Iceberg Research

www.iceberg-research.com
info@iceberg-research.com

Tutor Perini: Structural Issues Underestimated by the Market

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Revenue 9M 2016: $3.7b Net profit 9M 2016: $65.6m Equity: $1.5b Staff: 10,626 S&P rating: BB- (negative outlook) Moody's rating: Ba3 (negative outlook)	**Target Price: $13 (-55%)** Listed on the NYSE Market cap: $1.5b as of close November 15, 2016 PE: 19.27 Average daily volume: $25m Main shareholder: Ronald Tutor, Chairman and CEO (19.6%)

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Company Presentation

Headquartered in Sylmar California, Tutor Perini is one of the largest contractors in the US with revenue of $4.9b in 2015. The company has three business segments:

- Civil: construction, replacement of roads, highways, bridges, and mass transit.
- Building: large and complex projects in the hospitality, gaming, sports, entertainment, educational, transportation, healthcare markets.
- Specialty contractors: installation of electricity, plumbing, mechanical, fire systems, etc.

Summary of findings:

- Tutor Perini ("Tutor") is a $1.5b market cap company, but it has recorded only **$3m in operating cash flow** ("OCF") **since 2010**. Tutor has not paid dividends since 2010.

- Although Tutor records positive OCF quarters periodically, due to the fact that its revenue is amassed in lump sums and seasonal, its overall ability to generate cash has been structurally weak. Based on its average OCF since 2014, it would take **33 years to repay its existing net debt of $622m.**

- Tutor's stock surged by 47% after Trump's election. The President-elect pledged to spend $1 trillion over 10 years on infrastructure without raising new taxes. The sketchy plan would translate into a 60% increase in annual infrastructure spending. However, experts have already expressed **strong doubts over the feasibility of a plan that relies entirely on private funding.**

- Tutor's inability to generate cash has been partially explained by the growth in its "unbilled". We have compared the annual expectations of unbilled realization and actual OCF. Based on this analysis, we have **strong doubts regarding the recoverability of these assets.**

- Although Tutor presents its unbilled as a straightforward collection issue, in reality clients often counter-sue Tutor, for example for false claims. **We analyzed Tutor's legal cases and found the situation particularly concerning.** Tutor faces substantial contingent liabilities. In the past, Tutor had recognized insufficient provisions for these liabilities, even though it was clear that Tutor's legal position was very weak, and indeed they lost the lawsuit.

- **Large retainage ($542m)**, higher than competitors, suggests future collection issues.

- We expect Tutor to **continue to struggle to generate material OCF** on a sustainable basis.

- We think the market is unaware of the fact that **banks have been actively reducing their exposure** on Tutor. Tutor's interest expenses jumped by 32% in 9M 2016. Recently, the company had to withdraw a $500m bond offering as the pricing was too high.

- **Governance is very weak**, especially for a US company: directors on the compensation committee have been "independent" for an average of 14 years, shareholders' votes on remuneration policy have been systematically ignored, same auditor for the past 15 years, etc.

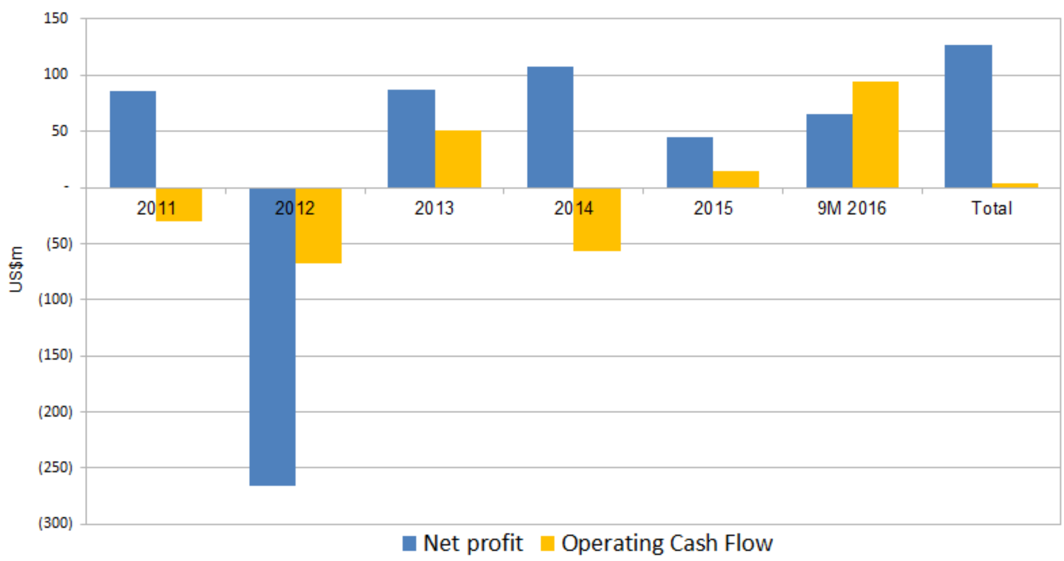
- Almost half of the shares of Chairman and CEO, Ronald Tutor, who controls 19.6% of shareholding, are **pledged as collateral** for a line of credit.

- Based on cash flow valuation, **we expect the stock to fall by at least 55%.**

1. The Role of the "unbilled" in the Very Poor Cash Flow Generation

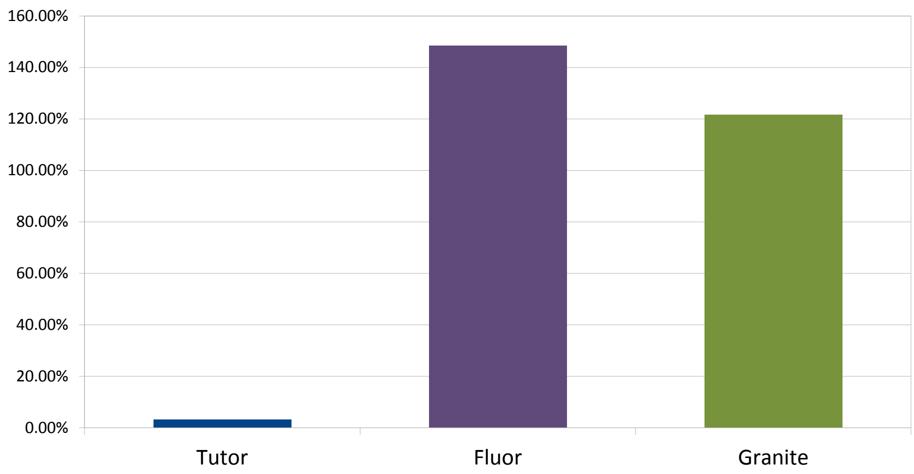
Tutor's inability to realize operating cash flow sets the company apart. Since 2011, Tutor has recorded total operating cash outflow of $3m and $504m negative free cash flow, against $127m net profit during the same period. Investment cash flow ($32m in 2015 and $12m in 2016) is mainly for the acquisition of construction machinery, a non-discretionary expense.

Operating Cash Flow and Net Profit



In contrast, Tutor's peers, US-listed Fluor and Granite, have generated OCF higher than net income over a long period of time.

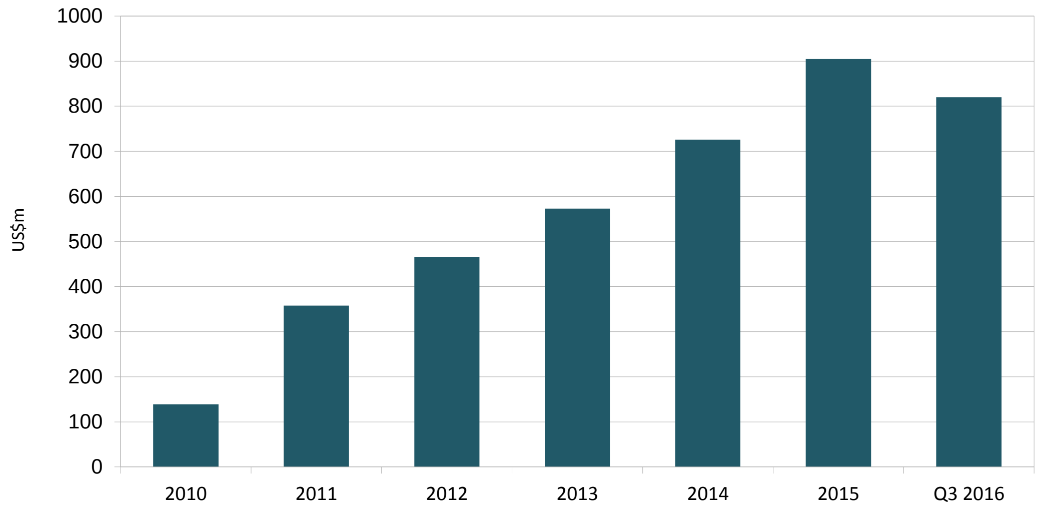
Total OCF as a % of Total Net Income since 2011



Due to the nature of its construction business, Tutor's revenue collection is amassed in lump sums and seasonal. As a result, Tutor has recorded positive cash flow quarters periodically. For example, Tutor recorded good OCF of $89.6m in Q3 2016. This was also the case in Q3 2015 ($52m) and in Q4 2014 ($87m). Yet, positive OCF quarters are often followed by negative OCF quarters as Tutor needs to pay its sub-contractors after receiving payment from its client. On average, cash flow generation has been a structural problem in the long term. This raises doubts over Tutor's ability to repay a net debt of $622m. Based on average OCF generation since 2014, it would take 33 years for Tutor to repay its net debt assuming no investment cash flow. Tutor has not paid dividends since 2010 and does not plan to pay dividends before 2018. The company is restricted by its banks from doing so. Financial strength is also very important for a contractor in order to pre-qualify for large projects for which smaller contractors are unable to meet the qualification requirements.

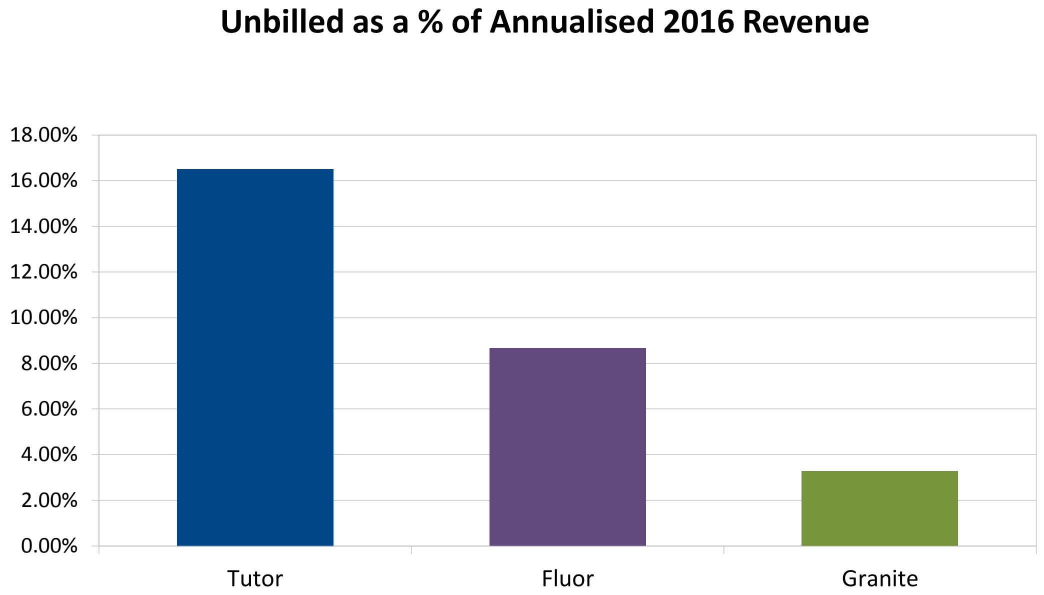
Tutor's poor cash collection can be partially explained by growth in the group "Costs and estimated earnings in excess of billings", alternatively called "unbilled" on the balance sheet. Research firms such as Glasshouse Research and recently Muddy Waters have pointed out the issue. The unbilled are the excess of contract revenue over the amount of contract billings to date. We explain their composition below. They surged from $139m in 2010 to $820m in Q3 2016. They represent 54% of Tutor's equity or 51% of its market cap. As we will explain later, the reduction in 2016 is not as positive as it looks.

Costs and Estimated Earnings in Excess of Billings ("Unbilled")



The unbilled are classified as current assets, which most people assume will mature within 12 months. In reality, they have been growing for years and clearly the company has struggled to realize them.

Tutor's peers have a much lower percentage of unbilled compared to revenue. But as we will see below, what matters is not really the level of unbilled, but rather the composition, which is very different from its peers.



Tutor's poor cash flow generation and high debt probably explain the discount that Tutor trades at, compared with its peers (PE of 19.3 against average of 39.8). However, it is generally assumed that Tutor will recover a substantial part of the unbilled. From that point, Tutor would be able to focus on its existing business and backlog, and would catch up to its peers.

The company has been given the benefit of the doubt by credit agencies as well. Moody's wrote: "The company should also benefit from its enhanced focus on the collection of outstanding receivables which is being reinforced by the requirements of its amended credit facility."[1] Moody's gives a rating of Ba3 (negative outlook), which is generous for a company that has hardly recorded operating cash flow since 2011. Credit agencies openly admit that they rely on the representations made by auditors and do not challenge these numbers in their approach. The case of Noble Group, on which we previously published, illustrated this problem: Noble used to be rated investment grade (BBB-) based on the auditor's representation, before credit agencies downgraded the rating by a total of five notches.

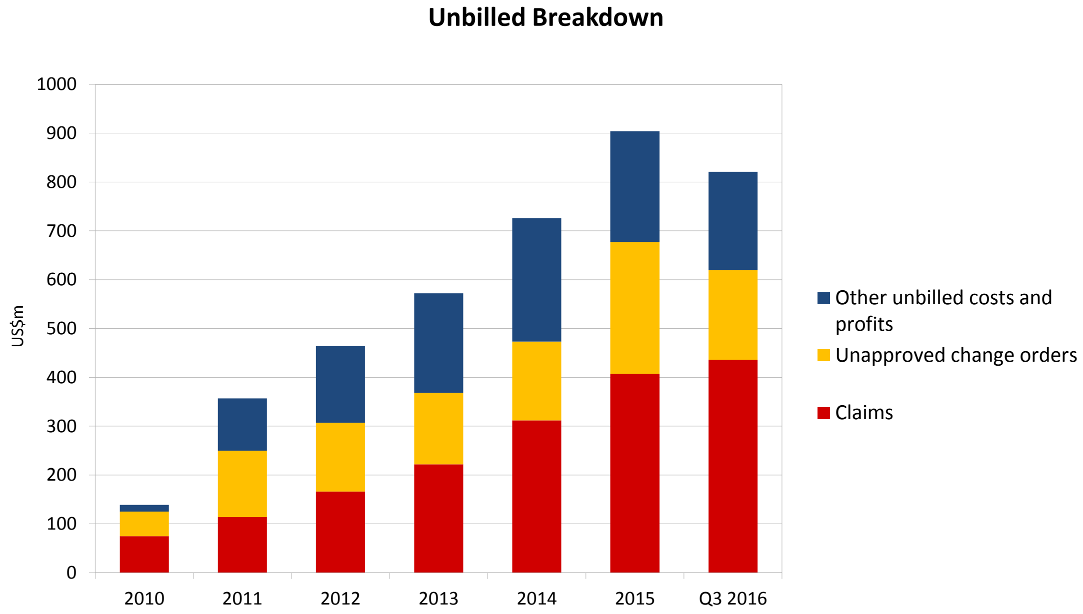
We conducted an in-depth analysis of Tutor's unbilled. We believe that Tutor's issues are much more structural than what the company admits. This is not a simple collection issue. We believe Tutor not only strongly overvalues its unbilled but also faces substantial contingent liabilities compared to its peers. As a result, we believe Tutor will continue to struggle to generate material cash flow on a sustainable basis.

2. Tutor has a Very High Level of Claims and Unapproved Changed Orders Compared to Peers

The unbilled are composed of:

1. Unapproved change orders
2. Claims
3. Other unbilled costs and profits

[1] Moody's opinion 29 March 2016



1. Unapproved change orders ($184m)

"Change orders" are submitted by contractors to seek compensation for unanticipated costs due to changes to the original contract, changes in conditions, or ambiguities in the contract, etc. For example, design documents omitted some details, causing additional costs for the constructor.

The contractor initially carries these costs and seeks reimbursement from the client. The client "approves" the change orders or not. When they are approved, they move to the receivable category, and are due for payment based on the contractual payment terms. Unapproved change orders involve a dispute on the price of the extra work, not the scope. They cannot be billed until resolution.

2. Claims ($436m)

Claims are quite similar to unapproved change orders but disputes relate to both a change in the scope of work and the price associated with that change. Claims are the most difficult to resolve, and they have been constantly growing. In 2016, they rose by $29m.

The submission of change orders or claims for approval can be a quite confrontational process. The client often argues that the work was beyond the scope of the original project plans and specifications, that extra-costs are not justified, and may reject them. Government agencies have also become more reluctant to approve change orders because of budget constraints. Industry experts confirmed that public clients are more willing to fight back than a few years ago. Local officials increasingly fear public scrutiny if budgets are materially exceeded due to out of control change orders. 55% of Tutor's revenue comes from state and local government agencies, and another 5% come from federal government agencies.

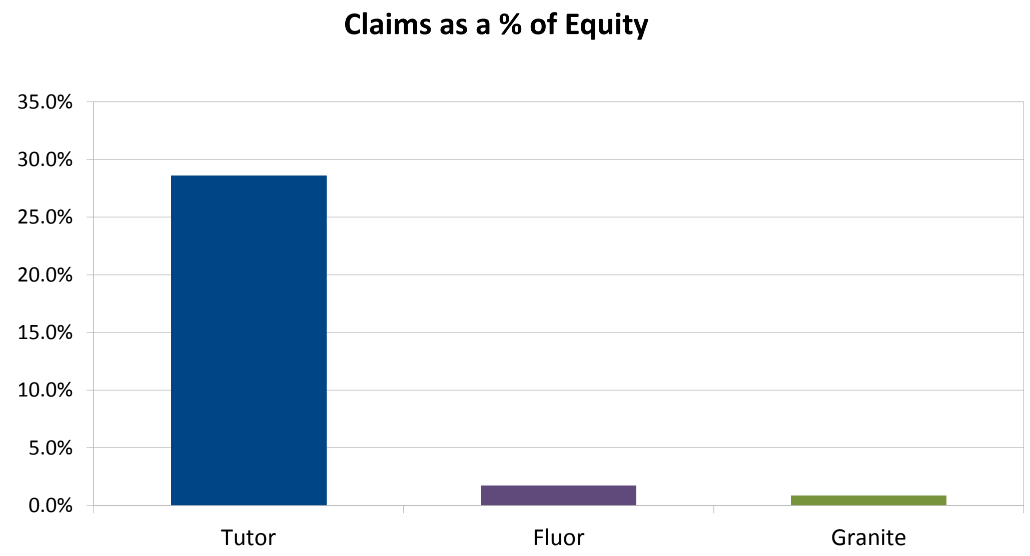
For claims and unapproved change orders, the company recognizes revenue (but not profit) when it is determined that recovery of incurred cost is probable and the amounts can be reliably estimated."[2] The profit portion is recognized at a later stage, when an agreement is found with the client or a favorable legal/arbitration decision is made.

If Tutor is unable to reach an agreement with its client or loses a lawsuit, it may have to recognize losses for revenue that had been overestimated. As Tutor has no less than $820m unbilled, the realization of these unbilled can heavily impact the company's future performance. The lack of

[2] Annual Report ("AR") 2015 F-8

reimbursement of costs can lead to dramatic loss. Worse, as we will see below, the clients often have their own claims against Tutor and the company faces important contingent liabilities.

Tutor has many more disputes with its clients than its peers. For example, claims as expressed as a percentage of equity are much higher.



The valuation of claims or unapproved change orders is far from being a mechanical and straightforward accounting exercise. Audit sign off and asset valuations are two very different things. Claims and unapproved change orders are by definition not yet approved by the client and these clients will often strongly oppose them, including by legal means. The auditor, Deloitte, underlines the subjective nature of the valuation of these assets: "These assessments require judgments concerning matters such as litigation developments and outcomes, the anticipated outcome of negotiations, the number of future claims and the cost of both pending and future claims."[3]

One might wonder why Tutor has so many disputes (and lawsuits) with its clients. Tutor's has been heavily criticized for its controversial commercial practices. A large number of sources, including reputable ones, have accused Tutor of bidding for projects at an unrealistically low level and then making up the difference with change orders. For example, The SFGate reported: "Tutor's bidding practices have drawn such scrutiny that at one point officials in Los Angeles and San Francisco both sought to bar the company from bidding.[4] In 2012, the non-profit news organization Bay Citizen conducted a survey on Tutor's history of overcosts: "History suggests that the transportation agency should proceed with caution: Collectively, 11 major Bay Area projects completed by the construction company since 2000 have cost local government $765 million more than expected, 40 percent above the initial bids, according to a review by The Bay Citizen."[5] A former San Francisco city contract compliance officer raised concerns about Tutor's work at San Francisco International Airport: "Tutor is doing the same thing that he has always done: He bids super low, but the project ends up costing a lot more in the end".[6]

In the industry, it is not uncommon for large projects to exceed budgets. Furthermore, when public agencies select a contractor, the determining factor is often the price, which encourages the practice of under-bidding. However, Tutor is a league of its own. We cannot find any listed company that has a history of such difficult relationships with clients, cost overruns and costly lawsuits. Some legal actions lasted more than twenty years. For example the Los Angeles Metropolitan Transportation

[3] AR 2015 F-20
[4] http://www.sfgate.com/bayarea/article/Low-bid-on-subway-station-could-cost-SF-3780385.php
[5] http://californiawatch.org/money-and-politics/front-runner-build-sf-subway-station-has-history-cost-overruns-17493
[6] http://californiawatch.org/money-and-politics/front-runner-build-sf-subway-station-has-history-cost-overruns-17493

Authority lawsuit started in 1995 and has been resolved only recently, 20 years later. These disputes consume a large amount of time and resources for the company, distracting it from its business. We believe that Tutor is now unable to fight all these disputes, when the company's financial situation has weakened and banks are actively reducing their exposure.

3. Other unbilled costs and profits ($201m)

For the third category ("Unbilled costs and profits"), revenue has been recognized in accordance with the percentage-of-completion accounting method, but for contractual reasons the portion of revenue recorded cannot yet be billed. As opposed to unapproved change orders and claims, the profit portion is recognized for other unbilled costs and profits.

With Tutor's peers, the unbilled category is mostly made of other unbilled costs and profits, not claims or unapproved change orders. The latter are much more problematic because they require the approval of the client or the resolution of a dispute.

Tutor pointed out that in 2016 its unbilled has started to decline. Tutor benefited from the resolution of $64m change orders that were approved by the California Rail Authority in June 2016. Tutor could not begin work because the state failed to deliver land parcels.[7] The company mobilized equipment and personnel. This was a straightforward situation. We expect other unapproved change orders and claims to be much more difficult to recover, as we explain below. The "unbilled costs and profits" category also fell by $26m. They do not require the client's approval to be billed, and are not the key issue for Tutor.

3. An Historical Analysis Raises Strong Doubts over the Recoverability of the Unbilled

> *"So we have a reputation to uphold with our owners, if any of them are listening, that you pay us what you owe us or we do it the hard way."*
>
> Ronald Tutor, Chairman and CEO, Conference Call third quarter 2016

Investors are not provided with any granular information on the counterparties and amounts behind the unbilled. They are a black box. Tutor insists the problem will fix itself because it is simply a collection issue. Tutor's management set the objective of reducing the unbilled by $450m from the end of 2015 to the end of 2017. In three quarters, the company only achieved a reduction of $85m. We believe this was substantially helped by the resolution of a straightforward case with the California Rail Authority.

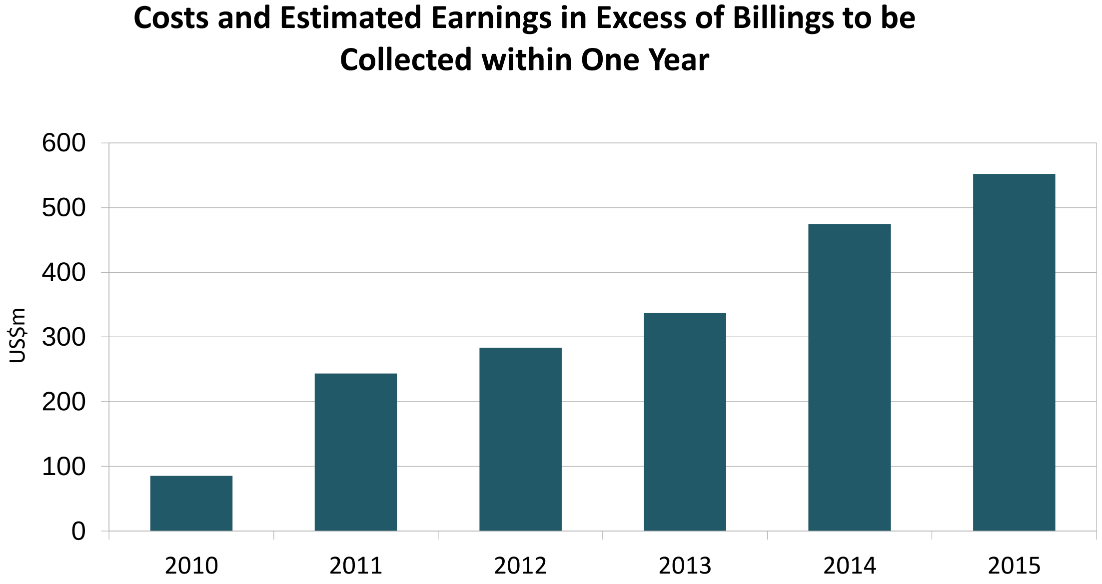
However, management has been repeating that they are focused on the resolution of their unbilled for years. Will Tutor ultimately manage to realize these assets? Are they overstated and by how much? If the unbilled had started to grow six months ago, it would probably be difficult to answer this question. However, the unbilled have been rising for years, and every year Tutor gave information on the proportion of unbilled the company expected to realize within one year. So we can go back in time and see how Tutor successfully converted these unbilled to cash.

For example in 2014, Tutor reports the amount of the unbilled that is expected to be converted beyond one year.

[7] http://www.constructiondive.com/news/ca-rail-authority-approves-63m-tutor-perini-change-order-extends-contract/421035/

"The amount of costs and estimated earnings in excess of billings at December 31, 2014 estimated by management to be collected beyond one year is approximately $251.3 million." [8]

From this, we can deduct the amount expected to be converted within one year.



As this chart shows, this amount has increased every year reaching substantial levels. For example, at the end of 2014, Tutor expected to realize $475m of unbilled within one year. This is a very large number, and we would have expected very healthy operating cash flow in 2015. This is obviously not what happened: Tutor recorded only $14m in OCF in 2015.

The very large gap between unbilled to be realized and operating cash flow repeated every year strongly suggests recoverability issues. Considering the sheer size of the unbilled, it is unlikely that Tutor realized these unbilled every year and booked hundreds of millions of new unbilled the same year. We believe Tutor rolled over a large portion of unbilled every year and is struggling to realize them.

4. Contingent Liabilities: Lawsuits Reveal how hard Clients Fight and that Tutor did not Record Necessary Legal Provisions

A reason why Tutor has been unable to collect these unbilled is that clients simply push back and come up with their own claims against Tutor. Tutor's lawsuits reflect these confrontations. Often, Tutor is counter-sued by its client for fraudulent change orders among other reasons. Tutor is both a plaintiff and a defendant. This gives rise to significant contingent liabilities. In the past, we found that Tutor had failed to book provisions for contingent liabilities that were likely to materialize, that did indeed materialize.

The auditor also underlines the difficulty to value contingent liabilities: "In addition, because most contingencies are resolved over long periods of time, liabilities may change in the future due to various factors."[9]

The CEO and Chairman, Ronald Tutor defended the legal track record of his company. For example, during the Q4 2015 conference call: "Well unfortunately ours is a business with a certain level of

[8] AR 2014 p. 57
[9] AR 2015 F-20

claims and litigation that you can never get away from, we have had a history of always winning with very few exceptions." However, this is a rosy depiction of reality. Tutor has been forced to settle to its disadvantage, has lost (see below for the Brightwater case), and often judgments recognized damages for both parties, not only in favor of Tutor.

The examples below show:
- How Tutor is counter-sued by its client, which creates significant contingent liabilities.
- Tutor has recorded insufficient legal provisions in the past even though it was quite clear that the company's legal position was very weak.
- Tutor does not report a lawsuit in its financial documentation even though the claims against the company appear significant.

Example 1: The Seattle Tunnel Case

The Seattle tunnel case is an illustration of the extraordinary degree of complexity of some legal cases. Tutor fights against parties that have much deeper financial resources.

Tutor is a 45% partner and the project manager in a joint venture "Seattle Tunnel Partners" ("STP") chosen by the Washington Seattle Department of Transport ("WSDOT") to construct a $1.4b tunnel in downtown Seattle.[10] The project is the biggest tunnel ever dug in North America. In December 2013, after only a few months of operation, the tunnel boring machine grounded to a halt. As it could not be repaired underground, a hole had to be dug and the tunneling machine was lifted out. SPT has filed a $480 million claim with the state to cover the cost of repairing and reinforcing the tunnel boring machine.[11] With a 45% share of the JV, this means $216m for Tutor.

All the parties are now blaming and suing each other in a case that involves not only the joint venture and its client, but the insurers, and the tunnel machine manufacturer (Hitachi). Tutor contends that the tunnel machine shut down because it hit an eight-inch steel pipe that the state failed to disclose to contractors. The state responded that this was "ridiculous."[12] The tunnel boring machine, a six-story high machine, could not be stopped by such a small pipe.

A judge recently ruled that by signing the contract, STP waived its right to recover money from damage to equipment, including the tunnel boring machine.[13] Although appeals are expected, the ruling in the state's favor is a milestone in the legal dispute, and definitely bad news for Tutor.

It is widely expected this case will last for years. The complexity of the case did not prevent Ronald Tutor from proclaiming his optimism at the end 2014: "I'm still more confident than ever that we will resolve all the issues during 2015 favorably for the joint venture."[14] This is obviously not what happened.

Tutor concluded that the potential for a material adverse financial impact due to the Insurer's and WSDOT's respective legal actions are "neither probable nor remote".[15] Tutor used very similar wording in the Brightwater case which it lost (see below).

[10] Q3 2016 p.15
[11] http://www.kiro7.com/news/local/as-seattle-tunnel-partners-seeks-480-million-for-berthas-breakdown-a-judge-deals-the-contractor-a/464074002
[12] http://www.npr.org/2016/07/22/487078932/seattles-bertha-tunnel-project-plagued-by-financial-woes
[13] http://www.kiro7.com/news/local/as-seattle-tunnel-partners-seeks-480-million-for-berthas-breakdown-a-judge-deals-the-contractor-a/464074002
[14] Conference call Q4 2014
[15] Q3 2016 p.15

Example 2: Tutor Perini vs the State of New York ("Long Island Expressway/Cross Island Parkway Matter")

This case shows how Tutor is counter-sued by a public client after claiming change orders, and finds itself accused of fraudulent practices.

Tutor was chosen by the State of New York to rebuild a $150m highway that was completed in 2004. Tutor sued the State of New York seeking damages of $53.8m in 2011 for unapproved change orders. The State of New York counter-sued Tutor for $151m accusing Tutor of failing to use disadvantaged business enterprise ("DBE") subcontractors for the project.[16]

The Court recently allowed the State of New York to depose Ronald Tutor to explore his knowledge of the fraudulent activities of former subordinate Zohrab Marashlian, the ex-President of Perini Corporation's civil division.[17] Perini Corporation is the previous name of Tutor Perini. In 2011, Mr. Marashlian was found guilty of fraud for using disadvantaged business enterprises as fronts when working at Perini Corporation, and conspiracy to launder money by a federal jury. He committed suicide before the sentencing. Perini Corporation had to pay $9.75m in a negotiated civil settlement to resolve its liability in this case. Since the statute of limitations had expired by the time the New York State asserted its fraud defenses and counterclaims, these defenses and counterclaims can only be used to offset Tutor's damages. The State of New York was allowed to inquire as to Mr. Tutor's knowledge of DBE fraud by Perini Corporation regarding not only the Long Island Expressway but also other projects.

Although Ronald Tutor is not personally sued in this case, it is worth noting that his company recently approved a change in its by-laws to offer better protection to its executives.[18] Previously, directors and officers were indemnified by the company against expenses incurred in proceedings in which they were involved. Under the amended by-laws, indemnification would cover all liabilities and expenses, including judgments, fines, penalties, settlement amounts and legal fees.

Example 3: The Brightwater Case

The Brightwater case shows how Tutor can use overly-optimistic assumptions, and booked insufficient legal provisions while its position was clearly weak.

A Tutor subsidiary was a 20% partner in a joint venture ("VPFK") to build the Brightwater sewage tunnel. In 2010, the client, the Department of Natural Resources of King County in the Washington State, filed a lawsuit against the joint-venture for failure to complete specified components of the project. The joint-venture counter-sued for additional costs incurred as a result of differing site conditions, defective specifications, damages sustained on the boring machine, etc.[19]

In December 2012 a jury issued a verdict favoring King county: King County was granted $155.8m while VPFK was granted only $26.3m. The JV appealed, but ended up paying the full verdict amount to terminate interest on the judgment. Tutor had to pay its 20% share of the judgment that we estimated to be $28.9m.

Although the JV had just lost the first trial and already paid the verdict amount, Tutor only recorded a $5m provision and justified: "Management determined that there was no estimate within the range of possible outcomes that was more probable than the other and recorded a liability at the low end of the

[16] http://vertumnus.courts.state.ny.us/claims/html/2016-015-117.html#NFLAG_2_
[17] http://vertumnus.courts.state.ny.us/claims/html/2016-015-117.html#NFLAG_2_
[18] Proxy Statement p.46
[19] AR 2015 F-22

range."[20] This $5m is the only case we have found in recent annual reports where Tutor booked a charge to income for a lawsuit.

In 2015, the court of Appeals of the State of Washington confirmed the initial judgment. This time, Tutor had to record a charge of $23.9m in the third quarter of 2015 which triggered a covenant breach. It is quite clear that from the beginning, Tutor should have recorded bigger provisions for contingent liabilities that were likely to materialize. The first adverse judgment clearly indicated that Tutor was in a legally weak position.

Noteworthy, the Seattle legal firm that handled the Brightwater case for King County is handling the Seattle Tunnel case for WSDOT.[21]

Example 4: The Los Angeles Airport (LAX) Case

Tutor does not give any information in its annual report on a lawsuit where the company may have substantial contingent liabilities.

Tutor formed a joint venture with O&G Industries to build the Los Angeles airport runaway. The project was completed in 2007 for a cost of $250m. Six year later defects were discovered including cracks, exposed steel reinforcing bars and deteriorating concrete.[22] The City of Los Angeles accused the contractors of using a defective mixture that eroded quickly. The City said it will be forced to prematurely reconstruct the runway and sued the contractors seeking unspecified damages.

The annual report does not mention this lawsuit. We did not have access to information on the damages claimed by the City of Los Angeles. Given the size of the contract ($250m) and how serious the accusations are, we believe Tutor should clarify the status of this lawsuit in its annual report.

5. High level of Retainage Suggests Future Trouble with Clients

Tutor's issues are not restricted to its unbilled or contingent liabilities. There are reasons to believe that Tutor will have trouble from another part of its balance sheet: retainage that reached $542m as of September 2016.

Retainage is the portion of the contract price deliberately withheld by the client until the work is substantially complete to assure that the contractor will satisfy its obligations and complete a construction project."[23] Retainage can be a fixed percentage (for example, 5% or 10%) of each billing.[24]

In some contracts, the client has the option to retain this percentage of the billing if the level of cooperation with its contractor is not satisfactory; for example, when the contractor does not respect milestones, or when the client fights change orders. Retainage is not supposed to be a punitive instrument but in practice, it does allow clients to put some pressure on their contractors in the case of conflicts.

Retainage is classified under the receivables group and accounts for 32% of overall receivables. Not all peers report their retainage numbers; however, we found that this percentage was higher than those reported by peers Granite and AECOM who reported 19% retainage. The higher retainage partly

[20] AR 2013 p.94
[21] http://www.seattletimes.com/seattle-news/transportation/king-county-prevails-in-fight-over-brightwater-tunnel-costs/
[22] http://articles.latimes.com/2013/oct/17/local/la-me-cracking-lax-runway-20131018
[23] https://en.wikipedia.org/wiki/Retainage
[24] AR 2013 page 42

explains why Tutor's Days Sales Outstanding (DSO) is much higher than its peers (DSO of 126 days against 33 days and 76 days for Fluor and Granite respectively in Q3 2016).

Retainage can also be found on the liabilities side for contracts between Tutor and its subcontractors. Strikingly, retainage on the asset side is $296m higher than on the liability side ($246m). We would have expected the opposite because sub-contractors hired by Tutor are smaller companies and typically higher retainage would be expected of them.

This suggests:
(1) Clients are taking a much more cautious approach with Tutor Perini due to its reputation for change orders/claims.
(2) And/or Tutor is already in dispute with its clients, for example on change orders/claims. In this case, it will be even more difficult for Tutor to collect unbilled if the client puts pressure on them with retainage.

6. Strong skepticism on the feasibility of Trump's infrastructure plan

Tutor's stock rose by 47% since the announcement of Donald Trump's victory in the 2018 presidential election. Tutor's peers also surged. The President-elect announced he would launch a $1 trillion infrastructure plan over a period of ten years ($100b per year). In his victory speech, he promised to "rebuild our highways, bridges, tunnels, airports, schools, hospitals." As infrastructure work currently accounts for $150b annually, this would mean an increase of 60% in infrastructure spending.[25]

The details of this plan remain sketchy, but there is already strong skepticism about the feasibility of this program. The proposal relies entirely on private financing. The federal government would only provide $137 billion of tax credits to lure private investors. The problem is that private firms are only interested in the type of infrastructures that offer a guaranteed revenue stream to make them profitable. Only a few projects meet the conditions needed to make them work.[26] Maintenance work or infrastructures in low-income areas, for example, are unlikely to attract them. One might wonder if the more profitable projects would have been built anyway, regardless of tax breaks.

A few Republicans have already thrown cold water onto Trumps' plan. For example, Senate Majority Leader McConnell said it was not a top priority.[27] A similar Obama administration proposal to use new revenue from a corporate tax overhaul was rejected by Congress last year.[28] The duration of the plan is ten years, while the president is only elected for four years. This raises obvious questions on how the Trump administration will deliver on its promise. The benefits of an infrastructure program can be seen only in the long term, which makes it a tough sell for the politicians responsible for approving the program.

Finally, there is already a shortage of qualified workers in the United States. Two thirds of construction contractors report having a hard time finding skilled workers, according to a survey by the Associated General Contractors, a trade group.[29]

In conclusion, we believe that beyond the political rhetoric, Trump's infrastructure plan will be much smaller than what has been announced and will take time to manifest. We expect the stock price of Tutor and its peers to lose momentum once investors realize the caveats of such a program.

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[25] http://www.wsj.com/articles/donald-trumps-plans-fire-up-builders-1478720481
[26] http://www.chicagotribune.com/news/nationworld/politics/ct-donald-trump-infrastructure-spending-20161111-story.html
[27] http://www.npr.org/2016/11/09/501451368/here-is-what-donald-trump-wants-to-do-in-his-first-100-days
[28] http://www.wsj.com/articles/donald-trumps-infrastructure-plan-faces-speed-bumps-1478884989
[29] http://www.cnbc.com/2016/11/11/trump-infrastructure-plan-may-have-a-hard-time-finding-workers.html

7. Banks Have Been Actively Reducing their Exposure to Tutor

Poor cash flow generation over the past years has led to a debt of $793m. Tutor has $171m of unrestricted cash on its balance sheet but only $84m for its own use. The rest is held at the joint-venture level and is not controlled by Tutor. We conservatively included cash at joint-venture level in our net debt calculation.

Due to poor cash flow generation, Tutor's balance sheet is significantly more leveraged than its peers. Net leverage (net debt/LTM EBITDA) reached 2.8x in Q3 2016 against 0.6x for Granite.[30] Fluor does not have net debt. Importantly, unlike OCF, EBITDA is a non-cash financial indicator. We believe it is less reliable than OCF in the case of Tutor.

Credit agencies have noted that the credit profile of Tutor is weak for its rating, and both Moody's and S&P have changed the outlook to negative.

The banks have been reducing their exposure by $146m from $378m at the end of 2015 to $232m in Q3 2016. This is concerning as they often have more knowledge of the financial situation than other stakeholders. For example, banks have access to the list of lawsuits that Tutor is involved in.[31] In February and June 2016, the consolidated leverage ratio covenant and the consolidated fixed charge coverage ratio covenant were breached. The company had to request two bank waivers. The banks did not only waive the covenants or increase their margins. They have actively reduced their exposure to Tutor, tightened their security package and monitored Tutor's cash flow. In particular:

- Tutor has to hold a weekly conference call on cash flow forecast and variance upon request by agent Bank of America.[32]
- The banks consented to the raising of an unsecured $200m convertible bond in June, due in 2021 provided Tutor applied a large share of the proceeds to bank repayment ($69m for the revolver and $125 for the term loan).[33]
- The banks consented to the sale of subsidiary provided $20m from the sale proceeds is applied to the term loan. The sale was supposed to be completed before September 1st but no announcement has been made by Tutor.[34]
- Tutor is required to achieve certain quarterly cash collection milestones to apply to the term loan balloon repayment.[35]

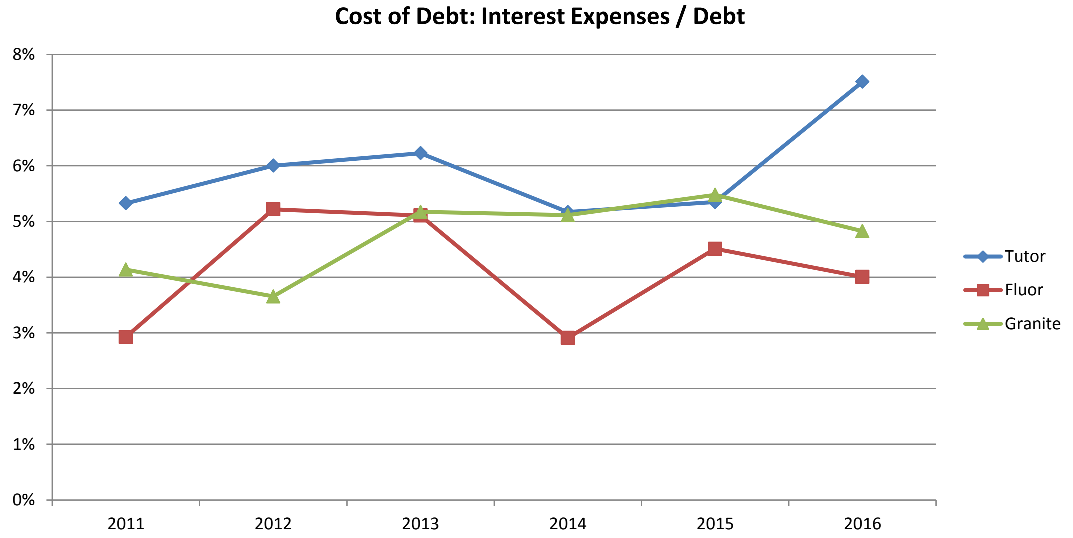
Meanwhile, the banks have tightened their collateral: they were already secured on all properties and added the equity interests of each direct domestic subsidiary.[36] In contrast, bond holders are completely unsecured.

Recently, Tutor wanted to raise $500m notes due 2024 to redeem the 7.625% notes due 2018 and pay off the existing term loan and revolver. Tutor had to withdraw and postpone the offering as the pricing was too high. The company blamed concerns over unbilled and market uncertainty due to presidential elections.

As a result, Tutor will continue to pay high interest expenses. The banks have increased margins after they waived the covenants. This has led to an increase in interest expenses in 2016. Tutor expects interest expenses for 2016 to be approximately $59m, up from $44m in 2015 (+34%).[37] Tutor's cost

[30] Source: Bloomberg for EBITDA numbers
[31] Credit Agreement 3 June 2014 – page vi
[32] Waiver and Amendment No. 1, entered into on February 26, 2016 p. 9.
[33] Consent and Amendment No. 2, entered into on June 8, 2016 p.7 ("Amendment No. 2")
[34] Consent and Amendment No. 2, entered into on June 8, 2016 p.6 ("Amendment No. 2")
[35] Waiver and Amendment No. 1, entered into on February 26, 2016 p.6
[36] Q2 2016 p. 35
[37] Conference call Q3 2016

of debt is now much higher than its peers. Going forward, higher interest expenses will negatively affect Tutor's performance.



8. Poor Governance ignores Tutor's shareholders

> *"This company has a systemic disconnect between pay and performance, and we hope going forward that investors hold the board accountable,"*

Mike McCauley, Senior Investment Officer at the Florida State Board of Administration.[38]

Governance of Tutor is particularly poor, especially for a company listed in the US. We generally see these problems in emerging countries.

Despite negative operating cash flow of $57m in 2014, CEO Ronald Tutor received not less than $25m that year. This made him the best paid CEO in the construction industry and the 39th best paid CEO among publicly-held companies valued at $1 billion or more.[39] In 2015, the remuneration was down to a more decent "realizable" $6.4m. The company underlined: "The Company retained Mr. Tutor's extraordinary leadership and management capabilities, which are important to the Company."[40]

This remuneration policy has naturally attracted criticism from its stakeholders. The Wall Street Journal reported that the executive compensation policy had been rejected every year since 2011.[41] In 2016 it was rejected by 54% of votes.

However, as the company puts it: "This proposal is advisory in nature, which means that the vote is not binding upon the Company."[42] It is approved by the Compensation Committee. The three directors of this committee are D. Snyder, P. Arkley and M. Klein. They have been "independent" directors for an average of 14.3 years. After such a long period, we consider these directors are de facto employees. Mr. Arkley is an independent director but the annual report mentions that Tutor conducts business

[38] http://blogs.wsj.com/cfo/2015/05/27/tutor-perini-fails-say-on-pay-for-fifth-straight-year/
[39] www.constructiondive.com/news/4-construction-heads-listed-among-200-best-compensated-ceos/399638/
[40] Proxy Statement p.26
[41] http://blogs.wsj.com/cfo/2015/05/27/Tutor-perini-fails-say-on-pay-for-fifth-straight-year/
[42] Proxy Statement p.3

with his employer Alliant for various insurance related business. Tutor paid Alliant $9.8 million in 2015.[43]

The reelection of the three directors of the Compensation Committee faced strong resistance in the May 2016 AGM.

	Votes For	Votes Withheld
Peter Arkley	23,673,379	20,022,004
Michael R. Klein	23,528,823	20,166,560
Donald D. Snyder	22,614,532	21,080,851

Ironically, Tutor Perini insists they listen to their shareholders: “Since 2012, we have conducted an ongoing shareholder outreach program to maintain an open and regular dialogue with certain of our large shareholders to understand their views regarding our executive compensation program.”[44] The company recognizes that its salaries are higher than in other public listed companies but claims they are lower than in privately held firms. We cannot check this fact on which we have doubts, in any case it is irrelevant: Tutor is a public company with minority shareholders, not a private company controlled by one family.

Despite the disappointing performance, replacing Ronald Tutor would be particularly costly for a company already dealing with poor cash flow generation. Ronald Tutor will receive $20.6m if dismissed. He can terminate his employment and receive the same amount if there is any adverse change in his titles, or material diminution of his authority, responsibilities or duties.[45] Similarly, the company will have to pay him $26.3m if there is a change in control.

It is worth noting that Mr. Tutor has pledged 46% of its shares as collateral for loans,[46] which obviously does not create any incentive to recognize impairments at Tutor Perini.

Finally, Tutor is audited by Deloitte. The auditor has remained the same for the past 15 years. It was hired by Tutor after the previous auditor, Arthur Andersen, sank in the Enron scandal. Serving a client for such a long time often creates a risk of complacency.

9. Valuation

Tutor trades at a high P/E of 19.5 considering the fact it has hardly generated any operating cash flows since 2011 and has not paid dividends since 2010. It is not permitted to pay dividends under its bank documentation. Tutor also has a large goodwill of $585m, which we think should require heavy impairments in light of the company's poor cash performance.

We showed that there are strong doubts over the valuations of the unbilled and that Tutor is definitely more vulnerable than competitors to the realization of contingent liabilities due to its very large number of disputes.

We believe that operating cash flows, rather than net profit, is a much more reliable measure of Tutor’s true performance. We use Tutor’s OCF numbers since 2014 (average of $18.8m) and apply the peers’ current average P/E for Fluor and Granite (39.8). This is very conservative as their PE is extremely high currently. We find a valuation of $746m, which is around 55% below current market price. Our target price is $13.

[43] AR 2015 F-33
[44] Proxy Statement p.17
[45] Proxy Statement p.36
[46] Proxy Statement p.42

This conservatively assumes that Tutor retains its ability to bid on large projects despite its weakening financial position.

10. Conclusion

Based on our analysis of cash flow and unbilled, we strongly doubt that Tutor will be able to materially improve its cash flow generation on a sustainable basis. The assumption that unbilled can be easily realized ignores two basic problems:

- Clients do not want to pay for them. Due to higher budget constraints, these clients push back much more than in the past. They often have deeper financial resources than Tutor and can fight these change orders or claims for years.
- Tutor may be counter-sued by its clients and faces significant contingent liabilities.

We believe the market underestimates how structural these issues are, in particular, the risk of adverse legal decision that could force the company to recognize heavy losses.

High retainage also suggests more confrontations with clients and potential future payment disputes.

This leaves the company with net debt of $622m when banks are clearly reducing their exposure as much as they can. Interest expenses will plague Tutor’s profitability compared to its peers. Shareholders are not even allowed to reject management’s remuneration practices, which could bring operating costs down.

The sketchy infrastructure plan announced by President-elect Trump will likely be much smaller than anticipated. Investors presently are overlooking the fact that financing relies entirely on the private sector, rather than public funding. If the federal government is forced to substitute for private firms, we would expect a Republican Congress to resist large scale spending on infrastructure.

Going forward Tutor may be engaged in a vicious cycle: its declining financial strength may prevent the company from bidding on some contracts or force the company to lower its prices even more aggressively.

We believe that Tutor will be forced to recognize heavy impairments in its unbilled, and the realization of contingent liabilities may result in additional losses. This may lead to credit rating downgrades for a company already under negative outlook. Our target price for Tutor’s stock is $13 per share (55% downside).