Orascom Construction [ORAS]

Sunday, 9 April 2023 / 10:30 am CLT
Egypt / Industrials / Core Coverage Update

PRIME

Market Price	Fair Value	12MPT	
EGP98.79	EGP189 (was EGP126)	EGP215 (was EGP146)	Investment Rating: Overweight ★ ★ ★
at close of 6 Apr. 2023	set on 9 Apr. 2023	set on 9 Apr. 2023	Risk Rating: Medium ! ! !

On Solid Foundations

Raising our 12MPT to EGP215/share; OW/M maintained

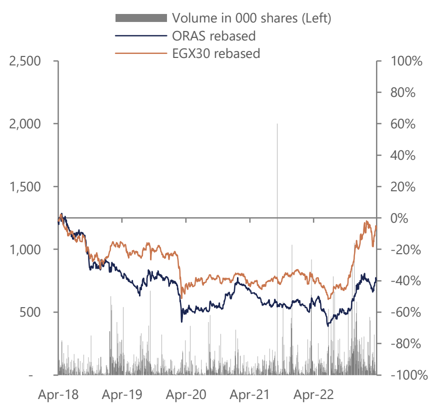
Abdelkhalek Mohammed
Equity Analyst
T +202 3300 5717
aabdelkhalek@egy.primegroup.org

An essential piece of Egypt's construction boom puzzle in the last decade, Orascom Construction [ORAS] enjoys a robust business model that benefits from the country's infrastructure spending and a stronger USD. This is apparent in ORAS's strong backlog and portfolio of projects that include Cairo's Monorail, the Grand Egyptian Museum, and more. Moreover, ORAS tries to diversify its portfolio in other countries, including the US, Saudi Arabia, and Europe (either directly through ORAS or indirectly through its 50%-owned BESIX). We believe ORAS is currently traded at unjustifiably cheap multiples (2022a/2023e P/Es of 3.3x/3.5x) despite its solid earnings quality and stable dividend stream. We value ORAS at USD6.1/share (equivalent to EGP189/share) with a 12MPT of USD6.9/share (equivalent to EGP215/share), all based on an FX rate of EGP30.9/USD.

Concrete fundamentals with a solid balance sheet: ORAS had a strong year in 2022, having achieved USD113.5mn in earnings (including USD55.5mn in Q4 2022 alone) on revenues of USD4.2bn. Its backlog registered USD5.3bn, c.77% of which is denominated in foreign currencies, which makes ORAS a natural hedge against any further EGP weakness. Additionally, new awards reached USD3.4bn in 2022 (-20% y/y), further supporting top line growth with a diversified portfolio of projects. However, GPM narrowed to 8.3% in 2022 (-1.5pp y/y) due to rising USD-denominated costs, which we think should ease off in 2023 on the back of new legislation in Egypt allowing contractors to renegotiate their government-related contracts. ORAS's fundamentals are also reinforced by a very strong net cash position of USD326mn at end of 2022, which represents 89% of its current market cap. Meanwhile, BESIX recorded a huge gain from its real estate segment, despite recording weak performance during 9M 2022. On the other hand, BESIX's standalone backlog increased slightly by 1.4% y/y to USD2.8bn (based on a 50% stake).

Steady steps to tap new growth segments: ORAS is trying to expand its portfolio of projects in new segments in Egypt, including green hydrogen, electric wind farms, and a new strategic warehouse for modern logistics solutions. Moreover, ORAS's management tries to select Egyptian contracts that are financed by a foreign entity to secure future cash flows. On the same wavelength, ORAS is looking to expand more in the MEA region, with focus on KSA and UAE due to their strong construction spending. As for Orascom USA, the subsidiary has seen steady growth in its data center projects, powered by current work in five data centers, including three hyper-scale data centers, among other commercial and housing projects.

Relative Performance (5y)



Source: Bloomberg, Prime Research.

Key Stock Statistics

Shares outstanding (mn)	116.8
Free float	22%
Market cap (EGPmn)	11,535
Market cap (USDmn)	373
52w range (EGP/share)	50-107
EGP100 invested 5y ago	60
EPS (2022a / 2023e) (USD)	0.97 / 0.92
P/E (2022a / 2023e)	3.3x / 3.5x
P/BV (2022a / 2023e)	0.5x / 0.5x
Last fiscal year's DPS (USD)	0.42
Dividend yield	13.2%
5y historical beta	0.83
5y Proj. EPS CAGR (2022-27)	4.7%

Source: Prime Research.

BESIX, unexpected performance despite the hurdles: BESIX operates three main business segments, namely construction, concessions, and real estate investments. On one hand, the construction segment has had some hurdles in the last few years within a rising-cost environment. On the other hand, the concession segment provides BESIX with steady and recurring revenues and cash flows. Meanwhile, the real estate investments segment booked a huge gain from the sale of an asset during Q4 2022, which we think is non-recurring. Overall, we expect BESIX's performance in the construction segment to improve slightly in the coming years and for BESIX to normalize overall from one-offs in 2022.

What do we expect? Over the next five years, we expect revenues to shrink at a 5y CAGR (2022-27) of 1.8% to USD3.8bn by 2027, and for earnings to grow at a 5y CAGR (2022-27) of 4.7% to USD139mn by 2027. Powered by a strong and diversified backlog, we expect new awards to average USD3.7bn a year, yet the backlog could slip by a 5y CAGR (2022-27) of c.5% mainly due to expected easing in the Egyptian government's infrastructure spending over the coming years. As for leverage, we expect total debt-to-EBITDA to decrease from 1.1x in 2022 to 0.9x by 2027 as working capital needs ease slightly. We like ORAS for its stable semi-annual dividend payments with an expected payout ratio of 40%, yielding c.12%.

We up our 12MPT to EGP215/share; reiterate our OW/M rating: Based on our discounted cash flow (DCF) model, we reached a fair value of USD6.1/share and a 12MPT of USD6.9/share (equivalent to EGP189/share and EGP215/share, respectively, based on an FX rate of EGP30.9/USD). According to our calculation, the higher valuation can be attributed mostly to the higher FX rate (EGP30.9/USD vs. EGP15.71/USD previously). Still, our new 12MPT of EGP215/share (47% higher than our previous 12MPT of EGP146/share) implies not-so-demanding 2022a/2023e P/Es of 7.1x and 7.6x, respectively, offering a potential triple-digit upside of 117%. Hence, we maintain our Overweight/Medium Risk rating for ORAS. We note that our valuation incorporates the worst-case scenario related to a dispute by Qatar Foundation, the owner of Sidra Medical Center in Qatar, against OHL, a 45%-owned subsidiary of ORAS. We also note that OHL had filed a counter claim against Qatar Foundation which was partially acknowledged. Notwithstanding this dispute, our 12MPT would be adjusted upward to EGP403/share.

Key catalysts: Strong backlog of government infrastructure projects. A diversified portfolio of projects (e.g. green hydrogen plants, infrastructure, power plants, and others). The new "Contractors Compensation Law" in Egypt allowing contractors to renegotiate their government-related contracts. A stronger USD.

Key risks: Sidra Medical Center lawsuit (our estimated charge of USD556mn, fully accounted for in our model). Continuation of the Russia-Ukraine war. Global recession fears.

Figure 1: Impact of Sidra lawsuit on our 12MPT for ORAS, different probabilities

Probability of Sidra lawsuit loss	12MPT (EGP/share)
0%	403
25%	356
50%	309
75%	262
100%	**215**

Source: Prime Research.

Key Assumptions

Assumptions	2021a	2022a	2023e	2024e	2025e	2026e	2027e
Summary							
Backlog (USDmn)	**6,090**	**5,271**	**4,479**	**4,306**	**4,413**	**4,676**	**5,008**
New Awards (USDmn)	4,193	3,359	3,149	3,465	3,708	3,950	4,143
Growth	25%	-20%	-6%	10%	7%	6%	5%
Total Revenues (USDmn)	**3,543**	**4,177**	**3,941**	**3,638**	**3,601**	**3,687**	**3,811**
Growth	5%	18%	-6%	-8%	-1%	2%	3%
MENA							
Backlog (USDmn)	**4,750**	**3,874**	**3,038**	**2,819**	**2,875**	**3,081**	**3,352**
New Awards (USDmn)	3,043	1,936	1,700	1,968	2,156	2,335	2,467
Growth	45%	-36%	-12%	16%	10%	8%	6%
Total Revenues (USDmn)	**2,493**	**2,813**	**2,535**	**2,187**	**2,100**	**2,130**	**2,195**
Growth	18%	13%	-10%	-14%	-4%	1%	3%
Gross Profit (USDmn)	**274**	**267**	**254**	**225**	**223**	**232**	**241**
GPM	11.0%	9.5%	10.0%	10.3%	10.6%	10.9%	11.0%
US							
Backlog (USDmn)	**1,340**	**1,398**	**1,441**	**1,487**	**1,538**	**1,595**	**1,655**
New Awards (USDmn)	1,150	1,422	1,449	1,498	1,552	1,614	1,676
Growth	-9%	24%	2%	3%	4%	4%	4%
Total Revenues (USDmn)	**1,050**	**1,364**	**1,406**	**1,451**	**1,501**	**1,557**	**1,616**
Growth	-17%	30%	3%	3%	3%	4%	4%
Gross Profit (USDmn)	**72**	**80**	**84**	**87**	**90**	**93**	**97**
GPM	6.9%	5.8%	6.0%	6.0%	6.0%	6.0%	6.0%
BESIX							
Backlog (USDmn)	**3,067**	**2,995**	**3,037**	**3,095**	**3,167**	**3,252**	**3,344**
New Awards (USDmn)	2,048	1,967	1,997	2,050	2,110	2,178	2,244
Growth	56%	-4%	2%	3%	3%	3%	3%
Total Revenues (USDmn)	**1,755**	**1,786**	**1,955**	**1,992**	**2,038**	**2,093**	**2,152**
Growth	11%	2%	9%	2%	2%	3%	3%
Net Income (USDmn)	**15.7**	**19.9**	**39.1**	**44.8**	**51.0**	**57.6**	**64.6**
Growth	-353%	27%	96%	15%	14%	13%	12%

Source: Prime Research.

Valuation Model

USDmn	2023	2024	2025	2026	2027	Terminal
EBIT	**137**	**127**	**129**	**138**	**145**	**147**
Taxes on EBIT	(34)	(32)	(32)	(34)	(36)	(37)
NOPAT	**103**	**95**	**97**	**103**	**108**	**111**
D&A	43	48	52	56	60	
Change in WC	(15)	(18)	(4)	3	6	
Capex	(63)	(62)	(65)	(70)	(76)	
Net investments	**(35)**	**(32)**	**(17)**	**(12)**	**(10)**	**(13)**
Board remuneration	(15)	(15)	(15)	(16)	(16)	(17)
FCFF	**54**	**49**	**66**	**76**	**82**	**879**
Present Value of FCFF	**49**	**39**	**47**	**49**	**48**	**512**

DCF Enterprise Value	**744**
Net (Debt)/ Cash	326
Other investments	240
Minorities	(40)
Lawsuit provisions	(556)
DCF Equity Value (USD)	**714**
NOS	116.8
FV (EGP/share)	**189**
Market price (EGP/share)	98.79
12MPT (EGP/share)	**215**
Upside/downside	117%

Reinvestment rate	**12%**
ROIC	**17%**
TGR	**2%**

Sensitivity Analysis

TGR \ Terminal WACC	9.2%	10.2%	11.2%	12.2%	13.2%
1.0%	245	225	209	196	185
1.5%	251	229	212	198	186
2.0%	257	233	**215**	200	187
2.5%	265	238.	218	202	188
3.0%	273	244	221	204	190

2023 Avg. USD/EGP	12MPT (EGP/ share)	2023 Backlog (USDmn)	2023 Revenues (USDmn)
25.2	229	4,541	3,974
28.0	221	4,508	3,957
31.1	**215**	**4,479**	**3,941**
34.2	209	4,455	3,929
37.6	204	4,433	3,917

Peers Analysis (as of 6-Apr-2023)

Based on TTM figures	Ticker	Country	Mkt cap (USDmn)	Revenues (USDmn)	Net income (USDmn)	ROE	ROA	P/E	EV/EBITDA
Local Peers' Average			**565**	**2,491**	**146**	**14.9%**	**5.1%**	**5.6x**	**5.8x**
Elsewedy Electric	SWDY	Egypt	1,117	4,884	287	21.5%	5.9%	6.8x	4.8x
Elsaeed Contracting	UEGC	Egypt	14	99	5	8.3%	4.2%	4.4x	6.7x
Global Peers' Average			**3,558**	**15,525**	**203**	**16.7%**	**-0.2%**	**12.0x**	**4.8x**
OHLA Construction	OHLA	Spain	316	3,433	(102)	-16.4%	-3.1%	n/a	0.8x
Hochtief	HOT	Germany	6,800	27,616	507	49.8%	2.8%	11.9x	4.8x
Peers' Average			**2,062**	**9,008**	**174**	**15.8%**	**2.5%**	**7.7x**	**4.3x**
Orascom Construction	**ORAS**	**Egypt**	**373**	**4,177**	**114**	**16%**	**3%**	**3.3x**	**2.0x**

Source: Bloomberg, Prime Research.

Financial Model

Financials (ends 31 Dec., USDmn)	2021a	2022a	2023e	2024e	2025e	2026e	2027e
Income Statement							
Total revenue (Net)	**3,543**	**4,177**	**3,941**	**3,638**	**3,601**	**3,687**	**3,811**
Cost of revenues	(3,197)	(3,830)	(3,604)	(3,326)	(3,289)	(3,361)	(3,473)
Gross profit	**346**	**347**	**338**	**312**	**313**	**325**	**338**
SG&A	(192)	(197)	(211)	(195)	(193)	(198)	(204)
Other operating (exp.)/ Inc.	2	5	11	10	10	10	10
EBITDA	**204**	**200**	**181**	**175**	**181**	**194**	**204**
Depreciation & amortization	(48)	(46)	(43)	(48)	(52)	(56)	(60)
EBIT	**156**	**155**	**137**	**127**	**129**	**138**	**145**
Finance (expense)/income	12	17	22	47	60	68	68
Profit before taxes	**168**	**172**	**160**	**174**	**189**	**206**	**212**
Taxes & minority	(54)	(58)	(52)	(57)	(62)	(68)	(70)
Net profit	**113**	**114**	**107**	**117**	**127**	**138**	**143**
Balance Sheet							
Current Assets							
Cash & Cash Equivalents	506	538	522	515	534	565	594
Accounts receivables	2,562	2,037	1,973	1,868	1,895	1,988	2,104
Inventory	307	248	243	233	239	254	272
Other Current Assets	-	-	-	-	-	-	-
Total Current Assets	**3,375**	**2,823**	**2,739**	**2,617**	**2,669**	**2,807**	**2,970**
Property, planet, & equipment (net)	199	147	166	180	193	207	224
Other Non-Current Assets	528	562	597	642	694	753	819
Total Non-Current Assets	**727**	**709**	**763**	**822**	**887**	**960**	**1,042**
Total Assets	**4,102**	**3,531**	**3,502**	**3,439**	**3,556**	**3,766**	**4,012**
Liabilities & Equity							
CPLTD & Credit facilities	63	212	185	168	161	158	156
Debit and Other Debit Accounts	3,192	2,514	2,429	2,297	2,327	2,437	2,577
Other Current Liabilities	104	67	67	67	67	67	67
Total Current Liabilities	**3,359**	**2,793**	**2,682**	**2,532**	**2,555**	**2,662**	**2,800**
LT Loans	1	-	5	8	11	15	20
Other Non-Current Liabilities	53	47	47	47	47	47	47
Total Liabilities	**3,414**	**2,840**	**2,734**	**2,587**	**2,613**	**2,724**	**2,868**
Minority Interest	50	40	52	66	81	97	113
Total Equity	**689**	**691**	**768**	**852**	**943**	**1,042**	**1,144**
Total Liabilities & Equity	**4,102**	**3,531**	**3,502**	**3,439**	**3,556**	**3,766**	**4,012**
Cash Flow Statement							
Cash from Operating	201	194	135	147	175	197	209
Cash from Investing	(53)	(75)	(98)	(107)	(116)	(129)	(142)
Cash from Financing	(116)	69	(52)	(48)	(40)	(38)	(37)
Net Change in Cash	**32**	**188**	**(15)**	**(7)**	**19**	**30**	**29**

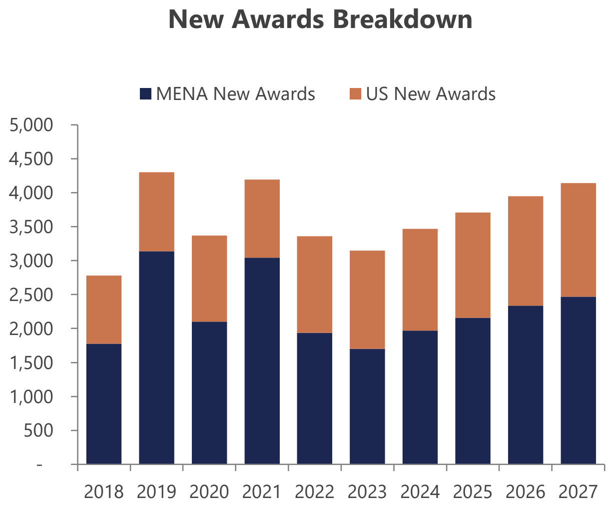
Source: Company reports, Prime Research.

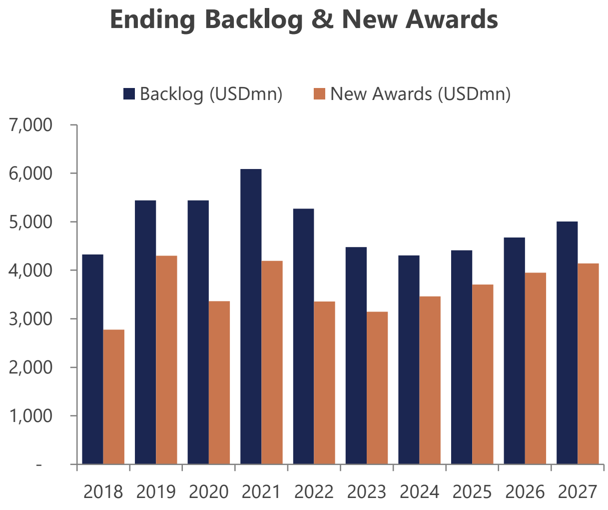
FINANCIAL MODEL (CONT.'D)

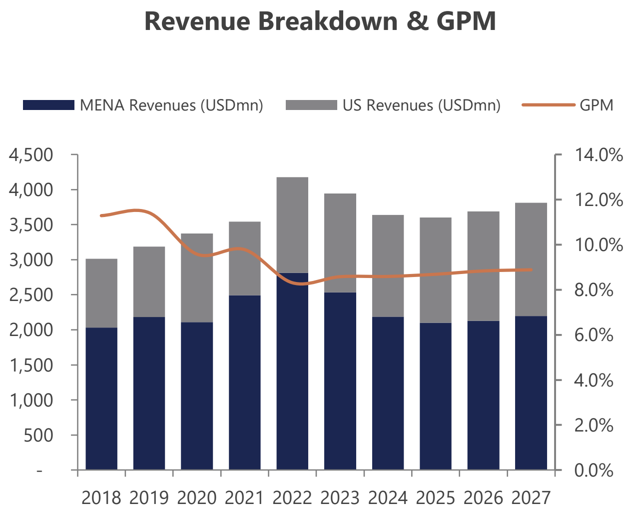
Key Performance Indicators	2021a	2022a	2023e	2024e	2025e	2026e	2027e
Per-Share Data							
Price (EGP)	70.00	97.75	98.79	98.79	98.79	98.79	98.79
# shares (WA, in mn)	116.8	116.8	116.8	116.8	116.8	116.8	116.8
EPS (USD)	0.97	0.97	0.92	1.00	1.09	1.18	1.22
Payout ratio	47%	39%	40%	40%	40%	40%	40%
DPS (USD)	0.46	0.42	0.37	0.40	0.43	0.47	0.49
BVPS (USD)	5.90	5.92	6.58	7.30	8.07	8.92	9.80
Valuation Indicators							
P/E (x), on end of FY market price	2.3x	3.3x	3.5x	3.2x	2.9x	2.7x	2.6x
P/E (x), based on our 12MPT		7.1x	7.6x	6.9x	6.4x	5.9x	5.7x
DY, actual on BoP price, est. on current		18.4%	11.7%	12.5%	13.6%	14.8%	15.3%
P/BV (x)	0.4x	0.5x	0.5x	0.4x	0.4x	0.4x	0.3x
EV/IC (x)	0.4x	0.7x	0.7x	0.7x	0.7x	0.6x	0.6x
EV/Sales (x)	0.1x	0.1x	0.1x	0.1x	0.1x	0.1x	0.1x
EV/EBIT (x)	1.2x	2.6x	3.0x	3.3x	3.2x	2.9x	2.7x
EV/EBITDA (x)	0.9x	2.0x	2.3x	2.4x	2.3x	2.0x	1.9x
Profitability & Growth Ratios							
Revenue Growth	5%	18%	(6%)	(8%)	(1%)	2%	3%
EBIT Growth	4%	-1%	-11%	-7%	2%	7%	5%
EPS Growth	25%	0%	(6%)	9%	8%	9%	3%
GPM	10%	8%	9%	9%	9%	9%	9%
EBITDA Margin	6%	5%	5%	5%	5%	5%	5%
EBIT Margin	4%	4%	3%	3%	4%	4%	4%
Net Margin	3%	3%	3%	3%	4%	4%	4%
ROIC	24%	26%	19%	17%	16%	17%	17%
ROA	3%	3%	3%	3%	4%	4%	4%
ROE	16%	16%	14%	14%	13%	13%	12%
Liquidity & Solvency Multiples							
Net Cash (Debt)	442	326	332	339	362	391	417
Net Cash (Debt) /Equity	64%	47%	43%	40%	38%	38%	36%
Net Cash (Debt) to EBIT	2.8x	2.1x	2.4x	2.7x	2.8x	2.8x	2.9x
Debt to Assets	0.0x	0.1x	0.1x	0.1x	0.0x	0.0x	0.0x
Current ratio	1.0x	1.0x	1.0x	1.0x	1.0x	1.1x	1.1x
Consensus Estimates (EGPmn)							
Revenues			**3,820**	**3,721**	**3,715**	**3,723**	
Prime Research vs. Consensus			3%	-2%	-3%	-1%	
Net Income			**79**	**94**	**109**	**116**	
Prime Research vs. Consensus			36%	24%	17%	19%	

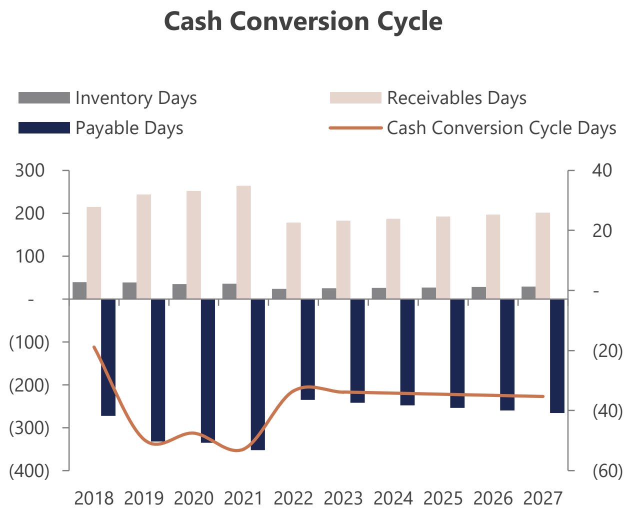
Source: Company reports, Prime Research.

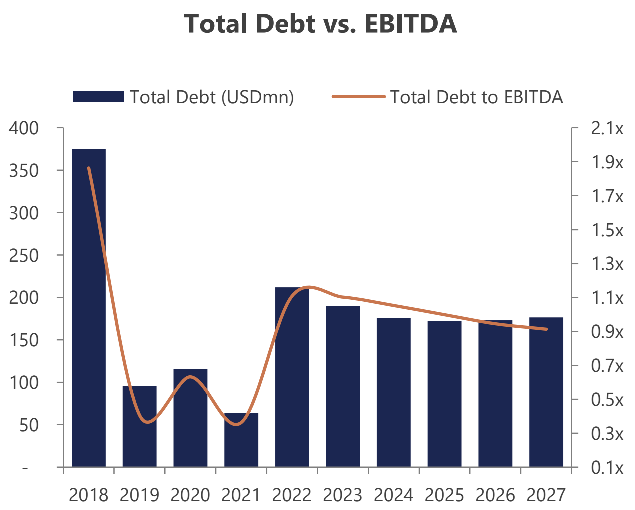
Story in Charts

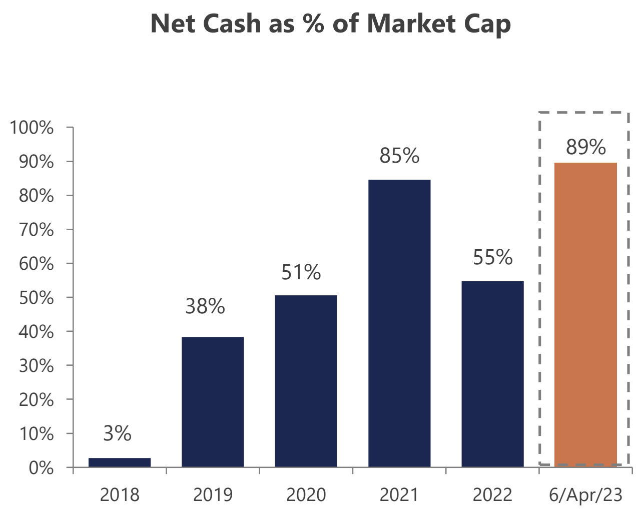












Source: Company reports, Prime Research.

PRIME

Prime Securities

Shawkat El Maraghy
Managing Director
T +202 3300 5622
SElmaraghy@egy.primegroup.org

Sales

Mohamed Ezzat
Head of Sales & Branches
T +202 3300 5784
MEzzat@egy.primegroup.org

Emad El Safoury
Manager
T +202 3300 5624
EElsafoury@egy.primegroup.org

Mohamed Ashmawy
Head of Institutional Sales
T +202 3300 5612
MAshmawy@egy.primegroup.org

Shawkat Raslan
Heliopolis Branch Manager
T +202 3300 8130
SRaslan@egy.primegroup.org

Amr Alaa CFTe
Team Head –Institutional Desk
T +202 3300 5609
AAlaa@egy.primegroup.org

Nashwa Abuelatta
Alexandria Branch Manager
T +202 3300 5173
NAbuelatta@egy.primegroup.org

Mohamed El Metwaly
Manager
T +202 3300 5610
MElmetwaly@egy.primegroup.org

Research

Amr Hussein Elalfy MBA, CFA
Head of Research
T +202 3300 5724
AElalfy@egy.primegroup.org

Head Office

Prime Securities S.A.E.
Regulated by FRA License No. 179.
Member of the Egyptian Exchange.

2 Wadi Elnil St., Liberty Tower, 7thFl.
Mohandessin, Giza, Egypt
T +202 3300 5700 / 770 / 650 / 649
F +202 3760 7543

Branches

Heliopolis
7 Elhegaz Square
Heliopolis, Cairo, Egypt
T +202 2777 0600
F +202 2777 0604

Alexandria
7 Albert Al Awal St.
Smouha, Alexandria, Egypt
T +202 3300 8170
F +202 3305 4622

Website

www.primeholdingco.com