

Engineeringgrowth

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Second-quarter 2015 global engineering and construction industry mergers and acquisitions analysis

Overview

M&A activity accelerated sharply in the second quarter of 2015 with substantial increases relative to the prior quarter in both volume and value of transactions. The number of transactions of \$50 million or above increased to 64, a 73% improvement over the first quarter and 33% greater than the second quarter of 2014. With \$29.4 billion in announced deals, 2Q15 totals were well below the record \$76.3 set in the same quarter of the prior year but nearly double the five year median rate. Mega-deal activity was robust, with seven announced transactions of \$1 billion or greater in the quarter.

Economic backdrop

US non-residential construction markets continue to grow at a steady pace and indicators on housing starts and building permits indicate improving fortunes for residential builders. Investment activities in Europe have held up despite the looming uncertainty over Greece leaving the Eurozone. A flurry of transactions in the region indicate a healthy deal market in the region, with activity among both strategic and financial investors. Large construction activity in China remains muted as the persistently weakening economy remains a key concern and inhibits inbound acquisitions. Frail real estate markets are putting downward pressure on the construction segment, along with continued drop in building products (cement, steel) output. However, policy makers continue to cut rates in an effort to spur growth, offset weak capital markets, and stimulate subdued commodity prices.

The oil price collapse has been a mixed blessing from an economic perspective, supporting real income growth and a surge in consumer confidence in many regions, even as commodity price volatility suppresses energy construction and deal activity. Going forward, low oil prices and expansionary monetary policies should support modest expansion, even as lack of funding for public infrastructure remains a key risk. Pockets of construction directly tied to upstream energy projects are similarly in danger of defunding, while downstream projects remain on track. Volatility in commodity and currency prices may hamper transaction activity, obscuring the growth outlook and appropriate pricing levels. The strong dollar could drive US outbound deals in the coming months (since foreign targets have become cheaper in US currency).

M&A themes

Business restructuring and strategic alignment was among the primary drivers of M&A in the last quarter, though investor groups also had a major role. Companies looked to simplify their businesses, focus on core operations, and shed non-strategic units. Local activity dominated, particularly in recovering markets where strategic buyers see opportunities to gain scale. Interestingly, the engineering services segment saw a pick-up in volume as high premium, specialty services emerged as a theme. In fact, two mega-deals involved environmental resource engineering specialists (by investor groups, in both cases).



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Construction companies in recovering markets looked to expand scale domestically. Firms continue to develop integrated capabilities through acquisition of complementary product/service offerings. Construction companies continue to build toward an integrated capabilities model by acquiring engineering-based firms.

Additional trends that are expected to affect the value and volume of deals in the sector:

- **Consolidation of mid-size E&C firms.** We expect a pick-up in activity among mid-size firms as they scale up to compete on larger, more complex projects and build-out capabilities. As projects grow in size and complexity, mid-size firms with limited scale have the most to lose from inactivity.
- **Financial investors search for yield.** Investor groups have become increasingly active and are investing in construction and building material companies, particularly in recovering regions. Construction companies have unlevered their balance sheets and monetized assets, and some are positioned for a strong return on investment.
- **Geographic footprint expansion has stalled.** Local consolidation was the dominant theme this quarter, but we expect companies to fill market gaps through geographic expansion. Emerging markets remain the engine of long-term global growth and potential acquirers have become more selective as new baseline growth rates are established. However, interest in the more traditional markets with more stable economic conditions is getting attention with long-term investment horizons.
- **Thin margins on new work continues to be a theme in the industry.** Companies are looking for ways to consolidate, manage their costs and supply chain, and retain key personnel. Managing risk, maximizing technological advances, and developing core competencies are a focus and will become a more critical consideration in merger due diligence.

Outlook

We remain optimistic that deal activity in the E&C sector will continue at a brisk pace. The biggest challenge for potential buyers is calibrating the long-term growth themes (emerging markets and resource scarcity megatrends) with near-term volatility. Companies are reevaluating growth opportunities in major markets as they digest both the direct and indirect economic implications of the rapid deterioration in oil prices and consider the potential impact of regulatory tightening on US economic activity.

Launch the data explorer at <http://www.pwc.com/us/en/industrial-products/publications/engineering-growth.jhtml> for a deeper dive into the data, or contact us to further discuss our insights.

Sincerely,



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