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Private Equity's Growing Role in Shaping the Built Environment

By David Guy

The built environment offers the private equity community an opportunity to invest in strong, growth-oriented companies with competitive returns.

The lower middle market is crowded and competitive. An overabundance of capital, coupled with an influx of family offices, independent sponsors and new private equity (PE) firms, has created a dynamic where more players are pursuing fewer quality deals. Unrealistic valuations; long, drawn out processes; and lower close rates are becoming the norm as the competitive landscape becomes just that—more competitive.

As a result, private equity firms are looking for additional areas to deploy capital and are increasingly looking to the engineering and construction (E&C) arena for those opportunities, including a broad range of industry sectors such as environmental, heavy civil, industrial, clean technology and energy services, construction materials, utilities and building products, to name a few. A recent example of a PE firm stepping outside of its traditional markets is Encore Capital Management, which is seeking to raise \$400 million to buy land and build homes.¹ Private equity firms don't generally “flip” homes, but they did buy thousands of properties after the national housing recession, with the intention of converting them to rental properties.

¹ “For Sale: A New Home Built by Your Local Private Equity Firm.” Bloomberg. June 1, 2018.

Ramping Things Up

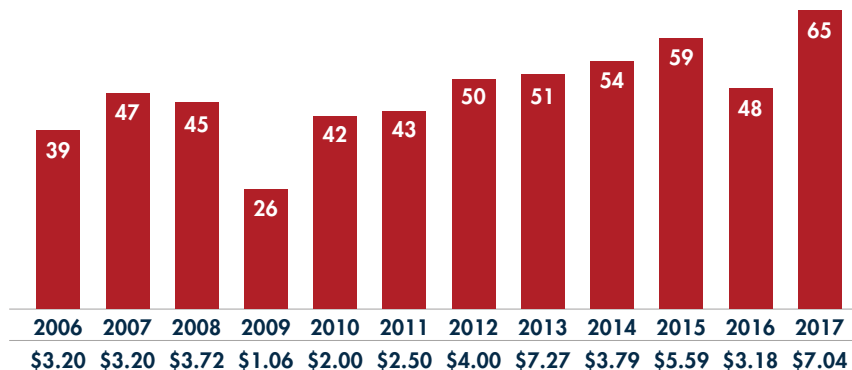
One of the industry's oldest and respected publications, Engineering News-Record, confirms these new trends: "Private equity investors have been fueling deals in the design and construction sector since the dot-com bust in the early 2000s. But with more investor cash within a booming economy, PEs are ramping up investments and seeking new niches that are helping industry firms to change corporate directions."²

Tim Huckaby, president of FMI Capital Advisors, Inc., concurs and adds that, "The M&A market for companies providing services, equipment, materials and technologies to the built environment has expanded over the last few years, and we expect M&A activity to remain robust in 2018. International buyers are aggressively seeking North American acquisition targets. Private equity funds continue to enter the sector and build companies with scale and scope through multiple acquisitions."

The types of companies that PE firms are targeting in today's fast-evolving E&C industry include companies that have a significant service component to the business (e.g., mechanical/HVAC that provides system maintenance) or a unique advantage over its competitors. Given the competitive landscape for deals and the ongoing integration of design, construction, operation and maintenance, PE firms are now more open to project-based businesses that in the past were perceived as being too risky.

Exhibit 1. Private Equity in Engineering and Construction

E&C Firm Deals by Total Number Closed and \$ Value (\$B)



Source: Pitchbook

"Interested PEs tend to invest in a specific industry trend—such as industrial services, renewable energy or efficient buildings—or create a platform in a fragmented market," explains Alex Miller, managing director with FMI Capital Advisors, Inc.³

Stone Arch Capital is a private equity firm that has found a way to make it work, having acquired Stueve Construction—an engineering and construction firm focused exclusively on the construction of dry fertilizer storage facilities throughout North America. This niche-oriented approach to the market, combined with a full-service

² "Private Equity Investors and Industry Firms Find New Links." ENR. January 2018.

³ Ibid.

business model (pre-construction, design, engineering, construction and project management), has allowed Stueve to become a dominant player in the market that produces consistently strong returns despite its project-based model.

Prospects in Today's Built Environment

Looking at E&C market conditions in the U.S. and Canada right now—and barring any unforeseen events—both are about as good as we can expect them to be. In both countries, the demand for investment in all types of infrastructure is very strong and pervasive. Broadly speaking and looking across the breadth of the built environment as a whole, and based on industry backlogs that are (on average) booked through 2018, the next 12 months should be as good as—or even better than—2017 (see “[FMI's U.S. Construction Outlook](#)” for more details).

It is within this context of continued growth and demand for new projects in the built environment that PE firms are taking a fresh look at strategic investments and acquisitions. One such segment is mechanical and electrical construction and service, which is being driven by multiple consolidating platforms in the HVAC and refrigeration service space (many backed by private equity) and the convergence of energy services (or ESCOs) and traditional mechanical and electrical construction and service.

Another segment where we see robust financial and strategic interest is in the utility construction segment, with transactions such as VINCI Energies' acquisition of PrimeLine Utility Services from First Reserve (a private equity firm) and Centuri Construction Group, Inc.'s acquisition of New England Utility Constructors Inc.

As Dan Shumate, director of FMI Capital Advisors' Utility Transmission and Distribution Group, suggests, “The utility transmission and distribution and communication distribution industries remain in a multiyear investment cycle, driven by the need to repair, replace and upgrade the transmission and distribution infrastructure across the United States. Couple this investment with growing demand for broadband network speed and an aging investor-owned utility workforce, and there are robust long-term tailwinds that will continue to drive growth for third-party construction and service-based companies.”

Recent notable private equity transactions in the built environment include:

- Oaktree Capital's GFI Energy Group's acquisitions of NAPEC and Sachs Electric
- New Mountain Capital's acquisition of TRC Companies
- AE Industrial Partner's acquisition of CDI Corp
- Warburg Pincus' acquisition of Service Logic, LLC
- Gryphon Investors acquisition of Shermco Industries
- First Reserve's acquisition of CHA Consulting, Inc. from Long Point Capital
- Orix Capital Partners' acquisition of Peak Utility Services Group



What's Ahead?

As the availability of investment capital continues to grow, private equity is more comfortable pursuing opportunities in the built environment. Keystone Capital's Jason Van Zant describes his firm's interest in the built environment this way: "We tend to gravitate toward AEC investments with a specialization or focus in a certain market that differentiates them from the rest of the competitive landscape. Although the AEC sector is not for everyone in private equity, we have been attracted to it mostly due to its asset-light nature and high cash-flow generation."⁴

Greg Powell, managing director with FMI Capital Advisors, adds, "While PE has historically shown more interest in the engineering sector relative to other parts of the AEC spectrum, momentum continues to grow. Funds are prioritizing more specialized design and consulting engineering firms as platforms they can continue to scale through targeted acquisitions. We are also witnessing growing PE interest in environmental services firms, both consulting and contracting. Funds look to piece together complementary firms in this highly fragmented and regionalized market to create something with scarcity value."

As with many industries, the cycles that exist within the built environment vary in length and can be quite unpredictable. However, most investors and industry observers describe the \$2 trillion-plus E&C industry as being ripe for disruption, particularly from a technology and project delivery standpoint, and the periodic pullbacks ultimately strengthen the industry by forcing it to become more innovative. For those financial sponsors that understand the market (including its cyclical nature and risks), companies in the built environment offer unlimited opportunities to grow and scale a company both at the regional and national levels. Now is the time to capitalize on those opportunities and embrace a new future in tomorrow's built environment.

⁴ "Private Equity Investors and Industry Firms Find New Links." ENR. January 2018.



David Guy is a director with FMI's corporate business development team. David helps drive the firm's revenue and customer growth goals by developing new opportunities for all FMI business units across all sectors of the U.S. and Canadian engineering and construction industry. In addition, he is charged with expanding awareness and a favorable opinion of FMI's brand and services across all sectors of the built environment. He may be reached via email at dguy@fminet.com.



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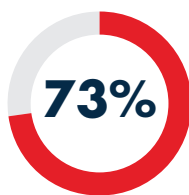
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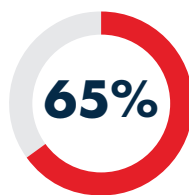
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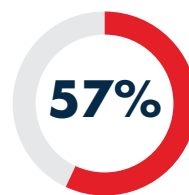
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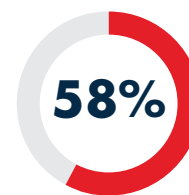
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