



South African Civil Construction Industry



SHORT TO MEDIUM TERM PROSPECTS FOR THE SOUTH AFRICAN
CIVIL CONSTRUCTION & ENGINEERING INDUSTRY

12 MAY 2015

**MAXIMIZING GROWTH POTENTIAL IN
LOW GROWTH ENVIRONMENT**

Presentation Outline



- Surveys
 - Civil Engineering Contracting Industry (SAFCEC)
 - Consulting Engineering Industry (CESA)
- Economic Environment
- Road infrastructure
- Key indicators and Trends
- Challenges
- Going forward?

Introduction



- Established in 2002
 - Background: CDSA, PPC, BIFSA (MBSA), SAFCEC
- Women owned private organisation specialising in construction business information
- Objective, unbiased and independent analysis of construction industry trends
- Monitor key indicators from expansive information base
- Building and Civil Industries
- Member of CIEF (Construction Industry Economist Forum)

Economic environment



- Civil industry faces difficult economic conditions
- Global growth outlook remains muted, more focus on developed economies
- Weaker growth outlook for emerging markets coupled with higher risk
- Four key elements:
 - Surplus oil production,
 - Currency shifts & Dollar strength,
 - Volatile capital flows
 - Lower commodity prices

Source: IMF April 2015

Economic environment



| | 2013 | 2014 | 2015 | 2016 |
|---------------------------|------|------|------|------|
| World | 3.0 | 3.3 | 3.5 | 3.8 |
| US | 1.9 | 2.4 | 3.1 | 3.1 |
| Eurozone | -0.4 | 0.8 | 1.5 | 1.6 |
| UK | 1.7 | 2.6 | 2.7 | 2.3 |
| Emerging Markets | 4.7 | 4.4 | 4.3 | 4.7 |
| Brazil | 2.3 | 0.1 | -1.0 | 1.0 |
| Russia | 1.5 | 0.6 | -3.8 | -1.1 |
| India | 4.4 | 5.8 | 7.5 | 7.5 |
| China | 7.7 | 7.4 | 6.8 | 6.3 |
| Sub-Saharan Africa | 5.1 | 4.8 | 4.5 | 5.1 |
| SA | 1.8 | 1.4 | 2.0 | 2.1 |

- **US GDP** growth lowered to 3.1% average 2015/16, tightening of MPC, dollar strength, but recovery still somewhat shaky
- **Brazil, Russia weak, negative growth, China slows to 6,8% containing commodity price recovery**
- Stronger growth in India, 7.5% avg 2015/16

Low growth challenges re-balancing of SA's economy

- GDP slowed to 1,4 percent, projected to increase to 2,1 percent in 2015?
- Sleuth of unknowns and uncertainties
 - Currency volatility linked to emerging market risks, US Federal Reserve tightening MPC, credit rating agencies (twin deficits), Electricity supply, labour unrests and strike actions...
- *On the upside:*
 - Strong consumption growth
 - More positive retail trade statistics
 - Low petrol prices and low inflationary environment (but for how long?)
- *On the downside:*
 - Electricity supply constraints
 - Probability of a downgrade in credit rating
 - Tighter fiscal stance
 - Interest Rate hike towards the end of the year?
 - Weak manufacturing data
 - Low consumer and investor confidence
 - Impact of strike action



SA Businesses optimism plummets



- 100 medium to large privately held businesses surveyed in Q1 2015 (Grant Thornton)
- Level of optimism hit **record low**

2013

39%

2015Q1

9%

- Rising levels of crime
- Exchange rate fluctuations
- Pending legislation – all in some way or the other affecting property rights
Expropriation Bill, the Land Act Amendment Bill, the Private Security Industry Regulatory Amendment Bill, the Minerals and Petroleum Development Amendment Bill and the Promotion and Protection of Investments Bill – 85% expect implementation of these bills will result in disinvestment by foreign owned companies
- Lack of skills
- Economic uncertainty
- Municipal Service Delivery

Source: Grant Thornton

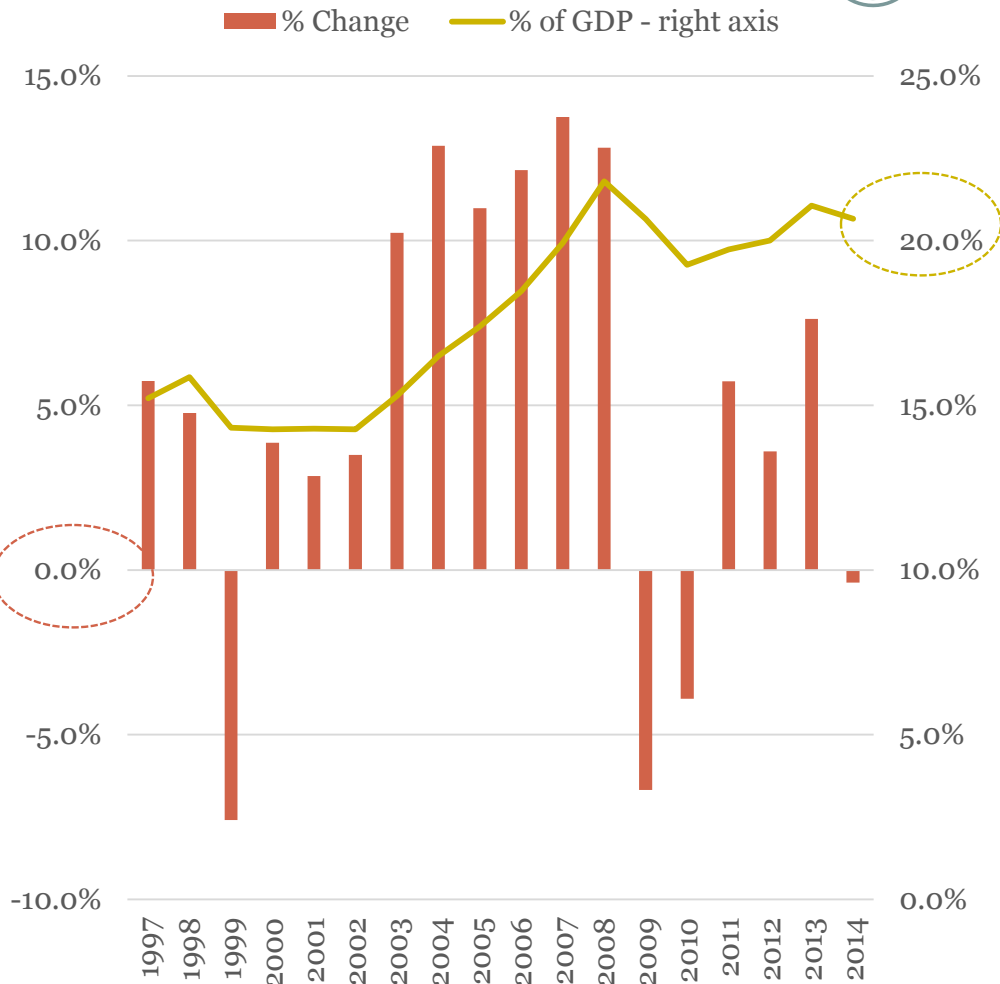
Municipal Service Delivery



Road infrastructure concerns, including potholes and traffic light issues, and the negative impact this has on South African business executives nearly tripled to **61% for the first quarter from just 21% during the comparative period of 2013....**

Source: Grant Thornton

Gross Fixed Capital formation



- Slowed to 20,7% of GDP in 2014 - remain below 21% of GDP in the next three years (well below NDP target of 30%)
- Negative growth in 2014, -0,4 percent, first time since 2010
- R348bn (2014)
 - Residential: -5,8% (-7,1% 2013)
 - Non-residential: -1.5% (0.4% 2013)
 - Construction works: 14% (11.8% 2013)
 - **Government: 24.8%**
 - SOE: 0.9%, first positive growth since 2009
 - Private: 21.5% (Renewable energy)

Source: SARB

SAFCEC Economic survey

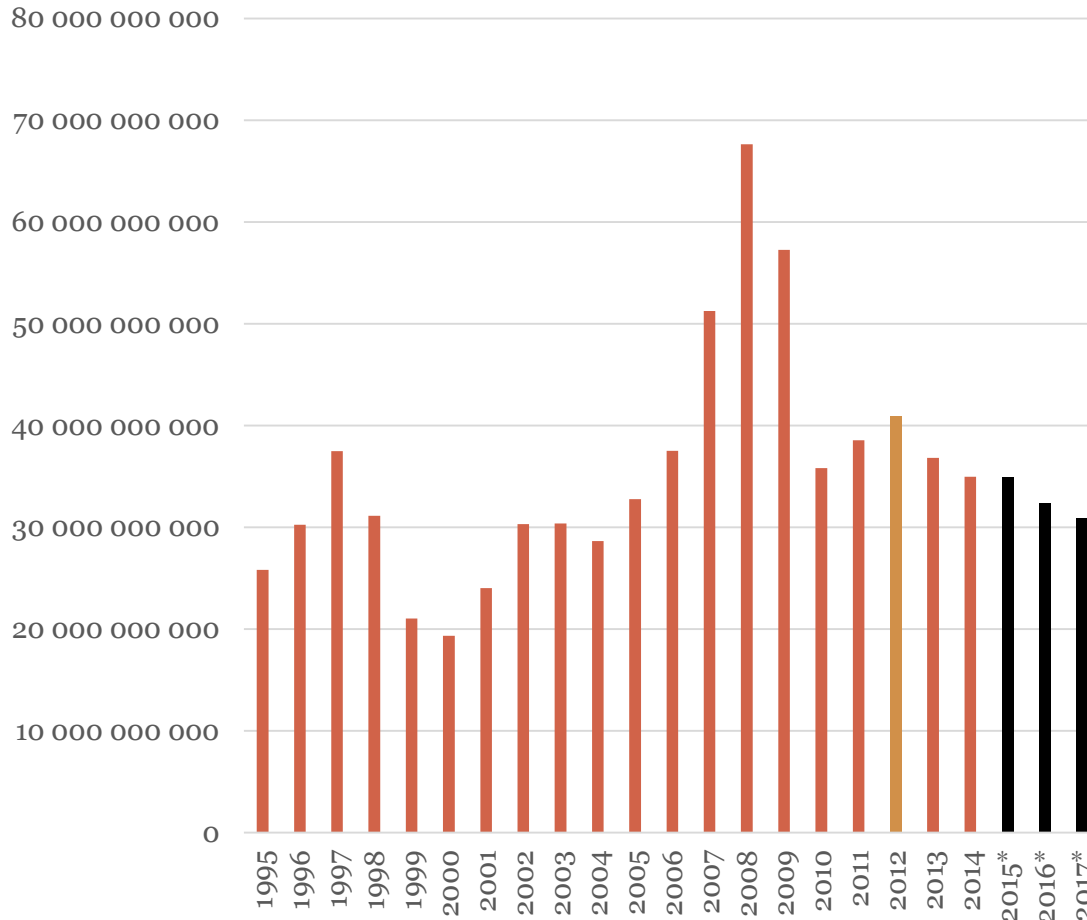


1st Quarter 2015

- Quarterly survey amongst SAFCEC members
- Monitor key indicators and trends in the civil engineering contracting industry
- Responses are weighted by firms size (based on total reported employment)

Turnover fell by 3% in 2014

Civil Industry Turnover (2012 prices)



- Turnover fell by R30bn since peak in 2008
- No recovery since 2010
- Total turnover for 2014 estimated to have declined by 2,5 percent (in real terms) vs contraction of 10,0 percent in 2013
- FORECAST
 - 4% nominal growth projected for 2015, -0,5% 2016, and -2,5% in 2017

Industry Respondent Profile



Project Type

Geographical

Client Type

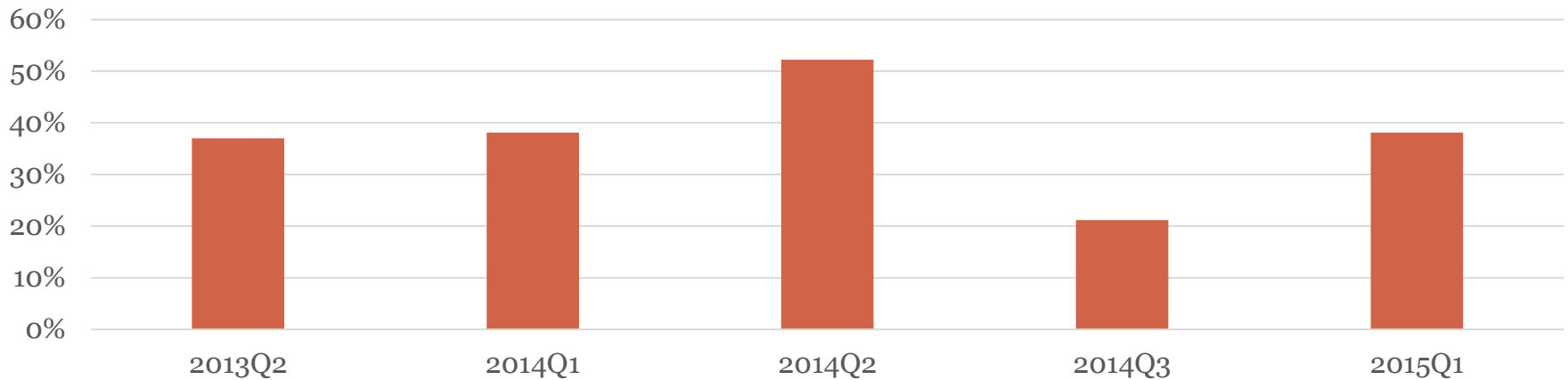
FIRM SIZE

Large: >1000
Medium: 100 - 1000
Small: < 100

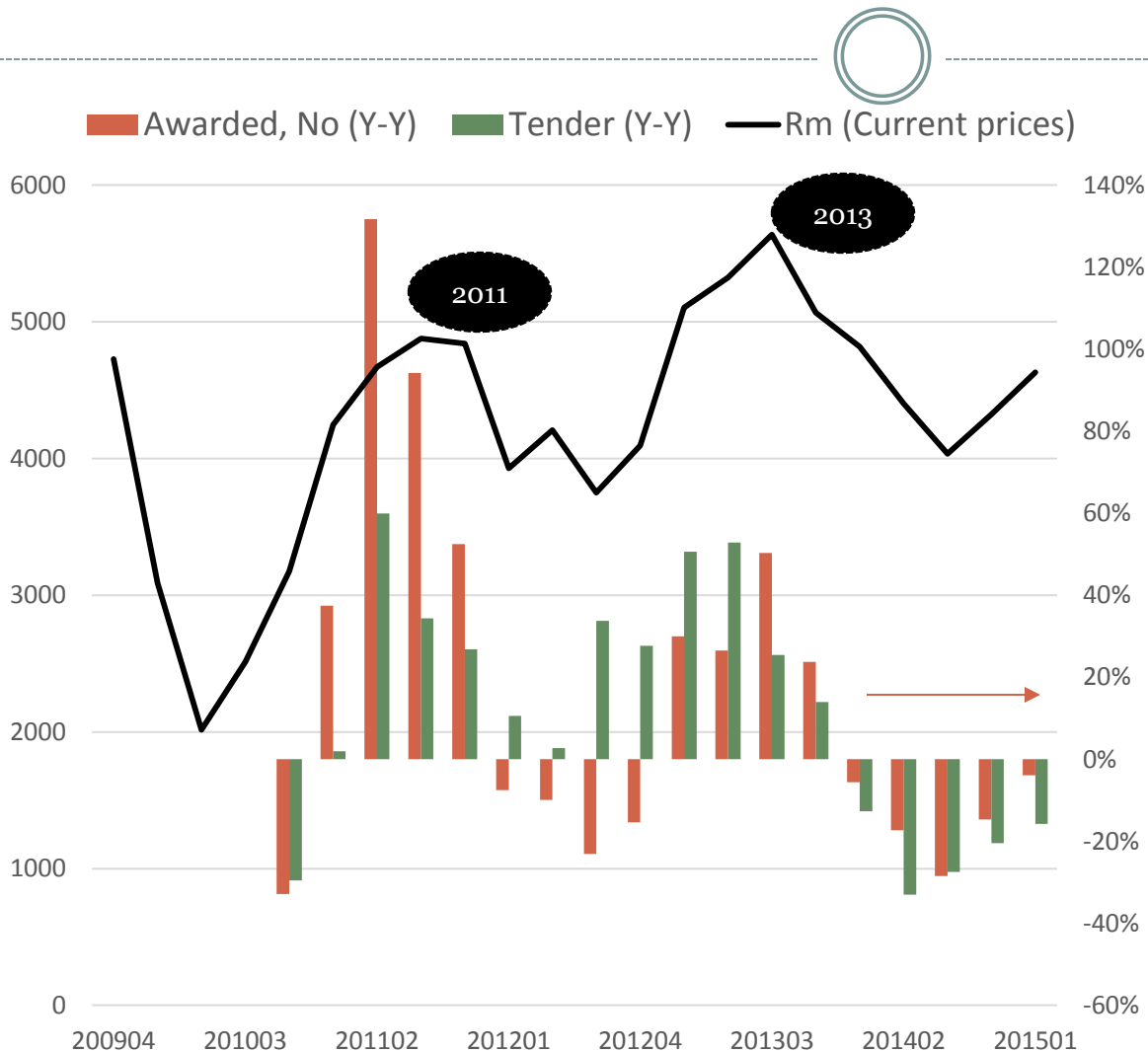
% of Turnover by Project Type

| Type | Large | Medium | Small |
|-----------------------------|--------------|--------------|--------------|
| Roads | 38.1% | 78.3% | 42.3% |
| Earthworks | 9.3% | 0.0% | 29.0% |
| Water (Bulk Infrastructure) | 5.7% | 0.0% | 0.0% |
| Water and Sanitation | 2.9% | 0.2% | 0.0% |
| Rail | 4.1% | 0.0% | 0.0% |
| Harbours | 0.5% | 21.5% | 0.0% |
| Power (Bulk) | 19.8% | 0.0% | 0.0% |
| Power (Services) | 0.0% | 0.0% | 0.0% |
| Airports | 0.0% | 0.0% | 0.0% |
| Mining Infrastructure | 7.1% | 0.0% | 0.0% |
| Mining Surface Works | 0.4% | 0.0% | 0.8% |
| Other | 12.0% | 0.0% | 27.9% |
| Total | 100.0% | 100.0% | 100.0% |

Roads % of Turnover (Larger Firms)



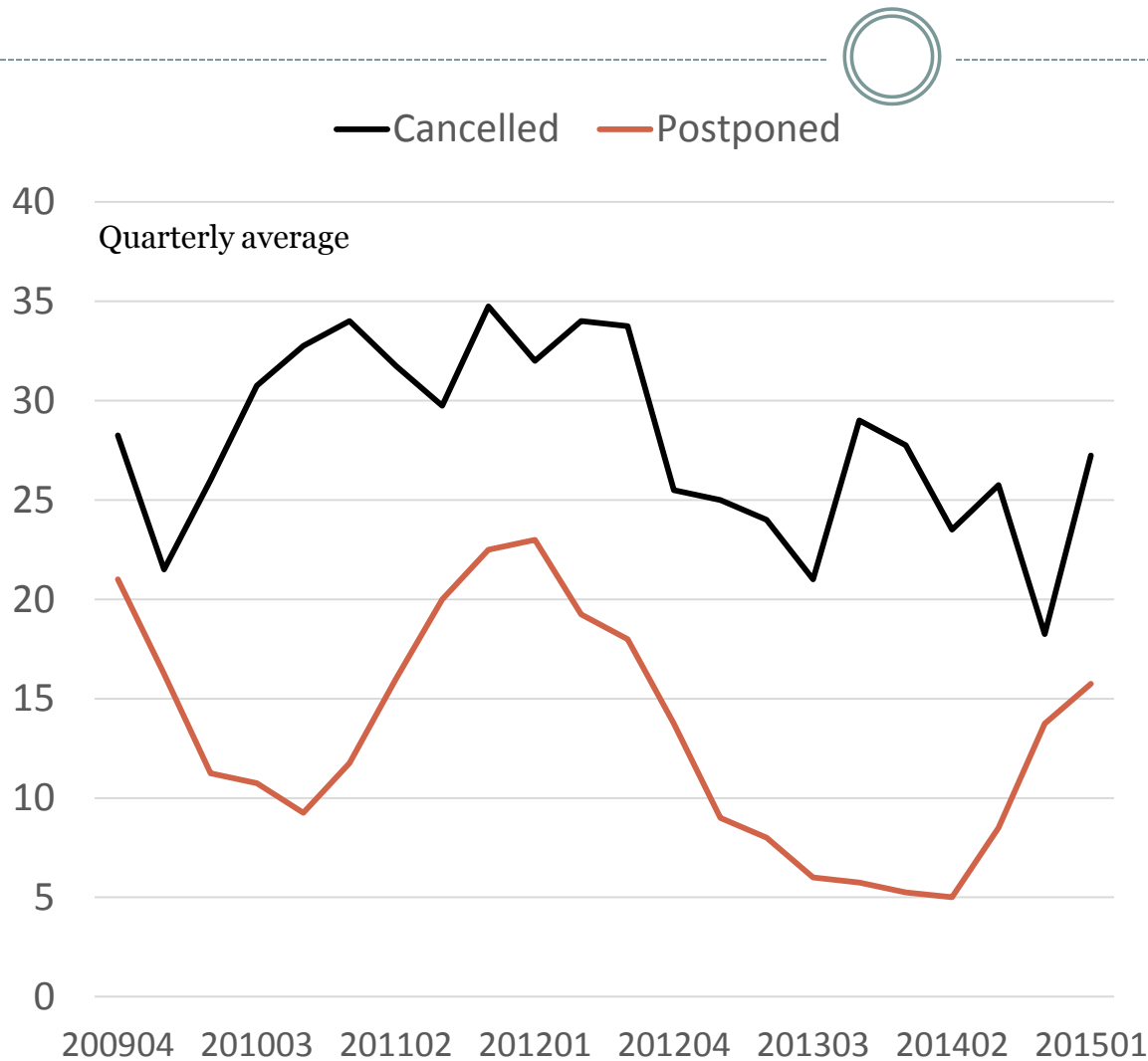
Value of Road projects awarded (QTR)



- Value of Road projects fell by 15% in 2014
- Fewer but larger projects awarded in the 1st QTR
 - Rm up 21% q-q (from lower base)
 - No of projects down 38% q-q
- Rate of decline (RM) moderated to -4.0% over the last four quarters
- Tender activity remains depressed down 22% q-q (Q1), -15.8% y-y over the last four quarters

Source: Databuild, Industry Insight

Alongside weaker tender environment Postponements on the rise since mid 2014

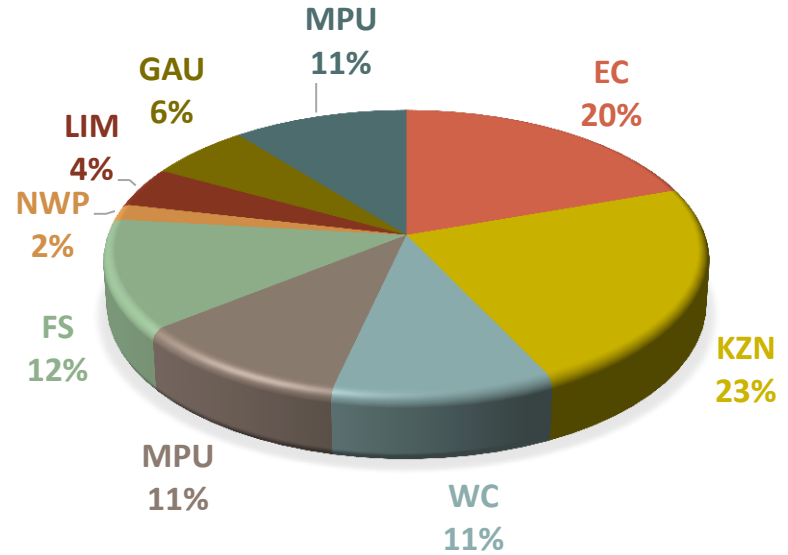


- Postponements of road projects started to increase mid 2014, up 200% y-y over the last four quarters
- Cancellations still negative over the last four quarters (-2%), but strong increase in Q1, +270%
- Affecting largely smaller scale projects (33% = Grade 3 projects)

Source: Databuild, Industry Insight

CIDB Grade 9 road contracts out to tender increased by **10%** in 2014 = 5% of Tenders

Grade 9 Tender % of total (Road)



2014: Dominated by KZN and EC (46% of total)

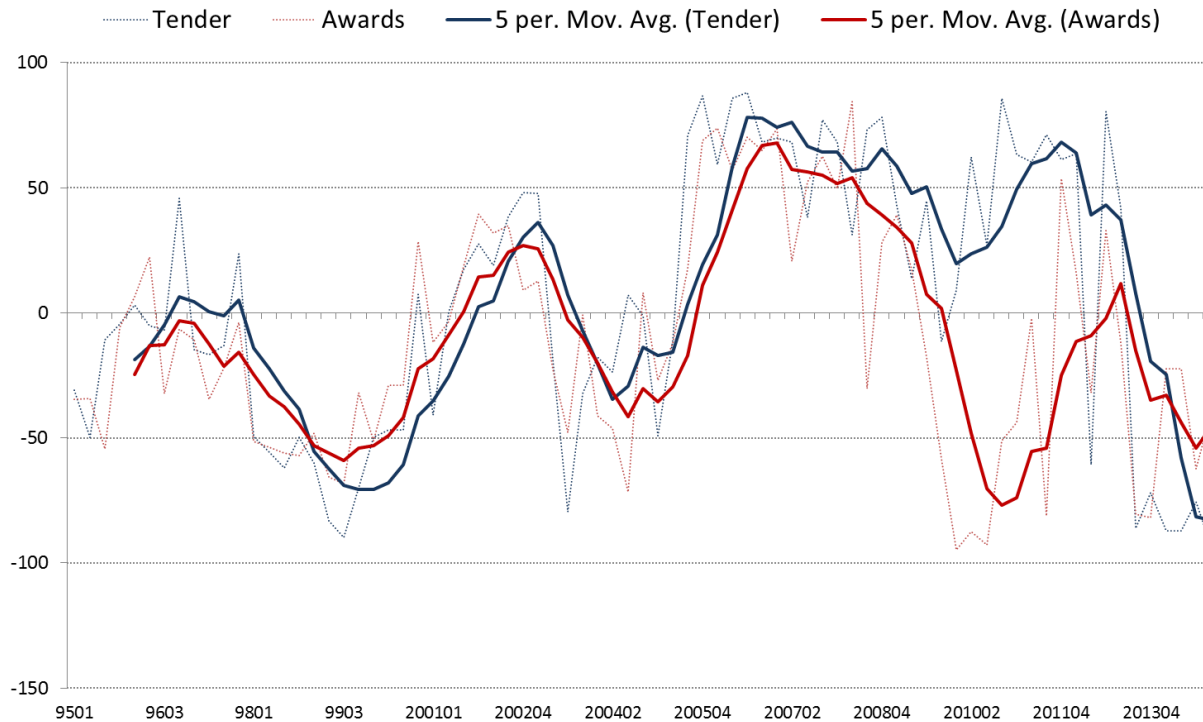
2015Q1: 4 projects (EC, FS, Gau, WC)

Source: Databuild, Industry Insight

96% of Respondents reported low tender activity



Confidence Indices: Tenders and Awards (% Satisfied)



TENDERS

- The nett % satisfaction rate deteriorated to -93 (from -75), surpassing 1999 level
- Supported by 18% contraction in actual tender activity in 2014 and staggering 40% drop in 2015Q1

AWARDS

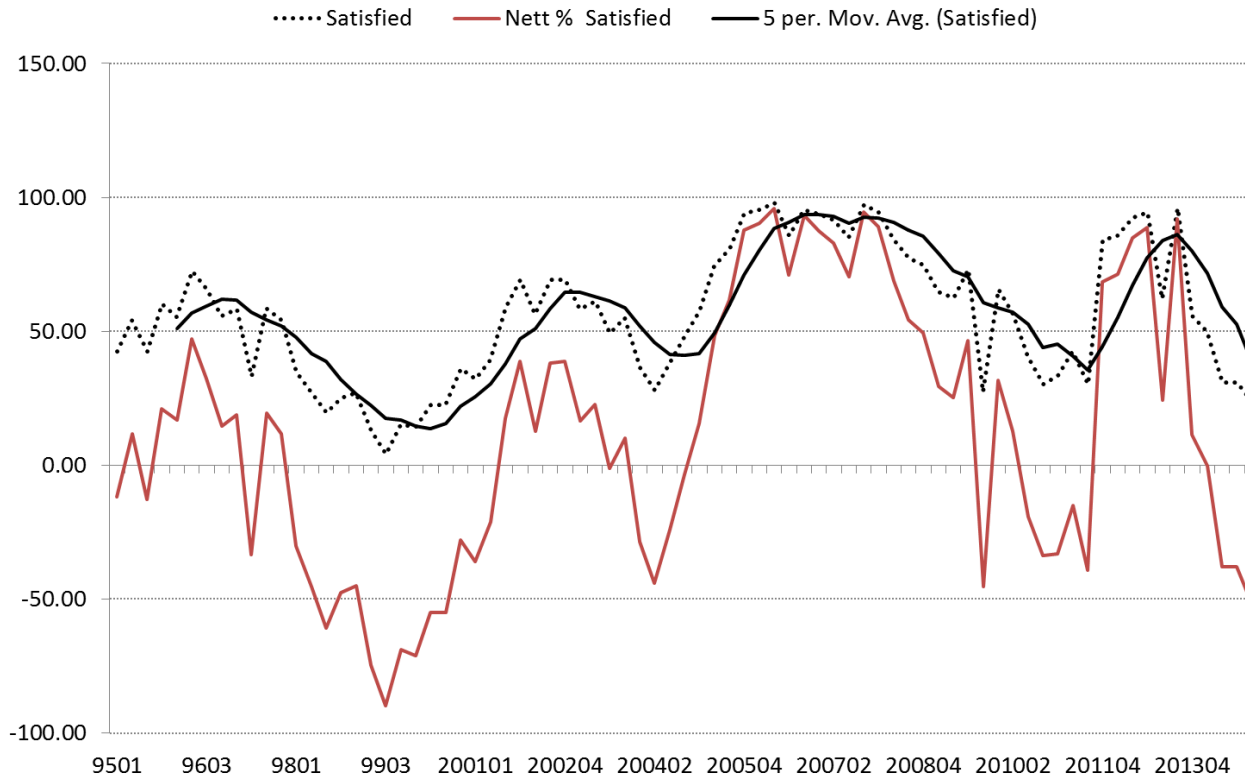
- The nett % satisfaction rate improved to -40 (from -62.0), still in the red

Source: SAFCEC Survey

Growing pessimism regarding outlook on two year forward looking Order Books



State of Orderbooks



Nett satisfaction rate deteriorated to 1999 level, currently at -50 (2015Q1)

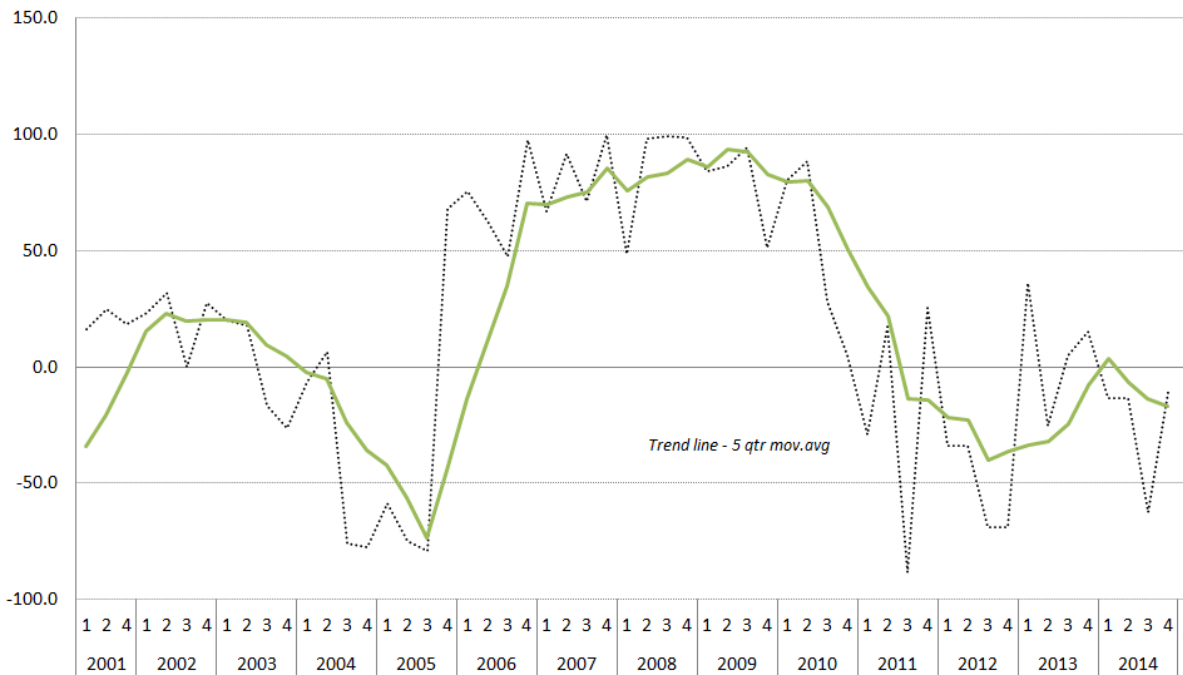
Source: SAFCEC Survey

Profit margins remain under pressure



Profitability

Nett Satisfaction Rate



- Outlook on profits on deteriorating trend since 2009
- Nett satisfaction rate improved remain in negative territory (2015Q1: -10.5%)
- Majority unsatisfied with profit margins – new norm
- Substantiated by Stats SA data, which moderated to 2,1%
- Operational efficiency

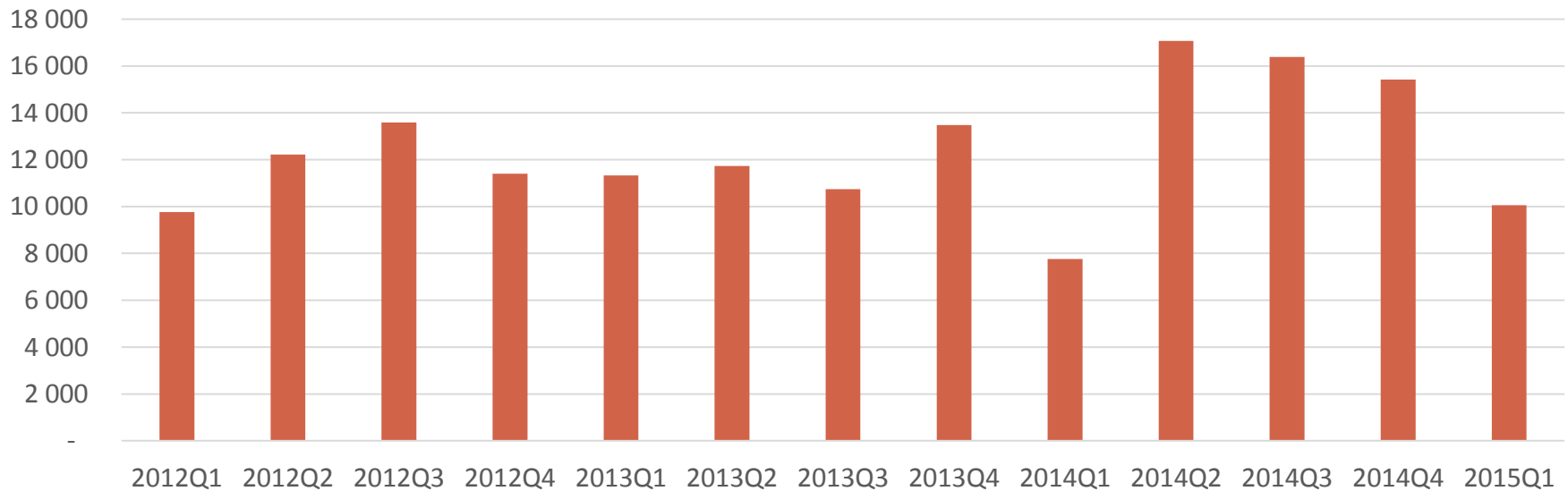
Source: SAFCEC Survey

Estimated Tender Values



| Quarter | Air | Bridges | Civil Other | Power | Rail | Road | Water | Grand Total | Y-Y Change |
|---------|-----|---------|-------------|-------|------|-------|-------|-------------|------------|
| 2014Q1 | - | 287 | 423 | 285 | 9 | 3,886 | 2,871 | 7,760 | -31.5% |
| 2014Q2 | 4 | 232 | 432 | 456 | 97 | 8,270 | 7,584 | 17,074 | 45.6% |
| 2014Q3 | 129 | 211 | 534 | 600 | 121 | 8,174 | 6,620 | 16,389 | 52.6% |
| 2014Q4 | - | 306 | 489 | 366 | 104 | 7,668 | 6,489 | 15,421 | 14.5% |
| 2015Q1 | 16 | 192 | 553 | 455 | 152 | 4,205 | 4,486 | 10,059 | 29.0% |

Rm, Current prices



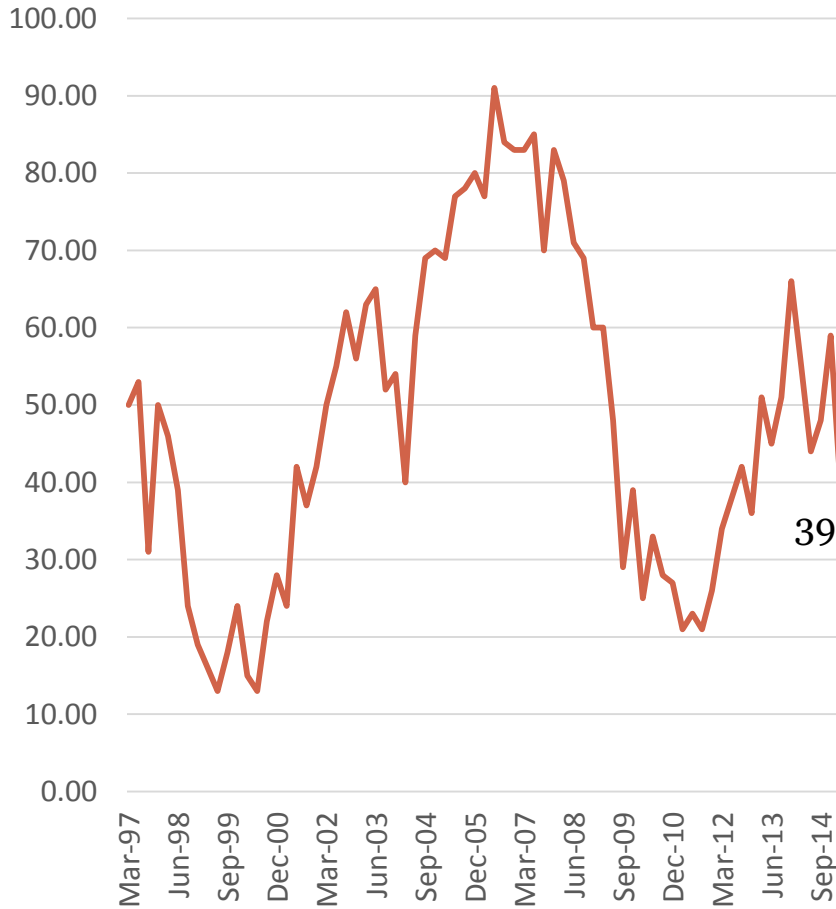
Source: Industry Insight

■ Rm

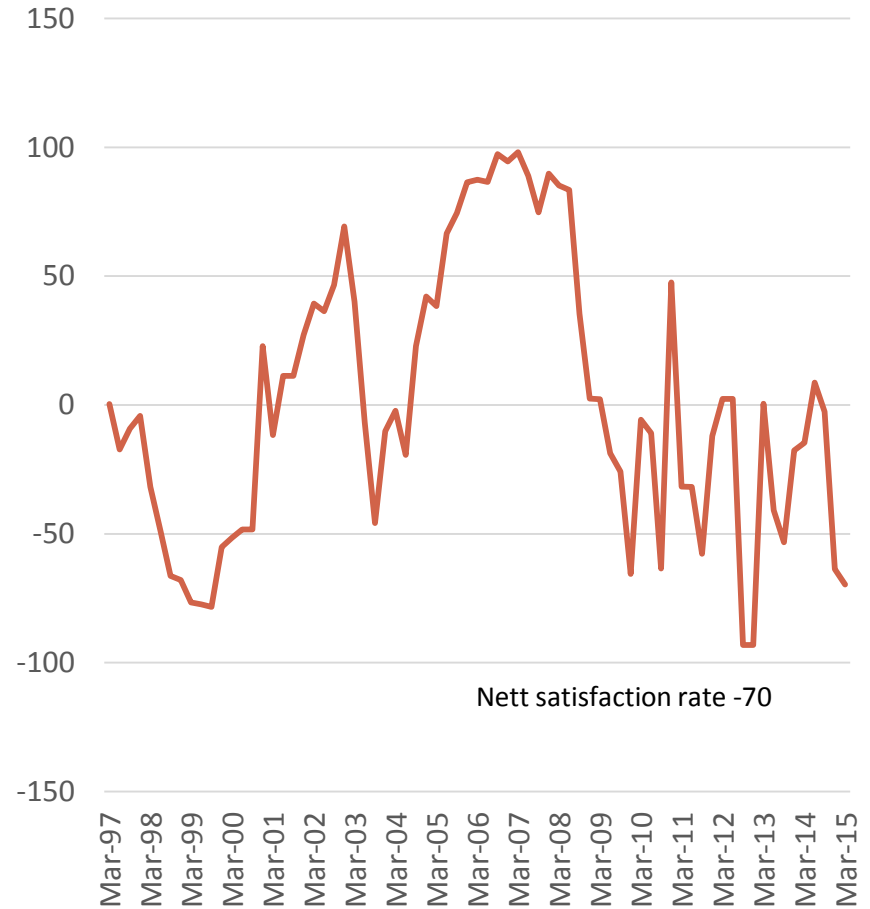
Civil Industry Confidence Indicators



FNB Civil Confidence



SAFCEC Civil Confidence



Civil industry faced by many challenges



- Payment
- Budget constraints
- Workflow (including spending of budgets)
- Postponements
- Corruption
- SOE's and rollout of projects
- Adjustments of budgetary infrastructure allocations
- Skills in planning, procurement and implementation
- Poor economic performance
- Paper to action

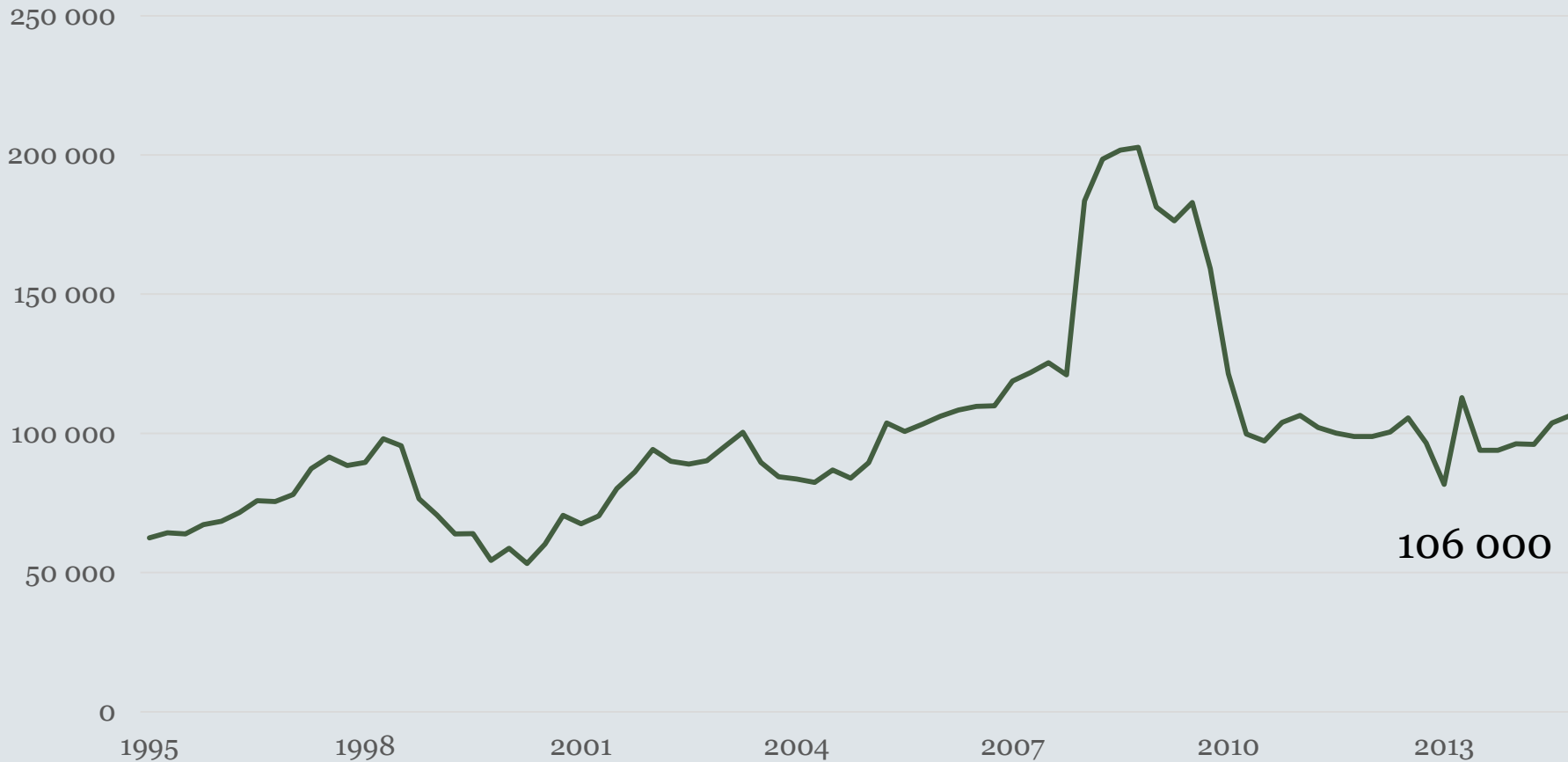
Industry shed 100 000 jobs since 2009

No real growth in employment since 2010

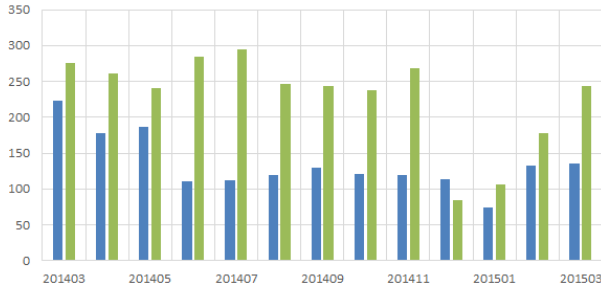
Source SAFCEC



Civil Construction



13 month - Civil Construction Activity



| | |
|-------------------|------------|
| Month, Y-Y % chg | -2% |
| Postponement rate | 47% |

| | |
|---------------------------|--------------|
| Year on year change (MAT) | |
| Awards: Rm | 10% |
| Tender: No | -24% |
| Awards: Rm | 4,490 |

Table 1: Total Number of projects

| | |
|----------|--------|
| Province | (All) |
| Sector | Civil |
| Month | 201503 |

| | | | | |
|--------------------|---------|---------|--------|-----------|
| Status | Awarded | Postpor | Tender | Cancelled |
| Number of projects | 135 | 20 | 243 | 94 |

Table 2: Number of Grade 9 projects

| | |
|------------|--------|
| Province | (All) |
| Sector | Civil |
| cidb grade | 9 |
| Month | 201503 |

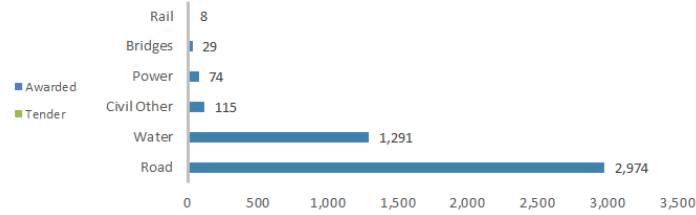
| | | |
|--------------------|---------|--------|
| Status | Awarded | Tender |
| Number of projects | 11 | 4 |

Table 3: Awarded (Rm) by type and by province | Current month

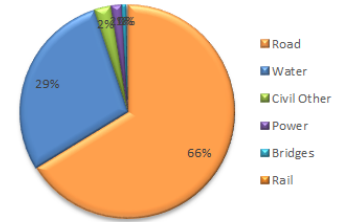
| | |
|--------|---------|
| Status | Awarded |
| Sector | Civil |
| Month | 20150 |

| Province | Road | Watervil Oth | Power | Bridges | Rail | Grand Total |
|--------------------|--------------|--------------|------------|-----------|-----------|--------------|
| Eastern Cape | 1,611 | 112 | 3 | 19 | 2 | 1,747 |
| FREE STATE | 821 | 3 | 4 | | | 828 |
| Gauteng | 2 | 14 | 46 | 10 | 6 | 77 |
| Kwazulu Natal | 80 | 671 | 16 | 30 | 27 | 825 |
| Limpopo | 11 | | | | | 11 |
| Mpumalanga | | 1 | 1 | 10 | | 12 |
| North West Provin | 4 | 10 | 15 | | | 30 |
| Northern Cape | 35 | | | | | 35 |
| Western Cape | 410 | 480 | 29 | 5 | 3 | 926 |
| Grand Total | 2,974 | ### | 115 | 74 | 29 | 4,490 |

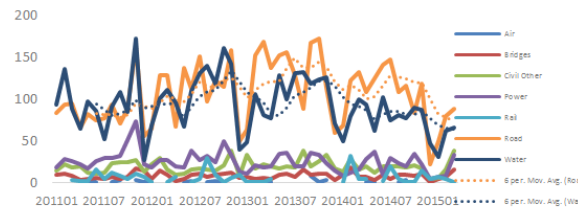
VALUE OF PROJECTS AWARDED RM (MONTH)



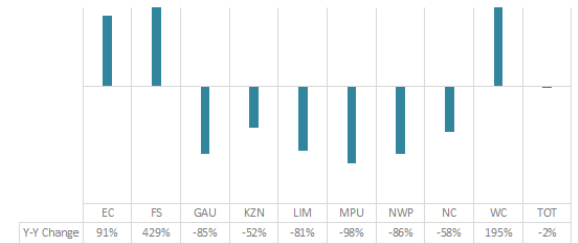
Percentage of Awards
Percentage Share



Tender activity

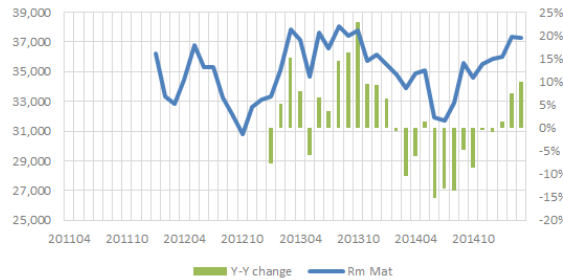


PROVINCIAL Y-Y CHANGE (MONTH)

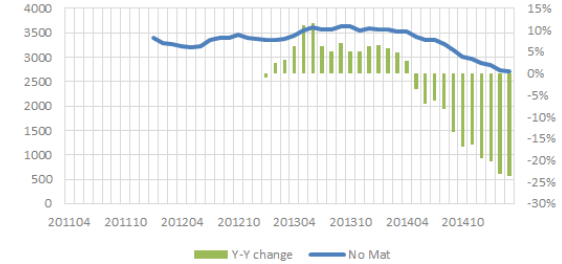


Trends: Awards and Tenders

Awards Rm



Tender (Number)



Customised Dashboards

CESA Bi-Annual Economic and Capacity Survey



JULY – DECEMBER 2014

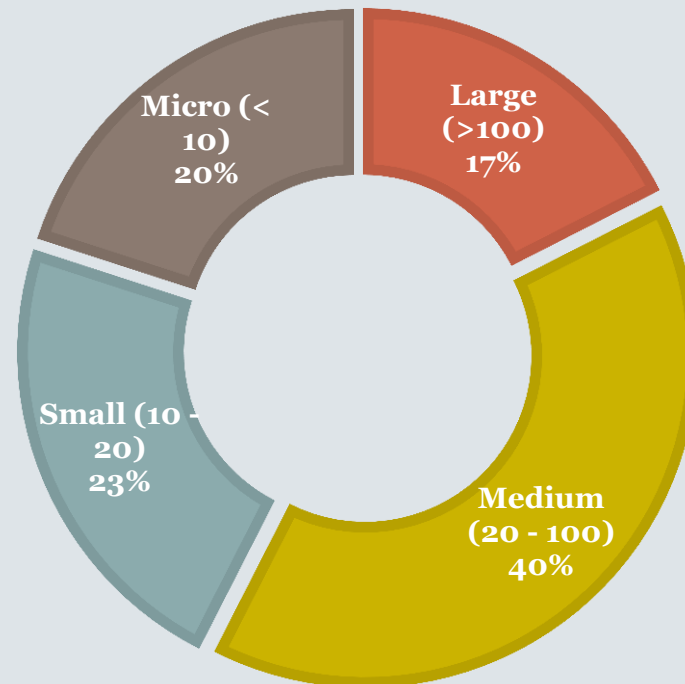


Survey Scope and Profile



- Bi-annual survey
- Since 1997
- CESA membership
- Consecutive sample to monitor *real* change
- Responses are weighted by employment contribution
- Represents app 1/3 of total employment

WEIGHTING RESPONSES



FINANCIAL

- Fee earnings
- Salary and Wage bill
- Discounting
- Profitability
- Payments
- Financial Benchmarks

HUMAN RESOURCES

- Employment Trends
- Employment Profile
- Capacity Utilisation
- Training, Bursaries

INDUSTRY PROFILE

- Geographical
- Disciplines
- Sector
- Clients

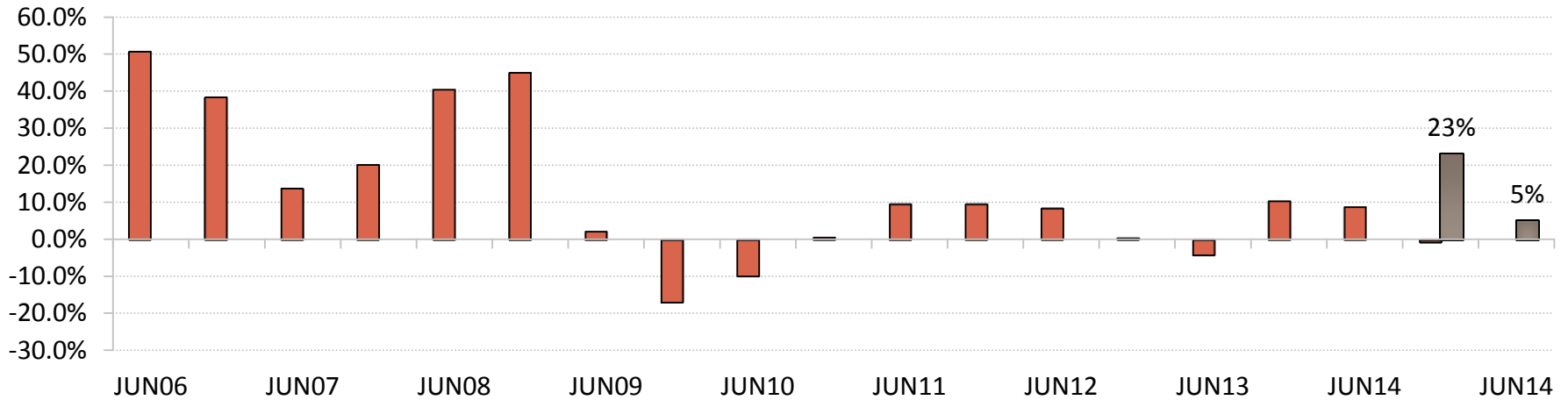
Industry Confidence

Industry Confidence

Earnings increased by 4% (real) 2014 (2013:3%)



■ Y-Y Per. Change

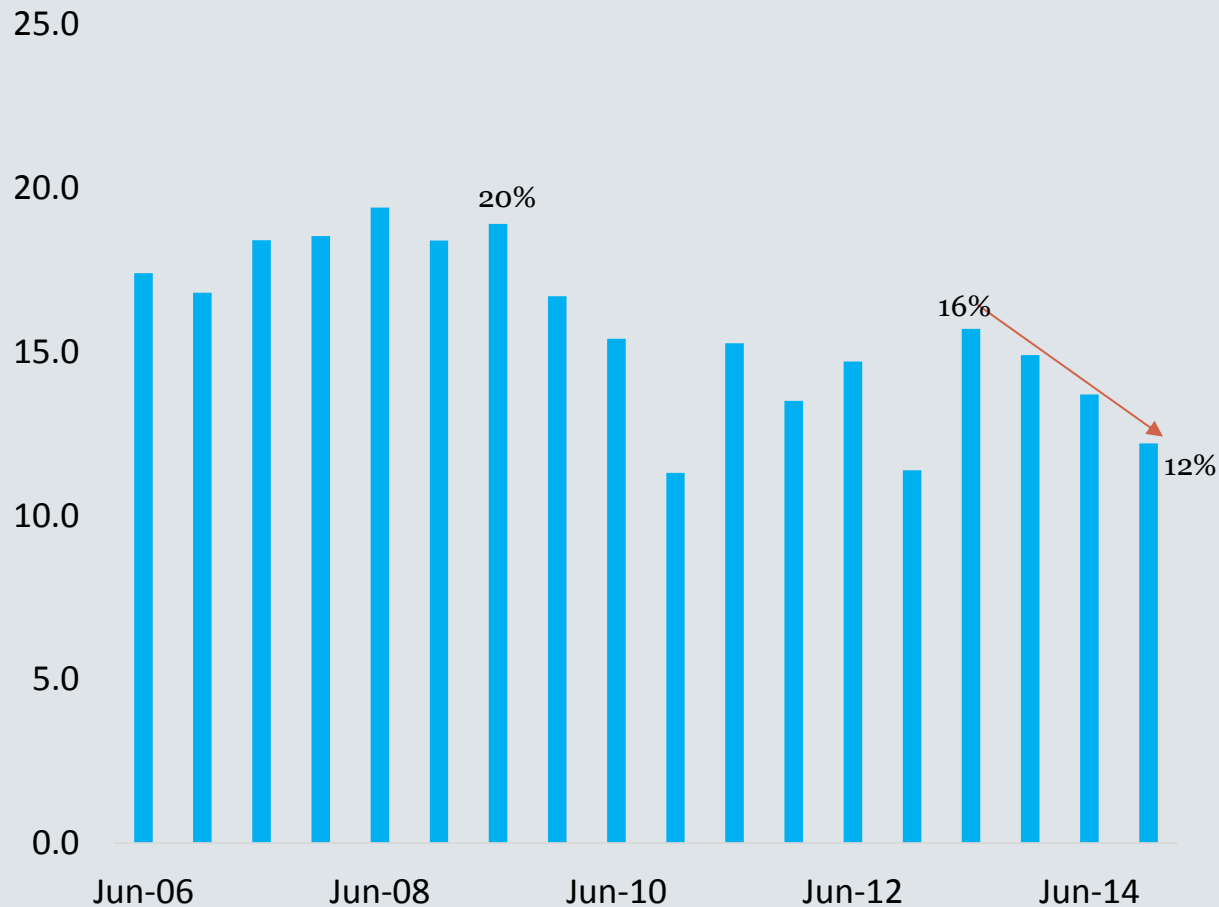


- Low growth 2009 onwards
- Expectations last six months of 2014 23% vs actual contraction of 0.7%
- Muted growth outlook for the first six months of 2015



Portside, Cape Town

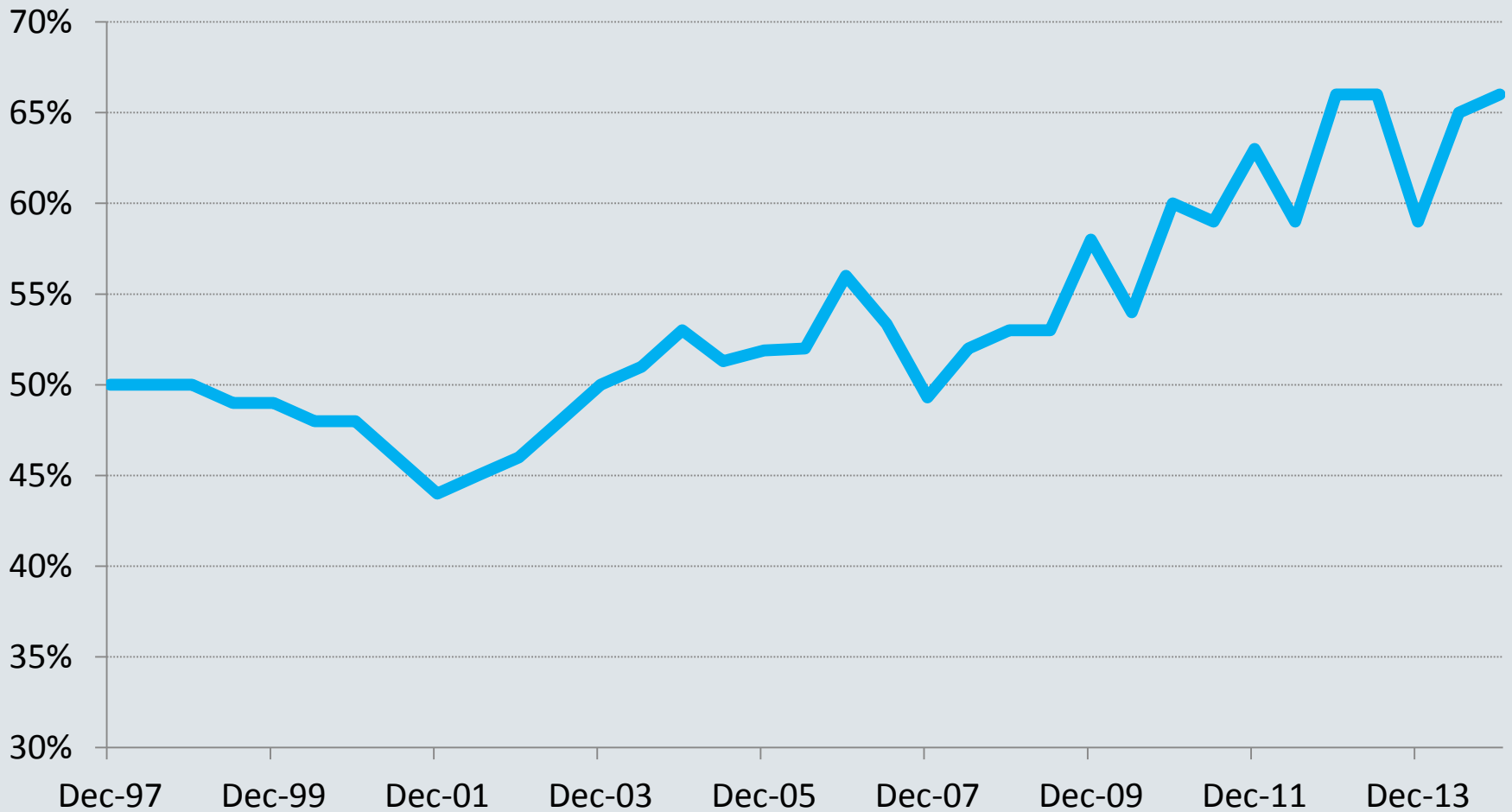
Profitability under increasing pressure



- Majority of firms have expressed dissatisfaction with profit margins
- 54% of firms expect margins to weaken



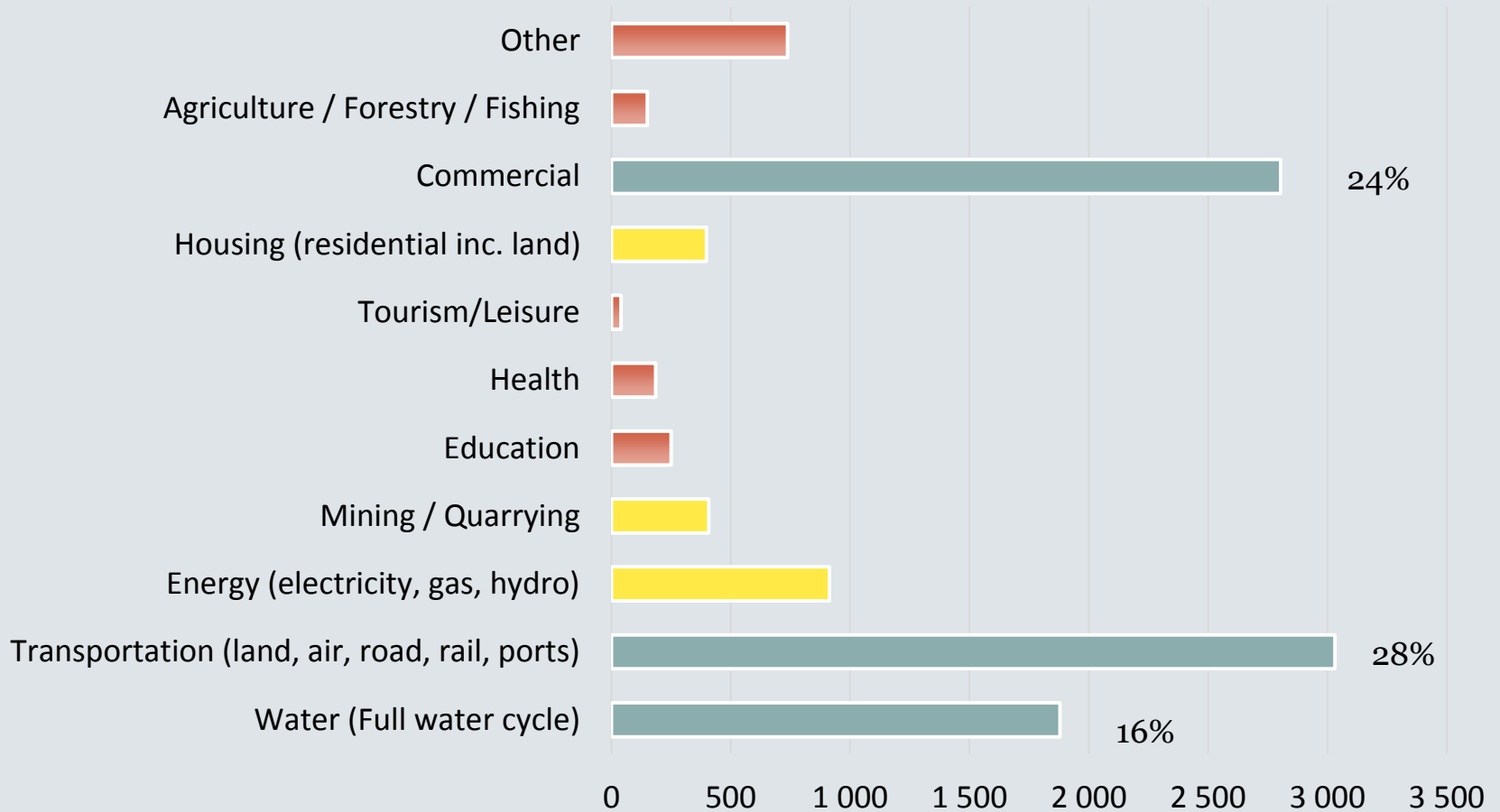
Salary and wages represent **66%** of earnings in the current survey



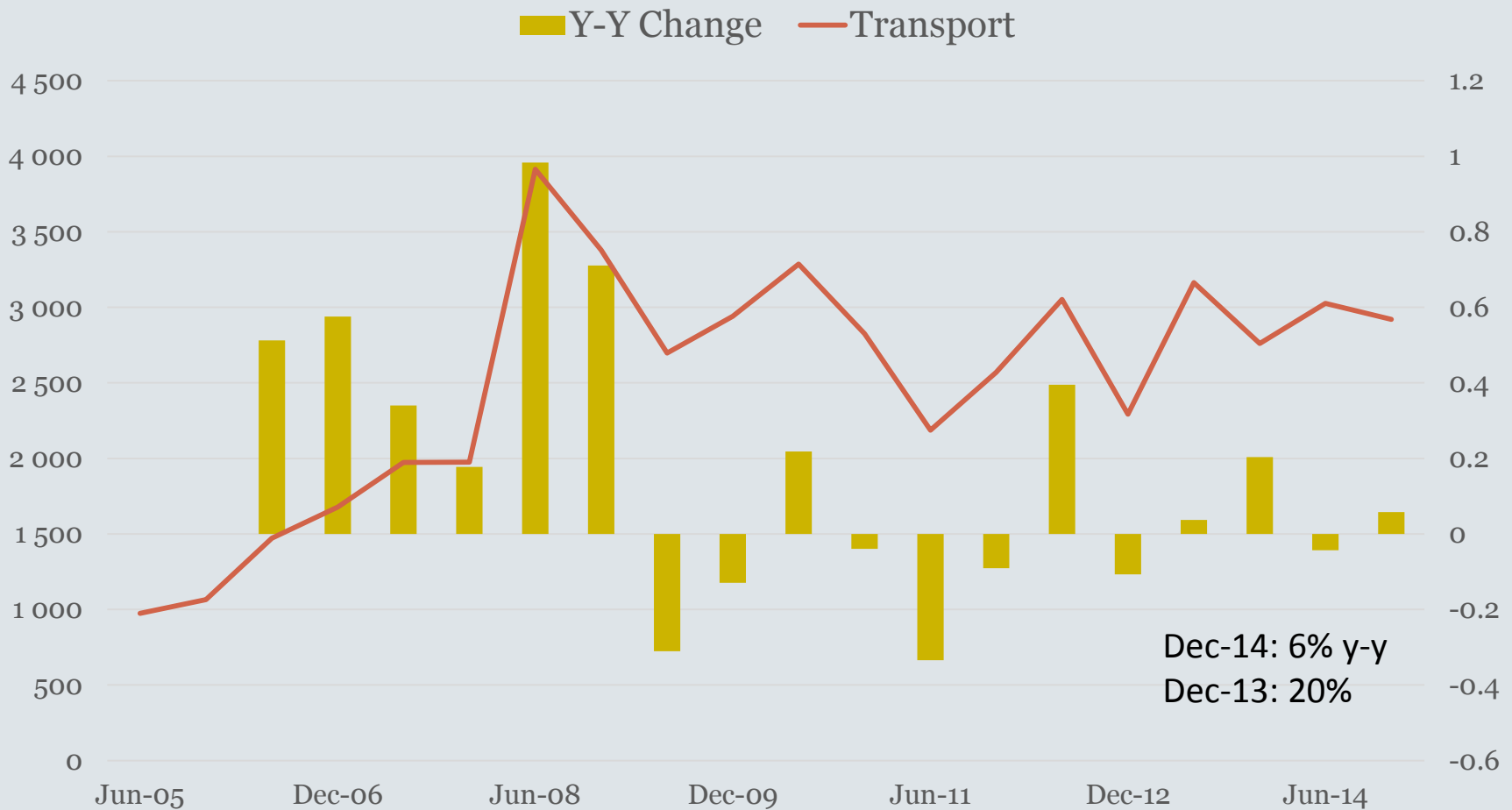
Skills shortages



Economic Sector profile of earnings 2014



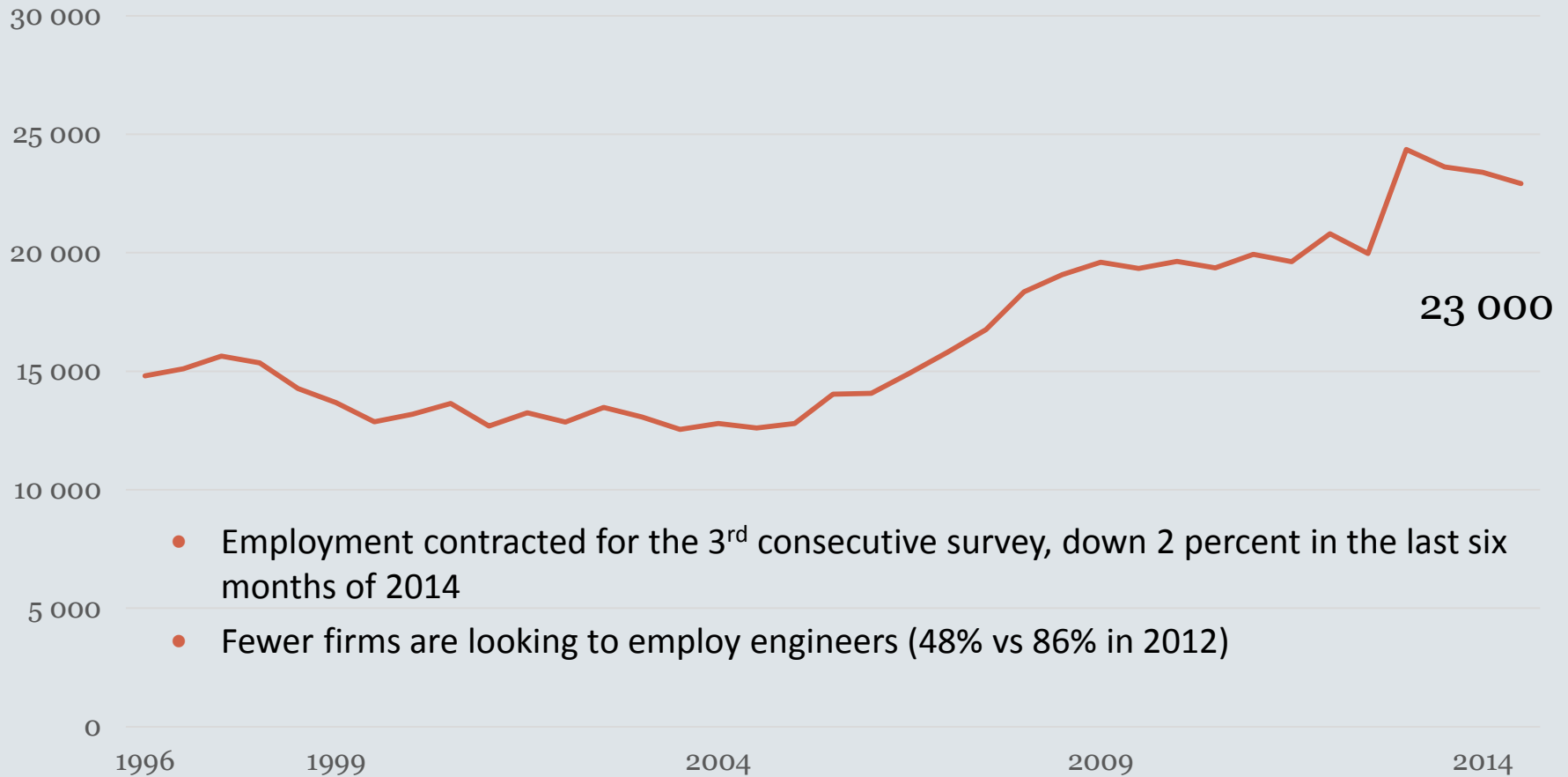
Low growth in Transport earnings



Greater employment stability, but trend reversing

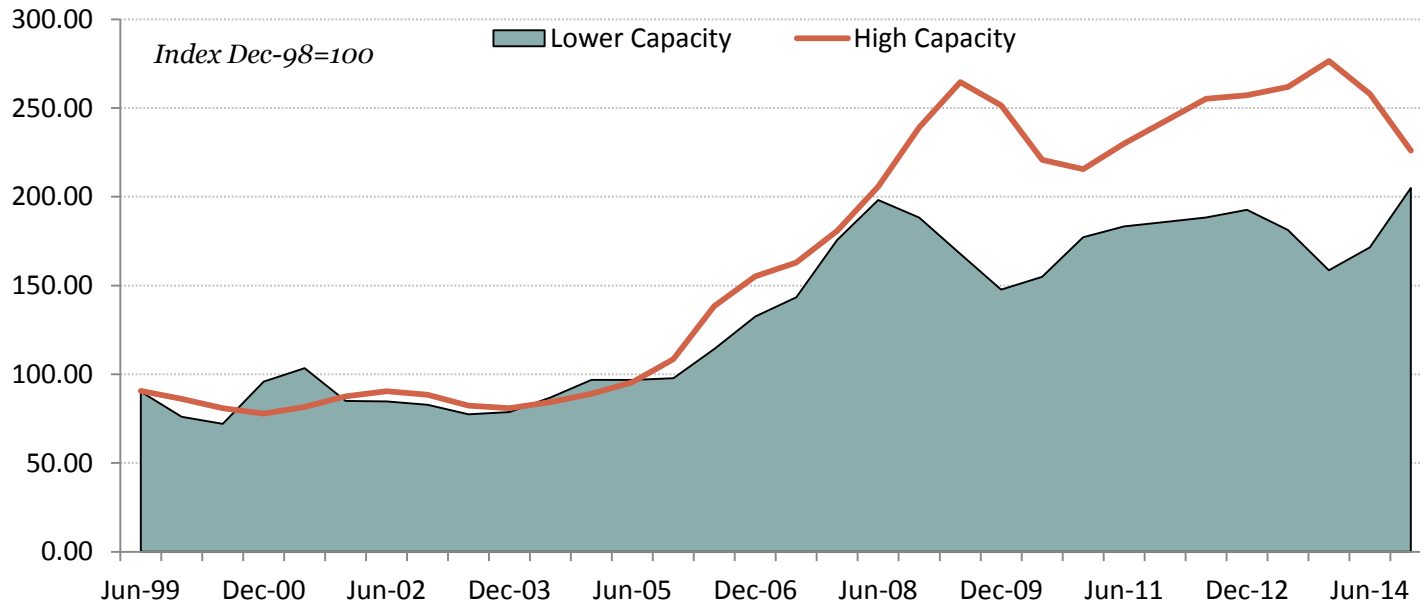
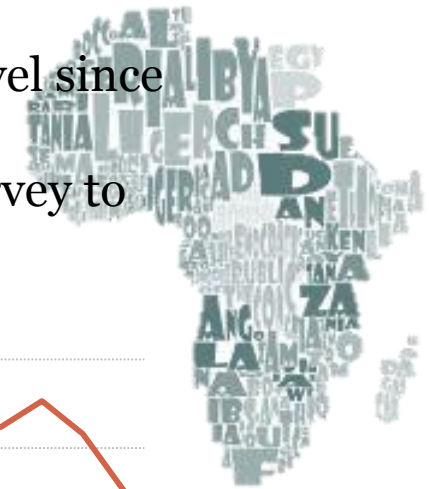


Consulting Engineering Employment (CESA)



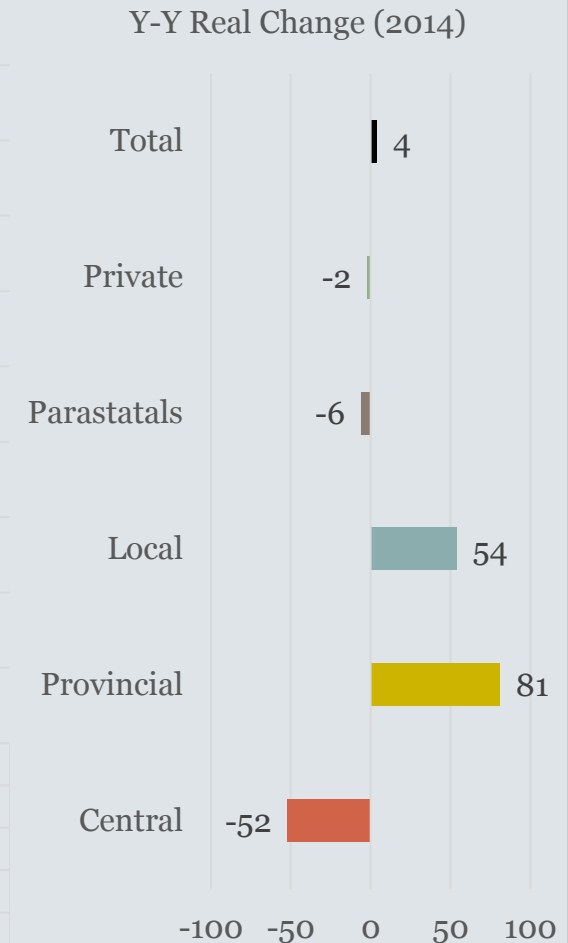
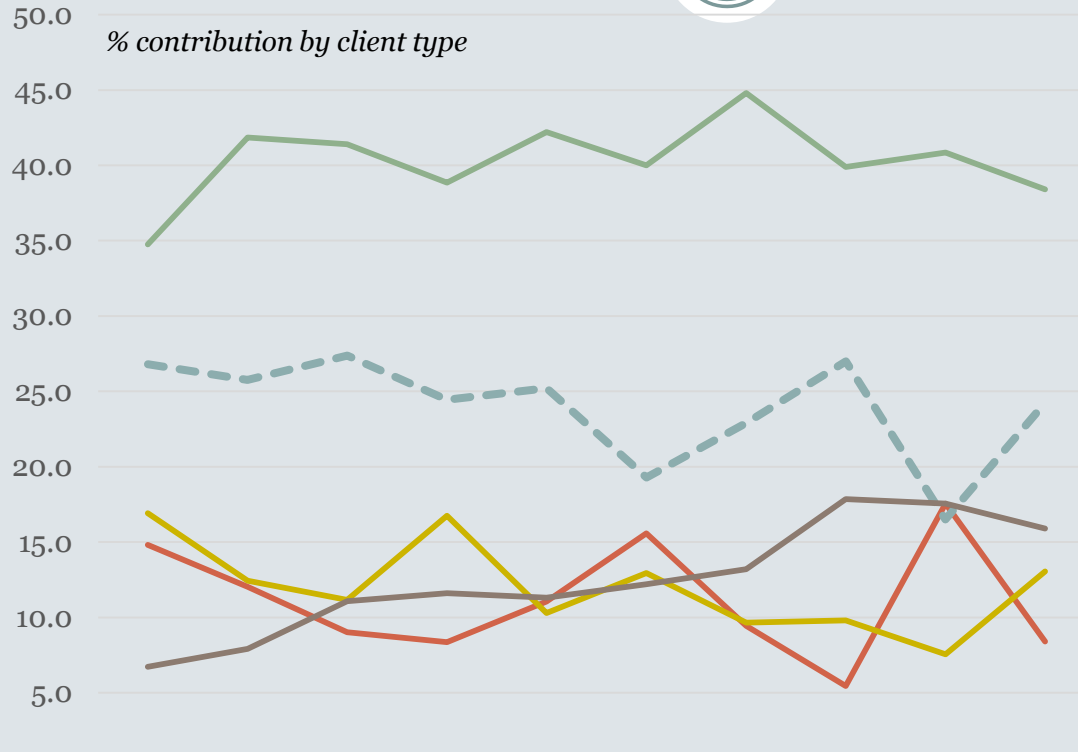
Redistribution in earnings

- 24% of earnings are outside of RSA
- 14% are in Africa (vs 10% ten years ago), the highest level since 2003
- Strong increase in international earnings in current survey to 10% (vs less than 3% ten years ago)



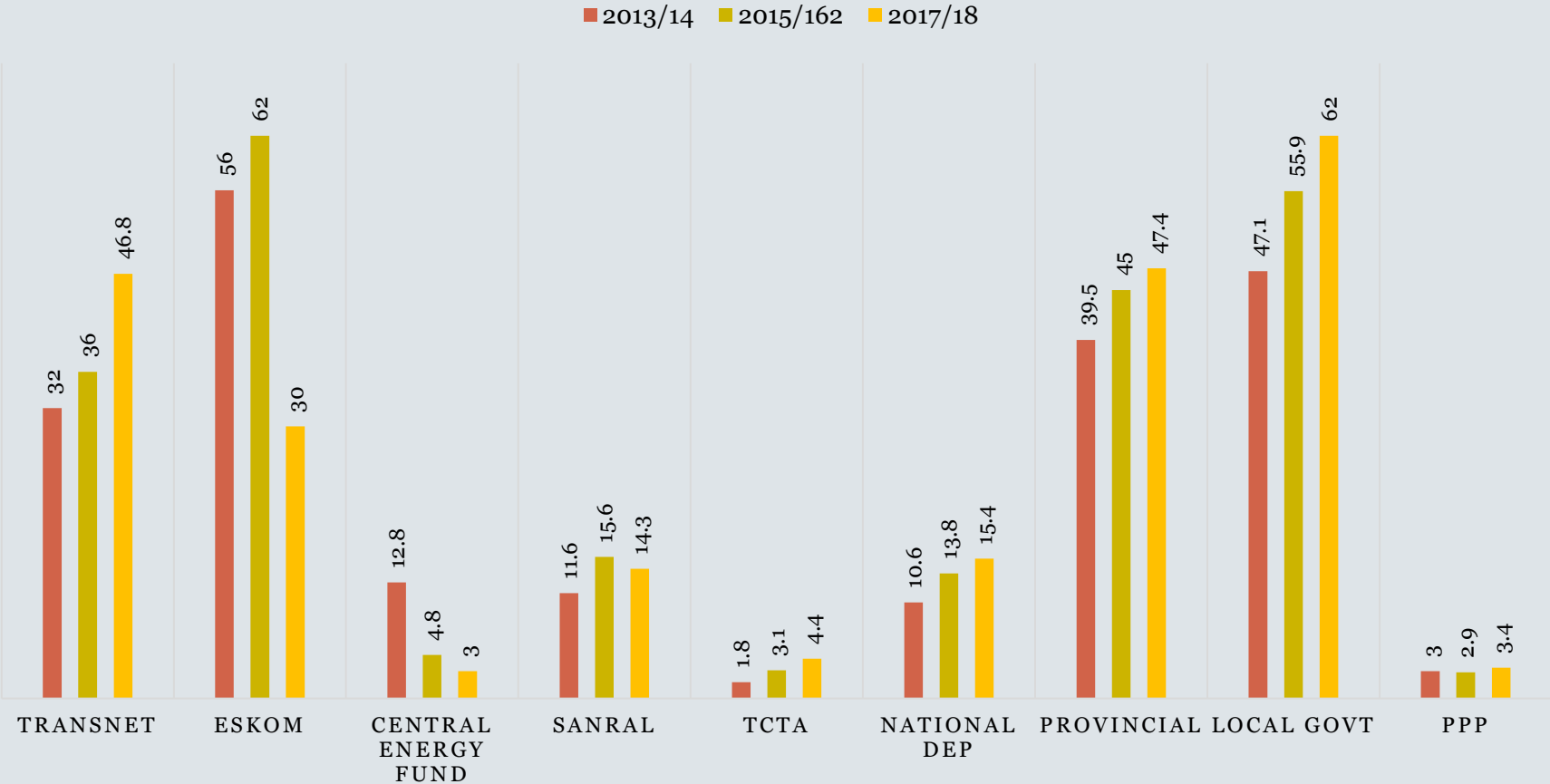
81% of earnings, but on downward trajectory

Improve local government efficiency, restore private sector confidence!!

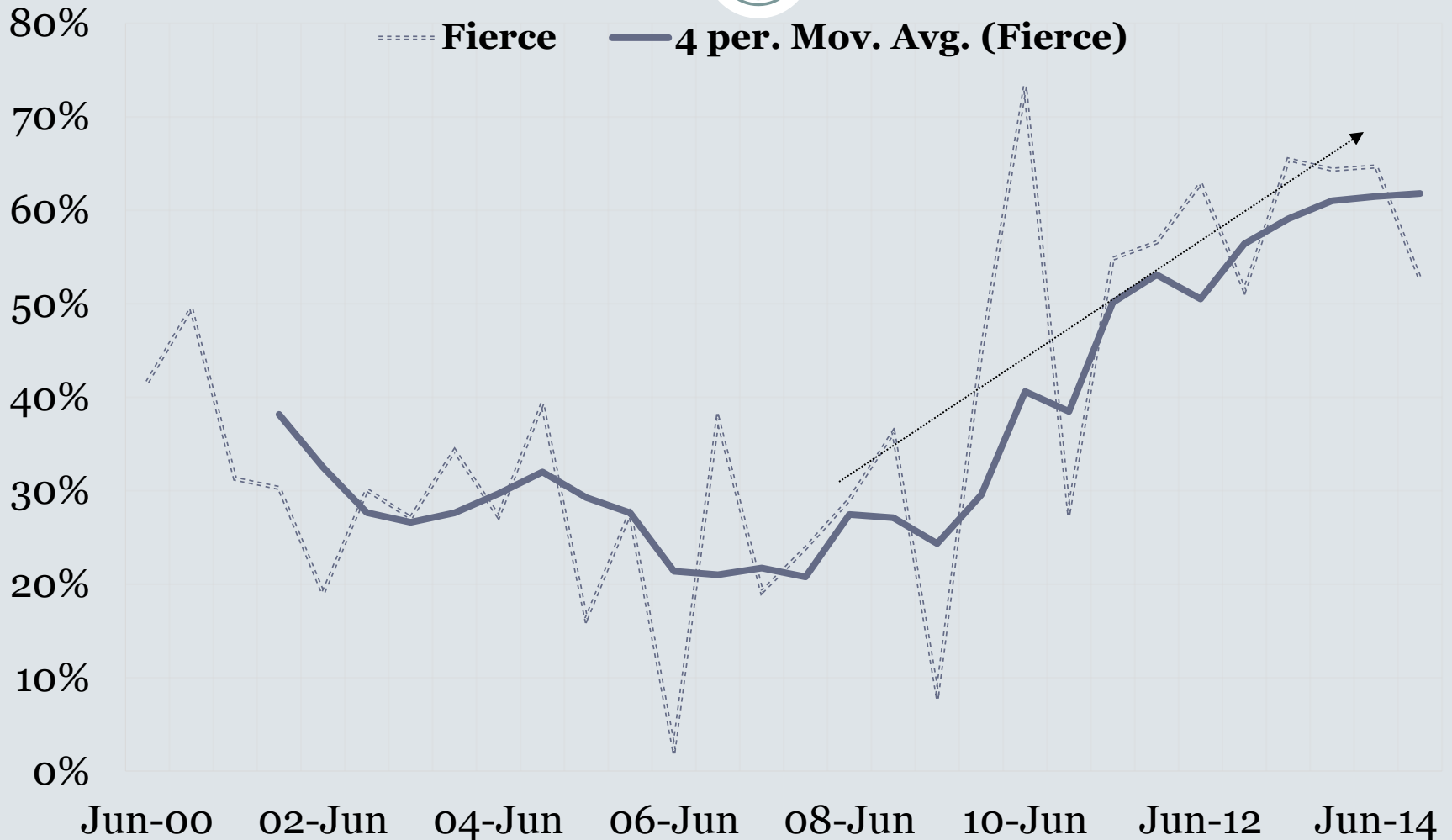


| | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 |
|-------------|------|------|------|------|------|------|------|------|------|------|
| Central | 14.8 | 12.0 | 9.0 | 8.4 | 11.1 | 15.6 | 9.5 | 5.5 | 17.6 | 8.4 |
| Provincial | 16.9 | 12.4 | 11.2 | 16.8 | 10.3 | 13.0 | 9.7 | 9.8 | 7.6 | 13.1 |
| Local | 26.8 | 25.8 | 27.4 | 24.5 | 25.2 | 19.3 | 22.9 | 27.0 | 16.5 | 24.3 |
| Parastatals | 6.7 | 7.9 | 11.1 | 11.6 | 11.3 | 12.2 | 13.2 | 17.9 | 17.6 | 15.9 |
| Private | 34.8 | 41.9 | 41.4 | 38.9 | 42.2 | 40.0 | 44.8 | 39.9 | 40.9 | 38.4 |

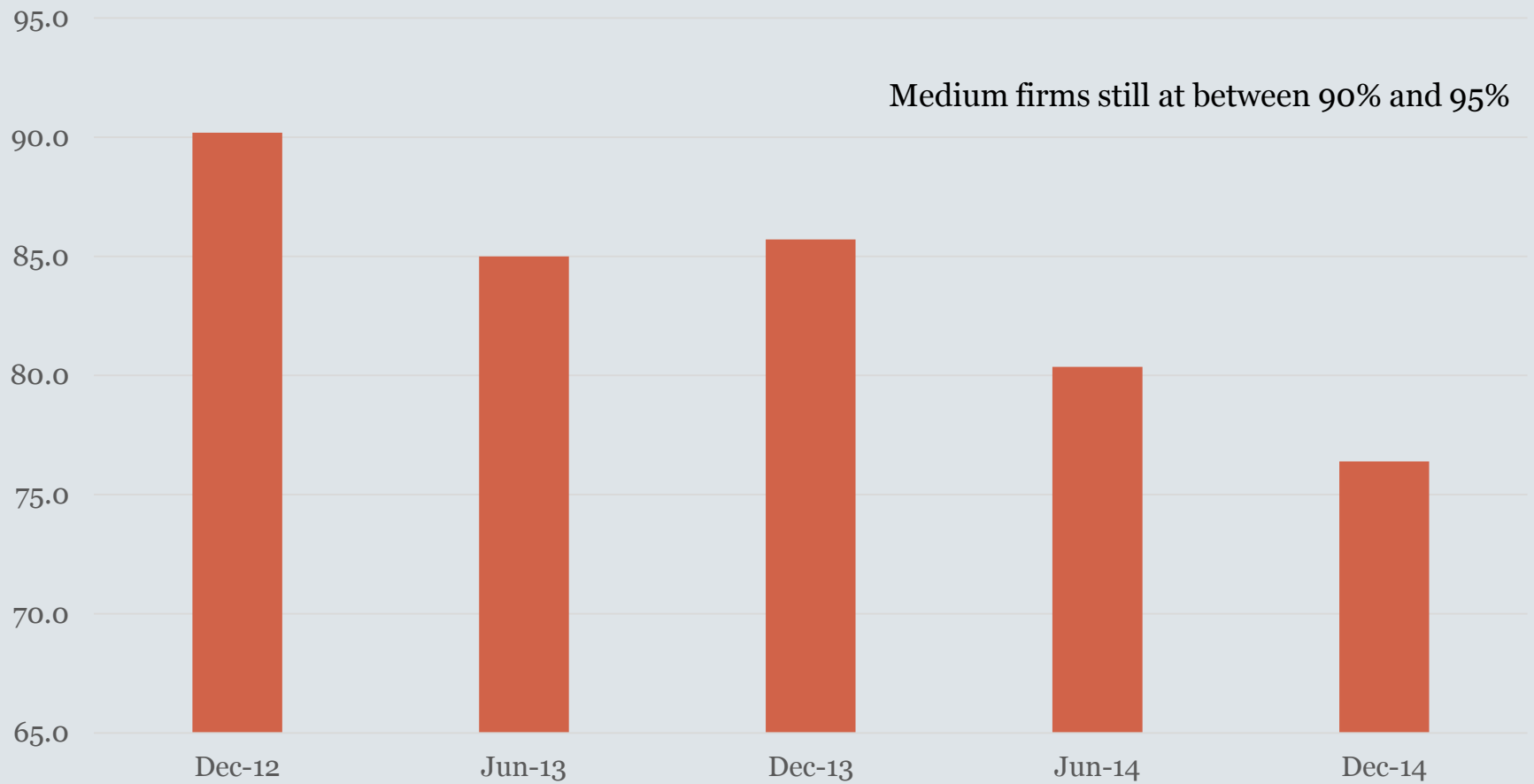
Local govt. earmarked as largest industry client by 2017/18



Competition in Tendering escalate as capacity utilisation slows

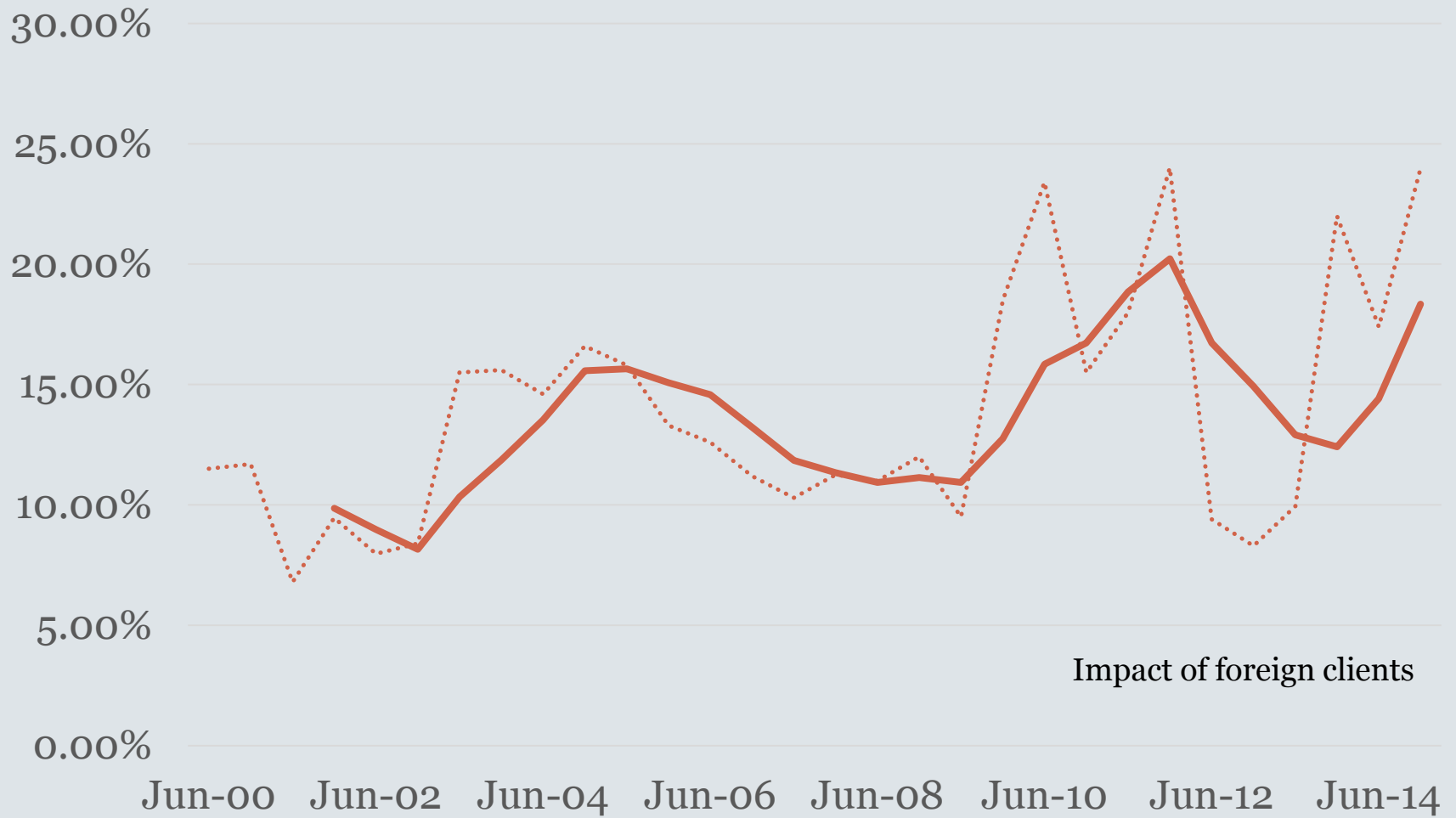


Capacity Utilisation of larger firms slow to 76%



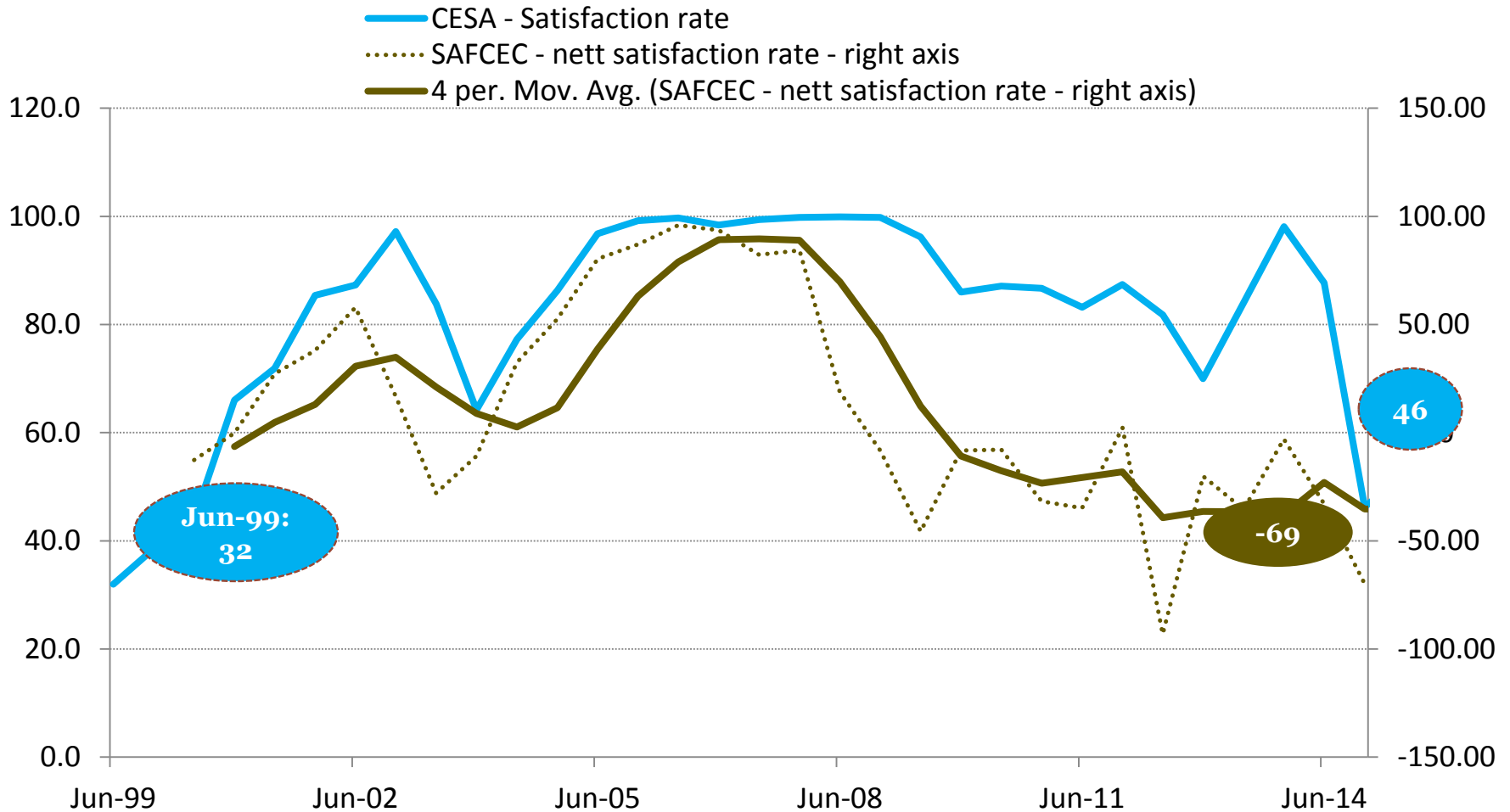
Utilisation of technical staff

Payments outstanding for longer than 90 days increased to 24% of total earnings



Impact of foreign clients

Industry Confidence



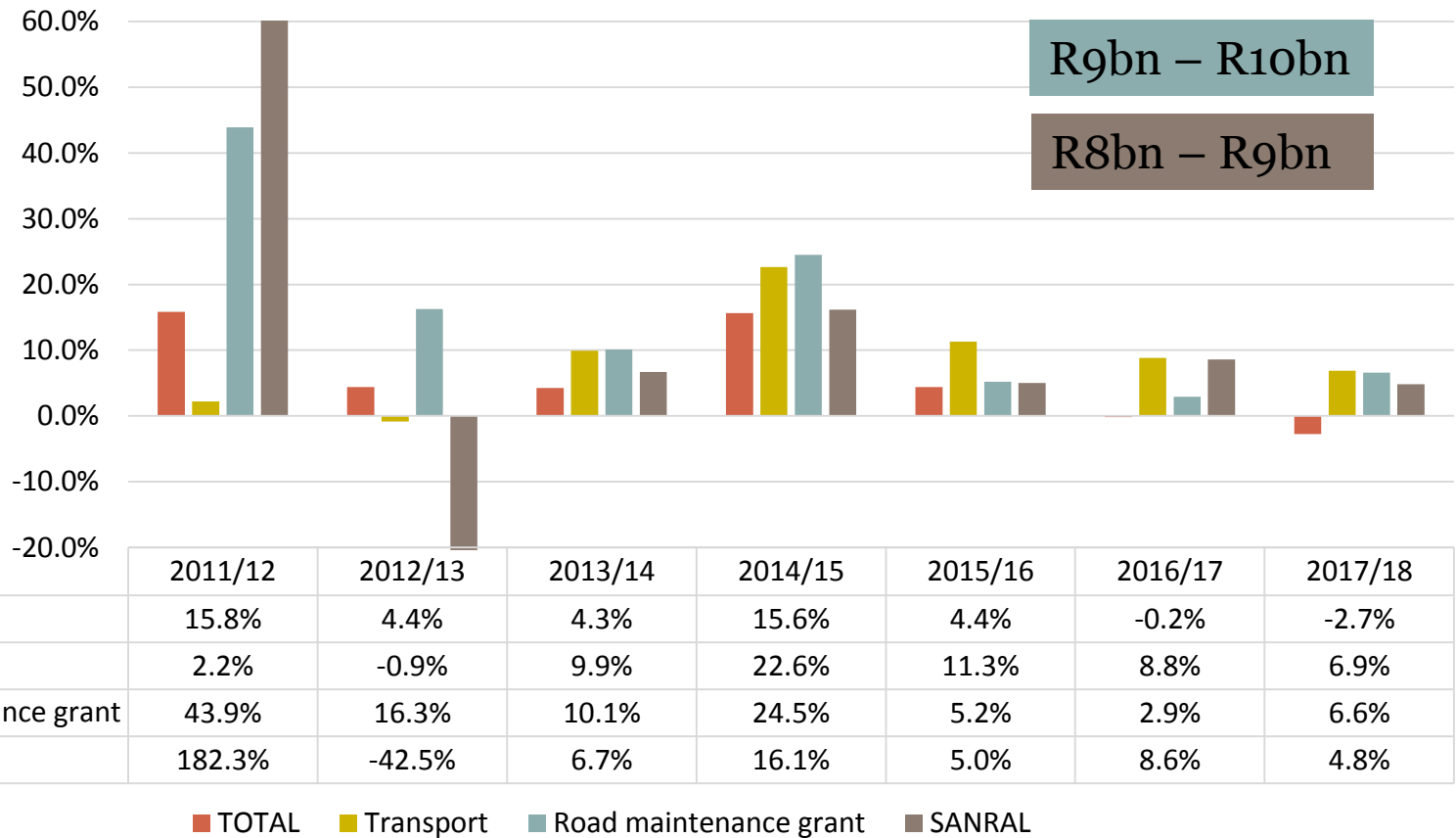
Key challenges faced by Engineering Industry



- Use of imported skills when there is spare capacity and skills available locally (i.e cost of 34 Cuban engineers = 60 local engineers)
- Procurement on price and BBBEEE, with little or no regard to functionality or quality
- Quality of technical personnel – skills shortages regarded as one of the most significant institutional challenges (client bodies), also affecting service delivery as municipal level
- Standardise procurement procedures amongst different departments
- Low growth environment, project implementation delays, budget cuts on infrastructure allocations

2015 Budget set the pace for difficult period ahead

Public Sector Infrastructure Estimates (Nominal Y-Y Per. Change)



Division: Road construction and earthworks



- The division delivered an **improved performance** for the year in an operating environment that remains very competitive.
- Management has focused its attention on **production monitoring** and driving **efficiencies** across the business units to ensure that the low margin work available is executed profitably.
- The divisional **order book grew significantly** following the awards of contracts from both SANRAL in South Africa and the Roads Development Agency in Zambia. R3.2bn (R1.5bn Zambia and Namibia)
- Revenue for the division increased **24,1%** to R1,46 billion (2014: R1,18 billion) with **operating profit increasing 37,8%** to R55,2 million (2014: R40,0 million).
- The divisional operating profit margins increased to **3,8%** (2014: 3,4%) with a marked improvement in the last six months due to a number of lower margin contracts being substantially completed in the first half.

Diversify



Expand footprint



Operational efficiencies



SAFCEC: State of the civil industry
www.safcec.org.za

CESA: Bi-Annual Economic and Capacity Survey
www.cesa.org.za

Thank you



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