European Construction Monitor

2015-2016: PE firms aim for European construction market

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1. Introduction

We are pleased to present the fifth edition of the European Construction Monitor, which looks at the latest trends and issues in mergers & acquisitions (M&A) in the European construction industry. This 2015-2016 publication complements the "European Powers of Construction" (EPoC) of 2014, a Deloitte research paper examining the status of major European-listed construction companies.

Market trends: ongoing international focus and supply chain pressure

Since 2013, our Real Estate experts have increasingly reported signs of market recovery in most of the local European construction markets. Market recovery is also reflected in the drop of insolvencies in the construction sector. In contrast, the number of deals in the European construction market has been relatively stable over the last years. In 2015, 129 deals were recorded compared to 128 in 2014. However, share of cross-border deals has increased to approximately 55%. This reflects the ongoing trend of European construction companies striving for international growth. Further analysis of the cross-border deals shows US-based private equity and Real Estate management companies to be the most dominant inbound intercontinental bidders.

An emerging trend in the recovering European construction market is the pricing pressure on labour and materials. In 2014, supply chain pressure was most evident in the UK and Ireland. In 2015, signs of supply chain pressure were picked up in the Netherlands and Germany as well. Anticipating increased labour costs and tougher competition, construction companies may seek to integrate their supply chain and might even abandon their model of subcontracted labour for a model of traditional employed labour. In Germany the strategy of supply chain integration is evident in the M&A activity. Our experts in Germany have noticed a focus on vertical M&A activity: mid-sized contractors seeking to acquire smaller targets like design engineering practices, glass fiber processors, or other niche businesses in order to integrate more downstream activities in their portfolio. We expect to see the same pattern of M&A activity in other recovering markets across Europe.

This European Construction Monitor analyses the market trends in the European construction industry by looking back, but also by looking forward. Deloitte has combined these analyses with the in-depth, local knowledge of its European member firms on M&A, real estate, construction and infrastructure to produce this outlook.

Highlights in this publication

- The number of deals slightly increased in 2015 (129) compared to 2014 (127).
- In 2015 over half of the deals where cross-border and the amount of cross-continental deals (Deal with EU target or acquirer) was the highest of recent years (36).
- The average PE deal size in 2015 rose sharply due to mega deals of e.g. Qatar Holding and Russian private investors. In contrast, disclosed strategic deals showed a sharp reduction in average deal size.
- The number of PE deals continued to rise in 2015 and in 27% of the deals PE firms were the acquirers.

2. Looking back

The European construction sector recorded 129 deals in 2015, slightly up from the 127 deals recorded in 2014.

In line with the 2014 monitor we have not only analysed the M&A activity of construction companies but also looked at installation, engineering and infrastructural companies involved in the construction sector. By including these in the sample size, a comprehensive picture of M&A activity within the construction sector can be presented, including trends like diversification.

Developments in 2014-2015

In last years' monitor, we expected a more dynamic M&A environment with a relatively stable number of M&A deals in line with the trend observed since 2010. This seems to be holding true for both 2014 and 2015.The increased focus on generating revenues abroad remains a major issue for the larger European construction companies, while supply chain pressure is observed in their recovering local construction markets, as subcontractors are rapidly increasing prices. As expected, the number of PE deals has increased over 2014 and 2015.

M&A deals within the European construction sector remained stable over 2014 and 2015: 129 recorded deals in 2015 compared to 127 recorded deals in 2014.

When analysing the 2010-2015 period using the broader definition of construction, we have noticed a relatively stable level of M&A activity: the number of deals fluctuated between 126 and 148 per year, with an average of 134. This makes 2014 with its 127 deals and 2015 with its 129 deals years on average. We do not expect this trend to change much in 2016. The ongoing recovery in local construction markets may result in a rise of the number of deals compared to the last few years.

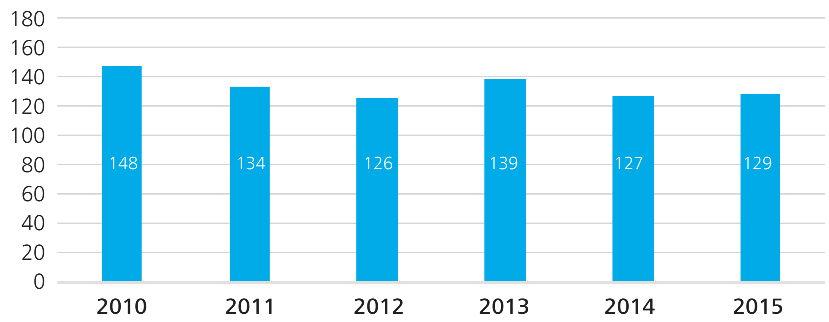


Figure 1: Number of deals in the construction sector (Source: Mergermarket, 2015)

Compared to an average deal size of approximately €350 million in 2013, the average deal size has dropped over 2014 and 2015. In 2014, the average deal value of individual transactions recorded was €253 million. In 2015, the average deal size of disclosed transactions slightly increased to €262 million. Notably, the deal size of strategic buyers was relatively high in 2013, averaging €389 million. This dropped to an average of €63 million in 2015. A strategic buyer is a company that looks for synergy in the target company. The average deal size of PE deals, on the other hand, increased sharply to €675 million. It should be noted that this increase in deal size was due to several major disclosed and other transactions.

In last year's monitor, we reported an increase in two different kinds of deals. Firstly, we saw an increase in the acquisition of operating companies, such as airport, toll road and parking operators, through which companies diversify away from the core construction business. These add-on deals were relatively small in value. Secondly, we saw an increase in the acquisition of entire construction companies and the acquisition of stakes in construction companies, mainly on a cross-border and cross-continental basis. These deals were generally higher in value compared to add-on acquisitions.

We mainly see a continuation of the latter trend over 2015. Furthermore, we noticed an increase in relatively small-sized deals concerning the acquisition of designing and engineering services firms by larger construction companies. These acquisitions may be considered to be deals to strengthen the core business. A reason for the increase of these deals can be found in the recovery of most local commercial and residential construction markets. Hence, construction companies are strengthening their core businesses to be able to profit from the upturn in local construction markets.

French builder VINCI expands its airport operations

In December 2015, VINCI Airports, a subsidiary of the French construction company VINCI, acquired the Dominican company AERODOM from an international private equity firm. AERODOM holds a concession contract with the Dominican government to operate six airports in the Dominican Republic. The deal signifies the diversified growth strategy of VINCI.

(Source: Nasdaq.com)

Selection of deals throughout Europe

Bidder origin	Description
Turkey	Renaissance Construction has acquired Netherlands-based Ballast Nedam N.V.
France	GCC SAS has acquired an undisclosed majority stake in Societe de Travaex et Construction, a French-based construction company
France	Vinci S.A. has agreed to acquire a 20% stake in Colombia-based Constructora Conconcreto S.A. through a capital increase.
Netherlands	OPSEU Pension Trust and Universities Superannuation Scheme Limited, PGGM N.V., a Dutch pension fund, have acquired GlobalVia Infrastructuras S.A. together.
Netherlands	Dutch Infrastructure Fund has acquired a 46% and a 75% stake, respectively, in concessions for the development of the M4 and M3 motorways
Belgium	Cordeel Group has acquired Imtech Belgium
Italy	Salini Impregilo S.p.A. has acquired the US-based The Land Construction Corporation, which is specialized in civil construction services
Switzerland	Implenia AG, a listed construction firm, has acquired Bilfinger Construction GmbH
Russia	Gazprombank and United Capital Partners have acquired Stroygazoconsolting (construction, infrastructure, rail, oil)

Market recovery

Since 2013, our experts have increasingly reported signs of market recovery in most of the local European construction markets. Although some of the European construction markets are recovering, the construction industry in Europe still experiences a squeeze on profits and cash flows due to supply chain pressure and limited availability of bank financing for the industry. Consequently, we observe an increase in M&A activities from international investors targeting Europe. In 2015, 18 inbound intercontinental deals were recorded, compared to 11 in 2014.

The number of insolvencies can be seen as a reflection of the market recovery. In last year's monitor, we reported a stabilization of the number of insolvencies in the construction sector in both Western Europe and Central and Eastern Europe. Over 2014 the number of insolvencies showed a significant drop.

The figure below shows a significant drop of insolvencies in the construction sector compared to 2013. In 2014, the number of insolvencies in the construction sector in Western Europe dropped by 5.8%. In Central & Eastern Europe, the number of insolvencies in 2014 was 5.3% lower compared to 2013. Fuelled by the recovery of most of the European construction markets, we expect that the number of insolvencies has dropped further over 2015.

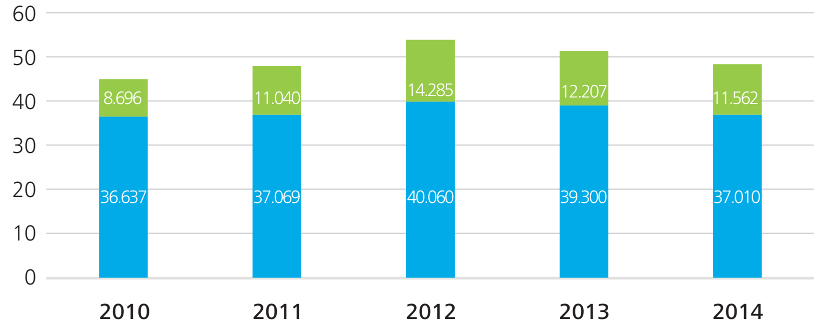


Figure 2: Number of insolvencies in the construction sector (based on Creditreform.de)

The European construction market has not changed significantly. Last year's identified trends in the construction monitor have materialised and they are expected to continue in 2016. We still observe the ongoing trends of internationalisation, involvement of private equity, and supply-chain pressure in the European construction market. The following section will elaborate more on these trends.

Trend I: Ongoing international focus

The figure below shows the percentage of cross-border deals as share of the total number of deals recorded in the construction sector. The number of cross-border deals has grown to 71 deals in 2015, up from 63 recorded deals in 2014 and 53 in 2013. The increase in cross-border deals over the last years reflects the increasing international focus in the construction sector, mainly driven by the lack of growth in domestic construction markets.

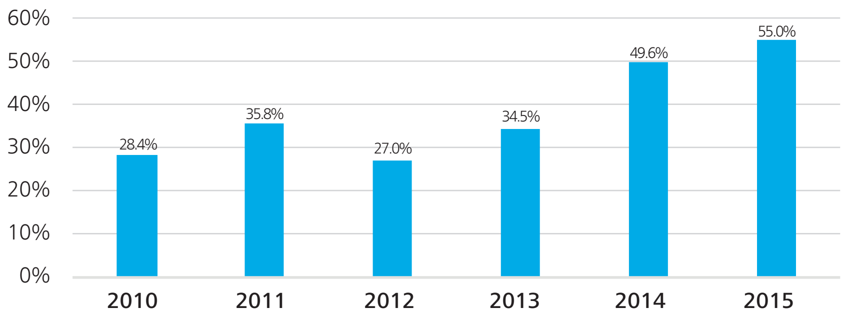


Figure 3: Percentage of cross-border deals (Source: Mergermarket, 2015)

Outbound intercontinental deal

In 2015, the listed Ireland-based construction company CRH, has acquired US-based C.R. Laurence Co. for a total deal value of approximately $1.3 billion. C.R. Laurence Co. (CRL) is a company engaged in designing, engineering, manufacturing and supplying architectural hardware for glazing in construction and other industries. The sale of CRL was run as an auction.

The focus on international and intercontinental markets by European construction companies is not only shown by the number of cross-border deals but also by the revenues generated from foreign markets. The Deloitte publication "European Powers of Construction" (EPOC) showed that the 50 largest listed European construction companies generated about 52% of their revenues abroad in 2014. As market conditions in the domestic markets are improving, we do not expect the share of revenues generated abroad to drastically increase in 2015 and 2016, as the increase of revenues generated from foreign markets is relative and triggered by a decline in domestic revenues.

Intercontinental deals

In last year's monitor, we described the significant share of intercontinental deals in the total of cross-border deals. In 2013, the number of intercontinental deals in which a European construction company was involved, totalled 27, which accounted for 19.4% of total deals (139). In 2014, the intercontinental deals accounted for 22.0% of the cross-border deals, totalling 28 intercontinental acquisitions. In 2015, the number of intercontinental deals increased to 36, 27.9% of the total number of cross border deals.

Of these 36 intercontinental deals in 2015, 18 were reported as outbound. In 2014, 17 of the 28 intercontinental deals were considered outbound. The number of outbound intercontinental deals is a reflection of the trend of focussing on generating revenues abroad. As growth in most of the European construction markets remains limited, larger construction companies move their focus to other continents.

Outbound target markets

Further analysis of the outbound intercontinental deals shows that North America and Asia are the main target markets for European construction companies. The figure below provides an insight into the outbound target markets over the period 2010 to 2015.

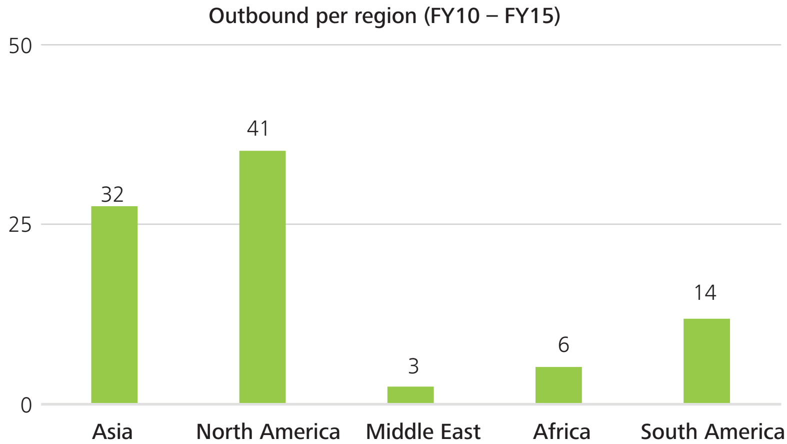


Figure 4: Number of outbound deals per region (Source: Mergermarket, 2015)

The amount of outbound deals targeting North American construction companies proves that most multinational construction companies tend to focus on stable target markets for their international expansion. Australia (8 deals) and India (16 deals) account for a large share of the outbound intercontinental deals targeting Asian construction companies. Australia represents stable legal and economic figures. The interest in India's construction market is mainly based on the historic ties between the UK and India. UK-based construction companies account for the main share of the outbound acquisitions in India.

Historic ties between countries are also reflected in the intercontinental deals targeting South American (14) and African (6) companies. For instance, Portuguese construction companies are mainly focussing on the Brazilian and Angolan construction markets, while French-based Eiffage is focussing on construction markets in Africa and the Middle East.

Inbound intercontinental deals
In 2014, 11 of the 28 intercontinental deals were reported as inbound. In 2015, the number of acquisition of European construction companies by businesses from other continents increased to 18, accounting for 50% of the total number of intercontinental deals.

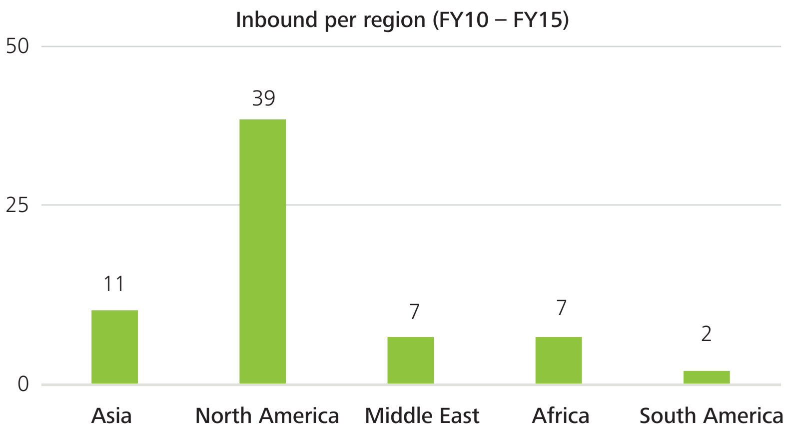


Figure 5: Number of inbound deals per region (Source: Mergermarket, 2015)

Intercontinental inbound PE deal

In 2014, Ares Management LCC, a US bases asset management and private equity firm, acquired a majority stake in London Square Limited, a company engaged in development of residential real estates, from Graphite Capital Management LLP, for a value of £110 million.

The figure above shows the origins of the bidders targeting the European construction market over the period 2010-2015. By far most of the companies targeting European construction companies are based in North America. Over the last 5 years, 11 acquisitions are made by Asian construction companies.

The activity of US-based businesses in Europe can be considered to be remarkable, as US-based construction companies are not known for their international orientation. The total of 30 inbound acquisitions since 2010 shows that US companies are the most active players on the European construction market. Further analysis of these inbound deals shows these bidders are mainly private equity or real estate management firms. A total of 14 acquisitions were made by private equity firms. These deals by US private equity firms account for 46.7% of the total of inbound US intercontinental deals since 2010. This figure is relatively high, compared to the 26% average share of PE deals in the European construction sector since 2010.

Private equity stake deals

BPI France SA and BNP Paribas Development SA have acquired a 20% stake in GCC SAS, the France-based construction company. The transaction was financed with €40m senior debt. GCC reported revenues of €683 million for the year 2014.

Trend II: Private equity

Over the last years, we have reported an ongoing increase in the number of deals by private equity companies in the European construction sector. Investment in the construction sector by private equity firms has been picking up in recent years. Activity increased in 2012, though it was not backed up by a corresponding number of deals. Since then, the percentage of deals has almost doubled to 27% in 2015, up from 10% in 2012 and 19% in 2013.

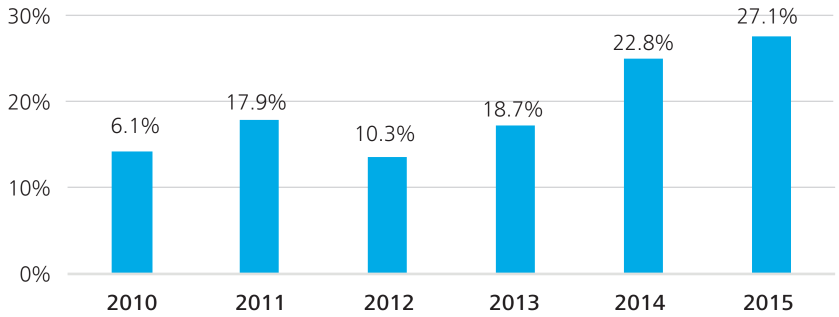


Figure 6: Percentage of PE deals (Source: Mergermarket, 2015)

Private equity

In 2011, private equity firms were generally acquiring business units and unique construction companies to add to their current business offerings. In 2012, they switched to funding construction businesses. In 2013, there was yet another switch, to long-term infrastructural projects and venture capital financing.

Over the past years, the pure construction services companies gained renewed attention from PE, with 15 deals recorded in 2015 compared to 8 in 2013. The improving construction market directly impacts the construction services sector due to the shorter lead time of projects. Combined with new projects started by construction companies the services sectors stands to benefit. Additionally, the supply chain pressure in the construction sector will most likely continue to improve the pricing in the construction services sector. PE acquisitions in the sectors heavy construction and residential construction remain relatively stable. Furthermore, PE invests mainly in specialised companies Only an average two deals where PE acquires a diversified construction company are recorded per year. Additionally, when PE does invest in diversified companies this is mainly to acquire a minority shareholding.

In 2015, PEseems to be more prominent in countries with a positive outlook for the construction market in the near future. Take for example Poland, in 2015 PE invested about PLN 718m (€175m) in GTC S.A. (LoneStar) and PLN 1.2 bn (€289m) in Echo Investment (Oaktree Capital Management). We expect the trend of acquiring Polish construction companies by large global asset management companies or global private equity houses to continue, as they seek to capitalize on the promising market perspectives in Poland.

Besides the fact that private equity seems to become more active in the construction sector, it invests in the largest deals as well. Over the past years, the average PE deal size was between €200m to €300m.The 2015 average deal value of disclosed PE deals is €675m compared to €63m of strategically oriented deals. The €675m average in 2015 is strongly impacted by a couple of billion dollar PE deals, including the acquisition by Gazprombank OAO of Stroygazconsulting LLC, a Russia-based company developing large-scale construction projects, for approximately €6.6 billion.

The outlook for most of the European construction sectors is either stable or positive. Hence, we expect the trend of acquiring construction companies (especially construction services companies) by private equity houses to continue in order to capitalize on the improving market perspectives.

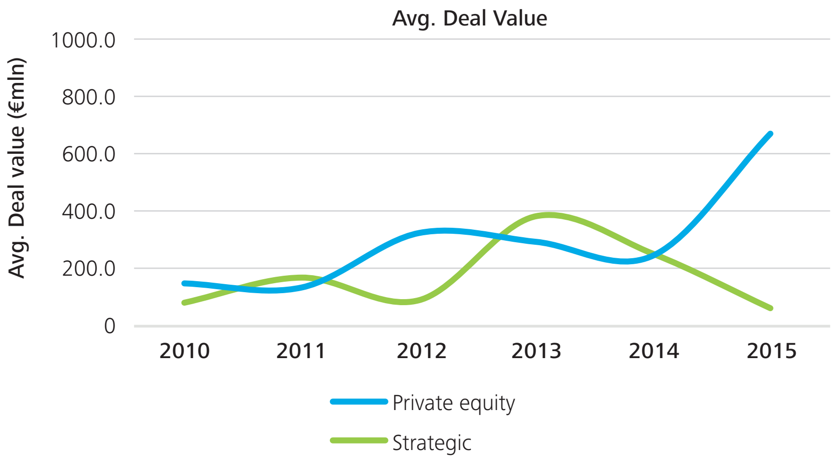


Figure 7: Average deal value

Trend III: Supply chain pressure

Last year our experts noted the first signs of supply chain pressure in Europe's recovering construction markets. Although macro-economic figures improved and demand for construction output was increasing on these markets, this did not lead to recovering operating margins for major construction companies. While construction output volumes grew, operating margins remained under pressure.

This pressure was due to subcontractors sharply increasing their prices. The economic downturn has hit the construction sector hard, leading to insolvencies and layoffs. Now, as markets recover and demand for construction increases, it is a challenge to attract sufficient labour and subcontractors with the right capabilities. The shake-out of small and mid sized specialized subcontractors during the years of crisis, has so far proven to be a brake on the recovery of the construction sector. The year 2015 did not change this.

In 2014, supply chain pressure was most evident in the UK and Ireland. In 2015, signs of supply chain pressure were picked up in the Netherlands and Germany as well.

On the back of the supply chain pressure tender prices are increasing. In the UK tender prices increased to 4.0% in the first half of 2015[1]. Over the same period tender prices in Ireland increased by 2.6%[2]. The tender prices are expected to increase further during the course of 2016 and 2017. Countries like Germany and the Netherlands show comparable patterns.

Anticipating increased labour costs and tougher competition construction companies may seek to integrate their supply chain and might even abandon their model of subcontracted labour for a model of traditional employed labour. In Germany the strategy of supply chain integration is evident in the M&A activity. Our experts in Germany have noticed a focus on vertical M&A activity: mid-sized contractors seeking to acquire smaller targets like design engineering practices, glass fiber processors or other niche businesses in order to integrate more downstream activities in their portfolio. We expect to see the same M&A activity pattern in other recovering markets across Europe.

Supply chain integration in the UK and Germany

Lakehouse PLC, the listed UK-based company engaged in providing construction and maintenance services, has acquired PLS Holdings Ltd, the UK-based lift services include lift installations and replacements, and planned lift servicing, for a £5.5 million cash consideration.

Zech Group Gmbh, the Germany-based company engaged in construction, real estate, and environmental services has agreed to acquire Imtech Deutschland GmbH & Co. KG, the German construction and engineering services branch of insolvent Imtech group, for an undisclosed consideration. Under the terms of the agreement, Zech will retain a majority of Imtech employees and take over 500 building sites.

(Source: Mergermarket)

1 Gardiner & Theobold, Tender Price Indicator (2015)
2 SCSI Construction Tender Price Index (2015)

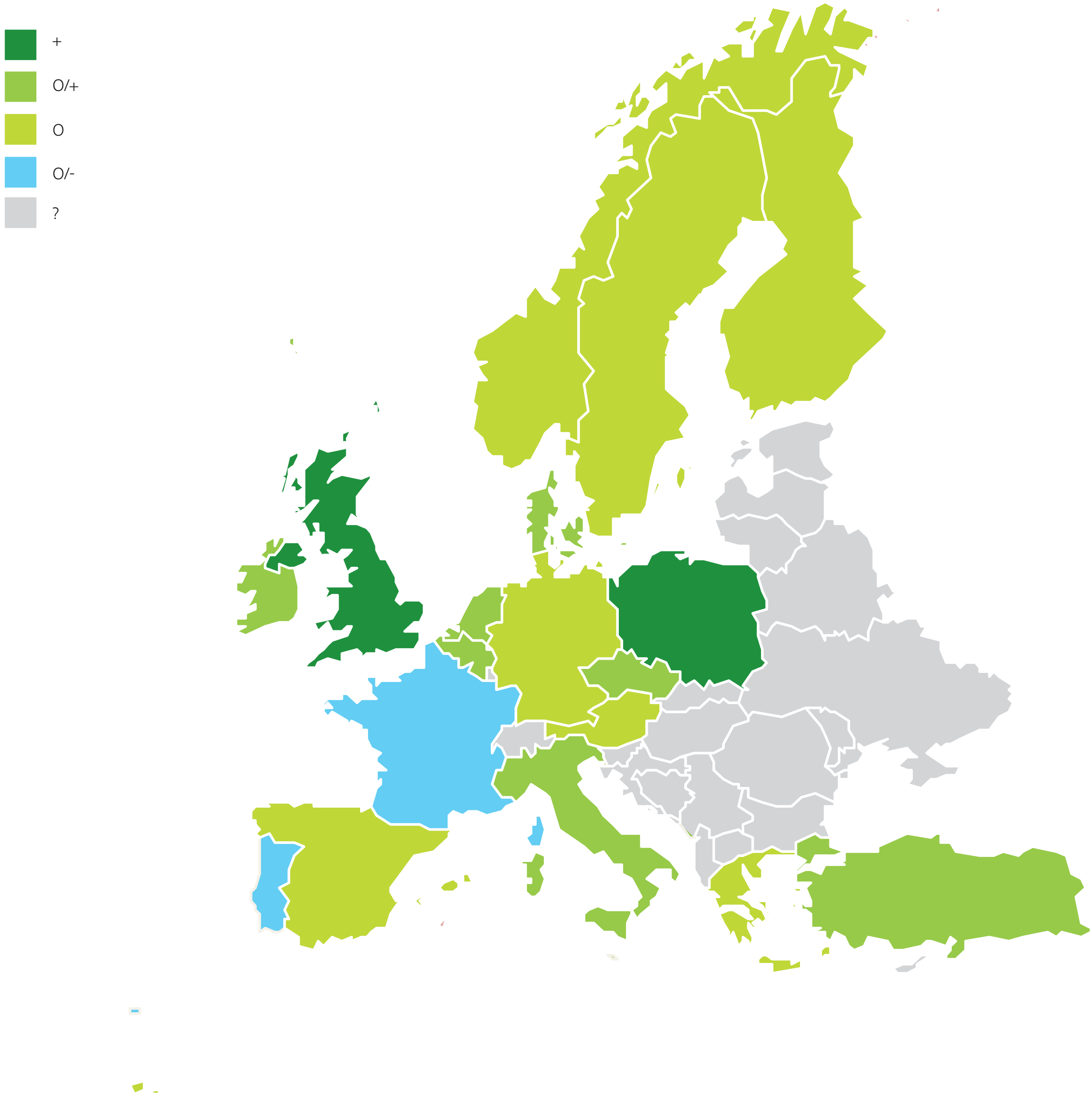
3. Going forward

The outlook on M&A activity in Europe

The table below provides an overview of the opinions and views of local Deloitte specialists on the short to medium-term outlook for M&A activity within their local markets. Subsequent pages provide extensive insights for each country.

Country	Outlook	Highlights
Austria	o	• Lack of growth on the home market • Ongoing internationalisation of Austrian construction companies, focus on Central and Eastern Europe
Belgium	o/+	• Slow growth predicted in construction market • Growth mainly in non-residential sector
Czech Republic	o/+	• The recovery of the Czech construction sector is expected to continue over the course of 2016 • Growth is fuelled by both private and public investments
Denmark	o/+	• Danish market for the construction sector has improved over the course of 2015 • Property market in major cities (Copenhagen, Aarhus) is very active
Finland	o	• Weak business cycle for the construction sector continues for the fourth consecutive year • Stable growth in renovation construction
France	o/-	• Significant investment programs end in 2015 and no similar investments are expected • M&A activity is dominated by the major companies focusing on intercontinental markets
Germany	o	• German construction companies aim to strengthen their market positions through acquisition of smaller, more specialized, firms
Greece	o	• The privatisation program, infrastructure concessions and PPP tenders are accelerating • Dynamic M&A environment due to privatisation of government assets
Ireland	o/+	• Lack of supply on domestic property market drives prizes and rents upwards • Foreign construction companies are increasingly active on the Irish PPP market
Italy	o/+	• Despite a reduction of investment in 2015, recovery is expected in the medium term (2016-2018) • Italian and overseas players acquire niche businesses to add on to existing activities
The Netherlands	o/+	• Pressure on margins in the local market is forecasted as subcontractors are expected to increase their prices rapidly • Small M&A by larger construction companies of technology related companies expected to adjust and prepare for digital construction, BIM in particular.
Norway	o	• Growth strategy of Norwegian construction companies is expected to lead to more M&A activity in the future • International players enter the Norwegian market through joint-venture constructions
Poland	+	• Strong pipeline of infrastructure projects co-financed from EU funds in the period 2014-2020 (infrastructural needs in Poland until 2020 are estimated at approx. PLN 300 bn) • Increasing M&A activity (including inbound cross-border deals), due to positive market prospects
Portugal	o/-	• Low public spending in large infrastructure projects • Large construction companies continue to focus on intercontinental markets (Africa, Latin America)
Spain	o	• Spanish construction companies continue to divest and reposition core divisions • Spanish outbound M&A is mainly intercontinental (Anglo-Saxon markets, Latin America, Middle East)
Sweden	o	• Production volume of both residential and commercial construction increased • Lack of supply on domestic property market drives prices and rents upwards
Turkey	o/-	• (Geo)political situation has negatively affected FDI interest in Turkey • Strong increase of PPP-projects, due to decreasing share of public sector funds in total budget
United Kingdom	+	• Strong growth in infrastructure and industrial construction output expected in the medium term • Supply chain constraints remain a challenge for the UK construction sector

+ : optimistic o : neutral - : pessimistic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Overview per country

(in alphabetical order)

o Austria

Residential construction is still the key driver within the Austrian construction sector. In 2014, the number of housing permits increased by 2.4%. According to forecasts for the years 2015 and 2016 a further increase in delivered housing permits is expected. Nevertheless, the residential construction sector is showing signs of decelerating and low growth, which is expected to drop to levels below 1% in 2015.

The non-residential construction segment is showing a rather poor performance, which is expected to lead to stagnation in 2015. The reason is the weak overall economic growth due to the exhibited minor industrial production and weaker foreign trade. Similarly, the civil engineering sector is not expected to be able to generate significant additional growth in the short-term, with a strengthening of the sector being forecasted to take place in 2017.

Due to the relatively small consumer market size of Austria and the lack of growth on the home market in recent years, Austrian construction companies have been expanding their cross-border operations. They have been following a strategy of internationalization for several years now, especially focusing on the relatively proximate markets in Central and Eastern Europe. In 2014, the largest Austrian construction company – Strabag - generated 85% of its output volume abroad. Porr AG, the second largest Austrian construction firm, had a foreign share in production output equalling approximately 39% as at year-end 2014 and 47% as of mid-of-year 2015 respectively.

Internationalization of Austrian construction companies is expected to continue to increase. In the infrastructure sector and construction industry, the Central and Eastern European countries are the markets of the future. The strong growth markets in Eastern Europe also offer expansion opportunities for construction companies in the commercial sector. Cooperation with Eastern European companies remains of the utmost importance for the Austrian sector.

o/+ Belgium

The overall outlook on the Belgian construction sector is mildly positive. The Federal Planning Bureau predicts slow growth. Added value is expected to increase by 1.8% between 2014 and 2019.

Between 2013 and 2014, the delivery of building permits in Belgium residential construction saw a steep increase. This increase was driven by anticipation of new, less favourable legislation. For 2015, analysts predicted a decline of 3.5% in the delivery of building permits. However, in the first two quarters the delivery of building permits for residential construction actually increased by 7.4% between quarter one (10,248 permits) and quarter two (11,011 permits). As analysts considered this still to be a consequence of the outburst in 2014, they predicted a decline in the second half of 2015.

In contrast to new building permits, the delivery of renovation permits in the first quarter of 2015 witnessed a decline of 6.5% compared to the first quarter of 2014. The main cause is the new legislation, which requires houses entitled to 6% VAT on renovation costs (instead of the usual 21%), to be ten years old instead of five. Market reports predict a recovery by the first quarter of 2016.

The delivery of non-residential building permits increased by 5.6% between the first two quarters of 2015. There was a 43.1% increase in cubic meters in quarter two of 2015 compared to quarter one. However, this increase is considered artificial because several large projects were granted a permit in quarter two.

In 2015, there was a wide variety of M&A activity within the Belgian construction sector. Some Belgian construction companies are specializing in their core activities by acquiring smaller firms, while others adopt a diversification strategy. Besides the strategic acquisitions of big and medium-sized Belgium-based firms, there were some private equity deals as well.

o/+ Czech Republic

Last year's statistics indicated the recovery of the Czech construction sector. In 2014, construction production grew by 2.3% in real terms, primarily due to engineering construction. For the first time since 2008, the Czech construction sector did not report a drop: the sector showed a growth of 2.3% year-on-year.

In 2015, Czech construction production continued to grow. In the first two quarters of 2015, the construction production increased by 6.9% and 9.8 %, respectively. Civil engineering production grew in both quarters by 4.9% and 2.9%, respectively, and engineering construction saw a year-on-year increase in construction production of 14.3% and 25.1%, respectively, in the first two quarters of 2015. The growth is fuelled by investments made by both private and public sectors.

Though the Czech construction sector is gradually recovering, and this trend is expected to continue in 2016, the acquisition activity on the construction market continues to be low. Even though the market is showing some signs of recovery, we expect M&A activity to remain relatively low in 2016.

o/+ Denmark

The Danish market for the construction sector has improved over the course of 2015 and the outlook is positive. The private housing market, which was more or less in default in prior years, has improved significantly driven by the increased demand for housing. Especially the property market in the major cities is very active. In Copenhagen and Aarhus, prices have increased significantly in recent years.

Consequently, a number of property transactions is observed due to the positioning of investors with different risk profiles and a general search for future yield. One of the major deals in 2015 regarded the acquisition of 50.1% of the share capital of the property company DADES A/S by Novo A/S and Tryhedsgruppen.

Furthermore, a significant number of government and municipality-funded projects are running in mainly the hospital and infrastructural sectors. These large-scale projects have boosted the activity of major international construction companies in the Danish market.

As in last year, M&A activity within the construction sector in Denmark is generally increasing due to an increased number of large and mid-sized transactions. The most notable transaction is the expected acquisition of Hansson & Knudsen and its subsidiaries by Per Aarsleff.

o Finland

The year 2015 seemed to be a stable year for Finnish construction and no growth or decline is expected. However, the second quarter of 2015 experienced a slight increase in the delivery of building permits of 0.3%. On the other hand, construction related employment declined between the first and second quarter of 2015.

The weak business cycle in the Finnish construction sector continues for the fourth consecutive year. The total construction volumes are expected to drop from 2014 levels by approximately 1%, but are expected to improve by 2% in 2016.

The decline in new housing unit construction has been compensated by the stable growth of renovation construction. This growth is driven by ageing of existing buildings and modernization requirements, especially in the Finnish capital Helsinki and its surroundings. The renovation construction sector is expected to grow by 2.5% in 2015 and 2% in 2016. The growth is expected to continue as residential buildings constructed in the 1970s and 1980s are facing renovation needs.

A noteworthy development in the Finnish market is the activity of the private equity backed construction company Consti. The company specialized in renovation has acquired sixteen other companies. During the first three quarters of 2015, Consti increased its net sales by 24.1%, to €181 million. According to the CEO, the company is constantly looking for add-on acquisitions to fuel growth.

At the same time, infrastructure construction is expected to slow down as large projects are being finished.

o/- France

Since 2008, the public work sector in France has been continuously declining, primarily due to a reduction in public spending, except for a slight upturn in 2011. This trend is forecast to deteriorate in 2015 with an expected decrease in volume by 4.5%, compared to a decrease by 2.7% in 2014. Furthermore, infrastructure construction is expected to slow down by the end of 2015 because significant investment programs (high-speed railway and new stadiums) are completed and no similar projects are expected in the near future. This slow-down in infrastructure construction will partly be compensated by anticipated government support. The expected government support in the course of 2016 mainly concerns highway and transport infrastructure development programs.

Similarly, the building construction sector has been declining over the past years in the context of the economic slowdown. This trend continues with a decrease in volume by 3.6% in 2015. In residential construction, building construction declined by 11.4% in 2014. A reverse trend is expected in 2015 (+3.5%) because of the government measures implemented in 2014. The reverse trend is expected to strengthen in 2016. In non-residential construction, volume decreased by 8.8% in 2014. A further decrease in 2015 is expected because of the decline in demand by the public sector.

Given the lack of growth in their home market, the main players in the French construction market (Vinci, Bouygues and Eiffage) have continued to develop internationally, partly fuelled by mergers and acquisitions. The deals of the major French construction companies have been mainly intercontinental. Eiffage targets Africa and the Middle East (and more recently Latin America), Bouygues targets Canada, and Vinci's energy division (Vinci Energy) targets Asia and the Pacific, while its subsidiary Eurovaria is targeting the Americas.

o Germany

No major change has been observed in the market conditions of the German construction industry in the recent years. Stabilization or modest growth is expected in the next few years.

However, some changes in M&A activity were noted. At the end of 2014, we have seen one major transaction. Bilfinger, at that moment the second largest construction company in Germany. It decided to sell its construction division to the Swiss Implenia group and focus on service provision instead. The deal value was approximately €230 million.

Despite of this big deal at the end of 2014, the year 2015 did not bring any major transactions in the German construction market. M&A activity in Germany in 2015 YTD seems to be all about acquiring smaller players who are specialized in niches. German construction companies aim to strengthen their market positions through acquisition of smaller and more specialized firms, active in specific areas and competencies. Our experts have noticed mid-sized contractors seeking to acquire targets like design engineering practices, glass fiber processors or several other niche businesses.

o Greece

Stabilization of the Greek economy, evident within 2014, was followed by adverse developments in the country's economy, due to political unrest in the first 9-month period of 2015. Following stress tests during the second semester of 2015, the Greek banking system proved to be successfully recapitalized. After a period of slow developments, the privatization program is accelerating and certain infrastructure concessions and PPP tenders started to move at a faster pace.

Greece's GDP is expected to contract slightly during 2015 and 2016. The main reasons are political and economic unrest, the introduction of new structural reforms and new tax or increased tax rates. However, following a prolonged period of recession, the country is expected to turn to positive growth rates during the second semester of 2016.

M&A activity in Greece remains dynamic, mainly due to the ongoing privatization of governmental assets and major ongoing tenders, including the privatization of the two major ports, the railway operating company, as well as the Hellenic Gas Transmission System Operator. In addition, the financial closing of the long-term concession of two clusters of, in total, 14regional airports is expected to be concluded within 2016, while numerous other tenders regarding smaller real estate assets are ongoing.

o/+ Ireland

In 2015, Ireland experienced a significant increase in customer sentiment and mortgage lending. As a result, Irish construction activity increased at the second-fastest rate in the 15-year history of the Ulster Bank purchasing managers' index for the sector, with an overall reading of 65.7%. Still the domestic property market is marked by a lack of supply in both commercial and residential housing. Severe housing shortages drive prices and rent upwards, especially in urban areas. In reaction to this development, the Irish government introduced rent controls in 2015, with a rent increase now only permitted once every two years. Average transaction prices in cities like Dublin (€312,000), Cork (€275,000) and Galway (€240,000) are far above the country-level average of €164,000.

The outlook for the Irish construction sector for the coming years is quite positive. Significant residential development in Irish cities is likely to increase, with regional areas following at much slower pace. In addition, growth in commercial property is expected to continue as well. Significant new developments of hotels and continued M&A activity in the hotel industry are expected.

M&A activity has been very strong across all property sub-sectors as deleveraging and secondary trading continues.

The Irish PPP market enjoys the attention of foreign construction companies. In 2015, Dutch-based construction company BAM was successful tenderer to complete seven courthouses and the tender for the M11 road. A consortium of the Polish construction company Prime and British/Irish-based construction company Balfour Beatty won the tender for 14 primary care centers across Ireland. Finally, the Dutch Infrastructure Fund acquired a 46% stake in Eurolink Motorway Operations Limited (M4) and a 75% stake in Eurolink Motorway Operations

Limited (M3). Ireland-based companies hold concession contracts to design, build, finance, operate and maintain expressways. The stakes formerly belonged to the Spanish-based infrastructure company Cintra.

o/+ Italy

The Italian economy is recovering. Forecasts from the EU, OECD and the Italian Confederation of Industries predict growth of 0.6 to 0% in 2015 and 1.2 to 1.5% in 2016. Yet, the construction sector still feels the effect of the market slowdown. In 2015 the construction sector recorded a reduction in investment of around 1.3% (with respect to 2014) reaching an investment level of around €128.8 billion. A further reduction was avoided mainly due to the extension of fiscal incentives for projects involving building renovation and energy efficiency, which accounted for around 37% (€47.9 billion) of the total.

The medium-term outlook, however, is positive. For 2016 the Association of Construction Companies (ANCE) has forecast a further small contraction of around 0,5% in the sector that will recover over the period 2016-2018, where investment in the sector is forecast to reach €1.017m in 2017 and €2.066m in 2018.This includes the effects of a proposed government stimulation package for infrastructure investments.

Consolidation and market presence are the main M&A themes in the construction sector in Italy. Both Italian and overseas players are taking advantage of the general market conditions to acquire niche / specialist businesses to add on to existing activities or to enter new markets. Large Italian construction companies focus on expanding their international operations through strategic acquisitions, such as the acquisition of Lane Industries by the Salini Impregilo group. In 2014, the revenues generated by Italian companies in the international market reached over €10.47 billion compared to around €5.85 billion generated in the domestic market.

The Italian PPP market has been shrinking, over the course of 2015 the number of opportunities as well as their average size decreased. In 2014, a total of 39 tenders were published whilst between January and March 2015, 16 tenders were published. The average value per project has fallen steadily from 2011. In 2014, the average value per tender was €23,7m to €7,8m and in the first quarter of 2015 this increased to €5,4m.

o/+ The Netherlands

In 2015 the cautious recovery of the Dutch construction sector continued. The recovery is mainly driven by the increasing growth in the residential sector, which in part is due to a backlog demand. Growth in commercial and infrastructure markets lags behind due to decreased public expenditure. This is partly compensated by the increased investments in industry and seaports driven by the economic growth. Although the market shows signs of recovery, pressure on margins in the local market is forecasted. There is still overcapacity among general contractors while there is capacity shortage among subcontractors and they are expected to increase their prices rapidly. In January 2015, tender price indices increased by 3.3% compared to January 2014. In January 2016, tender price indices further increased, by 4.3% compared to the same month one year earlier. The trend of increasing tender prices is expected to continue over the course of 2016.

The M&A activities are in line with recent years and were moderate over the course of 2015. Although larger construction companies are repositioning themselves for future growth and profitability, M&A activity is limited due to the lack of buying power and in anticipation of a more robust market recovery. A major transaction on the Dutch construction market was the acquisition of the ailing – publicly listed - Ballast Nedam by the Turkish-based international construction company Renaissance.

o/+ Norway

The accumulated GDP in the third quarter of 2015 for the Norwegian mainland was 0.8% and the expectations for 2016 are moderate. The public economy is strong and there are reasons to expect continued good growth in public demand. Yet, the overall market growth remains limited. Furthermore, a weak trend in households and in the industry will be met by targeted initiatives from the public sector. The total production in the construction industry has been stable, with only a slight increase of 1% between the first and second quarter of 2015.

The majority of large Norwegian construction companies have a growth strategy and with the limited market growth we expect to see more acquisitions in near future. Yet, there has been limited M&A activity on the Norwegian market in 2015.

In 2014, our experts observed international players enter the Norwegian market through joint-venture constructions, especially in conjunction with large infrastructure contracts. This trend continued in 2015.

+ Poland

The slowdown in the Polish construction sector, noted in 2012 and 2013, is over. In 2014, financial results of Polish construction companies first improved and this turned out to be a turning point in the Polish construction sector, which continued in 2015. The prospects for the Polish construction sector in the coming years are positive. The Polish construction sector is expected to grow.

Key drivers behind the growth of Polish construction are major investments in infrastructure (road construction €41.1 billion, over the timeframe 2014-2020; railway construction €16.2 billion until 2023; energy construction approximately €23.1 billion) and the related inflow of EU Funds. Under the new 2014-2020 EU financial perspective, Poland is expected to receive total funds in the record amount of €120 billion, out of which approx. €25.8 billion is earmarked for the development of infrastructure. Moreover, these drivers are backed by strong underlying macroeconomics. The average annual GDP growth between 2015 and 2018 is expected to reach approximately 3.0%.

In 2015, we observed increased M&A activity in the Polish construction sector. Until November 2015 twelve acquisitions were completed, eight of which were acquisitions of material manufacturing companies. In 2014 only four acquisitions were completed.

Due to the positive market prospects, we expect a further increase of M&A activity in 2016. First, construction companies active on the Polish market are expected to increase market share through acquisitions of mid-cap specialized and general construction companies.
Second, we expect further mid-sized transactions in the construction material manufacturing sub sector, as a continuance of the M&A activity in 2014 (4 acquisitions) and 2015 (8 acquisitions). Moreover, we expect acquisition of Polish construction companies by large global asset management companies or global private equity houses that plan to capitalize on the promising market perspectives in Poland.

o/- Portugal

The Portuguese market continues to suffer from the effects of the economic downturn. The low public spending and public investment in large infrastructure projects and very low demand in the new residential housing market, due to credit constraints, continue to affect the construction sector. Nevertheless, there is a slight recovery of domestic construction activity mainly in the building renovation sector due to the considerable increase of foreign investment.

Demand in the domestic construction market is still low and the number of bankruptcies is now stable but still high. As a result, some construction companies still need to restructure their operations and debts and divest assets and non-core businesses so they will shortly gain the necessary financial capacity and make a successful exit in the medium term.

On the other hand, companies that present a financial capacity keep on designing international expansion strategies in order to expand its operations to foreign markets. However, revenues obtained in the main oversea markets, Angola (decrease in oil prices) and Brazil (economic recession), are expected to decrease.

o Spain

The construction market in Spain remains strongly impacted by the austerity policies put in place by the Public Administration. Yet, macro figures are improving and Spain is expected to experience the highest GDP growth of the EU in 2015 (app. 3%). In this context, residential construction activity is slightly recovering but it remains far below the highest levels reached in 2006-2007.

The strategy of the most relevant construction companies has not significantly changed since last year. Firstly, the internationalization of Spanish-based construction companies continues. Spanish outbound M&A activity has been mainly transcontinental. The main target markets are Anglo-Saxon markets (the United States, Canada, UK/ Ireland and Australia), Latin America (Columbia, Peru, Chile, Mexico and Brazil) and the Middle East and India.

Secondly, Spanish construction companies continue to divest and reposition core divisions, bolstering businesses with activities such as industrial construction and urban services concessions (for instance water and waste management), whose margins are higher and, in case of concessions, whose cash flows are more stable and regular.

Finally, the increasing presence of institutional investors on the infrastructures market is facilitating construction companies to carry out an exit strategy. The development strategy is mainly driven by the EPC activity. It generally implies a disposal of the stakes in PPP projects once these are fully operational. This way, Spanish constructors can increase recourse to the capital markets as a source for funds, for both the development of new projects and the refinancing of the businesses.

o Sweden

Over the course of 2015, the Swedish construction sector experienced both strong and stable growth. Between 2014 and 2015 the production volume of residential as well as commercial construction increased. Still, at the same time housing prices and rent increased sharply due to a lack of supply. The housing prices are not expected to rise during 2016 even though there is a shortage of housing in especially major cities such as Stockholm, Gothenburg and Malmö. The reasons behind this are the rock-bottom interest rate, the disposable income per capita, which is not expected to rise in the coming four years, and there is an ongoing initiative aimed at dousing the overheated housing market by means of introducing a requirement to amortize housing loans (loans to buy newly constructed houses or apartments are not covered by this since this could act as a brake on the construction of new houses). The strong and ongoing demand for housing should, despite this, provide a good outlook for the Swedish construction sector in the near future.

M&A activity on the Swedish construction market remained steady. The number of deals in 2015 were more or less the same as in 2014, with some deals still in the pipeline. In 2015, international interest in the Swedish construction market slightly increased and there were more cross-border deals than in 2014. International interest in the Swedish market is mainly coming from Scandinavian neighbours. Swedish construction companies, in turn, are still looking to expand their cross-border operations as well, though to lesser extent. Swedish outbound M&A traditionally focuses on its Scandinavian neighbours (Finland, Norway and Denmark). However, this year’s outbound Swedish M&A activity included acquisitions in the United States, Australia as well as Brazil and Japan.

Still, Swedish M&A activity mainly involves small or mid-sized deals. Same as last year, the four largest Swedish construction companies (NCC AB, Skanska AB, JM AB and Peab AB) were not involved in any major M&A activity in 2015.

o/+ Turkey

The ongoing drop in oil and gas prices has triggered a cut in public spending in the Gulf region. Likewise, the military conflicts in the Middle East have inevitably affected the potential markets and export activities of Turkey. The Turkish economy is deemed to be vulnerable to due its high need of FDI, but unfortunately the geopolitical position has adversely affected the interest of foreign investors in Turkey in 2015.

In addition, Turkey’s public sector funds for construction spendings decreased sharply in 2015. Due to the decreasing share of public sector funds within the total public budget programme, Public-Private-Partnership (PPP) is expected to be the new big thing. Examples of ongoing massive PPP projects are a third Bosphorus Bridge, the İstanbul grand airport, the Gebze-İzmir highway and the Eurasia tunnel.

Despite the social and political uncertainties and geopolitical risks, real estate in Turkey is still considered to be one of the most solid investment options. Important prospects in Turkey for the next 5 years are the urban transformation and requirements for improving buildings to comply with safety requirements that are generating a demand; the continuing demand for residential units by non-Turkish citizens; PPP projects that are expected to continue and will support the construction activities; a better connection between multi-modes of transport will improve the accessibility of many regions and attract new businesses along these corridors; the ruling party have suggested to implement structural reforms after the November elections; the availability of lending resources; project financing; and regional political imbalance, lack of structural reforms and sustainability.

+ United Kingdom

The outlook for the UK construction sector is positive. In 2015, the total construction output in the United Kingdom (UK) grew by 3.6%. In 2016, the construction output growth is forecasted at 3.8% to a total volume worth £137 billion. The rise in construction output is attributed to private housing, commercial and infrastructure construction growth coupled with growth in privately funded projects in the education and the health sector. Construction sector growth in the UK is mainly driven by the good economic prospects and consumer, homeowner and business confidence.

The infrastructure and industrial output in particular are predicted to grow in the medium term. Infrastructure growth is expected to reach double digits every year between 2017 and 2019, as major projects gain momentum under the £411 billion National Infrastructure plan. Growth is anticipated across road construction (output expected to double by 2019) rail, energy, water and sewerage. Industrial Output is projected to grow by 30% by 2019. Within the industrial sector, warehouses output increased significantly by 45% in 2014, to a value of £1.6 billion (highest level since 2008) due to growth in e-commerce and favourable consumer spending.

There are, however, some risks and challenges that may or may not undermine or slowdown growth in the UK construction sector: slower economic growth in China and the recent stock market collapse, considerable uncertainty regarding the results of the UK's EU referendum. On top of that, supply chain constraints remain a challenge for the UK construction sector. Key concerns pertaining skills and materials shortages have already been reported in some sectors but these issues could become more prevalent in the industry over the next 12-18 months.

The number of M&A deals in the UK decreased. In 2014, our experts noted 17 deals in the UK construction sector. In 2015, the number of deals was only 12.

4. Conclusion

What to expect

The number of M&A deals in the European construction sector remained relatively stable. Where the sector recorded 127 deals in 2014, the number of deals recorded in 2015 was 129. Over the period from 2010 to 2015, the number of deals fluctuated between 126 and 148 deals per year, with an average of 134. We do not expect this trend to change much in 2016. The ongoing recovery in local construction markets may result in a rise of the number of deals compared to the last few years.

Overall, the European construction market has not changed significantly over the course of 2015. The trends identified in last year's construction monitor materialised over the course of 2015 and are expected to continue in 2016.

Firstly, the internationalisation of the construction sector continued to increase. The percentage of cross-border deals as a share of the total number of deals recorded in the European construction sector increased by more than 5% in 2015. In total 55% of the deals recorded in 2015 were cross-border. In line with the trend identified in 2014, the number of cross-border deals that was intercontinental increased. In 2015, the number of intercontinental deals increased to 36, which represents approximately 28% of the total number of cross-border deals. Not only are European construction companies expanding their international operations, interest in European markets increased as well. In 2015, half of the intercontinental deals (18) were inbound. By far, most companies targeting European construction companies are based in North America (United States, Canada). The past few years our experts identified the lack of growth on domestic markets as the key driver behind the increasing internationalisation of European construction companies. Now that domestic markets in Europe are showing more signs of recovery, we do not expect strong growth in the number of outbound intercontinental deals. On the other hand, we expect to see international interest in European construction markets increase in 2016.

Secondly, the number of private equity deals increased for the fourth consecutive year. In 2015, the share of private equity deals was 27% of the total number of deals. This is an increase of 4% compared to 2014, when the share of private equity was around 23%. Not only has the number of PE deals increased during the course of 2015, the average deal size of private equity deals increased as well. This further indicates the growing interest of private equity houses seeking to capitalize on the promising market prospects in Europe's recovering domestic construction markets.

Finally, though markets in Europe show more and more signs of recovery, margins of major construction companies are not improving due to supply chain pressure. The shake-out of small and mid-sized specialized subcontractors during the years of crisis, has resulted in a shortage of these subcontractors now that the market recovers. As a result, these contractors sharply increase their prices (tender prices are sharply increasing). In 2014, supply chain pressure was most evident in the UK and Ireland. In 2015, signs of supply chain pressure were picked up in the Netherlands and Germany as well. In 2016 supply chain pressure is also expected on other European markets as they start to recover.

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