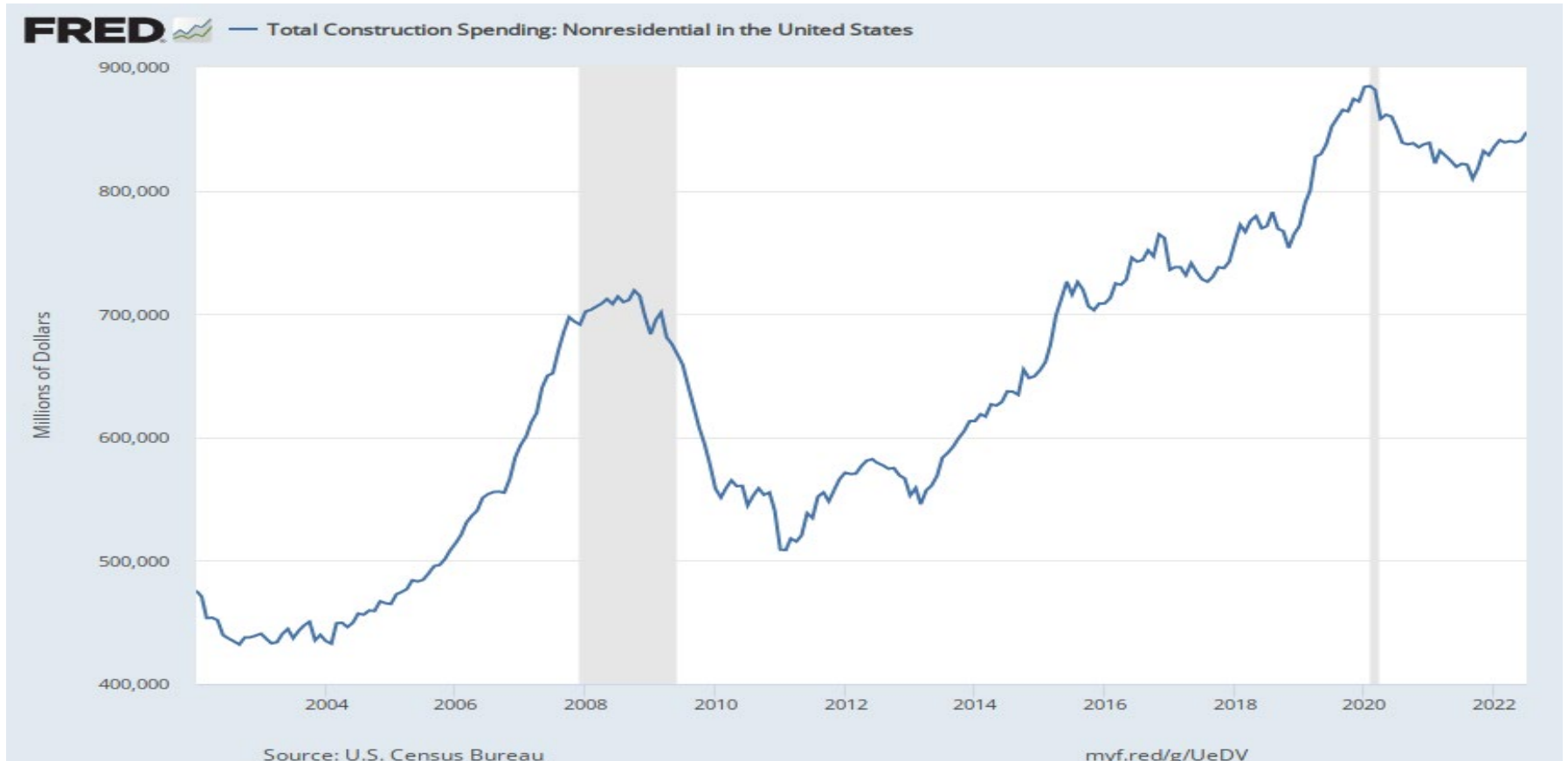




## TOTAL CAPITAL SPENDING -CONSTRUCTION



# TOTAL CONSTRUCTION SPENDING – NON-RESIDENTIAL



## SOME THOUGHTS ABOUT THE ECONOMY ...

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- The economy is highly uncertain
- Government debt is growing
- Interest rates are rising
- Recent inflation trends
- CAPEX spending is ok ... but ...

**Cause for concern ...**

**Cause for concern ...**

**Cause for concern ...**

**Cause for concern ...**

**Mixed signals**

## 5. SOME CASE STUDIES ... HISTORY HAS SOME VALUE!



## RECENT EPISODES – 1970S STAGFLATION

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- The 1970s Stagflation
- Guns and Butter
  - The Great Society
  - The New Deal
- Aggressive fiscal policy
- Causes the crash of Bretton Woods ... dollar as the peg
- An entire decade of ...
  - Inflation
  - Slow economic growth
- Brought to heel by the FED and Paul Volker ... but no soft landing!

## RECENT EPISODES - THE S&L CRISIS

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- Deregulation of credit unions
- Set high deposit rates to “buy” market share
- Maintained margins by seeking high return loans (meaning higher risk too)
- Lots of Commercial Real Estate loans!!
- Consequences ...
  - Too many loans
  - Too much construction
- RTC – Resolution Trust Corporation

## RECENT EPISODES - THE PANIC OF 2008

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- Very aggressive monetary policy
- Fast growing economy
- Lenders got aggressive
- Borrowers happy to cooperate
- LOTs of building going on
- LOTs of leveraging going on ... debt bombs
- Economic boom ... followed by economic bust
- Classic business cycle theory at work!

## 5.A CONSTRUCTION COSTS DATA (BONUS!)



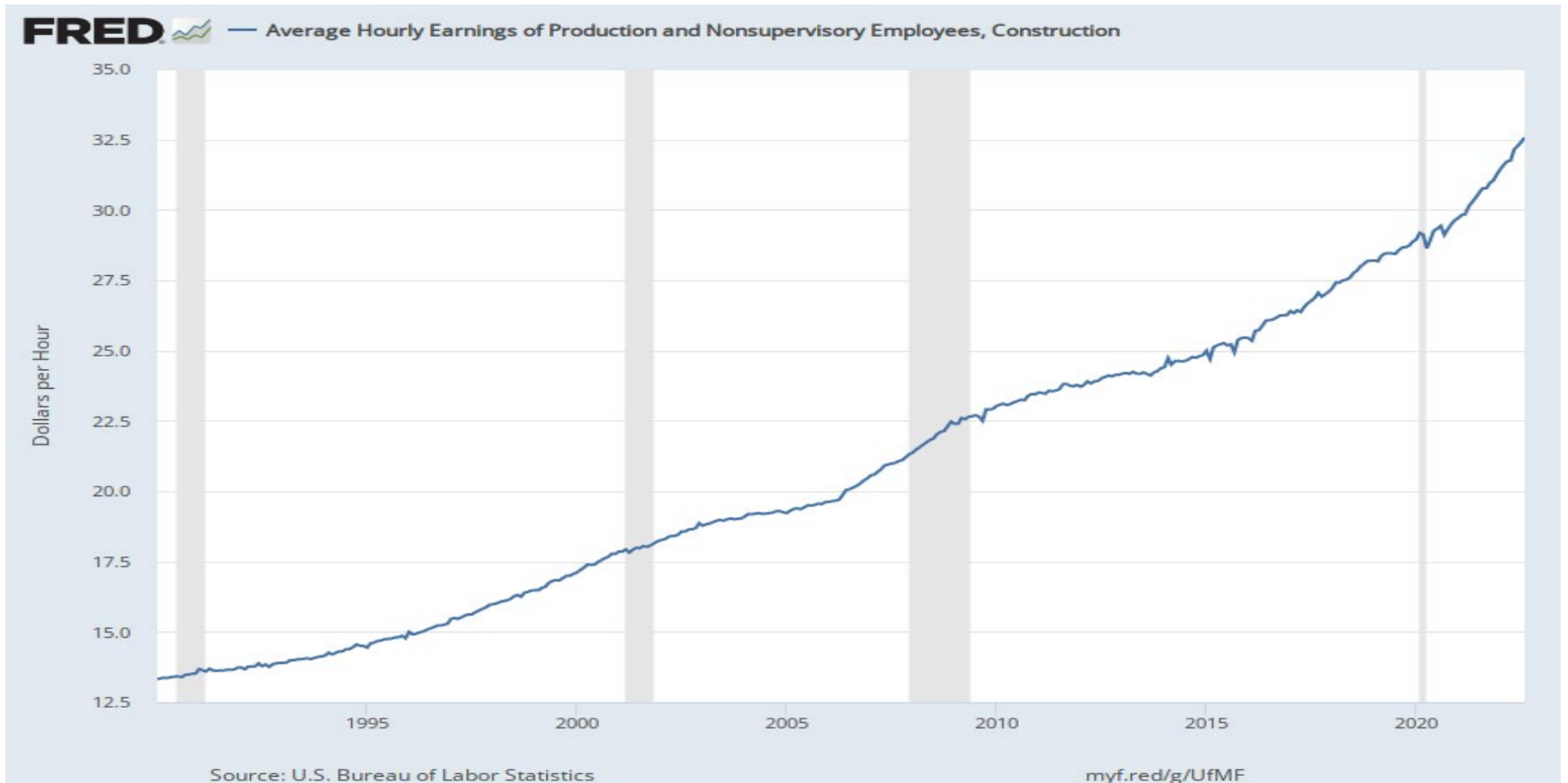


## THE COSTS OF CONSTRUCTION AND BUSINESS ...

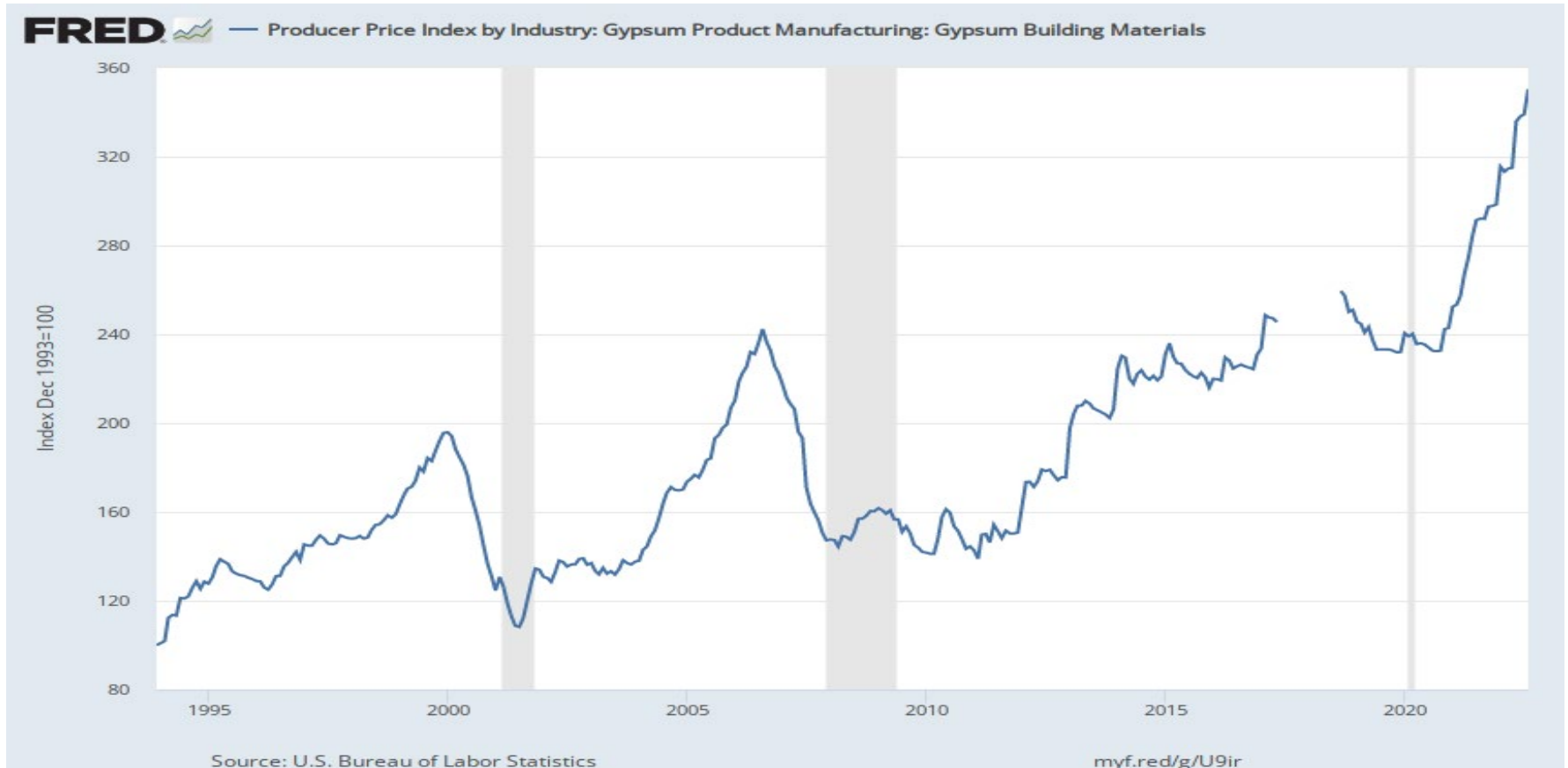
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- People
- Raw materials
- Energy costs
- Supply chains

# WAGES



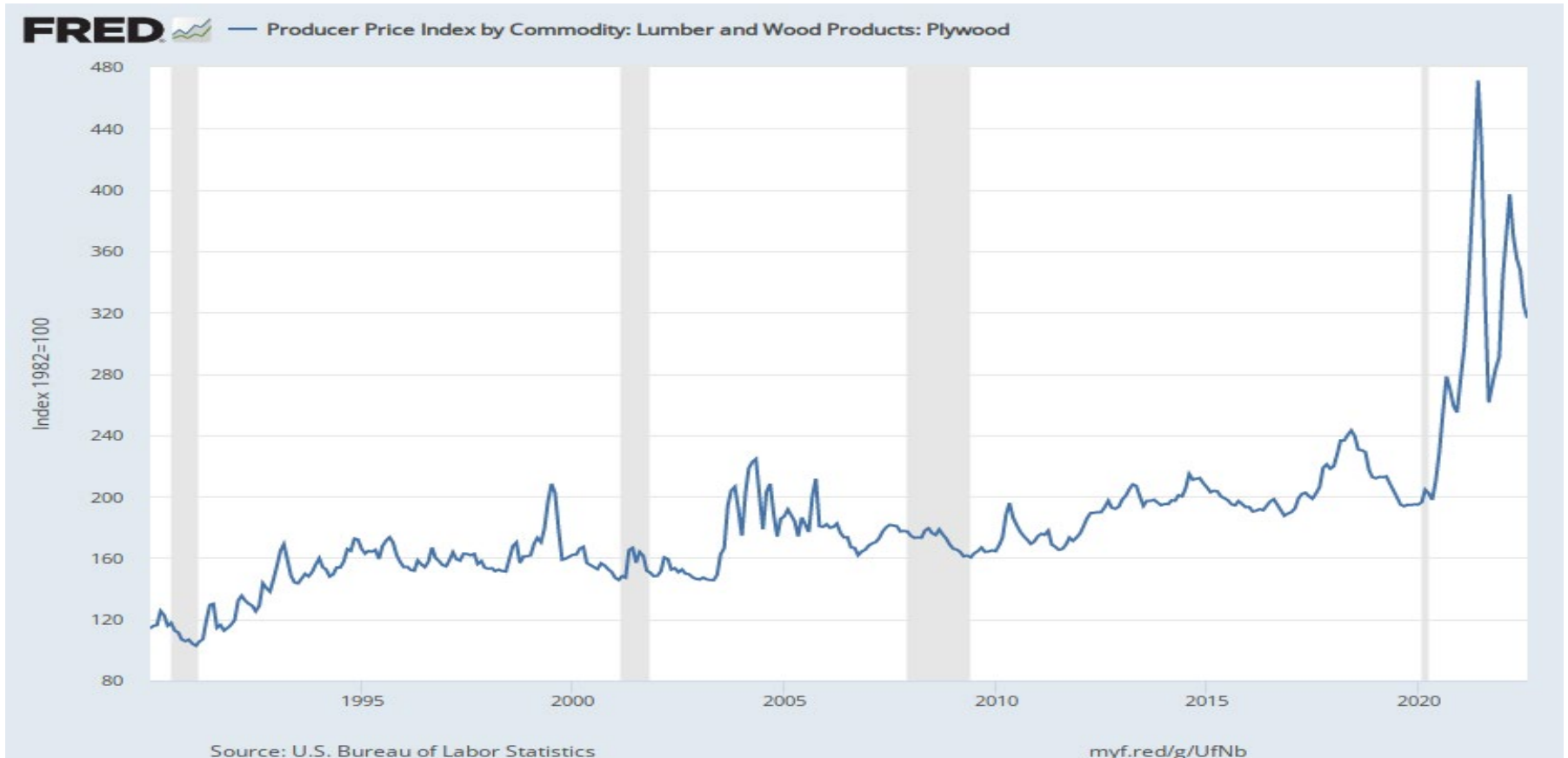
# COSTS - DRYWALL



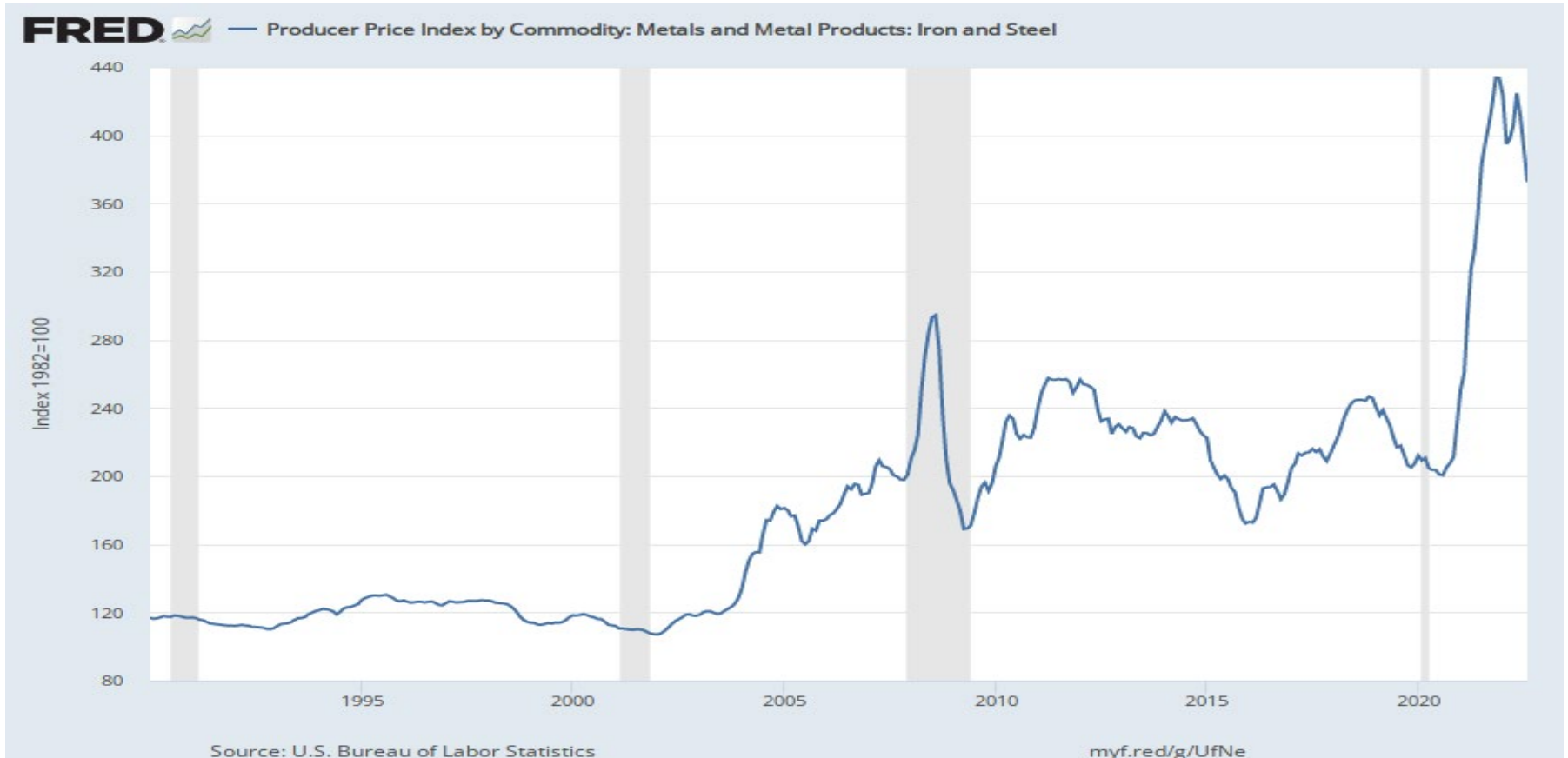
# COSTS - LUMBER



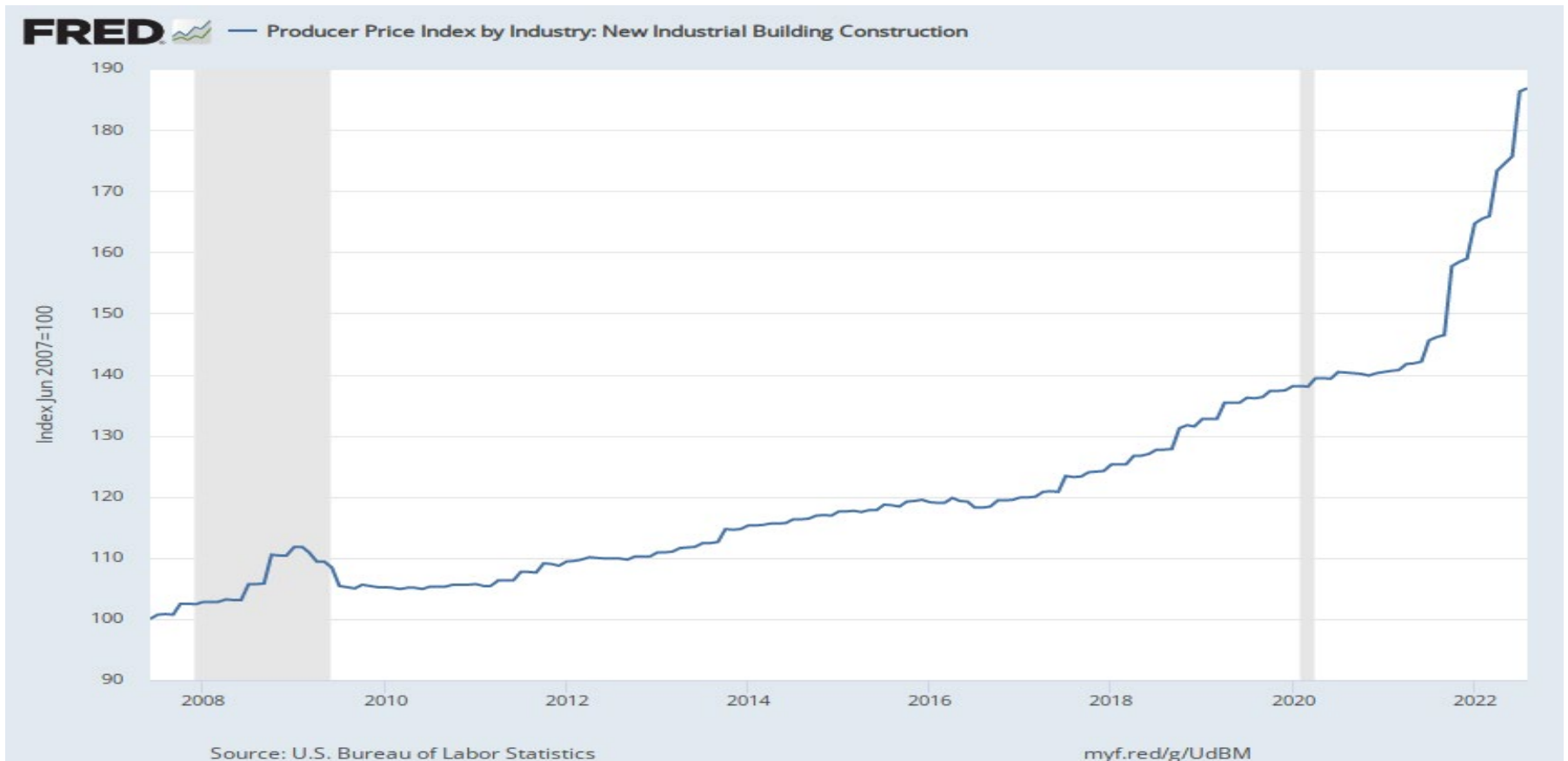
# COSTS - PLYWOOD



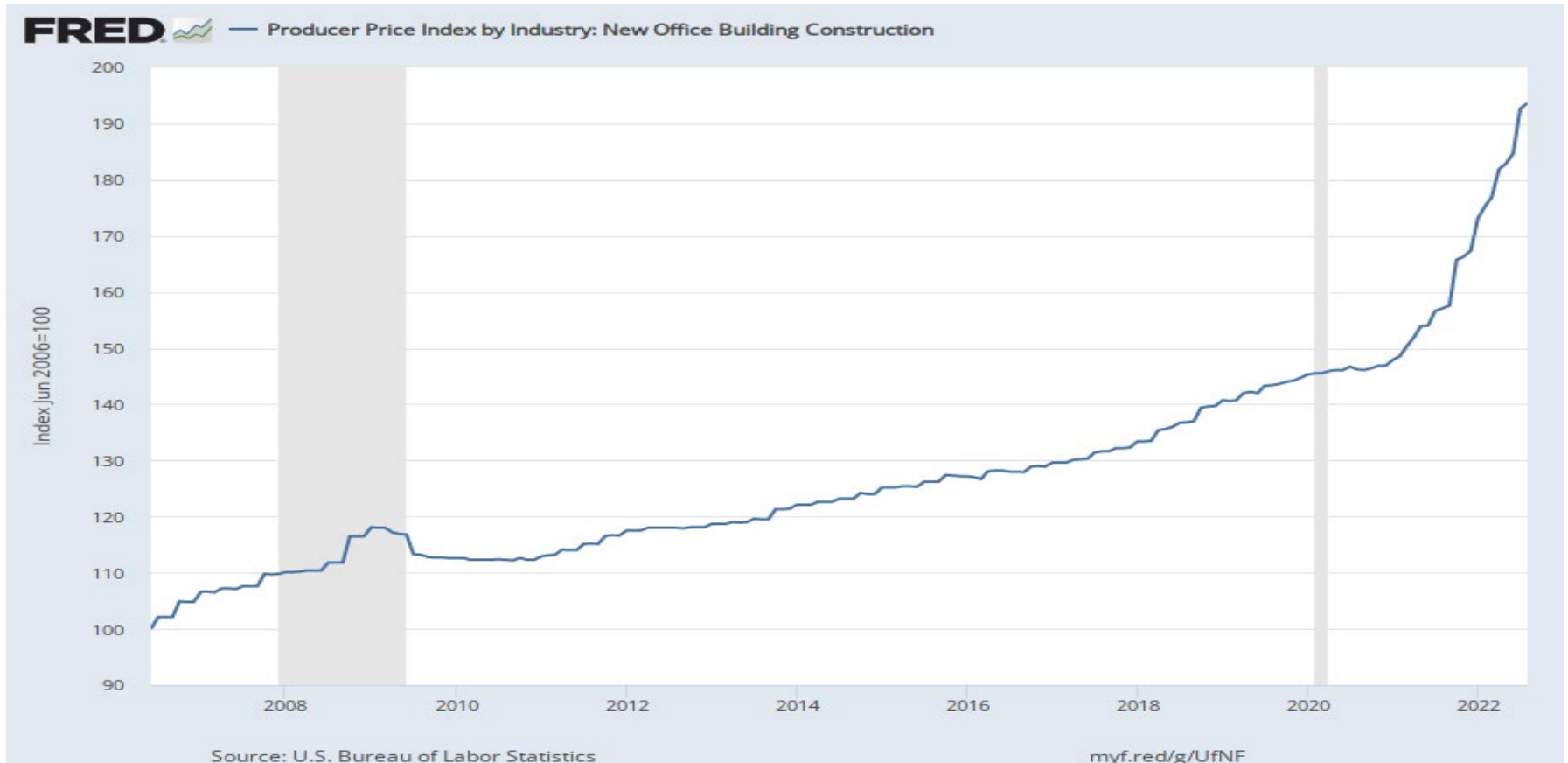
## COSTS – IRON AND STEEL



## COSTS – NEW INDUSTRIAL

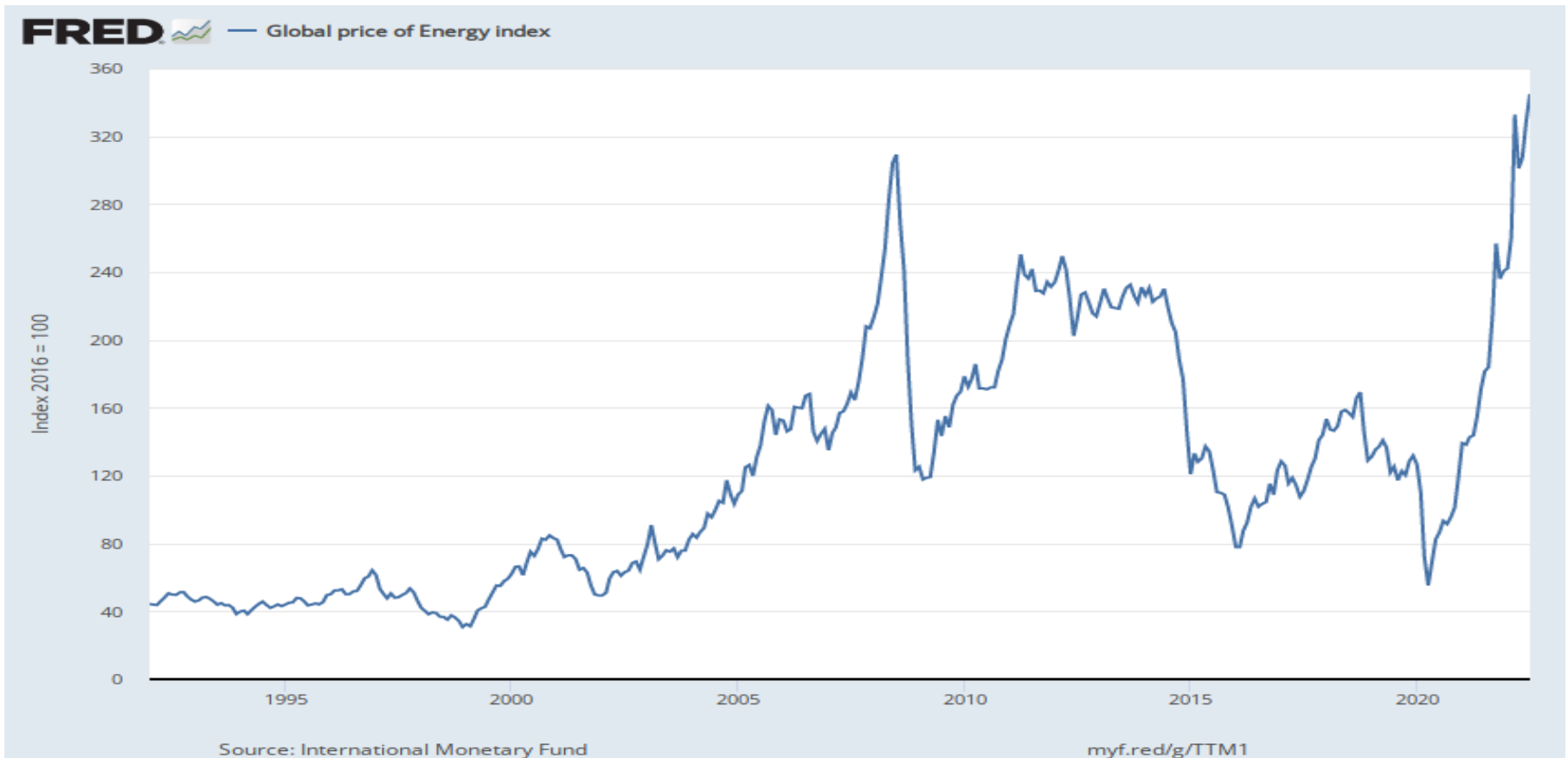


## COSTS – NEW OFFICE





# COSTS – ENERGY PRICES



## SOME CONCLUSIONS ABOUT COSTS

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- Raw material prices are high
  - Lumber
  - Steel
  - Drywall

**Good chance they will stay up**

- Energy prices are increasing

**Good chance they will stay up**

- Supply Chain

Not the issue it was last year

## 6. THE DOCTOR'S PROGNOSIS

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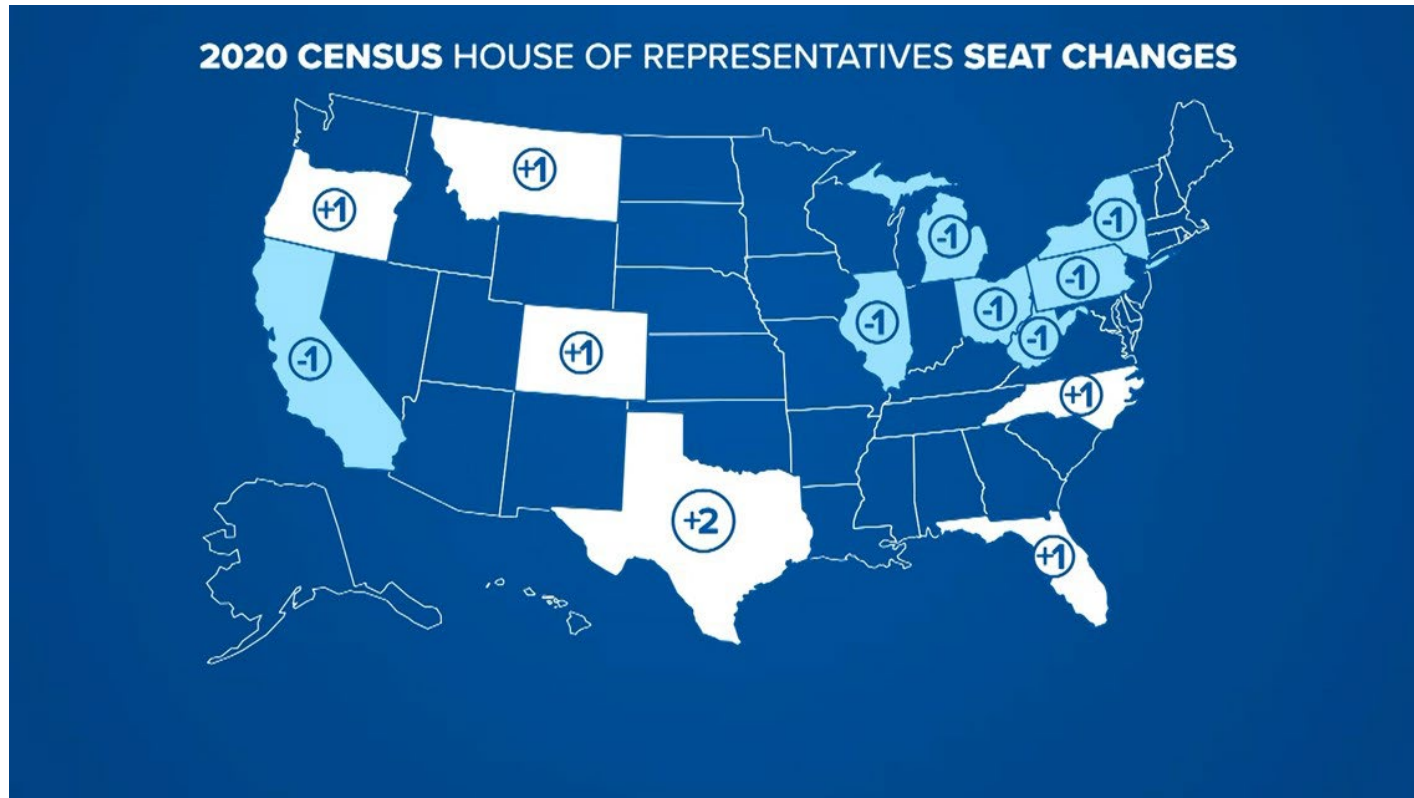
**REMEMBER THE LONG-TERM GOLDEN RULE!**

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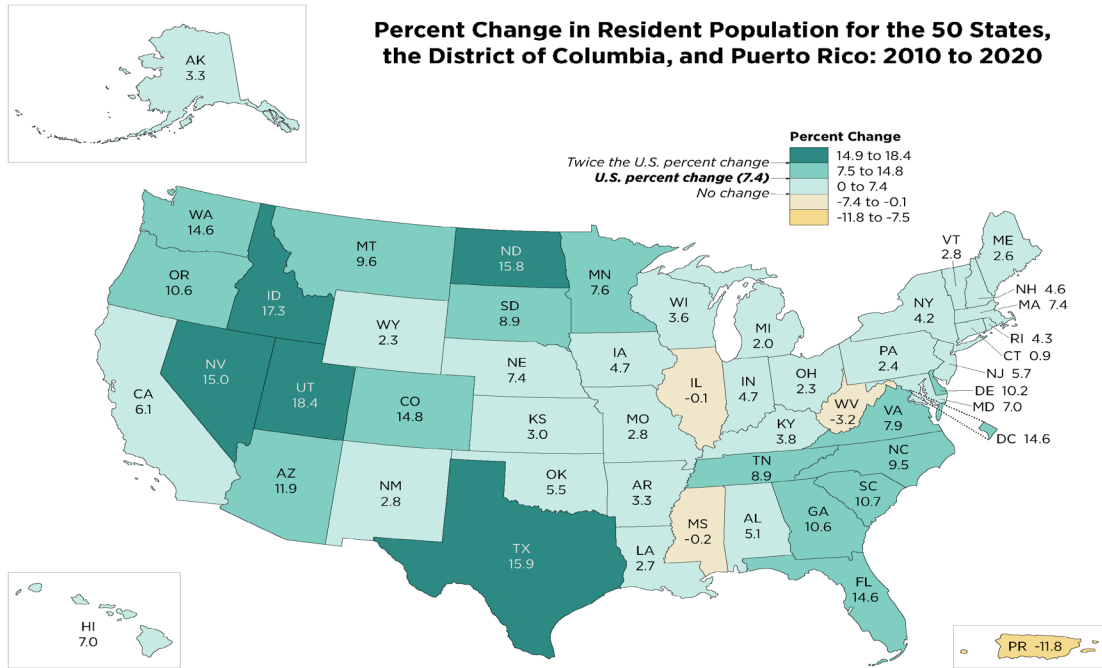
**Value follows feet!**



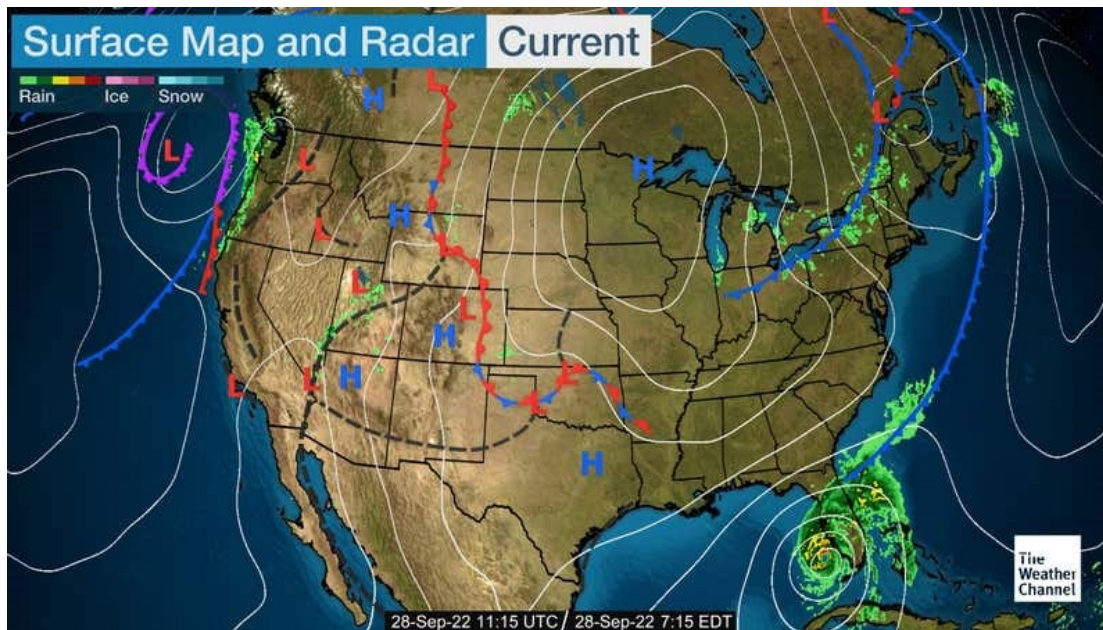
## DEMOGRAPHICS: HOUSE SEAT CHANGES ... 2020



# POPULATION SHIFTS ... 2010 TO 2020



## SHORT-TERM AND INTERMEDIATE-TERM THOUGHTS



## KEY POINTS ...

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- Relating to our case studies
  - Stagflation and the 1970s
    - Some correlations ... fiscal policy off the tracks
  - S&L Crisis
    - Not so much ... no overbuilding and/or financial institutions with portfolio issues
  - The Panic of 2008
    - Not so much ... no overbuilding and/or financial institutions with portfolio issues
- But keep in mind that the past is only a guide ... all events have a unique element to them ...



## THE ONE ITEM TO REMEMBER ...

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### • INFLATION ...

- Won't tame easily
- Creates confusing business signals
  - You might think you're making money, but you are not
- Creates higher levels of uncertainty
  - Stakeholder viability
  - Cost of money

## CONCERNS ...

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- The present situation is looking more related to the 1970s Stagflation scenario than others ... **this should be a cause for concern ...**
- But there are differences
  - Technology change is positively impacting the economy ... and in construction
  - Economic nationalism on the rise due to geopolitics ... impacts construction
- Other things to consider ...
  - Demographics ... movement away from Michigan ...
  - How strongly will Detroit CBD come back from COVID?
  - Some outstate growth areas ... Grand Rapids, Traverse City

## OPPORTUNITIES

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- Retail ...
  - Local grocery anchored shows promise
  - Regional and power centers are cause for concern
  - Water Tower (Chicago) gets handed back!!
- Office ...
  - Technology changing the game ... less overall demand
  - But huge need to renovate and reconfigure space
- Industrial
  - Some comeback in traditional manufacturing
  - Distribution centers in demand
- Multi-family
  - Younger generation less likely to own single family

## SOME CONCLUSIONS

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- **Bottom line ...**
  - **Keep an entrepreneurial mindset ...**
  - **But keep powder dry ... Don't take on too much leverage!**
- **We've seen it before ...**
  - **Likely a category 2 to 3 storm coming in the next 6 to 48 months**
    - **Might last a while ... not as deep as some others, but prolonged ... a "malaise"**
    - **Companies and lenders start out with decent liquidity**
    - **Global in nature ... first world economies well synched**
    - **Long enough to hurt businesses ... weak players will exit**
    - **Government's ability to intervene will be hampered ... only so much flexibility to use with monetary and fiscal policy**

## THINGS TO POSSIBLY CONSIDER ...

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- “Tight-size”
  - Focus on key human resource assets
  - Have a plan in place should down-sizing become necessary
- Deleverage as much as possible
  - Debt capital is the enemy in down economic cycles
  - Less debt creates more flexibility
- Be careful with contracts
  - Be wary of inflation and shortages when negotiating long lead times
  - Be more careful with underwriting and qualifying customers
  - Keep tabs on the financial health of subcontractors
- Michigan is a shrinking demographic market
- Talk to old business veterans ... buy them a cup of coffee ... listen!!

**TIME TO WRAP UP ... THANK YOU!**

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## CONTACT INFORMATION

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# UHY



**Ways To Improve Your Bottom Line  
With Good Accounting Records**



# What Is CAAS?

Client Accounting Advisory Services (CAAS) enables our clients for sustainable growth with the right people, process and technology.



# Will your construction company thrive?

*“The construction sector is one of the largest in the world with about \$10 trillion spent on construction related goods and services every year.”*

--McKinsey & Company

Successful construction companies can:

- Free up resources and improve productivity
- Be more agile and scale
- Make decisions with real-time visibility





# What we are hearing?

Need to do more with fewer resources, pushing investment in technology



Equipment and material prices are continuing to

rise, requiring deeper analysis of costs



Increased importance of harnessing real-time, actionable



# Common construction business back-office challenges!

- Excel-based consolidations and reconciliations are prone to errors and eat up valuable time
- Incomplete, delayed, or inaccurate visibility into the financial health of each project as well as across the entire business
- Metrics, budgets, and forecasts are no longer relevant by the time you get them
- Multiple disparate systems not talking to each other





# People Challenges

Today, we are seeing companies needs become extremely urgent:

- Extremely lucrative job market with high demand for resources causing staff departure
- Paying too much in salaries for what you're getting out of it
- CFOs are spending a good amount of time filling the gaps within the department and the CFO wants to get out of the day-to-day accounting
- Deploying new technology to support the new normal requires a different type of staff
- Competency of staff - Lack of understanding of fundamentals of their business, discipline and rigor to get things done



# People Solutions

How do we solve these challenges?

- On demand recruiting (continuous recruiting)
- Augment capacity (e.g., temp staffing, outsourcing)
- Project based staffing to support changes in a client's environment
- Add more permanent staffing to augment existing staff



# Process Challenges

Today, we are seeing clients need their processes improved immediately to support their business operations:

- Current processes are inefficient and cumbersome (E.G., paper based, manual approvals)
- Clients need their Financials statement timely and accurate to navigate through the new normal
- Accounting is falling behind
- Clients need the work to be done efficiently and securely from home
- Lack of, or weak internal controls, oversight, governance and approvals when working remotely





# Process Solutions

How do we solve these challenges?

- Digitalization transformation and implement automation
- Improve close process (e.g., close calendar)
- Focus on improvements with productivity and quality (e.g., establish targets)
- Enhance internal controls, oversight and separation of duties
- Update/create, document and train standard operating procedures





# Technology Challenges

Today, we are seeing clients need to upgrade their technology stack:

- Clients need to move off their existing platform quickly since their system is not setup for remote work
- Unable to have multiple people on the system at a time
- The client's performance is reduced dramatically since they are taking a paper process and trying to automate it
- Lack of security within their environment



# Technology Solutions

How do we solve these challenges?

- Improve their existing technology stack (multi entity consolidations, project costing and management)
- Deploying tools such as Accounts Payable Automation
- Leverage tools that have an open architecture
- Clients need to move off their existing platform quickly since their system is not setup for remote work



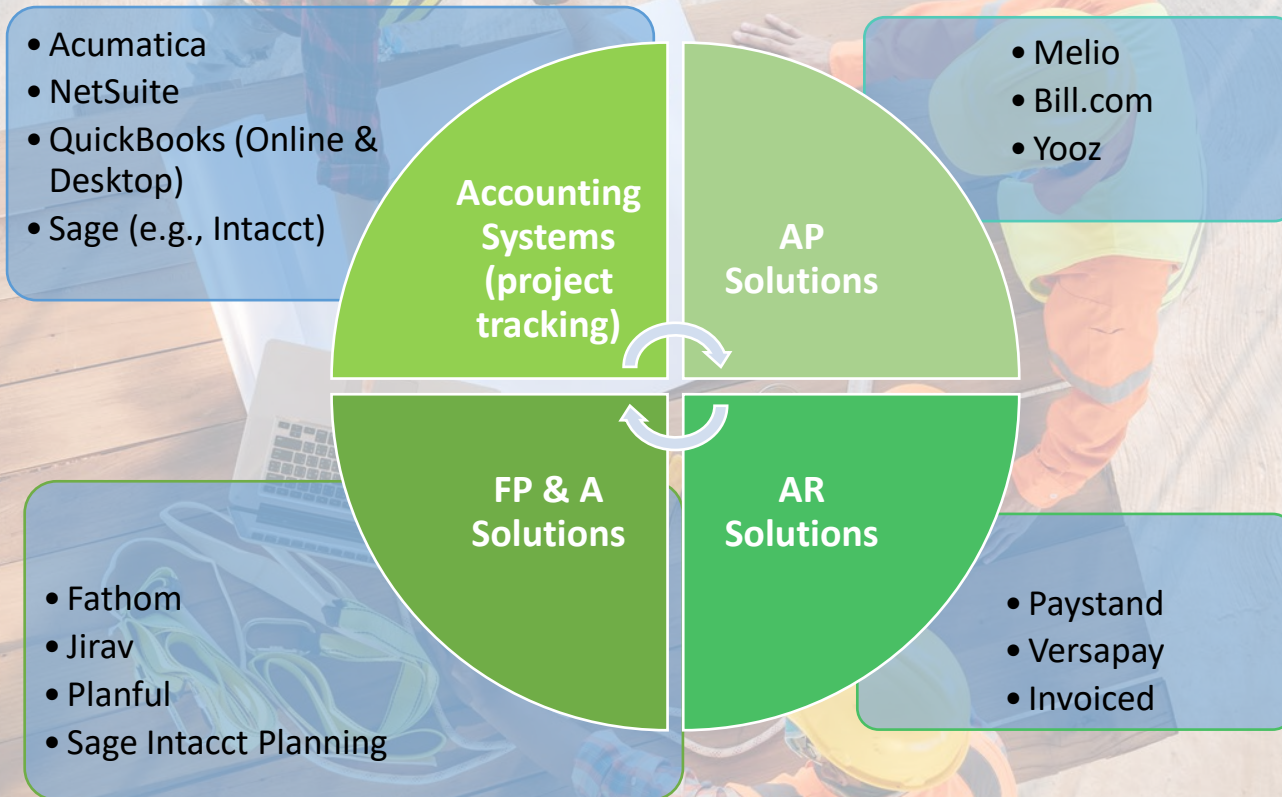


# Your Financial Ecosystem



# Software

Evaluate and determine the technology that allows the organization to build and transform your financial organizations.



# Technology Landscape

**Cloud Based Systems  
(Mobility)**

**Strong Authentic and  
Data Security**

**Document  
Management Systems  
(Image Repository)**

**Ability to ingest data  
from multiple  
channels**

**Operational workflows  
and metrics**

**OCR/RPA/Data  
Capture Processes**

**Financial Reports  
delivery (Ad-hoc  
reports)**

**Service Level  
Agreement (SLA)  
management**





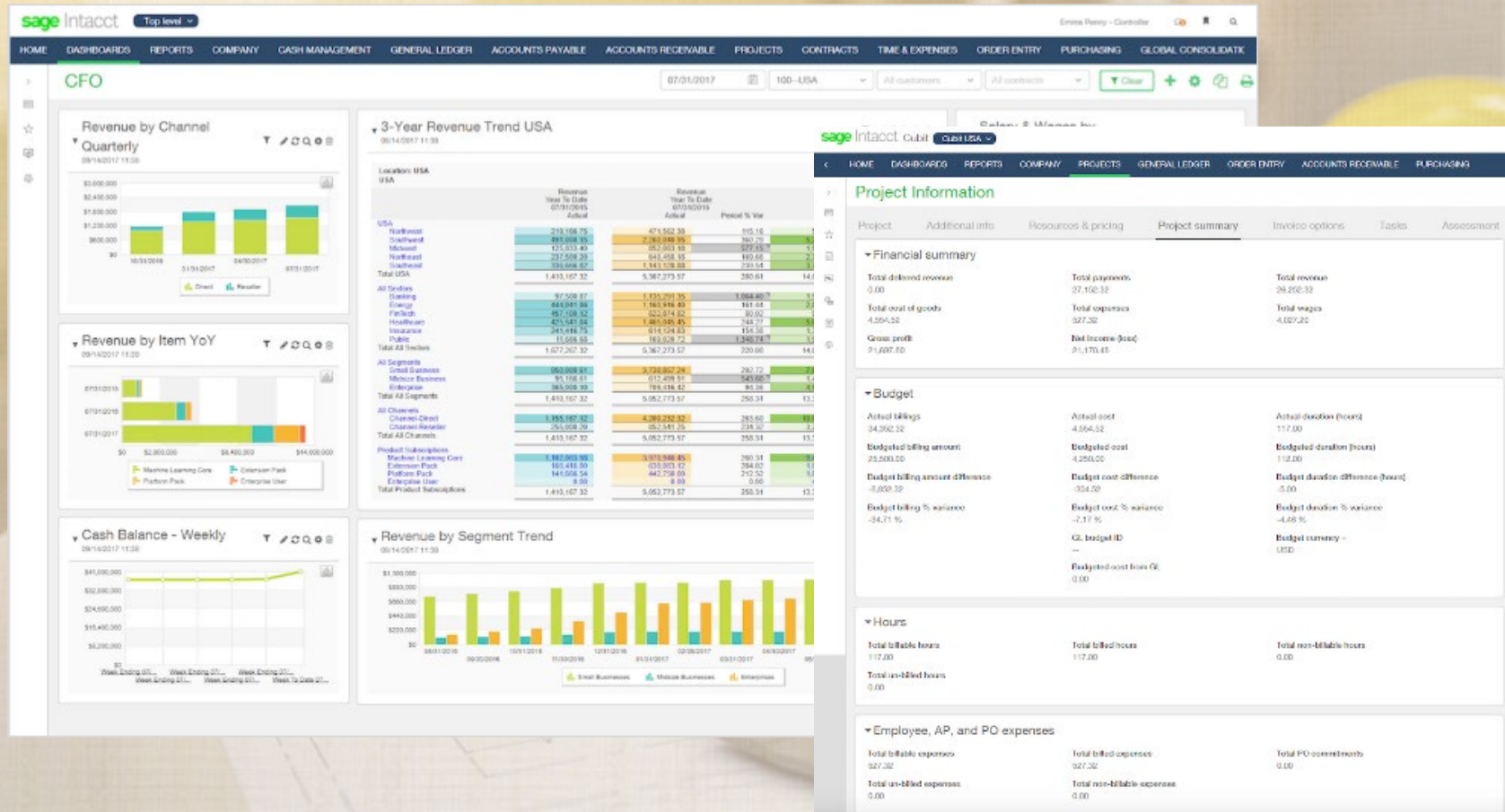
# Pressure Points

Warning signs you need an improved system:

- Over-reliance on spreadsheets
- Excess manual data entry and re-entry
- Limited access to information to drive decision-making
- High data volumes
- Remote access is a challenge
- Inadequate controls around financial processes
- Performance issue with existing systems



# Streamlined processes across all projects



# The way of the future!

- The pandemic has underscored the need for automated, efficient systems.
- Organizations are in the need to:
  - Have timely and accurate books and records
  - Improve or augment accounting staff
  - Migrate from on premise to cloud-based technology solutions to give employees virtual access
  - Deploy new technology to automate processes as well as enhance controls and reporting





# Looking Forward: FP&A, RPA & AI

**FP&A, RPA & AI adoption is growing rapidly**

- **89%** of High-Growth companies practices are providing FP&A
- **44%** of companies are now using RPA internally
- **38%** are using some type of AI

**Ai** ARTIFICIAL INTELLIGENCE

**RPA**

SOFTWARE

ROBOTIC

AUTOMATION

INTEGRATION

MACHINE LEARNING



**UHY**

# 7 Key Trends That Will Reshape Accounting And Finance In 2023



- The Cloud is here to stay.
- The labor crunch is accelerating the use of automation in accounting.
- Accounting AI investment will continue to grow, even in industries late to digital transformation.
- Outsourcing Accounting is becoming more common, driven by cloud accounting and talent wars.
- Analytics, action and storytelling will continue to converge with data automation.
- Blockchain adoption continues while cryptocurrency is still met with caution.
- Pace of new accounting regulation implementation will continue to be affected by the pandemic.



# Thank you!



**Kane Polakoff**

National CAAS Practice Leader

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## REFRESHMENT BREAK

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We will reconvene in 15 minutes







***Construction M&A Market Update:  
Buyer and Seller Strategies in Today's M&A Market***

**September 29, 2022**

Your Presenters:



**Jeremy Falendysz**

UHY Corporate Finance  
*Managing Director*



**Wiley Lane**

UHY Corporate Finance  
*Analyst*

# Who is UHY Corporate Finance?

What does the general M&A market look like today?

Is now a good time to sell my Construction company?

Deal process and terms

What are some next steps for business owners?

# Who is UHY Corporate Finance?

## A Full-Service Investment Banking Group

UHY CORPORATE FINANCE

### U.S. Team of IB Professionals

International Reach

### \$10+ Billion of Deals Since 2009

Industry agnostic, with a Construction Focus

### “Wall Street” Experience

Middle-market focus

Morgan Stanley



## Backed by a Global Attest, Tax, Consulting Firm

UHY LLP

### 25+ U.S. Offices

1,400+ professionals nationally

### 100+ Countries

8,100+ international employees

### “Big 4” Experience

Middle-market focus



Deloitte.



## NATIONAL CONSTRUCTION PRACTICE

Ranked in “The Top 50 Largest Construction Accounting Firms” in 2022 *(Constr. Exec. Mag.)*

### Cross-functional team of specialists dedicated to the Construction industry

~100 Construction professionals across UHY

M&A / Investment Banking, Accounting & Attest Services, Tax Services, Consulting Services

### Multiple Construction M&A Engagements Currently Underway

The team remains in active dialogue with buyers and sellers of Construction companies



## Full Suite of Investment Banking Services

### SELL-SIDE ADVISORY

**Strategic Sales**

**Private Equity Sales**

**Carve-Outs**

**Pre-Sale Preparation / Valuations**

### DUE DILIGENCE

**Quality of Earnings**

- Sell-Side & Buy-Side

**Buy-Side Due Diligence**

**Sell-Side Due Diligence**

**Financial Modeling**

### BUY-SIDE ADVISORY

**Buy-Side Search**

- Target Criteria
- Target Identification
- Target Assessment

**Acquisition Advisory**

**Post-Close Integration**

### CAPITAL RAISING

**Equity Capital**

- Minority Investment
- Private Equity
- Venture Capital

**Senior / Mezzanine Debt**

**Other Debt Capital**



Who is UHY Corporate Finance?

**What does the general M&A market look like today?**

Is now a good time to sell my Construction company?

Deal process and terms

What are some next steps for business owners?

## Warning Signs Are Flashing

- **Significant market uncertainty in the months/year ahead**

- Interest rates on the rise, 40-year high inflation, talk of a recession (are we in one already?)

- **U.S. M&A is down ~40% through September 2022 vs. 2021**

- Construction M&A is down *only* 8% (IIJA, emergence of PE buyers, etc.)

- **Large M&A deals are getting pulled**

- ...but others are still moving forward...for now

FRANCHISE GROUP, INC.  
**KOHL'S**

*Walgreens*  
Walgreens Boots

 **MERCK**  
 **Seagen**

jetBlue  
**spirit**

**AMGEN**  
CHEMOCENTRYX

 **Adobe**  
 Figma

- **Valuations have declined, with the S&P down ~21% YTD**

- Sellers want yesterday's prices; buyers want today's prices

- **U.S. IPOs are dormant**

- IPO activity is down 97% in Q2 2022 vs. record high in Q1 2021

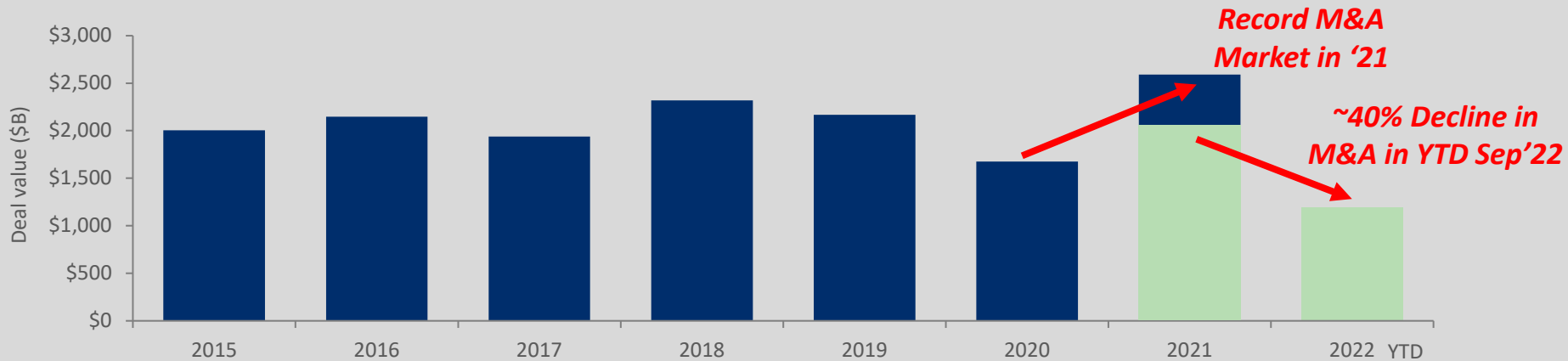
- **LBO activity is down 20%+**

- Primarily due to challenges in financing markets

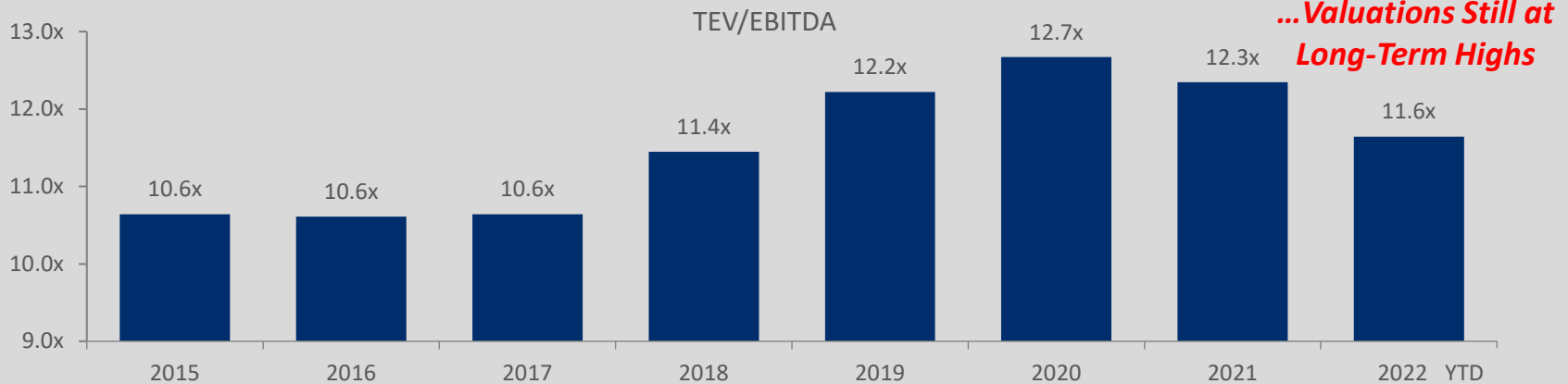
# What does the general M&A market look like today?

## Robust M&A Activity Continues

### U.S. Deal Activity Coming Off All-Time Highs



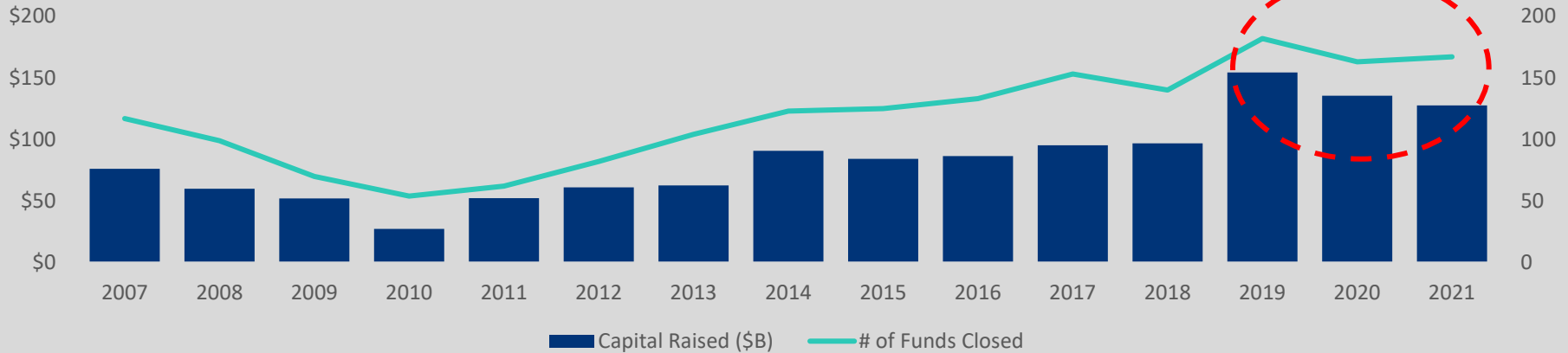
### U.S. Private Equity Valuation Multiples Cooling from Record Levels



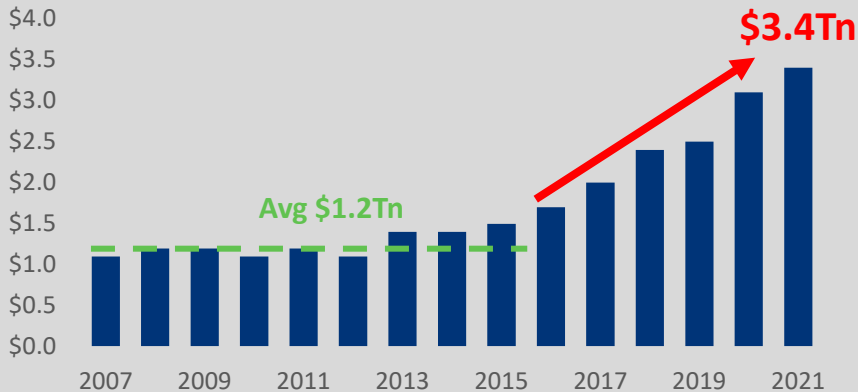
# What does the general M&A market look like today?

## Key Drivers of Momentum in M&A

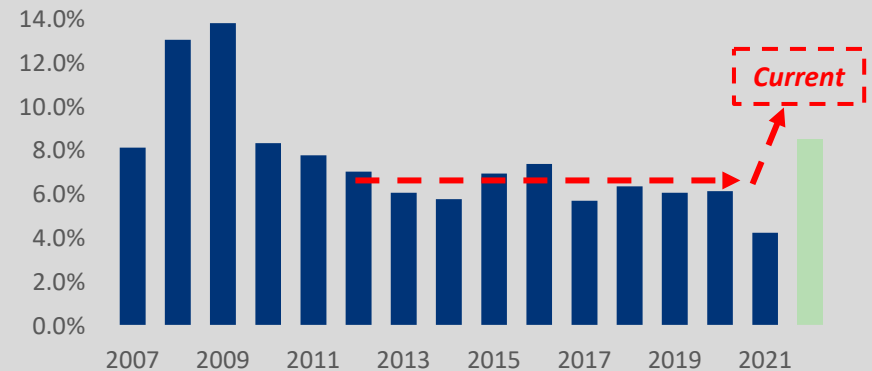
### Private Equity Capital Raised (\$B)



### PE "Dry Powder" Steadily Rising (\$Tn)



### U.S. High-Yield Index Effective Yield



Who is UHY Corporate Finance?

What does the general M&A market look like today?

**Is now a good time to sell my Construction company?**

Deal process and terms

What are some next steps for business owners?

## Current Construction Macro Picture Showing Strength

### ■ U.S. Construction spending continues to rise

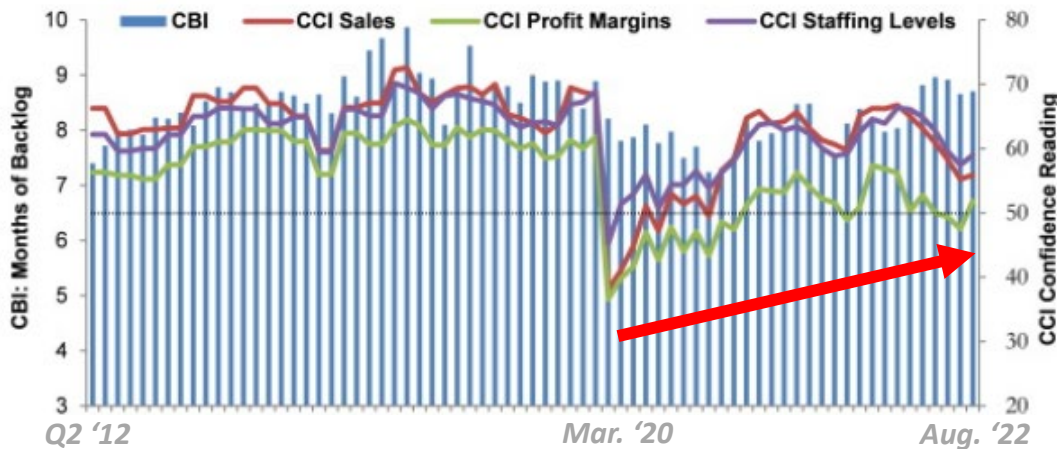
- Total: **+8.5%** year-over-year in July 2022 (up from +8.3% in June)
- Non-Residential: **+3.1%** year-over-year in July 2022 (up from +1.2% in June)

### ■ Healthy Construction Backlogs

- Total: **8.7 months** in August 2022 (flat vs. July levels)
- Middle-Market: **11.6 months** in August 2022 (down slightly from 11.9 mos. in July)

### ■ Construction Confidence Indicators remain elevated

- Confidence Indicators rose in Aug. for Sales, Profit Margins, and Staffing Levels (+6 mos. outlook)
- Many non-residential contractors are operating at capacity with primarily supply-side issues (worker shortages, equipment delays, materials inflation); residential driving down averages



**55.9** (vs. 55.2 in July)

**51.9** (vs. 47.5 in July)

**59.0** (vs. 57.5 in July)

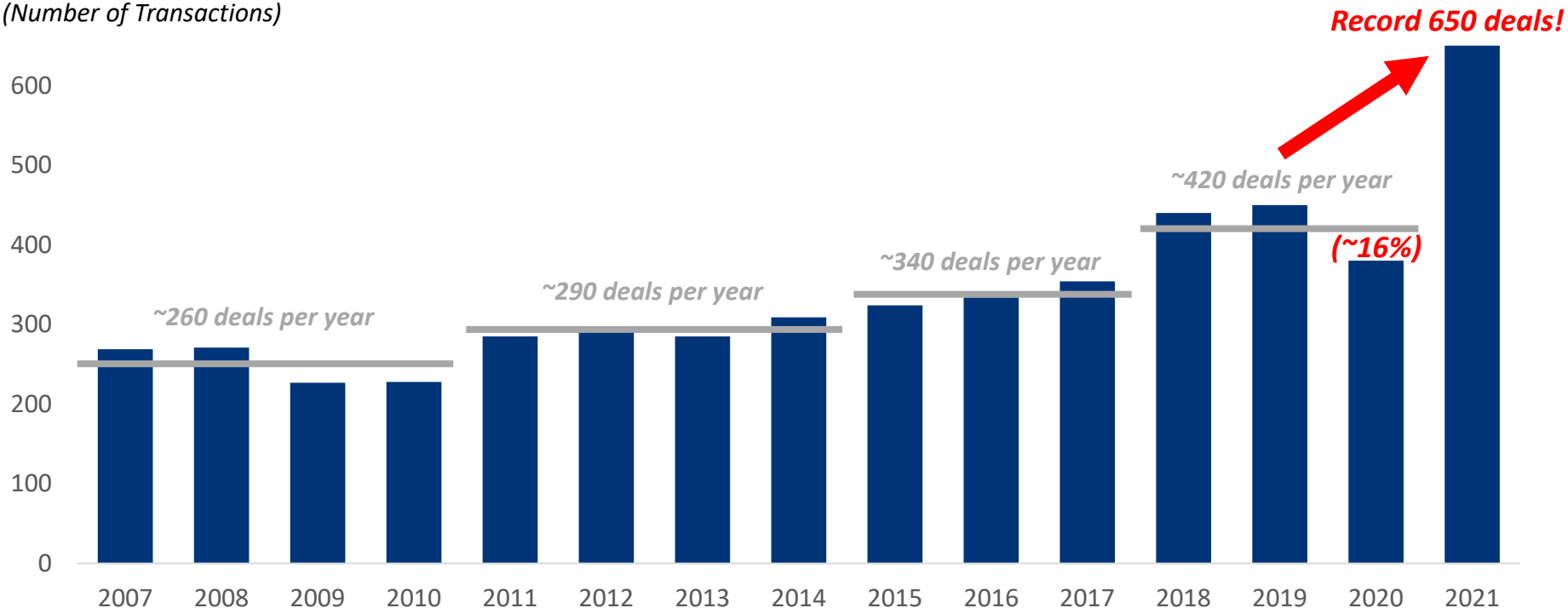
## Understanding M&A Market Cycles

### ■ The best time to sell is in an active M&A market

- Timing the market is difficult
- That said, the “market window” for Construction sellers is currently open!
- 15-year step-function of increased Construction M&A activity (undeterred by pandemic)
- Accelerating demand for Construction acquisitions since the IJA initially passed the House mid-2021

### Annual U.S. Construction M&A Activity: 2007 – 2021

(Number of Transactions)

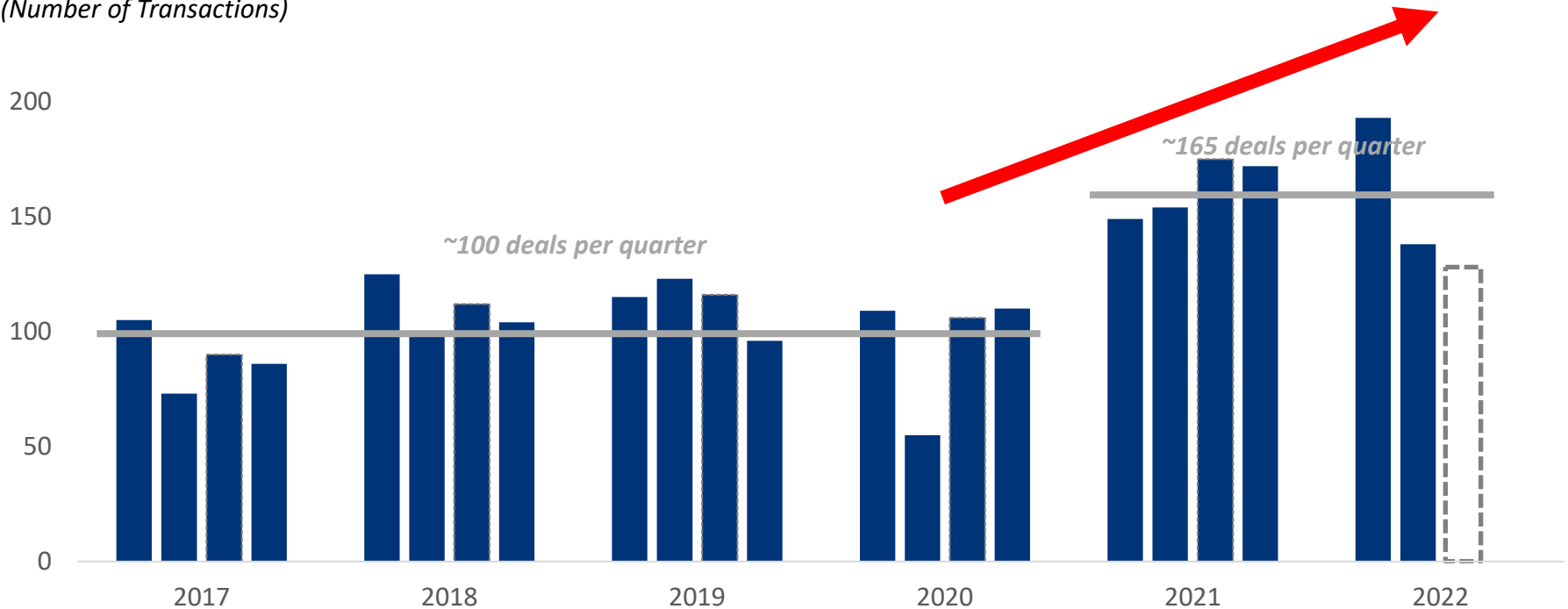


## Construction Companies are in High Demand!

- **Despite overall M&A decline, Construction M&A is +9.2% in H1 '22**
  - Pace of M&A activity has accelerated since IJIA initially passed the House in June 2021
  - ~165 deals announced quarterly since Q1 2021; vs. ~100 quarterly deals since 2017: **+65%**!
  - Buyers remain highly active/incentivized in growth via acquisition
  - For Buyers: Sellers are picking up the phone (strong Construction M&A pipeline for next 12-18 mos.)

### Quarterly U.S. Construction M&A Activity: 2017 – 2022 YTD

(Number of Transactions)





## An Evolving Buyer landscape

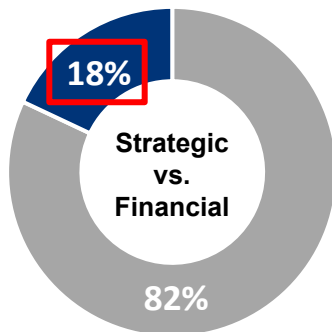
### ■ Strategic buyers typically dominated Construction M&A

- Strategics represented 80%+ of acquirors in 2017 and prior years
- PE roadblocks: Lumpy/project revenue; cyclical end-markets; short hold periods; “people-based”

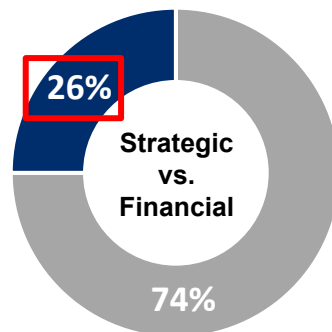
### ■ But Private Equity has become increasingly active in the sector

- PE buyers represented 40%+ of deals in 2021 (vs. <20% in 2017 and prior years)
- While the number of Strategic-led deals increased ~5% annually from 2017-2019, PE-led deals increased well over 30% annually
- Even as Strategics pulled back ~25% in 2020, PE deal activity actually increased over 10%, and this momentum continued as PE activity was up nearly 100% in 2021 (vs. ~40% for Strategics)
- We expect the buyer landscape to moderate at current levels

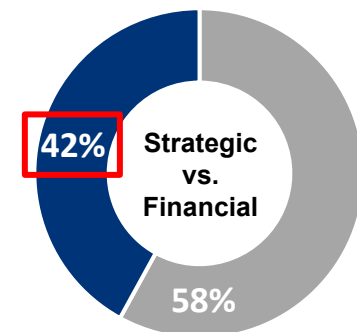
Buyer Composition: 2017



Buyer Composition: 2019



Buyer Composition: 2021

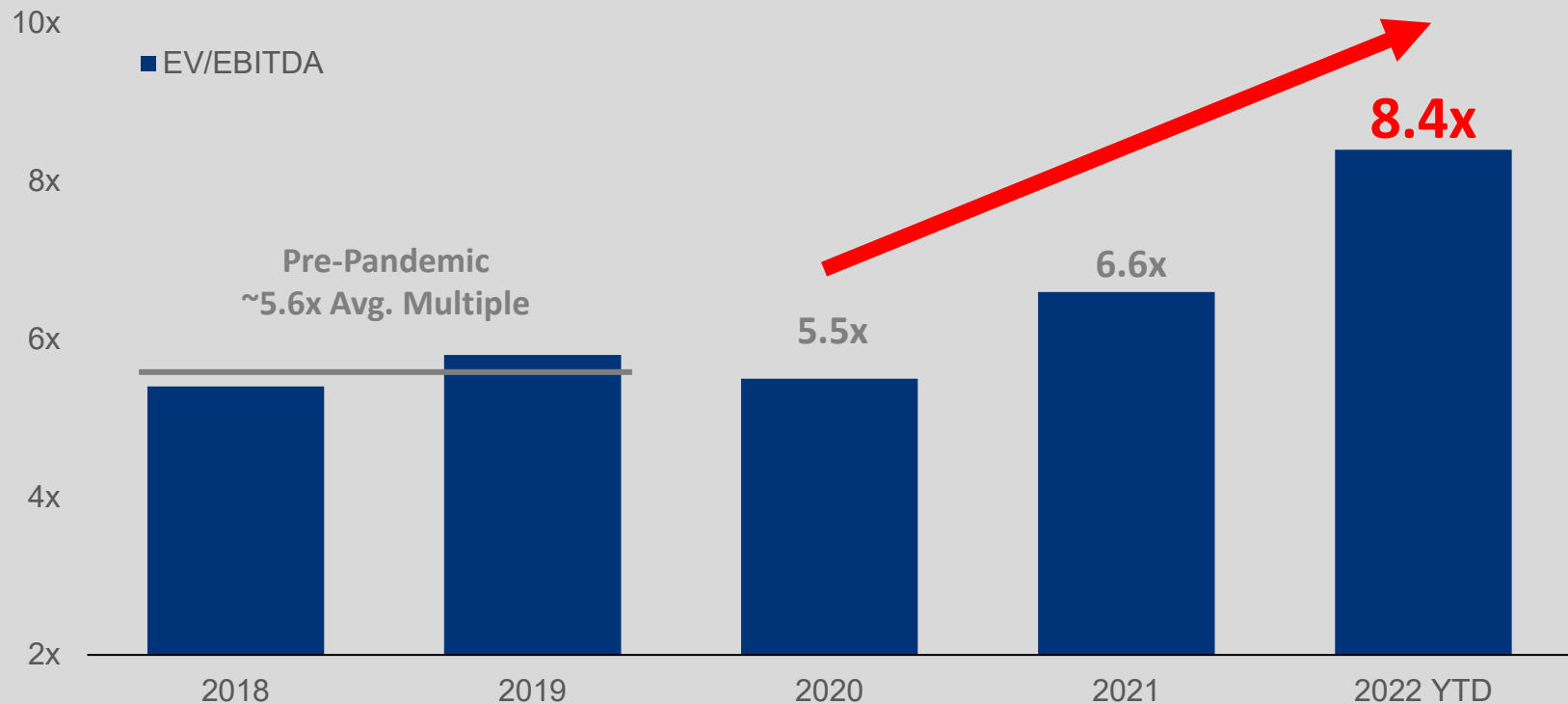


■ Financial ■ Strategic

## What do Valuations look like in the Construction sector today?

- **Construction multiples on a steady, upward trajectory**
  - Strong M&A valuations exist today, particularly for well-positioned Construction companies
  - Similar to the uptick in deal *activity*, Construction valuations have experienced robust tailwinds beginning in mid-2021 and continuing into 2022, following the passage of IJA

### Construction Company Peer EBITDA Multiples Over Time



## What is my Construction Company Worth Today?

- Valuations for Construction companies vary widely
- That said, certain sub-sectors tend to trade in ranges (“starting points” for buyers/sellers)
- Of course, stretch values (above the ranges below) are possible for high-performing companies with near-term growth opportunities and strong market positions

3.5x – 5.0x	5.0x – 7.0x	6.5x – 8.5x+
<p><b>General Contractors</b></p> <p>-----</p> <ul style="list-style-type: none"><li>▪ “Time and Materials” / fixed rate cost structures</li><li>▪ Project-based revenue</li><li>▪ Margins exposed to material, equipment, and labor inflation; cost over-runs</li></ul>	<p><b>Specialty: Heavy Constr.; HVAC; Plumbing; Electrical</b></p> <p>-----</p> <ul style="list-style-type: none"><li>▪ Average gross margins relative to broader industry</li><li>▪ Blend of project-based and recurring / “on-call” revenue streams</li><li>▪ Ability to directly provide niche services via a high-skill labor pool</li></ul>	<p><b>Specialty: Civil Engin.; Highway; Street; Bridges; Underground</b></p> <p>-----</p> <ul style="list-style-type: none"><li>▪ Significant pricing power drives strong gross margins</li><li>▪ Recurring revenue streams tied to maintenance and upgrade spend</li><li>▪ Direct provider of specialized services and equipment</li></ul>

- **Do you want to know the answer?**
  - UHY is completing more Valuations and Pre-Sale Preparation Processes than ever before!
  - A detailed assessment of each company’s scorecard informs ultimate values in the market

## What is my Construction Company Worth Today?

- “It Depends”
- What does your company’s scorecard look like?

### Value Drivers

- Large Size / Geo. Diverse (Rev., Employees)
- Strong / Growing Backlog
- Recurring Revenue
- Strong / Continuing Management Team
- Diverse Customer Base
- Talented Labor Pool; Access to Talent
- Robust, Sustainable Profit and EBITDA Margins
- Specialty Equipment / “Yellow Iron” In Place

### Value Considerations

- Small Size / Geographic Concentration
- Flat / Declining Backlog
- Project-Based Revenue
- Owner / Management Departing Post-Close
- Customer Concentration (Top 2 = 50%+ of Rev.)
- Scarce Labor Market; High Turnover
- Below-Industry, Volatile Profit and EBITDA Margins
- Asset-Light Businesses; Equipment Shortages

- Effectively positioning a Company’s key value drivers (and mitigating value considerations) is essential to maximizing value
- Can you and your advisors articulate what makes the Company unique?

Who is UHY Corporate Finance?

What does the general M&A market look like today?

Is now a good time to sell my Construction company?

## Deal process and terms

What are some next steps for business owners?

## Pre-Sale Preparation

## Sale Process

## Key Terms

- **Detailed assessment of historical financials**
  - Transparency is important
  - Sell-Side Quality of Earnings assessment (Understand your financials from an M&A perspective)
- **Detailed, “bottom up” forecast more critical than ever**
  - “10% growth” no longer sufficient for buyers
  - Monthly
  - By customer / project / end-market
- **Valuation Assessment**
  - Set realistic expectations
  - Not ready to sell? Devise a roadmap to value creation in the years ahead

**Assembling the right team is critical to achieving maximum value!**

## Pre-Sale Preparation

## Sale Process

## Key Terms

- **Be ready...this is a long process!**
  - “Value maximizing” sale processes = 6-9 months from start to finish
  - The right Investment Banking partner will take a lot off your plate
- **A milestone-driven process is critical**
  - Time kills deals
  - Maintaining momentum in the sale process is critical
- **Illustrative Timeline:**
  - Preparation
  - Launch transaction to buyers
  - Initial offers in 4-5 weeks (hard deadline)
  - Final offers in 4-5 weeks (hard deadline)
  - Closing in ~3 months

**Assembling the right team is critical to achieving maximum value!**

## Pre-Sale Preparation

## Sale Process

## Key Terms

### ■ **Cash-at-Close**

- Higher cash-at-close is becoming more common in Construction M&A
- Great news for sellers...but buyers are taking on more risk

### ■ **Structure (e.g., earn-outs, seller notes, etc.)**

- Sellers looking to minimize
- Buyers looking to maximize

### ■ **Working Capital**

- Setting “Target Net Working Capital” is a CRITICAL deal point
- Multiple valid approaches to setting the Target
- Can result in million-dollar value shift between buyer and seller if not done well

**Assembling the right team is critical to achieving maximum value!**



**Who is UHY Corporate Finance?**

**What does the general M&A market look like today?**

**Is now a good time to sell my Construction company?**

**Deal process and terms**

**Tips and next steps for buyers and sellers**

## Tips from the Investment Banker's Playbook

### Tips for Buyers

- **Assemble the right team**
  - Don't try a buy-side search on your own (thank me later)
  - Hire advisors familiar with Construction industry dynamics
- **Know the current market**
  - Many frustrated buyers offering stretch values...and still losing (cash at close)
- **Play the game**

Sell-side Investment Bankers hate this, but oh well

  - "Light touch LOIs" (dig in later)
  - Strategic bid ranges
  - Feel out the process

### Tips for Sellers

- **Assemble the right team**
  - Get the team together (VERY) early
- **Complete a Pre-Sale Prep.**
  - Get informed!
  - Sell now or grow into value w/ a plan
  - 1, 3, 5 years before a sale is optimal
- **Pick the "low hanging fruit" now**
  - Make sure you get paid for "easy fixes"
- **Know what to expect**
  - Sale process (a lot of work lies ahead!)
  - And beyond (how long will you stay on?)

## Take the Next Step Today!

### ■ Are you a buyer?

- You can still get a great deal in this market
- It may be getting a little bit easier

#### For Potential Buyers

##### Determine Target Criteria

Launch Buy-Side Search

Identify Targets

Agree to Price / Terms

Complete Diligence

Close Acquisition

4 – 6 Months

### ■ Are you a seller?

- Aggressive buyers will stretch on value / terms
- Opportunity to leverage current environment

#### For Potential Sellers

##### Value Assessment

Begin Prep. Process

Launch Sale Process

Sign Letter of Intent

Complete Diligence

Close Sale

6 – 9 Months

**Market Timing will be Critical to a Successful Transaction!**

### ■ Determine the right strategy for your business

- And ASSEMBLE THE RIGHT TEAM

# Q&A

# Feel Free to Reach Out to Today's Presenters:



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*Analyst*

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**(248) 204-9482**



# UHY ADVISORS CONSTRUCTION UPDATE

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**THURSDAY** September 29

JOHN GALLO

NATIONAL CONSTRUCTION PRACTICE LEADER



An independent member of UHY International



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## BUSINESSES

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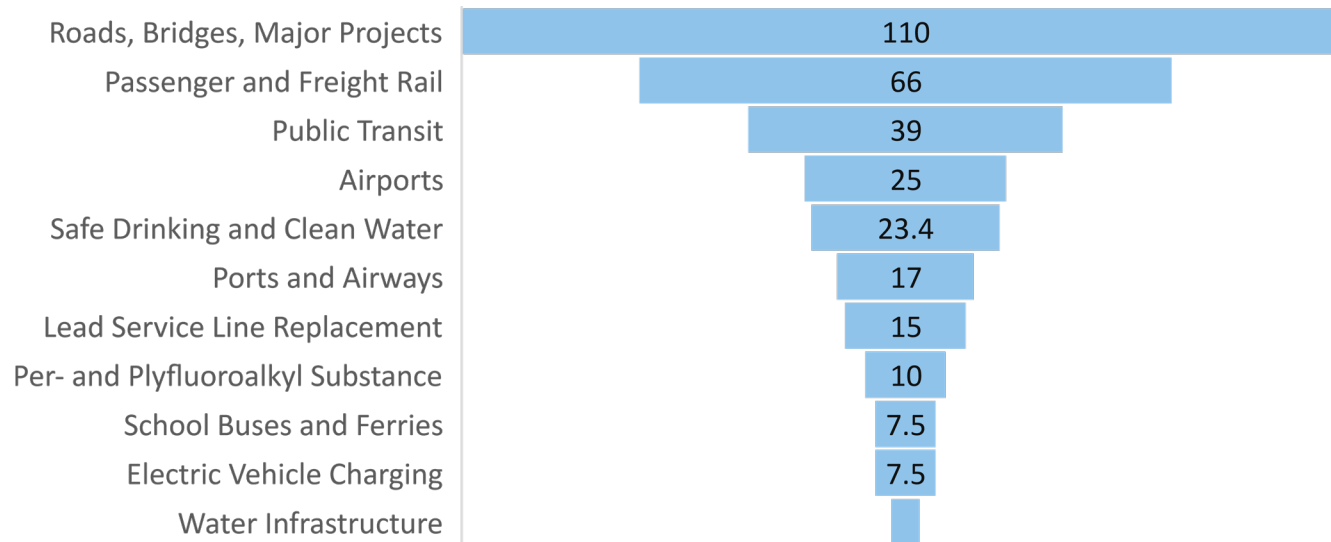


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## INFRASTRUCTURE INVESTMENT AND JOBS ACT

### \$550 Billion in New Additional Spending



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## CORPORATE TAXES

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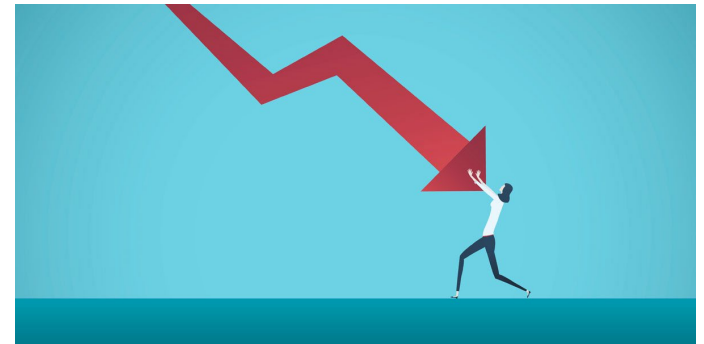
- The Build Back Better framework adopted a 15% minimum tax on profits from corporations who report over \$1 billion in profits.
  - Effective tax years after December 31, 2022.
- 1% surcharge on corporate stock buybacks.
  - Effective tax years after December 31, 2022.
- Changes to foreign deductions
  - Global Intangible Low-Taxed Income (GILTI) deduction reduced to 28.5%
  - Foreign-Derived Intangible Income (FDII) deduction reduced to 21.875% in 2025 (from 37.5%)



## NET OPERATING LOSSES (NOLS)

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- Can offset taxable income by 80%
- Can be carried forward indefinitely
- For 2022:
  - 80% limitation on NOLs generated
  - Any NOLs after 2021 can only be carried forward



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## CHANGES TO 179D BUILDING DEDUCTIONS

### Inflation Reduction Act of 2022

- Starting in 2023, the 179D deduction will be accessible to
  - Commercial building owners
  - Designers of buildings owned by government entities, non-profits, religious organization
  - REITs
- The new range is a sliding scale from 25-50% of reduced energy, with the base ranging from 50 cents to \$1/sqft.
- The bonus depreciation is a Sliding scale of \$2.50/sqft for energy savings of 25% and up to \$5/sqft for energy savings of 50% or greater for companies that meet the requirements for any laborers and mechanics employed by the taxpayer/contractors associated with the installation.



## CHANGES TO 179D BUILDING DEDUCTIONS

Provision	Effective Jan 1, 2006 – 2022	Effective Jan. 1, 2023
<b>Eligibility</b>	<ul style="list-style-type: none"> <li>Commercial Building Owners</li> <li>Designers of buildings owned by government entities</li> </ul>	<ul style="list-style-type: none"> <li>Commercial Building Owners</li> <li>Designers of buildings owned by:                             <ul style="list-style-type: none"> <li>Government entities</li> <li>Non-Profit Organizations</li> <li>Religious Organizations</li> <li>Tribal Organizations</li> </ul> </li> <li>REITs</li> </ul>
<b>Tax Deduction Range</b>	63cents/sqft - \$1.88/sqft per eligible system	<ul style="list-style-type: none"> <li><b>Base deduction:</b> Sliding scale of 50 cents/sqft for energy savings of 25% and up to \$1/sqft for energy savings of 50% or greater</li> </ul>

# CHANGES TO 179D BUILDING DEDUCTIONS

Provision	Effective Jan 1, 2006 – 2022	Effective Jan. 1, 2023
<b>Deduction Cap</b>	<ul style="list-style-type: none"> <li>A lifetime cap of \$1.80/sqft or \$1.88/sqft with inflation adjustment</li> </ul>	<ul style="list-style-type: none"> <li>A three year-cap that allows IRC Section 179D to be claimed on buildings if the previous full deduction claim occurred more than three taxable years ago</li> </ul>
<b>Technical Requirements</b>	ASHRAE standard in effect from four years prior to start of construction	<ul style="list-style-type: none"> <li>ASHRAE standard in effect from four years prior to completion of construction</li> </ul>
<b>Other Items</b>	N/A	<ul style="list-style-type: none"> <li>Must meet local prevailing wages</li> <li>Meet apprenticeship % hours for up to 15% of labor hours</li> </ul>



## SECTION 179 AND BONUS DEPRECIATION

	2021 Limits	2022 Limits	Qualified Property
Section 179 Maximum expense election	\$1,050,000	\$1,080,000	<ul style="list-style-type: none"> <li>• Machines and equipment</li> <li>• Computers</li> <li>• Office furniture and equipment</li> </ul>
Phase-out threshold	\$2,620,000	\$2,700,000	
Bonus Depreciation	100% of purchases	100% of purchases	Generally, applies to depreciable business assets with a recovery period of 20 years or less

	2022	2023	2024	2025	2026
Bonus Depreciation	100% of all purchases	80%	60%	40%	20%



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## RESEARCH & DEVELOPMENT CREDIT

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- Industry tax credit incentive for use of engineering to develop drawings (CAD/BIM) and construction techniques
- Creates a dollar-for-dollar tax reduction on top of normal operating deductions.
- Qualified activities for the credit
  - Technical Bidding/Estimating/Concept Development
  - Design Development
  - Development of Construction Means & Methods
- Qualified Contract Types
  - Lump Sum, Fixed Price or Milestone Based
  - Design Build, Design Assist, Plan to Spec



## PAYCHECK PROTECTION PROGRAM (PPP)

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- Many companies obtained funds
- Took a very long time to receive forgiveness
- Many taxpayers are receiving full forgiveness of the loan
- Of course, there are those that take advantage of the system:



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## EMPLOYEE RETENTION CREDIT (ERC)

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- Every company should evaluate their eligibility to qualify for an ERC
- Bright-line tests:
  - Number of Full-Time Employees
    - In 2020, the business must have less than 200 FTEs
    - In 2021, the business must have less than 500 FTEs
  - Revenue decline compared to 2019 base year
    - In 2020, Revenue must have declined 50%
    - In 2021, Revenue must have declined from 20%
- Construction industry was deemed an “essential service”



## EMPLOYEE RETENTION CREDIT (ERC)

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- Notice 2021-20 was issued by the IRS to “try” to help clarify certain items regarding the ERC. This notice is a 102 pages to clarify the rules for the ERC.
- “Section 2301(c)(2)(C)(i) of the CARES Act provides that in the case of an organization described in section 501(c) of the Code and exempt from tax under section 501(a) of the Code (a tax-exempt organization), sections 2301(c)(2)(A)(i) (relating to the requirement of carrying on a trade or business) and 2301(c)(2)(A)(ii)(I) (relating to a full or partial suspension of the operation of a trade or business due to a governmental order) apply to all operations of the organization.”



# INDIVIDUALS

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# CURRENT RATES – INDIVIDUALS\*

## Individual Rates

Ordinary Tax Rates – 2022	
Tax Rate	Income
10%	\$0 – 10,275
12%	\$10,276 – 41,775
22%	\$41,776 – 89,075
24%	\$89,076 – 170,050
32%	\$170,051 – 215,950
35%	\$215,951 – 539,900
37%	Over \$539,900

\*MARRIED FILING JOINTLY



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## CURRENT RATES – INDIVIDUALS\*

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### Capital Gain Rates

Capital Gain Tax Rates - 2022	
Tax Rate	Taxable Income Over
0%	\$0
15%	\$41,675 -459,750
20%	\$459,751+

\*MARRIED FILING JOINTLY



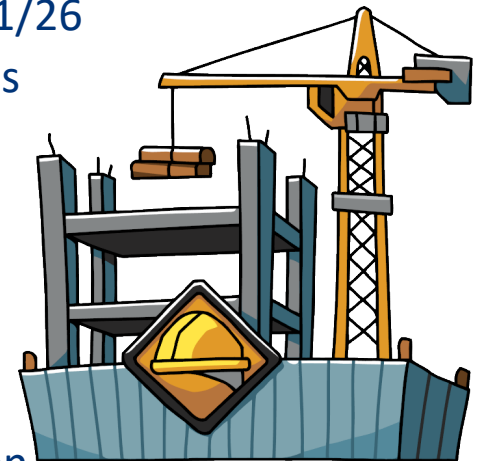
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## OPPORTUNITY ZONES IN CONSTRUCTION

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- Current tax benefits:
  - Tax on capital gains invested in QoF's deferred until 12/31/26
  - If investment is held for 5 years, a 5% step up in cost basis
  - If investment is held for 7 years, a 15% step up
  - If held for 10 years, no future tax on appreciation of the investment
- All investments would need to be made prior to 12/31/26
- Potential Opportunity
  - The bipartisan Opportunity Zones Transparency, Extension, and Improvement Act, if passed, would extend the deferral period to 2028, and allow all investments made prior to 12/31/22 to receive the full 15% basis increase.



# ESTATE TAX

- Tax on the transfer of the estate of a deceased individual
  - Applies to property transferred via a will or state law

	2022	2023
Exemption Amount	\$12,060,000*	\$12,920,000*
Tax Rate	40%	40% *deduction is per person



- Adjustment of exemption amount
  - Will sunset to \$5,490,000 per individual as of January 1, 2026.



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## TAX PLANNING TIPS

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- The golden tax rule is “Defer, Defer, Defer”
- Last year, we were thinking of ways to potentially accelerate income
- Now with Mid-Term elections approaching Defer income and cross your fingers
- Discussing with your trusted business advisor is crucial



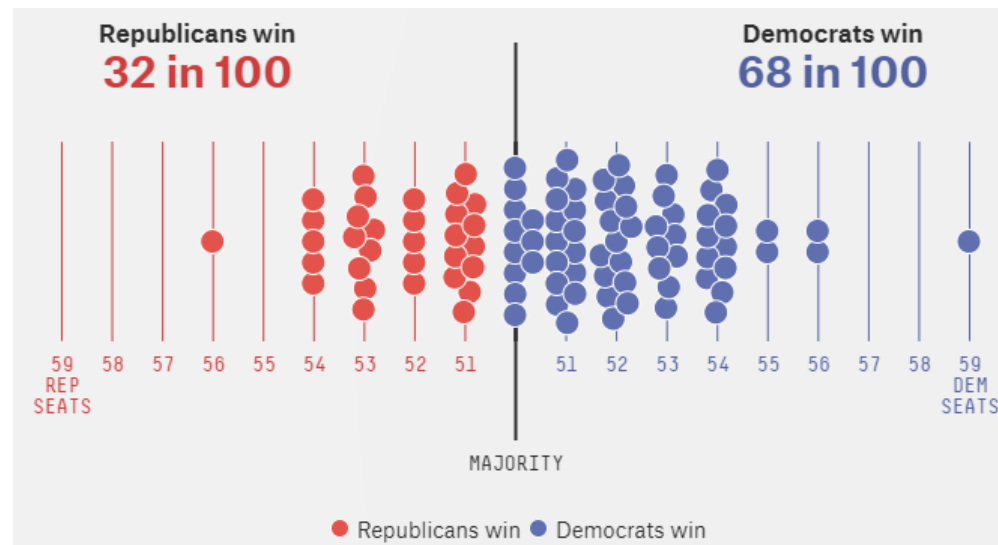
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## SENATE (PROBABLY) DEMOGRAPHIC

- Many predictions show that Democrats holding more seats in the Senate is the most likely scenario



A modeling company simulated the election 40,000 times to see which party wins the Senate most often. This sample of 100 outcomes gives you an idea of the range of scenarios the model considers possible.

## CONTACT INFORMATION

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