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CONSTRUCTION

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South Africa's construction industry is under severe strain and a number of the country's largest construction companies have been unable to continue operating in a constrained environment characterised by the slow roll-out of contracts by the public sector.

The country's low economic growth rate and concerns about political uncertainty and corruption, especially with regard to government and State-owned enterprises, have also negatively impacted on sentiment in the private sector, resulting in its also investing less in new infrastructure.

Data published by the National Treasury shows that the public sector invested about R3-trillion in infrastructure from 1998/99 to 2017/18. The public sector is expected to spend a further R864.90-billion on infrastructure from 2019/20 to 2021/22. Despite the continued investment in infrastructure, South Africa's gross fixed capital formation remains at about 20% of gross domestic product (GDP), which is below the recommended level of 30% of GDP.

Market intelligence firm Industry Insight has reported that tender activity in the construction industry decreased by 20% year-on-year in the fourth quarter of 2018, while tender award postponements increased by 24% year-on-year.

Meanwhile, as a result of government's efforts in recent years to transform the construction industry, more small and medium-sized enterprises (SMEs) have entered the industry. SMEs are estimated to have increased their market share from 16% in 2012 to about 40% by mid-2018, while the market share of the country's largest construction companies has decreased from about 60% in 2012 to about 45%.

This has, along with the slow pace of new contract awards, placed greater pressure on margins and resulted in more lossmaking contracts. Smaller contractors are, however, also feeling the pinch of the slow contract roll-out, with fewer subcontracting opportunities available as a result of the struggles facing the large construction companies. This is also having a knock-on effect on construction materials providers.

With all segments of the industry under pressure, many large and small companies have had to retrench employees as they restructure their operations.

Further exacerbating the challenges is the emergence of a "construction mafia", which involves certain business interest groups using threats of violence and intimidation to try to force contractors into awarding them subcontracts without participating in a tender process. These practices have resulted in projects valued at more than R25.50-billion being brought to a halt amid concerns about the safety of contractors and their employees at construction sites. Various industry bodies have called on the Police Minister and the President to intervene and find a solution to this practice.

COMPANY PERFORMANCE

Among the eight largest construction companies operating in South Africa, three – Basil Read, Esor and Group Five – have entered into business rescue in recent months.

Basil Read's management started efforts to restructure the group in 2015, but the company still incurred losses for the 2016 and 2017 financial years. Cash flow constraints, particularly within the construction division, and the group's inability to raise further bridging financing, forced the group to file for voluntary business rescue in June 2018.

The appointed business rescue practitioners (BRPs) Siviwe Dongwana and John Lightfoot presented a business rescue plan, which focused on completing construction projects that had been in progress, and selling certain assets, to creditors in September 2018. Creditors approved the plan, which set out targets to sell the assets between January 2019 and February 2020, but the BRPs reported in February 2019 that although there had been some interest from buyers, there had been few committed buyers.

Eventually, one asset was sold – Basil Read Mining Botswana's 28% interest in the Majwe Joint Venture for R110.50-million. Efforts continue to complete profitable contracts, cancel onerous contracts, sell noncore assets and reduce costs as part of the business plan.

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Esor, meanwhile, filed for business rescue of its construction division in August 2018. The company has, in recent years, shifted its focus away from civil- and building-related construction towards the water infrastructure market and, although there is great need for more water-related infrastructure in South Africa, delays in the awarding of contracts by the national, provincial and municipal governments took their toll on the business, resulting in a lower order book and contributing to lower revenues and higher financial losses. The BRPs appointed to oversee the business rescue of Esor's construction division said in February 2019 that there was potential to implement a business rescue plan.

Group Five was forced into business rescue in March 2019 after experiencing difficulties with a nearly complete energy project in Ghana.

The group, which has also been negatively affected by the general slowdown in the award of new contracts in South Africa in recent years, reported a R1.43-billion operating loss for the 2018 financial year, compared with a loss of R718-million in the prior financial year. As a result of the muted growth in the domestic construction industry, Group Five decided during the financial year to become an infrastructure solutions company and move away from the construction and engineering, procurement and construction (EPC) businesses.

The Kpone oil- and gas-fired combined-cycle power project, in Ghana, for which it was the EPC contractor, was also particularly problematic, with the group having incurred a R1.30-billion loss on the project during the 2018 financial year. The project was meant to have been completed in 2017, but had been delayed several times. While the project was near completion in November 2018, fuel contamination problems led to a dispute between Group Five and Kpone's owner Cenpower Generation.

Cenpower had, by late 2018, instituted a claim of $62.70-million against Group Five for earlier project delays and, in December 2018, moved to terminate the contract with Group Five as a result of the latest delay in the completion of the project. Group Five, meanwhile, said

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the termination of the contract was wrongful, claiming that the contaminated fuel that had contributed to the latest project delay had been provided by Cenpower and that Group Five was, therefore, not responsible for the delay.

Cenpower also instituted a further claim of $60.50-million against Group Five to cover the costs of completing the project. Group Five, however, did not believe it was liable for the claim.

Meanwhile, the BRPs appointed to oversee the business rescue of Group Five estimated in May 2019 that more than R700-million in proceeds could be raised from the sale of the plant, assets and property as part of the business rescue. While a business rescue plan was still being finalised ahead of its expected release in late June 2019, the BRPs said they had concluded agreements for the sale of Group Five's 40.10% interest in Intertoll Capital Partners, its 50% interest in Barnes Reinforcing Industries and its 28.90% interest in Jozi Power.

Among the other big construction companies, Aveng has also, in recent years, restructured its business, including the sale of certain assets and businesses. The company has decided to retain its focus on its Australian subsidiary McConnell Dowell and its contract mining business Moolmans. During 2018 and early 2019, it sold several noncore assets and businesses, including its rail business, its Aveng Water and Aveng Namibia Water businesses and its Aveng Infraset businesses.

It has also resolved not to sell its Grinaker-LTA business as a single going concern, but will instead follow a piecemeal sales process. The group plans to sell all its noncore businesses by the end of June 2019.

Murray & Roberts (M&R) has, meanwhile, successfully restructured into a multinational engineering and construction group with three business platforms – oil and gas, metals and minerals, and power and water. During 2018, there was a noticeable decline in large project opportunities in the Australian liquefied natural gas market, impacting negatively on the group's oil and gas platform. To offset that, the group sought new opportunities in the Australian metals and minerals and infrastructure markets and secured contracts from some of the world's biggest mining companies, including BHP, Alcoa and Rio Tinto.

With the Medupi and Kusile coal-fired power station projects in South Africa nearing completion, M&R's power and water segment has also been seeking new opportunities for growth. This prompted it in early 2019 to acquire South African company Optipower, subsequently providing M&R with access to the transmission, distribution and substation sectors of the energy industry.

M&R became a takeover target in 2018, when one of its biggest shareholders, ATON, making an offer to shareholders to acquire their shares in M&R at R15 apiece. While M&R had encouraged shareholders not to accept the offer, or a revised offer of R17 a share, stating that it undervalued the company, ATON eventually succeeded in acquiring a 44% interest in M&R, triggering a mandatory offer to shareholders who had not accepted its offer. The takeover by ATON, however, remains subject to approval by South African and Canadian competition authorities.

During its battle to acquire M&R, ATON also acquired a 25.40% interest in Aveng, with which M&R had been planning a merger. The merger plans were, however, scuppered by ATON's acquisition of this interest, forcing M&R to withdraw its buyout offer to Aveng.

Also among the country's largest construction companies is Raubex. As a result of a low volume of work in the road construction sector in the first half of Raubex's 2019 financial year, the company had to rightsize its asphalt and bitumen supply operations, resulting in the retrenchment of 280 employees. Raubex's road construction and earthworks subdivision was also negatively impacted on by the low volume of work in the road construction sector, but the company's infrastructure division was able to expand its affordable housing and commercial building operations, as well as take advantage of new opportunities in the renewable-energy sector.

For the full financial year, ended February 28, 2019, the group reported continued pressure on its roads and earthworks division, with the materials business having been the main contributor to its operating profit for the year.

Stefanutti Stocks also warned in May 2019 that it was experiencing short-term liquidity pressures amid a difficult trading environment and delayed payments from clients. As a result, it was considering raising funding through a combination of ring-fenced project financing, a number of alternative funding solutions and possibly also a fresh issue of shares. The company said it expected the contraction in construction activity to continue putting pressure on its turnover and operating profit margins.

Wilson Bayly Holmes-Ovcon (WBHO), meanwhile, is optimistic about growth opportunities outside of South Africa, particularly in Australia, but one contract nearly had a devastating impact on the group during the six months ended December 31, 2018. *Engineering News* reported in February 2019 that the Western Roads Upgrade road design and build project in Melbourne, Australia, had resulted in the group's operating profit for the six months decreasing to R2.72-million, from the R509.60-million in the first half of the prior financial year. This was as a result of the incorrect interpretation of the project's technical specifications, which led to the underestimation of the physical work required to meet those specifications.

INTERNATIONAL EXPANSION

As a result of the difficulties in the South African market, many of the large construction companies have been trying to diversify into overseas markets. This is, however, not without challenges, as reflected by Group Five's problems in Ghana.

Nevertheless, companies continue to pursue opportunities abroad.

M&R's Australian subsidiary Clough has achieved some successes in that region and is seeking opportunities further afield. M&R announced in February 2019 that Clough would acquire Houston-based oil and gas focused EPC contractor Saulsbury's Gulf Coast downstream, its chemical business unit and its EPC portfolio for $5.20-million. The acquisition is aimed at giving M&R access to a rapidly growing oil and gas market in North America.

WBHO is, meanwhile, pursuing opportunities in the UK. It has, in the past two years, acquired an 80% interest in frame contractor Byrne Group, a 60% interest in Manchester-based contracting company Russells and a 37% interest in Russell Homes, which specialises in land acquisition and planning for residential building schemes in the UK.

OUTLOOK

The continuing weakness in South Africa's economy is expected to continue weighing on business confidence and investment sentiment, with few of the large construction firms expecting a significant turnaround in the industry anytime soon.

Raubex said in May 2019 that the domestic construction industry faced an uncertain future, owing to the slow pace at which tenders were being awarded, especially in the public sector, and the disruption of various large-scale projects by the so-called "construction mafia".

Industry Insight has, meanwhile, warned that South Africa's struggling State-owned enterprises (SOEs) pose a major risk to the construction industry's future. Some of the country's largest SOEs, including power utility Eskom, are facing severe financial challenges while having to deal with the aftermath of years of State capture, which has not only impacted negatively on the finances of the SOEs but also undermined the public's and investors' trust in those entities.

While some of the smaller emerging firms in the industry have benefited from government's efforts to transform the construction industry, the difficulties facing the country's largest contractors are also having a negative effect on subcontractors, which are finding it difficult to secure work from main contractors.

Amid the slowdown in construction work in South Africa, construction firms continue to seek opportunities for growth abroad, but these too can result in difficulties and financial losses.

On a more positive note, there is some optimism that the infrastructure fund, launched by President Cyril Ramaphosa in September 2018, could provide some support for the construction sector. The infrastructure fund is being led by an executive team within The Presidency that will coordinate infrastructure initiatives across all spheres of government. Government expects the fund to invest R400-billion in public infrastructure over a three-year period.

Africa's tallest building

One of the most talked-about projects currently under construction in South Africa is the R3-billion Leonardo, in Sandton, which will become Africa's tallest building by midyear. Construction on the 55-storey building started in January 2016, with Aveng Grinaker-LTA the main contractor.

The building will feature residential apartments, penthouse suites and office space, along with other amenities such as a coffee shop, bar, restaurants, a crèche, a gym and a spa. Ten floors will also be used for a hotel to be operated by the building owners, Legacy Group.

Above the fifty-fifth floor, there will also be a sky bar and viewing deck.

Co-Arc International Architects is the architect of the Leonardo. Director Patrick McInerney told *Engineering News* Online in April 2019 that the building was an example of the future of property development in South Africa. He told the publication that, to solve South Africa's challenges and deal with its rapid urbanisation, property developers would need to look at how other countries in the world were approaching construction. He pointed out that the Leonardo was a showcase of how a building could help resolve challenges related to urban mobility and density.

Despite its impressive statistics, the Leonardo may not remain Africa's tallest building for long. The Pinnacle, which is being built in Nairobi, Kenya, is expected to take the crown as the continent's tallest building when it is completed in 2021. The building comprises two towers, with the tallest being a 70-storey mixed-used development that will feature a mall, office space and residential apartments. The tower will also feature a viewing deck from where Mount Kilimanjaro and Mount Kenya will be visible. The second tower will be a 45-storey, 255-room hotel operated by Hilton Hotels.

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Source: *Engineering News*

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