Ortiz Construcciones y Proyectos S.A.U.

Spain, Construction

BB- STABLE
Corporate Rating

Ortiz Construcciones y Proyectos S.A.U. ('Ortiz' or 'the group') is a well-established SME player in the Spanish construction market. Ortiz benefits from some good diversification across business lines with operations in Construction, Energy, Services, Concessions and Real Estate. Geographically, Ortiz is present in Spain, Latin America, Poland and Algeria, among others. Ortiz' turnover stood at €392 million in 2013. For the purpose of this analysis, Scope follows the accounting standards and includes in its financial analysis only those concessions which are controlled by Ortiz.

Rating

Corporate Rating:	BB-
Outlook:	Stable
Sector:	Construction, Industry
Monitoring:	Monitored

Analysts

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Rating Rational

Scope Ratings assigns a first-time rating of BB- to Ortiz Construcciones y Proyectos S.A.U. ("Ortiz"). The rating outlook is Stable. The rating reflects Ortiz' position as the eleventh-largest player in the Spanish construction market with a turnover of EUR 392m in 2013 (excluding non-controlled concessions). Due to its relatively small size, Ortiz is typically not the principal contractor in large construction projects.

Although its revenue diversity is improving in geographical terms, Ortiz is still very focused on the Spanish construction market, where it generated 63% of 2013 group sales. However, Scope Ratings recognizes that the company plans to boost the share of international sales to at least 45% of total group revenue in 2014 (2011: 10%). This increase will be driven by the group's significant order backlog, which amounted to EUR 1,061m in December 2013 and represents 2.7x of Ortiz' 2013 annual revenues. Sales from the backlog shall be generated by diversifying the existing customer base, thus reducing its current relatively high customer concentration on the Spanish government.

Although the company has a solid track record for executing projects, there is an inherent – albeit limited – risk on international expansion, which has been factored into the rating.

Scope Ratings considers Ortiz' financial leverage to be in line with the rating. Ortiz' Net Debt to EBITDA stood at 3.7x at year-end 2013 (3.5x if tradeable securities are fully accounted for) and is expected by Scope Ratings to increase before dropping back to 2.9x in 2016. The increase in debt levels is due to a planned EUR 100m bond issue, which will be used to repay part of the existing bank debt and to finance further investments in concessions.

Ortiz' liquidity is considered adequate for the rating. Ortiz' short-term financial debt stood at EUR 73m at the end of 2013. Its cash and equivalents position of EUR 39m at year-end 2013, together with its projected funds from operations and existing liquidity facilities, should allow the company to cover expected liquidity needs for the next 12 months, assuming modest capex, no major outflows for working capital and limited expansionary investments. Ortiz had considerable unused committed bank facilities of EUR 199m at year-end 2013.

The rating outlook is Stable. A positive rating action could be warranted if, once the bond is issued, Ortiz manages to deleverage as planned by 2016.

Rating Drivers

Positive	Negative
Solid position as an SME player in Spain's construction sector	Relative high exposure to the Spanish market; albeit decreasing with international revenues accounting for 37% of turnover in 2013
Diversified business model both in segments and geography. Geographic diversification is expected to increase in the next few years	Relative small size which limits diversification possibilities
Good level of diversified backlog provides visibility into the next couple of years	Execution risks, albeit limited, inherent in its expansion strategy
Adequate liquidity for the rating	Relative high leverage at a global level

Rating Change Drivers

The following might impact the rating in the future:

Positive	Negative
Successful execution of expansion strategy	Economic downturn in Spain impacting future sales and/or margins in the domestic construction business
Reduction in customer concentration	Increase in Net Debt/EBITDA above 5x on a continued time period
Increased critical mass in main markets	A less conservative strategic approach going forward
Divestment from the real estate business, which accounts for a large portion of Ortiz' debt	

Financial overview

	2011	2012	2013
P & L Statement			
Revenue (EUR millions)	509,9	499,4	392,2
EBITDA (EUR millions)	53,3	25,2	47,2
EBIT (EUR millions)	45,7	17,3	28,1
Interest expense (EUR millions)	10,8	12,9	16,5
Net interest income (NII) (EUR millions)	-7,2	-9,2	-11,0
Total Financial Debt (EUR millions)	205,4	200,9	204,7
Net Debt (EUR millions)	167,1	154,3	172,9
Cash Flow Statement			
Free Cash Flow (FCF) (EUR millions)	-8,6	58,0	-52,1
Operating Cash Flow (CFO) (EUR millions)	13,6	86,4	-42,5
Funds flow from Operations (FFO) (EUR millions)	19,0	10,1	27,9
Capex (EUR millions)	-22,2	-28,3	-9,7
Change in Working Capital (EUR millions)	-5,5	76,3	-70,3
Financial ratios			
EBITDA Margin	10,5%	5,1%	12,0%
EBIT Margin	9,0%	3,5%	7,2%
Total Debt / Total Assets	23,5%	25,5%	26,8%
Total Debt / EBITDA	3,9	8,0	4,3
Net Debt / EBITDA	3,1	6,1	3,7
EBITDA / Interest Expense	5,0	2,0	2,9
CFO / Total Debt	0,1	0,4	-0,2
FCF / Total Debt	-0,0	0,3	-0,3

Business Risk Profile

Well-established, family-owned construction company based in Spain

Ortiz is a well-established, familiy-owned Spanish construction company headquartered in Madrid, Spain. The company has a long-standing track record of more than 50 years which has enabled the company to build a good reputation and to establish strong relationships in the Spanish market. This was driven by the CEO and founder of Ortiz, Juan Antonio Carpintero Lopez (age 70). Following the planned orderly retirement of Mr. Carpintero Lopez in the near future, Scope expects his successor to continue the business in line with the existing strategy.

Sector-inherent cyclicality constrains the rating

The company operates in a highly cyclical sector in which demand fluctuates with the cycle. Even though diversification might reduce this impact, it can not eliminate it. Ortiz' exposure to its sector's cyclicality could be seen in 2013 when turnover dropped by 21.5% due to the Spanish crisis.

However, Ortiz has shown strong resilience in margins

While Ortiz' comparably small size increases its exposure to the cyclical development of the construction industry, Scope values the company's strong resilience in terms of margins. Based on the period between 2009-2013, Ortiz shows an average EBITDA margin of 11%.

Relative small size in the market limits cash flow diversification

Diversification in terms of value chain, sector/client exposure and geography limits the exposure to cyclicality and, hence, the volatility of margins and cash flow generation. While Scope notes that Ortiz has shown great efforts over the past three years to improve internationalisation, its rating is still held back by the group's relatively small size in the international construction industry. This makes it reliant on Joint Ventures, prevents it from being the principal contractor and limits its cash flow diversification.

Increasing geographic diversification, but still fairly dependent on Spain

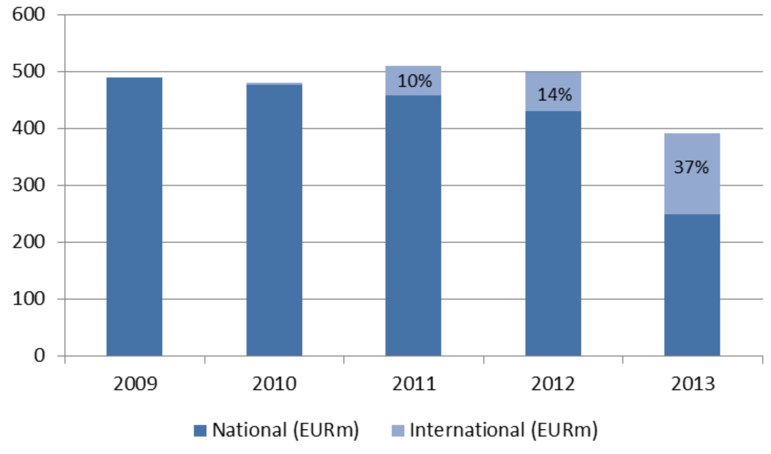
Although the group's business is focused on national construction projects, over the last few years it has also diversified into other business lines such as concessions and international construction projects.

Ortiz has followed an internationalisation strategy since 2011 and is currently active in 11 different countries in Latin America (Colombia, Mexico and Peru, among others), Eastern Europe (Poland and Romania) and North Africa (Algeria). This internationalisation strategy has proven very fruitful in light of contracting construction volumes in the domestic Spanish market. Although Ortiz is still small from an international perspective, Scope considers its international footprint to be better than that of other mid-sized Spanish construction companies.

International projects accounted for 37% of revenues in 2013. Scope trusts that the group will further strengthen its international footprint to at least 45% of expected revenues in 2014, backed by their order backlog. Nevertheless, Scope notes that the group's dependence on the Spanish market will remain relatively high and Ortiz still needs to mature in the international concessions business.

The group has a track record of entering new target markets very selectively; starting small without taking significant risks and teaming up with local players with a deep knowledge of the different markets. Furthermore, the group has also acted opportunistically by taking contracts with limited risks in countries where they might not necessarily be interested in staying in the long run.

Figure 1 – Regional revenue split

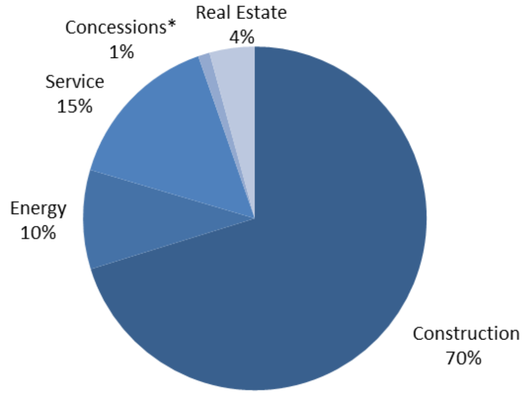


Source: Ortiz, Scope

Solid segment diversification

In light of sectoral segmentation, Ortiz has made strong progress in diversifying its business segments. In 2013, revenues derived from non-construction projects amounted to about 30% of total revenues. Scope considers this increase in diversification to be positive, as it allows the group to enhance margins and reduce sales and margin volatility. However, Ortiz' exposure remains high in the first steps of the value chain, including pre-construction and construction.

Figure 2 – Ortiz: Revenue split 2013



***** Adjusted concessions accounted for 10% of the revenues of 2013. The group utilizes the equity method to consolidate concessions as the group does not control those concessions.

Source: Ortiz, Scope

Concessions offer good growth potential …

While the international concessions business, in particular, offers good growth potential for Ortiz, Scope believes that the company has to show that they can execute their growth strategy successfully in these new markets. Scope believes that Ortiz has a good chance of sustaining its business model in this area due to its very conservative approach of limiting risks through local partnerships.

… but remain a drag on the rating if not churned as planned

Scope sees that Ortiz, as consequence of the situation in the Spanish market, could experience difficulty in successfully rotating some more mature Spanish concession assets. In particular, assets in the renewable energy sector might be negatively impacted by changes in regulation introduced by the Spanish government in 2013.

Order backlog points to strong growth prospects and margin improvements

Full order book provides some cash flow upside over the next few years

In Scope's view, the current order backlog of EUR 1,061m in 2013, which excludes concessions, bolsters Ortiz' growth prospects for the next few years. The order backlog, which represents 2.7x of Ortiz' 2013 group revenue, enables the company to bolster cash flow generation over the next few years. Scope recognizes that Ortiz' order backlog is somewhat diversified in terms of projects and clients, with the top five contracts representing 30% of the order backlog.

Figure 3 – Segment split of order backlog* at end 2013

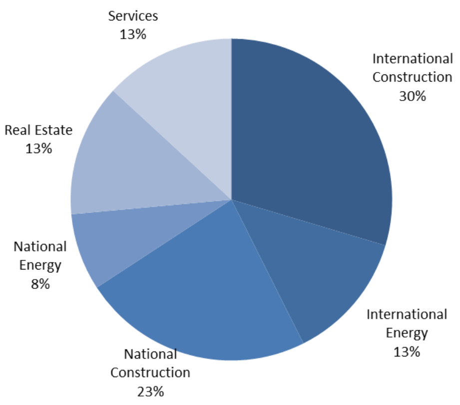
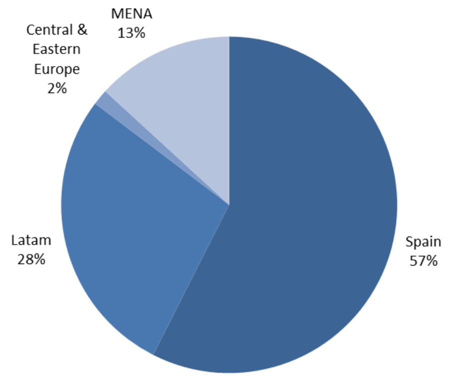


Figure 4 – Regional split of order backlog* at end 2013



* order backlog excluding concessions
Source: Ortiz, Scope

Consolidated EBITDA excludes not fully controlled concessions, although these might provide upside potential

For the purpose of this analysis, Scope follows the accounting standards and includes in its financial analysis only those concessions which are controlled by Ortiz.

Ortiz uses Project Finance non-recourse debt to finance its concessions. This non-recourse debt in general matches the cash flows of the project and limits risks for the operator. Ortiz profits from cash flows generated from its concessions portfolio via a mix of interest and dividends.

Financial Risk Profile

2013 increase in turnover from international activities not sufficient to compensate for decline in turnover in Spain

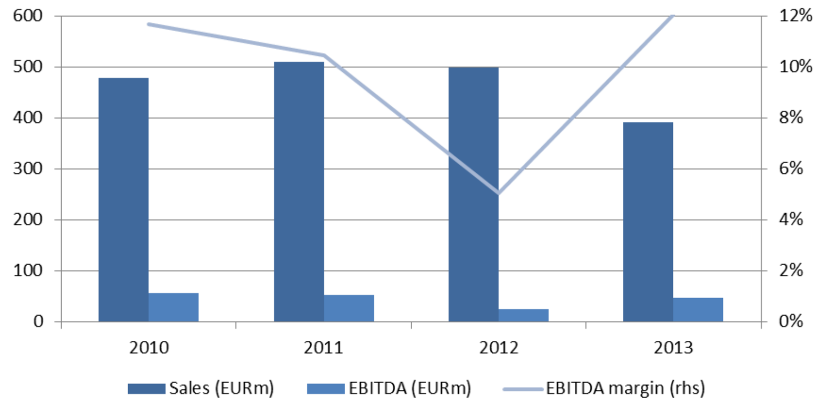
Ortiz' Financial Risk Profile reflects the cyclicality of the sector and the crisis suffered in the Spanish construction market. Even though the turnover increased by 64% from 2005 to 2012, in 2013 the group experienced a yoy reduction in turnover of 22%. This is mainly due to the drop in sales in the national construction business where yoy sales were down 41% as well as in energy, where turnover decreased by more than 80% in the national energy segment. This business was heavily hit by the changes in energy regulation introduced by the Spanish government in 2011.

Solid profitability – back on track after a hard 2012

Although the average group EBITDA margin at Ortiz was solid at between 10% and 12% since 2010, a yoy decrease in profitability from 11% in 2011 to 5% was seen in 2012, before increasing back to the average level (12% in 2013). Although some volatility in Ortiz' EBITDA margin is expected to remain, marked volatility bumps should be lower if the company manages to further implement their strategy to diversify their sources of revenues, in particular with respect to international markets. The company should also be well-positioned to profit from a rebound in the Spanish economy.

Scope recognizes that the company weathered the Spanish crisis much better than some of its highly leveraged Spanish mid-sized construction competitors.

Figure 5 – Historical turnover and margin



Source: Ortiz, Scope

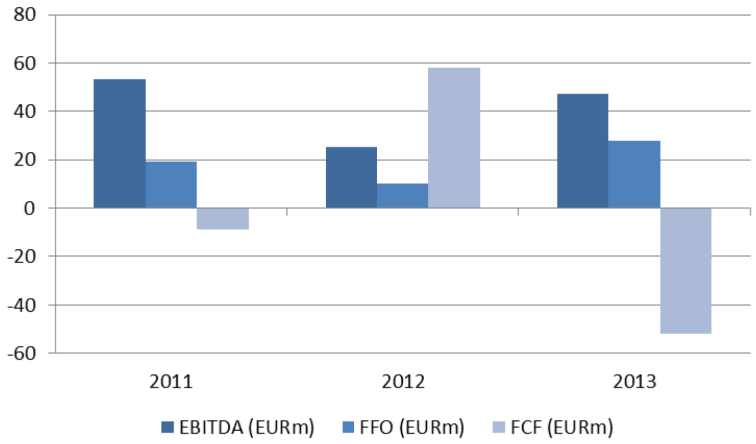
Liquidity is considered adequate

Ortiz' liquidity is considered adequate for the rating.

Ortiz' short-term debt stood at EUR 73m at year-end 2013. Its cash and equivalent position, which was EUR 39m at year-end 2013, together with its projected funds from operations and existing liquidity facilities, are considered sufficient to cover expected liquidity uses for the next 12 months. This incorporates assumptions about modest capex, no major outflows for working capital and limited expansionary investments.

Ortiz had considerable unused committed bank facilities of EUR 199m at year-end 2013.

Figure 6 – Cash Flow development



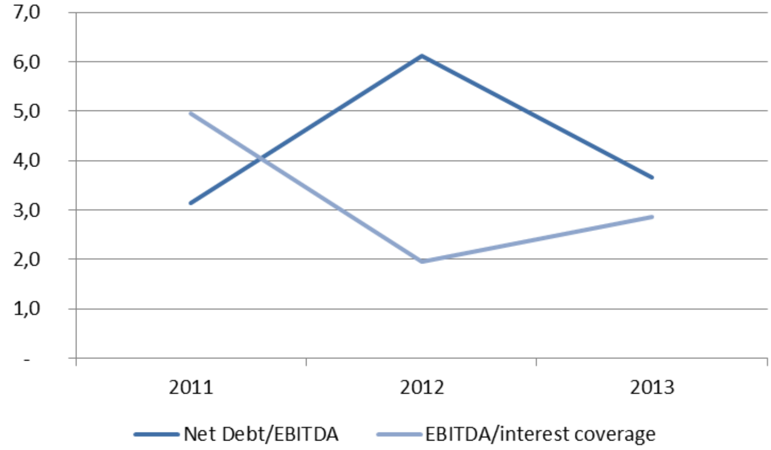
Source: Ortiz, Scope

Leverage commensurate with the rating level

Ortiz' debt ratio stands at the average level of the last three years of approximately 65% at the end of 2013. Ortiz' financial leverage is considered by Scope to be in line with the rating. Ortiz' Net Debt to EBITDA stood at 3.7x at year-end 2013 (3.5x if tradeable securities are fully accounted for) and is expected by Scope Ratings to increase before dropping back to 2.9x in 2016. The increase in debt levels is due to a planned EUR 100m bond issue, which will be used to repay part of the existing bank debt and to finance further investments in concessions.

Financial Debt/EBITDA increased from 3.9x in 2011 to 8.0x in 2012 before dropping to a more reasonable level of 4.3x in 2013.

Figure 7 – Leverage and interest coverage



Source: Ortiz, Scope

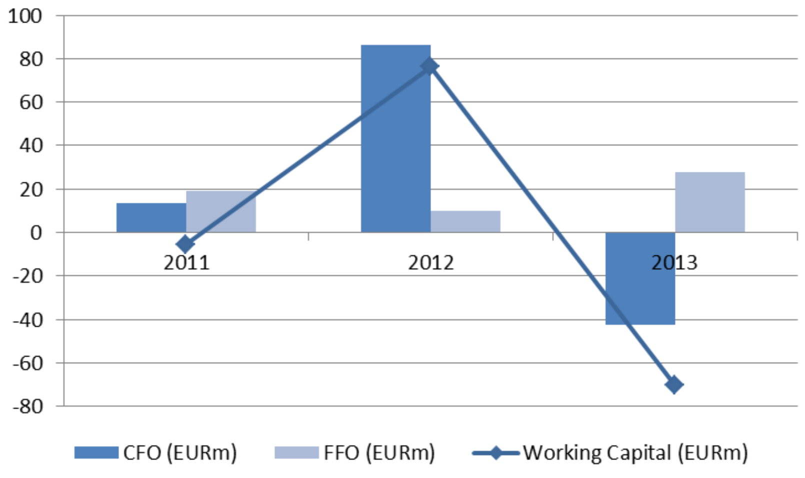
The sector's volatile working capital is aggravated by the concentrated customer base

Working capital fluctuations are typical drivers of cash flows in the construction industry as cash flows tend to suffer, among other reasons, as a consequence of the delay in payments by major customers. These potential swings in cash flows, paired with the cyclicality nature of the business, require companies in this industry to have a high degree of financial flexibility. Even though Ortiz has, in Scope's opinion, an adequate level of financial flexibility for the rating, it is not immune to the volatile nature of cash flows associated with the industry.

Ortiz' operating cash flow was heavily burdened by the mismatch of receivables and account payables in 2013 (EUR -42m). This mismatch was mainly due to delays in payments coming from the Spanish government.

A significant reduction in the mismatch between accounts payable and accounts receivable is expected as a result of a Spanish Royal Decree regulating the timing of payments from the Spanish public administration.

Figure 8 – Development of Working Capital



Source: Ortiz, Scope

Outlook

Outlook: Stable

The rating outlook is Stable. A negative rating action might be warranted if, once the bond is issued, Ortiz does not manage to carry out the deleveraging as planned by 2016.

Important information

Information pursuant to Regulation (EC) No 1060/2009 on credit rating agencies, as amended by Regulations (EU) No. 513/2011 and (EU) No. 462/2013

Responsibility

The party responsible for the dissemination of the financial analysis is Scope Ratings GmbH, Berlin, District Court for Berlin (Charlottenburg) HRB 145472, directors: Thomas Morgenstern, Florian Schoeller.

Rating prepared by

Rosana Pfaffe, Lead Analyst

Rating committee responsible for approval of the rating

Guillaume Jolivet, Committee Chair

The rating concerns an issuer, which was evaluated for the first time by Scope Ratings GmbH.

Usually a credit rating is accompanied by a rating outlook, which can be Stable, Positive or Negative. The Positive and Negative outlooks would normally refer to a time period of 12-18 months. These outlooks do not necessarily signal that a rating upgrade or downgrade, respectively, will automatically follow. The probability of such a rating outcome, however, would be higher than 50%.

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The rating was prepared independently by Scope Ratings but for a fee based on a mandate of the rated entity

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Key sources of Information for the rating

☒ Prospectus
☒ Valuation reports, other opinions
☒ Current performance record
☒ Annual financial statements
☒ Interview with the rated entity
☒ Press reports / other public information
☒ Website of the rated entity/issuer
☒ Annual reports/semi-annual reports of the rated entity/issuer
☒ Detailed information provided on request
☒ Data provided by external data providers
☒ External market reports

Scope Ratings considers the quality of the available information on the evaluated company to be satisfactory. Scope ensured as far as possible that the sources are reliable before drawing upon them, but did not verify each item of information specified in the sources independently.

Examination of the rating report by the rated entity prior to publication / Modification of the report after the examination

The rated entity was given the opportunity to examine the rating report prior to publication. Following that examination, the rating report was modified without impact on the rating.

Methodology

The methodology applicable for the rating of Corporates is available on www.scoperatings.com. The historical default rates of Scope Ratings can be viewed on the central platform (CEREP) of the European Securities and Markets Authority (ESMA): http://cerep.esma.europa.eu/cerep-web/statistics/defaults.xhtml. A comprehensive clarification of Scope's default rating, definitions of rating notations and further information on the analysis components of a rating can be found in the documents on methodologies on the rating agency's website.

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