

# REAL ECONOMY INSIGHT: CONSTRUCTION

JUNE 2015



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Sheila Barradas | Research Coordinator and Deputy Editor Research Channel Africa

The construction sector serves all segments of the economy and is highly labour intensive. It is a multifaceted sector comprising general building construction, industrial construction, commercial building construction and heavy civil construction.

In addition to new construction projects, the work scope of the sector also includes additions and modifications to existing structures, constructing temporary edifices and prefabricated buildings, as well as assembling and dismantling scaffolding.

Companies that are active in the South African construction industry and in projects beyond the country's borders include listed billion-rand-plus turnover groups such as Aveng, Basil Read, Esor, Group Five, Murray & Roberts, Raubex, Stefanutti Stocks and Wilson Bayly Holmes-Ovcon (WBHO). Small companies, some of which operate informally, pursue smaller-scale projects that subsequently complement these groups.

## Construction in South Africa's public sector

While the construction sector remains a sizeable economic contributor to and employment provider for

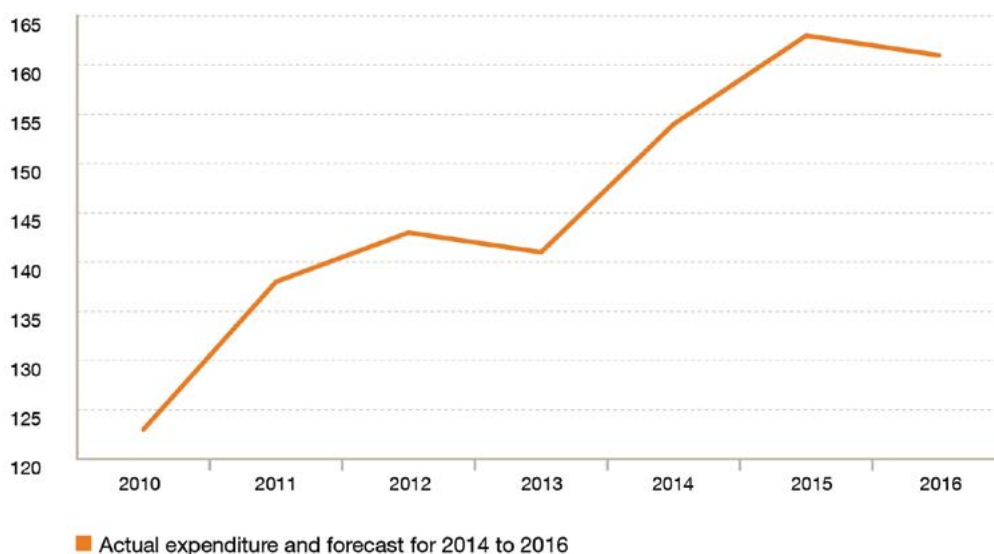
South Africa's economy, it has been in a slump for the past seven years. It has struggled to recover to the growth levels achieved in the build-up to the 2010 FIFA World Cup, when billions of rands were invested in projects associated with hosting the soccer tournament.

Construction-sector investment decline started in 2008, but the turning point was in 2010, when investment plunged by 11.8% year-on-year. Since then, investment has not shown any significant growth in real terms, achieving an average yearly increase of just 0.2% from 2011 to 2013. Consulting firm PwC notes that increased government spend on construction from 2010 to 2014 was a mere 5.7%, which was lower than the inflation rate. The firm expects the percentage to drop to 4.5% in 2016.

However, some industry players believe that the construction industry is showing signs of recovery, with expected government infrastructure expenditure, retail developments and residential building projects to boost the industry to a level considerably higher than that of 2014.

According to the South African Reserve Bank's (SARB's) Quarterly Bulletin – March 2015, the real value added by

**Public expenditure: New construction, property development and major rejuvenation (R-billions) – 2010 to 2016**



Source: PwC – SA Construction 2014



the construction sector progressed at an annualised rate of 3.5% in the fourth quarter of 2014, compared with a rate of 2.2% in the third quarter. Civil construction activity in the public sector maintained its underlying upward momentum, driven by general government spending on the construction and upgrading of roads, schools and hospitals.

Activity in the residential and nonresidential building industry also increased over the period. The SARB indicates that the real value added by the construction sector in 2014 increased by 2.9% – well above the growth rates recorded in the other construction sectors.

However, the First National Bank/Bureau for Economic Research (FNB/BER) Building Confidence Index, released in March 2015, stated that the recovery in the building sector, after it had accelerated towards the end of 2014, seemed to have lost some momentum in the first quarter of 2015, with the index dropping from 60 to 55 points.

The decline in overall confidence was partially because of a significant decrease in residential building activity, which negatively affected the confidence of particularly contractors and manufacturers.

Meanwhile, the building pipeline delivered mixed results, adding to the uncertainty regarding the outlook for the sector.

However, the FNB/BER noted that despite the decline in overall confidence, the index remained above 50 points.

The South African government's ongoing National Development Plan (NDP) and its continued commitment to public infrastructure investment of R847-billion over the next three years are deemed positive signals for future growth in the construction industry.

The NDP includes plans to build 1.5-million houses in the next six years, with a yearly investment of between R30-billion and R35-billion already allocated for this purpose.

According to materials-handling machines manufacturer, distributor and exporter Bell Equipment marketing and sales director Terry Gillham, the NDP is the single biggest opportunity for the construction industry in South Africa. "If government implements [the NDP], not necessarily in its entirety, but at least 60% to 70% of it, that would certainly be a massive boost for the construction industry in South Africa," he says.



Picture by Duane Daws

Other well-documented public-sector plans to upgrade and expand road, rail, power generation and water infrastructure, besides others, are expected to further unlock the construction industry. According to the medium-term expenditure framework (MTEF) communicated in South Africa's 2014 Budget, the major State-owned companies, which include Eskom, Transnet and South Africa National Roads Agency Limited, are forecast to spend R381.8-billion.

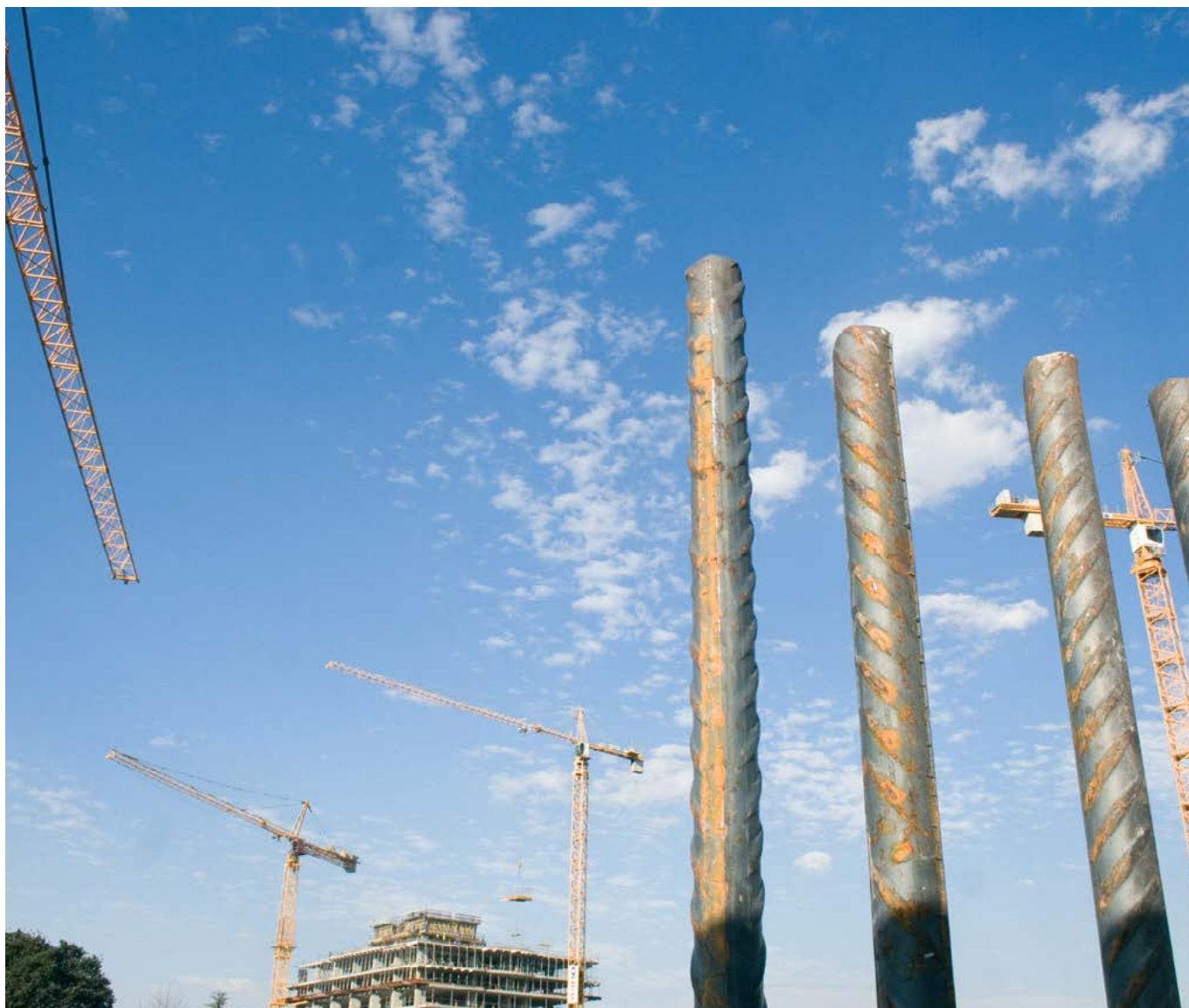
Nonetheless, construction and engineering group Aveng CEO Kobus Verster said in February 2015 that the company faced weak markets in almost every sector.

He added that low national infrastructure spend in South Africa, coupled with overcapacity in the construction market and low margins, had made it difficult for Aveng

subsidiary Grinaker-LTA to execute its long-standing turnaround strategy.

Meanwhile, construction major Basil Read CEO Neville Nicolau, has stated that while South Africa is "desperate" for increased infrastructure build, there is a disconnect between government, labour and the construction industry, which is impeding the progress of projects required to meet the country's energy, transport and public-service needs.

Speaking at the Captains of Construction Leadership forum in May 2015, Nicolau noted that the local construction industry was at the bottom of a cycle, which was impelling many local companies to pursue construction opportunities in the rest of Africa and beyond.



Picture by Duane Daws

**Ten major players in the construction sector in South Africa**

Company	Synopsis	Geographic footprint
<b>Aveng</b>	A construction and engineering group, specialising in energy, infrastructure and mining opportunities.	<ul style="list-style-type: none"> <li>• South Africa</li> <li>• Sub-Saharan Africa</li> <li>• Australasia</li> <li>• Asia</li> </ul>
<b>Group Five Construction</b>	The largest cluster in the Group Five group of companies and is involved in heavy construction.	<ul style="list-style-type: none"> <li>• Southern Africa</li> <li>• Sub-Saharan Africa</li> <li>• Poland</li> <li>• Hungary</li> </ul>
<b>Basil Read Holdings</b>	Involved in construction, mining, development and engineering, specialising in civil engineering, road construction, building, mixed integrated housing developments, property development, bitumen distribution, opencast mining, blasting operations and engineering design, procurement and construction management.	<ul style="list-style-type: none"> <li>• South Africa</li> <li>• Sub-Saharan Africa</li> <li>• South America</li> <li>• Australia</li> </ul>
<b>Esorfranki</b>	<p>A civil engineering and construction group. The company operates through the following units:</p> <ul style="list-style-type: none"> <li>• Geotechnical operations: Involved in the construction and provision of piling, pipe jacking, lateral support and ground improvement for the construction industry, primarily in South Africa. Operations are, however, diversely located throughout Africa.</li> <li>• Civils operations: Involved in the construction of roads, township infrastructures, water and sewerage reticulation and concrete projects.</li> <li>• Pipeline operations: Construction and rehabilitation of onshore pipelines.</li> </ul>	<ul style="list-style-type: none"> <li>• South Africa</li> <li>• Sub-Saharan Africa</li> <li>• Indian Ocean Islands</li> </ul>
<b>Murray &amp; Roberts Holdings</b>	An investment holding company with interests in the construction and engineering, underground mining development, construction materials and related fabrication sectors.	<ul style="list-style-type: none"> <li>• Southern Africa</li> <li>• Middle East</li> <li>• Australasia</li> <li>• North America</li> <li>• South America</li> <li>• Southeast Asia</li> </ul>
<b>Erbacon Investment Holdings</b>	Specialises in heavy civil engineering construction and building services. Core activities include construction and repair of reinforced concrete structures, roads and bulk earthworks, as well as the installation	Southern Africa
<b>Stefanutti Stocks Holdings</b>	<p>A holding company, operating through the following business units:</p> <ul style="list-style-type: none"> <li>• Structures – encompasses the group's civil structures, geotechnical and marine capabilities.</li> <li>• Building – services the full scope of infrastructure construction; in the commercial, industrial, residential and leisure industries.</li> <li>• Roads and earthworks – construction of transport, township and mining.</li> </ul>	<ul style="list-style-type: none"> <li>• South Africa</li> <li>• Angola</li> <li>• Botswana</li> <li>• Mozambique</li> <li>• Namibia</li> <li>• Sierra Leone</li> <li>• Swaziland</li> <li>• Zambia</li> <li>• Zimbabwe</li> <li>• United Arab Emirates</li> </ul>
<b>Raubex Group</b>	An investment holding company, operating through its divisional subsidiaries, in the road construction, rehabilitation and associated infrastructure development sectors.	<ul style="list-style-type: none"> <li>• South Africa</li> <li>• Sub-Saharan Africa</li> </ul>
<b>Wilson Bayly Holmes-Ovcon</b>	Operates as a holding company of a number of subsidiary companies principally engaged in building construction, civil engineering and roads and earthworks activities.	<ul style="list-style-type: none"> <li>• South Africa</li> <li>• Southern Africa</li> <li>• Australia</li> </ul>
<b>The South African National Roads Agency (Sanral)</b>	Undertakes construction and maintenance of roads for government.	<ul style="list-style-type: none"> <li>• South Africa</li> </ul>

Source: Gauteng Growth and Development Agency – Business Intelligence and Planning Unit: Construction sector fact sheet 2015



Engineering consultancy Knight Piesold MD Leon Furstenburg told the forum that infrastructure project development was being further debilitated by a lack of coordination between companies, government and individuals, as these parties appeared to plan and develop in silos. Nicolau commented that government no longer trusted the formal construction sector, owing to findings of collusion among the country's largest construction companies in 2013.

### Collusion in the construction sector

At the Captains of Construction Leadership forum, Nicolau further urged government to move beyond its mistrust of the construction industry, which had emerged in response to findings of collusion by the country's largest construction companies in 2013. "From the industry's point of view, it's time that we put the collusion matter aside. It was tens of projects among the thousands of projects completed. We've admitted our guilt, we've paid our fines and it's now time that we move forward," he appealed.

The Competition Commission identified 300 collusion cases in projects collectively valued at R47-billion, but limited the scope of its investigations to 160 projects from early 2006 to late 2009, eventually fining 15 construction and engineering firms a total of R1.46-billion.

#### **Government pioneers youth brigade programme for construction sector**

Drawing on a Cuban skills development model first implemented by the island State in 1964, the Department of Human Settlements (DHS), in partnership with the National Youth Development Agency, the National Home Builders Registration Council and the Estate Agency Affairs Board, has outlined plans to establish a National Human Settlements Youth Brigade in the domestic built environment industries.

The ambitious programme aims to create organised teams of youth who would be trained in the construction and engineering sectors, driving the upskilling of the country's unemployed youth, while advancing the DHS's housing delivery target of 1.5-million houses by 2019.

About 5%, or about R3-billion, of the national DHS's budget will be allocated to the programme, while provincial departments are expected to contribute an additional 5% of their respective budgets.

Source: *Engineering News*

The companies that incurred the largest penalties for collusive practices were Wilson Bayly Holmes Ovcon, fined R311.29-million for 11 projects; Murray & Roberts, fined R309.05-million for 17 projects; Stefanutti Stocks, fined R306.89-million for 21 projects; and Aveng, fined R306.57-million for 17 projects.

However, some observers have described the fines as a slap on the wrist, and there were calls at the time for the implicated construction companies to be banned from tendering for State contracts and for their executives to be jailed. There had also been a suggestion that the Construction Industry Development Board blacklist companies that had been found guilty of collusion.

### Construction in South Africa's private-sector

The private sector, often led by the mining industry, has been a significant contributor to total construction expenditure.

Sustainable energy investments in South Africa, mainly comprising solar and wind farms, have been significant contributors to capital expenditure in the construction sector. The country's current electricity situation has placed a renewed focus on independent power producers (IPP). By 2022, an additional 17 000 MW of IPP capacity is expected to be added to the national grid from renewable-energy, cogeneration, coal and gas sources. If positioned well, construction companies could benefit from this potential investment.

However, the severe pressure to which the mining sector is subjected to, with shrinking margins, owing to volatile commodity prices and labour unrest, will impact on future demand.

### Labour and skills

According to PwC's 'SA Construction Report 2014', many CEOs in the construction sector have expressed their concern about access to key skills. In addition, 70% have expressed concern about rising labour costs in high-growth markets and 37% believe that creating a skilled workforce should be a government priority.

A list of the 100 occupations for which there is a critical shortage in South Africa was gazetted by Higher Education and Training Minister Dr Blade Nzimande in May 2014. It lists electrical, civil and mechanical engineers, quantity surveyors and programme or project managers – all of whom are employed in the construction sector – as the top five occupations for which there is a serious shortage. Physical and engineering science

technicians occupy seventh position, with construction project managers in eleventh position.

The skills dearth not only affects a company's ability to compete for and complete contracts but also adds to the expansion risk it faces. Similarly, staff retention is crucial to the sustainability of a company. As a result, and in line with the requirements of the Construction Charter, construction companies recognise the development of skilled labour as being critical to their sustainability.

For example, Aveng runs the Ikhaya Fundisa Techniskills Academy, in Gauteng, an artisan training institute that offers training for learners, artisans and artisan assistants in the mechanical, electrical, motor/diesel and boilermaking fields.

JSE-listed construction company Basil Read also identified skills shortages as a material issue for the company and has spent more than R13-million on training and development. The major initiatives include managerial development, as well as carpenter, health and safety, diesel mechanic and blaster training.

Owing to the prevailing market conditions, Group Five's training and development spend during the 2014 financial year focused on core skills and productivity. The overall spend that year of R32.3-million was equivalent to 1.87% of payroll.

Murray & Roberts spent R260-million on skills training and development during the 2014 financial year, up from the previous year's R156-million. This expenditure equated to 2.7% of the group's payroll and was higher than the globally accepted benchmark of 2%.

Some commentators have suggested that construction companies' keenness to develop skills has been dampened by government not delivering the mega-projects needed to boost the economy, despite the Presidential Infrastructure Coordinating Commission having 18 strategic integrated projects, the South African Federation of Civil Engineering Contractors believes that companies would be more willing to train people if there was a guaranteed stream of projects.

## Outlook

While the South Africa's construction industry is expected to show restrained recovery in the short-term, its outlook remains uncertain. Analysts warn that the sector remains greatly exposed as a result of its high level of reliance on government spend. The impact of ongoing labour unrest is expected to continue to limit



Picture by Duane Daws

construction activity, particularly in the mining sector, and in other sectors of the economy.

Participants forecast that South Africa's larger contractors will progressively pursue better margins outside of South Africa's borders, where a growing number of large projects are breaking ground. In fact, with a number of African states already achieving notable economic growth rates, several analysts believe that the continent could prove to be the best investment for struggling South African contractors.

However, the construction industry continues to be a key sector in South Africa's economy. It has a strategic role to fulfil if the country is to develop and grow, as envisaged in the NDP.

Analysts believe that if government is to make inroads into the backlog of projects in its portfolio, a proactive partnership with the construction sector needs to be developed.

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This brief was compiled by Sheila Barradas – Research Coordinator and Deputy Editor Research Channel Africa.

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Tel +27 11 622 3744 | fax: +27 11 622 9350 | email: [subscriptions@creamermedia.co.za](mailto:subscriptions@creamermedia.co.za)

