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The Top 400 Contractors — Broad Downturn Touches Most

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For the last two years large American contractors have watched the dominoes fall. Implosion of the stock market beginning in the spring of 2000 stalled many corporate capital spending plans. This brought about the telecom bust, followed by the power market slump. Commercial building began to lose steam in 2001, followed by the terror attacks of Sept. 11, the Enron debacle and the insurance industry collapse. This led to a drop in tax revenue, causing many states and localities to rethink their capital construction plans. Then came the war in Iraq and new uncertainties.

With all this going on, is it any wonder that ENR's Top 400 Contractors saw their collective revenue drop in 2002 and believe things won't get much better in 2003? The Top 400 managed to generate contracting revenue of $194.39 billion last year, but the total is a 3.2% falloff from the $200.93 billion figure in 2001. This marks the first decline since ENR switched to a revenue-based ranking measure in 1995. U.S. revenue for the Top 400 dropped 2.9% in 2002, to $174.79 billion. Internationally, revenue dropped 10.9% in 2002, to $19.6 billion, from $22.03 billion in 2001.

Usually, construction downturns seem to have peaks and valleys among the various markets. But this one seems broad-based, although some sectors are doing better than others. "It does seem that this isn't one of those isolated recessions. It seems everyone is affected to one extent or another," says Bart Eberwein, vice president of Hoffman Corp. in Portland, Ore.

Other executives agree. "One of the unique things about the market now is the consistency of the way everyone seems to see the market," says Robert McCoole, CEO of Alberici Constructors Inc. He notes that previous market downturns seemed to hit at different times with differing intensities, depending on the market or region. "Now, there is a widespread consensus on the fragile nature of every market," he says.

More troubling to many contractors is that few projects seem safe. "It's not just that the markets are soft, but it's the softness of the opportunities," says McCoole. "We've seen projects canceled or put on hold while still on the boards, but now we are seeing them stopped well along in the construction process."

The vagaries of corporate life these days are affecting even the healthier markets. Health-care owner HealthSouth Corp. was forced to stop work on a $300-million hospital project in Birmingham, Ala., because of alleged securities fraud involving some top executives (ENR 4/7 p. 20). "We had 700 people on that job and had to redeploy in a hurry when it was shut down," says Jim Gorrie, president of Brasfield & Gorrie.

The slow market has taken its toll on contractors. Many firms, particularly in California's high-tech market, now are faced with much lower revenue levels, showing one-year dropoffs as high as 50% from the high-flying boom days.

"The markets are still not as robust as we would like," says Peter Nosler, CEO of DPR Construction. "We look at this as the ‘new normal' market." Nosler points to DPR's closing of offices in Seattle, Portland and Denver. "We followed major clients into those markets, but now we are restructuring and have pulled back," he says. However, DPR offices in Phoenix, Atlanta and Washington, D.C., continue to be strong, Nosler points out. The firm is building the Library of Congress' new Film Archive facility and its Southern California market continues to be strong. "But now the size of the projects we are chasing is getting somewhat smaller," Nosler says. "There are more $10-million to 30-million projects in the mix."

Many contractors don't anticipate future market changes, but rather let current shifts dictate strategy, says Peter J. Davoren, newly named president of Turner Construction. "When our commercial work was booming three years ago, we decided to diversify more strongly into health care," he says. Now that niche is one of Turner's strongest. "If you change your strategy after a recession hits, your firm will have an internal recession," Davoren says. One firm that foresaw the future was Austin Industries. "Right now, about 75 to 80% of our work is public or institutional. It used to be the reverse," says David Walls, president of Austin Commercial. The firm began moving toward more public work about five years ago, and that preparation now is paying off, he adds.

LIGHTS OUT

The surge and then collapse of the power market has been well documented, particularly in California. "Starting with California's deregulation of power, then the Enron debacle, followed by the state's reregulation of the industry, the market has been poor," says Tim Healy, vice president for industrial projects for ARB Inc. He notes that major financial turmoil in the state's two major utilities, Southern California Edison and Pacific Gas & Electric Co., has only compounded the market's problems.

Healy doesn't see any major improvement in the near future. "The banks simply won't lend on projects without an anchor agreement to purchase the power," he says. "And there won't be any investment until the regulatory situation has been clarified to ensure decent [profit margin] spreads."

But there are still some contractors who see a glimmer of light on the horizon. "Power has been down for a while, but we're getting more inquiries," says Don Zabilansky, senior vice president of Lockwood Greene. "We've seen more inquiries in the last several months than we did in the 18."

If there is a bright side in the market, it is in the smaller municipal and local agency projects. "We are seeing a major shift in the market," says Healy. "The independent power producers are really off, but municipalities are taking advantage of the soft market for generation equipment." He adds that "the GEs, Westinghouses and Seimens of the world have surpluses. You definitely can build cheaper now."

Some major utilities may be considering new programs. "We are seeing a lot of our old clients, the utilities, coming back into the market," says Craig Wright, vice president of construction for Black & Veatch. The firm also is doing a lot of Clean Air Act compliance work and startups for utilities."We are doing a lot of smaller jobs, but we are pleasantly surprised that we are seeing decent margins on many of these jobs," he says.

Clean air and related environmental compliance work is adding new market opportunity. "We are doing quite a bit of work in power, installing scrubbers, precipitators and the like," says McCoole of Alberici. "It's good work and labor intensive. And we don't have to worry about chasing down the next greenfield plant like the power specialist contractors do."

Petroleum is another big-ticket U.S. market that has been hit hard. "High energy prices in the U.S. have generated high feedstock prices to such an extent that new investment in the U.S. in petrochemicals projects will be limited," says Ken Allen, senior vice president of Kellogg Brown & Root. "Projects will go where there is cheap feedstock and large markets, like China."

However, there may be growing potential domestically in liquefied natural gas-related work. "The gas business is strong now because domestic demand is up," says Pete Leathard, president of Veco Corp. KBR's Allen agrees. "In the U.S. energy sector, there is interest in looking at the importability of LNG," he says. "There is a whole series of projects being looked at. With natural gas prices where they are, LNG looks more attractive economically." There is a lot of activity in conceptual design and permitting of LNG terminals, Allen says.

The major oil-related domestic market may be in transportation of product. "We are very confident that the proposed Alaska pipeline will get the go-ahead," says Leathard. "BP-Amoco and ConocoPhillips are champing at the bit to get it going." Veco is targeting a new oil market sector, bidding now on refueling centers for the U.S. Navy around the world. "We've been shortlisted for some of these naval refueling bases," says Leathard. He feels that federal work like this is a great opportunity, "but you have to set up your business to be able to handle it without jeopardizing your relationships with your private-sector clients."

However, many contractors are disappointed about airport work, which showed so much promise before 9/11. "We don't see any major investment in larger airports," says Shaw. "What investment there is going into security." Washington Group is one of five finalists for a large program management contract to handle security at New York City-area airports and other facilities run by the Port Authority of New York & New Jersey.

One contractor enjoying long-term airport work is Austin Industries. "We're working on Terminal D at Dallas-Fort Worth International, which won't be completed until 2005, and doing work for American Airlines at Miami International that's scheduled for completion in 2006," says David Walls, president of Austin Commercial. He does note that financially strapped American Airlines is the prime tenant at DFW and a client at Miami, which is a concern. But in both cases, the local airport authority can step in on the job, if necessary, Walls contends.

BONDAGE

If there is an overriding concern among contractors apart from the market, it is insurance and bonding. "Even the big guys are seeing a tighter market for bonds," says ARB's Healy. "We just went through the review process," says Charles Bacon, CEO of Bovis Lend Lease. "We didn't have a problem, but a lot of contractors out there are going to be in for a shock and some are being dropped completely by their sureties."

DPR's Nosler sees "a good side" in the bonding situation. "Corporate clients are paying more attention to the financial strength of their contractors, and we're passing that test," he says, adding that DPR has $350 million in work under bond.

Bonding may play a key role in business relationships. Many contractors see competitors shopping for partners merely to bring in bonding capacity to compete for a particular project. Not every firm is enthusiastic about the practice. "We have a lot of joint ventures, and the percentage of the project they get depends on how much they can bond," says Alberici's McCoole. "If you can only bond 25%, you aren't going to get 50% of the job."

One big concern among general contractors is the financial health and stability of subcontractors. "A lot of subs are hanging on by their fingertips," says Alex Ivanikiw, senior vice president at Barton Malow. "One may be doing a good job for us, but if something goes wrong with them on the project down the block, they can default and can hurt you as well."

Turner Construction now is using its own subcontractor default insurance program. "The sureties are having a hell of a time bonding subs," says Davoren. "So we have a group that comes in to look over our subs' balance sheets. If they qualify, we enroll them into our default insurance program." The program also benefits minority-owned or women-owned subs. "Many are trying to get into the business and don't have the track record to get a bond. We provide an alternative," he says.

Many contractors work closely with subs to ensure financial stability. "We spend a fair amount of time getting to know our subs," says Rich Erickson, CEO of O'Neil Industries. "Since 70 to 75% of our work is negotiated, we have the luxury of choosing our subs." Erickson cautions that more general contractors are going to have to do this. "The Subguard insurance product is very interesting, but you have to be prepared. [Subguard insurance provider] Zurich comes in to give you a full physical to make sure you're financially healthy before selling it to you," he says (ENR 4/14 p. 56).

Insurance also is a problem, especially among subs. "Many smaller subs are finding it difficult to find coverage at affordable prices," says Richard J. Haller, president of Walbridge Aldinger. "The larger subs generally have adapted through sophisticated safety programs, self-insurance and the like."

Bacon is concerned about contractor reaction to higher prices in the insurance field. "A lot of companies are trying to limit the damage by taking very large deductibles. We are careful about that," he says. "We look at our subs' deductibles and financial strength before hiring them."

Contractors are seeing more wrap-ups and other owner-controlled insurance programs. But some say that the effectiveness of an "OCIP" depends on the owner. "I don't think they're the silver bullet they're made out to be," says McCoole. "Owners like the potential savings but don't really look into how the program is being run until they're deep into the project. So they lose the chance for real savings."<p>

WHO ARE THESE PEOPLE?

As the market sags, the competition for available work is becoming more intense. "Competition is as tough as we've seen in a generation or so," says Shaw of Washington Group. "We see firms competing that we've never seen before. On jobs where we used to see three or four competitors, we're now seeing nine or ten."

Some Top 400 firm executives worry that, with a crowded field, someone is liable to win a job with a bad bid, rather than by smart calculation. "We're seeing wide spreads on bids," says Shaw. "We're seeing 25 to 30% difference on jobs that are fairly well defined and we're seeing bids coming in 10, 20, even 30% under the engineer's estimate."

The speed of the bidding process also worries contractors. "We used to do a lot of preconstruction work leading up to at-risk contacts," says Ivanikiw. "Now, we are being asked to bid on a lot less information. It's very risky. It's a very dangerous time for contractors."

Growing procurement pressure has forced contractors to work harder to differentiate themselves. "Customers are becoming more analytical in assessing value," says Haller of Walbridge Aldinger. "They are becoming more attuned to where the value is, so providers must find the true value-added to be differentiated from the competition."

Turner Construction has tried to bring a new element to the game. "We are now offering to buy equipment and materials for our clients through Turner Logistics, using our buying power to provide better prices than our clients could," says Davoren. He cites a recent project for Winthrop University

Hospital on Long Island, N.Y. "In addition to building an addition to the hospital, we bought the beds and equipment and the client saved money," he says. Turner also has begun buying other equipment, such as chillers and air handling equipment, that normally is left to the subs. "That way, we can leverage schedule as well as price," Davoren says.

ZERO TOLERANCE

Among the large contractors, safety remains a very real concern. "We've made progress as an industry, but I don't think it has been as quick as it ought to be," says McCoole of Alberici. "There are still too many people out there willing to accept the status quo."

Wright of Black & Veatch says that "clients are driving safety issues now. There is a growing expectation of zero accidents." He says that B&V began in the mid-1980s to measure its safety record against Construction Industry Institute numbers, which were six to eight times better than average incident rates documented by the U.S. Occupational Safety and Health Administration.

"Two years ago, we decided we had to go with a zero accident-zero lost day policy," Wright says. "Dollar-wise, we are on par with our major competitors, so a zero tolerance for injuries is a differentiator for our clients."

Bovis is another contractor that has adopted a zero tolerance approach to safety. "We call our program IIF–Incident and Injury Free," says Bacon. "We tell our subs that simply staying within OSHA statistics is not good enough, that IIF is expected of them as well. It's now part of our culture."

Many contractors are coping with the downturn by expanding, diversifying or bidding on everything in sight. Others believe that you can make major mistakes trying to scramble for any work. "We're not planning to go far afield. We think that the market will turn around in the next year or so," says Hoffman's Eberwein. He jokes that contractors should adopt this motto: "Survive 'til '05."