

*Presentation to AAEEES  
National Press Club  
Washington DC  
April 19, 2018*

# **Environmental Infrastructure Engineering / Consulting Industry Trends, Changes, and Challenges**

Presented by Paul Zofnass, President  
Environmental Financial Consulting Group

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# Participants in the 28<sup>th</sup> Annual EFCG CEO Conference & Survey\*

New York, NY Oct. 30 – Nov. 2, 2017

Gross Revs	# of Firms	'17 Gross Revs (\$Bil)
➤ > \$1 Bil	20	81
➤ \$250 Mil-\$1 Bil	38	18
➤ \$100 Mil-\$250 Mil	49	8
➤ \$50 Mil-\$100 Mil	48	3
➤ \$25 Mil-\$50 Mil	34	1
➤ < \$25 Mil	41	1
Total	230	\$112 Billion

\*Includes primarily engineering and consulting revenues; ~13% is in construction & EPC

# List of ~240 Firms (in '17 Survey) by approx. Rev Size (over \$30 mil only)

AECOM  
Suez  
Jacobs  
Kiewit  
SNC Lavalin  
CH2M  
WSP  
Gilbane  
Stantec  
Black & Veatch  
Tetra Tech  
HDR  
Sweco  
APTIM  
Ramboll  
AmecFosterWheeler  
GHD  
ICF  
CDM Smith  
Arcadis US  
EGIS  
HNTB  
Golder  
Hatch  
ERM  
TRC  
RPS  
Kimley-Horn  
Garney  
Systra  
Berger  
Chemonics  
Terracon  
Poyry  
Baker

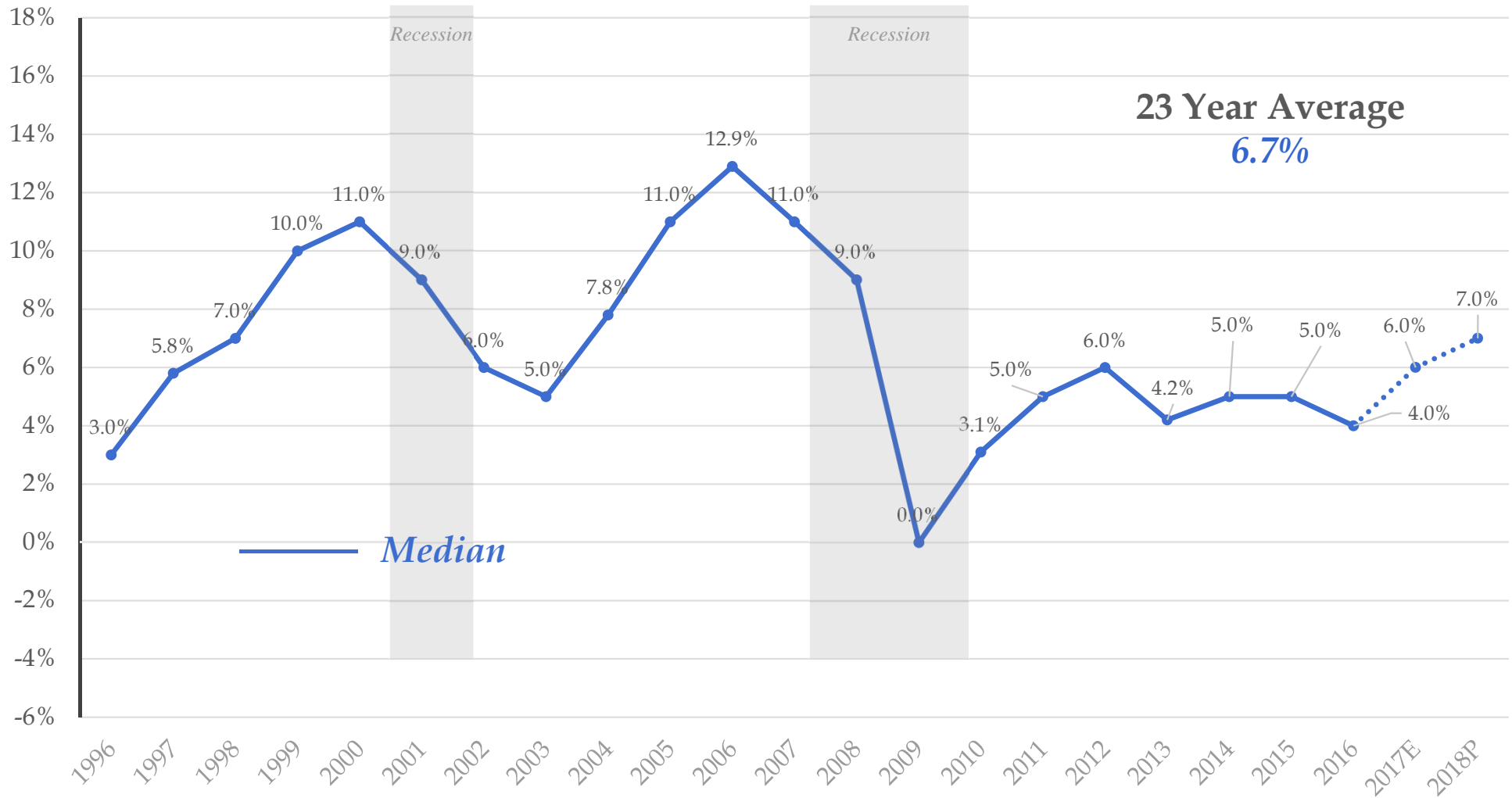
Fugro  
Turner & Townsend  
POWER Engineers  
Mott MacDonald  
Multiconsult  
STV  
Arup (North America)  
Sargent & Lundy  
Kleinfelder  
Calibre  
Brown & Caldwell  
Setec  
PM Group  
IBI  
ENVIRON  
IDOM  
NV5  
NIRAS  
Geosyntec  
Carollo  
Northwind  
CHA  
Enercon  
Weston  
Langan  
BE&K  
Meinhardt  
Ausenco  
Jensen Hughes  
Hazen & Sawyer  
KCI  
RS&H  
VHB  
Woodard & Curran  
O'Brien & Gere

GOPA  
TranSystems  
ECS  
CIMA+  
Haley & Aldrich  
SCS  
SSOE  
Volkert  
Stanley  
Gresham Smith  
Woolpert  
S&ME  
EN Engineering  
Apex  
GEI  
Moffatt & Nichol  
CRB  
Freese & Nichol  
Barr  
EA Engineering  
Associated Engin.  
GAI  
Partner Engineering  
HAKS  
David Evans  
Braun Intertec  
Merrick  
Envirocon  
Trinity  
Maser  
Lochner  
Charter  
Heery  
Mead & Hunt  
Psomas

Syska Hennessy  
LTK  
KLJ  
Anchor QEA  
SWCA  
Greeley & Hansen  
Vanir  
ESA  
Dudek  
Weston & Sampson  
Roux  
Ecology & Envir.  
Hanson  
Parametrix  
HR Green  
Strand  
Burgess & Niple  
Wood & Grieve  
AKRF  
Barge Design  
COWI NA  
McKim & Creed  
Raba Kistner  
Wade Trim  
H2M  
EnSafe  
Ulteig  
T&M  
Tighe & Bond  
LATA  
Schnabel  
Otak  
Bigen  
SME  
Harris Associates

# Internal Growth: *Median*

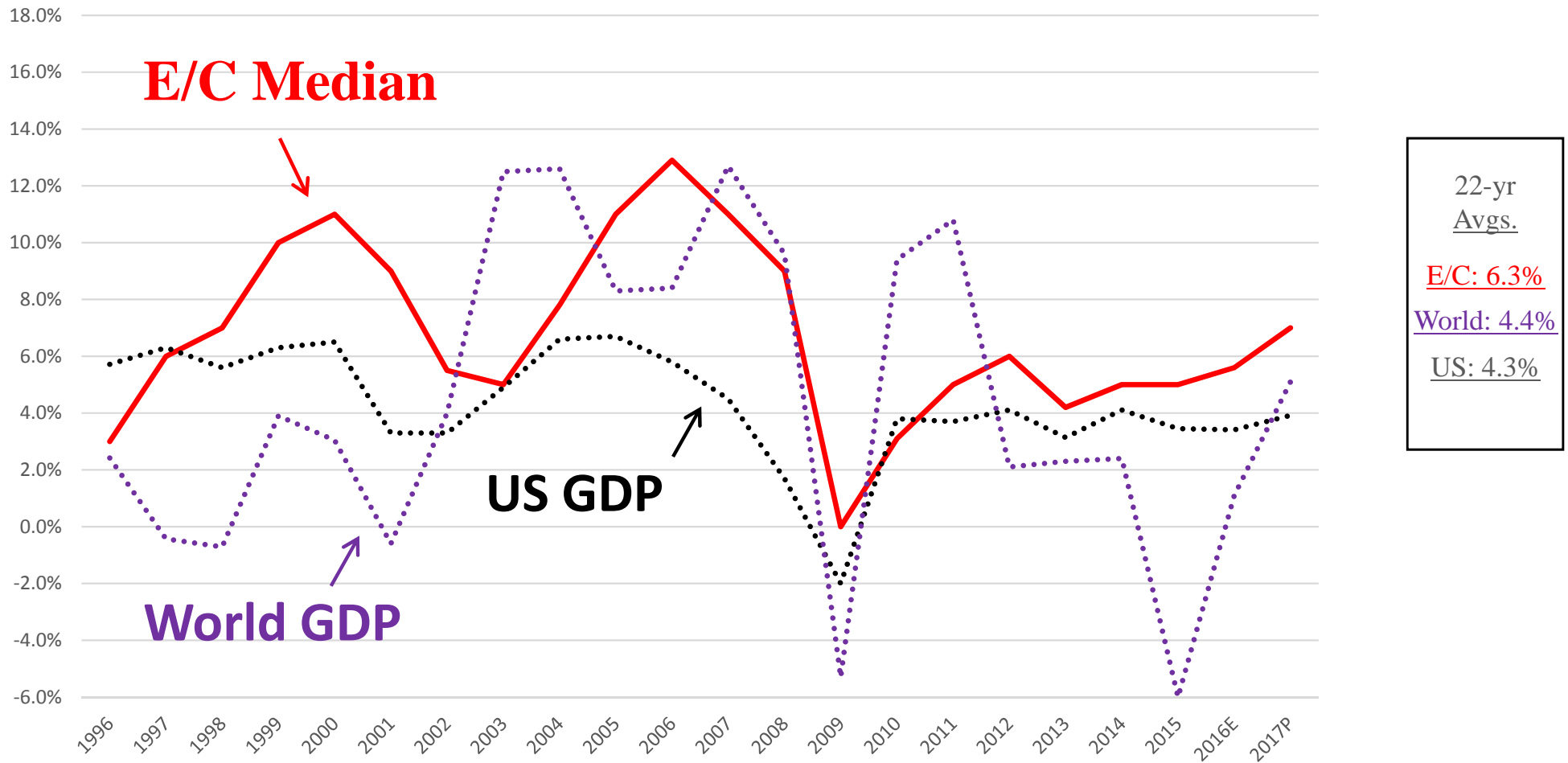
## Historical Perspective



- Growing industry, even in recessionary times; never a negative growth year!

# E/C Median Growth vs. GDPs

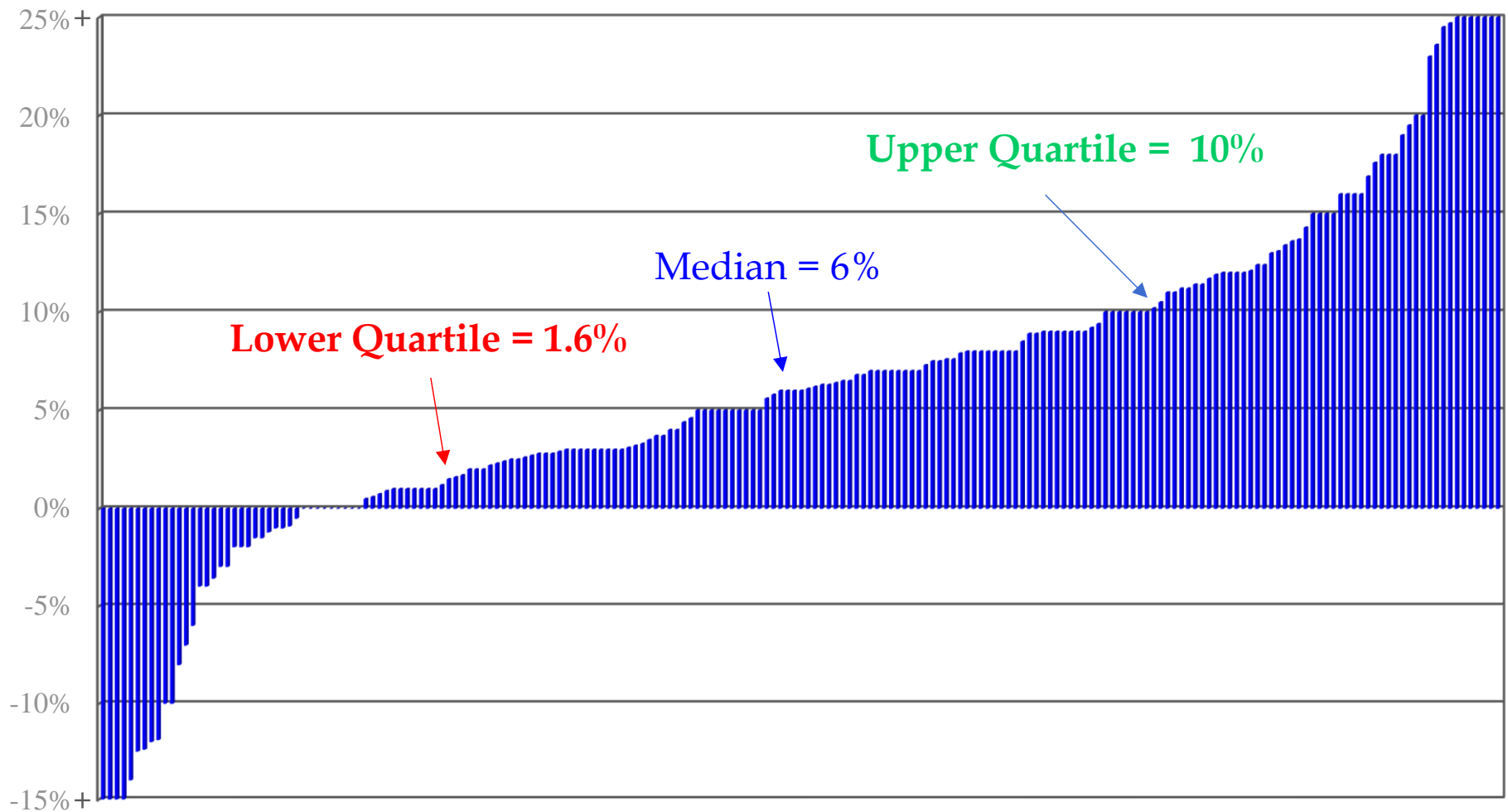
Nominal Growth Rates (in USD)



\* E/C industry average growth has been roughly 50% higher than US & World GDP

US & World GDP growth data source: IMF

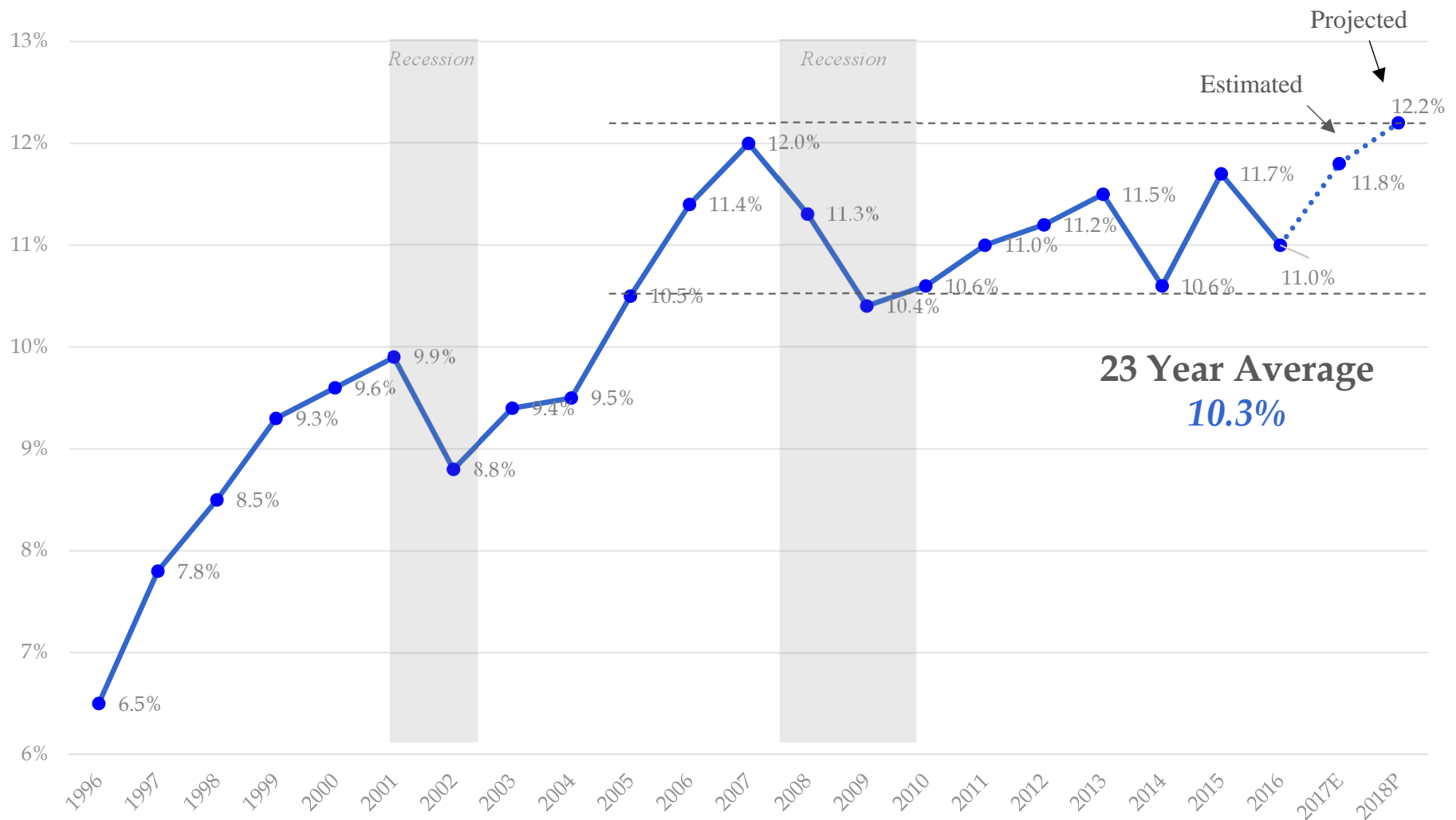
# 2017 Internal Growth Distribution



- Median doesn't tell the whole story: huge range; where is your firm? where should it be?

# Profitability

(Median EBIBT / Net Revenues\*)

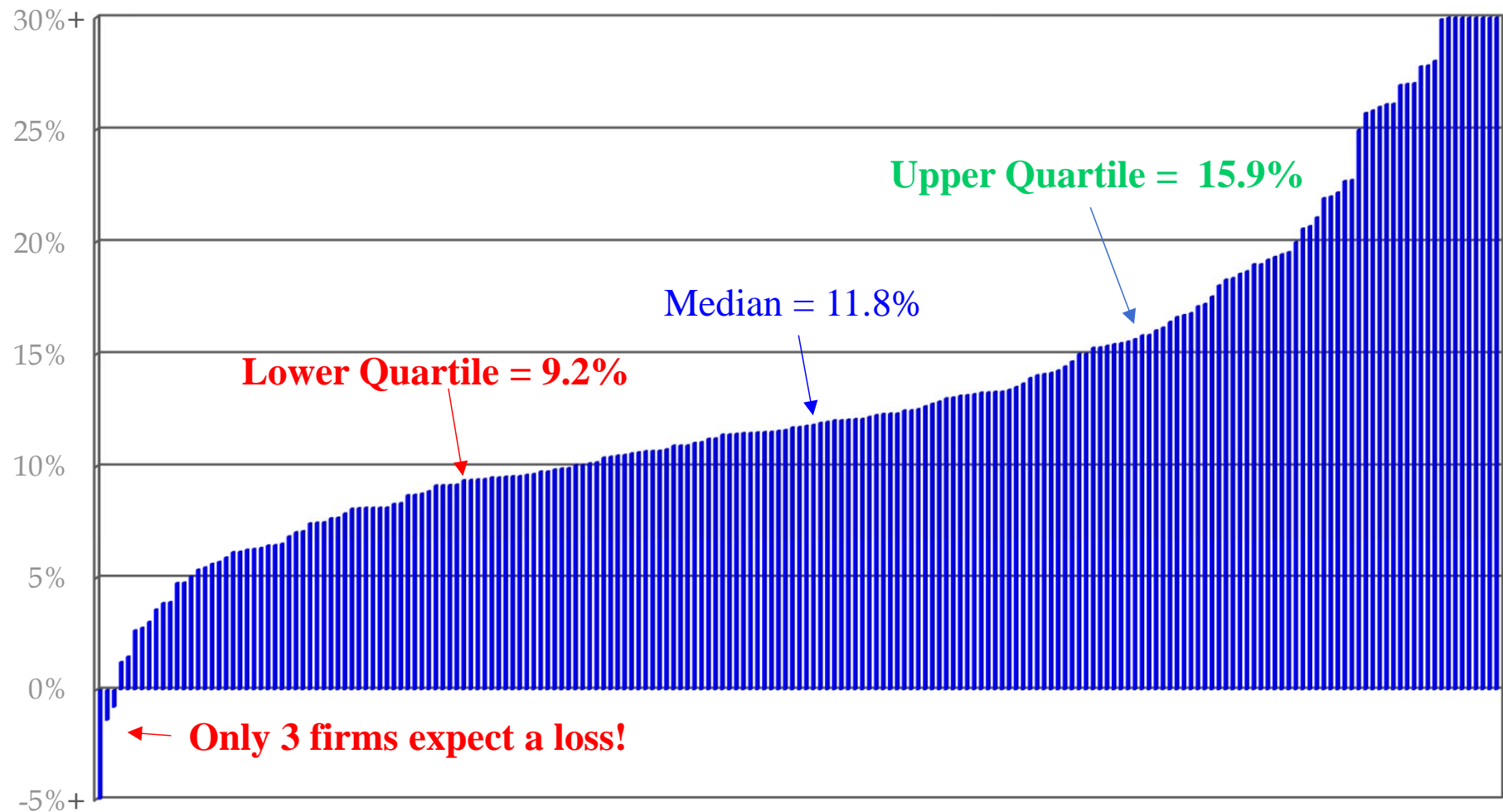


- Significant improvement over 20 years; Why?
- Profit margins decline only slightly during recessions – this is a resilient industry!

\*EBIBT = Earnings Before Interest, Bonuses and Tax; Net Revenues = Gross Revenues less pass-thrus (reimbursable expenses & subcontractors)

# 2017 Profitability Distribution

(EBIBT / Net Revenues)



- Median, again, doesn't tell the whole story
- Probably not appropriate to compare your firm vs. all firms
  - Better to compare by size, business, customer, geography & ownership (Peer Benchmarking Analysis)



# Hot & Cold Analysis\*

CEO Opinion Poll (sorted by 2017 "Net Positive Votes")

	2017			Change from 2016
	Best	Worst	Net Positive	
Transport/Infrastructure	111	6	105	27
Water/WW	59	1	58	15
Healthcare/Pharmaceutical	11	1	10	3
Power	12	6	6	-19
CM / PM	7	1	6	5
Sustainability/Resiliency	6	0	6	3
Technology	5	0	5	5
Renewable / Clean Energy	6	2	4	-9
P3	4	0	4	1
Industrial/Commercial Development	2	0	2	4
Residential/Land Development	8	7	1	-9
Municipal	6	6	0	5
Private Customer	1	1	0	-9
Buildings	6	11	-5	-12
Remediation	2	8	-6	-7
Environmental	19	24	-5	-17
Retail	0	10	-10	-10
Nat. Resources/Mining	3	15	-12	1
Federal	1	20	-19	-2
Energy / O&G	23	63	-40	11

\* Note: Transportation has been disappointing!

# Hot & Cold Analysis: 10-Year Perspective

## Sector Rankings by CEO's

2007 Rankings  
 #1 Trans./Infra  
 #2 W/WW  
 #3 Energy/O&G  
 #4 Power  
 #5 Env  
 #6 Nat.Resources

2017 Rankings  
 #1 Trans./Infra  
 #2 W/WW

#4 Power

#4 Power

#13 Private

#11 Res/Land Dev  
 #12 State/Muni  
 #12 Private

#17 State/Muni

#15 Env

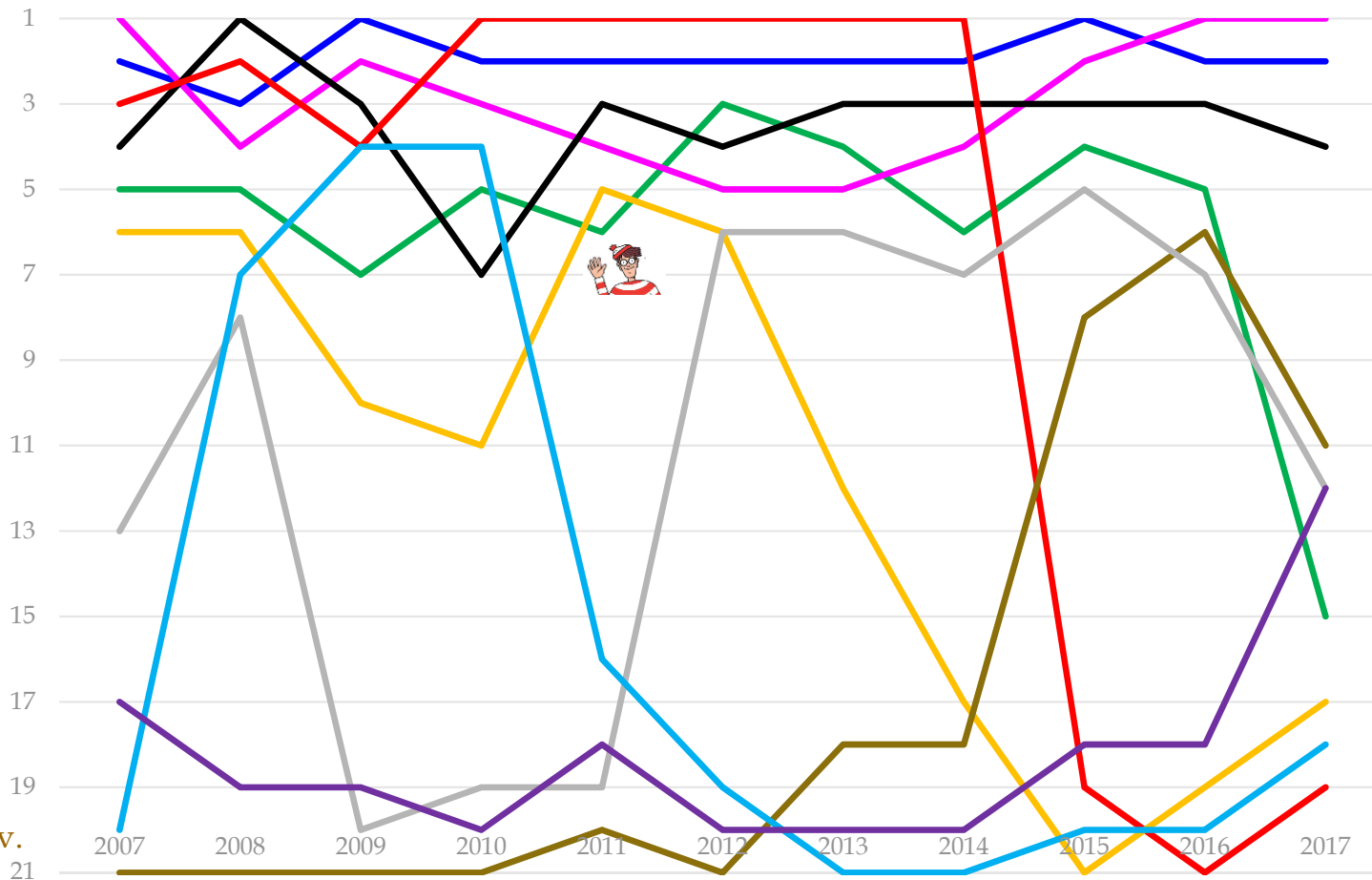
#20 Federal

#17 Nat.Resources

#21 Res/Land Dev.

#18 Federal

#19 Energy/O&G



Where's Waldo / Wally?

- Every sector has its ups and downs
- Argument for diversification?

# Who Disappears in 20 Years?

*All Firms >\$100 Mil Attending 1997 EFCG CEO Conf.)*

	1997 Revs (in \$Billions)	Current Rev (S = Sold, B= Bankrupt)	Ownership Change	
1	CH2M Hill	0.9	S / Jacobs (pending)	*
2	AECOM	0.7	18.0	*
3	Black & Veatch	0.7	3.0	*
4	Dames & Moore	0.7	S / URS / AECOM	*
5	ICF Kaiser	0.5	B/ S/ Earth Tech/ IPO	*
6	Parsons Brinckerhoff	0.5	S / Balfour Beatty / WSP	*
7	Montgomery Watson (MWH Global)	0.5	S / Stantec	*
8	OHM	0.5	S / IT / Shaw / CB&I	*
9	IT Group	0.4	B / S / Shaw / CB&I	*
10	URS	0.4	S / AECOM	*
11	CDM	0.4	1.3	*
12	Parsons (Trans)	0.3	3.1 (~8 Trans)	*
13	Tetra Tech	0.3	2.6	*
14	ERM	0.3	1.0	*
15	Foster Wheeler Environmental	0.3	S / TTEK	*
16	AWT	0.3	S / Vivendi	*
17	Woodward Clyde	0.3	S / URS / AECOM	*
18	Radian	0.3	S / D&M / URS / AECOM	*
19	Rust	0.3	S / EarthTech / AECOM	*
20	Morrison Knudsen Envir.	0.2	B / S / Wash / URS / AECOM	*
21	Arthur D. Little	0.2	B	*
22	Earth Tech	0.2	S / Tyco / AECOM	*
23	HNTB	0.2	0.9	*
24	HDR	0.2	2.2	*
25	Roy F. Weston	0.2	0.3	*
26	SAIC (Engineering)	0.2	Leidos	*
27	Law	0.2	S / Mactec / Amec	*
28	GHI	0.2	S / FD / IT / Shaw / CB&I	*
29	Metcalf & Eddy	0.2	S / AECOM	*
30	Golder	0.2	0.9	*
31	Geraghty & Miller / Arcadis	0.2	Arcadis, US	*
32	Smith	0.2	B	*
33	PSI	0.2	S / Intertek	*
34	ENSR	0.2	S / AECOM	*
35	Malcolm Pimie	0.1	S / Arcadis	*
36	Jacobs (Infra)	0.1	15.0 (~4 Infra)	*
37	Emcon	0.1	S / IT / Shaw / CB&I	*
38	Agra E&E	0.1	S / Amec	*
39	Harding Lawson	0.1	S / Mactec / Amec	*
40	Ogden	0.1	S / Agra / Amec	*
41	PBS&J	0.1	S / Atkins	*

Of the 41 firms in 1997 with Revenues > \$100 Mil:

- Only 12 still exist
- Only 6 have same ownership structure

70% of firms no longer around. Why?

*Red = no longer*

# *THEME #1: Profitability*

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## Why is Profit so Important? Multiplicity of Functions

- 1) Pays for Compensation (Salaries + Bonus); Helps Morale
- 2) Funds Growth (for Working Capital and Acquisitions)
- 3) Funds Internal Ownership Transition (“IOT”) (Stock Buyback)
- 4) Provides Buffer for Problems
- 5) Creates Stock Value

# THEME #1: Profitability

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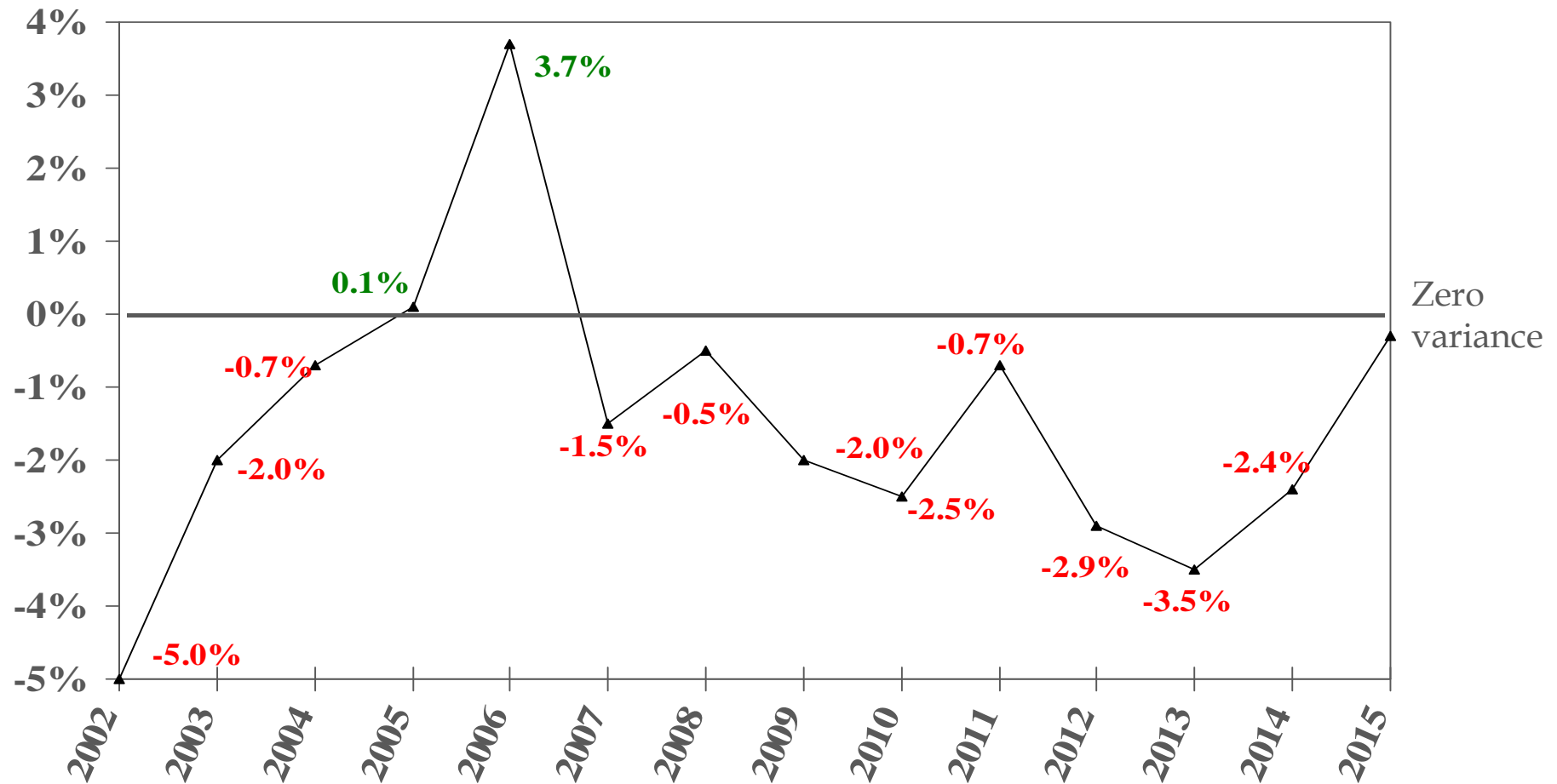
## How to Improve?

- 1) Better Budgeting / Forecasting / Response to Shortfalls
- 2) Better Management of Overhead (See O/H Analysis)
- 3) Billability of Highest Compensated
- 4) Incentivizing Profitability: “Dividends” vs. “Bonuses”
  - *“You get what you incentivize”*
- 5) Specialization vs. Diversification
- 6) Balancing Growth & Profit
- 7) Managing Balance Sheet

## ***THEME #2: Importance of Forecasting***

How Good Are Your Internal Revenue Growth Estimates for the Current Year?

*Variance: Actuals vs. March CFO Estimates*



- Growth estimations (@ March) consistently too high
- Reaction time
- What impact does this “over-forecasting” have on performance?

## THEME #2: Importance of Forecasting

### Theoretical Impact of an Unanticipated 5% Revenue Shortfall for an e/c firm

- Assumptions: \$100 expected revenue  
10% profit margin

- Calculation:

	<u>Expected</u>	<u>Actual</u>
Revenue	100	95
- <u>Expenses</u>	<u>90</u>	<u>90</u>
= Profit	10	5

- An unanticipated revenue shortfall of 5% would lead to a profit shortfall of 50%!
- Why so much negative leverage in our business?
  - No inventory (An hour of an engineer's billable time has a very short shelf life)
  - Thin margins
  - Most expenses "fixed"
- How much lead time do you need to cutback cost in response to revenue shortfall?
- Consider "Efficiency Budgeting" (staff for 5% less revenues than expected)

## *THEME #3: Balancing Growth & Profitability*

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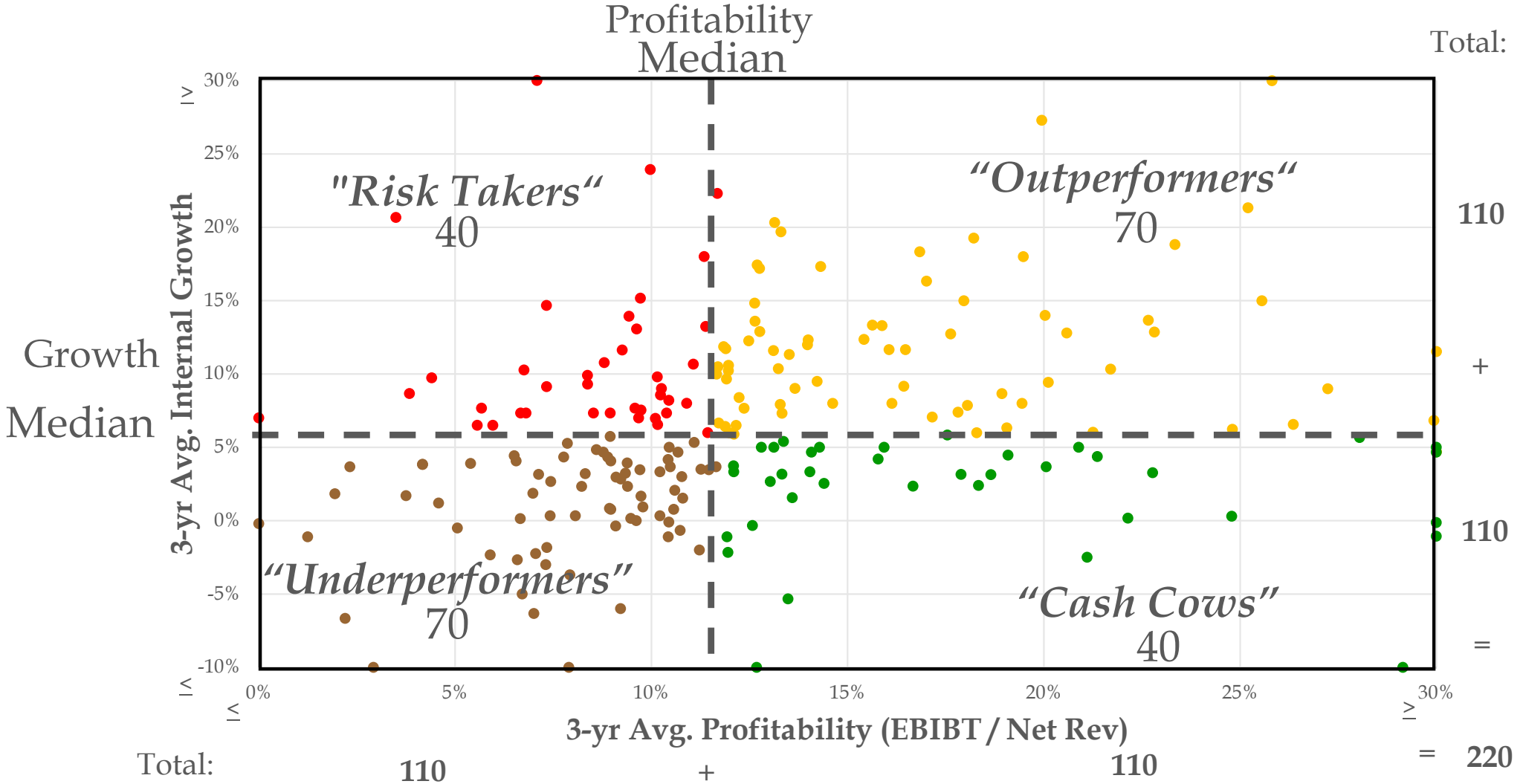
### Benefits of Profit vs. Growth Focus

- Growth requires capital, but profit creates capital
- Profit enables higher bonuses
- High growth is harder to manage and riskier
- Lower growth allows client & project selectivity:  
more profitable and less risky
- But growth does provide personnel opportunities & excitement
- Does **growth** increase or decrease profitability?



# THEME #3: Balancing Growth & Profitability: Growth & Profit Analysis (GPA)

(All firms shown)



- Unlike conventional wisdom, growth & profitability seem to be positively correlated
- Where is your data point?
- Which quadrant creates more value over time? Which destroys value?
- Happiness Quotient: internal growth rate + EBIBT/Net Revs = 6% + 11% = 17%
- What is yours?

# *THEME #4: Specialization vs. Diversification*

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## Diversification: Pros & Cons

### Is Diversification Important?

- Almost everyone says yes

### But what do you mean by “Diversification”?

- Service / Business Line
- Geography
- Clients
- Projects / Contracts
- Staff

# THEME #4: Specialization vs. Diversification

## Pros & Cons of Diversification

EFCG

### Thoughts

### Frequent Positives:

- Lower volatility: spreading of risk through different markets
- Cross-selling opportunities
- Potential to grow larger: if your market is “saturated”
- Can allocate existing overhead over larger revenues

Yes

Yes

Not sure

Not sure

### Negative:

- Lowers relative efficiency & know-how
- Higher overhead: overseeing more & different businesses
- Higher risk: moving into areas you don't know (“Learning Curve”)
- Competitive disadvantage: people there probably already know the business better than you
- Lose benefits of specialization
  - Diversification is good. But so is Specialization.
  - Which makes you more *efficient*?

## THEME #5: Challenges of Internal Ownership Transition (IOT)

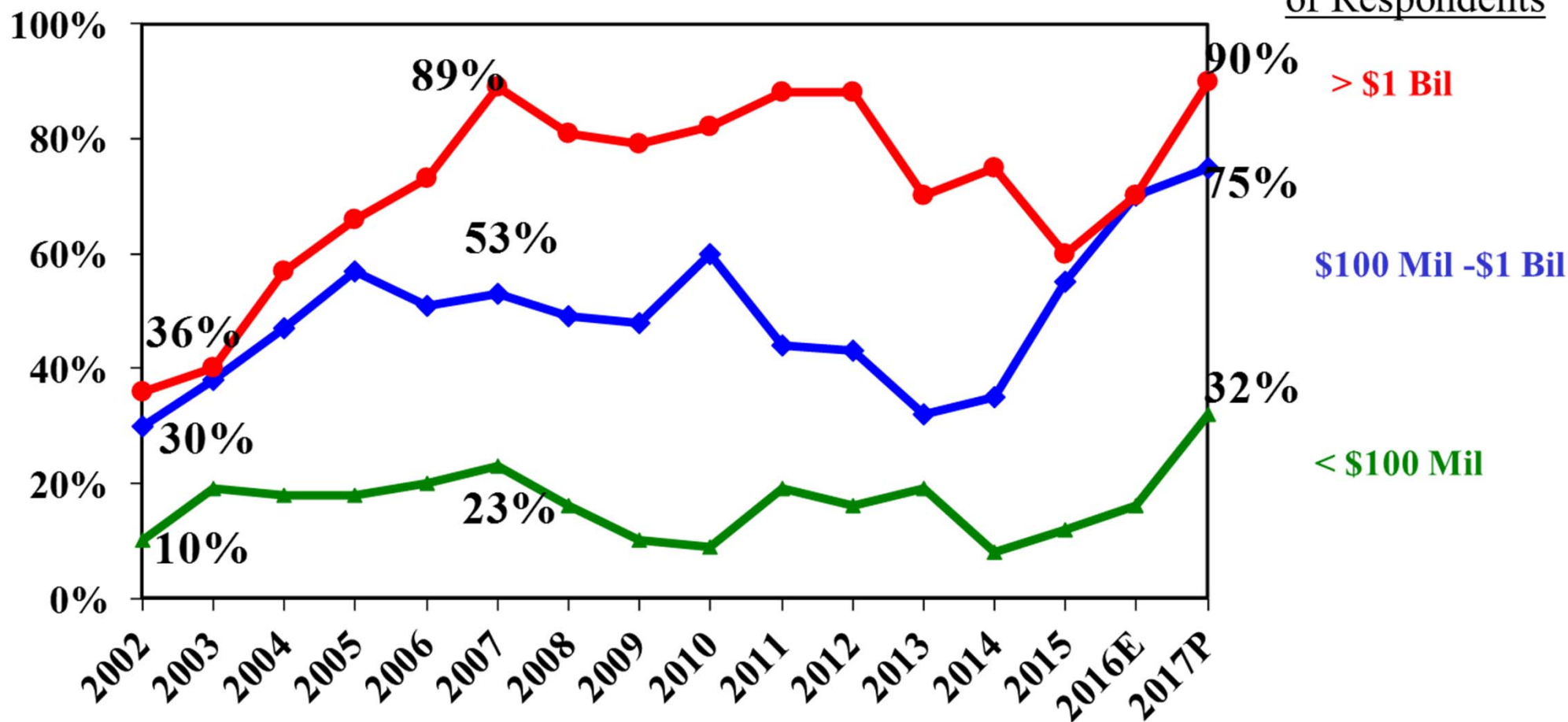
# Internal Ownership Transition (IOT):

*A major challenge for employee-owned firms. Why?*

1. Employee shareholders pull capital out when they retire  
(and younger employees have limited excess cash to “invest”)
2. Working capital needs are huge, relative to revenues, so growth requires significant capital
3. Much growth is coming via acquisitions, which requires more capital
4. Current Generation prefers Spending to Investing, and are more likely to leave the firm before retiring
5. IOT Valuations have increased (2x-3x) over past 25 years (from “Book Value” to “Multiple of Earnings”)
6. Valuation Conundrum:
  - Lower IOT valuations may be “unfair”, incentivize a sale,  
and make acquisitions difficult
  - Higher valuations make share repurchase more difficult
  - Getting the right balance
7. ESOP benefit: Can buy back shares in “pre-tax” dollars
8. Your approach to valuation needs to be strategic
9. The biggest reason firms “sell out” is because they **can’t fund their IOT**

# THEME #6: Who's Making Acquisitions?

## % of Firms Making Acquisitions



•Integral part of growth strategy for many firms

# THEME #6: M&A: "Success" of Deals

## Success of Acquisitions over last Five Years

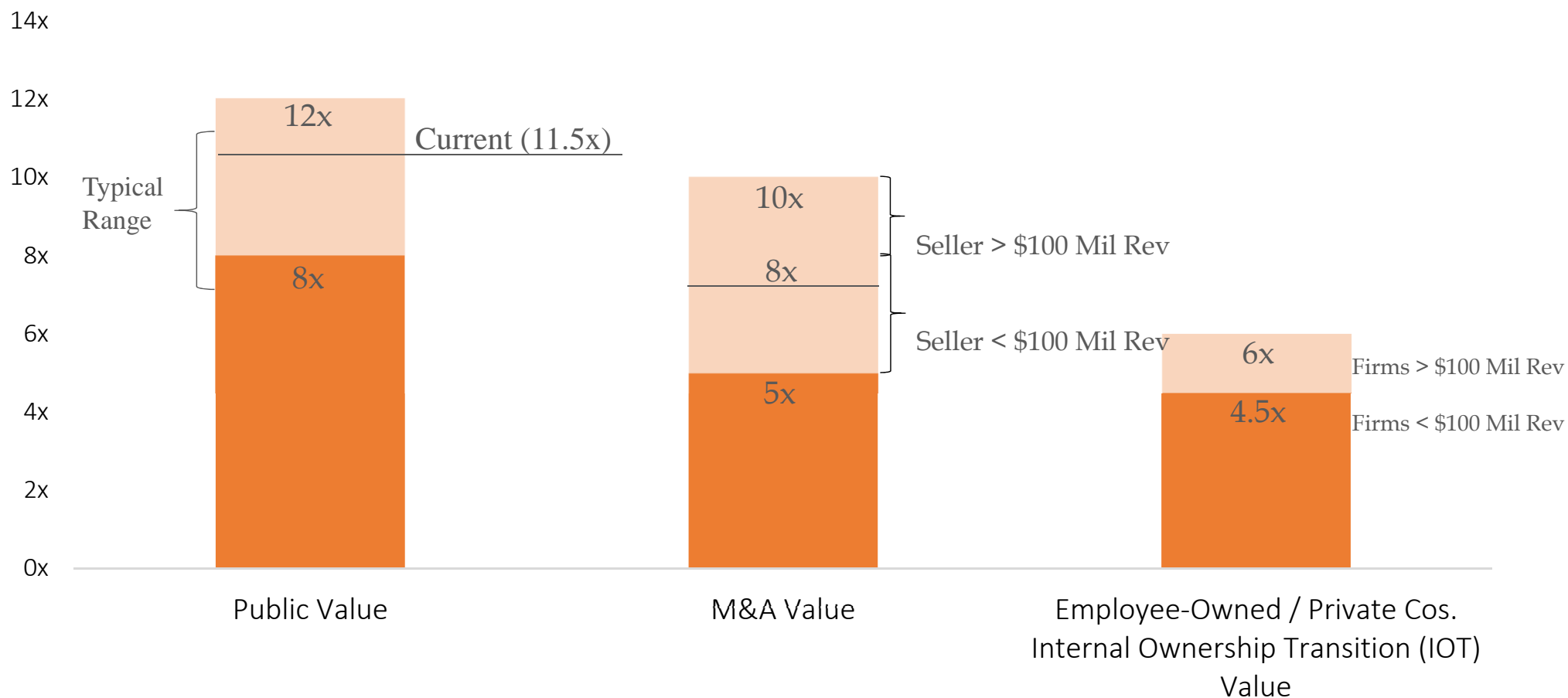
<u>Rev Size of Buyer</u>	<u># of firms</u>	<u># of Deals</u>	<u>Successful</u>	<u>Marginally Successful</u>	<u>Poor</u>
> 1B	22	233	161	47	25
250 Mil - 1B	30	123	80	30	13
100 Mil- 250 Mil	46	108	72	26	10
50 Mil - 100 Mil	48	42	31	8	3
25 Mil - 50 Mil	29	15	7	6	2
< 25 Mil	49	7	5	2	0
<b>Sum</b>	<b>224</b>	<b>528</b>	<b>356</b>	<b>119</b>	<b>53</b>
<b>%</b>			<b>67%</b>	<b>23%</b>	<b>10%</b>

- ~90% of transactions Successful or Marginally Successful over last 5 years
- If CEOs perceive so much M&A success, M&A likely to continue

# THEME #6: E/C Firm Valuation "Arbitrage"

## What is driving M&A?

Conservative Internal Values of Private Firms  
Make Them Accretive Acquisition "Targets" for Public Companies  
(Multiples of EV/"Normalized" EBITDA)



- Current public market is very high as are M&A values

# THEME #7: Alternative Delivery & Risk Management

E/C Industry expects to take on more risk in coming years from “Fixed Price”, “D/B” (Alternative Delivery) and “At-Risk” pricing

## CFO 2013 Conference: Fixed Price

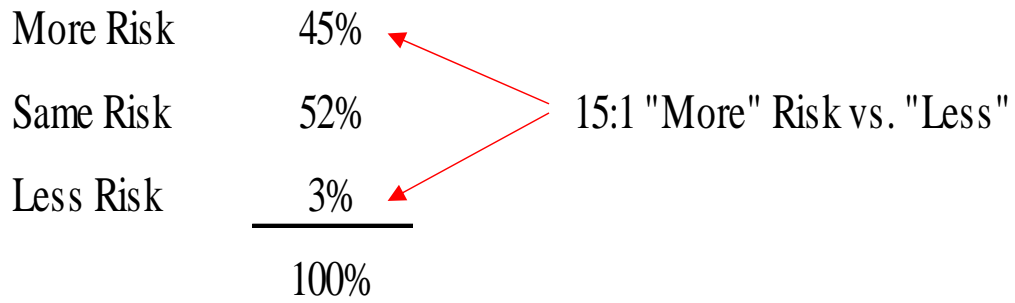
	<u>5 Years Ago</u>	<u>Today</u>	<u>In 5 Years</u>
Median % of Revenues	30%	35%	40%

## CEO 2014 Conference: Design-Build

	<u>Today</u>	<u>In 5 Years</u>
% of Firms Doing D/B	53%	60%
Median % of Revenues	7%	15%

## CFO 2015 Conference: At-Risk

Over the next few years, will your work have:



CFO 2016 Conference: At-Risk: 57% of firms say they are taking on greater risk  
30% say they are getting “compensated” for it!



## *THEME #7: Alternative Delivery & Risk Management*

The BIG Write-Off  
(Generally applies to “fixed price liability” contracts)

1. How to assess Risk / Reward ratio?
2. What is your downside exposure?
3. Can you afford it?

Example: 90% chance of project completion within budget; and expected profit @ 2x normal

“Biggest Killer of Great Firms”

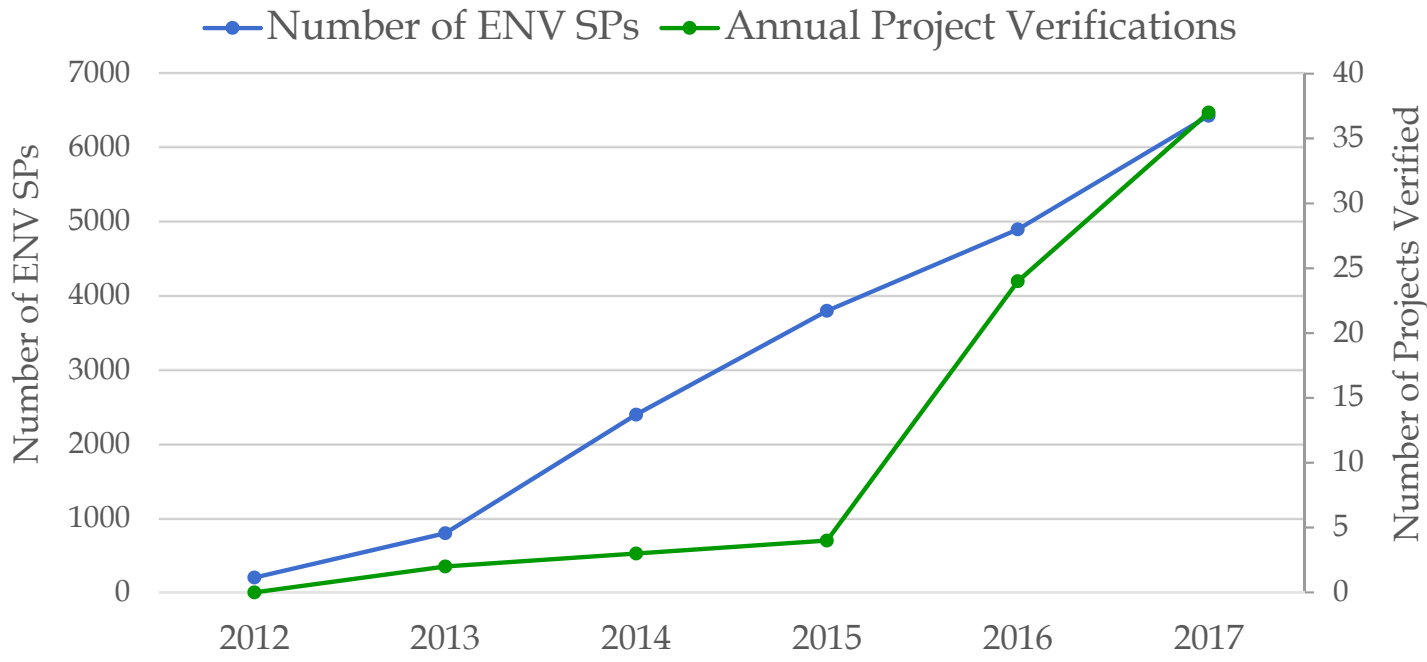
*We're not saying don't do it, but you need to know how to manage it.*

*That experience does not come easily*

# Sustainable Infrastructure & Envision Rating System

**Envision** is the name of the Infrastructure Sustainability Rating System developed by the **Zofnass Program for Sustainable Infrastructure at Harvard “ZPH”** (founded 2008), in conjunction with the **Institute for Sustainable Infrastructure (“ISI”)**, a joint venture between **ACEC, ASCE & APWA**. (Howard LaFever helped create this partnership).

**“ENV SP”** (Envision Sustainability Professional) is the credential given to engineers who complete formal training by ISI. There are currently **6400 ENV SPs** (4900 last year).



**SIAB\* Members:**

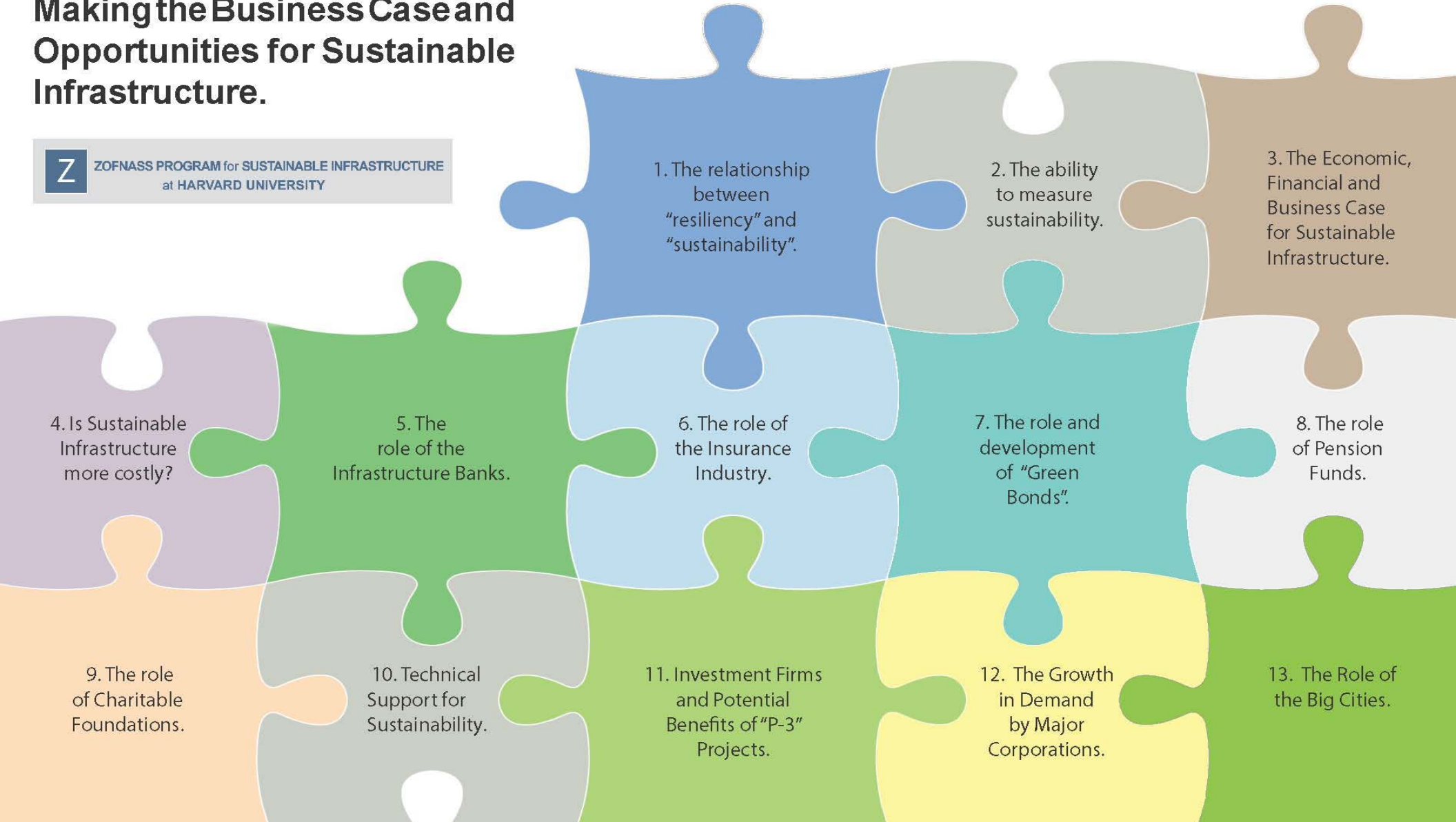
- Bentley Systems
- CDM Smith
- CH2M
- Ecology & Env.
- Golder
- HNTB
- LA Metro
- Louis Berger
- NV5
- Power
- Stantec
- The Nature Conservancy
- TRC

- “SIAB” is the Sustainable Infrastructure Advisory Board of Zofnass Program at Harvard
- Envision is used in 38 states and 43 cities in the US; used in rebuild of LaGuardia Airport (NYC) and Istanbul’s new airport
- Total Envision verified projects expected to be \$14 Bil by YE 2018

# THE PUZZLE OF SUSTAINABLE INFRASTRUCTURE

## Making the Business Case and Opportunities for Sustainable Infrastructure.

**Z** ZOFNASS PROGRAM for SUSTAINABLE INFRASTRUCTURE  
at HARVARD UNIVERSITY



# EFCG Services to E/C Industry

Founded in 1990, EFCG's mission is to help Engineering and Consulting ("E/C") firms become more business and financially efficient, so that they can improve global infrastructure and sustainability, while creating greater value and opportunities for their shareholders and employees.

## Financial & Strategic Consulting

*Advised majority of ENR Top 500 and 150 Global Design Firms, and serve on a retainer basis to roughly 50 a/e/c firms of all sizes.*

## Peer Benchmarking Analysis

*Perform ~100 PBAs annually - compares a firm to 20-40 peers across 150+ key financial metrics.*

## Mergers & Acquisitions

*Advised on over 150 completed transactions, representing cumulative valuation of roughly \$9 billion, with client size from \$3 million to \$10 billion in revenue. We advise both sellers and buyers.*

## Valuations

*~25 firms use EFCG to provide their annual internal stock valuations, and we perform ~50 additional ad hoc valuations each year.*

## Internal Ownership Transition

*Specialize in assisting employee-owned a/e/c firms to meet their internal ownership transition needs, through creation or restructuring of their ownership model, increased profitability, better management of their growth, more efficient balance sheet management, and a more strategic approach to their internal valuation.*

## 5 Annual Executive Conferences

*Address the key financial and strategic concerns of the a/e/c industry, and corresponding executives in attendance: CEO (29<sup>th</sup> annual), CFO (19<sup>th</sup>), CHRO (9<sup>th</sup>), CIO (4<sup>th</sup>), and Rising Leaders (4<sup>th</sup>).*

# Appendix

# THEME #1: Profitability

## How to Measure

Single-Line Metrics:  
("Profit")

- EBIBT (pre-bonus)
- EBIT/EBITA/EBITDA
- EBT
- After-Tax Income ("PAT")

Which is most important?  
(They each tell you something different)

Ratio Metrics:  
("Profitability")

- Profit / Rev ("ROR") [Gross Revs vs. Net Revs?]
- Profit / Assets ("ROA") [How to define "Assets"?  
- (G/W? Intan's? Real Estate?)]
- Profit / Capital ("ROC") [How to define "Capital"?  
- (Book value? Intan's w/ or w/out?  
FMV? IOT Value?)]
- Profit / Working Capital ("ROWC")
  - Most meaningful for e/c firms

- Remember: 2 ways to improve a ratio:

Increase the numerator; or decrease the denominator

- Use right measurement for the right purpose at the right time

# Managing Your Balance Sheet

“Common Size” Balance Sheet (Gross Revs = 100)

## Strategic Perspective

(Typical for Employee-Owned Firms)

Assets		Capital		
<b>Cash</b>	<b>3</b>	<b>Payables</b> (A/P & A/L) Cust. Adv. Defd Tax	<b>-16</b>	("Free Capital")
<b>Receivables</b>	<b>26</b>			
				} <b>“Working Capital” = 13</b>
<b>Fixed Assets</b>	<b>5</b>	<b>Debt</b>	<b>8</b>	
<b>Other (incl. Intang.)</b>	<b>6</b>	<b>Equity</b> ("Book Value")	<b>16</b>	(Most Expensive)
				} "Invested Capital"
<b>Total Assets</b>	<b>40</b>	<b>Total Capital</b>	<b>40</b>	

### Balance Sheet Management:

- *Squeeze Assets: particularly Cash & Receivables*
  - *Maximize “Free Capital”*
  - *Manage appropriate percentage of Debt/Equity (see EFCG Leverage Analysis)*
- } Minimize your investment in Working Capital (WC)

### Questions:

- 1) Is working capital “good” or “bad”? What is the optimal level of working capital?
  - 2) When do you pay for an hour of work vs. when do you get paid?
  - 3) Are you better with more equity or less equity?
  - 4) Is cash good or bad?
- **Observation: 2 ways to increase value per share: 1) increase numerator; 2) decrease denominator**

# Managing Your Overhead

## EF CG's Overhead Analysis Model "Mapping the Overhead Genome"

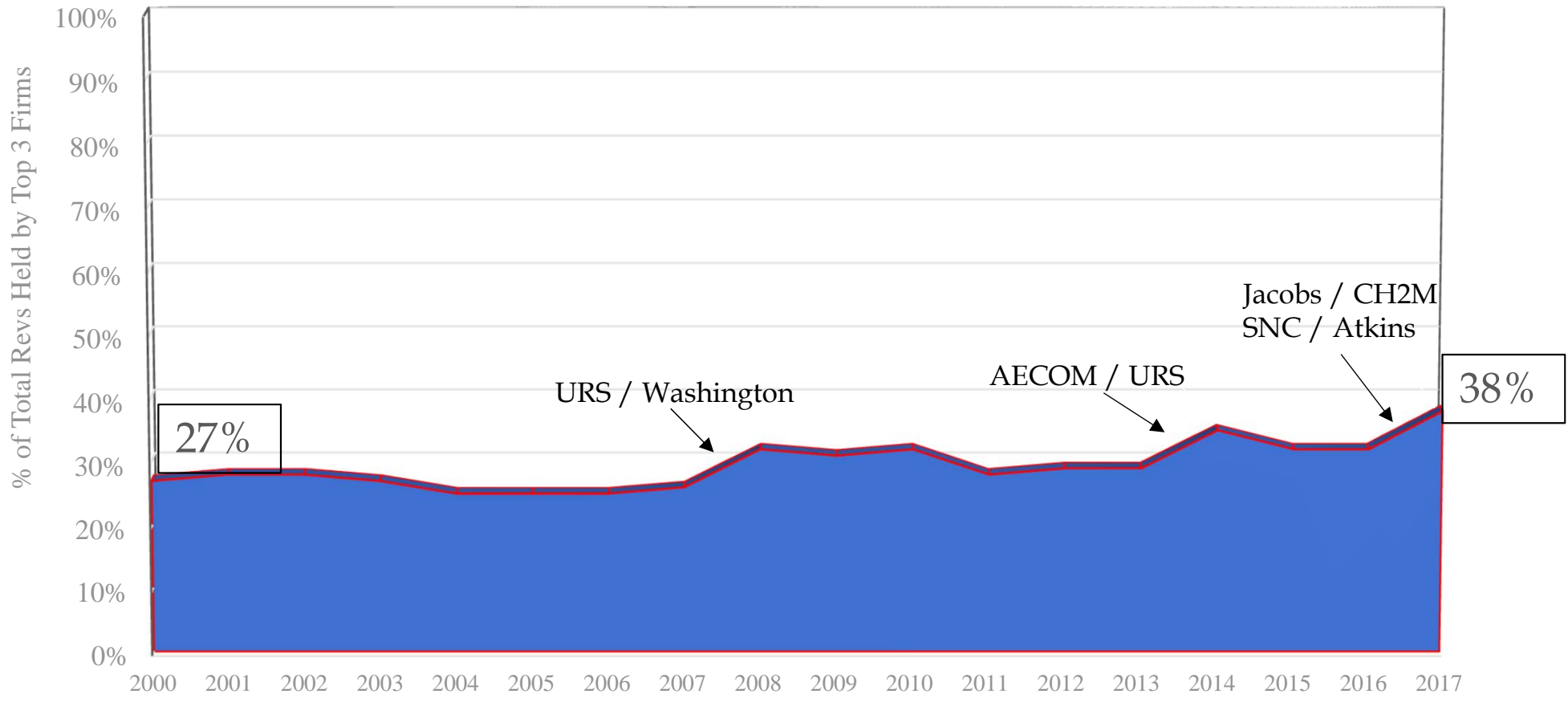
[Repeat Slide]

			<u>% of Net Revs</u>
Net Revenues			<b>100</b>
Direct Labor Costs (excl. fringe & bonus expense)			<b>36</b>
Gross Profit			<u><b>64</b></u>
<b><u>I. "6+ Buckets" (Indirect** and Non-Labor)</u></b>	<b>Indirect Labor</b>	<b>Non-Labor</b>	<b>Total</b>
1- Risk Management	0.4	1.7	2.1
2- MIS/Communication/IT	1.1	2.5	3.6
<i>As a subset, Annual Software Maintenance Fees</i>		0.6	
3- Finance/Treasury/Accounting	1.5	0.6	2.1
4- Human Resources	0.7	0.8	1.5
<i>As a subset, Training / Leadership Development</i>	0.1	0.3	
5- Business Development/Marketing	2.2	1.3	3.5
<i>As a subset, Bid &amp; Proposal</i>	0.6	0.1	
6- Occupancy	0.1	5.4	5.5
6+ Office of CEO / Chair / Board	1.0	0.4	1.4
6+ Other (incl. H&S)	1.2	0.1	1.3
Subtotal: "6+ Buckets"	<u>8.2</u>	<u>12.8</u>	<u>21.0</u>
<b><u>II. Non-Billable Time of Billable Personnel</u></b>			
1- PTO (Paid Time Off)	4.8		4.8
2- Business Development/Marketing	3.5		3.5
3- HR / Professional Development	0.5		0.5
4- "Admin Time" & Other	5.0		5.0
Subtotal: Non-Billable Time	<u>13.8</u>		<u>13.8</u>
<b><u>III. Fringe Benefits</u></b>			
1- Payroll Tax		4.5	4.5
2- Medical Costs		4.4	4.4
3- Retirement Costs		2.1	2.1
4- Other Fringe		1.2	1.2
Subtotal: Fringe Benefits		<u>12.1</u>	<u>12.1</u>
<b><u>IV. Other Non-Labor Cost (non-reimbursable)</u></b>			
1- Travel / Entertainment / Auto		2.0	2.0
2- Supplies / Office Equipment		1.1	1.1
3- Deprec. & Amort.		1.9	1.9
4- Bad Debt		0.2	0.2
5- Relocation Costs (should not be included in HR Bucket)		0.1	0.1
6- Civic Activities, Charities, Political Contributions		0.1	0.1
7- Other Non-Labor		1.6	1.6
Subtotal: Other Non-Labor		<u>7.0</u>	<u>7.0</u>
<b><u>Total Overhead = I-IV</u></b>	<u>22.1</u>	<u>31.9</u>	<u>54</u>
<b>EBIBT = Gross Profit - Total Overhead</b>			<u><u>10</u></u>

- How does your firm compare to peers?
- Are there areas for improvement?
- Recommend: EF CG Overhead Peer Analysis ("OPA")
- Reducing Overhead is not as important as maximizing Return On Overhead ("ROOH")
- Distinguish between "productive" vs. "non-productive" O/H



# Industry Consolidation since 2000: *Top 3 Market Share\**



- Some consolidation since 2000 (~11-percentage points among Top 3), but still a fairly “fragmented” industry
- Mega firms: lots of acquisitive growth, but not much internal growth since 2009
- How to define A/E/C industry? Data is very “noisy”!!

\*Represents % of total revenues at respective EF CG CEO Conferences