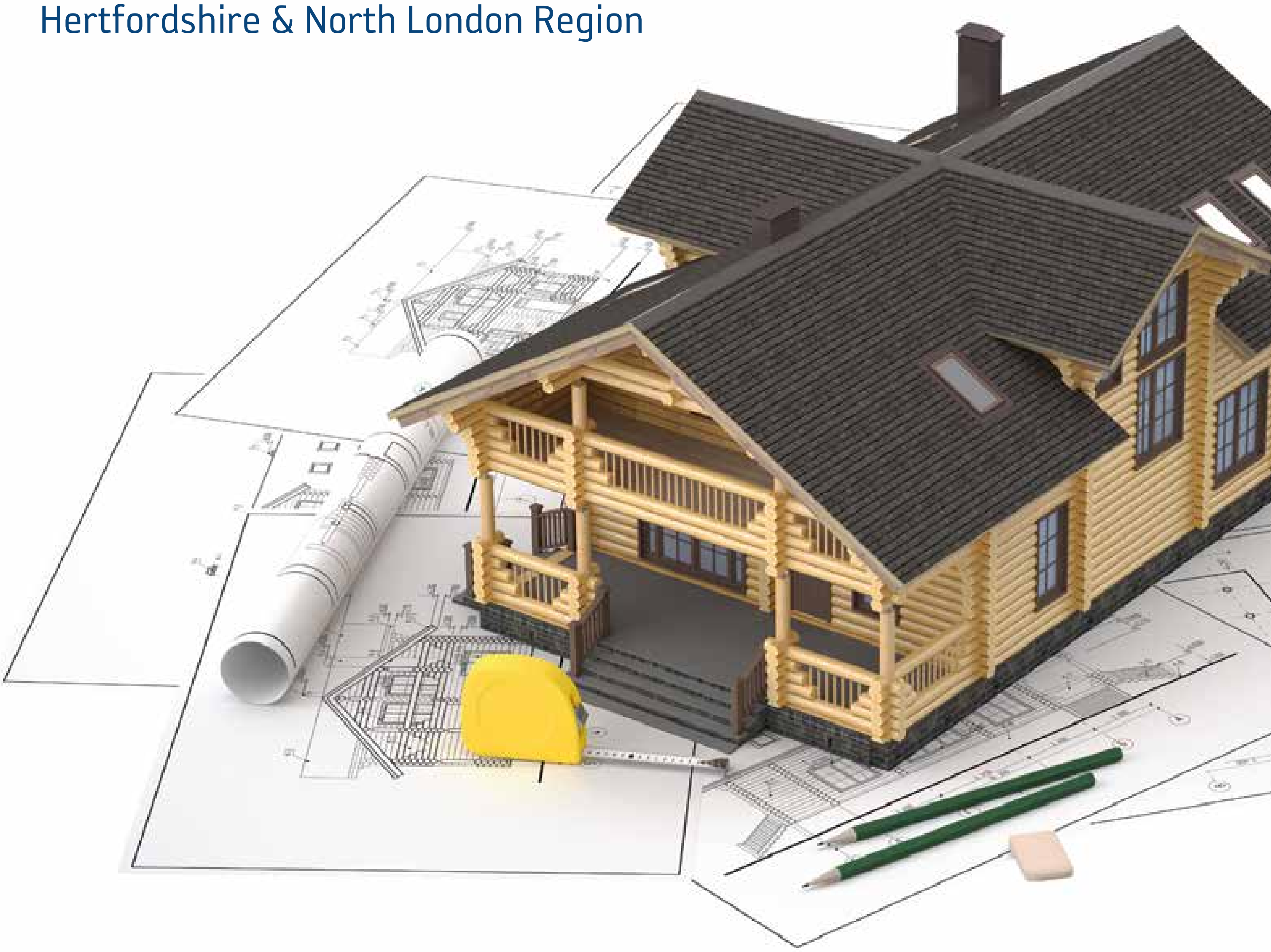
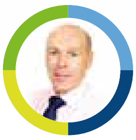
MHA MacIntyre Hudson
CHARTERED ACCOUNTANTS, TAX AND BUSINESS ADVISERS

2016 Construction Sector Report

Hertfordshire & North London Region





Presented by:
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Head of Construction and Real Estate
November 2016

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Introduction

Construction and Real Estate sector specialists

Welcome to MHA MacIntyre Hudson's 2016 Construction Report where Brendan Sharkey, Head of MHA MacIntyre Hudson's specialist Construction and Real Estate Sector Group, has recently undertaken financial research of construction companies in the Hertfordshire and North London (H&NL) region, to identify and highlight specific trends in the sector in the past three years. The aim is that similar construction businesses can use this report as a tool to benchmark their own business against. A similar report was prepared last year and is available.

Brendan is a Senior Partner and Chairman of our North London office which covers North London, Hertfordshire and Middlesex.

We have a dedicated team of individuals who have a strong background and a wealth of knowledge in the Construction and Real Estate sector, covering construction, property investment, development and much more. We keep abreast of all sector matters as well as legal and financial developments to ensure that our solutions are both innovative and also relevant to you.

About us

MHA MacIntyre Hudson is a top 20 UK accounting firm, offering a full range of compliance and advisory services to entrepreneurial businesses, groups and multinationals with operations in the UK. The firm has 84 partners and over 550 staff in 14 offices in London and the South East, and across East Anglia and the Midlands, servicing the whole country.

Analysis Snapshot

Taking data from a total of 73 construction companies in the region (last year's report was based on 76 so the comparative information will have changed), we have analysed their published accounts for the last three years. We have split the data into meaningful groups by turnover, in order to provide a clear snapshot for you to benchmark your own company against. This report is based on information that was available as of 31 July 2016.

As expected, it is not surprising that, as the sector on a nationwide basis climbs out of the recession, the combined average data of those 73 companies split over the last three years shows a steady increase in total turnover, gross profit and employees. In turn profit before tax has been improved over the last three years although it has fluctuated.

The combined average data of those 73 companies split over the last three years shows turnover has grown 23.1% (7.7% per annum). Although gross profit has increased it is only 14.4%, showing that companies have not been able to maintain their margins. Employee numbers have steadily grown over the three years (11.4%). Profit before tax is showing a 13.4% fall compared to the previous year.

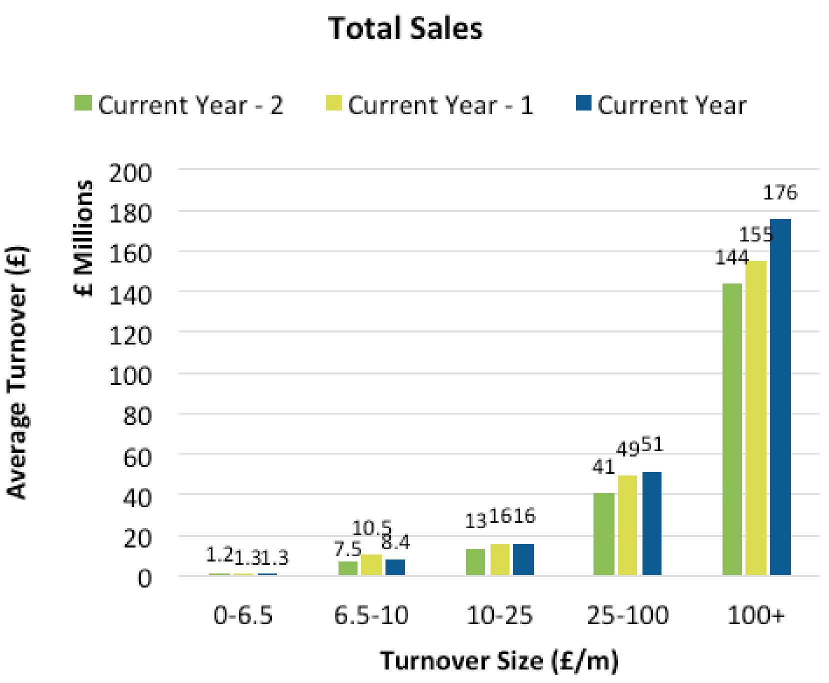
Companies by turnover

Turnover	No. of companies
£6.5m & Under	3
Above £6.5m - £10m	3
Above £10m - £25m	30
Above £25m - £100m	29
Above £100m	8
Total	73

Companies by year

	Current Year Minus 2	Current Year Minus 1	Current Year
Year	£'000	£'000	£'000
Turnover	2760,516	2,182,640	3,399,375
Gross Profit	295,048	330,854	337,673
%	10.7%	10.4%	9.91%
Profit Before Tax	61,306	81,436	70,523
No. of Employees	11,121	11,543	12,394

Turnover vs. Gross Profit

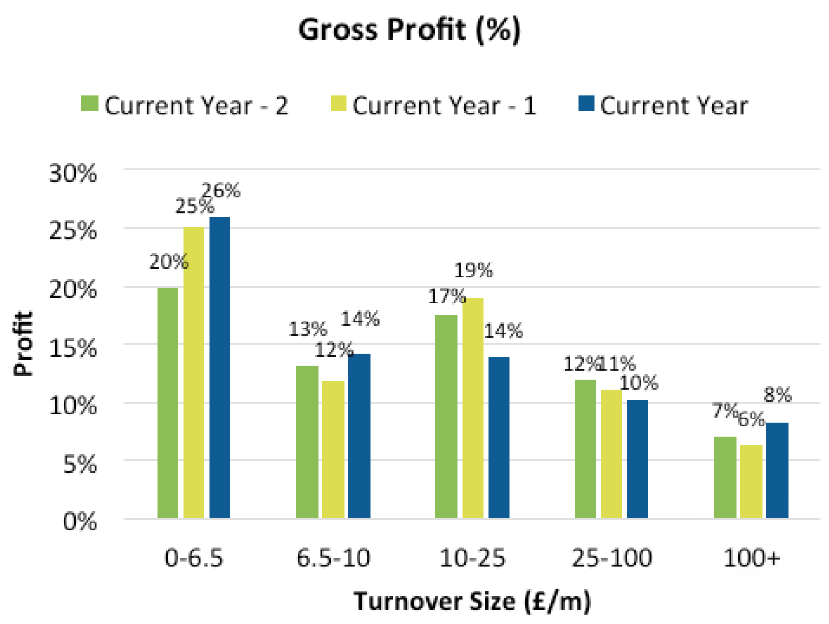


Key findings

Although our population of 73 companies is showing a 6.8% growth in turnover when you look at the profile, it is the £25m + turnover companies that have driven the growth. There has been little improvement for companies doing less than £25m.

80% of our population are in the range £10m to £100m and they have seen a clear fall in gross profit. The companies either side of this range have seen improvements. This is particularly impressive for the larger companies.

It must be of concern that the middle range companies £10m to £100m cannot improve their gross profit at a time when the financial climate has been reasonable. They do not generally have long term contracts (18 months plus) so their legacy issues should be behind them.

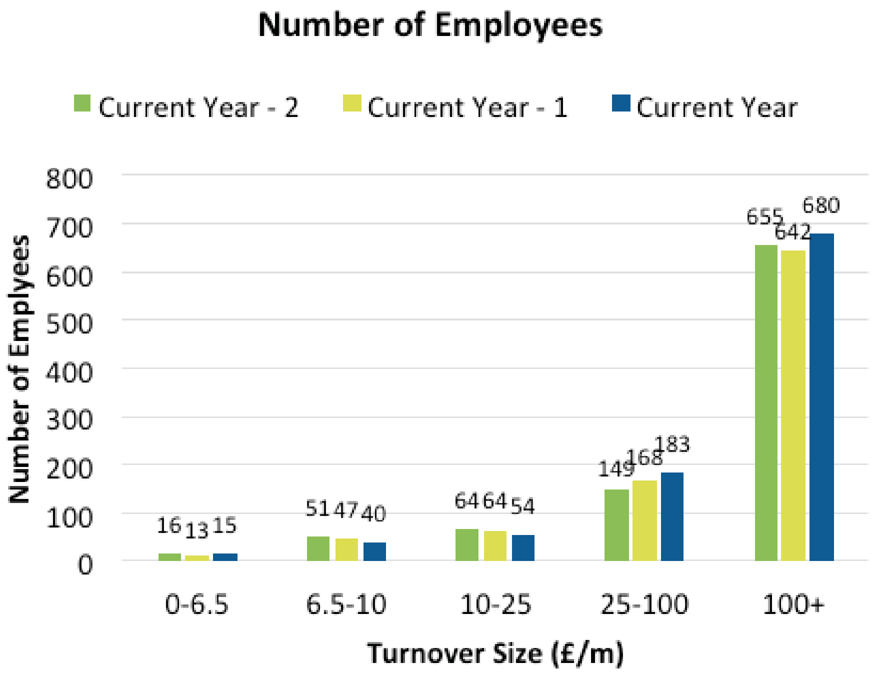


Turnover vs. No. of Employees

Key findings

In total the number of employees has risen from 11,543 to 12,394 (7.4% increase) in 12 months. The real growth in employment is with companies with a turnover greater than £25m. The smaller companies have cut back maybe using subcontractors or simply recognising that their turnover is not increasing.

Ultimately, companies must look at the bottom line and if profit before tax is falling, which our statistics imply, then employee numbers will be cut.



Profitability in the Sector

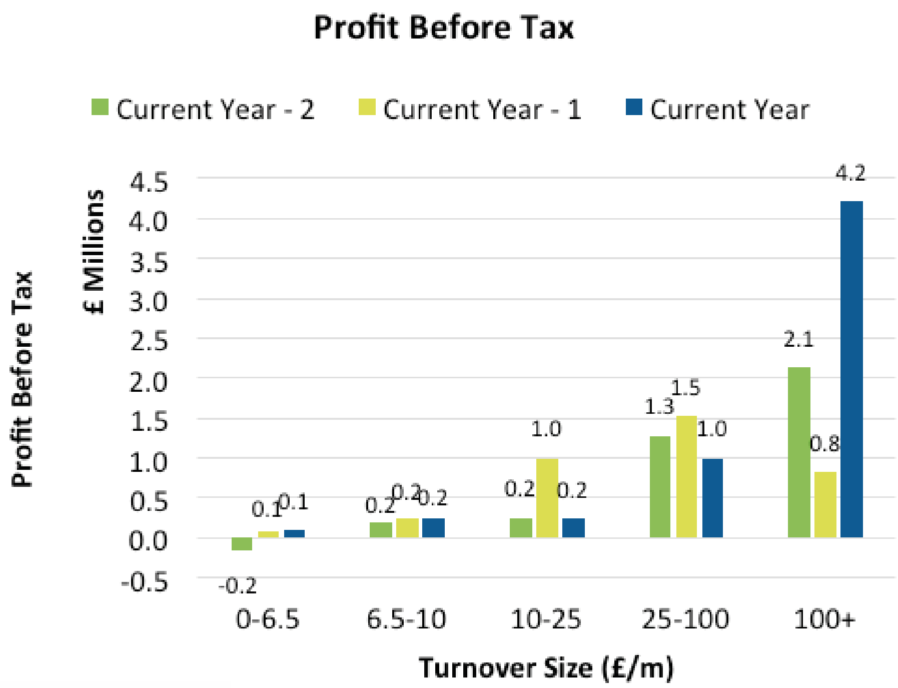
Key findings

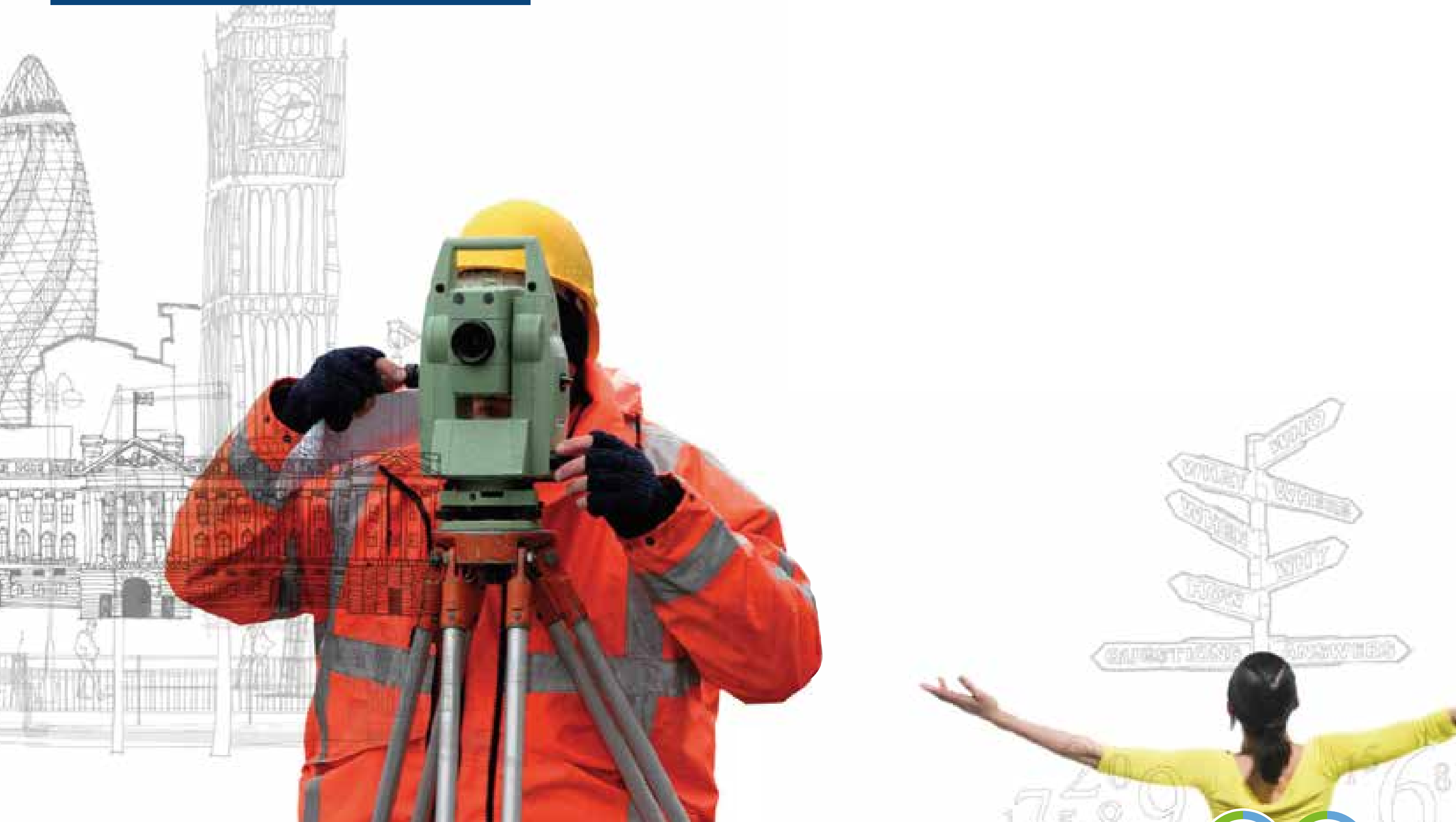
Aside from the £100m and above turnover companies, every other turnover category had a decrease, on average, in profit before tax.

The overall profit before tax for the construction sector in H&NL has decreased significantly over 12 months (£81m to £68m, see page 3).

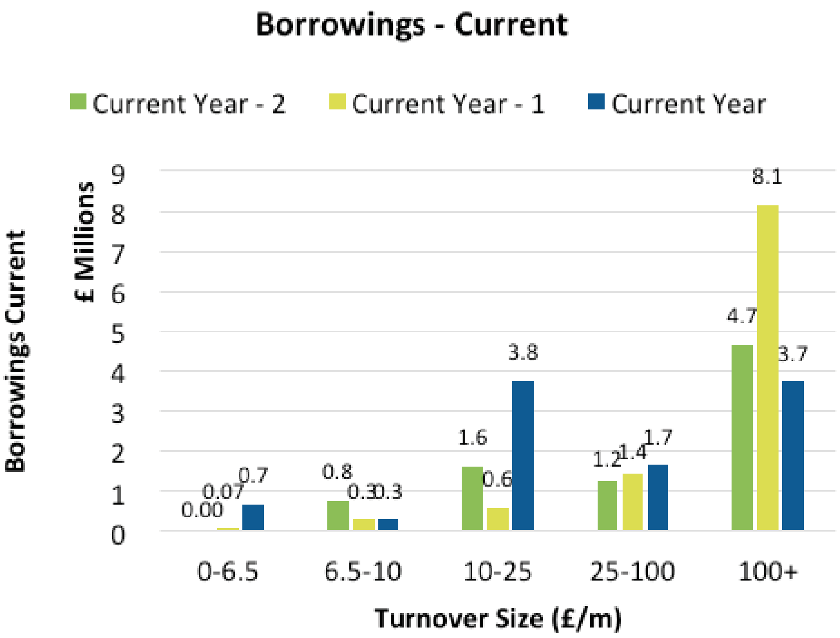
Last year we reported that growth in profitability had been achieved by the smaller companies. We now have a reversal.

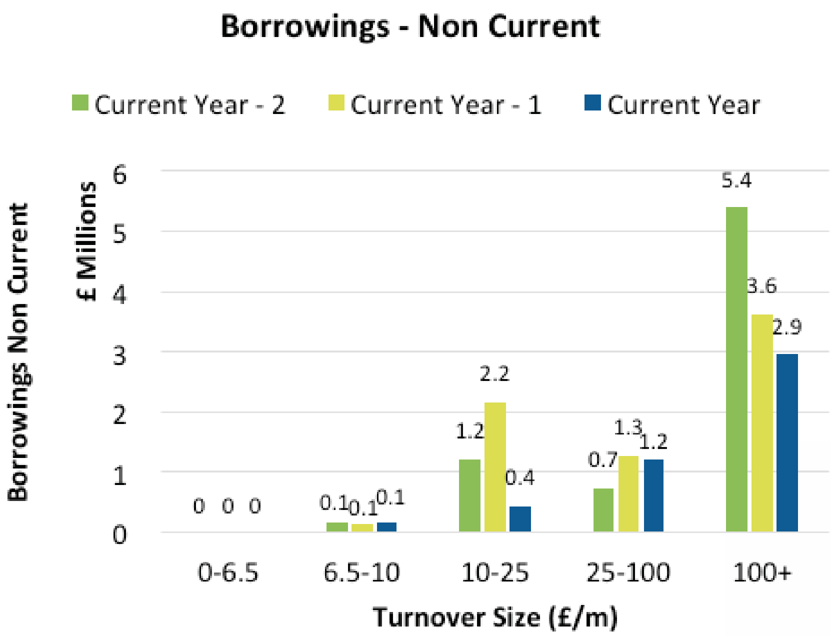
There is much talk in the construction industry of the recessionary hangover that the larger companies had with non performing contracts taken in the height of the recession (just to keep the wheels turning) which are still a legacy in the reported results. It could well be with the significant improvement shown that the 8 companies in the £100m plus band have got through this!





Borrowings





Key findings

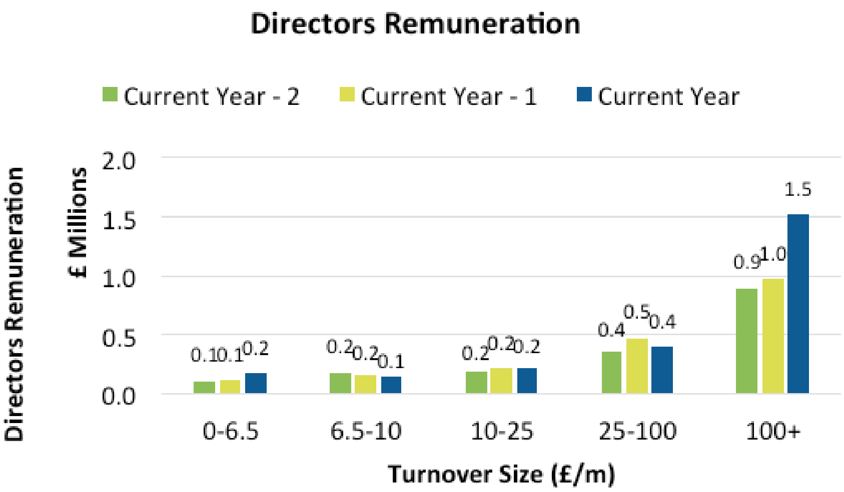
Company accounts split borrowings between those that are repayable on demand (current liabilities) and the amounts due after one year.

The £100m+ turnover companies have substantially reduced their short term debt and the long term debt has also come down. Debt reduction is coming from the significant improvement in profitability which has been turned into cash.

The £25m to £100m turnover companies have seen little movement in total borrowings whereas there has been an increase for the £10m to £25m range. The majority of the debt is less than one year so it could just be the normal vageries of cash collection and financing of work.

Borrowing has increased for those with a turnover up to £100m. Worryingly gross profit margins are falling (see page 3) for that same group.

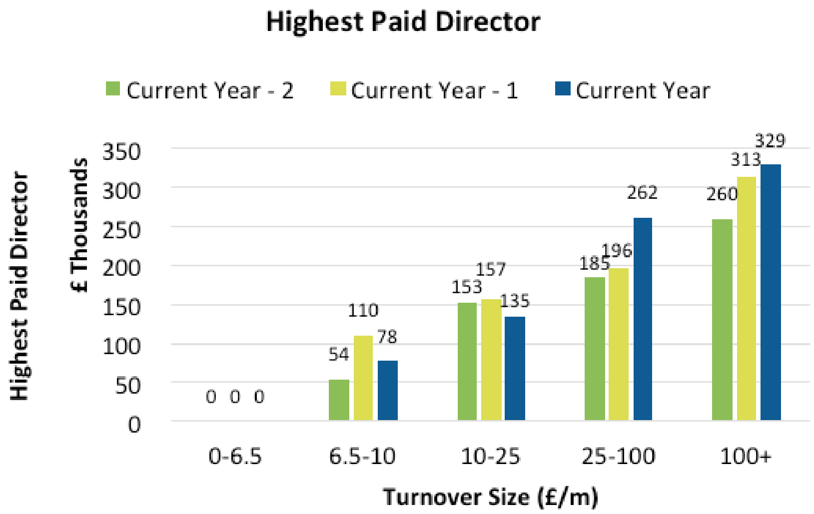
Director's Remuneration



Key findings

Director's remuneration as disclosed in the companies' accounts has seen little change other than in the £100m+ turnover range where the increased profits have been distributed in part to the directors.

The smaller companies with turnovers below £25m have significantly reduced their highest paid director from last year, whereas the large companies above £25m seem to have increased.

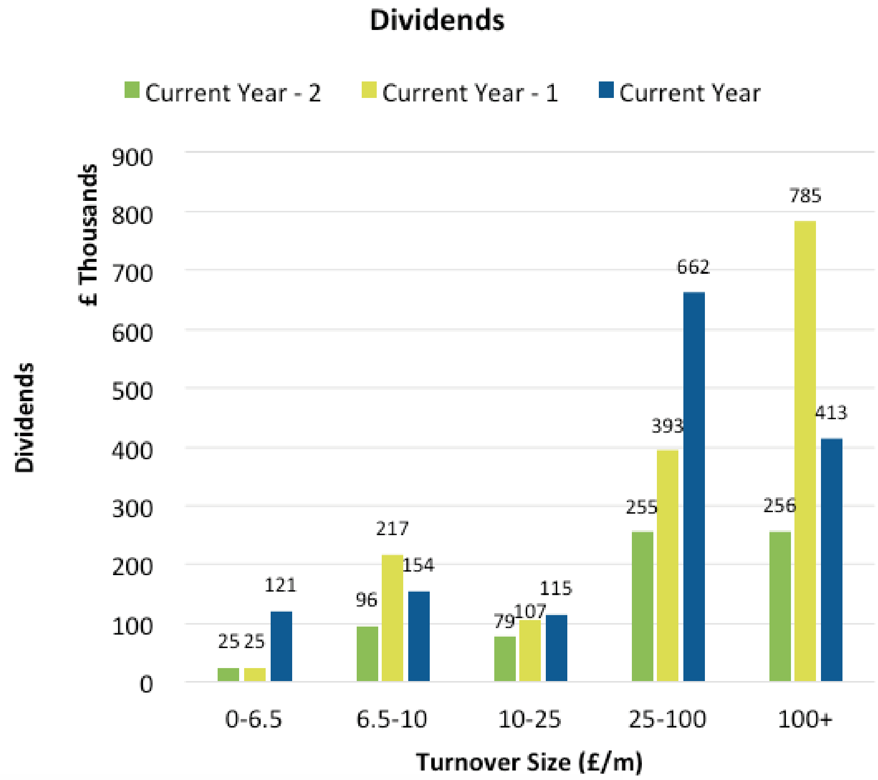


Dividends

Key findings

There have been varied trends this year. It is interesting to note that the £25m to £100m turnover group has taken a very large amount of dividends compared to last year, and the opposite can be seen for the £100m + turnover group.

Owner managed businesses tend to reward their owners by dividend. 3 years ago the total dividends extracted totalled £711m whereas for this year it is £1465m, more than double. Owners are clearly taking their profits out, possibly in part due to the 7.5% additional tax on dividends that arose on payment after April 2016.



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Construction Sector

Report summary

In conclusion it is clear from our analysis that regardless how different construction companies within the H&NL region may operate, they have shared common trends:

- Turnover has been generally up.
- Smaller companies have maintained their gross margins whereas larger companies have not.
- Larger companies are recruiting and smaller ones are not.
- The larger companies have seen significant increases in pre tax profitability which is not replicated in any of the other groupings.
- Borrowings have increased slightly in the band up to £100m whereas substantial debt reduction has occurred for £100m plus companies.

Sector overview

In order to get a real feel of how the H&NL region compares with the construction sector in the UK, we have compared our figures with those published in the September Construction News 2016 annual survey of the top 100 companies:

Although turnover has moved in line with the top 100, surprisingly profit before tax is lower. Construction News reported a 2.3% average pre tax margin for companies ranked 76 – 100 with turnovers of between £165m to £115m. Consequently, there is room for improvement in H&NL.

Looking forward to 2016/2017

Drawing on our knowledge in the sector, we expect to see construction companies across the UK experience:

- Improving turnover but static/declining gross profit.
- Margins squeezed with increased raw material prices and labour costs increasing above inflation. Skill shortages are also an issue which will be reflected by increased payroll costs.
- Static numbers of staff as contractors, have uncertainty of work following Brexit.
- The bigger will still get bigger (predominantly house builders and related services) although there will be ever more focus on risk management and margins.
- Those contractors allied to the residential market will see particular growth in turnover and profitability.
- Although owner managed businesses do not tend to buy competitors, larger companies may have an appetite for this if finance is available.

	Hertfordshire and North London	Top 100
Turnover increase	6.81% (LY 12.6%)	6.6& (LY 10%)
Pre tax Profit – all. *As a % of turnover*	2.1% (LY 2.7%)	2.4% (LY 1.9%)

Construction Sector

Maximising opportunities

Unsurprisingly UK trends are likely to filter through to regional areas, especially construction company clusters as we see in the H&NL region, making next year another challenging year for the sector, but perhaps one also for a real potential for growth. Indeed, at the time of reporting our clients have a stronger order book for 2016/17 than they did for 2015/16.

The key for business owners is to start planning now, in order to maximise on the opportunities available. Below are just some of the areas of potential opportunities we are working with our clients to explore:

- Research and Development Tax Relief.
- Capital Allowances relief on Investment in plant and equipment.
- EMI schemes to encourage staff retention.
- Refinancing opportunities whilst interest rates are low.
- Buying smaller competitors or affiliates to enhance service offering.
- Re-evaluation of supply chain / sub contractors to ensure value for money.

Unfortunately there are potential draw backs:

- Brexit “hangover” may dampen enthusiasm for speculative builds.
- Increases in planning application fees.
- Starter homes only available to first time buyer under 40 with prices capped at £250k outside London and £450k in the capital with minimum of 20% discount.
- Increased materials cost due to devaluation of sterling.
- London plan requirement has zero carbon homes or payment in cash in lieu in a carbon offset fund.
- CITB levy and government apprenticeship levy is payable by all construction companies with a payroll of more than £3m from April 2017.

Proposals that would help in the next 12 months if implemented:

- Heathrow commitment fast-tracked.
- Extension of Gatwick.
- Commitment to HS2 rail line.
- National Infrastructure Commission to become statutory body.
- Home building fund worth £3bn – supposedly to help SME developers.
- Accelerated construction initiative – worth £2bn - spare government land allocated to small builders (but offside housing delivery is wished for!)
- Reduction in stamp duty on property worth more than £1.5m which is taxed at 15%.
- Tax initiatives to contractors to develop offsite construction.

Construction Sector Specialists

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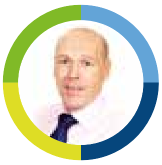

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