Challenging year ahead for SA construction

2015 was a challenging year for South Africa's construction industry, marred by industrial action, substantial delays on projects, as well as questions raised around safety concerns on structural projects.

Andries Rossouw, PwC assurance partner

"2015 proved to be a tough year for most construction companies, with lower revenue and profit margins, and less new projects in the offing," says Andries Rossouw, PwC assurance partner.

PwC's third edition of "SA Construction" highlights some of the trends in the South African construction industry. The study's findings are based on the financial results of the leading construction companies listed on the Johannesburg Stock Exchange (JSE) for financial year ends to June 2015.

The South African construction industry

The construction industry is cyclical in nature and the cycle is not in its favour at present. The 2015 financial year saw a decline in market capitalisation and financial performance. Eight of the nine companies reflected a decrease in market capitalisation. In aggregate for the nine companies analysed, market capitalisation decreased by 38% to R25.9bn as at 30 June 2015 (R41.6bn as at 30 June 2014).

From 30 June to 31 October 2015, the nine companies analysed showed a further 9% decline.

The South African government's ongoing National Development Plan and its continued commitment to public infrastructure investment of R810bn over the next few years are still positive signs for future growth in the industry albeit that this value has decreased from prior years.

Actual government construction expenditure in 2014 was R18.6bn below the 2013 forecast. This decrease in anticipated expenditure underlines the challenges experienced by the industry. With the announcement that the Commonwealth Games of 2022 will be held in Durban, the public sector is bound to invest in infrastructure. "To date we are not aware of how much will be spent on this infrastructure in the future," adds Rossouw.

This is the first time in five years that the secured order book decreased (4%) on the prior year. The secured order book covers 1.3 times current-year-revenue, in line with the prior year as the lower order book was mirrored by lower revenue.

Financial performance of the industry

Total revenue decreased by 7% to R129.3bn on the prior year mainly as a result of a decrease of R8.6bn from Aveng, a R5.4bn decrease from Murray & Roberts and a R1.6bn from Group Five partially offset by a R0.3bn increase from WBHO and a R1.4bn increase at Stefannutti Stocks. These decreases were largely as a result of the weaker economy, in particular for commodity markets with a notable decrease in revenue from oil and gas projects.

Total operating costs decreased by 5% in response to lower revenue. Staff costs continue to represent a significant component of operating costs constituting 29% of total operating costs (2014:28%).

Cash generated from operations increased by 2% on last year from R4.3bn to R4.4bn. Solvency and liquidity ratios continue to remain reasonably strong and remain in line with the previous year at 1.6 and 1.3 respectively.

Integrating risk for performance

With the downturn in the global economy and harsher local operating conditions, risk management continues to be a vital component of effective management in the South African construction industry. In order to remain sustainable during this difficult period, companies need to be proactive towards potential risks in order to compete.

The common risks identified by construction companies include monitoring and compliance with the B-BBEE codes; industrial unrest; talent management and the retention of staff; growth and expansion within the industry; project execution; liquidity risk; health, safety and environmental sustainability; legislative and regulatory compliance; tender risk; and credit risk management.

Tax challenges

Having regard to the international climate in which construction companies now operate, there are a number of tax matters that multinational construction groups will need to consider. These include base erosion and profit shifting (BEPS) as well as the imminent country-by-country reporting (CbCR) regime. This regime will require disclosure on a country-by-country basis in respect of each operating entity within a multinational group. In addition to the pending changes to the reporting of cross-border transactions, a new Double Taxation Agreement (DTA) between South Africa and Mauritius has been concluded, which will have significant relevance to multinational construction groups with Mauritian-based operations. Under the new DTA, the South African Revenue Service (SARS) and the Mauritian Revenue Authority must 'endeavour' to reach 'mutual agreement' on whether a dual-resident company should be taxed only in Mauritius or only in South Africa.

Improving value to stakeholders

The construction industry adds significant value to South Africa and its people. The monetary value received by various stakeholders is often summarised by companies in their value added statements.

Seven of the nine companies included in the construction industry analysis, comprising 69% of the revenue earned by all companies considered, provided readily available value-added statements.

The value received by heavy construction employees represented 83% (2014:71%). This is a significant contribution to the labour market. According to Stats SA, more than 1.4-million people are employed by the construction industry, either on a contract basis or permanently.

The state received 10% (2014:19%) of value created in the form of direct taxes. The reality is that the state receives significantly more if one takes into account the tax on employee income deducted from employees' salaries and net indirect taxes like VAT.

Rossouw concludes: "The South African construction industry is well placed to cope with new growth requirements as well as take on large scale projects. But it will need to manage short-term liquidity requirements."