

The Maturing Construction Technology M&A Environment

By Andrew Henderson



Construction technology investment and overall mergers and acquisitions (M&A) activity are stronger than ever. Strategic acquirers remain very active, and companies like Procore are continuing the M&A push to broaden solution offerings and provide more technology-enabled options for customers.

As technologies mature, private equity and venture capital dollars make more financial sense in the space as well. In 2019, for example, Brick and Mortar Ventures announced a \$97 million fund that's backed by several big names in the construction industry. At the same time, underlying market dynamics that serve as key investment drivers are continuing to present challenges for the industry. A shortage of quality labor, along with rising labor costs, presents major hurdles that can be addressed by improving construction technology.

Concurrently, we continue to see minimal change in construction productivity, although business owners are now looking to technology to finally move that needle. The problem is that construction executives still have a long way to go in their efforts to develop a coherent technology strategy. Siloed project sites and a lack of technology training for key project managers mean that significant structural changes are still necessary to make tech adoption a success.

With more approved budgetary dollars going toward construction tech, it will be important to monitor those investments in order to see where true value can be acquired.



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Assessing the key M&A deals for construction technology and what they mean for the E&C industry.

When it comes to technology deployments, the construction industry is severely lagging other industries. While many variables come into play here, there are a few root causes. For example, rolling out new technology across multiple, offsite construction projects is downright difficult. Furthermore, many smaller subcontractors that comprise a large percentage of the industry lack the scale to invest in technology that may not realize returns for some time. And finally, many industry players are so deeply rooted in the “old ways” of doing things—many of which continue to produce results for them—that they don’t want to shell out the money or devote the time to new technology implementations.

Whatever the root cause of the problem, the fact is technology plays a critical role in meeting the ever-changing needs of customers and internal stakeholders. An industry that is known for project delays, lagging labor productivity and an acute shortage of quality labor, engineering and construction (E&C) needs technology more than ever to ensure long-term growth.

Fortunately, the E&C industry does have deep pockets and is currently experiencing significant growth. So, while this multitrillion-dollar industry may be currently

lagging others on the technology front, E&C is well-positioned to quickly reverse that trend and bring its technology into the 21st century.

Where Does the Money Go?

Over the last decade, more than \$10 billion has been allocated to funding construction technology. Most of that money came through early-stage venture capital deals. Brick & Mortar Ventures, for example, completed 24 deals (with a median deal size of \$5 million), all of which have been minority investments.

Both financial and strategic investors have been active, but we have not seen the types of majority investments that are common across the rest of the industry. Given that many construction company boardrooms lack technology experience, many firms have used the minority investment approach to simply try out specific technologies of interest. We do expect the construction industry, which generally experiences a few years lag between early-stage venture capital funding and larger-scale, majority M&A activity, to follow the M&A trend we see across other industries.

Looking at recent deals, construction technology was distributed across three

main verticals: collaboration software, physical construction technology and data analytics/artificial intelligence/Internet of Things:

- **Collaboration software** can be any software tool that helps connect teams and assets across a business that helps them maintain and further grow mobility. This can be as simple as basic communication software or as complex as highly engineered sensors embedded in assets across multiple sites with built-in notification capabilities to help teams make better decisions.
- **Physical construction technology** includes digital mapping, design platforms, highly engineered materials, 3D printing, prefabrication and robotics. These technologies can be so different that, in many cases, it may make sense to further delineate subverticals when discussing comparable metrics.
- **Data analytics, AI and IoT** are all solutions that help E&C firms get good data from job sites (and from the employees who are working there) and then use it to generate actionable insights and make good decisions. Right now, for example, we see many IoT plays in this space that will hopefully one day help teams make more efficient, well-informed decisions.

The Deal-makers

As construction technology companies mature, larger acquirers are stepping in and making full (or at least majority) acquisitions. These acquisitions are being driven by both strategic and financial (e.g., private equity) acquirers. For example, strategic

acquirers have started making significant construction tech investments for various key reasons, including talent acquisition. Leveraging acquisitions to acquire and build talent can be a very efficient alternative to internal hiring and development practices. Trimble's \$1.2 billion acquisition of Viewpoint, for instance, added not only a leading construction management solution but also a team of over 700 experienced individuals capable of driving future business growth.

Another reason we are seeing an uptick in construction technology acquisitions is that the technology itself is maturing. Used as a testing phase, the traditional venture capital approach is no longer necessary because of the higher probability of investment success. With a proven technology comes the ability for acquirers to model projected cash flows and to more accurately identify the projected rate of return. Caterpillar, for example, made an initial investment in Yard Club, a provider of an online equipment rental platform, back in 2013. Caterpillar was then able to follow that business and prove its future profitability, which then led to the eventual full acquisition of Yard Club in 2017.

Key Acquisitions

The landscape of construction tech firms is very broad, and some acquirers are consolidating similar or complementary firms into larger entities in order to gain market share and increase company value. JDM Technology Group just acquired Integrity Software Solutions along with an add-on acquisition of Estimate Software, both of which further built a strong product portfolio of leading construction software solutions. And Autodesk just bought PlanGrid for \$875 million in one of the most significant

acquisitions in 2018 in an effort to further drive interoperability among E&C firms.

Vertical integration is also driving M&A activity among E&C firms. Companies like Katerra see the value in vertical integration with the ability to better control the full supply chain and reduce double marginalization with various third-party transactions. Additionally, as collaboration software matures, it's facilitating vertical integration even further.

Private equity (PE) deals have been driven by many of the same factors as strategic deals; however, given PE's business model, some additional factors come into play. Given the leverage used by these private equity firms, recurring revenue and cash flow generation are key in order to repay the debt. As such, private equity has been drawn to many construction tech targets that have an "as-a-service" model, which in many cases comes in the form of a software licensing model.

Genstar Capital took this approach when it combined iSqFt and BidClerk within the ConstructConnect platform to create a vertically focused software-as-a-service platform. The platform provides project data, analytics and software tools to the construction industry. This approach was successful for Genstar, as the firm later exited this investment and sold the platform to Roper Technologies.

The long-term contracts that come with this "as-a-service" model give investors more confidence in companies' future performance and allow them to more easily model out the return of that investment. In instances where future performance is uncertain, financial acquirers look to targets with a large, addressable market.

This situation occurs with many software-based construction tech companies that may not currently have a significant customer base but instead do show significant headroom to expand into the broader global construction industry.

Additionally, some buyers haven't been lenient when it comes to requiring a track record of historical profitability if the target—usually a software company—has a significant number of pre-existing users. In such situations, the acquirer can leverage that large user base, for growing not only the target in question but also potentially other platform companies that can cross-sell into that market.

In the end, the most significant driver for financial buyers in E&C is the maturation of the construction technology space. Investors want to know that they are going to generate a strong return on their investment, so it is crucial for mature constructing tech firms to provide greater transparency and clarity around future performance indicators.

Top Valuation Trends

Construction tech companies come in all shapes and sizes and serve various markets. As such, there is no one-size-fits-all model for company valuations in this space. In E&C, we generally see EBITDA multiples as the main base for valuation. We expect to see deals like Quest Integrity Group, a technology-enabled asset integrity and reliability management services provider, that was acquired by Team Industrial Services for a conservative value of nine times EBITDA.

This valuation approach makes sense until a construction management software

provider like CONJECT is acquired by Aconex, an Oracle subsidiary, at 81 times EBITDA. This proves that we must consider a broader range of metrics to better understand relative value among different acquisition types. Accepting that this still may be somewhat of an overgeneralization, we have seen a few broad deal types across the space. These include the acquisitions of non-profitable construction technology businesses, profitable construction software companies and profitable construction technology service providers.

When acquiring non-profitable construction tech firms, buyers are looking for some of the factors already mentioned in this article. The total addressable market, existing user base and strategic synergies are just some of the key points that they consider. For many construction tech deals, acquirers pick targets where they feel further consolidation would yield a significant strategic value. The idea that “1 + 1 > 2” has been a key driver of M&A activity in this space. Acquirers of these types of businesses also rely heavily on valuation multiples from similar transactions in the market, given the fact that stand-alone cash-flow modeling may not be possible due to a lack of profitability.

Finding Profitable Targets

When it comes to profitable targets, software companies have their own requirements for generating accurate valuations. Cash flow projections are a key source for valuers when they are looking at companies in this space. Acquirers will also look to the licensing base of software companies to value the recurring revenue stream that comes from that base. Additionally, as we see in any deal, acquirers of software companies will also look for

strategic synergies. For example, a general contractor with a large volume of assets across multiple project sites could gain significant value from a smart asset tracking system that allows management to make precise and potentially cost-saving decisions.

A significant number of deals in the construction tech space have revolved around service provider targets. In many cases, valuing these companies is like valuing a traditional construction company. To gain greater value, acquirers want to see (and therefore model out) cash flows based on a recurring revenue. The project-based nature of many construction companies is generally a value detractor, and the same



holds true for construction tech companies if they do not have long-term recurring revenue streams. The people aspect of the acquisition is also key here. From acquiring individuals with key expertise to gaining full teams of employees trained in a new technology, human capital can become a significant piece of the financial model for construction tech service providers.

More Transformation Ahead

Overall, we are still seeing significant variability in construction tech company valuations. Cash flow modeling can be very tricky at times, given the many variables and assumptions. Acquirers generally look

to comparable trading multiples and valuation metrics from similar transactions to determine the true market of such targets.

Given the infancy of the construction tech M&A space, these market metrics are still few and far between. For over 65 years, FMI has successfully led M&A transactions in the E&C space, and we see the market metrics in our deals every day. FMI, along with the acquirers in the construction tech space, will continue to develop a much narrower view on valuation as construction tech firms continue to mature and engage in M&A activity in the future.



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