

By David Sullivan: AE industry making progress towards a recovery

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Forecasts into the future for the AE industry point to increased future demand for projects in hot areas such as healthcare, biotech, senior housing, transportation, energy, general aging infrastructure and education. That's the good news; there is expected to be future demand for these services. The bad news is that the industry's recovery has been nearly as volatile as the stock market. You can expect slow growth well into 2012 as demand has not yet materialized into real projects. The American Institute of Architects (AIA) reported that the Architectural Billings Index (ABI), which had been trending slightly upward, dipped back below 50 in October, which is a signal of declining demand for services. Readings above 50 are a sign of expansion; those below 50 show declining demand. Fortunately, the northeast appears to be ahead of the rest of the country. AIA reported that the northeast is the only area of the country where billings were up for the second consecutive month in October.

So recovery seems to be taking place, at least here, but it is taking place slowly. Firms have adapted by operating more efficiently and, as a result, should be positioned for higher profits as the economy recovers. The following are some thoughts, comments and predictions looking forward to 2012:

1. Firm staffing levels - Many firms have survived by reducing staffing levels and accordingly, related benefits and payroll taxes. Most firms have now adjusted their staffing levels to be in line with current and projected backlog. With minimal growth expected, it is unlikely that firm staffing levels will grow any more than 5% in 2012.
2. Project pricing and competition - Just when firms start to see some stabilization and opportunities for growth, another obstacle to profitability has arisen; project pricing. Firms are constantly lowering their prices to obtain work. This is a reality in today's marketplace, but is very dangerous for many AE firms. As I watch this happen, I am compelled to say that the price cutting firms are the industry's worst enemy. In many cases I see firm's giving away their work. This will likely continue during 2012 until real demand increases.
3. Technology will continue to change the way AE firm services are performed and delivered. There is no doubt about this one. If your firm is not ready for integrated product delivery using building information modeling technology, make sure you take the time to get ready. You will likely find some of your most inexperienced staff have tremendous value when it comes to technology. The top heavy firms in the AE market will find it difficult to compete if they cannot master the new technology out there.
4. Consolidation - The consolidation of the AE industry is alive and well and will continue into 2012 at a strong pace. One year from now the list of firms competing with your firm will change dramatically. You will have larger firms growing in your market and will likely see mergers of firms

you would not have expected to merge. I believe that the number of buyers will increase during 2012 as large and even mid-size firms will continue to find it difficult to grow organically. The solution for many firms is to grow through acquisition.

There will also be more sellers in 2012. More than 70% of AE firm owners are believed to be 55 or older and are faced with the question of how they will monetize the investment made in their firm. Add to this, a very low capital gain rate through at least the end of 2012, and uncertainty about their internal succession plan, and you have a compelling argument for many firms to sell.

5. Firm profits - During 2011, we are predicting that average firm profits will rise at a modest pace to approximately 8-9%. For 2012, it will be interesting to see how firms deal with the effects of reduced pricing and increased competition in the marketplace. If firms can continue to run lean and control their costs, they should be able to achieve profits of 8-10% on average in 2012. Let's see how that plays out when we talk next year.

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