

ACQUISITION CRITERIA MEMO

Project Name: Reconstruction Experts

Executive:

Date: January 17, 2011

<p>Industry Description</p>	<p>Base Company provides construction defect repair services, which includes reconstruction, restoration, professional support and consulting services for residential and commercial properties. These services are typically not tied to any type of disaster, but issues are found over time due to poor original construction. The company also provides insurance / emergency restoration and reconstruction services due to floods or water intrusion, fires, storms or other disasters.</p> <p>The majority of company revenues come from litigation settlements due to construction defect cases against the original builder. The settlement payments are generally made by the original builder’s insurance carriers. Settlements paid to HOAs and property owners are typically managed by the Board of Directors of those properties and all monies are spent on repairs of the construction defects. Base Company has never run into a situation where the HOA has decided not to spend the settlement.</p>
<p>Size, Growth, Margins and Fragmentation</p>	<ul style="list-style-type: none"> • The total industry is responsible for about \$350 billion annually. • Gross Margins are between 20-40% depending on type of construction. • General construction work or repairs typically run under \$1M in size of project. • Construction Defect job size can range from \$1M to \$20+M in reconstruction/defect repairs depending on size of community and number of issues. • The market is very fragmented with small mom & pop type organizations that get enough small jobs and other work to keep their employees busy most of the year. • There are very few companies that have grown to the size of the Base Company. • Commercial Construction companies have tried to get into this market space when times are tough in their commercial market, however most companies will bid to buy the work rather than bid to win the work. They will lose money on those jobs that they win; therefore they don’t stay in this market very long.
<p>Key Industry Trends/ Opportunities</p>	<p>The key to understanding the revenue sources of this business is knowing the statute of limitations within each state for filing a notice of claim against the original builder. Each state has different statutes that determine how long a construction defect can go on before being detected and then claimed. Most construction defect cases include water intrusion and building envelope defects due to poor construction. Water intrusion is one of the leading indicators that the original contractor or subcontractors cut corners during the original building process. If water intrusion is found in one building, it is highly probable that it will be found in similar buildings.</p> <p>Changing legislation in certain states (i.e. Texas, Florida) has opened the markets up for Base Company to expand into those other states. Legislation favoring the home buyer has allowed property owners to sue the original builder for building defects that were overlooked in the past. Construction standards have increased over time and the expectation is that home buyers should not be burdened with construction defects due to poor original construction. These types of issues have in the past been taken care of through warranty claims against the original builder; however when the claims have gone unresolved property owners need another avenue to get issues repaired.</p>

	<p>Once a construction defect has been identified at a property, some state laws require that the property owner disclose any issues when listing the property for sale. This is a prime motivation for those property owners to spend their settlement money on getting those items repaired in a timely manner. Once the repair is completed, the property owner is not required to disclose the defect (there are some exceptions which would include mold and mold mitigation).</p>
<p>Key Threats/ Challenges</p>	<ul style="list-style-type: none"> • Fragmented Market: There are some key players across the nation that have tried consolidating the market through acquisitions (i.e. Belfor), however they specialize in disaster recovery type construction – not construction defect repairs. If those companies were to focus on construction defect repair, they could start a consolidation effort to buy up smaller companies like Base Company. • Poor management: Executive Management must understand the relationships and sales process to land the larger litigation settlement jobs. Needs good leadership. • Construction cycles: Cyclical construction of multi-family residential units can have an impact on the pipeline of potential jobs, however the statute of limitations provides for multi-year availability for settlements. Additionally, once the notice of claim has been filed, the actual settlement could take two to three years before the funds are available for the reconstruction. Pipeline remains strong. • Supplier pricing: Companies of this size should be taking advantage of purchasing power to negotiate preferred vendor pricing with all the large suppliers (Home Depot, Lowes, Etc.). Additionally, negotiations should also occur with suppliers of specialty products that are used in most jobs (i.e. roofing material supply companies).
<p>Key Offering Descriptions (prioritized and margins)</p>	<ul style="list-style-type: none"> • Superior Project Management: Base Company has hired some of the best Project Managers in this line of work. Processes and procedures have been put in place to track the budgets and actual costs of each job, as well as the margins by trade (i.e. masonry, roofing, etc.). Buy-out processes have been implemented to find the best subcontractor pricing offered by the most reputable subcontractors available. • Legal expertise & relationships: Base Company has an attorney on staff that worked in the construction defect arena for a period of time prior to coming inside the company. This individual has solid relationships with the local attorney practices in the Denver area. Some of these same firms have requested that Base Company follow them into other states to do business. • Home Owners Association and Property Management company relationships: Base Company has established relationships with most of the local property management companies in the Colorado Front Range area. Base Company has established relationships with some of the largest HOAs in Colorado. These relationships open the door when repairs or reconstruction is needed at any of their properties. Whether they are negotiating a contract with the Base Company, or looking for assistance to put the work out for bid (RFP) – Base Company offers assistance on all fronts for the HOAs and Property Managers.
<p>Key Markets</p>	<ul style="list-style-type: none"> • Home Owners Associations (HOAs): There were 305,600 HOAs housing 62 million Americans in 2009. These associations command an estimated \$41 billion in annual operating revenue, most of which is spent in associations’ local economies for goods and services. Additionally, these associations maintain investment accounts of more than \$35 billion for long-term maintenance needs. • Construction Defect Services: The market for these services is estimated to be over \$11 billion. Colorado alone is currently estimated to be over \$330 million. Settlement rates on defect claims typically run between 30 – 50% of the gross construction litigation claims. • Insurance / Emergency Services: The restoration and reconstruction services market is

	<p>estimated to be \$200 billion. This market is highly fragmented with an estimated 12,000 companies serving the industry.</p> <ul style="list-style-type: none"> • Specialty Services: This industry includes renovations, remodeling, roofing and maintenance services. This industry is estimated to be \$126 billion in 2010.
Job Prospecting processes	<p>Base Company has built relationships with key engineering firms, as well as all of the larger construction defect legal firms in Colorado. Many construction defect claims will begin with the engineers, attorneys or construction companies being called to investigate a lingering problem that a property owner or manager has found. Once the defect has been identified, the property owner will be directed to file a notice of claim against the original builder to get money to repair the items themselves. If the problems are large enough and wide spread through a community, it becomes a class action suit against the builder for poor construction standards.</p>
Acquisition Thesis	<ul style="list-style-type: none"> • Establish presence in new markets with repeatable model roll out. • Follow attorney and engineer partners into new states and regions. • Establish a pipeline monitoring system or protocol that follows litigation filings. • Open offices in markets that are heavy with litigation filings. • Establish relationships with attorneys and engineers working on litigation cases. • Result is platform positioned as #1 player in niche segment with above average margins and growth prospects • Growth strategy should include opening offices in target markets when jobs are identified and contracted to Base Company. Virtual offices can be opened up to get advertising and name into the markets and/or communities. Marketing events should be leveraged by Base Company to establish a presence in the market place. Educational seminars can be offered to property managers to gain their trust. • Growth strategy could include acquiring smaller mom/pop organizations in key markets to get immediate name recognition.
Top 5 Targets	<p>Key locations for new offices include Dallas, TX, Las Vegas, NV, Phoenix, AZ, Seattle, WA, Portland, OR. Additional locations would include Northern California, Houston, TX and New Mexico. Lastly, there is quite a bit of legal activity in Florida.</p> <p>A detailed target list by state can be developed.</p>
Geographic Preferences	<ul style="list-style-type: none"> • South – Texas, Arizona, New Mexico • West – Colorado, Nevada, California, Oregon, Washington • Southeast - Florida
Other	<ol style="list-style-type: none"> 1) The key management team is in place (some changes could/should be made). 2) A complete business plan is in place. 3) Satellite offices have been opened in Texas and Arizona. 4) Filings to do business in Oregon and Washington have been completed. 5) How to manage an NDA is a concern.

DISCUSSION LOG

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Next Steps and Follow-up	•