

## **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 2005 Consolidated Financial Statements and Notes. This MD&A has been prepared as of March 7, 2006. Additional information on Aecon is available through the System for Electronic Document Analysis and Retrieval ("SEDAR") at [www.sedar.com](http://www.sedar.com) and includes the Company's Annual Information Form and other security filings.

### **RESULTS OF OPERATIONS BEFORE DISCONTINUED OPERATIONS**

The following commentary, unless otherwise indicated, discusses the results of operations before 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 hydro-electric power projects domestically and internationally. This segment includes the mining, manufacture, and supply of asphalt and aggregate products, and the construction and/or installation of utility distribution systems for natural gas, telecommunications and electrical networks, as well as water and sewer mains, traffic signals and highway lighting 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, internationally. Aecon also provides a full range of infrastructure services through build-operate-transfer, build-own-operate-transfer and other alternative finance and procurement contract structures, as well as providing conventional construction services on a more traditional fee for service, construction management 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, airport terminals, 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. 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 including the construction of alternative, fossil fuel, cogeneration power plants and in-plant construction of nuclear power plants 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 and Europe, Aecon sells and installs once-through steam generators throughout the world through Innovative Steam Technologies.

The construction industry in Canada is seasonal in nature due to weather conditions, with less work performed in the winter and early spring months. Accordingly, Aecon experiences a seasonal pattern in its operating results with the first quarter of the year typically reflecting lower revenues and profits than the other three quarters. Therefore, results in any one quarter are not necessarily indicative of results in any other quarter or for the year as a whole.

**The MD&A presents certain non-GAAP financial measures to assist readers in understanding the Company's performance. Non-GAAP financial measures are measures that either exclude or include amounts that are not excluded or included in the most directly comparable measure calculated and presented in accordance with GAAP.**

### Consolidated Financial Highlights

\$ millions	<u>2005</u>	<u>2004</u>	<u>% Change</u>
Revenues*	\$ 1,120.2	\$ 1,002.5	11.7%
Operating profit (loss)*	7.2	(27.1)	n/a
Extraordinary gain before income taxes	4.1	-	n/a
<b>Income (loss) before interest and income taxes</b>	11.3	(27.1)	n/a
Interest expense	9.3	4.3	116.0%
<b>Income (loss) before income taxes</b>	2.0	(31.4)	n/a
Return on revenue	0.6%	(2.7)%	n/a
Backlog - December 31	\$ 577.3	\$ 565.0	2.2%

\* Revenues are from continuing operations and operating profit (loss) represents the profit (loss) from operations, before extraordinary items, interest, income taxes and discontinued operations.

Revenues from continuing operations in 2005 totalled \$1,120.2 million, representing an increase of \$117.7 million or 11.7% over last year. Revenues increased in all segments with the Infrastructure, Buildings and Industrial segments up by \$7.7 million, \$27.4 million and \$80.8 million, respectively. Results for each of the three principal operating segments are discussed separately under Reporting Segments.

Gross margins (revenues less costs and expenses) as a percentage of revenues increased from 3.2% in 2004 to 6.0% in the current year, reflecting increased margins from all business segments. Marketing, general and administrative expenses ("MG&A") amounted to \$49.6 million in 2005, which is \$3.2 million lower than last year. When the impacts on MG&A of 2004 costs of \$3.9 million for the relocation and consolidation of Aecon's offices in Toronto are removed, MG&A shows an increase of

\$0.7 million compared to last year. The increase results primarily from: the introduction of a long-term incentive plan to attract and retain key employees (this plan is entirely based on and dependent on operating profitability), which increased costs during the current year by \$1.3 million; higher MG&A costs of \$1.8 million for the Industrial segment, related to the expansion of this segment's western Canada operations; offset partially by lower MG&A costs of \$0.9 million for the Infrastructure segment, mostly as a result of lower bid costs and lower MG&A costs of \$2.1 million for the Buildings segment, resulting from targeted cost reductions.

Because of the significant impact of foreign exchange on Aecon's results, set out below is a table that shows what the Company's pre-tax income would be if all foreign exchange impacts were removed.

\$ millions	<u>2005</u>	<u>2004</u>
<b>Income (loss) before income taxes as reported above</b>	\$2.0	\$(31.4)
Deduct: Foreign exchange gains	-	2.0
Add: Foreign exchange losses	3.0	-
<b>Income (loss) before income taxes and foreign exchange</b>	<u>\$5.0</u>	<u>\$(29.4)</u>

Depreciation and amortization amounted to \$7.6 million for the current year and \$7.9 million for the prior year.

Net interest expense in the current year of \$9.3 million is \$5.0 million higher than the prior year. Interest on convertible debt, which is \$5.4 million higher in the current year, is the principal contributor to the increase in interest costs. The Company had two new issues of convertible debentures, \$30.0 million in November 2004 and \$32.5 million in March 2005. Interest expense related to these debentures has a cash component and a non-cash component. The cash component amounting to \$4.6 million in the current year (\$5.2 million annualized), results from the coupon rate of 8.25%. The non-cash component of \$1.3 million in the current year (\$1.4 million annualized) consists of the amortization (over the five-year life of the debentures) of debt issuance costs and accretion of the carrying value of the debentures. The amortization of debt issuance costs amounts to \$0.5 million in 2005, while accretion in the carrying value of the convertible debentures amounts to \$0.8 million. This accretion charge arises because, under Canadian GAAP, the Company allocates the proceeds of the convertible debentures into their debt and equity components on a relative fair value basis, resulting in the value of the \$62.5 million convertible debentures having a carrying value of \$58.4 million at inception. Each reporting period, the Company is required to accrete the carrying value of the convertible debentures such that, at maturity, the carrying value of the debentures will equal their face value of \$62.5 million.

In the fourth quarter of 2004, the Company provided a \$32.7 million valuation allowance against the net future income tax assets that had been recorded at December 31, 2003 and against future income tax assets that would otherwise have been recorded in 2004 with respect to its Canadian controlled operations. Consistent with this accounting treatment, future tax assets in respect of further tax losses from Canadian controlled operations will be offset by a valuation allowance whereas tax on income

from Canadian controlled operations will be offset by a reduction in previously recorded valuation allowances.

Aecon will continue to pursue opportunities to ensure that its Canadian tax losses will not expire.

Income tax expense related to continuing operations for 2005 amounted to \$2.5 million (2004 - \$23.3 million) on a pre-tax loss before discontinued operations and extraordinary items of \$2.1 million (2004 - loss of \$31.4 million). The 2005 income tax expense includes a valuation allowance of \$0.2 million (2004 - \$32.7 million).

Net loss for the year ended December 31, 2005 was \$1.1 million compared to a net loss of \$41.6 million in 2004.

Backlog at December 31, 2005, was \$577.3 million or \$12.3 million higher than the same time last year. On a segment basis, there was an increase in the Industrial segment of \$103.7 million and declines in the Infrastructure and Buildings segments of \$34.6 million and \$56.7 million, respectively. New contract awards of \$1,132.5 million were booked in the current year, which compares with \$1,020.9 million in 2004. The increase in awards in the current year was due to higher awards in the Infrastructure and Industrial segments, which exceeded the decline in awards in the Buildings segment. Further details for each of the segments are included in the discussion below under Reporting Segments.

At December 31, 2005, major projects backlog was \$1.9 million which is \$2.8 million lower than last year as Aecon's two large international projects in India and Israel have reached substantial completion. The financial close of the Quito Airport project in Ecuador is projected to add approximately \$250 million to major projects backlog in 2006.

## **DISCONTINUED OPERATIONS**

In 2004, Aecon sold its 38.75% interest in Canatom NPM Inc., which had been a part of the Industrial segment. Also in 2004, Aecon sold its Footage Tools division and its one-third interest in a small joint venture, both of which were part of the Infrastructure segment. Income from these discontinued operations during 2004 amounted to \$17.6 million before income taxes and \$13.0 million after income taxes. (See note 15 to the consolidated financial statements.)

## REPORTING SEGMENTS

### INFRASTRUCTURE

#### Financial Highlights

\$ millions	<u>2005</u>	<u>2004</u>	<u>% Change</u>
Revenues	\$ 457.0	\$ 449.3	1.7%
Segment operating profit (loss)	7.4	(3.0)	n/a
Extraordinary gain before income taxes	4.1	-	n/a
Income (loss) before interest and income taxes	11.5	(3.0)	n/a
Return on revenue	1.6%	(0.7)%	n/a
Backlog - December 31	\$ 117.0	\$ 151.6	(22.8%)

Revenues from the Infrastructure segment increased from \$449.3 million in 2004 to \$457.0 million in 2005, as revenue gains of \$36.1 million from roadbuilding operations and \$34.5 million from utilities operations offset revenue declines of \$44.4 million from the Quebec operations and \$18.8 million from other heavy civil operations.

The increased revenues from roadbuilding operations resulted from much higher volumes of activity generally, driven in part because of exceptional weather conditions compared to 2004.

Contributing to the improvement in utilities revenues were significant increases in gas pipeline installation and airport-related work in 2005 as well as increases in communications work, primarily in the area of fiber installation.

Revenues from the segment's Quebec operations dropped by \$44.4 million, partly as a result of the substantial completion of a hydroelectric dam project in Toulmoustouc and partly because of a decision to reduce new project pursuits in this market. The Toulmoustouc project generated revenues of \$51.4 million last year compared to \$6.7 million this year.

The decline in revenues from other heavy civil operations reflects the substantial completion of the Cross Israel Highway and Nathpa Jhakri projects.

Income before interest and income taxes from the Infrastructure segment is \$11.5 million in 2005, which is a \$14.5 million improvement over last year, as increases in earnings of \$5.8 million from roadbuilding operations, \$4.8 million from utilities operations and \$10.0 million from Quebec operations more than offset a \$6.1 million decline in earnings from other heavy civil operations. On a year-over-year basis, several large items affected the results between 2005 and 2004. Included in the 2005 results is an extraordinary gain of \$4.1 million resulting from the acquisition by Aecon of its partner's share in a joint venture whose interests include a one-third share in the joint venture that constructed the Cross Israel Highway. Also, earnings from roadbuilding operations in 2005 included gains of \$3.8 million related to claim settlements, whereas no claim settlements were recorded in

2004. Finally, included in 2005 is a gain of \$0.9 million from the sale of a 40% interest in the company that has a 51% interest in the entity that operates the Cross Israel Highway and a gain of \$0.7 million related to the partial recovery of bid costs incurred in the second half of 2004. On the other hand, included in the 2004 results are \$10.1 million in earnings from the Cross Israel Highway project and \$2.4 million in earnings from the Nathpa Jhakri project, both as a result of increases in the expected profits at completion of these projects. Foreign exchange also affected the comparison between 2005 and 2004 with net losses of \$2.4 million in 2005 compared to net gains of \$1.1 million in 2004. If the impact of all of these items were removed from the results of both years, the results for 2005 would be \$20.9 million better than 2004, an increase of \$6.4 million over the reported improvement of \$14.5 million noted above.

As discussed above, included in the 2005 roadbuilding operating results is a contribution of \$3.8 million related to claim settlements. The remaining operating profit improvement in roadbuilding relates to the higher revenues levels in the current year. Similarly, the increased operating profits in the utilities operations are also reflective of increased revenue volumes in 2005 and better equipment utilization.

The year-over-year improvement in Quebec operating profits is mostly due to losses totalling \$9.0 million on two projects in 2004, whereas no similar losses were incurred in 2005. Notwithstanding the improved results, Quebec operations incurred a loss of \$1.5 million in 2005.

As previously mentioned, the 2005 results from other heavy civil included an extraordinary gain of \$4.1 million, a \$0.9 million gain on sale, and a gain of \$0.7 million from bid cost recoveries. In addition to these items, operating results in other heavy civil operations in 2005 were also impacted by the substantial completion in 2004 of both the Cross Israel Highway and Nathpa Jhakri construction projects. Together these two projects contributed \$13.7 million less in operating profits in 2005 than in 2004. In 2004, revenues were principally derived from the Cross Israel and Nathpa Jhakri projects, both of which generated positive margins, whereas most of the revenues in 2005 come from the company that operates the Cross Israel Highway which, as expected, has generated negligible earnings in the current year. Further reducing results in this sector were foreign exchange losses of \$2.4 million in 2005 compared to a foreign exchange gain of \$1.1 million in 2004. As a result, foreign exchange impacts contributed to a \$3.5 million negative year-over-year impact on this sector's operating results.

The latest estimate for the joint venture involved in the construction of the Eastmain project in northern Quebec, in which Aecon has a 50% interest, shows that costs at completion for this project will be approximately \$50.0 million higher than the current contract price of \$136.0 million (the original contract price was \$107.6 million), which is an increase of approximately \$21.0 million in the cost of completion estimate at the end of 2004. Notwithstanding the increase in the cost of completion estimate, management continues to believe that it will recover the full amount of these incremental costs; however, the timeline to complete the negotiations for recovery of these amounts may extend through 2006.

The cost impacts of these client delays and scope changes are classified as unpriced change orders, which are change orders for which the client has agreed it is responsible but where the value of such change orders has not yet been settled. In accordance with Aecon's accounting policy for unpriced

change orders, until the value of an unpriced change order is settled with the client, contract revenues are recognized to the extent of costs incurred or, if lower, to the extent to which recovery is probable. Accordingly, no profit has been recognized on these change orders nor, on the contract as a whole. As of December 31, 2005, revenues of approximately \$23 million have been recorded to date in respect of Aecon's share of these unpriced change orders, which are included on Aecon's consolidated balance sheet as "deferred contract costs and unbilled revenue." Should the unpriced change orders related to this project no longer be considered probable of recovery and the Company is unsuccessful in recovering the full value of these cost overruns from the client, the financial results would be negatively impacted by charges to income of up to approximately \$23 million. Amounts not recovered through change orders would result in claims by Aecon against the client, which are recognized for accounting purposes only when the amounts are resolved.

In June 2005, the joint venture involved in the construction of the Nathpa Jhakri Project in India, in which Aecon has a 45% interest, was advised by the owner, Satluj Jal Vidyut Nigam Ltd. ("SJVN") (formerly Nathpa Jhakri Power Corporation Limited) of their intention to levy liquidated damages against the joint venture in the amount of \$29.8 million (original request for payment from SJVN at current exchange rates) for not completing the contract on time. Since the delay in the completion of the project was caused by numerous items outside of the joint venture's control and contractual responsibility, including, among many other things, a catastrophic flood in 2002, the joint venture believes that these claims for liquidated damages are unwarranted and without legal merit. The joint venture also believes that even in the unlikely situation that it might be found responsible (through arbitration hearings that are scheduled to commence in late March 2006) for some part of the delay, since this delay did not result in any damages to SJVN then, as a matter of law, liquidated damages cannot be enforced. The joint venture's conclusion regarding the impermissibility of SJVN to enforce liquidated damages is supported by two independent legal opinions. The joint venture has recently submitted for arbitration claims of approximately \$119.1 million against SJVN, the most significant of which is to cover the joint venture's cost of delays related to these same matters. This is in addition to \$9.3 million, at current exchange rates, which was previously received by the joint venture and is included in the joint venture's profit estimate for this project. Based on all of the above, no provision has been made for the liquidated damages nor, in accordance with Aecon's accounting policy, which is to recognize revenues from claims only when resolved, has any amount been recognized for potential recoveries under the claims.

Backlog of \$117.0 million at the end of December 2005 declined by \$34.6 million from the same time last year with most of the reduction related to the near completion of the Toulmoustouc and Eastmain projects in Quebec. Furthermore, major project backlog, which previously was represented by Aecon's two large international projects in India and Israel, is now down to \$1.9 million as these two projects are now basically complete. The financial close of the Quito Airport project in Ecuador is projected to add approximately \$250.0 million to major projects backlog in 2006.

A significant portion of the year-end roadbuilding backlog arises from a fourth quarter award of a \$59.8 million contract by the Ministry of Transportation of Ontario ("MTO") for work on the Queen Elizabeth Way ("QEW") in the Hamilton area to complete the QEW and Red Hill Valley Parkway interchange.

New contract awards of \$422.4 million were booked in 2005, which compares with \$381.9 million in 2004. The increase in awards year-over-year relates principally to roadbuilding and utilities operations and is consistent with the higher overall volume of activity experienced by both these sectors in 2005.

It is notable that significant and increasing commitments made to Aecon based on general contracts, supplier of choice and alliance agreements do not necessarily show up as firm backlog for external reporting purposes primarily due to the degree of uncertainty regarding the exact amount of work than can be expected. For example, Aecon has contractual arrangements with its two largest clients in the utilities sector that include geographic mandates for Aecon in certain parts of Ontario. Under these agreements, any work awarded by the client that is within the specified geographic area, and that meets the specifications and conditions in the contract, is awarded to Aecon as supplier of choice through the simple issuance of a purchase order. While it is possible to estimate with some confidence the minimum value of work likely to be awarded under these contracts, Aecon does not include work awarded under these contracts in backlog until the purchase orders have been issued. The effective backlog at any given time is therefore greater than what is reported to the extent that the expected volume of committed work under these general contracts and partnering agreements, for which purchase orders have not been issued, is significant. Because it is one of Aecon's strategic directives to focus on general contract, supplier of choice and partnering arrangements with clients, the amount of effective backlog that is excluded from reported backlog will continue to increase.

## ***Buildings***

### **Financial Highlights**

\$ millions	<u>2005</u>	<u>2004</u>	<u>% Change</u>
Revenues	\$ 394.8	\$ 367.4	7.4%
Segment operating profit (loss)	2.1	(13.2)	n/a
Return on revenue	0.5%	(3.6)%	n/a
Backlog - December 31	\$ 288.7	\$ 345.4	(16.4)%

Revenues in the Buildings segment increased by \$27.4 million or 7.4% over 2004. The increased revenue is comprised mainly of increases in the Greater Toronto Area operations of \$47.7 million and Montreal operations of \$31.1 million. The principal offset to these increases was a decline in revenues of \$46.5 million from the division's Seattle operations. The revenue increase in the Greater Toronto Area operations of \$47.7 million is due mostly to a high volume of work performed on three large projects, including the Pearson Airport Terminal project where an expansion and renovation of Terminal 3 is taking place, and a large design-build manufacturing facility. The \$31.1 million increase in revenues from the division's Montreal operations represents a combination of increased revenues resulting from the acquisition of the assets of Cegerco CCI Inc. in the second quarter of 2004 and new work from projects such as Montreal's Trudeau Airport, which includes a renovation of the terminal building and the expansion of the parking lot. The decline in revenues from Seattle operations reflects a combination of delays in awards for casino projects and less new work generally.

Operating results in 2005 were significantly better than last year with a return to profitability after four consecutive quarters of losses in 2004. An operating profit of \$2.1 million was realized in 2005 compared to an operating loss of \$13.2 million in 2004. Consistent with the increase in revenues, operating profits from the Greater Toronto Area and Montreal operations were \$3.0 million and \$5.7 million higher, respectively, than last year. Another \$6.2 million of the improvement relates to the Ottawa operations, which incurred significant losses last year in its Westeinde operations. In Seattle, despite significant reductions in revenue in 2005, operating results increased by \$0.1 million as a result of positive profit adjustments on completion of projects. The balance of the buildings operations produced operating results, which were up \$0.2 million over 2004.

As part of initiatives undertaken in the current year, the Greater Toronto Area operations were reorganized, the division's Montreal operations, which previously operated through two units, were consolidated, and the operations of Westeinde Construction Inc. ("Westeinde"), which were acquired in November 2003, were integrated into the division's Ottawa operations. While these restructurings had very little impact on the Building segment's earnings in 2005, they are expected to contribute to improved results in 2006 and beyond.

Backlog of \$288.7 million at the end of 2005 is \$56.7 million or 16.4% lower than last year. New contract awards of \$338.0 million were booked in the current year, which compares with \$470.0 million in 2004. The decline in awards occurred primarily in Toronto and Ottawa (\$136.3 million combined) and resulted from a combination of competitive pressures in these markets, a lack of suitable lump sum opportunities, and a strategy to pursue more negotiated contract management and design build work rather than higher risk lump work. Awards in Seattle declined by \$47.9 million mostly because of declines in new casino awards. As a result, Toronto and Ottawa backlog at the end of 2005 is down \$90.6 million and \$14.4 million, respectively, compared to last year. Also, Toronto backlog was down \$13.8 million because of progress during the year on the Pearson Airport project. Offsetting these declines are increases in backlog at Cegerco of \$30.7 million from new work and \$12.5 million at Seattle due to the award in late 2005 of casino projects delayed from 2004.

## ***Industrial***

### **Financial Highlights**

\$ millions	<u>2005</u>	<u>2004</u>	<u>% Change</u>
Revenues	\$ 273.3	\$ 192.5	42.0%
Segment operating profit	8.8	1.0	756.6
Return on revenue	3.2%	0.5%	528.3
Backlog – December 31	\$ 171.6	\$ 67.9	152.6%

Revenues in the Industrial segment of \$273.3 million were \$80.8 million or 42.0% higher than 2004.

Revenues from the segment's western Canada operations of \$120.3 million were up by \$81.1 million or approximately 207.0% over 2004, primarily because of demolition, rehabilitation and refurbishment work resulting from a major fire that damaged an oilsands facility in Fort McMurray,

Alberta. In 2004, revenues from western Canada operations arose primarily from a large module assembly contract.

Revenues from Construction operations of \$94.8 million were down \$11.5 million or 10.8% from the prior year. In 2004, Construction volumes were unusually high as one project in particular, a power contract in New Brunswick, generated revenues of \$28.8 million. The absence of a similar project in 2005 brought Construction revenues in 2005 back inline with historical levels.

Fabrication revenues in Ontario of \$24.9 million are \$10.7 million or 75.3% higher than 2004, due to the unit's Cambridge, Ontario facility running near full capacity for all of 2005 as a result of three large projects. In addition, fabrication revenues from the unit's joint venture interest in eastern Canada increased by \$1.7 million.

Revenues of \$30.8 million from Innovative Steam Technologies ("IST"), which sells and licenses the technology for once through steam generators ("OTSG"), were down \$2.0 million from the prior year. During 2005, IST worked on six OTSG boiler units and six steam injection gas ("STIG") turbine units, compared to nine OTSG boiler units and two STIG boiler units during 2004. OTSG units typically generate more revenues than STIG units.

Operating results of \$8.8 million from the Industrial segment were \$7.8 million higher than in 2004. Consistent with the increase in revenues noted above, operating profits from western Canada operations were \$4.5 million or \$3.4 million higher than last year. Despite the decline in revenues, Construction operations generated an operating profit of \$5.5 million compared to a profit of \$3.7 million in 2004, an increase of \$1.8 million. The increased operating profit on lower revenues reflects a combination of higher margin work in 2005 and the fact that 2004 results included revenues of \$28.8 million from a project that incurred a loss of \$1.4 million. Fabrication operations incurred a loss of \$2.6 million in 2005. This represents a net improvement of \$2.7 million over 2004, and consists of a reduction of \$2.3 million in the loss (\$1.1 million in 2005 and \$3.4 million in 2004) from Ontario operations, due to higher volumes, and a \$0.3 million reduction in the loss (\$1.5 million in 2005 and \$1.8 million in 2004) from the unit's joint venture operation in eastern Canada. A detailed analysis of Aecon's fabrication operations is currently underway with a view to identifying and implementing strategies that will improve the level and the consistency of profits from this operation. IST operating profits were \$1.4 million or \$0.4 million higher than last year. Despite a decline in revenue levels in 2005, IST benefited from a \$0.4 million gain in the second quarter from the termination of a licensing agreement with a German company, and from a more profitable mix of work than in 2004. Also, the 2005 work mix included more sales of STIG units, which generally produce higher profit margins than OTSG units.

Backlog at December 31, 2005 of \$171.6 million is \$103.7 million higher than last year. Similarly, new contract awards of \$376.9 million in the current year are \$201.3 million higher than in 2004. The increase in current year awards occurred primarily in Construction and western Canada operations. Construction backlog is up \$111.5 million, principally as a result of a \$204.0 million award to a joint venture (in which Aecon has a 50% interest) for a nuclear project in Ontario. In western Canada operations, backlog of \$23.9 million at the end of 2005 is unchanged from last year as projects completed in 2005 have been replaced with a new pipe fabrication and module project. In addition, Fabrication backlog for both Ontario and eastern Canada operations is \$6.7 million higher, principally

arising from two recent project awards. However, IST backlog of \$5.1 million at the end of 2005 was down \$14.1 million from last year as a result of fewer bookings for boiler units. At the end of 2004, IST had contracts in backlog for ten OTSGs compared to contracts in backlog for two OTSG units and three STIG units at the end of 2005. While IST experienced a slower sales period throughout most of 2005, this slowdown is believed to be a result of project by project delays, rather than a fundamental shift in the market. In fact, as of February 24, 2006, IST had added \$7 million to its backlog as a result of an award for the manufacture of two OTSGs. It also had received letters of intent for seven OTSG units, which will be included in backlog when awarded.

It is notable that significant commitments made to Aecon based on general contracts and partnering agreements do not necessarily show up as firm backlog for external reporting purposes primarily due to the degree of uncertainty regarding the exact amount of work that can be expected. The effective backlog is therefore greater than what is reported to the extent that the expected volume of committed work is significant.

### ***Corporate and Other***

Net Corporate expenses for the current year totalled \$11.1 million compared to \$11.9 million in 2004. After removing the effect of foreign exchange (a loss of \$0.4 million in 2005 versus a gain of \$1.0 million in 2004) and the impact on 2004 expenses of the one-time relocation costs of \$3.9 million referenced in the discussion above on the Company's consolidated results, corporate expenses would be higher by \$1.8 million. The new key employee long-term incentive plan noted above accounted for \$1.3 million of this increase, while an increased loss on disposal of capital assets accounted for most of the remaining balance.

### **Discontinued Operations**

See note 15 to the Company's consolidated financial statements.

### **Quarterly Financial Data**

Set out below are revenue, net income (loss) and earnings per share for each quarter in 2005 and 2004 (in millions of dollars, except per share amounts).

	2005				2004			
	Quarter 1	Quarter 2	Quarter 3	Quarter 4	Quarter 1	Quarter 2	Quarter 3	Quarter 4
Revenues	\$ 172.9	\$ 283.0	\$ 340.8	\$ 323.5	\$ 189.0	\$ 264.7	\$ 290.0	\$ 258.7
Net income (loss)	(8.4)	1.7	2.1	3.5	(2.4)	2.4	(0.9)	(40.7)
Earnings (loss) per share:								
Basic	(0.29)	0.06	0.07	0.12	(0.10)	0.08	(0.03)	(1.42)
Diluted	(0.29)	0.05	0.07	0.11	(0.10)	0.08	(0.03)	(1.42)

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

	2005		2004	
	Quarterly Total	Annual Amount	Quarterly Total	Annual Amount
Earnings (loss) per share:				
Basic	\$ (0.04)	\$ (0.04)	\$ (1.47)	\$ (1.51)
Diluted	(0.06)	(0.04)	(1.47)	(1.51)

Analysis of operating results for each of the first three quarters of 2005 was included in the Management Discussion and Analysis incorporated in the Interim Reports to Shareholders for each quarter.

For the fourth quarter of 2005, revenues amounted to \$323.5 million, which was \$64.8 million or 25.1% higher than the same period in 2004. Revenues increased in all operating segments, with the Industrial, Infrastructure and Buildings segments increasing \$35.1 million, \$19.3 million, and \$7.1 million, respectively.

Operating margins (revenues less costs and expenses) increased by \$25.8 million in the final three months of the year, going from a loss of \$2.1 million in 2004 to a profit of \$23.7 million in 2005, as all segments generated significantly increased margins.

MG&A amounted to \$13.7 million in the quarter, compared to \$14.8 million in the same period last year.

Operating profits in the current quarter are \$7.1 million compared to an operating loss of \$19.8 million during the same period in 2004, which is consistent with the increase in operating margins noted above.

Revenues and operating profit (loss) by segment for the fourth quarters of 2005 and 2004 are set out in the table below (\$ millions).

	2005		2004	
	Revenue	Operating profit (loss)*	Revenue	Operating (loss)*
Infrastructure	\$ 147.5	\$ 3.3	\$ 128.2	\$ (8.0)
Buildings	95.0	0.1	87.9	(7.1)
Industrial	82.6	6.4	47.5	(2.6)
Corporate	(1.6)	(2.7)	(4.9)	(2.1)
Consolidated	<u>\$ 323.5</u>	<u>\$ 7.1</u>	<u>\$ 258.7</u>	<u>\$ (19.8)</u>

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

In the Infrastructure segment, revenues were \$19.3 million higher than last year. Revenues from roadbuilding and utilities operations were a combined \$18.7 million higher in the fourth quarter than in the corresponding three months of 2004, aided by favourable weather conditions, increased backlog to start the quarter and accelerated work schedules on some projects. As well, there was a revenue increase of \$10.7 million in other heavy civil operations, which resulted primarily from Aecon's share of revenues from the company that operates the Cross Israel Highway on behalf of its owners. These increases were partially offset by reduced volumes in Quebec. Overall, segment revenues were 14.7% higher than last year.

The Infrastructure segment earned an operating profit of \$3.3 million compared to a loss of \$8.0 million in the fourth quarter. The largest year-over-year improvement of \$9.0 million was in the Quebec operations, which in the fourth quarter of 2004 recorded provisions for losses on two projects in Quebec and a downward revision of profitability on a third project in the province, whereas no such similar impacts were felt in 2005.

Revenues in the Buildings segment of \$95.0 million are \$7.1 million higher than the same quarter last year. Toronto and Montreal operations continue to produce higher revenues from a number of large projects discussed previously in the Buildings segment section. These increases offset revenue declines from Seattle and Ottawa in the current quarter.

The Buildings segment produced a small operating profit in the fourth quarter, compared to a loss of \$7.1 million last year. The Montreal operating profits increased by \$3.0 million from increased volumes in the quarter, whereas a \$2.5 million improvement in the Ottawa operations was related to 2004 events that included losses incurred on several large contracts, the write-off of goodwill associated with the Westeinde acquisition and charges taken for restructuring. Toronto operations were negatively impacted by a downward profit revision totaling \$2.5 million on two large jobs. Although Aecon expects these profit reductions will ultimately be settled through claims, in accordance with Aecon's accounting policy, such claim recoveries will not be recorded until settled.

The Industrial segment revenues in the current quarter were \$82.6 million or \$35.1 million and 73.9% higher than in 2004. The largest volume increases continued to occur in the Western Canada and Construction operations for reasons similar to those discussed in the section on the Industrial segment's results for all of 2005.

The Industrial segment recorded a profit of \$6.4 million in the last quarter, which compares with a loss of \$2.6 million in the same period of 2004. Volume increases from Construction and western Canada operations combined with increased production of STIG units by IST in the current quarter produced improved results in the segment.

Overall, income for the quarter from continuing operations, after interest and income taxes, amounted to \$3.5 million or \$0.12 per share which, compares with a loss of \$47.1 million or \$1.64 per share in 2004. The size of the 2004 fourth quarter loss was impacted by the valuation allowances taken against future tax assets, which were recorded in that 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>2005</u>	<u>2004</u>	<u>2003</u>
Total revenues	\$ 1,120.2	\$ 1,002.5	\$ 940.6
Loss before extraordinary items and discontinued operations	(4.6)	(54.7)	(18.7)
Per share:			
Basic	(0.16)	(1.98)	(0.79)
Diluted	(0.16)	(1.98)	(0.79)
Net loss	(1.1)	(41.6)	(13.9)
Per share:			
Basic	(0.04)	(1.51)	(0.59)
Diluted	(0.04)	(1.51)	(0.59)
Total assets	504.4	455.3	470.2
Total long-term financial liabilities	97.8	79.0	35.6
Cash dividends declared per common share	-	-	-

## FINANCIAL CONDITION, LIQUIDITY AND CAPITAL RESOURCES

Cash and cash equivalents at December 31, 2005 totalled \$27.0 million, which compares with \$50.1 million at the end of last year. Of these amounts, \$10.2 million and \$19.1 million, respectively, were on deposit in joint venture and affiliate bank accounts, which Aecon cannot access directly. Restricted cash of \$7.5 million at December 31, 2005 represents cash that was deposited as collateral for letters of credit issued by Aecon. As such, this cash was not available for general operating purposes. Restricted marketable securities and term deposits of \$15.3 million (2004 - \$15.6 million) were held within joint ventures and these securities cannot be accessed directly by Aecon.

Cash provided from operating activities amounted to \$9.8 million in the year, which compares to cash used last year of \$28.1 million (excluding discontinued operations). The \$37.9 million improvement reflects the improved operating results that occurred in 2005 - a loss before income taxes, extraordinary items and discontinued operations of \$2.1 million in 2005 compared to a loss of \$31.4 million last year.

Changes in other balances related to operations, which represents funds used or provided on account of changes in working capital balances, resulted in a use of cash of \$37.7 million in the year versus cash provided of \$7.1 million in 2004. Increased investments in holdbacks receivable and deferred contract costs and unbilled revenue, along with a decrease in deferred revenue, caused the highest uses of cash, while an increase in accounts payable represented the highest source of cash. The year-over-year increased investment in holdbacks receivable occurred primarily in the Buildings segment and resulted from the high level of large lump sum jobs, which were carried over from 2004 or awarded in early 2005, and were still in progress at the end of 2005. The Industrial segment was responsible for most of the \$15.1 million year-over-year increase in deferred contract costs and unbilled revenues. The Industrial segment reported an increase of \$15.9 million in 2005 compared to

an increase of \$3.5 million in 2004, mostly because of the large investment in working capital that was required in 2005 to support the very significant growth of operations in western Canada. Deferred revenues, which represent advance billings for work not yet performed, declined by \$17.1 million compared to an increase of \$7.6 million in 2004. The \$24.7 million unfavourable swing arose principally within the Buildings segment where deferred revenues decreased by \$6.5 million in 2005 compared to an increase of \$12.3 million last year. The sharp decline is due principally to fewer new lump sum jobs on hand at the end of 2005, which generally attract advance payments from customers. Most of the year-over-year increase of \$9.0 million in accounts payable and accrued liabilities was attributable to the Buildings sector and, similar to the increase in holdbacks receivable noted above, resulted from a higher level of large lump sum jobs during this period

Investing activities resulted in a use of cash of \$21.9 million, which compares with cash provided of \$0.7 million in 2004. The increase in other assets relates primarily to bid costs on the Quito airport project. All other year-over-year changes in investing activities, as outlined in the Company's consolidated statements of cash flows for the years ended December 31, 2005 and 2004, are self-evident.

Cash generated from financing activities amounted to \$27 million, compared to \$36.7 million in 2004. Issuances of long-term debt amounted to \$45.9 million while repayments totalled \$51.4 million. Gross long-term debt issuances and repayments were affected by a series of drawdowns and repayments under the Company's revolving term facility. Also a \$32.5 million convertible debenture financing was completed, which yielded net proceeds of \$31 million, full details of which can be found in note 11 to the Company's consolidated financial statements.

At December 31, 2005 long-term debt and convertible debentures, including the current portion, totalled \$108.7 million, compared to \$80.5 million at the end of 2004. The \$28.2 million increase is mostly due to the convertible debenture financing noted above.

Bank indebtedness of \$8.3 million at the end of 2005 includes \$8.2 million for Aecon's 45% share of funds borrowed within the Nathpa Jhakri hydroelectric project joint venture in India and a tender loan of \$0.1 million.

Interest bearing debt amounted to \$119.6 million at December 31 2005, compared to \$92.4 million at December 31, 2004, the composition of which is as follows (\$ millions):

	<u>2005</u>	<u>2004</u>
Bank indebtedness	\$ 8.3	\$ 11.9
Loan from a related party	2.5	-
Current portion of long-term debt	6.2	4.5
Convertible debentures - current	7.7	-
Long-term debt	35.7	40.4
Convertible debentures	59.2	35.6
Total	<u>\$ 119.6</u>	<u>\$ 92.4</u>

Aecon has a reducing revolving term loan to fund working capital and operating requirements (with a current limit of \$21.9 million).

In November 2004 and March 2005, Aecon raised \$30.0 million and \$32.5 million, respectively, from the issuance of convertible debentures. These financings provided Aecon with a significantly improved liquidity base among other benefits.

In September 2005, Aecon negotiated a \$15.0 million bank line to assist with very short-term changes in working capital balances and to support Aecon's ongoing letters of credit requirements.

The convertible debenture financings, combined with the revolving term loan facility, the bank line, and some modest short-term financing from Hochtief Construction AG related to the Eastmain project (which has now been repaid) were sufficient to finance the Company's operations in 2005. However, because of the significant build-up in working capital, mostly as a result of the very rapid expansion of the Industrial segment's western Canada operations, the Company's financial resources were at times nearly fully utilized, particularly during the summer and fall. To avoid a similar situation in 2006, Aecon is actively pursuing various financing alternatives to augment its credit and liquidity base. In this regard, Aecon recently announced an equity financing that is expected to yield gross proceeds of \$28 million and which is expected to close on March 17, 2006. The Company will also improve its liquidity by mandating improved commercial terms with stricter and improved terms of payment. This initiative has already commenced and has already had positive impact in some areas.

To fund investments in property, plant and equipment, Aecon has access to several committed and uncommitted equipment financing and leasing facilities. Remaining availability under these lines of credit is expected to be sufficient to meet Aecon's remaining anticipated requirements for 2006.

Aecon's surety capacity remains sufficient to meet its needs. However, surety capacity and pricing has become a constraining issue broadly within the industry and Aecon is not immune to these impacts. It is expected that certain of the above-noted initiatives to further improve Aecon's liquidity position will also have positive impact on Aecon's surety capacity.

## **NEW ACCOUNTING STANDARDS**

Several new Canadian accounting standards were adopted in 2005 and 2004, which are described in note 2 to the consolidated financial statements.

## SUPPLEMENTAL DISCLOSURES

### Responsibility of Management

The Company's management maintains appropriate information systems, procedures and controls to ensure that information used internally and disclosed externally is complete, reliable and timely. The Chief Executive Officer and the Chief Financial Officer of the Company have evaluated, or caused the evaluation of, under their direct supervision, the effectiveness of the Company's disclosure controls and procedures (as defined in Multilateral Instrument 52-109, Certification of Disclosure in Issuers' Annual and Interim Filings) for the year ended December 31, 2005, and have concluded that such disclosure controls and procedures are operating effectively.

### Contractual Obligations

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

	<u>Lease Payments</u>	<u>Long-term Debt Repayments</u>
2006	\$ 16,123	\$ 13,959
2007	12,575	5,346
2008	8,240	4,639
2009	6,470	33,880
2010	4,105	34,477
Beyond	13,202	19,829
	<u>\$ 60,715</u>	<u>\$ 112,130</u>

At December 31, 2005, Aecon had contractual obligations to complete construction contracts that were in progress. The revenue value of these contracts, which represents backlog, was \$577.0 million.

### 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, 2005 (2004 - \$6.4 million). The deficit remained unchanged during the year despite favourable investment experience and increased Company funding because of the impact of actuarial losses during the year on the benefit obligation. Actuarial gains and losses are changes in the value of the accrued benefit obligation and the plan assets resulting from experience different from that assumed; or changes in an actuarial assumption. These deficits include experience and other actuarial gains and losses which, in accordance with Canadian generally accepted accounting principles, are not immediately recognized in the accounts of the Company but are amortized over the average remaining service life of

employees. At December 31, 2005, unrecognized liabilities amounted to \$8.6 million (2004 - \$7.4 million). Details relating to Aecon's defined benefit plans are set out in note 19 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, 2005, the Company had net outstanding contracts to sell US\$3.6 million (2004 - sell US\$9.6 million) and sell euro nil (2004 - sell euro 0.6 million) on which there was a net unrealized exchange gain of \$0.2 million (2004 - net gain of \$0.6 million). The net unrealized exchange gains/losses represent the estimated amount the Company would have received/paid if it terminated the contracts at the end of the respective years. Financial instruments are discussed in note 21 to the consolidated financial statements.

In accordance with the terms of prior acquisitions agreements, the Company is liable to make earn out incentive payments totalling a cumulative maximum of \$1.2 million if certain financial performance targets are achieved.

### **Related Party Transactions**

Aecon from time to time receives financial support from Hochtief AG and its subsidiary companies ("Hochtief"), Aecon's largest shareholder. At December 31, 2005, 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, and for \$2.5 million in the form of a short-term unsecured loan which was repaid on January 13, 2006 as described in note 20(f) to the consolidated financial statements. Hochtief AG has issued guarantees totalling \$25.6 million 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 \$0.3 million in 2005 in connection with these guarantees. Hochtief AG has also counter-guaranteed an advance payment guarantee of \$0.7 million issued by Aecon for the Eastmain Powerhouse project joint venture.

Aecon and Hochtief are also joint venture partners in a hydro-electric project in Quebec. Note 20 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.

Unpriced change orders are change orders that have been approved as to scope but unapproved as to price. For such change orders, contract revenues are recognized to the extent to which costs incurred are expected to be recovered. Therefore, to the extent that actual costs recovered are different from

expected cost recoveries, significant swings in revenue and profitability can occur from one reporting period to another.

Claims are amounts in excess of the agreed contract price, or amounts not included in the original contract price, that Aecon seeks to collect from clients or others for client-caused delays, errors in specifications and designs, contract terminations, change orders in dispute or unapproved as to both scope and price, or other causes of unanticipated additional costs. In accordance with Aecon's accounting policy, claims are recognized in revenue only when resolved. Therefore, it is common 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 19 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>Dec. 31, 2005</u>	<u>Mar. 7, 2006</u>
Number of common shares outstanding	31,180,609	31,380,609
Paid-up capital of common shares outstanding (1)	\$ 95,985	\$ 96,705
Outstanding securities exchangeable or convertible into common shares:		
Number of employee stock options outstanding	625,000	425,000
Number of common shares issuable on exercise of employee stock options	625,000	425,000
Increase in paid-up capital on exercise of employee stock options	\$ 2,956	\$ 2,236
Principal amount of convertible debentures outstanding (see note 11 to the Company's 2004 consolidated financial statements)	\$ 70,231	\$ 70,231
Number of common shares issuable on conversion of convertible debentures	10,423,882	10,423,882
Increase in paid-up capital on conversion of convertible debentures	\$ 70,231	\$ 70,231

- (1) As described in note 14 to the Company's 2005 consolidated financial statements, in accordance with the recommendations of The Canadian Institute of Chartered Accountants, share capital has been reduced by \$1,585 thousand at December 31, 2005 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 projects provide opportunities for large revenue and profit contributions, but can occasionally result in significant losses.

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

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

As described more fully in notes 10 and 13 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 Project in India, although now complete, incurred significant delays in respect of which the joint venture, in which Aecon has a 45% interest, submitted requests for extensions of contract time as well as claims for significant compensation arising from the costs of delays.

The 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 requests has been included in the joint venture profit estimate for this project.

At January 31, 2006, joint venture claims to cover delay related costs amounted to approximately \$119.6 million, including interest at 10% to November 30, 2005. This is in addition to \$9.4 million, which was 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 \$8.6 million as full settlement was recommended by the Alternate Disputes Resolution Board ("ADRB"), which was appointed jointly by SJVN and the joint venture. However, since ADRB's recommendations are not binding, and as the joint venture was not satisfied with the level of the final settlement recommended by the ADRB, nor did SJVN support the recommendation, income from this award has not been included in the joint venture's and Aecon's profit estimate for this project. The claims have now been presented to an arbitration panel in accordance with the dispute resolution

process defined in the construction contract with SJVN. The contract stipulates that this arbitration is binding. The arbitration hearings are scheduled to commence in late March 2006.

In the event the joint venture is unsuccessful in its claims for additional compensation and request for extension of contract time, the joint venture could be faced with potential liquidated damages claims by SJVN of up to a maximum amount equal to \$29.8 million (10% of the contract value) plus interest for which the Company is jointly and severally liable. If such possible claims were to materialize and be successful, the financial results and the financial position of Aecon would be adversely affected. As at January 31, 2006, the Company had outstanding guarantees and letters of credit totalling \$25.3 million in support of financial and performance related obligations for the Nathpa Jhakri project. To December 31, 2005, the Company has profits of approximately \$13.3 million (2004 - \$13.3 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 was not able to collect its profits, Aecon's financial results and its financial position would be adversely affected. Construction of the Nathpa Jhakri project is fully complete and the warranty period has expired.

In connection with the Cross Israel Highway project, as at February 28, 2006, Aecon had provided two joint and several guarantees, a continuous guarantee, which guarantees the performance of the concessionaire, and a leakage guarantee, which is a guarantee by the operator of the toll highway, in which the Company has a 30.60% interest, to the concessionaire, and covers toll capture and collection rates generated from users of the highway during the operating period. These guarantees extend to the end of the concession period which ends in 2029. The continuous guarantee is in the amount of \$9.2 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 \$10.9 million or 6% of annual toll revenue. The value of this guarantee is indexed and the amount used is as at January 31, 2006. If such guarantees were to be called upon, the financial results and the financial position of Aecon would be adversely affected.

In addition, a significant portion of Aecon's capital (approximately \$46.4 million) is invested, directly or indirectly, in the Cross Israel Highway. As a result, any material diminution in the value of the Cross Israel Highway would adversely affect the financial results and condition of the Company.

It should be noted that all amounts quoted above are based on foreign currency amounts, which have been translated into Canadian dollars at current exchange rates.

The Company is currently engaged in a joint venture with Hochtief Construction AG. in the construction in northern Quebec of a hydro-electric facility for Société d'énergie de la Baie James (SEBJ), a subsidiary of Hydro Quebec (the "Eastmain Project"). 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 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 2006, 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, 2005, \$15.4 million of costs incurred on the Quito project had been deferred with further costs expected to be incurred and deferred until financial close is achieved.

### **Concessionaire Risk**

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

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

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

### **Ongoing Financing Availability**

Aecon's business strategy involves the selective growth of its operations through internal growth and acquisitions. Certain of Aecon's operating segments, particularly its Infrastructure and Industrial segments, require substantial working capital during their peak busy periods. As these businesses grow, Aecon is continually seeking to enhance its access to funding in order to finance the higher working capital associated with this growth. However, from time to time, Aecon is constrained in its ability to capitalize on growth opportunities to the extent that financing is either insufficient or unavailable.

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

Many 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 support by its surety provider, Aecon's recent poor profitability performance has not allowed Aecon to escape the pressures facing the industry. Although the Company believes it will be able to continue to maintain sufficient surety capacity adequate to satisfy its requirements, should those requirements be materially greater than anticipated, or should sufficient surety capacity not be available, this may

have a material adverse effect on the ability of Aecon to operate its business or take advantage of all market opportunities.

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

Aecon is from time to time engaged in large international projects in foreign jurisdictions. International projects such as the Nathpa Jhakri 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 economic, geopolitical, military, currency and foreign exchange risks, and other risks beyond the Company's control.

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

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

Aecon's investment in Derech Eretz Highways (1997) Ltd. ("Derech Eretz") is denominated in New Israeli Shekels ("NIS") and, as such, the value of this investment fluctuates with changes in the relationship between the Canadian dollar and NIS. Similarly, although much less significant, Aecon's investments in India and Israel (other than its investment in Derech Eretz), which primarily represent undistributed profits from its now completed construction projects in these countries, are denominated in foreign currencies (mostly NIS, Rupees and United States dollars) and the value of these investments fluctuate as the value of the Canadian dollar changes relative to the values of these foreign currencies.

### **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 fixed price ("Lump Sum") or guaranteed maximum price ("GMP"). In Lump Sum and GMP projects, in addition to the risk factors of a unit price contract (as described below), any errors in quantity estimates or schedule delays or productivity losses, for which contracted relief is not available must be absorbed within the Lump Sum or GMP, thereby adding a further risk component to the contract.

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

project execution, inclement weather, inflation or other factors, will negatively affect Aecon's profitability.

In certain instances, Aecon guarantees to a customer that it will complete a project by a scheduled date or that the facility will achieve certain performance standards. If the project or facility subsequently fails to meet the schedule or performance standards, Aecon could incur additional costs or penalties commonly referred to as liquidated damages.

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

Certain of Aecon's contractual requirements may also involve financing elements, where Aecon is required to provide one or more letters of credit, performance bonds, financial guarantees or equity investments. 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.

Change orders, which modify the nature or quantity of the work to be completed, are frequently issued by clients. Final pricing of these change orders is often negotiated after the changes have been started or completed. Until pricing has been agreed, these change orders are referred to as "unpriced change orders." Revenues from unpriced change orders are recognized to the extent of the costs incurred on executing the change order. Only when pricing is agreed is any profit on such change orders recognized. If, ultimately, there are disputes with clients on the pricing of change orders or disputes regarding additional payments owing as a result of changes in contract specifications, delays, additional work or changed conditions, Aecon's accounting policy is to record all costs for these changes but not to record any revenues anticipated from these disputes until actually resolved, even though the Company may believe that full compensation from clients is probable. The timing of the resolution of such events can have a material impact on income and liquidity and thus can cause fluctuations in the revenue and income of Aecon in any one reporting period.

## **Economic Factors**

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

In North America, which tends to have relatively sophisticated infrastructure, Aecon's profitability is dependent both on the development, rehabilitation and expansion of basic infrastructure (highways, airports, dams, 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 or the public sectors fiscal situation can have a significant impact on Aecon's operations.

Internationally, Aecon is involved with the development of basic infrastructure, particularly in developing countries. As such, the Company's growth and profitability from this work depends largely on the pace of growth in these foreign jurisdictions and the ability of these countries to allow for the arrangement of long-term financing.

### **Environmental and Safety Factors**

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

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

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

## **Labour Factors**

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

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

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

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

## **Potential Fluctuation in Financial Results**

Aecon's quarterly and annual financial results may be impacted by a variety of factors including, without limitation: the recognition of revenue from existing large project contracts; the opportunity to compete for new large projects; costs or penalties associated with unanticipated delays in project completion; fluctuations in the general economic and business conditions in the markets in which

Aecon operates, which may impact pricing levels of its services; actions by governmental authorities including government demand for the services provided by Aecon; government regulations and the associated expenditures required to comply with regulations; labour action involving Aecon's unionized workers; seasonal or materially adverse weather conditions; the risk associated with the use of Lump Sum and guaranteed maximum price contracts; geopolitical risks in the foreign jurisdictions in which Aecon operates as well as risk associated with foreign currency and exchange rates; and other circumstances affecting revenue and expenses. Aecon's operating expenses are incurred throughout the year. As a result, if expected revenues are not realized as anticipated, there may be significant variations in Aecon's quarterly and annual financial results.

### **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 full acceptance within certain segments of the industry for its innovative "once through" approach to heat recovery steam generators, 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, 2005 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 7, 2006. 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, the 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. In July 2004, Aecon shareholders voted not to approve an amalgamation proposal that would have resulted in its largest shareholder, Hochtief A.G. ("Hochtief"), indirectly holding all the outstanding shares of Aecon and thereby privatizing the Company. Subsequently, Hochtief indicated that its ownership position in the Company would not remain in the 48% range and that its intention was to either increase or decrease its holdings in the Company. Since then, Hochtief has neither increased nor decreased its interest in the Company. More recently, however, Hochtief, in an effort to bring clarity to its long-term intentions, had preliminary discussions with the Company about a number of possible transactions including a potential acquisition of certain of the Canadian construction operations and assets of the Company. However, Hochtief advised the Company on February 20, 2006 that it could not identify an acceptable proposal to all concerned. 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.

During 2001, the Company received federal income tax reassessments relating to deductions claimed by predecessor companies between 1993 and 1999. The reassessments, which disallow previously claimed Canadian development expense (CDE) deductions, amounted to \$10,581 at December 31, 2005. Provincial income tax reassessments related to the disallowed CDE and received to date amount to \$804. Although the Company has filed Notices of Objection, it was required to pay 50% of the federal assessed amounts and 100% of the Ontario provincial assessments pending resolution of the objections. At December 31, 2005, the Company had paid \$5,414 resulting from these assessments. To-date, the Canada Revenue Agency has not responded to the Notices of Objection. The total potential federal and provincial reassessments, including income taxes, interest and

penalties could be up to \$17,426. The Company believes it has adequate income tax provisions to cover the ultimate outcome of these reassessments.

### **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 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.

### **Subcontractor Performance**

The profitable completion of some contracts within Aecon's Buildings division depends to a large degree on the satisfactory performance of the subcontractors who complete different elements of the work. If these subcontractors do not perform to accepted standards, Aecon may be required to hire different subcontractors to complete the tasks, which may add additional costs to a contract, may impact profitability on a specific job, and in certain circumstances, lead to significant losses.

## **OUTLOOK**

In 2006, Aecon expects to see a continuation of the trend that resulted in improved bottom line results in each of its segments in 2005.

Within the infrastructure segment, Aecon's roadbuilding operations are expected to remain strong. The Ontario government's announced intention to at least maintain the increased level of roadbuilding activity it commissioned in 2005 should allow margins in this sector to solidify. And the increased roadbuilding backlog with which Aecon begins the year will provide the Company with added flexibility in its bidding strategy this year. However, as Aecon does not expect to repeat the significant level of claim settlements seen in 2005, a slightly smaller profit contribution is expected this year than was achieved in 2005.

Any decline in profit contributions from the roadbuilding sector in 2006 are expected to be more than offset by increased contributions from the utilities sector. Aecon's continued strong alliance with Union Gas and its recently expanded relationship with Expertech provide a very strong base for its

utilities operations and allow for a more selective pursuit of additional projects to round-out its utilities order book. As a result, Aecon's utilities business is expected to generate increased margins and an improved profit contribution in 2006.

Aecon's Quebec civil operations will generate significantly less revenue this year than it did in 2005 as the Eastmain hydroelectric project in northern Quebec, which has been the division's primary focus for much of the past two years, winds down. 2006 results are expected to reflect no material developments with respect to the outstanding issues on the Eastmain project as management continues to believe that the Aecon/Hochtief joint venture building the project will be successful in recovering from the client the value of unpriced change orders associated with the project. Nonetheless, Aecon acknowledges that an ongoing risk will remain with respect to the Eastmain project until the price of these change orders is resolved. In addition to settling these outstanding matters with SEBJ, Aecon's focus in this sector will turn to re-establishing its success in executing smaller civil and industrial projects in the province. Little or no profit contribution is expected this year as the division goes through this transition.

Other Canadian civil operations in 2006 are expected to include work on two large sewer projects north of Toronto - one currently underway and another for which contracts are expected to be signed in March or April of this year (Aecon and its partner were low bidders on the second project and are now awaiting formal contract award). In addition, Aecon plans to enter the Alberta civil construction market in 2006. Based in Edmonton, Aecon's Alberta civil operations will initially focus on building on the Industrial segment's success in oil sands projects in the Fort McMurray area by offering Aecon's civil construction services to projects and clients for which the Industrial segment is currently working. While Aecon sees significant potential in the Alberta civil market going forward, it expects to generate only modest profit contributions during its first year in this market.

Internationally, Aecon expects to be working on two major construction projects in 2006 - expansion of the Cross Israel Highway and construction of the new Quito International Airport. Both are projects in which Aecon is a partner in the concession company responsible for the project. The US\$150 million Cross Israel Highway extension, in which Aecon has a 25% stake, is subject to a number of conditions precedent, which are expected to be satisfied in time for construction to begin in mid-2006. Construction of the new US\$410 million Quito Airport will begin following the project's financial close, expected early in the second quarter. Aecon is a 50% partner in the joint venture building the airport, which is scheduled for completion in 2010.

Under Aecon's accounting policy for large multi-year contracts, construction 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). This milestone is not likely to be reached on either the Cross Israel Highway extension or the Quito project until 2007, and as such, no construction profit is expected to be recognized on these projects in 2006.

In the Buildings segment, 2005 produced four consecutive profitable quarters following four consecutive quarters of losses in 2004 - evidence that the recovery in this segment has taken hold. This improvement is expected to continue in 2006.

Despite an anticipated decline in revenue, profit contributions in the Greater Toronto Area (the largest region in the segment) are expected to increase in 2006 due in part to the anticipated settlement of outstanding project claims.

Profit contributions from Aecon's other business units in this segment are expected to approximate those reported in 2005, with most business units recording a modest increase in profit contributions.

Aecon's Industrial segment is expected to show improvement again in 2006, with increased profit contributions as compared to last year. The segment's fabrication business unit is expected to provide the most significant gains as it rebounds from operating losses in 2005, most of which were incurred at the Aecon-Fabco facility in Dartmouth, Nova Scotia to a positive profit contribution in 2006.

The segment's western Canadian operations, which provided much of the growth in this segment in 2005, is expected to generate reduced revenues in 2006 as the substantial volumes generated from the Suncor fire rebuild project in 2005 are not likely to be replaced. Last year's surge in volumes from the rebuild project and the expected dip in revenues in 2006 are viewed as an aberration in what is expected to be an overall steady increase in volumes and profit contributions from oil sands projects in the Fort McMurray region of Alberta. Despite the expected drop in revenues in western Canada in 2006, profit contributions from this business unit are expected to approach those recorded in 2005.

The industrial construction market in Ontario is expected to remain strong in 2006, with growth in the energy sector offsetting any decline in the manufacturing sector. The profit performance achieved in this market in 2005 was partly due to some very favourable project completions that resulted in higher than expected margins. As such, while Aecon's industrial construction operations in Ontario are expected to have another solid year, profit contributions are likely to fall short of those recorded in 2005.

IST is expected to generate increased revenue and profit contributions in 2006 despite starting the year with a smaller backlog of orders than it did last year. Throughout much of 2005 the industry experienced a sales slowdown that resulted in a substantial depletion of IST's backlog. However, key sales in Puerto Rico late last year and more recently in New York, as well as a very active order pipeline, seem to indicate that this sales slowdown is behind us.

Aecon ended 2005 with a greater backlog of work on hand than it had a year earlier. Backlog increased \$12.3 million or 2.2% to \$577.3 million. This includes Aecon's \$102 million share of a recent contract award for work at the Bruce nuclear station in Ontario to a joint venture in which Aecon has a 50% interest. Backlog increased over the past year in both the Infrastructure and Industrial segments, more than offsetting a decline in the Buildings segment. The decline in the Buildings segment is due largely to work-off of backlog at Pearson Airport and two other large projects in the Toronto area. Major project backlog is expected to increase by about a further US\$200 million when the Quito Airport project financing closes, likely in April of this year.

Not included in backlog, but important to Aecon's prospects, are the expected revenues from Aecon's growing alliance and supplier-of-choice arrangements, largely in the industrial and utilities sectors. As outlined earlier in this MD&A, Aecon's effective backlog is therefore greater than what is reported here.

Overall, Aecon's core markets of civil, utility, industrial and buildings construction in Canada continue to improve with further growth expected in 2006. Management believes that this strengthening of core markets along with the ongoing benefit of operational improvements now in place will result in increased margins and a positive net income for Aecon in 2006 on revenues similar to those generated in 2005.

This improved return is expected despite the fact that no income will be reported from two of Aecon's largest construction projects (the Cross Israel Highway extension and the Quito Airport) until they reach 20% completion in 2007, and despite the fact that the increasing economic value of Aecon's investments in these two concessions will not be reflected in earnings until the Cross Israel Highway concessionaire begins to pay dividends in 2009 and the new Quito Airport opens in 2010.

## **FORWARD-LOOKING INFORMATION**

In various places in Management's Discussion and Analysis and in other sections of this document, management's expectations regarding future performance of Aecon 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. Many factors could cause Aecon's actual results, performance or achievements to vary from those expressed or inferred herein, including without limitation, the ability of the Eastmain Joint Venture to recover the full value of unpriced change orders, the uncertainty intentions of Hochtief, failure to achieve the targets associated with the Quito Airport, the achievement of lower than expected volumes of work in western Canada and the failure of IST to secure anticipated contract levels. Risk factors are discussed in greater detail in the section on 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.