REAL ESTATE & CONSTRUCTION

2022 CONSTRUCTION REPORT

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BDO

OVERVIEW

The construction industry employs more people than any other industry in Australia and generates over $360 billion in revenue, producing approximately nine per cent of Australia's Gross Domestic Product (GDP). Despite a challenging year for the sector resulting from the residual impacts of COVID-19, unpredictable weather conditions, as well as supply chain, retention of staff and pricing challenges, the industry still has a projected annual growth rate of 2.4 per cent in the next five years.

The BDO Construction Survey 2022 provides insights into the financial well-being of the construction sector, using results obtained from our independently conducted survey. Our analysis comprises of financial data from Australian construction companies in FY22, transposed with the results of our previous **construction survey** (conducted at the beginning of COVID-19's spread in 2020). The results in the following report will highlight the significant changes that have occurred over this tumultuous period.

Most of the construction companies surveyed this year have operations in the commercial, industrial, and residential sub-sectors and on average have 104 full-time employees. While most of Australia's construction businesses are either sole traders or very small (employing less than 20 people), the range of organisations we surveyed for this report ranges from ten to 250 full-time employees. All the organisations surveyed reported revenues of less than $500 million in FY22.

REVENUE AND PROFIT TRENDS

The construction entities we surveyed reported mixed results for their FY22 revenue. Most of the companies, 60 per cent, reported an increase in revenue of more than ten per cent compared with their previous financial year, highlighted in **Figure 1**.

The remainder of the construction companies reported a slight or significant drop in revenues over the year. This is a minor shift from our 2020 survey where 84 per cent of surveyed participants reported an expected increase in revenue in 2020 (shown in **Figure 2**).

In both surveys, most of the companies that reported an increase in revenue demonstrated more than ten per cent increases in their figures from the previous financial year. Our findings suggest that the industry was at a peak in 2020 prior to the onset of COVID-19, where many organisations have not maintained the same growth prospects following COVID-19.

FIGURE 1: ACTUAL INCREASE IN REVENUE FOR FY22

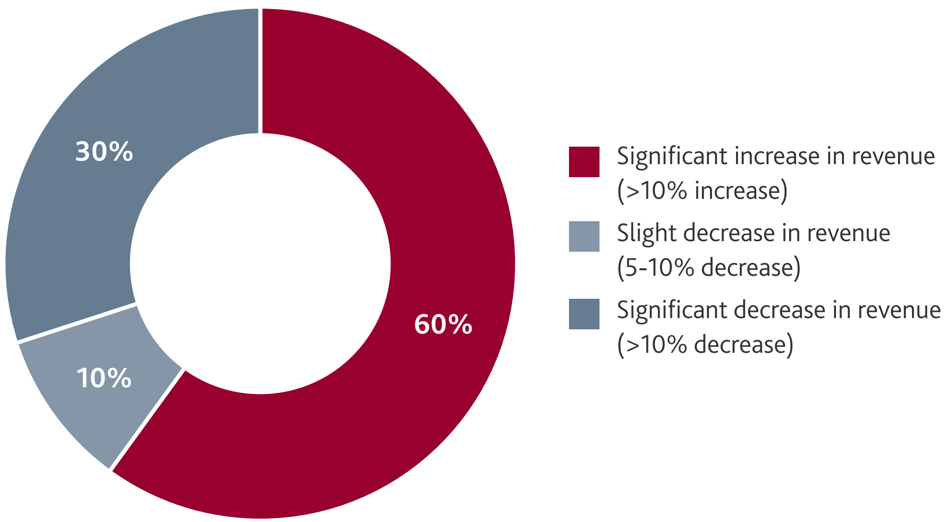
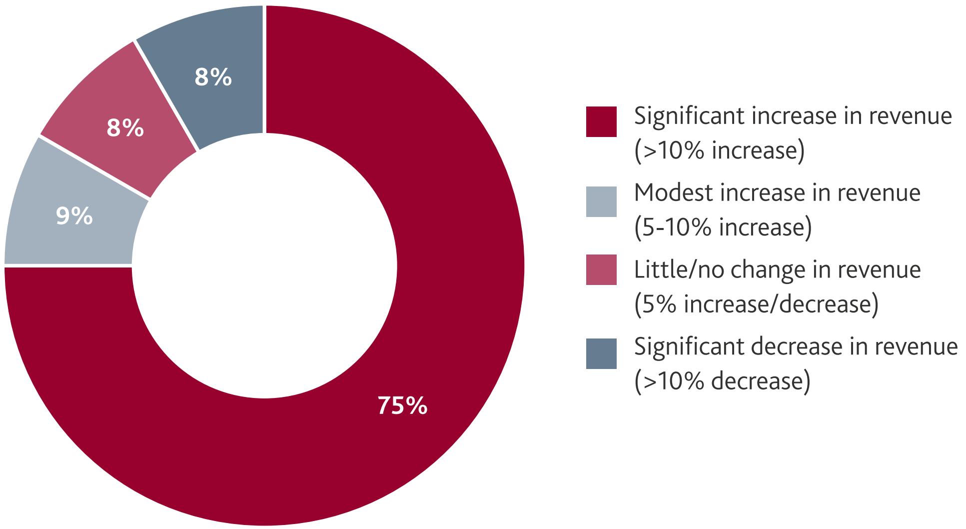


FIGURE 2: EXPECTED MOVEMENTS IN REVENUE FOR FY20



Despite the continued revenue growth for more than half of the surveyed participants, the net profit before income tax (NPBT) significantly declined across 60 per cent of the construction companies surveyed this year **(Figure 3)**.

In 2020, only eight per cent of surveyed participants reported an expected decline in NPBT **(Figure 4)**. This is likely attributed to the supply chain and pricing challenges that the industry currently faces. Competition for talent has also increased the cost of labour which has adversely affected the bottom line of all businesses.

FIGURE 3: ACTUAL NPBT IN FY22

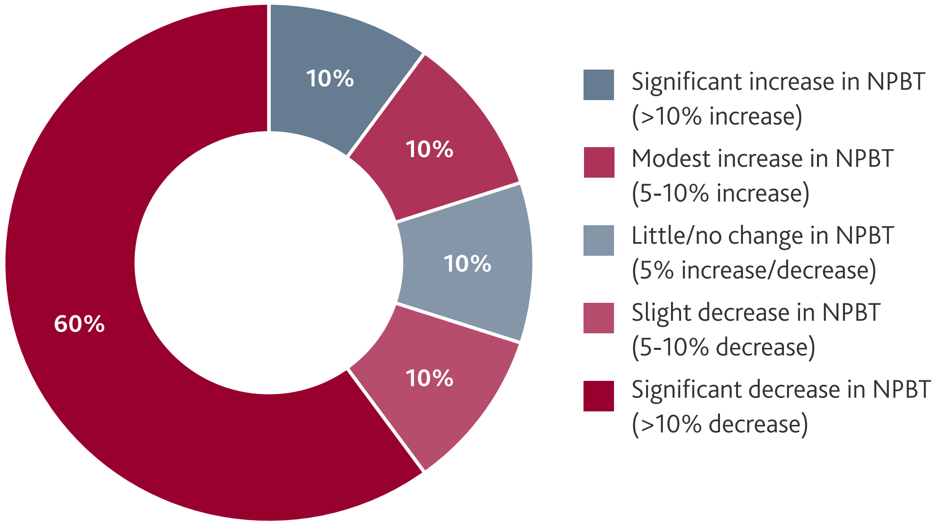
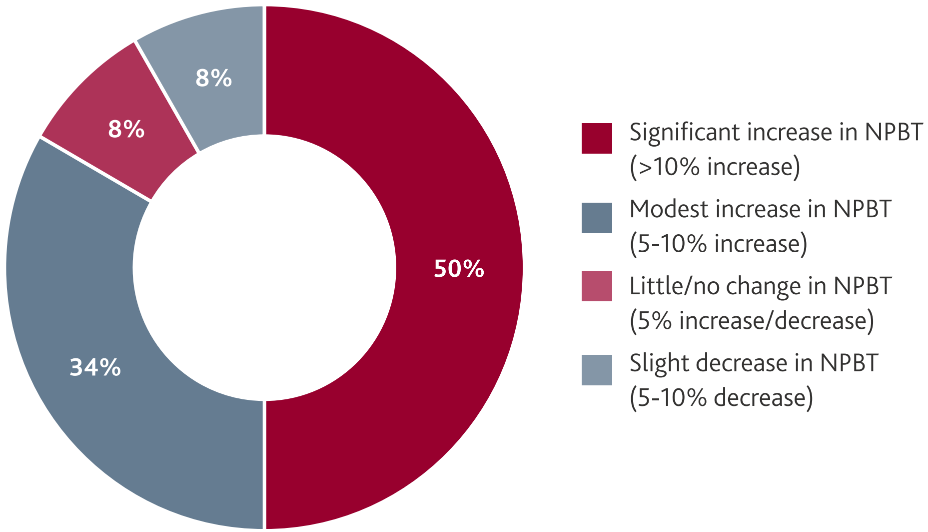


FIGURE 4: EXPECTATIONS FOR NPBT IN FY20



LIQUIDITY TRENDS

The working capital ratio is a good reflection of the solvency of a company. From the surveyed participants in FY22, working capital as a percentage of revenue showed a median response of 3.5 per cent, compared to a median of surveyed participants in 2019 of 5.8 per cent **(Figures 5 and 6, below)**. This suggests that more construction companies may be struggling to shore up their balance sheet with cash and other working capital accounts.

With several head contractors going into liquidation, construction companies have been subject to greater scrutiny from clients, lenders, and investors to ensure that their investments in the company are sound and secure. In many instances across large commercial construction companies, adverse impacts can occur if just one project turns bad. As such, it is important to have sufficient cash reserves and a strong balance sheet. These cash reserves would also serve as a buffer to those companies exposed to significant weather impacts this year. In cities such as Sydney, which recorded the wettest year in 164 years, projects timelines have been delayed and the close management of cash flow has never been more paramount.

FIGURE 5: WORKING CAPITAL RATIO 2022 (%)

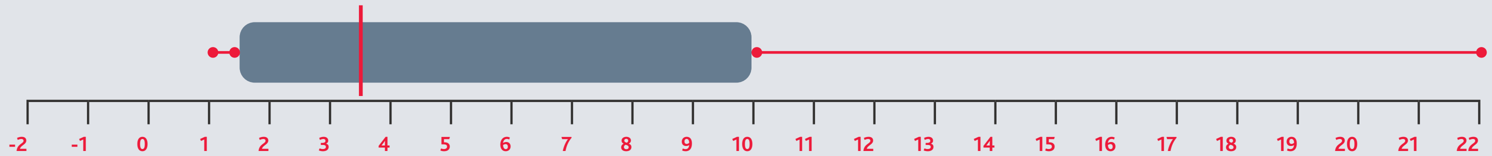


FIGURE 6: WORKING CAPITAL RATIO 2020 (%)

Our respondents also note that there has not been any change in the collection of debts from clients in the past twelve months. This is a positive trend in the industry, suggesting that the otherwise challenging macroeconomic conditions may not have a significant impact on construction clients' ability to pay their bills on time.

Solvency can also be measured through the ease of obtaining finance. Of those participants that sourced funding either domestically or internationally over the past twelve months, 33 per cent had issues with obtaining the funding.

"Throughout COVID the construction industry not only remained buoyant, but with low interest rates there was a noticeable increased level of confidence and thus the commencement of many large projects as well as residential growth buoyed on by various stimulus packages at both state and federal levels. The downside to all the stimulus packages was the increased sales made by companies that lacked the financial backing to see the projects through to the end."

SURVEY PARTICIPANT

BDO COMMENTARY FROM DUNCAN CLUBB

Lenders are being far more selective in terms of the developments that they are willing to fund, and we are also seeing finance only being advanced if the lender is comfortable with the financial viability of the construction company chosen by the developer. This scrutiny is designed to reduce the likelihood of the contractor failing mid project.

As such, construction companies with robust balance sheet strength will be well placed to win an increasing share of projects, compared to previous stages in the economic cycle.

We are also seeing head contractors going back to the customer to renegotiate pricing with increasing frequency, rather than forcing subcontractors to absorb cost increases (as has traditionally been the case).

DUNCAN CLUBB
PARTNER, BUSINESS RESTRUCTURING
+61 2 9240 9954
duncan.clubb@bdo.com.au

SUBCONTRACTORS AND SUPPLY CHAIN

Only 22 per cent of surveyed participants reported a financial loss due to subcontractor or supplier insolvency in the 12-months proceeding the 2022 survey compared to our 2020 survey where a loss was incurred amongst 40 per cent of participants. This indicates that construction companies have been more mindful of the risk of insolvencies in subcontractors since the pandemic.

Additionally, 56 per cent of surveyed participants reported that there had been some or greater demand by subcontractors seeking shorter payment terms compared to the previous twelve months. This indicates that the subcontractors are feeling the pressures of the pandemic and managing their cashflows carefully. Not surprisingly, all survey participants reported that there had been negative impacts to profits in the last twelve months resulting from intensified competition and supply chain issues.

COVID-19 has also caused labour shortages and disruptions to the global supply chain which in turn has caused increases in material costs and delays in receiving raw materials. CoreLogic's Cordell Construction Cost Index (CCCI) for Q3 2022 showed national residential construction costs increased by 11 per cent over the twelve months to September 2022. This is the highest annual growth rate, excluding the period impacted by the introduction of the GST. The rise in the costs has been felt across all areas from fuel, freight to electricity, but has seen a particular rise in timber and metal material costs over the past quarter.

Despite the intermittent lockdowns across Australia during the height of the pandemic, two thirds of survey participants reported negative impacts due to the restrictions placed on the number of tradespeople on site at a given time. This reflects the New South Wales (NSW) government's focus on keeping construction sites open through the pandemic to reduce the economic impact to the industry.

> ***"Significant inflation increases in materials and resources were amplified by shortages partly due to increased sick leave further impacting on the supply. Impact of significant rainfall in NSW and Queensland further stretched supply chains."***
>
> **SURVEY PARTICIPANT**

OUTLOOK ON BUSINESS RISKS

Business risk management is an important part of an organisation's strategy, particularly to minimise financial losses and avoid any non-financial negative impacts on the performance of the business. Of the construction companies surveyed, the top five business priorities were reported (in order) as being:

1. Attracting, recruiting and retaining employees
2. Improving profitability in existing core markets
3. Training and skills development for existing employees
4. Growing revenue in existing core markets
5. Improving the quality of completed projects/client satisfaction.

The issue of attracting, recruiting, and retaining employees remains the top priority for construction companies, in line with those surveyed in 2020.

Business priorities that surfaced in 2022 were the training and skills development opportunities for existing employees and improving the quality of completed projects and client satisfaction scores.

Priorities that have dropped in importance between the 2020 and 2022 surveys include providing an attractive workplace environment/employment conditions and improving safety performance.

Given the top business risk priority for construction companies is staff retention, it is interesting to note that the participant's most common cause for staff attrition was:

1. Remuneration
2. Personal reasons
3. Work/life balance.

Work/life balance remains a top cause for attrition in both 2020 and 2022. Both remuneration and personal reasons were higher ranked factors in the risk to staff attrition for construction companies surveyed in 2022 — the top cause of attrition in 2020 was 'lack of career development or opportunity'.

BDO COMMENTARY FROM JENINE WATERS

Remuneration factors have caused significant disruption across industries in Australia, and we are seeing organisations grappling with the impact of competitor organisations proactively poaching staff at significantly higher rates. The challenge with this approach to attracting and retaining talent, is that it does not resolve the issue of a lack of talent in the market, and so we often see a net zero increase in team size, at a significant cost to the business.

Outside of the proactive targeting of talent with increased salaries, remuneration as a reason for staff attrition can often mask underlying issues in areas such as leadership or career development. Organisations need will need to dig deeper beyond the 'reported' reasons for leaving, to understand what it is they can do to tie employees more deeply to the organisation in ways that cannot be easily replicated (money being one of the easiest areas that can be replicated).

Two areas we are seeing priorities for organisations to invest in are — development of leadership capability (ensuring managers are equipped to create high levels of engagement and support their employees) and, hand in hand with this, deliberately reviewing the culture they are wanting to create and the levers they pull to create this — for many this is focusing on how they can enable individuals to make choices that work for their personal circumstances.

JENINE WATERS
NATIONAL LEADER, PEOPLE ADVISORY
+61 2 9251 4100
+61 405 500 286
jenine.waters@bdo.com.au

MANAGING PEOPLE AND DIVERSITY

Of the construction companies surveyed, the majority (89 per cent) had seen an increase in the size of their permanent workforce in the last twelve months, with 56 per cent of the participants reporting an increase of more than ten per cent. Looking ahead, 67 per cent of these companies expected a further increase in their size of workforce in the next twelve months, with 22 per cent expecting an increase of more than ten per cent.

As for gender diversity findings, only 22 per cent of the construction companies surveyed had more than 20 per cent female representatives in all roles (salaried and wage-based staff). However, it is pleasing to note that this is a significant improvement from 2020 which found that 12.5 per cent of those companies surveyed had more than 20 per cent females in all roles.

In senior roles, only 33 per cent of organisations had more than ten per cent senior roles held by females, but none had more than 20 per cent of these placements held by females.

Finally, 67 per cent of construction companies surveyed reported that only five to ten per cent of project management roles were held by females. Interestingly, one construction company reported that over 50 per cent of project management roles were held by females.

WELLBEING

Alarmingly, approximately 190 construction workers take their own lives each year in Australia — more than one person every two days. In fact, that is six times more lives lost by suicide than through workplace related accidents. Now more than ever, it is vital for us to examine the wellbeing and mental health of Australia's construction workers.

Our survey responses from construction workers were inconclusive. Respondents that did participate in the survey varied in ages, longevity within the industry, levels of tertiary education and covered a vast array of roles through the sector. However, the data was not statistically significant to draw definitive conclusions about the state of the industry's mental and cultural wellbeing.

While the overall survey data was inconclusive, we did uncover that 79 per cent of respondents noted that a five-day working week would help with their overall wellbeing. Of those that currently work six or more days a week, 84 per cent of those respondents would support moving to a five-day working week.

> ***"Top priority for us to increase female participation within construction industry. Unfortunately (fortunately) our peers are doing the same so no easy solution but to develop talent within the industry."***
>
> **SURVEY PARTICIPANT**

ABOUT BDO

BDO is one of the world's leading accountancy and advisory organisations, with clients of all types and sizes, in every sector. Our global reach and strong collaboration across countries allows our real estate and construction experts to keep abreast of industry developments.

At BDO, we deliver tailored, commercially focussed and technically proficient solutions to one of Australia's largest and most important industries. In addition to key audit, tax, and advisory services, we provide financial analysis, capital raising and timely insights.

We can assist with areas ranging from construction and developer needs to infrastructure, international property investment, investment and funds management and real estate services.

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CONTACTS

Author: Elysia Rothwell

National Leader, Real Estate & Construction: Andres Reith

Contributors: Duncan Clubb, Jenine Waters

ELYSIA ROTHWELL
PARTNER, AUDIT & ASSURANCE
+61 2 9240 9918
elysia.rothwell@bdo.com.au

ANDRES REITH
NATIONAL LEADER, REAL ESTATE & CONSTRUCTION
PARTNER, BUSINESS SERVICES
+61 2 9240 9932
andres.reith@bdo.com.au

DUNCAN CLUBB
PARTNER, BUSINESS RESTRUCTURING
+61 2 9240 9954
duncan.clubb@bdo.com.au

JENINE WATERS
NATIONAL LEADER, PEOPLE ADVISORY
+61 2 9251 4100
+61 405 500 286
jenine.waters@bdo.com.au

1300 138 991
www.bdo.com.au

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