Facilities management
A quiet revolution
The facilities management (FM) market in the UK and internationally proved to be resilient in the economic downturn and remains an attractive space for investors.

Despite the subdued economic backdrop, FM has been a dynamic sector creating opportunities for those taking proactive steps to adapt to evolving customer needs. Consequently, the level of outsourcing is increasing and clients have become more demanding and sophisticated in procuring FM services. Clients continue to look for more integrated FM solutions and self-delivery capability to benefit not just from more efficient service provision but also to reduce the internal cost of procuring and monitoring those services.

We believe these developments represent a quiet revolution in the FM market. Our aim is to capture these evolving trends and examine the role of mergers and acquisitions (M&A) in pursuing the strategies chosen by suppliers to adapt to their changing environment. There’s no ‘one size fits all’ strategy to take advantage of changes in the market and secure growth opportunities.

The strategic direction adopted by individual players are to a large extent determined by their heritage and growth strategy in the FM sector.

Every approach carries different opportunities and risks. However, M&A activity has been significant and, in our view, will remain an important component in future growth.
**Structural challenges to growth**

**Overall demand for FM services grows on the back of fundamental macro drivers**

The FM market growth broadly follows GDP trends. It benefits from increasing outsourcing rates and internal cost cutting measures in times of economic slowdown and from larger contracts in times of economic growth.

The sector proved resilient through the 2008/09 recession, experiencing a 2% decline between 2008 and 2010, followed by a forecast 1.1% p.a. growth since then.

**European outsourced facilities management market**

![Graph showing the European outsourced facilities management market]

Source: Frost & Sullivan Forecast of the total European Facility Management Market and Penetration of I-FM, April 2012 represents actual data to 2010 and forecasts thereafter.

**The UK FM market is most mature**

Penetration of outsourcing varies by country. UK FM is the largest, most mature market in Europe. The FM market is less sophisticated in the emerging economies, where relatively lower labour cost means that the application of the Western FM model requires specific adaptations.

**Slower structural growth**

**Real GDP CAGR 2013-20**

![Graph showing real GDP growth rate]

Source: PwC Analysis

**Consolidating UK market**

**Top 7 as % of market (approx.)**

![Bar chart showing market share]

Source: PwC Analysis
Evolving customer demands

Cost is important, but it’s not the only driver

Budget constraints in both private and public sectors are driving the choice towards outsourcing, best-in-class solutions and redefining the type of services being procured, from input-based to output based.

Costs remain top of the agenda, however ‘Contract negotiations are moving towards value rather than purely the level of expense’.

said the vice president of a global property management company.

The more sophisticated providers recognise that value is gained through outsourcing and achieving cost savings in the client’s in-house procurement and administrative functions. There’s a continuing trend away from ‘lowest price’ services following the failures of high-profile FM contracts in recent years.

Public and private sector customers continue to move from single services to bundled or integrated FM

‘Single service’ procurement still represents a significant (c.60%) but declining part of the FM market today, within the other 40%, ‘single service’ has evolved into ‘multi-service’ procurement with FM providers managing the provision of multiple services across multiple sites, often acting as a master contractor.

But the approach taken by the public and private sectors towards FM outsourcing is evolving. We’re seeing a move towards greater financial value, wider scope (integrated facilities management (IFM)/total facilities management (TFM)) and longer-term contracts to drive better quality and economies of scale. While these contracts are commercially complex, at their best they create a relationship between provider and consumer akin to strategic partnership.

The adoption of bundled and TFM contracts has been seen across a number of industry verticals (financial services, pharma, consumer goods, etc.).

‘Even manufacturing, historically more resistant to TFM solutions, is now opening up to the concept’.

says the strategy director of a leading European FM business.

In the public sector, the new contracting framework for central government departments being mandated from June 2014 is driven by an increasing target of cost savings. Suppliers will need to pre-qualify to bid for central government FM work and, given the larger size of contracts, the framework may be better suited for integrated FM providers.

But, the longer-term impact on players in the sector is yet to be determined.

The creation of NHS Property Services, mergers of healthcare trusts and collaborative procurement by groups of local authorities are current examples of the public sector both at central and local government level driving demand for larger integrated FM solutions.

Large top tier clients show appetite for centrally run, international FM contracts

The private sector has seen emergence of large, multi-service, multinational contracts with either a single or a handful of FM providers taking responsibility for the delivery of both soft and hard FM services to the customer. The market has its eyes on big contracts such as Barclays and HSBC which have moved to the IFM model and drastically reduced their number of suppliers worldwide.

Source: Frost and Sullivan Forecast of the total European Facility Management Market and Penetration of FM, April 2012.

Frost & Sullivan estimates a 3.4% CAGR revenue growth in bundled services and a 4.4% CAGR growth in integrated/total FM with a corresponding decline in single service delivery.
How you’ll be evaluated

KPCs are evolving

‘Flexibility shown by the FM provider throughout the tender process was key’ says the Head of Procurement at a FTSE 100 corporate which recently concluded its TFM contract.

In selecting the provider, the organisation assessed flexibility in terms of delivery capability, proposed transition plan from c.200 incumbent suppliers and approach to negotiating what became a complex contract.

Evolving client demands

For large international clients, the integrated service capability and geographical reach are becoming increasingly important ways to consolidate the supplier base and achieve internal cost saving targets.

Whilst clients recognise that suppliers may need to use sub-contractors, most of them report that self-delivery capability has grown in importance as a competitive advantage and operational risk mitigant. From suppliers’ perspective, self-delivery capability, although it requires an initial investment, will help grow absolute margins.

Clients increasingly tell us they’re looking for strong evidence of sector expertise from their provider.

‘They need to really understand the differences in operational requirements that we, as a retailer, have versus a bank or an IT company and be able to provide a tailored solution’ commented a top ten UK retailer.

Increase in energy costs and the sustainability agenda are driving demand for expertise in energy management, building space management and optimisation.

Real-time reports and sophisticated data analytics are vital to assess and demonstrate cost savings in both service delivery and the client’s internal functions. The winners are providers with well-developed, robust and accurate MI systems which not only generate timely performance data to clients, but help providers to identify efficiency opportunities, price contracts competitively and achieve attractive returns.

Technology has become an important innovation and efficiency driver. For example, the use of GPS technology, motion sensors which detect space utilisation, web based booking systems are increasingly becoming common and expected as standard by some clients.
Drivers of growth strategy

These demands continue to drive FM providers to reshape their proposition in order to take advantage of evolving customer requirements. M&A activity has been at the heart of those changes in recent years. Our research focused on deals undertaken by eight large European FM companies between 2006-2012. This identified that these eight companies were involved in 200+ transactions with a total disclosed value of £7.8bn.

The data demonstrates that there’s no ‘one size fits all’ optimal strategy (e.g. everyone moving to global TFM). Indeed, the large players are actively pursuing diverse routes to growth.

This is dictated on the one hand by the service heritage of individual companies and their current core competencies (e.g. soft FM vs hard FM services) and, on the other, their attitude towards TFM and internationalisation of the FM scene (the two key factors driving change in the market).

National players are seeking to provide multiple, integrated services

The first group identified in our research comprises a significant number of national hard and/or soft FM players. This is not a homogeneous population as these businesses vary in size, capabilities and the market verticals addressed. Prominent players include MITIE and Initial Facilities (IF). Their strategies aim to develop self-delivery capability across a broad range of FM services to adapt to the changing market dynamics discussed earlier.

MITIE has grown from a single service, cleaning business in 1990s into a broad outsourcing business through a series of acquisitions. The key milestones were the acquisition of Rentokil’s Initial Security business in 2006, followed by the purchase of Dalkia Technical Facilities Management in 2009. In 2012 the portfolio of services was expanded through acquisition of Utilyx (energy management) and Enara (homecare services). The move into healthcare delivery is a new trend.

IF (proposed to be acquired by Interserve) has its origin in cleaning and catering, the bedrock of soft FM service offering. Over the last five years, however, if transformed into a multi-service provider through a series of acquisitions. These included Santia Fire & Water, Phoenix Fire, MSS and Modus which allowed IF to enter more attractive market verticals, e.g. healthcare, professional services and transport.
Strategic options

International FM consolidators extend their geographical reach, including into emerging countries

These are international, largely integrated service providers with their heritage commonly being soft FM. Prominent players include ISS and Sodexo.

These players have followed a strategy of ongoing international expansion, including into emerging economies. On Sodexo’s €525m acquisition of Puras do Brasil S.A. in 2011, the CEO commented that ‘this is in line with our strategy to consolidate Sodexo’s position in high-potential emerging economies’.

These players have also been developing global self-delivery capability across a broader spectrum of services to take advantage of the emerging global contracts, e.g. ISS’s multi-territory IFM contracts with Barclays and Novartis.

Property management companies are increasingly competing to provide FM services

Examples here include real estate management companies, such as Jones Lang LaSalle and CBRE. There the trend appears to be in driving consistent global roll-out across their managed service provision, for both their corporate and heritage client base, with a key focus on self-delivery. Thus, the expansion into delivery of FM services to their managed properties is a logical extension. CBRE’s recent acquisition of Norland is a prime example of the trend. According to the CEO of CBRE, Norland was seen as a strong complement to CBRE’s global platform giving them the ability to self-perform building technical engineering services for their clients in Europe and beyond.

This creates an interesting dynamic for the incumbent FM providers as their customers also become competitors. The extent of impact on the FM market remains to be seen.

Construction ‘heritage’ companies are moving into the FM space, including soft FM

The trend amongst construction companies to grow their presence in the FM space has continued.

Carillion is a primary example having acquired Alfred McAlpine and Eaga (energy management). More recently Bilfinger has been active in the UK FM market acquiring Rollright FM and Europa Support Services in 2013. The acquisition is expected to allow Bilfinger to position itself for larger contracts with international companies active in the UK. Similarly the recent proposed £250m acquisition of IF by Interserve appears to follow a similar rationale.

Construction companies tend to be anchored in hard FM services although we expect them to continue to push into the soft FM arena. Given their background they are well-positioned to target the industrial sector which has historically seen less FM outsourcing than other verticals.

Single-service providers are consolidating market position

At the other end of the spectrum are companies which pursue best-in-class provision of a single service offering in every territory, using their geographical reach to follow large international corporates and use the brand to play in local markets. This is an alternative to the TFM strategy followed by other players and it will be interesting to see how this plays out with major, international clients. Examples of single-service providers include Securitas and Compass Group.

Securitas focuses on provision of best-in-class security (primarily man guarding) services and has been consolidating market position in core territories as well as entering new markets. Larger transactions in the UK included the acquisition of Reliance Security (from Rentokil, 2010) and Chubb Security Personnel (2011). This single service strategy is supplemented by a move into adjacent specialist services, for example, electronic security. The company wants its security technology operations to reach 18% of turnover by 2015.

A similar strategy has been followed by Compass Group in recent years. While the restructuring in mid-2000s led to exit from a number of less profitable or operationally risky contracts and selective entry into other soft FM areas, e.g. the acquisition of VSG Group (security services) in 2010, the group maintains its footing firmly in the food service and catering sectors. Major transactions included the acquisition of a 51% stake in Levy Restaurants in 2006 and purchase of Sofra Group (2011).
M&A is fundamental to any strategy

Our secondary research was focused on transactions undertaken by eight selected core European FM players between 2006 and 2012 and provides clear support for the trends discussed earlier. The transaction volumes have been reasonably consistent throughout the period despite economic downturn and credit squeeze. It’s a great example of resilience of the FM sector as well as the fundamental role of M&A in pursuing the strategies.

The table below summarises the larger transactions over the period and their primary rationale. We comment on the overall M&A trends in this population on the following page.

<table>
<thead>
<tr>
<th>Acquirer</th>
<th>Target</th>
<th>Rationale</th>
<th>Year</th>
<th>Deal size (€m)</th>
</tr>
</thead>
<tbody>
<tr>
<td>UTC Fire &amp; Security</td>
<td>Initial Electronic Security</td>
<td>Consolidation, Mix</td>
<td>2007</td>
<td>899</td>
</tr>
<tr>
<td>Carillion</td>
<td>Alfred McAlpine</td>
<td>Consolidation</td>
<td>2007</td>
<td>845</td>
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<tr>
<td>Sodexo</td>
<td>Puras do Brasil</td>
<td>Consolidation, Geographic</td>
<td>2011</td>
<td>525</td>
</tr>
<tr>
<td>CBRE</td>
<td>Norland Managed Services</td>
<td>Mix</td>
<td>2013</td>
<td>356</td>
</tr>
<tr>
<td>Billfinger Berger</td>
<td>MCE</td>
<td>Consolidation</td>
<td>2009</td>
<td>350</td>
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<tr>
<td>Carillion</td>
<td>Eaga</td>
<td>Mix</td>
<td>2011</td>
<td>333</td>
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<tr>
<td>Cofely</td>
<td>Balfour Beatty Workplace</td>
<td>Mix, Geographic</td>
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<td>Jones Lang LaSalle</td>
<td>King Sturge</td>
<td>Consolidation</td>
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<tr>
<td>Compass Group</td>
<td>Levy Restaurants (51%)</td>
<td>Consolidation</td>
<td>2006</td>
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<tr>
<td>Coor Service</td>
<td>SAS Facility Management</td>
<td>Mix</td>
<td>2008</td>
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<td>Sodexo</td>
<td>Zehnacker Holding</td>
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<td>MITIE Group</td>
<td>Dalkia Technical FM</td>
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<tr>
<td>MITIE Group</td>
<td>Enara Group</td>
<td>Mix</td>
<td>2012</td>
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<tr>
<td>Compass Group</td>
<td>Sofra Group</td>
<td>Geographic</td>
<td>2011</td>
<td>103</td>
</tr>
</tbody>
</table>

Source: Merger market

Note: undisclosed value transactions are mostly small businesses
Evaluating different strategic options

While the ‘buy and build’ strategy and expansion of the existing customer base remains the single largest driver for deals, geographic expansion and service diversification are other important drivers for mergers and acquisitions.

Another dimension to service diversification has been the soft and hard FM acquisitions where we have seen a trend toward the use of M&A to acquire competencies not prevalent in the acquiring business. The majority of these acquisitions have been <€25m in size although some (e.g. MITIE’s acquisition of Dalkia Technical FM (€154m), have been more ambitious in nature.

As mentioned earlier, energy management is increasingly becoming an area of interest for traditional FM companies. MITIE’s acquisition of Utilyx (€25m, 2012) and Carillion acquiring Eaga (€333m, 2011) have been notable entries into the space by integrated FM providers. Other key players such as Inenco (recently acquired by Vitruvian Partners) and Utilitywise (two energy consulting acquisitions in the last 12 months) have been involved in M&A activity.

Primary acquisition rationale for acquisitions by selected core players

Note: transactions satisfying multiple rationale have been counted more than once in the chart above

Hard/Soft FM acquisitions by selected core players

2006–12 Transaction volumes by deal value

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Final thoughts...

The FM market has, and will continue to, experience a period of significant change. Whilst recent market growth has been modest, this belies a substantial level of corporate activity and strategic repositioning that is taking place behind the scenes. Client demands are evolving to become more sophisticated and output-driven in developed markets; in emerging markets the industry has begun a long-term process of professionalization and consolidation.

PwC has worked closely with a number of the leading players, many of whom have used the last two years to reflect on their competitive positioning, engage in tactical M&A and reconfigure their operating models. We believe there will be a number of common behaviours that will characterise the most successful competitors in this space over the next five years.

They will:
- not be afraid to challenge historical business strategies and will keep their approach to M&A relevant
- communicate their strategy clearly to external and internal stakeholders (‘what we do’ and ‘what we don’t’)
- accept that it will take time to implement changes as contracts run their course and acquisitions are embedded
- maintain a high level of focus on profitable growth and cash generation.

Beyond these common characteristics, it is clear that different companies will adopt a diverse range of strategies to gain market share, differentiate their offering and retain a seat at the client’s top table, based variously on competencies, clients and heritage. We expect these efforts to be maintained as the quiet revolution continues.
Facilities management

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