Engineering growth

Fourth-quarter 2014 engineering and construction industry mergers and acquisitions analysis

Highlights

To our engineering and construction readers

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To help provide further insights on recent mergers and acquisitions (M&A) activity, PwC is pleased to share our analysis of 2014 M&A activity in the global engineering and construction (E&C) industry. This edition of *Engineering growth* provides an overview of deal activity over the last 12 months, with a focus on the fourth quarter, as well as our expectations for the E&C industry in the near future.

Total deal value soared in 2014, more than tripling the prior-year result and reaching $172.6 billion worth of transactions greater than $50 million. That total is only slightly below the ten-year high set in 2007. Deal volume jumped by more than 25 percent over the prior year and included 21 announced megadeals, or transactions with an announced deal value of at least $1 billion. The average deal size for 2014 was nearly $800 million and more than $1.5 billion for US-based targets. The fourth quarter saw a slight drop in the number of transactions but included the largest deal of the year.

On a regional basis, Asia led the way in terms of volume of deals this past year but inbound activity in the region remained subdued. Foreign buyers have become wary due to a perceived oversupply of capacity, materials, and debt in the region and local consolidation is well underway. Europe, on the other hand, saw a significant amount of local, inbound, and output activity despite continued economic malaise in the region. Local and foreign buyers continue to scour the region for high-quality businesses as they look to align business portfolios with long-term attractive markets. Both strategic and financial buyers actively seek discounted assets from distressed sellers in Europe. Emerging market activity boomed in 4Q14, accounting for just shy of half the total transactions.

In 2014, large acquisition targets cut across a wide range of businesses with megadeal activity occurring in most segments of the industry. Megadeals were announced in civil engineering, construction materials, construction services, and construction machinery. Home builders were the anomaly with more limited activity despite improvements in housing starts as well as enhanced consumer confidence and a pickup in hiring activity.

The recently announced $35 billion acquisition of Baker Hughes, the third largest oil-field services and construction machinery company, by Halliburton highlights both the potential and associated risks of consolidation in oil and gas aligned businesses. Deal activity could accelerate as companies focus on eliminating overcapacity and reassess the marginal profitability of oil and gas projects at lower oil prices. However, given a much wider range of commodity price scenarios, the risks of incorrectly assessing valuation of targets are elevated. Both strategic and financial buyers with deeper pockets and a longer-term outlook are best positioned to see the current commodity pricing cycle and take advantage of shorter-term volatility.

PwC analysts are monitoring several additional trends expected to affect the values of deals in engineering and construction:

- **Full service integration is gaining popularity.** The industry continues on a path toward full service integration, which has been a central theme of acquisition activity. Multinational clients are 'rationalizing' vendors, choosing firms that can perform end-to-end service while firms are looking to leverage higher value added services, such as design.
- **Urbanization and demographic shifts play into global growth plans.** The near-term economic outlook continues to favor the United States, but emerging markets remain the engine of long-term global growth. Potential acquirers have become more selective as new baseline growth rates in emerging markets are established but should remain focused on the longer-term megatrends.
- **China construction outlook continues to be bleak.** Sales of commercial and residential buildings as well as development property continue to decline in China. The apparent oversupply in the building materials sector will continue to drive consolidation in the region.
- **Financial investors remain active in the sector.** Financial investors have shown interest in the sector as evidenced by their participation in several megadeals. They have shown particular interest in the European region on the expectation of finding undervalued assets after years of subdued earnings.
- **Joint venture activity is on the rise.** Companies are increasingly using joint ventures to expand geographic reach and broaden service lines but this increases project complexity and risk.
- **The talent gap widens.** The skilled labor gap is emerging as a major theme as companies struggle to fill talent needs, particularly in skilled areas such as engineering and design. As companies look to invest in growth, talent considerations will become a more critical consideration in merger due diligence.
- **As buildings go green, so do E&C companies.** With increasing regulatory pressure, the focus has intensified on sustainable and green construction, supporting the overall reduction in carbon footprint. The acquisition activity is expected to gain momentum in this space, with large firms eyeing niche companies specializing in sustainable development.

We remain optimistic that deal activity in the engineering and construction sector will continue at a brisk pace. The biggest challenge for potential buyers is calibrating the long-term growth themes (emerging markets and resource scarcity megatrends) with near-term volatility. Companies are reevaluating growth opportunities in major markets as they digest both the direct and indirect economic implications of the rapid deterioration in oil prices and consider the potential impact of the first round of regulatory tightening on US economic activity.

The main factors that will likely drive activity even amid a tepid, and highly uncertain, global economic environment include the increasing size and complexity of projects; a rising use of design-build contracts and search for talent and technical specialization, including PPP (public-private partnerships) experience; and the need for relationships in key growth regions.

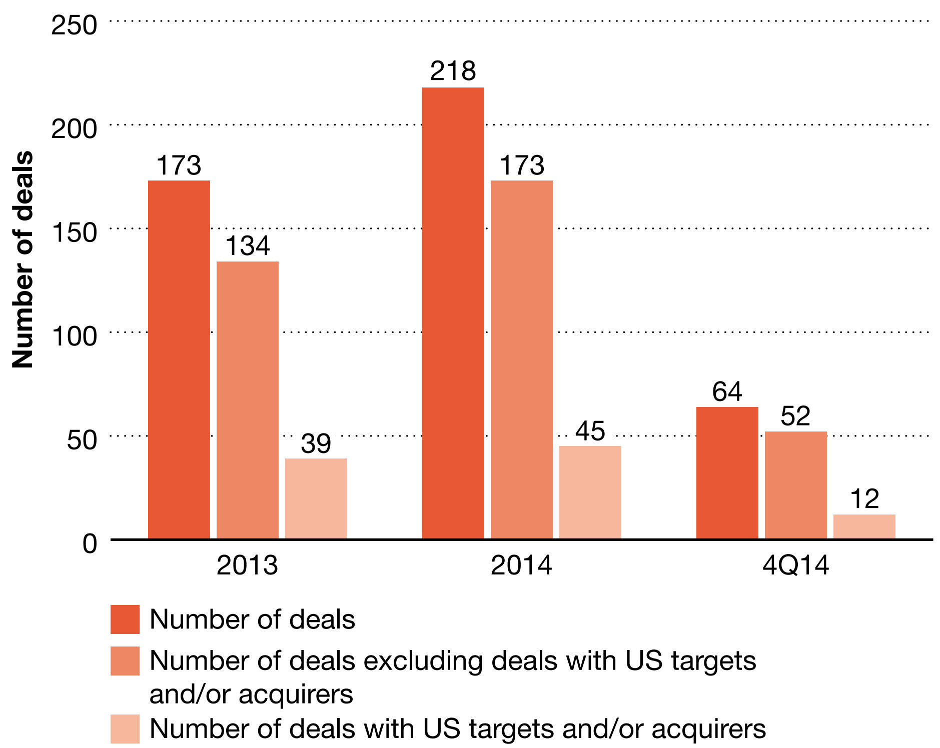
We're pleased to present our fourth-quarter 2014 analysis as part of our ongoing commitment to providing you with a deeper understanding of M&A trends and prospects in the industry.

For a deeper dive into the data, launch the data explorer at *http://www.pwc.com/us/en/industrialproducts/publications/engineering-growth.jhtml* or contact us to further discuss our insights.

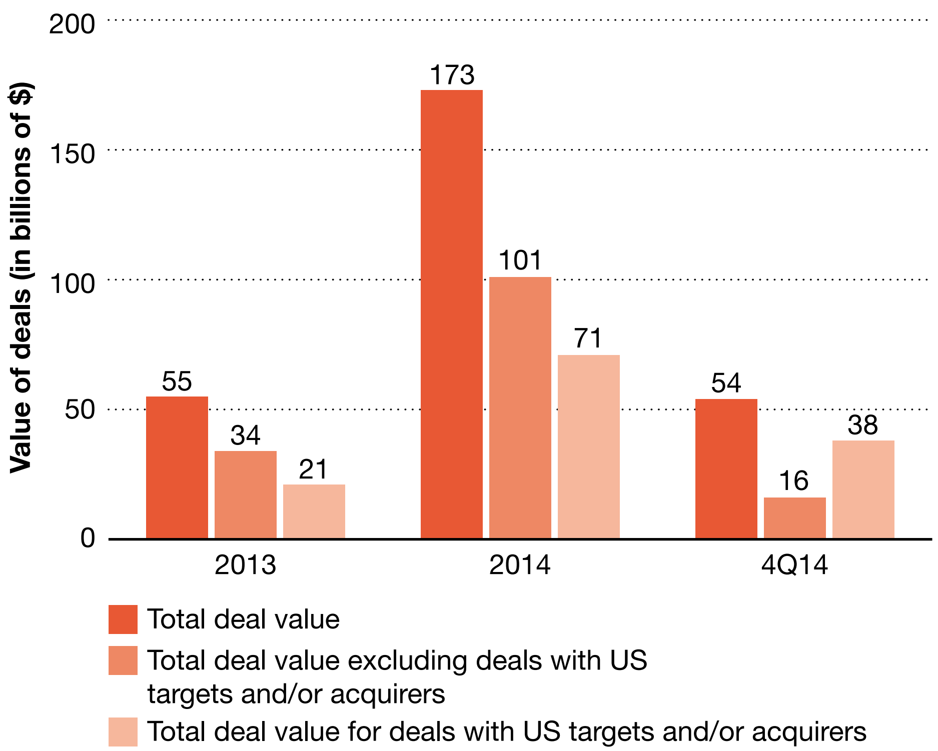
Deal activity

US and overseas deal activity by number and value of transactions

Deal activity by number of deals
Measured by number of deals worth $50 million or more (2013, 2014, 4Q14)



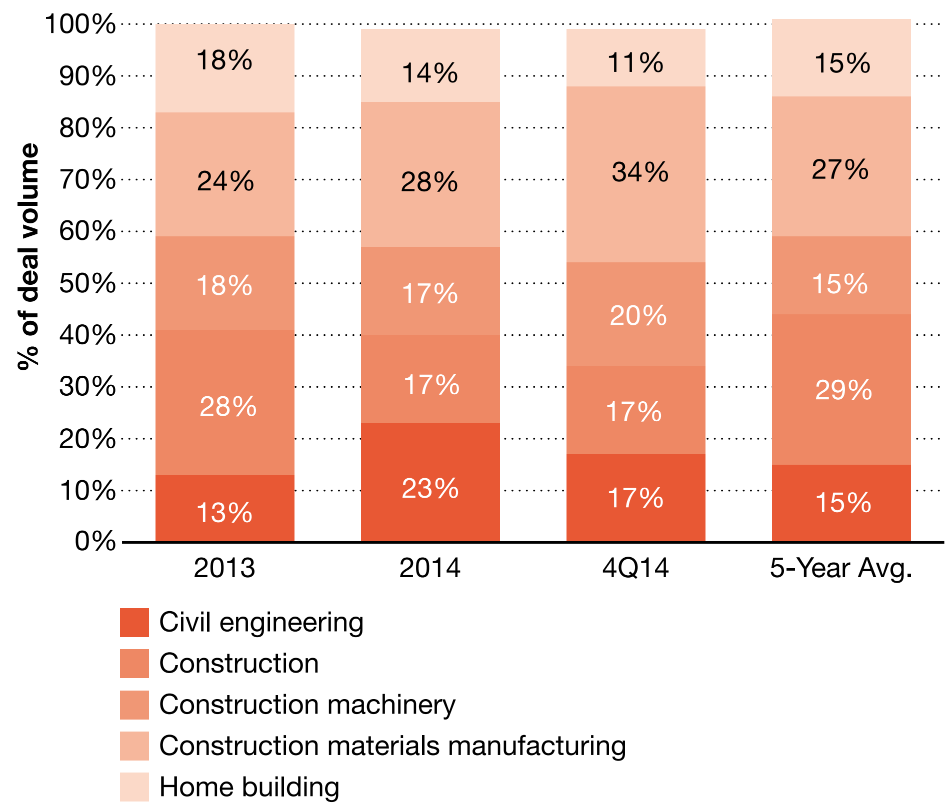
Deal activity by value of deals
Measured by value of deals worth $50 million or more (2013, 2014, 4Q14)



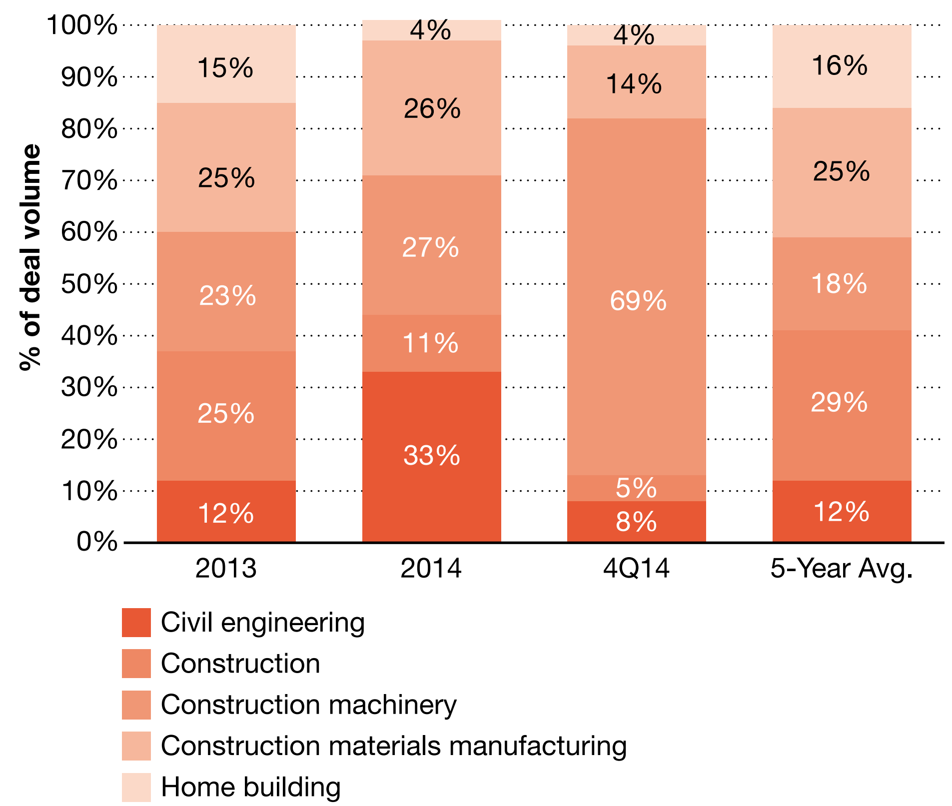
Engineering and construction transaction volume for deals above $50 million increased by 25 percent in 2014 as value of transactions more than tripled. Volume picked up considerably in the second half of the year with 72 deals in 3Q14 and 64 deals in the latest quarter. In contrast, the number of smaller deals (below $50 million in value) and transactions with no disclosed transaction value was somewhat more subdued, increasing by just 1.8 percent over the prior year. The average deal size for 2014 was nearly $800 million, and more than $1.5 billion for US-based targets.

Deals by target E&C category, with distribution by number and value of transactions

Deal composition by percent of announced deals (2013, 2014, 4Q14)



Deal composition by percent of announced deal value (2013, 2014, 4Q14)



Construction materials and machinery were most active in the final quarter of 2014. Home builders were the anomaly with more limited activity, as the real estate outlook in the United States remained relatively uncertain despite favorable housing starts and improving consumer confidence and hiring activity as the year progressed.

Large deals

Megadeals in 2014 (value of $1 billion or more)

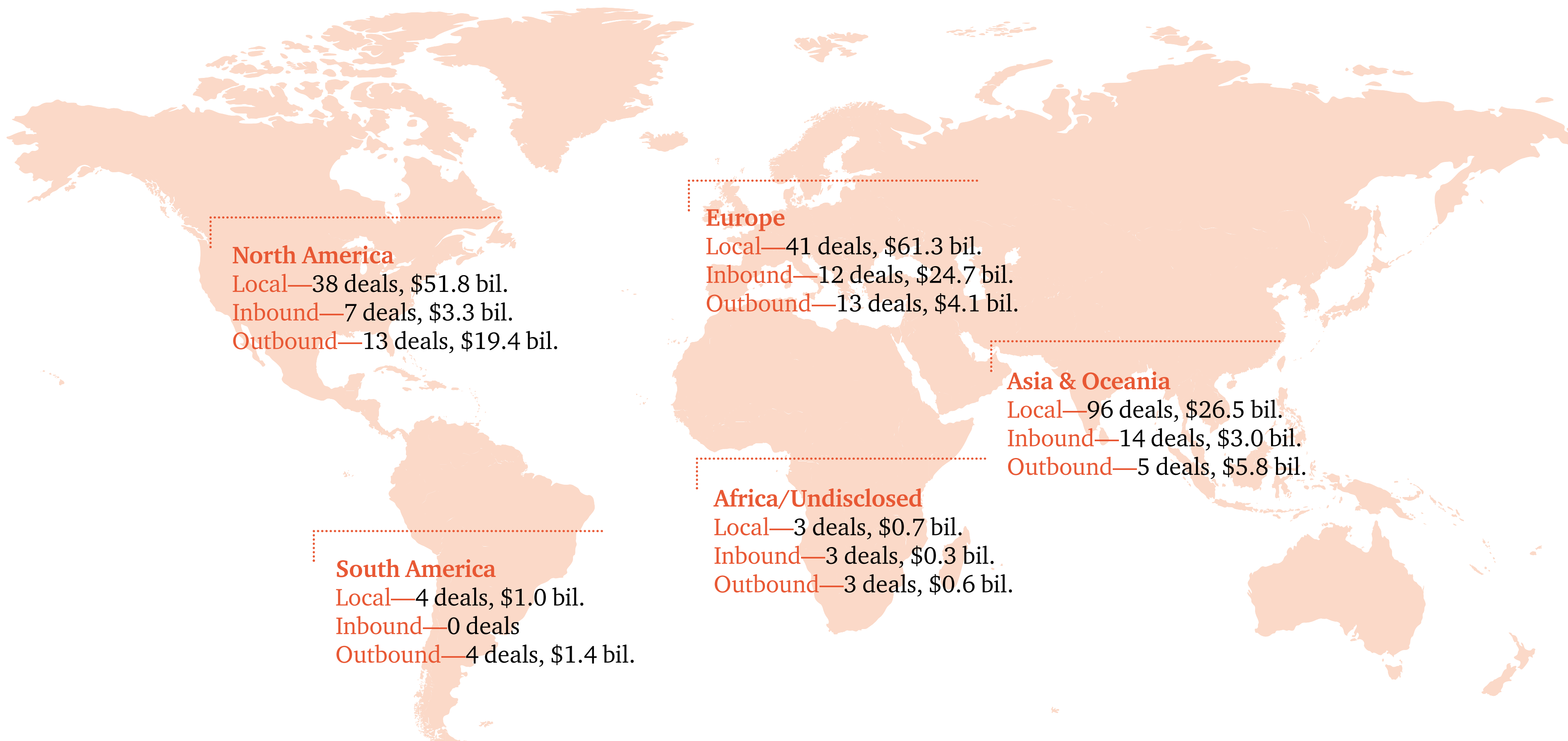
Megadeals in 2014 (value of $1 billion or more)

Month announced	Target name	Target nation	Acquirer name	Acquirer nation	Status	Value of transaction in US$ bils	Category
Nov	Baker Hughes Inc.	United States	Halliburton Co.	United States	Pending	35.27	Construction machinery
Apr	Lafarge SA	France	Holcim Ltd.	Switzerland	Pending	25.91	Construction materials manufacturing
Apr	Alstom SA-Energy Businesses	France	GE	United States	Pending	17.12	Civil engineering
Apr	Queensland Motorways Ltd.	Australia	Investor Group	Australia	Completed	6.61	Construction
Apr	Alstom SA-Gas Business	France	Siemens AG	Germany	Withdrawn	5.85	Civil engineering
Apr	Alstom SA-Steam & Nuclear Business	France	Mitsubishi Heavy Industries	Japan	Withdrawn	5.31	Civil engineering
Jul	URS Corp.	United States	AECOM Technology Corp.	United States	Completed	3.89	Civil engineering
Jul	Balfour Beatty PLC	United Kingdom	Carillion PLC	United Kingdom	Withdrawn	3.47	Civil engineering
Jan	Foster Wheeler AG	United Kingdom	AMEC PLC	United Kingdom	Completed	3.14	Construction
Jun	Alstom SA	France	France	France	Intended	2.94	Civil engineering
Jul	Aker Solutions Holding ASA	Norway	Shareholders	Norway	Completed	2.76	Construction machinery
Jan	Texas Industries Inc.	United States	Martin Marietta Materials Inc.	United States	Completed	2.11	Construction materials manufacturing
Jun	Kentz Corp Ltd.	Jersey	SNC-Lavalin Group Inc.	United Kingdom	Completed	1.94	Civil engineering
Feb	Veyance Technologies Inc.	United States	Continental AG	Germany	Pending	1.91	Construction machinery
Dec	Balfour Beatty PLC-PPP Portfolio	United Kingdom	John Laing Infrastructure Fund	Guernsey	Pending	1.56	Civil engineering
Jul	Lafarge Tarmac Holdings Ltd	United Kingdom	Lafarge SA	France	Pending	1.52	Construction materials manufacturing
Dec	Hanson Building Products North America	United States	Lone Star Funds	United States	Pending	1.40	Construction materials manufacturing
Sep	Parsons Brinckerhoff Group Inc.	United States	WSP Global Inc.	Canada	Completed	1.35	Civil engineering
Oct	Sanitec Abp	Finland	Geberit AG	Switzerland	Pending	1.34	Construction materials manufacturing
Mar	ParexGroup SA	France	CVC Capital Partners Ltd.	United Kingdom	Completed	1.21	Construction materials manufacturing
Apr	Alstom SA-Auxiliary Components Business	Germany	Triton Advisers Ltd.	Jersey	Completed	1.01	Civil engineering

Large acquisition targets in 2014 cut across most business segments including civil engineering, construction materials, construction services, and construction equipment. It should be noted that some of these are multiple, competing bids for the same asset. We include these in our total since they reflect the overall appetite for transaction activity in the sector. While we expect activity to continue at a brisk pace, it will be difficult to match the 21 announced megadeals from 2014.

Deal market characteristics

Global E&C activity in breakdown of transaction totals by region of acquirer and location of target



On a regional basis, deal volume was highest in Asia, where investors were involved with 115 deals for the year. A large majority of these deals were local as elimination of excess capacity has been the primary driver of regional consolidation across the engineering and construction sector. We expect inbound activity in Asia to accelerate and advise companies to keep their eye on long-term structural shifts in power and demographics that favor the region. Europe was a prime location for deal making with significant local and inbound activity. Foreign and local companies are shopping in the region for high-quality assets. The United States experienced limited inbound activity but local volume included some significantly sized megadeals; a strong dollar and aggressive valuations might deter foreign investors despite favorable economic conditions.

Methodology

Engineering growth is an analysis of deals in the global engineering and construction sector. Deal information was gathered from Thomson Reuters and includes deals for which targets have primary SIC codes that fall into one of the following SIC industry groups: single-family housing construction; residential construction; operative builders; industrial buildings and warehouses; nonresidential building construction; highway and street construction; bridge, tunnel, and elevated highway construction; water, sewer, pipeline, and utility line construction; heavy construction; plumbing, heating, and air conditioning; electrical work; carpentry work; roofing, siding, and sheet metal work; concrete work; water well drilling; structural steel erection; excavation work; installation or erection of building equipment; special trade contractors; asphalt paving mixtures and blocks; asphalt felts and coatings; flat glass; glass containers; pressed and blown glass and glassware; glass products made of purchased glass; cement, hydraulic; brick and structural clay tile; ceramic wall and floor tile; clay refractories; vitreous plumbing fixtures and bathroom accessories; fine earthenware (white ware) kitchen articles; pottery products; concrete block and brick; concrete products, except block and brick; ready-mixed concrete; gypsum products; cut stone and stone products; abrasive products; minerals and earths, ground or otherwise treated; mineral wool; non-clay refractories; nonmetallic mineral products; construction machinery and equipment; mining machinery and equipment, except oil and gas; oil and gas field machinery and equipment; elevators and moving stairways; conveyors and conveying equipment; hoists, cranes, and monorail systems; industrial trucks, tractors, trailers, and stackers; lumber, plywood, millwork, and wood panels; brick, stone, and related construction materials; roofing, siding, and insulation materials; construction materials; lumber and other building materials dealers; engineering services; architectural services; surveying services; and air and water resource and solid waste management. Balance sheet data was sourced from public company reports.

This analysis includes all individual mergers and acquisitions for disclosed or undisclosed values, leveraged buyouts, privatizations, minority-stake purchases, and acquisitions of remaining interest announced between January 1, 2013, and December 31, 2014, with a deal status of completed, intended, partially completed, pending, pending regulatory approval, unconditional (i.e., initial conditions set forth by the buyer have been met but the deal has not been completed), or withdrawn.

Regional categories used in this report approximate United Nations regional groups, as determined by the UN Statistics Division, with the exception of the North America region (includes North America, Latin America, and the Caribbean UN groups), the Asia and Oceania region (includes Asia and Oceania UN groups), and Europe (divided into UK and Eurozone and Europe ex-UK and Eurozone regions). The Eurozone includes Austria, Belgium, Cyprus, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Malta, Netherlands, Portugal, Slovenia, and Spain. Oceania includes Australia, New Zealand, Melanesia, Micronesia, and Polynesia. Overseas territories were included in the region of the parent country, and China, when referenced separately, includes Hong Kong. The term deal, when referenced herein, refers to deals with a disclosed value of at least $50 million unless otherwise noted.

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