

Aecon Group Inc.

Management's Discussion and Analysis

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 2004 Consolidated Financial Statements and Notes. This MD&A has been prepared as of March 17, 2005. Additional information on Aecon is available through the System for Electronic Document Analysis and Retrieval ("SEDAR") at www.sedar.com and includes the Company's Annual Information Form and other security filings.

RESULTS OF CONTINUING OPERATIONS

The following commentary, unless otherwise indicated, discusses the operating results and financial condition of continuing operations. Certain comparative figures have been reclassified, to be consistent with the presentation of discontinued operations.

Introduction

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

The Infrastructure segment includes all aspects of the construction and development of both public and private infrastructure, including roads and highways, principally within the Province of Ontario, as well as toll highways, dams, tunnels, bridges, airports, marine facilities, transit systems and power projects domestically and internationally. This segment includes the 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 also principally within the Province of Ontario. Services provided in the Infrastructure segment include conventional construction of civil infrastructure works as well as development initiatives including the development, design, construction, operation and financing of infrastructure projects in Canada and on a selective basis also internationally. Aecon also provides a full range of infrastructure services through build-operate-transfer, build-own-operate-transfer and public-private partnership contract structures, as well as providing conventional construction services on a more traditional fee for service or lump sum contract basis.

The Buildings segment specializes in the construction and renovation of commercial, institutional and multi-family residential buildings, including retail complexes, office buildings, entertainment facilities, schools, embassies and high rise condominium buildings among others. Work in this segment is concentrated primarily in Canada and the northwestern United States, as well as selected international venues. Services include general contracting and fee for service construction management, as well as building renovation and facilities management.

The Industrial segment encompasses all of Aecon's industrial construction and industrial manufacturing activities. Activities include in-plant construction and module assembly in the manufacturing, energy, petrochemical, steel and automotive sectors as well as the fabrication of small and large diameter specialty pipe and the design and manufacture of once-through heat

recovery steam generators for industrial and power plant applications. Although activity in this segment is concentrated primarily in Canada, with selected projects in the United States, Aecon sells and installs once-through steam generators throughout the world through Innovative Steam Technologies.

Consolidated

Financial Highlights

\$ millions	<u>2004</u>	<u>2003</u>	<u>% Change</u>
Revenues*	\$ 1,002.5	\$ 940.6	6.6%
Operating loss*	(27.1)	(21.4)	(26.8)%
Return on revenue	(2.7)%	(2.3)%	(19.0)%
Backlog – December 31	565.0	546.5	3.4%

* Revenues are from continuing operations and operating loss represents loss from continuing operations, before interest and income taxes.

Revenues from continuing operations amounted to slightly over \$1 billion in 2004, an increase of \$61.9 million or 6.6% over the prior year. This growth in revenues was generated from the Buildings segment where revenues were up by \$68.1 million, largely due to the impact of acquisitions in 2004 and 2003. Infrastructure and Industrial revenues were each about the same as last year.

Operating margins (revenues less costs and expenses) as a percentage of revenues declined from 3.6% in 2003 to 3.1% in 2004, due to a decline in profitability in the Buildings and Industrial segments. Foreign exchange gains amounted to \$2.0 million in 2004, compared to a loss of \$6.6 million in 2003. Foreign exchange gains and losses are included in operating costs, thus affecting operating margins, and also in marketing, general and administrative (“MG&A”) expenses. The year-over-year impact of foreign exchange on operating margins was \$4.4 million (a loss of \$1.7 million in 2004 and a loss of \$6.1 million in 2003) and MG&A was positively impacted by \$4.2 million (a gain of \$3.7 million in 2004 and a loss of \$0.5 million in 2003). Exclusive of foreign exchange, operating margins were 3.2% of revenue in 2004, compared to 4.2% in 2003. Results for each of the three principal operating segments are discussed separately under Reporting Segments.

Marketing, general and administrative expenses were \$0.4 million less than 2003 and amounted to \$49.1 million in the year. Foreign exchange, as previously noted, had a positive year-over-year impact of \$4.2 million, although this was largely negated by relocation costs of \$3.9 million related to the consolidation of Aecon’s offices in the Toronto area. Exclusive of these two items, MG&A was slightly less than 2003. MG&A had been running well below 2003 for most of the year as all divisions and the corporate office had been focusing on reducing their MG&A burden. In the fourth quarter however, Aecon incurred \$1.8 million in bid costs (compared to a total of \$1.7 million for the first nine months of the year). The largest expense are related to the Company’s unsuccessful joint venture bid for the Sea To Sky Highway project from Vancouver to Whistler – which is being undertaken as part of the 2010 winter Olympics. In addition, one-time restructuring charges of \$0.8 million were incurred in the Buildings segment and \$0.7 million in the Infrastructure segment in the fourth quarter.

Depreciation and amortization of \$7.9 million in the year was \$0.6 million less than 2003, principally reflecting reductions in the equipment fleet size at the utilities and roadbuilding divisions. A charge for impairment of goodwill and other intangible assets amounting to \$1.1 million was recorded in the year. This related to the write off of goodwill and other intangible assets arising from the 2003 acquisition of Westeinde Construction Ltd. in Ottawa. As a result of the losses suffered in that operation in 2004 and other changes in the nature of its operations, it was concluded that the goodwill and other intangible assets had been permanently impaired.

Disposals of assets, other than those related to discontinued operations, resulted in a gain of \$0.2 million in 2004, compared to a profit from dispositions of \$3.0 million in 2003. Last year's profit included \$2.3 million from the sales of the Company's investment in Tanknology Canada Inc. and real estate in Barrie, Ontario.

Net interest expense of \$4.3 million in the current year increased by \$1.0 million over 2003. This increase was due to a reduction in interest income generated by Aecon's joint venture in Israel, as construction of the Cross Israel Highway is now complete and most of the excess cash and marketable securities have been distributed to the joint venture partners or applied to reduce debts. A breakdown of the components of net interest expense is included in note 15 to the consolidated financial statements.

The loss from continuing operations, before provision for income taxes, amounted to \$31.4 million in 2004, compared to a loss of \$24.7 million in 2003. Infrastructure operations, although substantially improved from 2003, were still unprofitable due to significant losses incurred within the Quebec civil operations. The Industrial segment's operating profit was significantly below prior year and the Buildings segment had a loss of \$13.2 million in 2004, compared to a profit of \$2.2 million in 2003. Corporate expenses were also higher than last year due to one-time costs. Pre-tax income from discontinued operations amounted to \$17.6 million (after-tax of \$13.1 million). The combined loss before income taxes from continuing and discontinued operations amounted to \$13.8 million.

Income tax expense related to continuing operations for 2004 amounted to \$23.3 million. In accounting for income taxes, a future income tax asset is recognized with respect to unused tax losses and deductions when it is "more likely than not" that the benefit will be realized in the future. Realization of this benefit requires the generation of future taxable income sufficient to utilize the losses. As with all assets, the recoverability of future income tax assets must be regularly assessed, using in the case of taxes what the accounting literature terms both "favourable" and "unfavourable" evidence. Factors such as current and previous operating losses are given a greater weight than the outlook for future profitability. Under Canadian generally accepted accounting principles, a valuation allowance must be provided against future tax assets where there is a history of losses, regardless of whether or not there is an expectation of future profits to utilize such losses. Aecon incurred losses in its domestic Canadian operations in each of 2002, 2003 and 2004. Consequently, the Company is required to provide a valuation allowance against the net future tax assets that had been recorded at December 31, 2003 and against future tax assets that would otherwise be recorded in 2004 with respect to the Canadian operations. The result of this was a charge to income tax expense of \$19.3 million with respect to net future tax assets of the Canadian operations that had been recorded at December 31, 2003 and a valuation allowance of \$13.3 million with respect to

future tax assets that otherwise would have been recorded in 2004. Aecon does not expect that its Canadian tax losses will expire unused. Although future years are projected to be profitable, these future projections are assigned a lesser weight than current and prior losses in evaluating whether a valuation allowance is required. The Company also has the ability, through refiling prior years tax returns, to reduce discretionary deductions and thus reduce tax losses in the event they were about to expire.

Had the valuation allowances referred to above not been required, income tax expense would have been \$32.7 million less in the year.

The after-tax loss for the year from continuing operations, amounted to \$54.7 million or \$1.98 per share, compared to a loss of \$18.7 million or \$0.79 per share in 2003.

Backlog at December 31, 2004 was \$565.0 million or \$18.5 million higher than at the beginning of the year. Infrastructure backlog declined by \$67.3 million, of which \$26.4 million is on account of Aecon's two major international projects in Israel and India. These projects are now complete, except for a small amount of residual work, and Aecon no longer has any significant amount of what has historically been referred to as major projects backlog. The financial close of the Quito Airport project in Ecuador is projected to add approximately \$250 million to major projects backlog. New contract awards of \$1.02 billion were booked in the year, which compares with \$938.4 million in 2003, with the majority of the increase being generated by the Buildings segment.

DISCONTINUED OPERATIONS

In the fourth quarter, Aecon sold its 38.75% interest in Canatom NPM Inc., which had been a part of the Industrial segment. Also in the fourth quarter Aecon sold its Footage Tools division, and in the second quarter sold its one-third interest in a small joint venture, both of which were part of the Infrastructure segment. Income from discontinued operations amounted to \$17.6 million before income taxes. This was composed of \$9.9 million of operating income generated within these operations prior to disposition, and \$7.7 million profit on disposition. Income from discontinued operations after taxes amounted to \$13.1 million. Income from discontinued operations in 2003 was \$7.7 million before taxes and \$4.9 million after taxes.

Reporting segments

Infrastructure

Financial Highlights

\$ millions	<u>2004</u>	<u>2003</u>	<u>% Change</u>
Revenues	\$ 449.3	\$ 447.6	0.4%
Segment operating loss	(3.0)	(24.8)	87.9%
Return on revenue	(0.7)%	(5.5) %	88.0%
Backlog – December 31	151.6	218.9	(30.8)%

Revenues in the Infrastructure segment amounted to \$449.3 million in 2004, a slight increase from last year. The completion of the Cross Israel Highway in Israel and the Nathpa Jhakri hydro-electric project in India accounted for a significant reduction in revenues compared to 2003. Combined, these two projects, which generated revenues of \$43.3 million in 2004, were \$51.0 million lower in revenues than last year. Offsetting this reduction were Aecon's two large hydro projects in Quebec - a hydro-electric dam project in Toulmoustouc and a hydro-electric powerhouse project in Eastmain. Together they generated revenues of \$101.4 million, representing an increase of \$57.9 million over 2003.

Roadbuilding operations, which benefited from favourable weather conditions in the fourth quarter, ended the year with revenues up \$10.0 million or 6.3%. Utilities operations were up \$5.4 million or 5.0%, largely on the strength of communications work, which primarily involves cable installations and communication line maintenance. Other civil projects, principally in Quebec, generated \$20.6 million less revenue than 2003.

The Infrastructure segment incurred an operating loss of \$3.0 million in the year, which was significantly less than the loss of \$24.8 million incurred in 2003. The impact of foreign exchange accounted for \$7.4 million of the improvement. The segment had a foreign exchange gain of \$1.0 million in 2004, compared to a loss of \$6.4 million in 2003. Aecon's investment in the concessionaire operating the Cross Israel Highway is accounted for on a cost basis, whereas up until the second quarter of 2004, U.S. dollar deposits held in trust to fund this investment were translated at current exchange rates. This has resulted in a reduction in Aecon's accounting exposure to currency exchange fluctuations for financial reporting purposes.

Excluding the impact of foreign exchange, operating losses in the Infrastructure segment were \$14.4 million lower than 2003. An increase in profits from the construction joint venture, which built the Cross Israel Highway accounted for \$6.8 million of the improvement, despite revenues from this project being down \$39.2 million from last year. This improved profitability largely reflects the settlement throughout the year of outstanding contract change orders and claims.

Utilities operations produced a \$5.0 million improvement in operating results, generating a profit of \$1.1 million in 2004 compared to a loss of \$3.9 million last year. The improvement reflects a combination of stronger revenues, better pricing and mix, and cost reductions. Cost reductions in the Utilities operations have been realized in both MG&A and equipment costs. Results would have been even better but for the \$2.1 million negative impact of severance accruals and further losses incurred in the year on a major pipeline job, which is now fully complete.

Roadbuilding operations generated an operating profit of \$1.1 million in 2004, compared to a slight loss in 2003. Several factors hurt operating results in 2003, which were not recurring. These included implementation costs of a new enterprise accounting system and the write-off of software and hardware costs of the prior system, abnormally high equipment repair expenses, reduced profits from aggregate and asphalt material operations due to a combination of high production costs in aggregates and reduced volumes in asphalt as well as several large contract losses. The improved operating results in 2004 are still well below historical averages for this business. Changes in the Ontario provincial government as well as municipal elections in late 2003, caused delays in the awarding of road contracts, which had a carryover effect for much of 2004. Poor weather conditions

in the spring and summer, a three week labour disruption in June and the cancellation of the \$22 million project to construct a fixed-link bridge to the Toronto Island Airport also depressed earnings in this division. Bid costs were also abnormally high in 2004 as \$0.5 million was expended on Aecon's unsuccessful bid on a highway project in New Brunswick.

The segment's operations in Quebec incurred an operating loss of \$11.5 million in 2004, which was similar in size to the loss incurred in 2003. Several of Aecon's major projects in the province have suffered from significant cost overruns, largely because of customer changes to the original contract scope, with the largest loss being \$6.7 million on a now substantially complete hydro-electric dam project. A further loss of \$2.3 million was also incurred on a now completed highway construction project, which is in addition to \$7.1 million that was recognized in 2002 and 2003. Partial recovery of these losses is expected in the future through claims. Furthermore, a hydro-electric powerhouse project generated revenues of \$45.5 million in the year on which no profit has been recognized. Although the cost overruns are in certain circumstances the result of an underestimation of costs at the time of bidding or other issues with the contractor's performance, the majority are the result of customer delays or changes, which are supported by contractual change orders. Nonetheless, the amount of compensation received for unpriced change orders is a matter of negotiation, which is often difficult and protracted. Aecon's success in negotiating fair compensation, particularly with respect to large government hydro-electric projects in Quebec, has been disappointing and we are reassessing whether we will continue to bid on these projects.

Earnings contributions from the Nathpa Jhakri hydro-electric project in India declined by \$1.7 million due to the year-over-year impact of changes to the profit forecast and also due to lower work volumes as the contract is finished. Other operations within the Infrastructure segment improved by a net \$2.5 million in the year, with the largest year-over-year impact being \$3.8 million because of losses incurred in 2003 on a bridge contract in western Canada.

Backlog of \$151.6 million declined by \$67.3 million due to the reduction in backlog of \$26.4 million on the projects in Israel and India and over \$50 million of work completed on the two hydro-electric power projects in Quebec. New contract awards of \$381.9 million were booked in the year, which compares with \$367.8 million in 2003.

Buildings

Financial Highlights

\$ millions	<u>2004</u>	<u>2003</u>	<u>% Change</u>
Revenues	\$ 367.4	\$ 299.3	22.8%
Segment operating profit (loss)	(13.2)	2.2	n/a
Return on revenue	(3.6)%	0.7%	n/a
Backlog – December 31	345.4	242.8	42.3%

Revenues in the Buildings segment increased by \$68.1 million or 22.8% over 2003. Two recent acquisitions, Westeinde Construction Ltd. (“Westeinde”), which was acquired in the fourth quarter of 2003 and Cegerco CCI Inc. (“Cegerco”), which was acquired in the second quarter of 2004, accounted for an additional \$53.6 million of revenues in the year.

The first phase of the new \$1.4 billion terminal building at Toronto’s Pearson International Airport was completed during the year, and as a result revenue from the joint venture managing this project was down approximately \$11.6 million or 43% from 2003. Revenues from the balance of the Buildings’ operations were up \$24.5 million. Both the Toronto and Montreal markets were stronger and together had an increase in revenues of \$17.3 million or 11.0%, led by institutional and high rise residential work. Western markets, operated through Aecon’s subsidiary in Seattle and its joint venture interest in Vancouver, were up a combined \$5.4 million or 7.9%.

Despite higher revenues, the year 2004 proved to be very difficult for the Buildings segment. Margin erosion from increasing competition, the effect of the loss of several key personnel in 2003, extra costs from production delays and the integration of Westeinde in Ottawa and Cegerco with the Buildings group in Montreal combined to have an adverse impact on operating results. An operating loss of \$13.2 million was incurred in the year, compared to a profit of \$2.2 million in 2003. The impact of the Westeinde acquisition and integration costs in Montreal depressed results by \$7.1 million. This included \$1.1 million related to the write-off of all goodwill and other intangible assets associated with Westeinde in Ottawa. Revenues in Ottawa fell well short of projections due to the delayed tender of many of the large projects planned for the eastern Ontario marketplace and the unanticipated problems with jobs that were acquired as part of the acquisition. Write-downs were required on several large jobs acquired and additional overhead was absorbed due to a sharp reduction in proposal work, particularly in the design-build area.

The Buildings segment was also hurt by losses on several major contracts in Toronto. Since 2002 there has been a significant reduction in the portion of construction management and negotiated contracts compared to the lower margin fixed price and lump sum work. This shift was largely driven by market dynamics, as the commercial building market remained soft while the government driven institutional market was tremendously strong – the latter providing very few opportunities for negotiated or construction management contracts. Fixed price contracts, characterized by intense competitive pressures particularly in the Ottawa and Toronto markets, exhibit very low margins due to an extremely competitive environment and create additional exposure to Aecon in the event of cost overruns. The changes in management and progressive losses incurred during the year demonstrated severe weaknesses in project management and cost control practices. Substantial management improvements have now been effected and an intensive focus on improving project management and cost control systems and practices is well underway. With these improvements, with a strategic focus on increasing our negotiated and construction management work volumes by building on and further developing strong and sustainable client relationships, coupled with a uniquely national presence, the year 2005 is expected to be once again profitable for the Buildings segment.

As with certain of the major Infrastructure segment projects, it is expected that some of the losses recorded in 2004 will be recovered in future periods from the resolution of certain claims against our clients for some of these projects.

Backlog of \$345.4 million at the end of 2004 was \$102.6 million or 42.3% higher than the start of the year, with the metro Toronto, Seattle and Montreal markets showing the most increase. New contract awards of \$470.1 million were recorded in the year, which compares with \$355.3 million in 2003.

Industrial

Financial Highlights

\$ millions	<u>2004</u>	<u>2003</u>	<u>% Change</u>
Revenues	\$ 192.5	\$ 195.4	(1.5)%
Segment operating profit	1.0	7.6	(87.0)%
Return on revenue	0.5%	3.9%	(86.8)%
Backlog – December 31	67.9	84.8	(19.9)%

Revenues in the Industrial segment of \$192.5 million were 1.5% less than 2003. Revenues at Innovative Steam Technologies (“IST”), which sells and licenses the technology for once-through steam generators (“OSTG”) were more than double 2003, increasing approximately \$18 million to \$33 million from the year before. IST has been successful in 2004 in significantly improving its market share for steam generators in North America and worldwide. A total of seven orders were received for OSTG units in 2004, for a combined value of \$42 million, including service contracts. This compares with three orders in 2003 for a value of \$18.4 million. IST is entering 2005 with a backlog of \$19 million, compared to \$10 million in 2004.

Other sectors within the Industrial segment, however, had lower revenues than 2003. Automotive revenues were down \$9.7 million or 26.9% from the prior year, which was largely expected as it was decided to be much more selective in the type of automotive work that would be bid. The automotive sector is more competitive and has lower margins compared to other areas within the Industrial segment. Fabrication work was \$8.5 million or 13.4% less than 2003, due to a very large pipe fabrication contract in 2003, which was not replaced with similar volume in 2004. Revenues from project work, which is primarily for the power and steel industries, were \$4.9 million or 5.7% less than 2003 due to reduced volumes with Ontario Power Generation Inc.

Operating profit of the Industrial segment fell by \$6.6 million or 87.0% from 2003. The most significant drop was in fabrication and module assembly work, which went from a profit of \$5.0 million in 2003 to a loss of \$4.1 million in 2004. This work was only partially replaced in 2004, and at lower margins. In addition, a loss of \$1.8 million was incurred in a new joint venture in Atlantic Canada due to a large contract loss within its operations, and higher than anticipated overhead costs. Operating results at the automotive unit were down \$0.6 million from 2003 and project work generated \$1.4 million less profits than last year, both sectors being negatively affected by lower volumes. Significant volumes of fabrication and module assembly work had been expected in 2004 in western Canada for oil sands projects but this work was deferred into 2005, thus negatively impacting 2004 but boding well for strong performance in 2005.

IST returned to profitability in 2004 after two consecutive years of losses, generating operating profit of \$1.0 million in 2004 versus a loss of \$3.2 million in 2003. Due to cost overruns on one large project, contract margins as a percentage of revenue were lower than 2003, but this was more than compensated for by a significant increase in volume. Overall, contract margins are holding firm, as process and engineering improvements have offset the impact of rising costs. Plant labour and overheads as well as MG&A expenses were well controlled.

Backlog at December 31 of \$67.9 million was \$16.9 million less than the beginning of the year, as project unit backlog was worked off. New contract awards of \$175.6 million were booked in 2004, which compares with \$217.2 million in 2003. However, significant pending and expected work volumes cast a more positive light than these reduced backlog levels would otherwise suggest.

Corporate and Other

This category includes the elimination of inter-segment revenues, which totalled \$6.7 million in 2004 and \$1.8 million in 2003, as well as corporate expenses. Net corporate expenses amounted to \$11.8 million in the year, which compares to \$6.4 million last year. Several unusual items affected the year-over-year results. Included in corporate expenses in 2004 is \$3.9 million related to relocation and consolidation of Aecon's offices in the Toronto area, of which \$2.6 million was for a lease termination payment at one of the former locations. Also impacting costs in 2004 was \$0.5 million of expenses, net of a partial recovery from Hochtief Canada Inc., for legal, valuation and related costs in connection with the unsuccessful bid by Hochtief to take Aecon private. Reducing net expense in 2003 was a gain of \$1.5 million recorded on the sale of Aecon's interest in Tanknology Canada Inc. Other unusual items in the two years resulted in a net increase in corporate expenses of \$0.5 million. Exclusive of the above-noted items, general corporate overheads were down \$1.0 million from 2003, with reduced salary and benefit costs accounting for approximately 60% of the reduction.

Quarterly Financial Data

Set out below are revenues, net income (loss) and earnings or loss per share, for each quarter in 2004 and 2003 (in millions of dollars, except per share amounts).

	2004				2003			
	Quarter 1	Quarter 2	Quarter 3	Quarter 4	Quarter 1	Quarter 2	Quarter 3	Quarter 4
Revenues	\$ 189.0	\$ 264.7	\$ 290.1	\$ 258.7	\$ 178.5	\$ 234.3	\$ 259.5	\$ 268.3
Net income (loss)	(2.4)	2.4	(0.9)	(40.7)	(9.9)	(2.0)	0.7	(2.7)
Earnings (loss) per share:								
Basic	(0.10)	0.08	(0.03)	(1.42)	(0.42)	(0.08)	0.03	(0.11)
Diluted	(0.10)	0.08	(0.03)	(1.42)	(0.42)	(0.08)	0.03	(0.11)

As described in note 2 to the consolidated financial statements, in accordance with recommendations of The Canadian Institute of Chartered Accountants on accounting for share purchase loans receivable from employees, loans totalling \$857 thousand have been deducted from capital stock and the number of shares issued for purposes of calculating basic earnings (loss) per share is reduced by 1,522,063. For purposes of calculating diluted earnings (loss) per share, these shares are treated as options.

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, compared with the amounts for the full year are as follows:

	<u>2004</u>		<u>2003</u>	
	<u>Quarterly Total</u>	<u>Annual Amount</u>	<u>Quarterly Total</u>	<u>Annual Amount</u>
Loss per share:				
Basic	\$ (1.47)	\$ (1.51)	\$ (0.58)	\$ (0.59)
Diluted	(1.47)	(1.51)	(0.58)	(0.59)

Analysis of operating results for each of the first three quarters of 2004 was included in the Management Discussion and Analysis incorporated in the Interim Reports to Shareholders.

For the fourth quarter of 2004, revenues amounted to \$258.7 million, which was \$9.6 million or 3.6% less than the same period in 2003. The entire decline was in the Industrial segment. The final three months of 2003 had been exceptional in the Industrial operations due to an acceleration of work schedules needed to complete several large contracts. The Infrastructure and Buildings segments, however, both posted slightly improved revenues in the quarter.

Operating margins (revenues less costs and expenses) fell sharply in the final three months of the year, from \$8.5 million in 2003 to a loss of \$2.8 million in 2004 due to significantly reduced margins in the Buildings and Industrial segments. This decline was net of a \$0.9 million period-over-period improvement from foreign exchange.

MG&A amounted to \$13.6 million in the quarter, compared to \$12.6 million in the same period last year. Restructuring charges within the Buildings and Infrastructure segments of \$1.5 million, as well as a provision of \$0.3 million within Corporate and Other for rent on premises vacated as part of the consolidation of offices in the Toronto area, resulted in increased MG&A expenses in the fourth quarter of 2004.

Revenues and operating profit (loss) by segment for the fourth quarters of 2004 and 2003 from continuing operations are set out in the table below (\$ millions).

	<u>2004</u>		<u>2003</u>	
	<u>Revenue</u>	<u>Operating (loss)*</u>	<u>Revenue</u>	<u>Operating profit (loss)*</u>
Infrastructure	\$ 128.2	\$ (8.0)	\$ 123.1	\$ (11.7)
Buildings	87.9	(7.1)	85.7	0.7
Industrial	47.5	(2.6)	60.6	7.6
Corporate	(4.9)	(2.1)	(1.1)	(2.6)
Consolidated	<u>\$ 258.7</u>	<u>\$ (19.8)</u>	<u>\$ 268.3</u>	<u>\$ (6.0)</u>

* Operating profit (loss) represents net income (loss) before interest and income taxes.

In the Infrastructure segment, revenues from roadbuilding and utilities operations were substantially higher in the fourth quarter than the corresponding three months of 2003, aided by favourable weather conditions. This was largely offset by reduced revenue from Aecon's international joint ventures in Israel and India, which were a combined \$16.0 million lower than 2003, and reduced volumes in Quebec. Overall, segment revenues were 4.1% higher than last year.

The Infrastructure segment incurred a loss of \$8.0 million in the fourth quarter, as a result of provisions for losses on two projects in Quebec and a downward revision of profitability on a third project in the province. In total, these three projects, which were noted in the discussion on Aecon's annual results, caused a \$9.8 million decrease in earnings in the fourth quarter.

Revenues in the Buildings segment were slightly higher than last year in the quarter. A decline in interiors and renovations work and lower revenues from the joint venture building the Pearson International Airport terminal in Toronto largely offset the increase in revenues from the Ottawa and Montreal acquisitions.

Operating results in the Buildings segment were hurt by losses incurred on several large contracts, the \$1.1 million write-off of goodwill and other intangible assets associated with the Westeinde acquisition and \$0.8 million of charges taken for restructuring. As a result, the segment incurred an operating loss of \$7.1 million in the fourth quarter, compared to a profit of \$0.7 million last year.

Industrial segment revenues were \$13.1 million or 21.6% less than 2003 in the quarter. As previously noted, the fourth quarter of 2003 had been exceptionally strong, with several large contracts being completed. The consequent decline in volume in the fabrication and projects operations amounted to \$29.4 million, which more than offset the increase in revenue achieved by IST, which more than quadrupled its revenue in the fourth quarter.

The Industrial segment incurred a loss of \$2.6 million in the last quarter, which compares with a profit of \$7.6 million in the same period of 2003. A decline in the volume of work, as well as reduced margins because of the mix of work, affected year-over-year results and this was exacerbated by losses in the projects division on a large contract and in the fabrication unit by a joint venture in Atlantic Canada. The delay in fabrication and module assembly work, expected to be done in 2004 but deferred to 2005, also hurt results in the final quarter.

The loss for the quarter from continuing operations, after interest and income taxes, amounted to \$47.1 million or \$1.64 per share, which compares with a loss of \$5.9 million or \$0.25 per share in 2003. The size of the 2004 fourth quarter loss is distorted by the impact of \$32.7 million of valuation allowances taken against future tax assets, which were recorded in this period.

Selected Annual Information

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

	<u>2004</u>	<u>2003</u>	<u>2002</u>
Total revenues	\$ 1,002.5	\$ 940.6	\$ 1,010.4
Loss before discontinued operations	(54.7)	(18.7)	(3.6)
Per share:			
Basic	(1.98)	(0.79)	(0.16)
Diluted	(1.98)	(0.79)	(0.16)
Net income (loss)	(41.6)	(13.9)	0.2
Per share:			
Basic	(1.51)	(0.59)	0.01
Diluted	(1.51)	(0.59)	0.01
Total assets	455.3	470.2	515.7
Total long-term financial liabilities	78.4	35.6	40.3
Cash dividends declared per common share*	-	-	0.03

* Paid in the following year.

FINANCIAL CONDITION, LIQUIDITY AND CAPITAL RESOURCES

Cash and cash equivalents at December 31, 2004 totalled \$50.1 million, which compares with \$29.5 million at the end of last year. Of these amounts, \$19.1 million and \$22.4 million, respectively, were on deposit in joint venture and affiliate bank accounts, which Aecon cannot access directly.

Cash used in operating activities, because of the operating losses, amounted to \$28.3 million in the year, which compares with cash used last year of \$19.8 million, before changes in non-cash balances relating to operations. Changes in other balances, which represent operating working capital items, resulted in an increase in cash of \$14.9 million in 2004, of which \$7.3 million was provided through a reduction in marketable securities and term deposits. In 2003, changes in working capital resulted in a use of \$11.2 million. Increases or decreases in individual working capital components are set out in note 16 to the consolidated financial statements.

Investing activities resulted in a use of cash of \$6.9 million (2003 - \$7.9 million). Purchases of property, plant and equipment amounted to \$4.0 million in the year and proceeds from the sale of property, plant and equipment amounted to \$2.4 million. Cash proceeds from the sales of discontinued operations amounted to \$13.6 million in the year. This included \$11.0 million from the sale of the Company's 38.75% interest in Canatom NPM Inc., \$1.4 million from the sale of the Footage Tools operation and \$1.2 million from the sale of a small joint venture within the Infrastructure segment. Aecon also received \$4.3 million during the year on the transfer to a new partner of a portion of the Company's interest in the Quito Airport project. The \$4.3 million in proceeds were applied to reduce the carrying value of deferred bid costs on this project. Major uses of cash, in addition to purchases of property, plant and equipment, included \$14.3 million for the balance of the Company's committed investment in Derech Eretz Highways (1997) Ltd., the

concessionaire of the Cross Israel Highway. This investment which totals \$36.9 million at December 31, 2004, is shown on the consolidated balance sheet as a long-term investment. Cash of \$7.9 million was also used to finance a net increase in other assets. Included in this figure is \$4.4 million of development costs related to the Quito Airport project which have been deferred. As at December 31, 2004 deferred development costs included in Other Assets amounted to \$7.1 million. Also included in the change in other assets was an increase of \$3.4 million in the year representing a long-term receivable due with respect to work completed on the Cross Israel Highway, less \$1.0 million because of the partial repayment of a loan to Capital Projects Group Inc. (see note 8 to the consolidated financial statements).

Cash generated from financing activities amounted to \$36.7 million in 2004, compared to \$16.4 million last year. In 2003, cash was generated mainly through increases in long-term debt and bank loans. This year the principal sources of cash from financing activities were \$25.6 million from the issuance of shares in the first quarter and \$28.6 million net proceeds from the issuance of convertible debentures in the fourth quarter. The principal amount of the debenture was \$30 million. For accounting purposes, the conversion rights were assigned a value of \$2.0 million, which is included in shareholders' equity and \$28.0 million has been assigned to the debt component of the debenture. Issuances of long-term debt amounted to \$80.9 million in the year and repayments totalled \$81.0 million, resulting in a net cash outflow of \$0.1 million. Gross long-term debt issuances and repayments were affected by a series of draw-downs and repayments under the revolving term loan facility described in note 9(a) to the consolidated financial statements.

At December 31, 2004 long-term debt, including the current portion, totalled \$44.8 million, compared to \$43.3 million at the end of 2003. Borrowing under the revolving term loan increased by \$14.8 million during the year; \$9.7 million owing under a stand-by facility provided by Hochtief Canada Inc. was repaid; and capital lease obligations were reduced by \$3.2 million. The weighted average interest rate on long-term debt at December 31, 2004 was 6.1% (2003 - 6.6%).

Cash used to reduce bank borrowings amounted to \$17.4 million in the year. At December 31, 2004 there were no direct borrowings under the Company's bank credit facilities. Utilization, which amounted to \$7.0 million, was in support of outstanding letters of credit. Bank indebtedness of \$11.9 million at the end of 2004 includes \$9.8 million from Aecon's 45% share of funds borrowed within the Nathpa Jhakri hydro-electric project joint venture in India, \$1.9 million in a joint venture in Quebec and a small tender loan of \$0.2 million.

Interest bearing debt amounted to \$92.4 million at the end of 2004, compared to \$80.9 million the year before, the composition of which is as follows (\$ millions):

	<u>2004</u>	<u>2003</u>
Bank indebtedness	\$ 11.9	\$ 30.1
Current portion of long-term debt	4.5	16.0
Long-term debt	40.4	27.4
Convertible debentures	35.6	7.4
Total	<u>\$ 92.4</u>	<u>\$ 80.9</u>

Aecon has a revolving term loan to fund working capital and operating requirements. The revolving term facility has a remaining maturity of 13 years and an annuity style amortization schedule. The amount of the revolving term loan was established by reference to the appraised value of certain real estate and aggregate reserve assets, which serve as primary collateral for the loan. On the seventh anniversary, which is five years hence, the lender can request that a repayment be made to restore the agreed ratio between the then available loan amount and the then appraised value of the collateral assets. The revolving term loan provides Aecon with a very flexible and stable source of operating funding.

In June 2004, Aecon renegotiated and renewed its 364 day committed bank credit facility to June 2005, providing a committed \$35 million facility and a further \$15 million demand facility available during certain parts of the year. The bank credit facility requires compliance with a number of operational and financial covenants, which are highly complex and restrictive. Moreover, the value and contributions from Aecon's international projects are not recognized for bank purposes, nor are Aecon's numerous joint ventures, which is in direct conflict with Aecon's strategy of enhancing its competitive position and reducing its risk by joint venturing with experienced and financially capable partners on certain projects. Additionally, Aecon is subject to the annual refinancing risk of the bank facilities, as securing a longer term financing commitment is not possible. Finally, management of the bank financing consumes a disproportionate amount of management time. As such, the bank facility has not been well suited to Aecon's needs.

In late 2004, subsequent to and with the benefit of the issuance of \$30 million of convertible debentures, Aecon's three bank syndicate was requested to consider providing a reduced level of credit support of approximately \$30 million (compared to \$50 million as previously available) but with more flexible and cost effective terms. However, in light of Aecon's expected financial results for 2004, as indicated within its profit warning issued in January 2005, Aecon's ability to secure this requested level of credit was put in doubt. Ultimately, two of Aecon's three banks indicated that they would not be in a position to support Aecon's credit requirements into 2005. An agreement with the banks was then negotiated to shorten the maturity date of the bank facility from June 4, 2005 to April 30, 2005, reduce the available limit under the facility from \$35 million to \$18.0 million and provide a waiver of compliance with certain financial covenants as at December 31, 2004.

Concurrent to these bank discussions, Aecon was exploring alternative sources of capital to finance its working capital requirements in 2005, ultimately leading to completion of a \$32.5 million convertible debenture financing, which was completed on March 17, 2005. The convertible debentures mature on March 17, 2010, are unsecured and subordinated, have no financial covenants, and accrue interest at the rate of 8.25% per annum payable on a semi-annual basis. At the holder's option, the convertible debentures may be converted into common shares at any time up to the maturity date at a conversion price of \$7.60 for each common share, subject to adjustment in certain circumstances.

The convertible debentures are not redeemable before March 18, 2008. From March 18, 2008 through the maturity date the Company may, at its option, redeem the convertible debentures, in whole or in part, at par plus accrued and unpaid interest provided that the weighted average closing

price of the common shares on the Toronto Stock Exchange during a specified period prior to redemption is not less than 125% of the conversion price.

Subject to specified conditions, the Company will have the right to repay the outstanding principal amount of the convertible debentures, on maturity or redemption, through the issuance of common shares of the Company. The Company also has the option to satisfy its obligation to pay interest through the issuance and sale of additional common shares of the Company on a private placement basis. Additionally, the Company will have the option, subject to prior agreement of the holders, to settle its obligations on conversion by way of a cash payment of equal value.

With benefit of the recent convertible debenture financings, Aecon has sufficient liquidity to finance its expected operations and working capital requirements for the foreseeable future – without the need for bank credit. While these convertible debenture financings are more expensive than the previous senior bank facilities, they provide a committed source of long-term capital that eliminates refinancing risk through their five-year term, are not restrictive from an operational perspective and will not consume management time with complex quarterly financial covenants and related matters. With benefit of these financings, Aecon intends to cancel its existing bank credit facility. Aecon will attempt to secure a modest bank credit line of \$10 to \$15 million to assist with very short-term changes in working capital balances and to support its ongoing letters of credit requirements.

Hochtief AG, the Company's largest shareholder, has agreed that it will not sell or otherwise monetize any securities of Aecon that it directly or indirectly owns for a minimum period of 60 days following closing, without the prior approval of the underwriters.

NEW ACCOUNTING STANDARDS

Several new Canadian accounting standards were adopted in 2004 and 2003, which are described in note 2 to the consolidated financial statements.

New standards to be adopted in 2005 include Accounting Guideline 15 (“AcG 15”) – Consolidation of Variable Interest Entities, and a change to Section 3860 of The Canadian Institute of Chartered Accountants (“CICA”) Handbook related to Financial Instruments – Disclosure and Presentation.

AcG 15 is the Canadian equivalent of the United States' FIN 46R and modifies the principles used in determining when and by whom entities are consolidated. Existing consolidation rules are considered to be unsatisfactory as they do not properly address Special Purpose Entities or other structures where control is prearranged and voting control doesn't reflect the underlying economic risks and rewards. Broadly speaking, if a company is exposed to more than 50% of the economic risks of a variable interest entity, it is presumed to control the entity and must consolidate it, notwithstanding that its voting interest may be minimal. Two consolidation “models” are established under AcG 15 – a Voting Interest Model (“VOI”) and a Variable Interest Model (“VIE”). The VOI model has been the standard for purposes of determining control and in order to continue to use the VOI model it must be demonstrated that equity holders as a group control the entity and that they are truly at risk. One of the tests is that there must be a minimum amount of equity, as it appears in the financial statements of the entity being assessed. If the VOI tests are not met, the VIE model would be used. Proportionate consolidation is not permitted under the VIE model. Application of this new

standard is extremely complex. Aecon is currently assessing whether AcG 15 will result in any change to the manner in which it consolidates its operations.

The CICA Handbook section related to Financial Instruments now includes a new interpretation, which helps clarify the classification of a financial instrument as between debt or equity. None of Aecon's existing financial instruments will be classified differently as a result of this addition to the Handbook.

SUPPLEMENTAL DISCLOSURES

Contractual Obligations

Aecon has commitments for equipment and premises under operating leases requiring minimum payments and principal repayment obligations under long-term debt (including \$35.6 million convertible debentures described in note 11 to the consolidated financial statements) as follows (in thousands of dollars):

		Lease <u>Payments</u>		Long-term Debt <u>Repayments</u>
2005	\$	16,667	\$	4,477
2006		12,524		12,244
2007		8,818		8,502
2008		5,292		2,760
2009		4,000		30,493
Beyond		15,061		21,996
	\$	<u>62,362</u>	\$	<u>80,472</u>

At December 31, 2004, Aecon had contractual obligations to complete construction contracts that were in progress. The revenue value of these contracts, which represents backlog, was \$565.2 million.

On January 24, 2005, the Company closed a series of transactions, first announced on September 27, 2004, to increase its stake in Derech Eretz Highways (1997) Ltd. ("Derech Eretz") from an effective 22.2% to 25%. The transactions involved the exit of AMEC Inc., effective owners of 11.1% of Derech Eretz, from the project. On AMEC's departure, the Company increased its stake in Derech Eretz by approximately 3% to 25% and the Company's two partners, Housing and Construction Holding Company Ltd. and Africa Israel Investment Ltd., each increased their stakes by approximately 4% to 37.5%. In addition, the Company purchased AMEC's share of the company holding an ownership interest in the construction joint venture, which constructed the Cross Israel Highway, and in related companies. Under the terms of the transactions, the Company paid a net \$4,350 (US \$3,500) for its increased stake. As the fair value of the assets being acquired exceeds the acquisition cost, the Company will record an after-tax gain of \$3,400 on this transaction in the first quarter of 2005, which will be classified on the consolidated statements of operations as an extraordinary item.

Off-Balance Sheet Arrangements

In connection with its joint venture operations in India and Israel, Aecon has provided various financial and performance guarantees and letters of credit, which are described in note 10 to the consolidated financial statements.

Aecon's defined benefit pension plans had a combined deficit of \$6.4 million at December 31, 2004 (2003 - \$5.9 million). The deficit increased during the year, despite favourable investment experience and additional Company funding, due to the impact on benefit obligations of a change in mortality assumptions. 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 time. At December 31, 2004, unrecognized liabilities amounted to \$7.4 million (2003 - \$6.2 million). Details relating to Aecon's defined benefit plans are set out in note 18 to the consolidated financial statements.

Aecon from time to time 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, 2004, the Company had net outstanding contracts to sell US\$9.7 million (2003 - buy US\$2.5 million) and sell euro0.6 million (2003 - sell euro3.4 million) on which there was an unrealized exchange gain of \$0.6 million (2003 - loss of \$22 thousand). Financial instruments are discussed in note 20 to the consolidated financial statements.

Related Party Transactions

Aecon from time to time receives financial support from Hochtief AG and its subsidiary companies ("Hochtief"), which is Aecon's largest shareholder. At December 31, 2004, Aecon was indebted to Hochtief for \$7.7 million in the form of a convertible subordinated debenture as described in note 11 to the consolidated financial statements. As described in note 9(c) to the consolidated financial statements, on November 30, 2004, Aecon repaid borrowings, which amounted to \$9.7 million at December 31, 2003, under a stand-by facility with Hochtief Canada Inc. Hochtief AG has issued guarantees in support of the financial and performance related obligations of the Nathpa Jhakri hydro-electric project in India in which Aecon has a joint venture interest. Aecon paid Hochtief AG \$0.4 million in 2004 in connection with these guarantees. Aecon and Hochtief are also joint venture partners in a hydro-electric project in Quebec. Note 19 to the consolidated financial statements details various other related party transactions.

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.

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. Aecon, in estimating job profitability, includes the estimated revenue to be derived from change orders where the scope of the work has been agreed with the client but the final price has still to be negotiated. As the amount of compensation ultimately negotiated with a client can be considerably different from that estimated by Aecon, contract profit can be significantly affected.

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 not uncommon 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, 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 5 to the 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 18 to the consolidated financial statements.

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, 2004</u>	<u>March 17, 2005</u>
Number of common shares outstanding	30,524,609	30,800,609
Paid-up capital of common shares outstanding (1)	\$ 93,829	\$ 94,843
Outstanding securities exchangeable or convertible into common shares:		
Number of employee stock options outstanding	1,181,000	905,000
Number of common shares issuable on exercise of employee stock options	1,181,000	905,000
Increase in paid-up capital on exercise of employee stock options	\$ 4,787	\$ 3,773
Principal amount of convertible debentures outstanding (see note 11 to consolidated financial statements)	\$ 37,731	\$ 37,731
Number of common shares issuable on conversion of convertible debenture	6,147,568	6,147,568
Increase in paid-up capital on conversion of convertible debenture	\$ 37,731	\$ 37,731

(1) As described in note 2 to the consolidated financial statements, in accordance with the recommendations of The Canadian Institute of Chartered Accountants, share capital has been reduced by \$857 thousand on account of share purchase loans receivable from employees.

RISKS AND UNCERTAINTIES

Large Project Risk

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 Company 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 notes 10 and 12 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 would be adversely affected.

The Nathpa Jhakri hydro-electric project in India has incurred significant delays in respect of which the joint venture, in which Aecon has a 45% interest, has submitted requests for extensions of contract time as well as claims for significant compensation arising from the costs of delays.

The owner of the project, Satluj Jal Vidyut Nigam Ltd. ("SJVN") (formerly Nathpa Jhakri Power Corporation Limited) has granted a number of provisional requests for extensions of contract time as a result of which the joint venture was entitled to escalation on quantities previously billed. Income derived from these escalations has been included in the joint venture profit estimate for this project.

At February 28, 2005, joint venture claims to cover delay related costs amounted to approximately \$109.4 million of which \$10.2 million, at current exchange rates, had been received by the joint venture based on an interim recommendation made by a claims review panel and is included in the joint venture's profit estimate for this project. A further payment of \$9.3 million as full settlement was recommended by the Alternate Disputes Resolution Board ("ADRB"), which was appointed jointly by SJVN and the joint venture. Since ADRB recommendations are not binding and since the joint venture is not satisfied with the level of the final settlement recommended by the ADRB nor does SJVN support the recommendation, income from this award (nor from any further potential claim recoveries) has not been included in the joint venture's nor Aecon's profit estimate for this project.

In the event that SJVN denies the current request for extension of contract time and the joint venture is unsuccessful in its claims for additional compensation, the joint venture could be faced with potential liquidated damages claims by SJVN of up to a maximum amount equal to \$27 million (10% of the original contract value) for which the Company is jointly and severally liable. If such possible claims were to materialize and were ultimately successful, the financial results and the financial position of Aecon would be adversely affected. As at February 28, 2005, the Company had outstanding guarantees and letters of credit in the amount of \$30.3 million in support of financial and performance related obligations for the Nathpa Jhakri project. To December 31, 2004, the Company has earnings contributions of approximately \$13.3 million (2003 – \$11.6 million) after income taxes relating to this project which have not yet been distributed to the Company. If such guarantees were to be called upon and/or if Aecon were not able to collect its accrued cost recoveries and profits, Aecon's financial results and its financial position would be adversely affected. The Nathpa Jhakri project is now substantially complete and only some minor works remain, which do not affect the operational capacity of the powerhouse.

In connection with the Cross Israel Highway project, as at February 28, 2005, Aecon has provided a joint and several guarantee in the amount of \$9.3 million (February 29, 2004 - \$53.4 million) in support of performance related obligations. Aecon has also provided two other joint and several guarantees in support of the project, a Continuous Guarantee, which guarantees the performance of the Concessionaire under the Concession Agreement, and a Leakage Guarantee, which is a guarantee at the Operator level, in which the Company has a 31% interest, and covers toll capture and

collection rates generated from users of the Cross Israel Highway during the operating period. These guarantees extend through the end of the concession period, which ends in 2029. The Continuous Guarantee is in the amount of \$16.7 million and is renewed annually to its full amount, irrespective of any drawings made thereunder. The Leakage Guarantee came into effect when construction was completed and is renewable annually for the lesser of \$12.5 million or 6% of annual toll revenue. The values of these two guarantees are indexed and the amounts used are as at February 28, 2005. If such guarantees were to be called upon the financial results and the financial position of Aecon would be adversely affected.

Substantial completion of the Cross Israel Highway was completed on April 28, 2004. Tolling commenced in December 2002. As of the date hereof, the full 86 km of highway is open to traffic and is being tolled. Traffic levels are approaching anticipated levels.

In addition, a significant portion of Aecon's capital (approximately \$40 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 result and condition of the Company.

The Company is currently engaged in the construction in northern Quebec of a hydro-electric facility for Hydro Quebec. To date, the Eastmain project has incurred cost overruns, primarily because of customer changes to the original contract scope. The Company is currently negotiating with Hydro Quebec for a full recovery of these cost overruns and expects that it will be successful in doing so. Should the Company not be successful in recovering any of these cost overruns, its financial results and position would be adversely impacted.

The Quito Airport financial close has taken longer than originally anticipated due to the complicated nature of the transaction and the multitude of international public lending agencies involved, and although Aecon expects that financial close will be achieved in 2005, there is a risk that closing may not occur, which would result in costs that were previously deferred being written off. As previously noted, as at December 31, 2004, \$7.1 million of costs incurred on the Quito project had been deferred with further costs expected to be incurred and deferred in 2005 until financial close is achieved.

Ongoing Financing Availability

Aecon's business strategy involves the selective 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 and heavy civil business, require substantial working capital in order to bid on and execute large 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's capital base includes a revolving term loan that provides a stable and flexible financing source. Aecon has further supplemented its liquidity and financial capability with a \$30 million convertible debenture financing secured in the fourth quarter, and subsequent to year-end secured a similar \$32.5 million convertible debenture – both with the flexibility to pay interest and repay principal in either cash or shares. These new financings will substantially replace the

traditional \$50 million bank working capital lines that Aecon has maintained, which have never been suitably structured to address Aecon's seasonal and cyclical business profile, and which have been highly restrictive and challenging to maintain on reasonable and practical terms.

Access to Bonding and Pre-qualification Rating

Most of Aecon's construction contracts require either sufficient bonding or pre-qualification rating. As a result of the worldwide reduction in surety capacity and price increases, the Company continually monitors the surety market through its broker and surety firm. The surety industry has undergone significant consolidation in recent years, which has constrained overall industry capacity. While Aecon's improving balance sheet and liquidity have allowed for continued strong support by its surety provider, Aecon's lack of profitability has challenged its ability to secure increased surety capacity to provide Aecon a competitive advantage within the industry. Although the Company believes it will be able to secure and maintain surety capacity adequate to satisfy its current requirements, should those requirements be materially greater than anticipated, or 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, Ecuador and the United States. International projects such as the Nathpa Jhakri hydro-electric 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 geopolitical and military risks and currency and foreign exchange risks.

The anticipated contribution of various foreign projects to 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 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.

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 also involved in design-build contracts where, in addition to the responsibilities and risks of a unit price or lumpsum 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. 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.

Revenues from change orders are recorded when recovery is likely to occur. However, disputes with clients resulting in claims 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 to 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 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 from either late completion penalties imposed by the contract owner 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 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

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. The Company is aware of one such claim or dispute involving potential claims for liquidated damages and outstanding guarantees and letters of credit in respect of the Nathpa Jhakri Project.

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.

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 funding constraints, changing political priorities, or delays in projects caused by elections 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 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.

Protection of Intellectual Property and Proprietary Rights

The Company, particularly through its 100% interest in 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.

Acceptance of Innovation Steam Technologies

IST has yet to gain wide acceptance within the industry and, consequently, earnings derived from IST can fluctuate from quarter to quarter and from year to year. The success of IST's business will depend on its ability to promote commercial acceptance of its steam generators and associated technology, its ability to successfully develop its existing and future licence agreements in key markets outside of its core North American market, and to convince its customers of the reduced life cycle costs that IST's products offer compared to its competitors' products based on more traditional technology.

Hochtief AG and Certain Directors and Officers May be Able to Control Actions of the Company

Hochtief AG indirectly owns 14,429,330 of the outstanding common shares, holds a debenture, valued as of December 31, 2004 at \$7.7 million, which is convertible into common shares, has provided significant financial guarantees and direct loans to the Company and has four nominees on the Company's board of directors. Two officers of the Company, who are also directors, beneficially own or control, directly or indirectly, approximately 5.1% of the common shares as of March 22,

2005. By virtue of their significant direct or indirect shareholdings, Hochtief AG and those officers may therefore be in a position to significantly influence the election of the directors of the Company, appointment of officers and other matters requiring the approval of the shareholders or directors of Aecon. This concentration of ownership may also have an impact on a change of control or other significant transaction involving the Company. As disclosed in the Management Information Circular dated June 21, 2004, in a conference call with analysts and investors on March 15, 2004 Hochtief AG indicated that its ownership position in Aecon will not remain at 48%. As of the date hereof, Hochtief AG has not indicated to Management whether it intends to increase or decrease its interest. A significant change in the indirect ownership stake of Hochtief AG may have a material impact on the share price of the Company.

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.

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. The Company competes with many companies that have financial resources and staff larger than Aecon's and which may be able to benefit from economies of scale, pricing advantages and greater resources. Aecon has little control over and cannot otherwise affect these competitive factors. If the Company is unable to effectively respond to these competitive factors or if the competition in any of the Company's markets results in price reductions or decreased demand for Aecon's services, results of operations and financial condition will be materially impacted.

Loss of Key Management; Inability to Attract and Retain Management

The Company's future prospects depend to a significant extent on the continued service of its key executives. Furthermore, the Company's continued growth and future success depends on its ability to identify, recruit and retain key management and skilled trade personnel. The competition for such employees is intense and there can be no assurance that the Company will be successful in identifying, recruiting or retaining such personnel.

OUTLOOK

Aecon ended 2004 with a greater volume of new business awards and a larger backlog of work compared to a year earlier. New business awards increased to \$1.02 billion, an 8.7% increase over 2003, and backlog increased 3.4% from a year earlier to \$565 million despite a \$26 million reduction in backlog from Aecon's major projects in Israel and India.

The increase in backlog included an 8.7% rise in core backlog over the year, continuing a general upward trend that has seen core backlog increase by over 30% since the beginning of 2002. Major projects backlog, consisting of Aecon's major projects in Israel and India, fell to virtually zero as both of these projects were substantially completed in 2004 and have only minimal levels of clean-up work remaining in backlog. Major projects backlog is expected to jump sharply in 2005 as the anticipated closing of the Quito International Airport project is expected to bring approximately \$250 million into Aecon's major projects backlog.

In the Infrastructure segment, Aecon's Ontario roadbuilding business is expected to show improvement once again in 2005. Although it is anticipated that Ontario's Ministry of Transportation ("MTO") will continue its relatively slow rate of highway construction spending (as compared to traditional levels), a continued focus on non-MTO work is expected to result in increased revenues and profit contributions from this sector.

The ongoing recovery of Ontario's telecommunications sector as well as Aecon's continued strong relationship with Union Gas and a series of recent initiatives to reduce staff and improve fleet efficiency, should lead to stronger financial results from the utilities sector in 2005.

In Quebec, Aecon is currently working on two large projects for Hydro Quebec (the Toulnostouc and Eastmain projects), neither of which have met profit expectations - leading to a re-evaluation of Aecon's interest in bidding this type of work. It is expected that a continued focus on change order management and the settlement of a number of important issues with its key client Hydro Quebec will lead to an improvement in the financial results reported from this division in 2005.

In recent years, Aecon has benefited significantly from construction income generated from two large international projects: the Cross Israel Highway and the Nathpa Jhakri hydro-electric project in India. With construction on both of these projects being substantially completed in 2004 and significant construction on the new Quito International Airport project not likely to begin until the third quarter of 2005, Aecon does not expect to report material construction income from a major international project in 2005. Under Aecon's accounting policy for large multi-year contracts, profit is recognized only when progress reaches a stage of completion sufficient to reasonably determine the probable results (generally when the contract is 20% complete), which is not expected to occur on the Quito project until 2006.

Nonetheless, reaching financial close on the Quito project will be significantly cash positive, as following financial close Aecon will be reimbursed for all its previously expensed and capitalized bid costs as well as its development and internal costs, which will facilitate Aecon's ability to self-finance its planned equity investment in the project without any further expected contribution from

treasury resources. The signing of all required documents is expected in early April, with satisfaction of the final conditions precedent expected approximately 90 days thereafter.

Tolling and operations on the Cross Israel Highway are functioning well. Average traffic has reached over 65,000 cars per day – more than one-third of the traffic recorded on Toronto's Gardiner Expressway and in line with our forecast. While this cost accounted investment will not contribute to accounting profits until interest and/or dividends are received, which is not expected before 2009, the investment is on track to provide an annualized 12% to 15% after tax return.

After a difficult year in 2004, Aecon's Buildings segment is expecting significant improvement and a return to profitability in 2005. The turnaround is expected to be driven by improved project margins (as new project processes and controls implemented late in 2004 take hold) and by increased revenues.

Although the increase in revenues in the Buildings segment is a positive indicator of continued growth in this segment, it may tend to mask the continued softness of commercial based construction. While institutional construction remains strong, this sector generally includes a greater portion of lower margin 'hard bid' work and less of the higher margin 'construction management' or 'negotiated' work. Nonetheless, the increase is a positive indicator of continued growth in the segment.

The largest improvement in the Buildings segment is expected in Aecon's Ottawa business unit (formerly Westeinde Construction, acquired by Aecon in 2003), where a number of changes, including significant staff reductions, an increase in new work, the completion of a number of troublesome projects that began in 2003 and the adoption of new project controls are all expected to have a positive impact. While it may be 2006 before this business unit returns to profitability, a significant turnaround is expected in 2005.

Also expected to show substantial improvement in 2005 are the Greater Toronto, Interiors & Renovations and Aecon/Cegerco businesses, all of which are expected to make profit contributions in 2005.

Aecon's Industrial segment is expected to show strong improvement in 2005, with increased revenue and profit contributions as compared to 2004. The segment's western operations and its fabrication business unit are expected to show the strongest gains.

While IST's backlog levels and sales prospects appear very encouraging, many of its near term sales prospects have been delayed due to overall project commencement delays by its clients, such that any further delays in these projects, and thus sales for IST, may jeopardize IST's profit growth in 2005.

Aecon's fabrication business in Ontario is expected to increase its profit contribution as volume growth (largely from new project awards) and increased productivity lead to improved margins. Significantly, the western operations business unit is expected to take advantage of the very strong market in northern Alberta's oil sands, with significant revenue and margin growth.

Overall, the expected turnaround in Aecon's Buildings segment, the continued improvement in the Infrastructure segment operations in Ontario, the stabilization and improvement in Quebec infrastructure operations and stronger profit contributions from the Industrial segment are expected to result in a significant improvement and a return to profitability in 2005.

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.