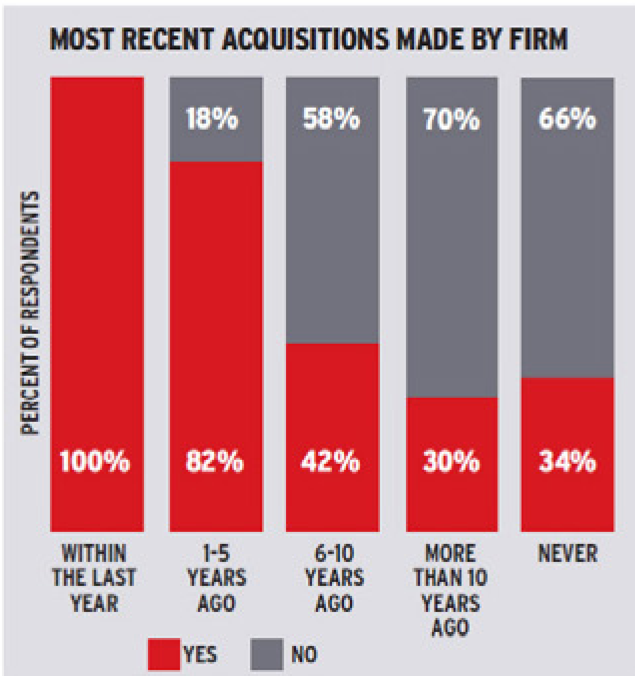
Recent Merger Activity Driven Largely by Technology Needs



SOURCE: FMI

Most FMI survey respondents report that their key acquisitions have occurred within the past decade or less.

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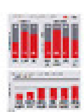

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An industry-wide sellers' market helped fuel record-setting merger-and-acquisition activity among engineering and construction firms in 2018, enabling buyers to better adapt to multiple trends reshaping the industry.

According to a recently released trends survey by FMI Capital Advisors Inc., the 534 industry transactions announced last year surpassed the previous record, set in 2015, by nearly 22%. The timing was right for such torrid activity, explains FMI Managing Director Alex Miller, particularly given the large "demographic backlog" of willing sellers.

> **"Owners want more accountability and value in the services they receive."**

"Many baby boomer owners who put off retirement because of the recession saw the current strong market as a good time to exit," Miller explains.

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– Yehudi "Gaf" Gaffen, CEO, Gafcon

Buyers were likewise plentiful, with heightened demand for technical expertise joining growth and service expansion as primary acquisition drivers, the survey found. "If you're not growing, you struggle to create opportunities for people and retain talent," says Dan Pleasant, COO of Fairfax, Va.-based Dewberry, which has made multiple acquisitions of regional engineering firms in recent years, including last year's purchase of J3 Engineering Consultants Inc., Greenwood Village, Colo.

Pleasant says that while a primarily organic strategy tends to be easier for smaller companies, there comes a point where sustaining that pace requires a firm to look outward. Dewberry applies both approaches, he says, with approximately 40% of its recent growth coming via "strategic" acquisitions aimed at a particular region, market sector or service line.

Vertical Integration Continues

Recent M&A activity also reflects a growing industry trend toward more vertically integrated service providers, an evolution that FMI's Miller says began in the industrial and process sectors. It has now made its way to traditional building markets in response to wider use of design-build-based project delivery models.

Contractors' willingness to adopt off-site component production and prefabrication methods is also a factor, says Trevor Schick, who heads Katerra's construction, renovations and supply chain.

Rather than focusing on increased revenue, Schick explains, Katerra's acquisition strategy aims to expedite a broader rollout of its technology-driven, integrated building approach, which he says has enjoyed success among West Coast clients. An early 2018 private capital infusion of $865 million helped the Menlo Park, Calif., company finance upgrades to its production facilities and acquire Bristlecone Construction Co., Littleton, Colo., and Fields Construction Co., Hoboken, N.J. Katerra also purchased two architectural studios and KEF Infra, an off-site manufacturing technology specialist based in India.

"Our goal is both 'feet on the ground' and executive-level talent who understand the construction industry has to change and are willing to help us do it," Schick says. However, the number of acquisitions over the past three years belies the challenge of finding prospective partners who embrace Katerra's approach. "A lot of GCs just want to keep the same model, whereas our approach requires a change in thinking," Schick says.

Katerra's recent introduction of its Apollo software platform to support the building life cycle also illustrated the FMI survey's finding that technology is increasingly seen as a market differentiator. Nearly half of FMI's 2018 M&A survey respondents reported having contemplated purchasing a technological solution or commercializing an existing in-house product.

Among those adding technology capabilities via acquisition was San Diego construction management services firm Gafcon Inc., which purchased Orange County, Calif.-based McDowell Scheduling. Founder Philip McDowell, who joined Gafcon as director of scheduling, also will contribute to developing new tools for project modeling and visualization.

Gafcon co-founder and CEO Yehudi "Gaf" Gaffen says technology capabilities have long been one of the company's core offerings, making it a potential acquisition target in recent years. Now, having turned the tables on the process, he says the new technology tool will be pivotal in helping Gafcon vie successfully for complex construction programs, which are increasingly the norm.

He notes that McDowell's technology already has proven itself by helping to clarify scheduling complexities associated with the $1.5-billion Seaport San Diego redevelopment. "Owners want more accountability and value in the services they receive," he says.

Preparing for Uncertain Prospects

While many industry firms used acquisitions to augment their size and capabilities in 2018, a significant number of large organizations opted to scale back. Notable divestitures included Jacobs' $3.3-billion sale of its energy, chemicals and resources business to WorleyParsons, and

Stantec's spinoff of MWH Constructors' construction division, acquired in the 2016 purchase of MWH Global.

In announcing the move, Stantec President and CEO Gord Johnston said MWH Constructors "has growth opportunities in the United Kingdom and the United States, and we believe this divestiture will better allow them to invest in and pursue growth while continuing to serve their clients."

FMI's Miller says such moves are indicative of larger firms reassessing the market and concentrating on core businesses, particularly in light of forecasts about a coming economic slowdown. "The sellers' market makes it a good opportunity to dispose of non-core assets because there's an appetite for them," he says.

FMI projects the uptick in M&A activity to continue through 2019 and beyond, albeit at a reduced pace. The year already has seen EMCOR, ranked second among ENR's Top Specialty Contractors, acquire Baker Electric of Des Moines, Iowa. Top 400 contractor Cianbro, Pittsfield, Maine, recently purchased Connecticut construction services provider A/Z Corp.

Miller believes that many active buyers may pause acquisition activity as they digest moves they've already made, integrate new staff and services, and assess the revised market landscape.

Other firms, however, may just be getting started.

"Some firms will see that competitors are growing and they're not," Miller says. "Even if a market slowdown were to happen, their growth expectations are still higher, and they'll see the need to take action."

Pleasant says that while Dewberry has the financial resources to remain alert for potential acquisitions, the pace will be moderated by availability of senior management resources to oversee what is typically a one- to two-year integration process.

"We've learned from past transitions that you need to assign a well-respected leader within the company who can focus exclusively on the process in order to make it successful," he says.