Aquisitions in the construction industry are a fairly recent phenomenon. Until the mid-1970s, the conventional wisdom was that no one would ever actually buy a construction company. If you wanted to expand into a specific market you merely opened an office. However, beginning about 1975, acquisitions of construction firms became fashionable. Since that time FMI has represented buyers or sellers of construction companies in more than 125 transactions.

What is the motivation of buyers and sellers of construction firms? Obviously, the reasons are unique to every transaction. This article discusses some of the common motivations of buyers or sellers as well as some of the keys to a successful transaction.

Why would someone be interested in buying a construction company? Hopefully, anyone contemplating making an acquisition of any type is doing it as a result of a well-reasoned strategic plan. The strategic plan may call for growth, diversification, geographic expansion, market penetration or a dozen other possible objectives. An acquisition is simply one possible method of achieving the desired objective. The common objectives identified by
conclusion company buyers are these:

**Growth.** Most construction companies have growth as a key objective and an acquisition provides a way to achieve rapid growth. It allows the buyer to acquire needed resources or utilize existing resources in an efficient manner. Of course, making an acquisition for the objective of growth assumes that growth is desirable in the first place.

**Diversification.** One of the most common strategies of the 1990s is diversification. Since survival is ultimately the key objective of a business, making sure that the company has market opportunities in more than one segment of the industry is a prudent strategy to pursue. Engineering a new market or business is certainly a risky undertaking. Each potential buyer will have to decide whether starting a new operation or acquiring another company with the desired expertise is the proper method of diversifying.

**Organizational development.** One of the key challenges to any business is to attract and retain managers who can continue the business and continue it profitably. Sometimes a company is in the fortunate position of having more key managers than there are positions for those managers. Sometimes an acquisition can create an opportunity for a key executive to take over and manage a business unit. An acquisition can also be the way to secure talented management from the selling company.

**Work force enhancement.** Frequently, one of the major impediments to entering a new market is the availability of a qualified work force. One way to secure that work force is to purchase a company already operating in the target market. If the market is controlled by a few key players with key local relationships, then acquisition becomes the only viable alternative for entering that particular segment.

**Customer demand.** One of the cardinal rules of customer service is to keep the customer happy. If the customer wants you to follow him

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into a new market, you may need additional skills and personnel to be able to serve that customer appropriately. An acquisition can be a way to secure those resources. In other cases, your business strategy may be to offer additional services to some of your existing customers.

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If you do not have the skills internally to be able to provide those services, then securing that capability through acquisition may be a viable strategy.

**Geographical expansion.** This is probably the most common reason for making an acquisition in the construction industry today. Many companies are seeking geographic diversification to reduce the risk of a downturn in a given area. Although start-ups are still very common, one way to have instant market participation in a new geography is to purchase a local player. This is certainly a more rapid form of market entry, and can be less costly, if done properly.

**Asset accumulation.** Sometimes key assets needed for expansion are owned by another firm and the only way to secure those assets is to acquire that firm. Examples would include aggregate resources, an asphalt or ready-mix site or permit or a dump site. Without acquiring another firm, entering a new market in those instances may be virtually impossible.

**Customer base.** If you are trying to break into a market segment, or want to work with a new type of customer, it might be more prudent to make an acquisition of a firm that is already there rather than try to steal customers via low or no-fee pricing. Frequently, customers are very loyal to a particular firm or to the employees of that firm. An acquisition is one way to purchase that loyalty. In other situations, getting pre-qualified can be accelerated by buying a firm that has a track record in the specific area you have targeted. This is particularly true in the private industrial sector.

**Competition consolidation.** In some segments of the construction industry, buying a competitor can make a tremendous amount of sense. In others it makes no sense at all. If your industry segment is one that has a lot of competitors, then buying one competitor will not help the situation very much. However, if there were only two or three competitors, then one competitor buying another can be a sound strategy. It also has the added benefit of allowing significant reductions in overhead when the two organizations are combined.

**Vertical integration.** This type of acquisition is more of a defensive acquisition than the others. One form of vertical integration is buying a firm that supplies you with services or products. Acquiring a supplier can guarantee a source of supply of some product or service
and eliminate the margin that the supplier has been earning. The other type of vertical integration is purchasing a customer. Buying a customer can guarantee an outlet for your service or product, and enhance your profit by eliminating the margin charged by the customer. There are certainly other strategies that could be executed via acquisition of a construction company, but these are the most common ones, according to FMI. Although there are logical reasons for buying a company, great care should be taken not to try to rationalize an acquisition and do it for the wrong reasons. The results can be catastrophic.

**Why Contractors Might Want to Sell**

A motivated seller is a prerequisite to having a successful acquisition. It is important to understand what these motivations are and how critical they are to the acquisition process. There are several reasons why owners of construction firms will decide to sell out to a third party. 

**Credit needs.** One of the most common forces causing construction companies to consider selling out in the 1990s is the undercapitalization of the industry. This undercapitalization causes the banking and bonding industries to be restrictive in the amount of credit they will provide. FMI predicts there will not be a dramatic improvement in this situation during the next several years. Consequently, there should be a steady stream of construction firms that have to seek financial partners due to credit constraints and lack of adequate capital.

**Growth or diversification.** Sometimes, a company lacks the capital or the human resources to be
able to grow or diversify their market areas. Since growth and diversification are common business strategies, a business owner will sometimes decide that selling all or part of the firm is necessary to allow that strategy to be implemented.

**Retirement.** Probably the dominant motivation causing the sale of construction companies in the United States is simply the age of the existing owner. If the owner has not done proper planning, then at retirement time there may be no alternative except to consider liquidation or a third-party purchase. Selling to the employees over a short period of time is usually not viable because they do not have the funds to be able to pay for the company. The major advantages of a third-party sale for the retiring owner is that he will get his money quickly and without risk.

**Estate planning.** A related motivation of business owners is to create some liquidity for their estates. It takes cash to pay estate taxes and to provide for a deceased contractor’s family. Since the construction firm is usually the owner’s major asset, selling the business outright is frequently seen as the only viable alternative.

**Management succession.** Frequently, small- to medium-size construction companies do not have successor management in place when the existing owner/manager decides to retire. One way to solve that problem is to sell the business to a larger company that has excess management talent who can be infused into the selling company.

**Persona/risk.** The construction industry is fraught with risk. The nature of the industry is such that large sums of money can be lost in short periods of time. This fact, combined with the requirement of personal guarantees for bonding and banking credit, puts the owner of a construction company in a very tenuous position. More and more company owners are deciding to take some of their money off the table by selling the company or some portion of it to a larger firm.

**Capitalize on valuable assets.** Sometimes a company has excellent customer relationships, or an excellent organization of people with unique skills, or it has unique assets that it has been unable to utilize because of lack of financial capacity. In those situations, the natural course of action would be to affiliate with a larger firm, so that the financial resources will be available to take advantage of those valuable assets.

**Declining market.** Sometimes companies simply can’t be competitive. Either they have a productivity problem in the field or some other management problem that is keeping the company from being profitable. A merger or a sale to the right firm can correct those problems and salvage what otherwise could be a disaster.

**Offer too good to refuse.** Believe it or not, there may be someone who thinks your business is worth more than you do. If someone calls you and would like to talk to you about buying your construction company, talk to him—it may be the only such call you ever get.

So there are reasons why a particular company may consider selling. Let’s look now at some of the attrib-
utes that make a construction company an attractive acquisition target.

**Location.** Generally, acquirers of construction companies are interested in moving into growing geographical areas. Unfortunately, the herd instinct usually prevails, and by the time most of the buyers move into a given area, the market has already peaked. There are some contrarians out there who will buy into a depressed market on the assumption that a recovery is inevitable.

**Type of work.** The same criteria applies here as with geographical location. Most companies are looking to buy into a growing sector such as infrastructure or environmental remediation. Others will try to buy good, quality companies that specialize in a type of work that has declined. Frequently, an excellent firm can be acquired at a relatively low price.

**Repeat customers.** One of the things that buyers like to see in a potential acquisition target is some source of recurring revenues. Does the company have a steady customer base that provides a stable base of business? Will those customers remain with the company after the acquisition? Being over-dependent on one or a few customers can be a negative if those customers are lost after the acquisition.

**Reputation.** All buyers are concerned about reputation of the company they purchase. They are concerned about how owners, subcontractors and sureties feel about the company. No one wants to buy into a problem.

**Management.** Several issues relative to management will impact the salability of a particular company. What is the quality of the management and the depth of the management? How old are the key executives? Will the managers remain after the acquisition is completed? If the owner is going to remain with the company, what was his motivation for selling in the first place? A quality management team that will remain with the firm after it is sold is one of the prime factors in making the firm salable and enhancing the purchase price.

**Staff.** In addition to top management, the key management staff (project managers, estimators and field supervisors) are also key factors in creating value and enhancing the salability of the company. The quality and the technical skills of these people are very important to future success. The likelihood that these key employees will remain with the firm after the purchase is critical.

**Profits.** Since the purpose of any acquisition is to generate future profits for the purchasing company, having a salable company with a history of profitable performance is a prerequisite for making a successful acquisition. In addition to histor-
Ultimately, all of the factors making a company attractive will be negated if the price is not reasonable relative to earning power. Is this the time to buy or sell a construction company? The answer depends on your particular situation. Make sure you have thought through the reasons why you might want to buy a company or why you may want to sell your business.

If you do decide to take the plunge, the best advice that FMI can give you is to proceed cautiously. CD

About the Authors
Hugh L. Rice is a director in FMI’s Merger & Acquisitions Group in Denver. He specializes in the buying and selling of construction companies, stock valuations, business continuity and management succession planning and Employee Stock Option Plans.

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Price. Ultimately, all of the factors making a company attractive will be negated if the price is not reasonable relative to earning power. The price that a buyer pays must be in proportion to the earnings of the company so that a reasonable return can be earned. In addition, there are constraints in terms of what buyers will pay for companies compared to the underlying asset value. Most construction firm acquisitions occur at prices between 1 and 1p times adjusted book value.

Deal structure. Sometimes prices will appear to be an insurmountable obstacle. But many transactions can be completed if the deal is structured correctly. If there are excess assets in the company that can be liquidated, then the effective purchase price can be reduced. Sometimes significant overhead cuts can be made when the companies are combined. Other times, a totally new entity can be established via a permanent joint venture between the potential buyer and seller, whereby the buyer only has to provide working capital and bonding credit to make the transaction occur. There are many ways to structure transactions that can make them very attractive for both buyer and seller.

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