Construction sector braced for more pain

By Andries Mahlangu

11 Jul 2014

Construction stock investors are taking it on the chin at the halfway mark of the year and the outlook remains uncertain for the struggling sector even as some analysts point to green shoots.

© Ivan Kruk – za.fotolia.com

The JSE's construction and materials index is still contracting amid lingering questions over the sector's outlook.

The slowdown in the government's multi trillion-rand infrastructure plan has stifled profit margins, forcing many players such as Aveng to diversify their operations away from South Africa, which still expects muted economic growth this year.

But the pain has been particularly acute in the small- cap construction counters in the past six months where Esor and Protech Khuthele have lost 52% and 65% of their market value before the latter was suspended last month and subsequently liquidated. Basil Read, which still expects its headline earnings per share to slide as much as 270% in the year to June, is down 22% so far this year.

"We are very cautious on the domestic construction sector - especially the smaller ones - due to some disappointing financials. The balance sheets of major construction and engineering groups are still showing strain," BP Bernstein Stockbrokers trader Vasilis Girasis said on Wednesday.

Challenging

Operating conditions remain equally challenging for the big-cap shares although slowly improving. The JSE construction and materials index, which consists of leading players such as Wilson Bayly Holmes (WBHO), is down 5% since the start of the year and is more than 50% below its 2007 highs. In its most recent trading guidance, Aveng expects full-year headline profit, excluding on e-off items, to be down by up to 10%.

"The Asia-Pacific region has been a lifesaver for big South African construction firms, including Aveng and Murray &

Roberts. Chinese demand for Australian minerals has complemented a boom in oil and gas projects in the region despite the global recession," Coface senior risk analyst Warrick Robertson said.

Stanlib industrials analyst Anashrin Pillay said order books and revenue growth in most companies had been stable, indicating that there was work, but there needed to be more of a buffer on the margin side. "Larger projects would need to come to market to absorb excess capacity and bring back some pricing power."

The lack of construction projects has also put pressure on the steel sector, forcing the small-cap Alert Steel into a business rescue, which triggered a slump in its shares before it was suspended.

WBHO ended 1.19% lower at R124.25 on Wednesday, with Group Five losing 1.19% to R39.80 and Aveng shedding 0.41% to R24.