

**Greg Malpass**  
January 2017

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**“I have received a fair amount of feed-back about the publicity surrounding my Report calling for UK Construction Groups to align for mergers, or get left behind in the Industry’s global consolidation. Today’s rumours about a potential tie-up between Atkins and CH2MHill don’t surprise me. I have been invited to talk with a few companies about specific M&A proposals. The Takeover Panel would require almost immediate response to any report of a possible merger involving a listed company. It’s par for the course to keep ‘rumours-rumours’ and read about the real deals, after they have been announced.”**

**Greg Malpass January 30<sup>th</sup> 2017.**



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Top firms must merge to X

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EXPERT OPINION

## Top firms must merge to break industry's vicious cycle

26 JANUARY, 2017 | BY GREG MALPASS



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16:48 26/01/2017

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EXPERT OPINION

## Top firms must merge to break industry's vicious cycle

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With some of the UK's largest contractors having posted massive losses in recent years, you'd be forgiven for thinking, 'Here we go again'.

The industry's cyclical nature, fragmented structure, low margins and project risk make sustained financial resilience challenging.

A few mainland European groups may disagree. They created and benefited from consolidation in their home markets, then proactively diversified their businesses. The combined market capitalisation of the top three French and top six Spanish is more than twice that of the top 13 UK construction groups; their combined turnover is threefold.

Closer analysis discloses some deep-rooted weaknesses in the UK construction sector. Drawing on conclusions from EY's *UK construction consolidation ahead* and Deloitte's *European Powers of Construction* reports, the analysis calls for significant consolidation to address the changes required. UK companies must start aligning themselves for M&A or overseas influence will eventually dominate.

### Consequences of failure

History tells us what happens when M&A is poorly planned: deals either fail or fair value is not derived. In the early 1990s contractors lost their perceived value in the process of company break-ups and divestments.

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Opinion

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GAVIN MCGUIRE Northern Ireland director, FMB

CITB devolution could offer solutions to ongoing debates

It's been interesting to follow the debate over the future of the CITB.

CITB Northern Ireland has always operated autonomously from CITB GB and enjoys a much better reputation in the province.

Much like the rest of the country, the Northern Ireland suffers from a chronic skills shortage. This has been a barrier to the nascent revival within the industry, which, although now rebounding, remains considerably below its pre-recession peak.

Tackling the challenge has not been helped by a tendency to slip into spells of political paralysis. It's against this challenging backdrop that CITB NI has offered a stabilising presence.

CITB NI has done a solid job in remaining reactive to the needs of industry. Led by a board of industry,

employee and educational representatives, it has been geared towards collaboration.

CITB NI has introduced training in supervision and leadership as a result of industry demand, and rolled out a programme to develop future leaders that has proved enormously popular. Another programme will also deliver 1,600 Level 2 qualifications to the industry without cost to employees.

These initiatives were not created in a vacuum. They were developed as

“There is a model CITB that is clearly working with praise and support from the firms it serves”

a result of a culture of partnership with industry that CITB NI has been proactive in cultivating, whether it's with representative organisations like the FMB or directly with SMEs.

Many of the business owners I meet speak positively about the relevance of the training on offer in Northern Ireland. Members also report that securing funding for such training is relatively uncomplicated.

This is surely a key measure of success for any industry training body and it is as clear an endorsement as any of CITB NI's effectiveness. It certainly contrasts markedly with the perception of the CITB that often appears elsewhere in the UK.

This is not to say that devolution presents a one-size-fits-all solution. The Northern Irish sector has a high number of smaller firms, to which the CITB board can tailor its offering.

However, it is interesting that, at a time of great debate over the future of CITB GB, there is a model CITB that is clearly working with support and praise from the businesses it serves.



GREG MALPASS Independent M&A construction industry analyst

Top contractors must merge to break industry's vicious cycle

With some of the UK's largest contractors having posted massive losses in recent years, you'd be forgiven for thinking, 'Here we go again'.

The industry's low margins, cyclical nature and fragmented structure make sustained financial resilience difficult.

Clear analysis discloses some deep-rooted weaknesses in UK construction, which call for significant consolidation. UK companies must start signing for M&A or overseas influence will eventually dominate.

History tells us what happens when M&A is poorly planned: deals either fail or fair value is not derived. In the early 1990s contractors lost their perceived

value in the process of company break-ups and divestments.

Poorly capitalised independent contractors then embarked on non-capital-intensive diversification, such as support services, to benefit from lower risk. Yet UK contractors have remained largely non-diversified.

In 2017 the UK market remains strong with the advent of new nuclear, High Speed 2, Heathrow expansion, Tideway and the government's housing drive.

In response, the industry should revitalise itself with mergers between the strongest UK groups to benefit from synergies and stronger balance sheets. Fewer companies, better operating

structures and more pricing power will reduce the need to underbid and can break the industry's vicious cycle. Projects will get larger and require firms with the resources and balance sheets to shoulder and manage risk.

Tideway is one pioneering project incentivising its private sector partners with its innovative government contingent support package contracts.

So who will take the bold steps to start the M&A led consolidation renaissance? Shareholder activism may play a part if die-hard boards ignore the signs. If domestic mergers do not take place, the threat of likely sources of external capital will come to bear.

Entities in south-east Asia and China in particular are no doubt interested. Sovereign wealth funds and private equity could also become a source of capital, and continental European players have the capacity to acquire. UK firms must address this threat.

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## Report calls for contractors to merge [Full Text]



The influence of the Top European Construction Companies

2015 COMPANY RESULTS	Turnover (€Bn)	Market Capitalisation (€Bn)	Profits EBIT (€Bn)
TOP 3 FRENCH	86	53	7
TOP 6 SPANISH	63	33	4
TOP 13 UK	46	41	3

**Growing overseas influence in the UK's construction market is a concern, a new report says, and Consolidation in the UK construction industry must and will happen.**

With some of the UK's largest contractors having posted massive losses you'd be forgiven for saying "here we go again." The industry's cyclical nature, its fragmented structure, low margins, and construction risk will never bode well for creation of a financially robust sector. A few mainland Europeans groups may disagree. They created and benefited from consolidation in their home markets, and then proactively diversified their businesses. The combined market capitalisation of the top three French and top six Spanish is more than twice that of the top 13 UK construction groups. Their combined turnover is three fold, and overall operating margins of the top ten exceeded 8% in 2015.

Closer research discloses some deep-rooted weaknesses in the UK construction sector. The analysis draws on conclusions from earlier reports by Ernst & Young 'UK Construction Consolidation ahead', and Deloitte's 'European Powers of Construction' in 2015, and calls for significant consolidation in order to address the changes required. UK companies are as well to start aligning themselves for M&A, or foreign influence will dominate over time.

History tells us what happens when M&A is poorly planned- deals either fail or fair value is not always derived. In the early 1990's contractors lost their perceived value in the process of company break-ups and divestments. The City no longer saw construction conglomerates as attractive. It wanted contractors to be lean, mean and cashed up. Analysts lost the will to "knuckle down" and do more maths to understand complex companies and encouraged the break-ups of well diversified asset strong businesses. They took place to the long term detriment of the sector in my view. Poorly capitalised independent contractors then embarked on non-capital intensive diversification such as support services to benefit from lower risk, and higher PE recognition in that FTSE market sector. UK contractors have however remained largely non-diversified, with a few exceptions, including the role of PFI.

There were some winners. Ray O'Rourke pulled off the legendary reverse takeover of Laing Construction for £1. Morgan Sindall inherited the bargain priced contracting business off-loaded by Amec; Hanson lent the MBO team at Kier the money to take its contracting business independent, and Wimpey gifted its construction business as a sweetener for Tarmac's asset swap of its Homes business for Wimpey Minerals. Thereafter Tarmac de-merged its contracting interests to form Carillion.

In 2017 the market in the UK remains strong with the advent of the New Nuclear Programme, High Speed 2, Heathrow Runway and Terminals, Thames Tideway and the Government's drive for more living accommodation. In response, the industry should revitalise itself with mergers between the strongest UK groups to benefit from synergies and strengthened balance sheets, and create shareholder value via some new thinking. Fewer companies, with better operating structures and more pricing power will reduce the need to underbid and break the industry's vicious cycle. Projects will get larger, and require contractors with the resources and balance sheets to shoulder and manage construction risk, and continue to participate in public private partnerships. Risk mitigation will become a driver. Thames Tideway is one pioneer mega project incentivising its private sector partners with its innovative government contingent support package contracts.

So who will take the bold steps to start the M&A led consolidation renaissance? Shareholder activism may play a part, if die-hard Boards ignore the signs. The research project starts to map out potential outcomes, but opportunities will arise, and appetites for investment will become apparent. If domestic mergers do not take place the threat of likely sources of external capital will come to bear. Entities in Southeast Asia and China in particular are undoubtedly interested. Sovereign Wealth



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Funds and Private Equity could also become a source of Capital, and Continental European players have the capacity to acquire. The next step in our research is to examine them all.

*Greg Malpass is an independent Construction Industry Analyst and author of the Industry Report: UK CONSTRUCTION CONSOLIDATION published by [www.thinkbigpartnership.com](http://www.thinkbigpartnership.com)*

### STATEMENT TO PRESS January 10<sup>th</sup> 2017 GREG MALPASS AUTHOR: UK CONSTRUCTION CONSOLIDATION REPORT

"There is no doubt that several of the UK Majors have had a 'wobbly time', of late. Chronic low margins and one-off major project losses have been the industry's Achilles heel for years- and it's high time someone shouted out 'The Emperor has no clothes.' It might be remembered that Ray O'Rourke himself picked Laing Construction up for £1 when the latter suffered a similar fate.

"Whether it's restrictive banking covenants forcing hands; forward thinking strategic leadership, or just common sense- Sir Neville Simms' Foreword to the Report concurs with the prediction that Industry M&A led consolidation must and will happen. Only then will UK Construction Groups have the Balance Sheets, and perhaps leadership, to look not just to consolidation and margin restoration- but to the future with diversification into higher margin long-term businesses (and finding finance for it) in mind. Some mainland European Groups have been impressive trail-blazers in this regard since the 1990s, and having fallen behind in the pack, a sell-out of any major UK construction group to a Chinese contractor, especially if at a bargain price, would be a travesty, and likely focus on more of the same in the UK- low margin contracting!



Industry Report is posted to website: [www.thinkbigpartnership.com/services.html](http://www.thinkbigpartnership.com/services.html)

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24 JANUARY, 2017 11:37 AM

TODAY'S PICK

Top firms must merge to break industry's vicious cycle



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## Article in Construction Index January 13<sup>th</sup>, 2017

**The UK construction industry needs some of its biggest contractors to merge, a new report says, and prime candidates include Costain and Interserve.**



In the face of growing overseas influence in the market, UK construction industry consolidation is needed, the report says.

Greg Malpass, construction industry strategist, former corporate development executive at Taylor Woodrow, Tarmac and Wimpey, and now an independent mergers & acquisitions analyst, has produced a 360-page industry research report calling for UK contractors to merge to make them better able to compete against overseas competitors.

The report analyses how the UK's biggest contractors struggle to match up to the European majors like Vinci, Skanska, Bouygues and ACS and how consolidation would strengthen them.

The call for consolidation is supported by industry veteran Sir Neville Simms, chairman of Thames Tideway, and previously chief executive of Tarmac and chairman of Carillion, who writes in the foreword: "British contractors are in danger of missing out on major international projects in the future, if they lack the financial muscle and diversity of say a £15bn-a-year contractor to handle the more complex projects."

On the premise that further consolidation in the industry "must and will take place", Sir Neville predicts that "increased market share, more innovation, improving profitability and more certain returns to shareholders should lead to a construction sector that in the future is both financially and operationally stronger."

In his report, Greg Malpass writes: "With an industry plagued by wafer-thin margins and some top construction groups declaring massive losses in the last three years (eg Balfour Beatty, Laing O'Rourke) it is no longer enough for major UK companies to focus on sustaining industry standard margins."

The industry's structure, contractor risk, and pressure on margins is holding back what are otherwise favourable infrastructure and housing sector outlooks already starting to get populated by leading European and global construction groups which operate in a different league in terms of size, financial strength and diversity, he argues.

The report concludes that consolidation will be best achieved by mergers between the strongest UK groups to benefit from synergies and strengthened balance sheets; followed by a new era of capital raising, investment and diversification strategies into higher margin expanding non-contracting and international activities, exemplified by companies such as ACS and Ferrovial of Spain, and Amec-Foster Wheeler.

Mr Malpass says that Costain has been continually punching above its weight since its near demise in the early 1990s. He says: "But its days as an independent company are probably numbered now the supportive minority shareholders have diluted their holdings and their nominees have left the board. With its cash position deteriorating somewhat, and future acquisition aspirations of any substance waning, surely it's time to seek to be positively acquired by a larger financially robust partner who can help it back into a Tier 1 position it deserves, given its unquestionable engineering capabilities."

Interserve is also identified as a likely merger proposed: "Interserve is a good candidate for merger to form one of the top tier construction groups in the UK. Due to its low market capitalisation, it could otherwise become an acquisition target."

Carillion also needs to merge with someone, he argues. "There are compelling reasons why Carillion should find a large merger partner. But focusing just on Balfour Beatty's woes since the failed merger in 2014 does not do justice to both sides of the argument. Two years since the failed buy, Carillion's margins have declined at the operating level. Net borrowing is higher than expected and a weak pound hurts, as Carillion's private placement borrowing is denominated in US dollars."

And the same goes for Balfour Beatty: "Balfour Beatty needs to proactively get successfully acquired or merged, asap. That way it can easily achieve synergistic savings, and provide a compelling investment case for shareholders regarding the future direction and success of the company. While it is focusing on retrenchment and consolidation in its core contracting businesses, it does not have the luxury to do what it needs to do for the longer term, which is to put in place a strategy, and the financing, for future diversification outside contracting."





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**REPORT MESSAGES**

## Report Foreword by Sir Neville Simms

### The Key Messages from the UK..

“UK Construction Consolidation Ahead”



**Sir Neville Simms FEng**

“ Industry Consolidation must and will take place....and company strategies that lead to increased market share, more innovation, improved profitability and more certain returns to shareholders should lead to a sector financially and operationally stronger.”



Source: [www.thinkbigpartnership.com](http://www.thinkbigpartnership.com) UK CONSTRUCTION CONSOLIDATION

## A few Mainland European Majors dominate the market

### European structural in-balance 2015

<b>TOP 5</b>		<b>EUROPEAN INDUSTRY STRUCTURE</b>	
<u>Market Capitalisation (€m)</u>		<u>(Turnover €m)</u>	
VINCI	34.8	TOP 3 FRENCH COMPANIES	85.8
FERROVIAL	15.3	TOP 6 SPANISH COMPANIES	63.1
BOUYGUES	12.6	TOP 13 UK COMPANIES	45.7
TAYLOR WIMPEY	8.9	<u>(Market Capitalisation €m)</u>	
ACS	8.5	TOP 3 FRENCH COMPANIES	52.9
<u>Turnover (€m)</u>		TOP 6 SPANISH COMPANIES	32.6
VINCI	38.5	TOP 13 UK COMPANIES	41.4
ACS	34.9	<u>(Profit: EBIT €m)</u>	
BOUYGUES	32.4	TOP 3 FRENCH COMPANIES	6.6
FERROVIAL	9.7	TOP 6 SPANISH COMPANIES	4.0
TAYLOR WIMPEY	4.3	TOP 13 UK COMPANIES	3.1
<u>EBIT (€m)</u>			
VINCI	3.8		
ACS	1.4		
FERROVIAL	0.9		
BOUYGUES	0.9		
TAYLOR WIMPEY	0.9		

UK Industry is more fragmented at the Top, and UK Companies lag behind the European Leaders, in size, value & profitability, with only Taylor Wimpey featuring in Top 5.



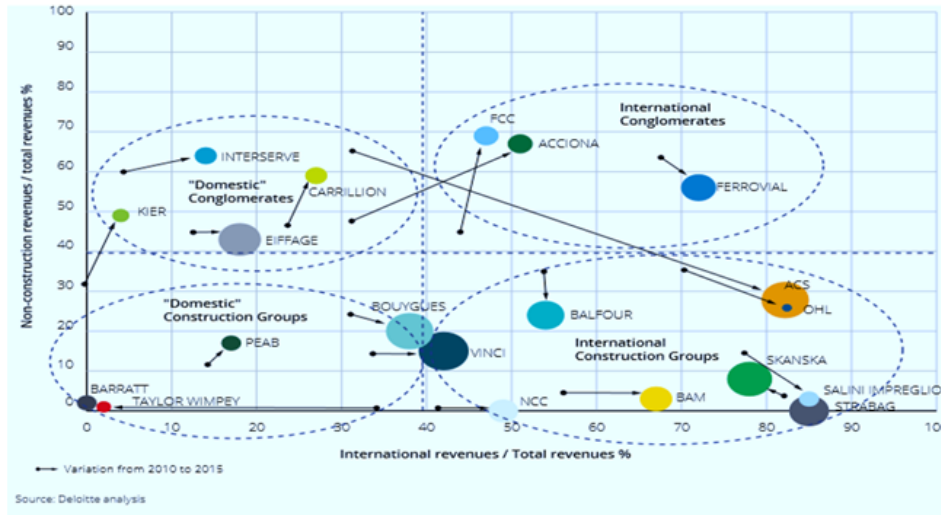


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Source: Deloitte & Annual Reports

## The Target is European levels of Diversity

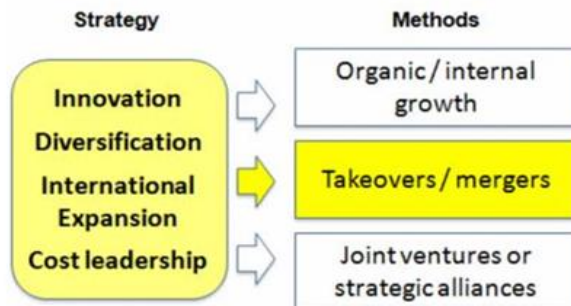


Those who have become diversified International Conglomerates lead in Europe



Source: Deloitte- European Powers of Construction

## It will only be delivered via M&A



Consolidation of the UK Construction Industry will not be achieved by companies' organic restructuring







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## Major UK Groups will emerge from Top 15



Source: EY

- Balfour Beatty
- Carillion
- Interserve
- Laing O'Rourke (Private Co)
- Kier Group
- Taylor Wimpey
- Morgan Sindall
- Vinci/Taylor Woodrow
- Amey Uk/ Ferrovia
- Galliford Try
- BAM
- Bouygues
- Skanska
- Costain
- Dragados

### Top 5 Listed Companies

Balfour Beatty

Carillion

Interserve

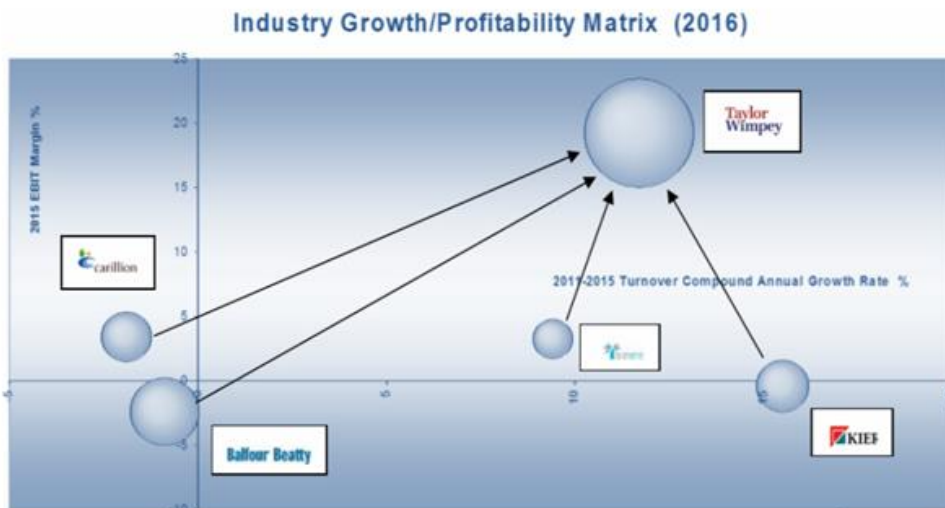
Taylor Wimpey

KIER

Top 8 UK Listed candidates for UK Mergers are: Balfour Beatty, Carillion, Interserve, Kier, Taylor Wimpey, Morgan Sindall, Galliford Try, & Costain



## Taylor Wimpey sets the UK (Financial) Benchmark



Taylor Wimpey is a non-diversified UK Housing Company, but the only European UK Player in financial terms, and an obvious Partner for M&A.



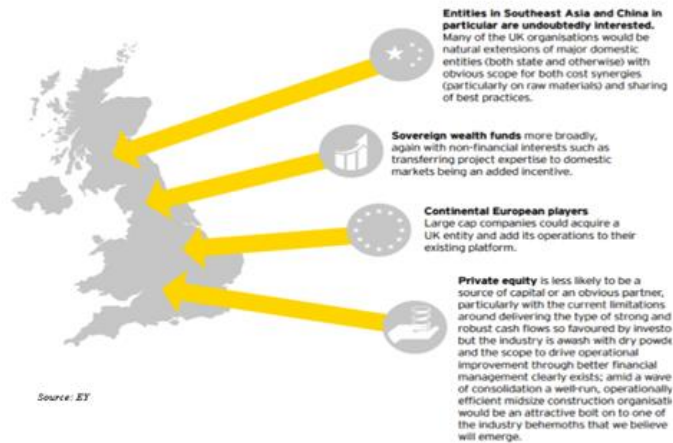


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## Possible Sources of External Capital



If UK Companies do not merge, changes may be dominated by flow of External Capital



Source: Ernst & Young

## 4 Stage Review being undertaken by 'Think Big Partnership'

### 4 Stage Review

**The UK needs to address Structural Reforms**

	T/O (€ Bn)	MKT CAP (€ Bn)	EBIT (€ Bn)
TOP 3 FRENCH	85.8	52.9	6.6
TOP 6 SPANISH	63.1	32.6	4.0
TOP 13 UK	45.7	41.4	3.1

Research UK Merger & Strategic Global Finance Options

**The Top 8 Listed UK Plc**

Taylor Wimpey (TW)
Balfour Beatty (BB)
Carillion (CAR)
Kier (K)
Galliford Try (GT)
Interserve (IS)
Morgan Sindall (MS)
Costain (COS)

**The Top 10 of 84 Possible 2 or 3 way Merger Scenarios**

BB/CAR
K/IS
GT/IS
GT/K
MS/IS
TW/BB/CAR
K/CAR/GT
K/CAR/IS
GT/K/IS
K/GT/TW

**The Top 2 – 3 way Merger Scenarios**

Taylor Wimpey
Balfour Beatty
Carillion
Kier
Galliford Try
Interserve

**Potential Sources of External Capital**

Entities from China & SE Asia
Sovereign Wealth Funds
Mainland European Companies
Private Equity



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