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# MARKET INSIGHT: UK Construction

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Xenia’s Market Insight reports are designed to work alongside a credit insurance programme. The purpose of this report is to provide you with objective and practical information that will help to advance your understanding of the issues and how they might impact your business.

We welcome your thoughts and questions on the issues covered. Please email us on [info@xeniabroking.com](mailto:info@xeniabroking.com) should you require any further advice or have questions about this report.

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# Introduction

Positive signs are starting to show for the construction sector after a somewhat stagnant and challenging period with confidence and optimism now beginning to surface. Even though some macro-optics are trending better, and the sector has finally registered small levels of growth, corporate insolvency levels remain heightened. With Inflation significantly lower than this time in 2023, and hope that interest rates could start to fall later this year, these factors should support a continued improvement in the outlook for the sector.

## Sector key data points

- Approximately 232k construction companies registered at Companies House.
- Construction GDP was £32.233 million to Q4 2023, a drop of 1.2% compared to previous quarter. This represents about 6% of total UK GDP.
- The industry employed some 2.12m people in Q4 2023, about 7% of the labour force.
- Corporate CCJs in general have maintained alarming levels in Q4 2023 reported at 26,356. Total value of debt increased by 15% from £102.4m in Q4 22 to £118m in Q4 2023.
- The material price index for all work actually decreased by 1.6 % in January 2024, compared to the same month in the previous year.
- Construction output fell by 0.9% in the three months to January 2024 according to the ONS, caused by a decrease (4.5%) in new work as repair and maintenance increased by 4%.
- Financial characteristics of the UK Construction Sector; Total Assets of £213 billion, Total Borrowings of £28 billion & Total Net Worth of £92 billion.

# Key observations

As with most sectors, construction faces a mixture of challenges that have been prominent for many years particularly during 2023. Main issues relate to legacy matters, which have of course troubled the sector for decades such as legacy contracts, wafer thin margins and payment delays. Other issues that have surfaced are more sequenced and challenging and require innovative and critical thinking to tackle along with specialist advice and facilities. These include:

**Rising input costs** - Despite the current deceleration in inflation, input cost rises are likely to have a medium to major impact on construction projects and activity. Maintaining strong supplier relationships and improving data collection through construction technology will be key to tackling cost issues in 2024.

**Thin profit margins** - In view of persistent input cost inflation and prevalent excessive competition, firms and industry leaders may acknowledge and voice the need for margin development especially as challenges ease during 2024, and this could, once again, mean pursuing volume through destructive bidding and alarm.

**Supply chain mismanagement** - This will forever remain a particular test for the sector as its one of the key reasons why many smaller businesses down the chain endure such distress. The capacity for large construction outfits to pass on a financial burden down the supply chain to small businesses and sub-contractors perhaps provides a rationale why this sector continues to top the charts for insolvencies year after year.

**Labour & skills shortages** - For years, the UK construction industry has grappled with a labour shortage, a situation exacerbated by a confluence of socio-political and demographic factors. This factor has certainly been an impediment for many years but recent data from RICS UK Construction Monitor for Q4 2023, suggests labour shortages have and are easing from the bar set in 2021/22 which confirmed 80% of firms in construction found it a challenge in hiring for many roles and disciplines. The result in the latest survey is still close to 50%. Skill shortages in specific areas still remain acute including both Quantity and Building Surveyors, and an even more acute is shortage of skilled trades.

**Digital adoption** - Like every other sector in the economy, construction is having to come to terms with the digital age which is driven with the advancements and utility in technology to help streamline efficiencies and productivity. This is affecting every aspect of operating models, workflow planning management and performance monitoring.

**Unprecedented supply-chain inflation** - Inflation in prices of materials, products, and labour has undoubtedly been the most challenging and widespread headwind facing contractors across the UK, particularly due to fixed-price contracts continuing to be commonplace.

## Key issues causing concern for the sector:

### Building costs remain a concern

- CPI increased by 4.2% in the 12 months to January 2024.
- Wages continue to rise as skills remain in short supply.
- Margin and cashflow pressures present and will remain into 2025.
- Material price index for all work decreased by 1.6 % in Jan 2024, compared to the same month in 2023.

### High indebtedness

- -11.7% fall Year on Year in UK SME construction debt.
- Companies pay CBILs or have become insolvent.
- 5.25% base rate 'maintained' will hinder renewal of financial support.

### High insolvency rate

- Q4/2023 - 1,154 insolvencies (7.5% increase Quarter on Quarter).
- 18% v all UK Sectors.
- 59% Increase v pre-pandemic.
- CVLs highest since 1960 at 20,577.

### **PMI rising slowly to range of growth**

- PMI 53.0 in April.
- Fastest expansion of Construction Output since February 2023.
- Outlook and Sentiment is most upbeat since January 2022.
- PMI trend continues on a positive trajectory up from 50.2 in March 24

### **Pressures on the Top-line**

- Turnover falling as activity is on the decline.
- Weak margins as competition increases.
- UK growth currently among weakest of G7.
- Delayed projects supporting modest growth against trend.

### **Overtrading en route**

- Period of economic volatility possible as weak companies try to trade back into the black taking higher risks.
- May lead to slower paying with lengthening Days-Payable-Outstanding. (DPO)
- Rapid growth in turnover that's not scalable and not relative to assets.
- Slow movement of stock and therefore cash tied up.

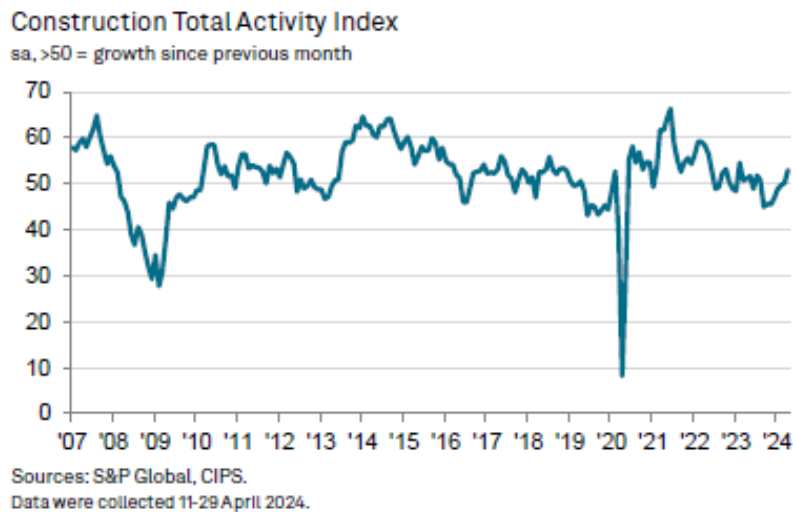


# UK Construction PMI

The latest PMI (Purchasing Managers Index) data for April 2024 continued on its positive trend seen in March as levels went from contraction to growth. Furthermore, optimism across the space improved for a fifth consecutive time in the last 5 months and was the highest since January 2022. The PMI for March was at 50.2, a pinch above the growth apex and up from 49.7 in February. It was the highest level since August 2023 and was fractionally above that the neutral 50.0 threshold.

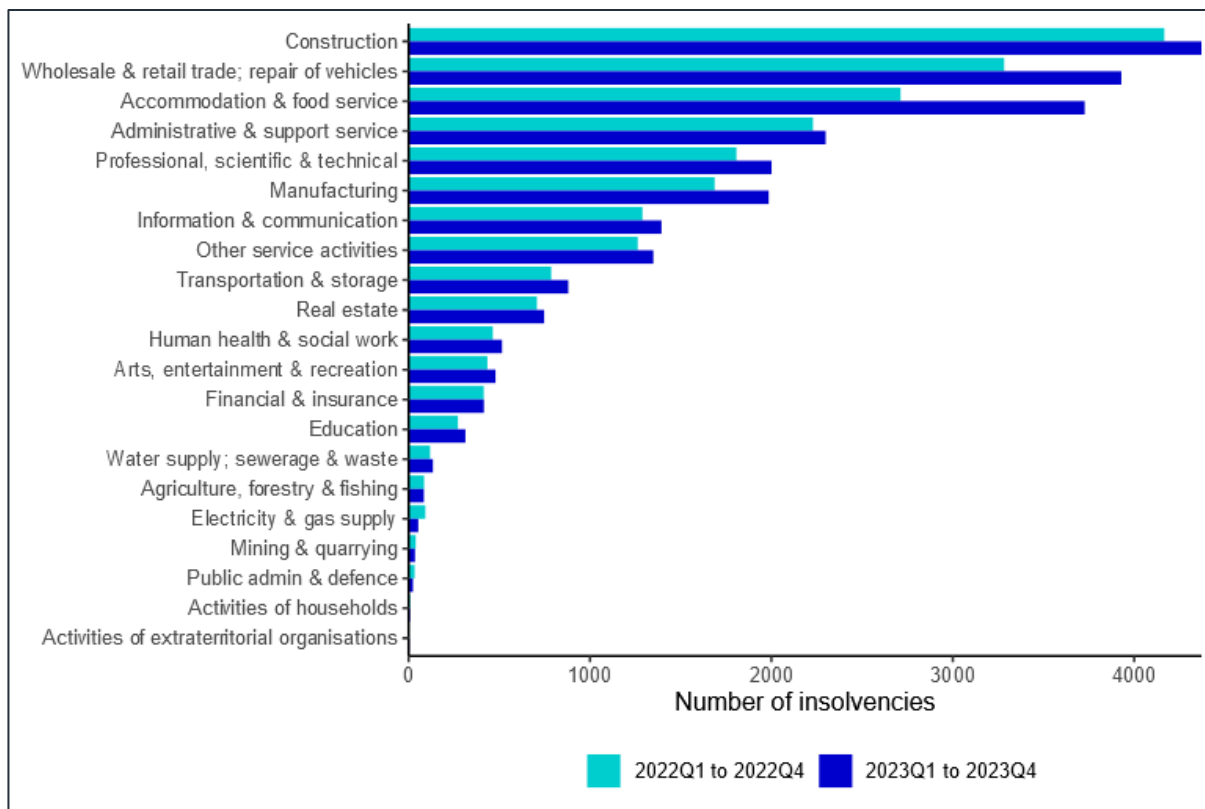
The latest calculus of measurement was propelled by business optimism improving and being at its highest since January 2022 reinforced with companies citing hopes of a sustained upturn in customer demand as well as more favourable economic and financial conditions over the course of 2024. Construction established its return to growth in April, with total industry activity rising at the fastest pace for 14 months amid an ongoing recovery in order books and opportunities.

Total new work increased marginally in February, thereby ending a 6-month period of decline. This appeared to reflect a turnaround in tender opportunities and greater client confidence, especially in the house building segment. Unease about the business outlook was overwhelmingly attributed to the on-going uncertainties that hover, and a corresponding drop in client spending and cost challenges prevalent across the economy.



# Insolvency analysis

As we stated in the Xenia's latest Corporate Insolvency Analysis, there has been a record-breaking number of UK construction insolvencies in the UK over the past twelve months. Construction remains the most significant contributor to the insolvency statistics, representing 18% of all insolvencies and in the period to Q4 2023, there 4,371 insolvencies registered in construction compared to 4,166 at the end of Q4 2022. In the quarter there were 1,154 insolvencies registered versus 1,073 in Q4 2022 and 1,005 in Q3 2023. Financial stability can be elusive for many construction businesses. Year and year out, in good times and bad, around a fifth of all UK insolvencies have been in the construction space and when compared to its 6% share of GDP, this is certainly acute.



Source: <https://www.gov.uk/government/statistics/company-insolvency-statistics-october-to-december-2022/commentary-company-insolvency-statistics-october-to-december-2023>

## Significant Construction insolvencies

- **Buckingham Group - £665m** - Unsecured Creditors £108m - Filed for administration in August 2023 primarily driven by deep losses and cash deficits.
- **Henry Construction - £402m** - Unsecured Creditors £43m - Went into administration in June 2023 becoming the largest firm to collapse in the construction sector since October 2021.
- **Tolent Construction - £198m** - Unsecured Creditors £76m - Collapsed in February 2023 following a series of financial difficulties such as a number of major loss-making contracts. 1000 creditors
- **Metnor Construction - £63m** - Unsecured Creditors £10m - Significant financial challenges amid contract losses and pressures on profit margins from rising input, labour, and raw material prices alongside supply issues against fixed price contracts.
- **Malin Industrial Concrete Floors - £26m** - Unsecured Creditors £11m - Significant drop in income, cash flow struggles caused by fixed price contracts and delays to several schemes in its pipeline.

**Some other notable insolvencies in this sector and latest turnover:**

- Michael J. Lonsdale Ltd - £191m
- UK Windows & Doors Group Ltd - £122m
- Westridge Construction Ltd - £64m
- AC Data Ltd - £43m
- James Killelea & Company Ltd - £11m

**There are many headwinds for the construction sector that influenced these insolvencies, notably:**

- High inflation
- Covid loan repayments
- High energy costs
- Higher Borrowing Costs
- Shortages and rising costs of equipment and materials
- Longer lead times, schedules, and cost overruns
- Not to mention the ever-present issues of labour shortages and slow digital adoption.



# Credit insurance and surety market sentiment

## Credit insurance market

Although the Credit Insurance market by its very nature will continue to write cover where possible, in such uncertain times, credit departments will remain more cautious in their underwriting approach and line.

Insurance claims have been increasing both in terms of both volume and value.

As we have observed, the speed at which a seemingly well performing construction business can deteriorate and collapse overnight is staggering. This requires extra scrutiny and evaluation in analysis of the top line, profit margins, debt position, working capital management, risk control measures employed and strategic roadmap. All of these are key areas that credit insurance underwriters will pay close attention to along with the following critical guidelines:

- **Information is always key** - Credit Risk departments remain in regular dialogue with a variety of businesses across the sector with a mission and to furnish updated management accounts to fully understand both the trading performance in the current environment in particular funding facilities that are being made available to support working capital.
- **Refinancing** - When meeting with the key buyers in the space, risk analysts and underwriters will seek to understand how they are mitigating inflation and the impact of increasing interest rates amongst other obstacles.
- **Case by case** - Each business is reviewed on its own financial merits for the purpose of its underwriting judgement.
- **Consistency** - Strike a balance between growth support & risk management discipline.

There is certainly an air of caution radiating across the credit insurance market, however, by and large the overall stance remains supportive.

## Surety market

Over the last year, the surety market has retrenched, some smaller insurers have exited the market or are restricting themselves to existing relationships. Conditions have hardened both in terms of rate and security required. The practice of taking partial cash security has increased and risk sharing between insurers has become a prominent feature. The requirement for performance bonds by employers has increased substantially as a protective measure anticipating the effects of increased contractor insolvencies. Wise contractors have latched onto the provision of advance payment bonds to secure upfront funding particularly where deposits are needed to secure material supply.

# Key measures & endorsed actions

The UK construction industry is not only a critical part of the economy but continues to evolve and transform as it navigates a rather challenging passage of time. The sector is affiliated with many industries given its foundational nature and this therefore covers a wide variety of businesses so naturally will face a number of key risks both on a micro and macro scale. It's clear that in the short term, where possible, suppliers should be considering strategic decisions to minimise their risk as well as curbing any overreliance on single customers. Although we are seeing some green shoots, the road to recovery is likely be bumpy with chicanes and obstacles. Companies will therefore need to become more agile, embrace change, introduce, or intensify use of digital technology and be open minded about innovation to enable survival and a positive evolution.

There are many warning signs that can easily help identify when an underperforming company is becoming highly distressed or approaching its Rubicon (Point of No Return). As a company progresses along this distress curve, its decline can quicken, therefore taking appropriate action as early as possible is vital in protecting your company's position.

In view of potential financial distress that can transpire from the challenges above and with insolvency on the rise, understanding and being able to identify certain warning signs is now an essential step to protect your business and avoid a bad debt or a potential liquidation.

- Refinancing Risk
- Change in Security
- Shareholders Support
- Profit Warnings
- Late Filing
- Ageing Debtor Profile
- Covenant Headroom
- Supply Chain Constraint
- Liquidity Headroom
- Access to financing markets
- Change in structure and shareholder
- Increased cost of debt
- Change in funding structure
- Change in Auditors
- Financial Transparency

Financial strategies for mitigation:

- Exercise a greater focus on controlling costs and optimising opportunities.
- Enhance the credit management function and system.
- Credit Insurance provision to not only protect against insolvency/bad debt but support growth ambitions.
- Review financial arrangements/facilities with financiers.
- Introduce or re-examine the hedging strategy.

# Xenia analyst assertion

Although current conditions across industry remain relatively subdued, the latest data points and market survey feedback shows a gradual improvement in forward looking sentiment, which is of course a welcomed change. This is not only supported by the prospect of interest rates easing during the year overall, but workloads are anticipated to rise, with an expectation this pick-up will be accompanied by a rise in employment levels across the industry. That said, the challenge around existing skills shortages remains a persistent theme. In essence, the latest analysis is one of hope and optimism although caution is still advised.

Trends in some pertinent, critical macro and sector-based data is encouraging and sentiment on the back of this has moved to another level of buoyancy especially with hopes and expectations of a cut to interest rates at some point in 2024. However, while this shift is noticeable, it is still moderate, and some key metrics would suggest continuing to exercise caution. With insolvencies at record levels, input cost inflation still enmeshed, borrowing costs still high albeit maintained and growth at crawling pace, the sector still has many milestones to achieve before we can be truly sanguine that it has turned a corner.

This will be a tough year for those running construction businesses, although at least they started an equally difficult year in 2023 with stronger finances than a year earlier. It will remain to be seen what the disruption to key sectors such as house building in 2023 has done to balance sheets and working capital resources. This year will be another one of uncertainties, not just over the diverse views on likely activity levels, but the potential for global geopolitics to move the UK's economic goal posts yet again. Steady as she goes seems an appropriate policy, with an even more intense focus on financial discipline and risk awareness.

To conclude, here is an abridgment of the critical matters to be conversant with:

- Delays and shortfalls in Investment both at home and from the continent.
- Overall credit insurance claims heavily linked to construction related fields.
- Rise in the number of construction companies in significant financial distress.
- Poor payment practices especially within sub-contractor field owing to deteriorating margins.
- Strained cash-flow with many firms having to raise their own prices to avoid losing money.
- A double-edged sword as this may impact competitiveness.
- Many legacy contracts in 2023 caused and continue to cause losses and a cash drain for businesses.
- CCJs in general have maintained alarming levels in Q4 2023 reported at 26,356.
- Total value of debt increased by 15% from £102.4m in Q4 22 to £118m in Q4 2023.
- A period of economic volatility possible later this year as weak companies try to trade back into the black taking higher risks.
- May lead to slower paying with lengthening Days-Payable-Outstanding. (DPO)
- Rapid growth in turnover that's not scalable and not relative to assets.
- Slow movement of stock and therefore cash tied up inhibiting liquidity.

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