Engineering growth

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First-quarter 2015 global engineering and construction industry mergers and acquisitions analysis

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Welcome to *Engineering growth,* our quarterly analysis of mergers and acquisitions (M&A) in the engineering and construction (E&C) sector. In this summary, you'll find an overview of mergers and acquisitions in the sector during the first quarter of 2015.

Overview

M&A activity slowed considerably in the first quarter of 2015 relative to the near record transaction volume and value recorded in 2014. The number of transactions of $50 million or above dropped to 34, 48% below the prior quarter but matching the first quarter of 2014. With $15.1 billion in announced deals, 1Q15 was the slowest in the last six quarters, though it remained in line with median historical quarterly totals. Megadeal activity was limited, with two announced transactions of $1 billion or greater in the quarter.

Regional activity

Overall, the US economy has been steady, while poor-to-mild economic activity across China, South America, and Europe has weighed heavily on the global construction sector. Going forward, low oil prices and expansionary monetary policies should support modest expansion, even as lack of funding for public infrastructure remains a key risk. Pockets of construction directly tied to upstream energy projects are similarly in danger of defunding, while downstream projects remain on track. Volatility in commodity and currency prices may have hampered transaction activity, obscuring the growth outlook and appropriate pricing levels. The strong dollar could drive US outbound deals in the coming months (since foreign targets have become cheaper in US currency).

Against that backdrop, consolidation among smaller, niche companies, particularly among Asian firms, remained the dominant theme. Cross border deals dropped below 30% of the total, and US-based activity slowed considerably, with just two transactions of $50 million or greater. Emerging markets accounted for half of all deals of this size, well above their typical share, with more than a third of the total represented by regional deals in China.

Despite easing monetary policy in China, burgeoning inventory and high debt levels are a drag on overall profitability in the Chinese construction market. Oversupply has led to consolidation activity among real estate developers, construction firms, and construction material manufacturers. Other major Asian economies are witnessing modest growth in the construction market, driven by increasing housing demand from a growing middle class population. There is an increased possibility for interregional M&A across Asia even if inbound activity is limited.

Segmentation activity

The construction materials segment dominated activity in the sector, as consolidation in cement/concrete manufacturing continued. The large building material megadeal from last year had a setback with shareholders planning to vote against the deal. However, both companies continue to shed assets to gain regulatory approval. In fact, 11 deals in the quarter, including two of the largest three, were related to the disposition of assets from the combined entity.

Additional trends that are expected to affect the value and volume of deals in the sector:

- **Consolidation of mid-size E&C firms.** We expect a pick-up in activity among mid-size firms as they scale up to compete on larger, more complex projects and build out capabilities. The industry continues on a path toward full service integration and mid-size firms have the most to lose from inactivity.

- **Financial investors search for yield.** Investor groups have become increasingly active and are investing in construction and building material companies, particularly in recovering regions. Construction companies have unlevered their balance sheets and monetized assets, and some are positioned for a strong return on investment.

- **Geographic footprint expansion has stalled.** Local consolidation was the dominant theme this quarter, but we expect companies to fill market gaps through geographic expansion. Emerging markets remain the engine of long-term global growth and potential acquirers have become more selective as new baseline growth rates are established.

- **The talent gap continues to widen.** 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.

Outlook

We remain optimistic that deal activity in the E&C 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.

We're pleased to present our first-quarter 2015 analysis as part of our ongoing commitment to providing you with a deeper understanding of M&A trends and prospects in the industry. Launch the data explorer at *http://www.pwc.com/us/en/industrial-products/%20publications/engineering-growth.jhtml* for a deeper dive into the data, or contact us to further discuss our insights.

Sincerely,

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