

State of the Consulting Engineering Industry January – June 2001

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EXECUTIVE SUMMARY

General economic background

The high level of business confidence maintained during the latter part of 2001 mirrored the resilient performance of the South African economy. Despite lower world economic growth forecasts (even prior to the attack on the United States), domestic activity, although not as vibrant as could be wished for, seems to have bucked the trend. Adverse social-political developments in Southern Africa, and even domestically, may well have fed negative sentiments towards Africa, but have not succeeded in causing damage to the inherent stability of the South African economy. Fiscal and monetary policy remained prudent and contributed towards the resilience that is shown by the economic performance. Although figures indicate that goods exports might be slowing, the volumes are still in excess of last year. Domestic demand also seems to be reacting favorably to the responsible easing of monetary policy. The greatest threat for the South African economy at this stage is a further weakening exchange rate, resulting in higher inflation, which could have a longer-term negative impact on interest rates.

Economic prospects

- Economic growth for 2000 was 3,1%, after being scaled down from the initial forecast of 3,3% to 2,5%. The improved performance is partially due to a revision brought about by the South African Reserve bank in the publication of national quarterly figures. Forecast for this year (2001) was scaled down from 3,4% to between 2,9% and 3,2%, although highly sensitive to prevailing global market conditions.
- Business confidence was stable at 9,2% higher than last year (measured in August 2001) which shows that the adverse social-political developments in Southern Africa, and even domestically, may well have fed negative sentiments towards Africa, but have not succeeded in causing damage to the inherent stability of the South African economy thus far.
- Lower inflation levels continue with headline inflation dropping to 4,6% year-on-year in August 2001. CPI(X) for the same period lower to 6,61% coming very close to the upper band of the South African Reserve Banks' target.
- This prompted a 50 points cut in the Reserve Banks' repo rate (the lending rate to banks), which cuts the prime-lending rate to 13%, lowering real interest rate (inflationary adjusted) to 8,4%.

Conditions in the civil engineering contracting industry

Positive trends emerged stronger after a slight softening in the first quarter of 2001. The fear of misallocation of funds, provincial and local inefficiencies and the contraction of privately funded projects due to global uncertainties, perturbs the industry. However, all signs that traditionally point towards a recovery in the civil industry continued over the past 6 – 8 quarters. Whether expectations will be met entirely depends on provincial and local governments to ensure that infrastructure developments are responsibly identified and funds appropriately allocated. Bottlenecks that traditionally caused projects to “float” needs to be effectively addressed. Central government aims to prevent the misuse of funds by “ring-fencing” allocations. Although this might take longer to penetrate the industry, it will ultimately reach the industry, thereby stimulating growth and investment. The mining industry in particular is showing significant growth prospects for the following three years. It is difficult to track developments and SAFCEC relies on responses from their members for information on developments in this market.

Conditions in the building industry

The stability shown in the financial markets is encouraging, despite several ongoing external threats. The recovery in the building industry is expected to continue during the next two to three years. Investment in the formal housing market will however, be the main impetus for the recovery during 2001, whilst investment in the non-residential sector is expected to only recover in 2002. As business activity accelerates during the current year, office developments could be revived during 2002, but combined with a slight slowdown in residential growth rates (as investment is coming from a higher base), the overall impact is a growth of between 1.8% - 2.0% for the building industry in 2002. (Extract from *State of the building industry: 2nd Quarter 2001*)

Position of the consulting engineering industry

Table 1: Financial statistics

Year	Employment	Salaries / Wages (R mill, current prices)	Fee Income, R mill			Cost Deflator
			Current prices	Constant 2000 prices	Year-on-Year real percentage change	
Dec-00	11,006	1,280	3,456	3,395	5.70%	101.8
Jun-01	10,236	1,332	3,905	3,716	14.03%	105.1
Dec-01 (forecast)	10,799	1,568	3,921	3,600	6.03%	108.9

Table 2: Year on Year percentage change

Percentage change (year-on-year) (inflation adjusted)				
Year	Employment	Salaries and Wages	Fee income	Cost escalation
Dec-00	6.01%	-3.6%	5.70%	6.8%
Jun-01	-3.75%	6.9%	14.03%	7.3%
Dec-01 (forecast)	-1.88%	14.5%	6.03%	7.0%

Fee income rose, against member's expectations, by 14% during the first six months of 2001 to R3,716 million, compared with the first six months of 2000. Expectations for the last six months of this year (2001) are for another but softer fee income increase of 6% in real terms. The salary and wage bill increased by 6.9% in real terms to represent 34% of gross income, which is lower than the increase reported in gross fee income. **Employment** levels dropped by nearly 800 people (or 3.7% year-on-year) to 10,236, after an increase of 6% in 2000. There are indications that members are expecting to increase employment levels by expanding the current levels of engineers and technical staff. The prevailing and future outlook of employment levels in the consulting engineering industry is somewhat perplexed. Whilst conditions are set to slowdown, the overall outlook is to increase staff levels. On the other hand whilst fee income increased by 14% in the latest survey, employment levels were further reduced.



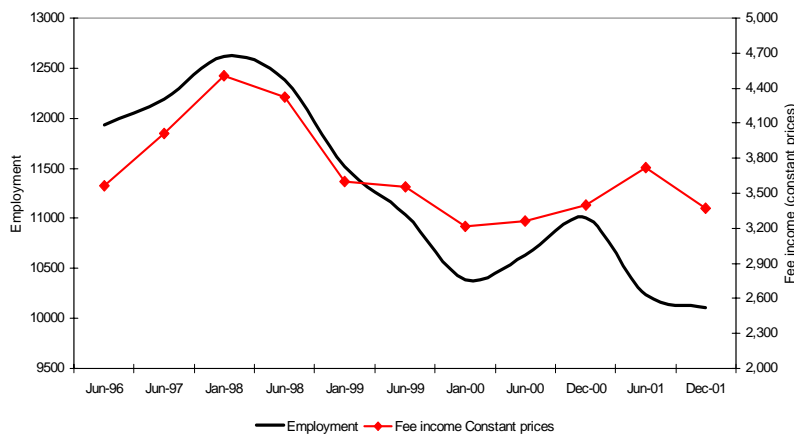
Salient features of the market

- Activities in civil works increased from 27% to 36%, structural work from 11.8% to 13.2%, and facilities management from 1,16% to 1,9%. This translates to turnover of just over R1,363 million in civil works, R488 million in structural works and R69 million in facilities management (expressed in constant 2000 prices).
- Gauteng regained market share with close to 40% of reported income generated here (up from 37% same time last year), which is an estimated R1,483 million, expressed in 2000 prices. Kwazulu Natal lost more market share from 13.7% to 10.70% of total fee income generated, and Western Cape dropped from 14% to 11,2%. Activities in Africa represent a higher 11% and other international countries rose from 1,2% to 3%. Combined this is a 32% increase in fee income earned to over R500-million in the first six months.
- The private sector as the largest sole contributor to fee income dropped from 44% of income earned to 40%. The most significant change in client contribution was found in provincial governments, which moved from 10% to 14% of total income earned.
- Fewer projects are undertaken with affirmable professional service providers
- Involvement in PPP's are between 10% and 15% of income earned. The nature of these involvements is mostly as an equity partner.
- Conditions are not expected to show any significant change during the next 12 months
- Competition for work remains keen to fierce, despite the increase reported in activity.
- **Non-payments, or delayed payments**, as a percentage of total fee income earned are at its lowest levels since 1998. Measured in December 1998, total fee income outstanding for more than 90 days was 44% of the total fee income. This threatened the survival of many firms and by means of successful lobbying, non-payments have been reduced to less than 7% of income earned. Although this is a substantial improvement it still compares poorly with payment conditions in the civil engineering industry where less than 2% are outstanding for more than 90 days.

Outlook for 2001



SAACE
Employment vs Real Value of Fee income



SAACE January - June 2001

Confidence levels of the consulting engineering fraternity have steadily dropped from the beginning of last year. Although more members are feeling less pessimistic regarding future and current trends, their expectations are not entirely being met. Nonetheless members were not overly optimistic regarding the future outlook of the industry in the last survey, it appears that the industry performed better than expected. Income rose 5,7% in 2000 (inflation adjusted) and similar growth rates are expected this year.