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Business

Squeeze on cash flow hurting house builders

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Residential property builder National Builders Group is the latest company to be issued with an ultimatum from its bank: either refinance its loan with another bank or sell the business.

The group, which generates revenue of between $25 million and $30 million selling home building services ranging from drafting, engineering, selecting fixtures then outsourcing construction to a builder, is in talks with the Malaysian company Mae Synergy to buy the business by December 30.

The company is understood to have told its staff late last week that after discovering a series of cash flow issues it was working through payment plans and hoped to have a new owner by December 30. The cash flow problems were blamed on a previous employee who failed to send out 290 invoices to creditors, which left the company with a huge financial hole.

Not surprisingly, it hit the Commonwealth Bank's radar when a series of credit risk calculations blew out. These include the credit risk probability ratio of experiencing financial distress in the next 12 months, which ballooned to 9.22 per cent, far greater than the industry average of 0.48 per cent.

But National Builders Group is still very much a going concern. Many in the sector have fallen by the wayside as banks get tough, creditors delay paying bills and the softening housing market crunches margins in the sector.

All of this has translated into 36 companies in the residential construction sector entering voluntary administration in the past two weeks. Twenty-two are in NSW, three in Victoria and 11 from Queensland. Voluntary administration is often a precursor to liquidation.

They follow the collapse of South Australian Candetti Constructions, which was placed into administration on Friday with debts of $7 million and Victoria's Galvin Constructions, which collapsed owing of more than $13 million, including a loan of $3.2 million to the Commonwealth Bank.

The move by the Commonwealth Bank to give National Builders Group the choice of refinancing its loan with another bank or selling the business might be seen as draconian but it is a strategy a number of banks have been adopting in recent months to avoid the pain and cost of receivership, where the insolvency practitioners are the big winners and assets are often sold at a fraction of their value.

One man who knows more than most how badly the residential building and construction sector is travelling is Roger Mendelson, the head of the debt collection agency **Prushka**, who believes it will get worse in the next few months.

"There has been a marked increase in the insolvency of builders and building-related businesses over the last few weeks, particularly in NSW, and this is likely to increase after Christmas when contractors have to fund the long slow-down or shut-down period, with little cash flow coming in," he said. "With banks being reluctant to increase facilities for building companies, this will only exacerbate the situation."

The latest housing finance figures released yesterday indicate the sector is getting hit from all sides, with a sustained period of low housing starts squeezing the margins of builders and contractors.

Loans for the construction of homes fell by 1.8 per cent in October, which is the fourth fall in five months. Loans to buy newly-built dwellings hardly budged, rising just 0.1 per cent. But loans for the purchase of established dwellings (ex-refinancing) rose by 2.8 per cent, while refinancing fell by 1.8 per cent.

A big part of the problem is the delay of payments to these businesses, which puts their cash flows under undue pressure. According to the country's biggest receivables management and credit report

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company, Dun & Bradstreet, the trade payment terms for the construction sector are at the highest level since the fourth quarter of 2009, at the height of the global financial crisis.

Over the past 12 months, payment terms in the construction sector deteriorated by nearly two days from 52.8 to 54.4 days, which is almost double the conventional standard of 30 days. In 2003 the average was 45 days. Payment trends are known to be an accurate leading indicator of an economic correction.

Indeed, the previous economic decline was preceded by a blowout in trade payments. The concern is that as the global credit market crunches, and credit availability starts to tighten again, the impact of late payments on cash flow will be devastating in a sector that is already hurting.

Housing and construction are key components of the economy and when things go south, they have a huge knock-on effect. It's likely to get worse before it gets better.

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