William Blair

Focus on Infrastructure Investment Drives Future Opportunity

At the recent P3 Conference & Expo, the Trump administration's push for a massive infrastructure spending plan sparked new conversations about infrastructure services opportunities and public-private partnerships playing a bigger role in the delivery of new projects.

Industry Commentary

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The Trump administration's stated goal of implementing a $1.5 trillion infrastructure framework has created significant excitement and optimism throughout the infrastructure services industry. While details of the plan are still being developed, many experts in the industry believe that to achieve such an ambitious plan, the private sector will have a major role to play in funding and executing future projects through public-private partnerships (P3s).

The infrastructure services industry continues to deliver strong financial performance, backed by a favorable transportation spending outlook and positive volume trends. This has led to many of the largest publicly traded engineering and construction companies significantly outperforming broader equity markets over the past six months, as well as an expectation of increased M&A activity.

Against this positive macroeconomic backdrop, several trends are causing infrastructure services companies to evolve as the industry responds to changing demands and new market pressures. These trends—and how companies can successfully adapt to them—were the focus of many presentations and conversations at this year's Public-Private Partnership (P3) Conference & Expo in Dallas.

As North America's largest P3 industry event, the February 26-28 conference featured nearly 65 exhibitors and more than 1,350 attendees from across the industry. Based on the presentations we attended and our conversations with executives and key decision-makers at the conference, we examine several of the most pressing opportunities and challenges facing the infrastructure services industry as P3 is poised to play a larger role in revitalizing U.S. infrastructure. We also look at how these trends will shape dealmaking and capital-raising activity in the infrastructure services industry.

Infrastructure Plan Remains a Key Focus

Many of the presentations and conversations at the conference focused on the impact that the Trump administration's spending plan could have on the infrastructure services industry. While the execution timeline remains in flux, the potential for a

robust, long-term infrastructure investment plan brought significant optimism for those in attendance at the conference. With approximately $1.5 trillion to be invested over a 10-year period, the discussed plan has the potential for broad impact across infrastructure services, design services, testing and inspection services, and other supporting industries.

Martin Klepper, former executive director of the U.S. Department of Transportation's Build America Bureau, noted that significant private investment, as well as state and local funds, will be needed to bridge the gap between the $200 billion in federal public funds currently allocated to infrastructure projects and the total $1.5 trillion cost of the administration's 10-year plan.

Mr. Klepper indicated that the $200 billion in funds will likely be allocated to a host of infrastructure initiatives, including rural infrastructure, broadband connectivity systems, and "transformative" mega projects. These funds will also help expand the existing Transportation Infrastructure Finance and Innovation Act (TIFIA) program for projects of national and regional significance.

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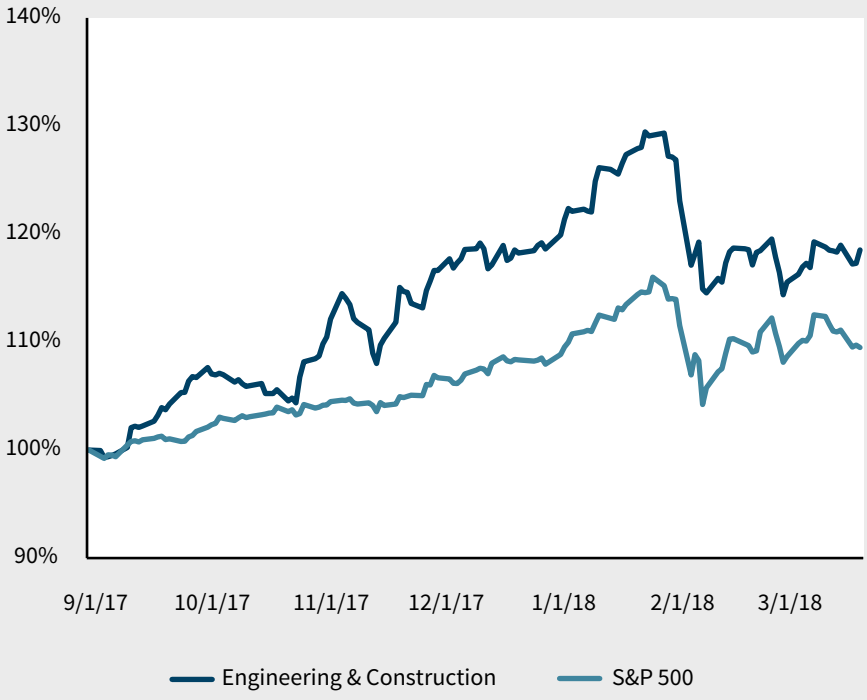
Engineering & Construction Outperform

Backed by a favorable transportation spending outlook and positive volume trends, the engineering and construction industry has significantly outperformed the broader equity market over the last six months. This performance, along with new growth opportunities for infrastructure services companies in light of the Trump administration's $1.5 trillion infrastructure spending goals, has generated M&A interest in the industry from strategic acquirers and financial sponsors.



Index includes: AECOM, Arcadis NV, Balfour Beatty plc, Bilfinger SE, EMCOR Group, Fluor Corporation, Granite Construction, Jacobs, and McDermott International

Source: S&P Capital IQ

encouraging for the infrastructure services industry. Increased spending on such projects would be significant tailwinds for architecture and engineering (A&E), consulting services, and materials testing companies.

Operations and Maintenance Play a Critical Role in P3 Success

Public sector agencies and owners say that one of the biggest reasons they are looking to increase their use of P3s is the opportunity to have a private company take on the long-term financial and logistical responsibilities of operating and maintaining assets. Deferred spending has led to systematic structured deficiencies that, combined with budget constraints have made it increasingly difficult for public entities to manage these ongoing responsibilities.

This creates both a challenge and an opportunity for the private sector. Within the design-build-finance-operate-maintain (DBFOM) life cycle, private-sector companies have traditionally focused on designing and building. But with most P3 projects, the private sector plays a major role in all phases of the DBFOM life cycle. As a result, private-sector companies that can successfully expand their capabilities related to operations and maintenance (O&M) have an opportunity to significantly grow their businesses.

Further, engineering consulting firms will continue to see more benefits of additional outsourcing for infrastructure design solutions. The use of private-sector design expertise enables innovative solutions based on the latest technology and research, and also provides incentives for cost efficiency.

Technology Creates Opportunities to Optimize Life Cycle Costs

The architecture and engineering industries in the United States have been a hotbed of technological innovation for decades. Despite this, many of the most valuable applications of engineering and construction technology have not been fully deployed in U.S. infrastructure.

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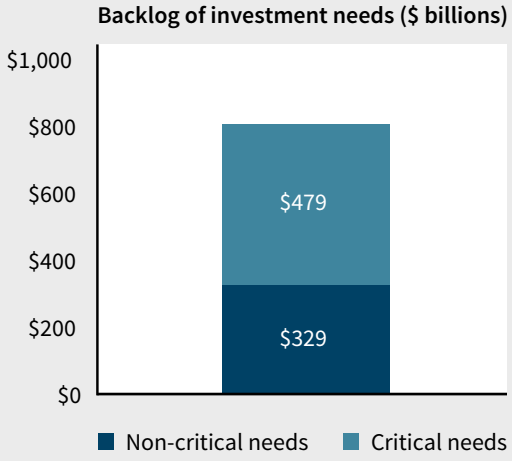
By the Numbers: The State of U.S. Highways and Bridges

Within the larger U.S. infrastructure system, highways and bridges carry an outsized load. As a result, they will be a focus of any future infrastructure investments. The U.S. Department of Transportation quantified the strain being put on the country's highways and bridges.



11% of assets deemed structurally deficient

14% of assets not designed for current traffic load

Source: U.S. Department of Transportation

The Internet of Things (IoT), data analytics, and material science advancements present tremendous opportunities to reduce the total life cycle cost of infrastructure projects in the United States. Public policymakers will continue to look for new, creative ways to enable private-sector partners to address holistic life cycle infrastructure management. When deciding which companies to partner with, public entities will increasingly look at how companies are using systems such as structural health monitoring, predictive maintenance, and other forms of data gathering and analysis to lower the project's total life cycle costs. In addition, there is much discussion about what role innovative materials and more sustainable construction processes should play in increasing the durability of U.S. infrastructure.

Risk Management Challenges Remain at the Forefront

With P3 projects, how risk is shared and managed between the public and private sector continues to be one of the greatest areas of concern—for both sides. Two of the most common sticking points are public-sector owners' reluctance to give up control and limit the oversight of the project, and private-sector designers' fear of taking on risks that are not insurable.

For the public-sector owner, transfer of control is often very uncomfortable, as the agency will ultimately own the asset and will maintain responsibility in the future. For the private sector, particularly with the use of DBFOM methods, there is a strong focus on mitigating the financial, maintenance, and design (including site condition) risks that are inherent to each project.

While these challenges continue to be significant, recent technological developments and innovative ways of thinking have created new opportunities for the public and private sectors to partner in ways that allocate risk more efficiently, according to Mike Bennon, a managing director at Stanford University's Global Projects Center. "Innovations in data analytics, program management, and project finance present significant opportunities for the public and private sectors to better mitigate risks for future infrastructure projects," Mr. Bennon said.

One option that is frequently discussed involves linking funding and financing to infrastructure delivery and performance. Using performance-based specifications in contract documents, as opposed to more prescriptive requirements, creates opportunities for the private sector to develop more cost-effective solutions.

Infrastructure "Resiliency" Becomes a Major P3 Focus

Many recent P3 projects are focused on improving the "resiliency" of U.S. infrastructure. Policymakers are prioritizing protecting scarce water resources, mitigating the impact of natural disasters, and reducing the impact of tornadoes, hurricanes, floods, excessive heat, and other forms of extreme weather. P3 projects have been considered for Disaster Recovery Zone projects in high-risk areas such as Florida, Houston, Georgia, Louisiana, Puerto Rico, and other locations.

Resiliency studies, such as the one performed on the city of Dallas in conjunction with the Rockefeller Foundation, help identify the largest vulnerabilities in the area's infrastructure, as well as understand the social and economic impacts of natural disasters. These studies often lead to recommendations for ways to improve the infrastructure's ability to withstand physical damage and the speed and efficiency at which infrastructure can be repaired, as well as solutions to help mitigate significant socioeconomic impacts.

To achieve these goals, public entities are increasingly considering the use

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of performance-based specifications in their contracts for resiliency-focused infrastructure projects. These specifications stipulate how a piece of infrastructure must perform under a certain set of outcomes. As noted previously, this approach could provide the private sector with the freedom to innovate, as well as the ability to insure against certain undesirable outcomes.

Future Infrastructure Services M&A Opportunities

Companies across the infrastructure services industry are sensing the opportunity to add capabilities to their platforms in an effort to reap the benefits of the new infrastructure plan. These efforts, in turn, are expected to lead to increased M&A activity across an industry that is characterized by a higher degree of fragmentation.

The shift toward technology-enabled solutions, as well as the additional demand for design and O&M solutions—and the capital expenditure required to keep up with these trends—create significant M&A opportunities for industry consolidators and private equity firms. Further, as P3 projects become more complex, many smaller firms may struggle to finance investments in new services and equipment that are needed to stay competitive.

Smaller companies can enhance their attractiveness as an acquisition target by successfully incorporating additional expertise and making investments to modernize their internal systems. The public sector is increasingly demanding flexible, adaptive, and nimble solution providers, and companies that have proven adept at delivering on these needs are well-positioned to gain market share and command premium valuations.

To learn more about the trends that are shaping the dealmaking and capital-raising landscape in the infrastructure services industry, please do not hesitate to contact us.