

The South African Consulting Engineering Industry

Presenting and interpretation of latest survey results:
July – December 2016

Presented by Elsie Snyman
21 June 2017

Industry Insight

- In operation since 2002
- Construction Business Intelligence to a wide range of stakeholders including government, manufacturers, suppliers and contractors
- Contracted by CESA
- Objective, Unbiased and Independent view of survey results
- Not engineering professionals

Purpose of the survey

- Quantitative as well as Qualitative monitoring of key set of indicators affecting the consulting engineering profession
- Leading indicator for the construction industry, affecting the outlook for contracting fraternity and downstream suppliers
- Shapes the outlook for future Economic Infrastructure
- Has a large multiplier effect on the development of infrastructure and therefore also employment

Bi-Annual Survey Established in 1997

Quantitative

- Fee earnings
- Profitability
- Payments
- Employment (Change & Profile (Gender and Race)
- Capacity Utilisation
- Profile (Geographic, Client, Disciplines and Economic Sector)
- Financial Benchmarking Indicators focussed primarily on larger enterprises

Qualitative

- Opinion based
- Monitor opinions of firms regarding current and expected business conditions
- Confidence Levels
- Perceptions of profitability, earnings
- Changes in employment

July – December 2016 Survey Scope and Profile

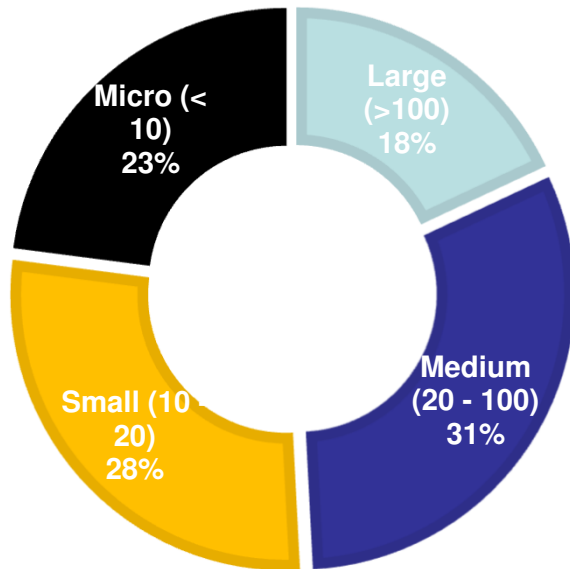
Employment
6000 (25% of total)



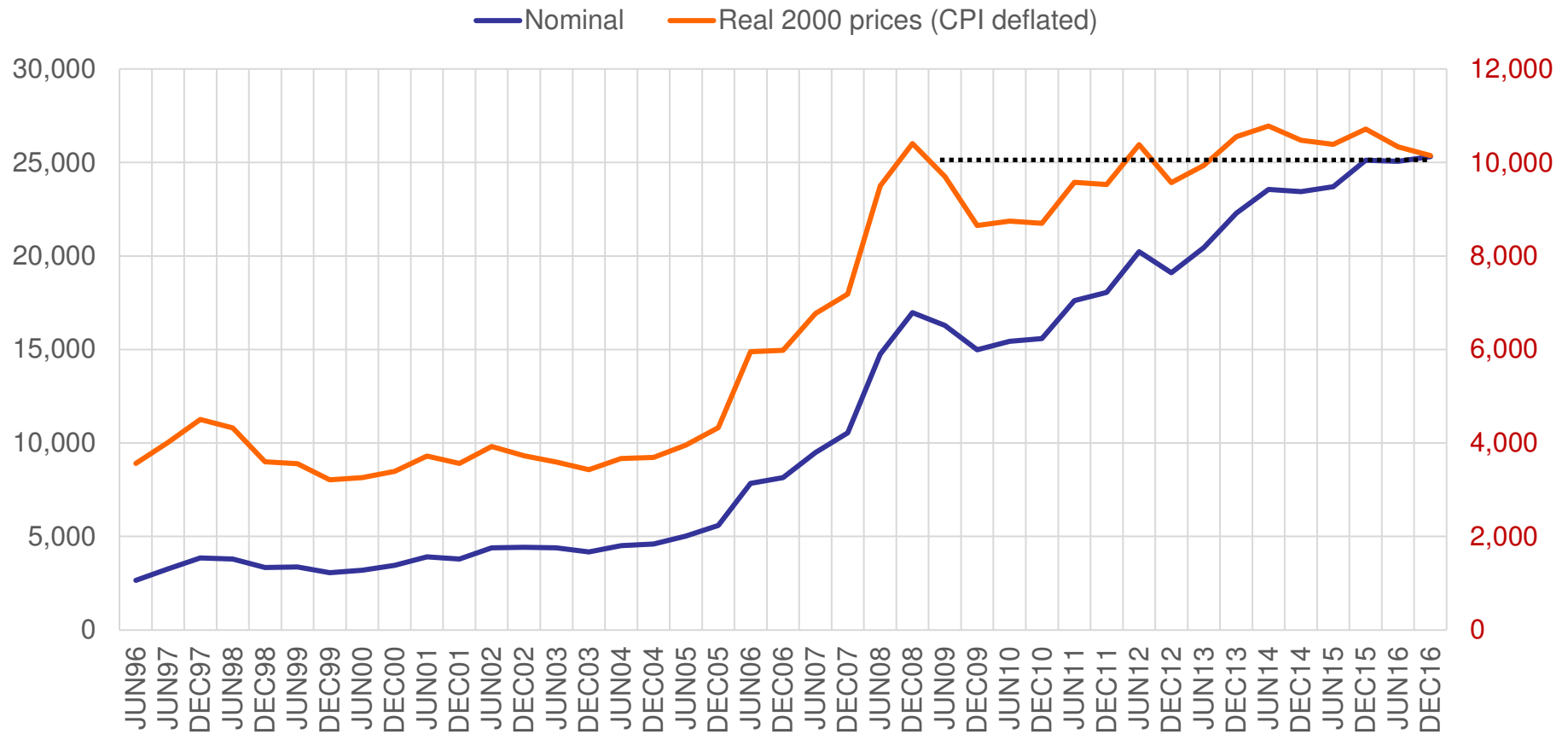
Weighted

Fee earnings
(6 month period)
R2,5bn (20% of total)

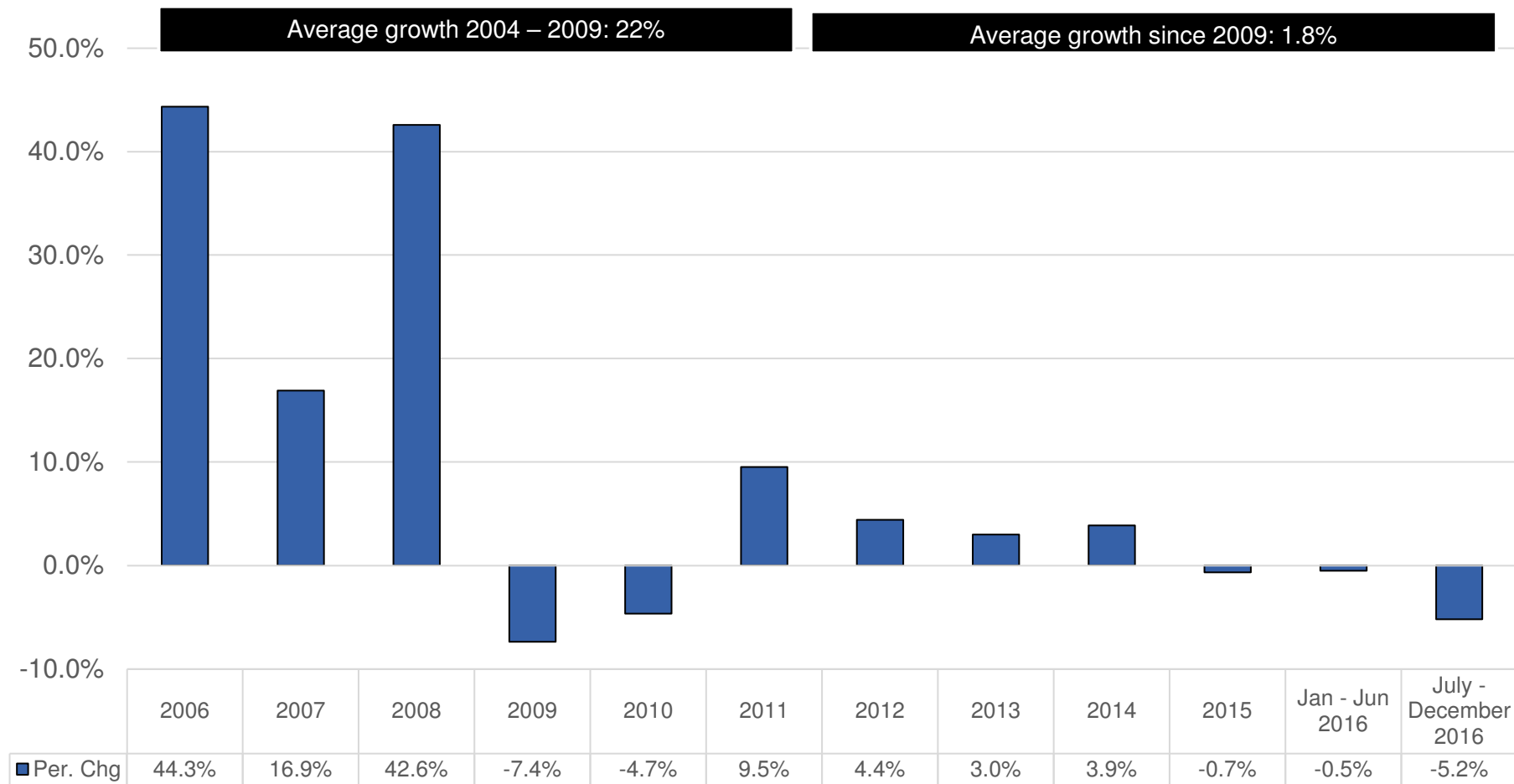
Respondents
63



Real fee earnings fall 5.2 percent y-y in last six months of 2016



Real earnings fell by an average of 2.9% y-y in 2016, following decrease of 0.7% in 2015

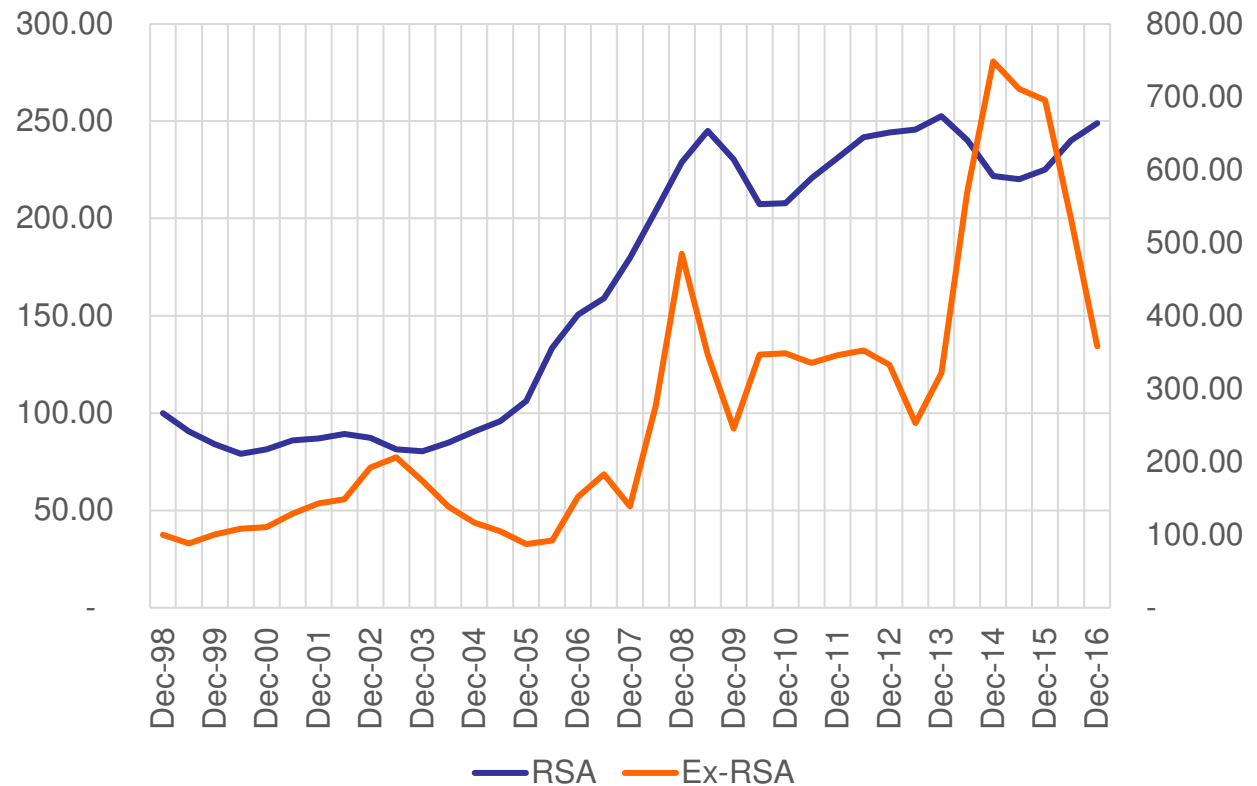


Earnings in South Africa rise by 8% in last six months of 2016 vs a 45% contraction in cross border earnings

Earnings: RSA vs EX-RSA
Index 1998 = 100 (2010 prices)

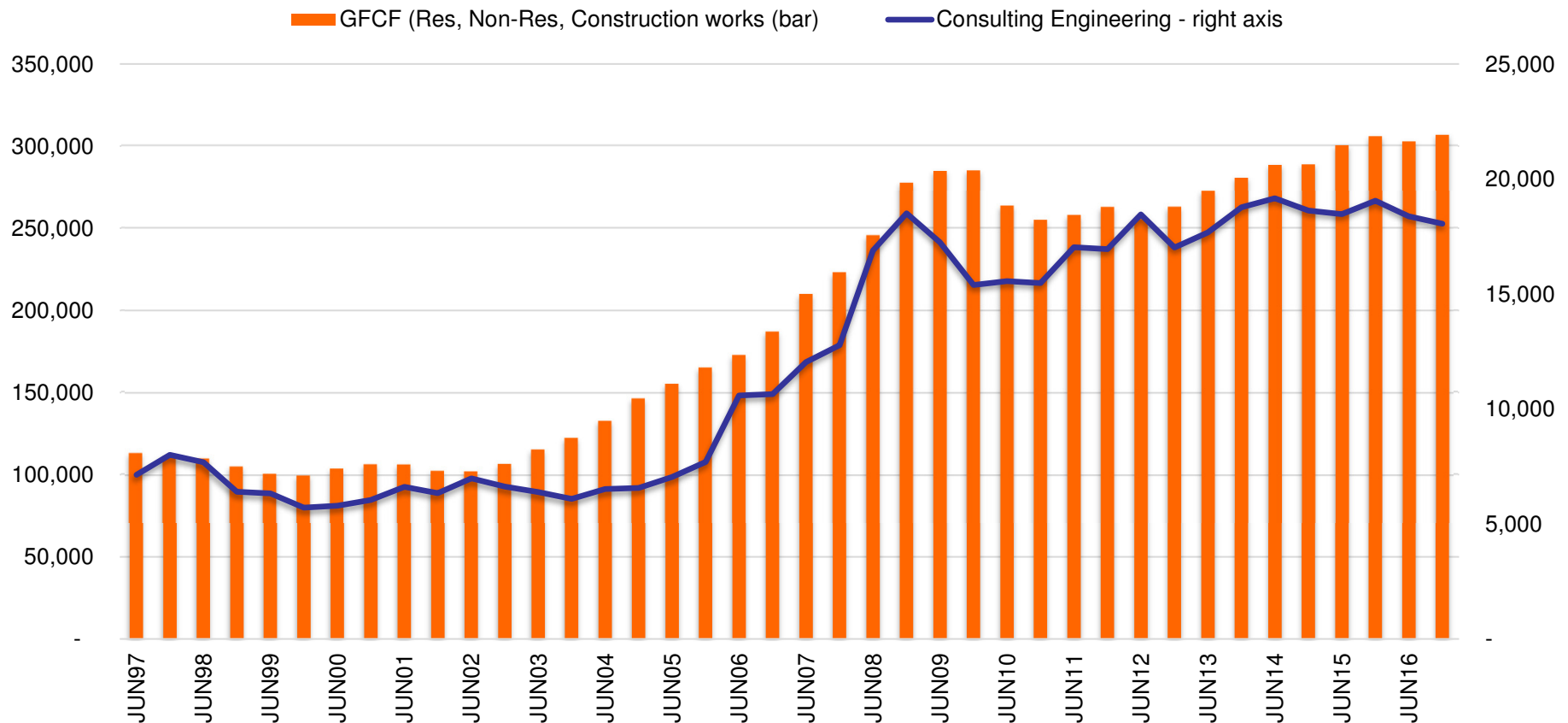
Contribution of EX-RSA earnings slowed to 15% from 25% in 2015

- Growth in Africa constrained by lower economic growth and weak commodity prices



Strong relationship between Consulting Engineering Fee earnings and GFCF

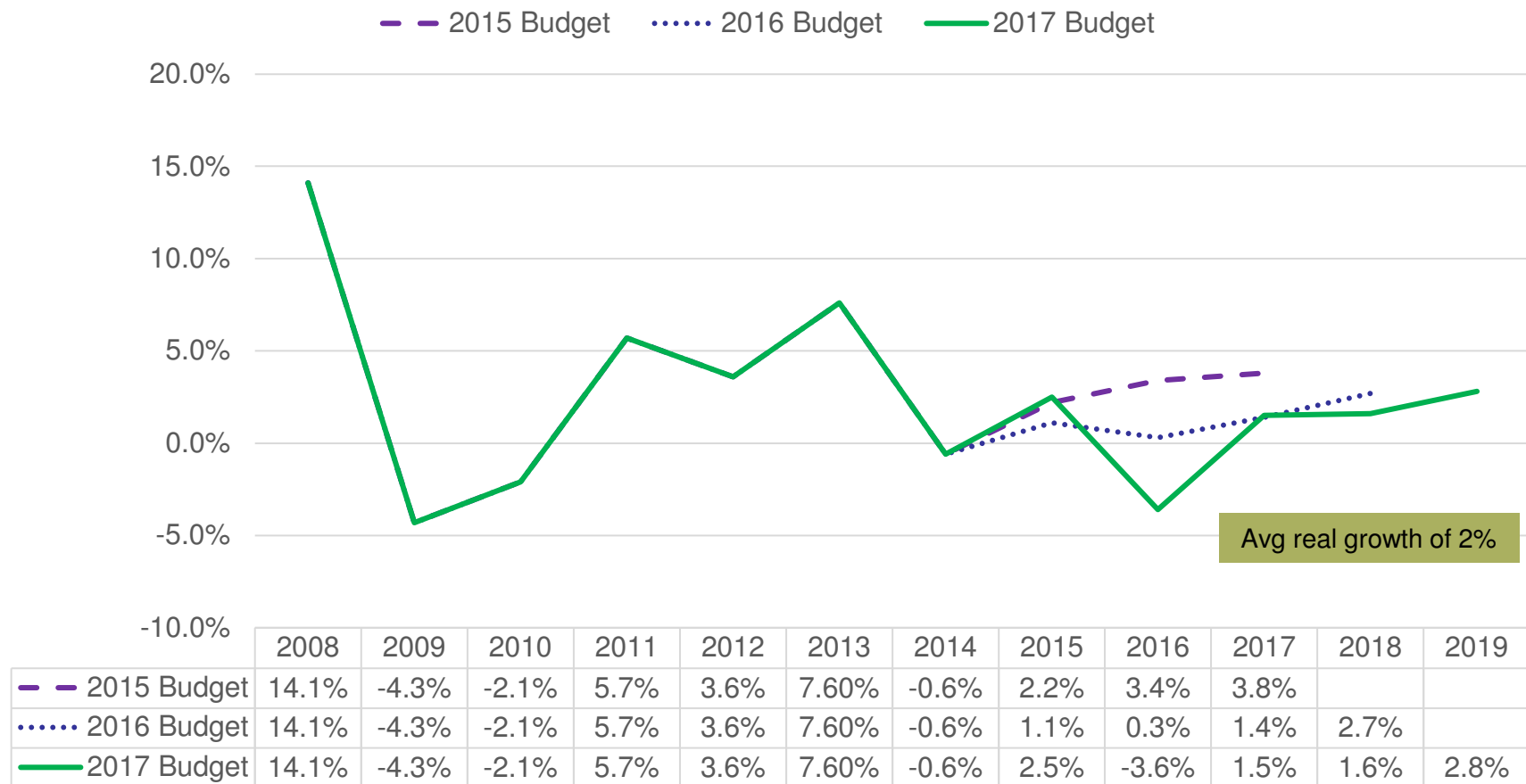
Consulting Engineering Profession in SA vs GFCF Construction works
Rand billions (Real 2010 rices)



Source: SARB, CESA

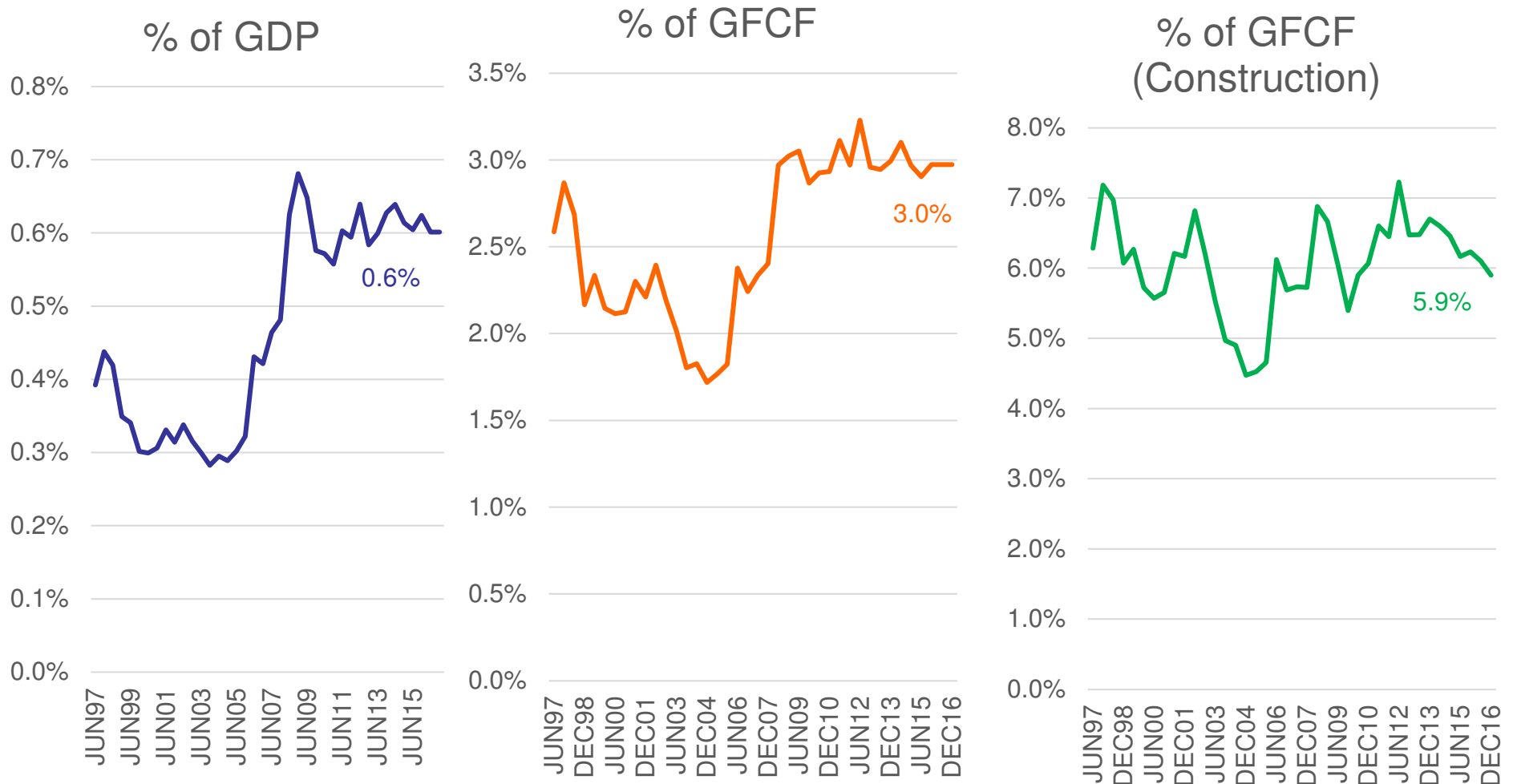
Weaker economic growth outlook combined with low investor confidence dampens GFCF growth outlook

GFCF Growth – Then and Now



Source: National Treasury

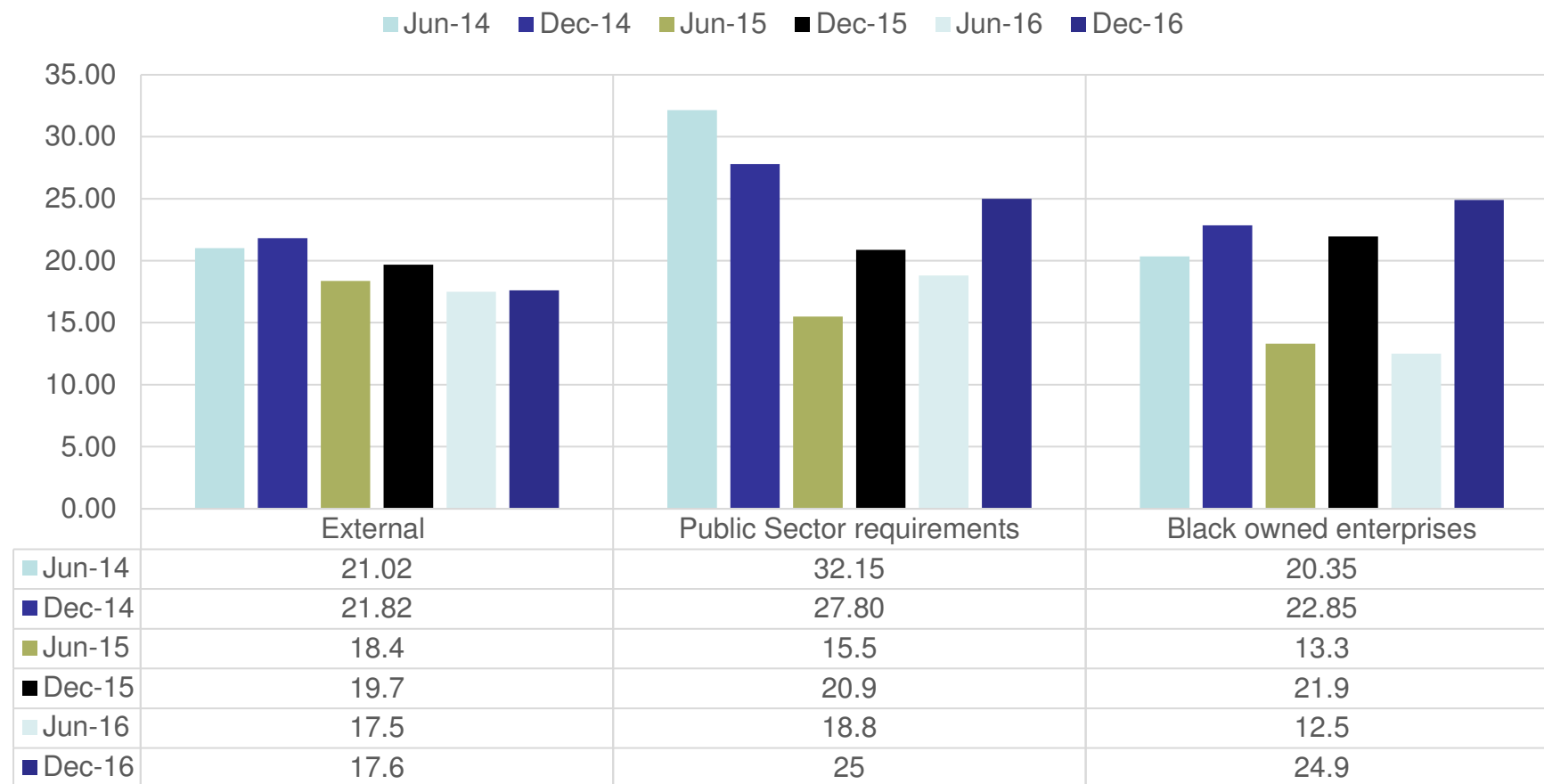
Contribution of Consulting Engineering Profession



Engineering firms **outsource** for various reasons including:

- External business enterprises or individuals including sub-consultants, JV's and contract workers 17.6%
- To satisfy public sector / transformational requirements as laid down by public sector clients 25.3%
- Black owned enterprises 24.9%

On average firms outsource a higher percentage of turnover due to procurement and transformation requirements...



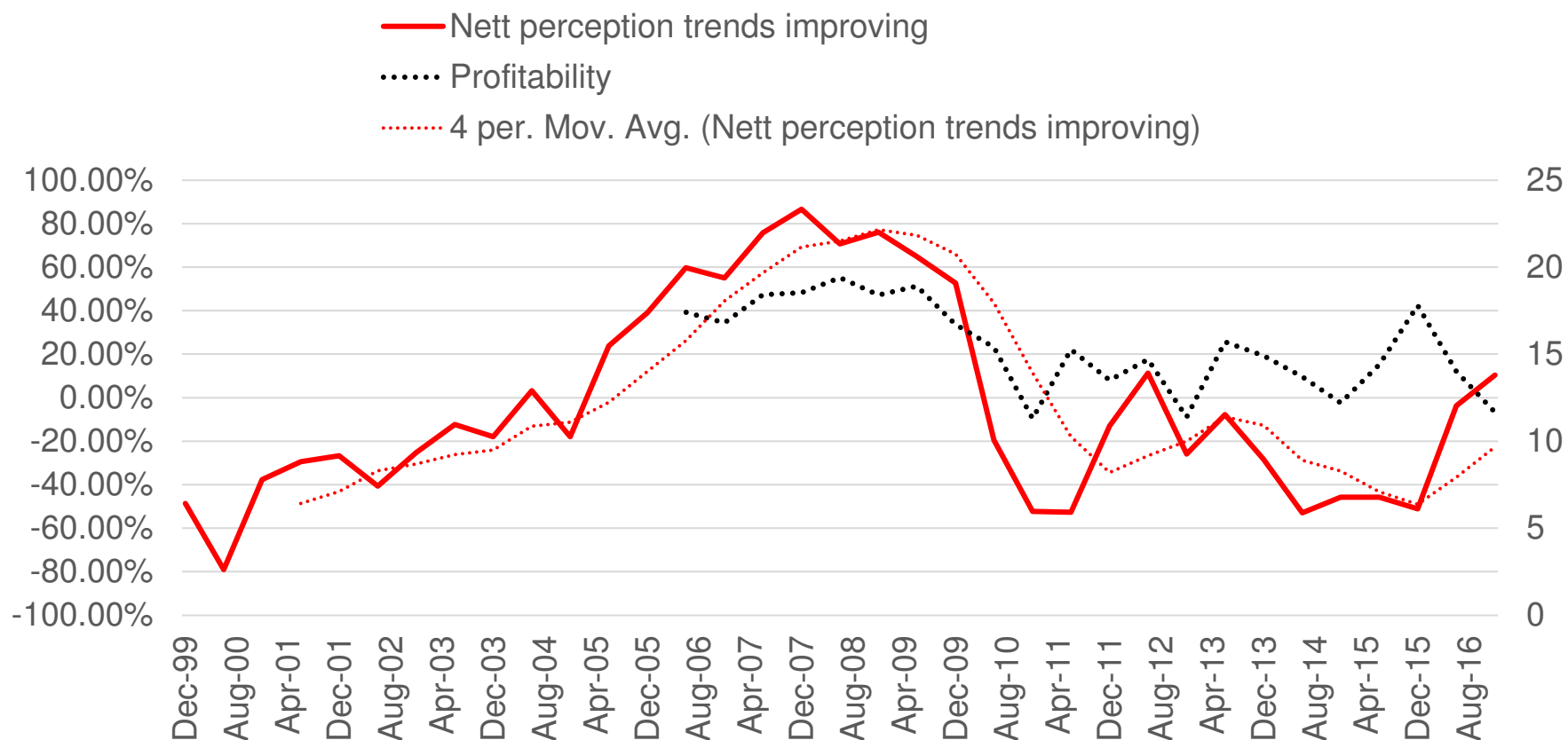
Profitability

Outlook on profitability has been largely negative since 2009, and although the nett satisfaction rate remains negative, there has been some improvement, although margins remain below historical levels.

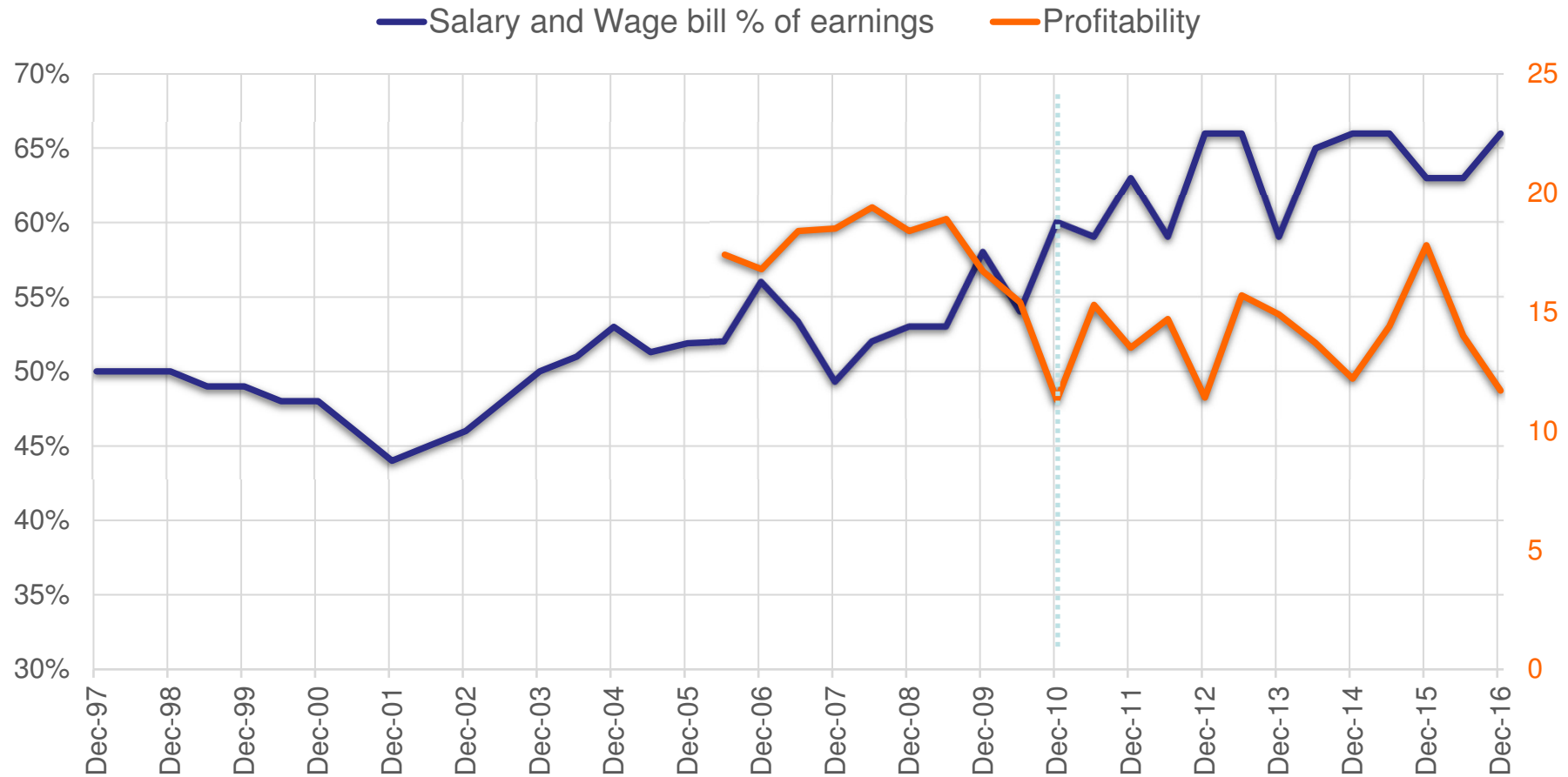
- Majority of firms expect profit margins to **stabilise** (56 percent), vs 25% improve and 15 percent recede
- 57% of firms are satisfied with current levels of profitability vs 60% in the previous survey

Profitability slows to 11% in last six months of 2016 (13% for 2016) from an average of 16.1% in 2015 (13% 2014)

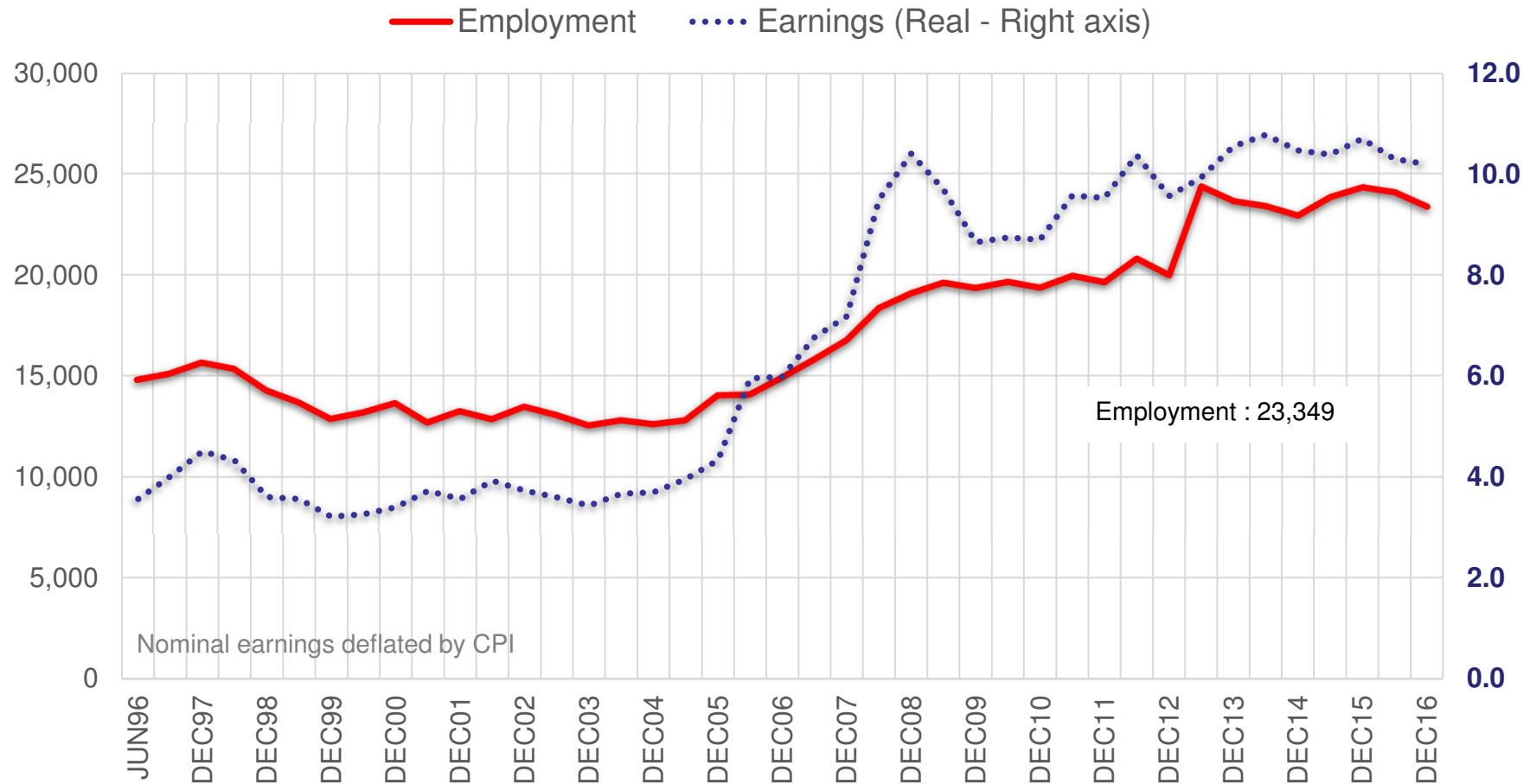
Profitability : Nett % Satisfaction rate



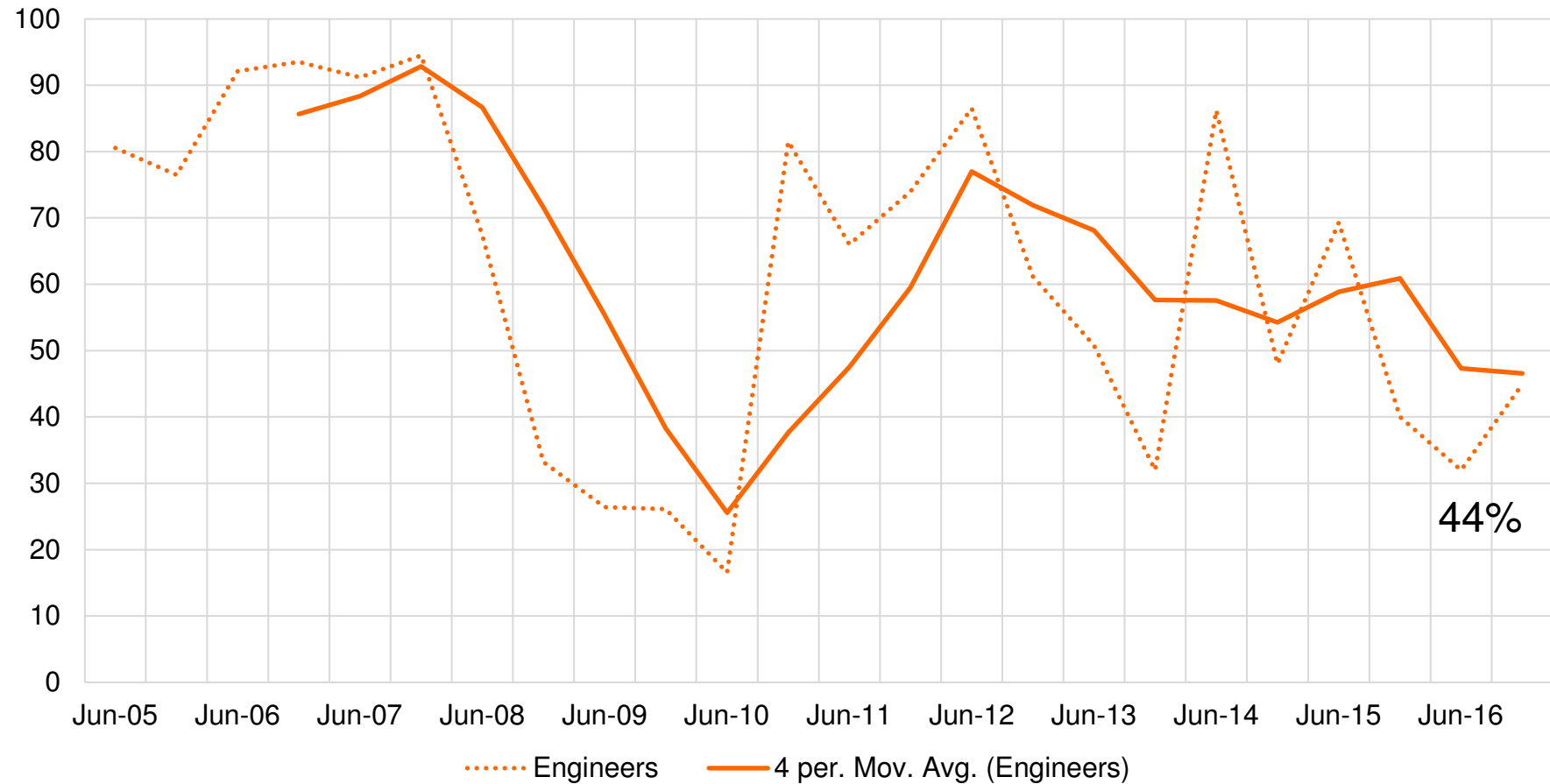
Salary and wages represent 66% of earnings in the current survey (Average 2015: 64.5%)



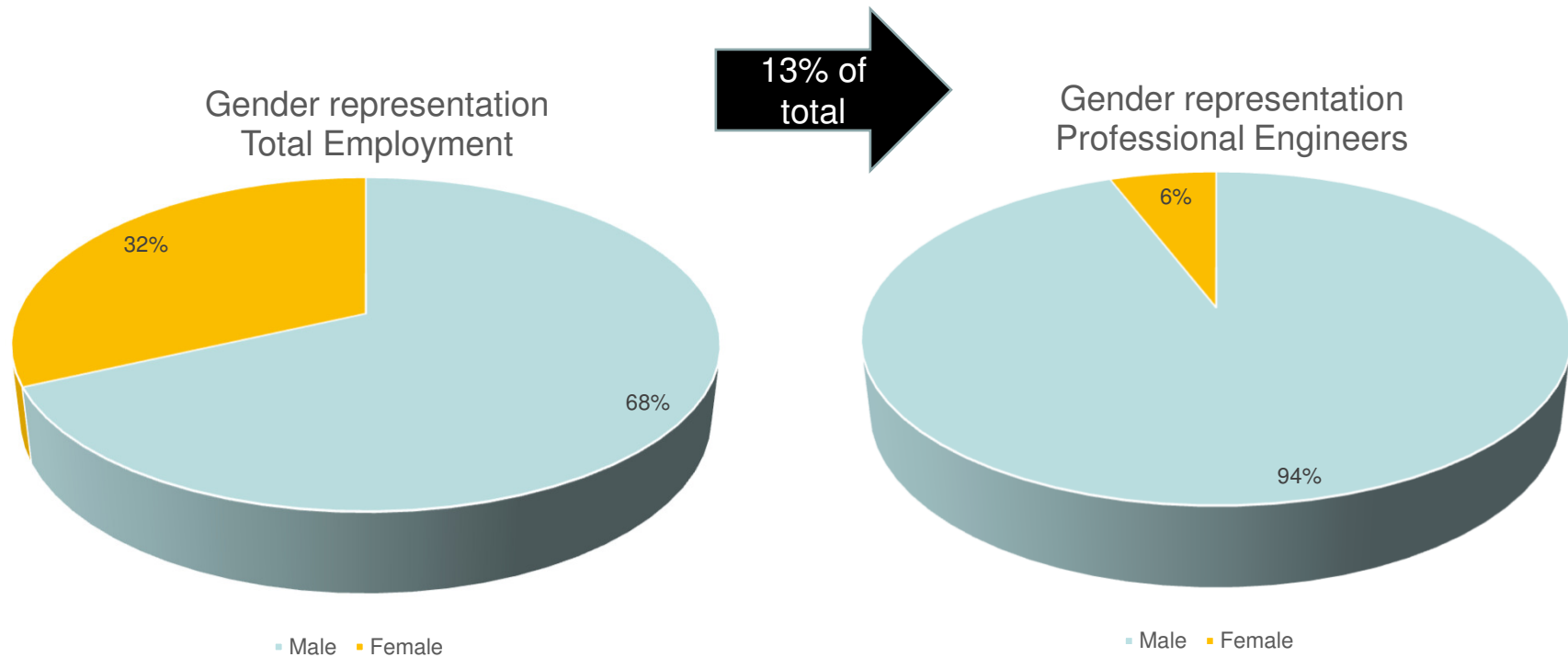
Employment contracted by 3% in H2 2016, 4% lower compared to same period in 2015, alongside weaker earnings on average during 2016



Slight improvement to 44 percent (from 32 percent in H12016) of firms looking to employ engineers

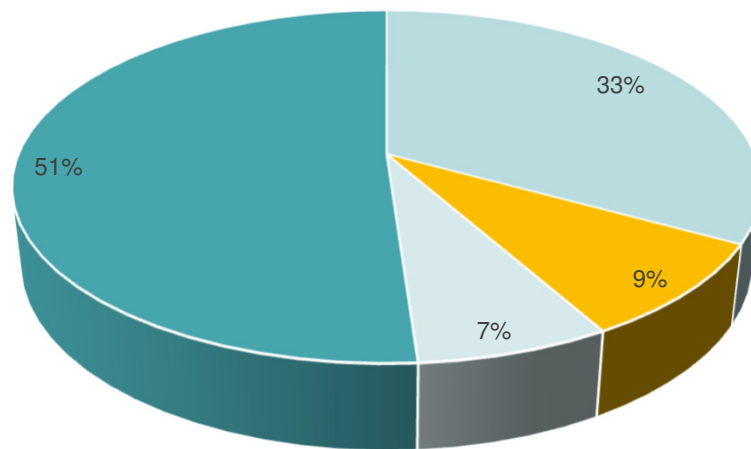


Employment profile by Gender



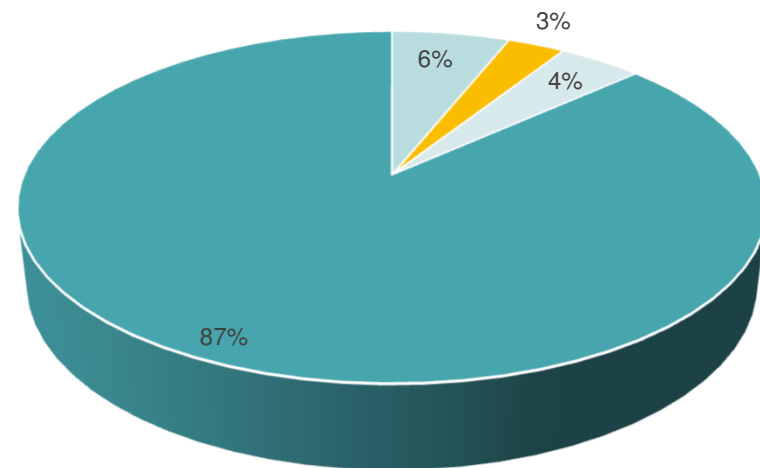
Employment Profile by Race

Total Employment



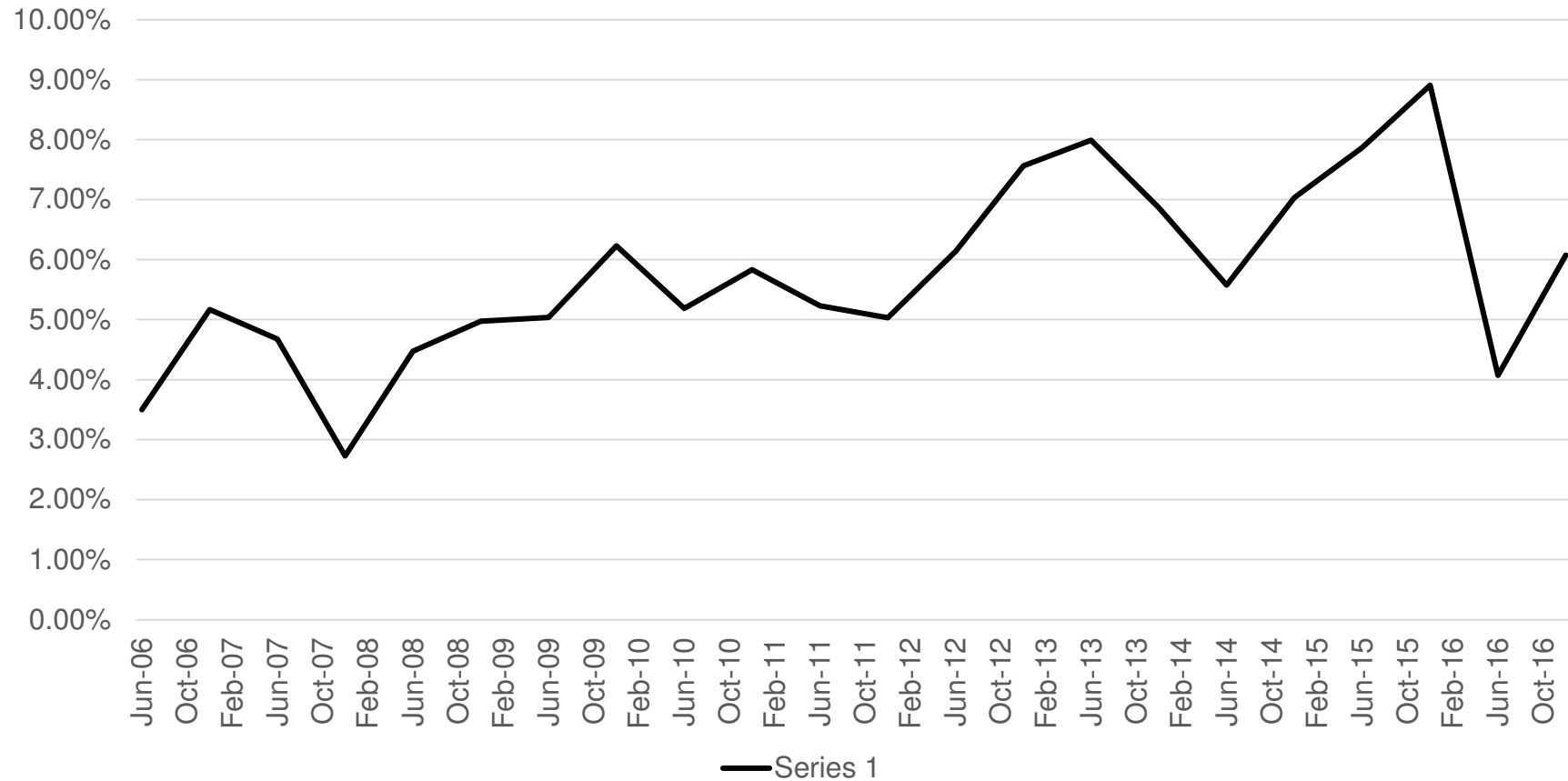
■ Black ■ Coloured ■ Asian ■ White

Professional Engineers

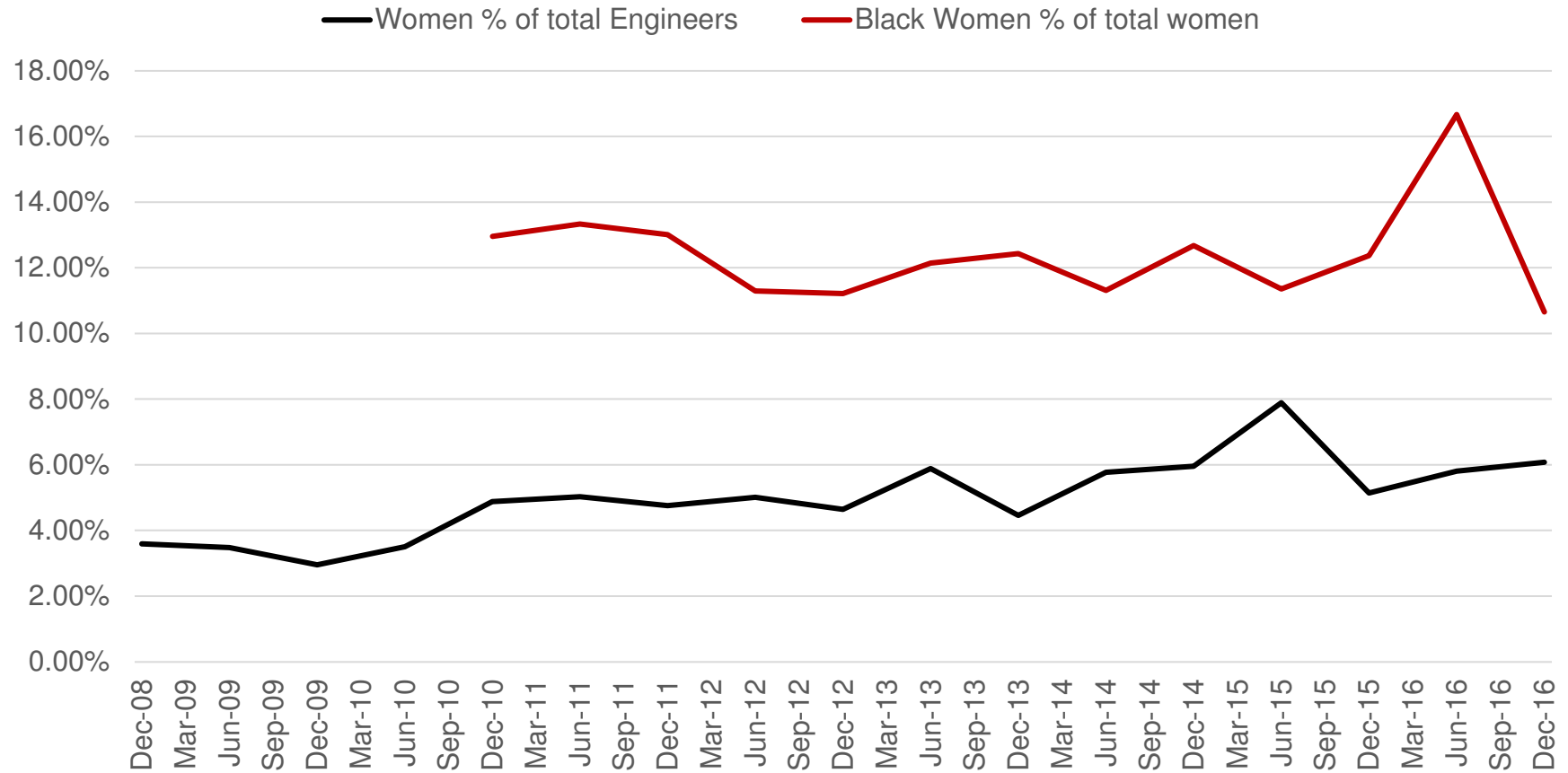


■ Black ■ Coloured ■ Asian ■ White

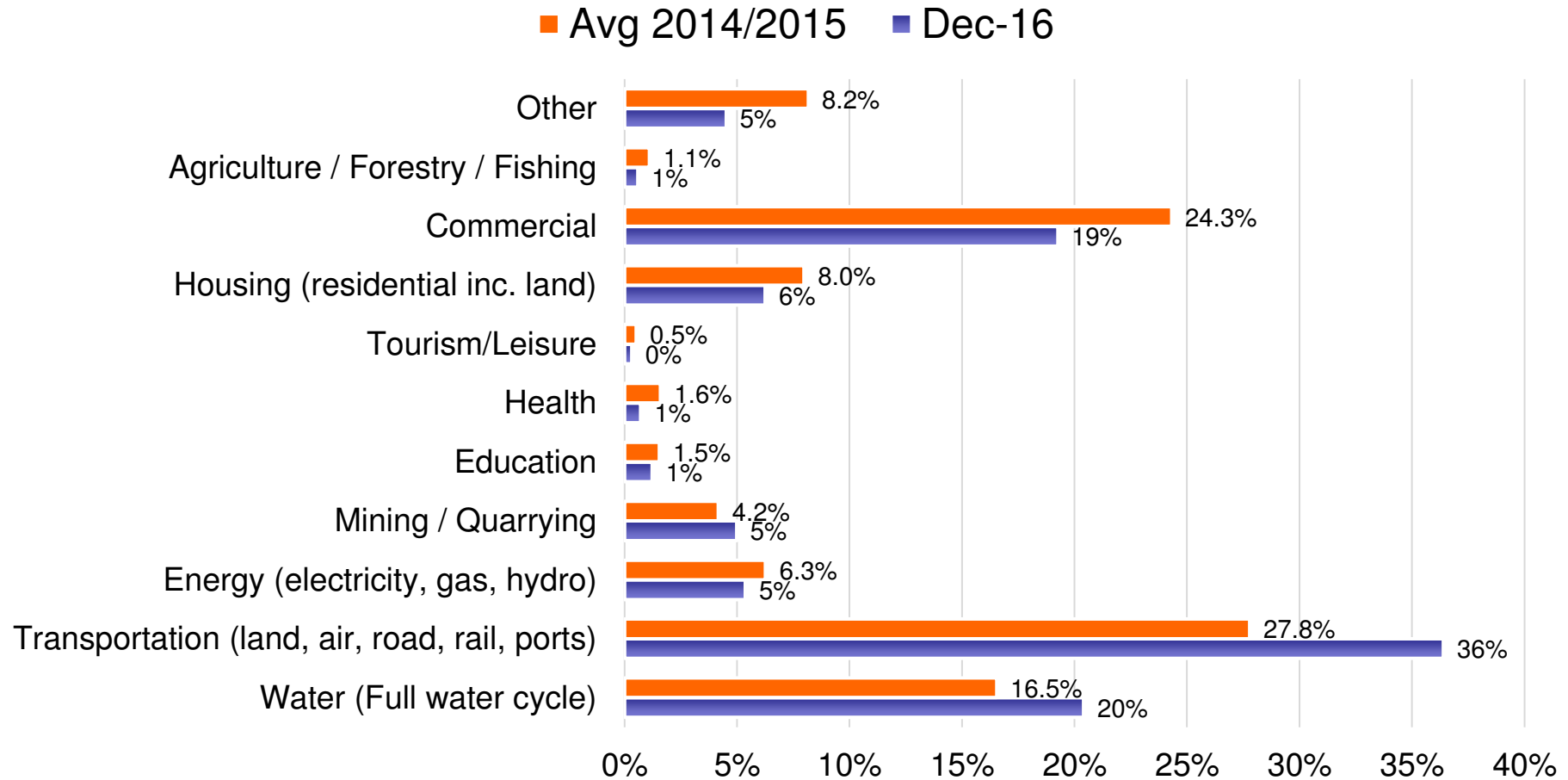
Black Engineers (excl Coloured / Asia) % of Total Engineers



Women Engineering Profile



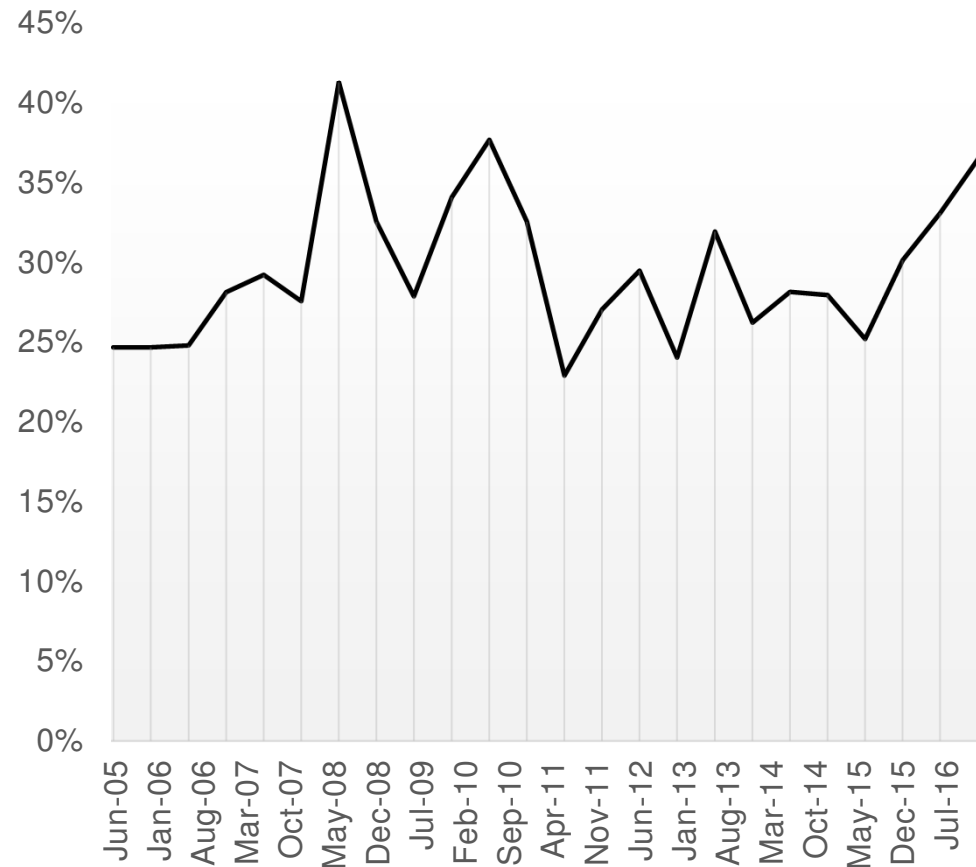
Earnings by Sector | Percentage contribution



Transport accounted for 36% of earnings in last six months of 2016 – the highest contribution since 2010

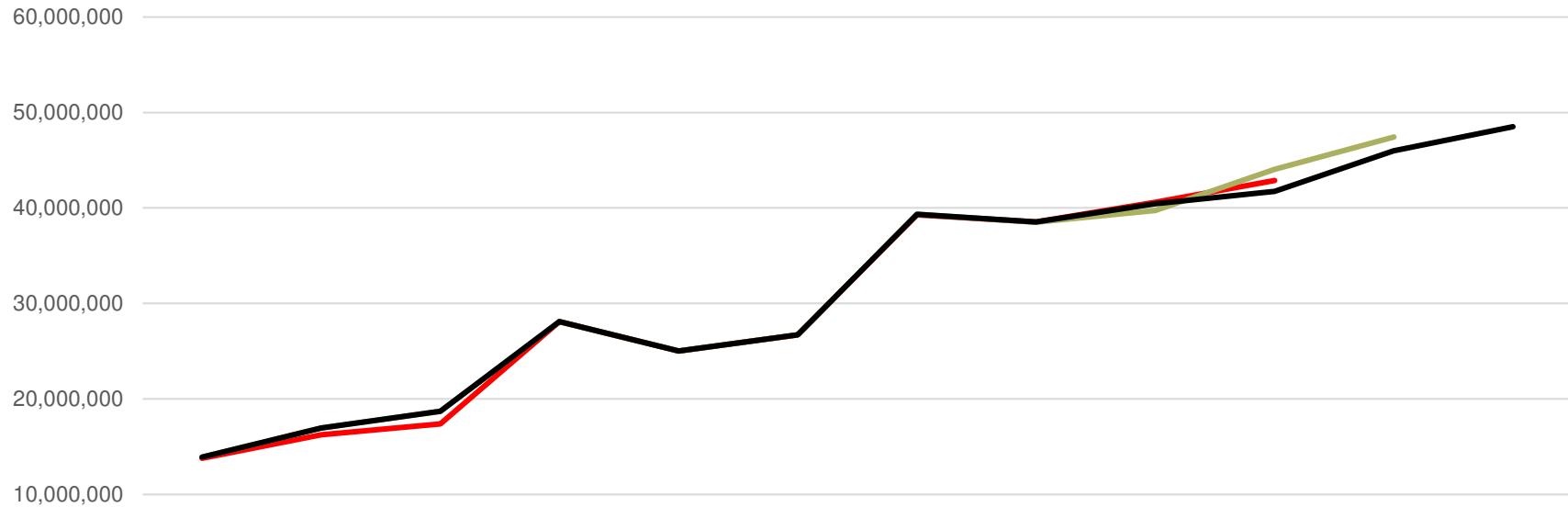
(from 33% in H1, 28% in 2014, 27.6% in 2015, 27.8% 2-year average)

- Transnet Allocations over State Capture and allegations of tender irregularities
- PRASA Tender irregularities
- Flat real growth in 2017 Transport infrastructure budget, focussed primarily on Dept of Transport. Less spending from SOE's
- SANRAL e-toll debacle continues – Downgraded in June 2017



Flat real growth on average over MTEF period, following -2.8% in 2016 Budget

Transport Infrastructure Expenditure Estimates
Then and Now



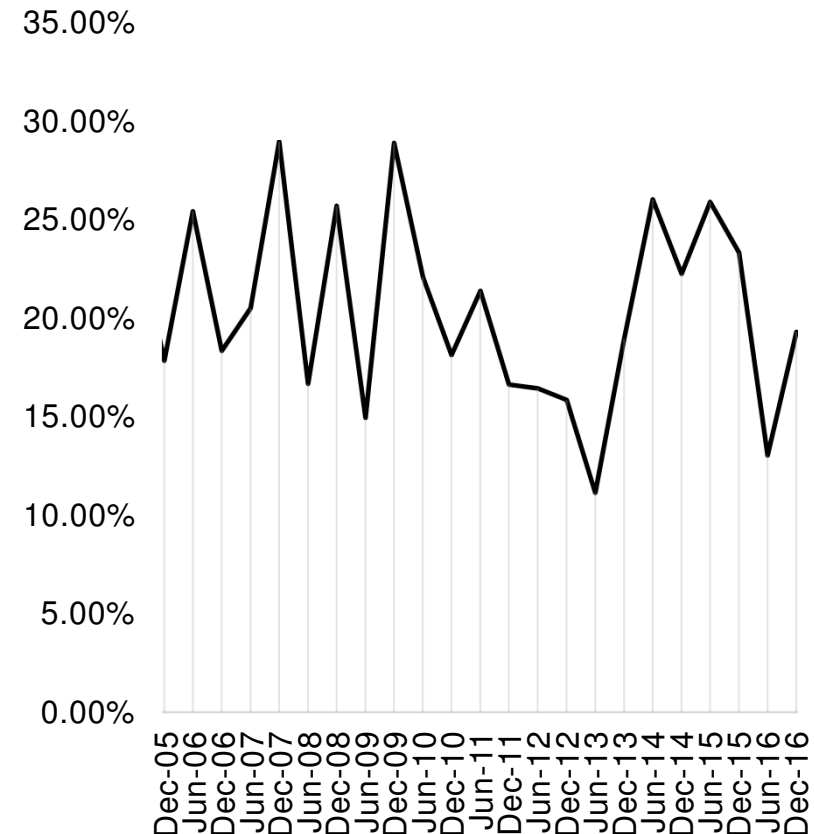
	2008/09	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20
2015 Budget	13,785,379	16,239,300	17,393,500	28,096,100	25,016,600	26,712,800	39,269,300	38,550,600	40,588,700	42,903,400		
2016 Budget	13,915,300	16,955,100	18,701,400	28,101,400	25,016,600	26,712,700	39,327,200	38,507,300	39,733,200	44,036,000	47,462,500	
2017 Budget	13,915,300	16,955,100	18,701,400	28,101,400	25,016,600	26,712,725	39,327,246	38,532,586	40,452,704	41,746,244	45,975,718	48,538,935

— 2015 Budget — 2016 Budget — 2017 Budget

Commercial sector accounted for 19% of earnings in first six months of 2016

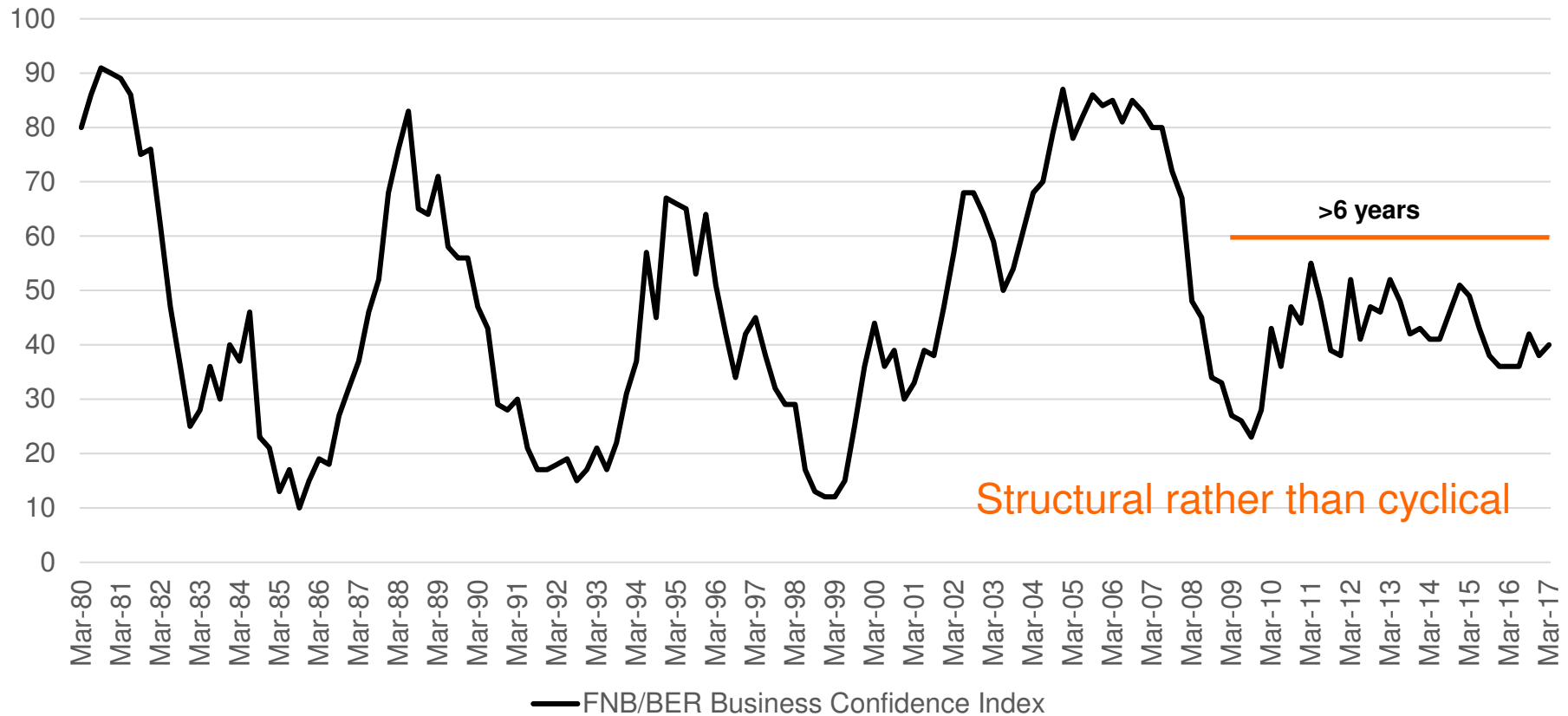
(from 24% in 2014, 24.6% in 2015, 24.3% 2-year average)

- Higher levels of investment in owner-occupied developments, offices and mixed use developments
 - Old Mutual Head office, PWC head office, 140 West Street, Silo no 5 (Water front), KPMG offices
- Retail development, extensions
 - Extensions to Balito Junction, Extension to Fourways mall, Springs Mall, Thavhani mall, Kyalami corner, Botshabelo shopping centre, Redevelopment of Village Walk shopping centre, Cornubia Mall, Whale Coast Shopping centre...



Business confidence remains weak and deteriorated to 38 in 2016Q4 before recovering to 40 in Q1

FNB/BER Business Confidence Index



Source: FNB

Initiatives to engage with and encourage investment with the private sector?

“To grow faster, the economy needs higher levels of private sector investment”

Pravin Gordhan October 2016

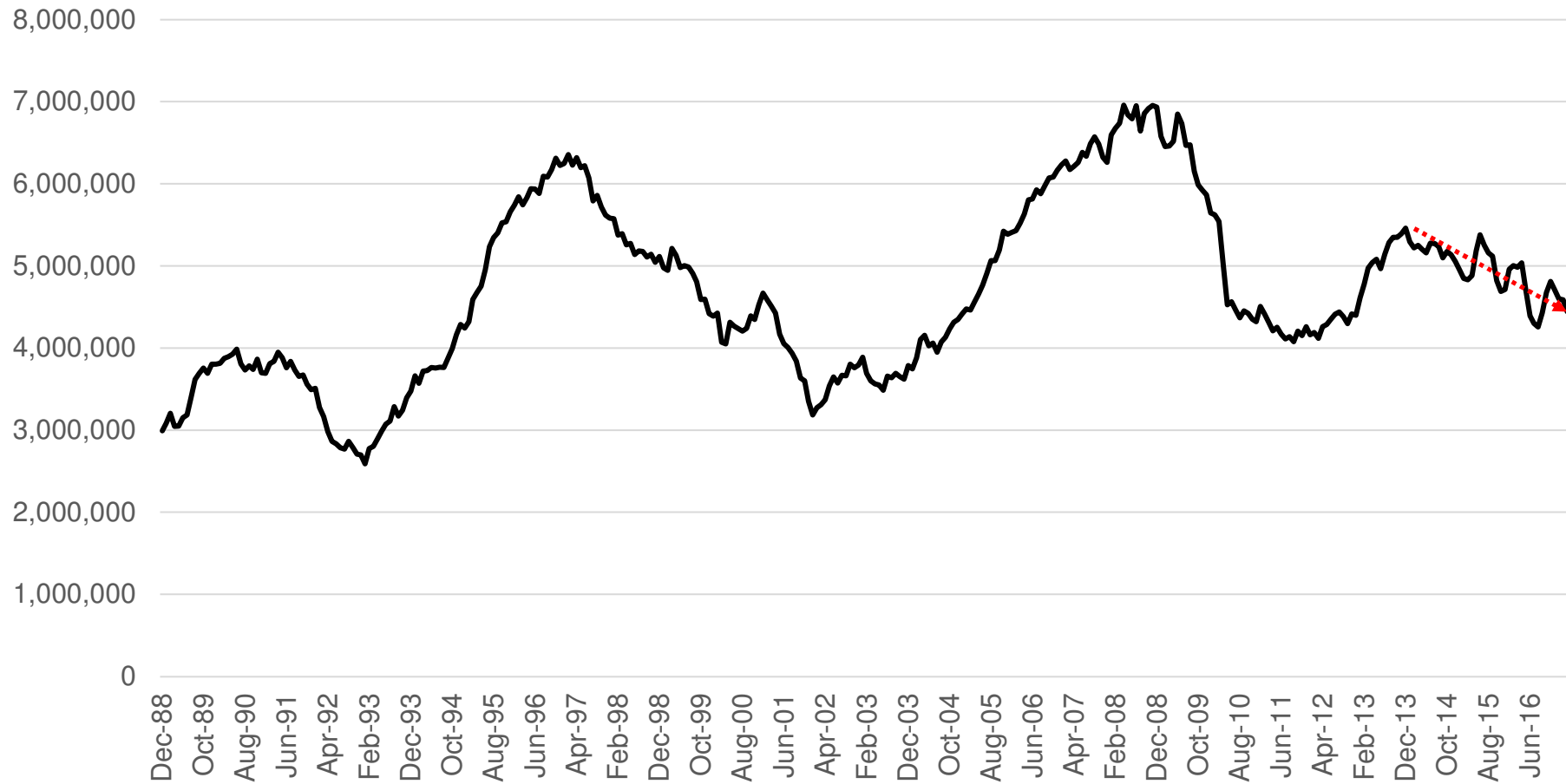
Government's plan to restore confidence:

- Finalising a regulatory framework for private-sector participation in infrastructure projects, including initiatives in partnerships with SOE's
- Addressing legislative and regulatory uncertainties that hold back investment in mining, agriculture and key technology sectors
- Rationalising, closing or selling off public assets that are no longer relevant to government's development agenda
- Concluding labour market reforms



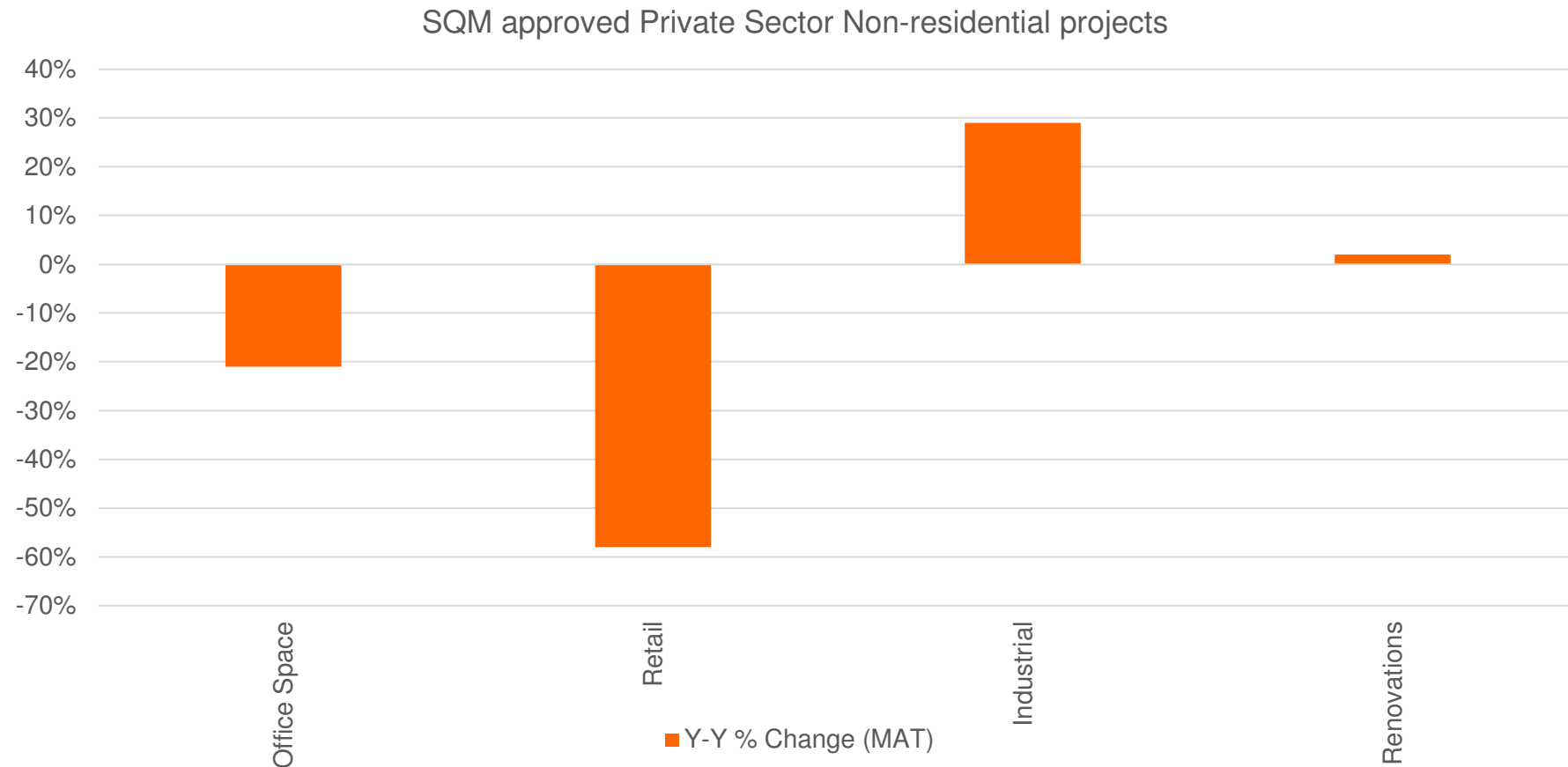
IMF highlights
political
instability/concerns
as key growth
constraints

Non-Residential SQM approved Down 11% y-y (MAT, Mar'17)



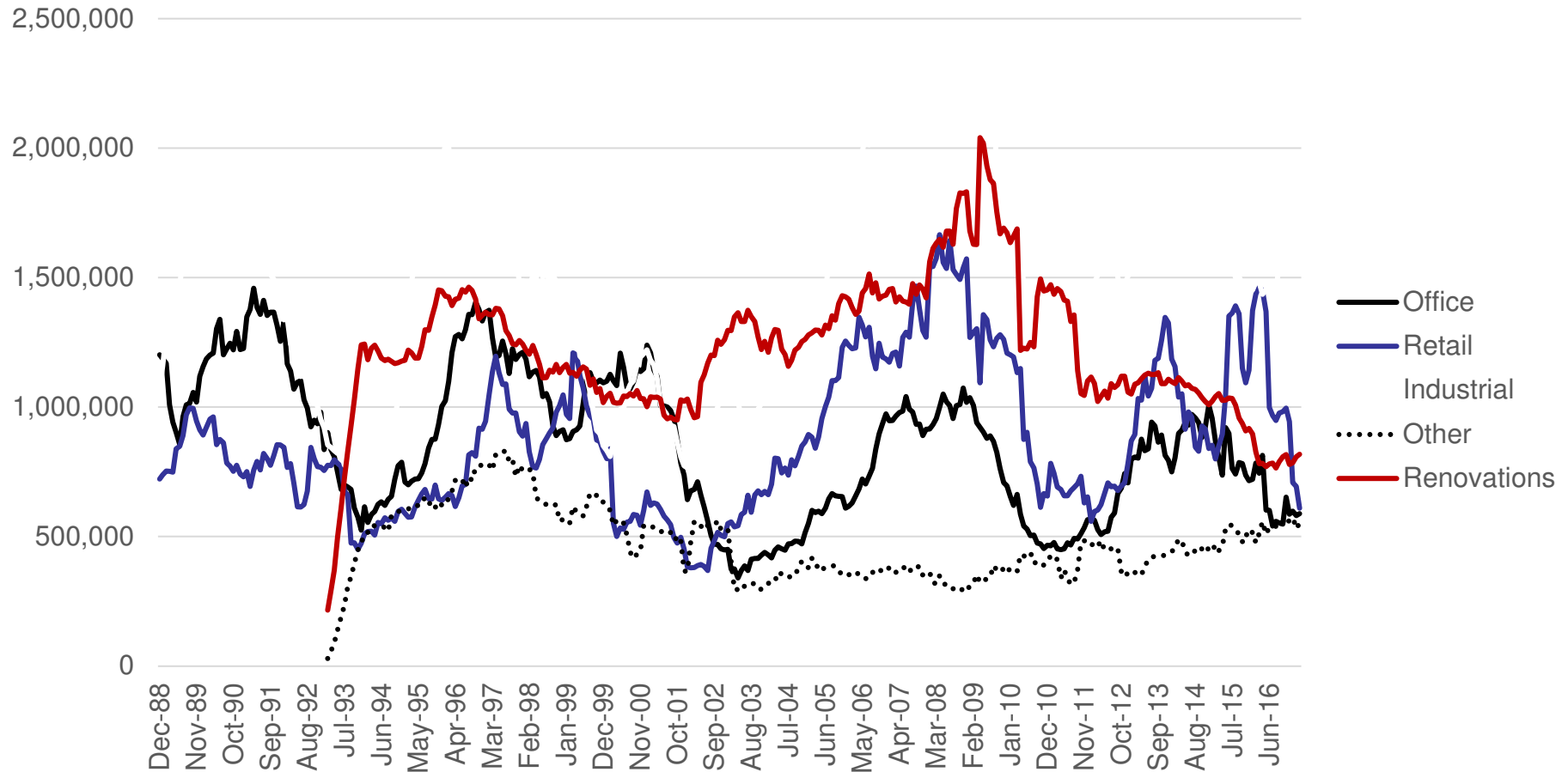
Source: Stats SA

Sharp declines in office and retail space, suggesting further contraction in private sector commercial pipeline projects



Source: Stats SA

Non-Residential SQM approved Down 11% y-y (MAT, Mar'17)

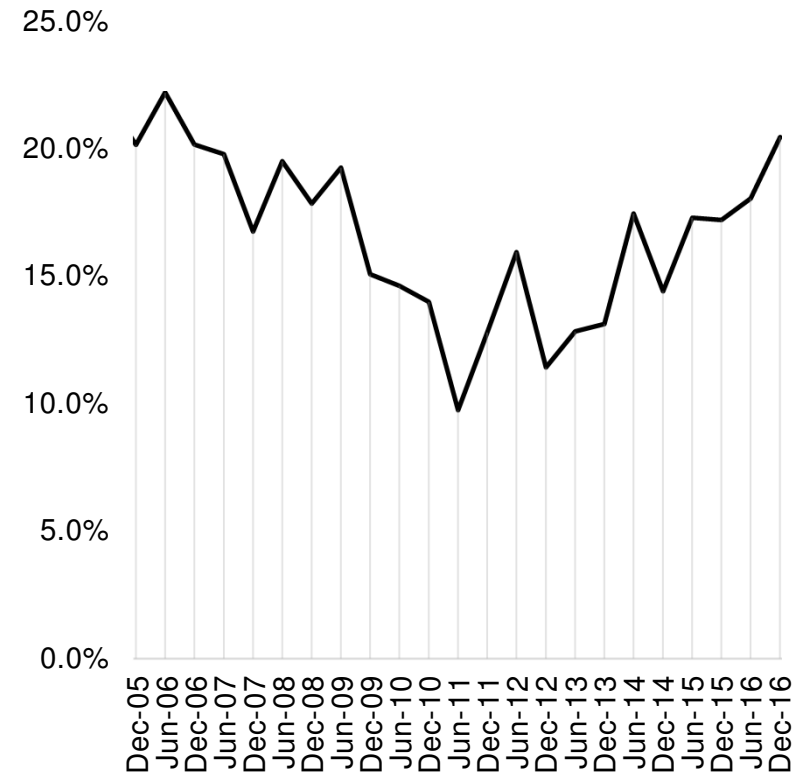


Source: Stats SA

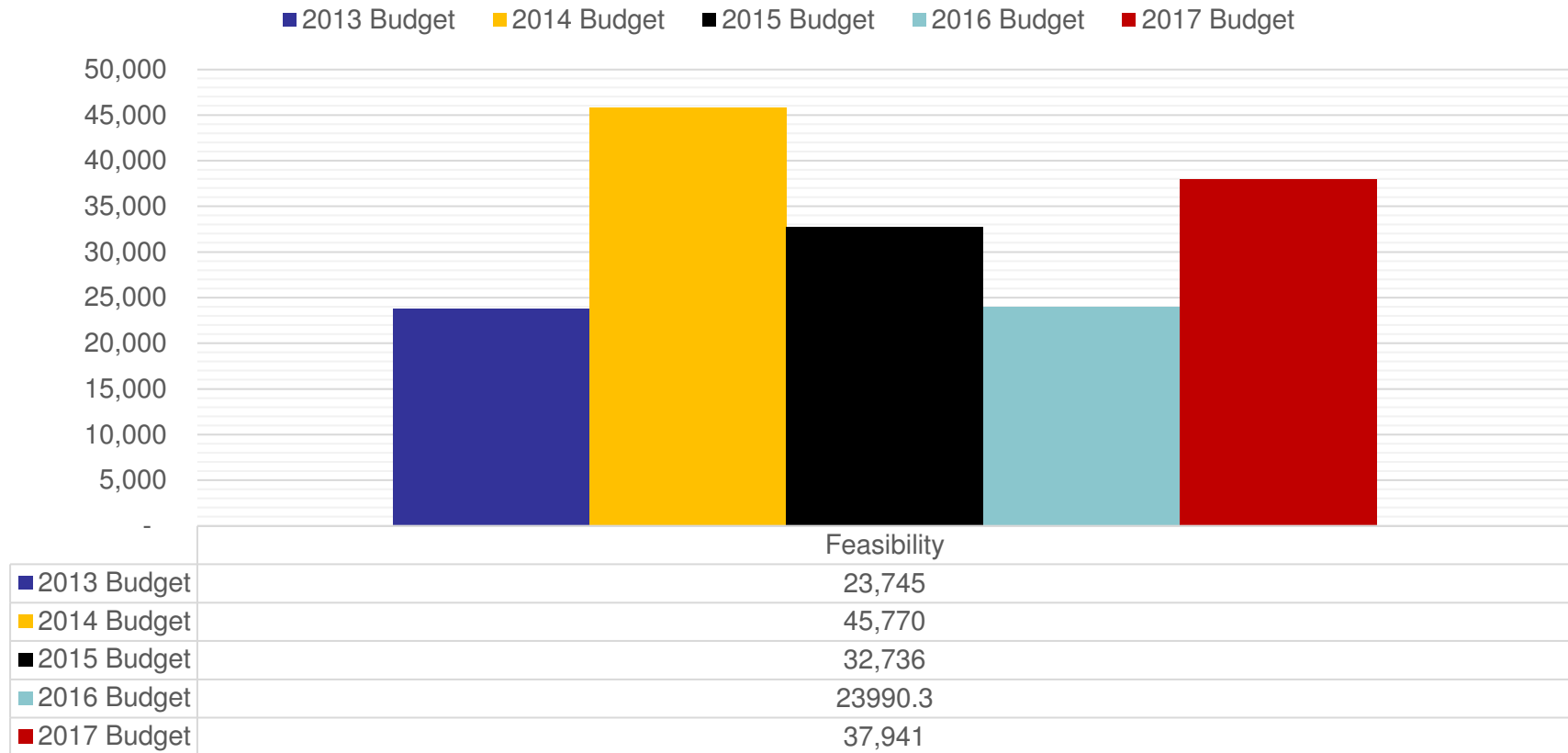
Water accounted for 20% of earnings in last months of 2016 (avg 19% 2016)

(from 14% in 2014, 17.2% in 2015, 16.5% 2-year average)

- Earnings nearly doubled since 2010 to R2bn
- Expenditure on Water & Sanitation projected to increase by 6.5% (nominal) over MTEF period, from an average growth of 10% in the 2016 Budget
- Avg spending of R40bn / year
- ACID Mine Drainage (R1.1bn – R1.5bn/annum)
- WATER CRISIS LOOMING – Required spending R300bn in 4 years (ActionAid South Africa Review), predict a 2 million cubic litre shortfall by 2025
- Demand side management, improve efficiency in usage, reduce wastage

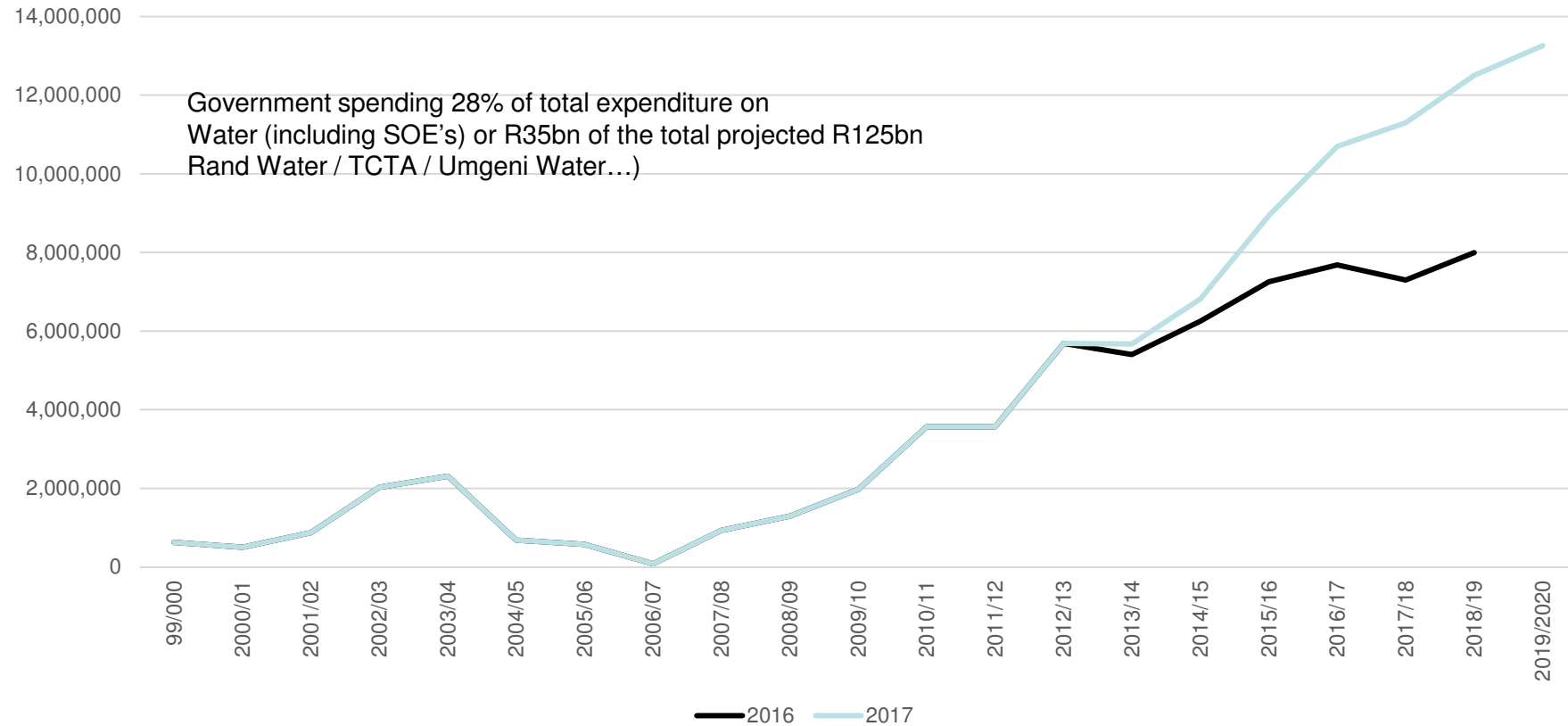


Water infrastructure budget allocations, FEASIBILITY STAGE (Rm)



Water & Sanitation Total Public sector Infrastructure: R125bn (MTEF) Average growth of 6.5%

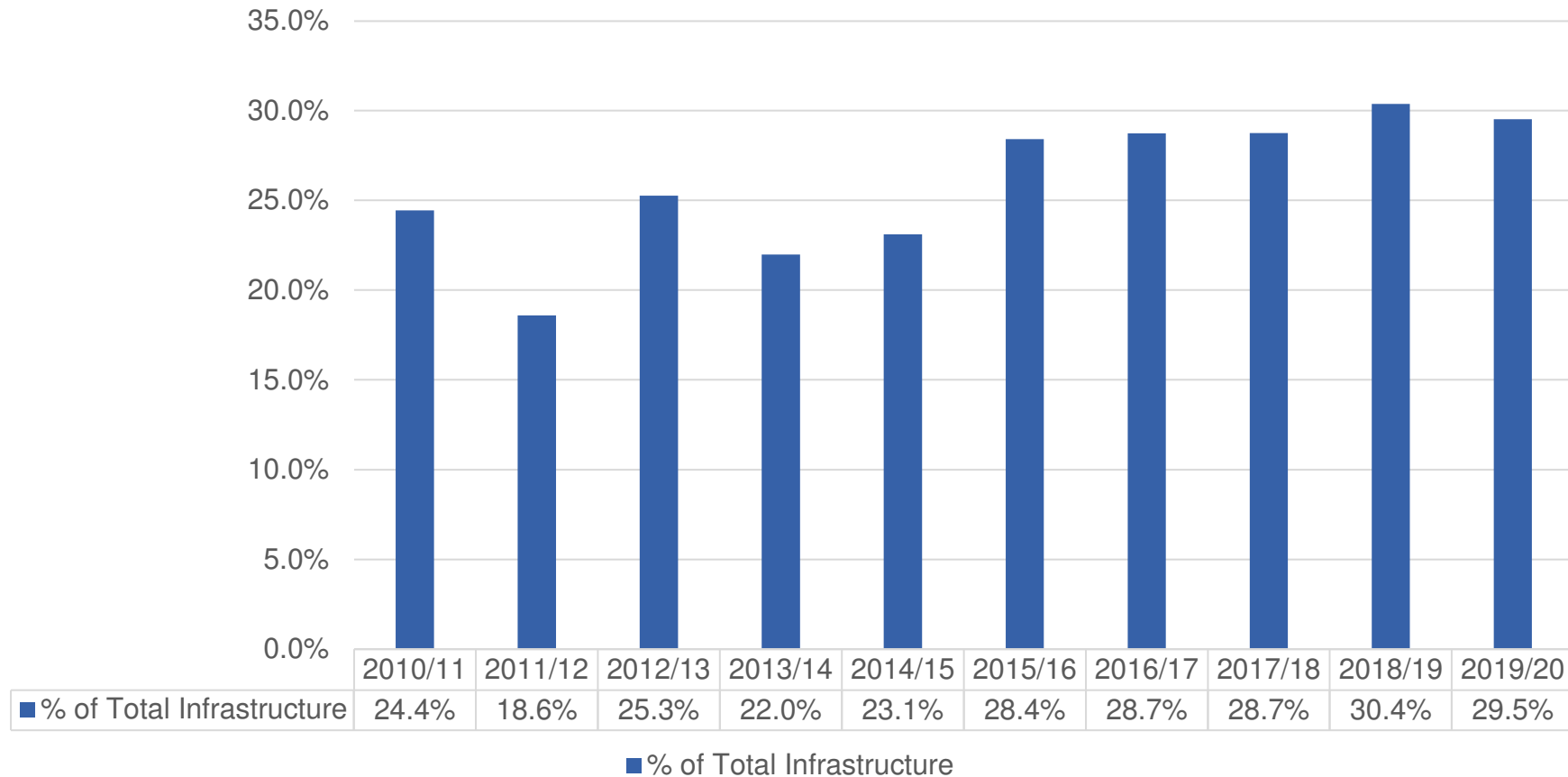
Dept of Water & Sanitation Infrastructure Allocations
(including transfers to SOE's)



Government's role in water infrastructure

Increased focus on water boards - Will tariff increases / borrowing be sufficient ?

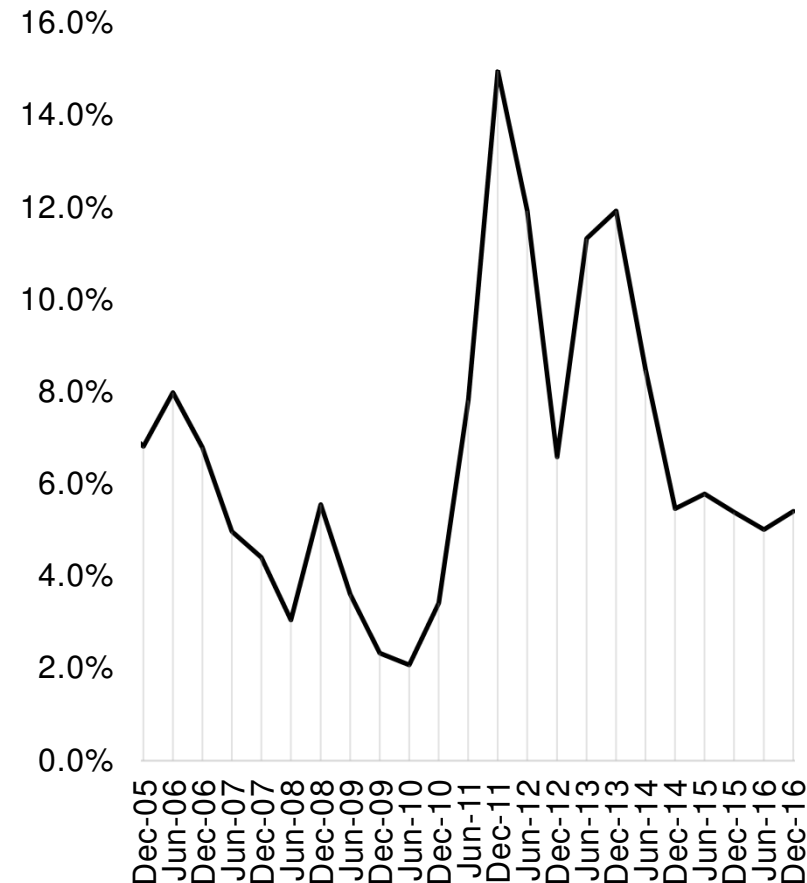
Government share of Total Water & Sanitation Infrastructure



Energy accounted for 5% of earnings in last six months of 2016 (avg 5.2% 2016)

(from 7% in 2014, 5.6% in 2015, 6.3% 2-yr average)

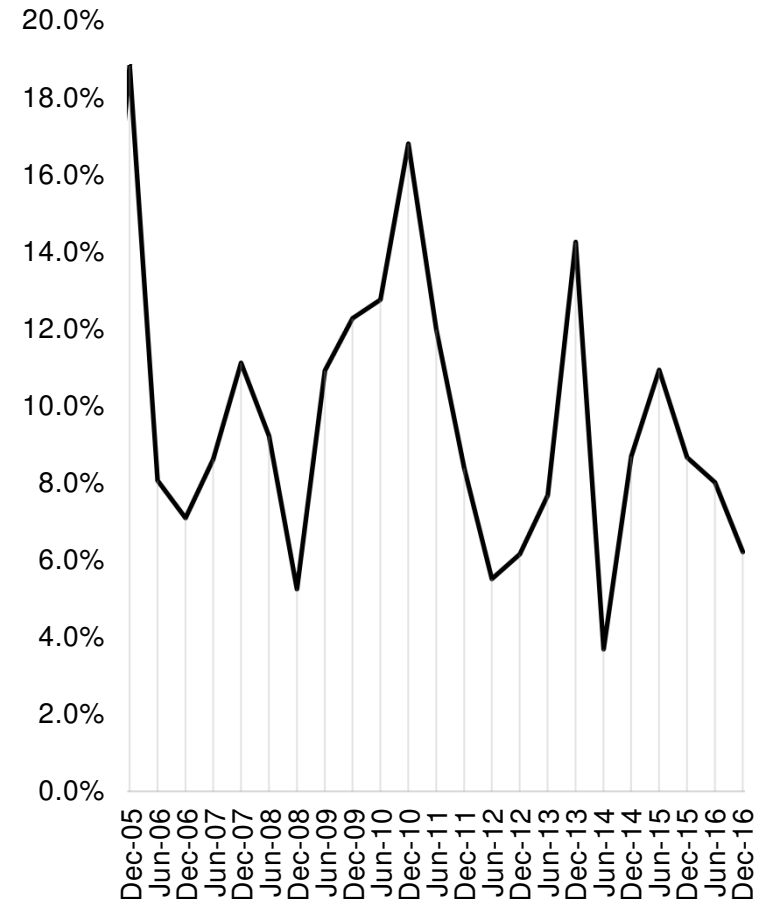
- Expenditure on Energy projected to decrease by 0.1% (2017 MTEF) from an increase of 10% (2016 MTEF)
- Finalisation of Medupi and Kusile
- Eskom looking for 20% tariff increase – 7 years to get back to financial stability
- Uncertainty in Renewable energy
- Diverse Energy Mix
- Nuclear
 - Zuma's top priority
 - New Cluster (Rosatom)



Housing accounted for 6% of earnings in last six months of 2016 (avg 7% 2016)

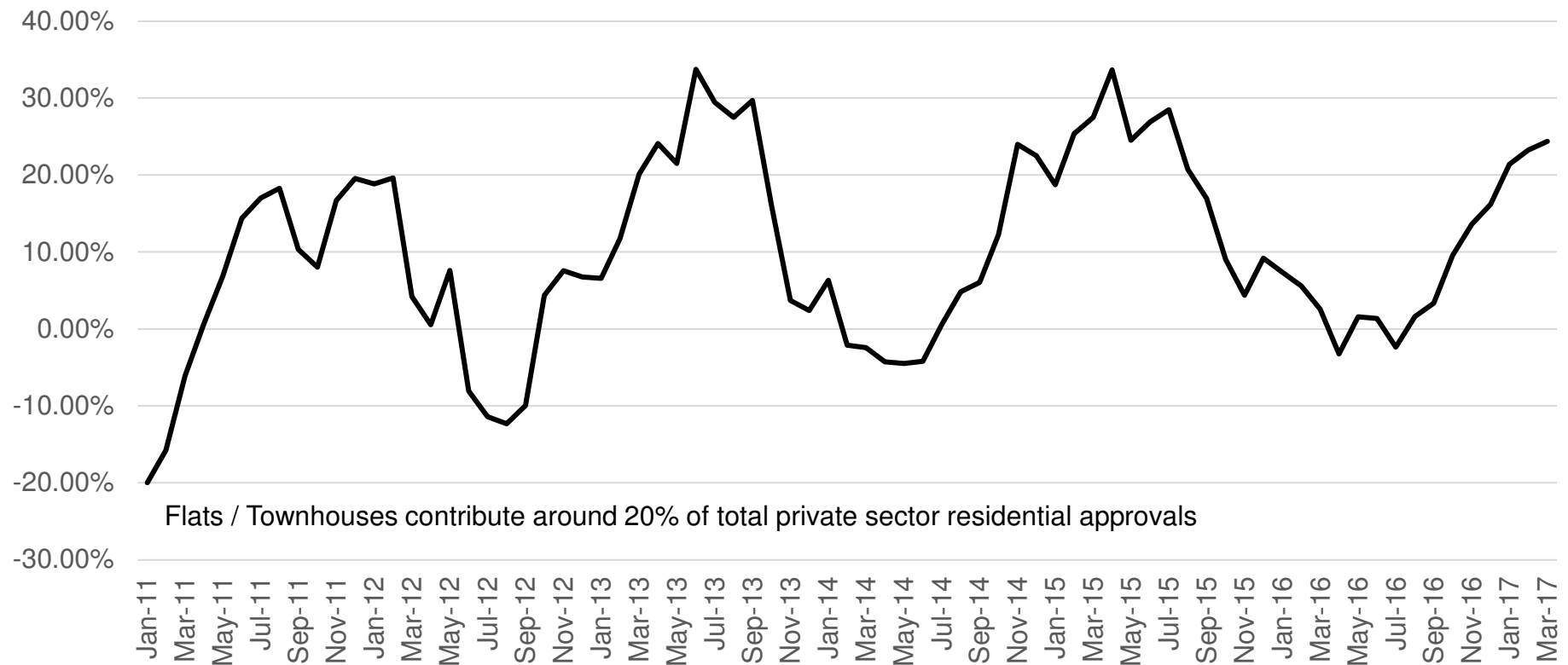
(from 6% in 2014, 9.8% in 2015, 8.0% 2-year average)

- Supported by higher levels of investment in large scale mixed-use developments
 - Moffat park South Hills
 - Savanna City
 - Jackal Creek
 - Steyn City
 - Cornubia
- Continued support for mega city, “catalytic” developments (Department of Human Settlement)
- Private housing supported by listing of residential property funds amidst growing housing shortage
 - Indluplace Properties – first to list
 - Balwin Properties – strong pipeline in the next five years, aims to be the largest fund on the JSE with market cap of R10bn (currently R3.3bn)



Welcome increase in approvals for private sector flats / townhouses up% y-y in 12 months up to March 2017

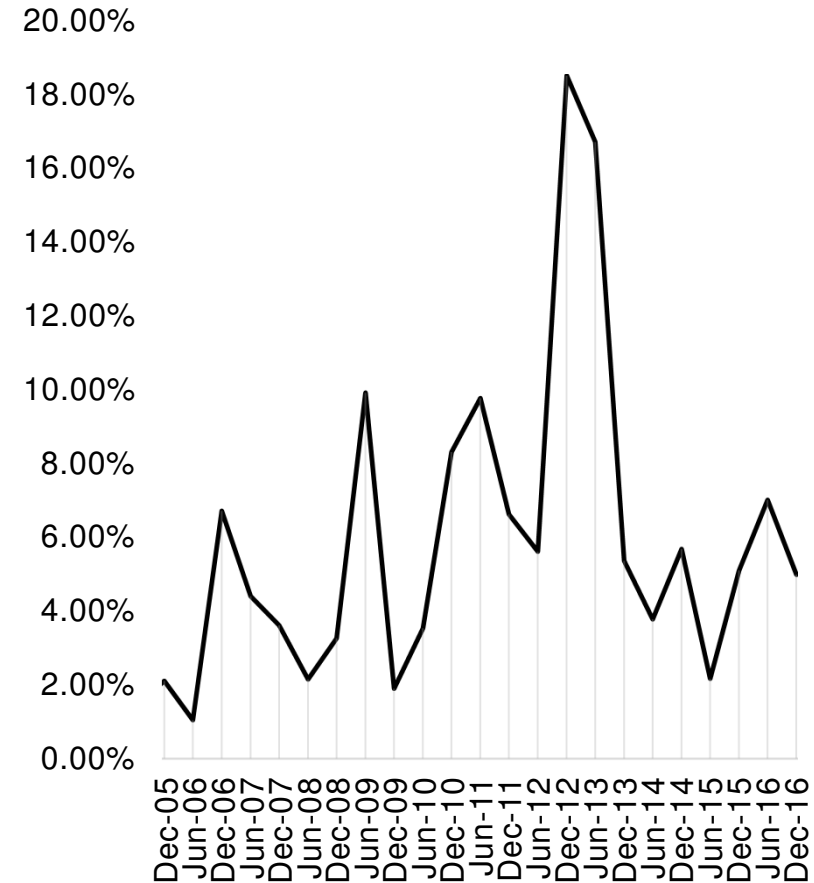
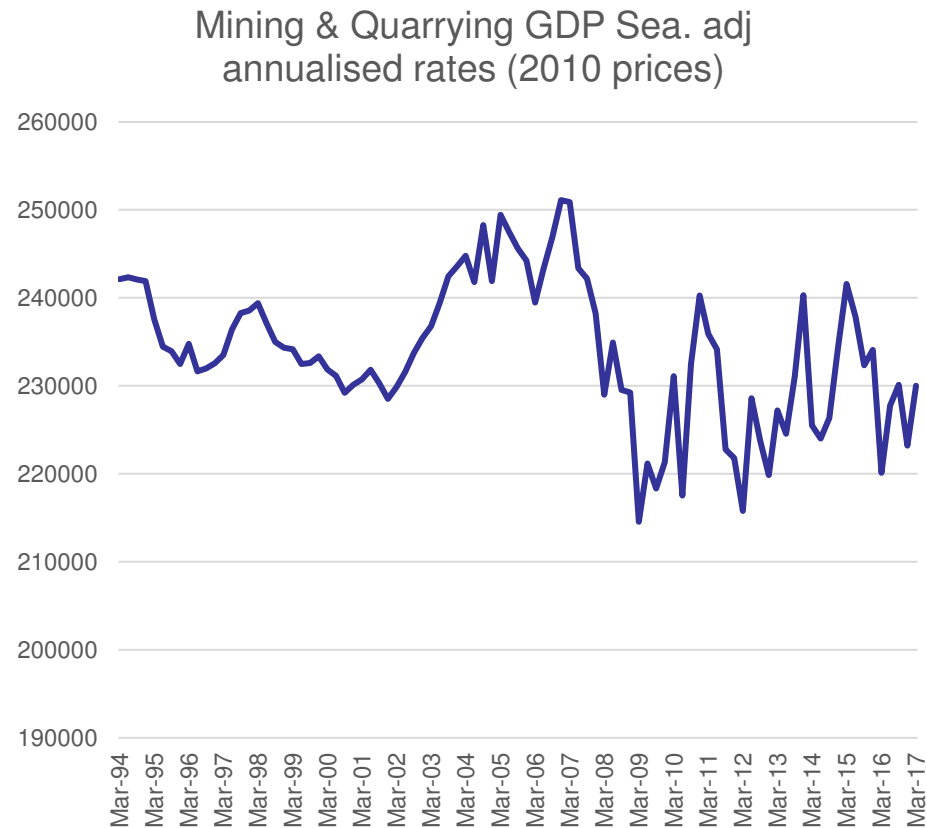
Flats / Townhouses: SQM Approved
MAT Y-Y percentage change



Source: Stats SA

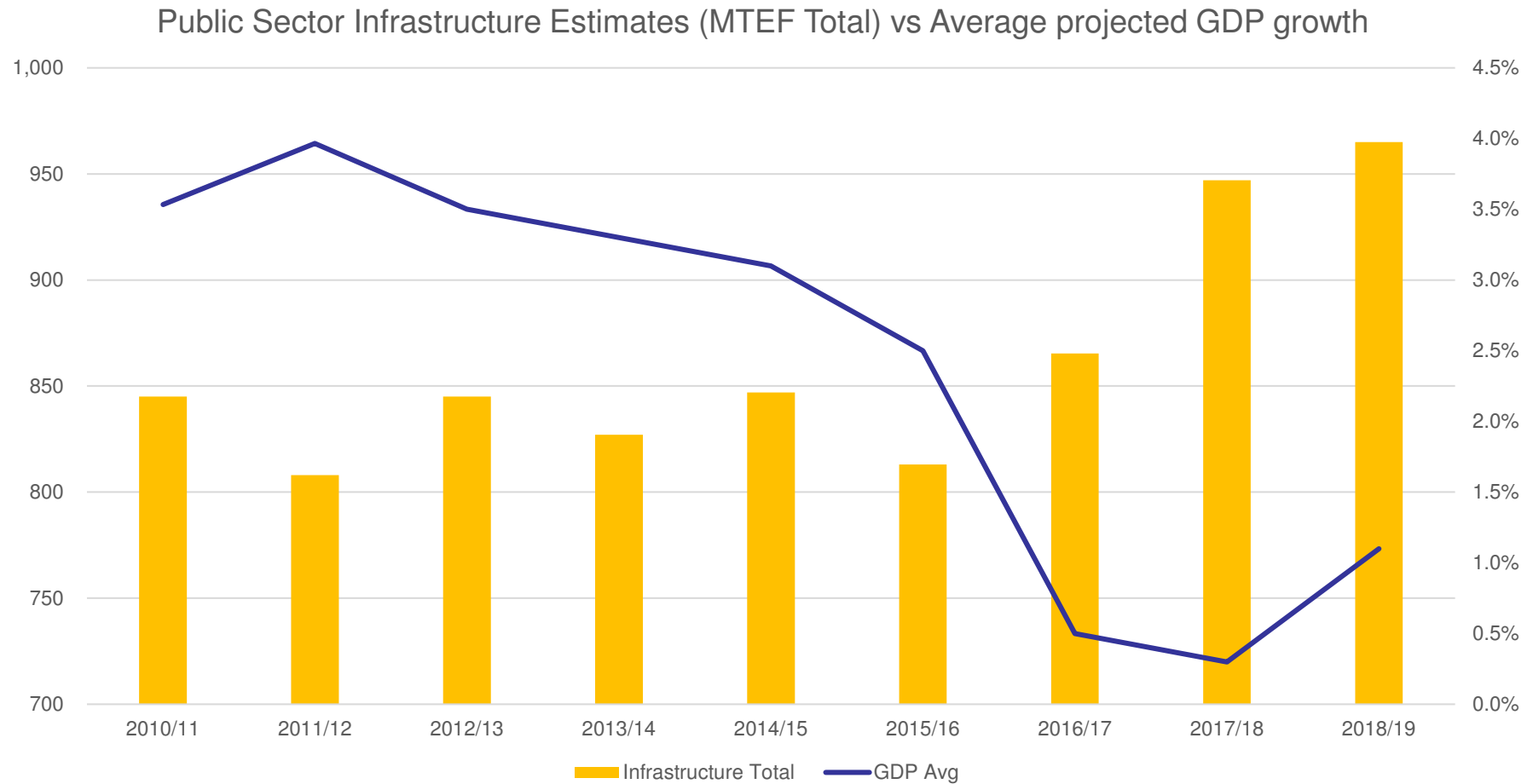
Mining accounted for 5% of earnings in last six months of 2016 (avg 6% 2016)

(from 5% in 2014, 4% in 2015, 4% 2-year average)



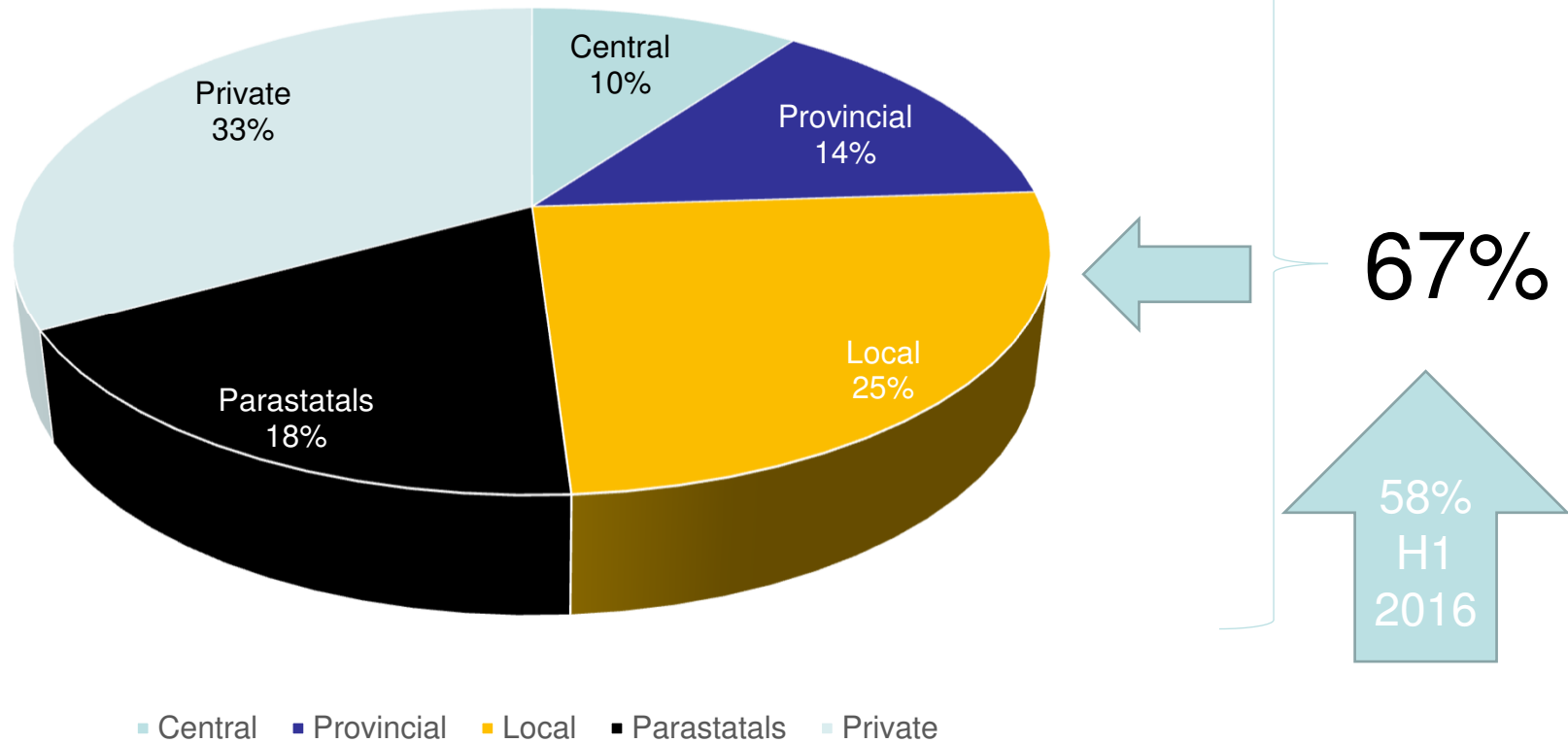
- Lower commodity prices
- Ongoing labour unrest
- Power shortages
- Water Resources
- Mining Charter?
- SA's contribution to global gold production expected to fall to below 5% by 2020

Disconnect between GDP growth and Infrastructure Allocations

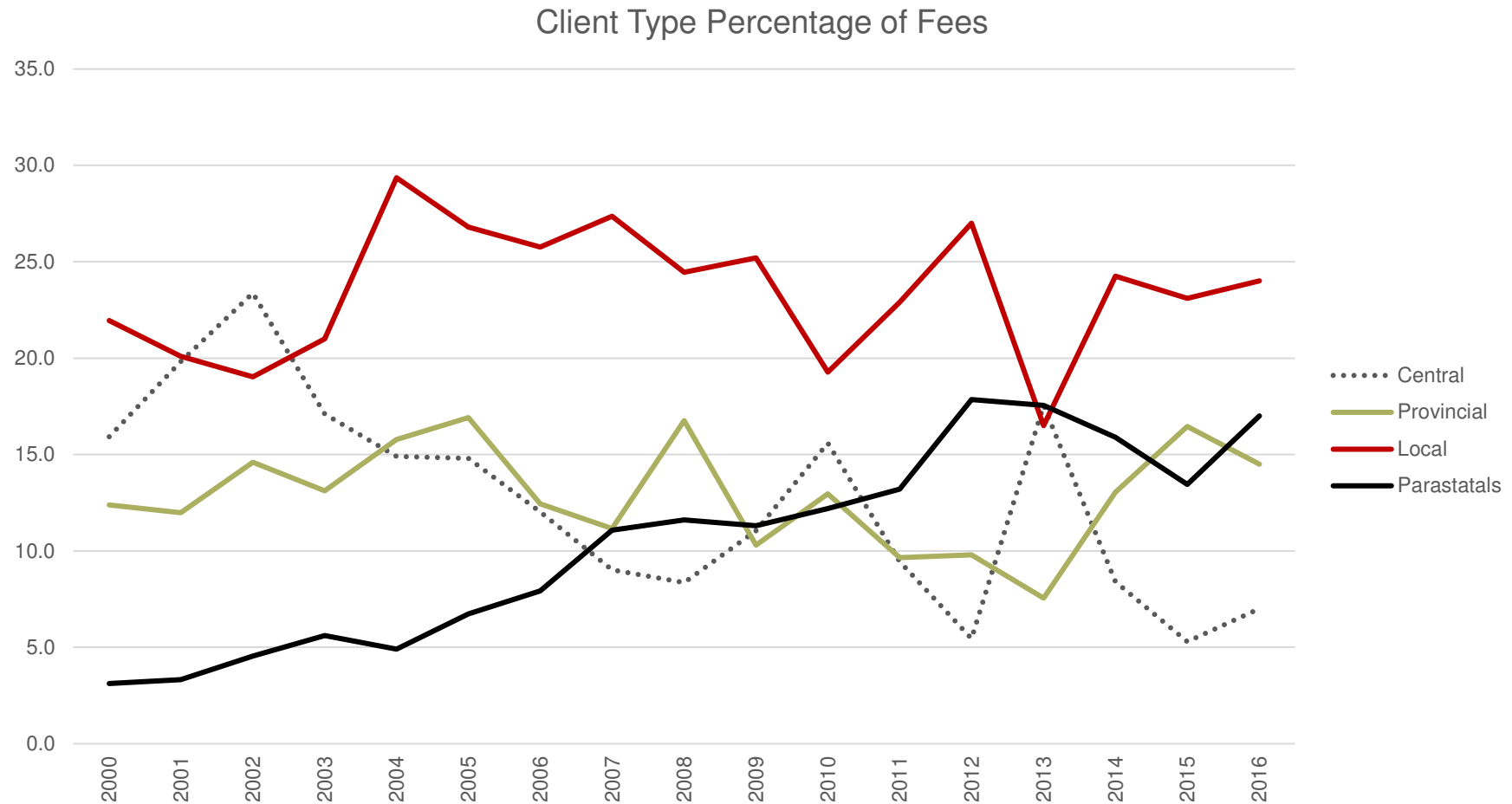


Earnings contribution by Client Type

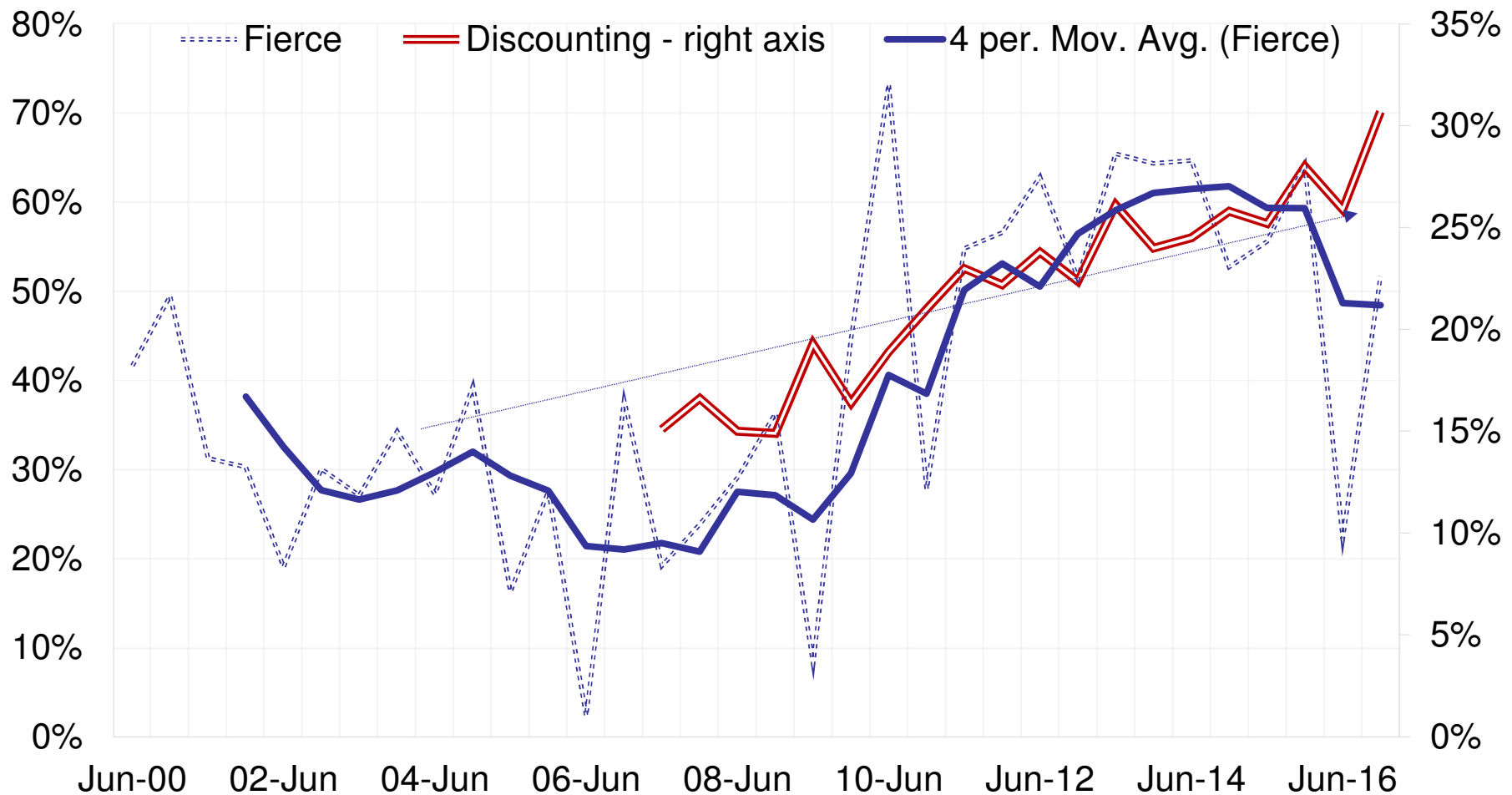
Client Contribution



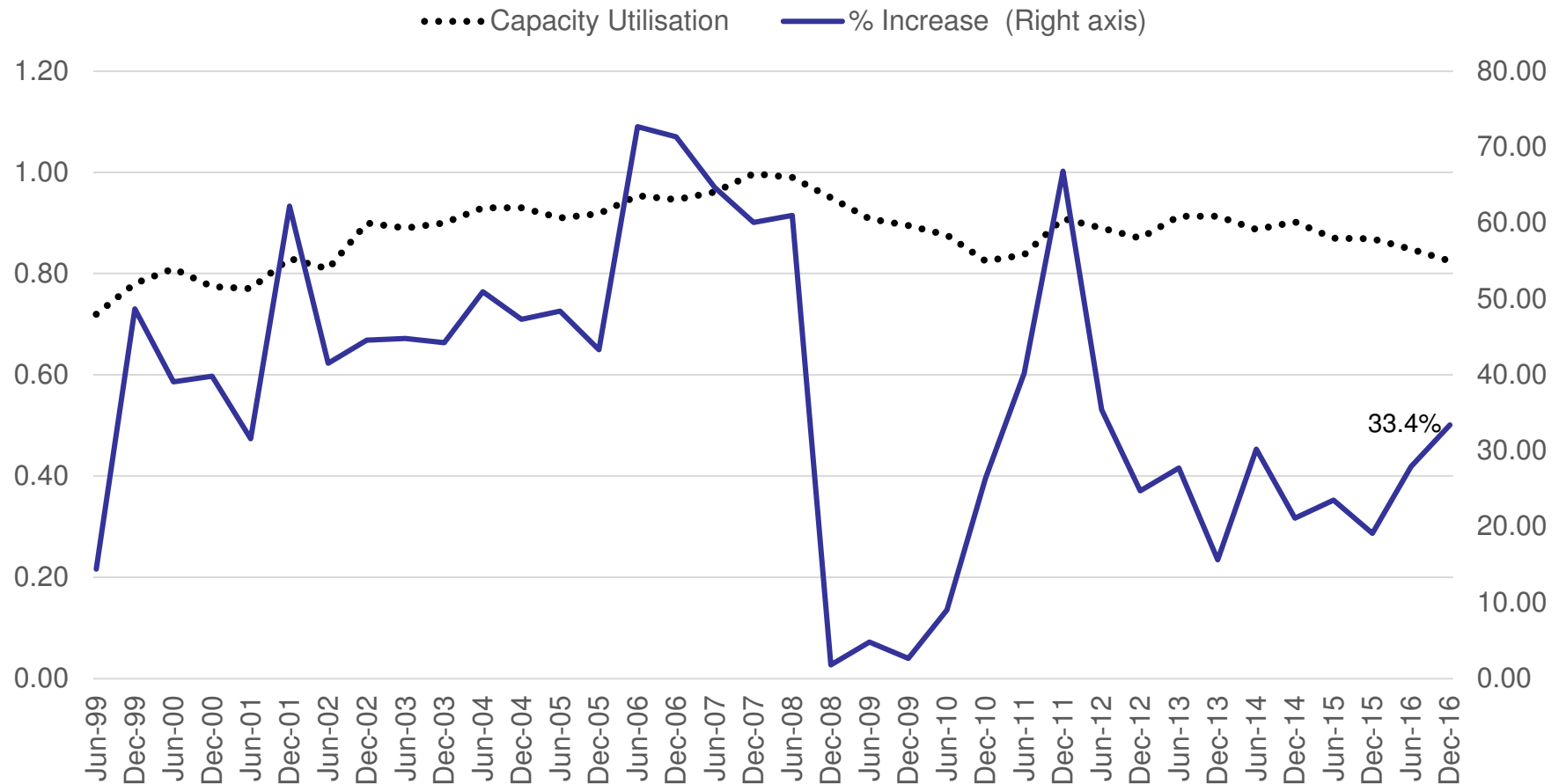
Local government remains largest public sector client while contribution by Parastatals gradually increase



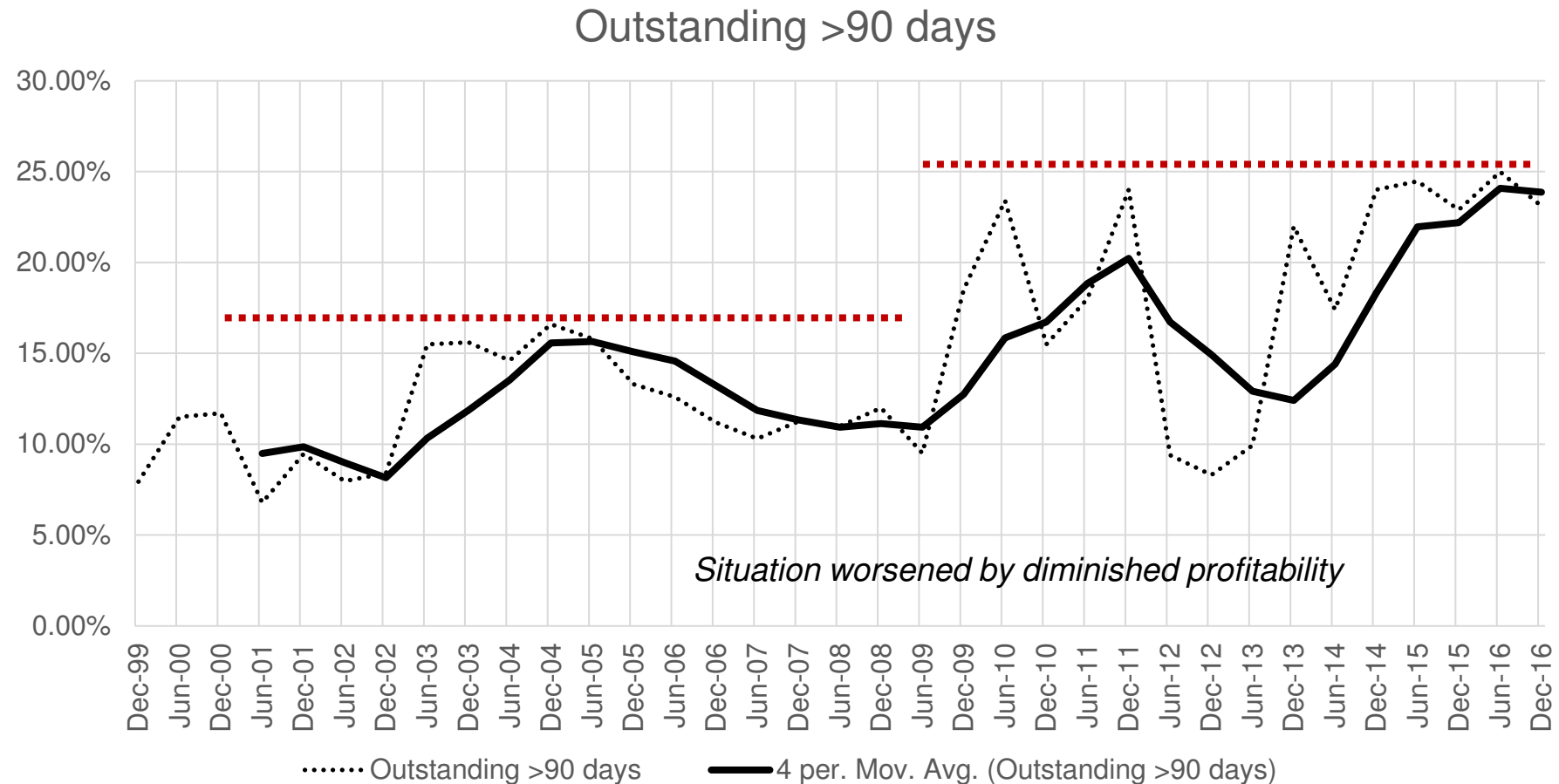
Increasing number of firms (52%) reported higher levels of fierce competition, increasing the discount rates to an average of 30%



Firms slightly more optimistic regarding improved capacity utilisation, while levels slow to 82.5 percent



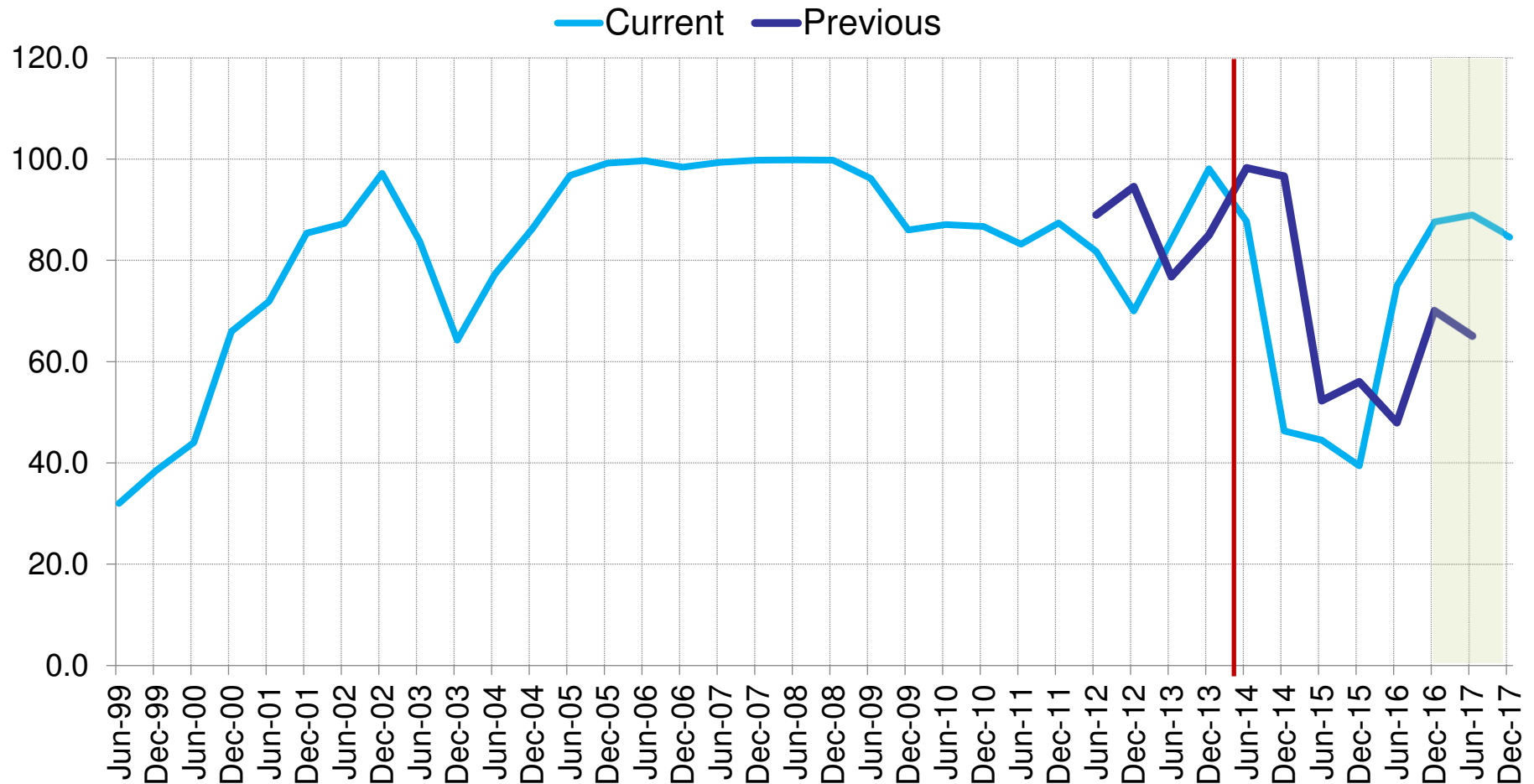
Payment outstanding for longer than 90 days moderated slightly to **23%** in last six months of 2016 from **25%** in H1 2016



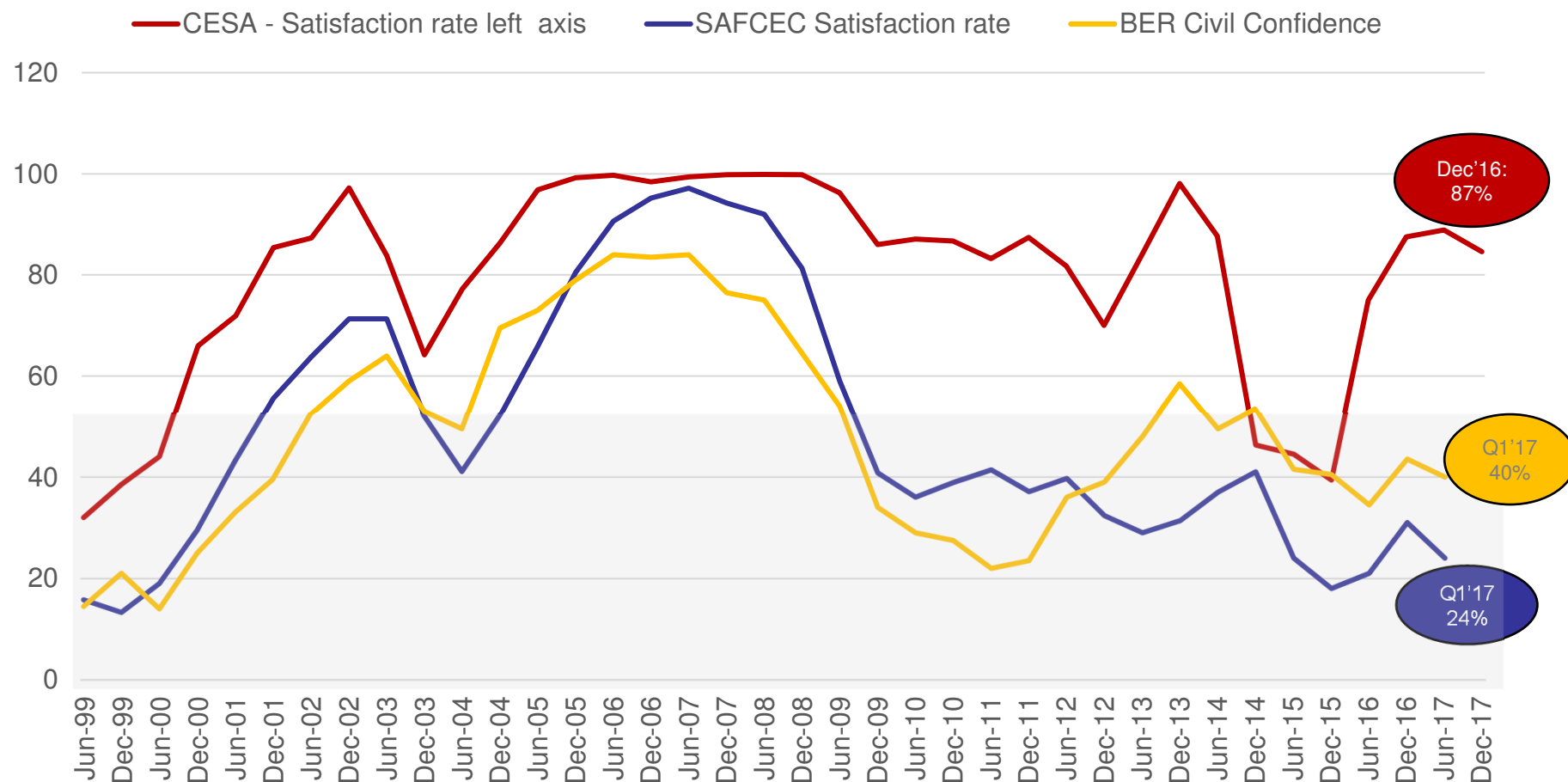
Prompt Regulations

Draft prompt payment regulations are delayed by the CIDB Act which doesn't make provision for regulations to be enforced. Dept of Public Works is currently preparing draft changes to the Act which will then provide Regulations to be issued.

Consulting Engineering Industry Confidence Index (Satisfaction rate)



Consulting Engineers outlook suggest further pressure on the construction industry



Source: FNB, SAFCEC, CESA

Key Challenges

- More emphasis on localisation of professional services to mitigate foreign competition
- Lack of a definitive project pipeline (NDP?)
- Weak private sector confidence
- Procurement
 - Greater transparency in procurement process
 - Standardisation of procurement procedures
 - Procurement on price and BBEEE, with little or no regard to functionality, quality, qualifications, experience, capability and/or innovation.
- Complexities around BBEEE requirements, difficult to comply due to shortage of skills
- Quality of Client's technical personnel – skills shortages regarded as one of the most significant institutional challenges (client bodies), also affecting service delivery as municipal level
- Low growth economic environment, project implementation delays, budget cuts on infrastructure allocations

Thank you

elsie@industryinsight.co.za

T 021 554 0886

C 082 822 9161