GERALD EDELMAN

INDUSTRY UPDATE
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YEAR 2021

Construction

Despite the various construction industry obstacles that were seen throughout 2020, the outlook for the construction industry remains positive, with growth rates estimates expected to continue at a rate of 12.9% in 2021 and 5.2% respectively in 2022.

This report provides an overview of the construction industry, exploring various industry segments and trends and examines M&A activity and resilience, forecasting continuing signs of recovery within the sector.

Overview

Construction output is typically considered to be highly sensitive to the overall health of the economy. Subdued growth reduces demand for new industrial and commercial facilities, and a loss of income and lack of confidence negatively affects residential construction and refurbishment demand.

With property values also generally tracking GDP, this substantially reduces demand for construction services. With the coronavirus and Brexit piling pressure on the UK economy, only those who can adapt to the rapidly changing economic environment will be perfectly poised to survive and thrive in the changing industry.

Market Structure

The construction industry captures a wide range of activities. To analyse the industry, we have divided the construction into the following three segments.

- Commercial
- Industrial
- Residential

The commercial and industrial segments are dominated by big name players such as Balfour Beatty, Galliford, Try and Kier. The residential segment is spread more thinly with large firms building complexes and new developments, although, the development of older residential properties and conversion of commercial properties into residential is controlled by multiple smaller firms and individuals.

Commercial

The commercial sector, which comprises of retail properties such as shopping centres, hotels and offices, has been dramatically impacted by the outbreak of the pandemic. Whilst the impact on the high street and shopping centres has been highly publicised and visible, it is becoming more clear that the pandemic was only a catalyst for a substantial increase in an ongoing trend of decline, with research showing an average of 10% decline in footfall in shopping centres in the seven years to 2019. With the industry seeing a structural shift in consumer preferences to e-commerce, which is expected to 'stick' going forward, this does not bode well for the high street and demand for retail construction.

Whilst the high street may be considered a 'loser' of accelerating online shopping trends, the 'winners' include logistics and warehouse space which have been booming since the pandemic started. In order to meet growing demand and ensure inventory can withstand any supply chain shocks, operators will be looking to increase capacity. Consequently, demand for related construction is forecast to increase going forward, with Knight Frank reporting that this trend could drive demand for 92 million sq. ft of warehouse space across the UK by 2024.

The shift to remote working has called into question the role and value of physical, city based, offices in the future. In a recent survey to its staff, Grant Thornton identified that nine in ten of its staff wanted to work most of their week from home.

A number of other large financial firms, including PwC and HSBC, have announced that they will be adopting more flexible working from home policies going forward. However, this is not a universal opinion, with many companies like Goldman Sachs, Credit Suisse and JP Morgan suggesting that all staff should return to the office once restrictions are lifted. It seems likely that a more hybrid working from home system will be adopted nationwide, with benefits to employees of both office and home working life. It is therefore likely that 'the city' may not look too different to its pre-pandemic state as was once speculated, and demand for office construction is set to continue.

Industrial

The Industrial segment primarily relates to large projects focussed on manufacturing, logistics and energy real estate. According to the Construction Product Association ("CPA"), industrial construction was least affected by the first lockdown primarily down to the ease of operating under COVID regulations, such as social distancing, however there were still significant interruptions throughout the past year.

The pipeline for industrial projects continues to look strong with HS2 (the high-speed rail network between London, the West Midlands, Manchester and Leeds) unsurprisingly dominating the list. Euston station, which will be the home of the London terminal, is undergoing a c. £2.2bn project with the Northolt tunnels following priced at £1.4bn according to Glenigan. The past year has seen delays in the construction of HS2, consequently leading to controversies surrounding its sizeable budget, which recently was extended by £1.7bn from the original £106bn because of delays.

Hinkley Point C, the nuclear power station site in Somerset, is also a construction project that has been struggling to complete in line with deadlines set. The original opening date of 2025 has been pushed back to 2026 because of delays. To ensure the plant does open in 2026, EDF, the energy company running the project, has announced they are looking to hire a further 1,700 people, taking the total workforce up to 7,000.

Both projects, alongside the sector's pipeline demonstrates the government and construction companies' commitments to the industrial sector in the UK, although they also show the difficulty in budgeting and forecasting the completion dates for large industrial projects. The CPA forecast the industrial sector to increase by 29.3% in 2021, however, if the commitments of all parties slow, then the sector could be hit drastically.

Position	Value £(m)	Project Name	Sector	Region	Start Date
1	2,200	Euston HS2	Civil (Infrastructure)	London	May
2	1,400	HS2 Northolt Tunnels	Civil (Infrastructure)	London	September
3	1,250	The Stag Brewery Regeneration	Private Housing	London	November
4	1,000	Elephant & Castle Town Centre-Phase 2	Retail	London	May
5	965	HS2 Chiltern & Colne Valley	Civil (Infrastructure)	South East	January

Source: Glenigan (https://www.glenigan.com/top-100-construction-projects-2021/)

Residential

The residential construction sector incorporates the construction of new buildings, home repairs and remodelling.

In 2021, revenue generated from this sector totalled £53.4bn, a decrease of 28.9% on the previous year to March 2020. This was largely driven by a slump in housing construction, which represents 60% of total sector revenue and was especially hard hit by uncertainty fuelled by the pandemic. According to the National House Building Council, in 2020 the number of new homes registered to be built in the UK fell to 123,151, its lowest level since 2012.

However, there are positive signs residential construction is showing early signs of recovery, with the IHS Markit/CIPS UK Construction Purchasing Managers' Index climbing to 64.2 in May 2021, up from 61.6 in April, with housebuilding representing the best performing category. Further, in the year to April 2021, the average house price increased significantly by 8.9%, a positive indicator for construction. Demand for private housing is expected to be sustained through government policy, including extensions to the stamp duty holiday, Help to Buy and job support schemes.

Stay-at-home measures have pushed people to take the plunge and renovate their existing homes in anticipation of their perceived future lifestyle and the 'new normal', with increased demand for both outdoor and office-related improvement projects. This has been boosted by high income households and those who have built up their savings throughout the pandemic and is expected to continue into 2022.

M&A Activity

Despite a strong start to 2020, deal activity in the year declined by 6%. This was mainly due to a significant shock to deal volumes in the second quarter, with the market experiencing a recovery later in the year. In fact, deal volumes in the year remained above 2017 levels, demonstrating the resilience of the industry. All signs indicate that this trend of recovery will continue, with the success of the UK's uptake in the vaccination programme and large planned infrastructure investments from the UK government as part of its Covid-19 recovery programme expected to boost activity.

In its recent spring industry update, the CPA forecasted that the UK would make up practically all the output lost in 2020, with further growth of 5.2% expected in 2022, so that output for 2022 would surpass 2019 levels.

Notable deals over the past year included the acquisition of Assa Abloy by FAAC for a reported €100m, the purchase of British Steel by Jinye Group for £70m, and Brickability acquiring Taylor Maxwell in a £63m deal. The industry has seen a jump in private equity investments, which represented 32% of total transactions in the year (22% in 2019), demonstrating the industry's perceived high growth potential. Whilst average multiples dipped slightly from 6.8x in 2019 to 6.7x EV/EBITDA in 2020, private equity multiples actually increased from 7.2x to 7.5x, and the average listed sector multiple rose from 9.4x EV/EBITDA in March 2020 to 12.1x in March 2021.

Going forward, it is expected that firms with a high ESG focus will be highly sort after. Similarly, businesses with high technological adoption (both in terms of everyday operations and creating new products) will see high market premiums, representing society's increasing need for smart infrastructure.

Highlights in M&A activity since 1 January 2020

Date	Company	Lead Investor	Amount
02/06/2021	Taylor Maxwell	Brickability	£63m
20/05/2021	City Plumbing Supplies	H.I.G. Capital	£325m
26/02/2021	DAM Structures	Severfield	£27m
01/02/2021	Wolseley UK	Clayton and Dubilier & Rice	£308m
01/12/2020	MDS Civil Engineering	Darren Chaston	Undisclosed
30/11/2020	Assa Abloy	FAAC Group	£100m
16/10/2020	Finlaysons Contracts	Cubby Construction	Undisclosed
09/03/2020	British Steel	Jingye Group	£50m
31/01/2020	Primaflow F&P	Newbury Investments	£50m

Outlook

The outlook for the construction industry is positive, with estimates showing growth is expected to continue throughout 2021, and into 2022 at a rate of 12.9% and 5.2% respectively.

In late 2020, the government committed to invest an astronomical £100 billion in 2021, £27 billion more than in 2020. Included in the £106 billion is a £7.1 billion National Home Building fund and a £4.4 billion "levelling up" fund for local councils. It is expected that the councils will use this increased funding to build new roads, libraries, museums/galleries and upgrade railway stations

However, the growth is hindered by both COVID and Brexit. With the UK officially exiting the European Union ("EU"), the construction sector is facing a severe labour shortage because of reduced access to the EU labour market. According to the ONS, a 42% decline in EU worker availability in the UK has driven the employment in the construction sector to decreased from 2.3 million in 2017 to 2.1 million in 2020.

For the UK construction industry to thrive of the next few years, the spending commitments by the government must be matched by supply levels. If it is not, then It is clear that the sector will not be able utilise the funding and consequently not grow reach its potential.

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