EXPERT OPINION

Carillion's woes prove the urgent need for industry M&A

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Greg Malpass

COMMENT

Carillion's current crisis shows it is time to address the elephant in the room.

Earlier this year, in a report on construction consolidation, I called for top groups to consider mergers to stop the vicious circle in the industry.

Laing O'Rourke boss Ray O'Rourke referred to this circle in an interview with *CN* in March as a "need to stop the race to the bottom."

In recent years, Balfour Beatty, Capita, Galliford Try, Interserve, Kier, Laing O'Rourke, Mitie and Serco have all experienced project losses and some have issued profit warnings.

I spoke with several chief executives, overseas investors and hedge fund managers (who were shorting Carillion's stock), and continued to cry out from the rooftops for urgent, synergistic M&A deals.

With open-book deals, due diligence on ongoing projects can be conducted, joint valuations agreed, and synergy strategies put in pace to stem cash outflows that might damage balance sheets.

Contractors under threat

Consolidation of the UK industry will not be achieved by companies' organic restructuring. If UK contractors retrench, continue to seek independence and duck and dive future one-off losses, in a few years they may cease to exist.

> "Investors will want to know where the floor for the shares is, as well as understanding the company's equity story for the future"

The UK needs contractors as well as service support companies to build its infrastructure. UK companies seriously lag behind their European rivals in size, value and profitability – and the ability to weather cyclical storms.

In a foreword to the same report on construction

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consolidation, industry veteran Sir Neville Simms said: “Industry consolidation must and will take place, and company strategies that lead to increased market shares, innovation, improved profitability and more certain returns to shareholders should lead to a sector financially and operationally stronger.”

At Carillion, it has proved to be too late in the day.

Writing on the wall

Before it had issued a profit warning, the hedge funds were quietly assessing the signs of strain: disproportionate growth in trade receivables; poor cashflow performance; funding of dividends from disposal proceeds; high debt levels and pension fund deficits; and aggressive payment terms with suppliers.

The writing was on the wall and it was too late in the day for a defensive mega-merger to prop up the balance sheet and overt this week’s share price crash.

If fundraising is now the solution to the company’s short-term problem, it may want to take its time in the preparation.

Investors will want to know where the floor for the shares is, as well as understanding the company’s equity story for the future. Convertible bond debt instruments may be traded in return for part of nominal value in cash, or converted into shares.

Either way, its future ability to secure bonding for projects and achieve growth will be impaired while it sells off businesses and re-organises.

Notwithstanding Balfour Beatty’s resurgance, maybe now is the consolidation moment for Carillion – as prey rather than predator.

Greg Malpass is an independent M&A construction industry analyst, author of UK Construction Consolidation and managing partner of thinkbigpartnership.com