

Engineering & construction industry outlook Canada

1H2022



Now, for tomorrow



Executive summary

Now in the middle of 2022, the Engineering and Construction industry has performed well during a pandemic recovery period. The industry's M&A activity has returned to an upward trend which has demonstrated resiliency and contributed to positive views towards the industry's outlook.

Canadian infrastructure

Our country's infrastructure program, the Investing in Canada Plan, continues to grow. As of February 2022, over 78,000 projects valued at \$118 billion were approved. 98% were either completed or still in progress¹. Although investment in nonresidential and commercial construction has slowed, we expect increased project productivity on existing work given the favourable weather conditions. From 4Q2021 to 1Q2022, the total value of building permits from all types had also increased by +23.7%². With strong building permit data, the Canadian construction industry's growth is anticipated to expand by +4% in real terms in 2022³.

Growing investment from the federal government will continue to bolster demand for construction and engineering services in Canada. The Investing in Canada Plan has continued to invest in five streams: i) public transit (\$28.7 billion), ii) green infrastructure (\$26.9 billion), iii) social infrastructure (\$25.3 billion), iv) trade and transport (\$10.1 billion), and v) infrastructure for rural and northern communities (\$2.0 billion). They will be areas with recurring demand⁴. Historically, the demand for infrastructure has outpaced investments for many decades. As a result of Canada's infrastructure gap, challenges emerged, such as infrastructure related to transportation and trade. 60% of Canada's GDP is tied to international trade⁵ so trade infrastructure affects the ability of Canadian businesses to compete in a global economy. Investment in this area will be a priority in the coming years as the current transportation infrastructure will not meet future needs.

Recent E&C acquisitions

There were acquisitions of tech-enabled companies for the purpose of digitalization last year. In the current period, acquisitions of technical capabilities were commonplace, such as BM Group of Companies' acquisition of LF Steel Fabricators Ltd. (June 2022). BM Group already had an existing portfolio of construction, project management, material supply, and land development companies. The acquisition of steel fabricator LF Steel Fabricators will allow BM Group to enter a new industry while enabling it to take on a larger and wider array of repair and restoration projects⁶.

Canadian deal market summary

In 1H2022, there were 201 private equity deals, representing \$25B of capital invested in transactions, and a total of 730 M&A deals, representing \$115B of capital invested in transactions. Thus far, deal volumes have slowed while the total capital invested per quarter remained stable for Canadian deals since 4Q 2021⁷. In summary, despite labour shortages, a rise in material prices, and a series of interest rate hikes, the industry has shown resiliency through 1H2022.

All figures are in CAD unless otherwise stated.

Operating environment

Overview



Key stats in 1Q 2022 compared to 4Q 2021⁸

Metric	% increase/decrease	
Investment in nonresidential construction	↓	0.8% QoQ
Investment in commercial construction	↑	+2.2% QoQ
Investment in residential construction	↓	11.6% QoQ
Overall investment in building construction	↓	8.7% QoQ
Housing starts	↓	29.9% QoQ
Wages and salaries	↑	+1.0% QoQ
Household consumption expenditure	↑	+2.4% QoQ

E&C industry – 1Q2022 vs 4Q2021

- The construction industry employs over 1.4 million people in Canada and generates about \$141 billion to the economy annually, accounting for 7.5% of Canada's gross domestic product (GDP)⁹.
- Housing starts has continued a downward trend. For the quarter, it significantly changed by 29.9% vs. 0.2% the quarter before. This was largely due to rising interest rates which has made home ownership less attractive¹⁰.
- Investment in nonresidential construction has slowed down after its largest quarterly increase since 3Q2017. The industry's revenue volatility depends on investment in the economy, political factors, and commodity prices. Thus, over the past five years, volatile commodity, and oil prices between 2017 and 2020 have hurt the value of nonresidential construction¹¹.
- Investment in residential construction continued to decline due to unusually frequent changes in macroeconomic indicators such as rising interest rates and inflation. Ontario and British Columbia have seen a disproportionate decrease in sales and prices despite upward momentum during the pandemic¹².
- Rising commodity prices and previously low interest rates spurred investment in industrial and manufacturing facilities. In the current period, however, industry operators have begun experiencing lower demand, causing price competition and subsequently lower profits. Earnings before interest and taxes (or operating earnings) over the past five years have fallen from 10.1% of revenues to 8.7% from 2017 to 2022, respectively¹³.

Market growth

Industry trends

Continued supply chain disruption, green investment, and key materials provide opportunities and challenges for prospective projects and future profit margins.

Industry shapers

The need for technological expertise and skilled labour has been a recurring theme for the industry, as infrastructure data becomes vital. Organized data helps assess development needs and aids in investment decisions for companies and governments¹⁴. Acquisitions of small enterprises have also become commonplace and may serve as a longterm catalyst for revenue and technological growth.

Longterm success will depend on an operators' ability to hire and retain a highly skilled workforce. While there is a lack of qualified candidates, a proficient workforce would inevitably require data engineers, data scientists, coders, and developers, as the industry undergoes a technological shift¹⁵. In a similar manner, operators who adopt new technology quickly will have an advantage mainly in downstream markets particularly in design and construction services. However, increasing industry wages will also impact profits which are expected to grow at a faster rate than revenue for the same period¹⁶.

As macroeconomic factors create volatility in future revenue and profit, the need to digitize becomes a greater priority. Information management systems will be invaluable as they assist operators in monitoring processes, assets, people, and work sites to improve work efficiency, reduce downtime, and provide better visibility of operations¹⁷. Previously, only engineers were tasked to provide these innovative solutions to alter construction frameworks or processes to save resources. Thus, digitalization will be instrumental in providing transparency on operations for all organization members.

Input raw materials, such as steel, remained at a historically high price level and will continue to be volatile. While global steel demand is expected to continually rise, a price decline is anticipated as supply and demand adjust. A potential uptick in steel prices will likely be limited by higherthanexpected production from producing countries that could supply undersupplied markets¹⁸. As such, any shortterm spike in steel prices due to strong demand would reverse in effect.



The prices we pay for these materials and equipment may be impacted by transportation costs, government regulations, import duties and tariffs, changes in currency exchange rates, general economic conditions, and other circumstances beyond our control. Although we may attempt to pass on certain of these increased costs to our customers, we may not be able to pass all of these cost increases on to our customers.

Charles (Charlie) A. Bacon, III,
President, CEO,
Limbach Holdings, Inc.

ESG & green building projects

The benefits of sustainable buildings have piqued in recent years with stable demand. Despite higher interest rates making investments in capital projects unattractive, renovations and green building projects have been the exception¹⁹. In the longterm, green buildings certified by LEED (the most widely used green building rating system worldwide) and Energy Star will not only be lower to maintain, but they will increase asset value, enhance occupants' wellbeing, and improve energy efficiency. Inevitably, this would increase their attractiveness and reinforce demand.

Inflation & interest rates

The interest rate hikes in March 2022 (+0.25%), followed by additional hikes in April 2022 and June 2022 (+0.50% each), have affected the E&C industry while easing housing prices. In June, annual consumer price gains hit a threedecade high of +7.7%, with CPI data now including more weight towards gasoline²⁰. Given that the industry commonly finances its projects through debt, the rise in the overnight rate makes costs associated with projects more expensive, thereby impacting industry revenue²¹.

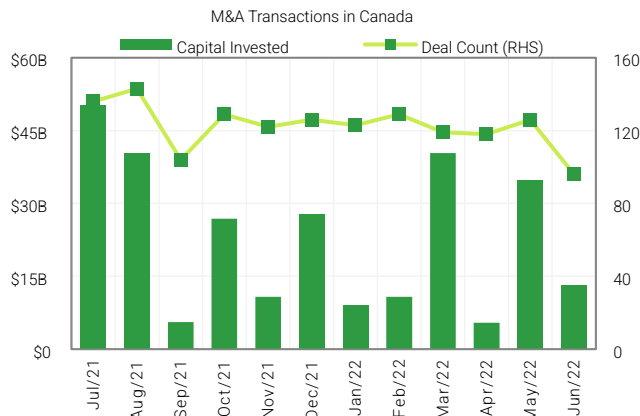
Key materials & supply chain

Supply chain issues will persist throughout 2022 as the scarcity of energy and metal products cause spillover effects that prohibit and reduce the production of other goods. To mitigate supply chain problems, operators may begin creating material reserves, develop backup suppliers, and rely on more domestic supplies over foreign made supplies²².

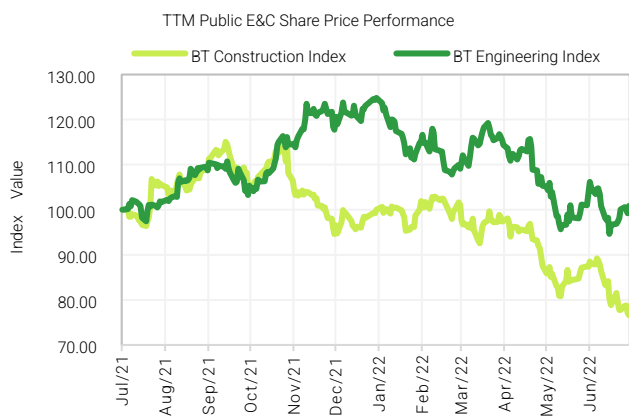
Industry Valuations

Mergers and Acquisitions (M&A)

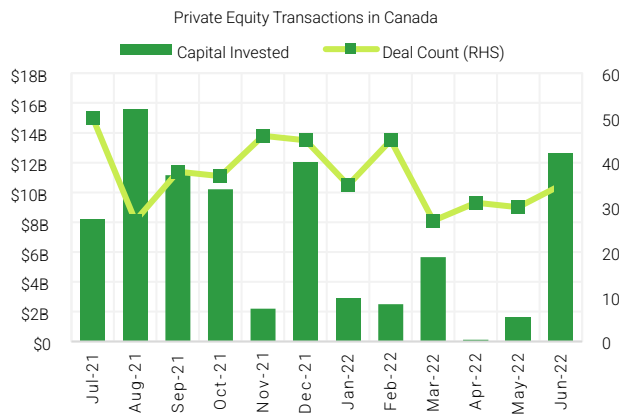
In 1H2022, there were 201 private equity deals, representing \$25B of capital invested in transactions, and a total of 730 M&A deals, representing \$115B of capital invested in transactions. Thus far, deal volumes have slowed while the total capital invested per quarter remained stable for Canadian deals since 4Q 2021²³. Note: Private company multiples may vary significantly lower from those of public traded companies.



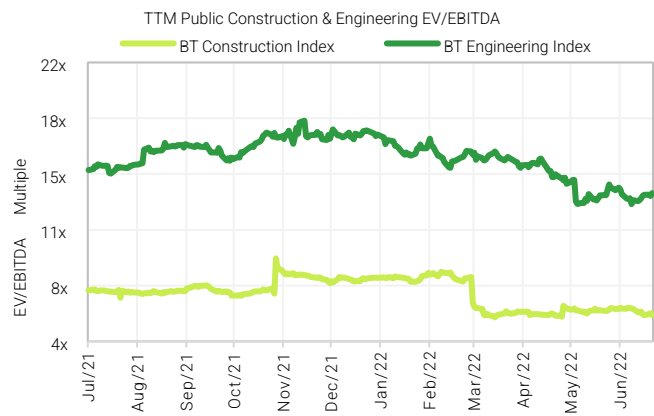
Source: PitchBook Data, Inc.



Source: Capital IQ | MarketCapitalization Weighted

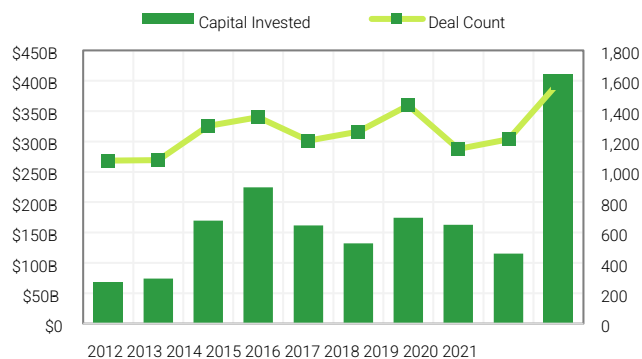


Source: PitchBook Data, Inc.



Source: Capital IQ | MarketCapitalization Weighted Index

Long Term M&A Trends in Canada (last 10 years)



Source: PitchBook Data, Inc.

BT Engineering Companies Index: Aecom, IBI Group Inc., Stantec Inc., and WSP Global Inc.

BT Construction Companies Index: Aecon Group Inc., Bird Construction Inc., and North American Construction Group Ltd.

Recent M&A Transactions

Select Transactions

Notable E&C transactions in Canada for this year include²⁴:

Companies	Deal Date	Deal Type	Investors
	22 June 2022	M&A	
	16 June 2022	M&A	
	07 June 2022	M&A	
	25 May 2022	M&A	
	02 May 2022	M&A	
	25 Apr 2022	Buyout/LBO	
	25 Apr 2022	M&A	
	04 Apr 2022	M&A	
	08 Mar 2022	M&A	
	03 Mar 2022	M&A	
	25 Feb 2022	M&A	
	22 Feb 2022	M&A	
	04 Feb 2022	Buyout/LBO	 
	01 Feb 2022	M&A	

Pitchbook Definition:

M&A: A company acquires at least a controlling position in another company.

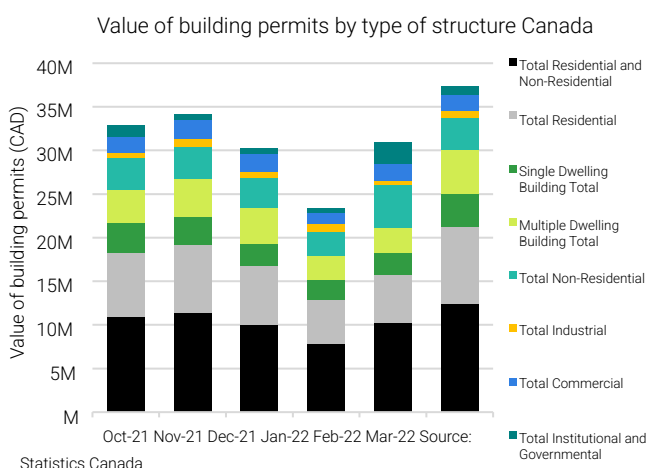
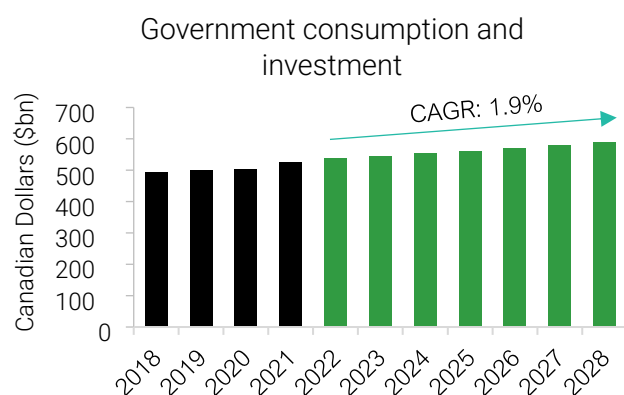
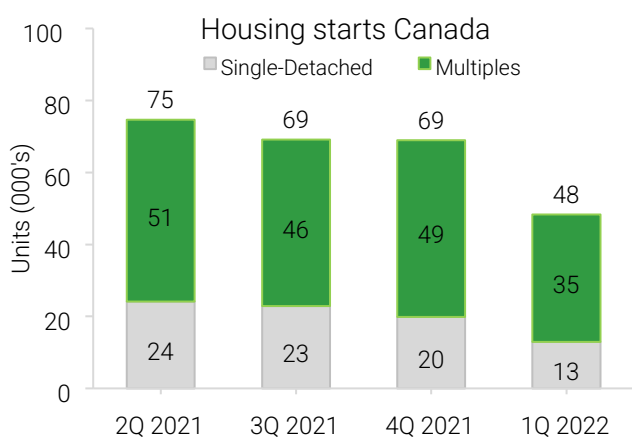
Buyout/LBO: A private equity firm acquires at least a controlling position in another company.

Key findings

Industry snapshot

The recovery for the industry has been steady despite headwinds from changes in interest rates, operating expenses, and commodity prices.

Current and prospective performance



Looking forward

Under the Investing in Canada Plan, one of the five priority investment streams is green infrastructure. \$26.9 billion has been allocated towards this stream to develop infrastructure that reduces greenhouse gas emissions, supports energy transition plans, and provides clean access to water and air²⁵. Specific examples of developments are energyefficient buildings, cleaner electricity grids, and transportation systems. Ultimately, investment in green infrastructure will support the robust green building demand and the industry's overall growth.

On the contrary, high oil and gas prices have increased demand for industry operators in the energy sector, thereby heightening demand for engineering services. In 2022, energy, mining, metals, and chemical projects are expected to account for 25.6% of revenue²⁶. While energy prices remain high, we may expect a revenue decline when prices simmer down, which previously occurred in Alberta's engineering services industry, where the majority of Canada's oil and gas is supplied from.

Industry Outlook



We expect organic net revenue growth to be in the mid to high single digits, supported by momentum from recordhigh US backlog and project opportunities arising from the US infrastructure stimulus bill, continued robust activities in Canada, and strong economic growth from continued demand and stimulus in infrastructure sectors in global segments.

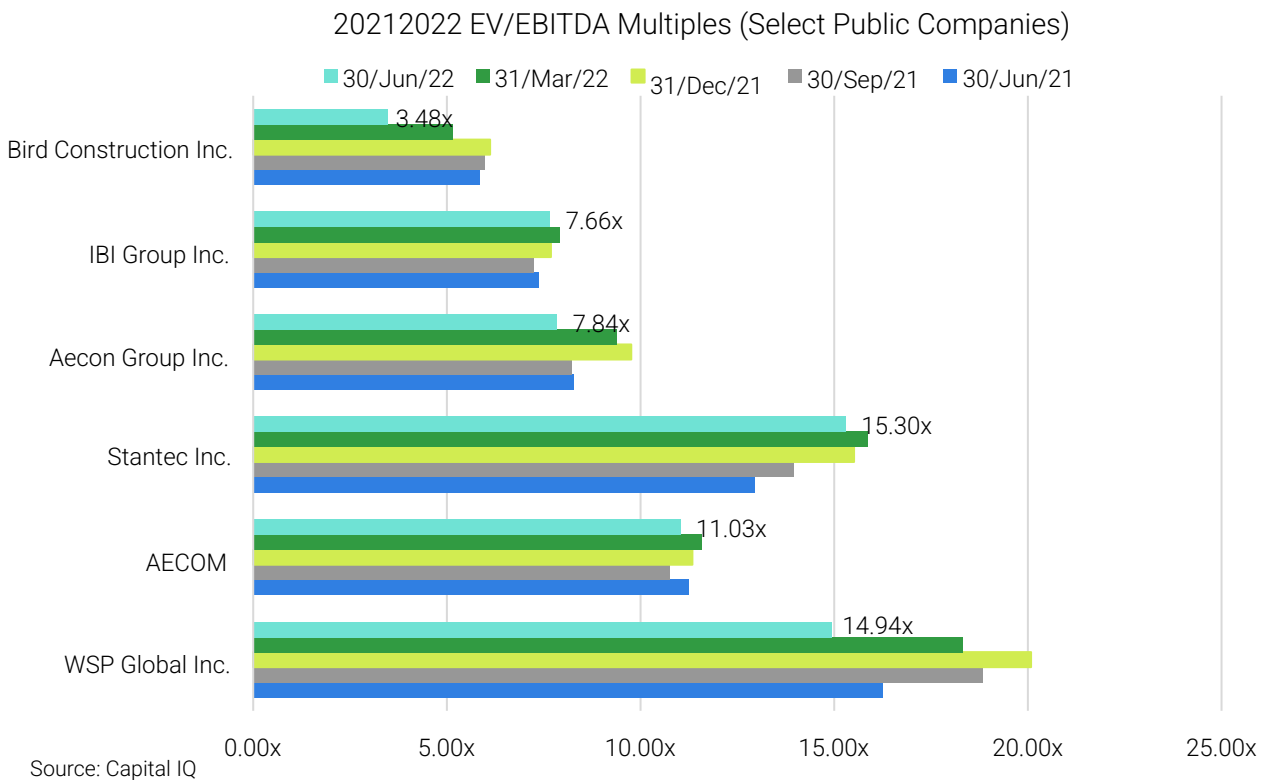
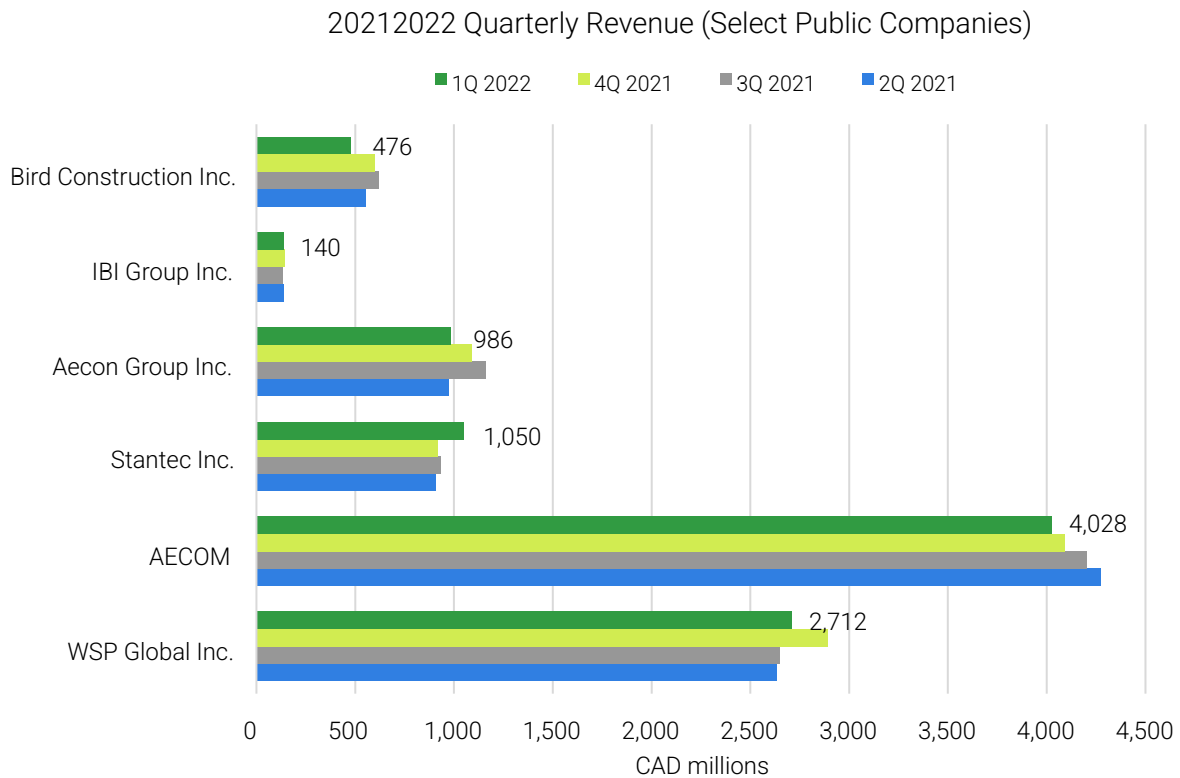
Gordon Allan Johnston
President, CEO & Director
Stantec Inc.

Conclusion

As we approach 2H2022, the outlook remains stable despite housing starts tapering and ongoing macro concerns. While opportunities are plentiful, project timelines and margins will still be dependent on material prices and accessibility²⁷. Moving forward, a historically strong backlog, increasing energy project opportunities, and higher government investments will fuel the industry's growth.

Key Findings (Continued)

TTM performance of key industry players – 1Q2022



Select M&A Transactions

Select Engagement Highlights

Jacob Bros Construction (BuySide Engagement)



Founded in 2008, Jacob Bros is a leading general contractor specializing in civil and buildings construction. Headquartered in Surrey, BC, it has delivered a diverse portfolio of projects for public and private clients across Western Canada.

Continental Chain and Rigging ("Continental") is a supplier of chain and rigging products including wire rope products, tire chains, synthetic slings, fall protection equipment, and much more. With headquarters in Edmonton, AB, Continental offers their products and services throughout Western Canada by using its robust distributor relationships.

Continental was growing impressively and achieving record results. This made agreeing on a purchase price challenging as financial results were improving more than expected every month the deal moved towards close.

Once the purchase price and terms were agreed, the parties needed a mechanism to address growing net working capital. The concern was the potential for a large purchase price adjustment postclose based on unprecedented working capital levels. Minority shareholder added complexity and required additional agreements to be finalized at close.

To provide price certainty, a "lock box" mechanism was established for working capital, which fixed the purchase price adjustments related to net working capital on agreed terms and at the "lock box date". The structure of the purchase and sale was negotiated to provide all shareholders a tax efficient transaction now and in the future. A minority stake in Continental was acquired at mutually agreeable terms. Management of Continental remain in place, while the Jacob brothers will join the board and act as advisors for Continental.

Baker Tilly Canada Corporate Finance Inc. acted as an exclusive financial advisor to Jacob Bros Construction in structuring and negotiating this transaction.

CCMET Group (SellSide Engagement)



Founded in 1987, CCMET Group ("CCMET") grew to become the leading engineering materials testing company in Western Canada. With 275+ employees, CCMET continues to deliver a full range of services including materials testing, materials engineering, geotechnical engineering, concrete restoration, environmental engineering and TQM. Its scale, reliability and quality of work makes it a key partner in many of the Canada's largest infrastructure projects.

As an employeeowned business, the rationale for the transaction was twofold: Form a partnership to provide resources to fuel future growth and liquidity for the transition of several senior employees.

Roster of 40+ potential purchasers was developed. 20+ reviewed the CIM and received offers from 5 parties. Accepted LOI to transaction closing took 97 days.

70% of CCMET was successfully sold to Equicapita, a Calgarybased private equity fund that has a history of acquiring and growing industrial companies.

Transaction valued the enterprise at \$47.5M, which was substantially above the target price agreed upon with the client.

Baker Tilly Canada Corporate Finance Inc. acted as an exclusive financial advisor to CCMET Group in structuring and negotiating this transaction.



Renaissance Mergers & Acquisitions [now Baker Tilly Canada Corporate Finance] facilitated the transaction from initial concept to the very end where they literally pushed it over the final goal line. [They] exceeded our expectations by over 100% and I could not be more pleased with the results and the new partnership.

Harry Watson
President, CCMET



We are excited to be partners in the ownership of Continental Chain and Rigging. They are good people and we see clear opportunities for both parties to benefit from this partnership. The Baker Tilly team did a great job of negotiating the fine details and pushing the transaction across the line.

Scott Jacob
CEO of Jacob Bros Construction

Endnotes

Sources

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Corporate finance

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Ongoing transaction project management

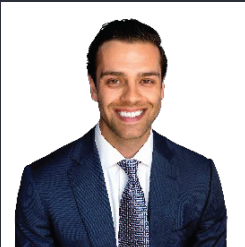
We are able to tailor our service offering to meet your deal requirements with services available using an integrated product approach or on a standalone basis, which will not impact our independence

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