Sales Rise in Q1 but Risks Prevail

Headlines:

- 48% of manufacturers reported that sales of construction products rose in 2011 Q1, compared to just 14% in 2010 Q4, and the outlook for 2011 as a whole has improved.

- 79% of manufacturers, however, stated that the strength of demand over the next 12 months will be their key constraint.

- Annual cost inflation remained strong (at of over 5% according to 42% of manufacturers).

- Growing confidence among manufacturers means that employment creation is likely over the next 12 months and 35% of manufacturers suggest headcount will rise.

- 33% of manufacturers reported that exports rose in the year to March, by more than 5% according to 17% of exporting manufacturers.

Unseasonal mild and dry weather, restocking and a favourable exchange rate improved operating conditions for construction products manufacturers in 2011 Q1, and the outlook is stable, according to the latest Construction Product Association’s State of Trade Survey. Inflationary pressure, however, continues to mount and is unlikely to abate in the short term and the looming cuts to public sector capital spending are a concern.

Official figures suggest that construction output contracted by 4.7% in 2011 Q1, a rate not seen since the depths of the 2009 recession, and this conflicts with the improving picture that the Association’s latest survey conveys. The scale of the fall in the official figures is surprising and not consistent with information from construction industry trade surveys or anecdotal evidence from companies within construction.

Heavy side product sales got off to a strong start to the year in 2011 as business as usual resumed following the severe weather disruption in late 2010. Harsh weather conditions also affected sales in 2010 Q1, making 2011 Q1 stronger on both an annual and quarterly basis. Sales of light side products, which are typically used at a later stage in the construction process, were broadly flat in 2011 Q1, compared with 2010 Q4, but remained significantly stronger than in 2010 Q4.

Prospects for sales of both heavy and light side products over the next year improved in 2011 Q1 and manufacturers have started to recruit after consistently reducing headcount throughout 2008, 2009 and 2010.

For manufacturers with established export links, the lower value of Sterling, and the relatively strong growth prospects of some overseas nations, continued to provide a boost to sales in early 2011, particularly for firms supplying heavy side products such as aggregates and metals. However, exports continue to account for a small proportion of total sales in the construction product manufacturing sector as a whole and the majority of manufacturers (64% of heavy side and 63% of light side firms) do not export at all.

Capacity continues to be under-utilised, with only 14% and 13% of heavy and light side respondents operating at more than 90% capacity, significantly lower than in 2007. Manufacturers of heavy side products expect capacity utilisation to increase marginally over the next year.

Expectations regarding the likely strength of industry-wide sales over the next 12 months may have improved but as 2011 progresses, industry conditions are set to become increasingly challenging. Almost 80% of construction products manufacturers reported that the sustainability of demand is a real concern and the single most likely factor to constrain activity over the next 12 months. Cuts to central government and local authority capital budgets from 2011/12, announced in the Comprehensive Spending Review, will begin to bite in the second half of 2011, well before the private sector construction recovery is fully entrenched.
Sales & Constraints

Better weather in 2011 Q1 boosts heavy side sales...

Heavy side firms, on balance, reported that sales picked up strongly between 2010 Q4 and 2011 Q1. Sales volumes increased according 56% of heavy side firms, whilst only 22% reported a fall over the same period, yielding a balance of 24%. For light side firms, 2011 got off to a more challenging start to the year, with the number of firms reporting an increased from 2010 Q4 exactly offsetting the number reporting a decrease. Over the short term, however, the expectations of both light and heavy side firms are firmly positive.

...and heavy and light side sales are up from 2010 Q1.

Compared with the same quarter one year earlier, sales volumes in 2011 Q1 were higher according to both light side and heavy side firms. 56% of heavy side firms and 44% of light side firms reported that sales volumes rose between 2010 Q1 and 2011 Q1, yielding balances of 36% and 12% respectively. The total sales volumes balance, compared with a year earlier, was 22%. Over the next 12 months, both heavy and light side firms expect sales to continue to rise. Heavy side firms are, on balance however, more positive than their light side counterparts.

Heavy side sales growth exceeds light side...

Out of the 56% of heavy side firms reporting an increased in sales over the past year, 40% suggested that growth was strong, at more than 5%. Conversely, only 12% of heavy side firms reported that sales recorded a significant contraction, of more than 5%, between 2010 Q1 and 2011 Q1. The change in sales experienced by light side firms was generally more modest. 24% of light side firms reported that sales rose by more than 5% during the period, but only 8% suggested a contraction of this magnitude. 20% of light side firms reported that sales rose by not more than 5%.

...and expectations are positive across the board...

Following an improvement in 2011 Q1, a quarter of heavy side firms and a third of light side firms expect sales to be flat over the next year. As concern about the stability of demand mounts, however, 21% of both heavy and light side firms anticipate that sales will fall over the next year. 54% of heavy side firms and 46% of light side firms expect sales to increase over the next 12 months as exports continue to rise. In spite of this optimism, many respondents remain concerned about the likely stability of domestic demand, as the public sector retrenches.

...but the stability of future demand remains a concern.

The stability of demand is the biggest threat facing product manufacturers over the next 12 months. 77% and 85% of heavy and light side respondents respectively suggested that demand is the most likely factor to constrain sales in the year ahead. Raw materials prices were cited as a potential factor by 12% of light side manufacturers, while capacity was a concern for 12% of heavy side manufacturers, for whom taking the decision to bring mothballed capacity back on stream is a significant commitment. Labour availability is not a concern in the current climate.
Costs, Employment, Capacity & Investment

Unit costs continue to increase at a rapid pace...

Pressure on unit costs has been strong for both heavy and light side firms since mid-2010. 77% of heavy side firms and 88% of light side firms reported that unit costs rose between 2010 Q1 and 2011 Q1 and the vast majority of these respondents, 50% and 64% respectively, experienced inflation of more than 5%. For 27% and 24% of heavy and light side firms, inflation of up to 5% was experienced. Only 4% of light side firms and 12% of heavy side firms reported that costs contracted during the year.

...due to raw materials, fuel and energy.

The soaring price of raw materials, fuel and energy costs are currently having a significant influence of the unit costs of manufacturing construction products. More than 50% of both heavy and light side firms reported that raw materials prices rose by more than 5% between 2010 Q1 and 2011 Q1. Fuel costs have also increased sharply, with 69% of light side firms, and a significant 80% of energy intensive heavy side firms, reporting that annual inflation exceeded 5%. Wage inflation in contrast is muted. Not a single firm reported that wages increased by over 5%.

Employment rose for the first time since 2007 Q3...

The change in labour force balances for heavy and light side manufacturers entered positive territory in 2011 Q1, for the first time since 2007 Q3, as manufacturers began to increase headcount. The heavy side balance climbed from -53% in 2010 Q4 to +19% in 2011 Q1, whereas the light side balance rose from -91% to +4%. Over the next year, employment is expected to continue to rise. On balance, 19% and 23% of heavy and light side manufacturers expect employment to increase over the next 12 months, compared to -20% and -14% in 2010 Q4.

...but there is still spare capacity...

In 2011 Q1, only 14% of heavy side firms and 13% of light side firms were operating at above 90% capacity, a significantly lower proportion than in 2007 when the quarterly averages equalled 24% and 29% respectively. Looking to the next 12 months, heavy side respondents anticipate that capacity usage is likely to increase moderately, and by 2012 Q1, 19% of heavy side manufacturers expect to be operating at over 90% capacity. Light side manufacturers, in contrast, expect usage to fall slightly, with only 9% expecting to operate at over 90% capacity in 2012 Q1.

...and firms continued to invest in product innovation.

Manufacturers of both heavy and light side products continued to invest in developing products, new equipment and e-business throughout the recession, but scaled back on investment in their physical infrastructure, such as funding the construction of new premises. This trend broadly continued in 2011 Q1. On balance, 33% of heavy side firms and 24% of light side firms invested in product improvement, and 19% and 38% respectively in R&D. 22% of heavy side respondents and 10% of light side respondents reported that investment in structures decreased during the year.
Spending on product innovation will continue to rise.

Capital investment intentions of both heavy and light construction product manufacturers generally strengthened in 2011 Q1, with positive balances being recorded across all categories for the first time since 2008 Q2. Over the next 12 months, almost 50% of heavy and light side manufacturers expect investment in product improvement and e-business to increase. 5% of heavy side firms on balance, and 8% of light side firms, expect to increase investment in their building infrastructure between now and 2012 Q1.

Exports continued to increase...

Buoyant economic conditions elsewhere in the world provided a boost to UK product manufacturing in 2011 Q1. On balance, 38% of heavy side manufacturers and 13% of light side firms reported an increase in sales volumes in the year to 2011 Q1. Manufacturers generally remained confident that export volumes will continue to expand over the next 12 months, with 29% of heavy side firms and 20% of light side firms expecting sales to rise, on balance. 29% of heavy side firms and 13% of light side firms expect export sales to rise by more than 5%.

...accounting for a significant proportion of light side sales.

Exports strengthened in 2011 Q1 and 36% of heavy side manufacturers and 38% of light side manufacturers export construction products. Export sales by light side manufacturers are likely to account for a larger share of total sales and account for more than 15% of total sales according to 17% of light side manufacturers. Only 4% of heavy side manufacturers make more than 15% of sales overseas. Europe is the largest export market for construction products by a wide margin. Exports account for up to 5% of sales volumes for 28% of heavy side firms.