



Orascom Construction 2Q-16 |

Stable earnings and profitability; Awards and net cash position a positive surprise; “Add” on FV of USD7.60

New FV, USD/Share	7.60		
New FV, EGP/Share	75.60	Reuters/Bloomberg	ORAS.CA/ORAS.EY
Recommendation	Add	S/O, m	117.8
Last Price, EGP/Share	62.18	MCAP, EGP m	7,323
Valuation Gap	22%	Free Float, %	13%
52W H-L, USD/Share	96.00 – 48.20	52W ADTV, EGP m	1,030

AWARDS; CASH MANAGEMENT AND LOWER LEVERAGE ARE KEY POSITIVES

New awards a positive surprise; Backlog records USD7.5 billion

Strong backlog addition is the key positive highlight this quarter, where consolidated backlog grew 4.8% (USD2.2 billion) to USD 7.5 billion. New additions are mostly in Egypt and the USA. Besix also added healthy awards worth USD2.8 billion, taking Pro forma backlog including OC’s 50% share in BESIX USD 9.5 billion. Egypt represented 63.5% of OCI’s backlog, followed by USD at 16.4% and Saudi Arabia at 4.6%; with infrastructure 72.3% of the total, represented by public sector clients.

Healthy executions reflect on revenue; margins lifted by MENA region

Revenue recorded USD1.024 billion in 2Q-16 and USD1.997 billion in 1H-16, recording 6.5% growth y-o-y and depicting stability in executions. EBITDA margin recorded 4.9% in 2Q-16 and 5.0% in 1H-16, which is slightly lower on an annual basis. MENA margins recorded 8.8% in 1H-16 compared to 1% at USA. Besix contributed USD7.5 million to bottom line in 2Q-16, which is a significant improvement from 1Q-16 contribution of USD2.0 million. The slight drop in margins was due to the Saudi business being on hold until late payments are received.

Net cash position improved on debt reduction; CFO turns positive on WC management

The company recorded a net cash position of USD299 million as of June end, which translates into USD2.54 per share, or 37% of market price using the official exchange rate. The company recorded a positive CFO of USD260.8 million, versus negative operating cash flow in December 2015, mainly on improved working capital management.

No further losses expected from IFCo; Debt might increase towards year end

Management noted in a conference call yesterday that no further losses should be booked in relation to the construction of Iowa Fertilizer Company (IFCo), and the project is being closely monitored to mitigate any risks. In terms of financing the loss, management noted that Nat Gasoline cash flows, potential receivables and possibly debt could cover the funding gap.

WE RECOMMEND AN “ADD” ON FV OF USD7.60; DEVALUATION IS YOUR UPSIDE

Orascom Construction is a play on infrastructure spending and devaluation in Egypt

MENA accounted for 51% of revenue in 1H-16 led by Egypt, which represented 44% of total revenues. MENA EBITDA margin recorded 8.8% in 1H-16 and 9.2% in 2Q-16, mainly driven by projects in Egypt.

According to management, 74% of the group’s total backlog is in FCY or priced in FCY. c.41% of backlog in Egypt is EGP denominated. FCY and FCY-priced backlog outweigh FCY costs in Egypt. The group also incorporates cost escalation clauses in the majority of Egypt contracts to protect against potential cost inflationary pressures.

Our fundamental FV is c. USD7.60; Official exchange rate is your upside

At the official exchange rate of EGP8.85/USD, our FV translates into EGP67.06, which is 7% above the current market price of EGP62.50. At a very conservative exchange rate of EGP9.95/USD, our FV is 75.60 (+21% upside). However, we estimate that the official exchange rate would average EGP10.95 over the next fiscal year, which takes ORAS’ FV to EGP82.97, offering 33% upside from current market price.

Our assumptions are conservative on backlog and margin fronts

We estimate that the backlog would reach USD8.0 billion by the end of 2016 and USD10 billion by the end of 2020. We estimate executions on an average of 2.0 years. On the margin front, we estimate that GPM would continue to average 8.0% and EBITDA margin would stabilize at c. 5%.

Stock is trading at discounted multiples compared to peers; Cash is 37% of market cap

Emerging market peers are trading at 18.1x P/E; 10.9x EV/EBITDA; and 1.5x P/B. Orascom is trading on 2016 projected numbers at 8.1x P/E; 4.3x EV/EBITDA and 1.4x P/B. The net cash position represents 37% of current market cap.

**Key tables presented next page*

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ORASCOM CONSTRUCTION 2Q-16 FINANCIAL INDICATORS

Fig. in USD million	1Q-16	2Q-16	1H-15	1H-16	2Q-16	1H-16
					Y/Y	Y/Y
Revenue	972.9	1024.1	1874.4	1997.0	0.7%	6.5%
Cost of sales	(891.5)	(953.0)	(1733.8)	(1844.5)	2.2%	6.4%
Gross profit	81.4	71.1	140.6	152.5	-15.9%	8.5%
<i>GP Margin</i>	8.4%	6.9%	7.5%	7.6%		
SG&A expenses	(47.7)	(37.9)	(74.1)	(85.6)	-3.8%	15.5%
Operating Income	35.6	35.6	72.2	71.2	-26.7%	-1.4%
EBITDA	48.8	50.3	101.4	99.1	-20.8%	-2.3%
EBITDA Margin	5.0%	4.9%	5.4%	5.0%		
<i>Besix</i>	2	7.5	11.1	9.5	-55.6%	-14.4%
Finance income	22.8	7.9	7.7	30.7	295.0%	298.7%
Net finance cost	(2.1)	(18.5)	(27.5)	(43.4)	14.2%	57.8%
Income from associates	6.5	7.6	16.5	14.1	-58.2%	-14.5%
Profit before income tax	40	32.6	56.7	72.6	-19.3%	28.0%
Net profit after minority	23.0	26.4	39.8	49.4	-22.4%	24.1%
NP Margin	2.4%	2.6%	2.1%	2.5%		

Consolidated Backlog

Equity Consolidation

Backlog	6,111.5		7,194.7	7,538.0
New Awards	510.4	2,221.7	3,270.2	2,731.6
Pro-forma (+50% of Besix)				
Backlog	8,100.2		9,025.8	9,517.7
New Awards	977.0	2,574.4	4,011.6	3,550.7

Summary Balance Sheet

	Dec-15	Mar-16	Jun-16
Cash and cash equivalents	574.9	466.7	571.3
Total debt	439.4	379.7	272.3
Total equity	560.5	531.2	539.3
Net debt (cash)	(135.5)	(87.0)	(299.0)

PROJECTED FINANCIAL PERFORMANCE

Income Statement (USD Mn)	2015	2016P	2017P	2018P	2019P
Revenues	3,882	3,996	4,856	5,619	5,766
Construction Cost and Cost of Sales	(4,094)	(3,684)	(4,467)	(5,170)	(5,305)
Gross Profit	(211)	312	388	450	461
SG&A	(198)	(180)	(219)	(253)	(259)
EBIT	(368)	144	185	214	219
Net Finance Cost	(21)	(25)	(23)	(22)	(14)
Income from Associates	5	25	27	29	32
Attributable Net Income	(348)	103	135	158	169

Balance Sheet (USD Mn)	2015	2016P	2017P	2018P	2019P
Cash and Cash Equivalents	575	84	23	92	194
Net operating Working Capital	323	195	276	206	212
Inventory, Net	203	202	245	283	291
Trade and Notes Receivable, Net	1,195	1,204	1,463	1,693	1,738
Trade and Other Payable	1,075	1,211	1,432	1,770	1,817
Other Short Term Assets	494	611	674	779	799
Contracts WIP	485	602	665	770	790
Investments in Long Terms Assets	768	760	838	879	931
Property and Equipment	280	300	324	349	363
Associates	339	365	392	422	453
Equity	484	588	722	881	1,050
Debt	739	362	334	307	198
Long Term Debt	47	89	91	94	14
Loans and Borrowings	26	74	77	80	0
Short Term Debt	692	273	243	213	184

Backlog (USD Mn)	6,660	8,093	9,365	9,610	10,177
New Awards (USD Mn)	4,846	4,371	5,219	4,828	5,272

Key Ratios	2015	2016P	2017P	2018P	2019P
EPS (USD)	(2.95)	0.88	1.14	1.34	1.44
BVPS (USD)	4.11	4.99	6.13	7.48	8.92
DPS (USD)	0.00	0.00	0.00	0.00	0.00
P/E (x)	n/m	8.1	6.2	5.3	4.9
P/B (x)	1.7	1.4	1.2	0.9	0.8
EV/EBITDA (x)	(2.6)	4.3	3.4	3.0	2.9
Dividend Yield (%)	0.0%	0.0%	0.0%	0.0%	0.0%
EV/Backlog (x)	0.12	0.10	0.09	0.09	0.08

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