

"A CALL FOR RETURN OF DIVERSIFIED CONSTRUCTION GROUPS- BACK TO THE FUTURE"

Why have you been promoting Mergers and Acquisitions in the industry?

As the saying goes, "One shouldn't be half-hearted about blazing a personal trail or endeavour." After a career in executive positions with International Construction Groups, in 2016 I set up as an independent M&A construction analyst and launched an industry wide campaign for top groups [to consider mergers to stop the viscous circle in the industry](#). I published a 360-page Research Report entitled "[UK Construction Consolidation 2017-2022](#)" on my website in January 2017. There is plenty of analysis in the report, and I contacted most of the CEO's of the major companies, to discuss. The reaction was mixed, many being defensive of their current strategies, although Carillion were quite responsive.

So, what's the problem that needs addressing at the industry level?

Low margin, high risk businesses need balance sheets and plenty of reserves. While the global consulting engineers sector has been consolidating, construction/ contracting sectors have been suffering from the effects of break-ups or demise of the well diversified and capitalised British groups in the 1980's and 1990's - such as Trafalgar House, Tarmac, Wimpey and Taylor Woodrow, Amec, P&O/Bovis, BICC/Balfour Beatty, John Laing, Costain and John Mowlem. Some could have weathered storms maybe better had they stayed in their same form, or grown through synergistic mergers. Those who are now pure contractors and support services businesses are generally poorly capitalised, and remain at risk of effects of project losses on their balance sheets, as adequately demonstrated these last two years of profit warnings. Those who became pure housing businesses are equally exposed to the effects of a cyclical economy on value of land banks, and house prices and demand.

And apart from recent losses and weakened balance sheets, what's the problem at the company level, in your view?

Private companies can legitimately be run by owners. Public listed companies need proven professional managers who know their business and understand how to manage the city. I see nothing to convince me that contractors have moved forward since I worked for some of the British majors listed above. Management behaviours, management competencies, ability to turn volume into cash backed profit consistently and at a margin level which leaves room for errors and unforeseen risks, all seem to have gone backwards rather than moved forwards. The Boards of some UK construction companies lack either the necessary industry skills or business acumen. The industry is crying out for new leadership to lead M&A strategies. At Carillion, this might be forthcoming from an acquiring company. CEO's of international standing are needed who are capable of leading future large, diversified and well capitalised construction groups and putting the UK back among the top European and International company rankings.

What about changes on the client's side?

Major contractors' losses have occurred despite clients having embraced contract styles, target cost, pain/gain sharing, alliancing, and better budgeting and estimating themselves, which should have meant there was more money available for competent contractors to make a decent return. Even "safe", mostly negotiated, at least in part, longer term, "predictable", services contracts are now causing areas for concern especially in terms of future cost estimates.

How will Mergers and Acquisitions solve these industry and company problems?

Consolidation provides synergies and cost saving opportunities without throwing the baby out with the bath water. It reduces competition, enlarges the client base and attracts the very best management. It is one of the very last possible solutions to an industry which otherwise will continue to struggle, and lose out to foreign competition in building the UK's infrastructure. What's going on now appears to be a slipping back to a very unsatisfactory place.

What's your view of the future of Carillion?

CN ran an expert opinion article on 13th July where I explained how [Carillion's woes prove the urgent need for industry M&A](#). But with respect to Carillion specifically, how an asset poor company racks up such a massive debt is frankly beyond me. As I said I think the business model offers a good up-side for an acquirer, but the losses and debt have to be shouldered by a bigger player to ensure both survival and growth. There is a lot at stake for the industry, banks, clients, suppliers, sub-contractors and shareholders alike. Interim management under the leadership of Keith Cochrane has its work cut out.

In terms of potential acquirers' interest, the jury is out until all the bad news and turnaround ideas and plans on stemming project losses, reducing debt and improving cash collection, debt-equity deals, and cash generation via a rights issue are on the table. Only then will the share price finally stabilise. Analysts and shareholders remain concerned about the serious dilution an estimated £500 rights issue may involve, counterpart risk as clients assess their exposure, and further write-downs as interim management and advisers potentially uncover further project losses.

No doubt several would-be acquirers have made representation to Lazard's, EY, or the Chairman Philip Green, but current management focus is on the balance sheet issues. I as an M&A analyst have personally canvassed expression of interest for more information from most of the major UK, Spanish, German, Middle East and Chinese players, as well as Sovereign Wealth Funds, and international conglomerates.

A UK acquirer would need a strong balance sheet and cash and strategic intent to make a bid. So far, no Group has publicly declared interest. In my Industry Research Report issued in January I speculated on several examples and scenarios. One included acquisition by Taylor Wimpey, using its financial strength to diversify outside its reliance on housing. This would turn it potentially into a fast-growing hybrid housing/construction/support services/ PPP company with a broad portfolio of cash generative and cash consuming businesses. Despite meeting with a Board member in April, the idea was rejected based on weakness of the strategic argument, and lack of management knowledge in those sectors. Analysts concur generally that shareholders can diversify their portfolios better than companies. But cash backed profit is king to survival and growth. As I said, it is the break-up of hitherto diversified and well capitalised groups that I believe has partially contributed to the perennial dilemma the UK major contractors face. If Taylor Wimpey were to acquire the financially struggling Carillion, at worst it might act as a poison pill to stave off any future predator, and at best the new well capitalised and diversified group would be the industry leader, representing the best combination and legacy of several big UK names and skill sets, including Taylor Woodrow, George Wimpey, Tarmac Construction, John Mowlem, and Alfred McAlpine. No doubt there would be a need to draft in new management and a formidable industry leader in construction, not to divert Taylor Wimpey incumbent management focus on housing, and convince the City that the combination would work.

I make my case to the industry and management with potential to revive the UK's construction sector and take a long-term view. Inspirational leaders - who take long term decisions, and look beyond their focus on their own typical five-year terms of office, bonuses, and managing the City's short-term view and influence - will prevail if the industry is to transform itself.

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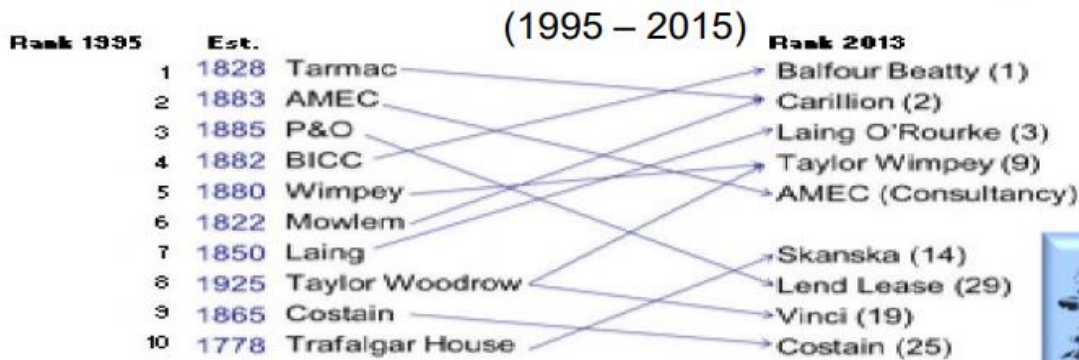
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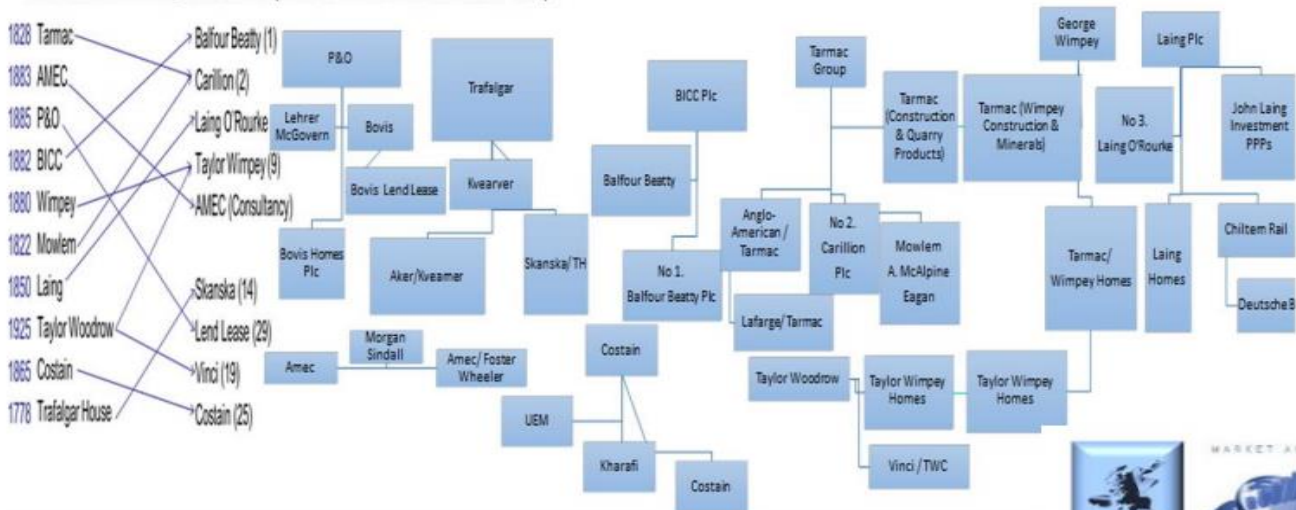
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