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Soaring demand and cultural compatibility: M&A today

A sellers' market and soaring demand characterise the acquisition landscape in the engineering consulting space, but buyers are no less determined to ensure cultural compatibility between M&A matches

In a webinar on M&A trends in a pandemic and post-pandemic world, panellists agreed that the focus on company compatibility has not been diluted by competition for targets – in what is currently a sellers' market in the North American architecture, engineering consulting and construction services (a/e/c) sectors.

The webinar was one of the sessions at the Chief Financial Officer Conference held by strategic advisory firm **EFCG** in April 2021.

Kicking off the session with an overview presentation, Jessica Barclay, managing partner of EFCG, set the scene by asking the audience



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Jessica Barclay, EFCG

to respond to four questions by anonymous poll. The questions were:

- Is your company working to grow inorganically?
- Since the pandemic began how acquisitive has your firm been relative to pre-pandemic times?
- Is your company working to sell or transition ownership or take on outside capital?
- What factors are most important to you in a transaction?

Answers from the delegates, said Barclay, reflected the patterns that EFCG is observing more widely, with half of participants actively acquiring or having recently done so and another third expecting to do so in the future; little overall effect caused by the pandemic on acquisitive trends; but nearly three quarters (73%) having no intention to sell, transition ownership or take on outside capital.

"This explains a lot in terms of the very heated M&A market that we're seeing," commented Barclay, observing that strong demand from buyers looking to acquire in this sector reflects their view of it as a relatively recession-proof business area.

Despite the scramble for target acquisitions, cultural compatibility between companies is still critically important in M&A transactions, and if not present can cause parties to pull out. This was reflected in delegates' answers to the fourth question, about the most important factors in a transaction. The answer given most frequently was culture. Strategic long-term value, location, profitability, diversity, transparency, cost and clients were close behind.

As well as intense demand from acquirers, Jessica Barclay revealed that EFCG's experience

suggests "the world is changing for the AEC industry, as we are seeing interest from different types of capital and financial sponsors".

The long-standing acquirers, the small and mid-size companies, she said, have always been there. Starting in the '90s there was the first wave of large strategic acquirers – such as **WSP**, which made 89 acquisitions over the last 20 years, and **Stantec**, which made 86.

Then, ten to fifteen years ago, Barclay observed, came a second wave of strategic acquirers. These took the form of traditional private equity firms, which recognised the recession resilient nature of the a/e/c industry.

Things have shifted again in the last couple of years, according to Barclay, during which a different and powerful third wave of acquirers have come into the market – family offices, holding companies, special purpose acquisition companies (SPACs), low-middle market PE firms, and pension funds and other large institutions – some of which are starting to invest capital directly into companies rather than via funds (**OMERS** and **AimCo**, who until recently owned a controlling stake in **ERM**, are in that bracket).

"PE firms are now holding on to a record \$2tn worth of dry powder," said Barclay, "that is, allocated capital they've already raised from their investors, that they're sitting on and have not deployed yet. So there is a rush to deploy capital right now and our industry is one of the beneficiaries. Although for those of you who are strategic firms competing with them, you may not be feeling like a beneficiary!"

Given the situation, anyone looking to sell will be interested to know how M&A multiples are looking right now – the metrics used for assessing the financial worth of a company.

These, said Barclay, are strongly correlated with target firms' gross revenue, with larger firms commanding higher multiples. Tech valuations, she said, are also driving M&A valuations higher, because a/e/c firms are becoming more tech focused.

While historically this industry's acquisition multiples have been lower and less volatile than in other sectors, the past five years have seen a spike in information services-related multiples with some reaching more than 30 times annual recurring revenue.

"I think the a/e/c multiples will absolutely continue to rise as we continue to embrace tech," concluded Barclay.

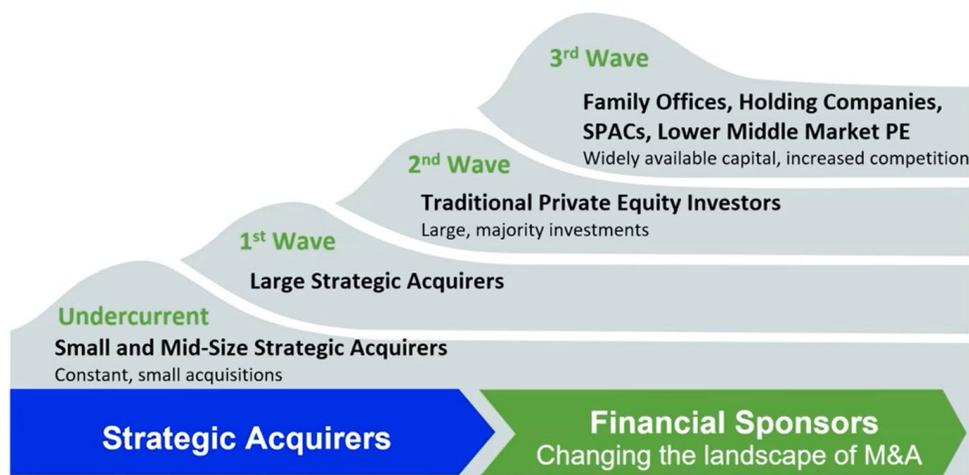
According to EFCG data, the pandemic had an unsurprising impact on activity, with a sharp dip in Q2 2020 followed by a rebound back to typical levels by Q4 2020. The number of transactions in Q1 of 2021 are already "pointing to robust deal-making throughout the year," Barclay said – some of which have been substantial, like the acquisition of **Golder** by **WSP**.

The webinar moved to a panel discussion introduced by Chip Elitzer, **EFCG** director of M&A, and bringing in Steve Metzger and Rob Pepe, CEO and CFO respectively of New York-based a/e/c firm **LaBella Associates** – which has grown in 10 years from 130 to 1,200 staff – alongside Chris Vincze, chairman and CEO of global environmentally-focused consulting firm **TRC**. The latter has acquired 23 firms in the last ten years.

"A lot of our growth has been down to M&A activity," said **LaBella's** Metzger, adding that their approach is to seek out companies that are a good fit from a cultural as well as performance standpoint.

"It's more of a marriage than a transaction. We take the approach that we're moving in together – we have to like each other, so we can live together and work together. When someone is selling their firm, they've got organisational pride and equity in that firm. The first thing is to

Waves of Acquirers Shape the A/E/C Industry



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establish the cultural fit. We call it the four-hours-in-a-car-with-someone test. Do you look forward to that, or not so much?"

Acquisition, said Vincze, is a key part of **TRC's** strategy: the company spends equally on its organic and M&A growth. "In the last five years we have closed on 11 transactions, three or four in last six to eight months," he revealed. "A couple of them have been over \$100m, some involving upwards of 1,000 staff – **Lockheed Martin's** distributed energy services business being one of the larger transactions. Most of the other deals range from \$10-35m."

"Key markets for us are power, digital solutions, and infrastructure. Right now, there's certainly pressure on pricing, although we don't look at price until later in the process. We're more interested in how a company fits with our business."

TRC also places a lot of store on cultural fit between companies: "If you think you can overcome [incompatibility], you cannot. It will cause a failure in the performance strategy of

the acquired company."

The panellists also shared their observations of a growing focus on diversity, equity and inclusion (DEI) in the context of M&A decision-making.

LaBella Associates has formed an internal "DEI council," while **TRC** has "a D&I Network, and evolving metrics that we measure against."

TRC also has seed money and mentoring mechanisms to help smaller firms operating in their markets with their growth and DEI initiatives, ultimately partnering with them "for mutual success".

So, while the forces of capital might be increasingly aggressive in chasing opportunities and driving up prices in the sector, those in decision-making positions recognise that returns aren't assured unless they continue to prioritise the human dimension, matching company cultures and maintaining equity for all concerned.

Further Information: www.efcg.com

We are delighted to have EFCG's director of sustainability and risk Dr Andreas Georgoulas and managing partner Jessica Zofnass Barclay speaking at the Environment Analyst Global Business Summit in June.

Designed for business leaders and senior executives in the environmental and sustainability services industry, this event will explore the challenges and opportunities ahead, and how ESG and sustainability are shaping the market.

Andreas, who leads EFCG's sustainability advisory practice and brings more than 20 years of advisory and sustainability experience and expertise, will be leading a roundtable discussion on how to quantify an organisation's ESG impact. Jessica, who is a managing partner of EFCG and leads the firm's M&A team, will be speaking in a panel discussion exploring recent industry mergers and acquisitions.

Find out more here: www.globalbusiness-summit.environment-analyst.com