S&P Global Ratings

Global Engineering And Construction

2024 outlook update

Fernanda Hernandez

Renato Panichi

Stephen Chan

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Key takeaways

- Engineering and construction (E&C) issuers in the U.S. and Europe are poised to grow over the next several years, propelled by historically high infrastructure spending, a conducive regulatory environment, and large governmental incentives and stimuli to support energy transition.
- Geopolitical tensions are a key threat for E&C issuers globally due to inflation and supply chain disruptions from extended and escalating conflicts.
- The cadence for growth in the U.S. will depend upon successfully implementing government programs and reducing delays in granting permits.
- Climate transition will dictate capital allocation and pave the way for E&C issuers to pursue new energy projects globally.
- In Europe, we anticipate weak conditions in residential building construction to persist for all 2024, though our rated companies do not display significant concentration in this segment.
- Growth in infrastructure investment will likely moderate due to more-disciplined spending from local Chinese governments amid their elevated leverage in 2024. However, we expect Chinese state-owned enterprises (SOEs) will see above-average growth and take market share from smaller industry players.
- E&C issuers with good scale, low leverage, and healthy cash flow generation are positioned well to capture above-average growth, resulting in modestly improving credit metrics. In Europe and the US, this is translating into positive rating actions.
- Higher interest expense weighs on lower-rated E&C issuers' earnings and cash flows, but we expect EBITDA growth will outpace interest expense, alleviating downside ratings pressure.

What we're watching

Geopolitical tensions and regulatory hurdles

Governments around the world aim to increase infrastructure spend and fuel economic growth, but a global economic slowdown, high sovereign indebtedness, and reliance on the successful implementation of government programs pose a risk to the cadence of top-line growth of our rated E&C issuers.

Materials and labor cost increases

Inflationary pressures have subsided but not disappeared. Cost increases for construction materials plateau at elevated prices, and we do not expect a decline. At the same time, wage inflation seems permanent due to scarce skilled labor in the sector. Project cost inflation remains a risk to profit margins in most markets across the globe. Larger issuers with stronger bargaining power and self-perform approaches are less exposed.

Refinancing needs amid sustained, high interest rates

We anticipate interest rate cuts in the back half of 2024, but rates in markets outside of China will remain elevated relative to 2022 levels. Our rated universe of E&C issuers do not face large maturities in 2024, but the wall is higher in 2025 and 2026.

Investments to support energy transition

Aging infrastructure that requires ongoing maintenance and upgrades across electric, gas, and water systems provide a recurring revenue base for many of our E&C issuers. This is boosted by investments in wind, solar, and battery storage assets, which drive strong secular tailwinds in light of energy transition goals, globally.

Investments to support AI and other new technologies

We expect long-term growth for communications infrastructure driven by demand for data and connectivity assets. Adoption of new technologies, such as AI, driverless cars, and others, will continue to boost demand for new builds and upgrades across data centers, semiconductors, and chips manufacturing.

Evolution of fixed-price contracts

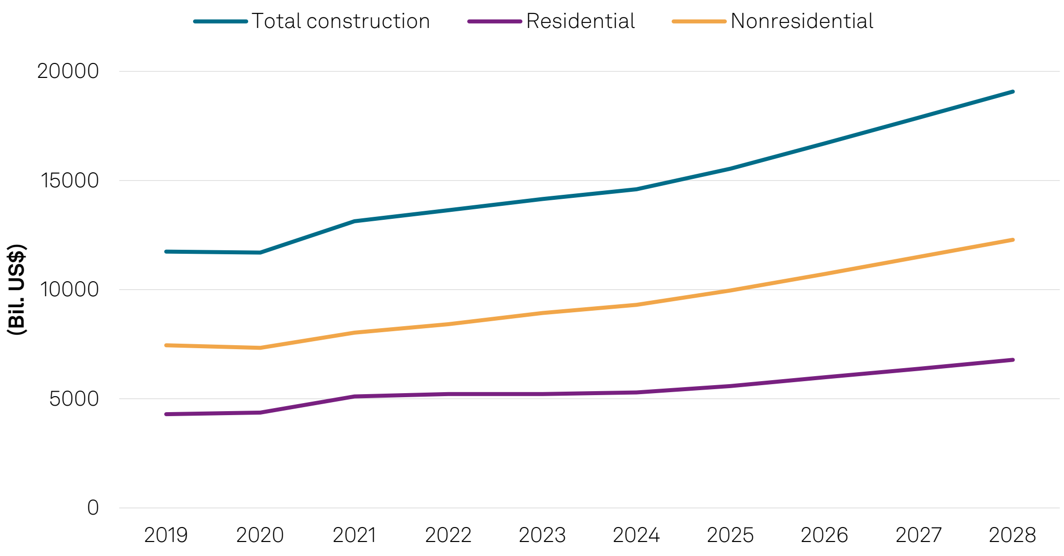
Pandemic-induced project delays and cost increases underscored the risk associated with fixed-price contracts. E&C issuers seek friendlier contract models and commercial terms to protect margins. In some cases, E&C issuers are passing on riskier projects, resulting in an evolving competitive landscape.

Global Construction Outlook

Global construction outlook | Spend will continue to grow

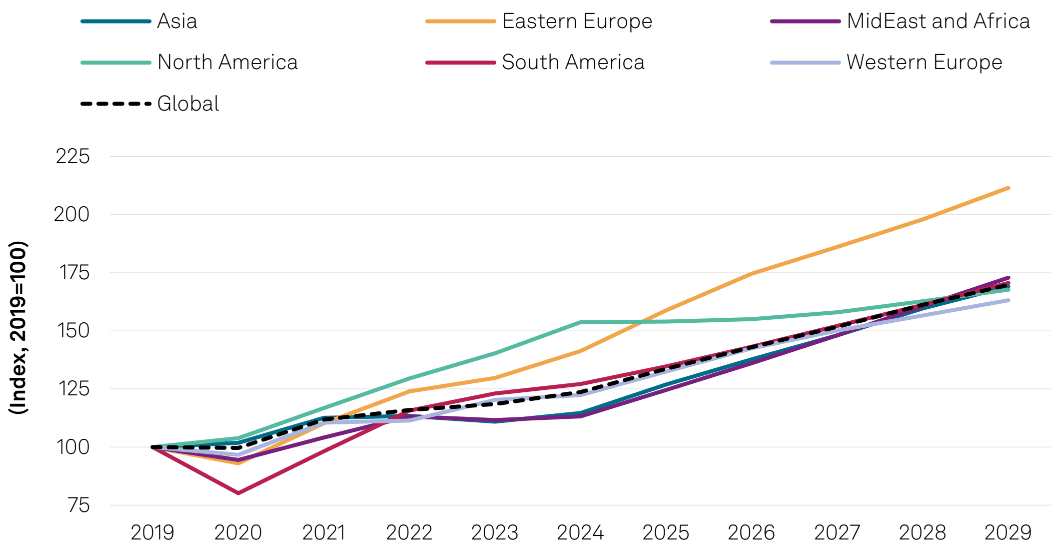
- We expect global construction spend will reach $14.5 trillion in 2024 and $15.7 trillion in 2025, a 4.3% and 8.1% increase from a year before, boosted by nonresidential spend and a sustained recovery for residential construction.
- Nonresidential and residential construction spend accounted for about 64% and 36% of total global construction spend in 2023, respectively. We expect the mix will remain relatively stable over the next few years.
- Construction spend in North America is set to outpace the rest of the world in 2024 due to accelerating infrastructure spend, which we expect will maintain a positive trend.
- In most other regions, we anticipate a modest but progressive growth, largely fueled by the civil and infrastructure segments.

Nominal global construction spend (bil. US$)



Sources: S&P Global Market Intelligence data insight as of July 2024; S&P Global Ratings calculations.

Construction spend by region



Sources: S&P Global Market Intelligence data insight as of July 2024; S&P Global Ratings calculations.

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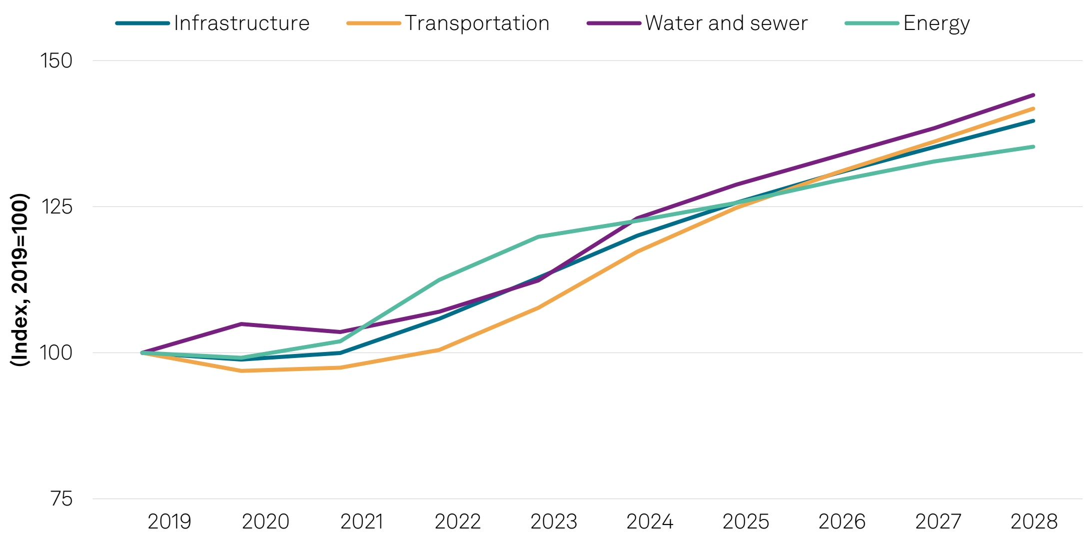
Global construction outlook | Overall growth

- We expect spend in infrastructure will remain sound globally, largely driven by investments in transportation, which is the largest infrastructure segment and accounts for about 50% of infrastructure spend.
- At the same time, we expect growth for water and energy infrastructure will accelerate due to regulation requirements and energy transition tailwinds.

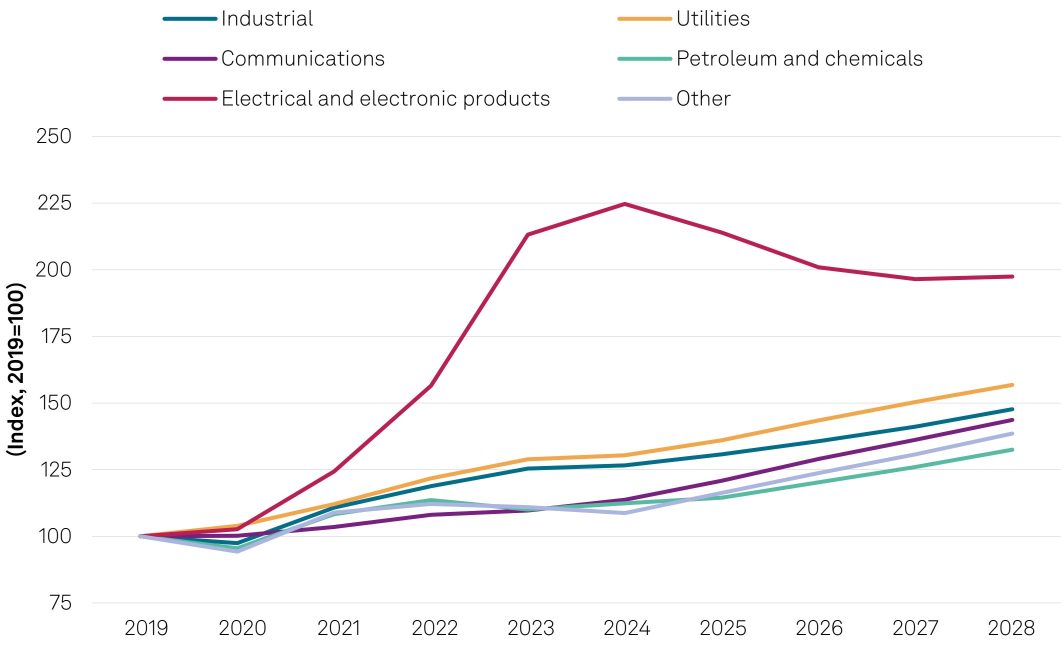
Global construction spend in infrastructure



Sources: S&P Global Market Intelligence data insight as of June 2024; S&P Global Ratings calculations.

- We expect construction spend for industrials will decelerate in 2024 and 2025 following an outsized growth for electrical and electronic products (which include chip-manufacturing facilities) in 2023.

Global construction spend in industrials



Sources: S&P Global Market Intelligence data insight as of June 2024; S&P Global Ratings calculations.

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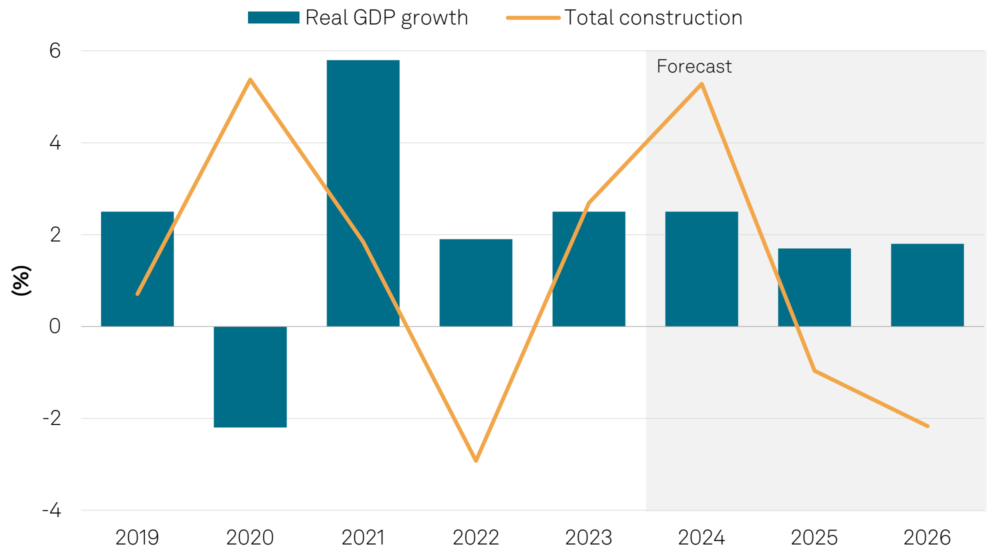
E&C U.S.

U.S. construction | Strong fundamentals fuel infrastructure spend

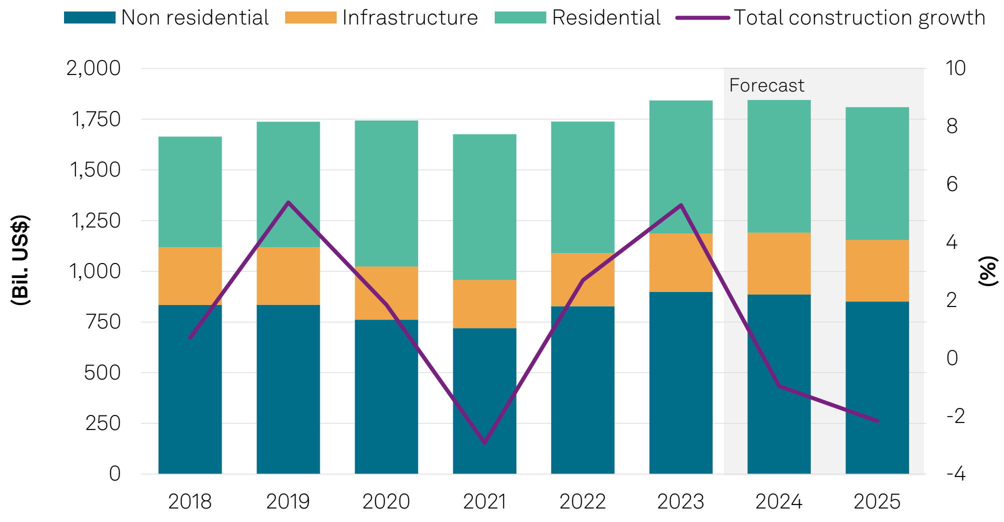
- Ageing infrastructure across the U.S. and historically high spending drive strong demand for civil engineering and construction services.
- Investments in energy transition, sustainability, and resilience drive demand across multiple end markets, particularly for power infrastructure.
- AI adoption and connectivity needs support long-term fundamentals for new and upgraded telecommunications networks and data centers.
- We expect governmental incentives, including the IIJA, Chips Act, and IRA, will further boost growth toward the back half of 2024 and beyond.
- Reshoring and nearshoring spiked demand for the E&C of manufacturing facilities such as semiconductor and EV batteries, but we expect it to moderate in 2025.

Real GDP and total construction growth



S&P Global Market Intelligence data insight as of July 2024. Source: S&P Global Ratings calculations. Figures shown in real terms. Adjusted for inflation, 2024 and 2025 construction growth is 7% and 1.6%, respectively.

U.S. construction by segment

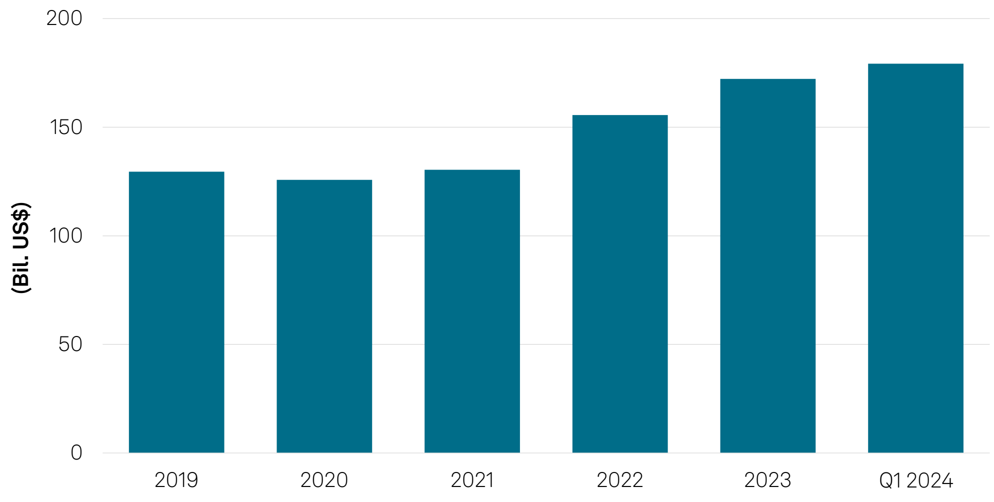


S&P Global Market Intelligence data insight as of July 2024. Source: S&P Global Ratings calculations.

U.S. E&C | Rated issuers show sustained backlog growth

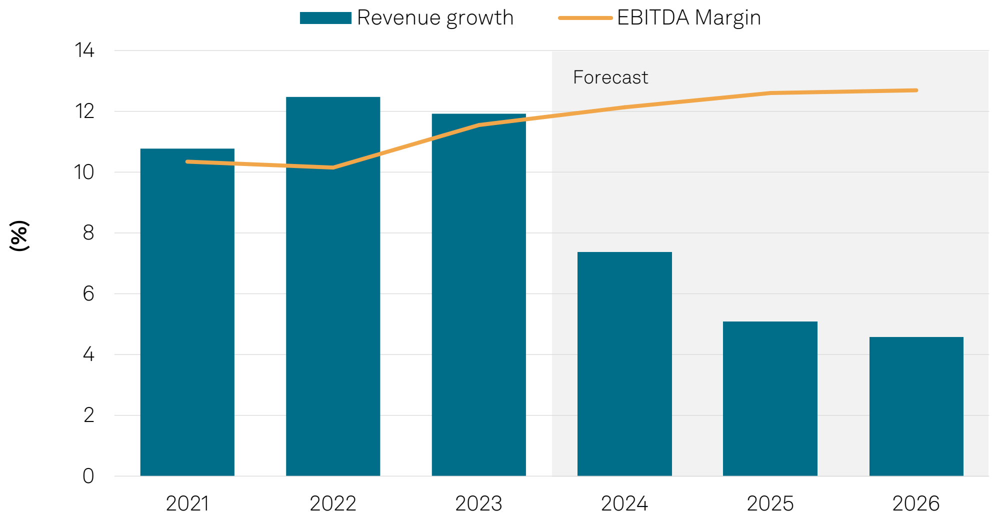
- Our rated E&C issuers posted strong backlog growth of about 11% in 2023; we expect this trend will continue through 2024, providing top-line visibility over the next 12–24 months.
- Contracts have evolved to include escalators, pass-throughs, and other cost-increase provisions to protect profits. We expect this will yield higher margins over the next couple of years.
- Skilled labor availability is a challenge (particularly for smaller issuers), and we think that the growing gap between job openings and new hires will increase issuer's focus on operating leverage.

U.S.-based rated E&C issuers' backlog



Sources: Company disclosures; S&P Global Ratings calculations.

U.S.-based rated E&C issuers' revenue growth and EBITDA margin evolution



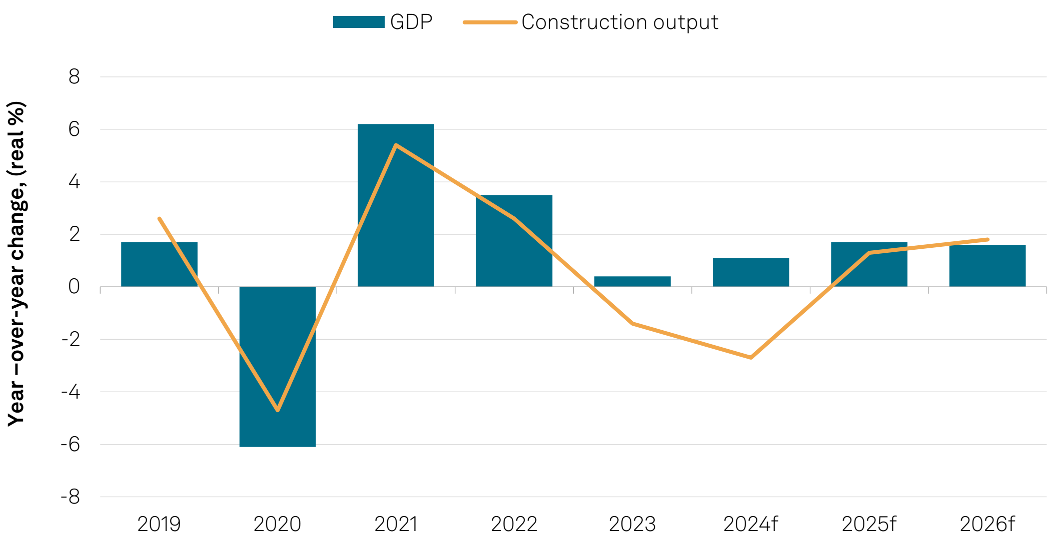
Sources: Company disclosures; S&P Global Ratings calculations.

E&C Europe

European construction | Environment remains gloomy in 2024

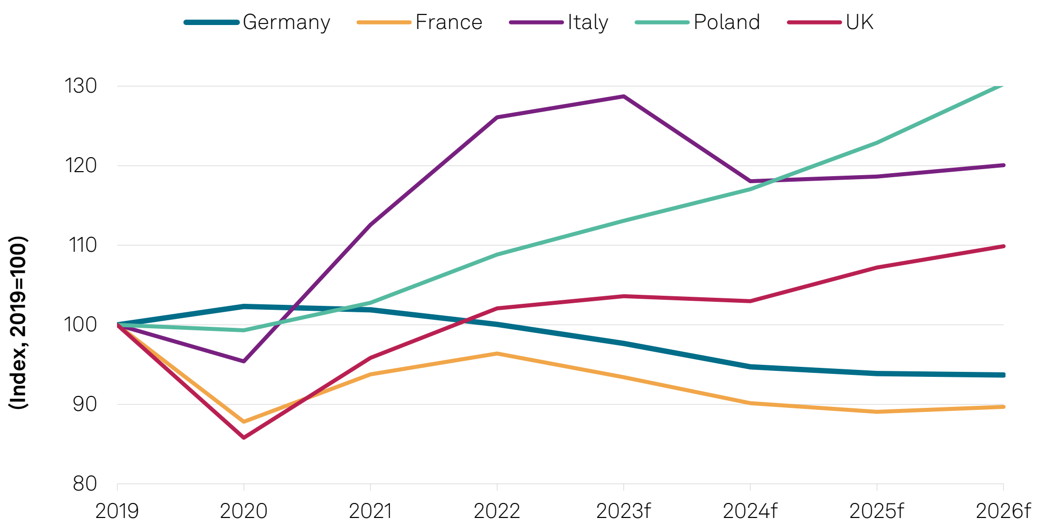
- The European construction outlook remains gloomy in 2024, especially in the Nordics, the U.K., and Germany, largely due to the contraction of residential building construction ahead of increased interest rates and households' reduced purchasing power. The drop in Italy in 2024 mainly reflects the reduction of generous tax grants that had fueled growth in the residential building renovation 2021-2023.
- According to Euroconstruct, construction output should contract 2.7% in 2024, after a decrease of 1.4% in 2023, and rebound moderately in line with GDP growth over 2025-2026.

GDP and construction output in Europe (EC-19)



f--Forecast, EC-19: Constant Euros 2019. Source: Euroconstruct, June 2024.

Change in construction output by country (EC-19)

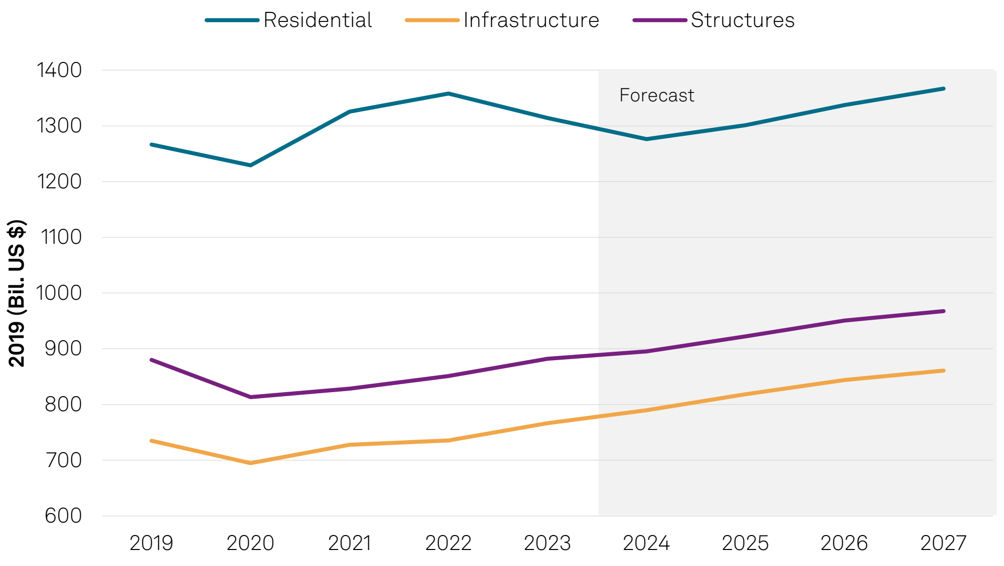


f--Forecast, EC-19: Constant Euros 2019. Source: Euroconstruct, June 2024.

European construction | In 2024 volumes reduce or stagnate in most segments

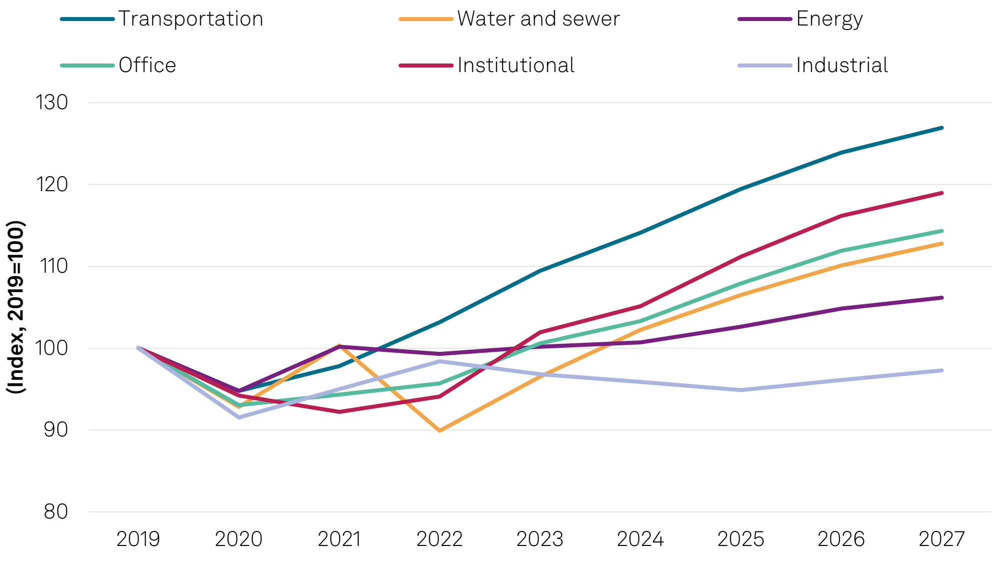
- Most of the drop in contraction still relates to the new residential sector, where housing permits remain depressed. The residential building renovation sector, which saw robust growth over 2021-2022, will likely contract in 2024 as in 2023.
- We expect nonresidential building construction to stagnate through 2024. In particular, the commercial real estate segment suffers from growing uncertainty about the future of hybrid work practices. By contrast, civil engineering and industrial construction should continue benefiting from investments in low-carbon energy production, energy distribution, and transport networks.

Construction outlook by sector



Data complied April 2024. Source: S&P Global Market Intelligence.

Construction outlook by subsector

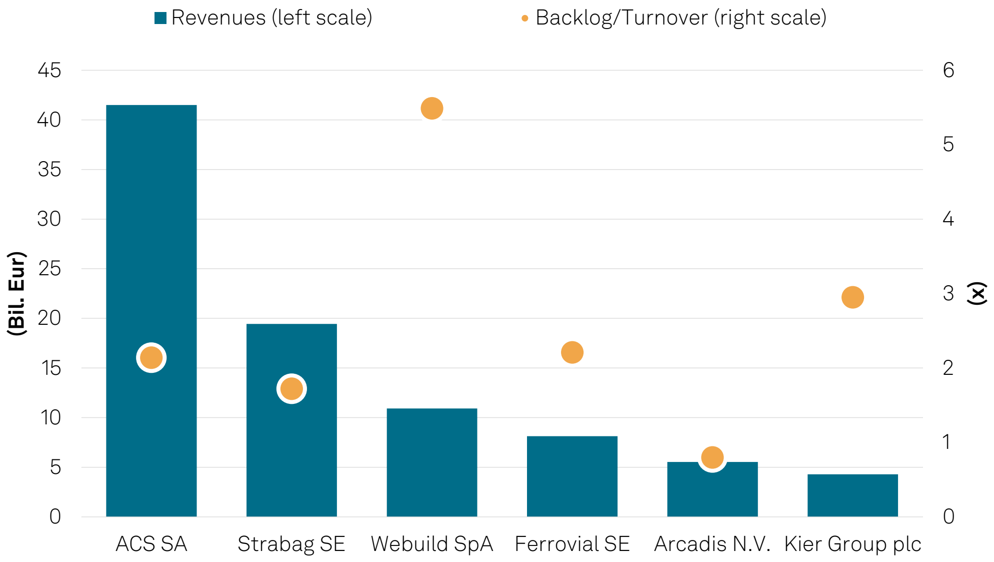


Data complied April 2024. Source: S&P Global Market Intelligence.

European rated companies | A healthy backlog provides revenue visibility

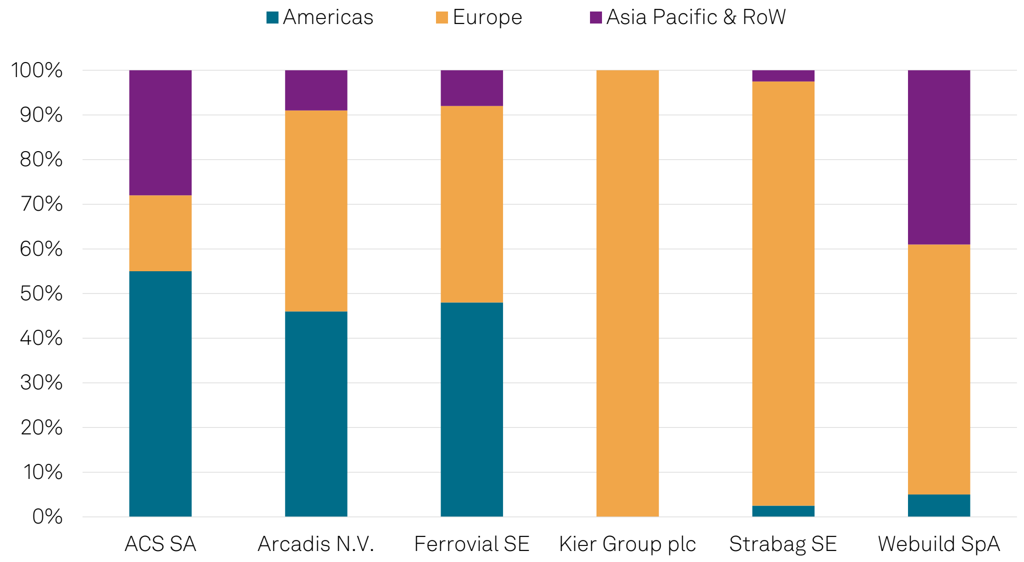
- The order intake of European companies remains solid thanks to new projects in the infrastructure segment across Europe, the U.S., and Australia. Backlog to revenues on average is well above 1x. Webuild SpA displays the highest revenue visibility in 2024-2026 because of its backlog.
- Most rated European companies, namely the ACS group, Ferrovial SE, Webuild, and Arcadis N.V., have a solid local presence in regions outside Europe, particularly in North America and in Australia.

Total backlog vs total turnover



Exchange rate GBP/EUR as of April 18, 2024. ACS SA--Actividades de Construccion y Servicios SA.
Source: S&P calculations; company data.

Total backlog by region



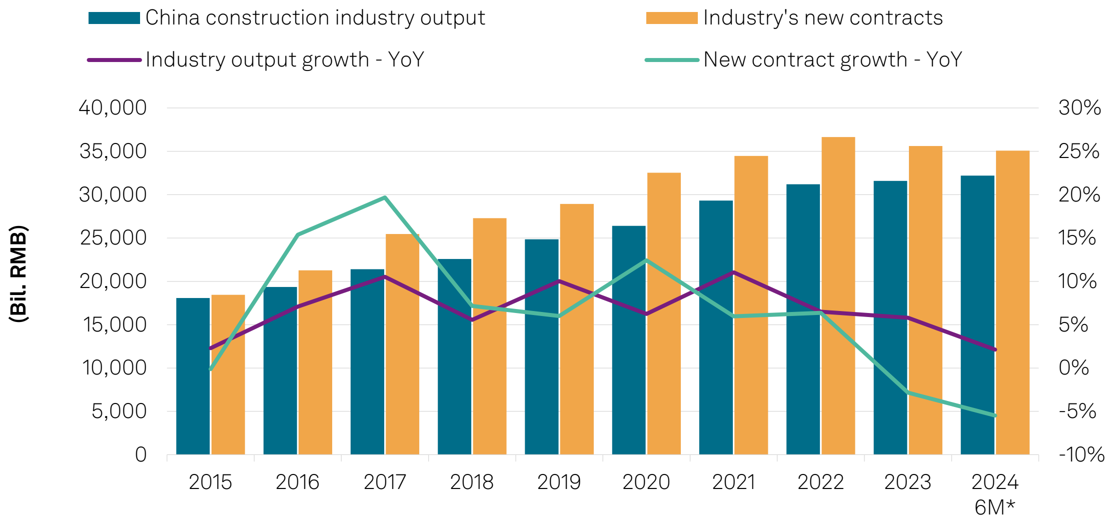
Exchange rate GBP/EUR as of April 18, 2024. ACS SA--Actividades de Construccion y Servicios SA.
RoW--Rest of the world. Source: S&P calculations; company data.

E&C China

China E&C | Slower growth, stricter supervision

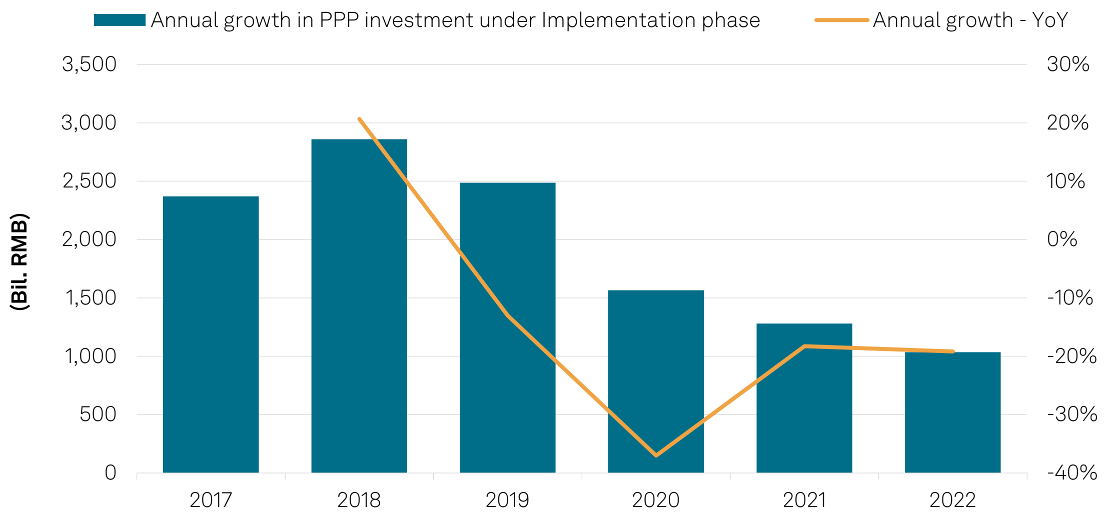
- We only expect low-single-digit percent growth in China's E&C sector in 2024, albeit off a high base. In 2023, growth of E&C sector output slowed to 5.8%, compared with 6.5% in 2022.
- Growth in infrastructure investment will likely moderate due to more disciplined spending from local Chinese governments amid their elevated leverage in 2024.
- Real estate investment is unlikely to meaningfully improve during the year.
- China's State Council is reforming the public-private partnership (PPP) model. It suspended all PPP projects that the National Audit Office had identified as containing issues, as well as PPP projects that were still under tendering processes by February 2023. Only user-paid projects with investment returns will be approved going forward.

Construction output and new contract growth are slowing



* Data from last 12 months up to June 2024. YOY--year-over-year. Sources: Wind Information Co. Ltd.; National Bureau of Statistics of China; S&P Global Ratings.

Growth of PPP project implementation has been declining

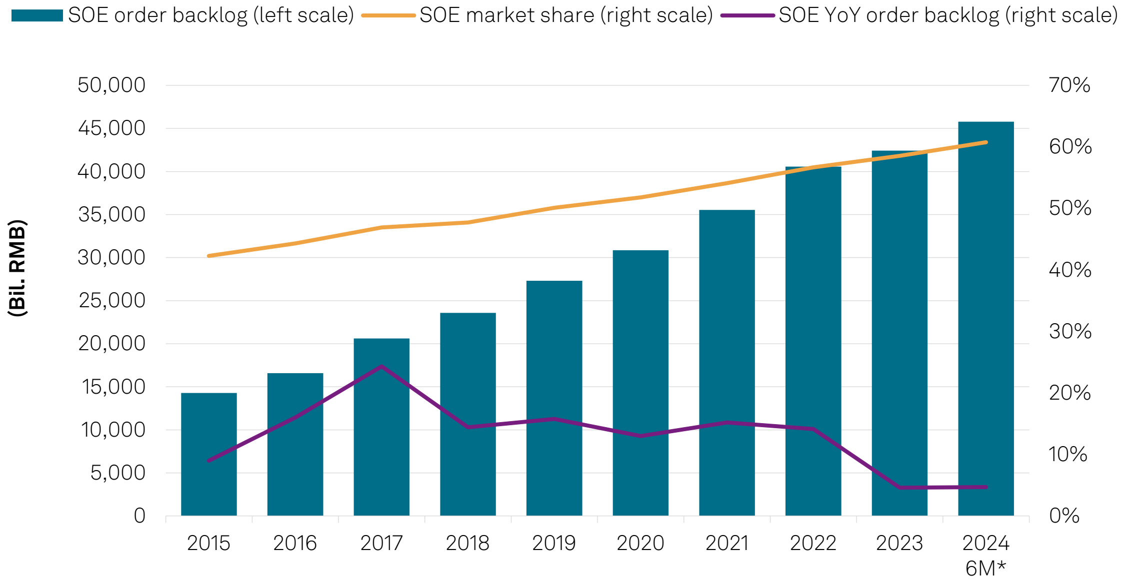


Data is not available after 2022. YOY--year-over-year. Sources: Ministry of Finance of China; Public-Private Partnership Center; S&P Global Ratings.

China E&C | SOEs continue to take charge of the E&C market

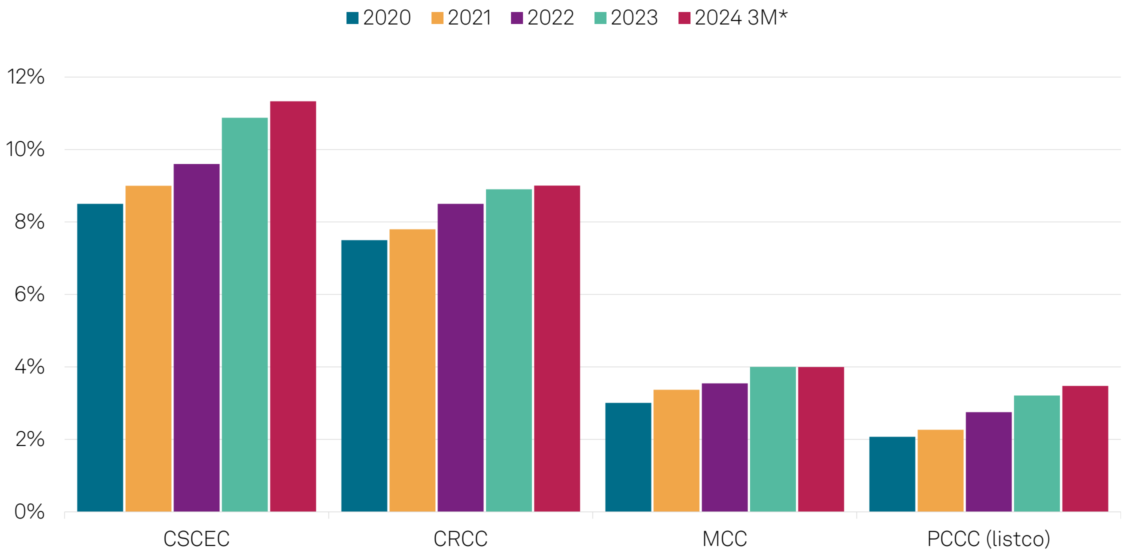
- Share of E&C SOEs rose to 61% in March 2024, measured by total order backlog on a last-12-months basis. It was 59% in the same period in 2023.
- All of our rated Chinese E&C companies are SOEs. They could experience faster-than-industry-average revenue growth in 2024. These companies have been taking market share from smaller players in the past three to four years in terms of new orders.
- We expect the share to remain at a similar level over the mid- to long term, as SOEs have financial stability with good access to funding for project execution and solid project execution track records based on their advanced construction technology for complex infrastructure projects.

SOEs will continue to dominant China's construction market



*Data from last 12 months up to June 2024. YOY--Year-over-year. Sources: Wind Information Co. Ltd.; S&P Global Ratings.

Shares of most of our rated SOEs should grow steadily

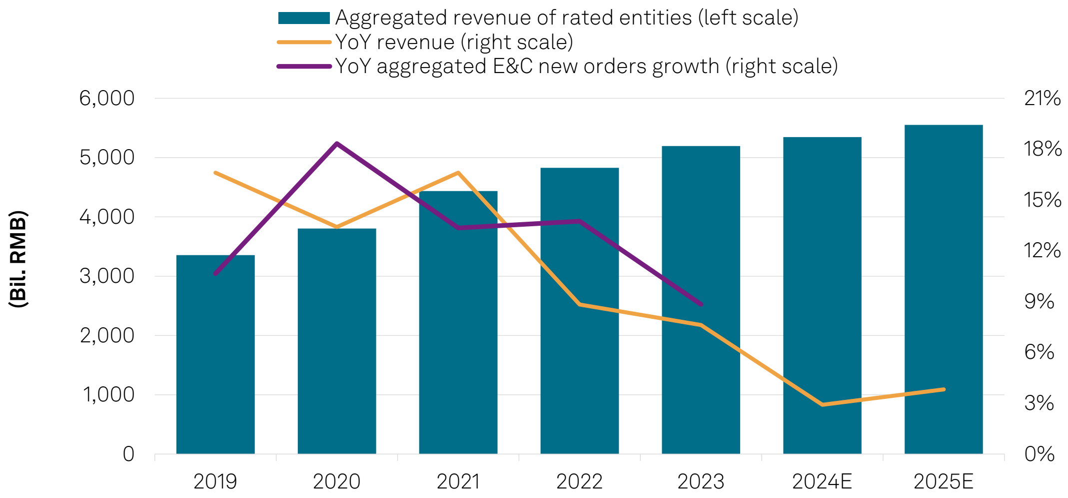


Market share in terms of new orders. *Data from last 12 months up to March 2024. CSCEC: China State Construction Engineering Corp. Ltd; CRCC: China Railway Construction Corp. Ltd., MCC: Metallurgical Group Corp. of China Ltd.; PCCC: Power Construction Corp. of China. Sources: Wind Information Co. Ltd.; National Bureau of Statistics of China; S&P Global Ratings.

China E&C | Growth slows for rated companies, but profitability improves

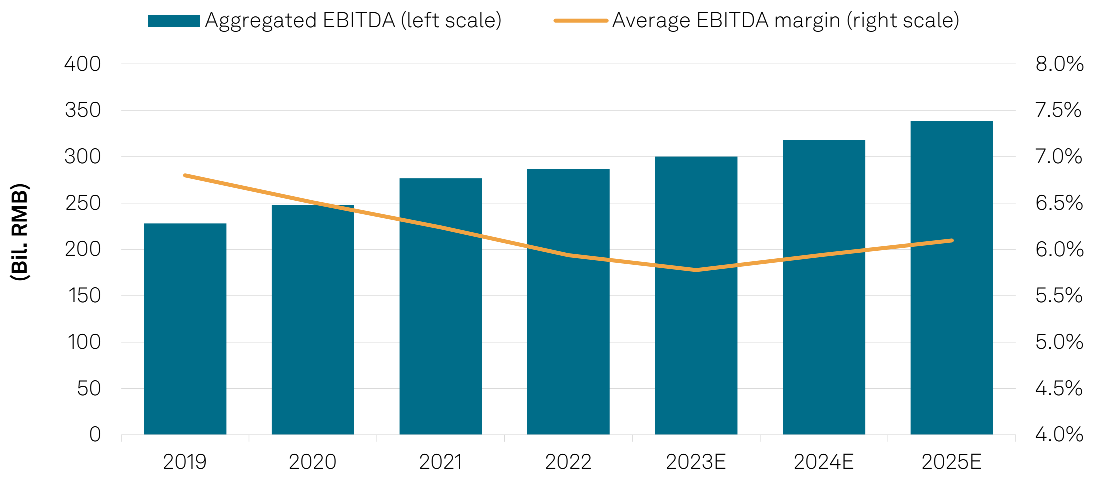
- We expect revenue growth of rated E&C companies to slow to 2%-5% in 2024, after 8% growth in 2023. High revenue base and stringent control on PPP projects will likely constrain the pace of revenue expansion of rated E&C companies in 2024.
- Some of our rated E&C companies have 4%-14% of revenue exposed to property development businesses. We anticipate a moderate decline of property sales amid weak market sentiment, which will likely constrain segment performance.
- EBITDA margins of most rated E&C companies will likely trend up modestly in 2024 after a drop in 2023. This has support from an improving selling, general, and administrative (SG&A) cost efficiency, stabilizing performance of property segments, and cautious project selection. Nevertheless, impairment provision ratios will likely stay high because of downside risk to cash collection from local government financing vehicles in 2024.

Rated entities revenue growth to decelerate to 2%-5%



Aggregated revenue includes CSCEC: China State Construction Engineering Corp. Ltd, CRCC: China Railway Construction Corp. Ltd., PCCC: Power Construction Corp. of China., CMGC: China Metallurgical Group Corp., SCG: Shanghai Construction Group Co. Ltd. and BCEG: Beijing Construction Engineering Group Co., Ltd. Aggregated E&C new orders growth includes CSCEC, CRCC, PCCC (listco), CMGC, SCG, and BCEG. YOY--Year-over-year. E—Estimate. Sources: Company disclosures, S&P Global Ratings.

Margins of rated entities may trend up mildly after 2023



Aggregated numbers include CSCEC, CRCC, PCCC, CMGC, SCG, and BCEG. 2023 data of PCCC is an estimate. E—Estimate.
Sources: Company disclosures. S&P Global Ratings.

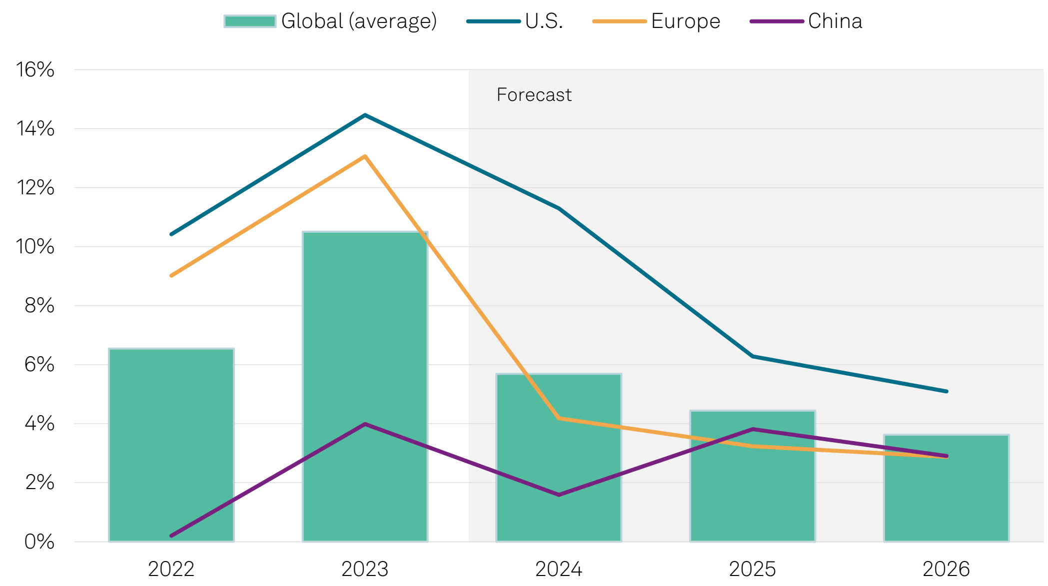
E&C Largest Markets Performance And Credit Metrics

Global E&C | Issuers poised to unevenly benefit from sector tailwinds

- We expect infrastructure spend, energy transition tailwinds, and government support will drive sustained growth across our global E&C portfolio over the next few years, though unevenly.
- We expect revenue growth for E&C issuers in the U.S. will outpace other regions as per record backlogs and a rising energy transition phase relative to other regions.

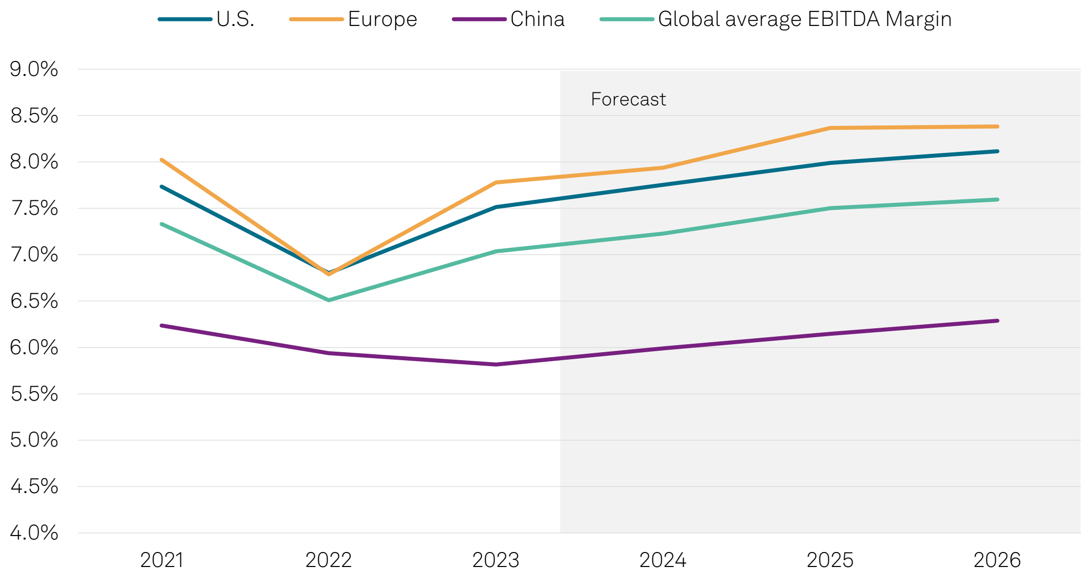
- Margins for our global E&C portfolio rebounded in 2023 (except for China due to an elevated impairment ratio) as inflationary pressures subsided, contracts rolled over (inclusive of material and wage inflation contingencies), and--to a lesser extent--losses were recovered.
- We expect EBITDA margins will grow modestly from operating leverage and productivity improvements and a continued shift away from lump-sum and fixed-price contracts.

E&C revenue growth by region



Revenue growth by region is based on weighted average year-over-year growth for selected issuers.
Source: S&P Global Ratings.

EBITDA margins by region

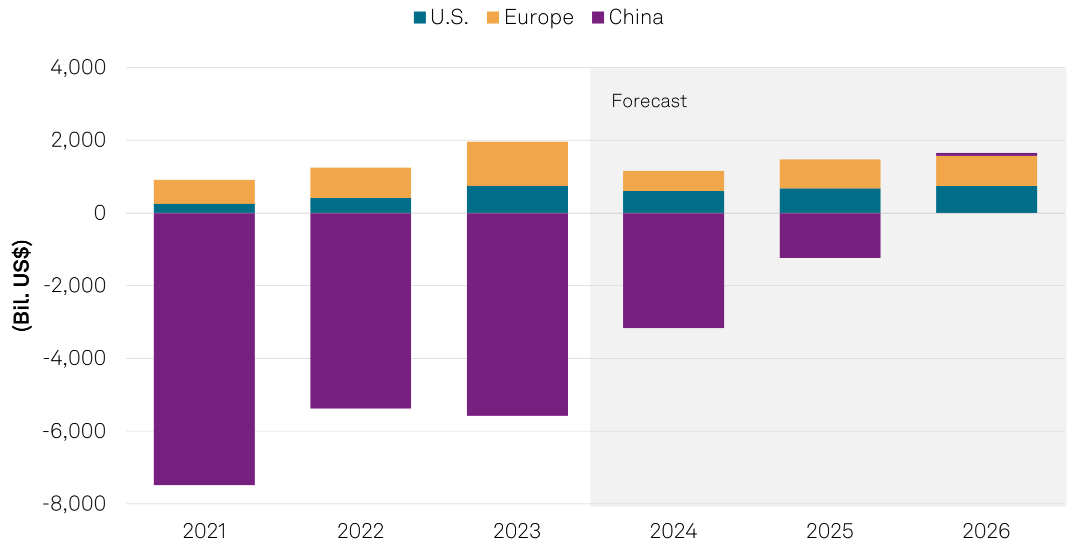


EBITDA margin by region is based on weighted average for selected issuers. Source: S&P Global Ratings.

Global E&C | Profit expansion supports FOCF, improved interest coverage

- Anticipated earnings growth will buffer the effects of sustained high interest rates in the U.S. and in Europe.
- In China, the FOCF of our rated issuers will likely remain negative due to working capital and capex needed for business growth in 2024-2025. However, we believe profit expansion, lower involvement in investment–linked projects, and a low funding environment in China will support gradual FOCF and interest coverage improvement during the period.

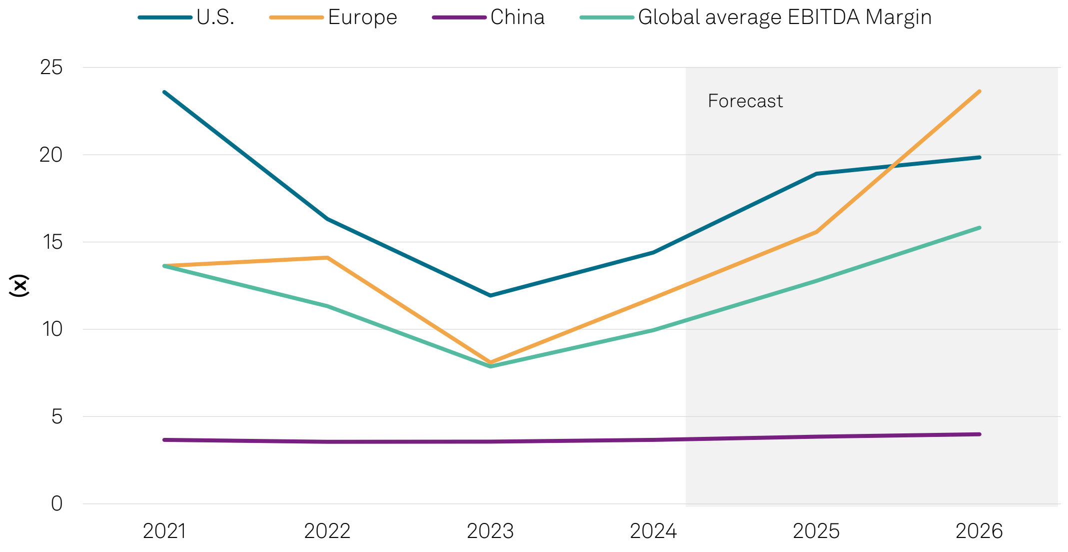
FOCF by region



The data is based on weighted average of selected issuers. Source: S&P Global Ratings.

- Following interest rate hikes, EBITDA interest coverage plunged globally, with the steepest decline in the Americas. This reflects the high proportion of speculative-grade entities in the U.S., its highly variable-rate capital structure, and margin declines.
- In China, anticipated profit expansion and a low interest rate environment will likely support stable interest coverage of rated issuers despite an expected increase in debt.

Interest coverage by region



The data is based on weighted average of selected issuers. Source: S&P Global Ratings.

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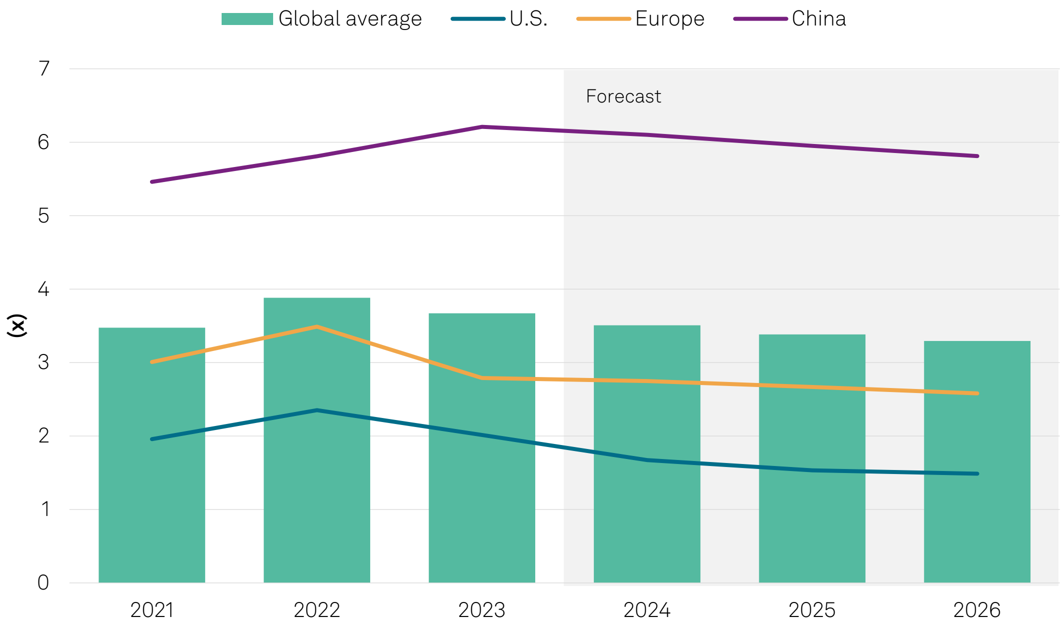
Global E&C | Improving cash flows also support lower leverage

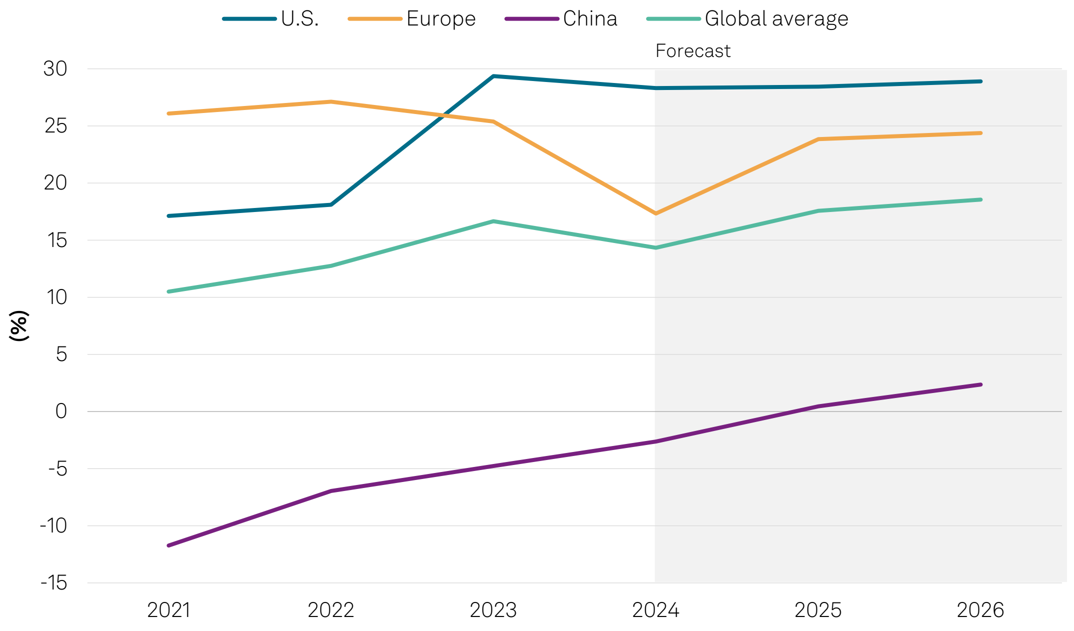
- Overall, we expect leverage metrics to improve for our E&C portfolio globally, supported by higher earnings and stronger free cash flows as issuers across the globe focus on cost efficiencies and working capital management.
- In China, our rated issuers continue to focus on earnings and cash flow improvement in at least the next two years under the new one-profit and five-ratio target set by the State-Owned Assets Supervision and Administration Commission of the State Council.

S&P Global Ratings-adjusted debt to EBITDA



Data is based on weighted average of selected issuers. Source: S&P Global Ratings.

S&P Global Ratings-adjusted FOCF to debt



Data is based on weighted average of selected issuers. Source: S&P Global Ratings.

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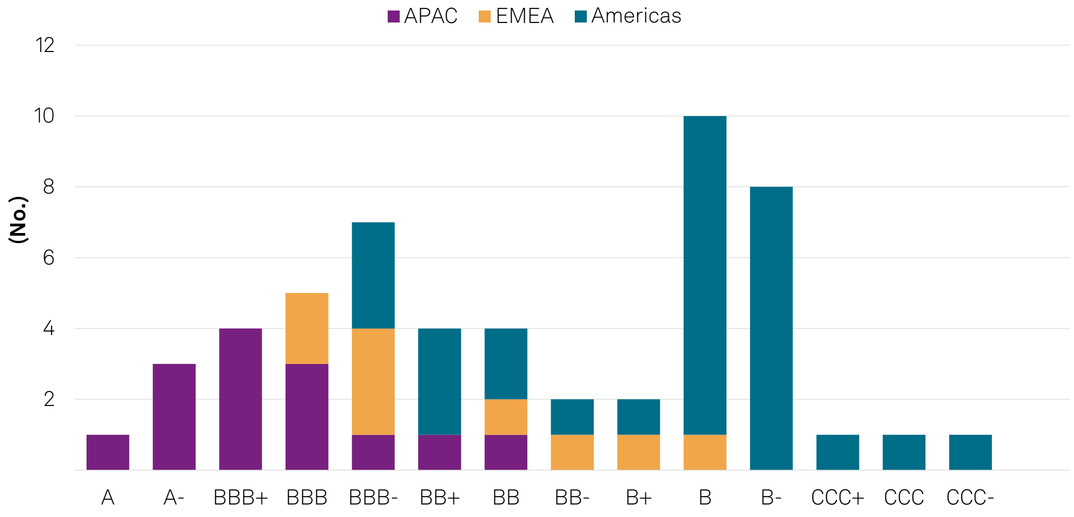
E&C Ratings
And Outlook Distribution

Global construction | Credit quality is largely stable

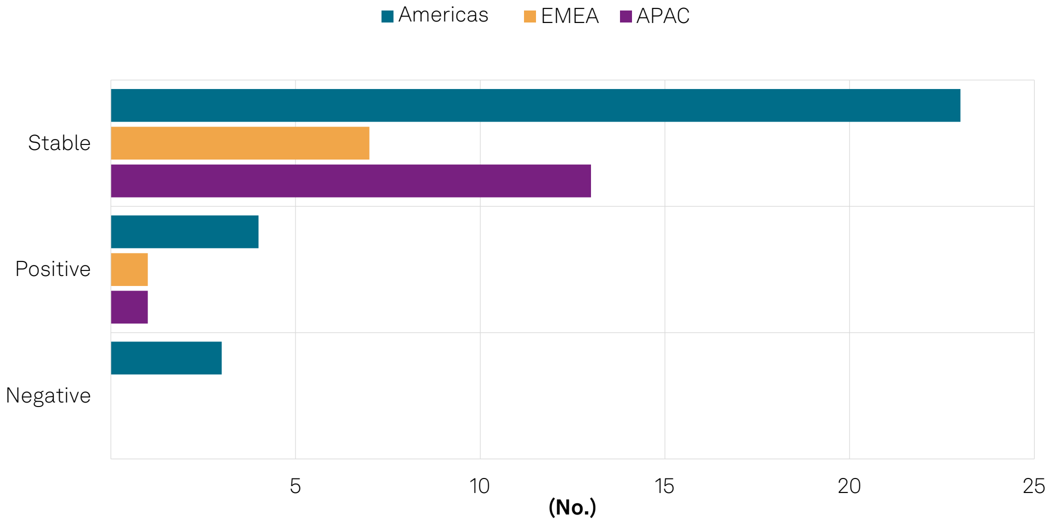
- We rate 53 E&C issuers globally, with the largest portfolio in the U.S. with 30 rated entities.
- We rate only a handful of investment-grade entities in the U.S. with a high concentration in the 'B' or below rating categories.
- Most of our U.S.-based entities rated 'B' or below are owned by financial sponsors.
- Ratings on EMEA-based E&C companies are evenly spread between investment grade and speculative grade, and most are listed and/or family owned.
- All of our China-based entities are rated at investment grade, benefiting from extraordinary government support.
- The vast majority of our E&C issuers globally have a stable outlook.
- However, we have a positive bias due to strong secular trends and our expectation for improved credit metrics over the next 12-24 months.

Ratings distribution by region



Source: S&P Global Ratings.

Outlook distribution by region



Source: S&P Global Ratings.

Analytical Contacts

Primary contacts

Fernanda Hernandez

Director – US Corporate Ratings

New York

fernanda.hernandez@spglobal.com

Renato Panichi

Senior Director – EMEA Corporate Ratings

Milan

renato.panichi@spglobal.com

Stephen Chan

Associate Director – China Corporate Ratings

Hong Kong

stephen.chan@spglobal.com

Research contributors

Marta Gamez

Analyst – EMEA Corporate Ratings

Milan

marta.gamez@spglobal.com

Torisa Tan

Senior Analyst – China Corporate Ratings

Shanghai

torisa.tan@spglobal.com

spglobal.com/ratings

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