

Measuring up

Morgan Stanley has partnered with the Australian Construction Industry Forum (ACIF) and AlphaWise to survey ACIF's construction industry constituents on current trends and Covid impacts. We received over 80 responses from construction industry participants in June 2020 providing invaluable insights.

About ACIF: ACIF (Australian Construction Industry Forum) facilitates and supports an active dialogue among the key players in residential and non-residential building, engineering and construction, other industry groups, and government agencies. ACIF members are the most significant associations in the industry, spanning the entire asset creation process from feasibility through design, cost planning, construction and building and management. Andrew Scott is a member of ACIF's Construction Forecasting Council, a panel of economists and industry leaders whose role is to review and provide input to the data that forms the ACIF forecasts.

Measuring up – about this survey

Morgan Stanley has partnered with the Australian Construction Industry Forum (ACIF) to survey ACIF's construction industry constituents on current trends and Covid impacts. We received over 80 responses from construction industry participants throughout June 2020 providing invaluable insights. A summary of participants by industry, construction segment exposure and firm size is included in Appendix: Characteristics of survey participants.

Survey part 1: Current impacts

Current impact #1: Level of activity

Covid is clearly impacting construction activity, with almost two-thirds of respondents indicating at least a 20% reduction in activity and a number of firms losing more than half of their normal business.

Non-residential construction firms have been hit hardest, with more than three quarters operating at less than 80% of normal levels.

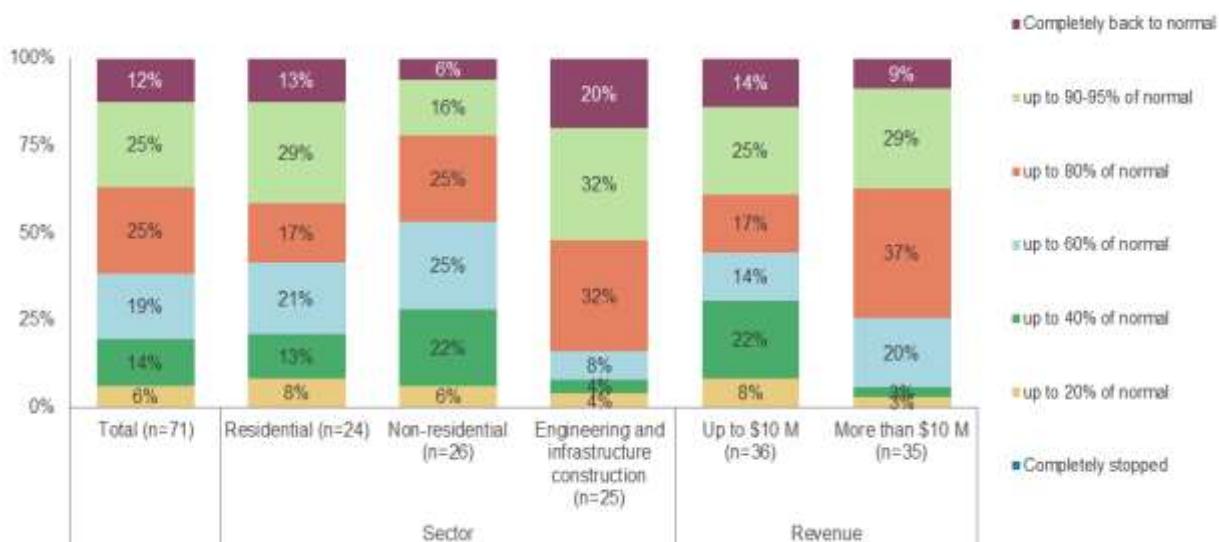
One-quarter of Residential firms have been significantly impacted, with demand falling to less than 40% of the normal level. On the positive side, 13% of Residential firms reported demand back to normal.

Engineering & Infrastructure is faring best of all the sectors, with 52% of firms retaining at least 90% of their normal business.

Larger firms (i.e. those with greater than A\$10m revenue) have fared better through Covid, with a greater proportion operating at or above 60% of normal levels (75% vs 56% of smaller firms).

Exhibit 1: A quarter of the firms surveyed have lost more than half their business

Current Business Activity vs. Normal



Source: Morgan Stanley Research, AlphaWise

Current impact #2: Covid disruptions

The most common impacts have come through delays to approvals, and supply chain disruptions.

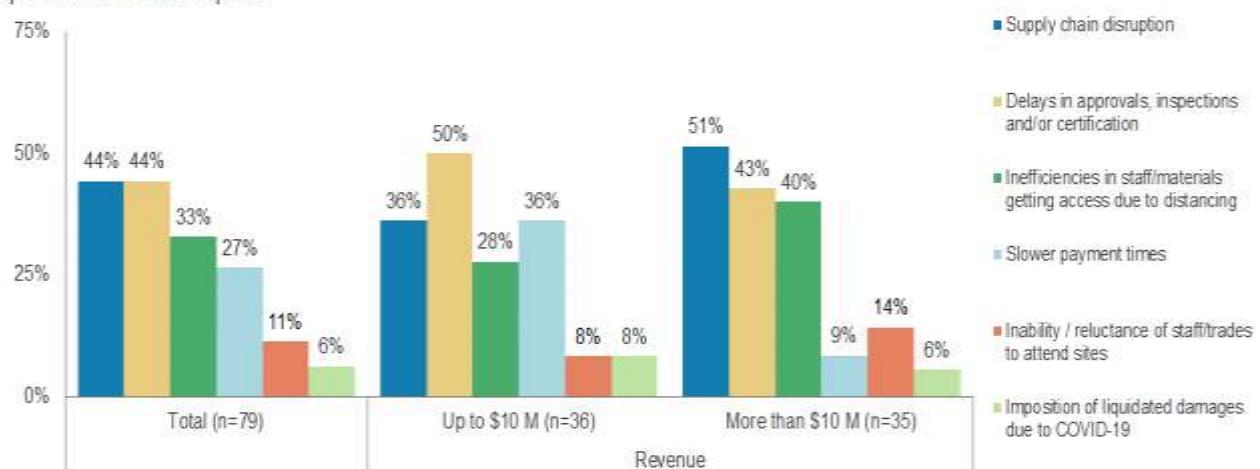
In the construction industry, Covid-related disruptions are most evident across the supply chain (44% of respondents) and in delays to approvals, inspections and certifications (44%).

Social distancing is also having an impact on one-third of construction firms, creating inefficiencies in materials and staff getting to site. In addition, 16% of Non-residential firms reported an inability or reluctance of staff to attend site (above the wider industry average of 11%).

For smaller firms (<A\$10m revenue), one of the largest impacts from COVID-19 has been slower payment times (impacting 36% of smaller firms).

Exhibit 2: Delays to approvals, and supply chain disruptions have been the most common impacts of covid

Top Covid-19 Related Impacts



Source: Morgan Stanley Research, AlphaWise

Current impact #3: Access to bank finance

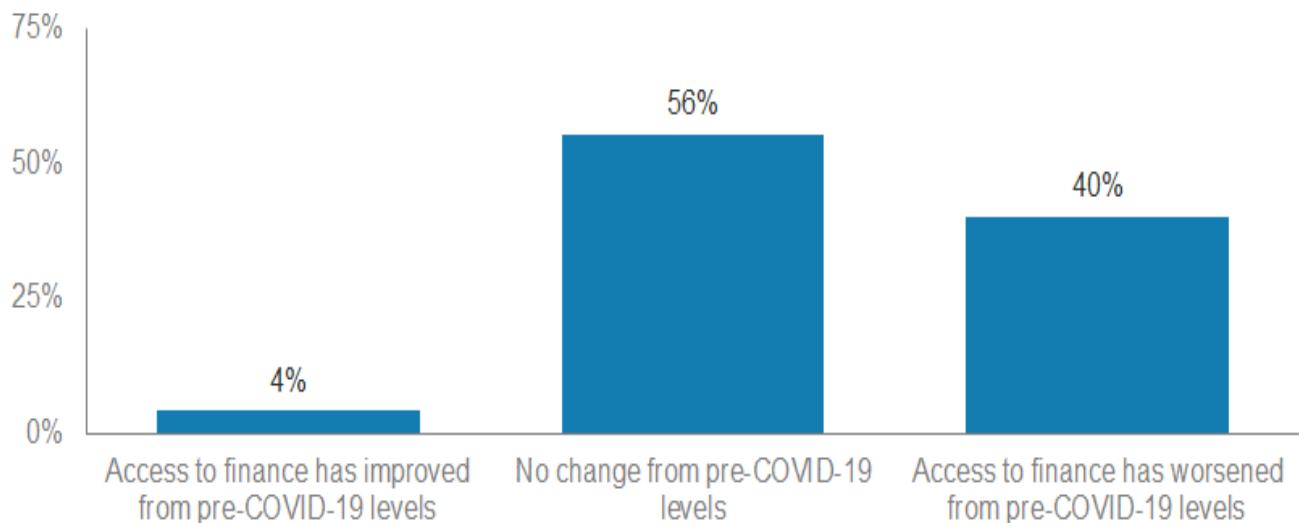
40% of firms are finding it harder for their customers to get finance, with the largest impact on Residential construction firms.

As a result of COVID-19, access to banking finance has deteriorated for 40% of construction firms. This is impacting the Residential sector most, with 65% of Residential firms indicating that access to finance has deteriorated.

On the other hand, 4% of firms report an improvement in accessing finance, relative to pre-crisis levels. The majority of respondents (56%) have not experienced a change in financing levels.

Exhibit 3: 40% of firms are finding it harder to secure finance

Change in Access to Banking Finance vs. Pre Covid-19 (n=72)



Source: Morgan Stanley Research, AlphaWise

Survey part 2: Outlook

Outlook #1: Leads & new tenders

Leads and new tenders are below pre-Covid levels. Two-thirds of respondents have seen new leads decline by at least 25%, relative to pre-Covid levels.

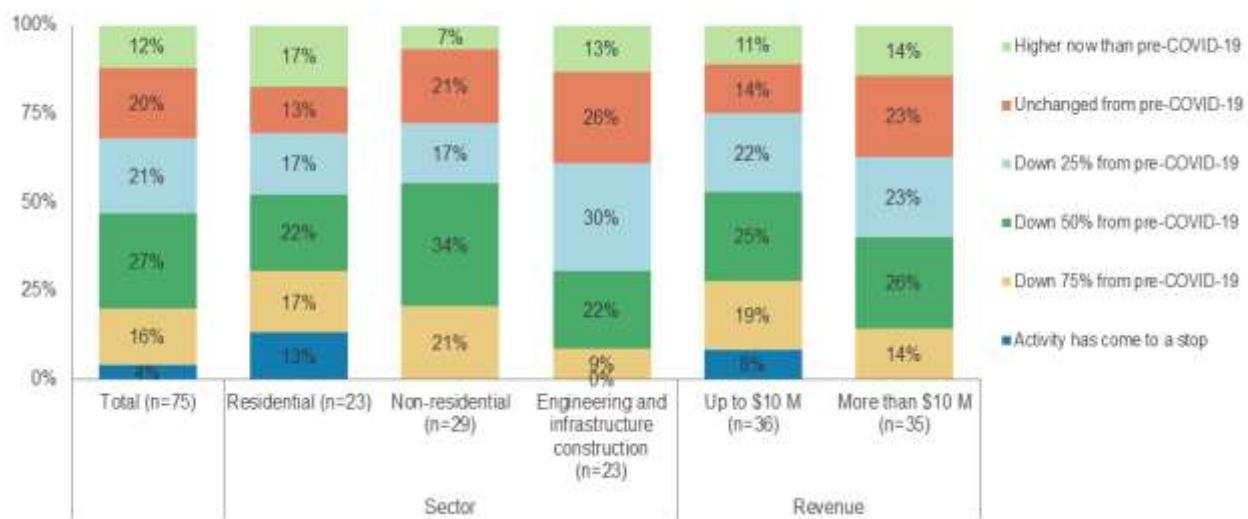
4% of firms reported a lack of any new leads, and notably these were all in the Residential sector.

Smaller firms (<A\$10m revenue) are experiencing a greater impact, with 52% seeing less than half the normal level of new business (vs just 40% of firms with >A\$10m of revenue).

12% of construction firms reported an increase in the level of new leads/tenders, relative to pre-Covid levels. Increased activity is most evident in the Residential sector, where 17% of firms reported an increase in new leads.

Exhibit 4: Leads and new tenders are well below pre-Covid levels

Current Level of Leads / New Tenders



Source: Morgan Stanley Research, AlphaWise

Outlook #2: Construction pipeline

More than half of construction firms are seeing less than six months in the pipeline.

This appears particularly concerning given the lack of new leads and tenders, and highlights concern about a drop off in activity around September/October 2020.

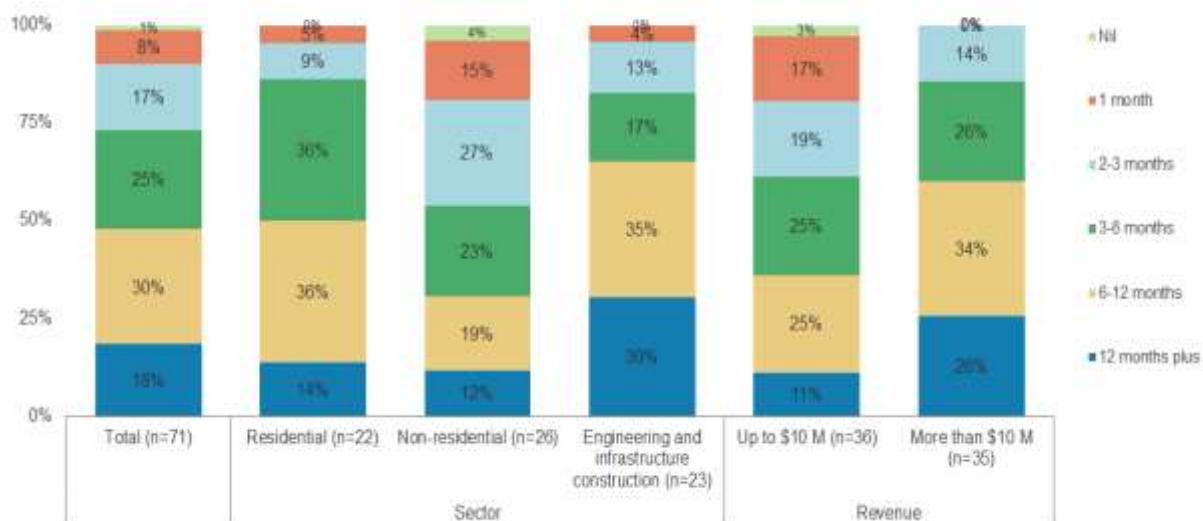
Non-residential construction firms reported the shortest pipeline of work, with most firms in the 2-3 months range. Residential construction firms most commonly have 3-12 months on the pipeline.

Despite a weak level of new tenders (see Exhibit 7), the Engineering & infrastructure sector has the healthiest pipeline. 65% of Engineering firms see a minimum six months of upcoming work, and half of those firms have at least 12 months of work in the pipeline.

Larger firms (>A\$10m revenue) clearly have longer pipelines than their smaller peers (<A\$10m revenue). 60% of larger firms had more than six months in the pipeline, compared with only 36% of smaller firms.

Exhibit 5: More than half of the firms have less than 6 months in the pipeline

Future Work Pipeline



Source: Morgan Stanley Research, AlphaWise

Outlook #3: Timeline for return to normal

The industry expects a return to 'normal' in CY21, with smaller firms expecting to bounce back faster than large firms.

41% of firms anticipate a return to normal in the first half of 2021. A small proportion of firms (just 18%) are more optimistic than that, expecting a return to normal before 1HCY21.

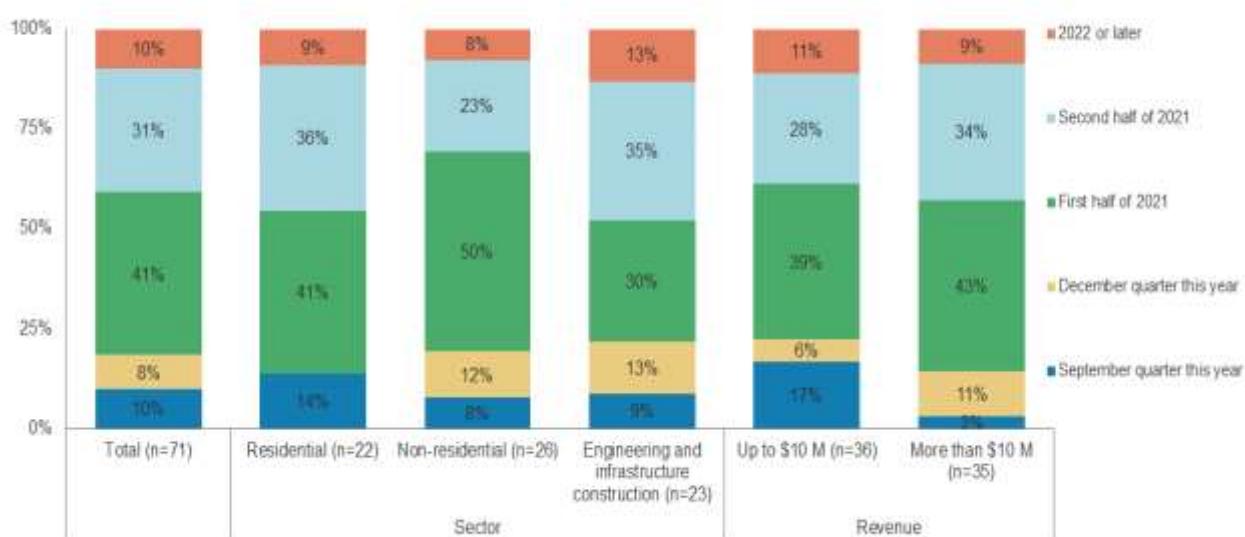
Beyond this, 31% of firms expect a return to normal in the second half of 2021, while 10% see a return to normal in 2022 or later.

Engineering & Infrastructure firms expect the longest-dated impact, with 13% of these firms seeing a return to normal in 2022 or later. Non-residential firms were the most optimistic about timing of the impact – 70% expect a return to normal by first half 2021 (at the latest).

Smaller firms are expecting to bounce back soon, with 23% of smaller firms expecting their business will go back to normal at some point this year, compared to only 14% of larger firms.

Exhibit 6: Most firms expect business to go back to normal in 1HCY21

Expected Time Frame of Business Returning to Normalcy



Source: Morgan Stanley Research, AlphaWise

Note: time frames are on a calendar year basis

Outlook #4: Input prices

More than half of industry participants expect the price of building materials to rise. On the other hand, one-third of firms expect cost-relief from labour and trades.

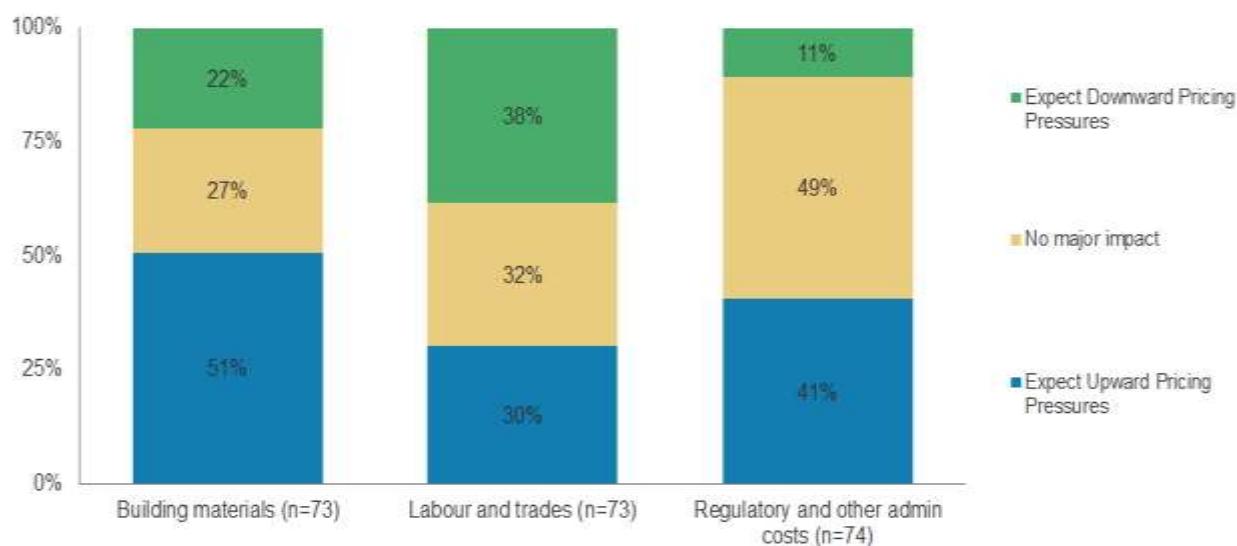
Building materials are expected by more than half of respondents to rise in price in the next 6-12 months (51% of respondents).

Labour and trades appear most likely to see price decreases, with 38% of firms expecting downward pricing pressure in the next 6-12 months. Our economists forecast Australia's unemployment rate to reach 8.1% by 4Q20, before declining to 7.1% in 2021.

The price of regulatory and other admin costs are not expected to change much (49% of respondents expect no change), but are seen as more likely to increase in price than to decrease.

Exhibit 7: Building materials are expected to rise in price, while labour costs are expected to fall

Impact of Covid-19 on Different Items



Source: Morgan Stanley Research, AlphaWise

Survey part 3: Industry issues

Industry issue #1: Hiring & firing

Almost half of the firms surveyed expect they will need to reduce their workforce in the next 6-12 months, with Non-residential the main area of job cuts.

47% of firms expect to reduce their workforce in the next 6-12 months (by cuts of at least 5%). 18% of firms expect to *increase* the number of employees.

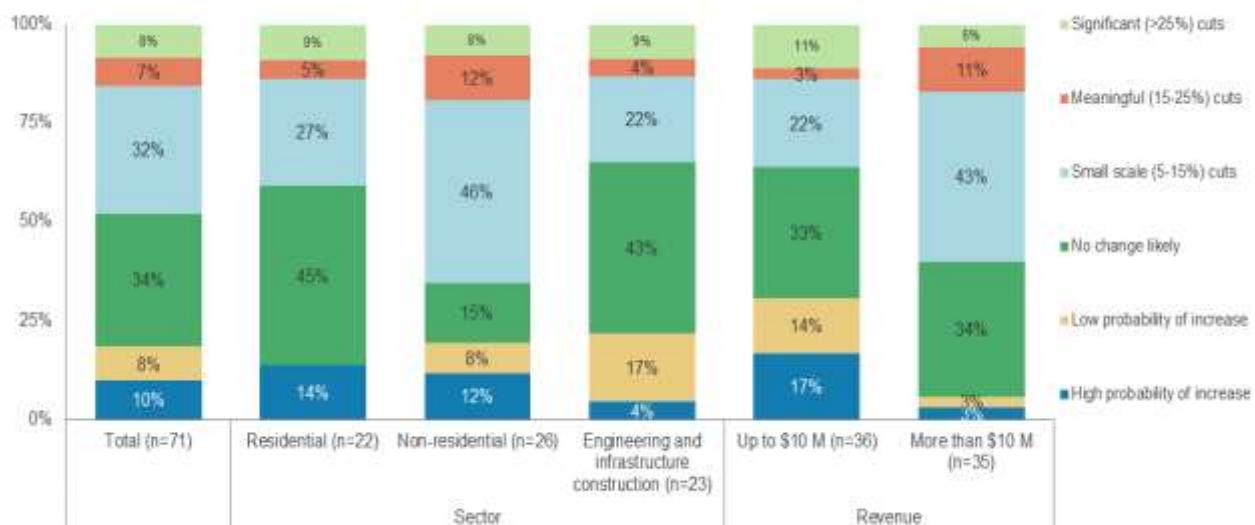
Cuts are most likely to occur in the Non-residential sector, where two-thirds of firms indicated that they expect to reduce headcount.

Jobs in Engineering & Infrastructure appear safest among the three sectors, with only 35% of firms likely to make cuts, and 21% of firms looking to *increase* their workforce in the next 6-12 months.

Smaller firms (<A\$10m revenue) are more likely to retain their employees, with only 36% of smaller firms likely to reduce their workforce, compared with 60% of larger firms (>A\$10m revenue).

Exhibit 8: Almost half of the firms expect to cut jobs in the next 6-12 months

Likelihood of Change in Workforce in Next 6-12 Months



Source: Morgan Stanley Research, AlphaWise

Industry issue #2: Health of the industry

Firms believe the industry is healthy enough to manage through the crisis, albeit with some degree of financial difficulty.

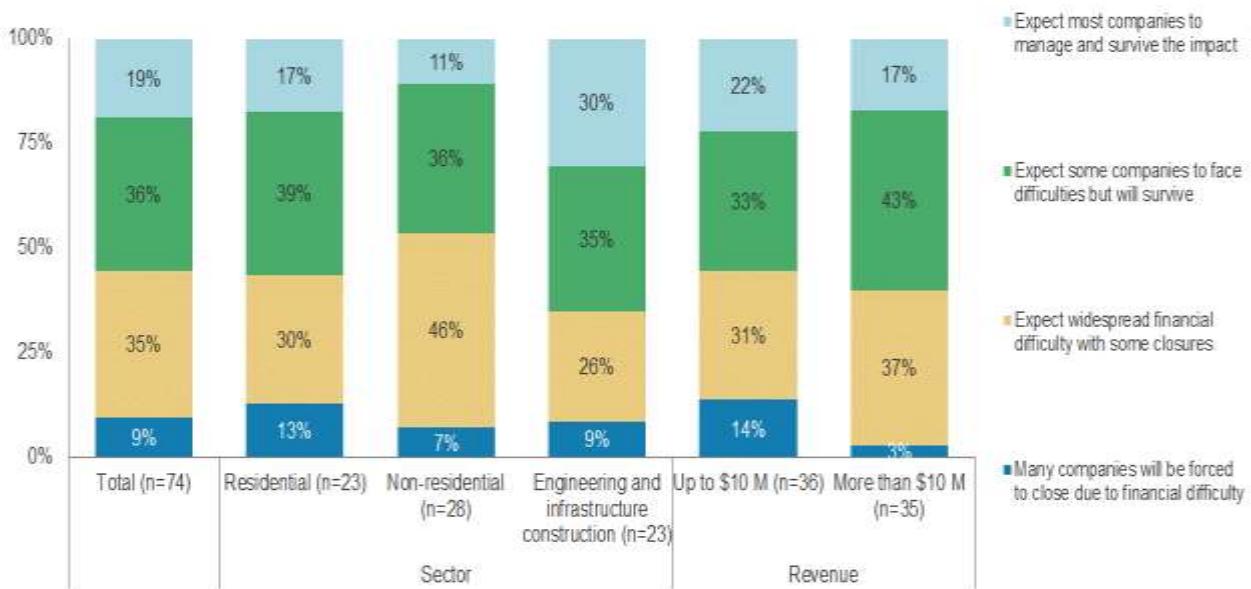
The Non-residential sector expects a greater degree of financial difficulty than other sectors expect, with 53% of Non-residential firms expecting closures in the industry.

Smaller firms (<A\$10m revenue) are more pessimistic about the health of the industry than larger firms (>A\$10m revenue) are, with 45% expecting closures (vs 40% of large firms).

As a whole, slightly more than half of the firms surveyed expect most firms to survive, albeit with some degree of financial difficulty.

Exhibit 9: Widespread closures are not expected by the majority of the respondents

Current Health of Industry



Source: Morgan Stanley Research, AlphaWise

Industry issue #3: Government stimulus

We polled respondents in an open-ended question about government stimulus. A number of common suggestions for future stimulus were:

- **Infrastructure** was the most popular stimulus suggested by the industry. Firms expressed increasing urgency around infrastructure stimulus, often frustrated with the time it takes between announcement of stimulus and the start of construction. A preference for small public sector projects was highlighted by a few respondents, and sustainability/renewables infrastructure was a recurring theme.
- Many firms highlighted **JobKeeper** as a positive for the construction industry, and expressed a desire for JobKeeper to be extended beyond end-September.
- **Social housing** was also a popular suggestion, with a desire for both federal and state government programs in this sector.
- **Tax reform** was highlighted frequently, and across a range of taxes from payroll tax, to land tax to stamp duty.
- **Grants** are popular among residential construction respondents, however participants were divided about the efficacy of the Homebuilder package.

A number of respondents were cautious and critical of past government stimulus, and had lost faith in government's ability to support the industry.

Exhibit 10: Selected verbatim responses

Stimulus suggestion	Selected verbatim comments
JobKeeper	"JobKeeper has been very beneficial to confidence." "Maintain JobKeeper past September or the industry will be decimated."
Social housing	"A serious whole of government approach to stimulus of the social and affordable housing sector across Australia as the Rudd/Gillard government oversaw in 2010"
Infrastructure	"Stimulus of Government projects for public sector work in the \$1m - \$30m range" "Further investment in green energy and renewables" "Stimulus through infrastructure building is a sensible long term investment - can we ramp up quickly enough?"
Tax reform	"Abolishing stamp duty will get the whole housing market moving"
Grants	"the 25K for building contract did not work as the land developers put the price of land up 25K" "Renovation stimulus to be attainable. Current criteria unrealistic."
Caution	"Media about possible stimulus causes consumers to hold off until an announcement is made, resulting in "false" declines in activity, which then justify the need for stimulus." "A stimulus package that takes years before construction starts does not help." "Unfortunately too much spin and not enough substance."

Source: Morgan Stanley Research, AlphaWise

Survey part 4: Future trends

Lasting impacts on the industry

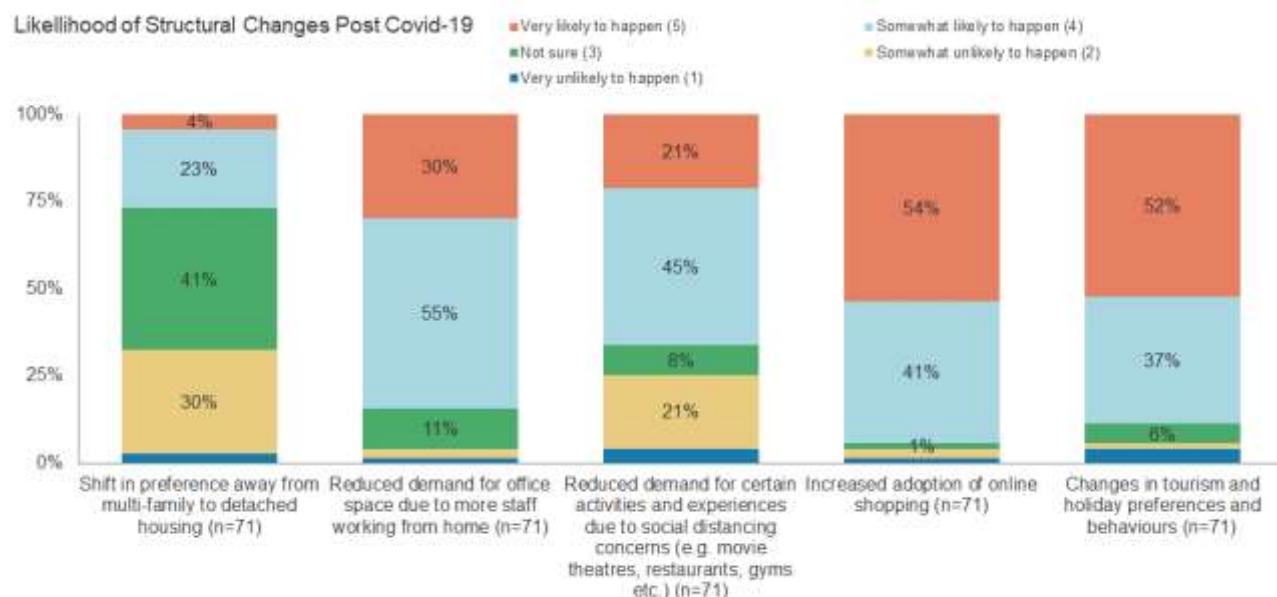
The majority of respondents expect lasting change as a result of Covid. Reduced demand for office space is one of the most widely expected changes, considered at least somewhat likely by 85% of firms.

Reduction in demand for office space was considered at least somewhat likely to happen, by the vast majority of respondents (85%), which is likely to reflect the shift towards working from home. The majority of firms that don't foresee a change, or were unsure, came from the Non-residential sector, which indicates this trend may be yet to play out on a widespread basis.

Respondents agreed that adoption of online shopping was likely to increase post-Covid, and that changes to tourism/holiday preferences were likely. Similarly, reduced demand for experiences that do not provide social distancing (such as gyms and restaurants), was considered at least somewhat likely by 66% of participants.

The most divisive potential change was a shift in preference away from multi-family to detached housing. 27% of participants expect a shift away from multi-family housing as a result of Covid, while 31% believe a shift is unlikely. 41% of respondents were unsure whether this change would play out.

Exhibit 11: Most firms expect some lasting change in the industry, with reductions in office space the most common response



Source: Morgan Stanley Research, AlphaWise

AlphaWise Methodology

In collaboration with Australian Construction Industry Forum (ACIF), Morgan Stanley AlphaWise conducted an online survey among 81 ACIF members during June 2020. We believe the respondent profile has a good representation of the construction sector participants in terms of regions, business size, industry segment and business activity.

Although the sample set is statistically robust for conclusions at the total level, findings for some sub-segments have a low base (<30) and are only directionally indicative.

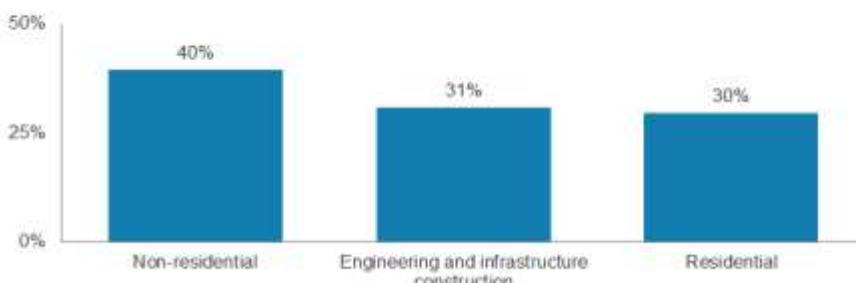
Appendix: Characteristics of survey participants

The following charts provide an overview of the characteristics of our survey's participants. 81 companies participated in the survey, from the audience of Australian Construction Industry Forum members. The survey was administered online during June 2020. Key characteristics of the survey population are highlighted below:

- The participants come from a broadly even mix of construction industry sectors: non-residential (40%); engineering and infrastructure (31%); and residential construction (30%)
- The majority of respondents business activity is construction or consulting (53% total).

Exhibit 12: What sectors of the construction industry does your business primarily participate in?

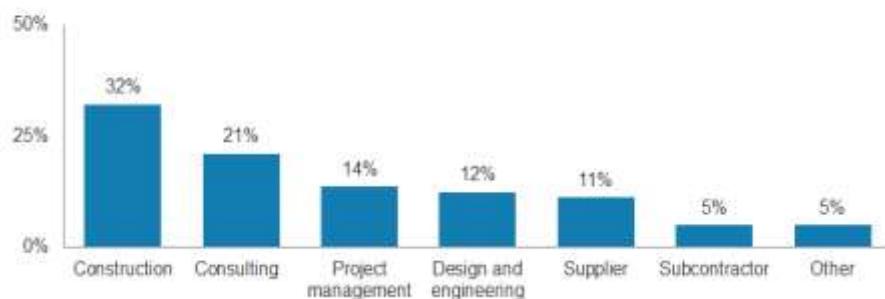
Sector in Construction Industry



Source: Morgan Stanley Research, AlphaWise

Exhibit 13: What is the nature of your primary business activity?

Primary Business Activity



Source: Morgan Stanley Research, AlphaWise

Exhibit 14: Select all regions your firm operates in

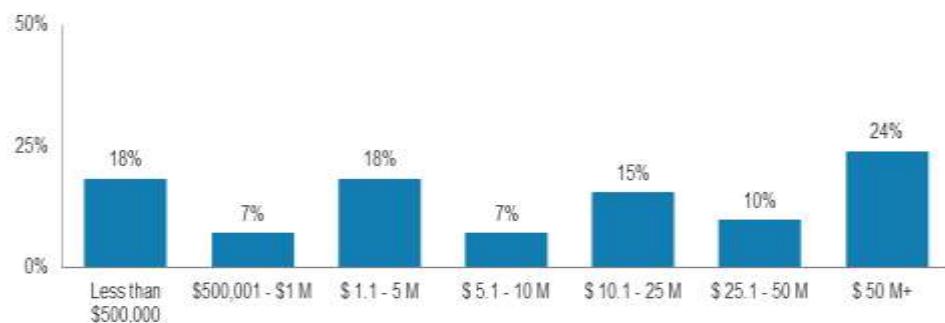
Regions of Operation



Source: Morgan Stanley Research, AlphaWise

Exhibit 15: What is your firm's total annual revenue

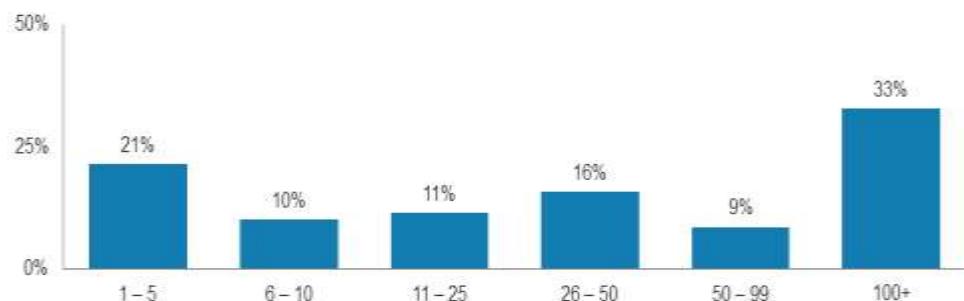
Annual Revenue



Source: Morgan Stanley Research, AlphaWise

Exhibit 16: How many people work in your firm?

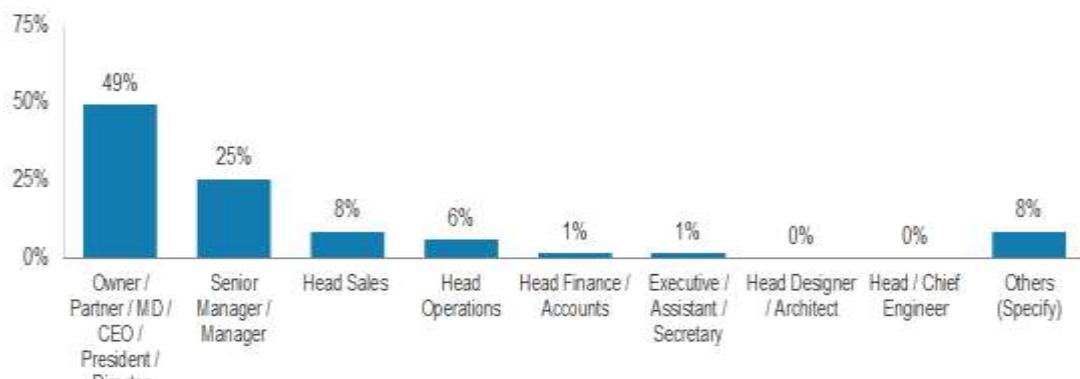
Company Size - Number of Employees



Source: Morgan Stanley Research, AlphaWise

Exhibit 17: Select the option that best describes your role in the firm

Role in the Firm



Source: Morgan Stanley Research, AlphaWise

This article is based on research published for Morgan Stanley Research on [published July 20, 2020]. It is not an offer to buy or sell any security/instruments or to participate in a trading strategy. For important disclosures as of the date of the publication of the research, please refer to the original piece. Contact Morgan Stanley for a copy of the published report. For important current disclosures that pertain to Morgan Stanley, please refer to the disclosures regarding the issuer(s) that are the subject of this article on Morgan Stanley's disclosure website. <https://www.morganstanley.com/researchdisclosures>