2016

State of the South African Civil Engineering Contracting Industry

SAFCEC

3rd Quarter 2016

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Executive Summary

Global economic conditions remain constrained for three reasons:

- Slowing growth and re-balancing of economy in China, resulting in longer than expected depressed commodity price cycle
- Oil dependent economies are faced with financial constraints resulting in debt traps, due to over dependency on oil revenue, further weakening economic growth and investment.
- Volatile capital flows affecting currency movements in particular emerging economies

Given the better than expected performance in the first half of 2016 (with a better than expected performance in Euro, counteracted by a weaker than expected performance in the US), and considering the potential downside risk following Brexit, projected world economic growth was revised downward by the IMF to 3.1 percent for 2016 and 3.4 percent for 2017.

South Africa's economic performance surprised on the upside, with mining and manufacturing showing a recovery in the 2nd quarter of 2016, increasing GDP to a seasonally adjusted and annualised increase of 3.3 percent q-q, following the 1.2 percent q-q contraction in the previous quarter. Although this provides a welcome sigh of relief as South Africa avoids a recession, and hopefully provided some satisfaction to credit rating agencies who are keeping a close watch on South Africa to restore economic growth, on a strictly year on year basis the economy rose only marginally by 0.6 percent in the 2nd quarter compared to a -0.1 percent contraction in the previous quarter. The economy is therefore by no means out of danger. Growth in the construction sector slowed further in the 2nd quarter, from a seasonally adjusted annualised increase of 0.4 percent q-q in the 1st quarter to just 0.05 percent q-q in the 2nd quarter. On a strictly year on year basis, growth slowed to 0.7 percent y-y from 2.5 percent y-y in the 1st quarter. Having contracted at an annualised rate of 2.8 percent in the 4th quarter of 2015 and 10.0 percent in the 1st quarter of 2016, real GFCF contracted by a further 4.6 percent in the 2nd quarter. Capital spending by private business and general government contracted at a slower pace in the 2nd quarter. Headline inflation averaged 6.5 percent in the first quarter of 2016, slowed to an average of 6.2 percent in the second quarter and to 5.9 percent in August 2016. Oil prices rebound somewhat in the first half of 2016, due to a drop in supply in non-OPEC countries and supply interruptions in Nigeria and Canada. A better than expected economic performance in China in the first quarter, also supported higher prices.

Employment rose by 1.0 percent, q-q in the 2nd quarter of 2016, following a decrease of 1 percent and 5.9 percent in the previous two quarters. Medium size firms reported the strongest increase, up 7.4 percent q-q, compared to a 0.4 percent increase reported by larger firms. Smaller firms reported a strong decrease of 14.8 percent. The total value of civil engineering construction certified for payment surprised on the upside and rose by 23.2 percent q-q in the 2nd quarter, after having decreased by 8 percent and 11.5 percent q-q in the previous two quarters. On the downside, the value of the two-year forward order book fell by 2 percent q-q in the 2nd quarter, following the 5 percent q-q increase in the 1st quarter. However, medium size firms again are bucking the trend with a 44 percent increase reported in their aggregate order book, while larger firms and smaller firms reported a 4 percent and 63 percent q-q decline respectively. Late payments continued to rise in the current survey. After having shown relatively consistent improvement in the value of late payments reported by contractors, late payments increased more significantly in the past two quarters, up 37 percent q-q in the 1st quarter and 14.3 percent q-q in the 2nd quarter. The index measuring late payments peaked at 389.3 in the 2nd quarter of 2014, improved to 36 in the 4th quarter of 2015, before rising to 57.2 in the current survey.

In terms of business conditions, the mostly negative market sentiment continued to prevail since 2009, and although the level of sentiment expressed by respondents reached new lows during the 2nd quarter of 2015 there was a marginal improvement in the last few quarters, but not enough to lift the overall sentiment out of the red. The outlook for the 4th quarter however has shown some improvement. Competition for tenders remain fierce, while tender prices remained under pressure. The nett satisfaction rate related to profitability was negative, -25.0 percent, with only 37.5 percent expressing satisfactory sentiment pertaining to levels of profitability. Majority (50 percent) reported low profitability.

The negative sentiment towards tenders was maintained in this survey, although there was another gradual improvement in the negative nett satisfaction rate to -45.3 percent from -51.9 in the 2nd quarter. The nett satisfaction rate regarding opinions related to the awarding of contracts deteriorated in the current survey, from (positive) 15.8 percent to -10.9 percent. Although the trend over the last five quarters remain in the red (due to the high levels of negativity since 2012 and the slow pace of recovery) the negative sentiment (rate of decline) has improved to -12.5 percent (the best level since 4th quarter 2012). On the upside there was an improvement in the nett satisfaction rate regarding the two year forward looking order book, which has now turned positive for the first time since 2013. In line with improved sentiment towards turnover and awards, the SAFCEC confidence index improved to a nett satisfaction rate of -35 percent from -57 percent in the 2nd quarter. Fewer contractors reported quiet conditions, down from 55 percent to 34.8 percent, while 65.2 percent reported satisfactory business conditions (from 38 percent) in the previous quarter.

Input cost inflation averaged 5.9 percent y-y in the 1st quarter of 2016, following an average increase of 1.2 percent in the 4th quarter of 2015. Price deflation still occurred in the material index, down 0.6 percent y-y, but at a much slower pace compared to the -7.1 percent average drop in the previous quarter. Price deflation in the fuel index also slowed from -8.4 percent y-y to -0.6 percent, while the annual increase in the plant index accelerated to 9.5 percent from 5.2 percent in the previous quarter. Labour costs, as measured by the CPI, also accelerated from an annual increase of 4.9 percent in the 4th quarter of 2015 to an average of 6.5 percent in the 1st quarter.

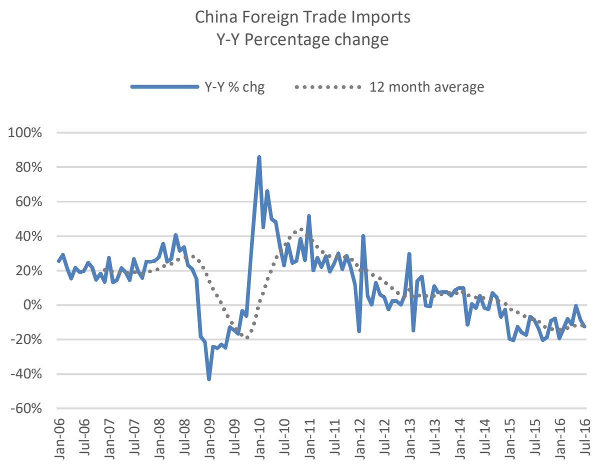
Overall, there have been both positive and negative developments, over the last three months, for the respective big contractors. There is however a perception in the market that the companies are undervalued to some degree, which is testament to the performance of the respective share prices. Looking at the chart below, the contractors index (which consists of all the listed South African contractors (WBHO, M&R, Group 5, Aveng, Basil Read, Stefanutti Stocks, Raubex, Calgro M3 and Esor), outperformed the overall industrials index as well as the JSE. The contractors' index closed at just above 140 points, 40 percent stronger than 12 months ago, and outperforming all other construction related segments, except for the suppliers' index.

Economic Background

Global growth recovery slower than expected, while the outlook for the South African economy deteriorated.

Global economic conditions remain constrained for three reasons:

- Slowing growth and re-balancing of Chinese economy, resulting in longer than expected low commodity prices, although there is some evidence of a commodity price rebound due to emerging economies in Southeast Asia.
- Oil dependent economies are faced with growing financial constraints resulting in imminent debt traps, due to over dependency on oil revenue, further weakening economic growth and investment. Oil prices were supported by declines in oil supply in the first half of the year due mainly to a gradual slowdown in non-OPEC production and some supply disruptions in Nigeria and Canada.
- Volatile capital flows affecting currency movements in particularly emerging economies



China's growth may be slowing, but there is evidence of commodity price rebound supported by emerging economies in Southeast Asia (including Indonesia, Thailand, Malaysia, the Philippines and Vietnam). Combined these economies will rise about a third to US$3 trillion in the next five years, fuelling commodities-intensive infrastructure projects such as $50bn of infrastructure spending in Thailand, $10bn rail modernisation in Vietnam, various roads and ports programmes in Indonesia and Philippines. Monthly foreign trade imports by China, has been in a year on year decline since March 2014, and fell by an average of 12 percent y-y in the last 12 months up to July 2016.

Another important development is the outcome of the U.K "Brexit" vote, which worsened the global outlook for 2016/17 despite the better than expected performance in the first half of 2016. This is mainly due to the expected macroeconomic consequences of a sizeable increase in economic, political and institutional uncertainty, which will take its toll on confidence and investment. As Brexit is still busy unfolding, the full impact on the global economy is yet to be known.

Given the better than expected performance in the first half of 2016 (with a better than expected performance in Euro, counteracted by a weaker than expected performance in the US), and considering the potential downside risk following Brexit, projected world economic growth was revised downward by the IMF to 3.1 percent for 2016 and 3.4 percent for 2017.

- UK experienced the largest downward revision in forecast growth, although growth was better than expected in the first half of 2016, the increase in uncertainty following Brexit will impact negatively on the second half of the year

- In the United States, first quarter growth was weaker than expected, there are some signs of an improved second quarter.

- In the Euro area growth was higher than expected in the first quarter, reflecting strong demand – including some rebound in investment. The fallout from the UK is expected to have a more negative impact on the Euro area.

- China's near-term outlook has improved due to recent policy support, including cutting of benchmark lending rates, more expansionary fiscal policy, higher levels of investment, and credit growth accelerating.

- The GDP contraction in first quarter in Brazil was milder than expected, as business and consumer confidence appears to be bottoming out, suggesting a weaker than expected recession for 2016, and a return to positive growth in 2017

- Higher oil prices have provided some relief to the Russian economy, where the decline in GDP is also expected to be milder, but with limited prospects of a more meaningful recovery in the next two to three years due to long-standing structural bottlenecks and the impact of sanctions on productivity and investments.

- Economic activity remains buoyant in India but due to a more sluggish recovery in investment, the growth outlook was trimmed down slightly for the next two years.

- Growth projections were revised downward in Sub-Saharan Africa, reflecting challenging macroeconomic conditions some of the larger economies (South Africa and Nigeria). Nigeria's economy is expected to contract in 2016, as the country needs to adjust to currency shortages, low power generation, and weak investor confidence. South Africa's GDP growth is expected to remain flat in 2016, with only a modest recovery in 2017.

Table 1: Overview of the World Economic Outlook Projections (IMF July 2016)

	Year over Year								
			Projections		Difference from April 2016 WEO Projections 1/		Q4 over Q4 2/	Projections	
	2014	2015	2016	2017	2016	2017	2015	2016	2017
World Output	**3.4**	**3.1**	**3.1**	**3.4**	**–0.1**	**–0.1**	**3.0**	**3.2**	**3.5**
Advanced Economies	**1.9**	**1.9**	**1.8**	**1.8**	**–0.1**	**–0.2**	**1.8**	**1.8**	**1.9**
United States	2.4	2.4	2.2	2.5	–0.2	0.0	2.0	2.5	2.3
Euro Area	0.9	1.7	1.6	1.4	0.1	–0.2	1.7	1.4	1.5
Germany	1.6	1.5	1.6	1.2	0.1	–0.4	1.3	1.5	1.3
France	0.6	1.3	1.5	1.2	0.4	–0.1	1.4	1.3	1.4
Italy	–0.3	0.8	0.9	1.0	–0.1	–0.1	1.1	1.0	1.0
Spain	1.4	3.2	2.6	2.1	0.0	–0.2	3.5	1.8	2.5
Japan	0.0	0.5	0.3	0.1	–0.2	0.2	0.8	0.6	0.2
United Kingdom	3.1	2.2	1.7	1.3	–0.2	–0.9	1.8	1.2	1.5
Canada	2.5	1.1	1.4	2.1	–0.1	0.2	0.3	1.8	2.2
Other Advanced Economies 3/	2.8	2.0	2.0	2.3	–0.1	–0.1	2.2	2.0	2.6
Emerging Market and Developing Economies	**4.6**	**4.0**	**4.1**	**4.6**	**0.0**	**0.0**	**4.1**	**4.4**	**4.9**
Commonwealth of Independent States	1.1	–2.8	–0.6	1.5	0.5	0.2	–3.4	–0.3	1.8
Russia	0.7	–3.7	–1.2	1.0	0.6	0.2	–4.0	–0.3	1.8
Excluding Russia	1.9	–0.6	1.0	2.5	0.1	0.2	...	...	...
Emerging and Developing Asia	6.8	6.6	6.4	6.3	0.0	0.0	6.8	6.3	6.3
China	7.3	6.9	6.6	6.2	0.1	0.0	6.8	6.5	6.1
India 4/	7.2	7.6	7.4	7.4	–0.1	–0.1	8.1	7.4	7.4
ASEAN-5 5/	4.6	4.8	4.8	5.1	0.0	0.0	4.8	4.5	5.3
Emerging and Developing Europe	2.8	3.6	3.5	3.2	0.0	–0.1	4.1	3.3	3.0
Latin America and the Caribbean	1.3	0.0	–0.4	1.6	0.1	0.1	–1.4	0.0	2.1
Brazil	0.1	–3.8	–3.3	0.5	0.5	0.5	–5.9	–1.2	1.1
Mexico	2.2	2.5	2.5	2.6	0.1	0.0	2.4	2.4	2.8
Middle East, North Africa, Afghanistan, and Pakistan	2.7	2.3	3.4	3.3	0.3	–0.2	...	...	...
Saudi Arabia	3.6	3.5	1.2	2.0	0.0	0.1	1.8	1.0	2.4
Sub-Saharan Africa	5.1	3.3	1.6	3.3	–1.4	–0.7	...	...	...
Nigeria	6.3	2.7	–1.8	1.1	–4.1	–2.4	...	...	...
South Africa	1.6	1.3	0.1	1.0	–0.5	–0.2	0.2	0.4	1.1
Memorandum									
Low-Income Developing Countries	6.0	4.5	3.8	5.1	–0.9	–0.4	...	...	...
World Growth Based on Market Exchange Rates	2.7	2.5	2.5	2.8	0.0	–0.1	2.3	2.6	2.8
World Trade Volume (goods and services) 6/	**3.7**	**2.6**	**2.7**	**3.9**	**–0.4**	**0.1**	...	...	...
Advanced Economies	3.6	3.8	2.6	3.9	–0.4	0.1	...	...	...
Emerging Market and Developing Economies	3.9	0.6	2.9	3.9	–0.5	0.1	...	...	...
Commodity Prices (U.S. dollars)									
Oil 7/	–7.5	–47.2	–15.5	16.4	16.1	–1.5	–43.4	13.7	5.2
Nonfuel (average based on world commodity export weights)	–4.0	–17.5	–3.8	–0.6	5.6	0.1	–19.1	5.0	–2.7
Consumer Prices									
Advanced Economies	1.4	0.3	0.7	1.6	0.0	0.1	0.4	1.0	1.7
Emerging Market and Developing Economies 8/	4.7	4.7	4.6	4.4	0.1	0.2	4.6	4.3	4.0
London Interbank Offered Rate (percent)									
On U.S. Dollar Deposits (six month)	0.3	0.5	0.9	1.2	0.0	–0.3	...	...	...
On Euro Deposits (three month)	0.2	0.0	–0.3	–0.4	0.0	0.0	...	...	...
On Japanese Yen Deposits (six month)	0.2	0.1	–0.0	–0.2	0.1	0.1	...	...	...

Domestic Economy

South Africa's economic performance surprised on the upside, with mining and manufacturing showing a recovery in the 2nd quarter of 2016, increasing GDP to a seasonally adjusted and annualised increase of 3.3 percent q-q, following the 1.2 percent q-q contraction in the previous quarter. Although this provides a welcome sigh of relief as South Africa avoids a recession, and hopefully provided some satisfaction to credit rating agencies who are keeping a close watch on South Africa to restore economic growth, on a strictly year on year basis the economy rose only marginally by 0.6 percent in the 2nd quarter compared to a -0.1 percent contraction in the previous quarter. The economy is therefore by no means out of danger. Although the mining sector did pose more positive results for the 2nd quarter, the compound growth is somewhat exaggerated by the steep decline in the 1st quarter, as the real year on year growth remains negative, although at a slower rate of decline, down 4.5 percent (following the 8.5 percent decrease in the 1st quarter). The manufacturing sector is therefore considered as the main driver in the 2nd quarter, with a compound q-q growth of 8.1 percent, and a 3.6 percent y-y increase (compared with a 0.9 percent y-y decline in the previous quarter). The economy for the first six months expanded marginally by 0.3 percent y-y, compared to the first six months in 2015, on par with growth expectations for the year.

Growth in the construction sector slowed further in the 2nd quarter, from a seasonally adjusted annualised increase of 0.4 percent q-q in the 1st quarter to just 0.05 percent q-q in the 2nd quarter. On a strictly year on year basis, growth slowed to 0.7 percent y-y from 2.5 percent y-y in the 1st quarter. The outlook for investment in construction remains bleak, with fewer private sector projects being approved for construction by local authorities and a contraction in tender activity. As a prominent job creating sector, this will have an adverse effect on employment in the country, and with growth now lower than population growth estimates, will also impact negatively on the country's ability to sustain higher levels of economic growth in the longer term due to the fact that investment has not kept pace with growing demands. Inevitably infrastructure backlogs in housing, transport, energy, and other critical infrastructure requirements will simply continue to expand.

Table 2: Gross Domestic Product, production estimates Year on Year percentage change (sea. adj. annualised)

	2013 Annual	2014 Annual	2015 Annual	2nd Quarter 2015	3rd Quarter 2015	4th quarter 2015	1st Quarter 2016	2nd quarter 2016
Agriculture, forestry and fishing	1.5%	5.6%	-8.4%	-20.4%	-11.8%	-6.7%	-6.5%	-0.8%
Mining and quarrying	4.0%	-1.6%	3.0%	-7.8%	-10.5%	1.4%	-18.1%	11.8%
Manufacturing	0.7%	0.0%	0.1%	-6.3%	4.7%	-2.5%	0.6%	8.1%
Electricity and water	-0.6%	-0.9%	-1.0%	-6.9%	-7.1%	1.0%	-2.8%	-1.8%
Construction	2.7%	2.9%	1.9%	1.6%	1.2%	1.4%	0.5%	0.1%
Wholesale and retail trade; hotels and restaurants	1.9%	1.3%	1.4%	-0.8%	1.2%	2.6%	1.3%	1.4%
Transport and communication	2.0%	2.3%	1.4%	0.1%	0.0%	-0.3%	-2.7%	2.9%
Finance, real estate and business services	3.0%	2.2%	2.8%	2.3%	2.5%	1.7%	1.9%	2.9%
General government services	3.1%	3.0%	0.9%	0.9%	1.3%	1.2%	1.1%	1.2%
Total value added at basic prices	2.3%	1.6%	1.2%	-1.7%	0.3%	0.6%	-1.2%	3.3%
Taxes less subsidies on products	1.3%	1.1%	1.7%	-5.1%	0.1%	-1.5%	-1.9%	2.7%
GDP at market prices	**2.2%**	**1.5%**	**1.3%**	**-2.0%**	**0.3%**	**0.4%**	**-1.2%**	**3.3%**

Gross Fixed capital formation

Having contracted at an annualised rate of 2.8 percent in the 4th quarter of 2015 and 10.0 percent in the 1st quarter of 2016, real GFCF contracted by a further 4.6 percent in the 2nd quarter. Capital spending by private business and general government contracted at a slower pace in the 2nd quarter. Real capital investment by public corporations turned negative over the period having increased in the 1st quarter of 2016. The level of real capital outlays in the first six months of 2016 was 2.6 percent lower than in the corresponding period in 2015. GFCF as a percentage of GDP slowed to 20.0 percent in the 2nd quarter of 2016, and 20.4 percent in the 1st quarter and an average of 20.9 percent in 2015.

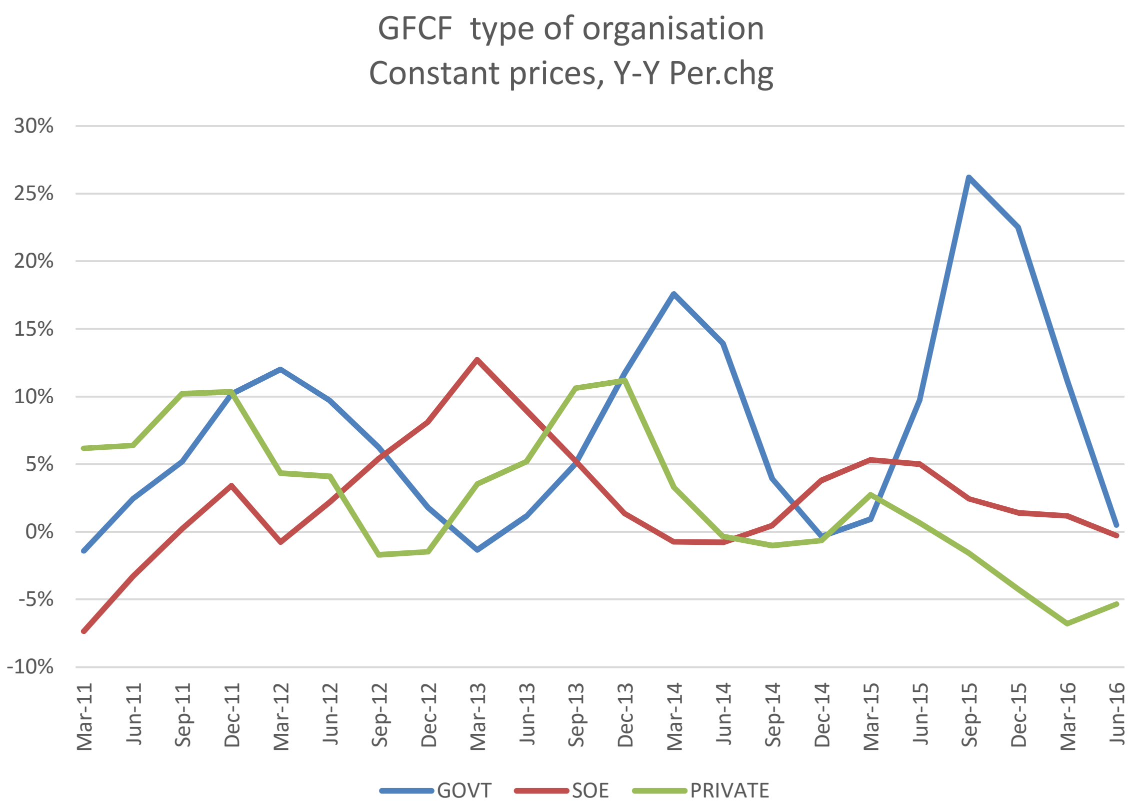


Table 3: GFCF by type of Asset (Residential, non-Residential and Construction Works)

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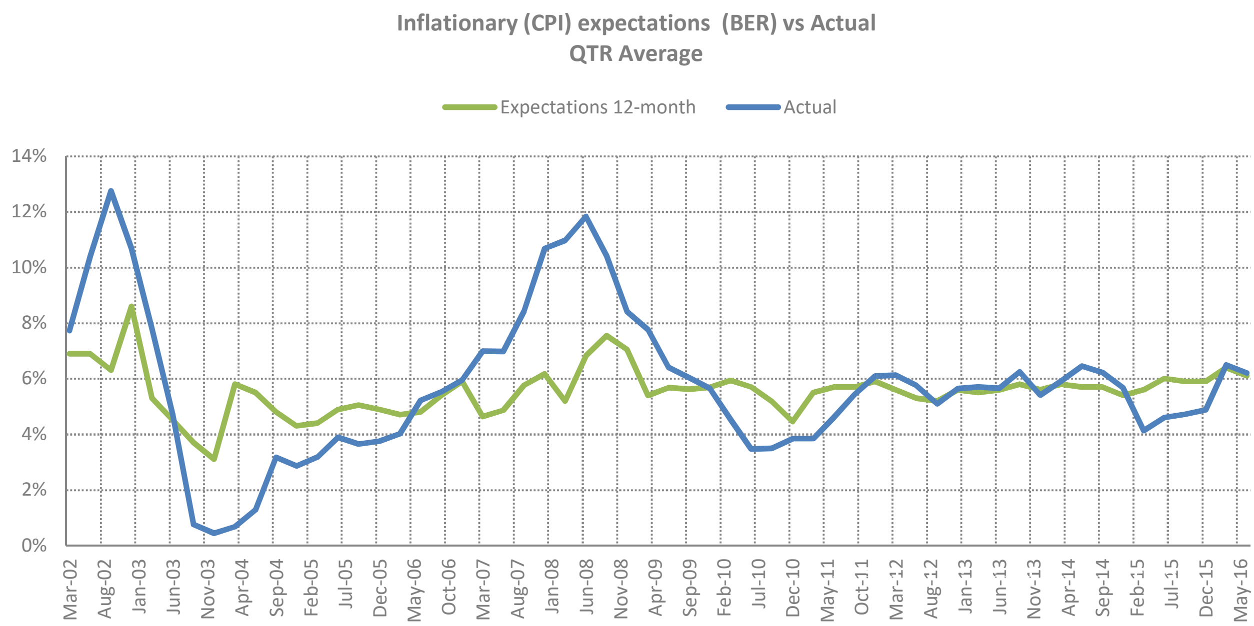
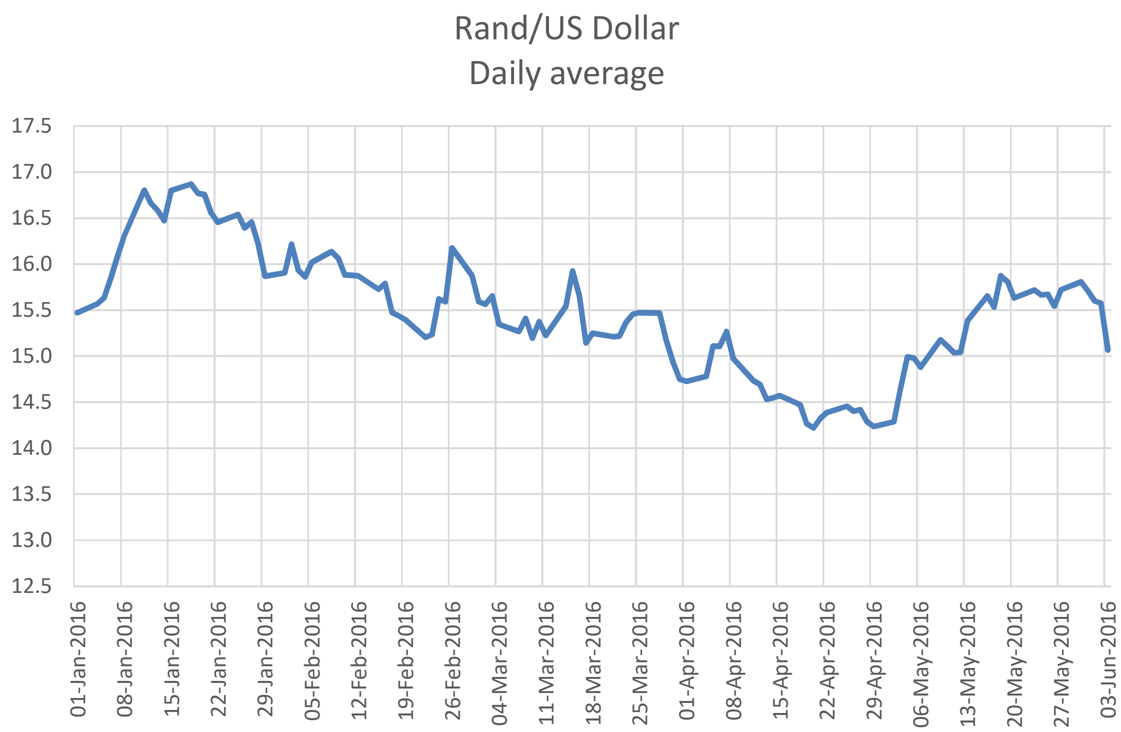
	Residential		Non-res		Total building		Construction works		Grand Total	
	Current prices	2005 prices, SEA Adj annualised	Current prices	2005 prices, SEA Adj annualised	Current prices	2005 prices, SEA Adj annualised	Current prices	2005 prices, SEA Adj annualised	Current prices	2005 prices, SEA Adj annualised
Mar-12	13650	48725	16047	57219	29697	105944	37847	149893	67544	255837
Jun-12	13040	49157	15763	56681	28803	105838	42288	149099	71091	254937
Sep-12	13521	48890	15351	55021	28872	103911	45806	156381	74678	260292
Dec-12	14571	49515	15630	54637	30201	104152	47301	161222	77502	265374
Mar-13	14887	50017	15583	52756	30470	102773	43093	167546	73563	270319
Jun-13	14512	51204	15694	52306	30206	103510	52447	171869	82653	275379
Sep-13	15432	52026	15671	52268	31103	104294	56418	172646	87521	276940
Dec-13	16129	50769	17081	54676	33210	105445	56778	177687	89988	283132
Mar-14	16200	50828	17559	55565	33759	106393	50192	180765	83951	287158
Jun-14	15607	51744	17755	56059	33362	107803	59256	186162	92618	293965
Sep-14	16326	51705	17806	54839	34132	106544	64392	179052	98524	285596
Dec-14	18654	55359	17798	53734	36452	109093	59532	182126	95984	291219
Mar-15	18811	56460	17762	53847	36573	110307	55261	188205	91834	298512
Jun-15	17873	56778	16845	51037	34718	107815	62263	192773	96981	300588
Sep-15	18546	56943	17982	53725	36528	110668	68401	193999	104929	304667
Dec-15	19826	56814	18078	53751	37904	110565	63931	196034	101835	306599
Mar-16	19018	54417	17738	51673	36756	106090	59816	197562	96572	303652
Jun-16	18816	56623	18137	52297	36953	108920	65290	190033	102243	298953

Headline inflation averaged 6.5 percent in the first quarter of 2016, slowed to an average of 6.2 percent in the second quarter and to 5.9 percent in August 2016. According to BER's inflationary expectation survey, financial analysts expect inflation to average 6.7 percent this year (surveyed in the 2nd quarter of 2016) from 6.4 percent in the 1st quarter, slowing to an average of 6.1 percent in 2017 and 5.5 percent in the next two years (from 5.7 percent in the previous survey). Thus while higher inflation may be expected for this year, inflation is expected to slow more dramatically in the following two years. Inflation is currently fuelled by higher food prices, currently at 11.5 percent as a result of the nationwide drought, the weaker currency elevating import prices, and the recent mild recovery in the oil price putting upward pressure on the cost of imported fuel.



Oil prices rebound somewhat in the first half of 2016, due to a drop in supply in non-OPEC countries and supply interruptions in Nigeria and Canada. A better than expected economic performance in China in the first quarter, also supported higher prices. Oil prices started showing a mild recovery in February 2016, reaching an average of $48/barrel in June 2016, before slowing to $45/barrel on average in July. The price war between OPEC and non-OPEC oil producing countries can have a serious long term impact on prices which may very well rally upwards in the not too distant future. A stabling global economy, a revival of emerging Chinese economies, and lower production in non-OPEC countries to cuts to exploration budgets, may see a drop in supplies sooner than one may realise. According to Bloomberg, oil explorers in 2015 discovered only about a tenth as much oil as they have annually since 1960 as exploration budgets are cut in light of the fact that oil prices are down by more than half since the price collapse two years ago. Oil demand is expected to grow by 11 percent to 105.3 million barrels per day in the next ten years to 2026, according to US Energy Information Administration research. Pending further developments in South Africa's currency, a sudden sharper than expected recovery in the price of oil could have a serious impact on inflation and further monetary policy development.



The SARB leading indicator showed a mild improvement in June 2016 to an index level of 91.58 from 90.76 in May 2016. On average the index has fallen by 4.3 percent y-y in the first six months of 2016 compared to the same period in 2015, suggesting weaker economic activity and because of the close correlation between SARB's leading indicator and GDP growth, the slowdown in the SARB's index implies further pressure on the economy.

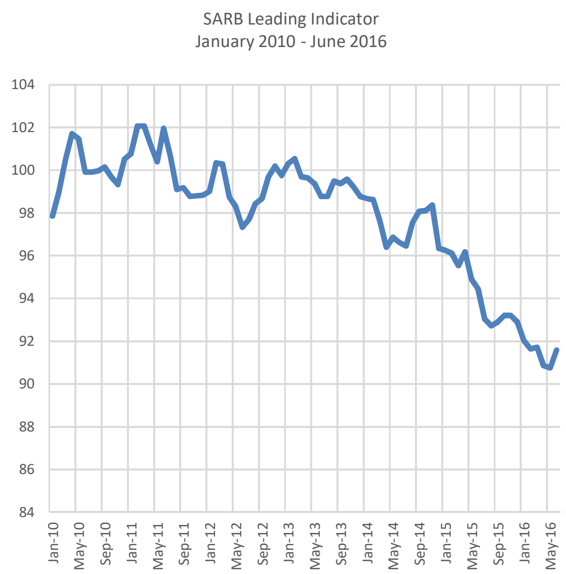


Figure 1: SARB leading indicator

Note: The leading business cycle indicator is a composite index comprising of time series, which tend to shift direction in advance of the business cycle.

Table 4: Macroeconomic performance and projections (Source Industry Insight estimates)

Macroeconomic Forecasts	*2013*	*2014*	*2015*	*2016*	*2017*	*2018*
GDP	2,5%	1,2%	1,3%	0,2%	1,5%	1,9%
Household consumption	2,0%	0,7%	1,7%	0,4%	1,2%	2,7%
Government consumption	3,8%	1,8%	2,0%	0,7%	0,7%	1,0%
Gross Fixed capital formation	7,6%	-0,4%	2,7%	0,4%	0,4%	2,1%
Imports	5,0%	-0,5%	6,4%	3,0%	3,5%	5,0%
Exports	3,6%	3,3%	3,0%	5,5%	4,5%	4,7%
Prime Rate	8,50%	9,25%	9,75%	10,50%	11,00%	11,5%
Rand/Dollar	9,70	10,80	12,10	16,80	15,60	15,00
CPI Inflation	5,80	6,20	3,80	6,20	6,00	5,80
Current Account Deficit	-5,9	-5,5	-5,1	-4,3	-4.0	-3.7

South Africa's economy is expected to grow by around 0.2 percent, recovering to 1.5 percent in 2017. Underpinning this forecast is a slowdown in household consumption, expected to grow by 0.4 percent in 2016. This is largely due to projected slowdown in spending on durables and non-durables, with spending on services keeping the statistics positive. This is amid a period of waning demand from the consumer side, with higher interest rates being detrimental and dampening demand, coupled with weak consumer confidence. Vehicle sales statistics and weak retail trade stats guide us in forecasting over household spending, which is projected to slow.

Government spending is only projected to grow by 0.7 percent in 2016 and 2017, off growth of 2 percent in 2015, which is also a large contributing factor to the slowdown in overall growth. Gross fixed capital formation is expected to only be 0.4 percent in 2016, and the same in 2017, recovering slightly the following year.

The South African economy remains sensitive to a multitude of downside risks. 2016 is expected to be the year in which growth bottoms out. Many economists and formal institutions do believe that the sovereign credit rating of the country will be downgraded to a non-investment grade by at least one of the three credit rating agencies come December, when our first inquiry will be made. Global factors do play a large role, but what they have done is exposed some of the structural weaknesses of the economy, which there was less attention on in periods of more thriving demand. Since South Africa avoided a credit rating downgrade at the beginning of the year, there have been several political developments which have impacted negatively on the probability of a further downgrade.

The rating agencies regard the economy and the political environment as fundamental when evaluating a sovereign's credit rating. If negative political developments are not kept in check, this will impact of the government's ability to implement policies to achieve objectives. Growth plays a big role, which is why many believe that the credit rating will be downgraded, with Industry Insight projecting 0.3 percent growth for 2016, increasing to 0.8 percent in 2017 and 1.2 percent in 2018.

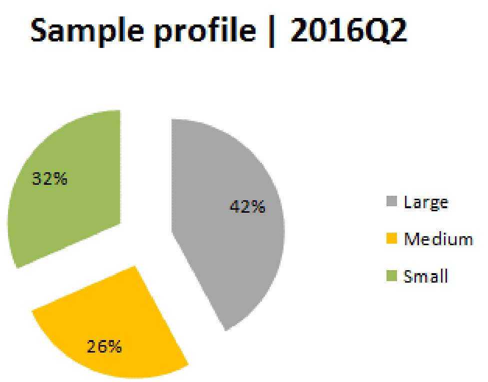
THE POSITION OF THE CIVIL ENGINEERING INDUSTRY

Background

- Questionnaires were distributed to all SAFCEC members during August and September 2016.
- It is important to increase the usability of the industry report for all SAFCEC members, including small, medium and large enterprises. For this reason more focus is given to the developing trends within the defined employment categories. The categories are as follows:
  - Small : Employing less than 100 people
  - Medium: Employing between 100 and 1000 people
  - Large: Employing more than 1000 people
- Responses are weighted according to employment only where applicable. Comparisons between the different firm-size categories are not weighted as responses between the firm sizes have already been categorised.

Sample profile

Survey participation fell by 5 percent in the 3rd quarter of 2016, due to a decrease in participation by smaller size companies. Larger firms contributed 39 percent to the current survey (from 42 percent in the previous survey), medium size firms 39 percent and smaller firms 22 percent. The lower participation rate will have a lesser effect on the survey results due to the weighting of responses.



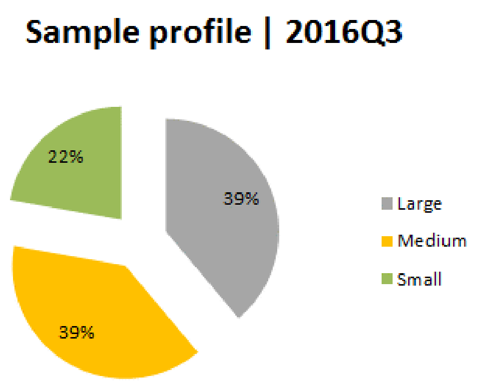


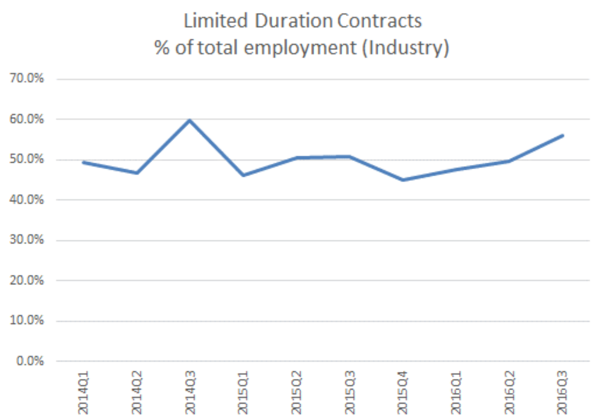
Figure 2: Profile of respondents

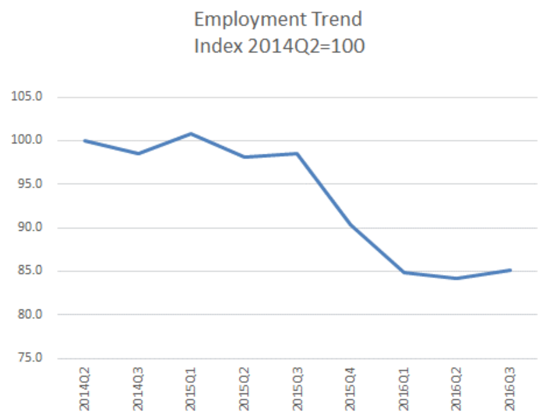
Key observations

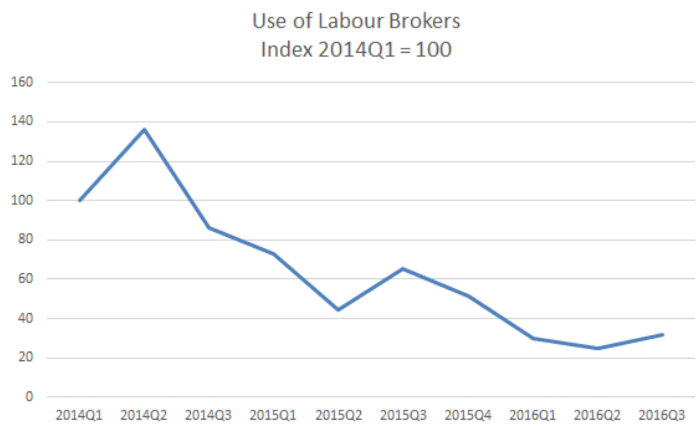
Human Resources

- Employment rose by 1.0 percent, q-q in the 2nd quarter of 2016, following a decrease of 1 percent and 5.9 percent in the previous two quarters. Medium size firms reported the strongest increase, up 7.4 percent q-q, compared to a 0.4 percent increase reported by larger firms. Smaller firms reported a strong decrease of 14.8 percent.
- Employment of Limited Duration employees supported growth in employment in the current quarter, which rose by 4.7 percent, but this was counteracted by a 3.2 percent decrease in permanent employment. Employment of limited duration employees by larger firms rose 3.4 percent compared to a 14 percent increase reported by medium size firms and a 10 percent decrease reported by smaller firms. All firm size categories reported a decrease in permanent employment, down 2.9 percent q-q for larger firms, -4.0 percent for medium size firms and -17.0 percent for smaller firms.
- Limited duration contributed 56 percent of total employment in the 2nd quarter of 2016, compared to a revised 54 percent in the previous (1st) quarter. In larger firms limited duration contributed 55 percent, slightly higher compared to the last survey. Medium size firms were represented by 67 percent, compared to 63 percent in the 2nd quarter, whereas smaller firms reported the lowest contribution of 33 percent, contradicting previous results, where smaller firms generally had the highest share of limited duration employees.

Firm Size Category	*Limited Duration*	*Permanent Employees*	*Total*	*% Limited Duration of total workforce*
Large	3.4%	-2.9%	0.4%	54.7%
Medium	14.1%	-4.0%	7.4%	66.9%
Small	-10.0%	-17.0%	-14.8%	33.0%
Total	4.7%	-3.2%	1.1%	56.0%







- Labour brokers represented 5.3 percent of the total workforce, up from 4 percent in the 1st quarter, but remains well below the trend in the last few years. Medium and small size firms did not report any use of labour brokers in the past three surveys. The use of labour brokers by larger firms fell by 7 percent q-q, following the 29 percent increase in the previous quarter.

Financial Statistics

Turnover, Wages and Order Books

- The total value of civil engineering construction certified for payment surprised on the upside and rose by 23.2 percent q-q in the 2nd quarter, after having decreased by 8 percent and 11.5 percent q-q in the previous two quarters.
- Larger firms reported a 20.0 percent increase (following the 8.5 percent and 12.5 percent q-q decrease in the previous two quarters), while medium size firms reported the strongest increase of 76.1 percent (following the 19 percent q-q decrease in the previous quarter). Smaller firms also reported improved turnover, up 15.1 percent q-q following several quarters of positive growth.

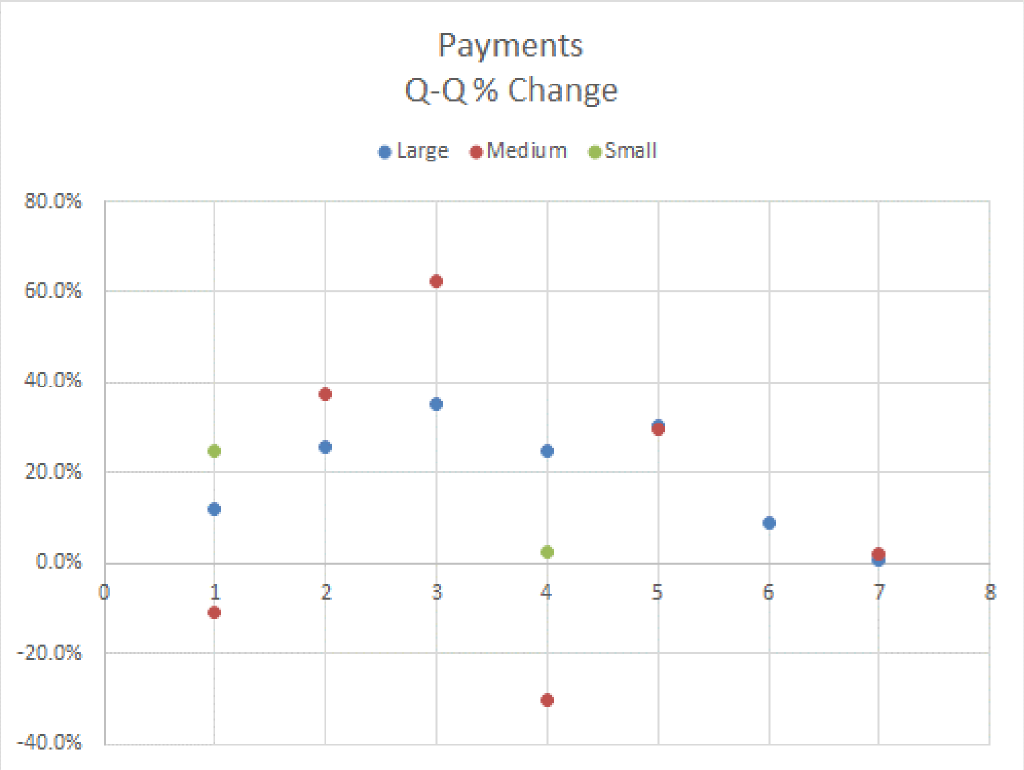


Figure 4: Civil Engineering certified payments, q-q percentage change, matrix

- The cumulative salary and wage bill represented 24 percent of total turnover, from 28 percent in the previous quarter, more in line with historical trends, but well above the 2014 Construction Census data of 16.6 percent. The construction census was released in September 2016 and includes spending on machinery and equipment, typically not included in the SAFCEC Survey. All firm size categories reported a drop in the contribution of the salary and wage bill to total turnover, with an average of 24 percent for both larger and medium size firms and 26 percent for smaller firms.
- Although employment rose marginally in the 2nd quarter, the salary and wage bill increased by a higher 5.1 percent q-q, with the strongest increase reported by medium size firms, up 26 percent. Larger size firms reported an average 3.4 percent q-q increase while smaller firms also reported a rather robust increases of 18.3 percent, in spite of the 14.8 percent contraction reported in employment.

- On the downside, the value of the two-year forward order book fell by 2 percent q-q in the 2nd quarter, following the 5 percent q-q increase in the 1st quarter. However, medium size firms again are bucking the trend with a 44 percent increase reported in their aggregate order book, while larger firms and smaller firms reported a 4 percent and 63 percent q-q decline respectively. Because of the small representation by smaller firms in this survey, responses are not included in the chart below.

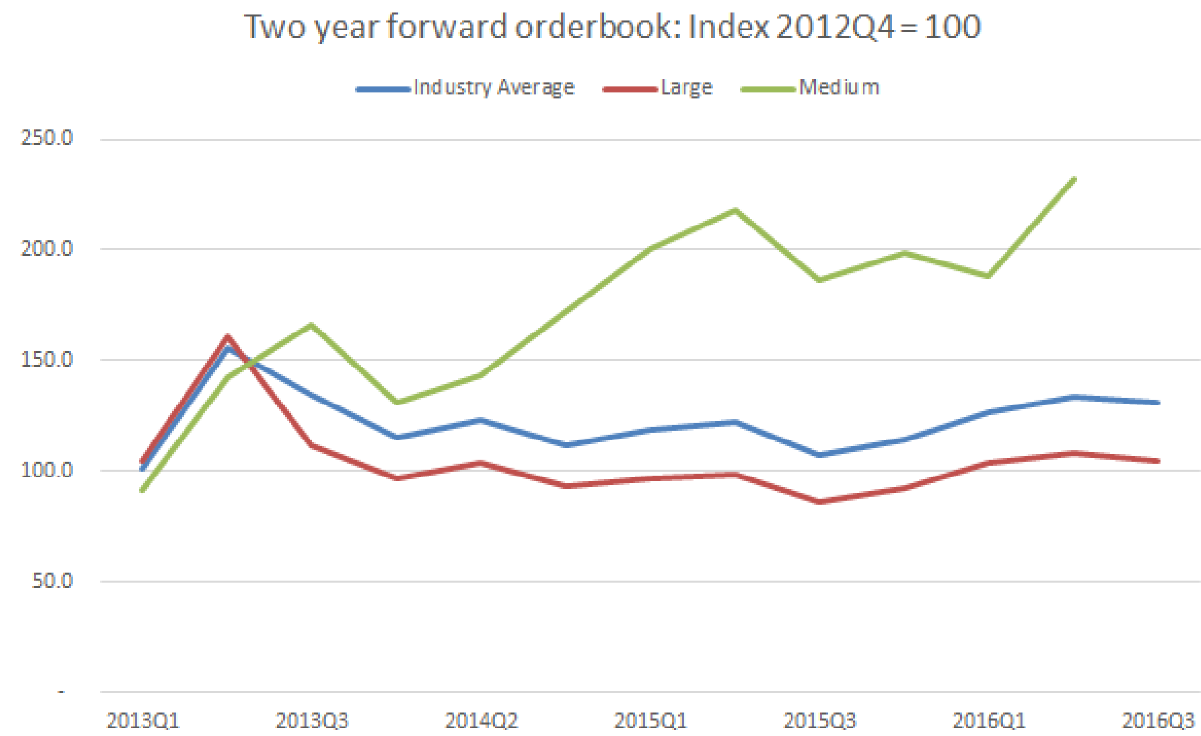


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Figure 5: Value of two year forward order book, Index 2012Q4=100

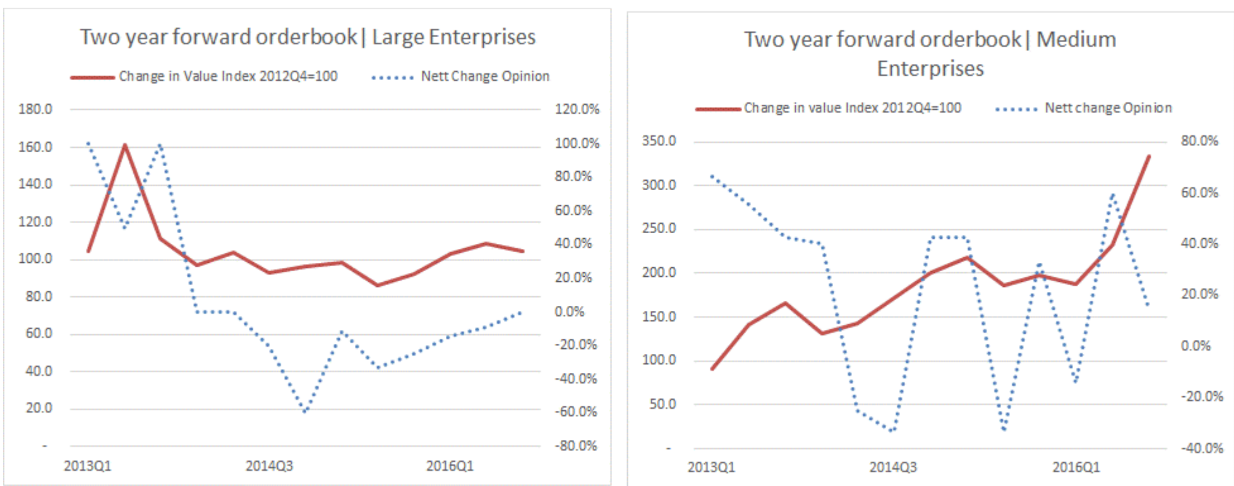
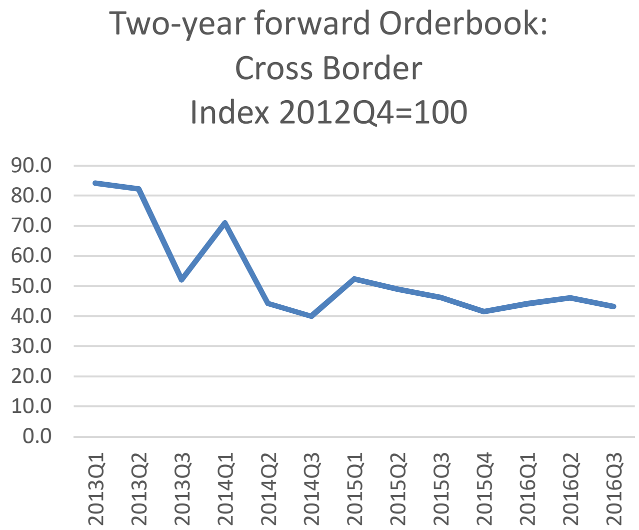
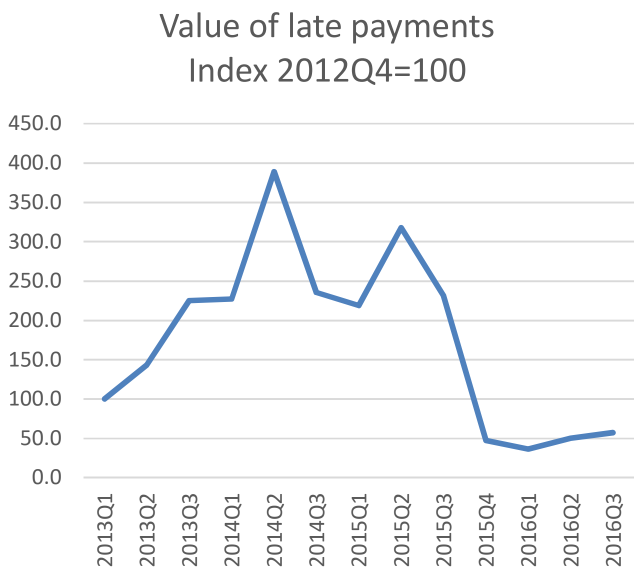


Figure 6: Two year forward order book, Large vs Medium Enterprises

- The order book for activities outside of RSA fell by 6 percent q-q, following two quarters of positive growth between 4 percent and 6 percent. The index has been on a decline since 2013 and after having shown some signs of stabilisation has reversed slightly again in the current survey.





Late Payments

- Late payments continued to rise in the current survey. After having shown relatively consistent improvement in the value of late payments reported by contractors, late payments increased more significantly in the past two quarters, up 37 percent q-q in the 1st quarter and 14.3 percent q-q in the 2nd quarter. The index measuring late payments peaked at 389.3 in the 2nd quarter of 2014, improved to 36 in the 4th quarter of 2015, before rising to 57.2 in the current survey.
- The rise in this quarter's survey was largely due to an increase in late payments reported by medium firms (up 135 percent – with majority of firms having reported an increase). Both larger and smaller firms also reported a weakening in payment, as late payments rose by 9 percent q-q for larger firms and by 20 percent for smaller firms.
- The increase in late payments was lower than the reported increase in turnover, and subsequently the value of late payments as a percentage of turnover moderated from 24 percent to 22 percent, still well above the average of between 15 and 17 percent in the previous surveys. Large firms reported a decrease in the representation of late payments to 22 percent (from 25 percent), medium size firms reported a more significant increased from 17 percent to 23 percent. Late payments would include any payments outstanding for 30 days or more.

- Of those payments outstanding for more than 90 days, the private sector contributed 39 percent, followed by SOE's at 48 percent, central government at 6.0 percent, local government at 4.9 percent and provincial government 2.3 percent.
- The value of payments outstanding for longer than 90 days represented 3.1 percent of turnover, down from 4.1 percent in the 1st quarter. The situation is similar for larger and medium size firms (3.1 percent), while smaller firms reported 1.5 percent of turnover still outstanding after 90 days.
- The CIDB legislation regarding Prompt Payment Regulations were submitted for public comment in July 2015 and are expected to be finalised later this year, but doubts regarding the implementation of these new regulations are rising. According to the CIDB, the Prompt Payment Regulations have regrettably been delayed as the CIDB may face a possible constitutionality conflict should the regulations be published in its current form, as the CIDB Act / mandate does not explicitly make reference to issues of payment. The Office of the Chief State Law Advisor has advised accordingly in this regard. The CIDB is still awaiting a ruling by the National Department of Public Works regarding the way forward. The Department of Public Works is currently preparing draft changes to the CIDB Act, which will then allow regulations to be issued.
- National Treasury has however issued an instruction note that deals with non payment issues and has also opened a hotline to assist with prompt payment. The Department of Public Works also has a dedicated hotline for payments outstanding for over 80 days (Tel: 0800 782 542).
- According to the Deputy Minister in the Presidency responsible for Planning, Monitoring and Evaluation, failure to pay invoices within 30 days is considered a financial misconduct. However the Presidency itself had over 330 invoices that were older than 30 days and had not been paid as at June 2016. Media reports highlighted the Department of Public Works as the worst of the defaulters with 10,757 unpaid invoices out of the total 12,870 invoices for the 40 government departments, representing 83 percent of the total. http://businesstech.co.za/news/finance/136943/these-government-departments-are-the-worst-at-paying-for-services/

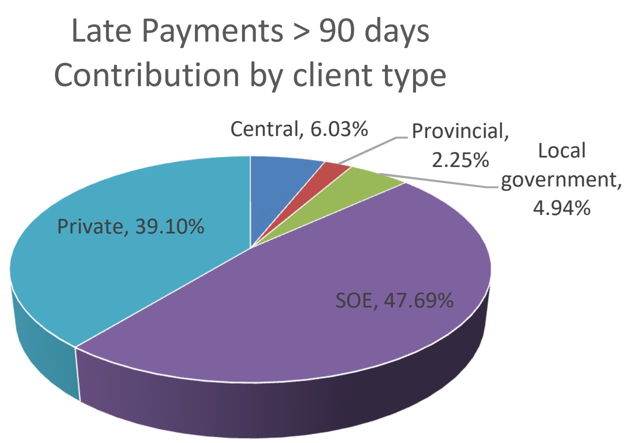
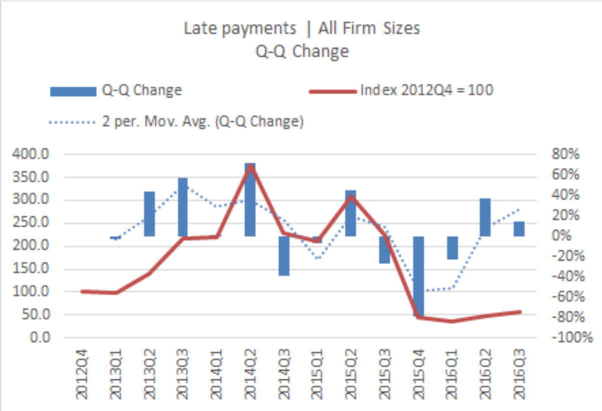
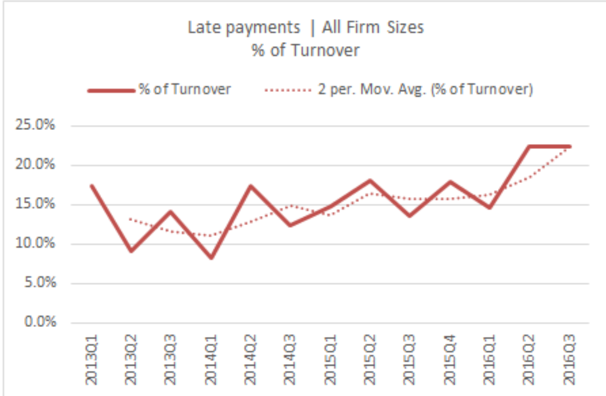
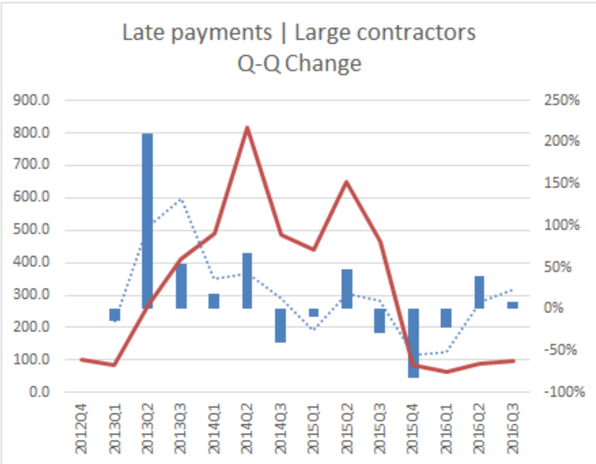
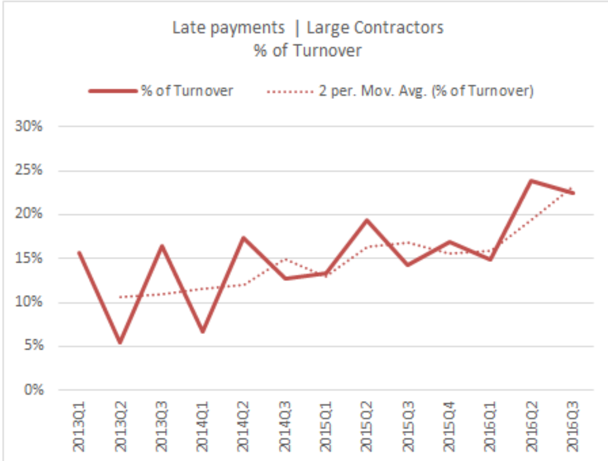


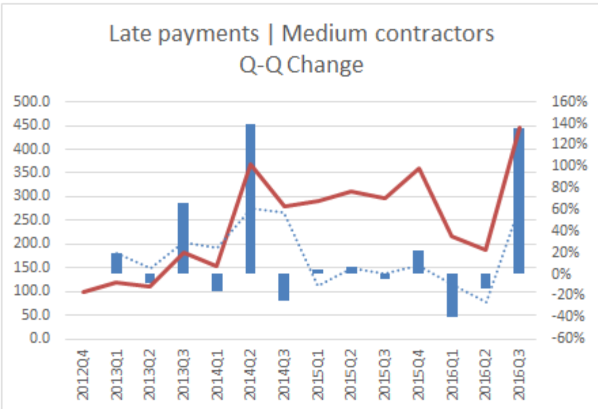
Figure 7: Late payments > 90 days, contribution by client











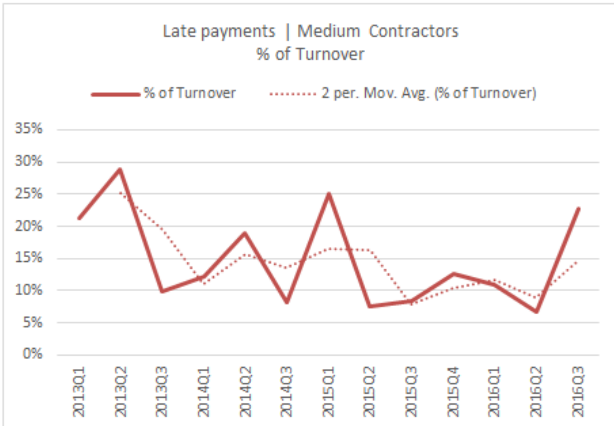


Figure 8: Late payments

Industry Profile

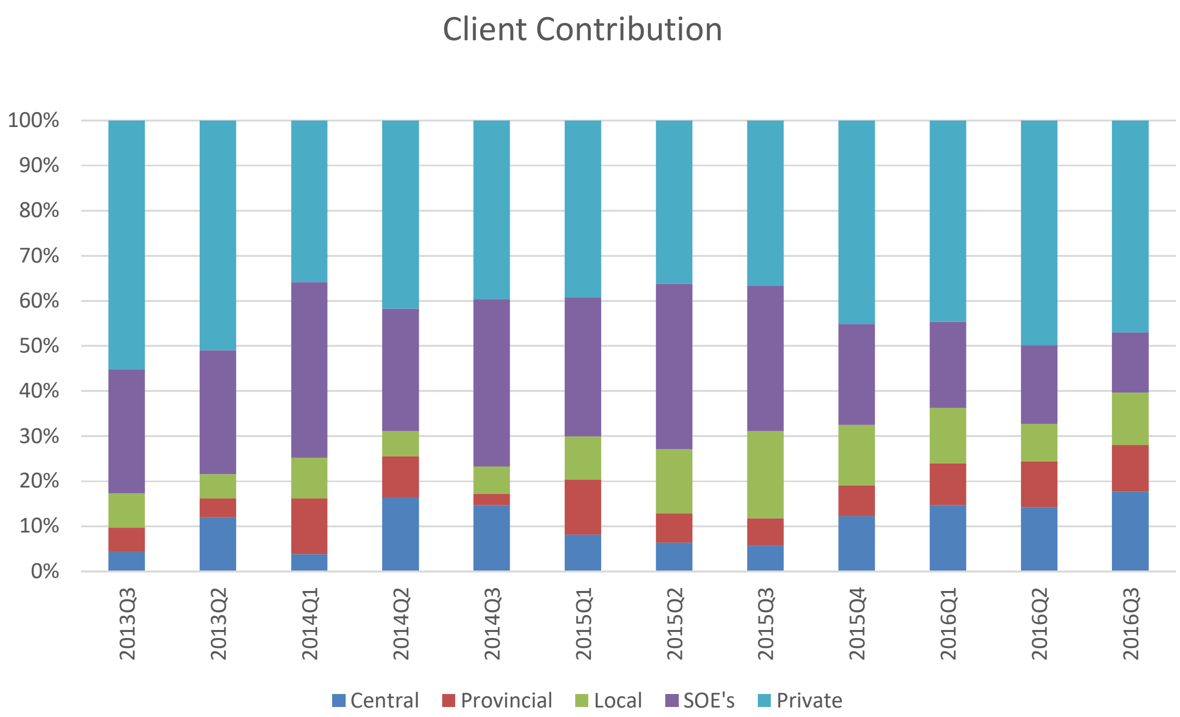
- The following section provides a snapshot view of responding firms' turnover earned by project type, client and province during the 2nd quarter of 2016 (surveyed in the 3rd quarter of 2016). This is not necessarily representative of the entire industry, but again shows the significant contribution by the roads segment.
- In this survey, roads contributed 60.3 percent to total turnover, relatively on par with the previous survey at 59.8 percent, with similar exposures by large and medium size firms (60.4 and 60.0 percent respectively). Smaller firms reported a far lesser exposure to the road segment of 12.8 percent.
- Tender processes for the construction of two mega-bridges will commence towards the end of the year, namely the Msikaba River Bridge and the Mtentu River Bridge on the new N2 Wild Coast Highway.
- Another blow to future road construction in South Africa is the announcement by Moody's in September that it may cut the investment grades of several state owned entities, including SANRAL. This highlights investor concern over state-owned companies and follows the decision by asset manager Futuregrowth to pull the plug on new loans to several entities. Moody's highlighted that SANRAL's review reflected the ongoing cash flow pressure faced by it despite government interventions to increase e-toll collections.
- SANRAL further lost the appeal to toll parts of the N1 and N2 in the Cape Winelands. Should SANRAL decide to proceed with plans to toll these roads it would require a complete restart of the process but is likely to be met with significant public resistance.
- In other news, SANRAL announced the appointment of the current CEO of the company operating Gauteng's e-toll system to succeed Sanral CEO Nazir Alli, who retires at the end of September.
- Road works represent a significant portion of total payments received by the civil engineering contracting industry, and although the Department of Transport has increased its transfers to SANRAL over the medium term expenditure framework (MTEF) period (2016/17 – 2018/19), revenue constraints due to the lower than expected toll revenue collected, is likely to have a negative impact on new road projects announced by SANRAL over this period.

Table 5: Turnover distribution by sub-discipline

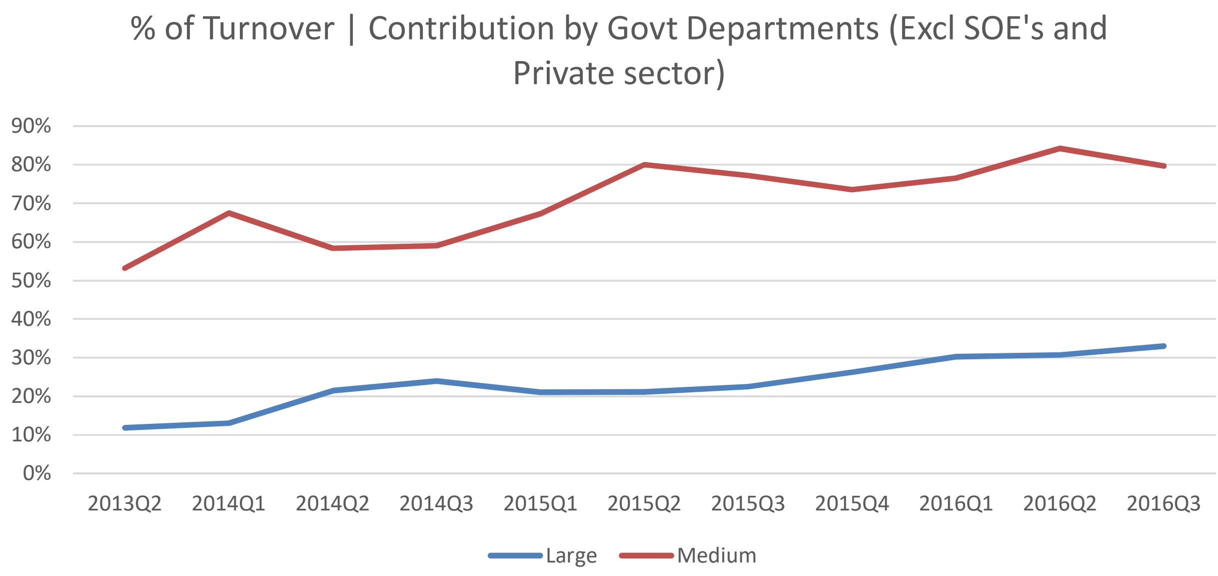
Discipline	Large	Medium	Small	Total 2015Q3	Total 2015Q4	Total 2016Q1	Total 2016Q2
Roads	60.4%	60.0%	12.8%	45.7%	55.3%	59.8%	60.3%
Earthworks	2.8%	3.1%	16.8%	4.2%	3.5%	5.7%	2.9%
Water Bulk Infrastructure	2.9%	15.9%	7.2%	15.0%	2.6%	3.3%	4.1%
Water and Sanitation	1.6%	1.8%	0.0%	3.9%	3.6%	2.0%	1.6%
Rail	0.8%	0.0%	0.0%	2.1%	1.7%	0.6%	0.7%
Harbours	1.7%	0.0%	12.8%	1.1%	2.0%	2.1%	1.6%
Power (bulk)	9%	0.0%	0.0%	11.7%	15.0%	7.7%	8.3%
Power (services)	6.2%	0.0%	0.0%	1.7%	2.3%	4.7%	5.6%
Airports	0.8%	0.0%	0.0%	0.3%	0.2%	0.0%	0.7%
Mining Infrastructure	3.6%	8.9%	0.0%	5.2%	4.6%	3.4%	4.0%
Mining (Surface earthworks)	1.3%	0.9%	0.0%	0.6%	1.6%	1.4%	1.3%
Other	8.8%	9.4%	50.4%	8.6%	7.8%	9.4%	8.9%
Total	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%

Table 6: Turnover distribution by client

	Large	Medium	Small	Total 2015Q3	Total 2015Q4	Total 2016Q1	Total 2016Q2
Central	19.3%	0.0%	0.0%	12.3%	14.7%	14.3%	17.7%
Provincial	10.3%	11.4%	7.0%	6.8%	9.3%	10.1%	10.4%
District/Local/Metropolitan Councils	6.8%	64.9%	6.2%	13.4%	12.3%	8.3%	11.6%
Parastatals	13.9%	7.5%	6.2%	22.4%	19.0%	17.4%	13.3%
Private	49.7%	16.3%	80.6%	45.2%	44.7%	49.9%	47.0%
Total	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%



- The contribution by the private sector in this survey fell slightly to 47 percent from 50 percent in the previous survey. Medium size firms were more exposed to local government, and represented 64.9 percent of total turnover in the 2nd quarter, while smaller firms earned 80 percent from the private sector.



Medium size firms are more actively involved in government departments, and will benefit from the medium term budget where government expenditure will increase at a stronger pace compared to spending by SOE's.

Table 7: Geographic distribution of the value of civil engineering construction work (turnover)

Province	Large	Medium	Small	2015Q3	2015Q4	2016Q1	2016Q2
GAU	20%	58%	33%	23%	16%	21%	24%
WC	13%	9%	5%	12%	15%	11%	12%
EC	10%	20%	4%	8%	9%	10%	11%
NC	6%	0%	2%	4%	5%	5%	6%
MPU	11%	10%	1%	18%	18%	14%	11%
FS	12%	1%	1%	11%	6%	9%	11%
LIM	5%	0%	3%	8%	7%	6%	4%
NW	3%	1%	0%	5%	2%	5%	3%
KZN	20%	0%	52%	12%	23%	20%	18%
Total	100%	100%	100%	100%	100%	100%	100%

- Gauteng contributed 24 percent to this survey, followed by 18 percent in KwaZulu-Natal, 12 percent in the Western Cape, 11 percent in Eastern Cape, Mpumalanga and Free State, and 6 percent in the Northern Cape. Both Limpopo and North West contributed less than 5 percent. Larger firms were equally active in Gauteng and Kwazulu Natal, while medium size firms earned 58 percent of turnover in Gauteng. Smaller firms turnover was more centred in Kwazulu Natal (52 percent) followed by Gauteng.

Economic Indicators

Economic indicators generally depict the "opinions" of respondents related to work conditions, tempo of work activity, competition for tenders, profitability and prices. It measures contractors' sentiment during the survey period (2nd quarter 2016).

The mostly negative market sentiment continued to prevail since 2009, and although the level of sentiment expressed by respondents reached new lows during the 2nd quarter of 2015 there was a marginal improvement in the last few quarters, but not enough to lift the overall sentiment out of the red. The outlook for the 4th quarter however has shown some improvement.

A positive rate implies more firms reported improved business conditions, while a negative rate implies majority of firms reported a more pessimistic outlook on the industry.

Please note that these calculations are weighted according to a firm's total reported work force in RSA.

- **The nett % satisfied with working conditions** during the 2nd quarter of 2016 (past quarter), remained in deep negative territory -29.4, although this was an improvement from -50.0, -52.9, and -60,8 reported in the previous three surveys. Fewer respondents (12 percent) reported "very quiet" conditions, compared to 22 percent in the previous survey. The outlook is similar for the 3rd quarter, but overall 58 percent expect satisfactory conditions for the next (4th) quarter. The nett satisfaction rate for the 4th quarter improved to a positive 29.4 percent.

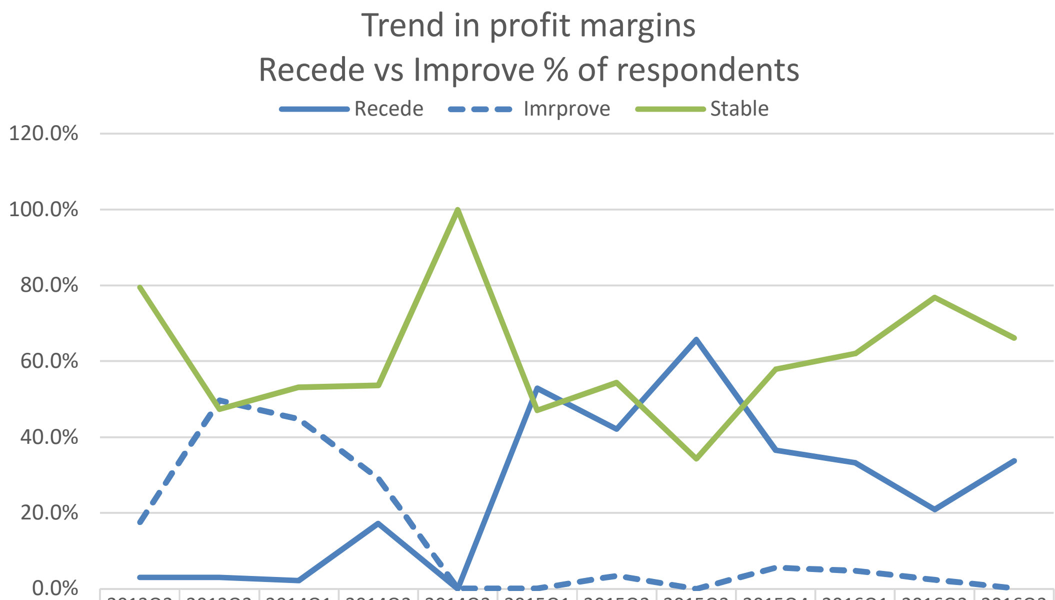
- **Competition for tenders** remain fierce, but improved slightly, with 57 percent of the contractors said that there were more than 11 bids pre contract, compared to 70 percent in the previous survey. It is also further possible that pre-qualification could be a contributing factor to the reduced number of bids.

- **Tender prices** remain under pressure. 53 percent of contractors reported very low prices, compared to 40 percent in the 2nd quarter survey. Interestingly in this survey, 16.7 percent of the larger firms reported tender prices as reasonable, up from 10 percent in the 2nd quarter survey. None of the medium or smaller size contractors reported reasonable tender prices.

- The nett satisfaction rate related to profitability was negative, -25.0 percent, with only 37.5 percent expressing satisfactory sentiment pertaining to levels of profitability. Majority (50 percent) reported low profitability while 12.5 percent reported "very low" levels.

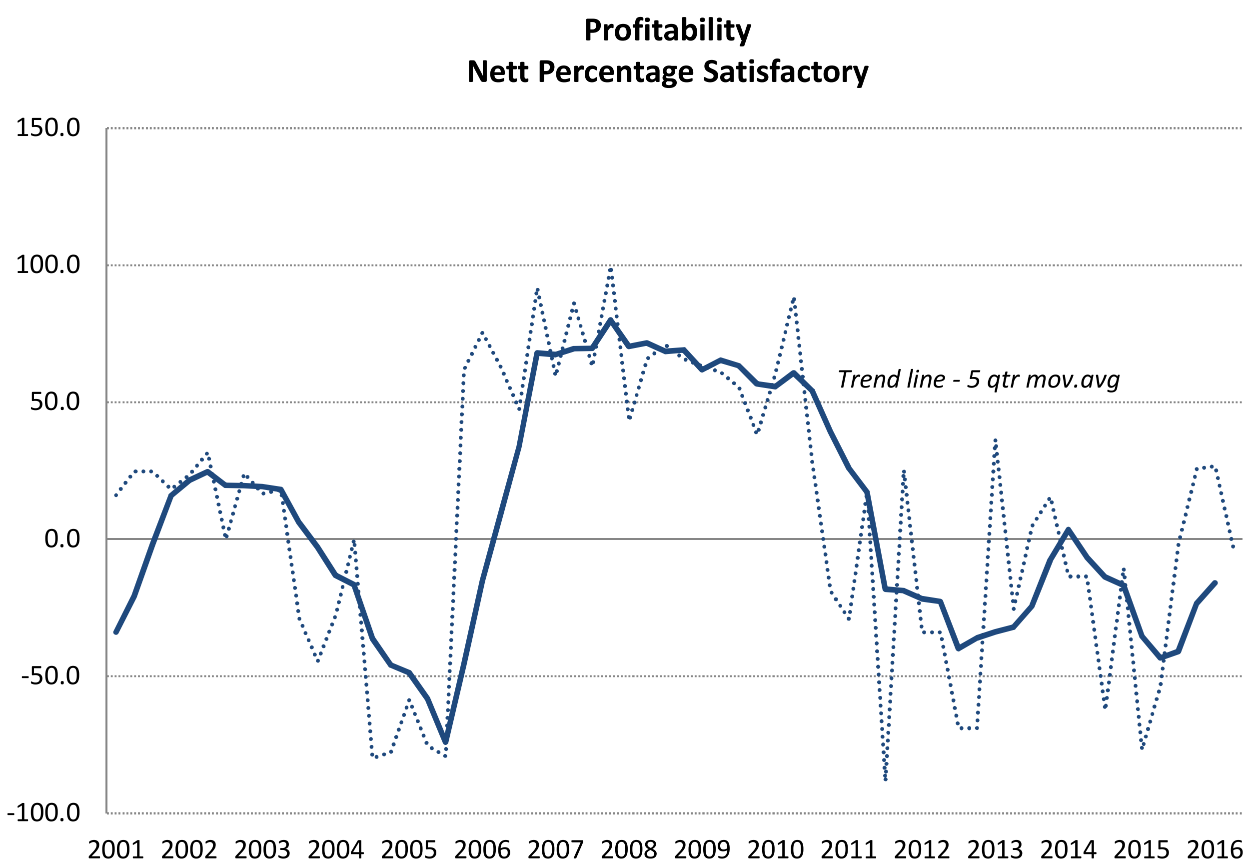
- Majority of contractors (supported mainly by medium size contractors) expect profitability trends to stabilise (56.3 percent), while less than 7 percent expecting margins to improve (mainly amongst smaller contractors). None of the medium or larger contractors expect profit margins to improve.

- Around 33 percent of the larger firms expect a further deterioration in profitability, while 66.7 percent expect it to stabilise.



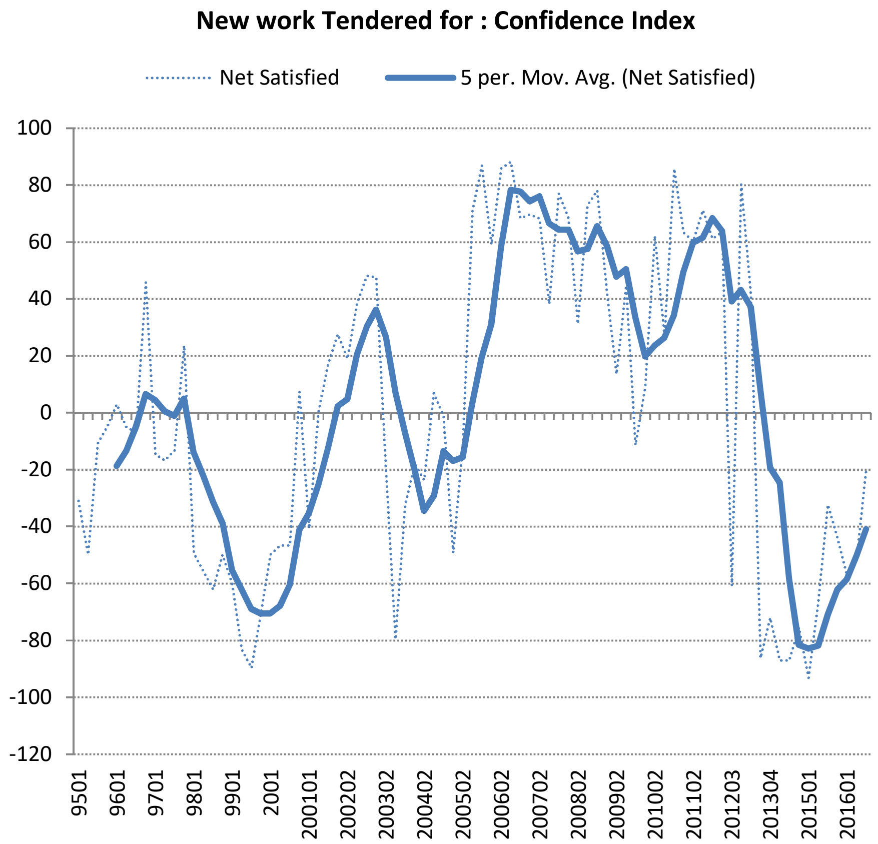
	2013Q2	2013Q3	2014Q1	2014Q2	2014Q3	2015Q1	2015Q2	2015Q3	2015Q4	2016Q1	2016Q2	2016Q3
Recede	3.0%	2.9%	2.2%	17.2%	0.0%	52.9%	42.1%	65.7%	36.5%	33.2%	20.9%	33.7%
Imrprove	17.6%	49.7%	44.7%	29.1%	0.1%	0.1%	3.5%	0.0%	5.6%	4.8%	2.4%	0.1%
Stable	79.4%	47.3%	53.1%	53.6%	99.9%	47.1%	54.4%	34.3%	57.9%	62.0%	76.8%	66.1%

Figure 9: Opinions related to Profitability



Opinions related to tenders, awards, order books and turnover

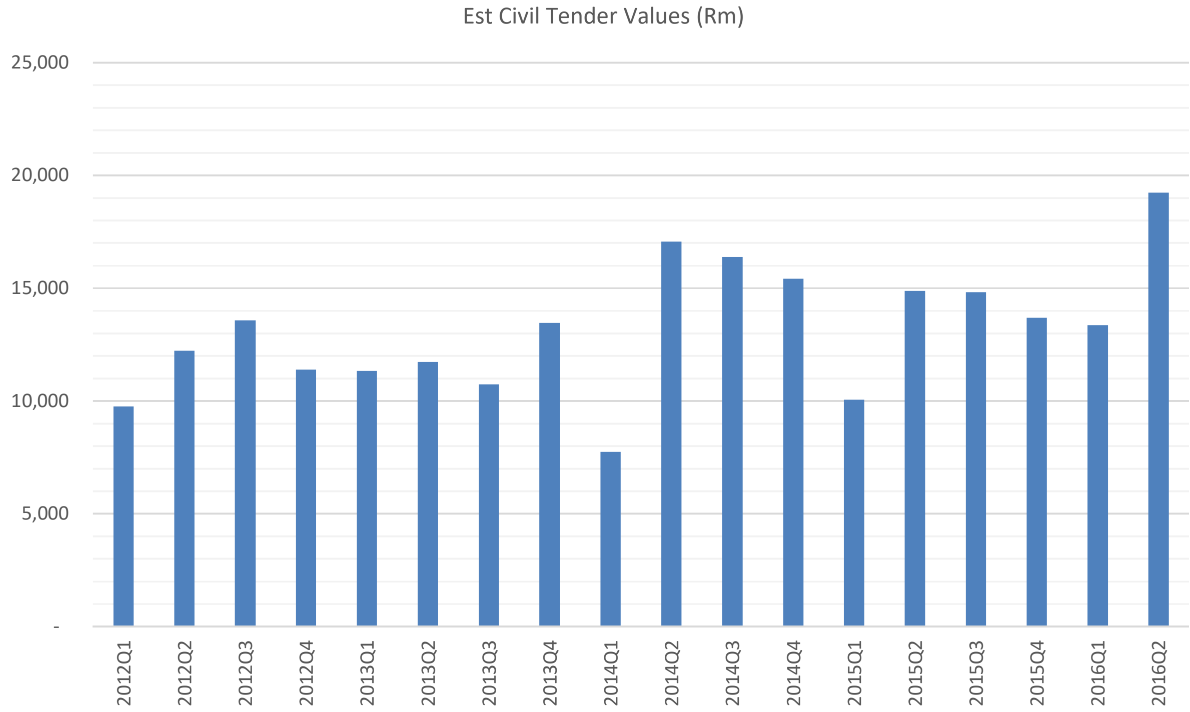
Tender activity



Explanatory note: Tender activity is a crucial indicator, being a first warning of the potential volume of work. The confidence reflected by companies regarding this indicator is therefore crucial and often deviates from the actual physical number of tenders during a period. The rate of involvement in cross border activity of larger contractors has increased in recent quarters, to counter act the impact of the dearth in work opportunities domestically in which they can compete. Some larger companies recently announced that the percentage contribution of work outside of South Africa is larger than revenue generated inside the country. Because these indicators are weighted, the opinions and perceptions of larger firms impacts quite heavily on the overall trend, and the impact of "cross border" activity must not be undermined in the movement of these indices.

Figure 10: Opinions of new work tendered for

- The negative sentiment towards tenders was maintained in this survey, although there was another gradual improvement in the negative nett satisfaction rate to -45.3 percent from -51.9 in the 2nd quarter. This is mainly as a result of fewer (59.9 percent) contractors reporting on low tender volume conditions (compared to 75 percent in the previous survey) while an increasing number of contractors (38.1 percent, compared to 21 percent in the 2nd quarter survey) felt that tender activity was at a satisfactory level.
- There was some improvement in the estimated value of tenders published for the second consecutive quarter, up by 29.3 percent y-y in the 2nd quarter following the 32.9 percent y-y increase in the 1st quarter. The higher values in the 2nd quarter of 2016 was supported by a 62 percent increase in the value of road projects out to tender, while the estimated value of water projects fell for the second consecutive quarter, down by 25 percent. Please note that this does not include mining infrastructure or bulk infrastructure projects.



Source: Industry Insight Project Database, Databuild

Table 8: Estimated civil tender values, by project type, by quarter (Rm, current prices- not adjusted for inflation)

Awards

	Air	Bridges	Civil Other	Power	Rail	Road	Water	Grand Total	Y-Y Per. Change (Nominal)
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	29.6%
2015Q2	102	467	418	476	153	9,252	4,006	14,875	-12.9%
2015Q3	128	380	388	765	108	8,924	4,129	14,822	-9.6%
2015Q4	4	492	365	700	277	5,245	6,615	13,697	-11.2%
2016Q1	-	467	495	516	50	7,789	4,048	13,364	32.9%
2016Q2	18	320	499	343	2	15,034	3,022	19,238	29.3%

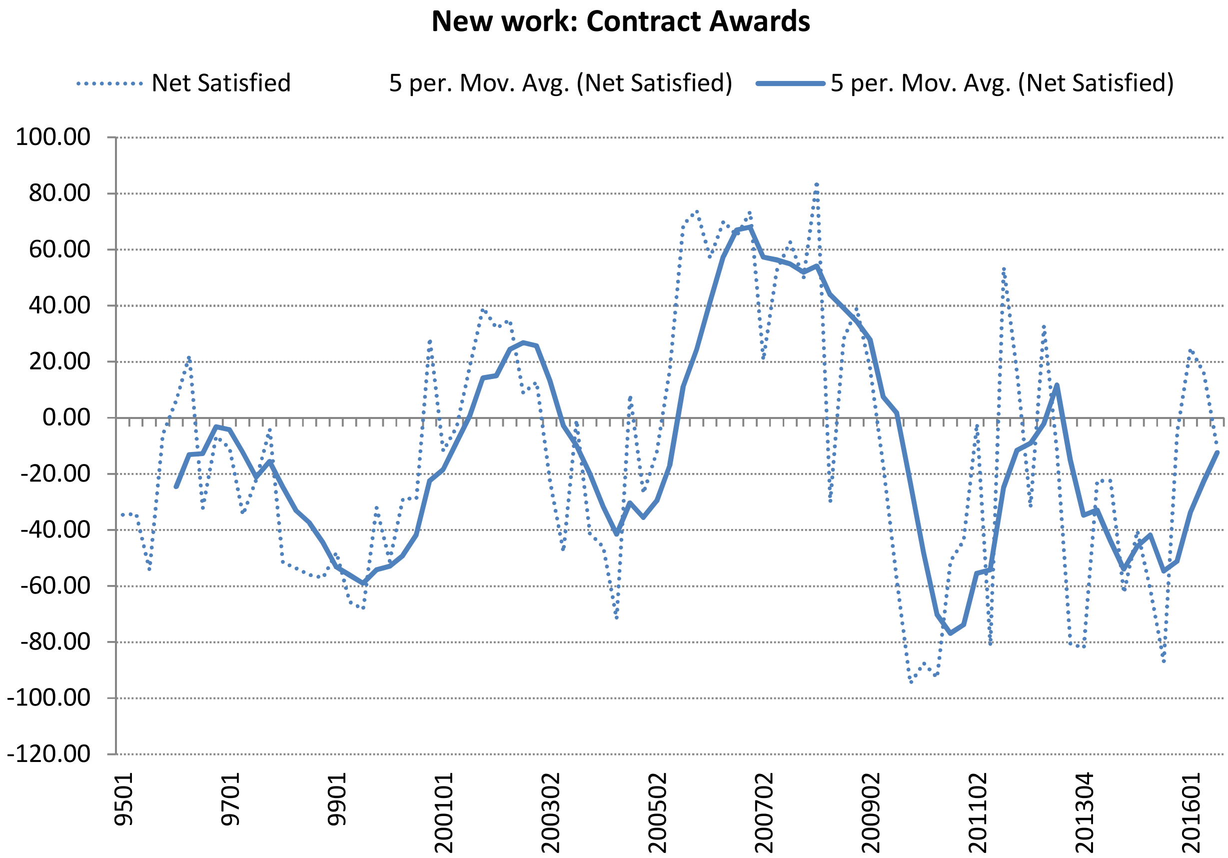
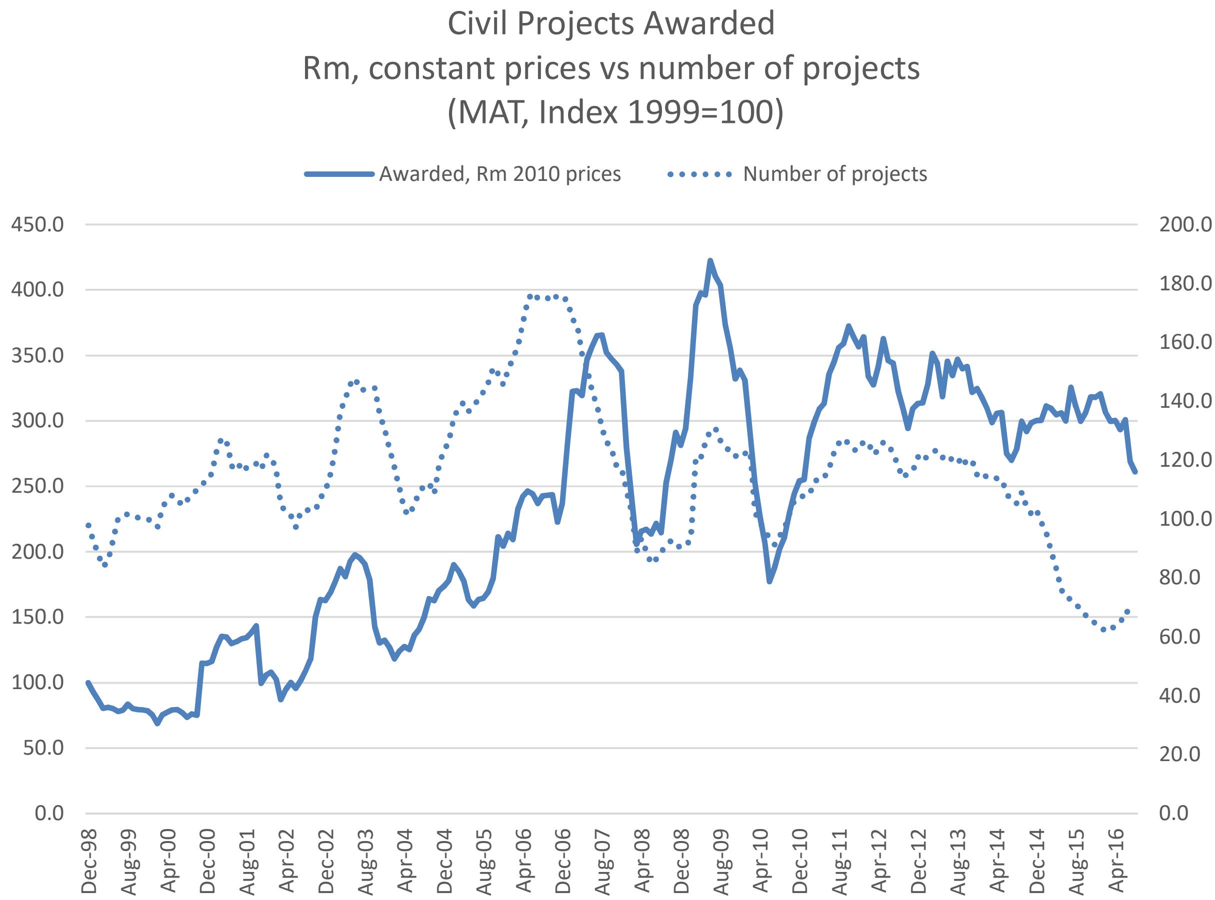


Figure 11: Opinions related to Awards

- The nett satisfaction rate regarding opinions related to the awarding of contracts deteriorated in the current survey, from (positive) 15.8 percent to -10.9 percent. Although the trend over the last five quarters remain in the red (due to the high levels of negativity since 2012 and the slow pace of recovery) the negative sentiment (rate of decline) has improved to -12.5 percent (the best level since 4th quarter 2012).
- The nominal value of civil contracts awarded increased by 2 percent y-y in the 2nd quarter, and is currently down 12 percent for the first six months of the year compared to the same period in 2015. Values for July and August suggest a weaker performance in the 3rd quarter with a drop of over 50 percent y-y for these two months compared to last year.
- During the same quarter (2nd quarter) the number of civil projects awarded increased rather robustly by 51 percent y-y, following the 8 percent y-y decrease in the 1st quarter of 2016. However the first two months of the 3rd quarter (July and August) has shown another contraction thus far, down 12.4 percent y-y. Although the annual growth in the award index remains negative over the last 12 months, the rate of decline has slowed to -5.0 percent y-y (as at August 2016) from -38 percent in 2015.


Civil Projects Awarded
Rm, constant prices vs number of projects
(MAT, Index 1999=100)
Awarded, Rm 2010 prices
Number of projects
450.0
400.0
350.0
300.0
250.0
200.0
150.0
100.0
50.0
0.0
200.0
180.0
160.0
140.0
120.0
100.0
80.0
60.0
40.0
20.0
0.0
Dec-98
Aug-99
Apr-00
Dec-00
Aug-01
Apr-02
Dec-02
Aug-03
Apr-04
Dec-04
Aug-05
Apr-06
Dec-06
Aug-07
Apr-08
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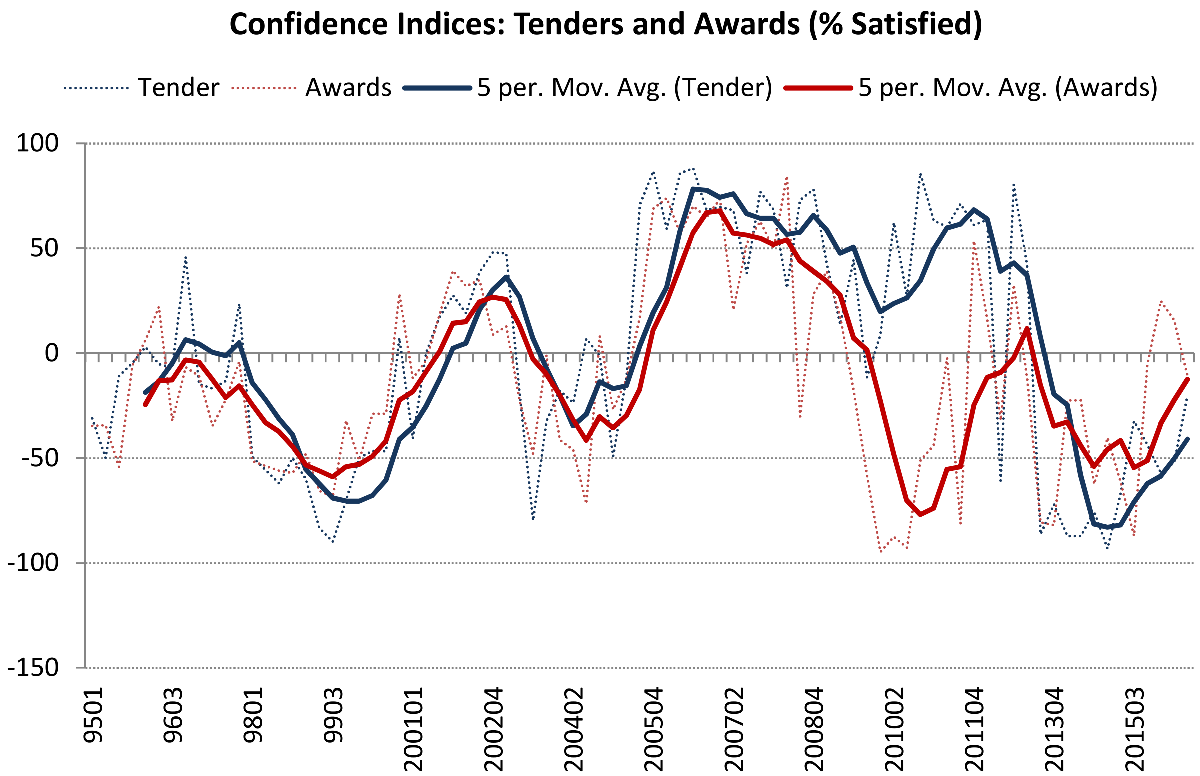
Dec-14
Aug-15
Apr-16


Confidence Indices: Tenders and Awards (% Satisfied)
Tender
Awards
5 per. Mov. Avg. (Tender)
5 per. Mov. Avg. (Awards)
100
50
0
-50
-100
-150
9501
9603
9801
9903
200101
200204
200402
200504
200702
200804
201002
201104
201304
201503

Order books

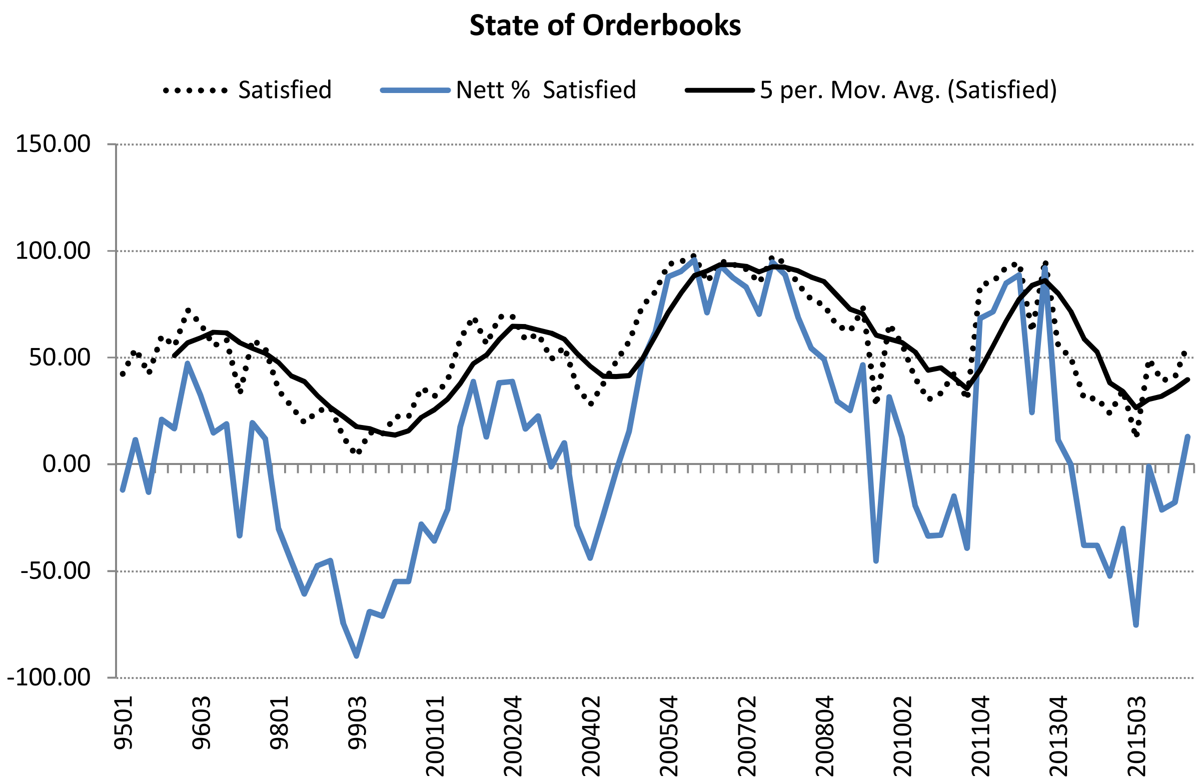
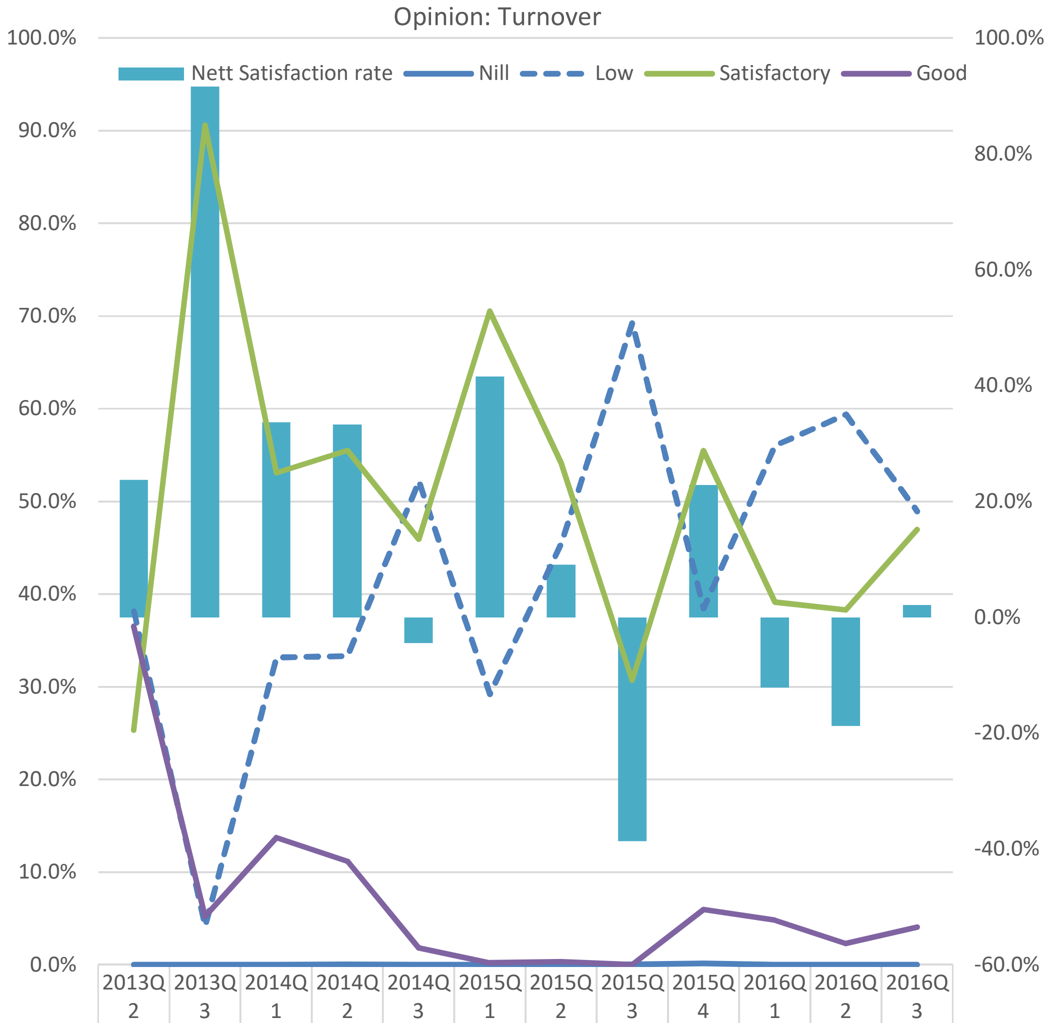


Figure 12: State of Orderbooks

- Sentiment towards order books has turned positive in this survey (13.0 percent), for the first time since 2013. Majority of contractors (56.5 percent) said they were satisfied with prevailing order books, while 43 percent still felt it was low (compared to 58.6 percent in the 2nd quarter survey). Larger firms have also reported less negative sentiment towards orderbooks.

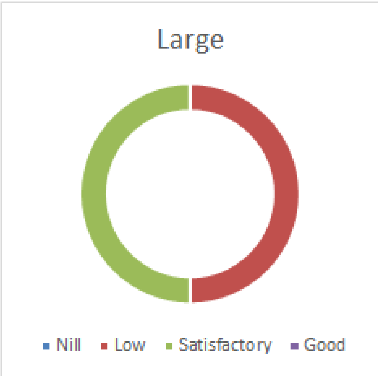
Turnover

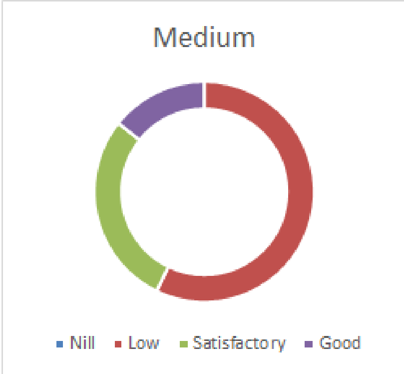
- The nett satisfaction rate in terms of opinions related to turnover also turned positive, from 18.8 percent in the previous survey to 2.1 in the current survey, as an increasing number of firms (47 percent) reported more satisfactory levels, while 4 percent (compared to 2.3 percent) said levels were considered as "good". Majority however (48 percent) reported low turnover levels.
- Details of the current sentiment levels amongst the various firm size categories (large, medium and small) are provided in the charts below.

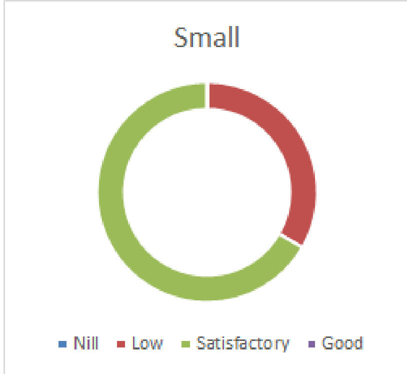


	2013Q2	2013Q3	2014Q1	2014Q2	2014Q3	2015Q1	2015Q2	2015Q3	2015Q4	2016Q1	2016Q2	2016Q3
Nett Satisfaction rate	23.7%	91.6%	33.6%	33.3%	-4.5%	41.5%	9.1%	-38.6%	22.8%	-12.1%	-18.8%	2.1%
Nill	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.1%	0.0%	0.0%	0.0%
Low	38.2%	4.2%	33.2%	33.3%	52.2%	29.2%	45.5%	69.3%	38.5%	56.1%	59.4%	48.9%
Satisfactory	25.3%	90.6%	53.1%	55.5%	45.9%	70.5%	54.2%	30.7%	55.5%	39.1%	38.3%	47.0%
Good	36.5%	5.2%	13.7%	11.2%	1.8%	0.2%	0.4%	0.0%	5.9%	4.8%	2.3%	4.1%

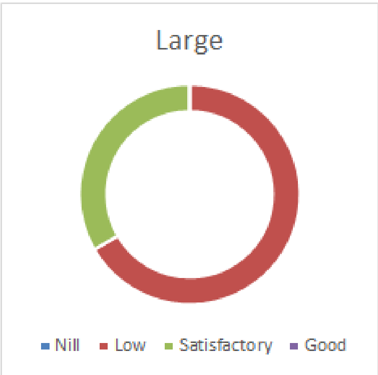
TEnder Volumes

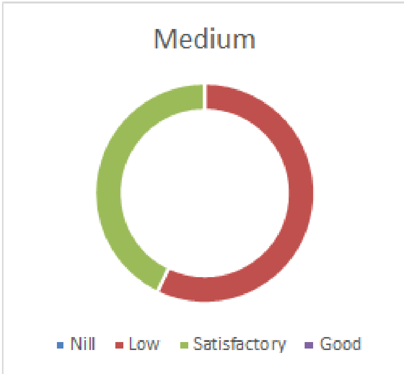


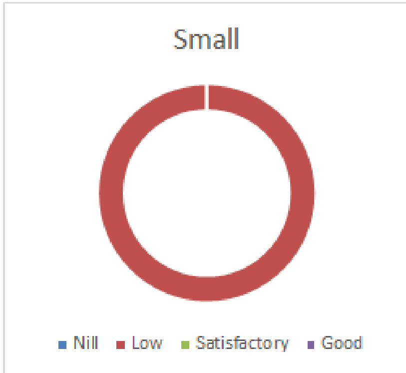




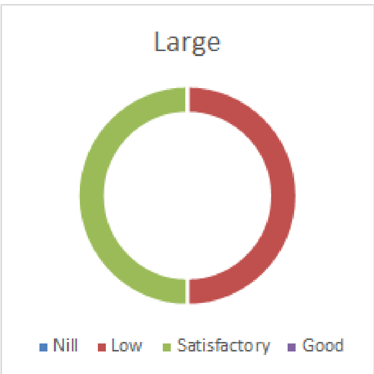
Contract Awrads

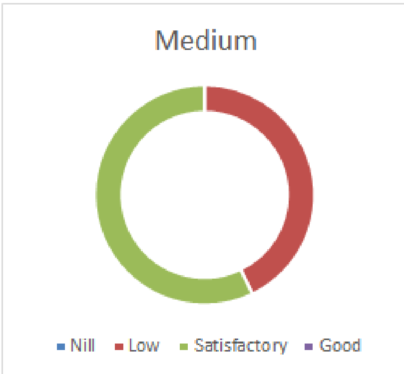


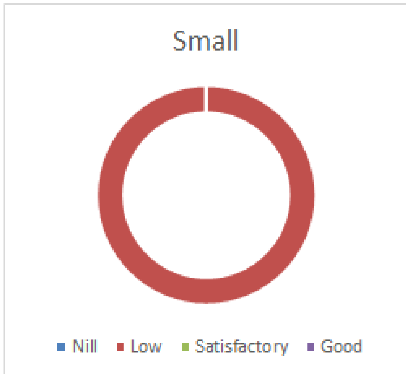




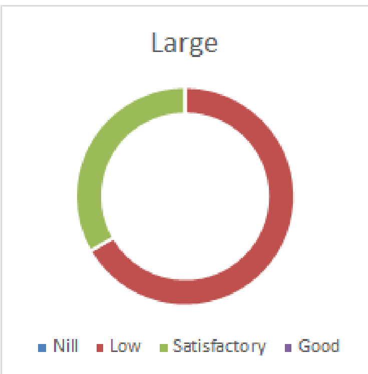
Order Book

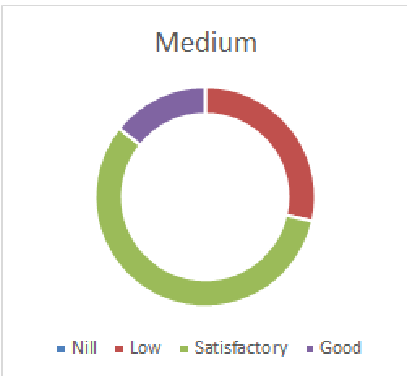


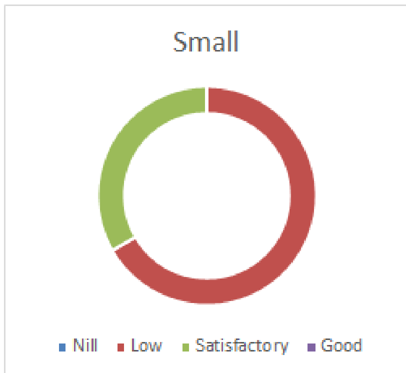




Turnover







Capacity Utilisation and Plant Equipment

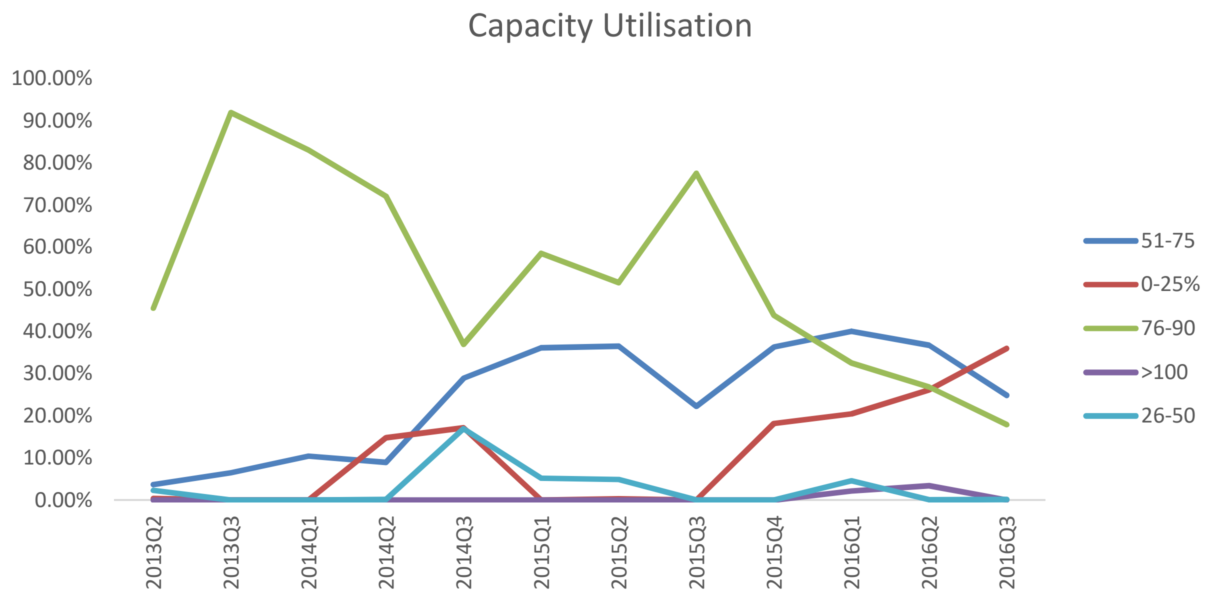


Figure 14: Capacity Utilisation, % of Respondents that reported between 51-75 percent

CAPACITY UTILISATION AND PLANT EQUIPMENT

Majority of firms (36%) reported capacity utilisation in terms of general plant and resources of less than 25 percent, strongly contradicting the more positive feedback in terms of turnover and awards. Since the last survey utilisation levels have continued to deteriorate. 50 percent of larger firms reported utilisation levels below 75 percent, while all medium size firms utilised 76 percent and more.

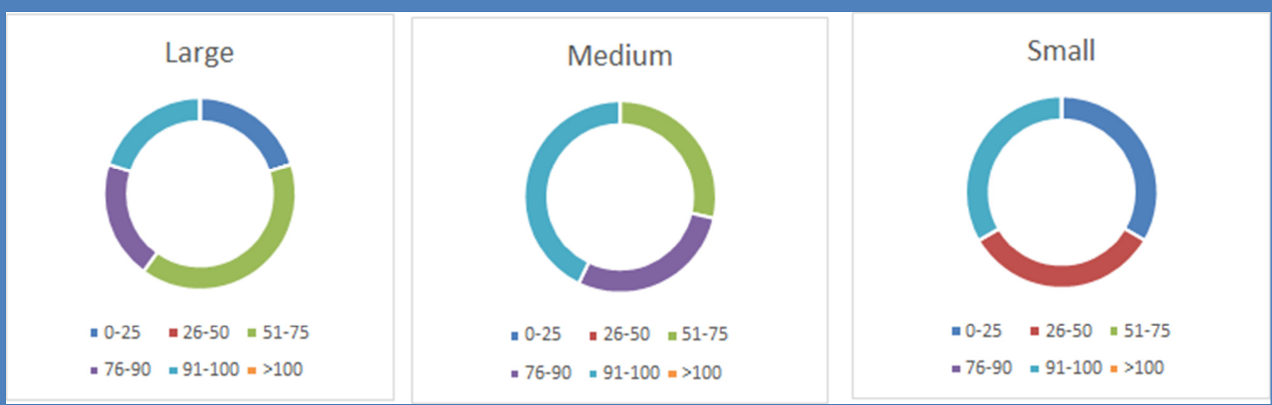


Figure 13: Capacity Utilisation by firm size

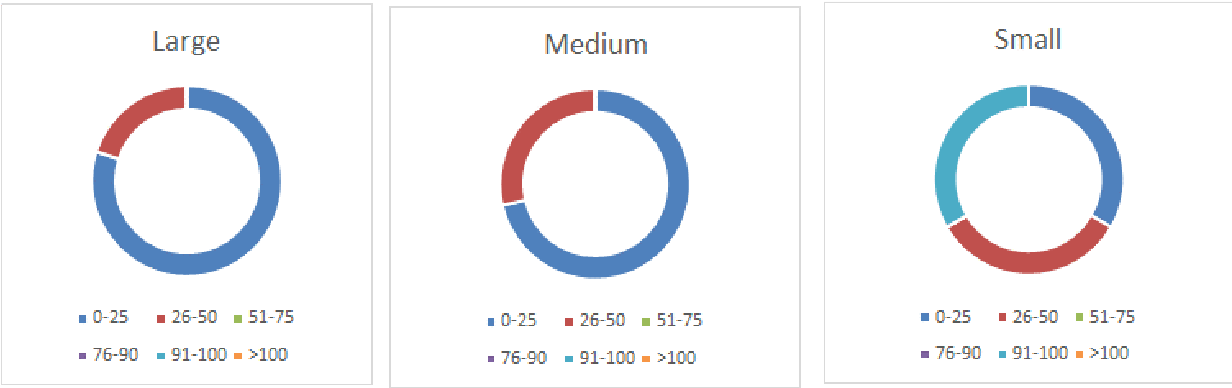
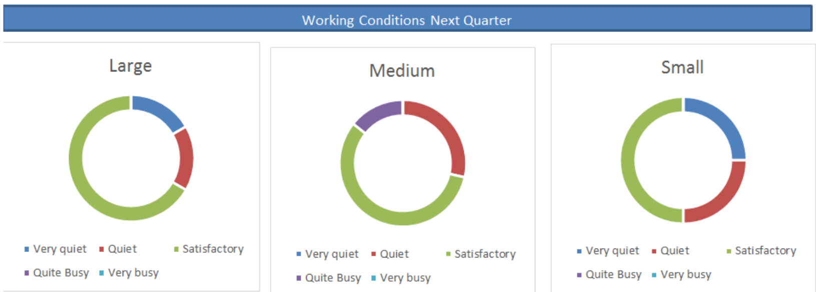
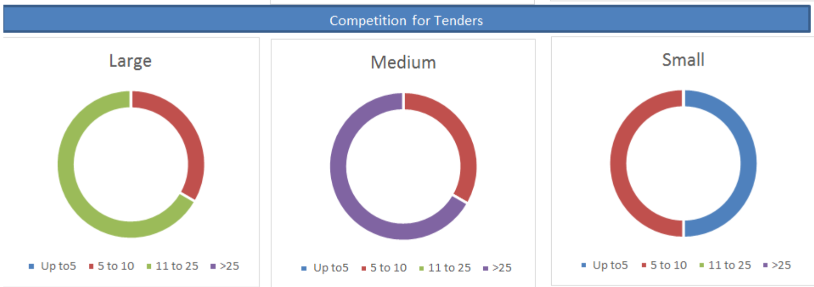
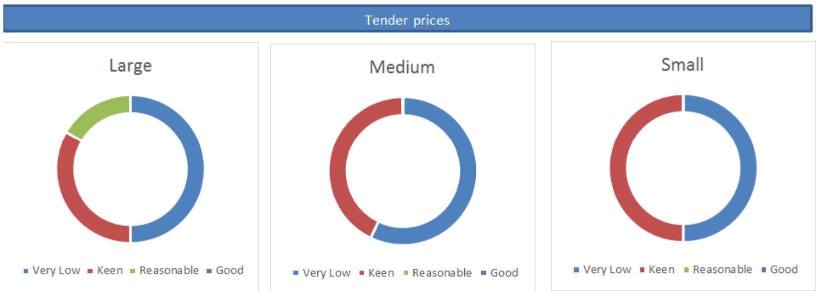


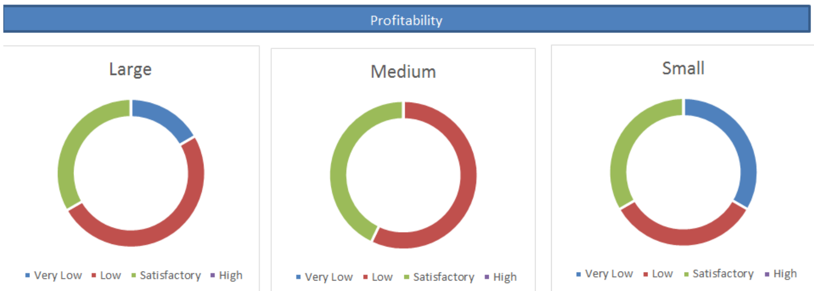
Figure 15: Percentage of company's internal plant idle, by firm size

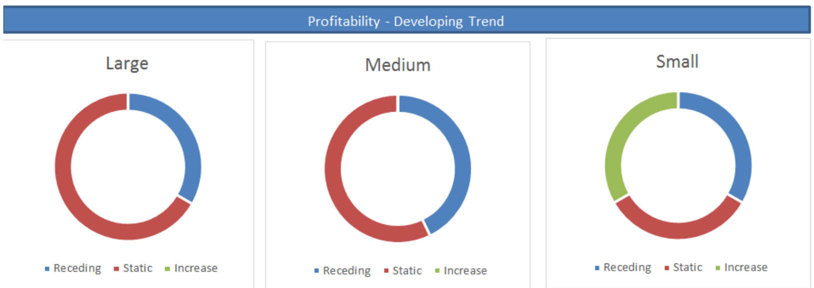
Majority of respondents (88 percent) reported that less than 25 percent of plant equipment was standing idle, compared to 57 percent in the previous survey and an average of 78 percent over the last two years (2015 and 2014). The percentage of respondents that reported more than 50 percent idle dropped to 0.1 percent from 11.3 percent and an average of 3.7 percent over the previous two years.











Firm size market segmentation

Opinions and sentiment are categorised by firm size, based on reported work force including permanent and limited duration employment.

Results for various indicators are shown here, summarised by firm size.

- Working conditions for next quarter
- Competition for tenders
- Tender prices
- Profitability
- Profitability – Trend
- Capacity Utilisation
- Plant Idle

Performance of the listed sector

Overall, there have been both positive and negative developments, over the last three months, for the respective big contractors. There is however a perception in the market that the companies are undervalued to some degree, which is testament to the performance of the respective share prices. Looking at the chart below, the contractors index (which consists of all the listed South African contractors (WBHO, M&R, Group 5, Aveng, Basil Read, Stefanutti Stocks, Raubex, Calgro M3 and Esor), outperformed the overall industrials index as well as the JSE. The contractors' index closed at just above 140 points, 40 percent stronger than 12 months ago, and outperforming all other construction related segments, except for the suppliers' index.

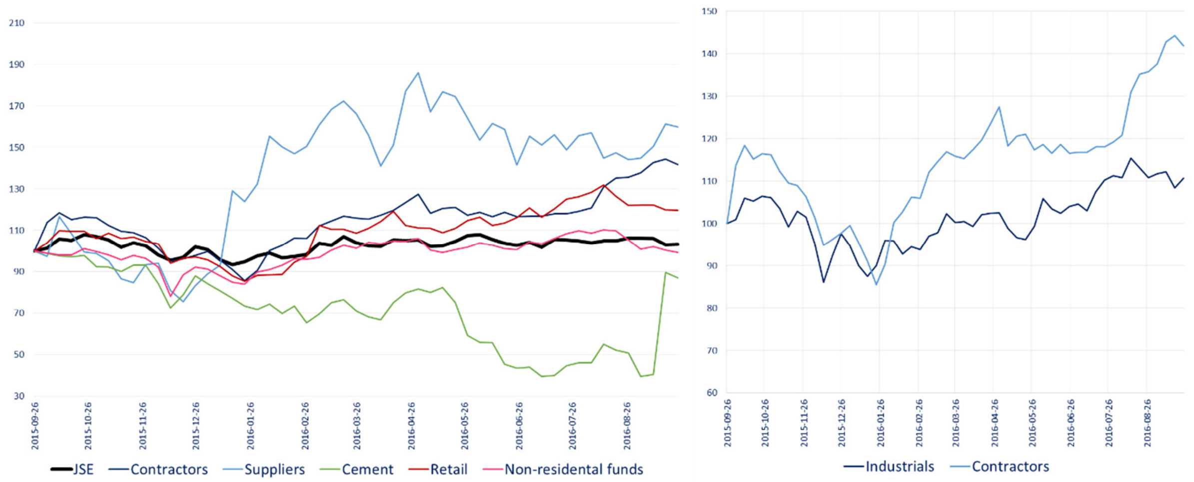


Figure 16: Indices based on aggregate market capitalisation values

In the last 3 months, five of the big listed contractors released financial results, with some interesting developments. Results were released from Aveng, Group 5, Basil Read, WBHO and Murray and Roberts. Aveng, reported a drop in revenue of 23 percent to R33.8bn from R43.9bn in the previous year, and recorded a net loss of R65 million. This is an improvement from the loss of R518 million in the previous year. Overall this should be seen as an improvement with some restructuring, with the contracting division (Grinaker-LTA) more or less breaking even in the financial year. Aveng had more exposure to the international market with local work contributing 37 percent of the order book, compared to 56 percent in the previous financial year. This is testament to conditions in the local market.

Murray and Roberts reported an increase in revenue of 9 percent, improved operating profit (of just under 20 percent) and slightly higher operating margins (from 4.4 to 4.9 percent). The group's order book did however decrease by 13 percent. The more pertinent news of the release was that the company was selling off almost their entire infrastructure and building business which is again testament to the low margins and lack of demand in the current market. Basil Read also cited local conditions for their poor performance, with revenue shrinking by 12 percent and the operating profit decreasing by 22 percent, according to the release of their interim results. Despite the weak conditions, their order book is still above target and only marginally down from last year, decreasing from R10.7bn to R10.4bn. The company is exploring looking for more projects in Africa.

WBHO reported a nominal increase of 6.3 percent in their revenue, the majority, 59 percent, came from projects in Australia. Projects in South Africa made up 32 percent, while projects in Africa made up the remaining 9 percent. The fact that WBHO's main share of their business is in Australia means that looking at the overall fundamentals of the company do not really tell us much about the South African construction sector. The group's order book is up quite significantly, by 14.1 percent to R42.7bn. This is again predominantly from work in Australia, specifically 72 percent, while the African order book has dropped to 28 percent, compared to 32 percent last year. The group has commented that work from building projects has largely offset waning demand for civil engineering and mining related construction. The CEO also noted on a pickup in government spending on infrastructure projects, which we have seen in the data for civil projects awarded, as well as the value of civil projects that have been coming out to tender.

Group 5 posted mixed results, with revenue down marginally by 1 percent, while operating profit, as well as margins were up slightly. Their order book was 8 percent lower however. These five results and consequences there-of are really indicative of current conditions, and what we have seen in the interim is many of these companies restructuring exploring new options to focus on efficiencies and possibly some sort of comparative advantage they may have. Listed contractors continue to face challenges following various Competition Commission investigations of collusion, aggravated by an increase of prevalence of project fragmentation.

Aveng

Basil Read

Stefanutti Stocks

Murray & Roberts

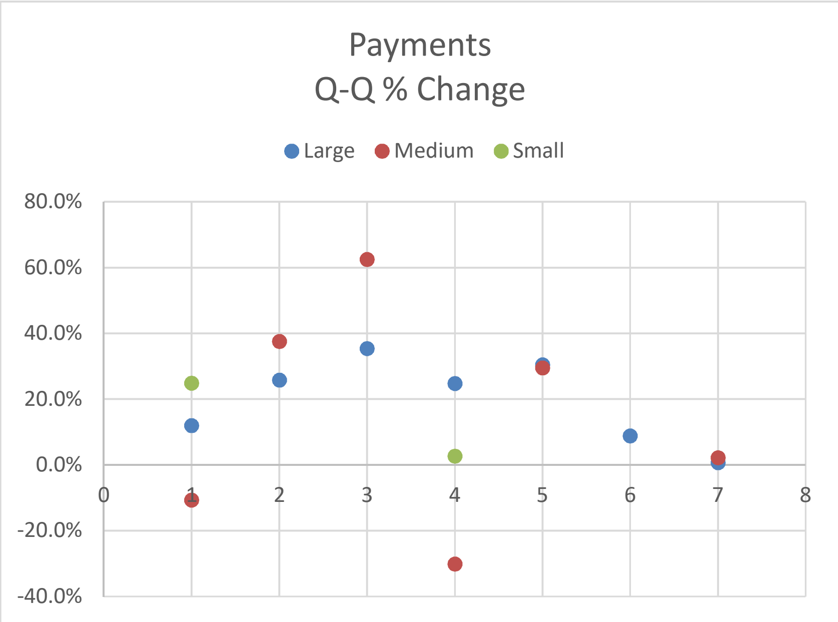
Raubex

WBHO

Group Five

Share price movement of listed contractors over the last 12 month period. (Source Sharedata)

Industry Turnover and Employment



According to responding contractors, nominal turnover based on certified payments received, rose 23.2 percent q-q in the 2nd quarter of 2016, following a decrease of 8 percent q-q in the 1st quarter. On a year on year basis, turnover ended flat, and is 2 percent lower for the first six months compared to last year.

Turnover generally increases at a stronger pace in the 2nd quarter as funds have been allocated towards infrastructure allocations for the next financial year, following the release of the budget in February each year. Change in payments received fluctuated notably between the various firms, but on average, majority of firms reported improved turnover levels compared to the previous quarter.

Turnover is not expected to increase in real terms over the short to medium term, based on current movement in key economic indicators, the contraction in the estimated value of civil contracts out to tender in 2015 (although the first six months of this year provides some hope for the latter part of 2016 and into the first half of 2017), the overall slowdown in the number of contracts out to tender accompanied by an increase in the number of civil projects placed on hold/cancelled and the cut in projected infrastructure expenditure by government and state owned enterprises announced in the 2016/17 Medium Term Expenditure Framework.

Turnover for 2015 is estimated to have increased by between 10 and 15 percent y-y in real terms, following two years of negative real growth, down 2.6 percent and 10 percent y-y in 2014 and 2013 respectively. Turnover was boosted by the awarding of few higher value projects, and not by a broad based recovery in tender or award activity. Turnover is projected to decline by between 3 percent and 6 percent y-y in real terms during 2016, allowing for an average increase in construction cost inflation of between 8 percent and 10 percent. Construction cost inflation estimates is discussed further in the report. Estimates released by Treasury on public sector infrastructure spending for the next three years, suggest marginal growth of 1.8 percent on average over the MTEF (2016/17 – 2018/19), which in real terms will be negative growth of between 4 and 5 percent on average. Government faces a difficult period ahead as it aims to stabilise public debt, reign in government expenditure and lower the current account deficit in an attempt to avoid a further downgrade by sovereign credit rating agencies. The impact of poor economic growth on government finances will be hard felt by the local construction sector.

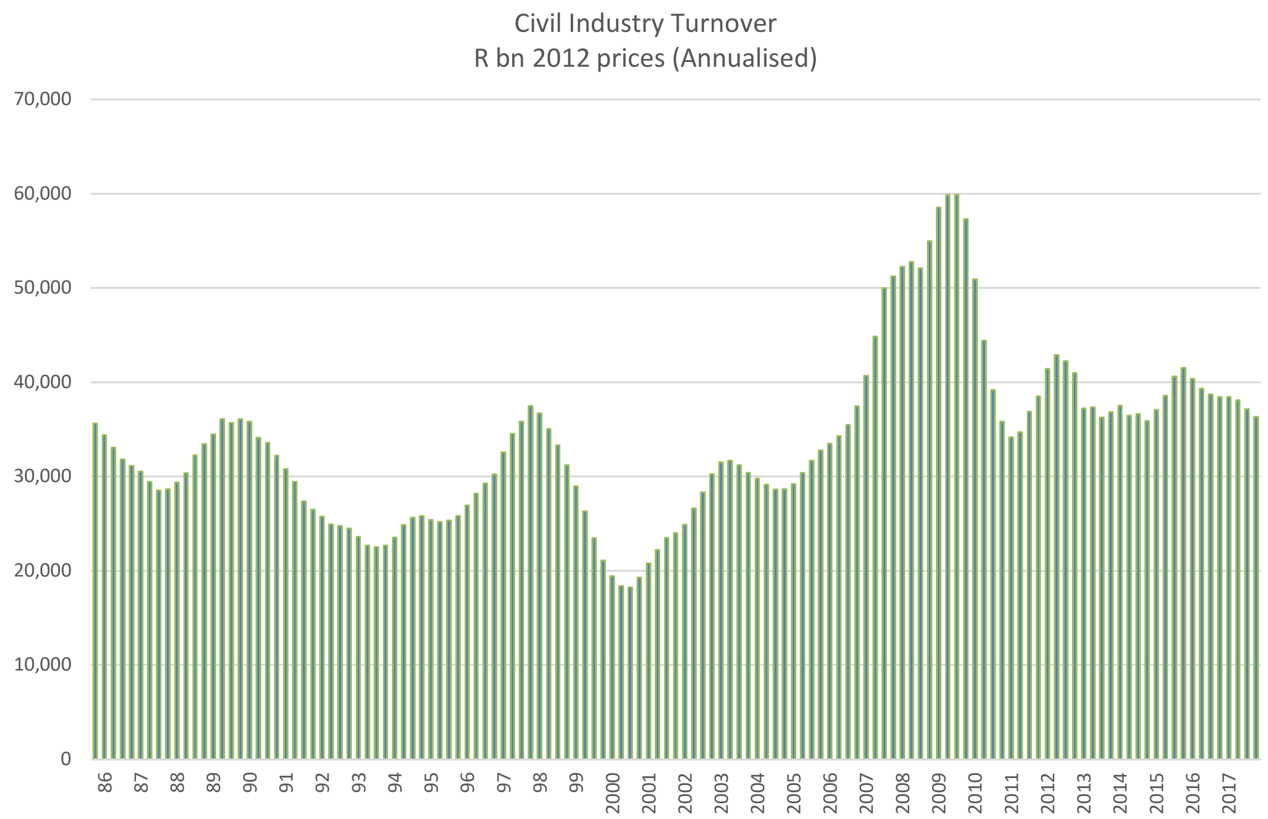


Figure 17: Civil Industry Turnover, Rm 2012 prices (annualised)

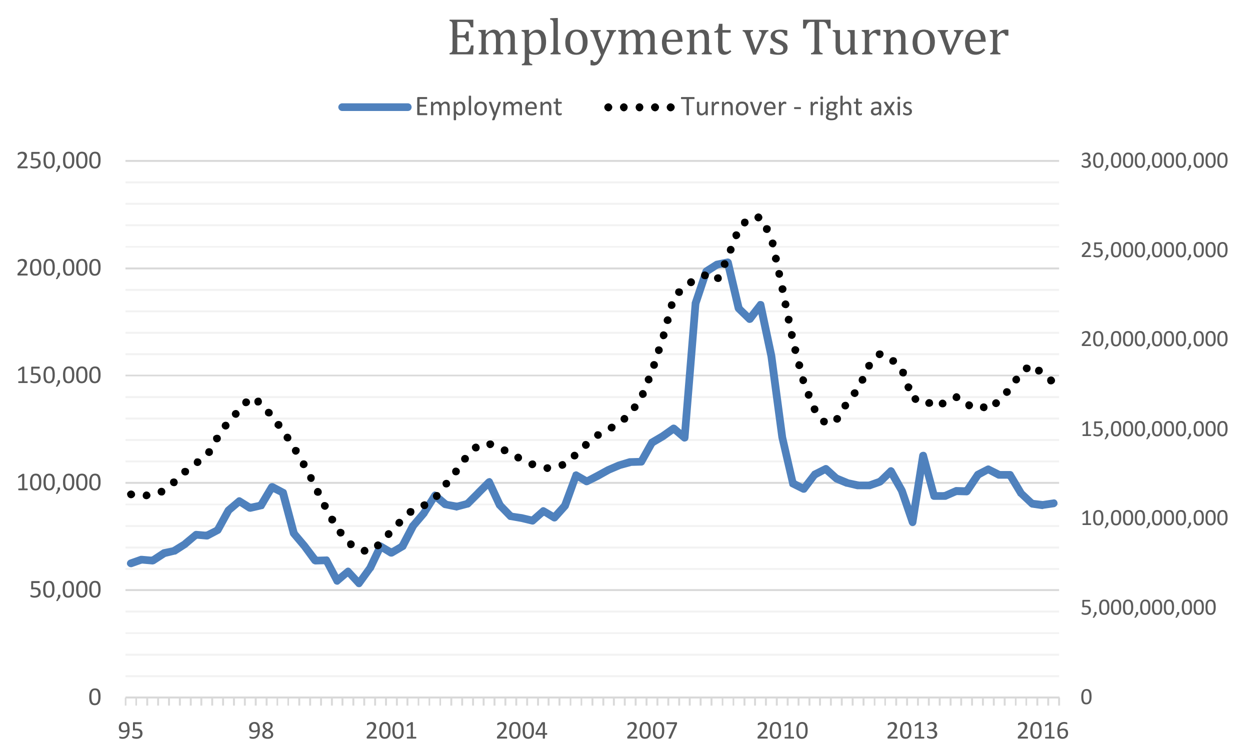


Figure 18: Employment vs Turnover

Table 15: Actual and Expected Turnover trends

	Turnover Nominal	*% Change (Nominal)*	*Turnover 2010=100*	*% Change (Real)*
1996	9,864,977,221	28.9%	27,485,856,690	15.3%
1997	13,282,356,448	34.6%	34,093,671,157	24.0%
1998	11,680,899,837	-12.1%	28,324,192,234	-16.9%
1999	8,600,472,761	-26.4%	19,152,137,970	-32.4%
2000	8,669,595,494	0.8%	17,588,090,052	-8.2%
2001	11,723,000,614	35.2%	21,842,034,976	24.2%
2002	17,138,501,083	46.2%	27,651,350,545	26.6%
2003	17,701,840,728	3.3%	27,666,385,851	0.1%
2004	17,180,281,073	-2.9%	26,089,962,307	-5.7%
2005	20,999,901,277	22.2%	29,825,989,361	14.3%
2006	25,783,535,490	22.8%	34,144,447,197	14.5%
2007	38,084,310,982	47.7%	46,580,085,992	36.4%
2008	58,063,639,993	52.5%	59,122,639,971	26.9%
2009	51,147,261,584	-11.9%	52,380,811,808	-11.4%
2010	32,744,103,366	-36.0%	32,744,103,366	-37.5%
2011	36,888,136,573	12.7%	35,232,222,132	7.6%
2012	40,952,061,358	11.0%	37,429,393,946	6.2%
2013	38,920,982,014	-5.0%	33,654,708,245	-10.1%
2014	39,941,145,748	2.6%	32,798,515,557	-2.5%
2015	46,049,492,101	15.3%	37,928,298,093	15.6%
2016 (f)	48,351,966,706	5.0%	36,214,866,986	-4.5%
2017 (f)	45,450,848,704	-6.0%	33,037,802,443	-8.8%
2018 (f)	45,905,357,191	1.0%	31,728,498,119	-4.0%

Table 16: Employment, Contract Awards, Turnover and Salaries and Wages

	Employment	Turnover (nominal)	Salaries and Wages (nominal)
2011	101,854	36,888,136,573	8,163,344,624
2012.1	98,837	11,324,591,712	2,506,132,146
2012.2	100,497	10,456,138,926	2,313,943,544
2012.3	105,522	9,933,331,979	2,198,246,367
2012.4	96,502	9,237,998,741	2,044,369,121
2012	96,502	40,952,061,358	9,062,691,178
2013.1	81,651	7,944,678,917	1,758,157,444
2013.2	112,823	11,122,550,484	2,461,420,422
2013.3	93,894	9,454,167,911	2,092,207,359
2013.4	93,894	10,399,584,702	2,301,428,095
2013	95,565	38,920,9982,014	8,613,213,320
2014.1	96,241	9,255,630,385	2,048,271,004
2014.2	96,048	10,643,974,943	2,355,511,655
2014.3	103,732	10,111,776,196	2,237,736,072
2014.4	106,326	9,929,764,224	2,197,456,823
2014	100,587	39,941,145,748	8,838,975,554
2015.1	103,774	10,525,550,078	2,526,132,019
2015.2	103,774	12,209,638,090	2,677,699,940
2015.3	95,161	12,270,686,281	2,455,450,845
2015.4	90,403	11,043,617,652	2,319,159,707
2015	98,278	46,049,492,101	9,978,442,510
2016.1	89,679	10,160,128,240	2,133,626,930
2016.2	90,576	12,192,153,888	2,560,352,317

Confidence Index

The quarter on quarter movement in the index has been more erratic lately, but after some improvement in the last few quarters brought about by a more optimistic outlook from medium size contractors, the trend has reversed, showing signs of a moderate improvement.

Explanatory note: The civil engineering confidence index relates to the overall business outlook amongst the companies within the industry. Levels below the 50-mark indicate pessimism, 0 equals total negativity, and 100 indicates absolute optimism. This is a continuously changing weighted index.

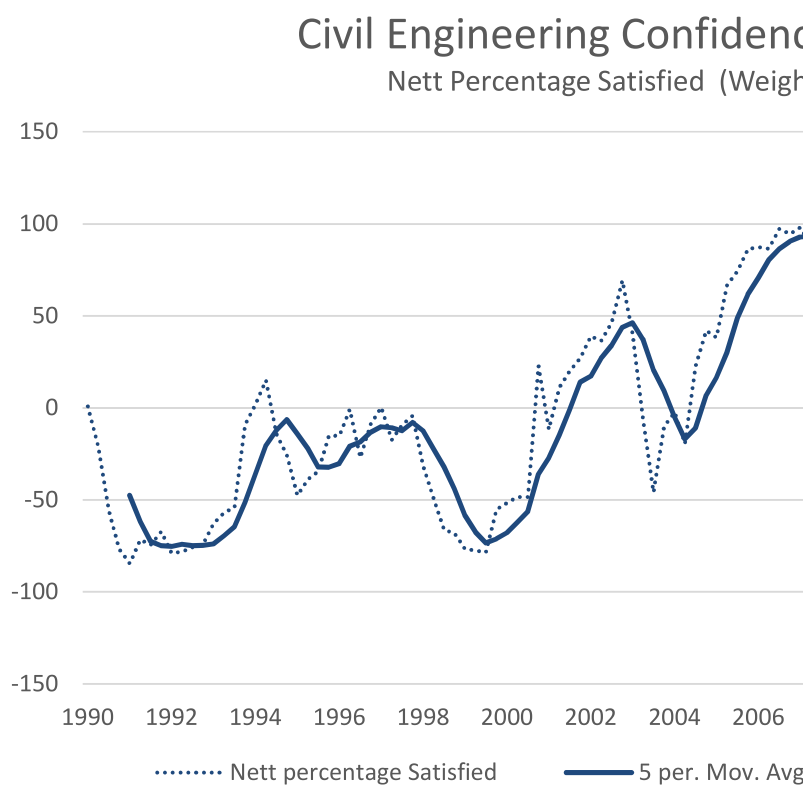
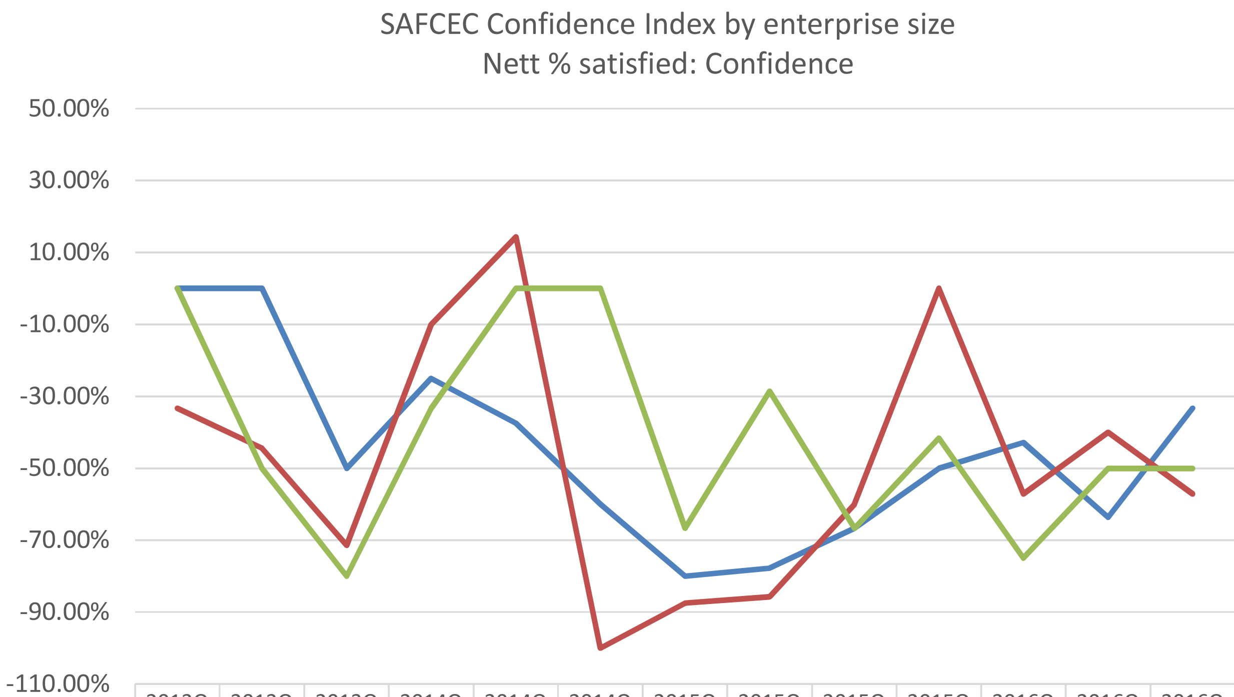


Figure 19: Civil Engineering Contractors Confidence Index

In line with improved sentiment towards turnover and awards, the confidence index improved to a nett satisfaction rate of -35 percent from -57 percent in the 2nd quarter. Fewer contractors reported quiet conditions, down from 55 percent to 34.8 percent, while 65.2 percent reported satisfactory business conditions (from 38 percent) in the previous quarter. In this survey, all firm size categories reported negative nett satisfaction rates, although larger firms were the most "negative", with a -63 nett satisfaction rate, followed by smaller firms at -50.0 and medium size firms at a level of -40.0.



	2013Q 1	2013Q 2	2013Q 3	2014Q 1	2014Q 2	2014Q 3	2015Q 1	2015Q 2	2015Q 3	2015Q 4	2016Q 1	2016Q 2	2016Q 3
Large	0.00%	0.00%	-50.00%	-25.00%	-37.50%	-60.00%	-80.00%	-77.78%	-66.67%	-50.00%	-42.86%	-63.64%	-33.33%
Medium	-33.33%	-44.44%	-71.43%	-10.00%	14.29%	-100.00	-87.50%	-85.71%	-60.00%	0.00%	-57.14%	-40.00%	-57.14%
Small	0.00%	-50.00%	-80.00%	-33.33%	0.00%	0.00%	-66.67%	-28.57%	-66.67%	-41.67%	-75.00%	-50.00%	-50.00%

The main difference between the SAFCEC confidence index and the FNB/BER is the fact that the SAFCEC responses are weighted according to firm size. Thus while the indices may be at a different level, the trends are very similar and clearly shows the depressed conditions currently being experienced in the civil industry. The SAFCEC confidence index is recalculated below to show the percentage satisfied as opposed to the nett percentage satisfaction rate, as shown in the chart above. According to the FNB/BER, the civil contractor confidence index declined sharply to 28 percent in the 1st quarter of 2016, from 42 percent the previous quarter (4th quarter 2015), and has been below the 50 percent neutral level since 2008. The chart below clearly reflects the structural shift that has taken place, as it the current trends depicted in the industry are no longer subject to normal cyclical patterns. Serious structural reforms are required to restore growth in the industry, highlighting constraints in both government and SOE's.

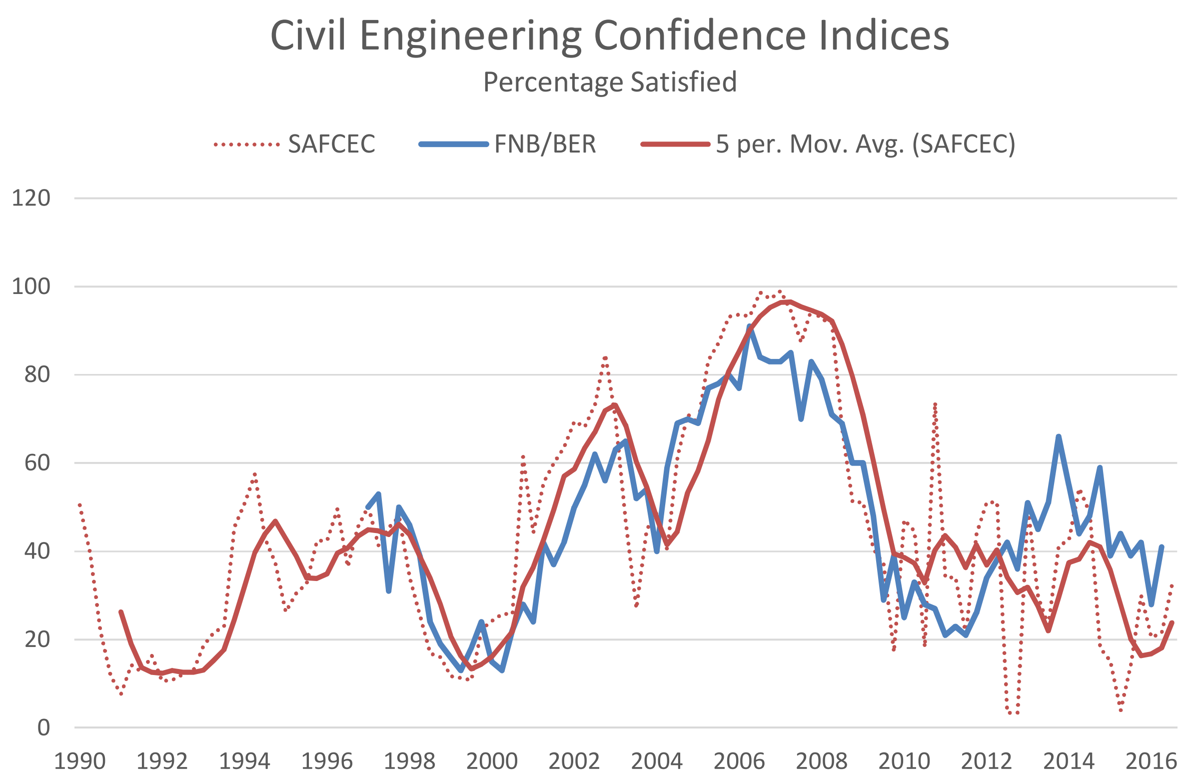


Figure 20: FNB/BER Confidence index vs SAFCEC Confidence Index

Update on Construction Sector Scorecard

Consensus was reached on new codes and a new scorecard by all Parties in the Construction Sector Charter Council in July. The draft codes are currently with the Minister of Trade and Industry for signature.

Once signed the codes and the scorecard will be published for public comment for a period of 30 days from date of publication. It is hoped that, once the draft codes have been published, the repeal of the previous sector codes and scorecard in February 2016 will be cancelled. Given the time frames taken in other sector scorecards it is anticipated that the new Construction Sector Codes will only be legislated sometime next year.

Survey results EX-RSA

Table 9: Business conditions during the past two quarters

	Previous quarter	*Current Quarter*
Very poor	17%	17%
Poor	0%	17%
Satisfactory	67%	50%
Good	17%	17%
Very Good	0%	0%
Nett Satisfaction	0%	-17%

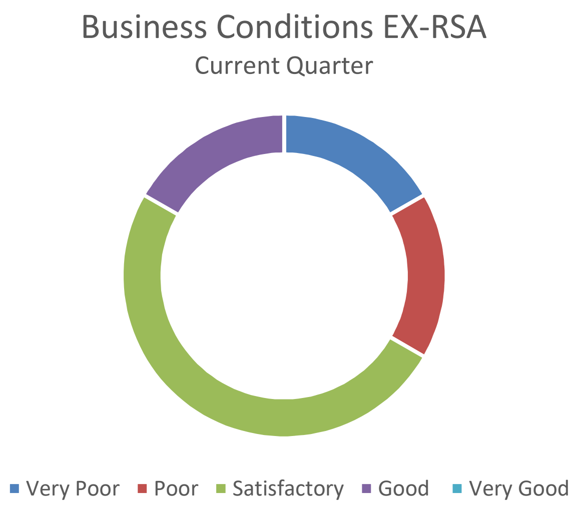
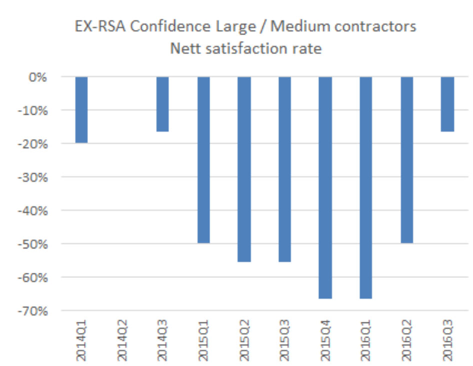
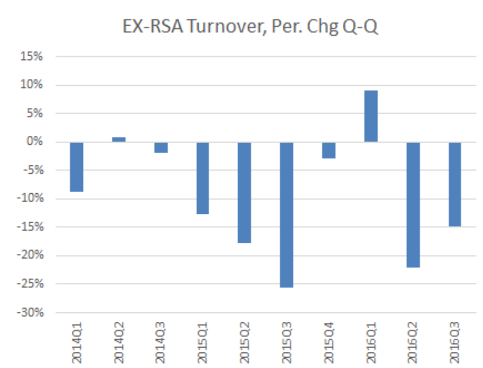
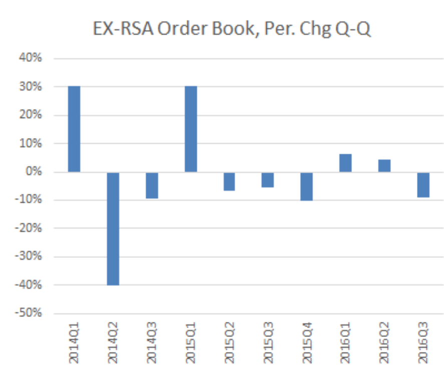


Table 10: Late payments, order books and turnover, EX-RSA

Survey period	*% late payments of turnover*	*% Change in* turnover	*% Change in order book*
2014Q2	46%	1%	-40%
2014Q3	47%	-2%	-10%
2014Q4	59%	-13%	30%
2015Q1	106%	-18%	-7%
2015Q2	133%	-26%	-6%
2015Q3	54%	-3%	-10%
2015Q4	59%	9%	6%
2016Q1	94%	-22%	4%
2016Q2	120%	-15%	-9%







PROSPECTS FOR 2016 and 2017

Key issues affecting current confidence levels in the industry:

- Global economic turmoil, affecting particularly emerging and developing economies.
- Domestic economic woes intensified in 2016 with elevated political instability, violent and disruptive protest action, while credit rating agencies remain largely supportive of a further downgrade. A looming recession will have a more profound impact on an already ailing construction sector.
- Skills related to engineering is becoming a more serious constraint largely aggravated through continued client interference which creates an environment whereby agents are being disempowered. This leads to project implementation delays and is a contributing factor to the increase in payment delays, through delays in certification.

- Slow roll out of public sector infrastructure projects, including the delays to implement the targets as set out in the National Development Plan, aggravated by cuts in projected infrastructure expenditure allocations which were announced in the 2015/16 Budget, has resulted in negative growth projected over the medium term expenditure framework period (2016/17 – 2018/19).
- Award delays are also becoming more significant. Contractors have a quarter of the time to prepare and submit tender document, compared to the time taken by clients to adjudicate.
- Currency volatility and depreciation of the rand (down close to 40 percent in 2015) means any gains from the lower oil price are eroded.
- Skills shortages in procurement which also include government's ability to implement proper project planning and implementation. It is also critical to shorten the delay between tender and awards which could take as long as one year.
- The inability of certain local and district municipalities to spend allocated budgetary allocations, which also suggest inadequate skills in planning and budgetary management.
- Low confidence in the mining sector and policy uncertainty is delaying private capital expenditure.
- Continued labour unrest affecting economic performance as well as critical project execution. Unrest is expected to escalate in 2016 because of the municipal elections. This could lead to even further delays in project implementation.
- The tendency by government to break what should be larger Grade 9 projects, into smaller grade projects, referred to as project fragmentation.
- Pricing by contractors remains a concern, as some contractors would tender on projects that fall outside the scope of the prescribed CIDB grade, leading to uncessary delays in the procurement process. Prices can also vary to the extent that it can almost be deemed as irresponsible, or below cost with little or no regard to operational efficiency or the impact of (negative) escelation on contracts.
- As the industry continues to shed employment, these and other challenges will impact on the industry's future capacity to respond effectively to increased demand when the industry starts to recover.

CIVIL ENGINEERING PRICE MOVEMENTS

The Baxter contract price adjustment formula (or CPAF), is widely recognised by the industry as an accepted set of indices to adjust contracts for payment escalation. However, it is important to clarify that these set of indices are freely available and published by Statistics South Africa and is not owned or manipulated by SAFCEC in any way

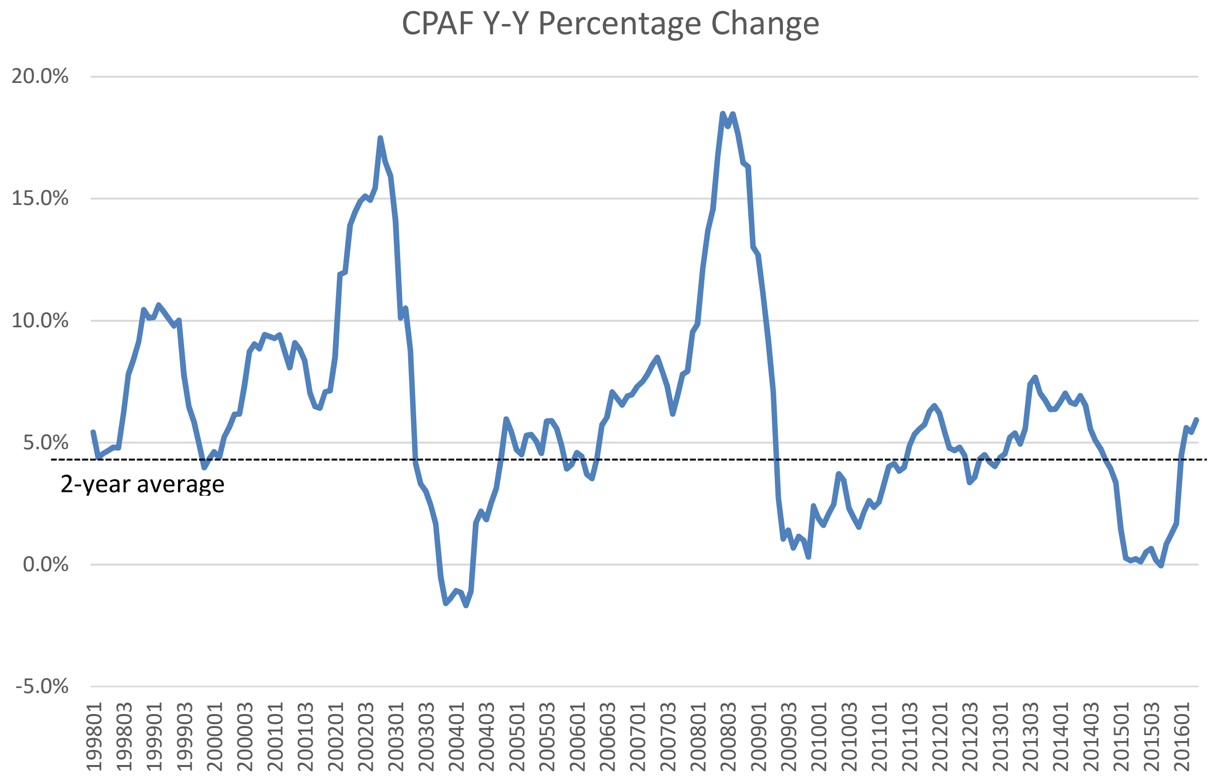
Input cost price movements based on the Baxter contract price adjustment formula (CPAF) averaged (revised) 0.6 percent in 2015, as opposed to a "negative" -0.3 as previously published. The revision is due to the termination of the PPI fuel index "Diesel Fuel: Coast and Witwatersrand" in February 2016 and replaced with "Diesel Fuel: Wholesale. Although price deflation still occurred in the fuel price index, the decline based on the new index was more moderate averaging -15.5 percent as opposed to -25.9 percent.

Input cost inflation averaged 5.9 percent y-y in the 1st quarter of 2016, following an average increase of 1.2 percent in the 4th quarter of 2015. Price deflation still occurred in the material index, down 0.6 percent y-y, but at a much slower pace compared to the -7.1 percent average drop in the previous quarter. Price deflation in the fuel index also slowed from -8.4 percent y-y to -0.6 percent, while the annual increase in the plant index accelerated to 9.5 percent from 5.2 percent in the previous quarter. Labour costs, as measured by the CPI, also accelerated from an annual increase of 4.9 percent in the 4th quarter of 2015 to an average of 6.5 percent in the 1st quarter. Pending further developments in the oil price and currency vulnerability, we expect the composite index to average an increase of 10 percent in 2016 (coming off a lower base in 2015 and assuming further currency weakening, but with more moderate oil prices), and 3.0 percent in 2017, accelerating to 5.2 percent by 2018. Our assumptions include a continuation of the low oil price, falling from an average of $48/barrel in 2015 to $40/barrel in 2016, before showing a mild recovery in 2017 and 2018, and faster than anticipated depreciation in the currency, averaging R16.0/US Dollar in 2016, pending further developments in South Africa's sovereign credit rating. The risk weighs more on the upside of a stronger recovery in the oil price, and if maintained at just below $49/barrel (as at June 2016) for the remainder of the year, will average $44/barrel for 2016. These developments and the impact on input cost construction will be closely monitored.

Please note the fuel index is now based on Diesel Fuel – Wholesale

Table 17: CPAF Indices Annual Percentage Change

Year	Material (SAFCEC)	Fuel (SAFCEC)	Plant (SAFCEC)	Labour (CPI)	Composite
2013	4.3%	7.2%	6.3%	5.8%	5.7%
2014	3.3%	3.1%	6.4%%	6.1%	5.6%
2015	-5.2	-15.5%	3.2%	4.6%	0.6%
2016*	2.0%	3.2%	26.0%	6.2%	10.0%
2017*	3.0%	3.0%	-1.9%	6.0%	3.0%
2018*	3.0%	14.2%	3.8%	5.8%	5.3%



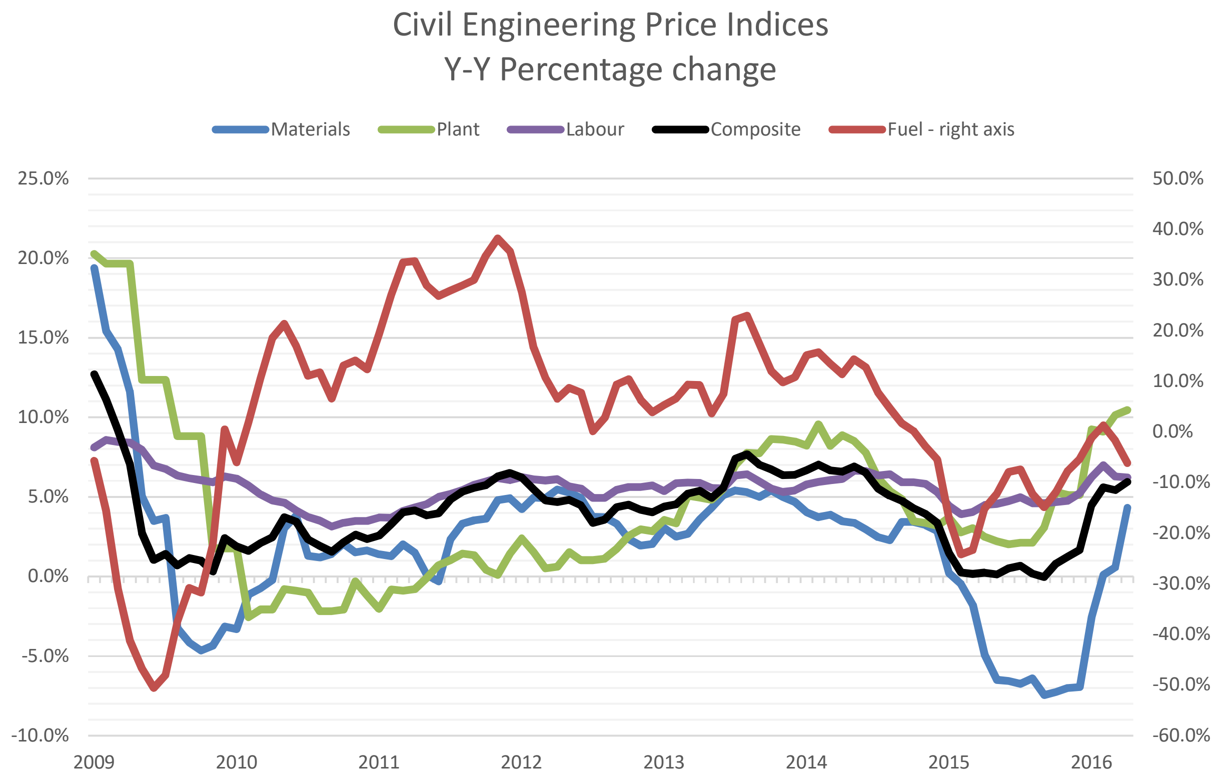


Figure 21: Civil Engineering price movements (source Stats SA)

Table 18: Macro Price Assumptions

	2012	*2013*	*2014*	*2015*	*2016*	*2017*	*2018*
R/US$ Exchange Rate	8.2	9.7	11.3	12.7	16.0	15.7	16.3
Oil price ($ per barrel, UK Crude oil)	111.8	108.0	96.0	48.8	40.0	42.0	46.2
Oil Price (ZAR per barrel)	917.9	1042.2	1085.1	620.2	640.0	659.4	753.1
CPI (% change)	5.7%	5.8%	6.1%	3.8%	6.2%	6.0%	5.8%

Table 19: CPAF Indices Forecast 2012-2017

Index 2012= 100	*2012*	*2013*	*2014*	*2015*	*2016*	*2017*	*2018*
Plant	100.0	106.3	113.1	116.8	147.1	144.3	149.9
Fuel	100.0	107.2	110.6	99.8	103.0	106.1	121.2
Materials	100.0	104.3	107.7	102.1	104.2	107.3	110.5
Labour	197.2	208.5	221.2	231.3	245.6	260.4	275.5
Composite	129.1	136.4	143.6	145.0	159.4	164.2	172.9
Y-Y Percentage Change							
Plant	1.6%	6.3%	6.4%	3.2%	26.0%	-1.9%	3.8%
Fuel	8.8%	7.2%	3.1%	-15.5%	3.2%	3.0%	14.2%
Materials	3.9%	4.3%	3.3%	-5.2%	2.0%	3.0%	3.0%
Labour	5.7%	5.8%	6.1%	4.6%	6.2%	6.0%	5.8%
Composite	4.5%	5.7%	5.3%	0.4%	9.9%	3.0%	5.3%

Table 20: CPAF Indices (Quarterly Average)

		CPAF Indices 2012=100					Y-Y Inflation				
Year	Quarter	Materials	Labour	Fuel	Plant	Composite	Materials	Labour	Fuel	Plant	Composite
2012	1	99.6	193.3	99.0	98.9	127.5	4.7%	6.1%	17.8%	1.5%	5.5%
	2	100.0	196.2	101.2	99.5	128.8	5.2%	5.8%	7.6%	1.0%	4.6%
	3	100.1	198.0	94.8	100.4	129.0	3.6%	5.1%	4.1%	1.3%	3.8%
	4	100.1	201.1	105.1	101.2	131.2	2.1%	5.6%	6.8%	2.8%	4.2%
2013	1	102.4	204.4	106.3	102.8	133.5	2.7%	5.7%	7.4%	4.0%	4.7%
	2	104.3	207.2	107.7	104.5	135.6	4.3%	5.7%	6.5%	5.1%	5.3%
	3	105.4	210.4	115.6	107.9	138.7	5.2%	6.2%	21.9%	7.5%	7.5%
	4	105.1	212.0	116.6	109.8	139.8	5.0%	5.4%	10.9%	8.6%	6.5%
2014	1	106.3	216.5	122.2	111.7	142.6	3.9%	5.9%	14.9%	8.7%	6.8%
	2	107.7	220.6	121.0	113.3	144.6	3.3%	6.5%	12.4%	8.4%	6.6%
	3	108.2	223.5	118.8	113.8	145.6	2.7%	6.2%	2.8%	5.5%	5.0%
	4	108.5	224.0	110.3	113.5	144.8	3.2%	5.7%	-5.4%	3.3%	3.6%
2015	1	105.6	225.4	91.2	115.2	143.0	-0.7%	4.1%	-25.4%	3.2%	0.3%
	2	101.3	230.8	105.3	115.8	144.9	-6.0%	4.6%	-13.0%	2.2%	0.2%
	3	100.8	234.1	102.1	116.6	145.7	-6.9%	4.7%	-14.0%	2.4%	0.1%
	4	100.8	235.0	100.7	119.4	146.6	-7.1%	4.9%	-8.7%	5.2%	1.2%
2016	1	104.9	240.0	100.3	126.2	151.4	-0.6%	6.5%	10.1%	9.5%	5.9%

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