

Management's Discussion and Analysis of operating results and financial condition

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 2002 Consolidated Financial Statements and Notes.

RESULTS OF OPERATIONS

Introduction

Aecon operates in three principal segments within the construction industry – Infrastructure, Buildings and Industrial.

Infrastructure includes all aspects of the construction of infrastructure including highways, expressways and toll routes, dams and tunnels, bridges, airports, marine facilities and transit systems as well as utility distribution systems including natural gas, telecommunications and electrical networks, water and sewer mains, traffic signals and highway lighting. Activities within this segment also include the development, design, construction, operation and financing of infrastructure projects by way of build-operate-transfer, build-own-operate-transfer and public-private partnership contract structures. Activities are primarily based in Ontario and Quebec, although operations extend across Canada on a limited basis and selectively within the United States and internationally.

Buildings is active in the construction of commercial and institutional buildings principally in Canada and the northwestern United States. This group also pursues selected international projects.

Industrial includes all of Aecon's industrial manufacturing and industrial construction activities. These operations include the fabrication of small and large bore pipe and module assembly for the petrochemical industry and the design and manufacture of once-through heat recovery steam generators for industrial and power plant applications. Also included are Aecon's industrial construction, installation and maintenance activities where Aecon has special expertise in the power, automotive and steel industries. Activities are primarily conducted in Ontario and Alberta, although selective projects are also pursued in the United States and internationally. Aecon's joint venture interest in the nuclear power market, which was previously included in Corporate and Other, is now included in this segment, and comparative figures have been reclassified accordingly. As a result of increased activity within this segment in servicing the nuclear market, management believes that this segment classification is appropriate.

Consolidated

Revenues in 2002 amounted to \$1.07 billion – a decrease of \$65.9 million or 5.8% from 2001. An \$83.5 million drop in revenues from the Industrial segment combined with a \$37.3 million decline in revenues from Infrastructure, more than offset a \$54.8 million improvement in revenues from Buildings.

Costs and expenses amounted to \$1.0 billion, which are \$28.5 million or 2.8% lower than the \$1.03 billion reported for 2001. However, as a percentage of revenues, costs and expenses increased from 90.8% in 2001 to 93.7% in 2002. Accordingly, operating margins (revenues less costs and expenses) as a percentage of revenues decreased from 9.2% in 2001 to 6.3% in 2002. The majority of the decline in the margin percentage is due to the impact of a \$22.2 million decline in margin in the Industrial segment, where sales to the power sector of high margin once-through steam generators fell sharply and to construction contract losses and profit erosion evidenced on some jobs. While it is reasonable to expect that some of Aecon's contracts will not produce satisfactory returns, contract performance in 2002 was below levels acceptable to management. Aecon previously adopted and continues to apply a risk review screening process for new project pursuits and is now taking aggressive measures to further refine and improve this process in order to reduce the risk of future contract losses.

Marketing, general and administrative expenses ("M, G&A") amounted to \$56.1 million in 2002, compared to \$51.5 million in 2001, and as a percentage of revenues increased from 4.5% in 2001 to 5.2% in 2002. The principal reason for the increase in M, G&A was the much higher spending on bid costs compared to last year. Bid costs incurred in 2002 amounted to \$5.6 million, of which \$4.2 million was expensed and \$1.4 million was capitalized. This compares to bid costs incurred and expensed in 2001 of \$0.9 million. Bid costs are deferred only when the award of a contract is considered to be highly probable. Also adding to the overall increase were higher costs related to the strategic growth of Aecon's new Quebec division, higher provisions for doubtful accounts and lower exchange gains. Partially offsetting the various increases was a \$4.2 million reduction in corporate overhead and administrative costs.

Depreciation and amortization declined by \$0.7 million, principally due to the fact that, in accordance with new recommendations of the Canadian Institute of Chartered Accountants, effective January 1, 2002, goodwill is no longer systematically amortized to income but is only expensed when there has been an impairment in its value. In 2001, goodwill amortization amounted to \$0.9 million. Aecon recorded a goodwill impairment charge of \$0.2 million in 2002 in relation to its interest in an investment (see note 16 to the consolidated financial statements).

The results for 2001 were negatively impacted by a provision for loss on impairment of Aecon's share of a grain terminal and handling facility in Gdansk, Poland amounting to \$12.9 million pre-tax (\$11.3 million after taxes). The facility is partially completed, but construction was halted in 2000 while attempts were made to replace the terminal operator and to obtain project financing on reasonable terms. Throughout 2001, Aecon attempted to obtain project financing in order to complete the facility but was not successful. Aecon therefore determined that its share of the partially completed grain terminal was impaired and recorded a provision of \$12.9 million to write

down its investment in the project to its net recoverable amount. No further progress was made in 2002 to advance the completion of the grain terminal and the impairment charge taken in 2001 remains appropriate. Aecon does not intend to invest further in the grain terminal project. The consolidated balance sheet as at December 31, 2002 includes the following amounts (exclusive of income tax recoveries) with respect to Aecon's investment in the Gdansk grain terminal: net working capital liabilities of \$5.9 million, redeemable preferred shares of a subsidiary of \$6.3 million and property, plant and equipment and other assets of \$12.2 million.

Net interest expense decreased from \$5.6 million in 2001 to \$2.9 million in 2002. A breakdown of the components of net interest expense is included in note 14 to the consolidated financial statements. Interest on short-term debt was down \$4.2 million from last year as a result of significantly lower average debt balances and interest rates throughout 2002. The decrease in average debt balances was due principally to the application of some of the proceeds from Aecon's equity issue to reduce both short and long-term bank financing. Interest on long-term debt and subordinated debentures was down from last year by \$0.9 million, reflecting a combination of lower long-term debt balances and lower amounts outstanding on Aecon's subordinated debentures. In April 2002, Hochtief, Aecon's principal shareholder, exercised its option to convert approximately \$2.2 million of convertible debentures into Common Shares (see note 10 to the consolidated financial statements). Interest income is earned primarily; on surplus operating cash balances, funds on deposit and marketable securities in connection with the Cross Israel Highway project; on holdback security deposits related to the Nathpa Jhakri hydro-electric project in India; and on an interest bearing loan to a related party (see note 18 to the consolidated financial statements). The decline in interest income compared to 2001 is due to lower rates and to the inclusion in last year's interest income of a \$0.8 million adjustment to interest earned on the related party loan.

Income subject to tax in 2002 was taxed at an effective tax rate of 75.1% (2001 - 49.1%) compared to the combined Canadian federal and provincial (Ontario) statutory income tax rate ("statutory rate") of 38.6% (2001 - 42.1%). The increase in the effective income tax rate is due to income earned in provincial and foreign tax jurisdictions that is subject to tax at rates that are greater than the statutory rate, to the tax benefit of manufacturing and processing losses being recorded at a rate lower than the statutory rate and to large corporations tax which is not based on reported income. This is partially offset by a reduction in the effective rate resulting from the revaluation of certain non-capital income tax losses and the effect of revaluing future tax assets and liabilities to take into account the reduction in substantively enacted future tax rates.

The increase in the effective tax rate as a result of provincial and foreign rate differentials is primarily due to 2002 reported earnings from the construction project in India which are subject to tax in India at a rate of 42.0% compared to the statutory rate.

The higher than expected effective tax rate in 2002 generally reflects the fact that legal entities that reported earnings in 2002 were subject to tax at rates higher than the statutory rate whereas the tax recovery reported in entities that incurred losses in 2002 were at rates which were less than the statutory rate.

Reporting segments

Infrastructure

Financial Highlights

\$ millions	<u>2002</u>	<u>2001</u>	<u>% Change</u>
Revenues	\$ 536.1	\$ 573.3	(6.5)%
Segment Operating Profit	5.7	15.8	(64.3)%
Return on Revenue	1.1%	2.8%	(62.0)%

Revenues of the Infrastructure segment were lower than 2001 due principally to a \$26.3 million decline in revenues from utilities service work in Ontario, an \$18.9 million drop in revenues from road construction and maintenance activities also in Ontario and a \$16.1 million decline resulting from a large contract that was completed early in 2001. Highway lighting installations represented the largest single decrease in the utility sector, dropping by \$14.3 million, with most of the balance of the decrease attributable to a fall off in telecommunications and water and sewer work. With the exception of the decline in telecommunications work, which was largely attributable to the downturn in this sector, most of the balance of the decline in utilities service work and road construction was a result of less work being tendered by Ontario's Ministry of Transportation due to a strike by Ontario civil servants in early 2002. Partially offsetting the declines were higher revenues from the Cross Israel Highway and Nathpa Jhakri hydro-electric projects and a net increase in revenues from Infrastructure's Quebec operations. The Cross Israel Highway project contributed total revenues of \$81.9 million during 2002, representing an increase of \$6.8 million over 2001, while the Nathpa Jhakri hydro-electric project in India contributed revenues of \$60.4 million during the year, \$25.8 million ahead of 2001. Revenues from the segment's Quebec operations increased by \$5.0 million, which included a contribution of \$16.3 million from the \$61 million Toulnostouc Dam project that commenced in August 2002.

Although the decline in operating profit from Infrastructure is, in part, reflective of the net decrease in volumes and revenues highlighted above, other factors also contributed to the net decline. Operating profit from the Cross Israel Highway project, while still positive, was \$9.2 million lower than last year and included a \$5.6 million adjustment in the current year resulting from a lowering of the total estimated profit from this project. The impact of exchange, slower construction progress than last year and the effect of adjustments of contract profit in 2001 contributed to the balance of the decline.

Significant contract losses and margin erosion was experienced on five projects in 2003, including three projects in Quebec, a bridge project in western Canada and a large utilities mainline project in Ontario, all of which contributed to a \$6.6 million reduction in segment operating profit. Also contributing to the decline in operating profit were higher bid costs than last year, mostly related to Aecon's involvement in the proposed US \$550 million development of a new international airport in Quito, Ecuador. Bid costs incurred by this segment in 2002 amounted to \$4.0 million, of which \$2.7 million was expensed and \$1.3 million was deferred. This compares to bid costs incurred and

expensed in 2001 of \$0.6 million. Partially negating the year-over-year decreases in operating profit was a \$7.3 million higher profit contribution from the Nathpa Jhakri hydro-electric project in India and a \$12.9 million improvement because of a write-down for this amount that was recorded in 2001 related to Aecon's investment in a grain terminal and handling facility in Gdansk, Poland. Aecon only began recording accrued financing fees owing from the Nathpa Jhakri joint venture in the fourth quarter of 2001 and, as a result of construction reaching 73% complete and continuing to progress well and with certain critical construction milestones achieved, Aecon began recording its share of joint venture profit starting in the first quarter of 2002. As a result, contribution from the Nathpa Jhakri hydro-electric power project was \$7.3 million greater than last year. Current estimated project profitability for this project excludes the potential positive impact of significant claims that the joint venture has made to its client for additional compensation and similarly excludes the potential negative impact of significant possible claims that the client might make against the joint venture for delays in project completion. Management does not currently expect there to be any net negative impact from the settlement of these various claims or possible claims, although the ultimate outcome is dependent upon future events and conditions. At year-end, the Nathpa Jhakri hydro-electric power project was 87.0% complete and the Cross Israel Highway project was 68.6% complete.

Buildings

Financial Highlights

\$ millions	<u>2002</u>	<u>2001</u>	<u>% Change</u>
Revenues	\$ 332.9	\$ 278.1	19.7%
Segment Operating Profit	5.6	5.8	(3.4)%
Return on Revenue	1.7%	2.1%	(19.5)%

Revenues in the Buildings segment improved by \$54.8 million or 19.7% over last year. The pace of growth during the first half of the year was much stronger than the latter half as construction activity in the now dormant suburban office segment was very strong earlier in the year. However, the reduction in activity in suburban office towers is being replaced by increased activity in high-rise residential buildings, with two projects underway in eastern Canada and five in western Canada, and with more work in education facilities where seven projects are underway. Also, the segment's newly formed Interiors and Renovations group, which is targeted as a significant growth area for the Buildings group and which achieves better margins than are earned in construction of new structures, continued to perform well, ending the year with 6.3% of total Buildings revenue compared to 1.3% at the end of the first half of 2002. The Seattle market for the Buildings group was weak however, with revenues down 20.2% from last year, largely as a result of weak economic conditions in that market and the unfavourable impact of currency exchange rate fluctuations.

A certain amount of the work undertaken by the Buildings segment is construction management or fee based. The revenue from these contracts is recorded only to the extent of the fee income earned, and thus the full value of the construction activity that is managed is not recorded as revenue. If the value of construction that the group manages had been included in revenue, its total construction

volume would have been \$555.6 million for the year compared to \$419.0 million in 2001. The Buildings segment's largest construction management contract is the Pearson Airport joint venture, which continues on schedule towards the initial opening date of October 2003 and final completion in 2006.

Operating profit, in absolute dollar terms and as a percentage of revenues, was down marginally from last year, reflecting, for the most part, competitive pressures in the group's building operations in eastern Canada.

Industrial

Financial Highlights

\$ millions	<u>2002</u>	<u>2001</u>	<u>% Change</u>
Revenues	\$ 208.4	\$ 291.9	(28.6)%
Segment Operating Profit	3.0	25.2	(88.1)%
Return on Revenue	1.4%	8.7%	(83.4)%

Demand for Industrial construction services was weak in 2002. Revenues from automotive sector work was down \$23.6 million from 2001, fabrication volumes, particularly in western Canada, were down \$35.2 million and sales of once-through steam generators at Aecon's Innovative Steam Technologies ("IST") division were down \$48.4 million. Other operations from this segment produced an increase in revenues of \$23.7 million over last year as a result of increased participation in construction service work for Ontario Power Generation and a rise in activity in the steel sector.

Operating profit fell by \$22.2 million from 2001. The decline is due primarily to a \$23.9 million drop in operating profit that resulted from the significant decrease in sales of high-margin once-through steam generators to the power sector. No new contracts were obtained by IST in 2002 and, although the division has now signed two contracts totaling \$10.5 million in 2003, it does not expect significant improvement in the power sector in 2003. Accordingly, significant steps, including a 75% reduction in staff levels, have been taken to bring IST's overhead and expenses to a level commensurate with its current sales expectations. Operating profit from all other activities in the segment was ahead of last year by \$1.7 million, due largely to a higher contribution from nuclear activities, where completion bonuses were earned in connection with a large multi-year equipment procurement contract in China, which was substantially completed in 2002. During the third quarter of 2002, Aecon completed the sale of its interest in a joint venture involved in pipe fabrication in Atlantic Canada, which resulted in a pre-tax gain on disposition of \$1.2 million.

Corporate and Other

The amount of the elimination of inter-segment revenues is consistent with last year. The \$6.6 million decline in operating loss is due principally to a year-over-year drop of \$4.3 million in corporate overhead expenses, resulting largely from lower severance, business development costs and rebranding costs, all of which were unusually high in 2001. Corporate and Other also benefited

in 2002 from approximately \$0.2 million in miscellaneous gains compared to miscellaneous losses of approximately \$1.8 million recorded in 2001.

Quarterly Financial Data

Set out below are revenues, net income and earnings or loss per share for each quarter in 2002 and 2001 (in millions of dollars, except per share amounts).

	2002				2001			
	Quarter 1	Quarter 2	Quarter 3	Quarter 4	Quarter 1	Quarter 2	Quarter 3	Quarter 4
Revenues	\$ 228.0	\$ 236.3	\$ 299.9	\$ 308.7	\$ 188.3	\$ 258.9	\$ 332.4	\$ 359.3
Net income (loss)	(1.0)	(3.9)	2.7	2.4	(2.1)	0.8	6.7	7.0
Earnings (loss) per share:								
Basic	(0.06)	(0.17)	0.11	0.10	(0.12)	0.04	0.37	0.39
Diluted	(0.06)	(0.17)	0.10	0.09	(0.12)	0.04	0.32	0.34

Due to the impact of share issuances and redemptions throughout the periods, the sum of the quarterly earnings (loss) per share will not equal the total for the year, although generally the difference is relatively minor. However, in the second quarter of 2002 a total of 6,963,693 shares and share equivalents (special warrants) were issued and, as a result, the average number of shares for all of 2002 was substantially higher than the number for the first three months of the year. The total of the quarterly earnings (loss) per share, compared with the amounts for the full year are as follows:

	2002		2001	
	Quarterly Total	Annual Amount	Quarterly Total	Annual Amount
Earnings (loss) per share:				
Basic	\$ (0.02)	\$ 0.01	\$ 0.68	\$ 0.69
Diluted	\$ (0.04)	\$ 0.01	\$ 0.58	\$ 0.61

FINANCIAL CONDITION, LIQUIDITY AND CAPITAL RESOURCES

Cash and cash equivalents at December 31, 2002 totaled \$76.0 million, compared to \$97.2 million at the end of last year. Of these amounts, \$72.5 million and \$93.9 million, respectively, were on deposit in joint venture and affiliate bank accounts, which Aecon cannot access directly. Marketable securities, which are held within a joint venture, amounted to \$12.6 million at December 31, 2002 compared to \$9.9 million at the end of 2001. These securities represent investments in short-term corporate debentures, the majority of which mature within 12 months of year-end.

Cash provided from operating activities, before accounting for changes in non-cash balances relating to operations, was \$1.5 million. However, because of a \$38.1 million increase in 2002 in the amount invested in non-cash balances relating to operations, there was a net cash outflow of \$36.7 million related to Aecon's operating activities. Although accounts receivable and deferred contract costs and unbilled revenues are lower than last year by \$43.4 million, the resulting cash benefit was more than offset by a decrease of \$40.5 million in accounts payable and accrued liabilities, and a reduction of \$32.4 million in deferred revenue. A large factor in this change was the impact of IST, principally as the benefit of deferred revenue (advance billings) on its contracts virtually eliminated given the lack of new orders during the year. Also, consolidated non-cash working capital at the beginning of 2002 was extraordinarily low compared to the opening balances in 2001 and 2000.

Investing activities resulted in a use of cash of \$0.7 million. Purchases of property, plant and equipment amounted to \$4.8 million. Proceeds from the sale of property, plant and equipment amounted to \$9.1 million and included proceeds of \$4.5 million from the sale and leaseback of Aecon's corporate office in Toronto. Aecon is increasingly obtaining equipment by means of operating leases rather than outright purchase as a means of reducing ownership and valuation risk of such assets, while still maintaining competitive pricing and the flexibility to purchase such assets at a later date if valuations at such times are favourable. The sale of Aecon's industrial joint venture interest in Atlantic Canada, referred to previously, generated proceeds of \$2.6 million. Other assets increased by \$7.0 million, of which \$5.4 million represented a further deposit in trust to fund Aecon's investment in the company that is operating and collecting tolls on the Cross Israel Highway. This obligation is described in note 7 to the consolidated financial statements. The total amount currently on deposit is \$17.5 million.

Cash generated from financing activities amounted to \$17.1 million, which included \$31.5 million from the issuance of special warrants, which were subsequently converted into common shares. The major uses of cash were an \$11.2 net reduction in long-term debt, a \$1.8 million reduction in bank indebtedness and \$2.2 million for dividends.

In Aecon's international joint venture projects, a substantial amount of cash is held in foreign currencies, principally U.S. dollars. Foreign exchange effects caused a \$1.0 million reduction in cash and cash equivalents in 2002, compared to an increase of \$1.8 million in 2001. As various liabilities are also denominated in foreign currencies, the net gain on foreign exchange in 2002 was \$0.4 million, compared to a gain of \$0.8 million in 2001. At December 31, 2002, Aecon had net investments totaling approximately \$35.0 million in enterprises in the United States, Israel and India, whose underlying net assets are denominated in a variety of foreign currencies (principally U.S. dollars, NIS and rupees).

Interest bearing debt amounted to \$64.8 million at the end of 2002, compared to \$78.9 million the year before, the composition of which is as follows (\$ millions):

	<u>2002</u>	<u>2001</u>
Bank indebtedness	\$ 30.1	\$ 32.2
Current portion of long-term debt	2.3	8.7
Long-term debt	25.0	28.8
Convertible debenture	7.4	9.2
Total	<u>\$ 64.8</u>	<u>\$ 78.9</u>

The weighted average interest rate on long-term debt at December 31, 2002 and December 31, 2001 was 6.6%.

Aecon's cash flow and working capital is supplemented with a committed bank credit facility to fund working capital and operating requirements as well as a revolving term loan that was obtained in December 2002. The working capital facility, which expires on April 30, is typically renegotiated and extended for periods of up to one year to meet Aecon's anticipated requirements. Availability under the working capital facility is linked to seasonally fluctuating current assets and liabilities, including accounts receivable and certain accounts payable. The new revolving term facility has a maturity of 15 years and an annuity style amortization schedule. Availability under the revolving term loan is based on the value of certain real estate and aggregate reserve assets. On the seventh anniversary, the lender can request that a repayment be made to restore the agreed ratio between the then available loan amount and the then value of the collateral assets. The revolving term loan provides Aecon with a very flexible and stable source of operating funding.

To fund investments in property, plant and equipment, Aecon has access to several committed and uncommitted equipment financing and leasing facilities. Remaining availability under these lines of credit is sufficient to meet Aecon's anticipated requirements in 2003.

Aecon continues to maintain, as it traditionally has, very lean working capital levels. To improve the overall liquidity position of the Company and strengthen the base from which to fund continued growth initiatives, Aecon raised \$31.5 million of equity in early 2002, disposed of non strategic assets for aggregate net proceeds of \$11.7 million and refinanced \$25 million of the working capital facility with the revolving term loan. To fund the seasonal requirements in 2003, management is currently in negotiations for an increase in operating loans currently available to the Company, and discussions continue with a small group of banks, including Aecon's existing bank lenders, with a view to establishing such working capital facility on mutually acceptable terms.

NEW ACCOUNTING STANDARDS

Management is currently evaluating the impact on Aecon's financial reporting of the following new accounting standards:

Hedging relationships

The Canadian Institute of Chartered Accountants (CICA) issued an accounting guideline which establishes certain conditions regarding when hedge accounting may be applied. This guideline is effective for Aecon's fiscal year beginning on January 1, 2004. Each hedging relationship will be subject to an effectiveness test on a regular basis to determine whether there is reasonable assurance that the hedge will continue to be effective. Any derivative financial instruments that do not qualify for hedge accounting will be accounted for on a mark-to-market basis.

Impairment of long-lived assets

CICA Section 3063, Impairment of long-lived Assets is effective January 1, 2003. Under these new rules, an impairment loss is recognized when the carrying amount of a long-lived asset is not recoverable and exceeds its fair value. The impairment loss is determined by comparing the carry amount to fair value. Under previous accounting rules, the impairment loss was determined by comparing the carrying amount to its net recoverable amount or estimated undiscounted cash flows.

Disposal of long-lived assets and discontinued operations.

CICA Section 3475, Disposal of long-lived Assets and Discontinued Operations is effective for disposal activities after May 1, 2003, although earlier adoption is permitted. Under this new accounting standard, a long-lived asset disposed of by sale should be measured at the lower of its carrying amount or fair value less cost to sell and should not be amortized while classified as held for sale. For a long-lived asset to be disposed of other than by sale, such as by abandonment, depreciation estimates are revised to fully amortize the asset over its useful life. The new rules require that the results of operations of a component of the Company that is disposed of either by sale or abandonment should be reported in discontinued operations. A component comprises operations and cash flows that can be clearly distinguished operationally and financially.

Share Purchase Loans

In December 2002, the Emerging Issues Committee of the Canadian Institute of Chartered Accountants concluded that share purchase loans receivable should be presented as deductions from shareholders' equity unless there is substantial evidence that the borrower is at risk for any decline in the price of the shares and there is reasonable assurance that the enterprise will collect the full amount of the loan in cash. The new accounting interpretation is effective on January 1, 2003.

RISKS AND UNCERTAINTIES

Large Contract Factors

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

Opportunities for Aecon to compete for these larger 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 Corporation may experience periods of irregular or reduced revenues.

The recording of the impact of large project contracts can distort revenues and incomes on both a quarterly and an annual basis and in some cases makes comparison of financial results difficult in particular reporting periods.

As described more fully in note 11 to the consolidated financial statements, Aecon has a number of commitments and contingencies. If Aecon was called upon to honour these obligations its financial results could be adversely affected.

The Nathpa Jhakri project has incurred significant delays in respect of which the joint venture, in which Aecon has a 45% interest, has submitted numerous requests for an extension of contract time as well as claims for significant compensation arising from the costs of delays and extra work resulting from changed conditions and other compensable matters. These claims amount to approximately \$144.5 million of which \$20.9 million has been received by the joint venture since commencing the project. The client has granted previous requests for extensions of contract time. In the event that the client denies the current request for extension of contract time and the joint venture is unsuccessful in its claims for additional compensation, the joint venture may be faced with potential liquidated damages claims by the client of up to a maximum amount equal to 10% of the contract value. If such possible claims were to materialize and were ultimately successful, the financial results and the financial position of Aecon could be adversely affected.

The Cross Israel project's substantial completion is being forecasted for April 2004. Tolling commenced in December 2002, with approximately 30% of the highway now open to traffic, and traffic volumes have been above anticipated levels. There are a number of claims and change (task) requests which have been issued or are in the process of being issued, both against the construction joint venture by its subcontractors and against the client by the construction joint venture. Allowances have been taken for these costs and probable recoveries on change (task) requests. The joint venture may be faced with liquidated damages which are capped at 10% of the contract value if it delivers the project late. However, management believes that such damages are unlikely and any delay in delivery will be alleviated by the granting of an extension of time in the contract schedule, which would include relief from liquidated damages and/or by income earned from operation of the highway during the delay period, which would reduce any amounts due for liquidated damages. Aecon has provided numerous guarantees in support of its various performance and financial obligations in this project (refer to note 11 in the consolidated financial statements). If such guarantees were to be called upon, the financial results and the financial position of Aecon could be adversely affected.

Ongoing Financing Availability

Aecon's business strategy involves the continued growth of its operations through internal growth and acquisitions. Aecon's ability to successfully bid on contracts for major projects is fundamental to its internal growth. Certain of Aecon's operating segments, including its infrastructure

development business, require substantial capital in order to bid on contracts. Aecon is continually seeking to enhance its access to funding in support of its growth. However, from time to time, Aecon is constrained in its ability to capitalize on new infrastructure development and other growth opportunities to the extent that financing is insufficient or unavailable. Aecon enhanced its access to funding through its 2002 equity issue and through the new revolving term loan. The revolving term loan provides both stability and flexibility in Aecon's financing structure. This term loan is primarily supported by collateral assets which are not part of the collateral pool of short-term assets ("Borrowing Base"), which constitutes the primary collateral support of the working capital facility. The utilization of the working capital facility follows a distinct seasonal pattern in parallel with the seasonal changes in investments in current assets. Within the constraints of overall leverage parameters, Aecon is looking to attract substantially more working capital financing than it currently has in place. The limit of the existing working capital facility, which expires on April 30, 2003 is \$30 million. The renewal and increase in this facility is expected but is not certain.

Aecon is dependent upon the continued access to working capital and equipment related financing sources to finance its day to day operations. Aecon's direct access to working capital lines of credit is subject to continued compliance with certain financial ratios and other terms and conditions and annual renewal of these accommodations by Aecon's lenders. To the extent that Aecon's cash flow is generated through, and its assets reside in joint ventures, Aecon's access to financing may be limited as the Company's lenders generally do not consider such cash flow and assets in their credit assessments. If Aecon's access to these credit facilities were reduced or eliminated, it would adversely impact the financial results and position of the Company.

Access to Bonding and Pre-qualification Rating

Most of Aecon's construction contracts require either sufficient bonding or pre-qualification rating. Management is aware of the worldwide reduction in surety capacity and is continually monitoring the surety market through its broker and surety firm. Should sufficient surety capacity not be available, this would have a material adverse effect on the ability of Aecon to operate its business.

International/Foreign Jurisdiction Factors

Aecon is from time to time engaged in large international projects in foreign jurisdictions. Currently Aecon is involved in projects in India, Israel, Kenya, Poland, China, Ecuador and the United States. International projects such as the Nathpa Jhakri Project in northern India and the Cross Israel Highway in Israel can expose Aecon to risks beyond those typical for its activities in its home market, including geopolitical and military risks and currency and foreign exchange risks.

The anticipated contribution of various foreign projects on the financial results of Aecon may be adversely affected by local political, military, economic and other events beyond the Company's control including several current projects that are located in regions that are, at the present time, facing heightened geopolitical tensions. 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 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 exposure. Such translation exposure will have an impact on Aecon's consolidated financial results. Cost effective hedging options to fully hedge this exposure are not generally available and the remaining exposure may have a material effect on the future results of Aecon.

Contractual Factors

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 guaranteed maximum price ("GMP"). In GMP projects, in addition to the risk factors of a unit price contract (as described below), any errors in quantity estimates must be absorbed within the 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.

Aecon is increasingly 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.

Certain of Aecon's contractual requirements may also involve financing elements, where Aecon is required to provide one or more of letters of credit, performance bonds, financial guarantees or equity investments. There can be no assurance that Aecon will be able to obtain the necessary financing on favourable or commercially reasonable terms and conditions.

Disputes with clients for additional payments owing as a result of changes in contract specifications, delays, additional work or changed conditions are an unfortunate but sometimes unavoidable part of the construction process. Aecon's accounting policy is to record all costs for these changes when known and not record the revenue anticipated from claims until they are resolved. The timing of the resolution of such events can thereby 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 of basic infrastructure (highways, airports, dams, hydro-electric 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, the general strength or weakness of the economy can have a significant impact on Aecon's operations.

Internationally, Aecon is much more 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.

Environmental 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 from either late completion penalties imposed by the contract owner or from the incremental costs of overtime work utilized to offset the time lost due to 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 said 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 which 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 any future legislation will not be material.

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 unrest in addition to competitive cost factors.

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 would likely have an adverse effect on the Company if that business could not be replaced from within the private sector.

Given the long lead time typically associated with the government review and awarding of public sector contracts, and the significant costs incurred by companies during this process, there are notional cost risks associated with continuing to bid on these types of contracts.

Potential Fluctuation in Quarterly Financial Results and Volatility of Public Markets

Aecon's quarterly 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 unrest involving Aecon's unionized workers; seasonal weather conditions; the risk associated with the use of 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 quarter. As a result, if expected revenues are not realized as anticipated, the Company's quarterly financial results could be materially adversely affected. Accordingly, there may be significant variations in Aecon's quarterly financial results.

OUTLOOK

With war in Iraq, sluggish capital markets in North America and a host of conflicting economic indicators around the world, Canada's economic outlook remains uncertain. Mitigating this uncertain outlook somewhat are the positive signs that governments in Canada may be preparing to increase infrastructure spending, especially in Ontario and Quebec where provincial elections are either currently underway or are widely expected within the year.

Aecon's backlog of work awarded, sometimes viewed as a good indicator of future revenue prospects, fell by \$93 million (or 13%) to \$628 million in the fourth quarter of 2002. This conceals however the impact of two significant fourth quarter contract awards. In October, Aecon announced that a consortium it leads had signed a series of core agreements for the development and

construction of the new international airport in Quito, Ecuador. Aecon's share of the US\$350 million revenue from this project will not be added to Aecon's backlog until the project reaches financial close, expected this summer. At that time, Aecon's large project backlog will jump sharply as a majority of the project's construction requirements are expected to be delivered by Aecon.

In December, Aecon also announced the establishment of a strategic relationship with Minto Developments Inc., ("Minto") including the award of three new construction management projects totaling \$265 million in construction value. Under construction management arrangements, the contractor is paid a fee to manage construction of the project on behalf of the owner. In such arrangements, contracts with subtrades and suppliers are held directly by the project owner, who retains most of the construction risk inherent in the project. This differs from traditional general contractor arrangements, where the contractor provides a full project price to the owner and then contracts with the subtrades and suppliers himself, assuming a greater portion of the construction risk. In these arrangements the full cost of the project passes through the contractor's books, much of it billed to the owner and then passed on to subtrades and suppliers as their work is completed. As such, in general contractor arrangements, the full construction value of the project is added to the contractor's backlog when a project is awarded.

Under construction management arrangements, such as those awarded to Aecon by Minto, only the contractor's fees are added to backlog when the project is awarded. This vastly different treatment of backlog must be taken into account when comparing backlog calculations in two different periods, especially when the mix of general contracting work and construction management work has changed substantially.

In Aecon's Infrastructure segment, core backlog at the end of 2002 increased to \$244 million from \$198 million a year earlier. This increase was more than offset by the decline in major project backlog, as Aecon's two major international projects, the Cross Israel Highway and the Nathpa Jhakri hydro-electric project in India progressed toward completion. In total, Aecon's Infrastructure backlog fell to \$359 million at the end of 2002 from \$434 million a year earlier. It is to this segment's major project backlog that the Quito airport project will be added pending financial close this summer.

Within the segment a number of different trends are apparent. Backlog in both the Ontario-based road building business and in the Quebec infrastructure market increased sharply during 2002, reflecting improved prospects in these two core businesses, while backlog in the utilities sector declined in 2002, due largely to continuing challenges in the telecom industry.

The increase in road building backlog is partly a result of the delay in contract awards in 2002 caused by the public service strike last spring. As a result of the delay, several projects that could have been substantially completed within the year remain in backlog for completion in 2003. This healthy backlog, combined with anticipated pre-election road building announcements, bodes well for Aecon's road building business in 2003.

The Quebec infrastructure market has emerged as a strong one for Aecon, highlighted by the award in 2002 of two contracts totaling \$86 million for construction at the Toulouste hydro-electric facility in northeastern Quebec. Aecon's presence in this market has been growing in the wake of the

Company's reorganization in Quebec including the establishment of Groupe Aecon Lté to focus on this market.

While the Utilities sector continues to suffer the effects of the decline in the telecom industry, there are promising signs that new opportunities in other areas may help to mitigate these challenges. Such opportunities include our continuing work with Union Gas and the recent award to Aecon by Enwave District Energy of Toronto of an alliance agreement contract to carry out its local services and distribution work.

Aecon's Buildings segment appears poised to carry its strong 2002 performance into 2003. While segment backlog is down substantially to \$180 million from \$278 million a year ago, much of this decline is due to the changed mix of construction management versus general contracting work as outlined above.

The focus placed in 2002 on growing the renovation and retrofit business and developing strategic client relationships within this segment have brought progress in both areas. Strategic relationships developed with Morguard Investments and Minto Developments, two of Canada's leaders in the property development business, provide potential long-term benefits for Aecon. Another area where Aecon looks for long-term benefits is in its interiors and renovations business, which had a strong year in 2002 with several new contracts and prospects for continued growth.

A substantial portion of Aecon's increased participation in the Canadian Public Private Partnership ("P3") market is also taking place within the Buildings segment. Aecon is participating in consortia bidding for the William Osler Health Centre in Brampton, Ontario, the Royal Ottawa Hospital in Ontario, as well as the Vancouver General Hospital in British Columbia. The award of any one of these important P3 projects would have a material positive impact, likely beginning in 2004.

Aecon's Industrial segment enters 2003 with a backlog of \$63 million, down from \$71 million a year earlier. Again, this conceals conflicting trends within the segment as the backlog in Aecon's once-through steam generator ("OTSG") business saw backlog decline sharply throughout 2002, while backlog in the balance of the segment increased.

As discussed earlier in this MD&A, the decline in the power industry had a serious negative impact on Aecon's OTSG business as the market for this product evaporated along with backlog. While aggressive cost cutting, a refocused marketing effort and an increase in new orders will all serve to mitigate the risks in this business, 2003 promises to be another challenging one in the power industry.

Offsetting much of the decline in backlog in the steam generator business is the substantial growth in backlog within the Industrial segment's fabrication and module assembly business. New orders from strong clients such as General Electric and Syncrude, as well as the general improvement of prospects in the oil and gas sector, particularly in northern Alberta, have created new opportunities for this business and an optimistic outlook for 2003.

Finally, the renewed and continuing effort to reduce SG&A and improve efficiencies across the company, as well as a strengthened focus on improving return on capital within the divisions, is

expected to improve profitability in 2003. Return on capital has been established as the key measure of performance on a division by division basis, with divisional executive incentives tied to this performance measure among others.

Current events have created significant economic uncertainty that may affect demand for our services, project timing, interest rates and other important business variables for Aecon. While these uncertainties prevent management from offering detailed guidance regarding net income and earnings per share expectations, management expects substantially improved results in 2003. Revenue in 2003 is expected to approximate the record levels of 2001 and net income should make strong gains from the disappointing results achieved in 2002. A substantial portion of these gains will be the result of Aecon's significant business development investments in 2002, most of which are expected to begin generating returns in 2003. It should be noted, however, that especially in the case of investment in new infrastructure development and P3 projects, the full impact of these investments would not be felt until 2004.

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 was 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. 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.