



Preserving Value under Supply Chain Pressure

Build UK

KPMG Major Projects Advisory

—
6 September 2022



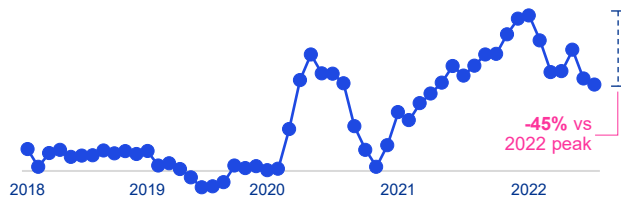
The volatile macroeconomic climate is leading to a fragile construction supply market; the need to preserve value has never been greater

The construction sector's post-pandemic road to recovery has been challenging. Over 2021, surging demand for key global commodities led to strained supply chains and global inflationary pressures. The impact of the Russia-Ukraine conflict at the start of 2022 exacerbated material and hydrocarbon shortages, with significant repercussions for global commodity markets.

The headwinds facing the economy into the second half of 2022 show little sign of abating, pointing to an increasingly fragile supply market. Consequently, insolvency risk may begin to rival inflation as a critical threat to the UK construction sector. It is never been more imperative for clients and contractors across the sector take steps to safeguard themselves to preserve value under significant supply chain pressure.

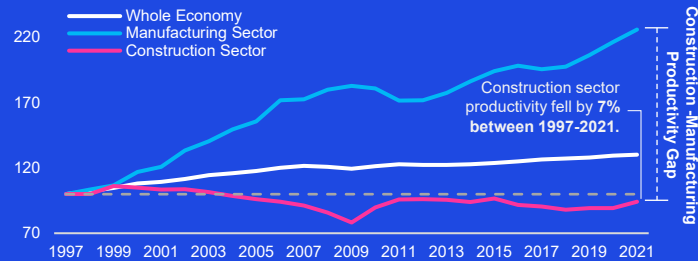
Global Supply Chain Pressures

remain elevated but there were indications of **easing** by Q2 2022. Supply chain pressure was **down c.45% vs its 2022 peak** by Q2



Source: New York Federal Reserve Bank, KPMG analysis.

Inflationary and supply chain pressures are exacerbated by the productivity gap suffered in the construction sector



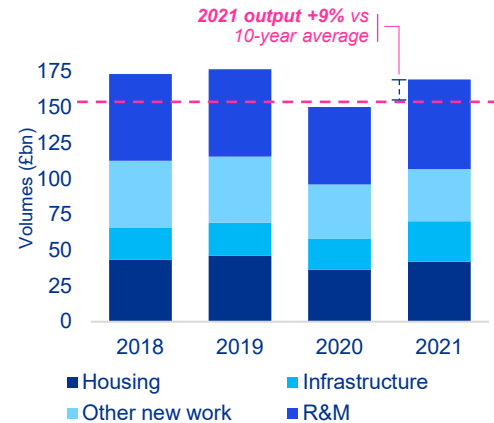
Source: ONS, KPMG analysis.

The construction sector's job vacancy rate rose to a 10-year high by Q2 2022

Pay has started to catch up putting further pressure on output prices.

Construction Output

recovered by 75% in 2021, seeing growth of 5% into 2022 until June which saw a 1.4% contraction.



Source: ONS, KPMG analysis..

Broad-based inflationary pressures

and the risk of recession or stagflation are leading to **highly volatile input prices**.

The below shows various key input prices changes vs their 2019 prices:

 **Steel**
+117% vs 2019

 **Timber**
+59% vs 2019

 **Cement**
+117% vs 2019

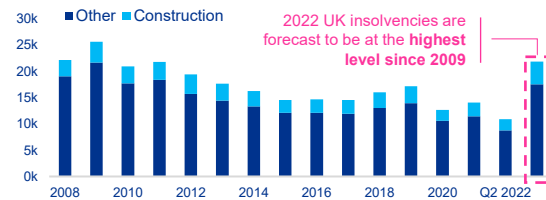
 **2 years**
until the BoE expect inflation to fall back to 2% target

Source: BEIS, KPMG analysis.

Construction sector insolvencies are expected to hit multi-decade highs in 2022; what can organisations do to preserve value?

The UK is facing record high levels of company insolvencies in 2022

Construction sector insolvencies are expected to exceed 2008 numbers in 2022.



Source: The Insolvency Service, KPMG analysis.

166% YoY increase in construction insolvencies (Q1 22 vs Q1 21)

51% forecast increase construction sector insolvencies in 2022 vs 10-year average

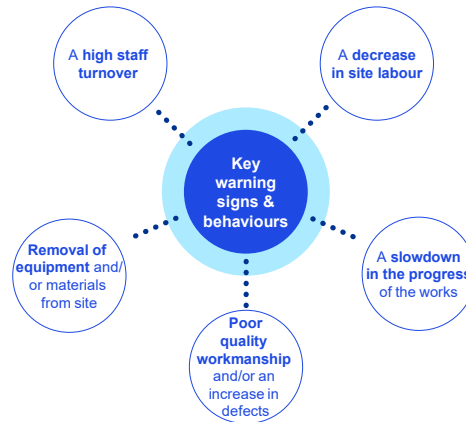
The key market pressures driving insolvencies

- The impact of **removal of covid-era government support** measures
- Rising inflation** leading to increasing input costs
- Accelerating monetary tightening** & rising interest rates (more expensive debt)

The post-2022 outlook will be determined by:

- The **global momentum of economic rebound** (stagflation)
- The **number of 'zombie companies'** post covid-era support
- The volume of fragile companies with **high default risk** (debt sustainability)

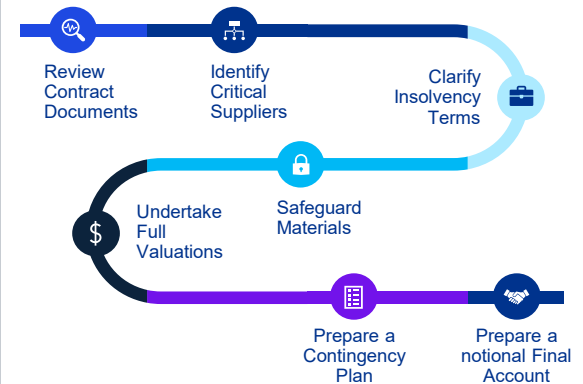
What are the tell-tale behaviors and indications of potential insolvencies on site?



What are the commercial behaviours and steps that distressed contractors might take to improve their cash flow?

- 1 Payment Terms:** requests from sub-contractors for changes to payment mechanisms
- 2 Financial Reporting:** late filing of annual returns to Companies House
- 3 Reduced Dialogue:** a lack of response to correspondences
- 4 Claims:** submission of unsubstantiated claims
- 5 Inflated Applications:** submission of inflated applications for payment

What steps should organisations be taking to safeguard themselves within a volatile supply market?



What are the actions that should be taken in the event of supplier insolvency?

Once the employer is certain that a contractor is insolvent, the following actions should be taken immediately:

- Secure the Site**
Secure materials & equipment and inform site security & change the locks
- Check the Contract**
Examine any bonds or Parent Company Guarantees in place. Notify insurers, ensuring that any insurance obligations have been fulfilled
- Terminate the Contract**
Typically, termination is effective upon the contractor receiving notice. Their obligations to complete the works are then suspended.
- Withhold Payment.**
The employer is not obliged to make any further payments if termination is in effect. If an interim certificate has been issued, a withholding notice should be issued



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Joe Manning is a Director in KPMG's Major Projects Advisory team, providing assurance and programme management for Infrastructure and Government. Joe has 15 years' experience delivering and advising across the lifecycle of major projects and programmes. He is experienced in providing clarity to SROs, Boards, Risk and Audit Committees and Executives on the performance of their projects and programmes, offering unique insights into 'what good looks' like, supporting capability improvement and the achievement of better outcomes.

A Chartered Quantity Surveyor by profession, Joe started his career in project delivery for one of the largest UK tier one contractors. Joe's career has included delivering major infrastructure projects and advising public and private sector organisations on project controls, governance, assurance and process improvement.

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