European Construction Monitor

Trends for 2013-2015: Supply chain pressure in recovering markets: an isolated case or an emerging trend?

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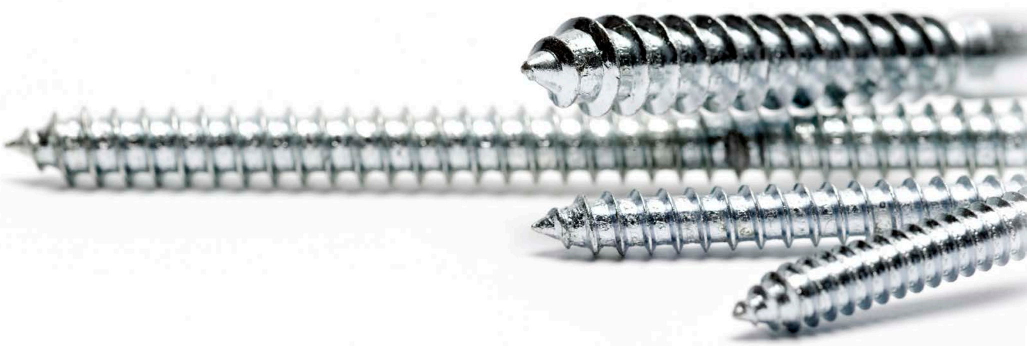


1. Introduction

M&A activity in the construction sector in Europe remains stable, private equity investments are up: the focus is on generating revenues in other continents and withstanding supply chain pressure in northern Europe

We are pleased to present the fourth edition of the European Construction Monitor, which looks at the latest trends and issues in mergers & acquisitions (M&A) in the European construction industry. This 2014 publication complements the "European Powers of Construction" (EPoC) of 2013, a Deloitte research paper examining the status of major European-listed construction companies.

Market trends: searching for (international) growth and managing future demand

The first trend to be spotted this year in M&A is intercontinentalisation. While the number of M&A deals in 2013 was slightly higher than in 2012, forecasts suggest the same number of deals in 2014 as in 2013. The number of deals may not changed, but the type of deals certainly has. There has been an increase in cross-border deals, with an even stronger focus on cross-continental deals, especially with the US and Canada. A good example is French company Bouygues Energies & Services, which acquired a majority stake of 85% in Plan Group, a Canadian company specialising in mechanical and electrical engineering.

The second trend to emerge in M&A is pricing pressure on labour and materials. Construction companies in recovering markets are experiencing difficulties in their supply chains. Demand for labour is rising and supply is falling due to the significant amount of defaults over the recent years. As a result, in the UK, the Tender Price Index increased from 0.5% in 2012 to 6.7% for 2013.

The third trend is the rise in private equity and the change in the involvedness and role of private equity firms. The number of private equity deals has increased for the third consecutive year, rising from 10% of all recorded deals in 2012 to 19% in 2013.

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

Highlights in this publication

- The number of deals was relatively stable in 2013 (139) compared to 2012 (126). A projection of H2 2014 suggests the same number of deals for 2014 (139).
- The number of cross-border deals in 2013 increased by a third to 35% and the amount of cross-continental deals almost doubled.
- The average deal size in 2013 increased by a third compared to 2012.
- The number of private equity deals almost doubled in 2013 (19%) compared to 2012 (10%).
- The amount of insolvencies in the construction industry throughout Europe in 2013 decreased slightly.

2. Looking back

The European construction sector recorded 139 deals in 2013[1] and an identical number is expected for 2014.

Broadening the spectrum

Given the continuous trend of diversification in the construction sector, the sample criteria for M&A deals have been broadened for the 2014 monitor. In the 2012 and 2013 editions, we looked at construction companies only. In this year's monitor we also looked at installation, engineering and infrastructural companies involved in the construction of windmill parks, nuclear power plants and highway concessions. By including these in the sample size, a comprehensive picture of M&A activity within the construction sector can be presented.

Developments in 2013 and H1 2014

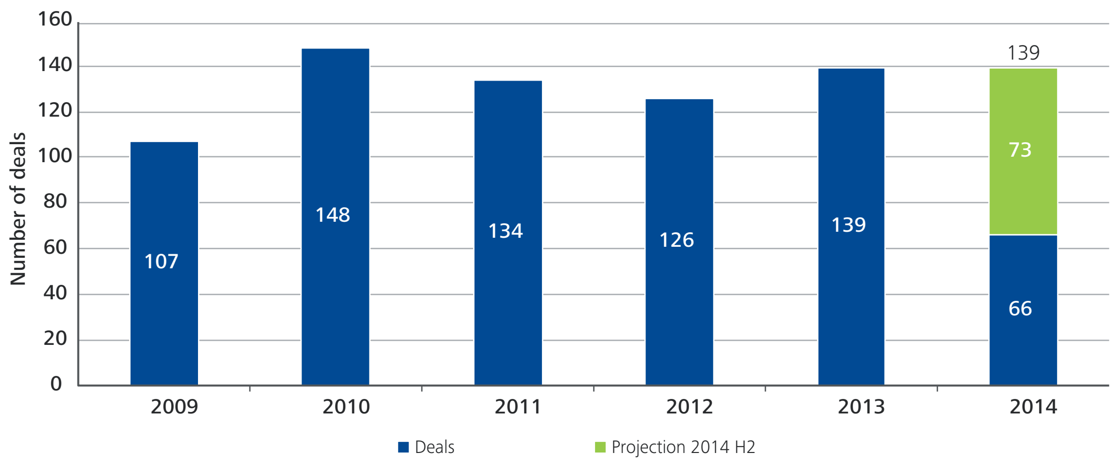
Deloitte expected a more dynamic M&A environment in 2013-2014, with a stable number of M&A deals, and this seems to be holding true for 2013 and H1 2014. Diversification and internationalisation remain major issues. This is due to companies searching for projects with higher margins and additional sales in an effort to avoid negative financial results.

M&A activity within the European construction sector remained relatively stable in 2013: 139 deals were recorded in 2013 compared to 126 deals in 2012. Based on the 66 deals recorded in H1 2014, we do not expect the total number of deals to exceed that of 2012.

Using the broader definition of construction to analyse the 2009-2013 period, we notice a relatively stable level of M&A activity: the number of deals fluctuated between 107 and 148 per year, with an average of 131. This makes 2013, which recorded 139 deals, an average year. By extrapolating these figures, we expect approximately the same number of deals in 2014, indicating the trend towards stabilisation in M&A activity.

Although we see some signs of market recovery, the construction industry in Europe is still experiencing squeezed profits, reduced cash flows and limited availability of bank financing. Consequently, we observe an increase in M&A activities as a result of international investors targeting Europe. In 2013, ten inbound intercontinental deals were recorded, compared to only six in 2012. Seven inbound intercontinental deals were recorded in H1 2014.

M&A activity in the European construction sector



[1] A deal is defined as a transaction involving at least 30% of the shares of a European construction company

Selection of deals throughout Europe

Bidder origin	Description
Netherlands	Strukton Rail acquired Balfour Beatty Rail Scandinavia
Netherlands	Van Oord (marine and offshore) acquires J.T.Mackley & Co. (UK marine civil contractor)
United Kingdom	Carillion plc. (integrated construction service) acquires John Laing Integrated Services Limited (facilities management)
United Kingdom	Oaktree Capital Group (private equity) acquires Millgate Developments to merge with Countryside properties
France	Vinci Autoroutes acquires 16.67% stake in Cofiroute SA (tunnels and bridges) which makes it a wholly owned subsidiary
France	Vinci Energies acquires Electrix (Australian electricity network installation and maintenance)
Germany	Bilfinger Bauperformance (consulting & management) acquires SPM Projektmanagement (construction)
Germany	Bavaria Industrie (financial reorganisation) acquires Bilfinger Government Services (construction support)
Spain	Abertis (infrastructure) acquires Italian Towerco (telephony towers on toll roads)
Spain	GlobalVia (DPMO transportation) acquires Seville Metro (now total 88.23% stake)
Italy	Salini Impregilo (construction) acquires Copenhagen Metro Team (40% Stake)
Portugal	Vallis Capital Partners SGPS (private equity) acquires Eusébios (construction)
Denmark	Colas Danmark (road and civil engineering) acquires Skanska Asfalt (asphalt producer)

Source: Mergermarket 2013-2014

Continuing to diversify

Italian-based Atlantia SpA, a construction company that constructs and manages toll motorways and related traffic services, acquired Gemina SpA in November 2013 for EUR 3,053 million. Gemina SpA's main activity is managing the concession for building and operating two of Rome's airports. By incorporating Gemina into its holding, Atlantia is expanding its business beyond the toll motorway market.

Last year, we expected European M&A deals in 2013 and H1 2014 to be relatively smaller in size compared to previous years, yet the average size of deals actually increased. However, it should be noted that this increase was due to several large (disclosed) transactions.

The average deal value of individual transactions increased from EUR 94 million in 2011 to EUR 281 million in 2012 and EUR 359 million in 2013. This does indicate that companies made fewer smaller deals, which are usually add-ons for their core business. Instead, they increased the number of larger deals.

We see an increase in two different kinds of deals. The first kind is the acquisition of operating companies, mainly airport, toll road and parking operators. These deals were made to diversify away from the construction business and to become less dependent on the tight margins common throughout the construction market. The second kind is the acquisition of entire construction companies and the purchase of stakes in construction companies. These deals were generally higher in value than add-on deals. They also differ in nature to add-on deals because they are being used by companies to diversify their construction business and to develop specialisms, with the ultimate aim of growing their construction business. This second type of deal is often done on a cross-border and cross-continental basis. This last observation is discussed in the following chapter.

Last year's European M&A Construction Monitor looked at the following trends: anticipating tomorrow versus surviving today. Since these trends have continued into 2014, this year's monitor will look at these as well as three 'new' major market trends for 2013-2015: the shifting of investments from an international to an intercontinental arena, the pressure on and within supply chains, and the increasing interest of private equity firms in the construction industry.

Looking back on the trends of 2013

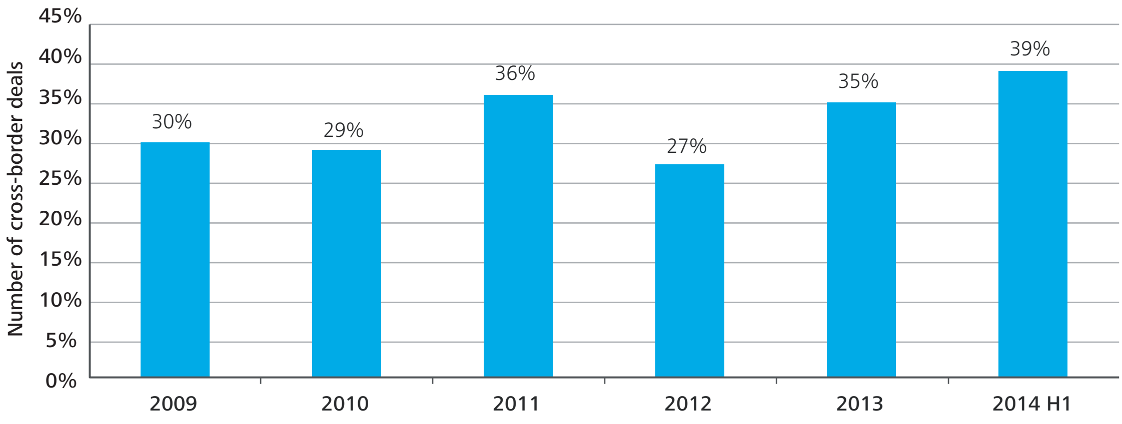
The 2013 monitor reported on the 'anticipating tomorrow' trend. Analysis of M&A in the construction sector had revealed sector diversification as a result of takeovers in various non-traditional sectors. The monitor highlighted the internationalisation trend as well. The top 50 construction companies in Europe had increased their non-domestic revenues from 50% in 2010 to 56% in 2012.

We also reported that European companies were making cross-border acquisitions within Europe, but that M&A activity was also increasing in the Americas, Oceania, Asia and the Middle East. The 2014 analysis shows construction companies are continuing to follow these trends by anticipating tomorrow's market.

As previously mentioned, the number of deals in the construction sector grew slightly between 2012 and 2013. Although influenced by several large transactions, the average deal size has increased. The smaller ticket deals were mainly the result of sector diversification. The number of recorded diversification deals grew from 26 (21% of total) in 2012 to 31 (22% of total) in 2013. Although this implies a slight increase in diversification, the figures of H1 2014 (10 deals accounting for 15% of total) indicate a possible decline in the diversification trend.

The 'surviving today' trend was also reported in the 2013 monitor. This related to construction companies facing too many operational and financial difficulties that made it impossible to look ahead. However, it appears that in 2013 and H1 2014 the number of insolvencies in the construction sector is stabilising in both Western Europe and Central & Eastern Europe.

Cross border deals in the European construction sector



Compared to 2013, the trends in the European construction market has not changed drastically, yet we do see a number of interesting developments across various geographical markets and within the construction spectrum.

The following sections will focus on the trends of intercontinentalisation by construction businesses, supply-chain pressure in construction markets and the growing interest/involvement of private equity investors.

Bouygues acquires 85% stake in Canadian technical service provider.

In July 2014, French construction company Bouygues Energies & Services acquired an 85% majority stake in Plan Group, a Canadian technical service provider. Plan Group is based mainly in Toronto and Ontario. It employs about 1,700 people and recorded sales of approx. EUR 242 million in 2013.

The acquisition is in line with Bouygues Construction Group's international aims and strategy, which includes growing its presence throughout the Canadian construction value chain.

Trend I: Intercontinentalisation

The internationalisation trend has continued over the last few years. Cross-border deals increased from 34 in 2012 to 48 in 2013. H1 2014 recorded 26 cross border deals, accounting for 40% of the total number of deals. The figure below shows that the percentage of cross-border deals has recovered from its 2012 low, and is now at a record-high (for the years displayed).

Further analysis of cross-border deals shows that intercontinental deals form a significant share. In 2013, the number of intercontinental deals in which a European construction company was involved totalled 19, compared to 11 in 2012. Of these 19 intercontinental deals, nine were reported as outbound, that is to say a European construction company acquired a target outside Europe. In H1 2014, ten intercontinental deals were recorded, of which seven were inbound.

The focus on international and intercontinental markets by European construction companies is shown not only by the number of cross-border deals but also by the amount of revenue generated from foreign markets. Local Deloitte experts have reported an increase in focus on international expansion by the larger construction companies from mainly the Southern European countries, including Portugal, Spain, France and Italy. This is reflected in the growing share of revenues and backlog gained in foreign markets. It should be noted that the increase in revenue generated from foreign markets is also relative and triggered by a decline in domestic revenues. In Western and Northern European countries, we observe that the construction companies have a focus on international markets. However, since the outlook of the domestic construction markets is improving in Western and Northern Europe, these construction companies are generating a larger share of revenue from their domestic markets.

Intercontinental target markets

Since construction markets in Europe continue to decline or show little growth, leading European construction companies are shifting their focus not only beyond national borders but also beyond Europe. Multinational construction companies tend to focus on stable target markets for their international expansion such as the USA, Canada and Australia due to good macro-economic figures, attractive infrastructure plans and stable legal & economic environments. Latin America and the Middle East are increasingly present amongst the target markets. In addition to their legal and economic environments, historical ties between countries seem to be a prevailing reason for entering a particular intercontinental market. Portuguese construction companies are focusing on Angola and Brazil as target markets, while some Dutch construction companies are focusing on developments in countries like Indonesia and Suriname.

Factors of success for international expansion

According to local Deloitte experts, the common assumption that ‘the construction business is a bad traveller’ is not completely valid. There are a number of success factors for international and intercontinental expansion. Construction companies have to get to know the target market, which often involves buying into it through acquisitions. Another way of entering a foreign market is ‘on the back’ of international customers or through joint ventures, which requires more time. Bringing in local market expertise and knowledge is considered paramount. Furthermore, deciding in which geographical markets to compete and to establish a long-term strategy is essential. While the ‘cherry picking’ of projects in several countries has proved to be unsuccessful in most cases, focusing solely on M&A joint ventures, projects or a mixture of entry approaches does also not seem to be the main driver for success. Combining an entry strategy with local knowledge is crucial for a successful international expansion strategy. This implies that international expansion does not necessarily involve extensive cross-border M&A activity.

Trend II: Supply chain pressure

The European construction industry has been affected significantly by the recession, and it is showing only modest signs of relief. Despite the number of insolvencies stabilising during 2013, most construction companies believe market conditions will remain difficult as margins are still under pressure and construction output remains limited

Competition in the sector is getting tougher, especially in Southern, Eastern and South-Eastern Europe.

The good news is that the bottoming out of insolvencies indicates that the decline in most European construction markets is also bottoming out. In addition, most countries are predicting a slight increase in production numbers. Will construction companies finally be able to strengthen their balance sheets after an extended period of squeezed operating margins?

Not necessarily. Our experts note that margins are also under pressure in countries where the construction sector is recovering, such as in the UK and Ireland. The significant number of defaults in recent years has made it a challenge to attract not only sufficient employees but also sub-contractors with the right capabilities. What is more, subcontractors' prices are starting to increase; they are likely to continue doing so as construction activity picks up. This development introduces the risk of cost inflation because some industry players are fully exposed to changes in input factor costs. The UK Tender Price Index moved from 0.5% in 2012 to 6.7% in 2013. This is expected to increase by another 4.5% over the next two or three years.

If we assume that the other European markets will follow the way of Ireland and the UK, more countries are likely to be faced with similar difficulties. Consequently, recovering markets will not necessarily result in recovering operating margins.

Supply chain integration

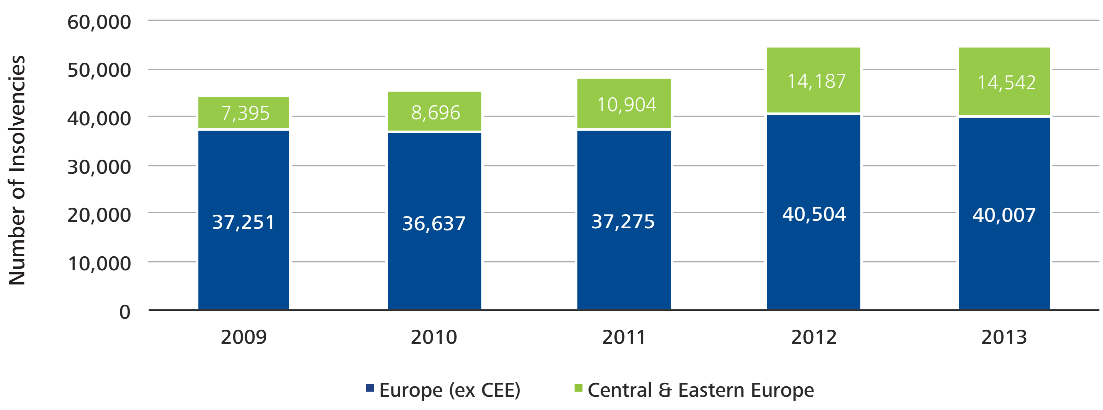
Our experts in the UK and Ireland anticipate increased labour costs and tougher competition, so they see the need for supply chain integration and more flexible business models. Some construction companies may start focusing on vertical M&A transactions and integrating the supply chain to increase efficiency and optimise operating margins. Other companies may change their business model by abandoning subcontracted labour and returning to traditional employed labour to overcome capacity and cost issues.

SNC-Lavalin – Kentz

Canadian-based SNC-Lavalin acquired UK-based Kentz for EUR 1,217 million in August 2014. The deal brings together the expertise of Kentz in construction management, commissioning and asset management with the capabilities of SNC-Lavalin in front-end design and engineering in the oil and gas sector. It is an opportunity to integrate the supply chain and broaden the services offered to clients. In addition, SNC-Lavalin will expand its presence in key growth regions, including the Middle East, North America and Asia Pacific, with a significant presence in Australia.

As Robert Card, president and CEO of SNC-Lavalin Group stated:
"We expect that our combined capabilities will give us one of the best broad-based service offerings in the engineering and construction industry, while expanding our presence in key growth markets."

Insolvencies in the European construction sector



Trend III: Private equity

Investment in the construction sector by private equity firms has been picking up in recent years. Activity increased in 2012, though it was not backed up by a corresponding number of deals. Since then, the percentage of deals almost doubled, from 10% in 2012 to 19% in 2013 and 23% in H1 2014. The table below shows this development clearly. While these statistics confirm last year's expectations, we do note a switch in the types of deal and in the investment horizon of private equity firms. Previously, they were buying add-on companies at a discount; more recently, they have been making long-term investments, especially in the infrastructure market.

Private equity

In 2011, private equity firms were generally acquiring business units and unique construction companies to add to their current business offerings. In 2012, they switched to funding construction businesses. In 2013, there was yet another switch to long-term infrastructural projects and venture capital financing. We see an increasing amount of venture capital companies willing to finance companies and fund expansion through private equity, particularly in Western and Northern Europe. Family firms, larger international private equity funds and wealthy individuals are heavily involved in these deals. The value of venture capital deals remains relatively small, while the value of company acquisitions and infrastructural projects, which are carried out mainly by large international firms, can run into billions of dollars. This not only confirms what we expected last year but also shows that innovation and entrepreneurs are once again being stimulated and supported by venture capital.

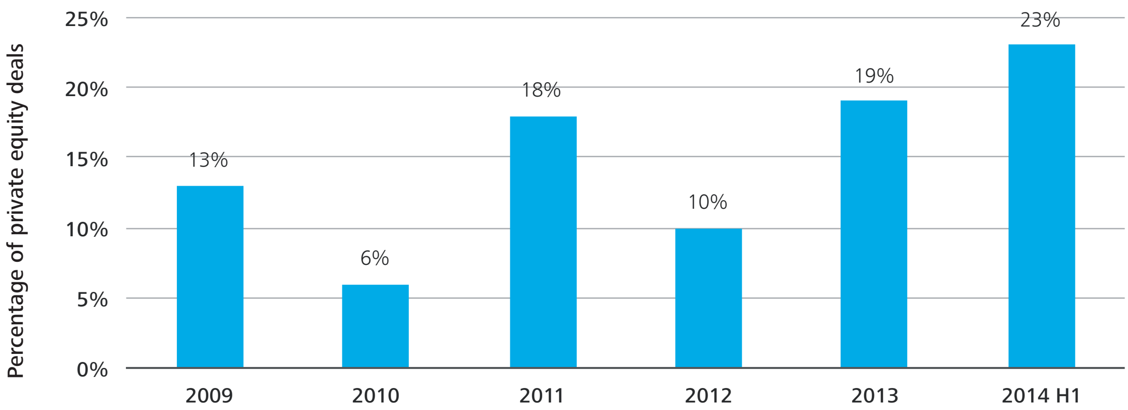
A new development in 2013 is the emergence of sovereign wealth funds and listed investment funds, which are interested in large toll road operators mainly and in construction firms to a lesser extent. Interesting private equity developments in 2013 and H1 2014 include:

- An increase in private equity investments throughout Europe from pension-funded and government-funded firms. These firms are searching for longer-term investments with lower margins, in contrast to smaller private equity firms. These longer-term investments are often found in the concession market and secondary operating market, but they can also be found in large infrastructure projects.
- A slow retraction from the construction market of smaller private equity firms because high returns and margins are not being achieved in the short horizon (4-7 years) that they find so attractive.

Reggeborgh acquires remaining CVC Capital Partners' investment in VolkerWessels

In September 2013, Reggeborgh, reached an agreement with private equity firm CVC Capital Partners to acquire a 25% stake in VolkerWessels, a Dutch company which designs, manages and develops construction companies. The estimated price was EUR 250 million. Reggeborgh, the private investment company of the Wessels family, had bought its first block of shares from CVC at the end of 2012 to gain a controlling interest in VolkerWessels.

Private equity deals



3. Going forward

The outlook on M&A activity in the construction business in Europe

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

Country	Outlook[1]	Highlights
Austria	o/+	• Residential construction is key driver, less favourable outlook for infrastructure • Ongoing internationalisation of Austrian construction companies as shown in recent years
Belgium	o/+	• Growth in construction market expected in 2014 • Strong increase in building permits for residential and non-residential and renovation
Czech Republic	o/-	• Growth for first time since 2011, mainly due to increase in public investments • Largest problem is the high competitive pressure
Denmark	o/-	• Construction market in private sector, both housing and commercial is at a historic low level • International interest has increased due to large infrastructural and hospital projects
Finland	o	• Total construction volumes are expected to decline for third consecutive year • Sale of new housing units have slacked
France	o/+	• Large construction companies shifting focus to international markets, mainly Canada and Americas • Construction tenders and M&A is dominated by large players, small players keep consolidating
Germany	o/-	• PPP projects still unattractive due to political resistance and lack of financing options • M&A activity remains focused on acquisition in the form of add-ons
Greece	o/o	• PPP start to increase due to stabilising macroeconomic environment • Dynamic M&A environment due to privatisation of governmental assets
Ireland	o/+	• Strong growth anticipated across most construction sectors • M&A activity will begin to improve albeit from a low base
Italy	o/-	• Decrease in construction sector is starting to stabilise • International investors are taking advantage of current market conditions, return of liquidity and financial incentives
The Netherlands	o/+	• Many are holding their breath for some sort of shake-up in the existing landscape of companies, given their current balance sheets and outlook • Large construction companies increasingly focusing on international markets
Norway	o/+	• The pipeline is increasing and margins are improving • A recent decline in oil prices has affected the M&A activity
Poland	o/+	• Strong pipeline of infrastructure projects co-financed from EU funds in the period 2014-2020 (approx. EUR 24 billion) • In line with the future EU budget, growth in buy-in specialisation and competences is expected to drive future M&A activity
Portugal	o/-	• Low public spending and investor confidence has resulted in an increase in bankruptcies • Large part of revenues is obtained overseas in countries as Angola and Brazil
Spain	o/-	• Arrival of international investors has provided some dynamism in the RE market • Lot of business is obtained in international markets • Non-banking fund sources as bond issues are expected due to improvement of financial conditions
Sweden	o/+	• An overall positive trend is seen in the order stock of Swedish construction companies • Growth is planned locally and organically and not by M&A, therefore M&A activity remains low
United Kingdom	o/+	• An increase in supply chain pressure is resulting in a steep increase in input costs • Value of construction output is increasing and expected to continue growing

+ optimistic o neutral - pessimistic


+
o/+
o
o/-
-

Overview per country

(in alphabetical order)

o/+ Austria

Residential construction is still the key driver in Austrian construction markets. Strong housing construction activity has been recorded, especially in urban areas north of the capital Vienna. The housing sector is also benefiting from renovation and modernisation activities. The trend towards low-energy housing is a good example.

The outlook for infrastructure projects is positive to a smaller extend. The economic upswing was not strong enough to boost this market segment solely through investments by the private sector. Therefore, developments in civil engineering will depend on public expenditures, which face increased uncertainties in light of the Austrian government's budgetary restrictions.

In previous years, the relatively small size of Austria and the strong level of competition had boosted internationalisation strategies, such as that adopted by the largest Austrian construction company Strabag. In 2013, Strabag obtained almost 40% of their total income abroad, while non-construction activities represented less than 10% of total revenue. Austria's biggest brick manufacturer – Wienerberger – has also been active in the Eastern European market for many years. These are just two examples of foreign activities by Austrian construction companies. Expansion opportunities for construction companies exist in the commercial sector, due in particular to the growth markets in Central Europe. Cooperation with Central European companies is of the utmost importance.

So far, the overall growth in the construction industry has remained subdued due to the aftermath of the economic crisis. Nevertheless, improved exports to fast growing markets strengthen revenue from foreign business activities. The domestic performance of the Austrian construction industry will depend on the fulfilment of the promising expectations of private and public spending into residential and infrastructure projects. These expectations are the main driver for the increasing foreign direct investments into Austria that will help the industry to grow slightly until 2018.

o/+ Belgium

The Belgium construction market recorded a substantial downturn in 2012 and 2013. However, the market proved its return to growth in 2014. Indeed, in Q2 2014, construction output decreased by 1% compared to Q1 2014 but the activity has increased by 3.5% compared to the same period in 2013.

In H1 2014, building permits for new residential houses recorded a sharp increase (+20%) compared to H1 2013. The number of renovation permits for residential houses on the other hand remained year on year stable (+1%).

In the non-residential market, the number of new building permits, for both renovation and new construction, remained rather unchanged in comparison with H1 2013 (+1%).

Despite the return to growth of the Belgian market since the beginning of 2013 and the decrease of construction companies going bankrupt (-5%). a substantial increase in the construction market is not expected until 2015. Furthermore, while construction activity is relatively improving across the country, the number of M&A transactions has slightly decreased during the past 12 months, even though 60% of those transactions involved private equity funds.

o/- Czech Republic

The construction industry in the Czech Republic has grown for the first time since the beginning of 2011. The main driver is an increase in public investments. It is widely believed among industry practitioners that the construction industry bottomed out in 2013 and will continue to grow slowly from now on. Despite this optimism, the increase in construction output in the first seven months was followed by a slowdown in August and September. Therefore, results for 2014 may represent only slight increase.
This development follows a decrease in construction output by more than 25% since 2008, which has led to stiff competition among construction companies. This competitive pressure has led to low contract prices, which construction companies currently see as the single biggest problem in the Czech construction sector.

M&A activity has remained low throughout 2014. The only large acquisitions have been the sale of two of Alpine Bau's subsidiaries: its Czech subsidiary went to PSJ, and its Austrian subsidiary BeMo Tunneling went to Metrostav, the largest construction company in the Czech Republic. Even though the market is showing some signs of recovery, we expect M&A activity to remain relatively low in 2015.

o/- Denmark

Last year's monitor reported that sentiment in the Danish construction market was improving slightly, being driven by an increase in housing prices, the recovery of corporate investments and an upswing in PPP projects. Nevertheless, the construction market in the private housing and commercial sectors is at a historic low. Consequently, the industry focus is on risk controlling and modelling. As in 2012 and 2013, there have been no significant transactions in Denmark this year. M&A activity is generally increasing due to an increased number of large and mid-sized transactions compared to prior years.

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

o Finland

The Finnish economy is showing a few signs of improvement: the GDP growth estimate for 2014 is close to zero. In the construction sector, the weak business cycle continues for the third consecutive year. Total construction volumes are expected to decline by approximately one per cent from 2013 levels. The construction of about 27,900 housing units in Finland was begun in 2013. The forecast for 2014 is about 25,000 units and for 2015 about 24,500 units.

Sales of new housing units have slackened, especially outside the Helsinki Metropolitan Area. Business with housing funds has compensated partly for weaker sales to individual households. Demand for housing is affected by major uncertainty. In the longer term, trends such as the migration to population growth centres and the smaller size of households will maintain the need for housing construction in Finland.

While commercial and office real-estate markets have shown small signs of recovery, the slow pace of economic recovery has kept the number of empty offices high. However, there is a need for modern premises with good transport connections. The number of commercial and office construction start-ups is expected to rise in 2014

Stable growth is forecasted in renovation construction. An increase in building stock, the ageing of existing buildings and modernisation requirements will also support renovation construction in the future. The situation in infrastructure construction has weakened due to the decline in new building construction work and the contraction of investments in highway construction and maintenance.

o/+ France

Construction tenders and M&A activity in France is dominated by the main players Vinci, Bouygues and Eiffage. As the large construction companies shift their focus to international markets, local construction companies are trying to consolidate partly by acquiring smaller companies in financial difficulty.

Vinci continues growing internationally, mainly in Canada and the Americas. Vinci also signed a contract with the Portuguese government to acquire 95% of ANA (for €3.08 bn) which comprises concessions for 10 airports over 50 years. After finalising their UK expansion programme in 2012, Bouygues also shifted its interest to Canada. Bouygues Construction recently acquired a majority shareholding in Plan Group (85%), a Canadian technical services provider. Colas, one of Bouygues construction businesses, acquired Furfari Paving in Canada. Although Eiffage targets mainly Africa and the Middle-east as potential development areas, it has continued to expand in Europe and North America by acquiring the leading companies of Smulders, a Belgo-Dutch company specialised in metal construction, and a 70% stake in the Canadian Innovative Civil Constructors Inc. (ICCI). The strong presence of former French colonies among the international target markets of France' key players is notable.

o/- Germany

Developments in Germany are comparable to those of last year. Companies continue to slowly divest their non-core assets and buy mid-sized companies that might give them a comparative advantage in local markets. This has resulted in relatively high transaction activity with low deal value throughout the country. An increase in takeovers in service firms and a decrease in construction focus and output is visible.

Hochtief and Bilfinger, still the largest builders in Germany, are continuing to pursue last year's strategies, which include acquisition and divestment. Hochtief is concentrating on infrastructural engineering. Bilfinger is trying to differentiate through technical services, while divesting significant portions of its former core construction business. PPP projects in both the public and private sectors are still unattractive due to political resistance and a lack of financing options. Private equity firms see PPP projects as risky investments. Therefore, they are not interested in providing funding. The significant backlog of infrastructural projects and public buildings still exists. This situation will continue for as long as the view of PPP projects remains unchanged. The political situation has not resulted in any new viewpoints.

o/o Greece

Despite continuing pressure on the housing market due to price deflation, unsold units and limited bank financing, the macroeconomic environment in Greece has been stabilising throughout 2014. This positive outlook is supported by a significant construction pipeline. After years of stagnation, a number of large motorways concession projects, which have a total estimated value of €5.5 bn, have restarted. In addition, the country's international PPP market is recovering strongly. In terms of project numbers and values as a percentage of GDP, Greece is currently ranked fourth in the European PPP market.

While the construction sector's macroeconomic environment is improving only slightly, M&A activity in Greece remains fairly dynamic. This is caused mainly by the (inter)national interest in the privatisations of governmental assets. The Hellenic Republic Asset Development Fund (HRADF), the authority responsible for the privatisation of governmental assets, has recently completed the tender for the privatisation of 6.2 mln square metres of development land (the old Athens Airport). More tenders for regional airports, marinas, the railway operating company and numerous smaller real estate assets are still ongoing.

o/+ Ireland

The Irish construction market is showing signs of growth across most divisions. This growth is anticipated to accelerate in the short to medium term. An undersupply in recent years has resulted in a shortage across the real estate and infrastructure sectors. The upturn in activity is taking place principally in Dublin, but it is anticipated that other urban areas will follow in due course.

While construction activity is improving, general M&A activity in the sector has continued at relatively low levels. CRH, traditionally Ireland's leading acquirer in the sector, recently completed a portfolio review that will see divestment of about 45 under-performing business units over the coming years. This programme is expected to yield EUR 1.5 bn – 2 bn, much of which will be reinvested in acquisitions for the core business.

Domestically, there were only two notable acquisitions/ investments in significant contracting businesses during the year, and we expect a similar level of activity for the coming 12 months. With the uplift in construction activities, input prices are starting to increase. However, the expected business failures of smaller subcontractors outlined in our report last year has not yet materialised at the levels predicted. We still believe that this section of the industry is financially vulnerable, which should lead to consolidation or acquisition opportunities.

o/- Italy

The Italian construction market continues to suffer from the malaise that persists in the general economy. Since 2008, construction investment in Italy has dropped by over 30%. However, the decrease is slowing down and starting to stabilise. Investment volume at the end of 2014 is expected to be around €126 bn. This is a small decrease of 2.6% compared to the recorded decrease of 6.9% in 2013. Nevertheless, during the first quarter of 2014, the number of construction companies that entered insolvency proceedings increased by just over 6% compared to the first quarter of 2012. Even so, there are signs that the economic situation in Italy is starting to stabilise. This is driven mainly by three developments: the renewed interest of international investors, who are taking advantage of the current market conditions to make acquisitions; the return of liquidity form of financial institutions, which assists private buyers in the housing market especially; and the continued use of fiscal incentives to stimulate activity.

The number of announced deals increased from ten in 2012 to fourteen in 2013. Of these fourteen deals, eight were cross-border deals targeted on an Italian company, five were domestic transactions and one was a cross-border acquisition of a French company. The most notable deal comprised the incorporation of Salini S.p.A. into Impregilo S.p.A. to form Salini Impregilo S.p.A. The value of the deal was reported to be €1.58 bn.

Since the domestic market is still suffering, construction companies are expected to devote their marketing efforts overseas to improve/increase revenues and margins. The scaling up of operations will be an important feature for Italian construction companies over the coming months because size and geographic presence are important factors in competing successfully on the international stage.

o/+ The Netherlands

The housing market is showing signs of recovery, but the infrastructure market has declined and the domestic construction market is still under great pressure. M&A activity is very moderate, mainly due to the receivership/ bankruptcy of smalller and mid-sized construction companies. Moreover, the default of at least one of the larger construction companies can still not be ruled out.

Large construction companies in the Netherlands are increasing their focus on generating revenues from foreign markets. Strukton is involved in a light-rail development project in Suriname, Volker Wessels continues to grow in Canada, while BAM is involved in various strategic projects in Indonesia and the Middle East.

o/+ Norway

The Norwegian construction market is showing signs of recovery. The pipeline is increasing and margins are improving. It should be noted that the pipeline is being largely funded by the government. Subsequently, the Norwegian state has large capital expenditure and maintenance backlogs, which will materialise in due course and generate business in the years to come. Nevertheless, the pace of M&A activity is still moderate.

The Norwegian market is distinctive because it is highly dependent on the oil and gas industry. The recent decline in oil prices has, therefore, affected the M&A construction market. Until now, most international players have entered the Norwegian market through joint ventures.

However, we expect international interest eventually will boost the number of M&A transactions. We also expect a consolidation wave owing to the fragmented construction market in Norway.

o/+ Poland

The Polish construction market has been facing serious challenges since 2012. This has affected key players and smaller subcontractors alike. Poland will receive EUR 82.5 bn from the European Union budget for the years 2014-2020 as part of the EU cohesion policy, which is the largest national allocation among the EU's 28 Member States. From this amount, approx. EUR 24 bn will be allocated to infrastructure development projects.

The current situation of the construction market and the availability of fresh EU funds from 2015 have made Polish construction companies cautiously optimistic about the future of the sector. The new EU funds will be used for specialised areas within the construction sector rather than to general construction. Examples of these specialised areas include waste-to-energy construction, road and railway construction, and hydro construction. Our experts foresee construction companies will anticipate on this trend by diversifying their current operations. This is done by acquiring especially mid-cap companies that already participate in these areas and may add competitive advantage to local markets.

o/- Portugal

The Portuguese market continues to suffer from uncertainty and lack of investor confidence due to the effects of the economic downturn. Limited public spending and public investment is affecting the construction sector severely. Demand in the domestic construction market is still declining, and the number of bankruptcies has increased compared to previous years. As a result, some construction companies still need to restructure their operation, debt and divest assets and non-core businesses so that they acquire the necessary financial capability in the short term and make a successful exit in the medium term.

Key players in the Portuguese construction sector are continuing to divert their international expansion strategy in order to pursue diversification and increase revenues. Former colonies such as Angola and Brazil are popular target markets for Portuguese construction companies. For some key players, the international markets account for over 70% of their revenue. Conduril, a civil engineering and public works company, is a good example of this. In 2013, 22% of its revenue came from the Portuguese market, a drop of 15%, while 93% of its revenue came from foreign markets.

o/- Spain

The construction market has been shrinking steadily since 2007. However, the market has shown some signs of recovery recently due to improvements in the macro economy and a soft easing of the government's austerity policies. The arrival of international investors looking for opportunities in mainly the real estate market, particularly in the office segment, has injected some dynamism into this sector as a whole. However, recovery in the residential segment seems slower. Infrastructure investments are still in the doldrums because the government is not expected to increase its budget considerably in 2015.

Most Spanish listed construction companies are adopting the following strategies:

- Internationalisation, mainly in target markets like the USA, Canada, the UK and Australia. They are also starting to invest in Latin America due to the significant investment plans of Colombia and Mexico in the coming years, though this accounts for only a small part of their international revenue. The international backlog accounts for about 70% of the total backlog of Spanish listed construction companies.
- Repositioning of core divisions, bolstering businesses with activities such as urban services concessions (environmental water, waste management and similar), which have more stable and regulated cash flows and higher margins.
- Divestment of non-strategic assets, which is expected to continue in the medium term.
- Improvement of the financial conditions, which has paved the way for non-banking fund sources to issue bonds.

o/+ Sweden

According to local real estate experts, the M&A activity of the major Swedish construction companies remains similar to previous years. Due to declining growth in geo-specific markets and sectors, some of the major companies have launched restructuring programmes during the year. Major publicly-funded infrastructure projects are proceeding as planned, while new major infrastructure projects are under political debate. Furthermore, the recovery of the housing construction sector is accelerating and the order book of major Swedish construction companies is increasing.

The overall construction industry in Sweden is expected to grow slightly compared to the previous year due to a fairly stabile housing construction sector and an increasing order book. During the last three years, M&A activity in the Swedish construction sector has been steady. Transactions include the mergers and acquisition of companies, construction projects and the purchase of strategic land, both in Sweden and abroad. However, the four largest Swedish construction companies have not been involved in any major M&A activity since the autumn of 2012. These listed companies (NCC AB, Skanska AB, JM AB and Peab AB) are pursuing growth strategies by expanding in their existing markets. The main driver is organic growth, but corporate acquisitions also play a part.

o/+ United Kingdom

Throughout the UK, the optimism amongst construction firms is increasing, driven mainly by an increase in private housing (both new and repairstorm/maintenance). The value of construction output is already approaching levels last seen in 2012. An increase in supply chain pressure across the UK is causing the sharp rise of input costs (primarily sub-contractor and labour costs) and a delay in receiving materials. Consequently, most construction companies are not expecting sustained improvement in performance for another 12-18 months.

Cost inflation inevitably exposes construction companies to risk, which may increase the supply chain pressure even more and create a lack of capacity and capabilities for large infrastructure projects. The M&A market in the UK rose by 33% in H1 2014, and it is expected to continue rising due to high growth expectations. 2014 has recorded a wave of M&A deals among engineering consultants: Aecom's announced its intention to buy URS Corporation for GBP 2.3 bn and WSP agreed terms with Balfour Beatty to buy its US professional services arm Parsons Brinckerhoff for GBP 820 mln.

4. Conclusion

What to expect

The number of M&A deals remained stable in 2013 compared to 2012. Using the broader definition of construction to analyse the 2009-2013 period, we see that M&A activity is relatively stable: the number of deals fluctuated between 107 and 148 per year, with an average of 131. This makes 2013, which recorded 139 deals, an average year. By extrapolating these figures, we expect the number of deals in 2014 to stabilise.

The number of deals may not been changing, but the type of deals certainly is. Although we notice some signs of market recovery, the construction industry in Europe is still experiencing squeezed profits, reduced cash flows and limited availability of bank financing for the industry. Consequently, we observe an increase in M&A activities as a result of international investors targeting Europe. The number of intercontinental deals recorded in 2013 almost doubled. We expect this trend to continue for H2 2014 and 2015 as companies search for high margin projects and additional sales in an effort to avoid negative financial results.

Construction companies in recovering markets are starting to experience pressure in their supply chains. The significant number of defaults in recent years has made it a challenge to attract not only sufficient labour but also sub-contractors with the right capabilities. This introduces the risk of cost inflation because some industry players have a large exposure to changes in input factor costs. We expect European construction markets to bottom out and then gradually recover in line with their domestic markets. In time, we expect additional countries to be faced with similar difficulties, and recovering market conditions will not necessarily result in recovering operating margins.

The number of private equity deals has increased for the third consecutive year, rising from 10% of all recorded deals in 2012 to 19% in 2013. This growing interest is also leading to larger private-equity-backed deals, particularly in long-term infrastructural projects as well as more venture and startup capital, which fuels innovation and growth.

We expect the flow of M&A deals to remain steady throughout 2014 and to pick up in 2015. Since the number of deals is expected to remain stable, the playing field should become even more diverse and even more focused on internationalisation and other types of deals.

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