

## Building Stocks on the Blocks

South Africa's construction boom is expected to continue for at least the next 10 years thanks to government investment and private-sector spend, creating a catalyst for further earnings growth.

Given the positive growth and earnings outlook and recent fall in prices, say analysts, construction stocks could be ripe for the picking, despite them trading at a premium to the overall market.

The average price-earnings multiple for the construction and materials index was 21.7 at the beginning of the year, and is now 17.1 times earnings; this compares with the all-share's average multiple of 16.7 times earnings.

For the year to date, the construction and materials index has fallen 6.2% while the all-share index is up 11%. The series of all-time highs reach in May mask the market corrections seen February and March.

Analysts say construction companies do not look expensive for investors who are taking a bullish view of growth in the industry.

"If we look forward and take a view of what the growth of these companies are – and we are bullish about the growth – then these construction stocks don't look too expensive," said Lance Krowitz, an analyst at Stanlib Asset Management.

### **Beyond 2010**

He said that projects such as the Gauteng freeway project and construction of power stations, would keep the industry alive beyond the 2010 Fifa World Cup.

"Some people tend to think that after 2010, everything stops, but actually, we are seeing additional projects coming online," said Krowitz.

Another analyst who did not want to be named said 2010 is history in the order books of construction companies. "2010, from an investors' perspective, is yesterday's news," he said.

Macquarie First South Securities infrastructure specialist Rowan Goeller said construction companies were "in good shape and couldn't be looking better."

"In the next three to five years, we will see 20% to 30% growth in the sector," said Goeller.

Group Five and Aveng are constructions counters favoured by Goeller as they have better opportunities for growth and enhancing their margins.

With commodity prices such as gold and platinum spiking to new all time highs in recent months, mining companies will continue to expand, driving the growth of construction companies.

### **Capacity Issues**

Krowitz said that the list of projects seems to be growing and construction companies' order books are getting bigger, but there comes a danger with expanding order books – capacity.

He explained that companies might not be able to handle the size of the order book, which could add pressure to staff and management.

However, an understanding of the work available in the market needs to be made by investors to decide whether stocks in the construction industry are cheap or not.

"One must take a view of what they think the growth is in these companies – and linked to that – where the industry is in the construction cycle."

"The construction of power stations isn't going to start right away, projects will be staggered," said Krowitz.

He added that the amount of resources available to do the projects would also impact the cycle, as fewer resources mean a longer period of time to complete jobs, extending the cycle.

"I am a construction bull, and I think that there is a lot more work than there is capacity. Jobs will be staggered, which means that the construction cycle could go on for 7 to 8 years more," said Krowitz.

Big construction companies that have projects in the pipeline will also be a source of revenue to the smaller construction companies.

The likes of WG Wearne and Afrimat will benefit from projects undertaken by heavyweights Group Five and Murray & Roberts as they are often contracted to supply materials for them.

### **Commercial, Residential 'tough'**

But the positive outlook is limited to companies with exposure to road, civil and mining projects.

Gavin Bantam, an analyst at Nedcor Securities, said the outlook for construction companies remains "fairly positive" if they weren't involved in residential or commercial building.

"Residential and commercial properties are interest rate-sensitive, and with rates continuously going up, both the residential and commercial property market will slow down," said Bantam.

He believes that construction companies with less exposure to interest rate-sensitive markets have a positive future and can reap the rewards from civil engineering projects.

Nevertheless, Goeller said that all the listed construction companies were "doing well" because of the current infrastructure spend.

All the analysts agreed that the industry remains buoyant due to the current market conditions, expecting growth in the companies' earnings and order books.

They listed some of their favourite companies to invest in on the stock exchange as a result of the growth prospects in terms of earnings and projects.

These include Group Five, Aveng, Murray & Roberts, Raubex and WBHO and Basil Read.