

**Aecon Group Inc.**

**Management's Discussion and Analysis  
of Operating Results and Financial Condition**

**December 31, 2008**

## **Management's Discussion And Analysis Of Operating Results And Financial Condition ("MD&A")**

The following discussion and analysis of the consolidated results of operations and financial condition of Aecon Group Inc. ("Aecon") should be read in conjunction with the Company's December 31, 2008 Consolidated Financial Statements and Notes. This MD&A has been prepared as of March 3, 2009. Additional information on Aecon is available through the System for Electronic Document Analysis and Retrieval ("SEDAR") at [www.sedar.com](http://www.sedar.com) and includes the Company's Annual Information Form and other securities and continuous disclosure filings.

### **Introduction**

Aecon operates in four principal segments within the construction and infrastructure development industry – Infrastructure, Buildings, Industrial and Concessions.

The Infrastructure segment includes all aspects of the construction of both public and private infrastructure, including roads and highways, as well as toll highways, dams, tunnels, bridges, airports, marine facilities, transit systems and hydroelectric power projects, primarily in Canada and, on a selected basis, internationally. This segment also includes the mining, manufacture and supply of asphalt and aggregate products, and the construction and/or installation of utility distribution systems for natural gas, telecommunications and electrical networks, as well as water and sewer mains, traffic signals and highway lighting. The design and construction of the new Quito airport project is included in the Infrastructure segment.

The Buildings segment specializes in the construction and renovation of commercial, institutional and multi-family residential buildings, including hospitals, educational facilities, office buildings, industrial buildings, airport terminals, entertainment facilities, embassies, retail complexes and highrise condominium buildings among others. Work in this segment is concentrated primarily in Canada and the northwestern United States. Services include general contracting, fee for service construction management, design build services, building renovation, tenant fit up and facilities management.

The Industrial segment encompasses all of Aecon's industrial construction and manufacturing activities including in-plant construction and module assembly in the energy, manufacturing, petrochemical, steel and automotive sectors. Activities in this segment include the construction of alternative, fossil fuel and cogeneration power plants, in-plant construction at nuclear power plants, the fabrication and module assembly of small diameter specialty pipe, and the design and manufacture of "once-through" heat recovery steam generators ("HRSGs") for industrial and power plant applications. Although activities in this segment are concentrated primarily in Canada, Aecon, through its subsidiary Innovative Steam Technologies Inc. ("IST"), sells HRSGs throughout the world.

Activities within the Concessions segment include the development, financing and operation of infrastructure projects by way of build-operate-transfer, build-own-operate-transfer and other public-private partnership contract structures. This segment focuses primarily on the operation, management, maintenance and enhancement of investments held by Aecon in infrastructure

concessions, which currently comprise investments in the Cross Israel Toll Highway and Quito airport project concession companies. This segment includes the operations of the Highway 104 Toll Plaza in Atlantic Canada. This segment also has a development function whereby it monitors and, where appropriate, brings together the unique capabilities and strengths of Aecon and its strategic partners for the development of domestic and international public-private partnership concession projects in which Aecon may play a role as an investor, constructor and/or operator.

The construction industry in Canada is seasonal in nature for companies like Aecon who do a significant portion of their work outdoors (particularly road construction and utilities work) and, as a result, less work is performed in the winter and early spring months than in the summer and fall months. Accordingly, Aecon has historically experienced a seasonal pattern in its operating results with the first half of the year typically reflecting lower revenues and profits than the second half of the year. Therefore, results in any one quarter are not necessarily indicative of results in any other quarter, or for the year as a whole.

The MD&A presents certain non-GAAP (Canadian generally accepted accounting principles “GAAP”) financial measures to assist readers in understanding the Company’s performance. Non-GAAP financial measures are measures that either exclude or include amounts that are not excluded or included in the most directly comparable measure calculated and presented in accordance with GAAP.

## CONSOLIDATED FINANCIAL HIGHLIGHTS

\$ millions	Year Ended	
	December 31	
	2008	2007
<b>Revenues</b>	<b>\$ 1,877.0</b>	<b>\$ 1,492.7</b>
Gross margin <sup>(1)</sup>	211.1	142.4
<b>EBITDA <sup>(2)</sup></b>	<b>124.7</b>	<b>82.7</b>
<b>Operating profit <sup>(3)</sup></b>	<b>97.2</b>	<b>60.8</b>
Interest expense	(9.3)	(11.2)
<b>Earnings before taxes <sup>(4)</sup></b>	<b>87.9</b>	<b>49.6</b>
Income taxes	(26.8)	(0.4)
<b>Net income for the period</b>	<b>59.3</b>	<b>48.3</b>
<b>Return on revenue <sup>(5)</sup></b>	<b>5.2%</b>	<b>4.1%</b>
<b>Backlog – December 31</b>	<b>\$ 1,254</b>	<b>\$ 1,234</b>

- (1) Gross margin is calculated as revenues less direct costs and expenses. Marketing, general and administrative expenses, depreciation and amortization, foreign exchange, interest, gains or losses on sale of assets, income taxes, and non-controlling interests are not included in the calculation of gross margin.
- (2) EBITDA represents earnings or loss before interest expense, income taxes, depreciation and amortization, and non-controlling interests.
- (3) Operating profit (loss) represents the profit (loss) from operations, before interest expense, income taxes and non-controlling interests.
- (4) Earnings before taxes represent income before income taxes and non-controlling interests.
- (5) Return on revenue is calculated as operating profit as a percentage of revenues.

Revenues in 2008 were a record \$1,877 million, representing an increase of \$384 million, or 26%, over the previous year. Revenues increased in the Infrastructure, Buildings, Industrial, and Concessions segments by \$50 million, \$75 million, \$214 million, and \$15 million, respectively. Results for each of the four principal operating segments are discussed separately under Reporting Segments.

Gross margin increased from \$142 million or 9.5% of revenues in 2007 to \$211 million or 11.2% of revenues in 2008, as gross margin improved in all operating segments except Buildings. Of the \$69 million increase in gross margin in 2008, the Infrastructure, Industrial and Concessions segments reported improvements of approximately \$11 million, \$53 million and \$6 million, respectively, while the Buildings segment reported a decrease of \$1 million. The gross margin increases resulted primarily from higher volumes and from the commencement of profit recognition in 2008 on some large projects, including the project to construct the new Quito airport. Improved margin percentages in some market segments, particularly in the Western Canada and Ontario operations of Industrial, also contributed to the gross margin improvement. The decline in gross margin in the Buildings segment resulted from weaker performance in the Montreal operating unit.

Marketing, general and administrative expenses (“MG&A”) as a percentage of revenues increased from 4.8% in 2007 to 5.1% in 2008. Higher revenues in a number of segments, the acquisition of Leo Alarie & Sons (“Alarie”) in late 2007, increased compensation expense (including higher share based compensation expense), expanded boiler product offerings by the Industrial segment’s IST

operations, and higher operating and restructuring costs in the Buildings segment's Montreal operations, all contributed to the increase in MG&A. Despite the increases in MG&A, operating profit as a percentage of revenues increased in 2008 compared to 2007.

Depreciation and amortization expense of \$27 million in 2008 was \$6 million higher than in 2007. The increase occurred mainly in the Infrastructure segment and resulted primarily from higher depreciation charges on equipment acquired as part of the 2007 acquisition of Alarie. Also contributing to the increase was a goodwill impairment charge in 2008 for \$1 million related to the Buildings segment's Montreal operations.

The net gain from the sale of assets in 2008 was \$0.1 million compared to a gain of \$7.8 million during 2007. The 2007 gain included \$3.4 million from the sale by Aecon of its right to participate in the joint venture that is constructing an extension to the Cross Israel Highway and \$4.3 million which Aecon received from Hochtief (Aecon's former largest shareholder) in connection with the sale of their interest in Aecon in 2006.

Interest expense of \$9.3 million in 2008 was \$2.0 million lower than in 2007. The conversion to common shares of all the outstanding convertible debentures, which occurred mostly in the fourth quarter of 2007 and in the first quarter of 2008, was the primary reason for the lower interest costs. The repayment of Aecon's term loan facility in the second quarter of 2008 also reduced interest costs year-over-year. Partially offsetting these savings in interest costs was interest on debt borrowed to finance the 2007 acquisition of Alarie.

Interest income of \$8.1 million in 2008 was \$2.1 million higher than in 2007. The higher interest income in 2008 was a result of having significantly higher cash balances on hand throughout 2008 as compared to 2007. These higher cash balances reflect improved operations in 2008 and 2007, higher advance payments from clients, particularly within joint ventures, and net cash proceeds of \$69.6 million from an equity issue in April 2008.

Earnings before taxes for the year ended December 31, 2008 were \$87.9 million, representing a \$38.4 million improvement over 2007.

Set out in note 6 of the 2008 Consolidated Financial Statements is a reconciliation between the expected income tax recovery/(expense) in 2008 and 2007 based on statutory income tax rates and the actual income tax recovery/(expense) reported for both these periods. In 2008, there was an income tax expense of \$26.8 million on pre-tax income of \$87.9 million, compared to an income tax expense of \$0.4 million on pre-tax income of \$49.6 million in 2007. The low tax expense in 2007 was due to the fact that income taxes that would normally have been recorded on income from Canadian controlled entities were offset by the reversal of tax valuation allowances recorded in prior periods. Without the benefit of this reversal, tax expense in 2007 would have been higher by \$14.6 million. As at December 31, 2008, Aecon has an estimated \$65 million in income tax losses that are available to offset cash income taxes otherwise payable on future domestic earnings.

Overall, net income for the year ended December 31, 2008 was a record \$59.3 million or \$1.20 per share on a fully diluted basis, which compares with \$48.3 million or \$1.16 per share in 2007.

Backlog at December 31, 2008 was \$1,254 million, representing a \$20 million increase over the same time in 2007. New contract awards of \$1,897 million were booked in 2008, which compared with \$1,941 million in 2007.

It is important to note that Aecon does not report as backlog the significant and increasing number of contracts and arrangements in hand where the exact quantity of work to be performed cannot be reliably quantified or where a minimum number of units at the contract specified price per unit is not guaranteed. Examples include time and material, and some cost-plus and unit priced contracts where the extent of services to be provided is undefined or where the number of units cannot be estimated with reasonable certainty. Other examples include the value of construction work managed under construction management advisory contracts, concession agreements, multi-year operating and maintenance service contracts, general contracts, supplier of choice arrangements and alliance agreements where the client requests services on an as-needed basis. None of the expected revenues from these types of contracts and arrangements are included in backlog. Therefore, Aecon's effective backlog at any given time is greater than what is reported.

Further details for each of the segments are included in the discussion below under Reporting Segments.

## **REPORTING SEGMENTS**

### **INFRASTRUCTURE**

#### **Financial Highlights**

<b>\$ millions</b>	<b>Year Ended</b>	
	<b>December 31</b>	
	<b>2008</b>	<b>2007</b>
<b>Revenues</b>	<b>\$ 739.4</b>	<b>\$ 688.9</b>
<b>Segment operating profit <sup>(1)</sup></b>	<b>23.7</b>	<b>23.5</b>
<b>Capital charges and allocations of corporate overhead <sup>(2)</sup></b>	<b>(22.7)</b>	<b>(18.6)</b>
<b>Segment profit before income taxes</b>	<b>1.0</b>	<b>4.9</b>
<b>Return on revenue <sup>(3)</sup></b>	<b>3.2%</b>	<b>3.4%</b>
<b>Backlog – December 31 <sup>(4)</sup></b>	<b>\$ 470</b>	<b>\$ 372</b>

- (1) Segment operating profit (loss) represents the profit or loss from operations, before interest expense, income taxes, non-controlling interests, and corporate allocations of overhead costs and capital charges.
- (2) Corporate allocations represent charges from the Corporate segment to each division for Corporate overhead costs and capital charges related to the cash, working capital and long-term capital invested in each segment.
- (3) Segment return on revenue is calculated as segment operating profit (loss) as a percentage of revenues.
- (4) Included in backlog at December 31, 2008 is \$100 million (2007 – \$98 million) related to the new Quito airport project. Although Aecon's 50% share of the remaining construction revenues from this project is estimated at \$174 million (2007 - \$170 million), the amount reported as backlog has been reduced by \$74 million (2007 - \$72 million) or 42.3%. This reduction is to reflect the fact that since Aecon has a 42.3% interest in the

concession joint venture for which the new airport is being constructed, it cannot report revenue, and therefore does not report backlog, that effectively arises from transacting with itself.

For the year ended December 31, 2008, Infrastructure segment revenues of \$739 million were \$50 million, or 7%, higher than in 2007. Revenues from roadbuilding, utilities and heavy civil operations increased year-over-year by \$41 million, \$8 million and \$2 million, respectively.

The majority of the growth in Infrastructure revenues occurred in Western Canada where the expansion of the segment's Alberta roadbuilding, utilities and heavy civil operations in 2008 produced revenue increases of \$36 million, \$8 million, and \$23 million, respectively. In roadbuilding operations, increased revenues were also reported by the Alarie and Karson operations in Ontario. In the fourth quarter of 2007, Aecon acquired the assets of Alarie, an integrated construction and materials company active throughout northern Ontario, and in the first quarter of 2007, acquired the Karson Group of Companies ("Karson"), a major aggregate, asphalt and civil construction company in Eastern Ontario. Partly offsetting these increases were reductions in revenues earned in the balance of Ontario roadbuilding operations, and a revenue decline from heavy civil operations in Ontario where a number of large power generation and tunneling projects came into peak production in 2007 and were not replaced with similar size projects in 2008, leading to higher revenues in 2007 compared to 2008.

The Infrastructure segment operating profit of \$23.7 million in 2008 represents a \$0.3 million, or 1%, increase over 2007. Heavy civil operations in 2008 benefited from the recognition of profits on the Quito international airport construction project, which reached 33% completion in 2008, whereas no profits were recognized on this project in 2007. However, the 2008 year-over-year comparison for heavy civil operations was negatively impacted by a \$3.4 million gain reported in 2007 on the sale of Aecon's right to participate in the construction of an extension to the Cross Israel Highway, and from lower operating profits from heavy civil operations in Ontario where, as noted above, a number of large power generation and tunneling projects in Ontario came into peak production in 2007 and contributed to higher operating profits in 2007 compared to 2008. Operating profits from utilities operations improved, reflecting the positive impact on margins from revenue increases in Ontario and Alberta in 2008. Operating profits from roadbuilding operations declined, in part from the impact of record rainfalls that occurred across much of Ontario during 2008, and from a return to more traditional winter conditions in Ontario during the first quarter of 2008. Winter weather conditions in Ontario during first quarter of 2007 were unseasonably moderate.

In the second quarter of 2008, the arbitration panel considering the first of two major claims launched by Aecon and its partner in respect of the Nathpa Jhakri hydroelectric project in India ruled substantially in Aecon's favour. The panel awarded the joint venture, Continental Foundation Joint Venture ("CFJV") (in which Aecon is a 45% partner), full extension of time as well as related indirect costs and interest resulting from project delays that the panel agreed were beyond CFJV's control and contractual responsibility. In its ruling, the panel also dismissed a counter-claim for liquidated damages filed against CFJV.

Based on the ruling, an agreement was reached in 2008 between CFJV and Satluj Jal Vidyut Nigam Limited ("SJVN"), the government agency responsible for the project, to accept the award of the arbitration panel subject to minor changes. Although SJVN had the right, until October 12, 2008, to appeal the ruling, it did not do so.

Resulting from the agreement, CFJV expects to receive approximately \$10 million in claim settlements net of expenses, of which \$4 million was received in 2008 with a further \$6 million expected to be received in the first quarter of 2009. Also as a result of the agreement, SJVN commenced the payment of normal contract amounts that were due to CFJV, but which were being withheld pending resolution of the first claim. In addition, as a result of achieving a successful resolution to a portion of the claims related to the India project, funds that were previously on deposit to secure letters of credit were partly released by the issuing banks. The release of these deposits along with the partial payment received from the claim settlement, were used in 2008 to reduce the joint venture working capital loan balance from approximately \$16 million to \$6 million. In addition, approximately \$13 million of the \$25 million in letters of credit filed by Aecon to cover working capital and performance guarantees had been cancelled as at December 31, 2008 and a further \$3 million are currently in the process of being cancelled.

A second claim for 2.26 billion Indian Rupees (approximately \$57 million) and a counter-claim for liquidated damages by SJVN, both in respect of an adjacent and concurrent project to the one that was settled, remains with the arbitration panel and is expected to be resolved in 2009.

Although significant progress has been made in resolving the claims situation in India, a considerable amount of work remains to be done on the second claim and considerable uncertainty exists with respect to the ultimate settlement of all claim matters. As a result, the net amounts received from the arbitration process in 2008 were applied to reduce the carrying values of the unbilled work-in-progress balances of the joint venture.

After deducting capital charges and allocations of Corporate overheads, which increased by \$4.2 million in 2008, the Infrastructure segment's operating profit before income taxes in 2008 was \$1.0 million compared to \$4.9 million in 2007. The higher capital charges in 2008 relate primarily to higher investments in working capital and long-term capital employed as a result of the Karson and Alarie acquisitions.

Backlog at December 31, 2008 was \$470 million, which represents a \$98 million increase over 2007. The improvement results primarily from higher backlog in roadbuilding operations, mostly in the segment's Alberta and Alarie operations. New contract awards totalled \$838 million in 2008 compared to \$640 million in 2007. The Alberta, Alarie and Quito airport operations were the largest contributors to the increase in new awards in 2008. In accordance with Aecon's backlog policy, similar to that for existing alliance type contracts with Bell Canada and Union Gas, among others, the reported amounts for new awards and backlog do not include the impact of the recent alliance agreement signed with Enbridge Gas Distribution Inc. in 2008. This alliance agreement with Enbridge has the potential to double Aecon's gas distribution revenues over the next few years.

As discussed in the Consolidated Financial Highlights section, Aecon is a party to significant contracts and arrangements based on time and material, cost-plus, unit prices, and supplier of choice and alliance agreements, which do not show up as backlog when the number of units or volume of work cannot be estimated with reasonable certainty. Therefore, the Infrastructure segment's effective backlog at any given time is greater than what is reported.

## **BUILDINGS**

### **Financial Highlights**

<b>\$ millions</b>	<b>Year Ended</b>	
	<b>December 31</b>	
	<b>2008</b>	<b>2007</b>
<b>Revenues</b>	<b>\$ 461.0</b>	<b>\$ 385.9</b>
<b>Segment operating profit</b>	<b>0.4</b>	<b>4.4</b>
<b>Capital charges and allocations of corporate overhead</b>	<b>(0.1)</b>	<b>(1.2)</b>
<b>Segment profit before income taxes</b>	<b>0.2</b>	<b>3.2</b>
<b>Return on revenue</b>	<b>0.1%</b>	<b>1.1%</b>
<b>Backlog – December 31</b>	<b>\$ 534</b>	<b>\$ 480</b>

Revenues in the Buildings segment of \$461 million in 2008 were \$75 million, or 19%, higher than in 2007. All operating units with the exception of Ottawa reported increases in year-over-year revenues with the largest increases occurring in Toronto (\$75 million) and Seattle (\$22 million). A large contributing factor to the increase in revenues was the substantial increase in Buildings' backlog at the beginning of 2008 - \$480 million compared with \$191 million at the beginning of 2007. This higher backlog contributed to increased production on a number of large projects throughout the year. Ottawa recorded a \$54 million decline in revenues due primarily to two large projects that were in full production in 2007 and have since been substantially completed.

Segment operating profit of \$0.4 million in 2008 compares with a profit of \$4.4 million in 2007. Most of the decrease in operating profits occurred in Montreal and Ottawa, and was partly offset by an increase in Toronto. The decline in Montreal of \$9.8 million was primarily due to profit writedowns on some projects, increased operating costs related to the relocation and restructuring of this unit's operations in 2008, and a goodwill impairment loss of \$1.2 million. Management has analyzed the circumstances that caused this unacceptable performance in Montreal and a substantive restructuring is now underway to improve future performance. Ottawa reported a \$1.6 million decline in operating profit, which is consistent with the decline in revenues noted above. The increase - \$3.8 million - in operating profits from Toronto is reflective of the higher volumes noted above and the impact of \$0.8 million in restructuring costs incurred in 2007. Ongoing efforts to improve the profitability levels of the Toronto operations have clearly taken hold.

After deducting capital charges and allocations of corporate overheads, the Buildings segment operating profit before income taxes for 2008 was \$0.2 million compared to a profit of \$3.2 million in 2007.

Backlog of \$534 million at the end of 2008 was \$54 million higher than at the same time in 2007 with the largest increase in backlog occurring in the segment's Toronto operations, which ended the year with a record backlog level of \$347 million, and the largest decrease occurring in Seattle. New contract awards totaling \$516 million were recorded in 2008, which compares with awards of \$675 million in 2007.

As discussed in the Consolidated Financial Highlights section, contracts awarded to Aecon based on supplier of choice and alliance agreements, as well as the value of construction work managed under construction management advisory agreements, do not show up as firm backlog. Therefore, the Buildings segment's effective backlog at any given time is greater than what is reported.

## **INDUSTRIAL**

### **Financial Highlights**

<b>\$ millions</b>	<b>Year Ended December 31</b>	
	<b>2008</b>	<b>2007</b>
<b>Revenues</b>	<b>\$ 612.4</b>	<b>\$ 398.1</b>
<b>Segment operating profit</b>	<b>75.0</b>	<b>36.2</b>
<b>Capital charges and allocations of corporate overheads</b>	<b>(3.8)</b>	<b>(7.5)</b>
<b>Segment profit before income taxes</b>	<b>71.3</b>	<b>28.7</b>
<b>Return on revenue</b>	<b>12.3%</b>	<b>9.1%</b>
<b>Backlog – December 31</b>	<b>\$ 250</b>	<b>\$ 384</b>

Revenues in 2008 of \$612 million from the Industrial segment were \$214 million or 54% higher than in the same period in 2007. While all operating units reported higher revenues, the segment's construction operations in Ontario had the largest increase in revenues. In 2008, revenues from construction operations in Ontario were up \$135 million over last year, mostly as a result of increased work in the power, nuclear, automotive and gas sectors. Revenues from the segment's Western Canada operations increased \$43 million in 2008 as increased revenues from module assembly and pipe fabrication projects in the oilsands offset decreases in revenues from site construction projects. Revenues in 2008 for IST of \$76 million were up \$30 million over the previous year, reflecting the impact of new orders received in 2007 and 2008.

In 2008, the Industrial segment generated an operating profit of \$75.0 million compared to \$36.2 million in 2007. Of the \$38.9 million or 107% improvement, the majority of the increase occurred in Ontario construction operations and in Western Canada operations where profits increased by \$19.9 million and \$16.7 million, respectively. These higher operating profits are mostly a function of the higher volumes and generally improved margins in 2008. The results for 2008 also benefited from the commencement of profit recognition on the East Windsor Cogeneration project which reached 20% completion during 2008.

After deducting capital charges and allocations of corporate overheads which decreased by \$3.7 million in 2008, the Industrial segment's operating profit before income taxes was \$71.3 million compared to \$28.7 million in 2007.

Backlog at December 31, 2008 of \$250 million was \$134 million lower than at the same time last year with the largest decreases occurring in the Ontario Construction and Western Canada operations. The decline in backlog in Ontario Construction and Western Canada is largely due to workoff on

large projects during 2008 that has not been replaced. Also of note, IST's backlog of \$52 million at the end of 2008 was one of the highest year end balances in its history. Overall, new contract awards of \$479 million in 2008 were \$118 million lower than in 2007. Most of the decrease in new awards occurred in Western Canada where award levels for 2008 are down compared to the previous year when a large module assembly contract was secured and added to backlog in 2007, and in Ontario Construction where a large award for a cogeneration project was received in late 2007.

As discussed in the Consolidated Financial Highlights section, significant contracts made to Aecon based on time and material, cost-plus, and unit priced contracts, including supplier of choice and alliance agreements do not show up as firm backlog when the number of units or volume of work cannot be estimated with reasonable certainty. Therefore, the Industrial segment's effective backlog at any given time is greater than what is reported.

## CONCESSIONS

### Financial Highlights

\$ millions	Year Ended December 31	
	2008	2007
Revenues	\$ 72.1	\$ 57.5
Segment operating profit	10.6	4.0
Capital charges and allocations of corporate overheads	(9.9)	(7.9)
Segment profit (loss) before income taxes	0.7	(4.0)
Return on revenue	14.7%	6.9%

Revenues in 2008 of \$72 million in the Concessions segment were up \$15 million, or 25%, compared to 2007. The majority of the increase in revenues came from Aecon's proportionate share of the revenues from operating the Cross Israel Highway which is being carried out on a fee for service basis by a company in which Aecon holds a 30.6% interest.

Aecon's long-term concession investment in the Cross Israel Highway, through its 25% interest in Derech Eretz Highways (1997) Ltd. ("Derech Eretz") is carried at cost and, as a result, income is only recognized to the extent of dividends received (i.e. a profit distribution) or when a portion of this investment is sold. As such, even though the Cross Israel Highway is performing well and is generating strong operating cash flow, Aecon has not reported any revenues and profits from this investment. Average weekday traffic on the highway in December 2008 surpassed 97,000 vehicles, a 4.5% increase over December 2007. The project remains on track to deliver an expected 14% after-tax internal rate of return on Aecon's investment.

Segment operating profit of \$10.6 million in 2008 increased by \$6.6 million or 167% over 2007, due to improvements in operating profits from the Quito airport concessionaire, which includes the results from operating the existing Quito airport while the new airport is being constructed, and higher results from Aecon's interest in the company that operates the Cross Israel Highway. Nearly

4.5 million passengers passed through the existing Quito airport in the twelve months of 2008, a 6.9% increase over the same period in 2007. It should be noted that operating profits from the operations of the existing Quito airport are required to be invested to finance the development and construction costs of the new airport.

After deducting capital charges and allocations of corporate overheads, the Concessions segment had an operating profit before income taxes for 2008 of \$0.7 million, which compared to an operating loss before income taxes of \$4.0 million in 2007.

Aecon does not include in its reported backlog expected revenues from operations management contracts and concession agreements. As such, while Aecon expects future revenues from its concession assets, no concession backlog is reported at December 31. Therefore, the Concessions segment's effective backlog is greater than what is reported.

For further details on Aecon's investment in the Quito airport concessionaire, refer to note 5 of the 2008 Consolidated Financial Statements.

## **CORPORATE AND OTHER**

### **Financial Highlights**

<b>\$ millions</b>	<b>Year Ended December 31</b>	
	<b>2008</b>	<b>2007</b>
<b>MG&amp;A</b>	<b>\$ (20.5)</b>	<b>\$ (16.3)</b>
<b>Other income (expense) <sup>(1)</sup></b>	<b>(0.1)</b>	<b>3.1</b>
<b>Interest income</b>	<b>8.1</b>	<b>6.0</b>
<b>Segment operating loss</b>	<b>(12.5)</b>	<b>(7.2)</b>
<b>Capital charges and allocations of corporate overheads</b>	<b>36.6</b>	<b>35.2</b>
<b>Segment profit before income taxes</b>	<b>24.1</b>	<b>28.0</b>

- (1) Other income (expense) in the Corporate and Other segment includes gains and losses on sales of assets, foreign exchange gains and losses, and depreciation and amortization expense.

Corporate segment operating loss in 2008 was higher than in 2007 by \$5.3 million. Negatively impacting the year-over-year comparison was a \$4.3 million gain included in other income (expense) in 2007 which is discussed in the Consolidated Financial Highlights section above. Also, impacting the operating loss in 2008 was marketing, general and administrative expenses ("MG&A") which were higher than 2007 by \$4.2 million. The largest increase in MG&A resulted from higher share-based compensation expense related to the granting of stock options awards in the third quarter of 2008. Also impacting the segment operating loss in 2008 was a favourable increase of \$0.9 million in year-over-year foreign exchange impacts, and a \$2.1 million increase in interest income in 2008.

Fluctuations in interest income are discussed in the Consolidated Financial Highlights section of the MD&A.

## Quarterly Financial Data

Set out below are revenues, net income (loss) and earnings (loss) per share for each of the most recent eight quarters (in millions of dollars, except per share amounts).

(Unaudited)	2008				2007			
	Quarter 4	Quarter 3	Quarter 2	Quarter 1	Quarter 4	Quarter 3	Quarter 2	Quarter 1
Revenues	\$ 602.7	\$ 534.7	\$ 437.7	\$ 302.0	\$ 482.3	\$ 430.4	\$ 338.3	\$ 241.8
Net income (loss)	20.4	23.1	15.6	0.3	22.5	19.0	9.7	(3.0)
Earnings (loss) per share:								
Basic	0.41	0.46	0.32	0.01	0.56	0.51	0.26	(0.08)
Diluted	0.40	0.45	0.31	0.01	0.50	0.44	0.24	(0.08)

Due to the impact of share issuances throughout the periods, the sum of the quarterly earnings (losses) per share will not equal the total for the year. The total of the quarterly earnings (losses) per share from continuing operations, compared with the amounts for the full year are as follows:

	2008		2007	
	Quarterly Total	Annual Amount	Quarterly Total	Annual Amount
Earnings per share:				
Basic	\$ 1.20	\$ 1.23	\$ 1.25	\$ 1.28
Diluted	1.17	1.20	1.10	1.16

The analysis of operating results for each of the first three quarters of 2008 is included in the Management Discussion and Analysis incorporated in the Interim Reports to Shareholders for each quarter.

For the fourth quarter of 2008, revenues amounted to \$603 million, which is \$120 million, or 25%, higher than the same period in 2007, as revenues increased in the Infrastructure, Buildings, Industrial and Concessions segments by \$52 million, \$4 million, \$41 million, and \$10 million, respectively.

Gross margin of \$72 million in the last quarter of 2008 was \$24 million higher than the same quarter in 2007. All operating segments with the exception of Buildings generated increased operating margins, generally as a result of strong industry conditions and higher revenue volumes. In addition, the Infrastructure segment margins benefited from profit recognition on a few large multi-year contracts which reached 20% completion during the fourth quarter of 2008.

MG&A as a percentage of revenues increased from 5.1% in the fourth quarter of 2007 to 5.6% in the same quarter of 2008 primarily as a result of higher performance-related incentive costs, higher costs associated with the growth in revenues, particularly in the Alberta operations of the Infrastructure segment, and from the Alarie operations acquired in late 2007.

Operating profit in the fourth quarter of 2008 was \$34.8 million compared to \$26.2 million during the same period in 2007. The \$8.6 million, or 33%, improvement was primarily a function of the higher operating margins noted above, offset in part by the previously noted \$4.3 million gain that was recorded in the fourth quarter of 2007.

Revenues and operating profit (loss) by segment for the fourth quarters of 2008 and 2007 are set out in the table below (\$ millions).

	<u>Quarter 4</u> 2008		<u>Quarter 4</u> 2007	
	<u>Revenue</u>	<u>Operating profit (loss)*</u>	<u>Revenue</u>	<u>Operating profit (loss)*</u>
Infrastructure	\$ 258	\$ 9.1	\$ 207	\$ 4.8
Buildings	135	(1.0)	131	3.2
Industrial	187	29.2	146	18.5
Concessions	25	3.5	15	0.2
Corporate	(2)	(6.0)	(16)	(0.6)
Consolidated	<u>\$ 603</u>	<u>\$ 34.8</u>	<u>\$ 482</u>	<u>\$ 26.2</u>

\* Operating profit or loss represents the profit or loss from operations, before interest expense, income taxes, non-controlling interests, and corporate allocations of overhead costs and capital charges.

In the Infrastructure segment, fourth quarter 2008 revenues were \$52 million higher than in 2007. Revenues from roadbuilding, utilities and heavy civil operations increased in the fourth quarter by \$32 million, \$6 million and \$14 million, respectively, compared to the corresponding three months of 2007. Similar to the full year's results, the largest increases in revenues occurred in the Alberta roadbuilding and heavy civil operating units and in the Alarie operations in Ontario.

The Infrastructure segment earned an operating profit in the fourth quarter of 2008 of \$9.1 million compared to \$4.8 million in the prior year. The segment's operating results were favourably impacted by higher quarterly revenues, the commencement of profit recognition on a few large multi-year contracts which reached 20% completion in 2008, including the Quito airport project, and favourable quarter-over-quarter foreign exchange rate impacts on international projects.

Revenues in the Buildings segment of \$135 million were \$4 million higher than in the fourth quarter of 2007. Continuing the revenue trends experienced throughout the year, the largest revenue increase occurred in Toronto, and was partly offset by revenue declines in Ottawa and Seattle as some large projects wound down activity after peak production levels in 2007 and early 2008.

The Buildings segment produced an operating loss of \$1.0 million in the fourth quarter of 2008, which is an operating profit decrease of \$4.2 million over the same quarter last year. The majority of the operating profit decline occurred as a result of lower volumes in Ottawa and Seattle, and from further project writedowns and a goodwill impairment loss in the segment's Montreal operations. Overall the Montreal operations were down \$3.6 million quarter-over-quarter.

The Industrial segment's revenues in the fourth quarter of 2008 were \$187 million or \$41 million

higher than in 2007. Volume increases occurred in most operations with the largest increases coming from the Ontario construction and IST units. The reasons for the increases in revenues from these units are similar to those cited above in the section on the Industrial segment's results for all of 2008.

The Industrial segment recorded an operating profit of \$29.2 million in the fourth quarter of 2008, which compares with an operating profit of \$18.5 million in the last quarter of 2007. A combination of increased volumes and improved gross margin percentages in the fourth quarter of 2008 produced the improved results in this segment.

Revenues in the Concessions segment of \$25 million in the last quarter of 2008 were up \$10 million from the same quarter in 2007, with higher revenues reported from both the Quito airport concessionaire and the operator of the Cross Israel Highway. Operating profit of \$3.5 million for the fourth quarter of 2008 represents a \$3.3 million improvement over the same quarter last year with most of the revenue and operating profit improvements relating to the Quito airport concessionaire.

The Corporate segment operating loss in the fourth quarter of 2008 was higher than in the same quarter of 2007 by \$5.3 million. A \$4.3 million gain included in other income (expense) in 2007, which is discussed in the Consolidated Financial Highlights section above, was the primary reason for the quarter-over-quarter change.

Overall, net income for the fourth quarter of 2008 amounted to \$20.4 million or \$0.40 per share on a fully diluted basis, which compares with \$22.5 million or \$0.50 per share in the fourth quarter of 2007.

### **Selected Annual Information**

Set out is selected annual information for each of the last three years (in millions of dollars, except per share amounts).

	<b>2008</b>	<b>2007</b>	<b>2006</b>
<b>Total revenues</b>	\$ <b>1,877.0</b>	\$ 1,492.7	\$ 1,113.3
<b>Earnings before extraordinary items and discontinued operations</b>	<b>59.3</b>	48.3	11.5
Per share:			
Basic	<b>1.23</b>	1.28	0.33
Diluted	<b>1.20</b>	1.16	0.31
<b>Net earnings</b>	<b>59.3</b>	48.3	11.5
Per share:			
Basic	<b>1.23</b>	1.28	0.33
Diluted	<b>1.20</b>	1.16	0.31
<b>Total assets</b>	<b>1,188.9</b>	910.7	716.3
<b>Total long-term financial liabilities</b>	<b>182.7</b>	180.6	158.2
<b>Cash dividends declared per common share</b>	<b>0.20</b>	0.07	-

## **FINANCIAL CONDITION, LIQUIDITY AND CAPITAL RESOURCES**

Aecon holds a 42.3% economic interest in Corporacion Quiport S.A. (“Quiport JV”), an Ecuadorian company, whose main operations consist of managing and operating the existing Quito airport, and the development, construction, operations and maintenance of the new Quito airport under a concession arrangement. Aecon’s investment in its joint ventures, including Quiport JV, are accounted for by the proportionate consolidation method, whereby the Consolidated Financial Statements reflect, line by line, Aecon’s pro-rata share of each of the assets, liabilities, revenues, expenses and cash flows of Quiport JV. Given the significant effect of Quiport JV and other joint ventures on Aecon’s Consolidated Financial Statements, Aecon provides supplemental financial information in note 27 to the 2008 Consolidated Financial Statements as additional information about its accounts, thereby enabling the reader to have a greater understanding of Aecon’s underlying assets, earnings base and financial resources.

### **Cash and Debt Balances**

Cash and cash equivalents at December 31, 2008 were \$292.9 million, which compares with \$134.6 million at December 31, 2007. Of these amounts, \$62.0 million and \$42.7 million, respectively, were on deposit in joint venture bank accounts, which Aecon cannot access directly.

Restricted cash of \$28.2 million at December 31, 2008 (December 31, 2007 - \$34.6 million) represents cash that was deposited as collateral for borrowings and letters of credit issued by Aecon. As such, this cash was not available for general operating purposes. These restricted balances arose primarily from advance payments received on certain joint venture projects where such payments have, in turn, been secured by letters of credit which are, at least in part, collateralized by this restricted cash.

Total debt of \$182.8 million at December 31, 2008 compares to \$187.3 million at December 31, 2007, the composition of which is as follows (\$ millions):

	<b><u>Dec. 31, 2008</u></b>	<b><u>Dec. 31, 2007</u></b>
Bank indebtedness	\$ 2.6	\$ 7.0
Current portion of long-term debt	16.4	17.5
Long-term debt – non-recourse	118.7	68.6
Long-term debt – recourse	45.2	64.1
Convertible debentures	-	30.1
<b>Total debt</b>	<b>\$ 182.8</b>	<b>\$ 187.3</b>
Debt held directly	86.7	110.6
Debt of joint ventures	96.1	76.7
<b>Total</b>	<b>\$ 182.8</b>	<b>\$ 187.3</b>

Bank indebtedness of \$2.6 million at December 31, 2008 compares to \$7.0 million at the end of December 31, 2007, and represents Aecon’s 45% share of funds borrowed by the Nathpa Jhakri hydroelectric project joint venture in India in respect of this now completed project.

At December 31, 2008, the long-term debt component of total debt, including the current portion, totalled \$180.2 million compared to \$180.3 million at December 31, 2007. Included in the December 31, 2007 balance was \$30.1 million of convertible debentures which were converted into common shares in the first quarter of 2008. Other changes in long-term debt included a \$13 million repayment on Aecon's term debt facility, a \$3 million net repayment on the note payable issued in connection with the acquisition of Karson in 2007, an increase in non-recourse debt of \$23 million resulting from the proportionate consolidation of Aecon's share of non-recourse borrowings to finance the Quito airport project, and an increase of \$28 million in non-recourse project debt related to the Phase I Rouge Valley Health System ("Rouge Valley Health") and the Toronto Rehabilitation Institute University Centre ("Toronto Rehab") projects.

On April 17, 2008, the Company issued 4,000,000 common shares at \$18.25 per share for gross proceeds of \$73 million. Net proceeds, after deducting agents' fees and expenses of the issue, were approximately \$69.6 million.

Aecon's liquidity position and capital resources continued to strengthen in 2008 and are expected to be sufficient to finance its operations and working capital requirements for the foreseeable future. Of note, Aecon's cash flow from operations in the twelve months of 2007 was approximately \$99 million higher than in fiscal 2006, and continued to improve in 2008 with cash flow from operations being approximately \$46 million higher than in 2007. This improvement in its liquidity position has, among other benefits, allowed Aecon to broaden and increase its surety capacity. In 2008, Aecon added a co-surety partner to its surety program and in the process has more than doubled its available surety capacity. In addition, in August 2008, Aecon signed a new three-year senior credit facility with a syndicate of lenders. The new \$100 million revolving operating line of credit replaces Aecon's previous facility, which included a \$15 million three-year term loan and a \$50 million three-year revolving operating line. The new facility, which expires on June 15, 2011, also extends by one year (until December 15, 2009) the expiry date of a special letter of credit facility in connection with certain financial and performance guarantees of the Nathpa Jhakri joint venture in India. Further details relating to Aecon's operating lines are described in note 10 to the December 31, 2008 Consolidated Financial Statements.

On January 15, 2009, Aecon acquired South Rock Ltd., an infrastructure construction company in Alberta focusing primarily on the Southern Alberta roadbuilding market. Under the share purchase deal, Aecon assumed South Rock Ltd.'s existing debt of approximately \$9 million and, subject to certain post closing adjustments, paid cash of approximately \$35 million for all the outstanding shares of South Rock.

On February 2, 2009, Aecon and Lockerbie & Hole Inc. ("Lockerbie") announced an agreement that contemplates Aecon will acquire, by plan of arrangement, all of the issued and outstanding common shares of Lockerbie for a total consideration of approximately \$220 million. Under the terms of the proposed transaction, Lockerbie shareholders will receive \$8.00 in value for each Lockerbie common share, comprised of, at the election of each shareholder, cash or common shares of Aecon or a combination thereof, subject to pro-ration such that 75% of the total consideration will be paid in cash and 25% of the total consideration will be paid in Aecon's common shares. Closing is expected to occur in early April 2009 and is subject to regulatory approval, approval by Lockerbie's shareholders, court approval and certain other conditions. This transaction will be financed by Aecon without any

additional debt through the payment of cash and the issuance of approximately \$55 million worth of Aecon's shares which, subject to adjustment at closing, will involve the issuance of approximately 5.4 million shares from treasury representing approximately 9% of Aecon's proforma diluted shares. Aecon's liquidity position and capital resources are expected to remain strong after the Lockerbie acquisition is completed.

In the first quarter of 2008, Aecon announced an increase in its dividend payout level. Annual dividends increased to \$0.20 per share, to be paid in quarterly payments of \$0.05 per share, representing a 43% increase over the \$0.14 per share (\$0.07 semi-annually) dividend rate that was established in late 2007.

Aecon's remaining equity investment of US\$3.5 million in the Quito airport concessionaire is expected to be generated from profits from construction of the new Quito airport. To date, Aecon has invested cash of US\$30.2 million as equity in the concessionaire for a total investment in the Quito airport concessionaire of approximately US\$45 million, which includes Aecon's share of the earnings of the existing airport, all of which are being directly invested in the cost of constructing the new airport. Aecon has also deposited US\$3.7 million with Export Development Canada ("EDC") to support letters of credit issued by EDC on the Quito airport project. Also, in accordance with an agreement with EDC, Aecon has US\$1.0 million in a segregated account to secure future equity investment requirements in the Quito airport concessionaire. These EDC deposits are included in restricted cash on the Consolidated Balance Sheet at December 31, 2008.

### **Summary of Cash Flows**

	<b>Consolidated Cash Flows</b>	
	<b>Year Ended</b>	
	<b>December 31</b>	
	<b>2008</b>	<b>2007</b>
<b>\$ millions</b>		
<b>Cash provided by (used in):</b>		
Operating activities	\$ 143.9	\$ 97.5
Investing activities	(53.3)	(52.0)
Financing activities	60.0	43.6
Increase in cash and cash equivalents	150.5	89.0
Effects of foreign exchange on cash balances	7.7	(4.5)
Cash and cash equivalents - beginning of year	134.6	50.1
<b>Cash and cash equivalents - end of year</b>	<b>\$ 292.9</b>	<b>\$ 134.6</b>

### **Operating Activities**

Cash provided by operating activities of \$144 million in the 2008 was \$46 million better than last year. The year-over-year improvement is due to higher cash earnings (an improvement of approximately \$43 million in 2008) and lower investments in working capital.

## **Investing Activities**

In 2008, investing activities resulted in a use of cash of \$53 million, which compares with cash used of \$52 million in 2007. Of the cash used in 2008, \$43 million represents Aecon's proportionate share of the cash used by Quiport JV for the construction of the new Quito airport (i.e. increase in concession rights). These cash outlays were, for the most part, financed by non-recourse project debt (see Financing Activities below). In 2008, a reduction in the amount of restricted cash required to be deposited as collateral for borrowings and letters of credit was also a source of cash from investing activities. During 2007, Aecon used \$33 million of cash to partially fund the acquisition of Karson and to purchase the assets of Alarie, another \$22 million to finance its proportionate share of the cash used by Quiport JV for construction of the new Quito airport, and \$8 million to increase its investments in restricted cash and marketable securities balances primarily held in connection with the Quito project. Partially offsetting these outflows in 2007 was a \$10 million return of capital on Aecon's long-term investment in Derech Eretz.

## **Financing Activities**

In 2008, cash provided by financing activities amounted to \$60 million, compared to cash provided of \$44 million in the prior year. During 2008, the largest source of financing related to Aecon's issuance of common shares for net proceeds of approximately \$71 million. Also during 2008, issuances of long-term debt amounted to \$34 million while repayments totalled \$26 million, for a net change of \$8 million. Of the increase in long-term debt, \$7 million related to Aecon's proportionately consolidated share of additional non-recourse financing for the new Quito airport project and \$28 million related to non-recourse project financing for the Rouge Valley Health and Toronto Rehab projects. Repayments of long-term debt in 2008 included repayment of Aecon's term loan facility of \$13 million, as well as a \$4 million scheduled principal repayment on a note payable issued in connection with the acquisition of Karson. This increase in cash was partially offset by dividends paid of \$10 million in the year. During 2007, net issuances of long-term debt amounted to \$51 million of which \$15 million relates to Aecon's proportionately consolidated share of additional financing for the new Quito airport project, \$15 million was borrowed in the second quarter of 2007 under Aecon's new term debt facility, of which \$6 million was used to repay existing debt, and debt of \$13 million was incurred in the first quarter of 2007 to finance the acquisition of Karson and additional debt of \$16 million was borrowed in the fourth quarter of 2007 to finance the acquisition of the Alarie assets.

## **NEW ACCOUNTING STANDARDS**

Several new Canadian accounting standards adopted in 2008 and 2007 are described in note 2 to the 2008 Consolidated Financial Statements.

In addition, note 2 to the 2008 Consolidated Financial Statements includes new CICA Handbook sections which became effective on or after January 1, 2009 for Aecon. Aecon does not anticipate any significant impact in 2009 on the Company's financial position or on the results of its operations from adoption of these new standards.

## **International Financial Reporting Standards (“IFRS”)**

In February 2008, the Accounting Standards Board confirmed that Canadian public companies will have to adopt IFRS effective for fiscal years beginning on or after January 1, 2011.

Aecon is currently evaluating this new requirement and is in the process of creating a detailed plan to convert to IFRS. Aecon has performed an initial project scoping exercise to identify the more significant differences between Canadian Generally Accepted Accounting Principles (CGAAP) and IFRS. The Company is focusing its efforts during the first two quarters of 2009 on these major areas of differences which are expected to involve the majority of the work for the transition to IFRS. The financial reporting impact of the transition to IFRS cannot be reasonably estimated at this time.

Aecon has hired a full-time project manager to lead its transition to IFRS. A steering committee with representation from operations, finance, information technology, investor relations and legal services was formed to provide overall guidance to the project as well as receive regular updates on the project’s progress.

Aecon’s audit committee will receive quarterly updates on the progress, cost and major milestones of the project.

The Company has established an IFRS technical committee to provide initial approval of IFRS accounting policies for recommendation to the audit committee. The technical committee will review the judgments and policy recommendations of the IFRS implementation team. The technical committee will meet monthly, starting in first quarter of 2009.

To date, the Company has completed a detailed plan for the 2009 portion of the transition project.

## **SUPPLEMENTAL DISCLOSURES**

### **Disclosure Controls and Procedures**

The Chief Executive Officer and Chief Financial Officer evaluated the effectiveness of the Company’s disclosure controls and procedures as at the financial year ended December 31, 2008. Based on that evaluation, the Chief Executive Officer and the Chief Financial Officer concluded that the design and operation of these disclosure controls and procedures were effective as at December 31, 2008 to provide reasonable assurance that material information relating to the Company, including its consolidated subsidiaries, would be made known to them by others within those entities.

### **Internal Control Over Financial Reporting**

As at the financial year ended December 31, 2008, the Chief Executive Officer and Chief Financial Officer evaluated the design and operating effectiveness of the Company’s internal control over financial reporting. Based on that evaluation, the Chief Executive Officer and the Chief Financial Officer concluded that the design and operating effectiveness of internal control over financial

reporting was effective as at December 31, 2008 to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with Canadian GAAP.

There have been no changes in the Company's internal control over financial reporting that occurred during the most recent period ended December 31, 2008 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

### **Contractual Obligations**

Aecon has commitments for equipment and premises under operating leases and has principal repayment obligations under long-term debt as follows (in thousands of dollars):

	<b>Lease Payments</b>		<b>Long-term Debt Repayments</b>
2009	\$ 20,094	\$	16,387
2010	15,483		36,592
2011	11,633		31,517
2012	6,999		16,281
2013	3,785		18,988
Beyond	10,012		60,447
	<u>\$ 68,006</u>	\$	<u>180,212</u>

At December 31, 2008, Aecon had contractual obligations to complete construction contracts that were in progress. The revenue value of these contracts was \$1,328 million. This consists of the reported backlog of \$1,254 million plus an additional \$74 million representing Aecon's share of the Quito project revenues not included in reported backlog revenues.

### **Off-Balance Sheet Arrangements**

In connection with its joint venture operations in Quito, India and Israel, Aecon has provided various financial and performance guarantees and letters of credit, which are described in note 11 to the 2008 Consolidated Financial Statements.

Aecon's defined benefit pension plans (the "Pension Plans") had a combined deficit of \$2.0 million at December 31, 2008 (2007 - \$0.7 million). These deficits include experience and other actuarial gains and losses which, in accordance with Canadian generally accepted accounting principles, are not immediately recognized in the accounts of the Company but are amortized over the average remaining service life of employees. At December 31, 2008, unrecognized liabilities amounted to \$7.2 million (2007 - \$2.8 million). Details relating to Aecon's defined benefit plans are set out in note 20 to the 2008 Consolidated Financial Statements.

The current actuarial valuation of the Pension Plans for statutory and contribution purposes was completed as at December 31, 2007. Under current pension benefits regulations, the next actuarial

valuation of the Pension Plans must be performed with a valuation date of no later than December 31, 2010.

In light of recent economic conditions, Aecon contributed the maximum allowable under the Income Tax Act (Canada) to its main defined benefit plan in 2008. In contributing the maximum amount, going concern and solvency special payments will be eliminated and future contributions to this plan (until the next valuation is filed in 2011) will consist of only normal cost contributions. No change in contributions will be required before 2011 and any change thereafter will reflect December 31, 2010 market conditions.

As a result of the significant increase in “AA” bond yields over the past year, the reported pension obligation amount and future service cost of the Pension Plans has been considerably reduced. However, this reduction in estimated pension obligations only partially offsets the significant reduction in investment market values experienced by the Pension Plans in the past year. The net effect of these changes has contributed to a year-over-year decrease in the funded position of the Pension Plans of \$1.3 million at December 31, 2008 (see above). In addition, these economic impacts also affect Aecon’s pension expense in 2009 which is expected to increase by approximately \$0.7 million when the 2008 experience and other actuarial losses begin to be amortized into income.

It is important to note that the accounting for pension plans involves a number of assumptions including those that are disclosed in note 20 to the Consolidated Financial Statements. As a result of the uncertainty associated with these estimates, there is no assurance that the plans will be able to earn the assumed rate of return on plan assets, and furthermore, market driven changes may result in changes to discount rates and other variables which would result in Aecon being required to make contributions to the plans in the future that may differ significantly from estimates. As a result, there is a significant amount of measurement uncertainty involved in the actuarial valuation process. This measurement uncertainty may lead to potential fluctuations in financial results attributable to the selection of actuarial assumptions and other accounting estimates involved in the determination of pension expense and obligations. Two of the more significant actuarial and accounting assumptions impacting the reporting of pension plans are the discount rate assumption and the expected return on assets assumption. As at December 31, 2008, Aecon has used a discount rate of 7% and an expected return on assets of 6.25% in its pension plan calculations for financial statement purposes. The impact of a 0.5% decrease in both the discount rate and the expected return on assets assumptions would have resulted in an increase in the Pension Benefit Obligation of approximately \$1.6 million at December 31, 2008 and an increase in the estimated 2009 pension expense of approximately \$0.4 million.

From time to time Aecon enters into forward contracts and other foreign exchange hedging products to manage its exposure to changes in exchange rates related to transactions denominated in currencies other than the Canadian dollar. At December 31, 2008, the Company had net outstanding contracts to sell euro 3.3 million, sell US\$16.0 million, buy euro 0.1 million and buy US\$0.7 million (December 31, 2007 - sell euro 6.7 million, sell US\$24.0 million and buy US\$12.0 million, sell US\$0.8 million) on which there was a net unrealized exchange loss of \$1.9 million (December 31, 2007 - net gain of \$1.0 million). The net unrealized exchange gain (loss) represents the estimated amount the Company would have received (paid) if it terminated the contracts at the end of the respective periods. Financial instruments are discussed in note 22 to the 2008 Consolidated Financial Statements.

In connection with a US dollar denominated term loan facility, Aecon entered into an interest rate swap with a financial institution on October 1, 2007 to help manage its exposure to interest rate volatility. By entering into the interest rate swap, the Company agreed to receive interest at a variable rate and pay interest at a fixed rate. Coincident with the repayment of the term loan facility in the second quarter of 2008, this interest rate swap contract was terminated.

### **Related Party Transactions**

During 2008, \$1.1 million of loans receivable from employees were repaid, reducing the balance to nil. Refer to note 21 to the 2008 Consolidated Financial Statements for details of related party transactions and balances.

### **Critical Accounting Estimates**

By its nature, accounting for construction contracts requires the use of estimates. Revenue and income from fixed price construction contracts, including contracts in which Aecon participates through joint ventures, are determined on the percentage of completion method, based on the ratio of costs incurred to date over estimated total costs. Aecon has a process whereby progress on jobs is reviewed by management on a regular basis and estimated costs to complete are updated. However, due to unforeseen changes in the nature or cost of the work to be completed or performance issues, contract profit can differ significantly from earlier estimates.

Unpriced change orders are change orders that have been approved as to scope but unapproved as to price. For such change orders, contract revenues are recognized to the extent of costs incurred or, if lower, to the extent to which recovery is probable. Therefore, to the extent that actual costs recovered are different from expected cost recoveries, significant swings in revenue and profitability can occur from one reporting period to another.

Claims are amounts in excess of the agreed contract price, or amounts not included in the original contract price, that Aecon seeks to collect from clients or others for client-caused delays, errors in specifications and designs, contract terminations, change orders in dispute or unapproved as to both scope and price, or other causes of unanticipated additional costs. In accordance with Aecon's accounting policy, claims are recognized in revenue only when resolved. Therefore, it is possible for Aecon to have substantial contract costs recognized in one accounting period with associated revenue recognized only in a later period.

In the preparation of the Consolidated Financial Statements, various other estimates are required, which are either subjective, could be materially different under different conditions or using different assumptions, or which require complex judgments. The more significant estimates are related to the accounting for income taxes, concession rights to operate the existing Quito airport, employee benefit plans and the accounting for pension expense, and the allocation of the purchase price to the fair value of assets acquired and liabilities assumed on acquisitions. The Company's accounting for income taxes is described in note 6 to the 2008 Consolidated Financial Statements and under Tax Accrual Risks in the following section of the MD&A, entitled Risks and Uncertainties. The significant actuarial assumptions used in accounting for pension expense are set out in note 20 to the

2008 Consolidated Financial Statements and are discussed above in the Off-Balance Sheet Arrangements section of the MD&A.

### Outstanding Share Data

Aecon is authorized to issue an unlimited number of common shares. The following are details of common shares outstanding and securities that are convertible into common shares.

(in thousands of dollars, except share amounts)

	<u>December 31, 2008</u>	<u>March 3, 2009</u>
Number of common shares outstanding (1)	50,899,290	50,899,290
Paid-up capital of common shares outstanding (2)	\$ 262,644	\$ 262,644
Outstanding securities exchangeable or convertible into common shares:		
Number of stock options outstanding	1,993,484	1,993,484
Number of common shares issuable on exercise of stock options	1,993,484	1,993,484
Increase in paid-up capital on exercise of stock options	\$ 22,441	\$ 22,441
Principal amount of convertible debentures outstanding (see note 12 to the 2008 Consolidated Financial Statements)	\$ -	\$ -
Number of common shares issuable on conversion of convertible debentures	-	-
Increase in paid-up capital on conversion of convertible debentures	\$ -	\$ -

- (1) The number of common shares outstanding as per the above table at December 31, 2008 includes 691,366 shares (March 3, 2009 – 691,366 shares) held by the trustee of Aecon’s Long-Term Incentive Plan (“LTIP”).

The number of common shares outstanding at December 31, 2008 for financial statement purposes, after deducting the above LTIP shares, was 50,207,924 shares (March 3, 2009 – 50,207,924 shares) (see note 16 to the 2008 Consolidated Financial Statements).

- (2) As described in note 16 to the 2008 Consolidated Financial Statements, and in accordance with the recommendations of The Canadian Institute of Chartered Accountants, share capital at December 31, 2008 has been reduced by \$7.6 million to reflect shares held by the trustee of the LTIP plan.

## **RISKS AND UNCERTAINTIES**

### **Current Global Financial Conditions**

Recent events in global financial markets have had a profound impact on global, North American and Canadian economies. Many industries have been impacted by the changes in market conditions to varying degrees. Some of the key impacts of the current financial market turmoil include contraction in credit markets and resulting widening of credit risk as well as enhanced volatility in commodity, equity and foreign exchange markets. A continued or worsened slowdown in financial markets or other economic conditions, including without limitation, constraints in credit or surety markets, a sustained slump in economic activity in the Alberta oilsands, the availability of private and public sector funding for infrastructure projects, pressure on margins arising from an altered competitive landscape or an increased risk of corporate bankruptcy in the markets in which Aecon operates, may adversely affect the Company in ways which are impossible to predict as of the date hereof given the unprecedented nature of the current crisis.

### **Large Project Risk**

A substantial portion of Aecon's revenues is derived from large projects, some of which are conducted through joint ventures. These projects provide opportunities for large revenue and profit contributions but can occasionally result in significant losses.

Joint ventures are typically formed to undertake a specific project, jointly controlled by the partners and are dissolved upon completion of the project. Aecon selects its joint venture partners based on a variety of criteria including relevant expertise, past working relationships as well as analysis of the prospective partners' financial and construction capabilities. Joint venture agreements spread risk between the partners and they generally state that companies supply their proportionate share of operating funds and that they share profits and losses in accordance with specified percentages. Nevertheless, each participant in a joint venture is usually liable to the client for completion of the entire project in the event of a default by any of its partners. Therefore, in the event that a joint venture partner fails to perform their obligations due to financial or other difficulties, Aecon may be required to make additional investments or provide additional services which may reduce or eliminate profit, or even subject Aecon to significant losses with respect to the joint venture.

Opportunities for Aecon to compete for large projects do not occur regularly. As a result, Aecon's ability to successfully compete for these opportunities and the length of time required to execute these projects are not predictable, and therefore the Company may experience periods of irregular or reduced revenues. In fact, since the completion of the Cross Israel Highway and Nathpa Jhakri projects, Aecon has not undertaken construction of a similar large project with the exception of the new Quito International Airport, which commenced in 2006.

The recording of the results of large project contracts can distort revenues and earnings on both a quarterly and an annual basis and can, in some cases, make it difficult to compare the financial results between reporting periods.

As described more fully in notes 11 and 15 to the 2008 Consolidated Financial Statements, Aecon has a number of commitments and contingencies. If Aecon was called upon to honor these obligations, its financial results would be adversely affected.

The Nathpa Jhakri project in India, although now complete, incurred significant delays in respect of which the joint venture, in which Aecon has a 45% interest, submitted requests for extensions of contract time as well as claims for significant compensation arising from the costs of delays. The joint venture has submitted for arbitration various claims against the owner, Satluj Jal Vidyut Nigam Ltd. ("SJVN") (formerly Nathpa Jhakri Power Corporation Limited), the most significant of which is to cover the joint venture's cost of extra work and delays related to these same matters. In 2005, the joint venture was advised by SJVN of its intention to levy liquidated damages against the joint venture for alleged delay damages resulting from not completing the contract on time. Since the delay in the completion of the project was caused by numerous items outside of the joint venture's control and contractual responsibility, including, among many other things, a catastrophic flood in 2002, the joint venture believes that these claims for liquidated damages are unsubstantiated, unwarranted and without legal merit. Currently, no provision has been made for liquidated damages, nor has any amount been recognized for potential recoveries under the claims. This treatment is in accordance with the Company's accounting policy, which is to recognize revenues from claims only when resolved. As discussed in further detail above under the Infrastructure section of the MD&A, the arbitration process is nearly complete and a decision on the second of two major claims is expected in 2009. For further information refer to note 15 to the 2008 Consolidated Financial Statements. In the event the joint venture is unsuccessful in its claims for additional compensation and request for extension of contract time, the joint venture could be faced with potential liquidated damages claims by SJVN for which the Company is jointly and severally liable. If such possible claims were to materialize and be successful, the financial results and the financial position of Aecon would be adversely affected.

In addition, as at December 31, 2008, the Company had outstanding guarantees and letters of credit totaling approximately \$12 million in support of financial and performance related obligations for the Nathpa Jhakri project. If such guarantees were to be called upon and/or if Aecon was not able to collect its undistributed profits, Aecon's financial results and its financial position would be adversely affected. Construction of the Nathpa Jhakri project is fully complete and the warranty period has expired.

In connection with the Cross Israel Highway project, the Company has provided two joint and several guarantees: a continuous guarantee, which guarantees the performance of the concessionaire in which the Company has a 25% interest; and a leakage guarantee, which is a guarantee by the operator of the toll highway, (in which the Company has a 30.60% interest), to the concessionaire and covers toll capture and collection rates generated from users of the highway during the operating period. These guarantees extend to the end of the concession period which ends in 2029. If such guarantees were to be called upon, the financial results and the financial position of Aecon would be adversely affected.

In addition, a significant portion of Aecon's capital (approximately \$42 million) is invested, directly or indirectly, in the Cross Israel Highway. As a result, any material diminution in the value of the Cross Israel Highway would adversely affect the financial results and condition of the Company.

Aecon is a partner with Hochtief Construction AG in a joint venture that constructed a hydroelectric facility in northern Quebec for Société d'énergie de la Baie James, a subsidiary of Hydro-Quebec (the "Eastmain Project"). The Eastmain Project although complete, incurred extra costs, primarily because of customer changes to the original contract scope. The Company is currently in litigation with Hydro-Quebec seeking a recovery of these extra costs. The Company believes that it has adequate reserves included in the carrying value of its accounts to cover potential non-recoveries that may arise from this project.

The Company holds a 42.3% effective economic interest in Corporacion Quiport S.A. ("Quiport JV"), an Ecuadorian company, whose main operations consist of: (a) managing and operating the existing Mariscal Sucre International Airport (the "Existing Quito Airport") until its operations are transferred to a new airport; and (b) the development, financing, construction, operation and maintenance of the new Quito airport under a concession arrangement with Corporacion Aeropuerto y Zona Franca del Distrito Metropolitano de Quito ("CORPAQ").

On January 27, 2006, Quiport JV assumed control of Existing Quito Airport operations and on June 28, 2006 financial close was achieved and the first tranche of financing was advanced by the Project Senior Lenders. The construction contract for the new airport was signed on June 22, 2005, and the formal construction commencement date was July 12, 2006. The new Quito airport will be constructed under a 51-month fixed-price Engineer-Procure-Construct contract signed between CORPAQ and Canadian Commercial Corporation ("CCC"), a Crown agency of the Canadian government. CORPAQ assigned the construction contract to Quiport JV. CCC subcontracted 100% of the construction work to the Company as its Canadian supplier, which then subcontracted 100% of the construction work to a 50%/50% joint venture consisting of the Company and Brazil's Construtora Andrade Gutierrez (the "Construction JV"). The Company is the managing partner of the Construction JV.

More specifically as it relates to the Quito airport concessionaire, as with other private concessions in Ecuador, the Quito airport project came under heightened scrutiny by the new Federal administration. Along with this scrutiny came a series of public criticisms by the administration against the Municipality of Quito, primarily directed at the lack of contribution by the Municipality, through the airport project, towards a national airport modernization program, as well as a recommendation by the State Comptroller's office that the Municipality should renegotiate the Quito airport concession contract. While there is no indication thus far that the administration intends to take any unilateral action that would run contrary to the contracts that Aecon and its partners have in place, the political environment reconfirms that the project and related investments are occurring in a country in which there is elevated political risk and uncertainty generally. Therefore, political risk may adversely impact the project's financial performance and its overall financial viability, and the value of Aecon's investment in the Quito airport concessionaire (Quiport JV) could ultimately be impaired.

In connection with the Quito airport project, the Company has made equity investments and provided letters of credit in support of its remaining equity obligations and for various project contingencies. These letters of credit are supported by guarantees issued on behalf of the Company to the issuing banks by EDC and will remain in place until its equity obligations are fulfilled and the conditions giving rise to the contingencies are satisfied or cleared. In addition, the Company and Andrade Gutierrez have provided surety bonds, guaranteed joint and severally, to cover construction and

concession related performance obligations, an advance payment bond and a retention release bond; in each case the Company's share is supported by guarantees issued by EDC. If Aecon was called upon to honor these obligations, or should the project incur significant cost overruns, its financial results and position would be adversely impacted. For further information on the Quito project, refer to note 5 in the 2008 Consolidated Financial Statements.

During previous years, Quiport JV exercised its right under its concession contract to increase tariffs for services rendered to the airlines using the Existing Quito Airport. These increased tariffs have on previous occasions been challenged by certain airlines. Should Quiport's rights to recent or future tariff increases be restricted or reduced, the reported value of concession rights related to the Existing Quito Airport could ultimately be impaired.

The failure to replace the revenue generated from these large projects on a going forward basis could adversely affect Aecon.

### **Concessionaire Risk**

In addition to its work providing design, construction, procurement, operation and other services on a given project, Aecon will sometimes also invest in the infrastructure asset itself as a concessionaire. In such instances, Aecon assumes a degree of risk (essentially equity risk) associated with the financial performance of the asset during the concession period. The Cross Israel Highway and the Quito airport are two current examples of such projects.

The financing arrangements on concession projects such as these are typically based on a set of projections regarding the cash flow to be generated by the asset during the life of the concession. The ability of the asset to generate the cash flows required to provide a return to the concessionaire can be influenced by a number of factors, some of which are partially beyond the concessionaire's control – such as political or legislative changes, traffic demand and thus operating revenues, collection success, operating cost levels, etc.

While project concession agreements often provide a degree of risk mitigation (for example, through minimum traffic guarantees in the case of the Cross Israel Highway), and insurance products are available to limit some of the concession risks, the value of Aecon's investment in these infrastructure assets can be impaired, and certain limited risk guarantees can be called, if the financial performance of the asset does not meet certain requirements.

On a going forward basis, a sustained global economic slump may, directly or indirectly, impact the ability of Aecon to make the necessary financing arrangements to pursue all of the concession opportunities it would otherwise be interested in.

### **Oilsands**

Recent delays, scope reductions and/or cancellations in previously announced or anticipated projects in the Alberta oilsands demonstrate that economic activity in the oilsands may be impacted by a variety of factors including: the current global economic crisis; the fluctuation in world oil prices; cost overruns on announced projects; fluctuations in the availability of skilled labour; lack of

sufficient governmental infrastructure to support growth; the potential introduction of new “green” legislation and a shortage of sufficient pipeline capacity to transport production to major markets. A sustained period of low world oil prices may result in material differences in previously projected oilsands development. Postponements or cancellations of investment in existing and new projects could have an adverse impact on Aecon’s business and financial condition.

### **International/Foreign Jurisdiction Factors**

Aecon is from time to time engaged in large international projects in foreign jurisdictions. International projects such as the Nathpa Jhakri hydroelectric project in northern India, the Cross Israel Highway in Israel and the Quito airport in Ecuador can expose Aecon to risks beyond those typical for its activities in its home market, including without limitation economic, geopolitical, geotechnical, military, repatriation of undistributed profits, currency and foreign exchange risks, and other risks beyond the Company’s control including the duration and severity of the impact of the current global economic crisis.

Aecon continually evaluates its exposure to unusual risks inherent in international projects and, where deemed appropriate in the circumstances, mitigates these risks through specific contract provisions, insurance coverage and forward exchange agreements. However, there are no assurances that such measures would offset or materially reduce the effects of such risks.

Foreign exchange risks are actively managed and hedged where possible and considered cost effective, when directly tied to quantifiable contractual cash flows accruing directly to Aecon within periods of one or two years. Major projects executed through joint ventures generally have a longer term and result in foreign exchange translation exposures that Aecon has not hedged. Such translation exposure will have an impact on Aecon’s consolidated financial results. Practical and cost effective hedging options to fully hedge this longer term translational exposure are not generally available to Aecon.

Aecon’s investment in Derech Eretz Highways (1997) Ltd. (“Derech Eretz”) is denominated in New Israeli Shekels (“NIS”) and, as such, the value of this investment fluctuates with changes in the relationship between the Canadian dollar and NIS. Similarly, although much less significant, Aecon’s investments in India and Israel (other than its investment in Derech Eretz), which primarily represent undistributed profits from its now completed construction projects in these countries, are denominated in foreign currencies (mostly NIS, Rupees and United States dollars) and the value of these investments fluctuates as the value of the Canadian dollar changes relative to the values of these foreign currencies. For further information on currency risk, refer to note 22 in the 2008 Consolidated Financial Statements.

### **Contractual Factors**

Aecon performs construction activities under a variety of contracts including lump-sum, fixed price, guaranteed maximum price, cost reimbursable and design build. Some forms of construction contracts carry more risk than others.

Historically, a substantial portion of Aecon's revenue is derived from lump sum contracts pursuant to which a commitment is provided to the owner of the project to complete the project at a fixed price ("Lump Sum") or guaranteed maximum price ("GMP"). In Lump Sum and GMP projects, in addition to the risk factors of a unit price contract (as described below), any errors in quantity estimates or schedule delays or productivity losses, for which contracted relief is not available must be absorbed within the Lump Sum or GMP, thereby adding a further risk component to the contract.

Aecon is also involved in fixed unit price construction contracts under which the Company is committed to provide services and materials at a fixed unit price (e.g. dollars per tonne of asphalt or aggregate). While this shifts the risk of estimating the quantity of units to the contract owner, any increase in Aecon's cost over the unit price bid, whether due to estimating error, inefficiency in project execution, inclement weather, inflation or other factors, will negatively affect Aecon's profitability.

In certain instances, Aecon guarantees to a customer that it will complete a project by a scheduled date or that the facility will achieve certain performance standards. If the project or facility subsequently fails to meet the schedule or performance standards, Aecon could incur additional costs or penalties commonly referred to as liquidated damages. Although Aecon attempts to negotiate waivers of consequential or liquidated damages, on some contracts the Company is required to undertake such damages for failure to meet certain contractual provisions. Such penalties may be significant and could impact Aecon's financial position or results of future operations. Furthermore, schedule delays may also reduce profitability because staff may be prevented from pursuing and working on new projects. Project delays may also reduce customer satisfaction which could impact future awards.

Aecon is also involved in design-build contracts where, in addition to the responsibilities and risks of a unit price or lump sum construction contract, Aecon is responsible for certain aspects of the design of the facility being constructed. This form of contract adds the risk of Aecon's liability for design errors as well as additional construction costs that might result from such design errors.

Certain of Aecon's contractual requirements may also involve financing elements, where Aecon is required to provide one or more letters of credit, performance bonds, financial guarantees or equity investments. In light of both the actual and potential impact of the current economic situation on the credit and surety markets throughout the world, there can be no assurance that Aecon will be able to obtain the necessary financing on favourable or commercially reasonable terms and conditions for such equity investments, nor that its available working capital and bonding facilities will be adequate in order to issue the required letters of credit and performance bonds. Further uncertainty in the credit and surety markets may, for reasons wholly unrelated to the business, affairs or results of the Company, impact the ability of Aecon to raise sufficient project based securities and financial instruments to pursue all of the opportunities it would be otherwise interested in.

Change orders, which modify the nature or quantity of the work to be completed, are frequently issued by clients. Final pricing of these change orders is often negotiated after the changes have been started or completed. Until pricing has been agreed, these change orders are referred to as "unpriced change orders." Revenues from unpriced change orders are recognized to the extent of the costs incurred on executing the change order, or if lower, to the extent to which recovery is probable. Only

when pricing is agreed is any profit on such change orders recognized. If, ultimately, there are disputes with clients on the pricing of change orders or disputes regarding additional payments owing as a result of changes in contract specifications, delays, additional work or changed conditions, Aecon's accounting policy is to record all costs for these changes but not to record any revenues anticipated from these disputes until actually resolved, even though the Company may believe that full compensation from clients is probable. The timing of the resolution of such events can have a material impact on income and liquidity and thus can cause fluctuations in the revenue and income of Aecon in any one reporting period.

## **Economic Factors**

Aecon's profitability is closely tied to the general state of the economy in those geographic areas in which it operates. More specifically, the demand for infrastructure, which is the principal component of Aecon's operations, is perhaps the largest single driver of the Company's growth and profitability.

In North America, which tends to have relatively sophisticated infrastructure, Aecon's profitability is dependent both on the development, rehabilitation and expansion of basic infrastructure (highways, airports, dams, hydroelectric plants, etc.) and on the type of infrastructure that flows from commercial and population growth. Commercial growth demands incremental facilities for the movement of goods within and outside of the community, along with water and sewer systems and heat, light and power supplies. Population growth creates a need to move people to and from work, schools and other public facilities, and demands similar services to new homes. Since growth in both these areas, with the possible exception of road maintenance and construction, is directly affected by the general state of the local economy, a prolonged economic crisis in the markets in which Aecon operates or related constraints on public sector funding may have a significant impact on Aecon's operations.

Internationally, Aecon is involved with the development of basic infrastructure, particularly in developing countries. As such, the Company's growth and profitability from this work depends largely on the pace of growth in these foreign jurisdictions and the ability of these countries to allow for the arrangement of long-term financing, which may on a going forward basis be impacted or constrained by the effects of the current global economic crisis.

## **Ongoing Financing Availability**

Aecon's business strategy involves the selective growth of its operations through internal growth and acquisitions. Certain of Aecon's operating segments, particularly its Infrastructure and Industrial segments, require substantial working capital during their peak busy periods. As these businesses grow, Aecon is continually seeking to enhance its access to funding in order to finance the higher working capital associated with this growth. However, from time to time, Aecon is constrained in its ability to capitalize on growth opportunities to the extent that financing is either insufficient or unavailable. It is too early to ascertain whether the current economic situation will alter either in 2009 or beyond the ability of Aecon to raise sufficient financing to execute its short and long-term strategy.

## **Access to Bonding and Pre-qualification Rating**

Many of Aecon's construction contracts require either sufficient bonding or pre-qualification rating. The surety industry has undergone significant consolidation in recent years, which has constrained overall industry capacity. The surety industry has also endured a certain degree of instability and uncertainty arising from the economic crisis, the long-term effects of which, if any, are difficult to predict. Furthermore, the issuance of bonds under surety facilities is at the sole discretion of the surety company. Although the Company believes it will be able to continue to maintain surety capacity adequate to satisfy its requirements, should those requirements be materially greater than anticipated, or should sufficient surety capacity not be available for reasons related to the current crisis or otherwise or should the cost of bonding rise substantially (whether Aecon specific or industry wide), this may have a material adverse effect on the ability of Aecon to operate its business or take advantage of all market opportunities.

## **Insurance Risk**

Aecon maintains insurance in order to both satisfy the requirements of its various construction contracts as well as a corporate risk management strategy. Insurance products from time to time experience market fluctuations that can impact pricing and availability. Therefore, senior management, through Aecon's insurance broker, monitors developments in the insurance markets to ensure that the Company's insurance needs are met. Although Aecon has been able to meet its insurance needs, there can be no assurances that Aecon will be able to secure all necessary or appropriate insurance on a going forward basis. Failure to do so could lead to uninsured losses or limit Aecon's ability to pursue some construction contracts, both of which could impact results.

## **Environmental and Safety Factors**

Unfavourable weather conditions represent one of the most significant uncontrollable risks for Aecon. Construction projects are susceptible to delays as a result of extended periods of poor weather, which can have an adverse effect on profitability arising from either late completion penalties imposed by the contract or from the incremental costs arising from loss of productivity, compressed schedules, or from overtime work utilized to offset the time lost due to adverse weather.

During its history, Aecon has experienced a number of incidents, emissions or spills of a non-material nature in the course of its construction activities. Although none of these environmental incidents to date have resulted in a material liability to the Company, there can be no guarantee that any future incidents will also be of a non-material nature.

Aecon is subject to and complies with federal, provincial and municipal environmental legislation in all of its manufacturing and construction operations. Aecon recognizes that it must conduct all of its business in such a manner as to both protect and preserve the environment in accordance with this legislation. At each place where work is performed, Aecon develops and implements a detailed quality control plan as the primary tool to demonstrate and maintain compliance with all environmental regulations and conditions of permits and approvals. Management is not aware of any pending environmental legislation that would be likely to have a material impact on any of its operations, capital expenditure requirements or competitive position, although there can be no

guarantee that future legislation (including without limitation the introduction of “green” legislation that may impact segments of Aecon’s business such as work in Alberta’s oilsands) will not be proposed, and if implemented, it may have a material impact on the Company and its financial results.

Aecon is also subject to and complies with health and safety legislation in all of its operations in the jurisdictions in which it operates. The Company recognizes that it must conduct all of its business in such a manner as to ensure the protection of both its workforce and the general public. Aecon has developed a comprehensive health and safety plan and is proud of its record in this regard. Nevertheless, given the nature of the industry, accidents will inevitably occur from time to time. Management is not aware of any pending health and safety legislation or prior incidents which would be likely to have a material impact on any of its operations, capital expenditure requirements or competitive position. Nevertheless, there can be no guarantee with respect to the impact of future legislation or accidents.

### **Litigation Risk**

Disputes are common in the construction industry and as such, in the normal course of business, the Company is involved in various legal actions and proceedings which arise from time to time, some of which may be substantial. In view of the quantum of the amounts claimed and the insurance coverage maintained by the Company in respect of these matters, management of the Company does not believe that any of the legal actions or proceedings that are presently known or anticipated by the Company is likely to have a material adverse effect on the Company’s financial position. However, there is no assurance that the Company’s insurance arrangements will be sufficient to cover any particular claim or claims that may arise in the future. Furthermore, the Company is subject to the risk of claims and legal actions for various commercial and contractual matters, primarily arising from construction disputes, in respect of which insurance is not available. Although as of the date hereof, Aecon has not seen a material shift, there can be no guarantee that one of the byproducts of the current economic crisis will not be a rise in litigation which, depending on the nature of the litigation, could impact Aecon’s results.

### **Internal and Disclosure Controls**

Inadequate disclosure controls or internal controls over financial reporting could result in material misstatements in the financial reporting or public disclosure record of Aecon. Inadequate controls could also result in system downtime, give rise to litigation or regulatory investigation, fraud or the inability of Aecon to continue its business as presently constituted. Aecon has implemented procedures (including the formation of an internal audit department) and a variety of policies to evaluate and maintain adequate disclosure and internal controls.

### **Labour Factors**

A significant portion of Aecon’s labour force is unionized and accordingly, Aecon is subject to the detrimental effects of a strike or other labour action, in addition to competitive cost factors.

The Company's future prospects depend to a significant extent on its ability to attract sufficient skilled workers. The construction industry is faced with an increasing shortage of skilled labourers in some areas and disciplines. The resulting competition for labour in markets such as Fort McMurray (which may be lessened by the decline in the price of oil and current market conditions) may limit the ability of the Company to take advantage of opportunities otherwise available or alternatively may impact the profitability of such endeavours on a going forward basis. The Company believes that its union status, size and industry reputation will help mitigate this risk but there can be no assurance that the Company will be successful in identifying, recruiting or retaining a sufficient number of skilled workers.

### **Cyclical Nature of the Construction Business**

Fluctuating demand cycles are common in the construction industry and can have a significant impact on the degree of competition for available projects. As such, fluctuations in the demand for construction services or the ability of the private and/or public sector to fund projects in the current economic climate could adversely affect backlog and margin and thus Aecon's results.

### **Dependence on the Public Sector**

A significant portion of Aecon's revenues is derived from contracts with various governments or their agencies. Consequently, any reduction in demand for Aecon's services by the public sector whether from traditional funding constraints, the impact of the current economic crisis (including future budgetary constraints or an eroding tax base), changing political priorities, change in government or delays in projects caused by the election process would likely have an adverse effect on the Company if that business could not be replaced from within the private sector.

Large government sponsored projects typically have long and often unpredictable lead times associated with the government review and political assessment process. The time delays and pursuit costs incurred as a result of this lengthy process, as well as the often unknown political considerations that can be part of any final decision, constitute a significant risk to those pursuing such projects.

### **Potential Fluctuation in Financial Results**

Aecon's quarterly and annual financial results may be impacted by a variety of factors including, without limitation: the recognition of revenue from existing large project contracts; the opportunity to compete for new large projects; costs or penalties associated with unanticipated delays in project completion; fluctuations in the general economic and business conditions in the markets in which Aecon operates, which may impact pricing levels of its services; actions by governmental authorities including government demand for the services provided by Aecon; government regulations and the associated expenditures required to comply with regulations; labour action involving Aecon's unionized workers; seasonal or materially adverse weather conditions; the risk associated with the use of lump sum and guaranteed maximum price contracts; geopolitical risks in the foreign jurisdictions in which Aecon operates as well as risk associated with foreign currency and exchange rates; and other circumstances affecting revenue and expenses. Aecon's operating expenses are incurred throughout the year. As a result, if expected revenues are not realized as anticipated, there may be significant variations in Aecon's quarterly and annual financial results.

## **Loss of Key Management; Inability to Attract and Retain Key Staff**

The Company's future prospects depend to a significant extent on the continued service of its key executives and staff. Furthermore, the Company's continued growth and future success depends on its ability to identify, recruit, assimilate and retain key management, technical, project and business development personnel. The competition for such employees, particularly during periods of high demand in certain sectors, is intense and there can be no assurance that the Company will be successful in identifying, recruiting or retaining such personnel.

## **Adjustments in Backlog**

There can be no assurance that the revenues projected in Aecon's backlog at any given time will be realized, or if realized, that they will perform as expected with respect to margin. Projects may from time to time remain in backlog for an extended period of time prior to contract commencement, and after commencement may occur unevenly over current and future earnings periods. Project suspensions, terminations or reductions in scope do occur from time to time in the construction industry due to considerations beyond the control of a contractor such as Aecon and may have a material impact on the amount of reported backlog with a corresponding impact on future revenues and profitability. The current global economic crisis may lead to more project delays, reductions in scope and/or cancellations such as those experienced in the oilsands in the last quarter of 2008 and first quarter of 2009. A sustained economic slump may negatively affect the ability of the Company to replace its existing backlog which may adversely impact results.

## **Risk of Non-Payment**

Credit risk of non-payment with private owners under construction contracts is to a certain degree minimized by statutory lien rights which give contractors a high priority in the event of foreclosures as well as progress payments based on percentage completion. However, there is no guarantee that these measures will in all circumstances mitigate the risk of non-payment from private owners and a significant default or bankruptcy by a private owner may impact results. The current economic crisis may give rise to a greater incidence of default (including cash flow problems) or corporate bankruptcy of clients, subcontractors or suppliers which could also impact results.

Credit risk is typically less with public (government) owners who generally account for a significant portion of Aecon's business as funds have generally been appropriated prior to the award or commencement of the project. See "Dependence on the Public Sector" for additional discussion of the risks associated with this type of contract.

## **Tax Accrual Risks**

Aecon is subject to income taxes in both Canada and numerous foreign jurisdictions. Significant judgment is required in determining the Company's worldwide provision for income taxes. In the ordinary course of business, there are many transactions and calculations where the ultimate tax determination is uncertain. Although Aecon believes its tax estimates are reasonable, there can be no assurance that the final determination of any tax audits and litigation will not be materially different

from that reflected in historical income tax provisions and accruals. Although management believes it has adequately provided for any additional taxes that may be assessed as a result of an audit or litigation, the occurrence of either of these events could have a material adverse effect on the Company's current and future results and financial condition.

During 2001, the Company received federal income tax reassessments relating to deductions claimed by predecessor companies between 1993 and 1999. The reassessments, which disallow previously claimed Canadian development expense ("CDE") deductions, amounted to \$10.6 million. Provincial income tax reassessments related to the disallowed CDE and received to date amount to \$0.8 million. Although the Company has filed Notices of Objection, it was required to pay 50% of the federal assessed amounts and 100% of the Ontario provincial assessments pending resolution of the objections. At December 31, 2008, the Company had paid \$5.4 million resulting from these assessments. To-date, the Canada Revenue Agency has not responded to the Notices of Objection. The total potential federal and provincial reassessments, including income taxes, interest and penalties could be up to \$19.3 million. The Company believes it has adequate income tax provisions to cover the ultimate outcome of these reassessments.

### **Reputation in the Construction Industry**

Reputation and goodwill play an important role in the long-term success of any company in the construction industry. Negative opinion may impact long-term results and can arise from a number of factors including competence, questions concerning business ethics and integrity, corporate governance, the accuracy and quality of financial reporting and public disclosure as well as the quality and timing of the delivery of key products and services. Aecon has implemented various procedures and policies to help mitigate this risk including the adoption of a comprehensive Code of Conduct which all employees are expected to review and abide by.

### **Aecon Operates in a Highly Competitive Industry**

Aecon carries on businesses in highly competitive product and geographic markets in Canada, the United States and internationally. Aecon competes with other major contractors as well as many mid-size and smaller companies across a range of industry segments. Each has its own advantages and disadvantages relative to Aecon. New contract awards and contract margin are dependent on the level of competition and the general state of the markets in which we operate. Fluctuations in demand in the segments in which we operate may impact the degree of competition for work. Competitive position is based on a multitude of factors including pricing, ability to obtain adequate bonding, backlog, financial strength, appetite for risk, and reputation for quality, timeliness and experience. Aecon has little control over and cannot otherwise affect these competitive factors. If the Company is unable to effectively respond to these competitive factors, results of operations and financial condition will be materially impacted. In addition, a prolonged economic slump may adversely affect one or more of Aecon's competitors or the markets in which it operates, resulting in increased competition in certain market segments, price or margin reductions or decreased demand for services, which may adversely affect results.

## **Increases in the Cost of Raw Materials**

The cost of raw materials represents a significant component of Aecon's operating expenses. As contractors are not always able to pass such risks on to their customers, unexpected increases in the cost of raw materials may negatively impact the results of the Company's operations. The global availability of basic construction materials such as cement and steel has at times in recent years been impacted by the massive requirements of the Asian market which has resulted in price fluctuations, price escalation and periodic supply shortages. Periods of high demand or the failure to anticipate or mitigate demand fluctuations may add a significant risk to many vendors and subcontractors, some of whom have responded by no longer guaranteeing price or availability on long-term contracts which has in turn increased the risk for contractors who are not always able to pass this risk on to its customers.

## **Subcontractor Performance**

The profitable completion of some contracts, primarily within Aecon's Buildings division, depends to a large degree on the satisfactory performance of the subcontractors who complete different elements of the work. If these subcontractors do not perform to accepted standards, Aecon may be required to hire different subcontractors to complete the tasks, which may add additional costs to a contract, may impact profitability on a specific job, and in certain circumstances, lead to significant losses. The challenges created by the recent economic crisis may also give rise to an increased risk of subcontractor default. A major subcontractor default could materially impact results.

## **Protection of Intellectual Property and Proprietary Rights**

The Company, particularly through its subsidiary IST, depends, in part, on its ability to protect its intellectual property rights. Aecon relies primarily on patent, copyright, trademark and trade secret laws to protect its proprietary technologies. The failure of any patents or other intellectual property rights to provide protection to Aecon's technologies would make it easier for competitors to offer similar products, which could result in lower sales or gross margins.

The Company's trademarks and trade names are registered in Canada and the United States and the Company intends to keep these filings current and seek protection for new trademarks to the extent consistent with business needs. The Company relies on trade secrets and proprietary know-how and confidentiality agreements to protect certain of its technologies and processes.

In addition, IST holds a number of patents on its once-through heat recovery system. Nevertheless, there remains a threat of others attempting to copy IST's proprietary technology and processes. To mitigate this risk, the normal business practice of IST includes the signing of confidentiality agreements with all parties to which confidential information is supplied including all customers and licensees.

## OUTLOOK

Canada's economic outlook as of the first quarter of 2009 is one of uncertainty. The instability in world equity and debt markets, which dominated the financial and business news in the fourth quarter of 2008, continues. The news from many of Canada's key economic sectors including the auto sector, pulp and paper, and the oilsands continues to worsen.

Yet, Aecon's outlook for 2009 is also impacted by a number of important positive factors, including the company's highest-ever year end backlog, a strong balance sheet and a bidding pipeline that remains robust.

These seemingly contradictory realities combine to form an outlook for Aecon that is characterized by strong fundamentals in most markets, within an environment of uncertainty. Adding to the series of conflicting trends are:

- Record levels of government investment in transportation infrastructure – with strong indications of more to come. Among the highest profile examples of this trend are the public transit build-out in Toronto, a new border crossing at Windsor, major bridge and power projects in BC, and a number of transportation improvements in Alberta, from ring roads to light rail transit lines.
- A virtual halt to new capital spending in the oilsands, where the over-heated market of just six months ago has gone cold, and where restart dates for many of the delayed projects remain uncertain.
- Continued strong capital spending on social infrastructure (from which Aecon recently gained another new hospital project), as governments remain committed to their healthcare and education spending priorities.
- Forecasts that tight credit markets and reduced demand would delay investment in new electrical generation capacity in Ontario have started to give way to growing optimism that the new Green Energy Act will result in substantial new investment in renewable power across the province.
- Growing demand for water and wastewater systems across the country, as under-investment in this infrastructure over the years has become problematic in many communities.

These trends have combined to produce near record year end backlog in the Buildings and Infrastructure segments, but a 35% decline in the Industrial backlog from a year ago.

As such, the outlook for Aecon's Infrastructure segment remains strong. While the segment showed little profit growth in 2008, its backlog has strengthened significantly, with segment backlog at December 31, 2008 reaching \$470 million, 26% higher than at the same time last year. In addition, the substantial backlog added as a result of Aecon's acquisition of South Rock in January 2009, along with strong new business awards in the utilities division (highlighted by the Enbridge Gas alliance in Ontario which does not form part of Aecon's backlog), and the continued strong bidding pipeline in transportation infrastructure, all bode well for strong results from this segment in 2009.

Similarly, record year end backlog of \$534 million in the Buildings segment is almost three times the level reported two years ago. This strong backlog growth, and the significant upturn in profitability of the Toronto business unit, are evidence that the turnaround in Buildings has taken hold. With most of the negative impact from the setback encountered in the segment's Montreal operations now behind us, the outlook for Aecon's Buildings segment remains strong.

The Industrial segment has driven much of Aecon's increased profitability over the last two years, with 37% revenue growth in 2007 and 54% revenue growth in 2008, complemented by even stronger growth in margins. This has produced extraordinary results in the Industrial segment that are not expected to be matched in 2009, especially given the market conditions outlined above. Nonetheless, the contribution of Aecon's Industrial segment in 2009 is expected to remain significant, and the proposed acquisition of Lockerbie & Hole will strengthen Aecon's position in the western Canadian market. Notably, the addition of Lockerbie's commercial mechanical business will further increase Aecon's backlog in the social infrastructure sector, adding an important western Canadian component to an already healthy social infrastructure backlog in Central and Eastern Canada.

In the Concessions segment, traffic continues to grow on both the Cross Israel Highway and the Quito International Airport, although a close watch is being held for any potential fallout from the current economic turmoil. On the Cross Israel Highway, the realities of the current market have increased the likelihood that the asset will be held until improved market conditions allow the concession partners to realize full value. In Quito, construction is progressing well and the project continues to proceed on track in a challenging economic and political environment.

Overall, notwithstanding the current economic and financial environment, management continues to believe that its record year end backlog and the relative durability of its Infrastructure and Buildings markets bode well for continued strong financial performance throughout 2009 and into 2010.

## **FORWARD-LOOKING INFORMATION**

In various places in Management's Discussion and Analysis and in other sections of this document, management's expectations regarding future performance of Aecon were discussed. These "forward-looking" statements are based on currently available competitive, financial and economic data and operating plans but are subject to risks and uncertainties. Recent events in global financial and credit markets have resulted in abnormally high market volatility and a level of uncertainty not seen in decades. The high level of uncertainty arising from this crisis may continue to impact the global, North American and Canadian economies in unpredictable ways and may impact the results of Aecon in a manner which is currently impossible to ascertain. In addition, factors could cause Aecon's actual results, performance or achievements to vary from those expressed or inferred herein, including without limitation, the ability of the Eastmain Joint Venture to recover the full value of unpriced change orders, and failure to achieve the targets associated with the construction of the new Quito airport or operation of the existing Quito airport. Risk factors are discussed in greater detail in the section on "Risk Factors" contained herein and available at [www.sedar.com](http://www.sedar.com). Forward-looking statements include information concerning possible or assumed future results of operations or financial position of Aecon, as well as statements preceded by, followed by, or that include the words "believes," "expects," "anticipates," "estimates", "projects," "intends," "should" or similar

expressions. Important factors, in addition to those discussed in this document, could affect the future results of Aecon and could cause those results to differ materially from those expressed in any forward-looking statements.