SECTOR INSIGHTS

BUILDING PRODUCTS & SERVICES

2023 | BDO MERGERS & ACQUISITIONS |
IN ASSOCIATION WITH THE CPA

SUSTAINABILITY
FRONT AND CENTRE

IDEAS | PEOPLE | TRUST

cpa | construction products association

BDO

GREEN GOALS

INTRODUCTION

Building Products & Services sector deal activity continues to surpass expectations. Headwinds have slowed M&A growth, as predicted last year, but the sector outperformed the wider market. Following the giddy rate of deal activity in 2021, transaction volumes were maintained in 2022.

UK deals in 2022 surpassed 2021 levels by 3.2%, compared with overall activity which fell 10%. And on a global basis, transaction volumes held firm, with marginal growth of 0.8%. There is plenty going on in the sector for investors to get excited about.

The unstoppable progress towards a more sustainable economy is driving new levels of innovation in areas ranging from modular construction to recycled materials to smart technologies. Sustainability is now right at the top of the Building Products & Services agenda, and we make no apology for devoting a substantial part of this report to it.

There is much for businesses to do. The built environment comprises 40% of the global carbon footprint – given the requirement to achieve a global reduction in emissions of 50% by 2030 to avoid tipping points, the sector has just seven years left to avert the most significant potential impacts of climate change.

The drive to Net Zero requires a focus on materials, technology, supply chain, processes, operations and skills, with a multi-pronged approach essential for decarbonising all sectors of the market. Sustainability reporting will formalise target-setting and provide a framework for progress.

While inflation and supply chain issues thankfully seem to be fading, the industry still faces a significant long-term challenge in attracting talent. And sector leaders cannot afford to miss ever-evolving regulations, such as the Building Safety Act in the UK.

These trends are creating a backdrop for varied corporate finance activity, from seed investment for innovative start-ups, to market consolidation plays and corporate carve-outs. Private equity remains a strong investor in the market, and we see a growing role for corporate venture funds too.

Company valuations have settled back to pre-pandemic levels, and activity remains very strong across the sub-sectors, with a number of hotspots to note. The Construction Products Association has confirmed a downturn of 6.4% in output this year in the UK market, with a return to growth in 2024, albeit there remain attractive niches still achieving growth.

Despite the subdued near-term outlook, a wealth of opportunities abounds in the sector – we invite you to have a read.

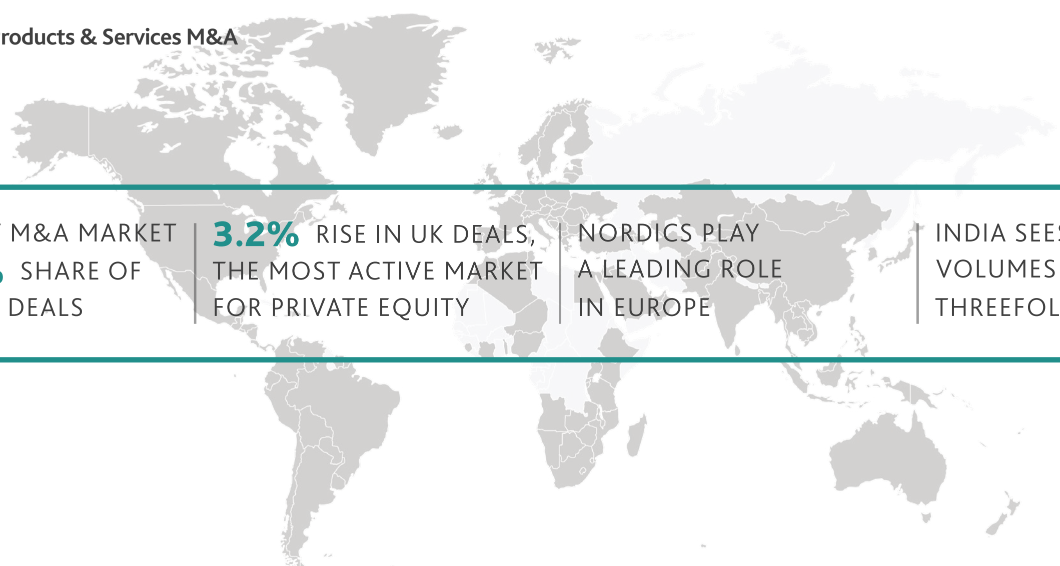
JOHN STEPHAN
Partner
BDO Building Products & Services M&A

MORE THAN **5,000** TRANSACTIONS ACROSS THE GLOBE IN THE LAST **5** YEARS

DEAL VOLUMES **UP 0.8%** IN 2022, WITH A RECORD **1,339** TRANSACTIONS WORLDWIDE

19% BUY-OUTS

24% CROSS-BORDER DEALS



US LARGEST M&A MARKET WITH **41%** SHARE OF ALL SECTOR DEALS

3.2% RISE IN UK DEALS, THE MOST ACTIVE MARKET FOR PRIVATE EQUITY

NORDICS PLAY A LEADING ROLE IN EUROPE

INDIA SEES VOLUMES RISE THREEFOLD

KEY MARKET THEMES AND MERGERS AND ACQUISITIONS (M&A) ANALYSIS

Featuring contributions from leading sector participants, the Construction Products Assocation and Eversheds Sutherland, this report looks at the key themes that are shaping the Building Products & Services sector and what they mean for M&A globally and in the UK.

KEY MARKET THEMES

ACKNOWLEDGMENTS:

BDO would like to thank the industry leaders who generously gave their time to provide views and comments used in the production of this report.

cpa construction products association

M&A ANALYSIS AND BDO IN THE SECTOR

construction products association

VIEW FROM THE CONSTRUCTION PRODUCTS ASSOCIATION

THE OUTLOOK FOR THE UK

The construction industry is in a different place to a year ago.

For construction product manufacturers, fortunes will depend on which sectors they sell to.

After strong growth in 2021 and 2022 for house builders and contractors, this year is likely to be challenging.

CONSTRUCTION OUTPUT

▲ 2.8% IN 2022

▼ 6.4% IN 2023

▲ 1.1% IN 2024

This is mainly driven by sharp falls in private new housing and private housing repair, maintenance and improvement (RM&I). Output in the third-largest construction sector, infrastructure, is expected to be muted.

Construction output is forecast to rise in 2024, with private new housing demand and RM&I recovering in line with the UK economy as inflation slows. Private housing was doing well until the Government's Mini Budget in Autumn 2022, which led to mortgage rates rising sharply – and a sea change in homebuyer sentiment.

Demand for housebuilding fell 30% to 40% at the end of 2022. This meant housebuilders focused on completions. Starts and land purchasing were subdued. Demand has picked up since the turn of the year as mortgage rates have fallen, but from a low base and with increased use of incentives.

Even if demand continues to rise over the year, the damage to the housing market has been done; barring a new stimulus to replace Help to Buy, private housing completions and output are likely to fall by at least 17% this year, before returning to growth in 2024.

Private housing RM&I is now the second largest construction sector after the pandemic 'race for space' boom that peaked in March 2022. Output has been falling as homeowners cut non-essential small improvements.

Larger improvements largely continued in 2022 as the planning approval and finance for it was set at the start of the year. Planning applications for improvements, however, fell by 19% in the second half of 2022 and this is likely to feed through into further falls in RM&I activity during 2023.

However, these falls are likely to be partially offset by booming energy-efficiency retrofit and solar activity, which has risen in line with homeowner concern over energy prices and security.

Infrastructure is the third-largest construction sector and while growth prospects were previously strong, they have been revised due to government delays to HS2, the Lower Thames crossing and other projects. Furthermore, new wind farm investment may be hindered as cost inflation has hit financial viability.

Despite these issues, infrastructure output is expected to rise slightly based on major projects and frameworks signed up to in previous years.

Commercial fit-out and refurbishment activity is strong due to the demand for grade-A office space, while conversion of existing developments to residential, industrial or logistics space also remains high. In addition, activity on data centres and biotech facilities is robust.

However, most work in the commercial sector traditionally has been on towers. Many tower projects that have not broken ground remain paused for repricing, given concerns from investors over spiralling construction and financing costs. Output is expected to fall 5% in 2023 before growth of 1% in 2024.

Industrial output over the last six to nine months has been at its highest levels on record, due to strong warehouse and factories activity. Warehouse activity remains strong due to online spending, exacerbated by the pandemic. Factories activity has been buoyant because of manufacturer decisions in Autumn 2021 to invest based on strong demand and capacity constraints at that time.

The new investment market for warehouses has now peaked, however, plus new manufacturing investment decisions in Autumn 2022 were put on hold due to economic and political instability. Output is forecast to rise by 1% this year before falling by 15% in 2024.

PRIVATE HOUSING STARTS

▲ 9.0% IN 2022

▼ 20.0% IN 2023

▲ 2.0% IN 2024

INFRASTRUCTURE WORK

▼ 0.6% IN 2022

▲ 0.7% IN 2023

▲ 1.2% IN 2024

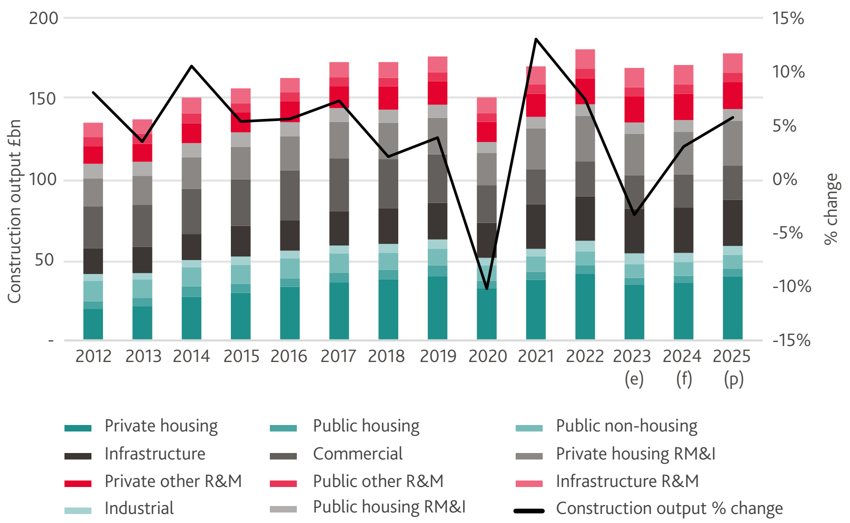
PRIVATE HOUSING RM&I

▲ 12.9% IN 2022

▼ 9.0% IN 2023

▲ 2.0% IN 2024

TOTAL CONSTRUCTION OUTPUT BY SECTOR



Source: CPA

"In terms of risks to the forecast, on the positive side product availability issues eased in 2022 and price inflation is likely to slow this year. This will be critical for the construction industry as specialist sub-contractors on fixed-price contracts, despite strong demand, have suffered from spiralling costs and delays over the last 18 months.

On the negative side, concern over whether the problems experienced by Silicon Valley Bank and Credit Suisse reflect wider issues in the financial sector may mean lenders become more cautious and price in additional risk.

A more direct risk in the longer term revolves around labour availability issues. UK construction has lost over 250,000 workers in the last four years, and attracting and retaining future employees is not straightforward.

While commercial activity overall remains subdued, due to a dearth of new investment in tower projects two years ago, there are other areas of commercial that are currently very buoyant.

These include fit-out and finishing works, changes in use into residential or warehouses, and high-end commercial refurbishments as clients downsize to smaller, high-quality office space when leases end, on the assumption that even in the medium term there will be fewer employees in the office at any given time.

Overall, commercial output is forecast to fall by 5.2% in 2023 and rise by 1.0% in 2024, but double-digit growth rates will only return once there has been a significant upturn in new tower projects activity down on the ground, which will not occur in the next two years."

PROFESSOR NOBLE FRANCIS
Economics Director
Construction Products Association

BDO VIEWPOINT

Areas to watch in the housing space will be the effect of interest rates on mortgage affordability and demand, stagnation in house prices generally, the end of incentives such as Help to Buy and stamp duty relief, and the introduction of new forms of support.

Given the age of the UK housing stock and the decreased levels of social housing built recently, it will be interesting to see if and how institutional money from bodies such as pension funds can help boost housing supplies by supporting new builds and the private landlords' market.

As labour availability remains in the spotlight, we expect to see rising focus on 'green jobs' to support the drive to Net Zero 2050 (78% reduction by 2030). As the built environment represents 40% of the global carbon footprint, we expect the sector to be high on the agenda for upskilling.

MATTHEW GOODLIFFE
Director
Building Products & Services M&A

WHY RM&I IS THE BIGGEST CHALLENGE FOR A SUSTAINABLE INDUSTRY

FIT FOR FUTURE?

The climate crisis is at the top of the agenda for governments, businesses and consumers – and rightly so.

Reducing carbon emissions (and even going carbon negative) is critical if the world is to avoid the worst global heating scenarios.

The most recent Intergovernmental Panel on Climate Change (IPCC) focused on a global reduction of 50% by 2030 to avoid tipping points. Despite this being an agenda topic for the last 35 years, we now only have seven years left to avert the most significant potential impacts. Accordingly, governments in most countries have instituted carbon reduction targets and associated measures.

Energy generation and transport are major contributors to carbon emissions worldwide – in the UK, these sectors account for 60% of emissions.

But decarbonisation of energy generation has been a great success, with around 60% reduction achieved since 2012. This has been driven by the emergence of renewables, and the rise of electric vehicles is expected to have a significant impact on transport in the coming years.

The built environment is another major contributor to emissions in the UK. Heating and powering buildings accounts for around 40% of the UK's total energy usage. The heating of residential buildings alone generates 17% of all emissions (and this excludes emissions from residential electricity consumption).

The good news is that technology to lower these emissions exists – this includes improving insulation, upgrading inefficient boilers, introducing heat pumps and potentially converting to hydrogen, despite divided views on hydrogen's utility in heating.

The bad news is that while official data indicates a c.24% drop in emissions from the residential sector since 2012, this data is flattered by a cold winter in 2012/13 and the impact of the energy crisis in 2022.

Accounting for these effects, one could argue that residential emissions barely moved over the past decade. Government needs to find a way to upgrade the 28 million homes that make up the UK's existing housing stock.

The UK's housing stock does not compare well with the rest of Europe; the country has:

- An older housing stock than the EU, with almost 40% of homes dating to pre-1946, compared with 24% in Germany and Sweden, for example
- A majority of housing that dates to pre-1990, when energy efficiency was not regulated at all
- Housing stock that loses heat on average three times faster than European equivalents. Less than 50% of homes have an EPC rating of C or above, meaning that over 12 million homes do not meet long-term efficiency targets.

Addressing heat leakage is crucial, not least to reduce costs and volatility for tenants but also to ensure efficient spending for the government. The impact of better insulation or more efficient boilers can be significant – the payback on cavity wall insulation or draught-proofing is only two to three years.

Improved social outcomes also arise from improved energy efficiency in the housing stock. Poor heating impacts health, and homes that are hard to heat correlate with areas of greater social deprivation.

And, of course, homes that are hard to heat are also hard to keep cool, meaning that heat stress during summer (particularly for more elderly people) will create further negative health impacts as the climate changes. We have identified five success factors to make this significant task achievable.

CPA OPINION

Housing associations, local authorities and private landlords will be pushed to retrofit homes that will only be permitted to be rented if they achieve Energy Performance Certificate 'C'.

Government is proposing that this applies to new lettings by 2025 and to all by 2028.

Whether it is financially viable to retrofit all these remains uncertain and we may see homes sold instead.

Most homes are under private ownership – and this is where the greatest issues remain, given lack of buy-in and finance for energy-efficiency retrofits.

Government has a key role to play, but so do other stakeholders, not least industry participants and 'gatekeepers' such as utilities.

1. REDUCING THE COMPLEXITY OF SCHEMES

The government has introduced a raft of measures, schemes and funds to facilitate the uptake of energy efficiency over recent years.

Some of these – such as the Green Deal and Green Homes Grant – have been unsuccessful, while others, such as the Energy Company Obligation, have had increasingly positive impacts over their evolution.

But what all these schemes have in common is a large dose of complexity in terms of what they fund, how to access funds, who can access them, and responsibilities and administration. Much of the execution lands on utilities and local authorities, who have much on their plates.

Furthermore, facilitating the installation of energy efficiency is not within their core competencies. Efficient channels to market and execution are crucial, but there are emerging companies that specialise in navigating this complexity – and can play a key intermediary role between households, utilities, local authorities and government.

2. IMPROVING THE CLARITY OF MESSAGING

The complexity of the current landscape makes navigation difficult for house owners and tenants. It means that the market relies much more on the push from the government and utilities than pull from consumers.

Significant confusion is being sown about new technologies, such as the benefits and dangers of hydrogen or heat pumps. Much of the messaging is muddled and run by different interest groups. Clear and balanced information is important to make future technologies and their uptake a success.

3. ENABLING ACCESS FOR ALL

Current schemes are aimed at low-income households or those receiving benefits. Focus on the energy poor must be a priority, especially in view of current energy prices. But the government should not forget the increasingly squeezed middle. Households that qualify for most schemes account for 20% of all homes, leaving a large stock to be dealt with.

The £1,000 to £3,000 spend required for cavity wall insulation, or upwards of £30,000 for some ground-source heat pumps, is not affordable for many households or landlords – but success in reducing emissions will require everyone to play ball.

Costs will come down as volumes grow, but this will take some time and may not make energy efficiency measures affordable for enough households.

A variety of financial measures and tax incentives should be available to all. Government subsidies should feature in the mix, but we need green finance options, too.

4. SUPPORTING SUPPLY CHAINS AND SKILLS

A significant gap remains between the number of qualified installers and the wider supply chain. This is especially true for newer or more complex solutions such as heat pumps. The government aims to install 600,000 heat pumps a year by 2028.

However, in 2022 only about 33,000 heat pumps were installed by 1,500 installers, while some 15,000 to 20,000 installers are required to meet targets. Investment in people and skills will be the key enabler.

5. AVOIDING BOOM AND BUST

Recruiting and up-skilling installers and setting up supply chains and distribution channels all takes time and significant investment. The industry has gone through difficult times in the past; for example, the abolition of feed-in tariffs led to difficulties in the burgeoning solar panel industry.

Consistency of messaging, policy and incentives will be key to providing the industry with the confidence to invest. The world and the UK have a burning platform and increasing willingness, experience and ability to address emissions.

Regarding housing, the challenge is large but achievable through coherent policies and execution, as well as a close partnership between government and industry. On the negative side, concern over whether the problems experienced by Silicon Valley Bank and Credit Suisse reflect wider issues in the financial sector may mean lenders become more cautious and price in additional risk.

DANIEL GUTTMANN
BDO Partner, UK
Head of Industrial Products, Technology & Services in Strategy & CDD

GOVERNMENTS DRIVING HEAT PUMP SALES

HEAT PUMPS FIRE UP

The imperative to meet climate targets is creating opportunities for companies that can bring innovative carbon reduction technologies to market.

A prime example is the heat pump industry, which is booming amid government efforts to electrify heating.

Global sales of heat pumps grew by 11% in 2022, according to the International Energy Agency (IEA), marking a second year of double-digit growth. In Europe, uptake was particularly strong, with nearly 3 million heat pumps sold in 2022, an increase of nearly 40%.

In the UK, the government has said it wants to phase out all new and replacement gas boilers by 2035 and has announced a £30m Heat Pump Investment Accelerator to help achieve a target of 600,000 heat pump installations a year by 2028.

"The Heat Pump Investment Accelerator will mean heat pumps are manufactured in the UK at a scale never seen before," said the government in its March 2023 Powering up Britain paper, published in response to a legal requirement for greater transparency over the country's net-zero emissions plans.

"We want to make it as cheap to buy and run a heat pump as a gas boiler by extending the Boiler Upgrade Scheme by three years, and by rebalancing the costs of electricity and gas," it said.

"Alongside this, we intend to implement the Clean Heat Market Mechanism in 2024 to incentivise heating system manufacturers to deploy heat pumps as a proportion of fossil fuel boiler sales."

Investor interest in the heat pump sector is soaring on the back of policies aiming to make carbon-polluting gas boilers a thing of the past. Furthermore, turmoil in Ukraine has driven focus on energy security.

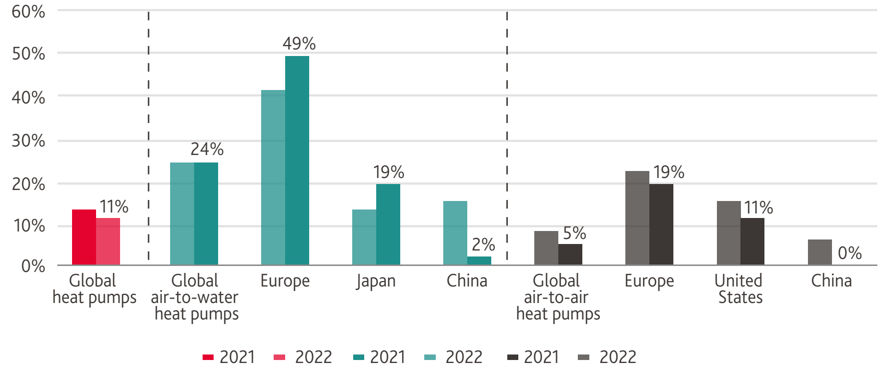
In April 2022, leading clean power provider Octopus Energy bought Craigavon, Northern Ireland-based manufacturer Renewable Energy Devices in a multi-million-pound deal aiming to scale heat pump manufacturing to 1,000 units a month.

November 2022, meanwhile, saw fuel distributor Certas Energy picking up Preston-based Freedom Heat Pumps with a promise to treble production. And in January 2023, smart technology behemoth Johnson Controls snapped up Norway's Hybrid Energy, which provides heat pumps for industrial heating and industrial processes.

Currently, heat pumps cover around 10% of heating needs in buildings across the globe, according to the IEA. To align with climate pledges, heat pumps will have to meet nearly 20% of global heating needs in buildings by 2030. This means installations will need to continue growing at a similar double-digit rate over coming years.

As discussed in the previous article, there are significant questions that need to be addressed to support the effective roll-out and adoption of heat pumps, but the money and ambition behind them will ensure that manufacturers and service providers of heat pumps will remain hot property for some time.

ANNUAL GROWTH IN SALES OF HEAT PUMPS IN BUILDINGS WORLDWIDE AND IN SELECTED MARKETS, 2021 AND 2022



Source: IEG

CPA OPINION

The market for heat pumps has considerable potential. It is a focus for the UK government, which has ambitions of 600,000 installations per year by 2028 and 1 million by 2030, an exponential increase from the 55,000 heat pumps installed in 2021.

Medium term, around 200,000 installations per year are likely to come from new-build homes as building regulations and the Future Homes Standard push housebuilders to use heat pumps by default. However, the heat pump market will be driven by energy-efficiency retrofits of existing housing stock.

Government announced a boiler upgrade scheme in 2021 that began in 2022 with £450m of funding over three years in England and Wales. The government target is to achieve 30,000 annual installations of heat pumps to replace boilers, using £5,000 vouchers. However, during the first year of the programme only 9,981 vouchers were redeemed at a total value of £50.2m, which left £89.7m unspent.

Given that air-source heat pumps cost between £7,000 and £14,000 to purchase and install, while ground source pumps can cost between £15,000 and £35,000, the extent to which the voucher changes decisions regarding heat pumps – and the extent to which government will meet its target – remains questionable.

BDO VIEWPOINT

The UK government is anxious to burnish world-leading green credentials and is keen to support heat pumps and other low-carbon technologies. This represents a major opportunity for the Building Products & Services sector and one that investors will be watching with interest.

Ongoing government incentives, along with effective communication of policy is essential to address affordability and accelerate uptake of heat pumps.

In time, we expect other decarbonising technologies to enjoy the spotlight. There are plenty of other innovations that deserve consideration, from zero emissions boilers to infrared wallpaper, as in some cases heat pumps will not deliver the required benefits on their own. Broader-minded thinking from government is required.

MATTHEW HOCCOM
Associate Director
Building Products & Services M&A

A GERMAN PERSPECTIVE

The German construction market has faced challenges in recent years, including interest rate hikes, drastic price increases across and ongoing shortages in many verticals. The 2023 outlook for the German construction market is negative, forecasted within a range of -2% to -7% year on year. While 2022 benefited from strong orderbooks, cancelation rates are high and order entry is low.

However, the insulation and window systems and heating, ventilation and air conditioning (HVAC) sub-sectors are getting a boost from regulation in the form of an amendment to the Gebäudeenergiegesetz building energy act that has been agreed in principle, to be introduced in 2024 instead of 2025 as first planned.

Government expects this to lead to roughly €50bn of investments by 2028, although the true figure could likely be much higher. The amendment has not yet passed parliament, but discussions are now focused on details such as the level of reimbursements for real estate owners.

The big picture for the verticals is unlikely to change. With residential new build orders tumbling, renovations will change the picture at least for HVAC and verticals such as insulation and windows that are related to energy improvements.

Furthermore, a German government coalition agreement of December 2020 foresaw the introduction in 2025 of strong restrictions on fossil-fuel-based heaters. Industry is preparing for this and investing heavily to ramp up production of low-carbon replacement devices. The Gebäudeenergiegesetz amendment could pull forward this obligation to 2024, so that any replacement heating device must source 65% of its power from renewable energy.

Although the law is technology neutral, for various reasons most replacements will involve a heat pump and gas boiler or heat pump alone. The German Heat Pump Association, Bundesverband Wärmepumpe, expects a massive ramp up in production, peaking around 2030 with about 1 million units a year.

The German government expects a cumulative 6 million heat pumps to be installed by 2030. This translates into an additional investment by real estate owners of roughly €50bn by 2028, according to government estimates.

Heat pump demand heavily exceeds supply currently, but major manufacturers including Bosch-Buderus, Vaillant, Viessmann, Stiebel Eltron and Weishaupt have announced investment programmes of between €500m and €1bn in various stages.

Due to the shortened time frame of the amended law, these companies' ability to deliver to the market and keep or even win market share will be key. Beyond strong heat pumps demand, there are plenty of secondary effects stemming from the fact that the efficient use of heat pumps requires low-temperature readiness in buildings.

Looking at the insulation categories across the building stock in Germany, this could trigger massive investments by most real estate owners.

Insulation and window systems will benefit, although the dynamics are totally different in these markets since adding extruders for PVC window profile production is less complex than building heat pump production lines and introducing new heat pump models.

Research and development in the heat pump market could drive differentiation, potentially further stimulating M&A that has been evident in HVAC sector since 2015 or so. Recent deals include Germany's Stiebel Eltron buying Danfoss's heat pump business Thermia in 2018, Niebe picking up Waterkotte in 2020 and Ariston acquiring Centrotec Climate Systems in 2022.

The acquisition of Viessmann by US corporate Carrier Global for €12bn in April 2023 underscores the attractiveness of this market. The enterprise value represents an EBITDA multiple of 17 times this year's EBITDA, a substantial premium compared with Carrier Global which trades on twelve times, or Italian peer Ariston on nine times.

Going forward, dry powder will be used for organic growth and capacity ramp ups, although the question remains whether players will want to push through their investment plans on a standalone basis or in partnership.

HANS-JÜRGEN RONDORFF
M&A Partner
BDO Germany

A US PERSPECTIVE

The US is lagging behind Europe in the implementation of sustainability initiatives. Yale University's 2022 Environmental Performance Index (EPI) report places the US 20th out of 22 wealthy democracies and 43rd in the world overall.

This relatively low ranking reflects the rollback of environmental protections during the Trump administration, in particular its withdrawal from the Paris Climate Agreement and weakened methane emissions rules.

EPI projections indicate that just four countries – China, India, the United States, and Russia – will account for over 50% of residual global greenhouse gas emissions in 2050 unless decision-makers in these countries strengthen climate change policies and accelerate decarbonisation efforts.

The Biden administration is attempting to do just that, and emissions are declining. The Federal Sustainability Plan has set out nine goals, including net zero emissions buildings by 2045 and net zero emissions operations by 2050.

Under the plan, new build and retrofit projects should consider and prioritise the following:

- Building electrification and replacement of fossil-fuel consuming equipment with technologies that use carbon pollution-free electricity
- On-site generation of carbon pollution-free energy and storage
- Technologies that reduce GHG emissions from building, campus, or installation operations
- Use of ongoing data analytics for system diagnostics and persistence of savings.

The renewed focus on climate goals is bearing fruit – in 2022, heat pump purchases exceeded those of gas furnaces for the first time in the US.

Accelerating the take-up of heat pumps hinges on overcoming key bottlenecks, chief of which are the upfront cost of installations, other non-cost deterrents to consumer adoption, manufacturing constraints and shortages of qualified installers.

The US is responsible for a quarter of global heat pump manufacturing and is rolling out incentives to further build out domestic manufacturing capacity. Deals such as Carrier Global's €12bn acquisition of Viessmann should provide a strong platform to bring additional expertise to the US market.

Carrier is in fact divesting its other businesses so the business can fully dedicate itself to becoming 'the global climate solutions champion.'

BOB SNAPE
M&A Partner
BDO United States

SMART TOOLS IN THE FIGHT FOR EMISSIONS REDUCTION

INNOVATION TO CUT CO2

Heat pumps are not the only innovation aiming to cut CO2.

Smart tools are on the increase to make it easier for businesses and consumers to understand and control energy consumption.

Typical of the companies innovating in the market is Chameleon Technology of Harrogate. Chameleon makes visual displays that help consumers better understand their energy usage by accessing the data held on their smart meters.

The company has been working alongside all but one of the UK's major utilities, supporting the nation's government-mandated smart meter rollout for the last decade.

Growing interest in energy efficiency has led the company to offer its products direct to consumers as well as through its traditional business-to-business channels, says Neil Horan, Director of Finance.

The consumer version is an augmented version of its utility package, underscoring the importance of innovation in helping to reduce emissions. An important challenge for decarbonisation efforts is that many obvious options, such as improving building insulation, do not get adopted because of the cost and disruption involved.

Even if a homeowner can afford better insulation, they may not feel motivated to put up with the inconvenience of renovation work.

In this context, digital tools such as smart thermostats, internet-of-things devices and demand-side response platforms can provide a valuable function by facilitating a reduction in energy consumption and emissions with minimal effort.

The rising cost of energy provided a strong impetus to consumers to adopt smart technologies but as prices settle, the focus will turn to maintaining adoption rates and progressing the product roadmap to future-proof solutions.

Integration of solutions with other home technologies will be key. Chameleon's smart home enabling technology already integrates with Samsung Smart Things and works alongside other smart home technologies, such as Alexa, Google and other smart thermostats.

The company is partnering with Salford University to further develop its products and platform to help create more useful customer offerings. They have also been awarded a six-figure sum from the Department for Energy Security and Net Zero to develop innovative V2X (vehicle-to-everything) technology.

The landmark V2X project will enable EV drivers to benefit from lower energy bills and cheaper motoring by powering their homes using the electricity stored in the battery of their EV.

Intelligent and automated smart charging is able to reduce electricity costs, resulting in lower bills; motorists can pay less for charging their cars, and the electricity powering them will be much cleaner and more eco-friendly, with sufficient development of national renewable energy infrastructure.

Unsurprisingly, the appetite for M&A in the smart-tech market is high. Auction processes attract a lot of interest and valuations are at the top end, especially where there are data flows that can be packaged as subscriptions.

2022 deals in the space include the acquisition of Reading, UK-based energy saving software specialist SmarterDM by Irish heating and industrial group Glen Dimplex. Another was the acquisition of Heatmiser UK, a smart thermostat control manufacturer, by listed engineering firm IMI.

The deal, valued at £110m, represents an adjusted EV/EBITDA multiple of 12x, and provides IMI with a strategic entry point to the rapidly growing connected controls market.

Of course, smart controls are only effective if supply is assured. Decarbonisation initiatives across buildings and transport will place significant increased demands on the electricity distribution network. Government investment in infrastructure will be the key enabler to ensure effective outcomes.

BUSINESS VOICES

"The recent significant increase in the cost of gas has sharpened the focus on efficiency in electricity and gas supply and usage. We've seen that in terms of the direct-to-consumer product that we've released recently, where we sold very healthy volumes over the winter period. Consumers are directly incentivised by savings in their pocket.

The pace of change is limited by customers' propensity to adopt and better information from both Government and industry is required to promote this.

You will ultimately see the integration of peoples' solar arrays, home storage systems, heat pumps, EVs and the grid controlled centrally by a Home Energy management System.

We're not there yet, however, and as well as increased public awareness, more investment in the infrastructure that will underpin this is required."

NEIL HORAN
Director of Finance, Chameleon Technology (smart energy technology)

CPA OPINION

Construction product manufacturers are at the heart of innovation within the construction industry, with manufacturing businesses tending to have higher R&D levels than construction generally.

An increasingly digital future for construction is emerging, with benefits right across the supply chain.

BDO VIEWPOINT

Plentiful funding is available for innovative technologies in the sector, particularly those aligned with the sustainability agenda.

There are many initiatives in development – some solutions seem to offer little tangible benefit, but others have clear differentiation and a great value proposition, which really help their target customers.

We specialise in helping businesses define their growth strategy, and explore the most appropriate avenues for accessing funding, depending on the size and growth stage of the business.

RUSTEM ZAGRETDINOV
Director Strategy & CDD
Industrial Products,
Technology & Services, BDO UK

INNOVATING UNDER THE NEW RESEARCH & DEVELOPMENT (R&D) TAX CREDIT REGIME

NEW RULES FOR R&D TAX

For innovators in the sector, the R&D tax credit regime has been a boon.

Government has set a target to raise investment in R&D to 2.4% of UK GDP by 2027, confirming ongoing provision of valuable financial support.

However, it is also introducing changes to the claims process to tackle errors and suspected abuse of the R&D tax relief regime. These include changes to relief rates and new definitions of what R&D may encompass and the geographical locations it can be applied to.

There are also changes to the claim process, with the requirement for digital submissions and the completion of an Additional Information Form (AIF) within a specific time window.

Understanding exactly how the R&D tax relief regime works after these changes come into force in April 2023 and April 2024 may be of critical importance to financial projections.

1. CHANGING RELIEF RATES

In the Autumn Statement, the Government announced that rates of R&D tax relief available on costs incurred from 1 April 2023 onwards would change.

The Research and Development Expenditure Credit (RDEC) aimed at large companies increases from 10.5% to 15% post tax, whereas small-to-medium enterprise claiming under the SME scheme attract a reduced rate of relief from 24.7% to 21.5% if profitable.

For loss making SMEs, the potential repayable credit rate has reduced from 33.4% to 18.6%, with the exception of loss making R&D intensive companies, where qualifying R&D expenditure constitutes at least 40% of total expenditure, for which the reduction in potential repayable credit rate has been to 26.97%.

2. CHANGING SCOPE OF WHAT MAY BE CLAIMED

For accounting periods beginning on or after 1 April 2023 there has been a broadening of the scope of who can apply for Advanced Assurance of their R&D claims and an updated definition of R&D. You can read further information on these changes here.

R&D expenditure categories have also been extended to include the costs of datasets and cloud computing, R&D in pure mathematics will also qualify. From 1 April 2024, R&D activity will have to be physically located in the UK for the costs to be included in R&D tax relief claims. UK companies who currently claim for R&D costs undertaken by overseas group companies or third parties may no longer be able to claim these costs.

The costs of externally provided workers (EPWs) will also be limited to work undertaken in the UK. However, there will be specific exemptions where work outside the UK is permitted for geographical, environmental, social or regulatory/legal requirements.

3. CHANGES TO THE CLAIM PROCESS

For R&D claims submitted from 1 August 2023 onwards, HMRC has announced that all claims will be required to be made digitally (except for companies exempt from the requirement to deliver a Company Tax Return online) and must include an Additional Information form to be submitted through a new online portal, separately from the Corporate Tax Return.

Each Additional Information form will have to be signed by a named senior officer of the claimant company and must contain detailed information on the R&D project – including the name of the agent who has advised the company on compiling the claim. The form must also include a breakdown of costs across categories.

Businesses will need to plan to ensure the opportunity to claim is not missed. A new rule, taking effect for accounting periods starting on or after 1 April 2023, means that companies must inform HMRC of their intention to file a claim with an 'Advance Notification Form'.

The window for this to be filed is from the start of the accounting period to six months after the end of the accounting period to which the claim relates. The aim of this rule is to prevent last minute 'speculative' claims made after the relevant accounting year.

If the Advance Notification form is needed but not completed, HRMC have confirmed that the R&D claim will be rendered invalid and, if shown in the Corporate Tax Return, it will be removed by HMRC as an 'error'.

There are exceptions to the Advance Notification requirement – for example, businesses do not need to make advance notification for every single project in an accounting period. In addition, where claims are made within six months of the end of the accounting period, provided a claim has been submitted in the three years preceding the end of the claim notification period, there is no need to notify.

But in reality, many R&D claims are made more than six months after the end of the accounting period (there is currently a 24-month deadline to make claims), therefore, most companies will need to make advance notification – at least for financial year 2024.

SECURING SUPPORT FOR YOUR INNOVATION

The enhanced compliance and enforcement measures will create more hoops to jump through for businesses claiming R&D tax relief, and the changes to qualifying costs will add to the complexity of claims.

It is crucial that companies ensure that claims are robust, accurate and beyond reproach to ensure ongoing financial support from the Government. Getting a reputable adviser to test, validate (and where necessary de-risk) claims before they are submitted will be increasingly important as inaccuracies in claims will lead to delays and may damage the company's reputation with HMRC.

TAKE THE FIRST STEP IN PROTECTING YOUR BUSINESS

Our AI powered R&D Tax Credit Benchmark tool combines our technical understanding of the R&D regimes, plus public and proprietary data sources on R&D claims, to calculate whether your claims are likely to be subjected to more scrutiny from HMRC.

It also ensures that your claim is aligned with your company's risk profile and assess whether your business is at risk of underclaiming or overclaiming, based on industry benchmarks.

To get ahead in mitigating the risks to your business, visit BDO store.

CONOR MANSFIELD
Associate Director
Innovation & Technology, BDO UK

THE QUICKENING QUEST FOR MORE SUSTAINABLE BUILDING MATERIALS

MATERIAL GAINS

Moves to bring circular economy principles to Building Products & Services are helping to deliver sustainability commitments – and creating opportunities for innovative ventures.

Take Edinburgh-based start-up Kenoteq, which looks set to upend the construction industry with a circular brick.

It is not the shape of Kenoteq's K-Briq that is circular, of course, but the way it is built. Traditional brick kilns are said to burn 375 million tonnes of coal a year, adding around a billion tonnes of carbon dioxide to the atmosphere—almost 3% of total emissions from human activity.

These emissions are just a part of brickmaking's environmental impact. Virgin cement adds to emissions, clay extraction results in environmental degradation and coal burning pollutes the atmosphere with particulate matter plus sulphur and nitrous oxides.

Kenoteq, a spin-out from Heriot-Watt University, has reduced these impacts by more than 95% using almost 100% recycled content to make bricks that do not need baking. Instead, the construction waste in each K-Briq is treated with a non-toxic, non-polluting agent that binds under pressure.

As well as reducing manufacturing emissions, Kenoteq's model could allow bricks to be made much closer to where they are needed, cutting transport costs and further adding to the sustainability benefits. The product is designed to address growing demand from housebuilders pursuing aggressive decarbonisation plans.

Coming up with the recipe for K-Briqs was not easy. Kenoteq's founders have been working on the concept for the best part of a decade and the company is still very much a start-up, about to launch its first commercial production line with a goal of delivering 3 million bricks in 2024.

This is a drop in the ocean compared to brick demand in the UK, which Kenoteq Chief Executive Sam Chapman puts at around 2.5 billion bricks a year. But the disparity in numbers only serves to highlight the scale of the opportunity facing Kenoteq and other circular economy ventures as society strives to reduce waste.

European Union legislation requires 70% of construction and demolition waste to be recycled, with none going to landfill. In the UK, a 2021 Environment Act aimed to curtail construction, demolition and excavation refuse that accounted for 62% of the country's waste in 2018.

Such regulations, along with others aimed at issues such as decarbonisation, are leading many companies in the Building Products & Services sector to address environmental, social, and corporate governance (ESG) concerns.

In BDO's second quarterly Rethink survey of 2023, almost 52% of real estate and construction respondents said their businesses were implementing formal sustainability and ESG frameworks to standardise non-financial reporting disclosures, a higher level than that of any other sector in the survey.

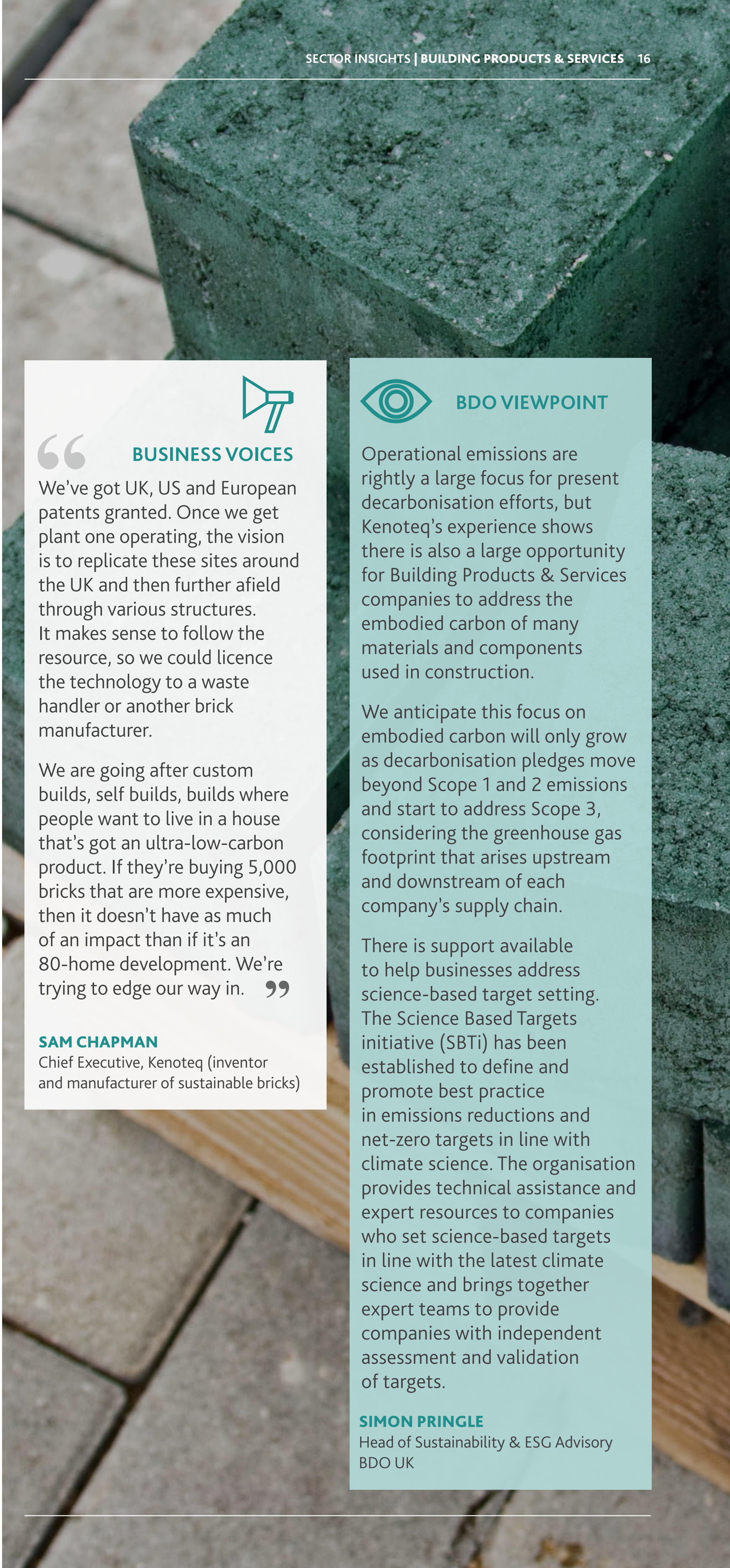
In addition, 27% of real estate and construction companies claimed to be developing a sustainability strategy with defined objectives across ESG pillars. Sustainability was also the sector's focus for technology investment, cited by 45% of respondents.

One provision of the Environment Act 2021 is that producers should be responsible for their waste disposal costs. In this context, having companies such as Kenoteq that can make new products out of old waste is likely to be a boon for the Building Products & Services sector.

This opportunity is attracting deals, such as UK PVC materials recycling and processing company Poly-Pure being snapped up last year by window and door manufacturer Epwin Group for £15m and cement giant Holcim, which aims to recycle 100 million tonnes of material by 2030, buying UK recycler Sivyer Logistics.

That said, Kenoteq's long path to commercialisation also points to the difficulties that still exist in creating circular economy business models. Innovators must disrupt some of the oldest and most established industries on Earth.

The premium door and window frame specialist Schüco International, for example, is winning business thanks to its green credentials but faces an uphill struggle in sourcing the low-carbon aluminium it needs for its products.



As a specialist building products supplier, Schüco is not able to force wholesale change on the aluminium industry. But its requirements are adding to demand for aluminium recycling, which carries a much lower carbon footprint than producing primary aluminium.

In time, the company hopes low-carbon aluminium will become the norm thanks to increasing demand from others in the Building Products & Services sector and beyond. As well as windows and doors, aluminium is used in roofing and cladding, curtain walls and building components such as gutters, spouts and signage.

But the biggest users of all are automotive giants such as Mercedes Benz and BMW, which are also under pressure to reduce waste and emissions. If they cannot force a move to more sustainable materials, then nobody can.

CPA OPINION

As the UK transitions to net zero, we need to look at how we should build in the future.

This involves designing, planning and building in a way that involves digitally-enabled return supply chains and intelligent assets, to enable all the products and systems in the supply chain to be re-used, re-distributed, re-manufactured and/or recycled.

This not only reduces the constant need for raw materials and product imports, but also increases the flexibility of an asset to extend its uses over its life.

BUSINESS VOICES

“We’ve got UK, US and European patents granted. Once we get plant one operating, the vision is to replicate these sites around the UK and then further afield through various structures. It makes sense to follow the resource, so we could licence the technology to a waste handler or another brick manufacturer.

We are going after custom builds, self builds, builds where people want to live in a house that’s got an ultra-low-carbon product. If they’re buying 5,000 bricks that are more expensive, then it doesn’t have as much of an impact than if it’s an 80-home development. We’re trying to edge our way in.”

SAM CHAPMAN
Chief Executive, Kenoteq (inventor and manufacturer of sustainable bricks)

BDO VIEWPOINT

Operational emissions are rightly a large focus for present decarbonisation efforts, but Kenoteq’s experience shows there is also a large opportunity for Building Products & Services companies to address the embodied carbon of many materials and components used in construction.

We anticipate this focus on embodied carbon will only grow as decarbonisation pledges move beyond Scope 1 and 2 emissions and start to address Scope 3, considering the greenhouse gas footprint that arises upstream and downstream of each company’s supply chain.

There is support available to help businesses address science-based target setting. The Science Based Targets initiative (SBTi) has been established to define and promote best practice in emissions reductions and net-zero targets in line with climate science. The organisation provides technical assistance and expert resources to companies who set science-based targets in line with the latest climate science and brings together expert teams to provide companies with independent assessment and validation of targets.

SIMON PRINGLE
Head of Sustainability & ESG Advisory
BDO UK

BRINGING THE SUPPLY CHAIN EMISSIONS INTO SCOPE

SUPPLY CHAIN PAIN

One of our clients had a proud tradition of lean manufacturing until recent supply chain problems forced a change of heart.

Shortages of essential components have forced the company to find ways to ease the pressure, including looking at dual sourcing and nearshoring.

It is not alone, according to our research.

BDO's latest quarterly Rethink survey shows 48% of real estate and construction players are planning to onshore as much of their operations as possible, while 37% are heading in the opposite direction and going all-out on offshoring. Only 16% of companies are planning to stick with current supply chain arrangements.

The upheaval comes as 75% of real estate and construction businesses report supply chain disruptions, and 36% say the issues will be the biggest challenge they face in the next six months. Almost 87% of companies experiencing disruptions say the issues are having an impact on business.

Although supply chain issues are already less severe than they were a year ago, businesses in the sector are taking action. Around 47% of those affected are planning to invest in supply chain resilience and durability over the next 12 to 18 months, ahead of other investment priorities such as increasing supplier transparency, deploying optimisation technology and monitoring sustainability.

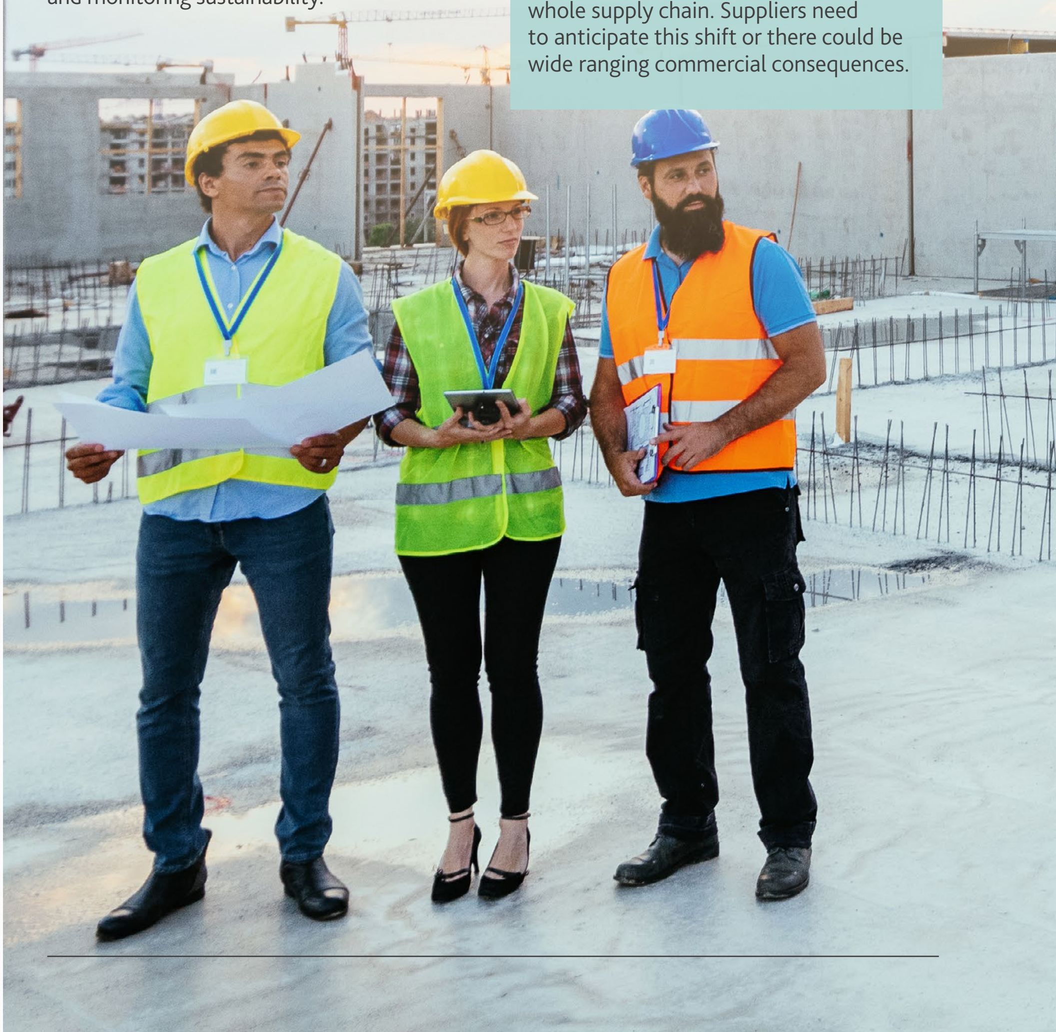
SUSTAINABILITY IN THE SUPPLY CHAIN

Sustainability is becoming a key issue for supply chains as companies look to reduce total carbon emissions, particularly those in Scope 3, which relate to the way products and services are sourced and used.

Grappling with Scope 3 is an issue for companies such as aluminium frame specialist Schüco International, which depend on metals produced by heavily polluting industrial suppliers.

These suppliers face growing pressure to decarbonise operations, but it remains to be seen if they will be able to do so in time to meet customers' climate targets.

There will be an inflexion point: big customers are starting to demand low-carbon products en masse, which will lead to domino effects across the whole supply chain. Suppliers need to anticipate this shift or there could be wide ranging commercial consequences.



BUSINESS VOICES

"We have a target to be net zero by 2040, and that means we must decrease our carbon emissions by 30% in 2025. It's hard because we have 99% in Scope 3 and 1% in Scope 1 and 2. The biggest issue here is materials: they are 86% of our CO2 emissions, and within them the biggest are from aluminium.

When we first started looking, our suppliers did not even know what 'low-carbon aluminium' meant. Now we are making progress – in 2022, 20% of our aluminium had a lower carbon footprint than before. But it took us a long time. If you think sustainability costs you nothing, that's green wishing.

It's a big transformation that takes a lot of investment on the part of our suppliers."

HENNING JÜNKE
Head of Sustainability, Schüco International (system solutions for doors, windows and facades)

CPA OPINION

Companies in the supply chain are increasingly having to balance profitability, risk and resilience. In the past, sourcing inputs from the cheapest place was the primary way of reducing costs. However, since the issues in 2020 and 2021, security will be as important as cost of supply.

Managing disruptions from supply channels includes sourcing closer to home as well as sourcing inputs from multiple suppliers.

Furthermore, it also increasingly about using tier one contractors in supply chain decisions, given their greater market power as well as their resource to plan, purchase and store inputs in which availability and cost inflation may be major issues.

BDO VIEWPOINT

The readjustment of supply chains can be a key contributor to de-risking a business, whether it is broadening the pool of suppliers or reshoring to secure supply and avoid uncertainties associated with shipping from China.

Appropriate stocking levels are another issue to consider in view of supply chain assessments and developments in the macro-economic environment. Advice on appropriate levels of working capital and supply chain security are key services we offer.

And there's certainly an important role for the top-tier players in the market to engage more with their supply chains – to educate, support and help them in their sustainability journey.

FRASER PAGET
Head of Supply Chain and Logistics Services, BDO UK

REGULATORS ADD ESG TO THE BUILDING PRODUCTS AND SERVICES RULEBOOK

ESG: GOING BY THE BOOK

It used to be enough to put out a slim annual report with a wind farm photo on the cover.

But now environmental, social and corporate governance (ESG) reporting is coming of age – and new international regulations are forcing the Building Products & Services sector to up its game.

Greenwashing concerns have led to tightened ESG reporting requirements in the European Union (EU) and US, where lawmakers are keen to ensure sustainability claims can be trusted by investors and other stakeholders.

In the EU, a Corporate Sustainability Reporting Directive (CSRD) entered force in 2023 and will have to be applied from 2024 across an estimated 50,000 companies, affecting reports issued in 2025. The CSRD makes it mandatory for companies to have an audit of the sustainability information they report.

The CSRD stems from the EU taxonomy, a set of rules for investment in sustainable activities.

In the US, meanwhile, the Securities and Exchange Commission has proposed new climate disclosure regulation that builds on voluntary codes already being adopted by many listed entities.

Investors are pushing for greater transparency as ESG alignment, which is often hard to ascertain in a corporate environment, becomes more tightly linked to company performance and value. But the upcoming changes could pose challenges for many businesses.

One issue is that some types of ESG metrics, such as the carbon emissions of supply chains, are hard to measure at present. It is hoped the new rules will help address this issue. But perhaps a more immediate concern is who will do the work.

Sustainability and finance teams have tended to focus on quite different areas of the business. In the next few years, they may find themselves working together – and learning a lot in the process.

EVIDENCING CLAIMS AND AVOIDING GREENWASH

Our current decade represents the last meaningful chance for global society to address the most harmful impacts of climate change. The latest IPCC report identified that humanity must halve its carbon emissions by 2030 in order to meet the goals of the Paris Agreement. It is also the decade in which we must take meaningful action to address the biodiversity crises, alongside widespread issues of social equity.

The built environment sits front and centre of these critical imperatives. As noted elsewhere, buildings and related infrastructure contribute around 40 percent of greenhouse gas (GHG) emissions worldwide, with a significant percentage of the impact sitting within the supply chain.

Buildings also typically account for a significant percentage of an organisation's carbon footprint and are amongst the most visible and tangible expressions of an occupier's identity. The operational performance of buildings – such as the consumption of energy for heating, lighting, or hot water – is relatively easy to measure and report.

This means that related data tends to feature prominently in corporate reporting, with improvements often used to evidence decarbonisation commitments or to underpin reputation and brand promises.

The industry has done an impressive job of innovating new and effective solutions to support decarbonisation. Carbon in the supply chain, however, is much more difficult to measure and track.

Embodied supply chain carbon consists of all the emissions associated with building construction, including those that relate to the extraction, transportation and manufacture of building materials on site.

Without specific data it can be very difficult to differentiate a resource intensive product from an apparently similar but more efficient alternative. The same challenges apply to natural capital and the protection of biodiversity, alongside the need to evidence the social impact of goods and services.

As the sustainability lens focusses ever more on the supply chain and reporting frameworks become more established, there are potential opportunities for organisations within the Building Products & Services sector. Establishing robust systems will help increase the quality of data, improve transparency, and allow for greater assurance over the real impact of buildings.

As we have experienced in other sectors, this active engagement from the supply chain is likely to serve as a commercial differentiator – with investors, developers and end users all gaining confidence that their sustainability commitments will be more evidencable and less likely to be challenged with potential accusations of greenwash.

SIMON PRINGLE
Head of Sustainability & ESG Advisory
BDO UK

BUSINESS VOICES

"The new corporate sustainability reporting directive requirements coming in within the EU are trying to move sustainability reporting much more closely to the process and rigour that financial reporting has. That's something that companies are grappling with."

ROSIE HOWELLS
Group Head of Sustainability, Grafton Group (international building materials distributor and DIY retailer)

CPA OPINION

There are many ways in which businesses in the Building Products & Services sector may report on their sustainability ambitions, actions and impacts.

Some reporting is in response to legislation such as being part of the UK Emissions Trading System, or as a requirement of water extraction licenses, or perhaps due to air quality requirements. Other forms of sustainability reporting may be voluntary responding to demands from clients or to changing social values or to a company 'wanting to do the right thing'.

In response to the climate emergency, many businesses have sought to make public pledges and commitments stating their ambitions to reduce their climate change impact and this is accompanied by an action plan.

Sustainability reporting can be at several different levels: The CPA provides Briefing Papers on the topic of Sustainability Reporting to help the wider construction industry and policy makers to gain a better understanding of sustainability reporting in the construction product manufacturing sector, which on product reporting goes back almost 30 years to the BRE's LCA-based Green Guide to Specification which assessed the environmental impact of over 2000 building elements.

BDO VIEWPOINT

Increased rigour in sustainability reporting is to be welcomed but multinationals should beware of differences in standards and interpretation between the rules in the US, Europe and elsewhere.

Another challenge will be how companies can meet increased regulatory requirements with limited resources and spur the whole supply chain to embrace the required change.

We have experts at BDO who can help you create a roadmap of what needs to be achieved and help you fulfil sustainability commitments.

DANIEL GUTTMANN
BDO Partner, UK
Head of Industrial Products, Technology & Services in Strategy & CDD

HOW PATIENT PRIVATE EQUITY IS FUNDING A MODULAR FUTURE FOR CONSTRUCTION

MAKING IT MODULAR

You may need to look twice if you are seeking the UK home of the future.

Walk past an estate built by a modern homebuilder and the houses on display will look much like any other new-builds.

There is little to indicate they were constructed in a factory and are twice as energy efficient as the UK average. Nor is it clear at first sight that this modular form of construction allows a modular house builder to erect top-quality houses at a much faster rate, saving many weeks on site compared to a traditional home build programme.

Or that modular factory workers can be up and running with only months of training, compared to the years it takes for most construction specialists to complete their apprenticeships.

The fact that such innovations are largely hidden from house buyers is intentional, as modular housebuilders aim sell their products based on quality and cost efficiency rather than novelty and innovation. But they also show the extent to which modular construction is becoming part of business as usual in Building Products & Services.

Modular homes built using modern methods of construction (MMC) are still rare in the UK, accounting for fewer than one in ten new builds, but modularisation is becoming more popular with housebuilder and homeowners alike.

It is also being pushed by government initiatives such as the Crown Commercial Services' £10bn offsite construction framework package and a British Standards Institution Kitemark for MMC.

With the underlying long-term demand for housing, we can expect more support for the sector to follow, especially as MMC also helps address the sustainability and skills challenges faced by the country. Make UK has recently established a modular industry lobby group to help drive focus.

Companies taking advantage of this momentum include Benx Group, a leading supplier of through-wall façade systems, which achieved more than 20% growth in 2022, despite facing industry-wide recruitment and cost inflation challenges.

The company is targeting further expansion in 2023, in large part thanks to modular, off-site manufacturing.

MMC has a lot going for it. Assembling building components in a factory allows for high-precision, standardised production, delivering better quality for the same cost as on-site construction.

Higher quality controls create more defensible data and the ability to report on a transparent basis. Factory processes can allow manufacturers to develop more sustainable designs, with typical walls containing around 90% insulation compared to a standard new build's 20%.

And although MMC has yet to achieve the standards of automation seen in car making or electronics, current processes still allow for significant levels of innovation and technology integration.

It is important for MMC hopefuls to take advantage of this potential rather than simply replicating on-site processes in an off-site environment, according to Benx's Group Chairman, Ian Wilson.

Modular house designs are also starting to come with pre-installed solar panels, a residential heat pump and battery, with the potential for a bespoke zero-cost energy tariff from an energy provider.

Although these homes cost more than a standard house, they can save homeowners up to say 10% a year of the typical build cost premium on energy bills. Monthly energy savings mean buyers can access larger mortgages, as well as being eligible for green mortgage offers from a growing array of lenders.

The main challenge for MMC is it requires investment in a factory. This high upfront cost in vertical integration and the relative novelty of MMC can be a barrier to modularisation, particularly since factories must be certain of a given level of production to achieve required economies of scale.

The business model needs to be carefully established; the high-profile failure of Legal & General's modular housing factory in April 2023, with a loss of 450 jobs, demonstrates the cost of getting it wrong. It follows the administration of Urban Splash, which collapsed in May 2022, owing about £20m.

The finger was pointed at various issues, such as Covid and the planning system, but ultimately it came down to the challenges of scaling up production, break-even output requirements and an unreliable pipeline. MMC is a nascent sector and business leaders are still grappling with the best way to structure operations and funding.

More widely, the modular sector is attracting important capital flows and consolidation. In late 2022, for example, MMC specialist Modulex Modular Buildings plc backed into US special purpose acquisition company PHP Ventures Acquisition Corp in a deal valuing the UK listed company at $600m.

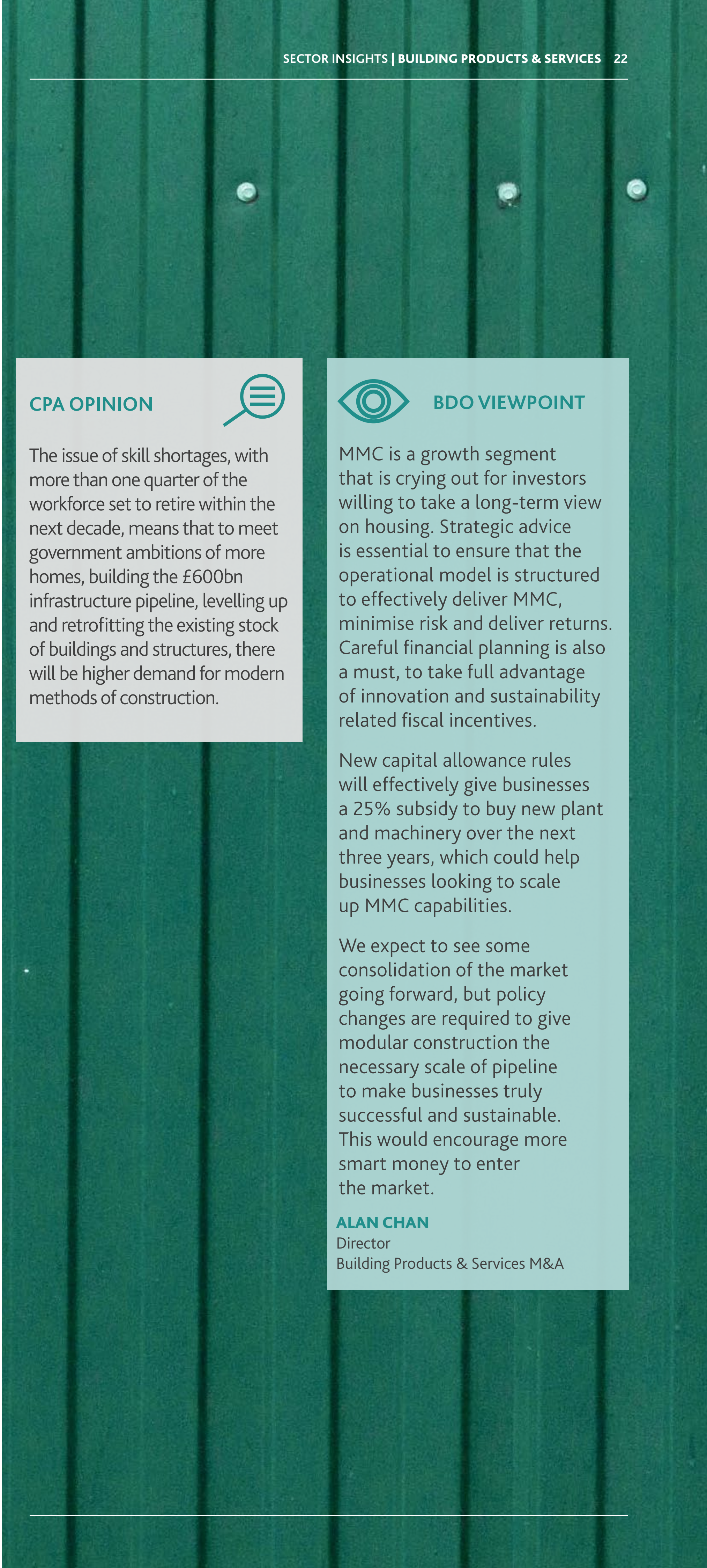
Meanwhile the leading modular space leasing business Modulaire Group acquired temporary accommodation specialist Procomm Site Services and then site housing business Mobile Mini Holdings in December 2022 after a $5bn buyout by private equity house Brookfield Business Partners in 2021. Expect more deals in this space.

MMC housebuilder TopHat has recently secured £70m in funding to support the development of Europe's largest modular housing factory, and Cabot Square Capital is said to be exploring options for divesting its majority shareholding in the UK-based corporate construction group Premier Modular.

Building an MMC factory carries higher risks and longer payback times than pumping cash into a digital enterprise, for instance, but private equity providers with patient investment strategies are well placed to exploit this segment. And the rewards could be immense.

Housebuilders completed 204,530 dwellings across the UK in the 2021-2 financial year, according to the Office for National Statistics. Taking the average £384,560 price for a new-build property in England in September 2021 as a rough guide, that equates to an annual market worth almost £79bn.

In theory, too, the MMC techniques now being pioneered in the UK could be used across the world—where there is a need for 13,000 new buildings every day between now and 2050. This extraordinary statistic underscores Building Products & Services as a primary point of leverage in respect of the climate crisis.



CPA OPINION

The issue of skill shortages, with more than one quarter of the workforce set to retire within the next decade, means that to meet government ambitions of more homes, building the £600bn infrastructure pipeline, levelling up and retrofitting the existing stock of buildings and structures, there will be higher demand for modern methods of construction.

BDO VIEWPOINT

MMC is a growth segment that is crying out for investors willing to take a long-term view on housing. Strategic advice is essential to ensure that the operational model is structured to effectively deliver MMC, minimise risk and deliver returns. Careful financial planning is also a must, to take full advantage of innovation and sustainability related fiscal incentives.

New capital allowance rules will effectively give businesses a 25% subsidy to buy new plant and machinery over the next three years, which could help businesses looking to scale up MMC capabilities.

We expect to see some consolidation of the market going forward, but policy changes are required to give modular construction the necessary scale of pipeline to make businesses truly successful and sustainable. This would encourage more smart money to enter the market.

ALAN CHAN
Director
Building Products & Services M&A

MMC HELPS WITH SKILLS. BUT IS IT ENOUGH?

WORKFORCE IS A WORRY

Modern methods of construction (MMC) could help reduce demand for new-build construction skills as the Building Products & Services sector continues to face workforce woes.

MMC factories have access to a wider pool of potential workers as automated production requires fewer skills.

However, skilled tradespeople are still needed for repairs, maintenance and improvements. And finding the right people is becoming more challenging among younger workers, with Gen Zers citing construction's negative environmental and social credentials as reasons to shun the real estate and construction industry.

Companies with a strong sustainability story can use this to their advantage, with frame specialist Schüco International claiming an influx of qualified workers attracted by the company's green credentials.

The construction industry is going to be a prime focus for 'green jobs'. The supply chain will be under increased scrutiny for reportable data in support of transparency commitments.

But at façade manufacturer Benx Group, where demand for modular components is booming, Group Chairman Ian Wilson reports challenges with recruitment – some applicants not turning up for interviews, for example, or occasionally, not turning up for work after accepting a job offer – and a consequent need to really focus on ways to attract and retain talent. This view of changing workforce priorities is borne out by research.

BDO Global's survey on the Future Workforce in Construction found skills shortages and talent retention challenges were negatively impacting on industry performance and although demand for skilled roles remained robust, students were turning away from careers in the sector.

Corporates in construction are not aligned on what is important to students' future career aspirations, the research found, and students do not believe the sector will give them what they want from work.

In a separate quarterly BDO Rethink study in the UK, 30% of real estate and construction industry respondents said their businesses faced workforce challenges and a similar percentage claimed they had not been able to replace staff who retired during the COVID-19 pandemic.

Such problems could be exacerbated as companies look to expand, with 51% of global construction industry leaders consulted by BDO expecting their workforces to increase over the next six months. Wage bills are increasing to attract and retain staff, adding pressure to margins that are already under stress.

Furthermore, the research suggests competition will be greatest for highly skilled roles such as those in engineering and procurement. Competencies in data analytics, environmental expertise, computer science and health and safety are also expected to be in demand.

Addressing this skills gap will likely require companies to adapt to Gen Z norms and preferences. In BDO's Rethink research, almost 31% of respondents said they were changing recruitment practices to attract more diverse talent and offering incentives such as health and wellness support.

BDO's global construction research suggests companies will also need to adjust the way they reward and communicate with their younger employees. Gen Zers want to be recognised and respected for their contribution in the workplace, the research says, with 45% describing this as 'essential' and 37% as 'important'. This generation also prefers careers where they can move up the ladder quickly, based on performance.

Access and security specialist Allegion is backing the development of solutions that could help with the growing requirement for flexible working. The company acquired German software-as-a-service workforce management solution provider plano in January 2023.

plano's platform enables workers to self-schedule, while helping employers to flexibly adapt their workforce planning to actual needs and better understand workforce productivity.

At Benx, Wilson says there is now a strong focus on mental health to support employees. The company is also keen on visa schemes to bring back Eastern European workers lost to Brexit. In March 2023, the UK government changed rules so overseas bricklayers and carpenters could enter the country more easily.

As Building Products & Services continues to fight for talent, we expect to see the visa scheme extended more widely, and apprenticeship schemes to broaden. The Diversity, Equity and Inclusion agenda could also become a positive, as industry reaches down into various levels of education to encourage a focus on STEM skills and related courses.

The future of the sector will depend on such measures.

FIVE STRATEGIES TO PULL IN NEXT-GENERATION TALENT

01 Talk up the sector's role in supporting the transition to net-zero emissions through sustainable design and construction methodology and the installation of circular and energy-efficient building materials, as well as retrofitting older assets to bring them up to modern green building standards. This work is vital if national governments are to meet their net-zero pledges over the next decade. In the same way, the sector can provide important social benefits such as local employment, community regeneration and support for local businesses and suppliers.

02 Promote employment opportunities within the sector more widely through initiatives with young people in schools, colleges and universities. Offer apprenticeships or internships and consider offering scholarships or bursaries.

03 Highlight the sector's job opportunities in technology, robotics and automation, and the digital skills required in data and cloud management, cyber security and artificial intelligence.

04 Communicate the efforts being made to improve work-life balance and flexibility, wellbeing, mental health, gender diversity, career progression and safety at work.

05 Offer training schemes as way to ensure employees have the skill levels they need to succeed. This includes upskilling staff to take on new positions.

Read the findings of The Future Workforce: Global Construction Survey Report and UK Rethink survey here.

BUSINESS VOICES

“The whole social contract has changed between employer and employee, in recent years.

It can take a bit longer to know that you've got the right person. There is a cohort of largely very capable, talented young people, but they just view the work dynamic differently to previous generations.

As an industry, we are making progress in adapting to the challenges this brings.”

IAN WILSON
Group Chairman, Benx Group (specialist provider of building façade systems)

CPA OPINION

A direct risk in the longer term revolves around whether the need for more homes, the government's infrastructure pipeline, levelling up and retrofitting the existing housing stock and non-domestic buildings as part of the transition to net zero will be feasible given labour availability issues.

UK construction has lost over 250,000 workers in the last four years, it has an ageing workforce issue and a lack of new apprenticeships.

BDO VIEWPOINT

With workforce challenges a major issue for 30% of global real estate and construction firms, per BDO's Rethink survey, Building Products & Services employers are having to get creative in finding and retaining the right people.

Favoured strategies include offering incentives appealing to a more diverse employee base (favoured by 35% of those experiencing challenges) and changing recruitment practices (31%).

Adopting workforce management technologies that support flexibility could be a big help in retaining workers.

And addressing the perception gap to promote Building Products & Services as an attractive sector to Gen Z workers will be another essential move.

SUSANNAH PERKINS
Associate Director
Building Products & Services M&A

EVERSHEDS SUTHERLAND

THE IMPACT OF THE UK BUILDING SAFETY ACT

NEW ACT PUTS SAFETY FIRST

The Grenfell Tower tragedy was an industry defining event that demanded a fresh look at the way in which the construction industry operates.

The repercussions of external walls and cladding failing to comply with safety standards had consequences that nobody wishes to see again.

The final report of Dame Hackitt proposed a new regulatory framework, the Building Safety Act 2022 (BSA), aiming to:

- Create a simpler and more effective regime for driving building safety
- Provide stronger oversight on duty-holders with incentives for the right behaviours and effective sanctions for poor performance
- Reassert the role of residents in being able to seek legal redress for unsafe work.

KEY CHANGES UNDER THE BSA

The BSA is one of the most extensive legal reforms the industry has seen in many years, key changes include the introduction of:

- Regulatory reform for higher risk buildings, creating new roles and additional duties and responsibilities, as well as introducing registration and procedural requirements during a building's construction and occupation (including the provision and retention of key information)
- The extension of existing rights of recourse for dwellings that are unfit for habitation
- New powers granted to the courts to impose orders requiring remediation works and/or financial contributions for mid-rise buildings that pose a building safety risk
- Wider classification of liable parties where the courts have the power to pierce the corporate veil, so companies associated with the original party can be made liable if rights can no longer be enforced against the original party (for example if they are insolvent, or a special purpose vehicle with no other assets)
- Extended limitation periods: the BSA has extended limitation periods for existing building safety defects prior to 28 June 2022, which have a limitation period of 30 years, and building safety defects thereafter have a 15-year limitation period.

All of this is backed up with the creation of the new Building Safety Regulator in the Health & Safety Executive to oversee compliance.

IMPACT ON M&A

SELLERS PREPARING FOR SALE

Sellers preparing for a transaction should expect questions on the BSA to be asked by potential buyers through the due diligence process and must assess the impact of the BSA in advance.

We recommend as part of the preparatory work for a sale that the business considers not only whether they own properties or supply products which are caught by the BSA, but also how they will practically implement and assess the cultural changes and staged implementation of regulations which the BSA foresees.

Any product liability claims are likely to be a key focus of a buyer's diligence, and a strategy may be required as to how any such claims are to be presented in the process.

Extension of the limitation periods means that loss of records to evidence compliance and changes of ownership could make the provision of information more challenging.

The preservation of data is going to be increasingly important, both in managing claims and in fulfilling regulatory registration and management duties. Buyer's and their advisers will want to have confidence that they are inheriting a compliant position or be able to quantify the risk of any non-compliance.

It will be necessary for those in the industry to review their document retention policies and to consider investment in a suitable electronic document storage and retrieval system.

BUY-SIDE DILIGENCE AND APPROACH

We expect to see a renewed focus through the due diligence process to identify any BSA issues prior to completion.

Alongside a legal questionnaire, additional operational due diligence may be required, and there will be a particular focus on claims diligence, potentially via specialist insurance diligence, alongside the legal review of compliance.

"

It should be noted however that the availability of insurance may be limited, as fire safety issues are often excluded or only available as an aggregate sum under current policies. The effects of the BSA are also likely to be seen in the recourse sought against sellers.

This may take the form of a wider scope of compliance warranties to drive disclosure, but also through indemnities and other specific protection (such as longer limitation periods in respect of any identified BSA issues) in transaction documents.

INSURANCE

Product liability matters are typically carved out of a warranty and indemnity insurance policy, and we expect further interest in separate product liability insurance policies and a greater focus on operational insurance diligence.

The subsequent discovery of widespread building safety issues after Grenfell means almost all professional indemnity insurance policies limit or exclude cover for fire safety defects.

STAY UP TO DATE

The BSA provides a clear framework of the cultural changes that will take place across the industry. The legislation is multi-phase and new provisions continue to come into force. Those looking to acquire businesses with residential and/or mixed-use portfolios will need to keep a watching brief to ensure that their M&A strategy and diligence exercises keep ahead of any further changes in the legislation. "

NIGEL COOKE
Partner (M&A Head of Building Products and Services),
Eversheds Sutherland

TOM MILBURN
Principal Associate,
Eversheds Sutherland

CPA OPINION

The construction products industry faces major changes in the years to come. The Building Safety Act is the most significant change that we will see and there will increasingly be a shift to liability, responsibility, accountability and transparency across the construction supply chain.

Liability will key in the Building Safety Act – firms will be forced to contribute towards the cost of remediation works when the use of their products has caused or contributed to buildings being unfit for use. In addition to reactive measures, firms in the supply chain will need to ensure and show evidence of competence and clarity.

Firms need to demonstrate they are doing the correct thing and it is compliant, safe and ethical or a new building regulator and product regulator will act. They will have surveillance and enforcement powers to support this position.

BDO VIEWPOINT

It will be essential for relevant businesses to seek advice on how the Building Safety Act impacts them, to ensure that they are well-prepared and well-resourced for what is to come.

High levels of scrutiny in due diligence processes will add to the complexity of transactions, but these are areas where expert advisors can add a lot of value.

JOHN STEPHAN
Partner
Building Products & Services M&A

BUILDING PRODUCTS & SERVICES DEFIES MARKET HEADWINDS

THE UK M&A PICTURE

Despite the challenging market backdrop, M&A volumes in the UK Building Products & Services sector continued to increase in 2022. 387 deals involving a British business completed in the year, a rise of 3.2% on levels seen in 2021.

THE UK MARKET IN FIGURES

MORE THAN **1,000 DEALS** IN THE LAST THREE YEARS

387 UK DEALS IN 2022

UK SECTOR DEALS UP **3.2%** ON 2021 LEVELS

OUTPERFORMS WIDER UK MARKET, WHICH SAW DEALS DECLINE BY **10%** IN 2022

(PER BDO'S PRIVATE COMPANY PRICE INDEX)

387 deals involving a British business completed in the year, a rise of 3.2% on levels seen in 2021.

This is impressive, considering the 51% rise in transaction volumes already witnessed in 2021, and confirms Building Products & Services as a hot sector, outperforming a wider market that dipped by 10% in 2022, according to BDO's Private Company Price Index.

In 2021 we saw private equity surging ahead, with investors behind 41% of all transactions in the market.

Having been quick off the blocks to seal deals post-Covid, the share of deals backed by investors dipped to 37% in 2022 – but interest was consistent throughout the year.

Meanwhile, trade deals surged by 10% in the year, with corporates acquiring 63% of target businesses.

The thirst for deals was particularly evident across manufacturers and services, both of which saw activity rise by 11% in 2022.

The year-on-year rise in services deals is widening its lead, with 44% of all transactions in 2022 relating to businesses with a services-oriented business model.

One of the bigger deals in the services segment this year was rental specialist Aggreko's acquisition of Resolute Industrial, a US provider of specialised heating, ventilation and cooling (HVAC) solutions, for an enterprise valuation of US$440m, representing an EV/EBITDA multiple of 8.3x.

Building services relating to compliance were a hotbed of M&A activity, with acquirers including Churches Fire Security, EA-RS Fire Engineering, Walker Fire and Compliance Group, all completing multiple deals in the year to extend geographical coverage and the range of building compliance services on offer.

Serial UK acquirers in the manufacturing segment include the Engineered Stone Group, which has continued to buy manufacturers of premium engineered stone bathroom products in Spain and the US to widen its portfolio of brands.

In terms of materials, timber continues to attract high levels of interest, with ongoing consolidation of merchants.

Stand-out deals include BSW Timber's acquisition of £240m-turnover group Scott Group, and James Jones' first overseas acquisitions, of Australian businesses Hyne Timber and XLam, both pioneering the use of mass timber.

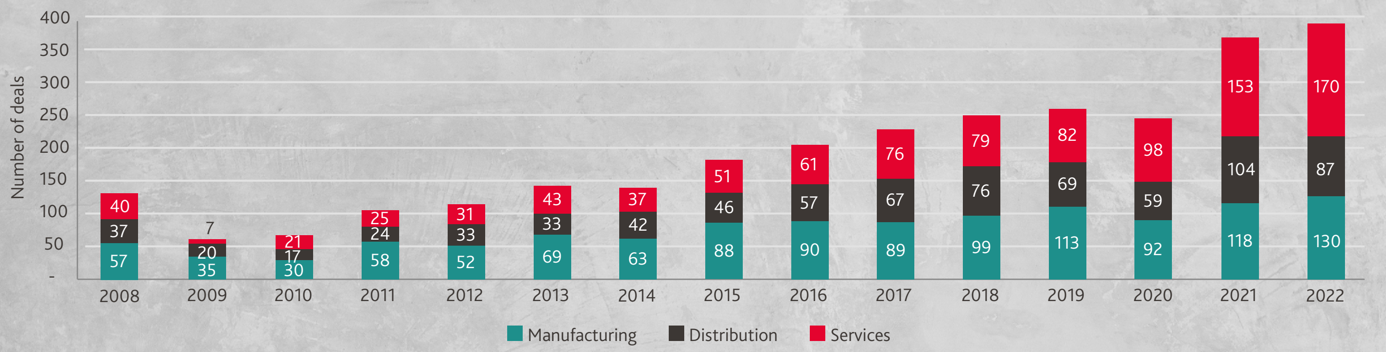
Another notable deal in manufacturing was the acquisition of roofing systems business Marley by landscaping products company Marshalls for £535m, representing an EV/EBITDA multiple of 10.7x, and providing an exit for Inflexion.

The deal is part of the Marshalls' ongoing diversification strategy, accelerating the company's five-year plan to become the UK's leading manufacturer of products for the built environment.

Distributor deals declined in the year but were dominated by serial acquirers: Lords Group acquired four companies to extend its merchanting and plumbing and heating businesses, while UK-listed Ferguson acquired 12 North American businesses.

Meanwhile, private equity-backed merchants continued to consolidate, with Cairngorm's Independent Builders Merchant Group acquiring no less than six businesses, including Dougfield Plumbers Supplies, Pennyhill Timber, Cornish Fixings, Merkko, Independent Roofing Supplies and Wantage Builders Merchants.

NUMBER OF TRANSACTIONS BY TYPE



Source: Experian MarketIQ, BDO analysis

The big deals in the distributor sector last year were the carve-outs from Saint-Gobain. International Decorative Surfaces, a €130m specialist flooring, worktop and laminate distributor, was bought by private equity firm Chiltern Capital, while Jewson was sold to Danish Stark Group, backed by CVC Capital Partners, for £740m.

The Jewson deal was just one of several high-profile transactions involving overseas buyers acquiring UK targets, with others including Fortune Brands' acquisition of shower products manufacturer Aqualisa from LDC for US$160m and Swedish group Bufab's acquisition of construction products supplier TIMCO for £54m.

Last year we predicted a rise in international M&A, and this has played out strongly, with cross-border M&A involving UK businesses rising by 47% in the year.

Most of these deals involved the sale of UK businesses to international buyers.

As we emerge from Brexit and the pandemic, many UK businesses in the sector have proven their resilience in the face of pressure, challenge and instability.

The confidence of international corporates is returning as they recognise the UK as a highly attractive market to do business.

THINKING OF BUYING OR SELLING A BUSINESS THIS YEAR?

SPEAK TO YOUR LOCAL ADVISOR OR ONE OF THE SECTOR CONTACTS LISTED AT THE BACK OF THIS REPORT.

BDO VIEWPOINT

Following the 51% increase of deals in 2021, it was incredible to see the sector hold on to these levels of activity in 2022, particularly as the wider M&A market saw a decline. The outlook for M&A is strong – it can take longer to complete a deal in the current market, but the pipeline of opportunities remains significant.

Each business is unique and requires careful positioning in terms of its offering, market dynamics and potential. Knowledge of the most appropriate funding structures, and relationships with key potential buyers and investors, are key.

We specialise in helping entrepreneurs, corporates and funders agree a deal that maximises value for all parties.

ALAN CHAN
Director
Building Products & Services M&A

THE OUTLOOK
FOR VALUATIONS

VALUATIONS COME OFF THE BOIL

A huge spike in the listed markets led to frothy valuations in recent years.

But markets are now settling back to more normalised levels.

AVERAGE SECTOR MULTIPLE FOR DEALS
6.9X EV/EBITDA
(7.7x IN 2021)

AVERAGE FOR TRADE
6.7X (7.5x IN 2021)

AVERAGE FOR PRIVATE EQUITY
7.3X (7.9x IN 2021)

AVERAGE LISTED SECTOR MULTIPLE
7.9X EV/EBITDA
(APRIL 2023)

Average listed company multiples have dipped to 7.9x EV/EBITDA in April 2023, down from the high of 12.8x seen last year.

Private markets have followed suit but not to the same degree, with the average multiple paid for private Building Products & Services sector businesses in 2022 declining to 6.9x EV/EBITDA from 7.7x in 2021.

The market dynamics in 2020-2021 were very different, as businesses grappled with the pandemic and then readjusted.

Transactions were largely put on hold, creating pent-up demand to get deals done once the markets opened. The spike in public markets created a seller's market where it was easy to justify higher valuations.

Following the period of strain, reported disclosed earnings in the public domain did not always reflect the underlying performance of a business. More recently, trade and private equity multiples have returned to levels seen in 2019.

Private equity remains slightly ahead of trade, with an average multiple of 7.3x EV/EBITDA, while the average multiple paid by trade in 2022 was 6.7x. Across 11 sub-sectors, long-term average valuations held firm in six.

Slight increases were seen in Building Materials, HVAC and Electrics, while there were dips in Kitchen & Bathroom and Merchant/Distributor valuations.

With all the change in recent years, the all-important question is: how have buyers been adjusting valuations? Here we are seeing three trends:

- We are still seeing a mixture of completion accounts and locked box. There are benefits to both approaches, but in some instances completion accounts have been chosen if there is any uncertainty from a buyer's perspective, or for buyers looking to get the full benefit of profits to completion;
- Fundamentals remain important but may be adjusted to focus on EBITDAC (earnings before interest, taxes, depreciation, amortisation and COVID), last 12 months, run rate or forward-looking statements, depending on the circumstances;
- There have been a number of deals with earnouts. Particularly with uncertainty, these are the go-to mechanism to bridge valuation gaps while mitigating risks on future trading.

BDO VIEWPOINT

Valuations have now returned to more normal levels, but it can be a challenge for buyers and sellers to arrive at a shared view of underlying earnings because there have been so many exceptional events and costs in recent times.

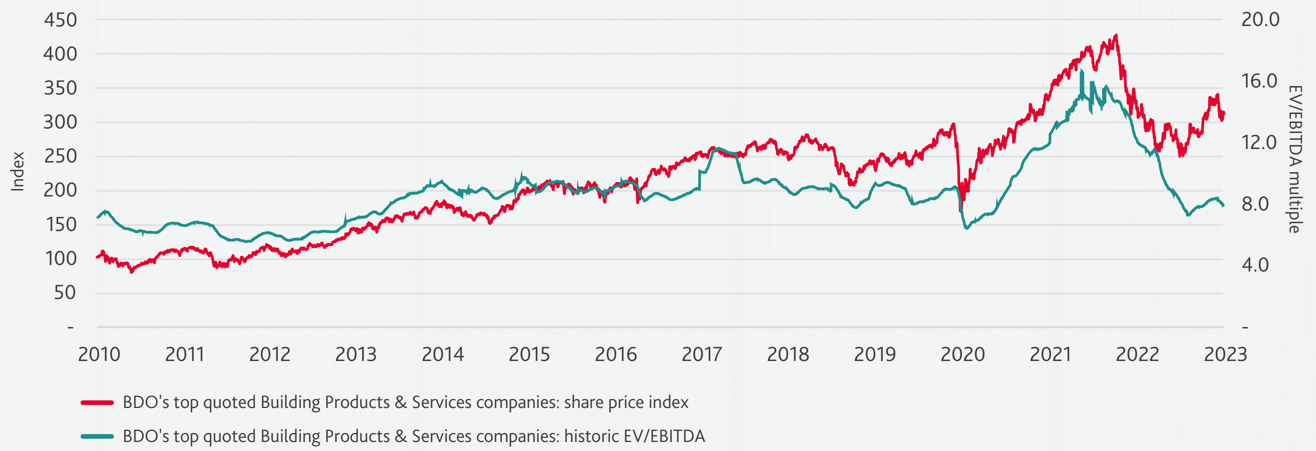
Normalising turnover and profit levels can be a barrier to getting deals done, but this is our bread and butter.

Different business models attract different multiples. More traditional businesses tend to be valued at the lower end of the scale, whereas those that offer connected technologies, and especially those that achieve recurring revenues, can command much higher valuations.

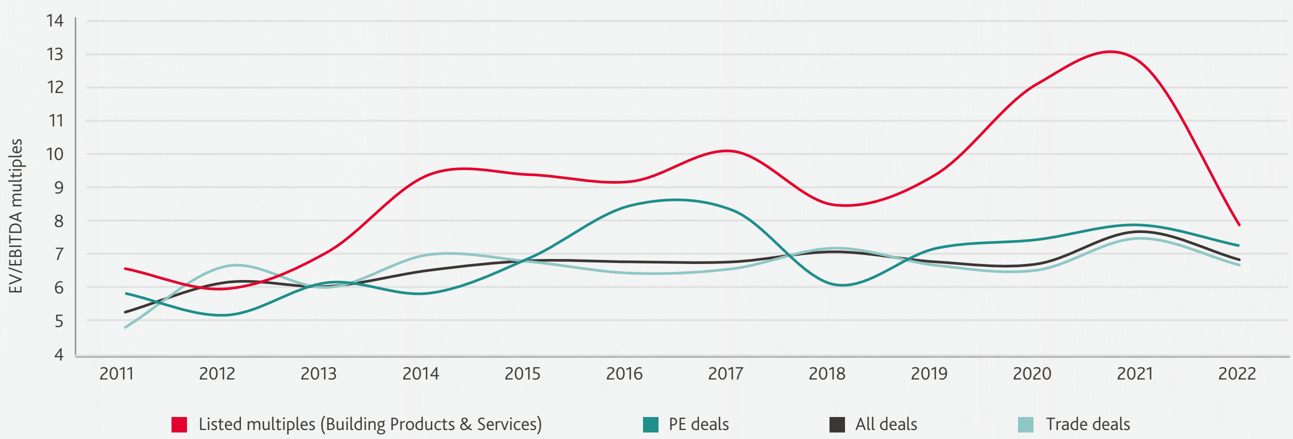
High-quality assets will always carry premium prices.

MATTHEW GOODLIFFE
Director
Building Products & Services M&A

SHARE PRICE PERFORMANCE AND EV/EBITDA IN THE BUILDING PRODUCTS & SERVICES SECTOR

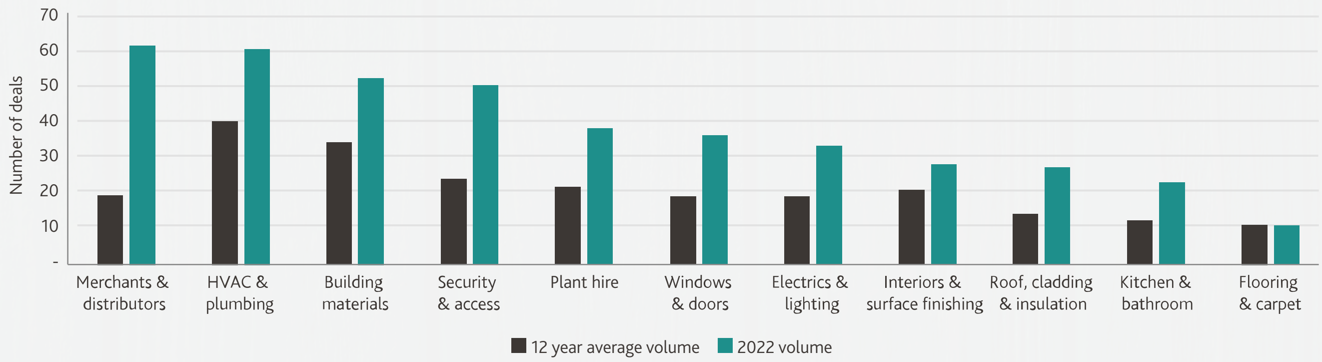


EVOLUTION OF LISTED AND TRANSACTION EV/EBITDA MULTIPLES IN THE SECTOR



TRANSACTION VOLUMES AND EV/EBITDA MULTIPLES BY SUB-SECTOR

	Merchants & distributors	HVAC & plumbing	Building materials	Security & access	Plant hire	Windows & doors	Electrics & lighting	Interiors & surface finishing	Roof, cladding & insulation	Kitchen & bathroom	Flooring & carpet
12-YEAR AVERAGE EV/EBITDA	6.4X	6.7X	7.1X	7.3X	6.0X	6.2X	6.1X	6.2X	6.3X	6.8X	6.4X



Source: S&P Capital IQ, Experian MarketIQ, BDO analysis

PRIVATE EQUITY IN THE SECTOR

PRIVATE EQUITY HARNESSES CARVE-OUTS

Private equity firms continue to be stalwart investors in the Building Products & Services sector, with 142 UK deals – involving an investor in 2022.

This was slightly down on 2021 activity, but volumes were still roughly double pre-pandemic levels.

While some investors are looking for disruptive business models they can help accelerate, or fragmented markets to consolidate, others are keen on businesses which have been under-invested or become non-core for a corporate.

One such example is Aurelius, which acquired CTD Tiles from Saint-Gobain in April 2022. Aurelius specialises in the acquisition of corporate carve-outs, especially complex, multi-jurisdictional cases.

It works with corporates which are looking to focus their strategy and divest unintegrated or non-core divisions, and identify their most suitable home.

Aurelius can take these divisions on a transformation journey that is easier to progress away from the public markets, bringing fresh focus and expertise.

In addition to investment highlights, there can be gaps in the management team, financial challenges or issues in the supply chain; the market could be mature, even declining or facing sharp cyclicality; Aurelius thrives on such challenges.

Since acquiring CTD, Aurelius has consolidated its position as the most significant trade player in the market – acquiring 13 stores from Tile Giant – and is backing investment in IT systems and digitisation.

Zentia, acquired from Knauf in 2019, is another example of an Aurelius portfolio business making strides – it has been driving digitisation and product innovations to slicken up the design of acoustic ceilings in what has historically been an analogue sector.

Customers can model and personalise their requirements in a digital environment, which then feeds directly to the manufacture and installation side of the business.

Aurelius has also helped Zentia to manage waste levels, supporting its ESG journey.

Investment in digital capabilities and ESG initiatives are typical considerations when upskilling and aligning with market opportunities while making businesses more attractive to potential buyers.

The value that private equity can add is frequently rewarded with enviable returns.

In 2022, LDC sold shower brands business Aqualisa to Fortune Brands for £130m, generating a money multiple return of 4x. During LDC's tenure, the business had achieved a near-threefold increase, with profits more than doubling since 2019.

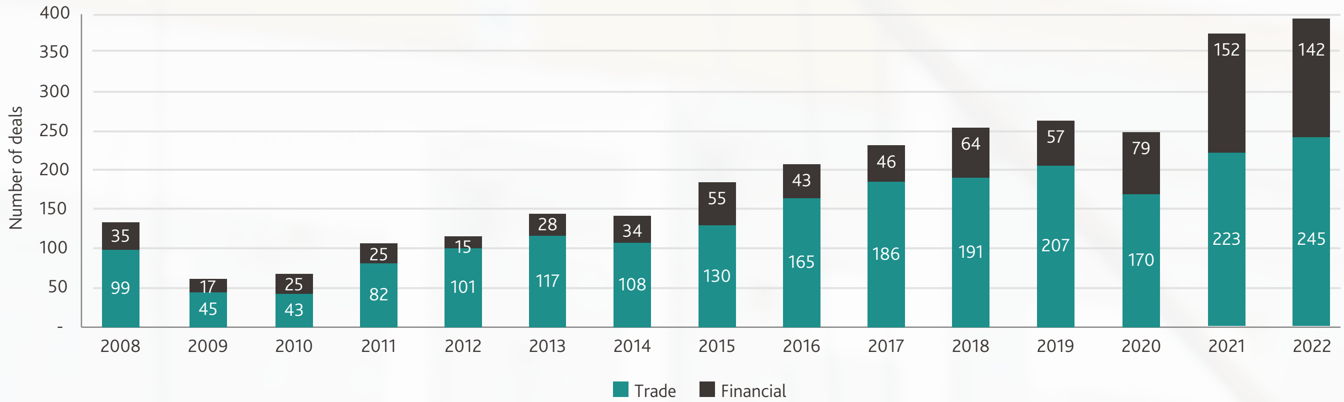
Inflexion, too, sold roofing systems business Marley to Marshalls in 2022 for an enterprise value of £535m, representing an EV/EBITDA multiple of 11.1x.

As market instability continues, some businesses are facing real challenges which could call into question highly leveraged models that private equity often employ.

Some investors may turn elsewhere, but there are plenty of successful blueprints in the market – and alternative investment structures to consider.

PRIVATE EQUITY BACKED **37%** OF ALL UK DEALS IN 2022

TRADE AND PRIVATE EQUITY TRANSACTIONS



Source: Experian MarketIQ, BDO analysis

CONSIDERATIONS FOR CARVE-OUTS

Many transactions in the Building Products & Services sector have involved an acquirer carving out a business unit from a larger group.

Saint-Gobain has been particularly high profile in this regard: as well as selling CTD Tiles last year, the business exited all UK distribution brands, disposing of Jewson to Stark Group, Ideal Bathrooms to Wolseley and International Decorative Surfaces to Chiltern Capital.

Many complexities exist in a transaction of this nature. This includes how central services are maintained in the carved-out business until full separation occurs, the cost of transitional services and defining a plan to implement the separation. Often, procurement synergies will dissipate as economies of scale are lost.

Customer contracts need careful examination too as change of control clauses may exist. For a seller, it is imperative to summarise the carve-out considerations in a separation blueprint document.

This should define the transaction perimeter, the proposed transitional service arrangements and costs, the proposed standalone operating model and an indicative roadmap to achieve separation.

Often, a significant amount of one-time resource is required to support separation activities – estimating resources and how the cost will be shared is also important to evaluate the viability of the transaction.

Including this information in the separation blueprint limits the level of buy-side due diligence required and de-risks the transaction. It provides acquirers with clarity and confidence that carve-out considerations have been thought through and an implementation plan exists for the separation.

For an acquirer, it is imperative that a proper understanding of the standalone P&L is determined, to show the future profitability of the carved-out entity after it is separated from the parent.

Defining the future operating model from a bottom-up perspective is essential to ensure the standalone organisation is right-sized and not overburdened with unnecessary costs.

Often this can yield savings, as the actual cost of replicating a service in-house is lower than the charge received from a parent, due to the arbitrary way group allocations are commonly made.

Having a clearly defined programme to implement projects required to wean the business off transition service agreements (TSAs) is essential to ensure separation is completed before the TSA period ends.

It is in the acquirer's interest to migrate off TSAs as rapidly as possible, to minimise TSA charges and potential dual-running costs. This can be achieved through effective planning of carve-out projects and ensuring sufficient resources are allocated to implementation.

Where a carved-out business is being merged with an existing company, further work is required to assess how the entities can be integrated effectively to drive revenue and cost synergies.

The appointment of advisers to navigate complex carve-outs is a worthwhile investment to ensure the transition is smooth and value is maximised for buyers and sellers.

STEPHEN COONEY
Principal
Value Creation Services, BDO UK

BUSINESS VOICES

“We see ourselves as a professional solution provider for corporates who are seeking a home for a division that has become non-core. We thrive on complexity of the situation and bring a lot of carve-out expertise.

We're looking to build on the experience we've had more than 7 investments in the building products space. We are one of a smaller subset of financial investors that are willing to take on the challenges and opportunities of more cyclical businesses.

We have over 150 Aurelius operational experts who can help manage transition from the corporate owner to Aurelius, then work with companies on efficiency, best practice, then ultimately growth and M&A.

Private equity brings investment, innovation and new perspectives to an industry that will help it on its ESG and digitisation journey.”

PETER WOOD
Managing Director, Aurelius Group
(private equity investor)

BDO VIEWPOINT

Private equity remains a valuable force in the Building Products & Services market.

From providing strategic focus for non-core units to giving undervalued businesses some tender loving care or rolling up fragmented markets, private equity brings professionalism and complementary skills to drive the sector forward.

Assets of particular interest include products with market-leading potential, and those offering a service angle alongside a product. Hot sectors would include the MMC market, assets with an 'energy efficiency' proposition, or those underpinned by regulatory drivers, such as fire safety.

Given ongoing instability in markets, we expect to see corporates continuing to resize and reshape their portfolios, leading to more carve-out opportunities.”

SARAH ZIEGLER
Director
BDO Private Equity Coverage

CORPORATE VENTURES
SUPPORT THE DISRUPTORS

FUNDING A DEAL

Corporate venture funds are an emerging and important part of the investment landscape for businesses in the Building Products & Services sector.

CRH launched a $250m venturing and innovation fund in 2022, to invest in construction and climate technologies.

Meanwhile, CEMEX's corporate venture capital unit has announced an investment in Zacua Ventures, a global early-stage venture fund that aims to tackle the construction industry's biggest challenges in sustainability, productivity and urbanisation.

Allegion, a business with roots in door security, has been evolving to offer a full spectrum of products, from mechanical locks to smart devices, that enable seamless access to buildings. The company set up a Ventures arm in recognition of the fast-paced change in the sector.

Allegion Ventures launched in 2018 with a fund of $50m and has launched a second fund worth $100m to accelerate technology and software investments in the Internet of Things, data security, building analytics, construction lifecycle and property management.

Recent investments include proptech startup Latchel, a software company empowering property managers to streamline operations and create seamless experiences for residents. Another is VergeSense, which employs connected sensors in the workplace to help building owners and operators understand how people use space.

Ventures help Allegion understand emerging technologies and market dynamics, get alongside entrepreneurs and push boundaries without needing to commit to full ownership.

The arms-length relationship is also beneficial to start-ups: they receive investment, a sounding board, strategic advice and a platform as they explore commercialisation of technology. Investor and investee can develop their relationship and consider the best home for the business as it matures.

There is no set path; while multiple rounds of investment may be provided, not all businesses are acquired. For example, venture-backed Openpath, a provider of access-as-a-service solutions and early addition to the Allegion Ventures portfolio, was sold to Motorola.

However, ventures put a corporate in pole position to acquire, scale up, accelerate the innovation curve and bring disruptive technologies to market.

M&A FUNDING CONSIDERATIONS

In the current macroeconomic environment, acquirers have been under strain and the level of scrutiny of potential acquisitions has increased. The capital that's available to spend has generally shrunk, while the cost of capital has increased.

In the absence of debt funding, vendor finance can be an important mechanism to help deals get away. There are anecdotes of corporates so keen to complete a divestment that they have supplied a term sheet before the binding bid to offer help towards funding the acquisition.

Clearly, this allows the acquirer to progress knowing they should be able to achieve the required returns and provides much needed security on big-ticket transactions.

At the smaller end of the market, there are huge amounts of funding available for innovative businesses, especially those aligned with sustainability objectives or offering potentially disruptive technologies.

From government grants to seed investors and angel syndicates, family offices, venture capital trusts and corporate ventures, there is plenty of money out there to support growth and innovation.

JOHN STEPHAN
Partner
Building Products & Services M&A

WILL THE DEBT MARKETS RECOVER?

Whilst debt markets have made it more difficult to get larger deals done, money is still available in the mid-cap market. There has never been such a board range of debt options available, the challenge for borrowers is finding the most appropriate lender that is likely to have an appetite for their credit whilst delivering their funding objectives.

There has been some reshaping in lender behaviour, including:

- A polarisation of lender appetite towards credits that have reduced exposure to the economic cycle
- A greater degree of scrutiny from lenders to deliver credit approvals
- A softening of appetite for leverage, largely due to increasing debt service requirements constraining debt capacity.

However, with the recovery in UK energy prices, lenders now have more confidence that inflation should be approaching its peak. The markets currently expect bank rates to peak at 5.5% towards the end of this calendar year and start to reduce thereafter.

And despite the fundraising challenges, there remains substantial private debt fund dry powder. Therefore, as lenders become increasingly confident regarding the economic outlook and borrowers demonstrate how they have managed the economic headwinds, we expect to see a more 'borrower friendly' environment to materialize.

Having aa specialist independent adviser can help you identify the funders that will be the best fit for your business.

ROSS MCDONALD
Head of Debt Advisory, BDO UK

BUSINESS VOICES

The construction industry is evolving and changing rapidly - making innovation an integral part of any business strategy.

At Allegion, M&A as well as ventures align to our build-partner-buy approach to innovation. Both have a role to play, but ventures, in particular, is a logical approach if you're in a business that generates cash and is looking to innovate.

You can gain first mover advantage and, just as important, bring value to those investments, giving them visibility and opportunities to scale.

PHIL STREET
Vice President of Business Development, Allegion
(access and security specialist)

BDO VIEWPOINT

Corporate venture capital can be a win-win for corporates and start-up businesses. Corporates can tap into diverse innovations, gaining cutting-edge know-how, while start-ups can access funding, resources, channels, visibility and strategic frameworks.

We expect more corporate ventures to emerge, especially in fast-moving technology sectors.
We predict growing interest in next-generation solutions that advance digitalisation, optimise marketplaces, evolve connected technologies and progress the decarbonisation agenda.

MATTHEW HOCCOM
Associate Director
Building Products & Services M&A

SUB-SECTORS REVEAL DYNAMICS FUELLING GROWTH

DELVING INTO THE SUB-SECTORS

Deal activity was spread across Building Products & Services sub-sectors, with most seeing yet another record-breaking year.

There were notable increases in windows and doors transactions, which nearly doubled, while the roof, cladding and insulation sub-sector saw deals rise by 35%, driven by opportunities in the retrofit market.

Double-digit increases were also seen in plant hire (+23%), kitchen and bathroom (+21%), building materials (+18%), and merchants and distributors (+17%).

In building materials there were several circular economy investments, with businesses acquiring know-how in materials recycling – in aggregates, plasterboard, PVC and aluminium. The increase in volumes in the merchant and distributor segment was notable as it followed the huge surge already seen in 2021.

Meanwhile, HVAC and security and access deals dropped back a little in 2022, having seen heady year-on-year increases in recent years. Across 11 sub-sectors, long-term average valuations held firm in six.

Slight increases were seen in building materials, HVAC and electrics, while there were minor dips in kitchen and bathroom and merchant/distributor valuations.

BDO VIEWPOINT

We predict ongoing M&A interest across the sub-sectors. Merchant and distributor volumes may start to decrease following an intense period of market consolidation.

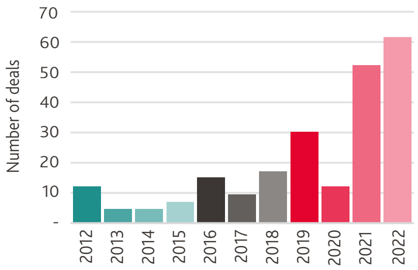
Interest in technologically advanced businesses, such as those prevalent in the security and access, electrics and lighting and HVAC sub-sectors, will remain strong, as will those with strong regulatory underpinning such as fire safety, while near-shoring of supply chains could lead to an increase in transactions involving UK building materials businesses.

SUSANNAH PERKINS
Associate Director
BDO Building Products & Services M&A

MERCHANTS & DISTRIBUTORS

Overtaking the HVAC and security and access segments to become the largest for deal volumes in 2022, with a 15% share. While deal volumes continued their impressive trajectory, multiples pulled back to 6.4x, having spiked at 7.0x in 2021. The most notable deal was the £740m carve-out of Jewson from Saint-Gobain, sold to Stark Group. Private equity was behind many deals, with Cairngorm particularly active.

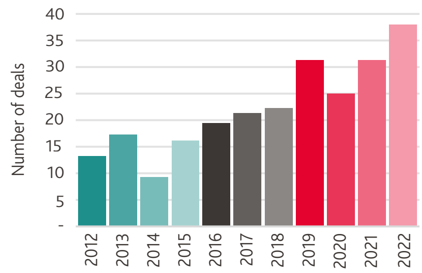
Average EV/EBITDA multiple **6.4x**
2012-2022



PLANT HIRE

Another record-breaking year in the plant hire sector, with 38 deals completing in 2022. Ashtead Group continued its consolidation of the market, alongside other serial buyers including Fox Brothers, Briggs Equipment, Molson Group and RSK Group.

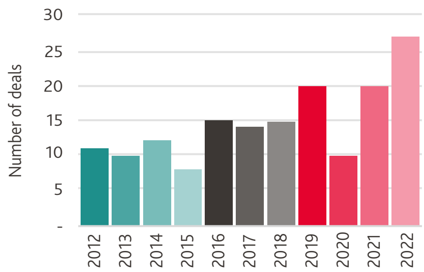
Average EV/EBITDA multiple **6.0x**
2012-2022



ROOF, CLADDING & INSULATION

Surge in deal volumes with 27 completions and multiples holding firm. Active corporates include Kingspan and Ibstock, while Marshalls entered the market with the acquisition of Marley for £535m.

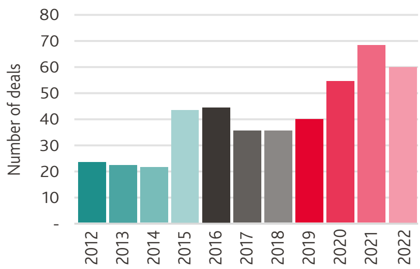
Average EV/EBITDA multiple **6.3x**
2012-2022



HVAC & PLUMBING

Deal volumes slipped back slightly in 2022, but valuations increased to 6.7x. Homeserve continued to consolidate the HVAC servicing market, while large deals included IMI's acquisition of Heatmiser for £118m and Aggreko's £365m acquisition of Resolute Parent in the US.

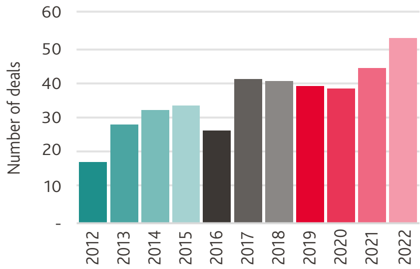
Average EV/EBITDA multiple **6.7x**
2012-2022



BUILDING MATERIALS

Last year saw 52 deals in building materials, an uptick of 18%. The sector also saw a slight increase in average multiples paid, reflecting the premium essential construction materials can attract.

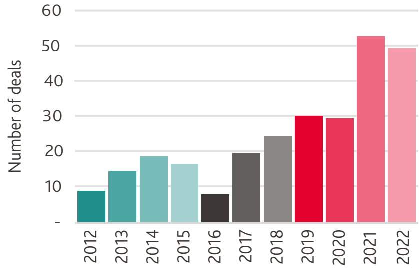
Average EV/EBITDA multiple **7.1x**
2012-2022



SECURITY & ACCESS

Deal volumes remain well ahead of pre-pandemic levels. A notable deal in 2022 was Allegion's $900m acquisition of Stanley Black & Decker's access technologies business. The sub-sector attracts the highest multiples: it includes innovative, connected businesses some with recurring revenue streams. Fire safety business are also highly sought after.

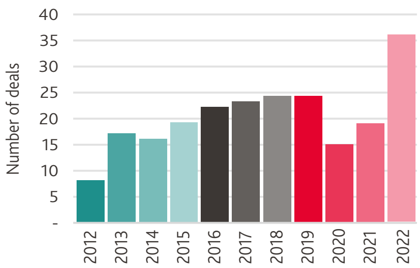
Average EV/EBITDA multiple **7.3x**
2012-2022



WINDOWS & DOORS

Huge uptick in transaction volumes in 2022, with numbers almost doubling. Moves by Swedish conglomerates into the UK market, with Indutrade, Storskogen and Lagercrantz all acquiring in the sub-sector.

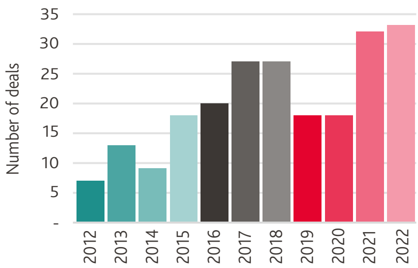
Average EV/EBITDA multiple **6.2x**
2012-2022



ELECTRICS & LIGHTING

Marginal increase in deal volumes and valuations increased slightly too. A notable increase in deals involving businesses supporting the energy transition, such as manufacturers of solar construction equipment and providers of electric vehicle charging installations.

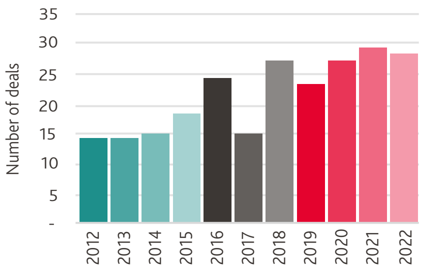
Average EV/EBITDA multiple **6.1x**
2012-2022



INTERIORS & SURFACE FINISHING

Stable deal activity in the sub-sector, with just a slight decline in 2022. Private equity continues to dominate with home improvement being a driver of volumes.

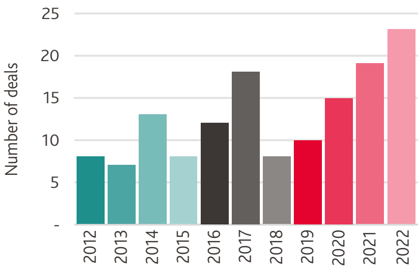
Average EV/EBITDA multiple **6.2x**
2012-2022



KITCHEN & BATHROOM

2022 saw the fifth consecutive year of deal volume increases. Engineered Stone Group continued its acquisition trail, while sizeable deals were completed by Norcros, which acquired Granfit Holdings for £92m, Fortune Brands, with its £130m acquisition of Aqualisa, and Wolseley's acquisition of Ideal Bathrooms from Saint-Gobain.

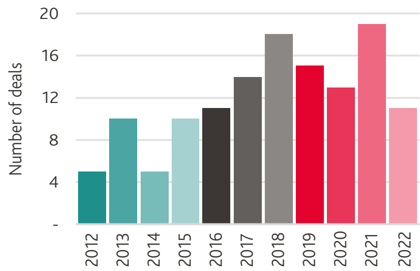
Average EV/EBITDA multiple **6.8x**
2012-2022



FLOORING & CARPET

Deal volumes declined in 2022, but multiples were maintained. Victoria and Likewise Group continued to make considered buys, and one of the larger deals in the year was the carve-out of Milliken's North American and European Mat businesses to US based M&A Matting.

Average EV/EBITDA multiple **6.4x**
2012-2022



Source: Experian MarketIQ, BDO analysis

INTERNATIONAL DEAL VOLUMES HOLD FIRM

THE GLOBAL M&A PICTURE

Following a spectacular 69% surge in global volumes in 2021, it was impressive to see worldwide deal activity holding firm in 2022.

Despite considerable market headwinds, the sector saw activity rise by 0.8% to 1,339 transactions.

MORE THAN **5,000 DEALS** IN THE LAST FIVE YEARS

DEAL VOLUMES UP **0.8%** IN 2022, WITH A RECORD **1,339** TRANSACTIONS WORLDWIDE

The US was the most active market, with 514 buyers and 542 sellers, representing 41% of global deals. The UK held on as the second most active market with a share of 26%. Together these markets accounted for the lion's share of activity, followed by Sweden in third place with a 5% share.

Volume increases were seen in Canada, France, the Netherlands and Italy, while markets including Sweden, Finland, Ireland and Spain saw a decline. There was a notable rise in cross-border activity, with 24% of deals attracting overseas buyers.

This is a significant increase on proportions seen in 2021 and reflects increasing appetite for international activity post-pandemic. Interestingly, there was a slight decline in domestic deals in both the US and UK markets, and it was the increase in overseas acquirers into these markets that propped up the overall figures.

In the US, 68 businesses were sold to overseas buyers in 2022, a rise of 74% on 2021, demonstrating the attractiveness of the country.

In the UK, buyers and sellers stepped up international deal activity, with 39 UK purchasers acquiring overseas businesses in 2022, up from 22 in 2021 – a rise of 77% – while 46 UK targets were sold in cross-border transactions, a 35% increase on the previous year.

Cross-border deal activity in European markets, which have historically attracted the highest proportions of international buyers, was more subdued in 2021. Elsewhere, Canada saw proportions rise to 55% and Australia saw a doubling in the number of targets sold to overseas buyers.

Buyouts dipped a little in the year, with this dynamic seen across all major markets. Pent-up demand from private equity investors following the pandemic has largely been deployed, with investment levels returning to normal levels.

The UK remains the strongest market for buyouts, where they represented 37% of activity in 2022. This compares with 12% in the US and 6% in Sweden, where trade transactions remain the norm.

BUYOUTS

2022 BUYOUTS:

19.0%

2021 BUYOUTS:

21.0%

CROSS-BORDER DEALS

2022 LEVEL:

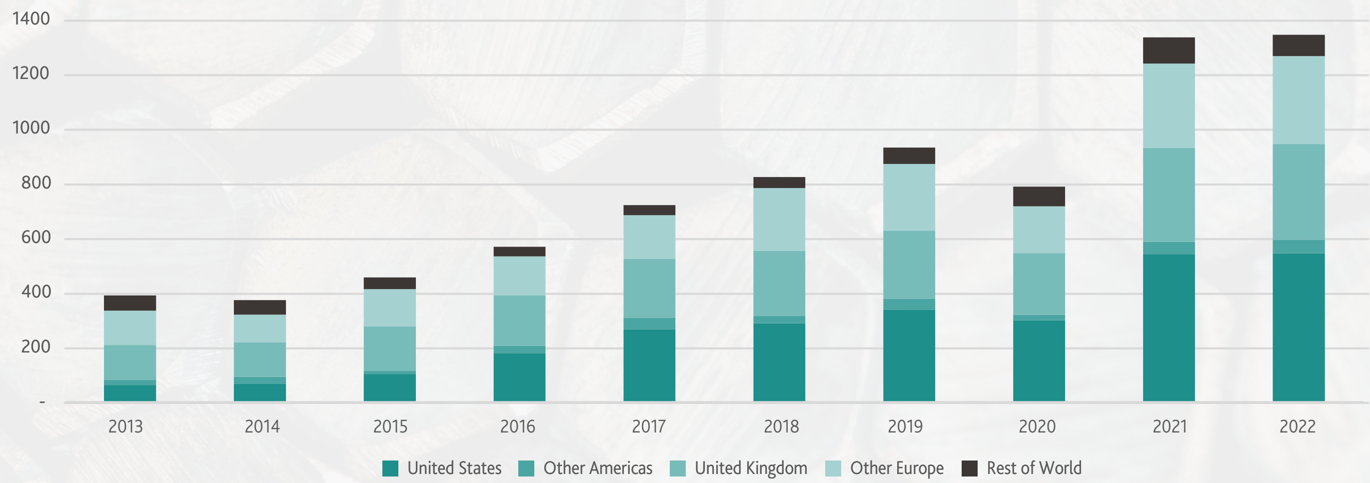
24.0%

2021 LEVEL:

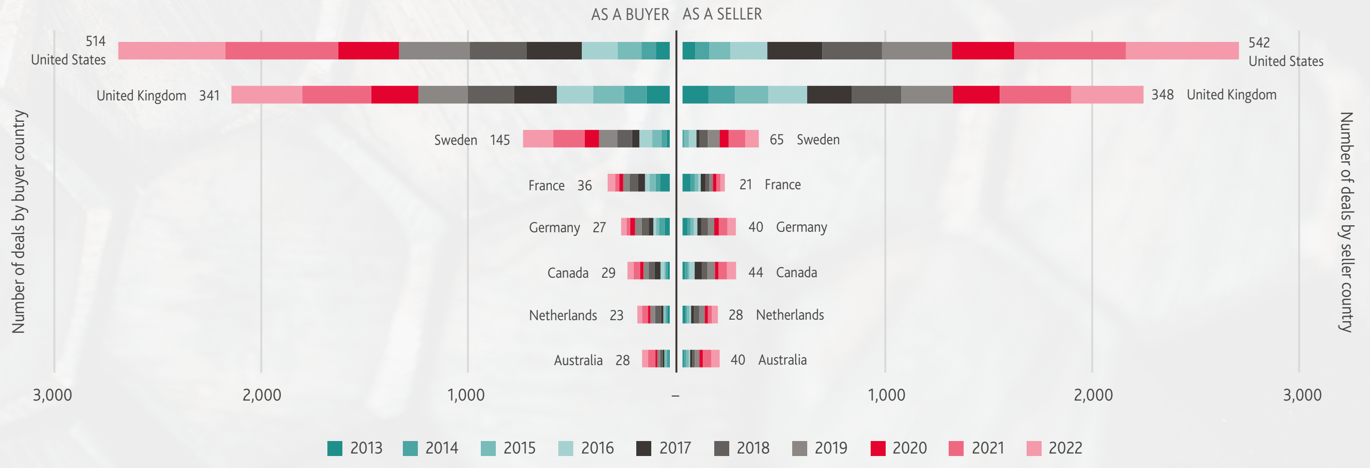
20.0%

GLOBAL DEAL VOLUMES, 2013-2022

YEAR ON YEAR GROWTH									
	-4.4%	22.0%	24.7%	26.9%	14.2%	13.2%	-15.4%	69.3%	0.8%



PRIMARY DEAL MARKETS



Source: Experian MarketIQ, BDO analysis

US ACTIVITY MODERATING FROM RECORD 2022 PACE

M&A IN NORTH AMERICA

Building Products & Services M&A activity in the US set a record in 2022, with 542 deals reported by target – an all-time high and slightly above the 538 deals reported in 2021.

However, looking more closely at the statistics, 2022 was a story of two halves, with the first half of the year continuing the unprecedented pace of activity set in 2021 while the second half of the year saw a significant moderation in the number of deals reported.

Much of the slowdown in activity was attributable to the first housing slowdown in the US in nearly a decade, as market participants assessed soaring inflation, rising interest rates and the looming prospects of an economic recession.

Stubborn and prolonged inflation is the root cause for much of the stagnation in M&A activity as market observers debated from month to month over the balance of 2022 on whether high prices had peaked and the Federal Reserve would pivot on rate policy.

Such sentiment caused buyers to take a more conservative stance on potential acquisitions and to adopt a 'risk-off' mentality to M&A – especially in sectors deemed cyclical, such as Building Products & Services.

To further put pressure on the Building Products & Services sector, US housing starts declined throughout 2022 as demand weakened, and prices declined. As would-be homeowners delayed home purchases due to higher mortgage rates and economic uncertainty, existing owners pursued renovation and maintenance work.

As a result, investors rewarded assets with exposure to the repair and renovation market, while increasing due diligence on companies focused on new residential construction. Conversely, commercial construction starts remained strong throughout 2022.

The tailwinds seen across the commercial construction market are due in part to delays during 2021 and first half of 2022 due to supply chain issues. That created a backlog of high-necessity work that continues to be worked through.

Industry participants remain cautious about the long-term strength of commercial construction activity as architects reported weakening billings to close out the year.

Cash-rich trade buyers in the Building Products & Services sector, less impacted by the raising interest rate environment, continue to pursue acquisitions to grow market share and as a path to deploying capital and creating shareholder value. Noteworthy US M&A deals led by trade buyers included:

- The Quikrete Company's acquisition of Forterra in a transaction valued at $2.75bn. Forterra is a manufacturer of water and drainage pipe products
- CRH's acquisition of Barrette Outdoor Living, a residential fencing business, for $1.9bn
- The acquisition of Emtek and Schaub door and cabinet hardware brands from Assa Abloy by Fortune Brands Innovations for $800m.

Private equity firms facing higher acquisition financing costs have become more selective of assets in the Building Products & Services sector, focusing on businesses less impacted by supply chain constraints and inflationary pressures, which have become difficult to forecast and value in the current environment.

Despite this, private equity firms continued to contribute to sector M&A volume. The sheer amount of private equity dry powder, combined with a booming economy and a liquid debt market, has increased activity.

Many private equity firms focused on the Building Products & Services sector subscribe to the longer-term secular thesis of a major housing shortage in the US as well as a mass relocation of the population fuelled by the fallout of COVID-19.

As a result, private equity buyers are seeking platform and add-on acquisition targets that include leading brands with established and growing market positions, innovative solutions and direct-to-consumer or direct-to-professional business models.

Notable private equity deals in 2022 included Clayton Dubilier and Rice's $5.4bn acquisition of exterior building products provider Cornerstone Building Products and the $3.8bn purchase of architectural hardware, glass and glazing systems manufacturer and distributor Oldcastle BuildingEnvelope from CRH.

A drop in public equity markets due to lower earnings expectations for North American corporates caused valuations for most companies to fall during 2022. At the same time, leverage multiples and the cost of debt has risen significantly in a short period of time, resulting in buyers having less access to attractive financing.

Given the continued fiscal tightening amongst central banks, most market participants are now pricing a moderate recession into valuation models.

The confluence of these factors has resulted in falling purchase price multiples and more structured deals, causing would-be sellers to remain on the sidelines until conditions moderate or improve.

Consequently, valuations in the Building Products & Services sector have contracted as the earnings and prospects of target companies continued to slow and the competition for deals abated.

“

OUTLOOK FOR 2023

While residential and commercial construction activity in the US remained robust at the start of 2022, growing supply disruptions, labour constraints and input costs exacerbated concerns for the Building Products & Services sector and impacted M&A for the balance of the year.

In 2023, would-be acquirers are assessing the severity of rising inflation and supply chain shortages on their existing operations – and could turn even more cautious with time.

Although most companies have been able to pass on cost increases, many have incurred at least a portion of the increase which has temporarily resulted in lower gross margins, dampening valuations and enthusiasm for deal-making.

Of greater concern for the industry is the potential impact of sustained high interest rates on housing demand and home improvement activity.

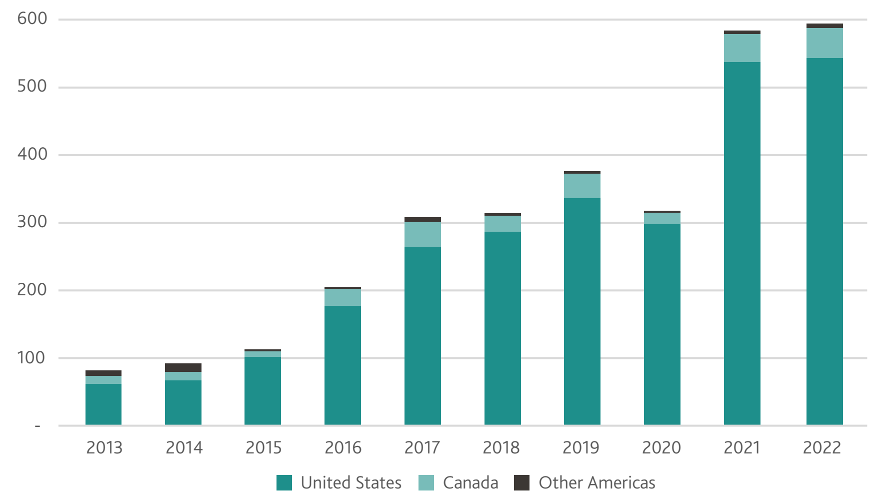
If interest rates continue to rise or remain elevated for a prolonged period, the result could be a fall-off in demand for goods and services in the sector.

This would negatively impact growth and profitability, resulting in still lower valuations and muted M&A activity.

Despite these concerns, the overall environment for deal-making in the Building Products & Services sector is still attractive and consistent with historical norms.

BOB SNAPE
M&A Partner, United States

NORTH AMERICA DEAL VOLUMES



Source: Experian MarketIQ, BDO analysis

US REMAINS THE BIGGEST CONTRIBUTOR OF **GLOBAL DEAL VOLUMES: 41% IN 2022**

542 DEALS BY TARGET, **A 0.7% YEAR-ON-YEAR INCREASE**

INCREASE IN CROSS-BORDER M&A TO 12.5% **OF DEALS, UP FROM 7.2% IN 2021**

DECREASE IN INVESTOR-BACKED DEALS: **12.4% BUYOUTS IN 2022, COMPARED TO 13.9% IN 2021 AND 17.1% IN 2020**

BUSINESS VOICES

“As we look ahead in 2023, we expect softening demand in most of our end markets.”

WILLIAM J CHIRISTENSEN
CEO, JELD-WEN Holding (international manufacturer of windows and doors)

UNITED STATES

“M&A activity within the Building Products & Services sector in the US was record-setting in 2022, but slowed as the year came to a close, given lingering concerns over inflation, the higher cost of capital and the severity of a potential economic recession.

Despite the headwinds facing the sector, we expect M&A in the US to remain active as lower valuations have made Building Products & Services deals more attractive to purchasers and longer-term investors.”

BOB SNAPE
M&A Partner
United States

ERIC HIGGINS
Managing Director
United States

CANADA

“Canadian M&A activity within the Building Products & Services sector maintained its elevated level of activity from 2021 through 2022, seeing a further increase of 8% in deal activity to set a new ten-year watermark of 44 transactions.

Robust consumer demand, combined with elevated levels of liquidity, drove market participants to be active across a variety of sub-sectors, with cross-border deals making up 55% of the volume.

A material shift in the market, starting in the second half of the year and persisting into 2023, is expected to impact deal volume moving forward, with the past couple of years of high activity being replaced with more measured opportunistic and highly strategic activity.”

RYAN FARKAS
Managing Director
M&A and Capital Markets, Canada

BDO CAPITAL CASE STUDY

Sale of Synergi, LLC to
Eureka Equity Partners

SYNERGi

SALE TO

EUREKA
EQUITY PARTNERS

BDO Capital senior investment bankers involved in this transaction

BOB SNAPE
President

PATRICK BISCEGLIA
Managaing Director

THE TRANSACTION

- BDO Capital served as exclusive financial advisor to Synergi LLC on its sale to Eureka Equity Partners, a leading private equity firm.

COMPANY BACKGROUND

- Synergi is a tech-enabled engineering and construction services company that designs, fabricates and installs architectural stairs, railings, windscreens and ornamental metals for landmark properties across North America
- Syenrgi has built a leading reputation and recurring, blue-chip customer base with exceptional platform diversity and a nationwide presence
- Synergi's scalable, demand-driven business model and proprietary design-assist process was purpose-built to consolidate the market and capitalise on some of the fastest growing design trends being embraced by customers such as Amazon, Capital One, Ford, Gensler, Google, Kaiser, Meta, Microsoft and others.

THE TRANSACTION PROCESS

- BDO Capital prepared a confidential information memorandum, identified and contacted a targeted list of potential investors, negotiated the transaction on behalf of Synergi and led the sale process from start to finish
- CEO Jim Admiraal said: "We interviewed several leading investment banks at the start of this process and ultimately selected BDO Capital due to the unique global reach of its platform, commitment to senior banker involvement [and] appreciation for the key value drivers of our business and how best to communicate those."

SUCCESSFUL OUTCOME

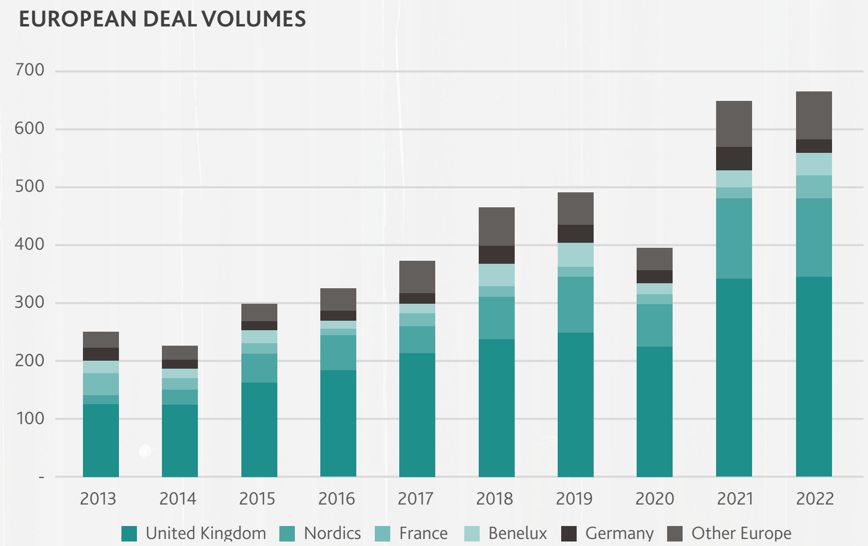
- "BDO Capital delivered an exceptional outcome for our shareholders, management team and entire organisation," Admiraal said. "This transaction allowed us to expand our ownership group to include more key leaders in the organisation and to add the expertise required to take Synergi to the next level."

UK: EUROPE'S TOP MARKET FOR M&A

M&A IN EUROPE

Europe accounts for 50% of global transactions in Building Products & Services, with half generated by the UK.

Activity levels held firm across most European markets, with the Nordics and Germany seeing marginal dips, and strong growth in France and the Benelux region.



Source: Experian MarketIQ, BDO analysis

UNITED KINGDOM

In spite of a difficult and unpredictable market, transaction volumes in the UK market remained resilient in 2022. There is strong underlying demand in the sector, which continues to defy market headwinds.

Although it's taking longer to complete a deal currently due to the uncertain outlook, we see no shortage of deals coming to market. Market volatility is leading businesses to examine their portfolios and entrepreneurs to look closely at their positions, resulting in a rise in potential opportunities.

And private equity continues to find ways to do deals. We have seen an element of modest restructuring of deal terms to help bridge value expectations and achieve strategic objectives for buyers and sellers.

The popularity of earn-out structures continues – amidst ongoing economic uncertainty – with parties using these mechanisms to ensure a fair reflection of value and risk.

We could potentially see a busier second half in 2023 as businesses start to look ahead to the prospect of political change in 2024 and the potential for a clamp down on capital gains tax, which could impact entrepreneurs.

JOHN STEPHAN
Partner
BDO Building Products & Services M&A

CPA OPINION

Despite the improvement in the outlook for the UK economy compared to six months ago, falling real incomes and interest rate rises remain.

For construction, the most acute effects of this will be felt in the two largest sectors of activity and those that are most exposed to a slowdown in discretionary household spending: private housing and private housing RMI.

In previous years, infrastructure activity has helped cushion falls elsewhere, but delays to HS2 work and major road schemes have weakened near-term prospects. The falls that are forecast for housing in 2023 mean that overall a construction recession will be unavoidable.

However, it is important to emphasise that the starting point is a record-high level of activity and the contraction expected is smaller than during the construction recessions of 2008-09, 2012 and 2020.

Growth is expected to return in 2024 as a wider recovery boosts demand for new-build housing and RMI.

BDO UK CASE STUDY

Sale of Dorsey Construction to Röko AB

DORSEY CONSTRUCTION MATERIALS

SALE TO

RŌKO

BDO UK senior team involved in this transaction:

JOHN STEPHAN
Partner

MATTHEW GOODLIFFE
Director

THE TRANSACTION

- BDO served as exclusive financial advisor to Dorsey Construction Materials Limited ('Dorsey' or the 'Company') on its sale to Röko AB, a Swedish perpetual owner of small and medium-sized businesses in a variety of industries across Europe.

COMPANY BACKGROUND

- Dorsey is a market leading specialist B2B distributor of construction accessories, principally to housebuilders and brickwork contractors
- The business has experienced strong growth over recent years, which was historically focussed on the South East of the UK, but has an expanding geographic spread across the UK
- Success has been driven by a strong brand developed through years of focus on delivering exceptional service and reliability, along with a wide one stop shop product range and innovative own design products.

THE TRANSACTION PROCESS

- BDO ran a streamlined process, ensuring the business was well prepared for sale and the detail of buyer due diligence. BDO provided a full service offering from preparation through to completion, with the business being marketed to a targeted list of potential investors, aided by the team's sector knowledge and buyer intelligence.

SUCCESSFUL OUTCOME

- The transaction delivered a highly successful outcome for the shareholders, ongoing management team and employee base

"Having no previous M&A experience going into this process, the shareholders were looking for an adviser that could carefully guide us through its complexities and find us an acquirer that could help support Dorsey with the next stage of its journey.

BDO were excellent at achieving both of these goals and successfully steered us through the twists and turns of the process.

We had senior team involvement throughout who were responsive and very diligent in their work and produced some excellent marketing material.

Their sector knowledge and contacts were also a great use and they brought a number of new parties to the table (UK & International) that we would not otherwise have had access to. We would not hesitate to recommend the team."

HOWARD BIRD
Managing Director and Shareholder, Dorsey Construction Materials Limited

SWEDEN

Sweden maintained its position as the world's third most active M&A market for Building Products & Services, registering 11% of global transactions in 2022 based on buyer activity.

Sweden continued to be heavily weighted as a buying market, with 145 deals completed as a buyer and 65 as a seller, and 60% of targets acquired by Swedish buyers were overseas. The deal activity continued to increase during the first half of 2022.

Due to a rapid turnaround in economic conditions in late spring, both in Sweden and in the rest of the world, deal activity slowed down in the second half of the year, recording a 29% decrease compared to the second half of 2021.

The Swedish M&A landscape is dominated by serial corporate acquirers such as Assa Abloy, Atlas Copco, Assemblin, Bravida Holding, Fasadgruppen Group, Indutrade, Instalco, Lifco, Lindab, Storskogen, Sweco, Teqt Group AB and Vestum, all completing multiple acquisitions in the year.

While several serial buyers have significantly slowed or paused their M&A activity, there is continued strong consolidation in many sub-sectors, such as the installation market.

Although total investments in the Swedish construction sector continued at high levels in 2022, housing starts and building permits for residential properties plummeted from around 68,000 and 77,000 units to 54,000 (-21%) and 57,000 (-25%), respectively, between 2021 and 2022.

In 2023, construction investments are expected to decline by 14%, driven primarily by a drop in residential construction due to falling housing prices, rising interest rates and increased construction costs.

CLAES NORDEBACK
M&A Partner, Sweden

FRANCE

The French construction market was strongly affected by the COVID-19 crisis and is still having to cope with the effects of the war in Ukraine, including shortages and disruptions in the supply of materials, and ongoing cost increases.

Demand is also weakened by the economic context: inflation, reduced purchasing power, rising housing prices and more difficulties in accessing credit due to rising interest rates and High Council for Financial Stability limitations on the duration of loans and debt rates.

As a result, the solvency of households, particularly first-time buyers, has deteriorated. The housing market saw a positive year in 2022, with rising housing starts over the first eight months of the year.

However, the market is expected to decline in 2023 due to the deteriorated macroeconomic and financial environment.

We think the new housing market could return to a positive level in 2024 as inflation normalises. Meanwhile, the renovation market should be quite dynamic over the forecast horizon, boosted by the MaPrimeRenov' scheme.

As for non-residential buildings, permits and starts were up 5% and 13% respectively in 2022. The increase in permits reflects a rebound following COVID restrictions in 2021. Compared to 2019, starts are down by 6%.

For 2023, the outlook is positive but has been downgraded to reflect the context described above.

As regards production, 2022 benefited from the flow of building sites initiated since the end of 2020 but the rate should drop in 2023 (2.4%) and in 2024 (1.9%). The hysteresis effect of the current context is expected to weigh on the next two years.

Civil engineering output is expected to exceed the last two years, but not reach the high levels of 2019. In 2022, output slowed by 2% and was subject to many uncertainties. From 2023 to 2025, activity is expected to grow at a moderate rate of 1.4% in volume per year.

It was an active year for M&A in 2022, with 36 deals involving French buyers (compared to 20 in 2021), even if a drop off occurred in the fourth quarter. The biggest deal was by Bouygues which took over Equans from Engie for €6.1bn. Active acquirers included Saint-Gobain, Sonepar and TSG.

PASCAL MARLIER
Advisory Partner, France

GERMANY

The German construction market has faced challenges in recent years, including interest rate hikes, drastic price increases across and ongoing shortages in many verticals. The 2023 outlook for the German construction market is negative, forecasted within a range of -2% to -7% year on year.

While 2022 benefited from strong order books, cancellation rates are high and order entry is low. The most robust sector is public construction, contrasting with residential.

This is expected to be severely hit, with forecasts ranging from -2% to -10% in 2023, year on year.

However, there are some hotspots of activity, especially in the RM&I market. Upcoming regulation will benefit manufacturers and installers of energy-saving materials and systems, including insulation, window systems and heat pumps.

The M&A market has seen stable levels of deal activity, albeit there was a decline in transactions in the fourth quarter which may herald a more subdued outlook.

The German market remains attractive to overseas investors, with 58% of Germany targets sold to international buyers in 2022.

HANS-JÜRGEN RONDORFF
M&A Partner, Germany

NETHERLANDS

Building activity in the Netherlands has been under pressure the past decade, mainly fuelled by national policies pressuring agricultural and other sectors and businesses to decrease nitrogen levels in the atmosphere.

Besides the agricultural sector, the construction sector is seen as a key contributor to atmospheric nitrogen levels, and because of ongoing public pressure, interest in the takeover of such companies has been lower than previously. Recently, interest for construction companies has picked up again to pre-pandemic levels, especially given the large housing need and corresponding high prices in the Netherlands – albeit that these are coming down somewhat due to interest rate rises.

The public debate is shifting from nitrogen control to the need for more affordable housing, especially for first time buyers, and government is adjusting legislation to address this. Construction prices have been rising rapidly however, due to raw material price increases and good staff being extremely scarce.

Acquisition demand remains strong for companies that have a distinguishing focus or specialisation. There also remains broad interest from a growing number of international private equity investors. Of particular interest are technical servicing and maintenance capabilities – for large property owners and housing associations – and installation companies, where consolidators keep looking to buy many smaller players, thereby creating national and sometimes international players via a buy-and-build-strategy.

JOOST COOPMANS
M&A Partner, Netherlands

EUROCONSTRUCT OPINION

Risks and uncertainties are impeding the growth of the European construction market. Construction output increased by 3% in 2022 and is forecast to decline by 1.1% in 2023 and by 0.7% in 2024. This is a decline compared to the previous forecast of 0% stagnation in 2024. Recovery is not expected until 2025.

Civil engineering is forecasting a positive output as many countries invest in low-carbon energy and renovate existing infrastructure, but other sectors are expected to decline. Much of the negative outlook is driven by the new housing and residential renovation sectors.

The era of low interest rates led to a boom in new-build housing across Europe, but the situation has changed substantially in the past six months. Housing sales have slowed down, consumer confidence has dropped and there is now oversupply in many countries. Mortgage interest rates have doubled in most European countries in 2022 and tripled in Finland, Slovakia, Switzerland and the UK.

Italy saw the strongest growth in Europe in 2022, with 12.4% increase in output, driven in part by EU subsidies.

With the exception of France, Ireland, Portugal and Spain, all other European countries in the EC-15 face a negative construction output growth cycle in 2023.

In 2024, ten countries are forecast to turn to growth, while five remain in negative growth or stagnate. Germany faces the deepest decline, and a negative outlook for growth through to 2025.

M&A DIPS IN REST OF WORLD, BUT STILL AHEAD OF 2020

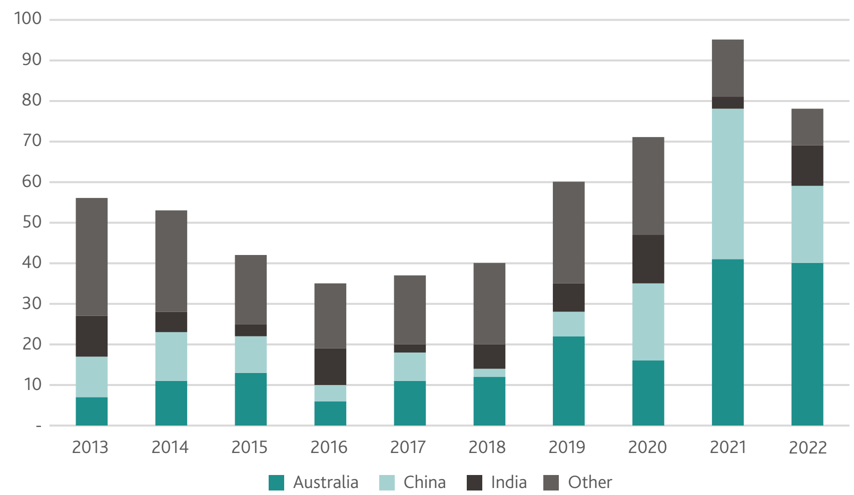
BEYOND EUROPE AND NORTH AMERICA

Deal activity outside Europe and North America declined by 18% in 2022.

China saw the biggest decrease in volumes, while Australia saw only a marginal decline. In contrast, India saw volumes rise threefold.

Government stimulus programmes are underway in China and India, which should boost activity in the Building Products & Services sector in coming years.

REST OF THE WORLD DEAL VOLUMES



Source: Experian MarketIQ, BDO analysis

AUSTRALIA

M&A activity in the Australian Building Products & Services sector remained strong in 2022 compared to the prior year, despite challenging operating conditions as COVID-19 stimulus programs ended and construction and labour costs increased. Strategic acquirers continued to drive deal volume.

These included listed players such as MAAS Group Holdings, which completed three acquisitions of construction materials and engineering companies. International strategic players also remained active as they sought to gain vertical integration capability, access to technology and labour expertise – of significant importance given a tight local labour market.

Whilst the outlook for the residential construction market looks to be softening and will likely increase the levels of distressed M&A in this space, construction activity (both public and privately funded) across infrastructure, defence, energy projects and manufacturing is expected to remain strong. This will continue to make Australian companies attractive as targets for overseas companies wanting to enter or expand into the market.

ANDREW MCFARLANE
M&A Partner, Australia

CHINA

Cross-border M&A activity in Building Products & Services in China declined in 2022, with 18 deals completed in the year, compared with 37 deals in the previous year.

In 2022, China experienced a slowdown in homebuilding, a sharp decline in property sales and increases in mortgage repossessions. China launched initiatives in early 2023 to revive its real estate market.

This includes a pilot programme in February 2023 which will allow qualified private equity investors to raise funds for investment in residential and commercial real estate markets, as well as in infrastructure projects in China.

Licensed foreign investors are also encouraged to invest in these funds, via a qualified foreign limited partnership programme.

Some improvements have been reported in China's housing market after the launch of these measures.

Therefore, a slow recovery in China's Building Products & Services market is expected in 2023, but market uncertainty will likely continue for this year.

KENNETH YEO
Advisory Partner, China

INDIA

The International Monetary Fund has projected that India will be one of the fastest-growing among the world's large economies in 2023. A resilient economy coupled with increased allocation to capital expenditure by the government, to approximately US$130bn, is expected to boost the real estate and infrastructure sector.

The Indian building materials industry is poised for significant expansion, with several favourable factors continuing to contribute to its growth. These tailwinds include rising urbanisation, greater discretionary spending, a good monsoon and advances in innovation and technology.

The Indian capital markets have performed well, allowing stronger brands to raise capital. Further, major domestic and international companies are looking for consolidation opportunities and are likely to pursue aggressive inorganic growth strategies.

Significant investment in infrastructure, availability of skilled manpower and various government schemes like production-linked incentives (PLI) for ease of doing business in India and various financial incentives, makes India an attractive destination to foreign investors to consider India as a sourcing hub.

MAULIK SANGHAVI
Partner, India

AUSTRALIAN CONSTRUCTORS ASSOCIATION (ACA) OPINION

Construction in Australia is a key contributor to the economy, as the country's fourth largest industry, employing one in ten of the working population and contributing 7% of GDP.

A recent announcement proposing a review of the Federal Government's AUD$120bn investment in state infrastructure projects is concerning to businesses in the sector and could result in significant cancellations and deferrals.

The ACA is calling for a steady and transparent pipeline of government infrastructure projects to allow the industry to plan and invest for the future.

This is particularly important at a time where the sector accounts for 26% of all business insolvencies and estimates a 214,000 shortfall in workers.

DELIVERING SERVICE THAT EXCEEDS EXPECTATIONS

BDO ADVISORY SERVICES

The BDO brand is about exceptional client service delivered by empowered people.

Nothing is more important to us than our clients.

Our aim is to be the market leader for service delivery in our profession, with a brand that stands for quality, service and exceeding client expectations.

WHICH QUESTIONS ARE ON YOUR MIND...?

Talk them over with our expert advisers – we offer a full spectrum of advisory services to help you succeed.

- How can I grow my business and what options are there?
- How can we make the most of the market opportunities?

- Is an IPO a good option for our business?
- What is my business worth?

- How should we reshape our business?
- How should we plan for growth?

- How can I manage the risks in my supply chain?
- How should we navigate the R&D tax regime?

- What acquisitions should we make?
- How can I access funding?

- What should we be doing to deliver ESG?
- How should we evidence sustainability claims?

- Who would be interested in buying our business?
- How could private equity investment help our business?

NO 1 GLOBAL FINANCIAL ADVISOR

- 2,500 corporate finance professionals globally
- We are global leaders in the M&A market, focused on maximizing value for our clients
- We are proud of our broad and deep sector experience, which drives demonstrable results.

INTEGRATED ADVISORY SERVICES

M&A - Strategy - Commercial due diligence - Growth advisory - Financial modelling - Value creation services - Transaction services - Fundraising - Debt advisory - Acquisition search - Plc advisory - Private equity advisory - Turnaround services - Sustainability & ESG consulting - R&D tax services - Supply chain consulting and much more.

BDO IS RANKED **No.1** GLOBAL FINANCIAL ADVISOR

(Experian & Pitchbook league tables, 2022)

BUSINESS VOICES

BDO Corporate Finance supported Hill & Smith Holdings plc throughout the part sale of a Swedish subsidiary.

The multi-jurisdictional BDO team worked well with the Hill & Smith Holdings team and local Swedish management through all stages of the deal, resulting in a sale to a Swedish subsidiary of a French group.

BEN GRIFFITHS
Corporate Development Senior Manager, Hill & Smith Holdings, on carve-out of ATA Hill & Smith to Loxam business Ramirent

BUSINESS VOICES

The BDO team were extremely supportive throughout this transaction, helping prepare the business through all the steps of the process up to completion of the deal.

Their deep understanding of the sector meant they represented the business knowledgeably and quickly identified a strategic buyer that is a great fit for the business. I would highly recommend them to any business owner who is considering selling their business.

MICHAEL BROUGHTON
Joint Managing Director, Michael Broughton, on sale to Lifco

THE BDO BUILDING PRODUCTS & SERVICES TEAM HAS COMPLETED MORE THAN **600 DEALS** IN THE LAST **THREE YEARS**

QUALITY ADVICE WHERE IT MATTERS

SERVING BEYOND EXPECTATIONS: A REVIEW OF RECENT DEALS

Here are just a few recent Building Products & Services sector corporate finance deals where we have advised our clients.

BDO COMPLETED **229** DEALS IN THE SECTOR IN **2022** A RISE OF **8%**

ADVISOR ON MORE THAN **600** SECTOR TRANSACTIONS IN THE LAST **3** YEARS

MANUFACTURING	**ACQUISITION OF ARRAN ISLE BY ASSA ABLOY** — Manufacturer of door and window hardware	**SALE OF STEINFORM KISTLER** — Manufacturer of kitchen countertops	**SALE OF JF METAL TO PHYXIUS** — Manufacturer of metal structures
MANUFACTURING	**ACQUISITION OF WISCHEMANN BUSINESSES BY EWALD DÖRKEN** — Thermoformed plastic building products	**SALE OF AISLENVAS TO BEWI** — Manufacturer of expanded polystyrene insulation	**ACQUISITION OF TACFOR BY NORTHERN COUNTOURS** — Veneer wrapped mouldings for kitchen cabinets, windows and doors
DISTRIBUTION	**SALE OF DORSEY CONSTRUCTION MATERIALS TO ROKO** — Specialist distributor of construction accessories	**ACQUISITION OF MINKA LIGHTING BY FERGUSON ENTERPRISES** — Lighting and fan wholesaler	**ACQUISITION OF SV TIMBER BY NATIONAL TIMBER GROUP** — Timber merchant
SERVICES	**SALE OF BROUGHTON HIRE & SALES TO LIFCO** — Specialist hire serving mechanical, electrical and fire protection industries	**ACQUISITION OF SCHAHLLED LIGHTING BY FW THORPE** — Intelligent lighting solutions, including lighting as a service	**SALE OF HILL & SMITH SUBSIDIARY ATA HILL & SMITH TO LOXAM GROUP** — Road safety rental business
SERVICES	**MAJORITY STAKE INCHARTWAY GROUP BY CABOT SQUARE** — Housebuilder and construction contractor	**ACQUISITION OF SIX EQUIPMENT RENTAL BUSINESSES BY EMPOWER RENTAL GROUP** — Equipment rental	**ACQUISITION OF ALPINE FIRE TOPCO BY WESTBRIDGE** — Design and maintenance of complex fixed fire suppression systems

ACQUISITION OF THREE BATHROOM PRODUCT MANUFACTURERS BY THE ENGINEERED STONE GROUP

Manufacturers of solid surface shower trays and washbasins

SALE OF TEMATI TO IPCOM

Manufacturer of insulation products

ACQUISITION OF CHARCOOL HEATING & COOLING BY HIDDEN HARBOR CAPITAL PARTNERS

Manufacturer of HVAC equipment

SALE OF SAINT-GOBAIN SUBSIDIARY GLASSOLUTIONS TO SEMCOGLASS

Manufacturer of flat glass products

SALE OF THURSTON GROUP TO HLD GROUP

Design and manufacture of modular buildings

ACQUISITION OF FIBERLINE COMPOSITES BY GURIT HOLDING

Manufacturer of pultruded composites profiles in glass and carbon

ACQUISITION OF 70% STAKE IN SAFETY LINK BY DELTA PLUS GROUP

Manufacturer of worker fall protection systems

ACQUISITION OF JORO TÜREN BY EWALD DÖRKEN

Manufacturer of innovative doors

ACQUISITION OF TERÄSTORNI BY VOLATI

Manufacturer of boilers and towers

SALE OF SOLATUBE INTERNATIONAL TO KINGSPAN GROUP

Manufacturer of tubular daylighting devices

ACQUISITION OF SIX DISTRIBUTORS BY GRUPO SIETE CONSTRUCCIONES

Building product distributors

ACQUISITION OF KENT BLAXILL GROUP BY PAINTWELL

Supplier of building materials

ACQUISITION OF PPC BY NEWPORT CAPITAL

Merchant specialising in parquet flooring

ACQUISITION OF BUILDING PRODUCTS OF AMERICA BY EMPOWER RENTAL GROUP

Distributor of fasteners and other building material products

ACQUISITION OF CENTRO ALUM BY CORIALIS INTERNATIONAL

Distributor of home improvement products

ACQUISITION OF ONE SOURCE EQUIPMENT RENTALS BY H&E EQUIPMENT SERVICES

Equipment rental

CARVE-OUT SALE OF IMPLENIA SCHALUNGSBAU TO PERI VERTRIEB DEUTSCHLAND

Formwork solutions

ACQUISITION OF ODERMATT GROUP BY POLYGON

Window repairs and replacement

SALE OF BELCOTEC TO WESTFA HOLDING

Design and implementation of HVAC and electrical installations

SALE OF HARMONIE TO SMRD-BAT92 AND ANDERA PARTNERS

Thermal insulation specialist

ACQUISITION OF BMS GLOBAL SERVICES BY POLYGON

Decontamination and renovation of damaged sites

ACQUISITION OF JUDD FIRE PROTECTION BY HIDDEN HARBOR CAPITAL

Installation and service of HVAC and fire protection systems

ACQUISITION OF VISTA ECO SOLAR SOLUTIONS BY DESERT TECHNOLOGY

Installation of solar panels

ACQUISITION OF INVENT BY CAG GROEP

Advisor in air and water quality and hygiene in buildings

ACQUISITION OF HEINZ SCHULLER BY LIFCO GROUP

Supports construction projects with cable support, line and pipe systems

DELIVERING SECTOR INSIGHT AND THOUGHT LEADERSHIP

EXPERTS IN THE SECTOR: YOUR UK & INTERNATIONAL TEAM

Our Building Products & Services team was established to work with leading midmarket privately owned businesses and private equity firms that, like us, believe strongly in the opportunities available in the sector.

With deep expertise in the sector, we understand company strategy, market and commercial drivers and have advised private equity and portfolio companies at all stages of the investment life cycle.

YOUR UK M&A CONTACTS

JOHN STEPHAN
PARTNER | SECTOR CO-LEAD
+44 (0)797 970 6731
john.stephan@bdo.co.uk

ALAN CHAN
DIRECTOR
+44 (0)780 068 2871
alan.chan@bdo.co.uk

MATTHEW GOODLIFFE
DIRECTOR
+44 (0)780 068 2418
matthew.goodliffe@bdo.co.uk

MATTHEW HOCCOM
ASSOCIATE DIRECTOR
+44 (0)782 706 3209
matthew.hoccom@bdo.co.uk

SUSANNAH PERKINS
ASSOCIATE DIRECTOR
+44 (0)780 068 2066
susannah.perkins@bdo.co.uk

EMMA LEVELLE
RESEARCH ANALYST
+44 (0)121 352 6236
emma.levelle@bdo.co.uk

IVA GRIGORAS
RESEARCH ANALYST
+44 (0)753 358 3274
iva.grigoras@bdo.co.uk

STRATEGY & CDD CONTACTS

DANIEL GUTTMANN
STRATEGY & CDD PARTNER
+44 (0)739 300 2560
daniel.guttmann@bdo.co.uk

RUSTEM ZAGRETDINOV
DIRECTOR
+44 (0)778 847 4991
rustem.zagretdinov@bdo.co.uk

MINGLUN DAI
CONSULTANT
+44 (0)739 326 7127
minglun.dai@bdo.co.uk

FURTHER KEY CONTACTS

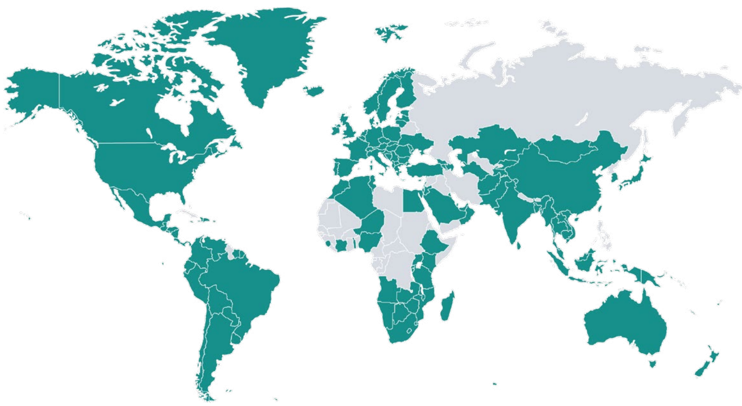
SIMON PRINGLE
HEAD OF SUSTAINABILITY AND ESG ADVISORY
+44 (0)740 787 3412
oliver.back@bdo.co.uk

CONOR MANSFIELD
ASSOCIATE DIRECTOR, INNOVATION AND TECHNOLOGY
+44 (0)798 570 4994
conor.mansfield@bdo.co.uk

ROSS MCDONALD
HEAD OF DEBT ADVISORY
+44 (0)777 912 4664
ross.mcdonald@bdo.co.uk

STEPHEN COONEY
PRINCIPAL, VALUE CREATION SERVICES
+44 (0)797 643 0648
stephen.cooney@bdo.co.uk

FRASER PAGET
HEAD OF SUPPLY CHAIN AND LOGISTICS SERVICES
+44 (0)779 592 6381
fraser.paget@bdo.co.uk



YOUR INTERNATIONAL CONTACTS

AUSTRALIA
ANDREW MCFARLANE
M&A PARTNER
+61 292 409 895
+61 417 494 475
andrew.mcfarlane@bdo.com.au

AUSTRIA
BERND WINTER
M&A AND TAX PARTNER
+43 153 737 406
+43 664 800 37 406
bernd.winter@bdo.at

BELGIUM
ALEXI VANGERVEN
M&A PARTNER
+32 11 286 060
+32 479 408 490
alexi.vangerwven@bdo.be

CANADA
RYAN FARKAS
M&A MANAGING DIRECTOR
+1 416 775 7804
+1 416 577 4953
rfarkas@bdo.ca

CHINA
KENNETH WONG
PRINCIPAL, SPECIALIST ADVISORY SERVICES
+852 2218 8487
kennethwong@bdo.com.hk

DENMARK
NIELS SCHIANDER
M&A DIRECTOR
+45 391 552 00
+45 507 015 05
nsc@bdo.dk

FRANCE
PASCAL MARLIER
PARTNER – BDO ADVISORY
+33 170 372 301
+33 630 994 806
pascal.marlier@bipe.fr

GERMANY
HANS-JÜRGEN RONDORFF
M&A PARTNER
+49 699 594 1118
+49 151 5254 4476
hans-juergen.rondorff@bdo.de

INDIA
SAMIR SHETH
PARTNER, DEAL ADVISORY
samirsheth@bdo.in

IRELAND
KATHARINE BYRNE
M&A PARTNER
+353 147 00524
+353 863 844 534
kbyrne@bdo.ie

ITALY
STEFANO VARIANO
M&A PARTNER
+39 025 820 1152
+39 335 364 439
stefano.variano@bdo.it

NETHERLANDS
JOOST COOPMANS
M&A PARTNER
+31 402 698 168
+31 651 428 181
joost.coopmans@bdo.nl

SPAIN
JUAN VEGA DE SEOANE PALLARES
M&A DIRECTOR
+34 917 022 212
+34 675 540 768
juan.vegaseoane@bdo.es

SWEDEN
CLAES NORDEBÄCK
CORPORATE FINANCE PARTNER
+ 46 812 011 894
claes.nordeback@bdo.se

SWITZERLAND
JÜRG GLESTI
M&A PARTNER
+41 444 443 593
juerg.glesti@bdo.ch

UNITED STATES
ERIC HIGGINS
MANAGING DIRECTOR
+1 978 761 8111
ehiggins@bdocap.com

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2,095 COMPLETED DEALS IN 2022

WITH A TOTAL DEAL VALUE OF **$114.6bn**

38% PRIVATE EQUITY DEAL INVOLVEMENT

26% OF OUR DEALS ARE CROSS BORDER

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*1st Financial Advisor Globally by volume – Factset league tables 2022
1st most active Advisor & Accountant Globally 2021 – Pitchbook league tables 2021
2nd leading Financial Due Diligence provider Globally – Mergermarket global accountant league tables 2022

FOR MORE INFORMATION:

JOHN STEPHAN
john.stephan@bdo.co.uk

ALAN CHAN
alan.chan@bdo.co.uk

MATTHEW GOODLIFFE
matthew.goodliffe@bdo.co.uk

DANIEL GUTTMANN
daniel.guttmann@bdo.co.uk

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