Keith Pickering Catalyst Corporate Finance

RECOVERY TRANSLATES INTO MERGERS ACTIVITY

THIS TIME LAST year I committed to print my view that the positive momentum being experienced by many businesses in the sector was beginning to translate into M&A activity driven by the strategic rationale of buyers and the confidence of owners and managers in the performance of their businesses.

During the first half of 2014 both of these factors gathered pace, underpinned by further growth in output across the whole spectrum of the sector. Examples of these dynamics playing out into completed deals during the six months to June included:

- Cala Group, the subject of a significant private equity investment only 12 months before, acquiring Banner Homes to expand its share of the upmarket segment and its geographic coverage;
- Masonite, the NYSE-listed £1.5bn revenue door manufacturer, acquired Door-Stop Limited, to secure a leading position in the fast growth UK composite door market;
- Wolseley represented the major merchants with its purchase of the Fusion utility business; and
- a number of energy efficient installation businesses found new homes, including Miller Pattison strategically sold by SIG plc to Help-Link, Everwarm acquired by Lakehouse and CDA Contracts which was acquired by Indsur Global, the Indian manufacturer of insulation products.

The period also saw larger UK corporates make further investments overseas, including Tyman's acquisition of Vedasil of Brazil and Wolseley's foray into Finland. In addition, we also saw deals representing a few of the more macro sector drivers such as the global construction services businesses becoming ever more white collar in their business mix – Bilfinger's acquisition of GVA Grimley – and the impact of the online channel on product distribution and retail – the £200m private equity investment by TPG into Victoria Plumb.

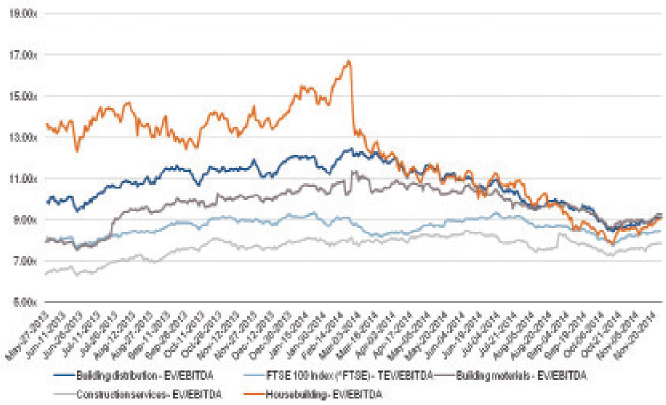
So what happened in the second half and what platform is that giving the market moving into 2015?

Construction sector output continued to show year-on-year growth, with the new housing segment output well up on the previous year by the end of Q3. Therefore, business performance for many in the supply chain will have stayed strong, which should have encouraged both buyers and sellers to engage and close out a greater number of deals. However, what we saw was a second half with deal volumes very similar to the January to June period but, arguably, transactions of less significance and strategic importance.

For instance, aside from the acquisition of Scotshield by Spie of France, there was minimal other inward investment. However, this possibly says more about the health (or lack of it) of the wider European construction market than the UK. Of the major merchants, only SIG seemed to get their deal engine into gear, buying a handful of businesses, in France and The Netherlands, albeit at very modest values.

The contents of the chart might show why the second half failed to deliver, showing as it does the valuation multiples of the major listed construction businesses in their respective "baskets". House builder valuations

> **"House builder valuations took a significant hit as some of the froth started to come out of the housing market with the impending threat of interest rate rises"**



took a significant hit as some of the froth started to come out of the housing market with the threat of interest rate rises. This, plus the general uncertainty surrounding macro elements such as the Ukraine, the Middle East and European deflation, all caused valuations to ebb lower through March to October.

Media noise around the green agenda and the failure of The Green Deal to take off may also have dampened appetite. Given this, it was interesting to see both Epwin and Entu go to the public markets in the second six months of the year and, as at the time of writing, have a share price marginally ahead of the float price, which was priced keenly at around a 6-7x profits multiple.

Returning to the chart, the four different areas of activity have converged around an average 8-9x EBITDA multiple and all shown an uptick since mid-October. This uptick is too embryonic to call it a trend, however, it has arrived at the same time as a few interesting deals, both in our pipeline and in the general market covering niche growth areas (e.g. lighting – the acquisition of Ansell by Endo of Japan, composite doors – private equity investment, utility infrastructure service providers – Mott Macdonald's acquisition of Bentley).

Over the next six months I foresee this positive activity continuing, although as we near the general election more caution may be evident, particularly in those areas heavily driven by specific government policies. However, one area where activity at good prices will continue is in technology-led energy efficient products and services. Whilst not every deal will enjoy the metrics of Google's investment in smartphone heating and smoke controls specialist Nest Labs, businesses delivering proprietary products and services will prosper.