

Commercial Particularities in the Construction Industry

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Trade Fair Berlin

Introduction

What distinguishes the construction industry from other sectors?

Individual production – unique objects

- Long preparatory stages, in some cases over several years



high acquisition costs

- Constantly changing operating sites
- Change in services and further factors affecting projects

e.g. due to:

- customer requirements
- user requirements (tenants)
- geological changes
- weather factors



high earnings fluctuations

Introduction

What distinguishes the construction industry from other sectors?

- Multi-year project terms - average project terms are:
 - building projects 20 months
 - civil projects 24 months

Mega-projects have even longer project terms:

 - Gotthard base tunnel 240 months
 - Taiwan HSR 65 months
 - NBS Nürnberg Ingolstadt 105 months

- Execution of projects with partners (joint ventures)

Construction comparable with plant construction companies

Joint Ventures

What are joint ventures (JVs) and why are they formed?

- JVs are companies founded in accordance with the German Civil Code (BGB) with joint and several liability among 1 to n partners and with autonomous accounting structures
- Formation of temporary JVs in order to execute an order jointly

The reasons for the founding of a JV include:

- spreading of risk
- pooling of expertise
- pooling of capacity across companies
- client request

Joint Ventures

Sample extract from the master data of a JV

Stammdaten

CA00052 Arge NBS BA Mitte Los B

1. Projekt			
Bez.	Arge NBS BA Mitte Los B		
4. Partner/Gemeinschaftsprojekt			
4.1 Arge	Arge-/Führung		
HTC AG		21,6%	TGF
	Arge-Partner		
	PHILLIP HOLZMANN AG	21,6%	KGF
	BILFINGER + BERGER AG	21,6%	OGF
	STRABAG AG	11,8%	OGF
	WALTER BAU AG	11,4%	OGF
	HEITKAMP	4,0%	OGF
	WAYSS & FREYTAG AG	4,0%	OGF
	IL-BAU	4,0%	OGF



Earnings Fluctuations due to Retrospective Valuation

HTC has a highly conservative approach towards the valuation of retrospective claims

(based on the cautious valuation regulations set out in the German Commercial Code – HGB)

IFRS already permits valuations leading to earnings improvements in cases where negotiations mean that the granting of the order is probable.

A distinction should be made in this respect between:

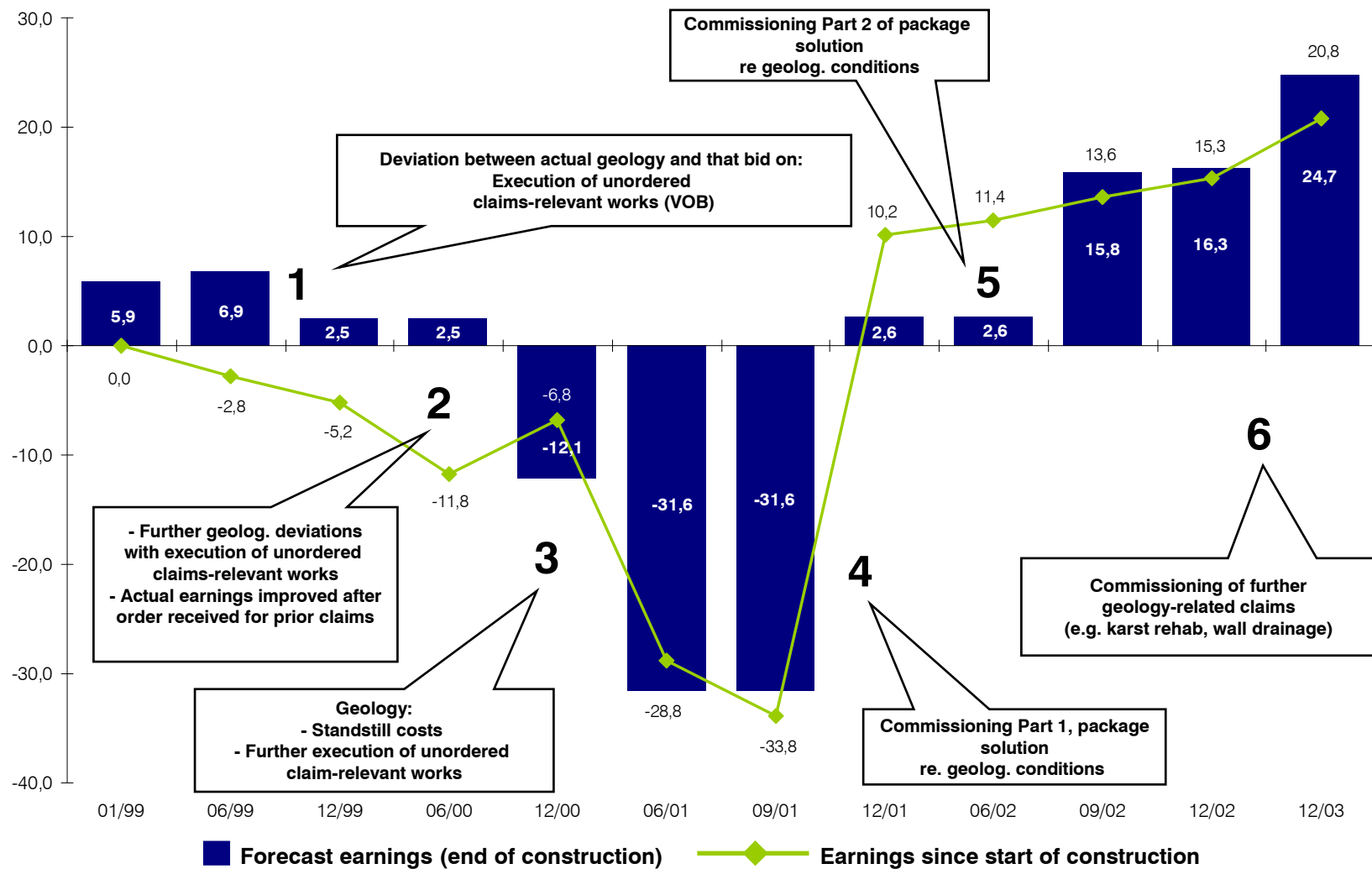
- | | | |
|-----------------|---|------------------|
| ▪ Change orders |  | safe valuation |
| ▪ Claims |  | unsafe valuation |

HTC nevertheless takes a conservative approach in this respect and generally only capitalizes retrospective claims following receipt of a written commission.

Earnings Situation in the Project Stages

Example: construction of a infrastructure project

Project earnings
(EUR m)



Security for Projects

Security is generally required from the construction company for the project cycle from the acquisition to the warranty stage.

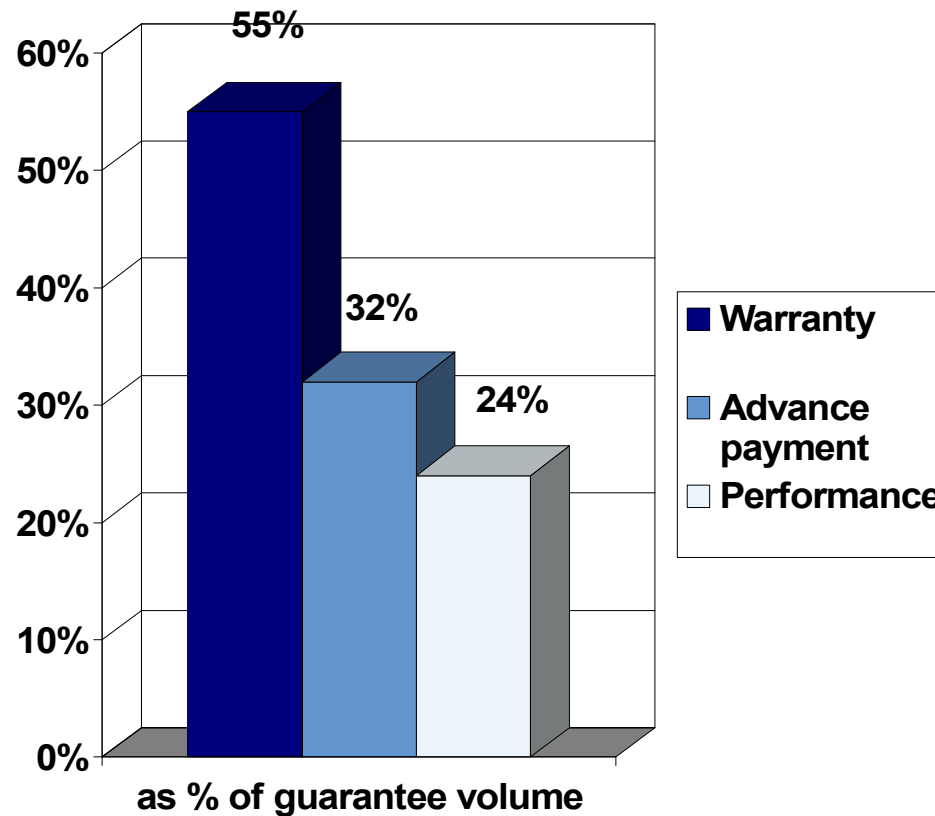
The most significant forms of security are:

- Bid guarantees 2-10 % of bid value
- Performance guarantees 10 % of order value
- Advance payment guarantees 100 % of bid value
- Distribution guarantees 100 % of distribution
- Warranty guarantees 2-10 % of order value
 - Term: generally 5 years, in exceptional cases 10 years

The company endeavors to achieve continuous contracts in its contract negotiations with subcontractors.

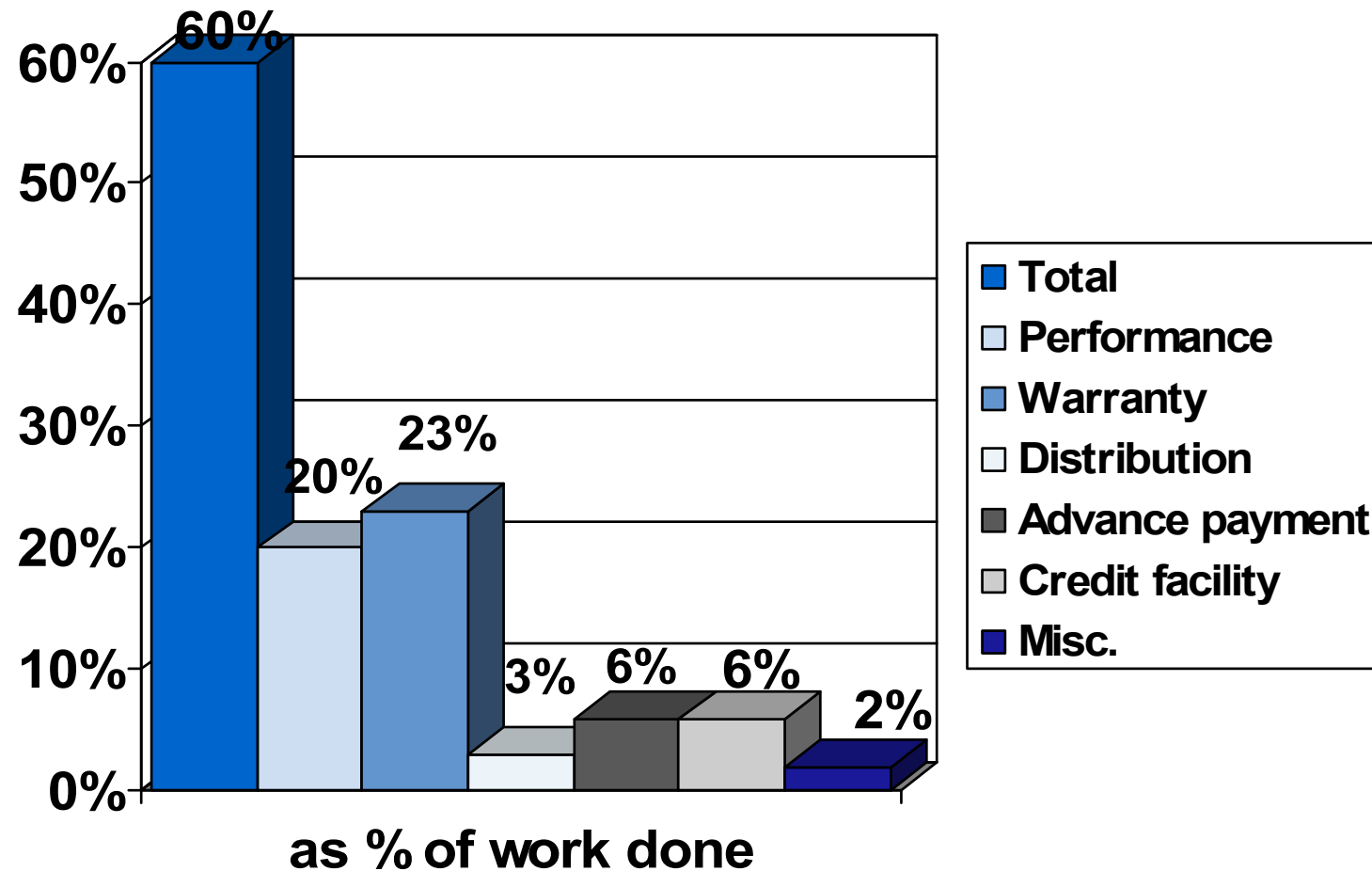
Security for Projects

Degree of coverage provided by subcontractor guarantees



Security for Projects

Guarantee volume as % of economic value of work done



Security for Projects

The guarantee credit line of

EUR 1,650,000,000.00

agreed with a consortium of banks within the framework of the Syndicated Guarantee Facility (SGF) is available.

The Syndicated Guarantee Facility was negotiated in the second half of 2004 and agreed on 12.20.2004.

HOCHTIEF
Euro 1,650,000,000
Syndicated Guarantee Facility



General conditions

Borrower

- HOCHTIEF Aktiengesellschaft, Essen

Guarantors

- HOCHTIEF Construction AG,
- HOCHTIEF Projektentwicklung GmbH,
- HOCHTIEF AirPort GmbH,
- HOCHTIEF Facility Management GmbH,
- HOCHTIEF Gebäude Management GmbH & Co. oHG,
- Lufthansa Gebäudemanagement
- PPP Solution GmbH

Credit Line

Euro 1,650,000,000

Utilization Purpose

Issuing of guarantees and sureties for payment


Term

3 years, with extension options of 2 x 1 year

Payment Arrangements for Projects

Construction projects, especially those for public sector clients, are generally remunerated in line with the progress made.

Other payment arrangements are also negotiable in the case of private clients:

- Advance payments  Major fluctuations in financial funds
- Payment in line with payment schedules
- Financing by HTC
generally refinanced by banks
- Security deposits over and above the guarantee structure

Balance Sheet of HTE Corporate Division as of 31 Dec. 2004

Corporate Division (IFRS)

EUR million	31.12.2004		31.12.2004
Intangible assets	8,2	Subscribed capital	100,0
Property, plant equipment	66,1	(capital) reserves	103,8
Financial assets	12,8	(group) reserves	159,3
Fixed Assets	87,1	(group) unappropriated net profit	0,0
Inventories	36,0	Minority interests	2,7
Non-invoiced constr. work	20,1	Shareholders' Equity	365,8
Other inventories	15,9	Pension provisions	208,2
Receivables and other assets	1.153,7	other provisions	255,5
Marketable securities (of current assets)	373,0	Provisions	463,7
Cash and cash equivalents	72,6	Liabilities	923,7
Current Assets	1.635,3	Deferred tax liabilities	
Deferred tax assets/ prepaid expenses	33,0	deferred income	2,2
ASSETS	1.755,4	PASSIVA	1.755,4

Balance Sheet of HTE Corporate Division as of 31 Dec. 2004

The Key balance sheet items affected by the construction business are:

- Receivables and other assets
- Other provisions
- Liabilities

The most important IFRS valuation regulation is IAS 11 “Production Orders”

- HTC reports project earnings in line with degree of completion
- Losses are anticipated immediately