sarria

OHLA

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International construction company based in Spain

Last Update 26.3.2024

POST Capital Structure EUR mm	Facilities Sep-23 Amount	Gross Sep-23 Amount	Net Sep-23 Funded	Net of cash Book Val. Multiples	Coupon (a)	Maturity	Market Value	Market Value	Market Val. Multiples	YTM
Available Cash			**(307)**							
Held in JVs	**236**									
O/W Reported Cash			**(447)**					(447)		
O/W Cash collateral - per	**140**	**140**	**140**	held against Spanish performance gtee			100%	140		
Non-recourse debt	-	-	-		3.000%		100%	-		
Non-recourse factoring	28	28	28				100%	28		
State-backed EUR140m	-	-	-		4.500%	Feb-22	100%	-		
Credit lines and other	-	-	-		5.000%	1-year	100%	-		
Leases	65	65	65							
Performance guarantees	3,227	-	-				100%	-		
Senior debt level	**93**	**93**	**(355)**	**-3.1 x**			100%	(280)	-2.4 x	
Sec Mar 25	260	200	200		5.100%	Mar-25	91%	181		16.3%
Sec Mar 26	260	200	200		5.100%	Mar-26	91%	181		10.8%
Unsecured debt level	**612**	**493**	**45**	**0.4 x**				7	0.1 x	
					Shares Outstanding					
Market capitalization			**225**	**2.0 x**	591		0.38	225		
Enterprise Value			**270**	**2.4 x**				270		
Total Liquidity			307							
Steady state EBITDA			114							

Notes Valuation:	
EBITDA Forward	114
EV Multiple	6.00 x
Exs. Cash	200
EV core	886
Canalejas	198
War Office	65
EV + non-core assets	1,148
Senior debt	(93)
Value for SSNs	1,056
SSNs	(400)
Unsecured coverage	264%

Shareholders; Amodio Family 26%, GVM 7%, Tyrus 3%,

Areas for further work:
- Model major projects
- Understand future composition of "CapEx"
- Expected evolution of concessions business.

Relevant Credit Statistics:

Dec. Year-End Pre IFRS 16	2021 Actual	2022 Actual	2023 Forecast	2024 Forecast	Q122 Actual	Q222 Actual	Q322 Actual	Q422 Actual	Q123 Actual	Q223 Actual	Q323 Actual	Q423 Actual
Revenues	2,904	3,358	3,310	3,214	674	831	908	945	653	830	859	967
Revenues growth yoy	1%	16%	-1%	-3%	10%	13%	20%	18%	-3%	0%	-5%	2%
Gross profit	780	919	604	822	175	232	262	249	154	139	191	120
Gross profit margin	27%	27%	18%	26%	26%	28%	29%	26%	24%	17%	22%	12%
Staff/Other	-689	-804	-478	-704	-163	-209	-228	-205	-134	-109	-157	-79
Staff / Revs	-24%	-24%	-14%	-22%	-24%	-25%	-25%	-22%	-21%	-13%	-18%	-8%
adj. EBITDA	**91**	**114**	**126**	118	**18**	**23**	**30**	**44**	**20**	**31**	**33**	**42**
Margin	3%	3%	4%	4%	3%	3%	3%	5%	3%	4%	4%	4%
Exceptionals/ One-off/ leakage	24	-43	49	-12	-10	-19	-4	-10	7	3	30	9
Cash taxes paid	-36	-33	-38	-36	-2	-12	-8	-12	-7	-4	-12	-15
CF from change in WC	-69	-53	4	-12	-151	23	-109	184	-78	-11	21	72
Unexplained										-4	-12	
CFO unlevered	**9**	**-14**	141	59	**-145**	**16**	**-92**	**206**	**-58**	**15**	**60**	**108**
Net payments for PPE & intangibles	-5	-12	6	-40	0	-1	0	-11	-22	-26	42	12
Other Investing Activities (excl. CapEx	55	1	0	0	-3	6	39	-42	-22	-26	-3	51
FCF	**60**	**-25**	**146**	**19**	**-147**	**21**	**-53**	**153**	**-102**	**-38**	**99**	**171**
Interest paid	-32	-16	0	-32	-16	0	0	0	0	0	0	0
Dividends/Equity Raise	50	0	0	0	0	0	0	0	0	0	0	0
Gr. Debt Chg	5	-56	55	0	-95	12	35	-8	-5	52	4	4
Other CF Fin	-47	61	-80	0	150	-33	-51	-5	-8	30	-57	-46
NCF	**37**	**-37**	121	-13	**-107**	**-1**	**-69**	**140**	**-115**	**45**	**47**	**128**
Other changes in cash & FX	0	0	21									21
Cash and cash equivalents	**508**	**471**	**592**	**458**	**400**	**399**	**331**	**470**	**356**	**401**	**447**	**597**
									356	401	448	597
FCF excl legacy projects	**96**	**5**	**146**									

nvestment Rationale:

We hold c. 6% of NAV in the SSNs. However, we still see OHLA being able to refinance its bonds in 2025 and 2026. The coupon will be in the 10% area. Management has consistently said it will efinance the bonds in the market, so we do not expect an amend and extend operation, but this could yet be required.

We expect that the company will refinance in Q124, and the bonds will be redeemed at par, giving us a 15% return over six months (annualised 32%). The equity has underperformed and we see a isk of a cash raise diluting us. We will exit the equity now. The current price is 0.38c. The overall return will be 90bp return on NAV.

In the event no refinance takes place, we have a potential loss of 23% over the same period, equating to around 140bp of NAV. We would expect the bonds to trade down to 70c/€ (where they raded before the previous restructuring).

We have significantly cut our equity price target due to the significant rise in risk premia and risk-free rates. We have also reduced the growth rates into the future. Our DCF model points to an intrinsic value of 42c for the equity.

We will update our view when the Q3 numbers are published (in November, no date has been published yet). The Q3 results will give an insight into how the traditionally busier summer months ave been and how the order book is shaping up for 2024. There are continued concerns over the health of European and US construction have held back spending on post-COVID recovery. The Jkraine war continues to hurt activity.

Description:

OHL is a significant construction group based in Spain. Its primary focus is on large infrastructure projects, but it also has a presence in Industrial and Commercial Developments.

COVID19 forced management to restructure the group with bondholders taking a haircut (with the opportunity to be partially equitized) and new cash coming in from outside investors.

The Amodio family of Mexico, the owners of the Caabsa group of construction companies increased their stake to 26% as part of the restructuring process. They had acquired a 16% stake in OHL rom the previous controlling shareholders, (Villar Mir family), for EUR50m or EUR1.1 per share.

OHLA is still working through onerous contracts (largely in Emerging markets) where margins are minimal at best. Most of the remaining costs have now run through the P&L.

The company also has some very significant legal cases where it is both a litigant and a defendant. Headline figures can be huge but counterclaims reduce this and the final result is usually more manageable. The largest claim is for the Sidra Hospital in Qatar, with a headline figure of €800m, however, our analysis of the potential cost outs it closer to €113m

Construction disputes can drag on for years in arbitration. Overall, we expect the outstanding legal cases mainly balance each other out, however timing could mean negative flows

Order backlog: 35% Europe, 46% US, 18% Latam.

Having largely exited the concessions business in Latam, OHLA has begun building this business again. The scale is smaller than in the past

Opportunities:

OHLA is now more focused on civil engineering and development projects. Profit margins are lower but so are the risks.

Post completion of the restructuring, OHLA's banks agreed to extend the size and term of its guarantee facilities. This will aid the company in bidding for larger construction projects.

New knowledgeable shareholder: the arrival of the Amodio brothers as the largest shareholder of OHLA is supportive. An informed investor with extensive experience in the construction sector in Latin America will help steer OHLA away from the mistakes made previously in project bids. The Amodio family should see a reverse takeover of Caabsa by OHL as an attractive proposition. A Spanish isted business would allow cash to be raised at developed markets rates and used to support EM building operations.

Simpler financials post Concessions disposal: following the disposal of the Concessions arm, OHLA now has a more conventional set of accounting statements, which do not include issues such as selling assets to itself after development. Profitability allocation and other major problems can occur when a construction company also operates a concession arm. The modest new Concessions portfolio could see some of these issues re-emerge.

Risks:

Cash Generation: OHLA does not have a good track record of generating cash.

Cost increases: Post covid there have been significant increases in labour and material costs (both from shortages and inflationary pressures)

- Legal liabilities: OHL still has several material legal cases currently pending. This could result in significant additional liability.

Operating liabilities from onerous projects: despite the gradual progress in winding down its portfolio of onerous projects, they remain a drag on both margins and working capital-related cash outflows. We are comfortable with management's view that these projects will fall away as expected over time but it will remain one of the questions on any call.

Track record of low recoveries in the construction sector: this sector has traditionally operated with significant performance guarantees/bonding lines and structurally senior project company debt, all at the level of the operating subsidiaries. This has led to low recoveries in most construction high yield bond issuers.

OHLA

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Valuation

- Combining DCF and the sum of the parts we have an equity valuation of €0.57 per share on OHLA. Our initial valuation of €1.15 was reflective of a much lower rate enviornment.
- We see the equity market as undervaluing the construction business (at around €0.53) per share.
- We see upside from the current price of €0.94 but acknowledge we were too slow to pull the trigger on exiting the equity early in the year.
- There is also hidden value in the Canaleja projects and the Cemenosa settlement came in above our estimates (due to interest paid on the sum).
- Some further upside could be seen in the construction business if the EU/US starts releasing the infrastructure cash quickly.
- Profitability could be hurt by cost inflation (material and labour) hurting profitability, but we are also seeing government and infrastructure contractors install additional clauses allowing pass-through of costs. The delays in delivery of projects as agencies and governments argue with contractors overpayments has blighted projects in the EU and the US.
- If there is a downside surprise in our analysis it could be in the various legal claims. On a net basis, we see the claims as balancing each other out, however, in terms of timing, there can be significant differences. Our downside case scenario is €50m (or around €0.09).
- Our valuation also assumes that OHLA is not overly aggressive in chasing Latam business, where margins are higher but mask difficulties in managing local and currency risks.

Sarria Valuation

DCF	**€ m's**	**Share Impact**	**Notes**
Construction division	**222**	**0.38**	Cost of debt is inflated (reorganisation), eg reducing it to 7% (vs 9.5%) => €0.40 of equity upside
Other Assets/Liabilities			
Canalejas Project	198	0.33	In Arbitration onver project management
War Office		-	Collected
Cemonasa Settlement		-	Collected
CHUM (Montreal)	28	0.05	Still for sale
Other Claims	166	0.28	
Sidra Settlement Estimate	(111)	(0.19)	
Other Settlements	(159)	(0.27)	If Orascom gtee not valid => €0.15 of downside
Additional Assets	**121**	**0.20**	
Equity Value	**343**	**0.58**	

Sarria Equity Valuation	0.58
Share Price 24/10/23	**0.38**

DCF portion

	€
Equity Valuation	**0.38**
Assumptions	
Tax Rate	30%
Discount Rate (WACC)	14%
Perpetual Growth Rate	3.0%
EV/EBITDA Multiple	6.0x
Transaction Date	26-Mar-24
Fiscal Year End	31-Dec-23
Current Price	0.38
Shares Outstanding	591
Debt	493
Excess Cash	200
Capex	(6)
WACC Calculation (Recap)	
Capital Structure	
Debt to Total Capitalization	50.00%
Equity to Total Capitalization	50.00%
Debt / Equity	1.0 x
Cost of Equity	
Risk Free Rate	3.96%
Equity Risk Premium	15.00%
Cost of Equity	**18.96%**
Cost of Debt	
Cost of Debt	13.00%
Tax Rate	30.00%
After Tax Cost of Debt	**9.10%**
WACC	**14.03%**
Unlevered Beta	1.25

Discounted Cash Flow	**Entry**	**2023**	**2024**	**2025**	**2026**	**2027**	**Exit**
Date	*27-Dec-23*	*31-Dec-23*	*31-Dec-24*	*31-Dec-25*	*31-Dec-26*	*31-Dec-27*	*31-Dec-28*
Time Periods		*0*	*1*	*2*	*3*	*4*	*5*
Year Fraction		*0.01*	*1.00*	*1.00*	*1.00*	*1.00*	1
EBITDA		126	118	115	122	122	
Less: Cash Taxes		-38	-36	-34	-37	-37	
Less: Capex		6	-40	-40	-40	-40	
Less: Changes in NWC		4	-12	2	-1	1	
Unlevered FCF	-	98	31	42	45	46	580

Intrinsic Value	
Enterprise Value	514
Plus: Cash	200
Less: Debt	493
Equity Value	222
Equity Value/Share	0.38

Terminal Value	
Perpetual Growth	429
EV/EBITDA	731
Average	580

Comment: Intricsic Value

- Enterprise value will be driven by the ability of OHLA to sucessfully tender and deliver profitable projects.
- The absence of historically mispricved contracts should boost margins given management is keenly aware of the pitfalls, particulalry in Latam.
- Despite the large cash balance of >€600m, much of this is nneded withing the business to support seasonality in working capital flows. We estimate excess cash at closer to €200m

Market Value	
Market Cap	224
Plus: Debt	493
Excess Cash	(200)
Enterprise Value	516

Peers

LTM (6/2023)	**OHLAA**	**Porr AG**	**ACS**	**SEK Skanska**	**Hochtief**	**Fomento de Construcion**	**Eiffage**
Revenue	3,337	6,081	35,233	164,358	27,290	8,441	21,753
EBITDA	124	338	2,212	9,958	1,261	1,278	3,586
Margin	3.7%	5.6%	6.3%	6.1%	4.6%	15.1%	16.5%
OCF	71	306	1,346	(617)	981	1,310	3,074
Capex	(59)	(207)	(351)	(1,971)	(235)	(770)	(901)
FCF	12	99	995	(2,588)	746	539	2,173
	1.8%	3.4%	1.0%	1.2%	0.9%	9.1%	4.1%
Book	6,038	8,995	72,484	250,300	53,600	41,464	19,800
Book/Revenue	181%	148%	206%	152%	196%	491%	91%

Comment:

- OHLA has lower margins than its competitors, reflecting its problems winning orders whilst restructuring its balance sheet. We anticipate a recovery in the margin to around 4%.
- OHLA's disclosure is unhelpful on Capex. Figures are annual and look way too high for a construction business. We would expect a number nearer 1% but without some data on what is passing through this line, it is impossible to create an accurate figure.
- The reduction in higher-risk development construction will constrain margin growth.
- Eiffage has a significant concessions business which also boosts overall margins.

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Other Assets and Liabilities

Assets

Projects for Sale	€m's	
Canalejas Project Madrid	198	Valuation informed to CMVA in 2020
Old War Office	100	Sale to Hindujas should have completed in Q4, according to presentation €35m received => €65m financial receivable
Total	**298**	

Canalejas Project

- OHLA will eventually sell this project, however with significant cash on the balance sheet already and momentum behind the growing retail rent roll, the valuation is likely to rise as yields move into line with more mature projects. Opportunistic low ball bids will eventually be displaced by institutional interest. The latest reports indicate that Mohari and OHLA have agreed to allow the project to be marketed at €800m (our valuation is c€550m.
- The potential cash value of Canalejs is a comfort when viewed against the potential costs of a negative outcome in the Sidra (Qatar) dispute, as long as it sits on the balance sheet it represents a buffer in the event of arbitration in Sidra being settled.
- According to recent reports, the delays is executing the Canalejas deal (€200m), the CHUM sale (€50m) and the Service Business sale (€45m) have prompted OHLA's banks to push the company towards a €150m reights issue. This is going to be partly to nudge the company into executing on disposals.

Details.
- Central Madrid by the Puerta del Sol.
- Prime central Madrid real estate.
- 5 Star Hotel, the opening was delayed due to Covid but is now fully open.
- 22 high-value residences, 90% sold and now fully open.
- High-end Shopping Mall, the opening was delayed by covid and subsequent lockdowns. Now open, in October 21, occupancy rates were 30%.

Canalejas Project

€m's	Units	Av size	price Sqm	Sqm	Vacancy	Rent psqm	GRI	Yield	Valuation		
Hotel				26,000	0%	35	11	3.5%	312		
Galeries				15,000	20%	35	5	3.8%	134		
Residences Sold	20	300	15,000	6,000	-	-	-	-	90		
Unsold	2	300	-	-					6		
									543		
Bank Debt									196	Euribor +4%	
									347		
Metro Repair subordinated loan from OHLA									48	Libor +5%	
Canalejas Equity (Sarria)									299		
OHLA Share	50%	The other 50% is owned by Mark Scheinberg through his vehicle Mohari Ltd .							149	Book Value	146
Subordinated loan									48		
									198		
Discount	0%								198		

Liabilities

Legal Claims

Claim	min	max	estimate		Liability	min	max	estimate	
Kuwait	-76	308	116		Sidra Qatar	-354	1,108	111	
Metro Qatar	-243	365	61		Welsbach	0	35	18	average
PGB	0	45	23		TDA M-12 to	0	283	142	average
Rio Magdale	-169	62	-54						
Anesrif	0	0	0	Settled					
MEXICO SAPI	-34	4	-15						
EJE	0	70	35						
Total	**-522**	**853**	**166**		**Total**	**-354**	**1,426**	**270**	
	min	**max**	**average**						
Net Liabs	(1,207)	1,948	104						

Comment.
- We do not discount the potential for significant losses in the litigation roster of OHLA but, our best estimate places claims and potential liabilities in balance.
- Timing of various settlements can be an issue, however, OHLA has the cash at hand to manage timing issues.
- Claims and counterclaims are headline-grabbing figures but ultimately settled claims in arbitration are usually much lower.
- The arbitration process is very lengthy even "binding" arbitration can end up in the courts.

- Kuwait: According to the UNCTAD website (they ran the arbitration), there was a ruling in December 22. This ruling has not been made public. In the 2022 Annual Report, OHLA said the claim from the JV was EUR308m. The Arbitrator rejected both claims in December 2022, with costs ordered to be shared. OHL launched an appeal in March 2023.
- QatarMetro : No update.
- PGB; Nothing reported. Damages claim related to the building of a road in Gdansk. OHLA is seeking EUR41m in damage from PGB. The litigation is in the early stages. PGB was a contractor on the project and the claim relates to joint liabilities. PGB has already been through a restructuring so even if awarded it might not get paid.
- Rio Magdalena (Columbia): Aleatica has submitted an arbitration claim of EUR226.5m and OHLA is claiming EUR61.8m. Aleatica has also called guarantees of EUR25.2m for advances and EUREUR32.4m in compliance deposits. Aleatica cancelled a construction contract due to alleged delays in a 155km and a 1.36km bridge. Aleatica is now controlled by the Australian Infrastructure Fund IFM. The cases are still at an early stage.
- Atizapan-Atlacomulco (Mexico) - 30-year concession, 77km four-lane road which was also cancelled in 2019 over contract breaches. OHL had sought EUR130m arbitration in 2018 over changes in the cost and scope of works in this project and the Rio Magdalena project. When that arbitration ended, Aleatica ended both contracts.
- Anserif: Won by OHL awarded EUR17.5 +€19.5m in guarantee release = €37m
- EJE: The Spanish government set compensation for creditors of Aeropistas y Eje Aeropuerto at zero. OHLA is appealing and thinks it can get €70m more interest. The case is expected to resume again in December.
- TDA funds holding senior debt sued OHLA for €212m. OHLA is requesting the contribution via a subordinated loan. That amount has now reached €283m i.e. +€71m in interest on arrears. The court of first instance ruled in favour of OHLA and dismissed the fund's claims. The Provincial court of Madrid has ratified that ruling. But this is subject to appeal.

Sidra Hospital Litigation: The largest legal dispute.

Liability estimated at a maximum of €200m

- At the low end, we see liability at EUR21m-EUR38m. We do not see the upper end of the Qatar Foundations completion cost claim of USD1.1bn as credible.
- Our analysis has a realistic maximum liability of USD200m. OHL would expect to share this with its partner Contrack, owned by Orascom Construction) and have a maximum liability of USD100m (assuming the partner guarantee is enforceable). It is legally possible but unlikely that the contract guarantees are not joint and several. With the arbitration process ongoing, none of the parties is saying much.
- Orascom Construction is a substantial business and provided a guarantee to Contrack. It is disputing the enforceability of this guarantee (in a connected but separate to the dispute over liability). OHL could lose the Qatari arbitration case and find itself liable for the full award if Qatar cannot recover from Contrack/Orascom.
- Our analysis applied an average figure to apply a EUR350m liability with 100% attributable to OHL. We will continue to monitor the legal progress and acknowledge that this represents a significant part of our EV analysis.
- We recognise that there is a high probability that the claim from the Qatar Foundation will be cut to a fraction of the sum claimed. However, that is not cut and dried. The sharing of liability between the JV partners is not straightforward.

Background:

- The Sidra project relates to the construction of a large medical facility in Qatar. The contracting party was the Qatar Foundation (QF), and construction was carried out by a joint venture between Obrascon Huarte Lain and the Cypriot subsidiary of Orascom Construction of Egypt (Contrack Cyprus Ltd).
- The project was a design and build contract with a QAR7.6bn value and was awarded to a joint venture company owned 55% by OHL and 45% of Contrack Cyprus (a subsidiary of Orascom Construction Ltd). The contract award and beginning of construction were both in 2008.
- In July-2014 the contract was terminated by Qatar Foundation with another contractor brought in to finish the job. On 30th July 2014 QF applied to the International Chamber of Commerce for Arbitration. The arbitration applies English law and the English courts have been the forum for appeals in this case. The JV was replaced with a local contactor majority-owned by the Qatari State. The project was finished in 2016.
- In November 2018, the High Court upheld the Arbitral Panel decision that the Termination of the contract was lawful. That judgement allowed QF to seek recovery of costs above the original contract price. However, the Arbitral Panel also found that the project was 95% complete when the JV was removed from the contract.

JV Guarantees:

- It is important to understand the potential impact of Parental Guarantees and Contract Liability of the JV. Given a subsidiary was set up, this would suggest parental guarantees and joint and several liability. However, it does not follow on legally.
- It is possible that a defect in the guarantee from Orascom could leave OHL on the hook for all of any net costs if Orascom declined or was unable to support its subsidiary and there was no side indemnity agreement between OHL and Orascom.

Currency Rate	Spot	6m	1yr	5yr	
QAR/EUR	0.24	0.23	0.23	0.26	The QAR is pegged to the USD

What is being Arbitrated?

Claims by JV against the QF:

	QAR m's	Accepted	EUR m's	Accepted	Decision	Implication
Enforced Guarantees	880	880	211	211	Recognised by arbitrator	Collection right in JV's favour
Unpaid Alterations	182	182	44	44	Recognised by arbitrator	Collection right in JV's favour
Unpaid Alterations	76	-	18	-	No Arbitral award yet	
Construction Prolongation	322	-	77	-	No Arbitral award yet	
Total Claims	**1,460**	**1,062**	**350**	**255**		
Compensation for Disruption	67				Dismissed	Jun-19

Note:
Accepted/Recognised => the Arbitrator has assessed the claim and accepts it as valid. It can still be netted off against any award to the other side in the dispute

QF Claims against the JV:

	QAR m's	Accepted	EUR m's	Accepted	
QF Termination costs above outstanding price	-3,636	-	-873	-	No Arbitral award yet
Penalties for Delay	-792	-	-190	-	No Arbitral award yet
	-4,428	0	-1,063	0	
Defect Repair Costs	-320	- 124	-77	- 30	
	-4,748	-124		-30	

	Rejected	Stub
Jun-19	-168	-28

Completion Cost estimate % of Project		QAR m's	USD m's
Project Size		-9,231	-2,400
Claim	39%	-3,636	-945
Settlement Scenario:			
95% Completed*	5%	-462	
Excess Costs	10%	-923	
		-1,385	

*Arbitral panel has accepted that project was 95% complete, but we do not know what that means in monetary terms

Potential Arbitration outcome

- We have calculated our own expectations, however below is a list of the outstanding issues and amounts that are before the arbitration panel.
- Various differing amounts can be tested and updated as decisions of the Arbitral panel of publicised.

JV Level: QAR m's	**Panel Award**	**QAR m's**	**EUR m's**	**Note:**
Collection Rights for JV	100%	1,062	255	- Enter 100% in Panel Award column to generate worst case scenario, subject to assumptions
Defect Repair Costs awarded to QF	100%	-124	-30	On QF Termination Cost / Cost of Completion Estimate above.
Completion Cost Estimate	100%	-1,385	-332	
Penalties for Delay	100%	-792	-190	
Unpaid Alterations	100%	76	18	
Construction Prolongation	100%	322	77	
Total		**-841**	**-202**	Negative figure => payment due from JV to QF.

Partner Level:

JV Share		QAR m's	EUR m's	
OHLA	55%	-462	-111	Ultimate OHLA Potential Cash Liability (if Orascom g'tee found enforceable)
Orascom	45%	-378	-91	Orascom is disputing the enforceability of its guarantee.

Project History

Sidra Project Overview

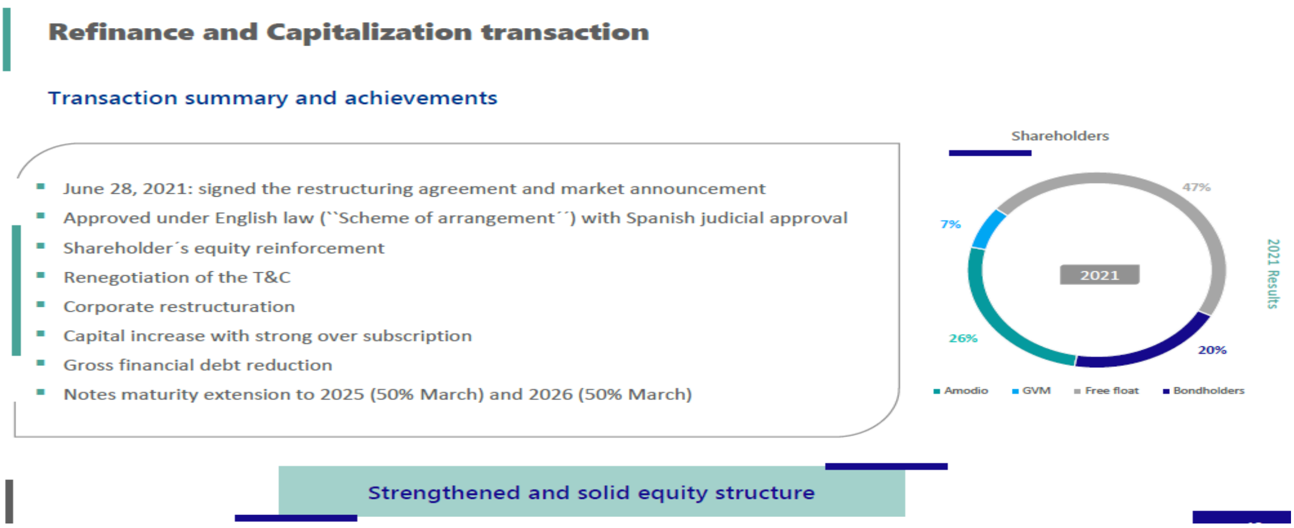
- 2006 Qatar Foundation (QF) announces the decision to build a 400-bed state of the art women and children's hospital in Sidra,
- 2008 QF announced a $7.9bn contract to build the hospital awarded to Consortium led by OHL and Contrack (a Cypriot based subsidiary of Orascom Construction Industries).
- 2011 Original date project was supposed to be delivered. That deadline was missed for unspecified reasons. By 2013 the project was slated to be completed by Q1 2015.
- In July 2014 OHL/Contrack are removed from the project. Arbitration begins, with OHL claiming that the Q1 2015 delivery date could have been met and that the work was "95% complete".
- July 2014 Midmac Contracting and Consolidated Contractors Company (CCC) are appointed as replacement contractors. CCC is the largest construction company in the Middle East is Arab (Syrian/Palestinian) owned and Athens based. Midmac is owned by Qipco a private vehicle led by Sheikh Hamad Bin Abdullah Al Thani (related to the ruling Al Thani family)
- May 2016 First out-patients treated.
- Jan 2018 First in-patients treated.
- When the project was originally conceived AECOM (infrastructure consulting firm) was involved, it left the project when it switched to a design-build and delivery method (we don't know when). AECOM eventually returned to the project after 2014. AECOM attributes the delays partly to the size and complexity of the building but also changes in the building team. No further comment has been made and given AECOM is highly active in the Middle East, it is not going to want to be too open about which changes and whose decisions caused the delays even without the ongoing arbitration.
- It is credible that the project was 95% finished in July-14 if the delivery date of Q1 15 was credible. The fact that the new contractors took a further 15-months before accepting patients indicates that either remedial work was needed (which could be charged to OHLA/Contrack) or that further construction was needed.
- We do not know what the delays were that pushed delivery of the project from 2011 to 2015.- The Middle East has a long history of delays in construction projects.
- Often (not always) and particularly where the state is involved, a local official must be consulted and approve major decisions or changes.
- If the client demands changes, the process of re-costing and adjusting delivery schedules can become very difficult.
- Getting reliable information on issues is not straightforward in the Gulf
    - There is no free press
    - The monarchies are near absolute and the laws reflect this. (including those on surveillance)
    - The monarchy/state can be very sensitive to criticism online
    - The legal system can be labyrinthine, horrendously expensive, and capricious.
    - Writing stories online and outside the country is safer but not a perfect way to avoid legal issues
    - When the added secrecy of arbitration is added then finding out reliable data is difficult.
- Contractors on large projects do not (generally) recruit all of their labour. Much of the lower-skilled labour is recruited by locally owned companies that are contracted to supply workers to projects. Much of the corruption and abuse in the sector emanates from this system. Although if lead contractors wanted to know they would be able to see it.
- This system is normal in the Gulf

From Human Rights Watch

- Qatar relies almost entirely on about two million migrants, who make up ninety-five per cent of the country's workforce in sectors ranging from construction to services to domestic work.

Restructuring

- The restructuring is done and dusted, however, we include some of the details for fullness.
- In 2021 OHLA completed its restructuring using the High Court in England.
- There was a part Equitization of the bonds reducing debt by €105m and extending maturities to 2025/2026.
- The bonds are secured and have a 5.1% coupon plus 1.5% pik (Increasing to 4.5% in 9/2023)
- €70m of new equity was raised and the Amodio family became the major shareholders.
- Post the restructuring being completed in Q121 that the banks backing its EUR340m of performance guarantees in Spain agreed to extend the guarantee lines by up to three years. These banks hold EUR140m of cash collateral against these lines. This collateral is outsized vs the size of the Spanish performance guarantees because it was originally sized to the much bigger multi-line credit facilities. These were mostly paid down with the cash from the Concessions disposal, of which the performance guarantees are a legacy.
- Value of two non-core real estate projects: OHL's IR sees no changes to the previous guidance on the valuation of its two real estate assets to be sold - EUR150-200m for the Canalejas stake and EUR100m for the War Office stake.
- The War Office stake was sold for €100m and this is expected to have closed in Q421.
- The Canalejas project in Madrid has finally opened (following delays due to Covid). OHLA is not going to want to sell this project given the construction risk has now passed and the project is beginning to generate cash.



Analyst: Aengus McMahon amcmahon@sarria.co.uk International construction company based in Spain Last Update 26.3.2024

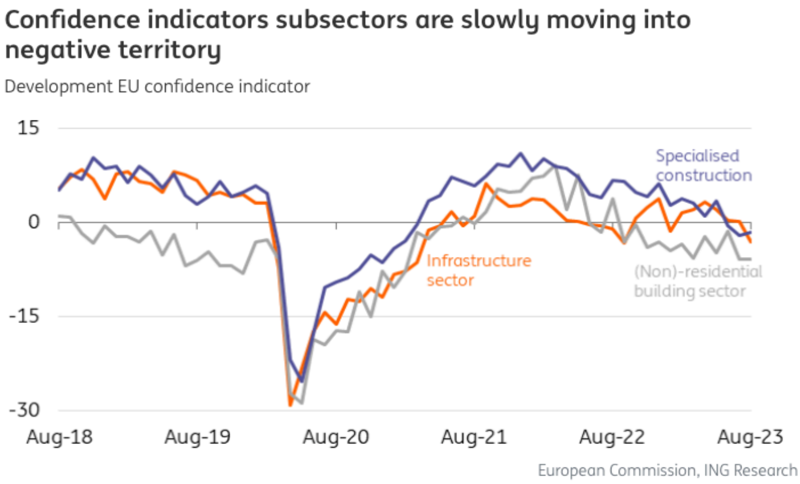
Industry:

Overview:

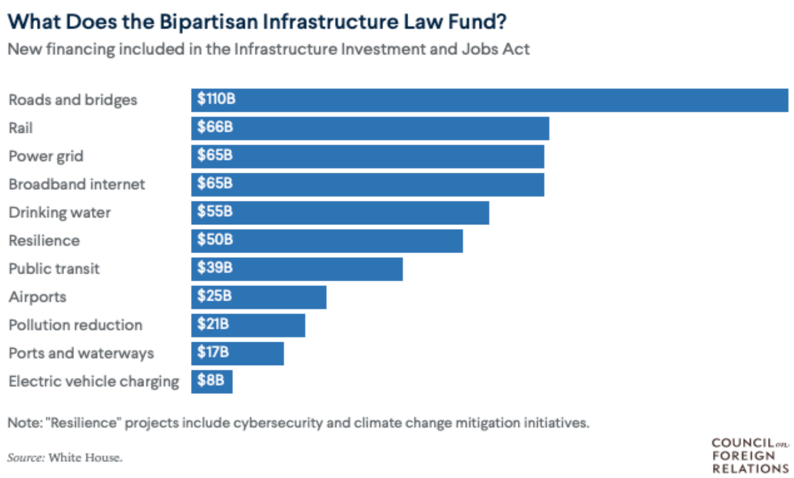
- Fragmentation: Construction is a localised business, so the industry is still highly fragmented. Even in segments such as infrastructure and commercial, which tend to require a certain amount of scale, most firms tend to have national or even regional scale. In this sector, having senior management close to the worksites is a key factor of differentiation. The density of the network is more important than the total size.
- The most successful construction companies in the long term have usually been family-controlled groups where the founder has maintained a strong grip on management and a significant aversion to public investors and creditors, and in many cases even to bank creditors. They have traditionally been able to better price contracts, retrench when aggressive competitors have overbid, and do a better job of executing projects. The very existence of a public capital structure can be a disadvantage for construction groups over the long term. It appears that the very act of having to translate results from an activity that is inherently long-term into short-term quarterly results already significantly distorts some management incentives.
- Costs and revenues timing mismatch: There are heavy cash outlays before any actual cash revenues flow into the company. This has led to accounting problems as well as execution difficulties.
- EM carry trade: many construction groups based in developed countries have tried to address the issue of low margins and competitiveness in their home countries by expanding into EM. However, as in the case of most EM expansions, it became difficult to discern between what is the true economic return vs what is just a cost of capital arbitrage, FX risk compensation, and other financial and macroeconomic sources of risk and return.
- Legal disputes: these are very frequent in construction projects. Execution is very unpredictable. The original contract can never even come close to reflecting the myriad of risks, opportunities and issues that will unexpectedly materialize. For large projects, which often involve either a political entity or a large corporation, the complexity is significantly higher, as they contain a major element of excessive distance between the representatives of the ultimate interest party (the voters?) and the representatives of the contractor (shareholders?).
- Asymmetry of information: the construction sector is often characterized by meaningful information asymmetries between the client and the contractor, regarding the nature of the work to be done, the expectations, the cost, the complications, the risks, and other factors. This can also be the case when it comes to the operating environment, which is why construction groups based in developed countries often seem to significantly underestimate the costs and risks in Emerging Markets. And naturally, the asymmetry of information between insiders and external investors is very large.
- Competitiveness: in this sector, the technical knowledge to operate usually resides in key professionals instead of within the company. As a result, barriers to entry apart from the capital are relatively low, and margins can be thin.
- Agency conflicts between management and shareholders: because of the multi-year nature of most large projects, the system of compensation for key professionals, including management but also other key staff such as project managers, tender managers and others, is inevitably insufficient to address the difficulty to estimate the true profitability of a contract until several years after the start date.

Industry trends:

- Financial distress: the construction sector has seen numerous distressed capital structures over the past 5-10 years. This has led to less competition, especially for the overly aggressive type. But it has also led to higher investor scrutiny and a much higher cost of capital for the surviving players.
- EM retrenchment: the surviving large construction groups have finally learned that EM comes with significant underappreciated risks that have often become fatal to most capital structures. As a result, they are now gradually moving back towards developed countries and more stable EM ones - such as Central and Eastern Europe.
- Smaller is better: the industry is currently in the process of refocusing on smaller contracts. This trend is clear from the recent statement and trends at Aldesa, OHL and others. Smaller contracts are less risky, easier to execute and provide more diversification vs the significant and inevitable operating risks for the sector. However, they also offer much lower margins.
- Falling margins: due to the trends above, construction margins are being squeezed and the EM carry trade is squeezed out of the margin, the contract size premium is reduced, and competition remains intense.



- The outlook for construction in the EU is expected to be marginally softer in 2024.
- OHLA is predominantly involved in Infrastructure projects even here confidence is now turning negative.
- The construction picture is for a slowdown (-1% according to ING) rather than a major reduction in activity.
- The post COVID investment programs have been scaled back due to the inflation crisis and the impact of the Ukraine war on



- The framework in the US is a little better.
- However, the Federal dollars need to be matched by either local government dollars and/or private investment.
- The increases in labour and material costs comes on top of significant increases in the cost of debt for municipalities.
- Much of the Infrastructure projects will be in the competence areas for OHLA.

Company:

- OHLA is still one of Spain's largest construction groups.
- The question of the ability of OHLA to generate free cash flow remains to be answered, however, the company has cash balances which will allow it leeway for operations in the medium term. We are sceptical of the construction industry's ability to generate cash consistently outside of higher-risk development projects.
- OHLA took the same route as European construction peers that hit problems. Aggressive contract bidding and M&A, especially in Emerging Markets, increasingly complex organizations and projects, "sales to itself" via a concessions arm, poor execution, ballooning working capital needs as clients delayed payments, serious legal disputes, and ultimately debt restructuring.
- The emergence of the Amodio family as the major shareholders should help with avoiding the mistakes in EM that contributed to the previous restructuring.
- The re-emergence of a concessions arm does raise the spectre of some of OHLA's previous issues in LATAM. We take some comfort from the presence of the Amodio family on the shareholder register given their experience in the region.
- Several major legal disputes are outstanding although we estimate that in the downside case, net costs should be <€100m.
- The completion of the debt restructuring leaves the company in a position to get bank guarantee lines to increase the size of its order book. There is still €140m of trapped cash used to back bank guarantees. OHLA has not been able to get the banks to release this.

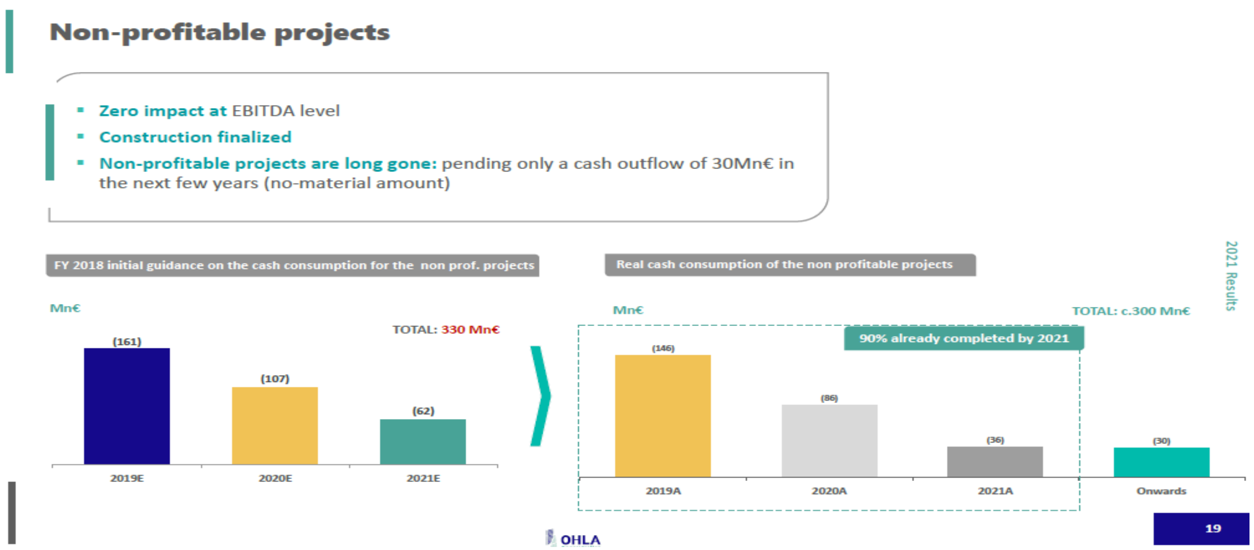
Onerous projects estimates

Comments:

- OHLA replaced management in 2018 as part of a plan to deal with a legacy of unprofitable contracts due to poor discipline in bidding on projects in Latam.
- The process of dealing with these costs bedevilled OHLA, but the process is drawing towards a close.
- The expected cost of the onerous projects was ~€300m and at the 2021 results OHLA confirmed that the final costs are expected to be will be €30m, with most of that falling in 2022.
- According to OHLA, the business outside of these legacy issues has been FCF positive.
- Improvements in free cash flow should flow as the impact of these contracts runs off
- We did observe some improvement in the rate of cash burn in 2019/2020, it was difficult to independently verify OHLA's claims that its core business was fundamentally sound and that the company should return to growth once the drag from legacy projects goes away by the end of 2022. The generation of cash has been driven by significant inflows from investment. This is not something that can be repeated. OHLA

	2019	2020	2021	2022	comments
OHLA legacy project cash (	146	86	36	30	
Split estimate					the cash outflow guidance is for all three items
EBITDA	30%	30%	30%	30%	company did not provide the break down between EBITDA, working capital and capex for the split
Capex	20%	20%	20%	20%	
Working Capital	50%	50%	50%	50%	
EURm impact per item					
EBITDA	-44	-26	-11	-9	
Capex	-29	-17	-7	-6	
Working Capital	-73	-43	-18	-15	
Revenue estimates	3,008	3,046	2,882	2,904	
Impact on EBITDA margin	-1.5%	-0.8%	-0.4%	-0.3%	

Distribution per quarter	**Q1 20**	**Q2 20**	**Q3 20**	**Q4 20**	**Q1 21**	**Q2 21**	**Q3 21**	**Q4 21**	**Q1 22**	**Q2 22**	**Q3 22**	**Q4 22**
EBITDA	-6.5	-6.5	-6.5	-6.5	-2.7	-2.7	-2.7	-2.7	-2.3	-2.3	-2.3	-2.3
% of sales	-1.0%	-0.9%	-0.9%	-0.8%	-0.4%	-0.4%	-0.4%	-0.3%	-0.3%	-0.3%	-0.2%	-0.2%
Capex	-4.3	-4.3	-4.3	-4.3	-1.8	-1.8	-1.8	-1.8	-1.5	-1.5	-1.5	-1.5
Working Capital	-10.8	-10.8	-10.8	-10.8	-4.5	-4.5	-4.5	-4.5	-3.8	-3.8	-3.8	-3.8



Main Figures	1H23	1H22 Restated	Var. (%)
Sales	**1,412.4**	**1,263.1**	**11.8%**
EBITDA	**50.8**	**34.2**	**48.5%**
% o/ Sales	*3.6%*	*2.7%*	
EBIT	**14.0**	**23.1**	**-39.4%**
% o/ Sales	*1.0%*	*1.8%*	
Attributable Net Profit	**0.6**	**-60.7**	**-101.0%**
% o/ Sales			

Sales and EBITDA Breakdown	1H23	1H22 Restated	Var. (%)
Sales	**1,412.4**	**1,263.1**	**11.8%**
Construction	1,309.2	1,207.9	8.4%
Industrial	90.4	44.5	103.1%
Other	12.8	10.7	19.6%
EBITDA	**50.8**	**34.2**	**48.5%**
Construction	61.4	49.8	23.3%
% margin EBITDA Construction	*4.7%*	*4.1%*	
Industrial	3.3	0.0	n.a.
% margin EBITDA Industrial	*3.7%*	*0.0%*	
Corporate and other	-13.9	-15.6	-10.9%

Order book	1H23	2022 Restated	Var. (%)
Short term	6,037.8	5,923.3	1.9%
Long term	1,079.2	490.1	120.2%
Total	**7,117.0**	**6,413.4**	**11.0%**

Comments:

Revenue

- Construction is the key business and will remain so
- OHLA has begus bidding on Concessions projects (particularly in health projects)
- The concessions business became a good way to hide loss making projects that morphed from construct to construct and operate. The current concession projects are starting out as concessions.

Order Book

- In 21Q4 the short-term order remains skewed more towards the US, reflecting the greater ease of securing bank backing for projects. Our expectation is that OHLA's European book will eventually overtake the US again as the largest region. This will be driven by the EU infrastructure spending programme and the increasing availability of bank guarantee lines.

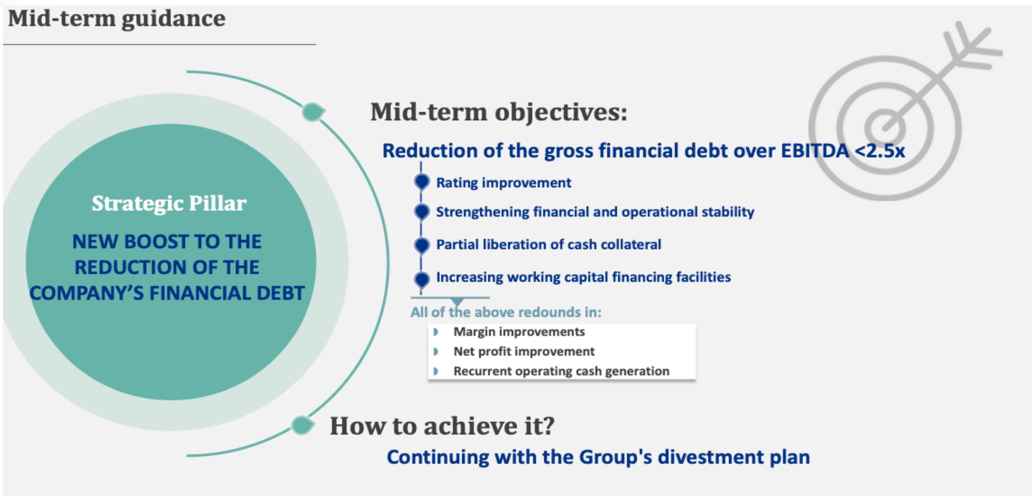
34% Europe
45% US
21% Latam

- The overall size of the order book will also be driven by government infrastructure spending.

- The nature of orders is also moving away from building to Road/Rail projects. This is a slow process but reflects managements claims of de-risking the business.

Q421
Roads 46%
Railways 21%
Energy & Mining 21%

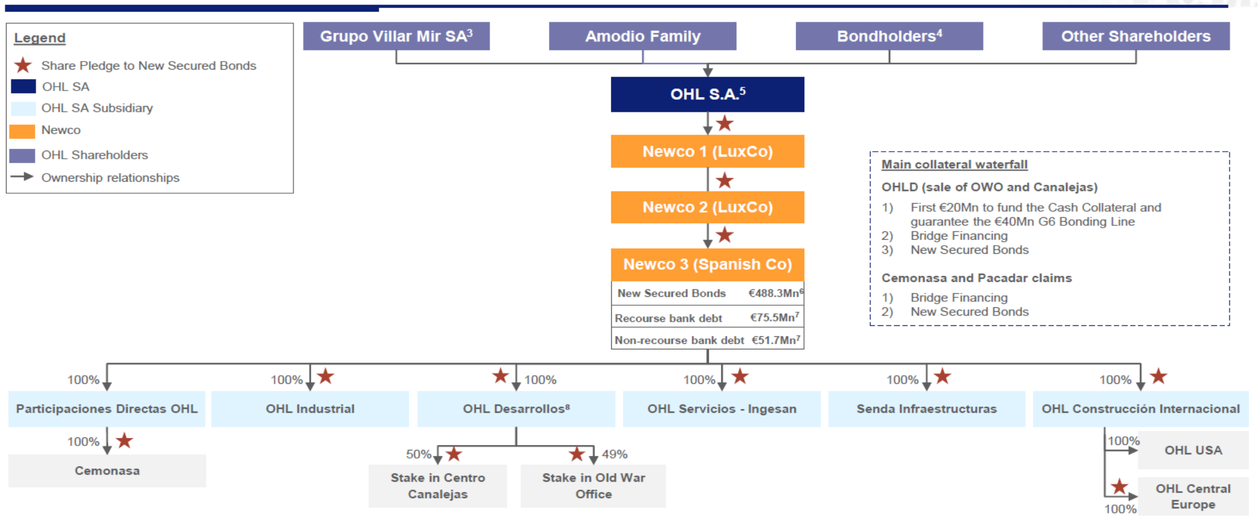
Company Guidance



Comments:

- OHL will start to hit its targets in 2022 now that the pandemic largely behind us.
- Revenue and operating cash flow will begin to be boosted by infrastructure projects in the EU and US
- 2022 revenue guidance of >€3bn is in line with our modelling with EBITDA slightly ahead of or €97m.
- The re-emergence of the Concessions business will need close monitoring this is a modest start. Management also intends to only hold 15% to 20% of the equity in these projects.
- Gross Financial Debt (mainly bonds is targeted at below €300m in the medium term.

Legal:



(1) The chart below shows an indicative simplified corporate structure and does not show all entities within each OHL SA Subsidiary. Furthermore, details below only include main security package of New Secured Bonds and does not reflect personal guarantees. Aside from pledges illustrated, the New Secured Bonds are also secured by means of pledge of credit rights of certain construction contracts, credit rights under intragroup loan agreements and pledge over certain accounts
(2) The target of the hive down is that the sales generated by entities within the issuer group account for at least 80% of the overall group, subject to certain agreed headroom
(3) OHL has reached an agreement with GVM in relation to the debt owed to OHL. Please refer to slide 32 for further detail. Pacadar will be pledged in favor of the New Secured Bonds to the extend it becomes a subsidiary
(4) Bondholders that would become shareholders of the Company post-restructuring are not all current bondholders, but only those who have opted for Alternative 2 (which is capped at 38.25% of the bonds)
(5) There is a cash account with €140m that is pledged to the €313.7Mn G6 Bonding line. Cash collateral to be increased to €160Mn upon a divestment of OHL Desarrollos. This additional €20Mn will guarantee the €40Mn G6 Bonding Line. Subject to an agreement with banks, these cash collaterals would also guarantee the New Secured Bonds
(6) This figure assumes 100% of noteholders adhere to the lock-up agreement
(7) Amount outstanding as of September 2020
(8) OHL Desarrollos SAU has €307.5Mn of intragroup debt outstanding as of July 2020, securing the Bridge Financing and the New Secured Bonds

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Negotiating Position:
- In case of any insolvency, management on behalf of theAmodio family would default to filing in Spain, where the process affords the debtor possession of the business and where a process can last for two years. This would maximise the family's negotiating position, but would likely also trigger most of the debt, including bonding lines.
- If bondholders want to be part of the solution, they could agree with management to use their share pledges in Luxembourg and inject any fresh cash at that level in return for new shares. This would be a clean option, but requires a consensual approach.

Waterfall (subject to intercreditor agreement:
1) The project debt resides at individual project level and is therefore structurally sr. to any other debt. Note however, that the bonds benefit from extensive sr. guarantees at various propcos, intermediate holdcos and holdcos.
2- The lenders under the performance guarantees should have claims against individual opcos in case of non-completion. Against their claims these institutions still have EUR140m cash collateral, which they will net in the case of any insolvency. This collateral should begin to reduce as it was related to larger bonding lines. Banks are prone to drag their feet on releasing security.
3) The secured notes are issued at holdco level out of Spain, structurally pari passu with certain non-recourse and recourse debt. The SSNs benefit from extensive guarantees across OHL's holdcos, midcos and opcos, as well as from share pledges at most relevant entities.

Security:
- The notes are widely guaranteed by OHL's opcos, propcos, midcos and topcos.
- They also benefit from share pledges over the double luxco structure, the Spanish issuer and the Project Companies, including those that own the stakes in Canalejas, Old War Office and Cemenosa.
- Additionally, the bonds have guarantees over the bank account of OHL Operaciones, this includes pledges over any credit rights over construction contracts that are part of the Direct OHL business (in Spain).
- Charges over various deposit accounts of OHL in Spain. This gives bondholders and any other secured creditors control over cash held at the corporate level by OHL but also any value that may accrue at the project level.
- The security is subject to the application of the Intercreditor Agreement.

Covenants
- Limitation of indebtedness: Coverage ratio of 3:1

Buckets
- Existing Bonding Lines of €314m, additional bonding lines of up to €200m.
- Confirming lines €100m, reduced by any increase in the existing bonding lines.
- €50m of bonding lines incurred by non-guarantor subsidiaries.
- Asset-based borrowing €35m.
- Additional debt €70m.
- There is a restriction of €50m on the above debt in total excluding debt at project subsidiaries.
- Guarantee maximum of €20m for non-guarantee subs.

Jurisdictions:
- Bonds: English Law, apart from Condition 13a ie Modifications and Waiver, which are under Spanish Law. Condition 13a is key as it regulates the Syndicate of Noteholders, which is the forum to request modifications or waivers of the notes - the present situation. In a Syndicate of Noteholders (Sindicato), the first meeting must have a minimum quorum of 2/3 to pass valid decisions. Otherwise, the Syndicate can reconvene one month later, with no minimum quorum. A resolution is passed with an absolute majority of the nominal of the notes, only of those properly present or duly represented at one of the meetings.
- The company is headquartered in Spain.
- The issuer is located in Spain.

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