

European M&A Construction Monitor  
Trends for 2012-2014: Anticipating  
tomorrow versus surviving today



European M&A Construction Monitor is a publication  
edited and distributed by Deloitte.

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November 2013





# 1. Introduction

## M&A activity has increased: focus is on strengthening core business and/or further diversifying via (small) add-on companies

We are pleased to present the third edition of the European M&A Construction Monitor. This monitor looks at the latest trends and issues in mergers & acquisitions (M&A) in the construction industry in Europe. This 2013 publication complements the "European Powers of Construction" (EPoC) of 2012: a Deloitte research paper examining the status of major European listed construction companies.

### Market trends: anticipating tomorrow versus surviving today

The number of M&A deals was higher in 2012 than in 2011. This increased activity reflects the strategies of European construction companies, which include sector diversification and internationalisation. These diversifying strategies form the first trend: many companies are anticipating tomorrow's construction market by optimising their competencies and capacity.

At the same time, a significant group of construction companies is not in a position to pursue such forward-looking strategies: it is all they can do to keep their business afloat from day to day and avoid defaulting on their financial obligations. These survival tactics form the second trend that will be discussed in this publication.

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

### Highlights in this publication

- The number of deals was higher in 2012 than in 2011. M&A activity in 2013 is expected to be in line with 2012.
- The average deal size remains limited in 2012 and 2013.
- Sector diversification is still on the agenda of larger construction companies that are in a position to anticipate developments in the construction markets.
- Sector diversification seems more profitable than cross-border M&A strategies.
- It seems that companies with a strong focus on internationalisation have lower profit margins: cross-border strategies involve high entry and start-up costs which affect profitability of non-domestic acquisitions.
- Alongside diversifying strategies, we see a new item on the agenda: refocusing on core business and divestment of assets that do not fit into the new strategy.
- DBFM(O) contracts are becoming more interesting to construction companies, despite slightly narrowing profit margins due to tougher competition.
- Although the number of insolvencies in the European construction sector seems to have stabilised (>1% of the construction companies per year), both smaller and larger construction companies are still filing for insolvency.
- Lenders seem to take, to a certain extent, a more lenient stance when debtors are defaulting on their obligations.
- More private equity involvement, both in financing business and acquiring assets of construction companies.

## 2. Looking back

### The European construction sector recorded 122 deals in 2012<sup>1</sup>

#### Development 2012-2013 H1

M&A activity within the European construction sector was higher in 2012 than in 2011: 2012 recorded 122 deals, compared to 104 deals in 2011. An increase in deals for 2012 was foreseen in last year's publication, but our projection (based on an extrapolation of 2012 H1) was more optimistic than the actual number.

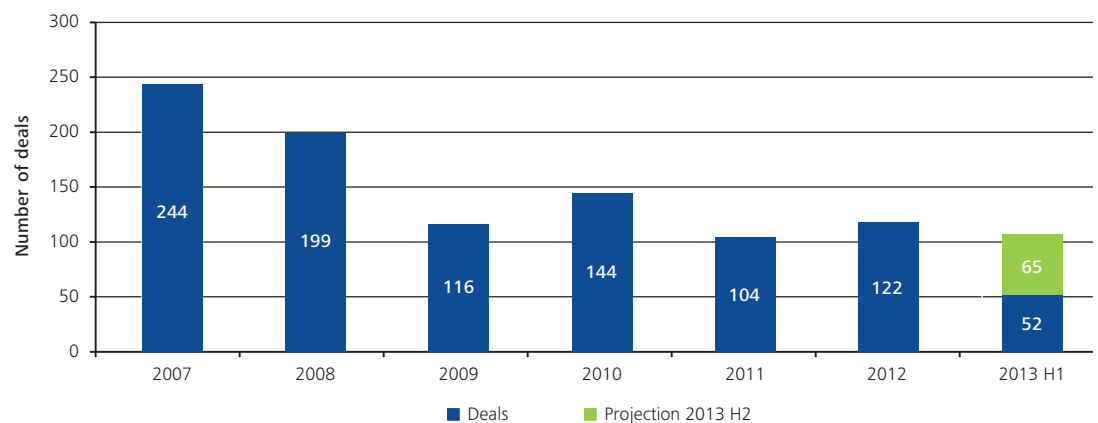
With 58 deals recorded in H1 2013 (2012 H1: 72 deals), the total number of deals in 2013 is not expected to exceed the 122 deals in 2012, although we do see an increase in deal activity for H2 2013 compared to H1 2013.

Looking at the period 2009-2012, we see a relatively stable level of M&A activity: the number of deals fluctuates between 104 and 144 per year with an average of 122. This makes 2012 with 122 deals an average year and it is hard to predict when M&A activity levels of 2007 (244) and 2008 (199) will be reached again. The expected consolidation in the European construction sector has not yet boosted M&A activity. More importantly, the construction industry in Europe is experiencing a squeeze on profits and cash flows and limited availability of bank financing for the industry.

Last year we anticipated relatively smaller deal sizes for Europe as a whole. A year later, recorded deal values of individual transactions are indeed small. For 2013-2014, we do not foresee an increase in deal value, because the focus will remain on either strengthening core business or further diversifying via (smaller) add-on companies. One of the exceptions to this general trend, however, is this year's merger between two large Italian-based construction companies with a deal value of EUR 1.6 billion: Impregilo and Salini Costruttori. Impregilo and Salini's aggregate revenues are projected to reach EUR 7 billion by the end of 2016, which would earn them a ranking among Europe's 20 biggest construction companies.

Last year's European M&A Construction Monitor discussed the following trends: European construction companies defaulting on their financial obligations, focusing on deleveraging, and diversifying business activities and geographical markets. This year we will discuss two major market trends for 2012-2014: anticipating tomorrow versus surviving today. And while doing so, we will follow up on last year's trends.

#### M&A activity in the European construction sector



<sup>1</sup> A deal is defined as a transaction involving at least 30% of the shares of a European construction company

### Trend I: Anticipating tomorrow

Top European construction companies want to anticipate tomorrow's construction market by optimising their competencies and capacity, and they do this with diversifying strategies. These strategies involve anticipating developments in the markets where they are currently active - in terms of both business activities (sectors) and geographical presence (countries and continents) – as well as other markets, and determining how the company should go forward.

#### Ferrovial enters new sector in already present geographical market

An example of both sector and cross-border diversification is the acquisition of **Enterprise** by **Ferrovial Services** in February 2013. Enterprise is active in utilities, waste collection, social housing, highways and facilities management. Ferrovial acquired 100% in Enterprise for GBP 385 million. This acquisition marks Ferrovial's entry into the UK utilities sector: approximately 50% of the target's business relates to infrastructure maintenance services to the utilities industry

Enterprise will be integrated into Amey, which is Ferrovial services' subsidiary in the UK. In 2012 the company employed 9,600 people and had revenues of GBP 1.1 billion. With the integration of Enterprise into Amey, Ferrovial will create one of the most diversified companies in its sector with combined revenues of GBP 2.3 billion and over 21,000 employees. The acquisition will allow Ferrovial to capture a good number of synergies on the cost side as well as offering integrated service solutions across the UK.

### Sector diversification

In 2012 the larger European construction companies generated 23% of their total revenues with non-construction activities. This percentage was stable compared to 2011. The profit margins on these activities (11.2%) are substantially higher than the margins on construction activities (2.6%). The best performing construction companies in 2012 were the companies with the most diversified portfolio of services.

Take-over targets in 2012 and H1 2013 are active in various sectors outside traditional construction, including services (e.g. maintenance, engineering, management), manufacturers (e.g. of fire detection and alarm systems), infrastructure (e.g. motorway operations), energy (e.g. distribution, mining) and waste. These relatively profitable sectors are and will remain on the agenda of the top construction companies that are in a position to look for opportunities to improve their performance.

The deal size is often limited, because most of these more knowledge-driven add-on companies are active in niche markets and therefore generally smaller. The aim of these transactions is to build market share or capabilities. For example, the Italian contracting company Condotte has increased its revenues by 30% through the acquisition of Inso, a smaller international Italian construction company focused on hospital and health-related construction, including the supply and engineering of medical equipment. Most of the smaller deals are outside the scope of this research paper, but they do support the continuous trend of sector diversification.

Given that this business model has been proven to be profitable, we expect that companies will continue to acquire targets in other sectors. At the same time, we have observed that a number of top construction companies have reaffirmed their key sectors and are divesting business parts outside these key sectors. In 2012, as examples, BAM sold its consultancy and engineering firm Tebodin to Bilfinger and Ferrovial sold Edinburgh Airport to Global Infrastructure Partners. In 2013, Hochtief sold its technical services division to French engineering and services provider SPIE and Balfour Beatty sold its UK facilities management business to GDF Suez Energy Services. How do these divestments relate to the trend of diversification? Or are these deals primarily used to reduce debt levels and improve financial ratios?

#### Back to core business

German construction company **Hochtief**, a subsidiary of **ACS**, has sold its airports division to Canada's Public Sector Pension Investment Board (PSP Investments) for EUR 1.1 billion. Hochtief will use the cash to cut debt and invest in its infrastructure business. This is in keeping with its strategy to refocus on construction activities after having actively expanded into services and other non-construction sectors. Hochtief is also investigating the sale of other activities, including facility and energy management units.

#### DBFM(O)

As mentioned last year, the life cycle of buildings and their sustainability is starting to play a more prominent role in the construction of real estate. This has led to construction contracts being signed which integrate the DBFM(O) - Design, Build, Finance, Maintain (and Operate) - of infrastructure or building projects for their entire life cycle. These contracts generate stable or more guaranteed cash flows, which makes them very attractive to construction companies especially after the downturn in recent years. The growing popularity of DBFM(O) contracts and other long-term contracts like concessions has somewhat boosted the number of cross-sector deals. After all, to remain competitive in tenders like these, construction companies need to have an integrated service offering for the entire life cycle of such projects. This has led to vertical integration of the value chain. However, another way to win long-term contracts is to form a joint venture with one or more strong partners or to simply acquire a target that holds a sought-after concession. An example of the latter is French-based Vinci signing a contract with the Portuguese government earlier this year to acquire 95% of ANA. ANA holds the long-term concessions of 10 airports.

In 2012, we noticed a small decline in profit margins for DBFM contracts due to tougher competition. Nevertheless, the concession market presents significant growth perspective in the mid-term, especially through public-private partnerships (PPP).

#### Vinci acquires concessions for a period of 50 years

In 2013, **Vinci** signed a contract with the Portuguese government to acquire 95% of national airport operator **ANA** for EUR 3.08 billion. ANA holds the concessions for ten airports for a period of 50 years. Activities include the management of airport hubs (including Lisbon, Porto, the Azores and Madeira) and their retail spaces, as well as ground handling services. Vinci was awarded the contract by the Portuguese government after submitting the highest bid, beating three consortia from Germany, Switzerland and Brazil/Mexico.



### Strengthening presence in non-domestic markets

Austrian-based **Strabag**, one of Europe's leading construction groups, has been active in the Benelux countries for years. By the acquisition of the Dutch-based **Janssen de Jong Infra** for an undisclosed price, Strabag is expanding its regional capacities within transportation infra-structures in the Netherlands. The objective is to use the newly acquired resources to establish a firm presence on the Dutch market.

Skanska from Sweden expands, through its subsidiary Skanska UK, its footprint in the United Kingdom by acquiring a highway operation and maintenances business. Skanska paid GBP 18 million (of which GBP 2 million is deferred and paid following future performance) to the seller, Atkins. Skanska is worldwide active in highway operations. The purchase is in line with Skanska's strategy to position itself as a significant player in the UK highway operations and maintenance market.

### Internationalisation

The top 50 European construction companies have increased their revenues outside their domestic markets in recent years. While in 2010 50% of total revenues were generated abroad, this percentage rose to 56% in 2012. During the period under review, we have seen European companies acquiring companies within Europe, but also in North America (US and Canada), South America (Brazil, Costa Rica, Argentina, Chile), Oceania (Australia and New Zealand) and the Middle East and Asia (Oman, Israel, India, Thailand). In Africa, no significant M&A deals have been recorded yet, but Africa is on the agenda of construction groups like French-based Eiffage.

Ferrovial, for example, was active both in Europe and on other continents. In April 2013, the leading Spanish construction company acquired UK-based Enterprise via its subsidiary Amey. Outside Europe, in Chile, Ferrovial acquired a 70% stake in Steel Ingenieria, a leading mining services company specialised in industrial maintenance and heavy machinery operations. Spain's top construction companies are expanding outside Spain and, more specifically, outside Europe in order to escape the continent's persistently gloomy financial climate.

However, it seems that companies with a strong focus on internationalisation have lower profit margins. This could be explained by higher (management) costs for more complex organisations and high entry and start-up costs related to individual acquisitions in new markets. When first entering an overseas country, the acquiring company faces a period of high start-up costs relating to incorporating the target, (re)building a local team, the regulatory and legal system, but potentially also the new business culture. This organisation cost premium and these start-up costs come prior to the benefits of the overseas acquisition. So the question arises when, or indeed if, the profits of the overseas investment make up for these additional costs.

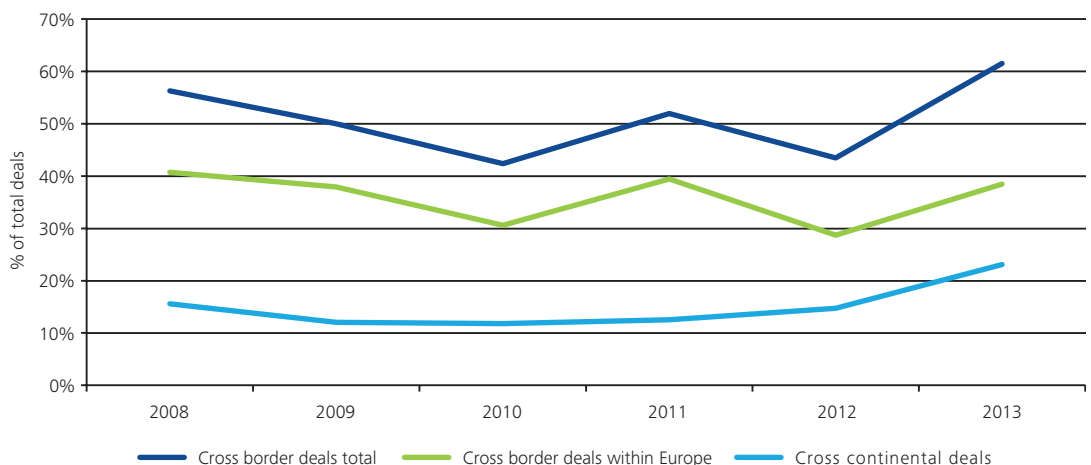
While several construction groups are active cross-border, this does not always involve entering new markets. Some strengthen their position in markets where they are already present: they have achieved their international expansion goals and opt to strengthen their international position. Costs of entering new markets do not apply in this case. Examples include the acquisition by Ferrovial in the UK, Skanska's acquisition of a subsidiary of Atkins in the UK and Strabag's acquisition in the Netherlands (discussed in the text box on the previous page).

In 2012, we have seen a retreating focus on internationalisation, followed by a significant increase in recorded international transactions in H1 2013. When looking at the period 2009 - H1 2013, the graph shows that the total number of cross border M&A transactions per year is volatile and variable: an increase in the number of deals one year alternates with a decrease in the following year, and vice versa.

The share of cross-border deals within Europe has dropped from just under 40% of all recorded deals in 2011 to 29% in 2012. The share of cross-continental deals has edged up in 2012, as in previous years since 2009, and is expected to continue climbing slowly and steadily into 2013.

Time will tell if it is sensible from a financial perspective to enter new overseas markets when domestic markets are struggling, in other words, whether the overseas profits will make up for the high entry and start-up costs. No two companies are alike and cross-border strategies can be successful. However, at this moment - based on publicly available data - it can be concluded that in the current market cross-sector acquisition strategies are more likely to be successful than cross-border acquisition strategies, at least in the short to medium term.

Cross border deals as a % of total M&A deals



### Trend II: Surviving today

We discussed that top construction companies look ahead and are in a position to design and execute strategies that anticipate the developments in the global construction market. On the other hand, we see construction companies that face a level of difficulties that make it impossible to look ahead: they need to cope with today and find ways to avoid defaulting on their financial obligations or going bankrupt.

#### Bankruptcy

In most of Europe, the construction industry is considered to be the sector hardest hit by the financial crisis. This has continued into 2012 and 2013. Although we do see signs of modest recovery in some European markets – including an improving order outlook – it is likely that we will see more company insolvencies before Europe recovers. Especially smaller contractors feel the pressure and run an increased risk of insolvency. But larger construction companies, too, are filing for insolvency due to an overall reduction in construction output, limited availability of funding and overcapacity in the market. These larger companies include Austrian-based Alpine, a subsidiary of FCC (June 2013), and the large Danish residential developer Sjælsø Gruppen (August 2013).

Insolvency is the inability to meet one's debt obligations. The figure on the previous page shows the number of insolvencies in Europe (excluding Central and Eastern Europe) in four sectors: construction, commerce, manufacturing and services. Again, the construction sector recorded the most insolvencies, but the number appears to have stabilised while still edging up in the other three sectors. Both 2011 and 2012 recorded 107 insolvencies per 10,000 companies in Europe.

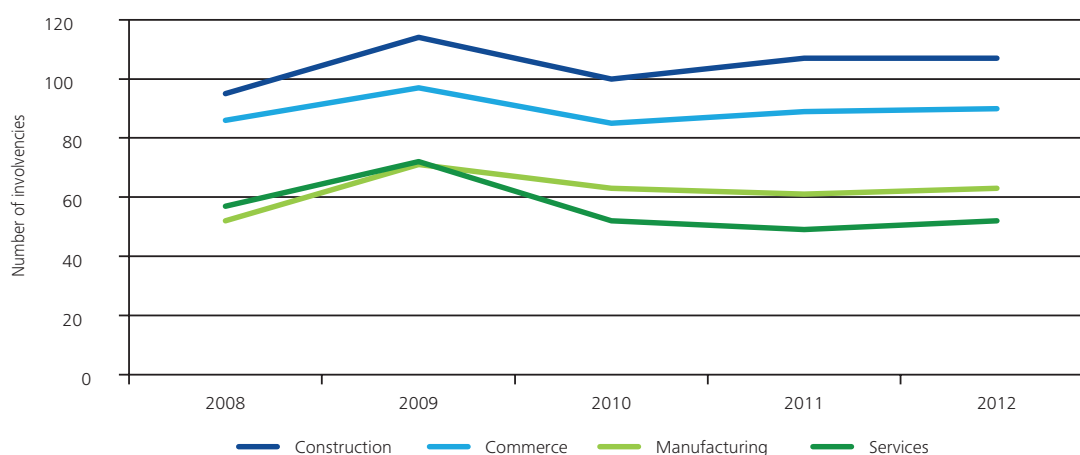
#### Largest bankruptcy of Austria also affects strategy of Spanish parent

Alpine, Austria's second largest construction firm with 6,500 employees, was declared insolvent in June 2013. Efforts to restructure the EUR 2.6 billion of debt did not succeed, which led to the biggest failure in Austria's history since World War II. Alpine attempted to dispose of its energy and engineering activities in order to raise cash, but the effects of the company's costly expansion into Eastern Europe could not be averted. Spanish parent company FCC pulled the plug when it took the decision not to provide additional funding: Alpine's bankruptcy became inevitable.

Besides the Austrian government - who invested EUR 150 million in state guarantees in a last-ditch attempt to keep the company afloat – the heavily indebted parent company FCC also suffered a significant net loss of EUR 289 million. This one-off item accounts for the bulk of FCC's overall loss in 2012 of EUR 420 million. FCC subsequently decided to reduce net debt by disposing of non-core business and assets, making the group viable in the long term.

### Insolvencies per 10,000 companies in Europe\*

\*excluding Central and Eastern Europe



The stabilising number of insolvencies in construction reflects that most European construction markets are bottoming out, but also that companies have found ways to outrun bankruptcy. Asset sales, the willingness of debt holders to serve a mutual interest in the face of a pending bankruptcy and growing interest from private equity firms appear to be vital factors.

Up to 2012, we see more and more insolvencies but also an increase in alternative routes to avoid bankruptcies. Divesting assets is a common route towards improving a company's financial situation. Also the number of share-financed transactions has increased due to the lack of availability of debt financing.

#### Asset sales

Companies' main reason for selling assets is to continue to meet bank and debt obligations. The sale of assets and thereby the reduction of debt results in stronger financial ratios and a stronger balance sheet. However, in these times it is especially difficult to sell assets at reasonable prices.

Many companies are scrambling to meet debt obligations in order to avoid debt restructuring, new debt repayment calendars, additional warranties and financial covenants. But their goal may also be to recover from financial difficulties. Several construction companies, either voluntarily or under pressure, are reducing their debt levels through the divestment of non-strategic assets and highly leveraged assets, which cuts the cost of capital and thereby overall expenses. FCC drafted a divestment programme of EUR 2.2 billion after its subsidiary Alpine filed for insolvency. The programme aims to make FCC sustainable in the long term.

### **Private equity investor acquires airports division, seller reduces debt**

In May 2013, German-based Hochtief, a subsidiary of ACS, agreed to sell its airports division to Canada's Public Sector Pension Investment Board (PSP Investments) for EUR 1.1 billion, seeking to cut debt and invest in its infrastructure business. Hochtief is narrowing its focus to construction, seemingly marking the end of an era in which the company was actively expanding into the services sector. Hochtief is also looking into selling other units, including facility and energy management.

Construction companies are increasingly divesting assets for other reasons than just getting the necessary cash to stay in business. Under growing pressure to deliver the highest quality for the lowest price, companies need to achieve economies of scale and synergies within their value chain. Asset sales also fit into strategies of cost reduction and focusing on core business. An additional advantage of returning to core business is that it enables companies to beef up their research and development in one key area and become the cheapest, most advanced, most experienced and best constructor in their chosen niche.

Sale of non-core assets is expected to become a more prevailing strategy in coming years.

### **Debt providers**

If the divestment program does not yield sufficient financial resources, or does not do so quickly enough, companies need to (re-)engage with their providers of funding to stay in business. A typical situation that is occurring more frequently in the market is an intervention prior to insolvency proceedings. Several European construction companies have rescheduled their financial debts during 2012 and 2013.

Banks are aware of the effect of a company going bankrupt: they need to take immediate losses on their loans. Providers of junior debt facilities are realising that in the case of a bankruptcy they may not recover any of the funding provided. Both are, under certain conditions, lenient and willing to look for solutions (e.g. debt rollover) if there is a good chance the debtor will repay some of the loan provided. Companies therefore need to make every effort possible to stay afloat. An example is Polimex Mostostal. This Polish firm signed a restructuring agreement with its creditors stating that before year-end 2015, Polimex should sell assets (subsidiaries, parts of enterprises and real estate) worth at least EUR 143 million. On 1 August 2013 Polimex sold assets with a total value EUR 66 million.

One of Denmark's largest real estate development companies; Sjøelso Gruppen, filed for bankruptcy in August 2013. Its core activity is residential development. The company had been struggling for the last two to three years, in which it depended on financial assistance from creditors and banks. This shows that banks and creditors are lenient to a certain extent. The stance of creditors may change over time if the outlook deteriorates or if they are being pressured by national banks and other (European) authorities, making them unwilling or unable to extend any credit. Construction companies should therefore remain proactive on their debt levels and payments, and take timely decisions to start selling assets, reduce costs and focus on their business to remain profitable.

### **Private equity**

We have seen private equity investors as cash-rich parties who can take over assets and business units from construction companies. But during recent years private equity has become a more popular form of direct funding of businesses. Since banks are becoming more careful about expanding their portfolios, getting more expensive and introducing stricter demands for new financing, construction companies are becoming more open to new financing options and especially private equity. Private equity firms buy a substantial stake in the company's shares and bring expertise and knowledge to the boardroom. This is especially of value for smaller and mid-sized companies. The entrance of private equity gives them room to meet their debt covenants and to find and expand their core business.

#### **Private equity firm acquires majority stake in large construction company**

In May 2013, Swedish-based private equity firm Ratos acquired a 73% stake in Hent for approximately EUR 34 million. Hent is Norway's fifth largest construction company and is focused on project development and project management. The company's management will increase its stake from 22% to approximately 27% in conjunction with this transaction. Large blocks of shares were bought from Heimdal Gruppen (36%), also a construction company, and from several financial investors.

The construction sector is currently an interesting investment opportunity for private equity firms for a number of reasons:

1. Consolidation and integration of multiple companies within the construction sector (for example focussing on DBFM) creates more upside potential. These gains can be realised through restructuring, realising economies of scale or divesting non-core assets.
2. Listed construction firms are often undervalued, making it relatively cheap to build stakes in these companies.
3. Underdeveloped infrastructure in some regions in Europe is attracting EU and national funding. This creates solid demand with multiple large deals currently already in the backlog.

Examples of private equity activity this year are Ratos' acquisition of a substantial stake in Hent (discussed in the text box on this page) and Triton's acquisition of Alpine Energie. In the course of the insolvency proceedings of Alpine Bau Germany, private equity firm Triton acquired Alpine Energie, which used to be Alpine's telecom/energy infrastructure company.

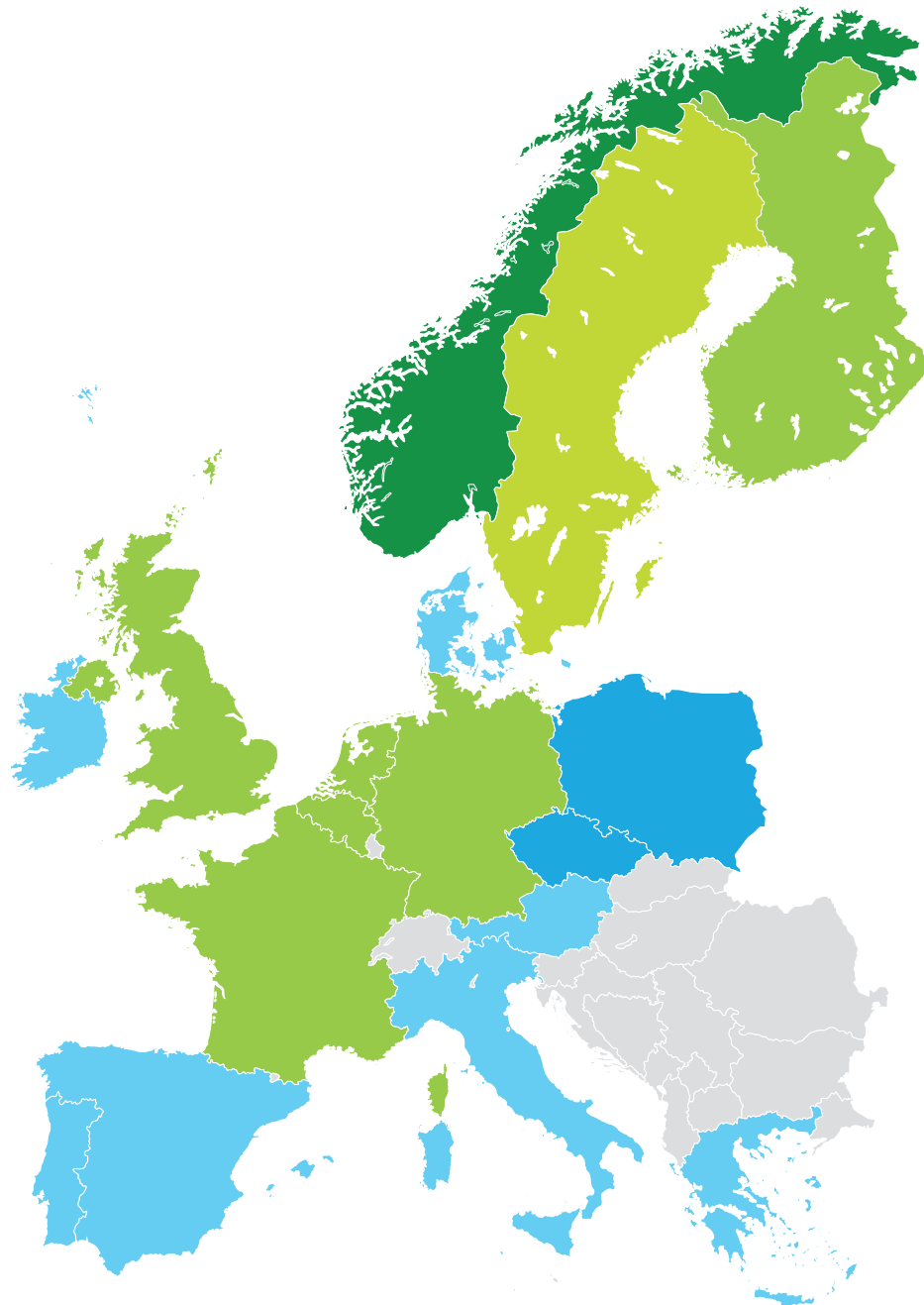
# 3. Going forward

## The outlook on M&A activity in Europe

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

Country	Outlook	Highlights
Austria	o/-	<ul style="list-style-type: none"> <li>Bankruptcy of Alpine has cast shadow over construction sector</li> <li>Low M&amp;A activity due to already consolidated market</li> </ul>
Belgium	o/+	<ul style="list-style-type: none"> <li>Upward trend in M&amp;A activity while construction companies are looking for more diversification in their portfolio</li> <li>Severe price pressure in commoditised segments and war for talent</li> </ul>
Czech Republic	-	<ul style="list-style-type: none"> <li>Construction output has decreased by 25%</li> <li>Larger construction companies out-price smaller companies</li> </ul>
Denmark	o/-	<ul style="list-style-type: none"> <li>Market is showing positive signs</li> <li>No significant M&amp;A transactions expected</li> </ul>
Finland	o/+	<ul style="list-style-type: none"> <li>Finnish construction have interest in expanding towards international markets including Russia</li> <li>Market consolidation is expected to continue at a modest level</li> </ul>
France	o/+	<ul style="list-style-type: none"> <li>Growth has largely been fuelled by M&amp;A, both within France and cross-border</li> <li>Local players will continue to consolidate</li> </ul>
Germany	o/+	<ul style="list-style-type: none"> <li>Construction companies increasingly divest businesses that no longer fit strategy</li> <li>M&amp;A activity is expected to remain at a reasonable level</li> </ul>
Greece	o/-	<ul style="list-style-type: none"> <li>Lack of funding / high cost of funding</li> <li>Privatisation of governmental assets is expected to boost transaction activity</li> </ul>
Ireland	o/-	<ul style="list-style-type: none"> <li>Extremely low levels of domestic construction activity</li> <li>M&amp;A activity to remain at relatively low levels</li> </ul>
Italy	o/-	<ul style="list-style-type: none"> <li>Larger international groups will target acquisitions in niche areas</li> <li>M&amp;A activity in 2013 and 2014 is expected to be above the level of 2012</li> </ul>
The Netherlands	o/+	<ul style="list-style-type: none"> <li>M&amp;A focused on diversification to (technical) services</li> <li>In midterm changes are imminent in Dutch Top 10 either through M&amp;A, delisting or default</li> </ul>
Norway	+	<ul style="list-style-type: none"> <li>Number of transactions in the Norwegian construction sector has been on a stable, high level since 2010</li> <li>Private equity will continue to play a significant role in subsector consolidation</li> </ul>
Poland	-	<ul style="list-style-type: none"> <li>M&amp;A activity has been very limited in recent years and is expected to remain at a low level in 2013 and through 2014</li> </ul>
Portugal	o/-	<ul style="list-style-type: none"> <li>Low levels of domestic construction activity, therefore companies look in to other markets, especially in Africa</li> <li>Some M&amp;A activity is expected from international players</li> </ul>
Spain	o/-	<ul style="list-style-type: none"> <li>Divestment of non-strategic assets and highly leveraged assets</li> <li>Spanish construction companies target overseas markets to evade troubling domestic construction market</li> </ul>
Sweden	o	<ul style="list-style-type: none"> <li>Focus on organic growth and growth via acquisitions in existing markets</li> <li>Stable and growing economy is expected to attract more international activity</li> </ul>
United Kingdom	o/+	<ul style="list-style-type: none"> <li>Transactions focus on expanding market share of service offerings</li> <li>Majority of deals are small add-on transactions to build market share or capability</li> </ul>

+ optimistic      o neutral      - pessimistic



■ +    ■ o/+    ■ o    ■ o/-    ■ -



## Overview per country (in alphabetical order)

### o/- Austria

Based on the rather small market size, the collapse of one of the country's major construction companies, Alpine, in the summer of 2013 has cast a shadow over the construction sector. Currently, parts and projects of Alpine are being taken over by other local construction companies including PORR and Strabag.

With regard to cross-border activity of Austrian construction companies: since 2008 they have been withdrawing from Eastern Europe and Russia, and there are still no signals of major steps back into these markets. Instead of looking abroad, companies are re-orientating towards offering other services. An example is Strabag's M&A service offering. The deal flow in Austria is low and expected to remain low due to an already consolidated market featuring a small number of large players.

### o/+ Belgium

Contraction of the construction industry as a whole in 2013 is expected to amount to 1.5-2.0%. The difficult economic conditions in the home market are clearly reflected in the recently surveyed opinions of construction industry leaders, as more than 90% believe that the industry in Belgium will stay the same or decline in the next 6 to 12 months. They are slightly more optimistic about the medium-term outlook, with 24% believing the industry will improve over the next 2 to 3 years.

Concerning M&A activity, the Belgian construction sector appears to be following the European trend with the number of M&A transactions during Q1-Q3 2013 already reaching the level of full year 2012. Even more than in 2012, deals in 2013 are overwhelmingly corporate transactions (77%) as opposed to private equity transactions (23%). In July 2013, for example, Belgium-based Group De Cloedt (manufacturer of granulated materials) acquired Société d'Exploitation des Carrières d'Yvoir SA (Belgian manufacturer of hard sandstone granulates used in the top layers of asphalt roads and as railway ballast), from Dutch listed builders Ballast Nedam N.V. In September 2013, holding company Ackermans & Van Haaren NV agreed

to acquire Compagnie d'Entreprises CFE SA through a three-step transaction. The transaction will include the issue of new shares as well as the acquisition of shares from Vinci SA and a mandatory public offer on the free float shares. Total deal value amounts to EUR 1.5 billion. This deal gives Ackermans & Van Haaren a large majority share in Deme, of which they already owned 50%.

### - Czech Republic

The situation in 2012 has continued unchanged in 2013 and is expected to last through 2014. Construction output has decreased by 25%. Instead of looking abroad, larger construction companies also target smaller size projects to achieve at least some cash flow. These companies have a long wind compared to smaller players, and this, in combination with economies of scale, makes it possible for them to out-price the smaller construction companies. The smaller companies are struggling at the moment or even filing for bankruptcy. No large or mid-sized companies have filed for bankruptcy recently. Consolidation, leaving a limited number of stronger players, would be good for the Czech construction market.

### o/- Denmark

The Danish construction market has been under pressure for the past four years, but sentiment is improving slightly. House prices have been rising, corporate investments have begun to recover, and – although the project volumes are in many cases small – PPP activities are picking up. The PPP market is still waiting for the final breakthrough, and may be facing a setback due to the bankruptcies of Sjælsø Gruppen (one of the largest residential developers) and E. Pihl & Søn (the fourth largest construction company in Denmark with 2,300 employees), both in August 2013. Pihl & Søn have in recent years won large and prestigious projects in Denmark including The Opera House, The Tunnel to Sweden, the new Aquarium, the UN-building etc. Approximately 70 projects under construction are currently on hold, as solicitors negotiate with banks, authorities and other construction companies to take over and complete them. This is a difficult process under current circumstances, and some of the projects may have to be retendered.

There have been no significant M&A transactions in 2012 and 2013. At the moment, while the market as a whole is showing positive signs, conditions will remain difficult and therefore an increase in the number of transactions is not foreseen in the short term. However, the hole in the market left by Pihl & Son could result in more activity by foreign companies in the Danish construction market.

#### o/+ Finland

M&A activity in Finland has mainly focused on small add-on acquisitions and market consolidation, especially in the services sector, and is expected to continue at a modest level.

Large Finnish construction companies have announced acquisition plans and expressed their interest in expanding, mainly towards international markets and Russia in particular. We observe widely different growth strategies at two large Finnish construction companies. YIT is strengthening its core activities, focusing on organic growth within Finland and aiming to grow business abroad via acquisitions in Russia. Lemminkäinen, on the other hand, solely focuses on Finland to improve profitability and competitiveness; its strategy may include divestment of non-core business in the near future.

#### o/+ France

In France, Vinci, Bouygues and Eiffage are the main players in the construction market, dominating large construction tenders and M&A activity. Given the lack of growth in their domestic market, growth at these firms has largely been fuelled by mergers and acquisitions, both within France and cross-border. Vinci has targeted companies inside Europe, but the current and future growth strategy points towards Africa, America and Asia. Bouygues has finalised its UK expansion programme late in 2012 and aims to strengthen its international presence mainly in Asia and the Middle East. Eiffage has the smallest international presence of the big three and is mainly targeting Africa and the Middle East. Local Deloitte specialists expect that these large international groups will continue to expand outside of France and that local players will continue to consolidate, partly through the buy-out of smaller companies in financial straits.

#### o/+ Germany

In Germany, on the one hand we see construction companies increasingly divesting businesses that no longer fit their strategy. On the other hand, we see an increase in acquisitions of specialised mid-sized businesses and companies with local market power. This has resulted in relatively high transaction activity (including M&A), reflecting disposal of non-core activities and acquisitions in line with revised long-term strategies. For 2013 and through 2014, overall M&A activity is expected to remain at a reasonable level.

The largest German firms, Hochtief and Bilfinger, pursue strategies that include acquisitions. Hochtief seeks growth in infrastructure engineering, Bilfinger in technical services. Both have significant financial power that enables acquisitions. In the German construction sector, we will probably see some mid-sized transactions, mostly focused on businesses that have singular competencies or local market power in singular regions. Both the public and the private sector are still cautious about PPP, which is seen as controversial by political players. However, there is a significant backlog regarding infrastructure projects and public buildings. Things might accelerate depending on the results of current negotiations to form a new federal government.

#### o/- Greece

The largest Greek construction groups continue to face significant challenges, including the lack of funding for new projects, the high cost of funding, and the slowdown in the construction of a number of projects. This has led Greek construction companies to venture into foreign markets.

Before Greece's economic downturn, construction had already begun of a number of large motorways through PPPs. Subsequently, due to changed market conditions, most of these projects have been on hold, but a restart is expected. In addition, there is a pipeline of 12 waste management PPP projects with a total value of EUR 2.1 billion. The Hellenic Republic Asset Development Fund (HRADF), the authority for the privatisation of governmental assets, is proceeding with tenders for the privatisation of long-term concessions, several real estate plots that may be used for tourism or residential developments, and public administration buildings. These tenders are expected to boost transaction activity, including M&A.

#### o/- Ireland

In overall terms, the construction market continued to decline during the year, but activity levels are likely to be at or near the bottom of the cycle. Development activity is improving, principally in Dublin, and in time local Deloitte specialists think 2014 will be seen as the first year of a turnaround in the sector.

There has been very limited M&A activity in Ireland over the last 3 years due to extremely low levels of domestic construction activity. The most notable domestic transaction during the period related to Cemex's acquisition of the remaining 38% of Readymix shares in 2012. In terms of building materials CRH has also been very active over the period, completing a significant number of cross-border transactions in China, India and America. Domestic M&A activity is likely to remain at relatively low levels for the foreseeable future, due in part to the absence of bank financing for the industry. It is probable that as the market recovers, smaller subcontractors and material suppliers will encounter financial difficulties from rising input prices, leading to some consolidation at that level. This could present opportunities to acquire niche players. In the future local Deloitte specialists envisage some international appetite to invest into the domestic sector, but they believe that the recovery must stabilise for a number of periods before meaningful activity can be expected.

#### o/- Italy

The Italian construction market has been contracting over the past years, and 2013 was no exception. The falling level of investment, the difficulty of financing projects and the increasing efforts dedicated to credit recovery have all contributed to the lethargy in market. This difficult situation has also exposed companies with financial weakness leaving them vulnerable to either failure or being targeted by more financially robust and stable competitors. These players are not necessarily interested in buying whole companies but more frequently look to acquire only the most attractive projects.

The number of announced deals in the sector has steadily declined from 13 deals in 2010 and 11 in 2011 to 8 deals in 2012. However, the first signs of recovery are starting to appear since in the first eight months of 2013, 7 deals were announced and it is expected that M&A activity will continue to increase through to the end of 2013 and also into 2014.

Given the current market conditions, it is expected that M&A activity will continue in the following three main areas:

1. Consolidation to increase size: the small to medium-sized companies need to grow in order to be able to compete in the highly competitive national and international markets outside the EU where large corporations dominate.
2. Niche "add ons": larger international groups will take the opportunity offered by current market conditions to make targeted acquisitions in niche areas in the Italian market acquiring new and specific skill sets.
3. Strategic focus: engineering companies will look to develop core competencies and sectors where they have existing strengths. For example following the union of Salini and Impregilo the new group set out its strategic focus to concentrate on its core contracting activities whilst developing its presence in the concession market. Likewise, another large Italian company Astaldi is also seeking to increase its involvement in the concession business to support its efforts to participate further the European market.

#### o/+ The Netherlands

The Dutch economy is slowly recovering, but there has been a long period of low consumer and investor confidence due to a troubling political climate, a paralysed housing market and declining funding opportunities. This has resulted in structurally low construction output and low housing demand for 2012 and 2013. Although most of the top 15 construction companies in the Netherlands reported higher sales in 2012 (with respect to the year 2011), the construction sector remains weak and margins are under high pressure.

M&A activity is currently mainly the result of receivership/bankruptcy of small and mid-sized construction companies, i.e. consolidation. In the mid-term, a default of one of the larger construction companies in the Netherlands cannot be ruled out, as market conditions are still adverse. We may also see delisting of and/or mergers between Top 10 construction companies in the Netherlands. For the moment though, Q1 2013 - Q3 2013 did not feature any major M&A deals.

Large construction companies are increasing their focus on technical services, international (niche) opportunities (e.g. Strukton, Ballast Nedam, BAM, VolkerWessels) as well as DBFM(O) projects. BAM and large Dutch institutional investor PGGM (with assets under management of approximately EUR 140 billion) have started a joint venture which targets public private partnerships (PPP). In May 2013, they concluded a road contract in Ireland comprising design, build, finance (project volume: approximately EUR 282 million) and a maintenance contract of 25 years. We have also noticed more private equity activity: in October 2012 and September 2013, Reggeborgh - the investment vehicle (family office) of the Wessels family - acquired the 42.5% interest held by CVC Capital Partners in VolkerWessels, the second largest construction company of the Netherlands based on sales.

Dutch construction companies are often technology-driven and are renowned for their knowledge and experience. Mid-sized to large Dutch construction companies could become more attractive targets to international construction groups the moment the outlook for the Dutch economy, and subsequently the outlook for the construction sector and companies, improves.

#### + Norway

The number of transactions in the Norwegian construction sector has been on a stable, high level since 2010. Transactions have generally involved small local or mid-cap regional targets, as the large domestic and Nordic players such as Veidekke, Skanska, AF Gruppen, NCC, Betonmast and Peab have made smaller, selective acquisitions to fill geographic, capacity or competency gaps. The relatively favourable Norwegian market conditions attract substantial interest from players from other countries. To date, however, Implenla is the only non-Nordic group to enter the Norwegian market through an acquisition back in 2010, taking over Betonmast Anlegg AS, one of Norway's largest independent infrastructure construction companies. Other international companies have chosen to tap into the Norwegian market through joint ventures. Private equity (PE) companies have generally been more active in the subcontractor space, such as technical building services. However, in May 2013 Sweden-based PE-company Ratos purchased Hent, the first PE-backed acquisition of a traditional construction company in Norway.

Given current market conditions, local Deloitte specialists expect continued high M&A activity in Norway. The market is still fragmented, capacity is scarce, and the trend towards larger, more complex projects will continue to be an incentive for the domestic and Nordic companies to create larger entities. This will also make them better suited to face the increased international competition. As a result, we expect that larger transactions may also take place among the traditional Norwegian and Nordic construction companies. On the other hand, we expect non-Nordic companies to continue to compete for the large infrastructure projects. The primary vehicle for this will be through joint ventures, yet the special opportunities and challenges of the Norwegian market may well prompt other companies to follow Implenla's example of acquiring a more permanent presence in Norway. We also expect continued high M&A activity in the very fragmented subcontractor markets, such as technical service contractors, consulting engineers etc. Private equity will continue to play a significant role in subsector consolidation.

#### - Poland

The Polish construction sector fell back as funding programmes ran out of money. The EU regional programme will end in 2013 and the sector is waiting for a new one for the 2014-2020 period. However, the Polish construction sector is urgently in need of new construction and renovation projects. That goes for the public as well: especially infrastructure (including energy and sea transport infrastructure) and retail property (i.e. shopping centres) need to be expanded, modernised and improved. New investments are expected sooner or later, which improves Poland's outlook compared to last year. Nevertheless, M&A activity has been very limited in recent years and is expected to remain at a low level in 2013 and through 2014.

#### o/- Portugal

The Portuguese construction market continues to suffer from uncertainty and lack of investor confidence. Investment in the construction sector has plummeted, mainly due to the economic context and limited credit availability. Domestic demand, both public and private, has declined severely and the number of bankruptcies has increased. Some companies are restructuring their operations and debt and/or divesting assets and non-core businesses in an attempt to deleverage their balance sheets and to ensure the necessary financial capability in the short term - and a successful exit in the medium term. Meanwhile, consolidation has been an option for some companies, assisted by the recently created "Consolidation Fund for the Construction Sector". Other companies are exploring overseas opportunities, transferring their capacity and knowledge to international markets such as Africa, South America and the Middle East.

#### o/- Spain

Due to the current situation in the Spanish construction market, Spanish construction companies are applying the following guidelines:

1. Internationalisation strategies focus on investment grade countries (good macro-economic figures, attractive infrastructure plans and stable legal and economic environments) such as the US, Latin America, the UK, Central and Eastern Europe, the Middle East, Brazil and Australia.
2. Internationalisation is implemented through participation in Public Private Partnerships (PPP) acquisitions and/or consortiums with local players.
3. Divestment of non-strategic assets (renewable energy, infrastructure concessions, parking areas, real estate, urban services, handling, logistics, etc.) and highly leveraged assets provides financial resources to be used for debt reduction, new investments and the realisation of capital gains.

Spanish construction companies have focused on their core construction business, diversifying internationally in order to maintain a level of activity that enables them to meet their restructured debt objectives. Going forward, Spanish construction companies will seek to further deleverage by divesting non-core assets, focusing on their core construction business while consolidating their international position.

#### o Sweden

During the last three years M&A activity in the Swedish construction sector has been quite stable. Transactions targeted companies (M&A), construction projects and strategic land, both in Sweden and abroad. However, there has not been any major M&A activity from the four largest Swedish construction companies from autumn 2012 up until now. Publicly, however, NCC, Skanska, JM and Peab have expressed their intention to grow both via largely organic growth in their existing markets and via corporate acquisitions. Strengthening their position in existing markets is definitely on the agenda of these construction groups. International growth should be pursued with caution.

The stable and even growing economy in Sweden compared to the Eurozone is expected to create the right conditions for more international activity in the Swedish construction sector.

#### o/+ United Kingdom

As noted in last year's report, the UK remains an attractive market for overseas investment and this is reflected in the Ferrovial investment in Enterprise. 2013 has seen a slight reduction in the number of deals involving UK companies. This was expected, as the construction industry in the UK continues to feel a squeeze on profits and cash flows. The current year has seen four transactions of over GBP 100 million, three of which related to service businesses: Amey's acquisition of Enterprise, Balfour Beatty's disposal of its facilities management business and Kier Group's merger with May Gurney Integrated Services. Keller has expanded its Canadian operations with the acquisition of North American Pilling. While the majority of the deals are small add-on transactions to build market share or capability, there continued a theme of expansion into new markets including Canada, the Middle East and BRIC countries. With the exception of Keller's acquisition, however, these transactions were relatively small in value. Balfour Beatty's divestment of its facility management business to concentrate on its core infrastructure business is an interesting move and could herald a new trend for businesses to focus on core offerings, a departure from the previous trend towards diversification.

Over the last two to three years the construction industry has been hit hard by insolvencies and perhaps is the hardest hit sector in the UK. This has continued into 2013. The improving outlook on orders may be positive news, but there are likely to be more insolvencies before the market recovers. Especially at risk are smaller contractors and the supply chain, where the pressure is really being felt.

# 4. To conclude

## What to expect

The number of M&A deals was higher in 2012 than in 2011. However, when looking at the period 2009-2012, it seems to be an average year with 122 recorded deals. 2013 is expected to be about the same, but in 2014 we foresee growing confidence in the sector, driving M&A dynamics while prices are expected to remain low.

This could present opportunities for cash-rich/expanding companies to target and acquire smaller to medium-sized companies that have a local market presence or specialist competencies (niche players), for example companies supplying construction products, technology or services. The profit margins on these non-construction activities are substantially higher than the margins on traditional construction activities: a diversified portfolio of services clearly improves the performance of construction groups.

At the same time, mid-sized companies will need to find ways to get bigger in order to be able to compete with other international players. M&A and joint ventures will be the main routes for companies to quickly gain size and create an effective international presence. This will lead to some further consolidation in the European construction market.

While the majority of transactions are smaller add-on transactions to build market share or capability, there continues a theme of expansion into new markets including Russia, North and South America, Africa, Middle East, Asia and Australia. We expect large international companies to continue to expand outside of Europe (partly to enter new markets but mainly in order to strengthen existing positions abroad) and local players to continue to consolidate partly through the buyout of smaller companies in financial difficulty. Also individual projects of companies in difficulty remain of interest.

At the same time, we see some sales by large construction companies that are demerging businesses that do not (or no longer) fit with their strategy. Several construction groups are seeking to further deleverage by divesting non-core assets, focusing on their core construction business while consolidating their international position. This trend is likely to continue in the coming years. Private equity seems increasingly interested in these businesses and non-core assets, which is expected to lead to more dynamic M&A markets in particularly Europe.

Depending on the specific situation, construction companies will remain focused on debt reduction, improving profitability, strengthening current international presence, and contracts with recurrent revenues such as PPP and concessions.

We envisage that M&A deal flow will continue to be moderate over 2013 and H1 2014, but a pick-up in M&A activity is anticipated from H2 2014 onwards. Meanwhile, it remains uncertain when the M&A activity levels of 2007 and 2008 will be reached again.





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