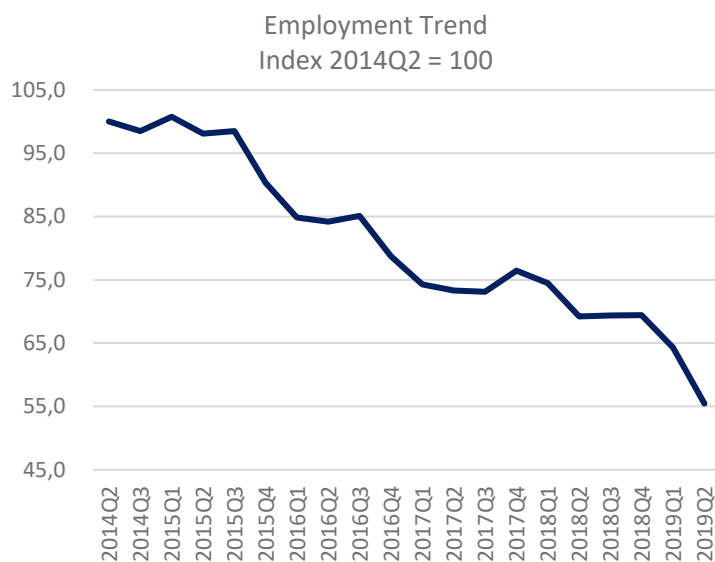


STATE OF THE SOUTH AFRICAN CIVIL ENGINEERING INDUSTRY 2019Q2

This press release statement is prepared by Industry Insight on behalf of the South African Forum of Civil Engineering Contractors (SAFCEC)

The South African civil engineering industry remains in disarray, according to data from the 2019Q2 survey as well as independent data sourced from organisations such as Industry Insight, Stats SA and the Bureau for Economic Research (BER). The SAFCEC civil engineering **confidence index** remains at near rock bottom, with a nett satisfaction rate of -96.3, a marginal improvement from -99.9 in the first quarter (the worst it can be is -100). **Employment** in the 2nd quarter fell by 13.8 percent y-y and has fallen sharply over the last few years. Since 2014, employment has fallen by just over 45 percent according to the survey, which is a serious cause for concern, and evidence of the tough conditions faced by the industry. Data from the current survey shows that the civil construction industry remains highly competitive, with an oversupply of contractors in the market competing for fewer work opportunities. This is evident in that 84.6 percent of contractors said that there were more than 11 bidders per tender.

This has also had serious implications on firms bottom line, with a 7.6 percent decline in revenue reported in the 2nd quarter (compared to the same quarter last year), as well as shrinking 2 year order books, which declined by 9.9 percent in the quarter on average. Subsequently, profitability has deteriorated to one of the lowest levels recorded in the survey, with a nett satisfaction rate of -89.6 reported, with only 5.2 percent of respondents saying that profitability was reasonable. In this increasingly competitive environment, contractors have been forced to slash their margins just to remain competitive and ensure some sort of workflow.



Years of corruption and maladministration, which has now become systemic in the public sector, has crippled South Africa's state owned entities, who are the biggest spenders of government's infrastructure budget. The fact that we saw the biggest cuts to infrastructure spending since the late 90's at the beginning of last year also didn't help, and facilitated a sharp downturn in an already declining industry (albeit coming off a very high base). The economy has also performed poorly, and continues to stagnate as evident with the release of the latest GDP figures, with a severe lack of policy certainty and political stability.

The 'shock' GDP figures recently released by Stats SA really highlight the dire state of the economy, with Gross Domestic Product contracting by 3.2 percent in the first quarter of the year. This is the worst decline recorded since the global financial crisis, and was a broad-based contraction across the economy, with very few sectors managing to escape the downturn. Looking at the figures from the production side (where the figures are broken down by sector), the contraction was broad based, the largest being in agriculture (down 13.2 percent), mining (down 10.8 percent) and manufacturing (down 8.8 percent). **It was no surprise that the construction industry again saw a**

decline, with the sector contracting by 2.2 percent in the quarter, with declines across all segments, with less residential, non-residential and civil building activity in the quarter. The construction industry has underperformed the rest of the economy in terms of the GDP figures, with contractions recorded in both 2017 and 2018. The tertiary sector performed slightly better, with only a 0.7 percent decline on average. The average consumer is becoming poorer and poorer, with a 0.8 percent contraction in overall household expenditure.

What is much more of a worry for the medium to longer run, is the lack of investment in the South African economy, which is a long-term driver of growth and prosperity, as well as a catalyst for job creation. Many investors were supposedly adopting a 'wait and see' approach, waiting to see what happened at the May 2019 election which is now concluded. Even though there were no big surprises within the election results, it is unrealistic to expect big reforms in the short run, due to the fractured nature of the ruling party. This has been evident in past weeks. One example is ANC secretary general Ace Magashule refusing to acknowledge Cyril Ramaphosa as a factor in their election win, saying that voters voted for the party and not the man. This couldn't be further from the truth, because over 650 000 voters voted for the ANC on a national level, but another party on a provincial level, meaning Ramaphosa certainly played a role. The debacle about changing the Reserve Banks mandate is another example of the deep divisions.

According to Industry Insight, as well as some anecdotal comments from contractors in this survey, there has been an uptick in the **number of projects coming out to tender** (an increase of 18 percent y-y, **but the awarding of contracts remains elusive**. In the first quarter, there was a 13 percent nominal decline in the value of **civil projects** awarded y-y. There is however some optimism around the awarding of water contracts, with a significant uptick in the estimated value of water projects that have come out to tender. And although we have a mostly new cabinet who have vowed to root out corruption, this is yet to happen, **as many contractors reported corruption (specifically in the awarding of tenders) as a major constraint to their business**.

Key observations/results from the survey:

- **Employment** decreased quite sharply in the current quarter, with the negative longer-term trend persisting. Employment fell by 13.8 percent on a quarter on quarter basis. The civil engineering industry has now shed just under 45 percent of its total work force over the last 5 years, from 2014. Employment was down across the board, with medium sized firms reporting the starkest decline in employment, down 24.1 percent.
- The total value of civil engineering construction certified for payment decreased by 7.6 percent q-q. Large and small sized contractors reported decreases of 14.6 percent and 7.9 percent respectively, while medium firms collectively reported an increase of 14.5 percent which is good. Overall another poor quarter in terms of revenue.
- Overall conditions in terms of the two-year forward order book continue to deteriorate, with a relatively sharp decrease of 9.9 percent. This is off the back of a 3.7 decrease in the 1st quarter. Medium sized firms again reported the strongest decrease in order books this quarter, down 21.7 percent q-q, following a decline of 25.4 percent in the previous quarter.
- **Value of late payments** decreased by 18.2 percent in the 2nd quarter of 2019, down again after a decrease 29.1 percent in the first quarter. The data is somewhat volatile and differ for the different sized firms. Medium firms reported the biggest decrease in late payments, down by just over 43 percent which is quite significant.

- **Competition for tenders** was slightly less fierce than in the previous quarter but there are still more than 90 percent of companies that said there were more than 11 bids per contract, compared to 99.3 percent and 98.0 percent in the previous two surveys. Overall 84.6 percent of firms said that there were between 11 and 25 bids per project.
- **Tender prices** climbed to a more elevated level, with 83.2 percent of contractors reporting keen tender prices, which is the highest level since the first quarter of 2015, but this trend however does not fully correlate with some of the other opinions in the survey. None of the respondents (across all firm sizes) reported reasonable or good tender prices in the current survey, on par with the previous surveys.
- The net satisfaction rate around **profitability** deteriorated to one of the lowest levels recorded in the 2nd quarter, with a nett satisfaction rate of -89.6 reported overall. 50 percent of contractors said that profitability was very low, which is the lowest on record. And only 5.2 percent said that profitability was reasonable.
- Interestingly, there was again a big improvement in opinions around **tender activity**, with 41.5 percent of respondents reporting satisfactory levels of tender activity, up considerably from the previous surveys and is the highest in a few years. This marks the 2nd consecutive survey where opinions related to tender volumes have improved. Majority of firms (44.5%) reported capacity utilisation in terms of general plant and resources at between 76 and 90 percent, and more firms reported higher levels of capacity utilisation in general. On average, utilisation levels were up in the 1st quarter, with only 0.01 percent of firms saying that they were operating at between 0 and 25 percent, compared to over 30 percent in the previous two surveys. Only 2.3 percent of respondents reported capacity levels of lower than 75 percent, but only 7.4 percent reporting levels of above 90 percent, which suggests that firms may still not have fully adjusted to overall levels in the civil industry.
- **Input costs** dropped significantly to an average annual increase of 5.3 percent in the 1st quarter of 2019, from an average (revised) increase of 7.9 percent and 7.8 percent in the 3rd and 4th quarters of 2018.
- The overall **confidence level** recovered ever so slightly from rock bottom levels in the previous two surveys, where a satisfaction rate of -100 was recorded for two consecutive surveys. Conditions remain dire, with a negative satisfaction rate of -96.3 percent recorded in the second quarter of the year, barely an improvement. For the past 5 quarters, the index has been extremely poor, with little signs of respite.
- Although we have a reformed government, to some degree, with promises to root out corruption, many contractors still complain about corruption specifically in the awarding of tenders at various government departments. Civil unrest was also noted, which has picked up over the last few months, with little intervention from national government. Many contractors also noted that they had seen a pick up in the number of tenders that have been coming out, but absolutely no pick up in the awarding of tenders what so ever. The lack of work is always the most prominent complaint, especially from various government departments.

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