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RESEARCH REPORT

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Can SA's construction industry meet the infrastructure promise?

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The South African government has highlighted infrastructure investment as key to the economic recovery post the Covid-19 pandemic. However, the local construction industry has faced increasingly difficult conditions over the past decade. After the boom of the 2010 Fifa World Cup, government contracts dried up while companies also endured difficulties related to long contract approvals, non-payment and crime at construction sites. Some companies filed for business rescue.

In this note we set out our views on whether the construction industry has the capacity to meet the envisaged infrastructure pipeline.

Both through on-budget spending and partnerships with the private sector, the government intends driving a major boom in infrastructure investment. Were government to successfully shepherd the many projects at various (largely early) stages of planning to construction phase, we have considered what capacity there is in the industry to deliver them. Limited capacity could both frustrate the infrastructure rollout and increase its cost.

Capabilities and technical expertise

Table 1 shows the share of revenue in each competency at the main listed construction companies. This highlights which areas the company has greatest capacity in. The "other" column includes various sources of non-construction revenue like mining or materials handling for mining companies.

Table 1: Allocation of revenue by construction category (including business rescue status)

Company	Financial year	Percentage of revenue in SA	Building & civil construction	Roads and earthworks	Other	Business rescue
Aveng	1H21	35%	68%		32%	
Wilson Bayly Holmes-Ovcon	FY20	22%	87%	12%	1%	
Raubex	1H21	78%	32%	37%	31%	
Group Five	FY18	77%	67%	14%	19%	Yes
Basil Read	FY18	>90%	32%	22%	46%	Yes
Esor Construction	FY17	>90%	100%			Yes

Stefanutti Stocks	1H21	63%	100%
Calgro M3	FY20	100%	100%

Source: Company reports, Intellidex calculations

Table 2: Geographical split – revenue

Company	**South Africa**	**Rest of Africa**	**Australia**	**New Zealand**	**United Kingdom**	**UAE**	**Southeast Asia**	**Other**
Aveng	35%		43%	10%			6%	6%
Wilson Bayly Holmes-Ovcon	22%	6%	57%		15%			
Raubex	78%	9%	13%					
Group Five	77%	15%						8%
Stefanutti Stocks	63%					37%		
Calgro M3	100%							
Basil Read*	>90%	<10%						
Esor Construction*	>90%	<10%						

Source: Company reports, Intellidex calculations (*estimates by Intellidex)

The analysis shows that companies with high exposure to civil construction and building activities (particularly in SA) have borne the brunt of the decline in the industry since 2010. This was the case with Group Five, Basil Read and Esor Construction, which are all struggling financially. Companies such as WBHO and Raubex were able survive by having broader construction capabilities locally and expanding offshore, reducing their South African exposure. WBHO has a particularly large offshore construction operation, with the UK and Australia contributing 72% of revenue in FY20 (Table 2).

At Aveng, McConnell Dowell operates the group's construction activities in Australia, New Zealand, and southeast Asia which, when combined, accounted for 65% of revenue in 1H21 (includes the "other section"). Moolmans operates the group's mining services business in SA which accounted for 17% of revenue in 1H21. The other non-core business units (SA construction, steel and manufacturing) accounted for the remaining portion of group revenue.

Included in the non-core business units is the Aveng SA construction business which was sold to the Laula Consortium (Oteo Investment Holdings, Manzini Ventures and Upsize Trading) for R100m in 2019. This included Oteo Investment Holdings, a black-owned and managed investment holding company. Aveng's FY20 financial statements showed that the construction and engineering business in Southern Africa generated revenue of R1.9bn (discontinued operations) and had asset and liability amounts of R349m and R404m, respectively. All remaining assets and liabilities after the sale were related to the closing out of historical contracts. The sale of the construction business is part of a change in operations at Aveng, which has seen it reduce its exposure to the construction industry in SA.

Group Five, Basil Read and Esor Construction did not have explicit figures of their geographical splits available in their FY18 results. However, we estimate their respective exposures to Southern Africa to be more than 95%, with a majority of that being to SA.

Murray and Roberts sold its infrastructure and building business to a consortium led by Southern Palace Group in 2017 for R314m. The infrastructure and building business generated R3.7bn in FY17 (discontinued operations) and had net assets (assets minus liabilities) of R255m. After the transaction it was rebranded as Concor Holdings, an independent private construction company. Murray and Roberts now operates three business units: mining; power, industrial and water; and energy, resources and infrastructure. The latter segment currently has no operations in SA.

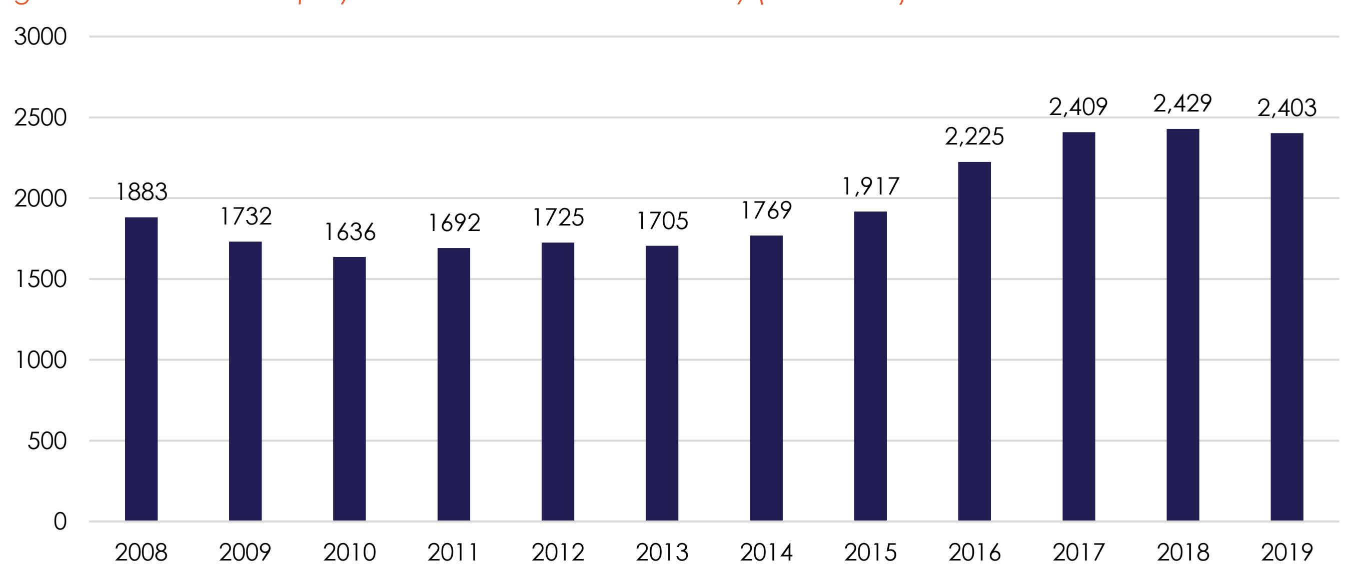
Calgro M3, a property developer that provides a mix of public (social and subsided) and private residential units, generated 97% of revenue from residential property development in FY20. Calgro M3 may not be a diversified or pure construction company but it is also positioned to benefit from the R138bn in expenditure on human settlements as outlined in government's infrastructure projects pipeline.

Employment figures

Construction industry employment levels were largely flat in the years after the 2010 Fifa World Cup before ticking up from 2015 (Figure 1), which may be due to an increase in the number of construction companies in SA. The Construction Industry Development Board (CIDB), a government entity tasked with developing a developmental and regulatory framework for the industry, recorded an increase in the number of contractors on its register to 56,653 in 2019/20, from 51,513 in 2018/19.

In addition, the actual number of workers increased to levels above the average number of workers from 2008-2019 (1.96-million). However, gross fixed capital formation has been falling from the post-World Cup peak of R635bn in 2015. In addition, construction expenditure by the public sector has declined from a R194bn peak in 2016, which coincides with the decline in headcount at the companies discussed below. The reduction in headcount resulted from expansion of operations offshore and the restructuring of businesses due to the weak operating environment.

Figure 1: Number of employees in the construction industry (thousands)



Source: Statistics South Africa (Stats SA)

The decline was particularly pronounced at Stefanutti Stocks, where the number of workers employed in SA decreased by a compounded annual rate of 9.2% to 6,339 workers in FY20 from 10,295 in FY15. At Raubex, the headcount in SA shrank 4.5% annually, to 6,884 workers in FY20 from 8,654 in FY15.

In table 3 below, the *total* number of workers at selected (SA and group) companies is shown. Aveng experienced the biggest decline in headcount, down to 7,266 workers in FY20 from 25,245 in FY15. The group restructured (by selling its construction, steel and manufacturing businesses) into a two-business unit, one of which is a mining materials business in SA (Moolmans) and the other a construction business in Australia, New Zealand and southeast Asia (as discussed above). This would have led to a larger reduction in its workforce. Moreover, table 3 shows the compounded annual rate change in the number of workers at companies with available data on headcount.

Table 3: Number of workers at selected companies (SA shown where companies disclose, otherwise group figures shown)

	FY15	FY20	Annualised change
SA			
Raubex	8 654	6 884	-4.5%
Stefanutti Stocks	10 295	6 339	-9.2%
Group			
Aveng	25 245	7 266	-22.0%
Wilson Bayly Holmes-Ovcon	10 687	9 470	-2.4%
Raubex	9 598	7 418	-5.0%
Stefanutti Stocks	13 812	9 768	-6.7%

Source: Company reports, Intellidex calculations

Overall, the broad decline in headcount across the businesses resulted from the poor economic environment and decline in construction expenditure, which forced companies to adapt or face business rescue or liquidation. However, the analysis of the headcount at selected companies combined with the financial analysis below shows that companies with adequate financial strength may be able to increase their headcounts to execute on projects that are awarded in future.

Order books

In their latest results, the companies below had order books valued at R100.3bn. Importantly, all firms have highlighted that they are well positioned to benefit from the government's proposed infrastructure spending in the short to medium term. Table 4 below illustrates that a sizeable amount of various company pipelines consists of work from the South African economy.

Table 4: Company order book exposure

Company	Order book	Total: SA	Public sector (SA)	Private sector (SA)	International
Aveng	R27.7bn	16%	*0%*	*16%*	84%
Wilson Bayly Holmes-Ovcon	R35.4bn	24%	*11%*	*13%*	76%
Raubex	R11.7bn	90%	*63%*	*27%*	10%
Stefanutti Stocks	R7.4bn	59%	*21%*	*38%*	41%
Calgro M3	R18.1bn	100%			0%

Source: Company reports, Intellidex calculations

Aveng has the lowest exposure to SA through its mining services division, Moolmans. The rest of the firms have an average SA exposure of 68% for private clients and public sector for economic (roads; energy) and social infrastructure projects (housing; schooling).

Financial analysis

While construction companies were hit hard by the Covid-19 lockdown measures, the industry in SA may have relatively positive post-pandemic prospects. Companies that survived the tough decade focused on cost management, reducing debt and de-risking their business models mainly by broadening operations (locally and offshore).

The companies considered here vary in financial stability (Table 5), with Stefanutti Stocks having the worst debt:equity ratio at a high 2.11 times, resulting in a poor average operating cash flow over the FY16-FY20 period. WBHO is in the best shape of the five firms, closely followed by Raubex – these two companies are well capitalised with good net operating cash flow. This suggests that they may have better capacity to bid for tenders from government at reasonable margins and to execute projects successfully.

Table 5: Selected financial metrics for companies

	Debt: equity ratio (FY20)	Cash/Assets (FY20)	Average net operating cash flow (FY16-FY20)
Aveng	1.29	15.1%	-R550m
Wilson Bayly Holmes-Ovcon	0.05	36.3%	R1bn
Raubex	0.18	12.7%	R771m
Stefanutti Stocks	2.11	11.6%	R37m
Calgro M3	1.20	9.3%	R109m

Source: Company reports, Intellidex calculations

Construction industry capacity

In table 6 below, we list a compilation of contractors with their grades as assigned by the CIDB. As indicated, grades reflect the value of contracts that contractors may bid for, with only grade nine contractors able to bid over R200m.

In categories eight and nine 333 and 86 companies were ranked, respectively. These 419 firms may represent adequate capacity to take on big contracts as they are likely to offer broader construction services such as infrastructure, building (property) and roads. Further CIDB data show that the public sector awarded 87% of contracts to firms in grades seven to nine in the 2019/20 fiscal year. That represented 1,220 possible contractors.

Table 6: Percentage of contractors and grade designation levels (2019/20)

Value of tender range (less than or equal to)	Grade	Number of companies
R500,000	One	47 077
R1m	Two	3 102
R3m	Three	1 398
R6m	Four	1 421
R10m	Five	1 089
R20m	Six	1 346
R60m	Seven	801
R200m	Eight	333
No limit	Nine	86
Total firms		**56 653**

Source: Construction Industry Development Board (Cidb) annual report 2019/2020

Conclusion

Overall, we believe the industry has the following features that would be relevant to a large infrastructure rollout:

- There has been a reduction in capacity from an employment perspective. However, several firms have quite large international operations which could redirect skills into SA if needed.
- The larger firms are not doing much public sector work and are refocused on private/foreign work. There is some potential to redirect activity but this will take some time.

- There is still financial distress among large construction firms with three in business rescue and others with high debt levels. These constrain their ability to take on large projects, especially those that have a high construction risk burden placed on construction firms.

The significant decline of the construction industry's fortunes over the last decade means capacity is now limited. However, global links will enable a moderate rate of capacity increase if public sector demand were to develop. This would need to be gradual, however, with the industry in a strong pricing position should demand come on stream too quickly.

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