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Building a solid bottom line for when the downturn ends

BAM chief executive Theo Cullinane says the Irish construction industry needs to be prepared for the day when we finally leave the recession behind

He probably wouldn't admit it, but Theo Cullinane looks close to mastering the art of being in at least two places at once. The Corkman is chief executive of Netherlands construction giant, Royal Dutch BAM's Irish subsidiary, known here as BAM. He still lives in his native city but spends most of the working week in Kill, Co Kildare, from where he oversees operations not just in Ireland, but also in locations such as Germany and the Middle East.

Formed in 1958 specifically to build Wexford Bridge, and known until its takeover by the Dutch plc in 2003 as Ascon, BAM has been in the top two or three players in the Irish industry for much of its career, and has just as consistently held the number one slot in different sub-sectors, civil engineering, roads, marine construction etc, along the way. "We'd like to be number one," Cullinane says.

That means growth, which, these days, is a tall order. This month, the Republic's construction industry began its seventh straight year of decline. Official figures show that it has gone backwards for 72 consecutive months, falling from where it was obviously bloated, past where it should be to a point where most measures suggest that it is now too small.

Cullinane knows the figures all too well. He points out that in 2006, now recognised as the absolute height of the bubble, construction output was €37 billion. Today it is worth €6 billion, less than one sixth of that. He argues that in an economy of the Republic's size, the number should be between €15 billion and €18 billion.

The norm in Europe, he says, is around 11 per cent to 12 per cent of gross domestic product (GDP). "But our infrastructure is lagging behind most European countries, so our industry should be about 14 per cent or 15 per cent of GDP, 2 per cent to 3 per cent more than our competitors." We need this, he says, in order to be prepared for the day when we finally leave the recession behind.

The macro-economic picture is mainly beyond Cullinane's control. His immediate job is to get a bigger slice of a shrinking cake. He believes that the business could have an optimum turnover of €400 million a year, a figure that it could achieve in 2014, while delivering margins in the region of 2 per cent to 3 per cent.

Consolidated accounts for BAM Contractors Ltd, the key Irish company, show a €229 million turnover in 2011 – earning it 229th place in The Irish Times Top 1,000 – and pre-tax profits of €4 million. Last year, revenues were €234 million. In 2013, its chief executive hopes it can deliver €325 million.

Like everyone else in the business, it is swimming against the tide, but Cullinane believes it is making progress. The company is working on a range of public and private sector developments, including eight schools for the Department of Education, the Sutherland School of Law in UCD and Curraheen Hospital in Cork. Also in Cork, it was also the main contractor on Citygate, a business park at Mahon backed by John Cleary Developments.

At the more specialised end, it is about to begin work on the 4.9km tunnel beneath Sruwaddacon Bay in Co Mayo that will ultimately bring gas ashore from the Corrib field. That is a €68 million joint venture with Wayss & Freytag, and is probably the most complex engineering project under way in the Republic at the moment.

In partnership with its parent, it is working on the €270 million Borders Rail Project in Scotland, the redevelopment of the port in Aqaba in Jordan, and it has just finished building the Hazza Bin Zayed Stadium at Al Ain in Abu Dhabi in the United Arab Emirates, for Manchester City owner, Sheikh Mansour Bin Zayed Al Nahyan.

International business

The international dimension has spared it some – but not all – of the worst effects from the recession. In 2007, BAM had between 2,500 and 3,000 people working for it in Ireland, including staff and those employed on its various projects. Its actual core workforce was between 800 and 900 – that figure has not change much since the collapse of the industry began six years ago.

The overall group's international business has allowed it to keep a high proportion of those who were on its payroll in those days. "They upskilled and we redeployed them to our international companies over the last few years," Cullinane says, adding that as a result, "they're working on some fantastic projects".

The Irish staff are working on secondment in other BAM companies, and are paid through the business here. This has allowed it to keep skills that might otherwise have been lost if it had been forced into job cuts amongst its core staff. It also means that they are gaining valuable experience that can be re-imported once the economy turns around.

Cullinane is quick to emphasise that this is not all a one-way street as the Irish operation is exporting its expertise to other divisions. For instance, staff from its offices here are working on BAM road building projects in Germany because their experience in this field is the most up to date.

"We have people that have built a lot of roads over the last 20 years," Cullinane explains, "but in Germany they have not had a major roads programme since shortly after the war, so they are now upgrading." He points out that it makes sense for the group to be able to tap into the skills that have developed here over two decades.

Similarly, BAM in Ireland has developed a particular experience in marine construction. It has worked on projects for all the major State-owned ports, including Cork, Dublin and Rosslare, and also built the Irish Navy's new HQ, at Haulbowline in Cork Harbour.

"We have a strong position in the marine sector in Ireland and that expertise is very exportable," Cullinane says. As a result, the Irish company is leading the group's project in Aqaba, with a contracts manager and senior staff from the Republic all working there.

Its home market remains tough, but just over six weeks ago, it scored a significant win. At the end of April, the National Roads Authority awarded BAM the €282 million contract to design and build major new elements of the N7 and N11 roads. The deal is a public-private-partnership (PPP) and includes carrying the N7 over the Belgard Road in Dublin on a new flyover and 16km of dual carriageway on the N11, which connects the capital with Wexford.

BAM is working on the planning phase at this stage and hopes to complete the job in 28 months. At the time that it was announced, Cullinane himself pointed out that the N7/N11 project would allow motorists to travel the length of the country without stopping at traffic lights (it connects with the M50, which gives access to the M1, the main route north out of the capital). In effect, it is the last piece of a jigsaw that will allow someone to drive – on the national motorway and dual carriageway network – from Cork to Belfast without ever seeing red, green or amber.

The project may be nationally significant in that sense, but Cullinane says that it was significant in every sense for BAM. “It’s five or six years since the last PPP was signed,” he points out, adding that not only is his company the first to win such a deal from the State for that time, but also the only single entity to do so.

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All the other major road-building PPPs were partnerships, normally involving a local and multi-national player. BAM is managing all aspects of the deal, its PPP arm provides the equity, its contracting division does the actual building and its facilities management business will maintain the roads for the length of the 25-year concession that the contract involves. “We are a one-stop-shop for PPPs,” its chief executive proclaims.

Not surprisingly, given the Republic’s near 14 per cent unemployment rate, the 1,000 jobs that the project promises to create grabbed many of the headlines. Cullinane dismisses what he sees as a perception that construction workers are often imported from elsewhere. This has gained so much traction that politicians frequently suggest that State contracts should stipulate that at least 20 per cent of the work on a given development should go to locals.

“All construction is local,” Cullinane argues. “Why would I bring up a fellow from Kerry to plaster a house in Donegal?” he asks, pointing out that the extra expense in accommodating someone brought in from outside the area is enough to deter any contractor. The only situation where it makes sense is one that calls for specialist skills that are not available locally.

BAM PPP’s partner is Dutch pension fund, PGGM, which is providing half the equity. The fund is responsible for assets of about €140 billion, which it manages on behalf of 2.5 million participants. In that context, taking equity in a €282 million road project is probably small beer.

However, against a background where the State has yet to exit its bailout, PGGM and BAM’s willingness to provide their share of financing for what is effectively a Government project could be seen in another light. Cullinane is in no doubt that the move is a vote of confidence in the Republic on the part of his group’s partner.

He also argues that it can potentially have a domino effect. If one such organisation is willing to take the plunge and invest here, others suddenly pay attention to what is going on and possibly follow suit. Of the €282 million total, the State is borrowing €190 million through the National Pensions’ Reserve Fund, and from Bank of Ireland and the European Investment Bank.

Cullinane is a strong advocate of the PPP system, which he argues should allow the Government to maximise the slender resources it has and keep the cost of major and necessary public building projects off its balance sheet. The system is simple – the contractor puts up equity, which is combined with bank debt to fund the project, at no cost to the State.

Construction projects

In return it designs and builds it, and once it is complete, manages the development under a concession agreement with the Government. This is already how most toll roads operate. The State begins regular repayments once the project is built, but in the meantime, it has benefitted from tax paid by those who worked on the project or supply goods and services.

What he sees as the value of properly structured PPPs is something that Cullinane returns to several times during the interview. Not only that, he says that if the Government goes ahead with its proposal to set €1 billion aside for construction projects in next year's budget, this is how to get the best out of it.

"If they decided to go ahead with the children's hospital, that could be €500 million or €600 million, so that's half of your €1 billion gone already on just one project," he argues. "They could use PPPs to leverage it and get 10 projects, and keep it off the State's balance sheet. Why not do 10 projects instead of just one or two?"