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Engineering & Construction

Beyond Borders: Opportunities and Challenges in New Markets

Panel Discussion, June 19, 2015

Speakers

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Special Guest

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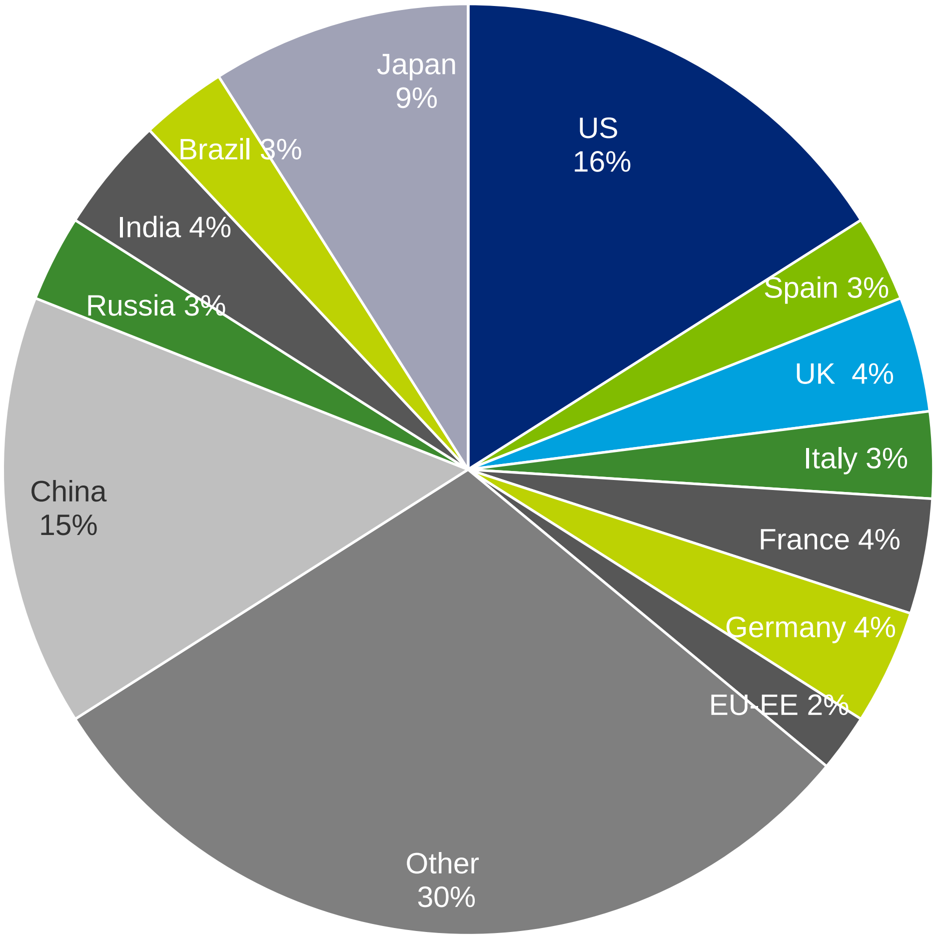
Construction: 2013 share of world gross value added (2010 US$bn)

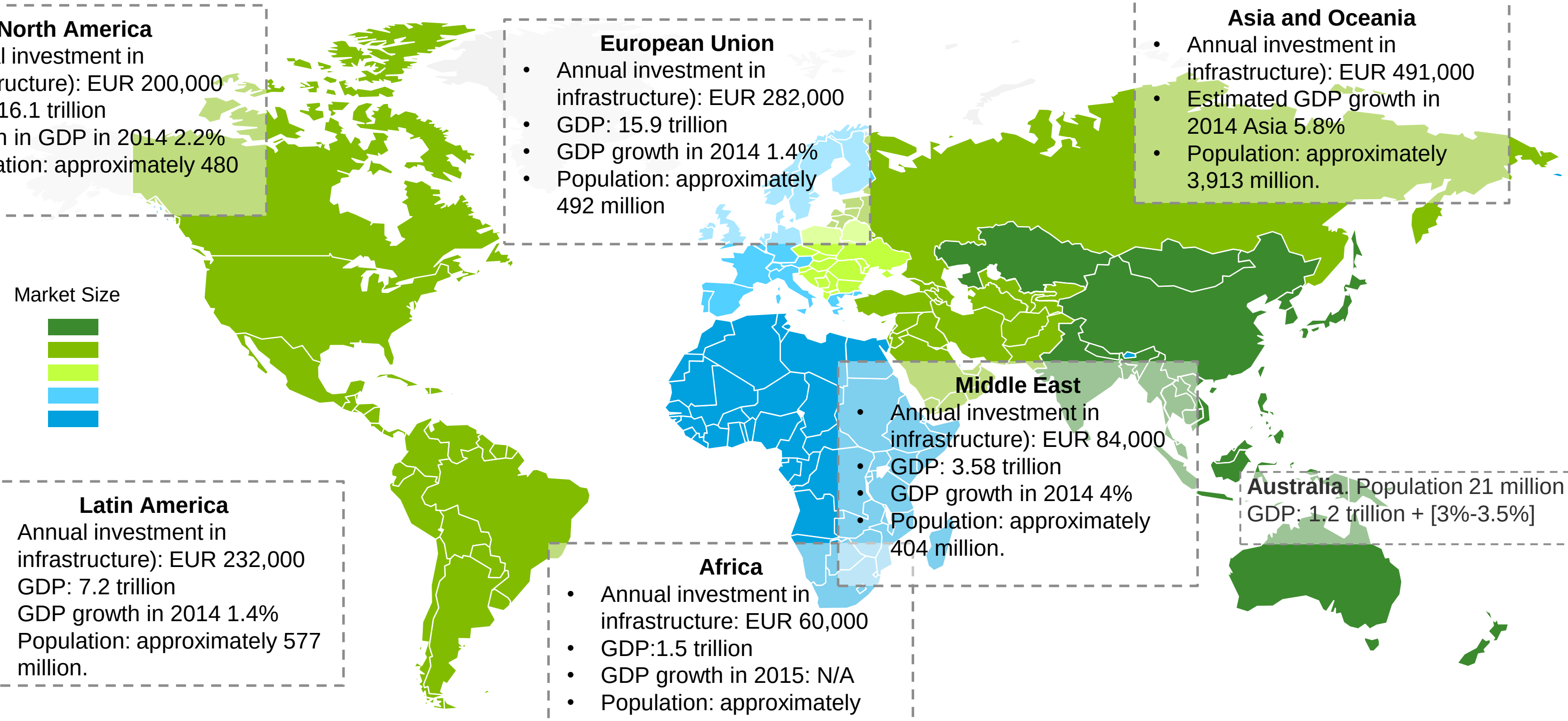


Internationalisation of Construction Companies

The world has an enormous need for investment in infrastructure in order to address its growing population and the tendency towards urban concentration. Average forecast annual investment in infrastructure (2005-2030): USD 1.6 trillion (USD 374 billion in transport). BRICS countries represent 40% of the world's population, 15% of the world's economy and 61% of the forecasted investment in infrastructure.

Average annual investment at international level EUR 1,349,000 million (estimate 2005-2030)

Brazil, Russia, India and China represent 61% of the total estimated investment in infrastructure for the coming years



North America
- Annual investment in infrastructure): EUR 200,000
- GDP: 16.1 trillion
- Growth in GDP in 2014 2.2%
- Population: approximately 480 million

European Union
- Annual investment in infrastructure): EUR 282,000
- GDP: 15.9 trillion
- GDP growth in 2014 1.4%
- Population: approximately 492 million

Asia and Oceania
- Annual investment in infrastructure): EUR 491,000
- Estimated GDP growth in 2014 Asia 5.8%
- Population: approximately 3,913 million.

Middle East
- Annual investment in infrastructure): EUR 84,000
- GDP: 3.58 trillion
- GDP growth in 2014 4%
- Population: approximately 404 million.

Australia. Population 21 million GDP: 1.2 trillion + [3%-3.5%]

Latin America
- Annual investment in infrastructure): EUR 232,000
- GDP: 7.2 trillion
- GDP growth in 2014 1.4%
- Population: approximately 577 million.

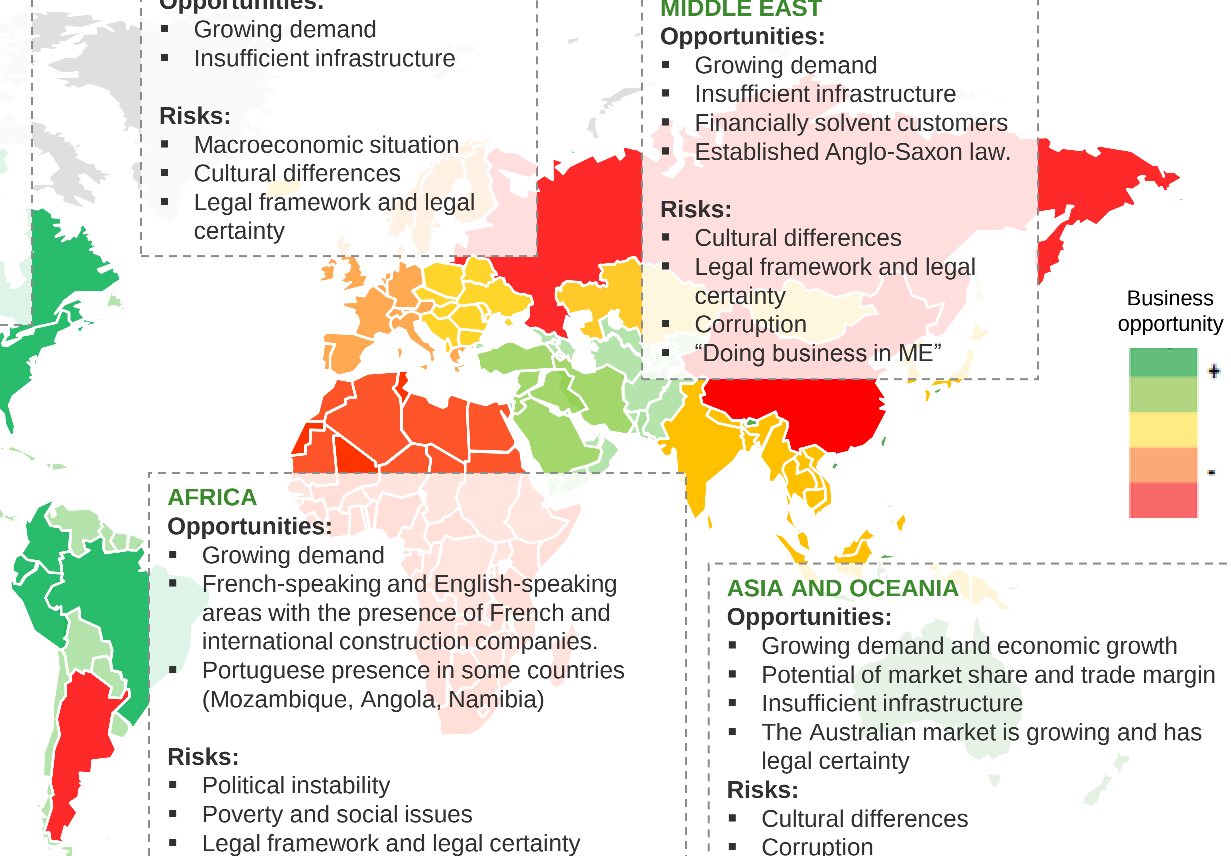
Africa
- Annual investment in infrastructure: EUR 60,000
- GDP:1.5 trillion
- GDP growth in 2015: N/A
- Population: approximately 1,000 million.

Trends in Construction sector EMEA Region

Strategy of the main construction companies

Internationalisation

If an in-depth analysis of the opportunities and risks of each market is performed, the map of the potentially attractive countries and areas for infrastructure companies is significantly different.



NORTH AMERICA AND OLDER MEMBERS OF THE EU

Opportunities:

- Enormous need for investment in certain countries (USA/Canada) and a pipeline of projects
- Macroeconomic stability
- Political and social stability
- Legal certainty

Risks:

- High level of competition
- Increased costs
- Potential industrial disputes between states

NEW MEMBERS OF THE EU

Opportunities:

- Growing demand
- Insufficient infrastructure

Risks:

- Macroeconomic situation
- Cultural differences
- Legal framework and legal certainty

MIDDLE EAST

Opportunities:

- Growing demand
- Insufficient infrastructure
- Financially solvent customers
- Established Anglo-Saxon law.

Risks:

- Cultural differences
- Legal framework and legal certainty
- Corruption
- “Doing business in ME”

Latin America

Opportunities:

- Growing demand
- Shared culture
- Spanish companies and products are viewed favourably

Risks:

- Regular economic crises
- Political instability
- Poverty and social issues
- Legal framework and legal certainty
- Corruption
- Competition: Brazilian construction companies

AFRICA

Opportunities:

- Growing demand
- French-speaking and English-speaking areas with the presence of French and international construction companies.
- Portuguese presence in some countries (Mozambique, Angola, Namibia)

Risks:

- Political instability
- Poverty and social issues
- Legal framework and legal certainty
- Corruption
- Competition: presence of Chinese construction companies

ASIA AND OCEANIA

Opportunities:

- Growing demand and economic growth
- Potential of market share and trade margin
- Insufficient infrastructure
- The Australian market is growing and has legal certainty

Risks:

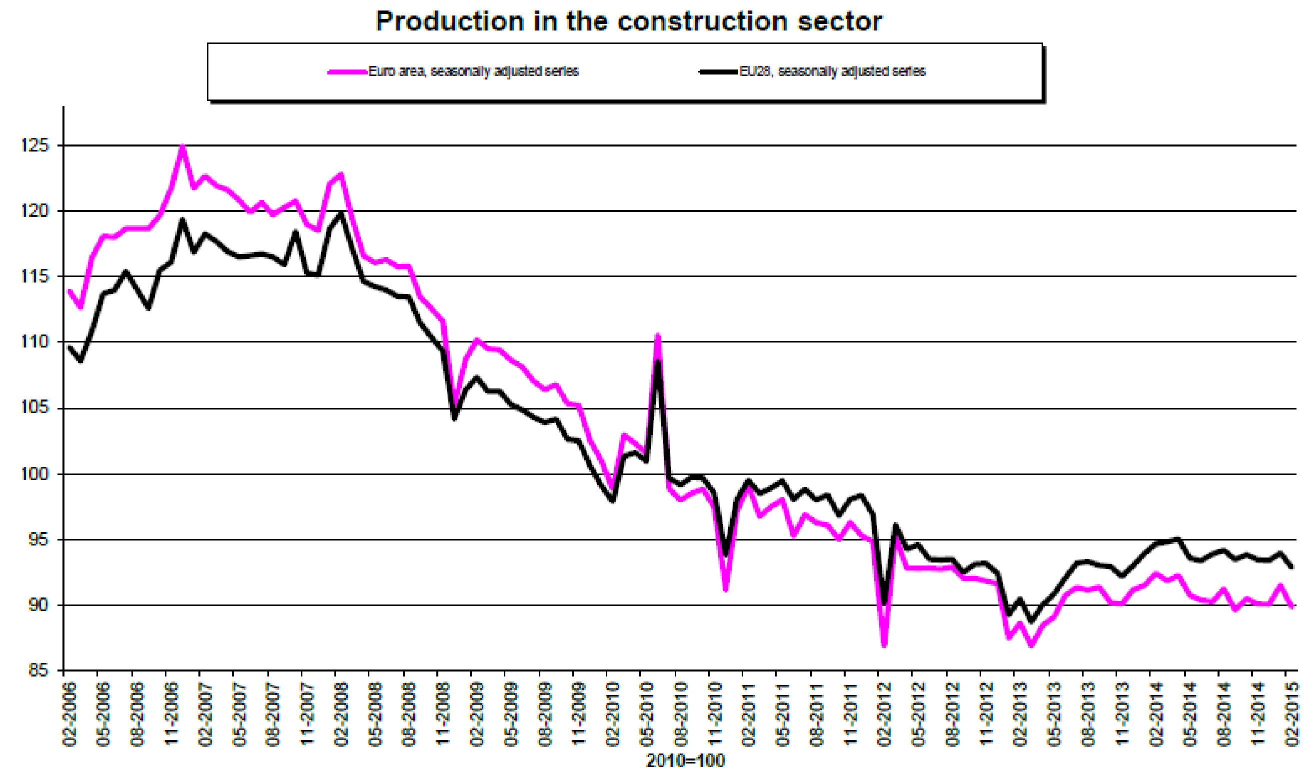
- Cultural differences
- Corruption
- China: The market is closed to foreign construction companies
- India: Corruption, industrial practices

Strategy of the main construction companies

Outlook for the construction industry

A characteristic of construction activity is that it is particularly cyclical, as it is influenced by business and consumer confidence, interest rates and government programmes.

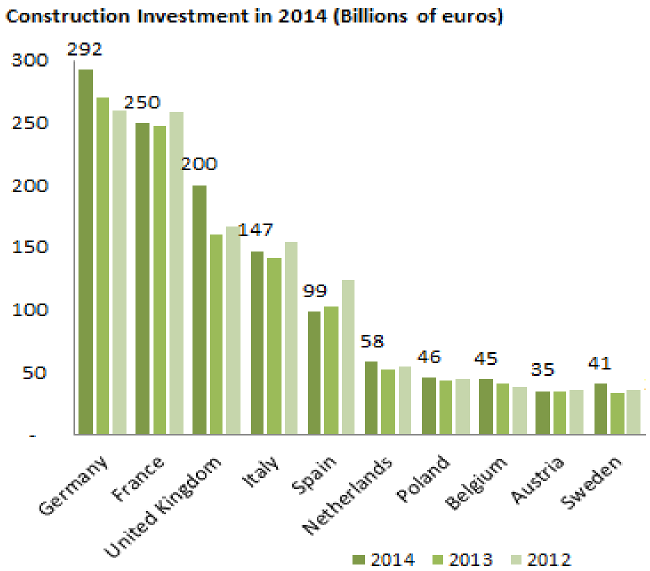
Business and consumer confidence started to decline in 2008 and now, after falling for a few years, construction investment is projected to return to growth in 2014 and to accelerate further in 2015



Source: Eurostat.

Strategy of the main construction companies

Outlook for the construction industry



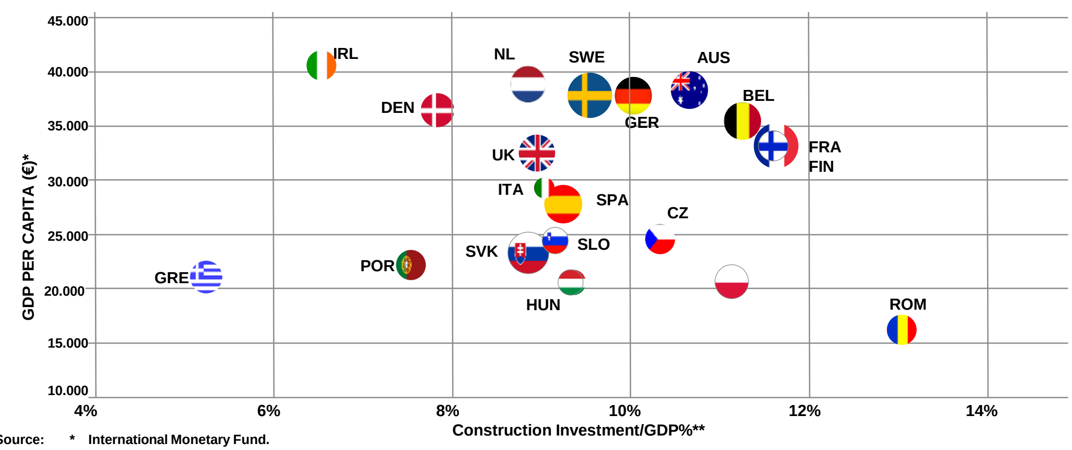
Source: Ameco, February 2015

Total construction investment in the European Union in 2014, 2013 and 2012 amounted to €1.37 trillion, €1.27 trillion and € 1.33 trillion, respectively, indicating that European construction has fallen below levels last seen in the mid-1990s.

As in previous years, **the three largest construction markets in Europe are Germany, France and the United Kingdom**. Additionally, the Top 5, which also includes Italy and Spain, represented 72% of total construction investment in the European Union in 2014. In the aforementioned markets, construction investment represents between 8% and 12% of total GDP. Construction investment in smaller countries such as Finland or Romania is significantly lower but in relative terms it represents more than 12% of total GDP.

There seems to be a direct correlation between the construction Investment/GDP ratios and GDP per capita.

Those countries that recorded construction investment / GDP ratios above 9% in the last years obtained an average GDP per capita of higher than the GDP per capita recorded by countries with lower construction investment ratios.

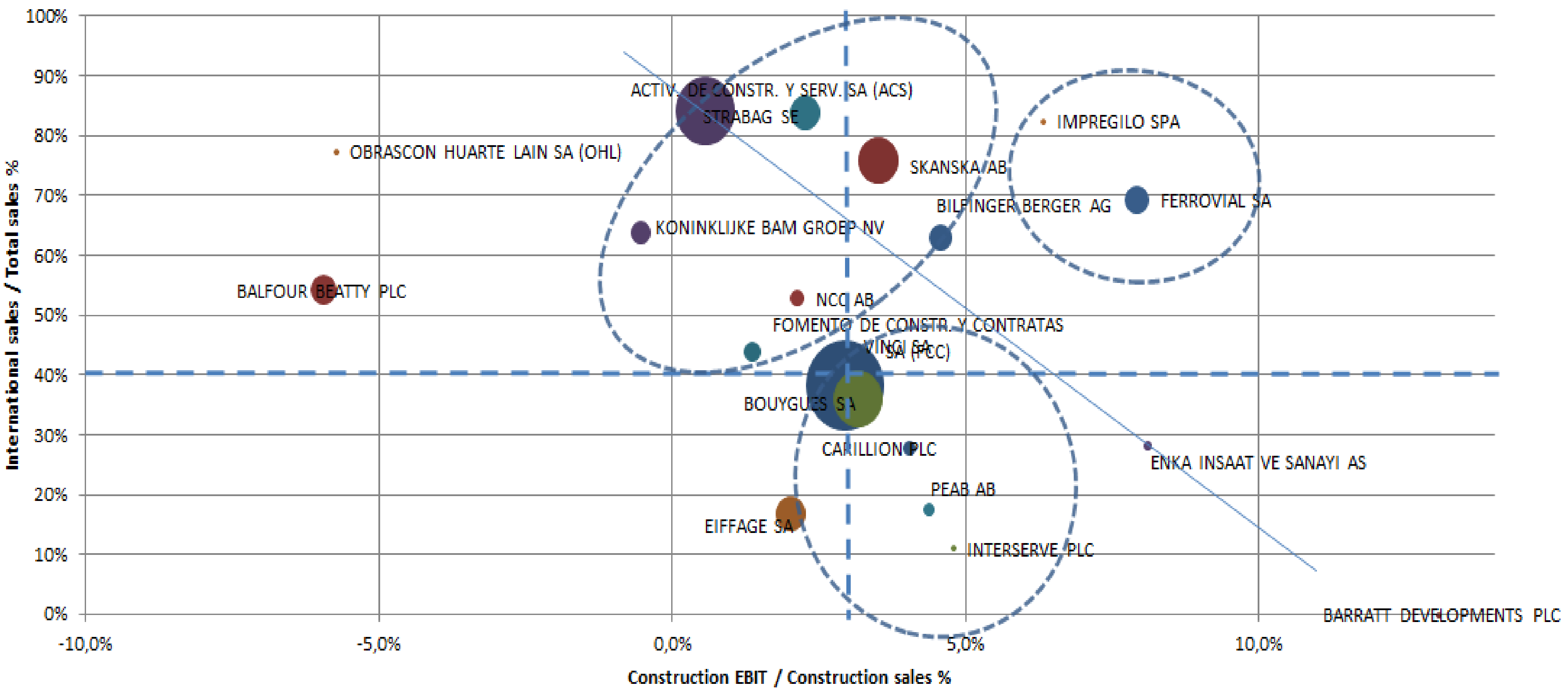


Source: * International Monetary Fund.
** Ameco.

In 2014 the international sales of the 20 leading European construction companies accounted for, on average, 52% (56% in 2013) of their revenue while diversification (non-construction sales) accounted for 26% (23% in 2013)

Strategy of the main construction companies

Internationalisation is producing disparate results. There appears to be an inverse correlation between the level of internationalisation and the margins of the main European construction companies.



Source: Deloitte Analysis.

Strategy of the main construction companies

Diversification

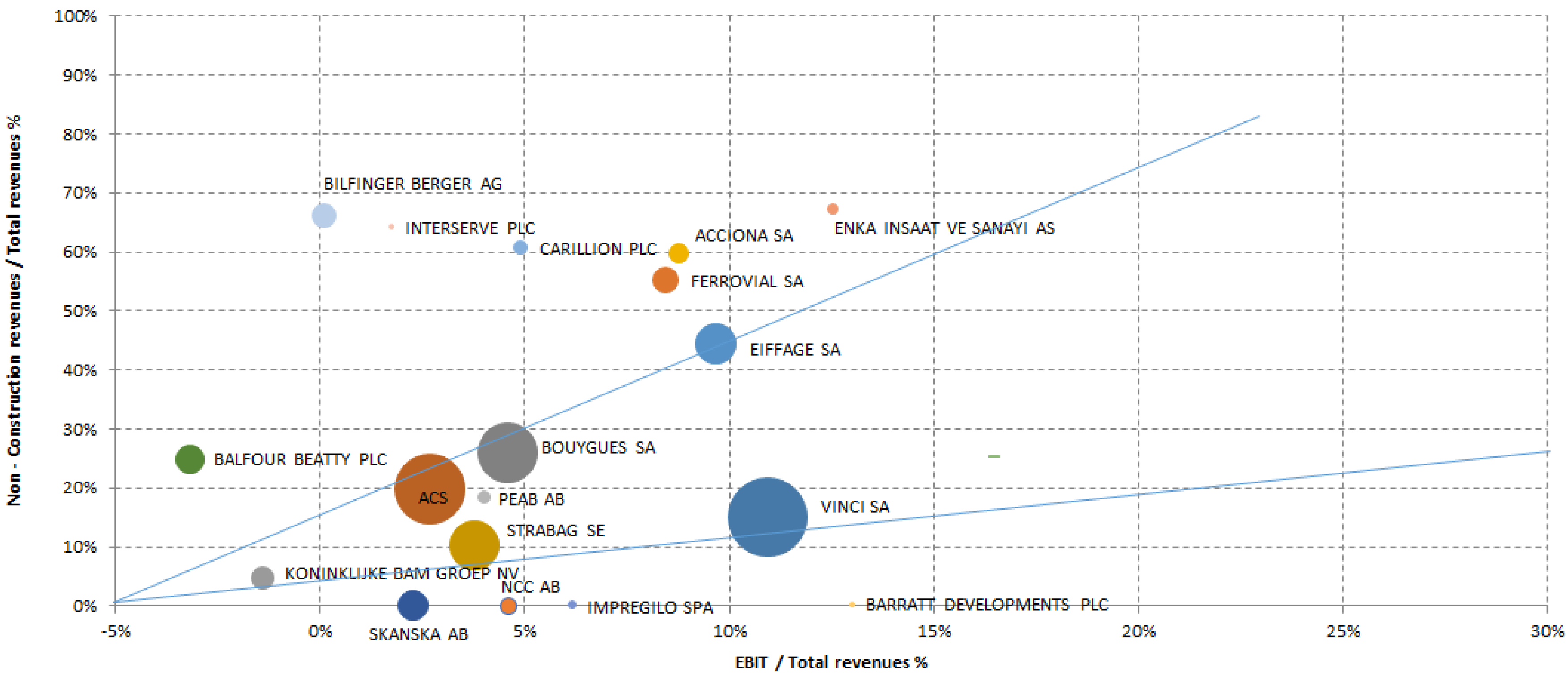
The diversification of the European construction companies follows a similar pattern.

Company	Construction	Real Estate Development	Concessions	Industrial & Services	Environment & Water	Energy	Telecom	Other Activities
VINCI SA	Sales over €1,000 million	Sales below €1,000 million	Sales over €1,000 million	Sales over €1,000 million	No presence or residual presence	Sales over €1,000 million	No presence or residual presence	No presence or residual presence
ACTIV. DE CONSTR. Y SERV. SA (ACS)	Sales over €1,000 million	Sales over €1,000 million	Sales below €1,000 million	Sales over €1,000 million	Sales over €1,000 million	Relevant presence through equity investments	Relevant presence through equity investments	Sales below €1,000 million
BOUYGUES SA	Sales over €1,000 million	Sales over €1,000 million	Sales below €1,000 million	Sales below €1,000 million	No presence or residual presence	Relevant presence through equity investments	Sales over €1,000 million	Sales over €1,000 million
SKANSKA AB	Sales over €1,000 million	Sales over €1,000 million	No presence or residual presence	Sales over €1,000 million	No presence or residual presence	Sales over €1,000 million	No presence or residual presence	No presence or residual presence
EIFFAGE SA	Sales over €1,000 million	Sales below €1,000 million	Sales over €1,000 million	Sales below €1,000 million	No presence or residual presence	Sales over €1,000 million	No presence or residual presence	No presence or residual presence
STRABAG SE	Sales over €1,000 million	Sales below €1,000 million	Sales below €1,000 million	Sales below €1,000 million	No presence or residual presence	Sales below €1,000 million	No presence or residual presence	Relevant presence through equity investments
BALFOUR BEATTY PLC	Sales over €1,000 million	No presence or residual presence	Relevant presence through equity investments	Sales over €1,000 million	Sales below €1,000 million	Sales below €1,000 million	Sales below €1,000 million	Sales below €1,000 million
BILFINGER SE	Sales over €1,000 million	Sales over €1,000 million	No presence or residual presence	Sales over €1,000 million	Sales below €1,000 million	Sales over €1,000 million	No presence or residual presence	No presence or residual presence
FERROVIAL SA	Sales over €1,000 million	Sales below €1,000 million	Relevant presence through equity investments	Sales over €1,000 million	Sales over €1,000 million	No presence or residual presence	No presence or residual presence	Sales below €1,000 million
KONINKLIJKE BAM GROEP NV	Sales over €1,000 million	Sales below €1,000 million	Relevant presence through equity investments	Sales below €1,000 million	No presence or residual presence	No presence or residual presence	No presence or residual presence	No presence or residual presence
FOMENTO DE CONSTR. Y CONTRATAS SA (FCC)	Sales over €1,000 million	Relevant presence through equity investments	Relevant presence through equity investments	Sales over €1,000 million	Sales over €1,000 million	Sales below €1,000 million	No presence or residual presence	Sales over €1,000 million
NCC AB	Sales over €1,000 million	Sales over €1,000 million	No presence or residual presence	Sales over €1,000 million	No presence or residual presence	No presence or residual presence	No presence or residual presence	Sales below €1,000 million
ACCIONA SA	Sales over €1,000 million	Sales below €1,000 million	Sales below €1,000 million	Sales below €1,000 million	Sales below €1,000 million	Sales over €1,000 million	No presence or residual presence	Sales below €1,000 million
PEAB AB	Sales over €1,000 million	Sales below €1,000 million	No presence or residual presence	Sales below €1,000 million	No presence or residual presence	No presence or residual presence	No presence or residual presence	Sales below €1,000 million
ENKA INSAAT VE SANAYI AS	Sales over €1,000 million	Sales below €1,000 million	No presence or residual presence	No presence or residual presence	No presence or residual presence	Sales over €1,000 million	No presence or residual presence	Sales below €1,000 million
CARILLION PLC	Sales over €1,000 million	Sales below €1,000 million	Sales below €1,000 million	Sales over €1,000 million	Sales below €1,000 million	No presence or residual presence	No presence or residual presence	No presence or residual presence
OBRASCON HUARTE LAIN SA (OHL)	Sales over €1,000 million	Sales below €1,000 million	Sales below €1,000 million	Sales below €1,000 million	No presence or residual presence	No presence or residual presence	No presence or residual presence	Sales below €1,000 million
BARRATT DEVELOPMENTS	Sales over €1,000 million	Sales below €1,000 million	No presence or residual presence	No presence or residual presence	No presence or residual presence	No presence or residual presence	No presence or residual presence	No presence or residual presence

Sales over €1,000 million   Sales below €1,000 million   Relevant presence through equity investments   No presence or residual presence

Strategy of the main construction companies
Diversification

The cyclical nature of construction activity causes many companies signficant financial dificulties in times of recession. In order to offset the negative effects of the economic and financial situation, most of the EPoC pursued diversification strategies aimed at both achieving sustainable growth and increasing the low margins typical of construction activities.



Source: Deloitte Analysis.

E&C Industry Trends in UK

Key trends in Engineering & Construction
Outlook for the sector

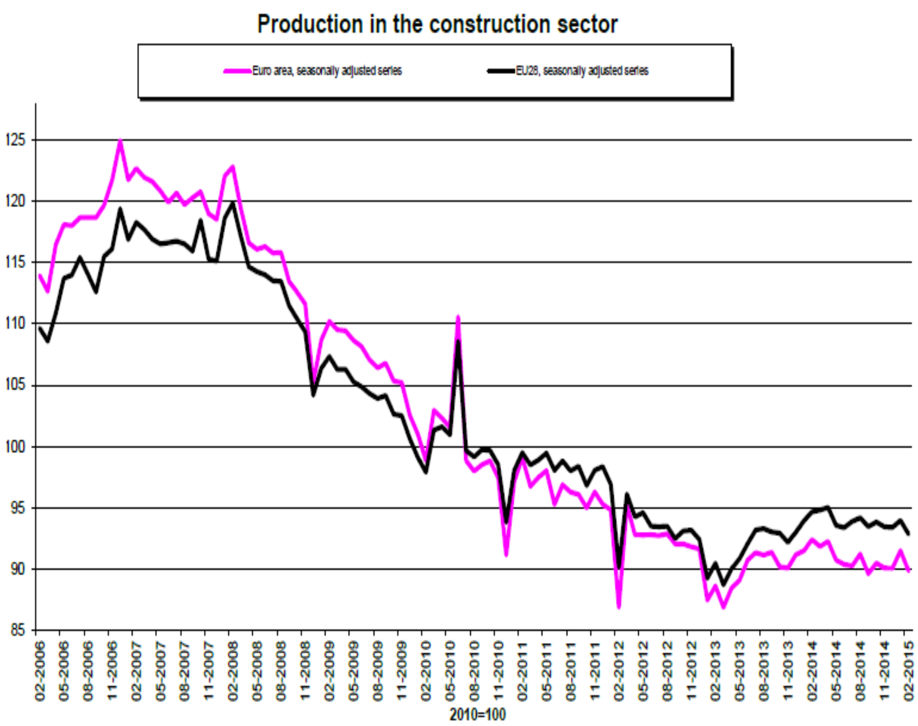
The new market situation provides a reference framework for companies which differs from that prior to the crisis.

	Until 2008	2008-2013	2014-???
Cycle/Vision	Expansion	Slowdown	Stabilisation and selective growth
Financial model	Cash generators (for the business and for the rest of the Group –diversification activities-)	Seekers of financing and working capital management. Refinancing and restructuring	Debt restructuring, diversification of funding sources, alliances with institutional investors (funds)
Territoriality	Distribution (opening of branches)	Concentration (optimisation of operational deployment)	Without significant changes
Tactical variables	Commercial and operational: fulfilment of the commitments acquired	Financing and cost management: minimisation of structures	Financing and growth. Risk and reputation control (CSR)
Strategic variables	Diversification - Internationalisation	Internationalisation Divestment of residual businesses and search for new avenues for financing in capital markets	Internationalisation Selective diversification Financial flexibility

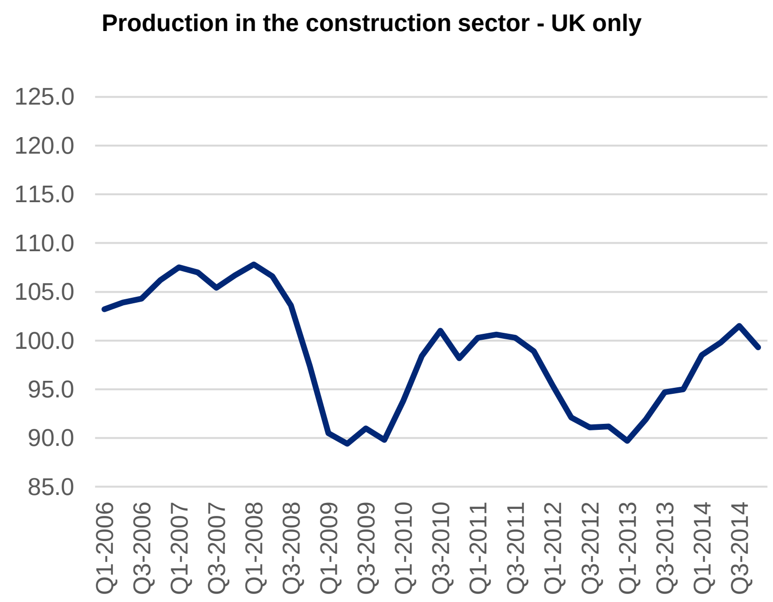
Key trends in Engineering & Construction

Outlook for the EU & UK

Construction output - EU



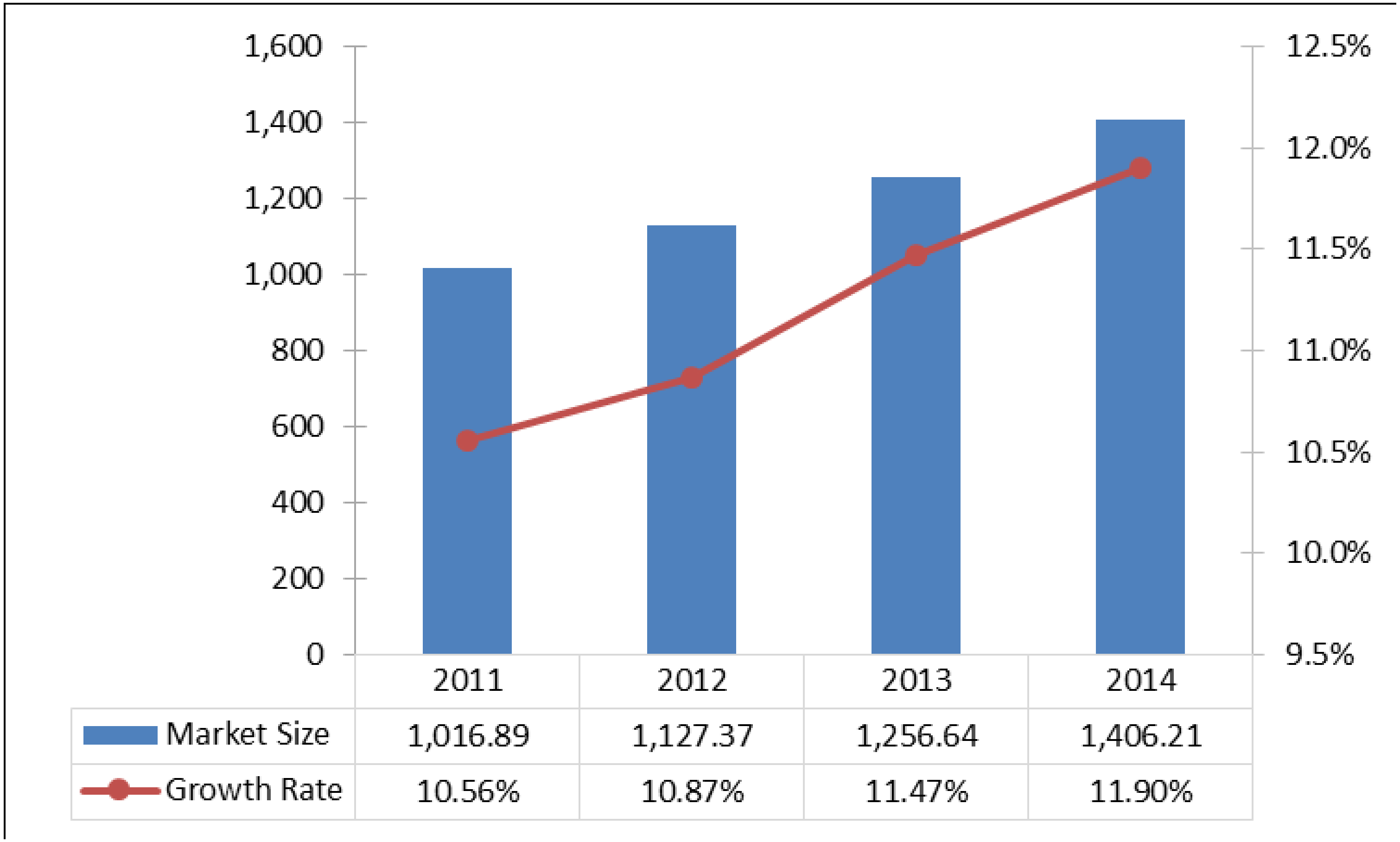
Construction output - UK



E&C Industry Trends in Canada

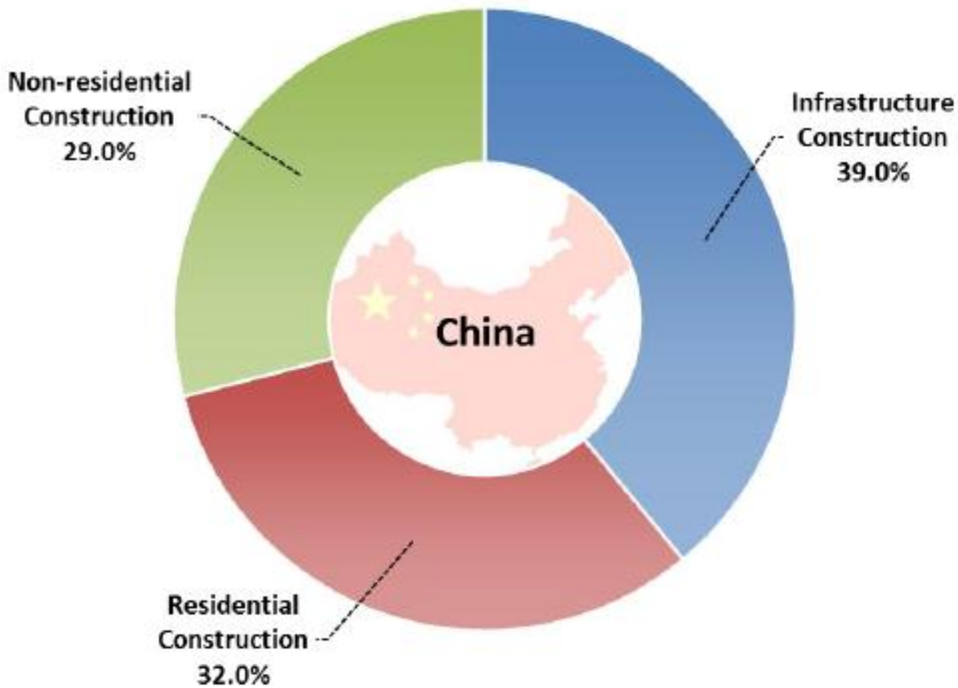
E&C Industry Trends in China

Construction Market in China 2011-2014 ($ billions)



Source: Technavia Research

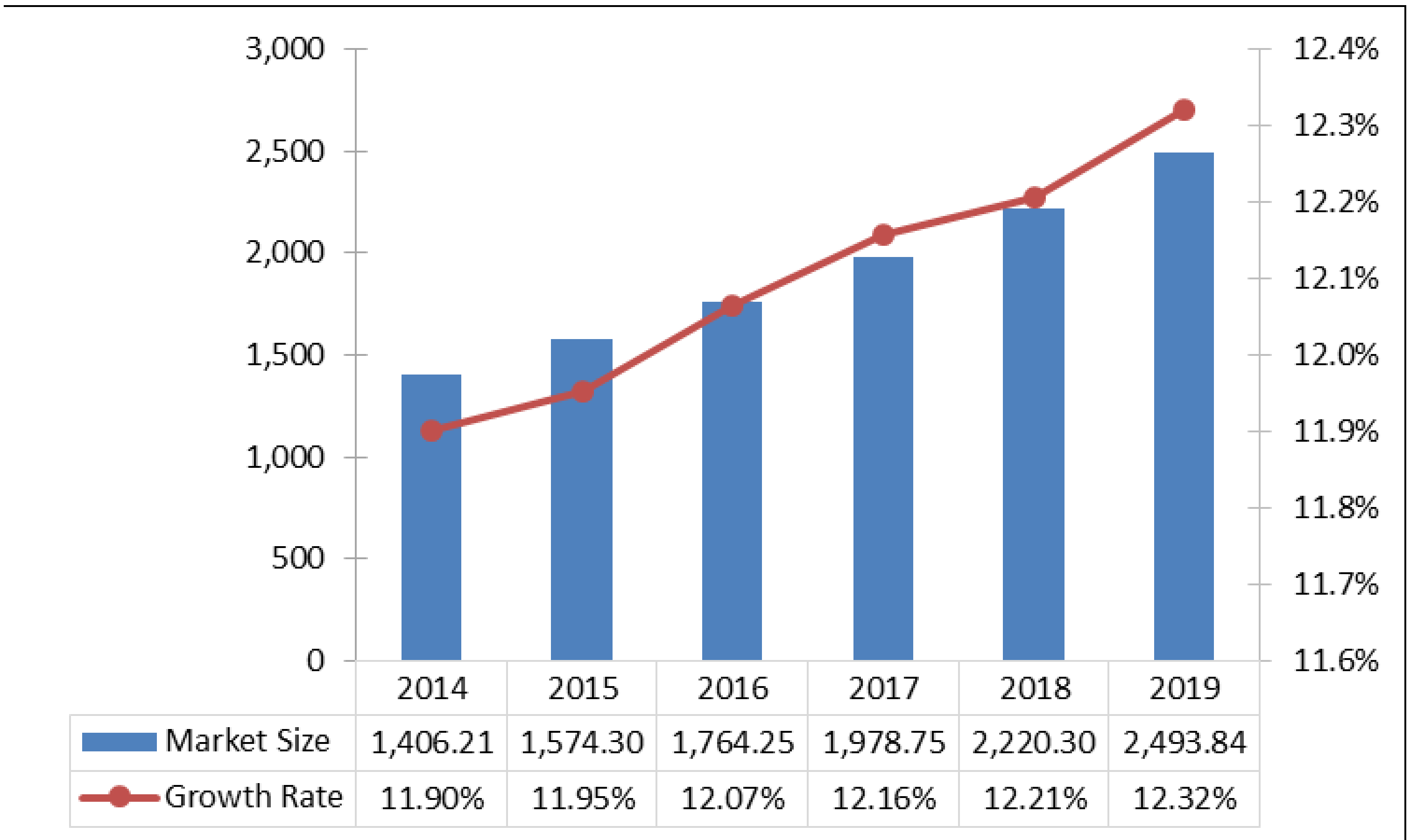
Construction Market in China by Sector 2014



Sector	Market Size 2014 ($ billions)
Infrastructure Construction	548.42
Residential Construction	449.99
Non-residential Construction	407.80
Total	**1,406.21**

Source: Technavia Research

Construction Market Size in China 2014-2019 ($ billions)



Source: Technavia Research

Key Market Trends

Market Drivers

- Government Initiatives
- Shift from Rural to Urban Development
- Investment in Construction Sectors

Market Trends

- Increase in Sustainable Buildings
- Adoption of Labor-saving System

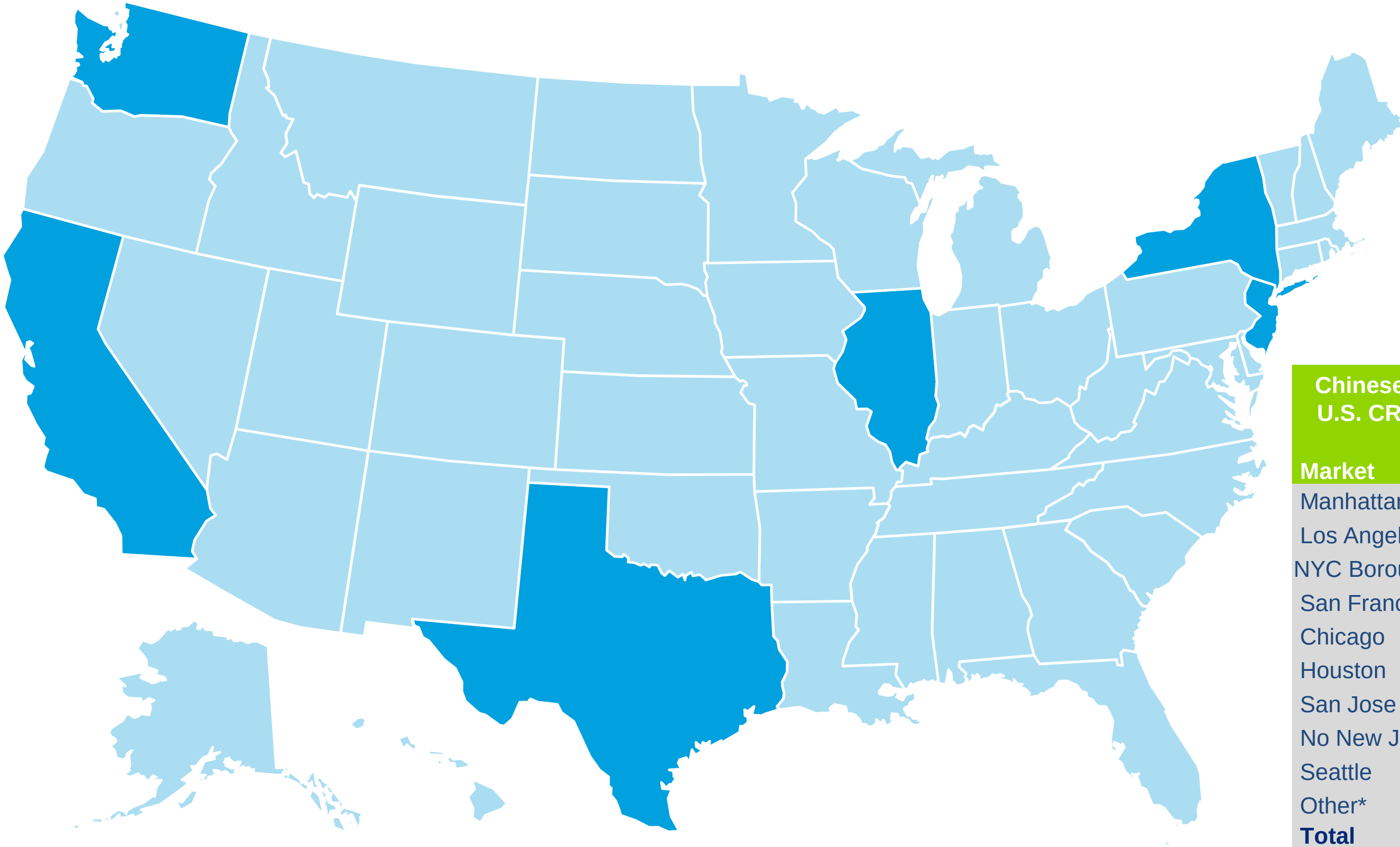
Market Weakness

- Weak Regulatory Framework
- Low Infrastucture Quality
- Lack of Quality Management System

Trend to watch:

Chinese investment in US real estate and construction

Chinese Cross Border Capital into U.S. CRE – Top Markets by Destination

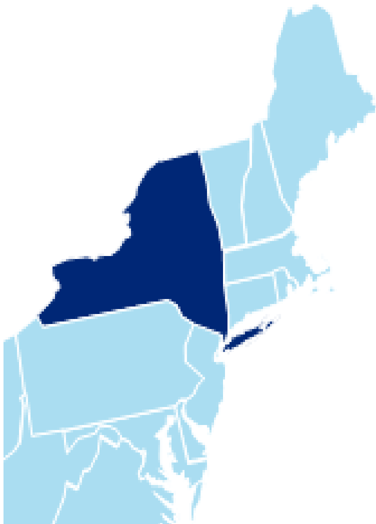


Chinese Cross Border Capital into U.S. CRE by Market Destination – last 3 years	
Market	**Total Vol. ($ mil.)**
Manhattan	$4,058.9
Los Angeles	1,322.2
NYC Boroughs	543.1
San Francisco	511.1
Chicago	458.1
Houston	374.5
San Jose	139.8
No New Jersey	139.6
Seattle	102.3
Other*	638.0
Total	**$8,287.7**

Source: Real Capital Analytics, *Cross Border Capital Tracker*. February 23, 2015

*Other markets include: Jacksonville, Atlanta, Inland Empire, East Bay, Detroit, Dallas, SW Florida, Memphis, and Toledo.

Chinese direct capital focused on prime assets



Acquisitions By Chinese Investors, Last 12 Months

Buyer	Capital Type	Acquisitions (in $mil.)	# of Properties	Asset Type
Anbang Insurance Group	Institutional, Insurance	2,375.0	2	Hotel
Bank of China Limited	State Owned Enterprises	600.0	1	Office
Dalian Wanda Group	Developer/Owner/Operator	510.0	2	Office
Greenland Group	State Owned Enterprises	406.0	1	Development Site
Genzon Group	Developer/Owner/Operator	315.0	1	Retail
China Cinda Asset Management	Investment Manager	302.4	1	Office
Oceanwide RE Group	Developer/Owner/Operator	296.0	4	Office
Sunshine Insurance Group Corp	Institutional, Insurance	230.5	1	Office
Shanghai Yudu Group	Developer/Owner/Operator	153.8	1	Development Site
Hazens RE Group	Developer/Owner/Operator	104.2	1	Development Site
Sinopec	State Owned Enterprises	100.0	1	Hotel
Wanxiang Group	Developer/Owner/Operator	80.1	5	Development Site

Source: Real Capital Analytics, February 23, 2015

Recent Significant Chinese deals:

Waldorf Astoria Hotel
301 Park Ave., New York, NY/ US
Buyer: Anbang Insurance Group
Seller: Hilton Worldwide Holdings
Price: $1.95 bil. Anbang is paying $1.37 mil. per unit

Baccarat Hotel Plaza
20 W 53rd St. New York, NY/ US
Buyer: Sunshine Insurance Group
Seller: Starwood Capital Group
Price: $230.5 mil.

First and Mission sites
San Francisco, CA/ US
Buyer: Oceanwide RE Group
Seller: TMG Partners JV
Price: $296 mil. Total: 104,690 sf. part of 4 property portfolio

Robinsons-May Store (former)
9900 Wilshire Blvd. Beverly Hills, CA/ US
Buyer: Dalian Wanda Group
Seller: CBRE Group JV
Price: $420 mil.

Source: Real Capital Analytics, February 23, 2015

Key tax themes in EMEA

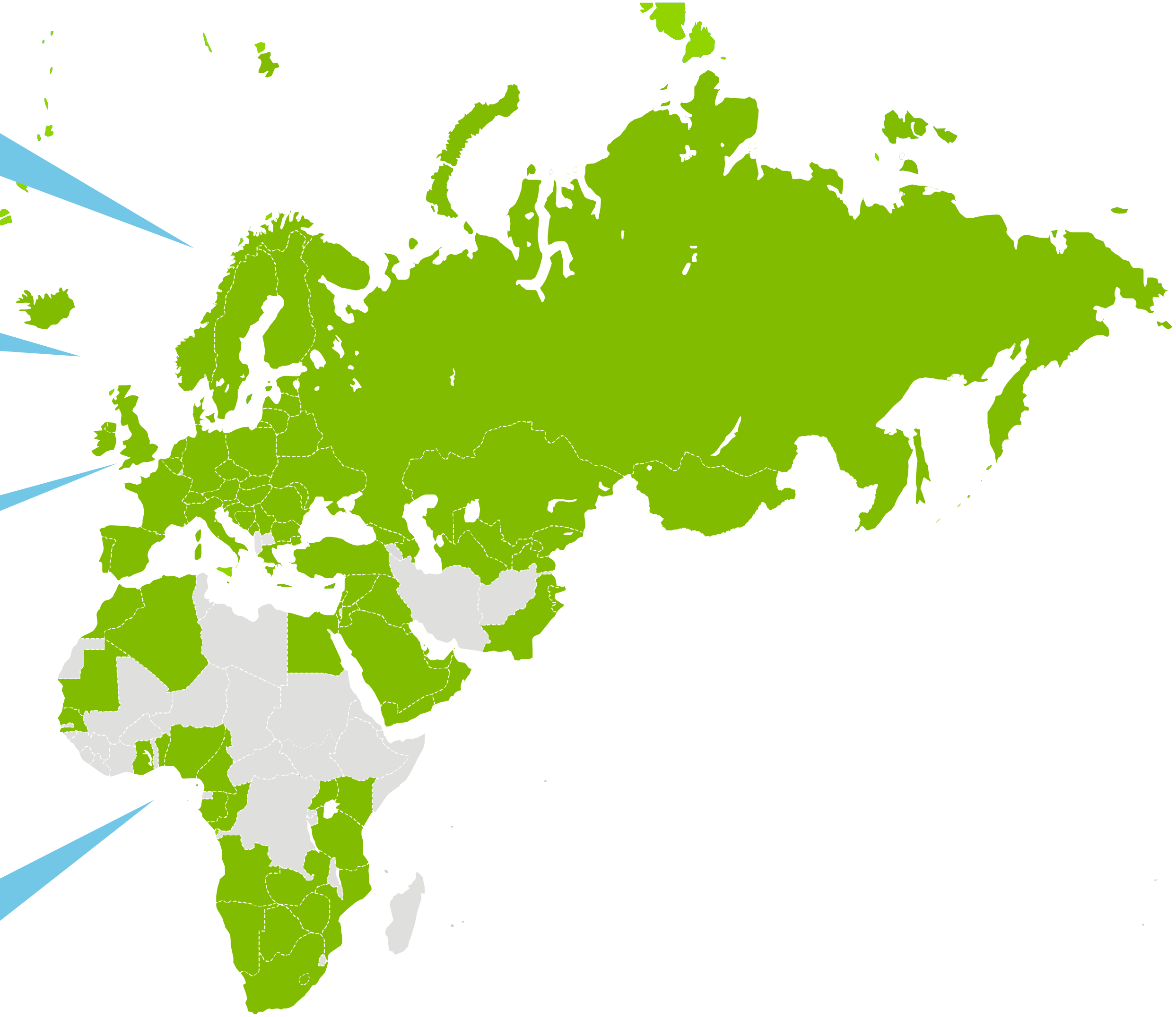
Key tax themes in EMEA

Base Erosion & Profit Shifting (BEPS)

EU State Aid

Unilateral measures (e.g. UK DPT)

Euro uncertainty



European Tax Survey 2014
Key findings

The Netherlands and the UK were seen as the most attractive of the large jurisdictions from a tax perspective. Italy seen as most challenging

70% of respondents had experienced a tax audit in prior 3 years.

56% More than half of respondents (56%) thought there has been an increased level of discussion and scrutiny around corporate tax strategy

69% Only half of respondents thought that BEPS was important and 69% had not started planning for the likely impact

ETR was <u>not</u> the most important measure of success – compliance and close collaboration with the business and its strategy were more important

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The BEPS project
Key themes

Widening the tax base

Interest expense

Taxable presence

Profit allocation:

- *Intangibles*
- *Methods*

Compliance

Transfer pricing documentation

Enforcement

Disclosure obligations

GAAR

Mutual agreement

Harmful tax practices

Data collection

Digital business

Coherence | Restoring international standards | Transparency and certainty

The BEPS project

Agreed timeframes

- We are now positioned a considerable distance along the agreed OECD BEPS timeline, with the majority of the published discussion drafts for each of the actions setting clear direction.

November 2012 — G20 Leaders meet

February 2013 — OECD released "Addressing Base Erosion and Profit Shifting"

May 2013 — European Council Meeting; Forum of Administration meeting

June 2013 — G8 Summit; OECD's Committee on Fiscal Affairs to agree action plan

July 2013 — OECD's Action Plan delivered to G20 Finance Ministers

Action plan working groups

September 2014

- Digital economy
- Hybrid mismatches
- Treaty abuse
- Transfer pricing documentation
- Transfer pricing of intangibles (1)
- Harmful tax practices
- Multilateral instrument

September 2015

- CFC rules
- Permanent establishments
- Transfer pricing of intangibles (2), risks and capital, other
- Disclosure of aggressive tax planning
- Dispute resolution
- Data collection and analysis measuring BEPS

December 2015

- Interest deductions
- Harmful tax practices
- Multilateral instrument to address BEPS

BEPS Survey – May 2015

Key findings

Significant change is fully expected – BEPS is highly likely to have a significant impact on many businesses and may take time to implement.

90% **Major impact on compliance burden** – 90% expecting compliance burden to increase (mainly country-by-country reporting)

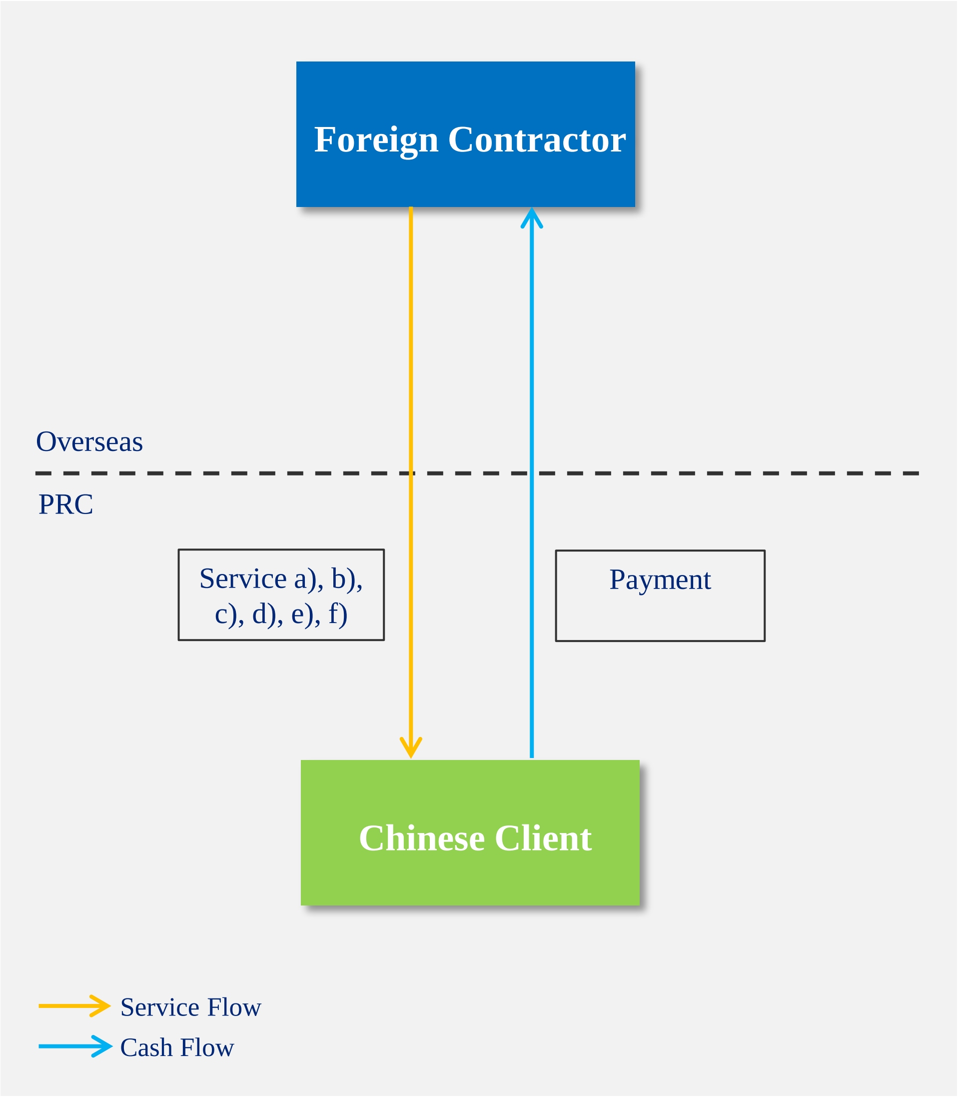
75% **Concern over unilateral action** – 75% are anticipating double taxation as a result of BEPS

91% **Greater scrutiny by tax authorities** – 91% agree that tax structures are under greater scrutiny by local tax authorities than a year ago

58% **Greater impact on business** – 58% feel that the BEPS project will have a greater impact on their organization than they originally thought

Key tax and regulatory challenges in China

Typical business arrangement



- Under a typical contract project, there are the following 4 components:
  a) Off shore engineering and design
  b) Onshore engineering and design
  c) Offshore purchase of materials
  d) Onshore purchase of materials
  e) Onshore construction
  f) Onshore project management

- In a turkey project, the payment term is usually based on milestone progress of a project

Tax and regulatory issues

- Each payment may cover different components as discussed above
- Each payment needs to be cleared with the tax authorities before the bank can process foreign exchange remittance out of China to overseas bank account
- Each component has different PRC tax implications, which involve the following aspects:
  - a) Onshore and offshore claim or split
  - b) PE issue
  - c) Corporate income tax (“CIT”)
  - d) Deemed profit rate
  - e) VAT issue and deduction of VAT by the project owner
  - f) Deduction of sub-contract payments for computing CIT and VAT liability for foreign company
  - g) Registration of the contract with the local administration of industry and commerce and tax authority
  - h) Tax clearance with the local tax authority
  - i) Preparation of sound documentation to minimize Chinese tax cost

- In practice, the commercial team may not pay too much attention to the above issues when they negotiate contract terms related to payment and tax clauses in the contract with their Chinese clients
- In addition, more and more Chinese clients prefer using Rmb instead of foreign currency in order to avoid burdensome document and procedural requirements for foreign exchange payment

How to deal with those challenges

- In a real-life case, a client of ours did not receive payment of USD 19 million for almost a year from its Chinese client as the client claimed that there is no sufficient documentation to provide to the local tax authority for tax clearance. Later we helped the client with the following:

  a) Registered the contract with the relevant authority and the tax authority
  b) Broke down payment amount into the 6 categories of service nature as discussed above
  c) Discussed with the tax authority on tax position on each category
  d) File the required tax returns and settle the tax liabitiies
  e) Obtain tax clearance document from the tax authority
  f) Assist in communicating with the bank and get the bank process the remittance

- Get your tax advisor involved in review of a contract on payment term and tax clauses before finalizing the contract with your Chinese client

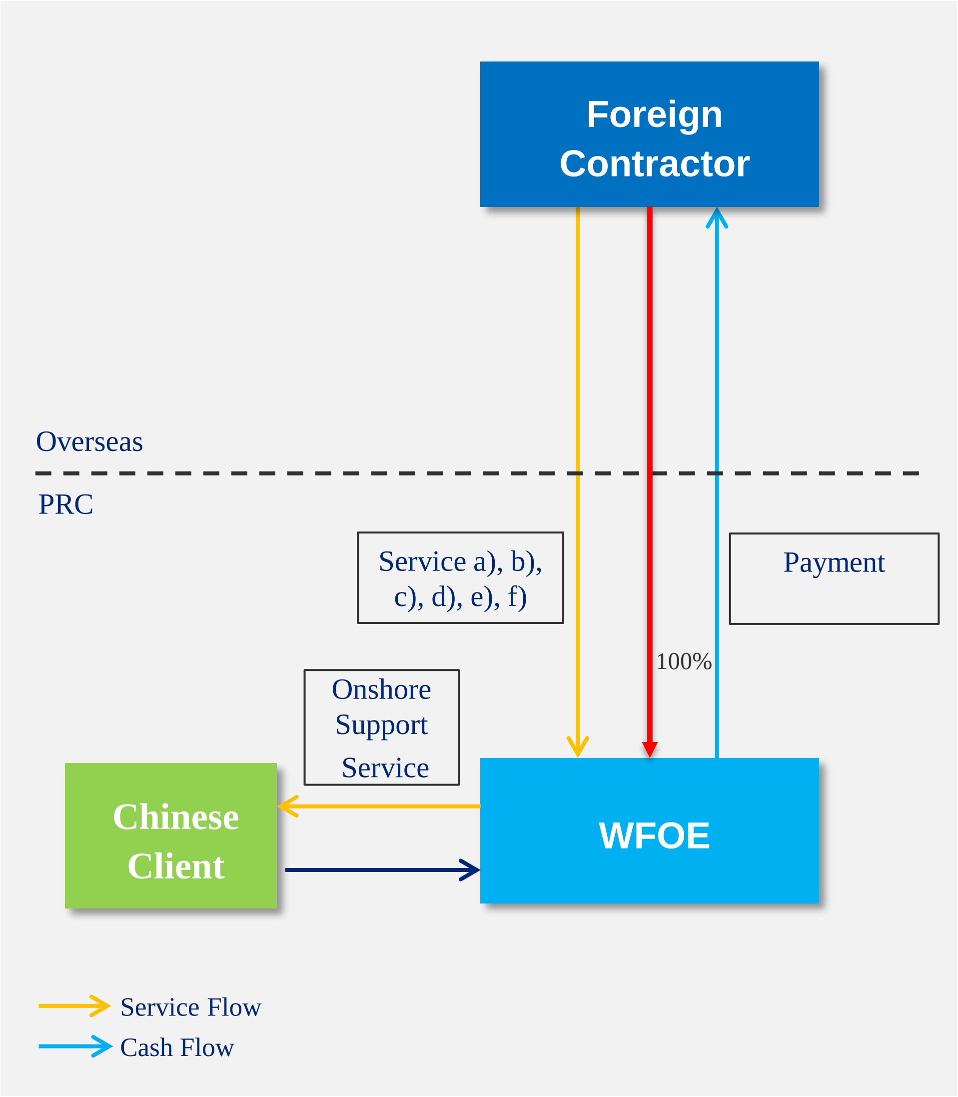
- Prepare all the required documents and information immediately after the project is started based on the service nature

- Register the contract with the local tax authority within 30 days after the contract is executed

- Prepare technical discussion paper on tax position all the service components covered in the contract with the local tax authority as early as possible before the first payment is due

- Keep good records of all the documents and information

Business arrangement for contracts denominated in Rmb



- In order to settle in Rmb, it is required for a foreign company to set up a WFOE to be the main contractor for the purpose of signing the contract with the Chinse client
- The WFOE then subcontracts majority of the work to its overseas parent company and may provide liaison and project management and other limited functions

Tax and regulatory issues

- The same issues as discussed on page 3
- Transfer pricing issue for sub-contracting relationship with the WFOE and its overseas parent company (e.g. what should be the reasonable profit level for the WFOE)
- It is required to do a transfer pricing study to determine the reasonable level for the WFOE depending on the functions and risk profile of the WFOE

Questions?

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