WEATHERING THE STORM

There's nothing like a recession to test the business nous of a company. Building has undertaken an analysis of the financials of the top 20 major contractors to work out how they have fared over the past six years. Here, **Joey Gardiner** gives an overview of where the firms were in 2008 and where they are today

It can be hard to cast your mind back to life before the recession. The innocent heady days when then chancellor Gordon Brown was still trumpeting 60-plus quarters of uninterrupted economic growth, before the phrase "sub-prime housing market" was emblazoned into everyone's subconscious, and we'd all signed up to Robert Peston's twitter feed in order to find out which global financial institution was going to go to the wall next.

A lot has happened to the construction industry in the intervening six years. And for the top 20 contractors, it has been a period of wildly differing fortunes, with their position today determined by a host of decisions made as the financial crisis broke. In the following sections we chart these alternative courses by comparing where some of these individual firms were back in our 2008 top contractors' guide – and where they are now, according to their latest published figures.

But there's also a raft of general conclusions to be drawn from looking at the performance of the top 20 contractors overall. Profit margins, as you would expect, have significantly contracted over the period. In the latest results, the top 20 produced just £683m of pre-tax profit from almost £40bn of turnover, a margin of just 1.7%. As a margin, this is a fall of a third from that recorded in the 2008 survey – a decline that is unlikely to surprise anyone.

What may surprise you more is that the current top 20 are now turning over, at £39.85bn, 2.2% more than the 2008 edition. This in a period where, according to the Office for National Statistics, overall output is running 11% lower than it was then. Therefore as a whole the biggest contractors – whatever their problems – have seriously outperformed the market. Tony Williams, MD of analyst Building Value, says: "In this market if you're a 100% UK contractor, you should have seen a reduction in turnover or margin, and if you haven't, you're doing something very good."

Part of this is down to consolidation, even if only a few firms have benefitted seriously from acquisition growth in the period – for example, Keepmoat, which was outside the top 20 in 2008, Vinci and Balfour Beatty. Although the figures cannot be directly compared, because top 20 contractors get a proportion of their revenue overseas, the interesting implication of this rise is that they are taking a greater share of UK construction from their smaller rivals. In 2008 the turnover of the top 20 was equivalent to just under 31% of total UK construction output; today it accounts for 35.7%.

Whatever happened to…?

There are four firms on the 2008 top 20 list that don't appear in 2014. The biggest, Taylor Wimpey, doesn't appear simply because it sold its contracting business to Vinci UK in 2008.

The second absentee is Rok, which collapsed in spectacular fashion in 2010. Rok was a patchwork "local" firm built up of acquisitions during the boom time by chief executive, Garvis Snook, that was hit by financial jitters when the market turned. After profit warnings and the departure of the firm's finance director, fears snowballed as one of its largest rivals, Connaught, collapsed, triggering concerned customers to walk away. It finally called in the administrators on 8 November, and remains the biggest casualty of the whole recession.

Another absentee is Bowmer & Kirkland, the family-run Derbyshire-based contractor, which was ranked 18th largest in the 2008 tables. However, the 21% decline in turnover since then to £662m is not dramatic in the context of the huge contraction in the regional construction market. And its healthy pre-tax profit margin for the year to August 2013 of over 3.5% speaks of a firm that has been willing to sacrifice turnover in order to focus on profitable work.

The final name to disappear from the top 20, Lend Lease, has, in contrast, experienced a spectacular fall-off in work in the period, the largest of any firm in the 2008 top 20. Then called Bovis Lend Lease, in 2008 it was still the 10th biggest in the UK, turning over £1.38bn. But since then turnover at its UK businesses has fallen by 61% to just £543m, and it reported a pre-tax loss in the most recent year, to 30 June 2013, of £16.3m.

This decline follows a period of turmoil in the firm's senior management in the UK and Europe, with five different people running the construction business over the period. During the recession the contractor picked up little work, amid claims from some inside the business that its Australian parent company was setting unrealistic restrictions on what it could bid for.

But it may be that with more stable leadership in the shape of Dan Labbad (at the European level) and Neil Martin (for the UK construction business), the firm is finally about to reverse its downward trajectory. One source says: "The vibe now is that they are on the up." »

2008 Top 20 contractors, ranked by turnover (methodology overleaf)

	Firm	turnover (m)	pre-tax profit (m)	Pre tax margin (%)
1	Balfour Beatty	7488	157.0	2.1%
2	Taylor Wimpey	4714	-19.5	-0.4%
3	Carillion	3951	94.4	2.4%
4	Laing O'Rourke	3037	44.5	1.5%
5	Kier	2127	77.6	3.6%
6	Morgan Sindall	2115	57.6	2.7%
7	Sir Robert McAlpine	1792	46.6	2.6%
8	Interserve	1738	69.3	4.0%
9	Galliford Try	1409	60.2	4.3%
10	Bovis Lend Lease	1383	17.8	1.3%
11	Skanska UK	1308	38.0	2.9%
12	HBG UK	1043	39.5	3.8%
13	Wates	974	37.7	3.9%
14	Keller	955	103.2	10.8%
15	Rok	950	28.3	3.0%
16	Costain	878	19.8	2.3%
17	ISG	833	8.4	1.0%
18	Bowmer & Kirkland	833	36.6	4.4%
19	Vinci	774	40.5	5.2%
20	Shepherd	685	42.2	6.2%
Total		38,987	1,000	2.6%

2014 Top 20 contractors, ranked by turnover (methodology overleaf)

	Firm	turnover (m)	Increase on 2008	pre tax profit (m)	pre tax margin	increase in margin on 2008
1	Balfour Beatty	10118	▲ 35.1%	32.0	0.3%	▼ -84.9%
2	Carillion	4081	▲ 3.3%	110.6	2.7%	▲ 13.4%
3	Laing O'Rourke	3567	▲ 17.5%	57.0	1.6%	▲ 9.0%
4	Interserve	2582	▲ 48.6%	68.1	2.6%	▼ -33.9%
5	Morgan Sindall	2095	▼ -0.9%	13.9	0.7%	▼ -81.8%
6	Kier	1982	▼ -6.8%	43.0	2.2%	▼ -40.5%
7	Bam UK	1673	▲ 2.2%	19.9	1.2%	▼ -68.6%
8	Galliford Try	1467	▲ 4.1%	74.1	5.1%	▲ 18.2%
9	Keller	1318	▲ 38.0%	43.5	3.3%	▼ -69.5%
10	ISG	1284	▲ 54.1%	2.5	0.2%	▼ -80.9%
11	Vinci	1255	▲ 50.7%	7.2	0.6%	▼ -42.9%
12	Mace Group	1183	▲ 116.7%	32.4	2.7%	▲ 38.4%
13	Skanska UK	1092	▲ 12.1%	43.5	4.0%	▲ 2.9%
14	Willmott Dixon	1038	▲ 151.33%	13.0	1.2%	▼ -49.1%
15	Costain	960	▲ 9.3%	12.9	1.3%	▼ -40.4%
16	Wates Group	931	▼ -4.4%	23.0	2.5%	▼ -36.1%
17	Sir Robert McAlpine	898	▼ -49.9%	5.9	0.7%	▼ -74.7%
18	Keepmoat	890	▲ 67.0%	37.2	4.2%	▼ -55.7%
19	Shepherd	742	▲ 8.3%	13.0	1.8%	▼ -71.6%
20	VolkerWessels UK	691	▲ 15.4%	11.7	1.7%	▲ 52.0%
Total		39847	▲ 2.21%	680.3	1.7%	▼ -35.0%

Margin performance?

Margins as a whole have decreased sharply, but certain types of businesses seem to be in better shape in terms of profitability than others.

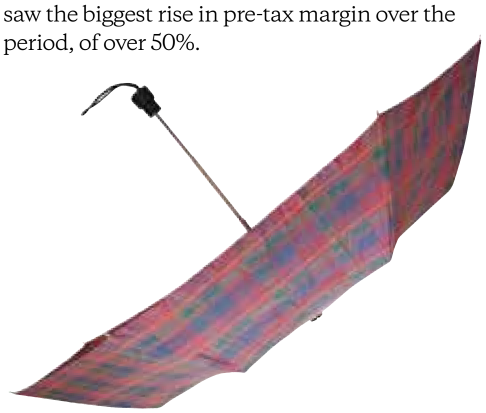
Profit figures vary widely from year to year and therefore only provide a snapshot that can be hugely affected by one-off exceptional issues. But at a most basic level, those that have focused most on general construction, seem to be less profitable than the firms which have either diversified or specialised. The most obvious example of the success of diversification is Galliford Try's private housebuilding business, Linden, from which the group gets about 40% of its revenue. Galliford Try has the single highest pre-tax margin in the top 20, at over 5%, but the vast majority of this profit (84%) comes from its housing business.

Carillion, likewise, has kept a relatively high margin for a contractor, at 2.7%, and even increased this over the period. It has done this by pursuing a strategy of deliberately downsizing its UK construction business, and instead expanding its support services business and overseas construction work.

Balfour Beatty, however, is one example where a growth in revenue has been accompanied by poor profitability. It grew turnover very quickly through acquisition over the period, but its most recent figures show a pre-tax margin of just 0.47%, a fall of more than three-quarters. ISG, on a smaller scale, has seen its margin fall by over 80% in the period despite revenue growing by more than half to £1.28bn. Likewise Vinci UK grew revenue by almost two-thirds to £1.26bn, but pre-tax profit fell to just £7.2m, a margin of only 0.57%.

Alastair Stewart, Building Analyst at Progressive Research, says: "This highlights two issues affecting the wider construction sector: to what extent are contractors tempted to 'buy work' during a downturn, and what type of work are they taking on? Companies can be tempted to take on work with what looks like zero margins, in order to pay creditors, but, with any false assumptions, these can turn negative."

The case for specialisation is made by infrastructure specialist Volker Wessels, which saw the biggest rise in pre-tax margin over the period, of over 50%.



Turnover: Biggest winners and biggest losers

Of the contractors remaining in the top 20 this year, there's no doubt which has seen the biggest turnover fall – and it's a name which might surprise many. In 2008 Sir Robert McAlpine was on a high, having just picked up the £429m Olympic stadium job, and benefitting from being one of a select few go-to firms for major high-quality office projects. Its turnover of £1.79bn (for the year to October 2007) made it the seventh biggest contractor in the UK. Fast forward to its most recent results, covering the year to October 2013, and turnover of its parent company, Newarthill, has halved, to £898m, leaving it in 17th place. But not only has turnover shrunk, its pre-profit margin too has fallen dramatically, by around three-quarters, to just 0.66%.

And yet all this almost certainly overstates the extent of problems at Sir Robert McAlpine. The huge fall in profits is largely down to a one-off writedown related to a problem project in the Caribbean: otherwise the firm has maintained its profitability during the recession at around the 2-3% margin achieved in 2007. It remains a major player, picking up the £500m US Embassy job during the recession, and a major redevelopment for Selfridges department store just this month. One industry source says: "The sense is that SRM has just been a bit sensible; they've shrunk their business according to the market, and only taken on work where they've been able to get a margin."

There is no doubting the two big winners from the analysis: Willmott Dixon and Mace, both of which more than doubled turnover in the period, crashing through the £1bn turnover barrier. Willmott Dixon showed the biggest rise in turnover proportionately, increasing it by 151% and staying in profit. Mace, which before 2008 was known mostly for construction management, grew by 117% but also saw its profits soar, increasing its margin by 38% to record a £32m pre tax profit for 2013. Neither firms was in the 2008 Top 20, but now occupy the 12th (Mace) and 14th (Willmott Dixon) spots (see boxes, right).

Stephen Rawlinson, analyst at Whitman Howard, says: "Both Willmott Dixon and Mace have done well in the last few years. They both seem to have a better appreciation of what their customers want."

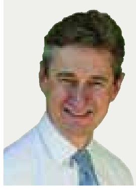
Methodology

The data for 2008 is from Building magazine's Top 150 Contractors and housebuilders for that year. This was based on the most recent published data at the time of printing in June 2008, which for most firms covered the 2007 financial year. All data for 2014 is from most recent published accounts, which is for the 2013 year for all except Keller, Skanska and Volker Wessels. The figures for Bovis Lend Lease and Lend Lease refer to UK operations only, Skanska results refer to Skanska UK, and the VolkerWessels figures include Fitzpatrick.

WILLMOTT DIXON'S SUCCESS

Rick Willmott, chief executive of Willmott Dixon (pictured), says the growth of the public sector-focused contractor has "not been rocket science". "It's applying simple principles and focusing on our core abilities," he says. Recording turnover of £413m in 2007, Willmott Dixon's turnover was boosted by around £250m the next year with the re-purchase of its social housing business, then called Inspace. Otherwise, however, its growth to £1.05bn turnover over the period has been largely organic. In part it has achieved this through what Willmott calls a "gamble" that public capital spend would remain high, despite government pledges to cut.

While expanding it has stayed profitable by working hard to keep its place on local major public sector frameworks, such as Scape and IESE, where margins can be preserved. Willmott says: "The nature of the frameworks is that nothing is single stage tendering, giving you the time and ability to negotiate with your supply chain. The profits aren't massive but they are predictable and reliable."



In addition to its construction expertise, particularly in housing and education, it has invested in a developments business and is at the forefront of developing homes for rent with institutional investors.

MACE: FLEXIBILITY HAS BEEN KEY

Mace's success since 2008 has been founded on a number of key contracts, such as its programme manager role on the London Olympics, and in particular the £425m job to build the Shard. This was its first major fixed-price contract, moving it out of the realm of construction management just as the market swung back to lump sum contracting. It has diversified both in terms of its offering – adding FM, consultancy and development to its armoury – and geographically, with international work making up a small but growing proportion of its turnover. Chief executive Mark Reynolds (pictured) says the firm has benefitted from being privately owned during the recession, and therefore able to take long-term decisions: "We entered the recession with a number of long-term projects and programmes with repeat order clients; our pipeline has remained strong on the back of delivering those projects successfully.

"We've been able to build on these successes and the development of expertise to secure new work, such as Kingdom Tower in Saudi Arabia and bringing programme management skills to Birmingham New Street, working with Network Rail. Strategically we have focused on major projects and major programmes, but recognised we still need to be agile and flexible, working across complex and simple, large and small projects."