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## Construction M&A Environment



CAPITAL ADVISORS

Investment Banking for the Built Environment

#CFMARM2019

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# Ryan Foley – Managing Director



Ryan Foley  
Managing Director

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- Focus on contractors
- Over 20 years of investment banking experience
- Experience in M&A, private equity, public/private placements of capital, recapitalizations and restructuring transactions in an aggregate amount of \$3.0 billion
- Previously an investment banker at Green Manning & Bunch, a Denver-based M&A advisory firm
- Additional banking experience at Allegiance Capital and BMO Capital Markets
- B.S. in finance from Boston College and an MBA from The University of Texas at Austin
- Holds Series 79 and 63 licenses with FINRA and the SEC

# Who is FMI?

6

North American  
Offices

65+

Years in  
Business

175+

Professionals

500+

Annual Client  
Engagements

25+

Annual M&A  
Transactions

## Investment Banking (FMI Capital Advisors)

- ▶ Sell-Side M&A
- ▶ ESOP Advisory
- ▶ Buy-Side M&A
- ▶ Private Capital Placements
- ▶ Financial Advisory

## Management Consulting (FMI)

- ▶ Strategy
- ▶ Market Research
- ▶ Business Development
- ▶ Operations
- ▶ Risk Management
- ▶ Organizational Development



of the ENR  
Top 400  
Contractors



of the ENR  
Top 200  
Specialty  
Contractors



of the ENR  
Top 100  
Design  
Firms



of the ENR  
Top 200  
Environmental  
Firms



of the ENR  
Top 100  
CM for  
Fee Firms



# Where are We Today?



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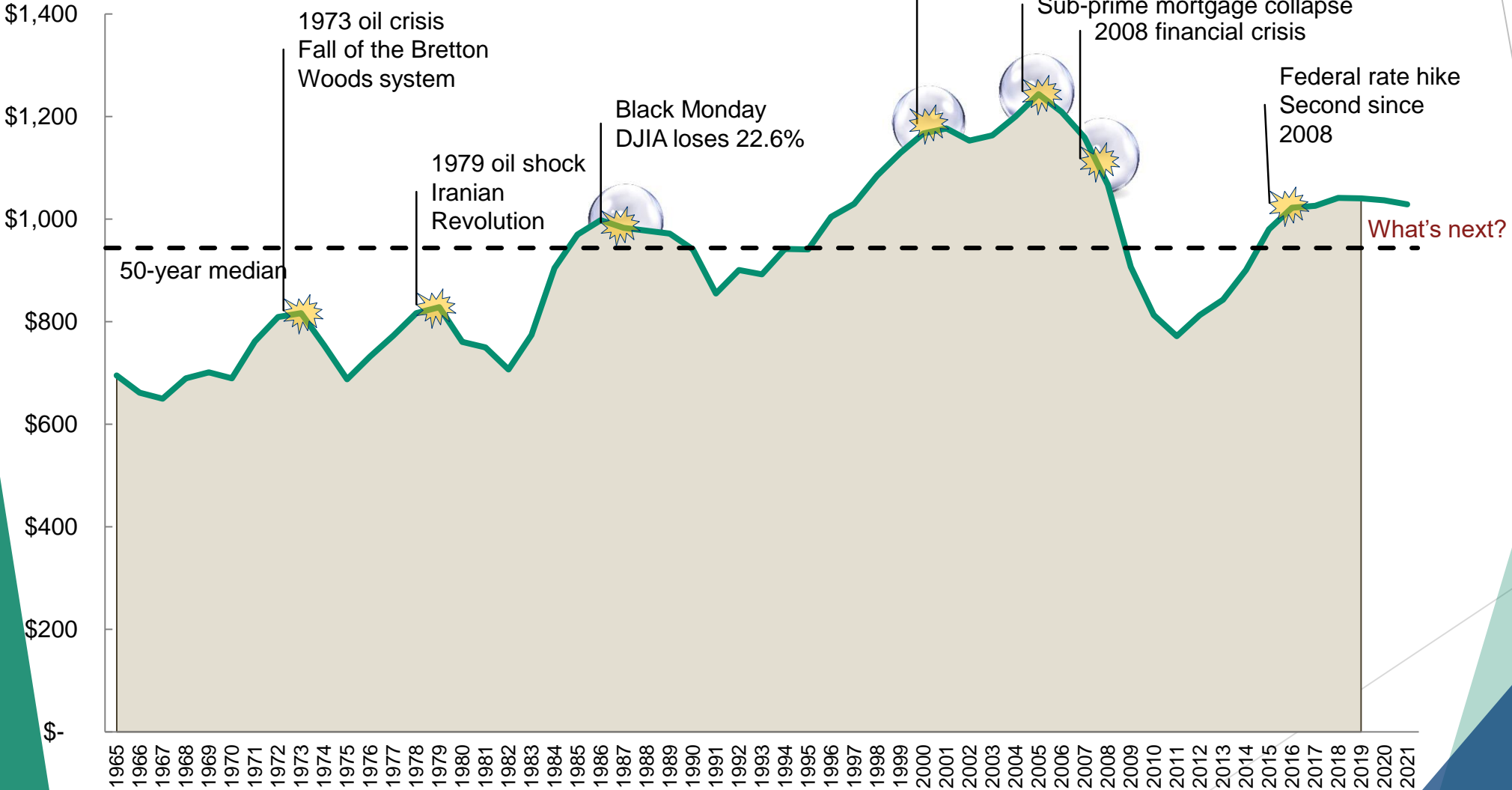
Investment Banking for the Built Environment

# Where are We Today?

## Total construction spending put in place (US)

Billions of constant 2009 dollars

















Source: FMI Q2 2019 Construction Outlook



# Predicting the Next U.S. Recession

## Predictive indicators

Source(s): FMI analysis of multiple sources

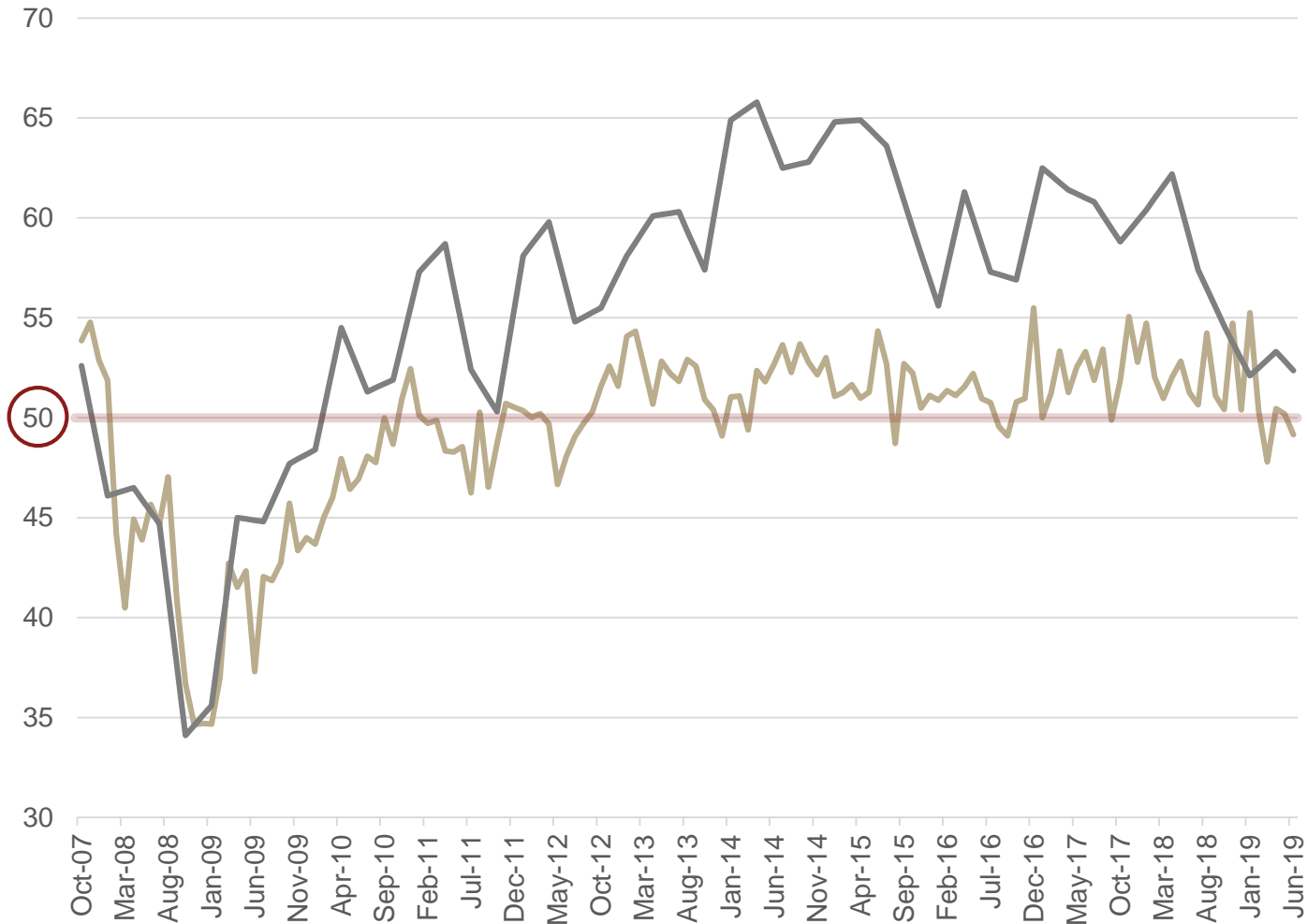
Indicators / Metrics	Recessions Considered	Correct Predictions	False Positives	Prediction Strength*	Flag/ Warning Timing	Risk Assessment/ Trending
Yield Curve Inversion	5	5	-	High (100%)	~2-3 year	HIGH 
New Home Sales	6	5	1	High (67%)	~1-4 year	MODERATE 
Unemployment Rate	6	4	-	High (67%)	~1 year	LOW 
US Trade Balance (BOP % change)	6	6	2	High (67%)	~1 year	LOW 
Money Supply	7	5	1	High (57%)	~1-3 year	MODERATE 
Lumber Sales	2	2	1	High (50%)	~1-2 year	HIGH 
MBS Held by Banks	2	2	1	High (50%)	~1-2 year	LOW 
Rental Vacancy Rates	9	4	-	(44%)	~1-4 year	MODERATE 
Residential CPIP	6	3	1	(33%)	~1-3 year	MODERATE 
Stock Market Performance	3	2	1	(33%)	<1 year	MODERATE 
Copper Price (Doctor Copper)	7	4	2	(29%)	~2-5 year	HIGH 
Consumer Confidence (OECD)	8	5	4	Low (13%)	~1 year	MODERATE 
Heavy Duty Truck Sales	7	4	4	Low (0%)	~1-2 year	MODERATE 
Manufactured Goods, New orders	2	1	1	Low (0%)	~1 year	MODERATE 
US Trade Balance (values)	6	1	1	Low (0%)	~1 year	LOW 
Unemployment Claims	7	4	5	Low (-14%)	~1 year	MODERATE 

# Modest Industry Optimism or Cause for Concern?

## AEC-specific economic indicators

AIA Architecture Billings Index (AIA) and FMI Nonresidential Construction Index (NRCI); October 2007- July 2019

Source: AIA, FMI

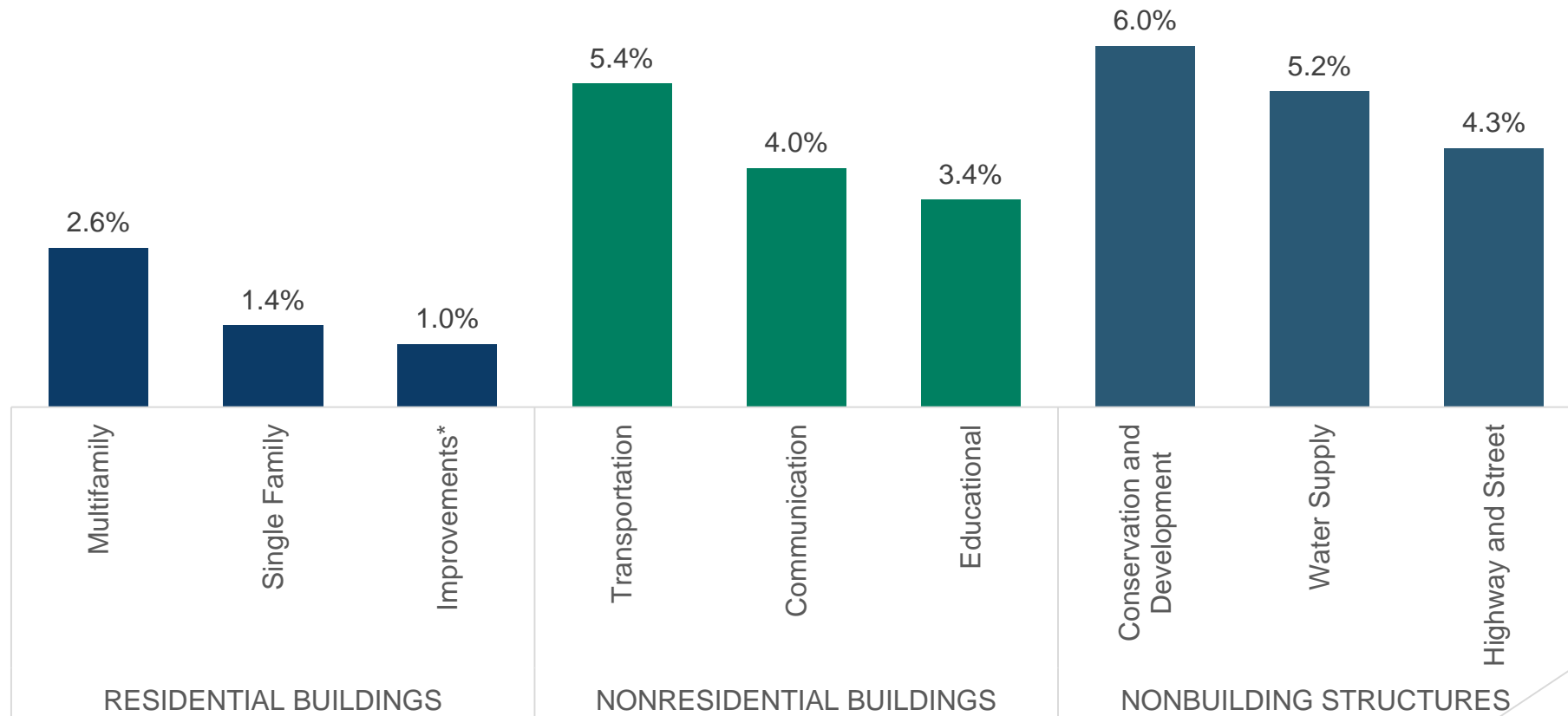


**51.9 (Q2 2019)**  
FMI Nonresidential  
Construction Index (NRCI)

**49.1 (June 2019)**  
AIA Architecture  
Billings Index (ABI)

# Construction Put in Place Growth in the U.S.

Top Three 2018 – 2023P CAGRS per Category – Current Dollar Basis  
2<sup>nd</sup> Quarter 2019 Forecast (based on Q1 2019 Actuals)



\*Improvements include additions, alterations and major replacements.  
It does not include maintenance and repairs.

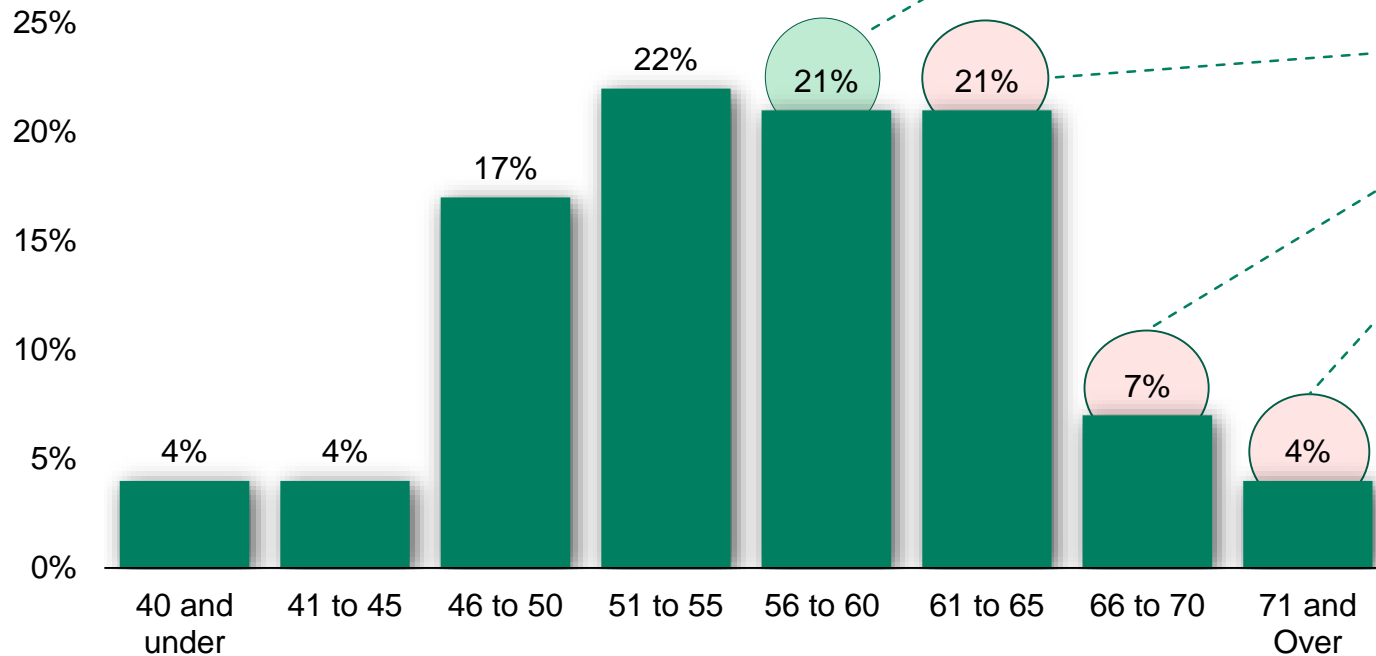


# The Construction Industry is Beginning a Massive Generational Transition

**56%**  
of  
Owners

*Have no formal plan to transition themselves out of managing the business*

**Contractor Ownership: Distribution by Age Group**



21% will transfer within the next decade.

32% will transfer within the next five years or fewer.

# The Majority of Owners are Unprepared

**57%**  
of  
Owners

*Have owned stock for more than 20 years*

**68%**  
of  
Owners

*Expect to sell stock gradually to new owners*

**67%**  
of  
Owners

*Expect their company to be valued at a pretax earnings multiple of 4x or greater*

# Company Ownership Dynamics are Changing

- ▶ Fewer respondents have family members active in the business today than in 2013 (45% in 2017 versus 73% in 2013).
- ▶ Even fewer respondents plan to pass the business on to the next generation (32% in 2017 versus 52% in 2013).



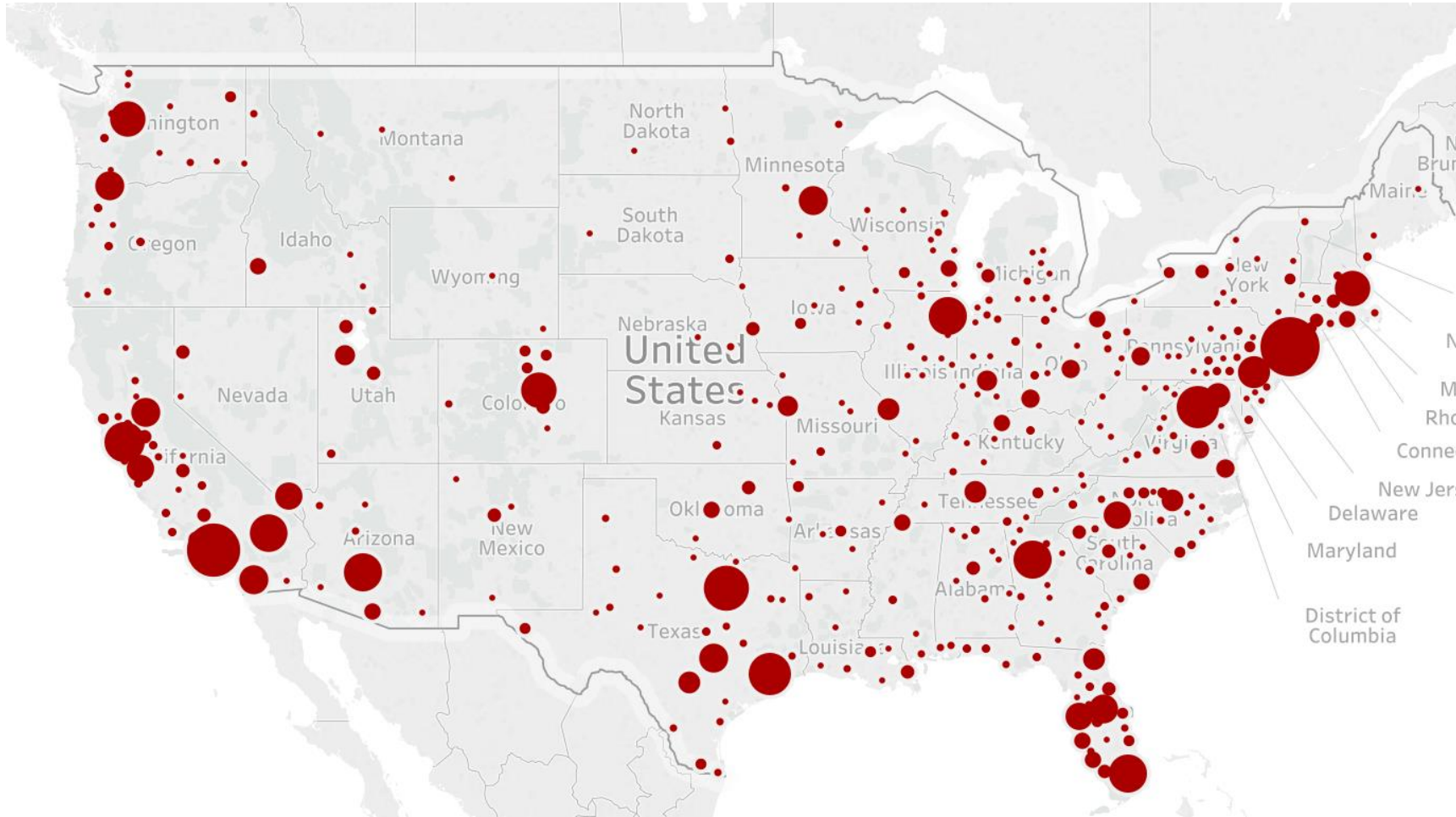
Do you consider your business a family business?



Do you prefer that family members ultimately run the business?



# Construction Spending is Concentrating in Fewer Markets



**Total construction spending put in place by metro market (2018)**  
Forecast by Metropolitan Statistical Area (MSA)  
Source: 2018 FMI Overview, Featuring FMI's Fourth Quarter 2017 Construction Outlook

# Labor is a Top Impediment to Growth

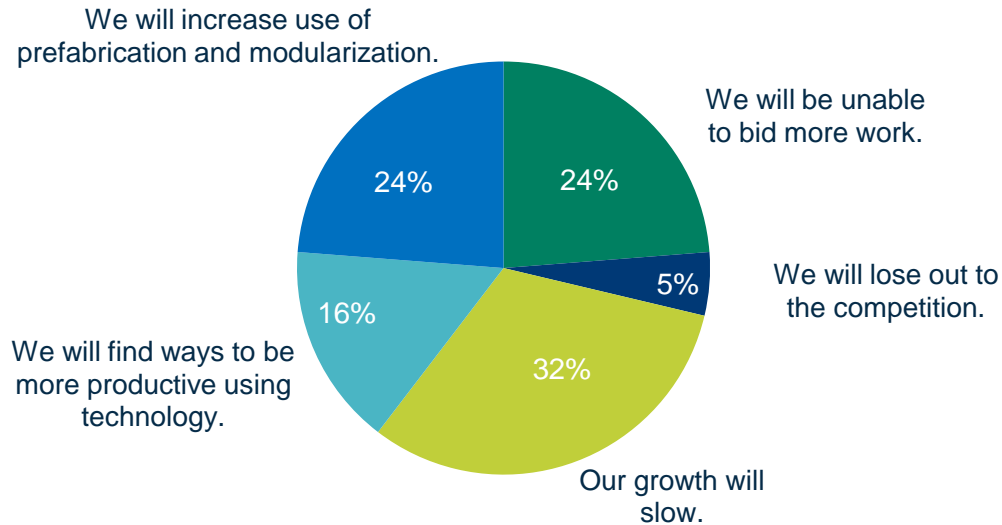
- ▶ Recession created industry exodus
- ▶ Baby boomers retiring
- ▶ Slowdown in U.S. immigration

## Implications:

- ▶ Top strategic leader focus – how do we attract and retain an “unfair” advantage of a limited talent pool?
- ▶ Understand what’s required to attract and effectively leverage Millennials
- ▶ Internal development of talent
- ▶ Can applied technology produce more with fewer people?

### *FMI Survey:*

If you cannot reasonably meet the need for skilled labor and tradespeople in the next few years, how will that affect your business?



61% believe the lack of skilled labor will impact competitiveness and / or slow ability to grow



# Valuation in Construction M&A



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# E&C Public Company Valuation Trends

## Public Construction Firms Average TEV / EBITDA

Source(s): FMI, CapitalIQ

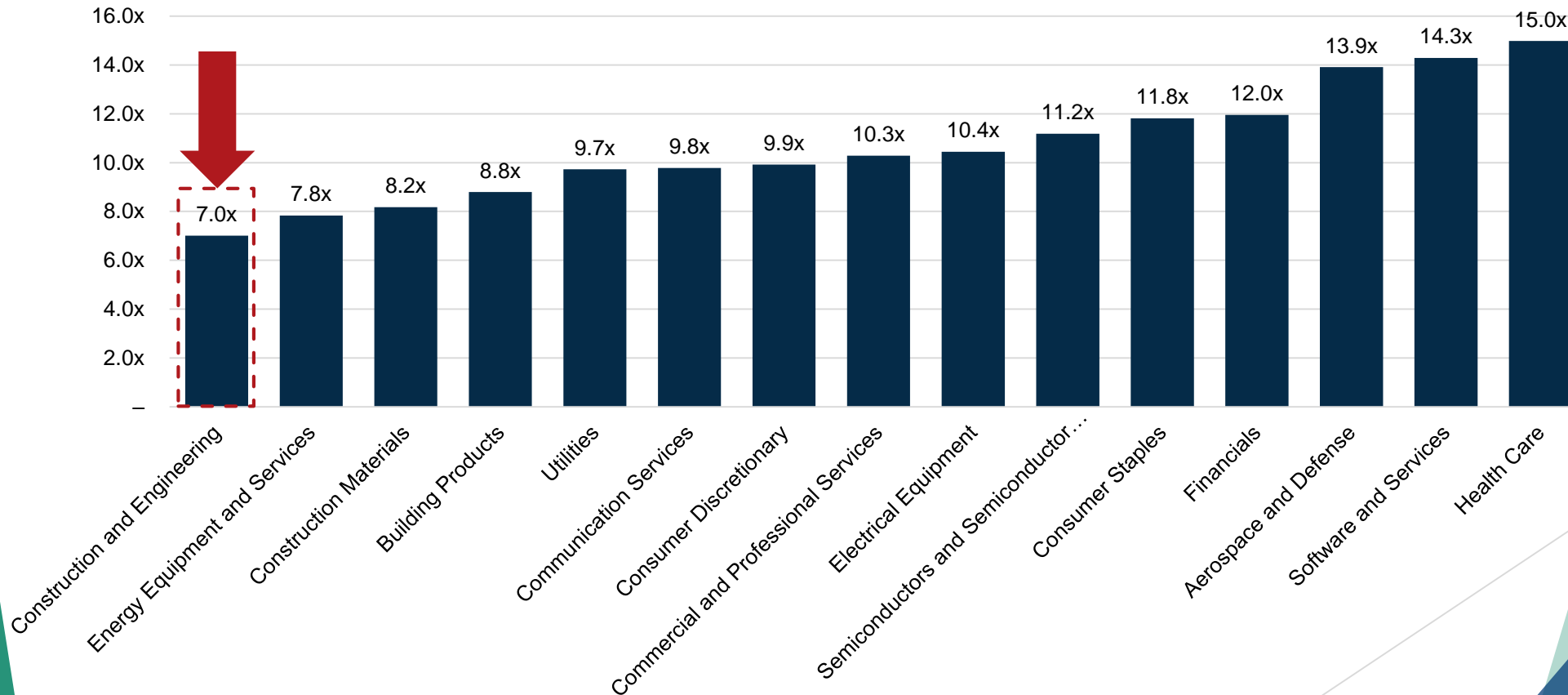


# E&C Multiples Compared to Other Industries

C&E valuations remain the lowest

Cyclicality, project-oriented, regional markets, scarce labor, volatile financial performance

Enterprise Value / Forward EBITDA - Multiples for Public Companies across Various Industries





# Case Study – Large Deals

## J2 Acquisition Limited

Has Acquired



### Transaction Figures

**Revenue (2019E):** Approx. \$4.0B

**Employees:** 15,000+

**Locations:** 200+ throughout U.S.

### Transaction Overview

- ▶ API is a market-leading provider of commercial life safety solutions and industrial specialty services, performing work primarily in North America
- ▶ This is J2's initial acquisition – it will change its name to APi Group Corporation upon close and expects to list its shares on the New York Stock Exchange under the symbol APG

### Publicly Available Deal Terms

- ▶ Purchase price of approximately \$2.9 billion
- ▶ Approximately 10% adjusted EBITDA margins (2019E)
- ▶ LTM adjusted EBITDA of \$371 million
- ▶ J2 expects adjusted EBITDA margins to expand to 12%+ by 2023
- ▶ High single-digit average earnings growth is expected
- ▶ Long-term leverage ratio is expected to be between 2.0x – 2.5x
- ▶ The transaction includes a tax asset with an NPV of approximately \$180 million
- ▶ Net purchase price multiple of 7.4x EBITDA

# Building Contractor Acquisitions

## ▶ GCs remain a challenge

- ▶ Value of the business is often tied up in 1-2 key people exiting the business
- ▶ Low margins
- ▶ Most value of business is tied up in cash

## ▶ Renovation/retrofit markets attractive

## ▶ Foreign interest due to:

- ▶ Ratio of purchase price to volume is low
- ▶ With established bonding capacity, little capital is required
- ▶ Delivery mechanism for PPP

## ▶ Book value + premium is the most popular benchmark (why not just keep the business and wind it down?)



# Industrial Contractor Acquisitions

- ▶ **Industrial contracting maintenance is particularly attractive**
  - ▶ Meaningful barriers to entry
  - ▶ Specialized work force
  - ▶ Valuable relationships
  - ▶ Good cash flow, recurring revenues
  - ▶ No bonding
  - ▶ Safety is key to value



# Heavy Highway Contractor Acquisitions

- ▶ **State budget deficits have constrained spending**
- ▶ **Large international acquirers seeking large targets in the U.S.**
- ▶ **Federal funding more certain, but diminished**
- ▶ **Most projects are being awarded below budget**
- ▶ **Valuations often not compelling for sellers**
  - ▶ Asset value often exceeds earnings value
  - ▶ Most small to medium sized heavy civil contractors only attractive to regional players
  - ▶ Large players in multiple geographies can attract more interest
  - ▶ Private equity has struggled (Insight's acquisition of American Civil)



# M/E/P Contractor Acquisitions

- ▶ **Hottest segment of the Built Environment**
- ▶ **Large public companies continue to grow through acquisition**
- ▶ **Energy efficiency upgrades to buildings drawing economic, political and social support**
- ▶ **Service and maintenance recurring revenue models attract private equity**





# Trends in Construction M&A

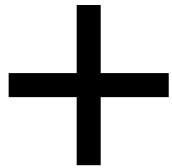
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# 2018 – Record Year for E&C M&A Activity

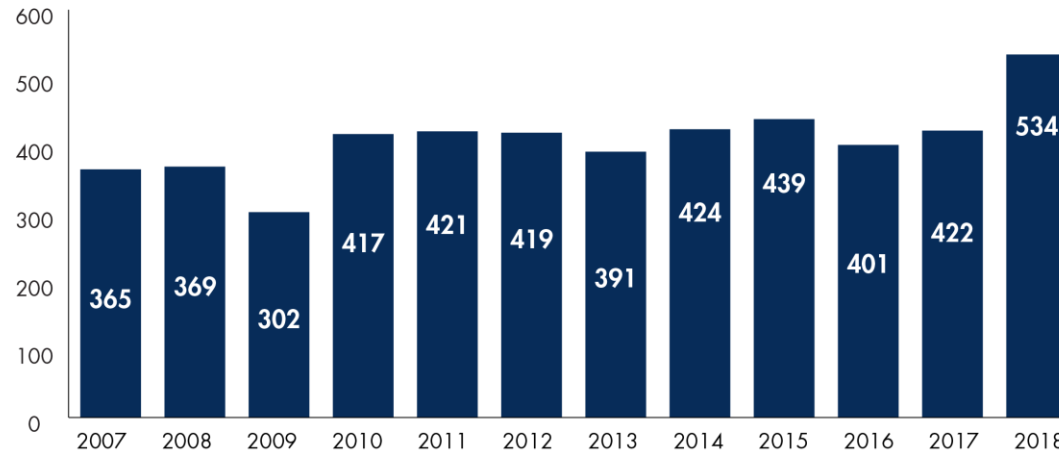
Demographic succession  
needs



Increased buyer interest



Record M&A activity



***2018 represented 26.5% increase in deal activity over 2017 and, by far, the highest level of activity we have ever recorded***

***2019 is also proving to be a strong year in terms of deal activity – expected to be on pace with 2018***

# Case Study – Recurring Services



has been acquired by



a subsidiary of



*The undersigned served as the exclusive financial advisor to CMS Mechanical Services in this transaction*



## Transaction Overview

- ▶ CMS Mechanical Services is headquartered in Windsor, CO, is a leading commercial and industrial HVAC services, pipefitting and sheet metal company serving Northern Colorado
- ▶ CMS provides 100% service work, primarily through renewing, negotiated bid contracts, contracting directly with customers
- ▶ Its recurring work yields high margins, which attracted a number of prospective suitors

## Transaction Figures

**Revenue:** N/A

**Employees:** N/A

**Locations:** Undisclosed

## Differentiators

- ▶ 100% service
- ▶ Identified successors
- ▶ Attractive geography



# Construction Market Trends

## Current / Short Term: 1 -2 years

- ▶ Most markets have recovered, profits rebounded
- ▶ Tax reform is improving valuations; infrastructure funding hopes dashed
- ▶ Contractors are strategically expanding their businesses through selective acquisitions
- ▶ Specialty trades remain the most attractive segments of the U.S. construction market
- ▶ Continued interest in building services
- ▶ Revised strategies leading to corporate divestiture activity

# Construction Market Trends

## Current / Mid-Term: 2 - 5 years

- ▶ Recession likely
- ▶ Contractors that embrace technology and energy efficiency capabilities will continue to drive activity
- ▶ Infrastructure spending will be driven primarily by states, with federal infrastructure spending a wild card
- ▶ Surety markets may tighten; return of personal guarantees and stricter ratios
- ▶ Large will continue getting larger; rise of megaprojects

# Construction Market Trends

## Current / Long Term: 5 - 10 years

- ▶ More rigorous regulations and commercial demand for “green” infrastructure will foster revenue growth into the future
- ▶ Labor will influence contractor strategy, project delivery and M&A
- ▶ Long-term U.S. population trends will offer tremendous growth opportunities
- ▶ Megaprojects and urbanization will draw interest to growing cities

# Contractor Acquisitions – What Drives Buyers?

## ▶ What Drives Buyers?

- ▶ Diversify geographic risk
- ▶ Diversify capabilities or integrate
- ▶ Provide people
- ▶ Establish local “partner”
- ▶ Ongoing dilemma – hire or acquire?



# Contractor Acquisitions – What Drives Sellers?

## ▶ What Drives Sellers?

- ▶ Financial constraints
- ▶ Opportunity for employees
- ▶ Right timing / right price
- ▶ Retirement / succession
- ▶ Personal risk



# Contractor Acquisitions – What Drives Activity?

## ▶ What Drives Activity?

- ▶ Motivated buyers and sellers
- ▶ Changing market conditions, abundant “catalysts”
- ▶ Low interest rates, strong stock market valuations



# Case Study – Renewable Energy Capabilities



## Transaction Figures

**Revenue:** \$265mm+

**Employees:** 1,300+

**Location:** California

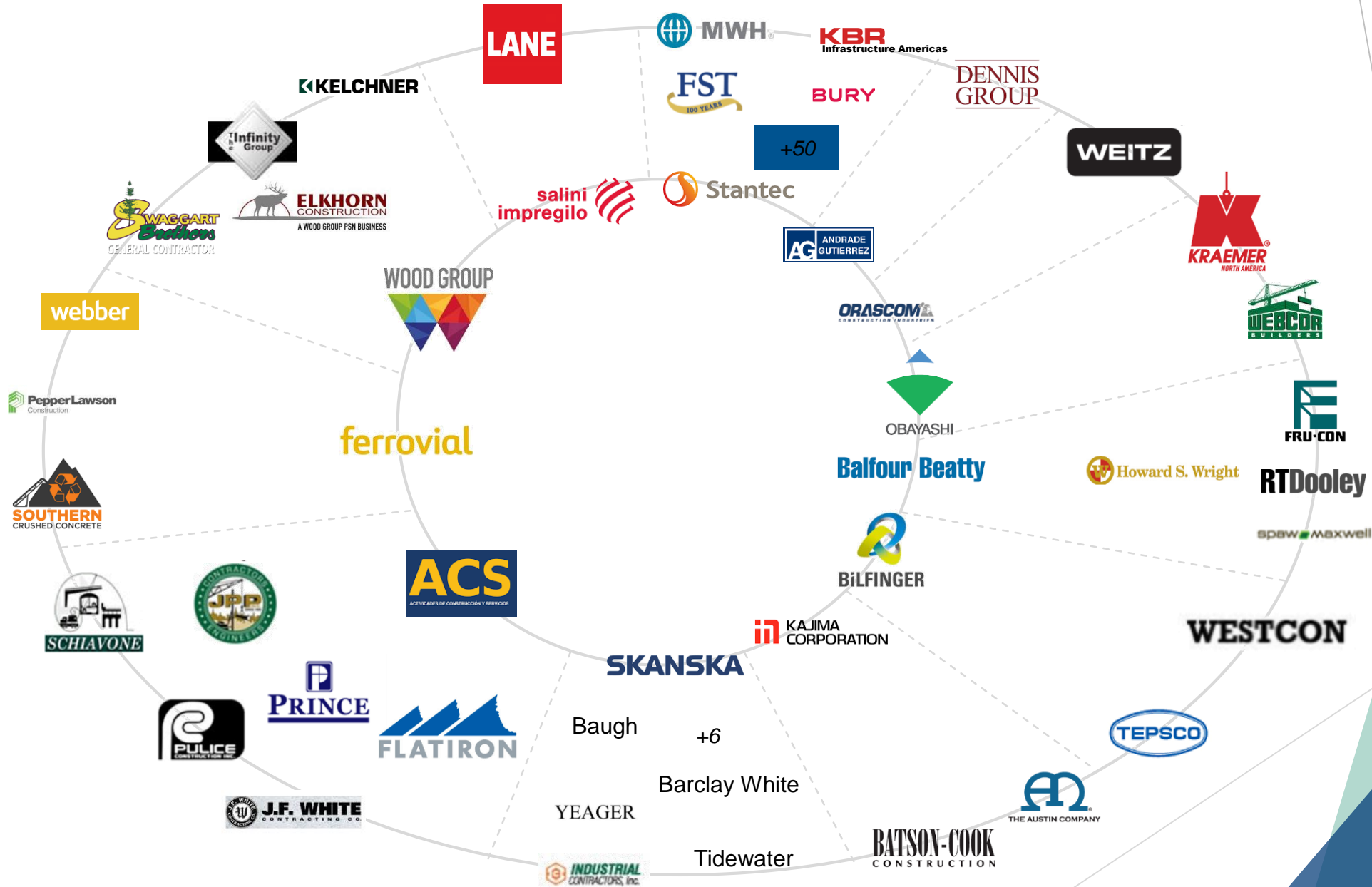
## Transaction Overview

- ▶ CSI is a leading electrical contractor providing services throughout California primarily to the commercial, aerospace, healthcare, biomedical, and solar markets
- ▶ CSI's large-scale renewable energy expertise was attractive to multiple buyers
- ▶ After receiving multiple indications of interest from third-party bidders, MYR came through with an attractive offer but more importantly, the best cultural alignment with the business

## Publicly Available Deal Terms

- ▶ Enterprise value of approximately \$79.7 million, subject to working capital and net asset adjustments
- ▶ Average annual revenues of approximately \$265 million over the two years prior to the transaction

# Foreign Interest in U.S. Construction





# Case Study – International Interest (ENGIE)

## Recent ENGIE Acquisitions



has been acquired by



The undersigned served as the exclusive financial advisor to Conti Corporation in this transaction



has been acquired by



The undersigned acted as the exclusive financial advisor to Donnelly Mechanical in this transaction



has been acquired by



The undersigned acted as the exclusive financial advisor to Unity International Group in this transaction



a portfolio company of



has sold



contractors | engineers



Systems Mechanical, Inc.



to



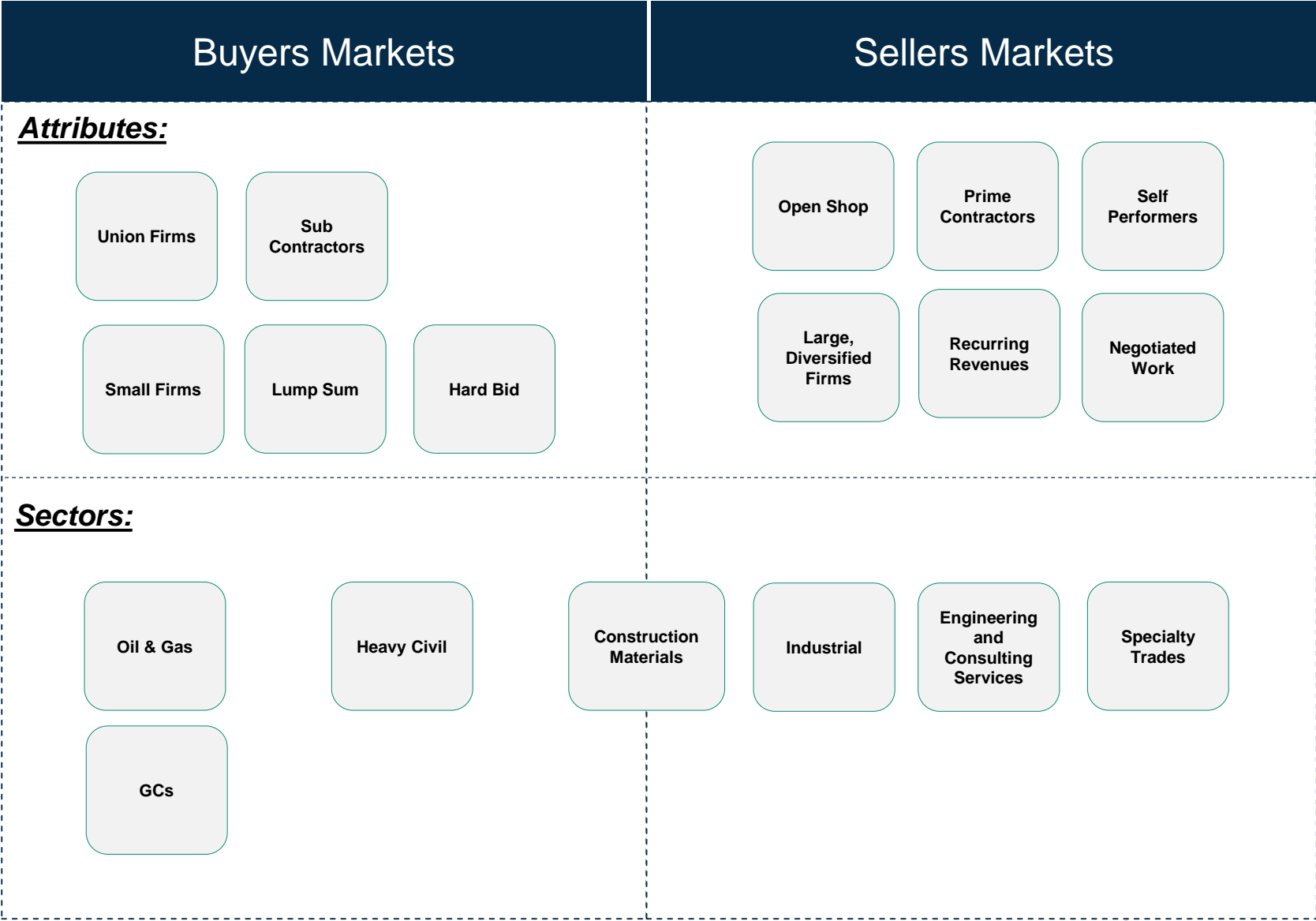
The undersigned acted as the exclusive financial advisor to Talen Energy in this transaction



## Overview of International Interest – ENGIE

- ▶ ENGIE is a France-based engages in power, natural gas and energy services with a \$36 billion market cap
- ▶ ENGIE’s strategy in the U.S. revolves around creating a robust energy efficiency services platform by acquiring billions of dollars worth of mechanical and electrical specialty contractors that can provide energy efficiency services
- ▶ Multiple international firms have interest in firms across the Built environment
- ▶ With growth tepid across the rest of the world, the U.S. remains an attractive geography for acquisitions and investment

# Buyers and Sellers Markets



# Private Equity – a Key Player in M&A

## What is “Private Equity”

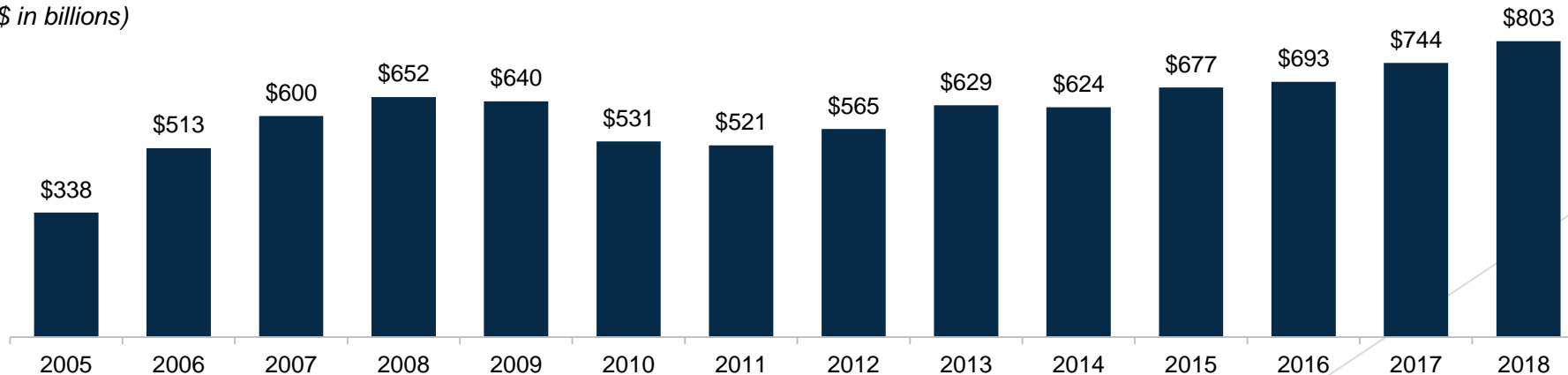
- ▶ Pools of private funds invested primarily in private businesses.
- ▶ Typical investors include individuals, pension funds, family offices and other investors
- ▶ Funds will typically acquire businesses with combination of equity and debt, hold for 3 to 7 years and divest to strategic buyer or another fund
- ▶ Investors expect high returns on equity, frequently in the 25-30% IRR range per year
- ▶ Private equity has traditionally avoided construction due to bonding constraints, contract-based revenues, people dependency, market cyclicalities and limited barriers to entry

## Private Equity Trends

- ▶ **Elevated deal size:** PE firms are raising increasingly larger funds which pushes deal sizes higher as those firms allocate capital
- ▶ **Private equity now makes up a larger part of total M&A activity:** the 1<sup>st</sup> half of 2019 saw over 4,750 deals completed in North America totaling nearly \$850 billion in value and firms are incentivized to deploy capital now to save costs related to rising interest rates
- ▶ **Time to deploy dry powder:** FMI expects increased activity from private equity funds, which notwithstanding a record \$803 billion in “dry powder” in 2018 — capital available for investment purposes

## U.S. Private Equity Dry Powder

(\$ in billions)



Source: Pitchbook

# Case Study – Private Equity Interest



has been acquired by



*The undersigned served as the exclusive financial advisor to P.J.M. Holding Corporation in this transaction*



## Transaction Overview

- ▶ PJ Mechanical is one of the largest commercial HVAC mechanical contractors in the greater New York City metropolitan area, providing services to some of the most iconic buildings in NYC
- ▶ PJM was an excellent candidate for a private equity suitor given the growth ambitions of the owners – they wanted a capital partner who agreed with their vision and would support them over the next stage of PJ's growth
- ▶ FMI was the sole financial advisor on the transaction and received interest from both strategic and financial parties, before PJM ultimately sold to a private equity firm that put a sensible amount of leverage on the business and aligned with the owners' growth path

## Transaction Figures

**Revenue:** ~\$200mm

**Employees:** 450+

**Location:** New York, NY

## Differentiators

- ▶ Unique scale in attractive geography
- ▶ Blue-chip client base
- ▶ Excellent performance history
- ▶ Experienced management team
- ▶ Repeat client revenue
- ▶ Growing service and maintenance segment

# Key Takeaways

- ▶ **Valuation multiples are reaching cyclical peaks; meaningful expansion unlikely**
- ▶ **Ample “dry powder” in PE, selective participation in construction markets**
- ▶ **Select markets will continue to consolidate:**
  - ▶ Self-performing trades
  - ▶ Specialty
- ▶ **Foreign buyers continue to see U.S. as attractive**
  - ▶ Heavy civil
  - ▶ General contractors

# Questions?



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