STANDARD & POOR'S RATINGS SERVICES
McGRAW HILL FINANCIAL

Research

Summary:
Strabag SE

Primary Credit Analyst:
Renato Panichi, Milan (39) 02-72111-215; renato.panichi@standardandpoors.com

Secondary Contact:
Alexandra Balod, London (44) 20-7176-3891; alexandra.balod@standardandpoors.com

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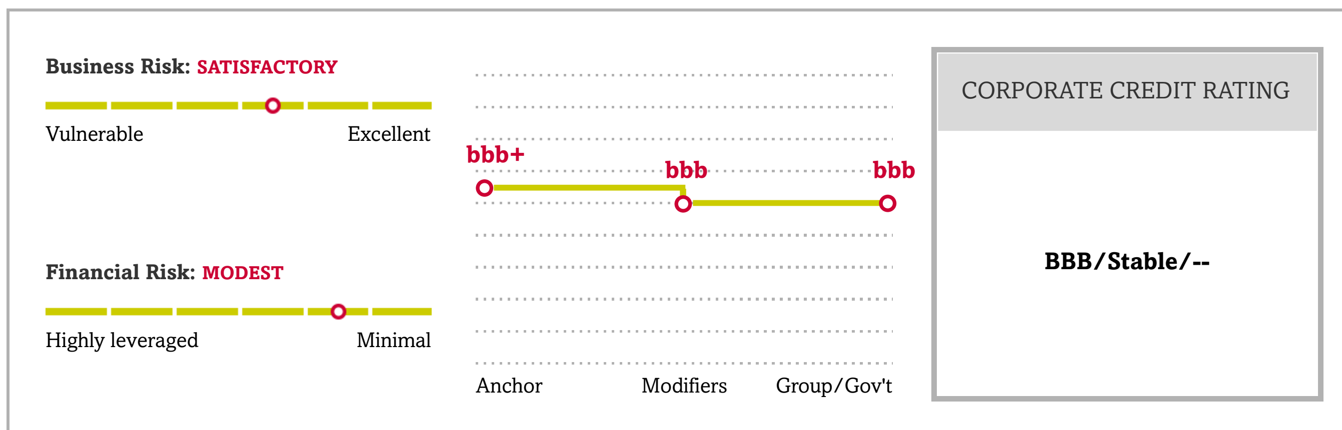
Summary:
Strabag SE



Rationale

Business Risk

- Leading market positions in construction markets in Central Europe and some parts of Eastern Europe.
- Vertical integration, which provides barriers to entry and strategic access to raw materials.
- Track record of largely stable operating margins, which indicates generally good project execution and cost management.
- Cyclical and competitive industry that is inherently exposed to project risk.
- Relatively low adjusted EBITDA margin of 5.0%-6.5% historically, which is below the industry average.

Financial Risk

- Relatively low adjusted debt, translating into strong core credit ratios for the financial risk profile assessment.
- Strong liquidity position.
- Volatile free cash flow generation, with sizable seasonal swings in working capital.
- A more conservative financial policy than in the past.

Outlook

The stable outlook on Austria-based construction group Strabag SE reflects Standard & Poor's Ratings Services' view that the company will post an adjusted EBITDA margin of about 6% in 2015 and 2016. We think that Strabag currently has some headroom in its leverage metrics to absorb some expansionary investments in working capital, capital expenditures (capex), and selected bolt-on or midsize acquisitions. We expect Strabag's Standard & Poor's ratio of adjusted funds from operations (FFO) to debt will exceed 45%, with debt to EBITDA remaining below 2x and continued strong liquidity over the next few years.

Downside scenario

We could consider a negative rating action if Strabag's debt-to-EBITDA ratio rises to more than 2x and FFO to debt drops to less than 45% over a sustained period of time. We believe that there is significant room for a potential

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weakening of operating performance at the current rating level. However, a weaker operating performance and higher working capital needs could result in weaker leverage metrics and put pressure on the ratings. Downside pressure on the ratings may also arise from high debt, owing, for instance, to sizable acquisitions or increased shareholder returns.

Upside scenario

We could raise the ratings if we observed a track record of consistently positive discretionary cash flows, while at the same time FFO to debt and debt to EBITDA were more than 60% and less than 1.5x, respectively. We note that Strabag's financial metrics within the year are generally significantly weaker, mainly reflecting seasonal working capital requirements. We could also raise the ratings if the company's operating performance improves significantly, leading to much stronger profitability metrics.

Standard & Poor's Base-Case Scenario

Assumptions

- Volume growth in the 2%-4% range in 2015 and 2016. We expect the company's sizable order backlog, which provides good short-term visibility over activity levels, will back volume growth. We also expect some growth in Strabag's international business and property and facility services.
- Operating margins should benefit from past restructuring and Strabag's risk management program, which should compensate the negative impact from continued intense pricing pressure.
- Capex of about 3.0%-3.5% of sales between 2015 and 2017, coupled with working capital investments, partly shaped by a reversal of advance payment trends.
- About €50 million-€100 million for bolt-on acquisitions annually.

Key Metrics

	2014a	2015e	2016e
EBITDA margin (%)*	6.5	5.5-6.5	5.5-6.5
FFO/debt (%)*	123.7	>60%	>60%
Debt/EBITDA (x)*	0.6	<1.5	<1.5

a--Actual. e--Estimate. *Data represent year-end figures when Strabag's net working capital position is at the lowest level of the year. Figures include several adjustments. See also the reconciliation table below.

Business Risk

The major factors supporting Strabag's "satisfactory" business risk profile remain the company's leading market positions in Central and Eastern Europe's engineering and construction markets.

Strabag's good order backlog, usually covering about one year of earnings, provides decent forward visibility. We also consider the company's cost base to be relatively flexible, which underpins its credit profile.

We assess as positive Strabag's generally effective risk management and low volatility in profitability metrics over the past few years. At the same time, profitability, although likely to improve somewhat over the next few years, is still below the industry average. This reflects the competitive landscape of the industry in countries and segments where

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the company operates. That said, the company's strengthening of risk management systems and streamlining of parts of the organization under the task force 2013ff program could result in operational improvements.

The industry's above-average risk profile constrains the group's business risk profile. Fixed-cost contract pricing and the potential of misjudging project expenses or timing can lead to cost overruns, which are usually the liability of the contractor. In civil engineering, competitive tenders and large projects with low insight in terms of contract risk and performance heighten operating risk.

Financial Risk

Strabag's "modest" financial risk profile reflects the company's strong balance-sheet structure, with strong core credit metrics for the modest category. We expect Strabag will maintain careful control over its debt because inherent industry risk can lead to significant deterioration in metrics in a relatively short period.

Our assessment of Strabag's financial risk profile incorporates our view that the company has strong liquidity and good financial flexibility. We regard this as a positive rating factor. Strabag's demonstrated ability to obtain progress payments from customers, which generates working-capital resources, further supports our assessment.

Strabag has a track record of expansionary spending and debt-financed acquisitions, which have frequently resulted in negative free operating cash flow (FOCF) after acquisitions. However, the company has adopted a more conservative financial policy in past couple of years.

As is typical in the engineering and construction industry, Strabag has substantial seasonal working capital swings over the year, which can amount to up to €500 million in the first three quarters.

We do not include on- and off-balance-sheet nonrecourse debt relating to public-private partnership investments in any of our adjusted leverage ratios. This is because we do not expect Strabag will provide financial support to these concessions in case of need.

Liquidity

We consider Strabag's liquidity to be "strong" under our criteria. We estimate that liquidity sources will exceed needs comfortably by more than 1.5x in 2015 and 2016.

Principal Liquidity Sources

- About €1.9 billion in cash (net of €20 million we consider to be tied to subsidiary AKA) on March 31, 2015.
- Access to a fully undrawn €400 million syndicated loan facility maturing in June 2019.
- #Annual cash FFO generation of €550 million-€650 million.

Principal Liquidity Uses

- Short-term maturities of €447 million by the end of March 2015, but we note that a large proportion relates to bilateral bank lines that we expect Strabag will roll over.
- Capital spending of about €400 million per year over the next two years.
- Significant cash outflows related to seasonal working needs--due to the nature of the business--of about €500 million

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by the end of the third quarter, when debt generally peaks.

- Bolt-on acquisitions of about €50 million-€150 million annually for the next few years.
- Dividends of about €60 million-€80 million annually.

Other Credit Considerations

We believe Strabag's business risk profile is weaker than some peers we assess as having "satisfactory" business risk, reflecting its comparatively low geographic diversification and profitability. Consequently, our comparable ratings analysis modifier for Strabag is negative.

Ratings Score Snapshot

Corporate Credit Rating

BBB/Stable/--

Business risk: Satisfactory

- **Country risk:** Low
- **Industry risk:** Moderately high
- **Competitive position:** Satisfactory

Financial risk: Modest

- **Cash flow/Leverage:** Modest

Anchor: bbb+

Modifiers

- **Diversification/Portfolio effect:** Neutral (no impact)
- **Capital structure:** Neutral (no impact)
- **Financial policy:** Neutral (no impact)
- **Liquidity:** Strong (no impact)
- **Management and governance:** Satisfactory (no impact)
- **Comparable rating analysis:** Negative (-1 notch)

Related Criteria And Research

- Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Key Credit Factors For The Engineering And Construction Industry, Nov. 19, 2013
- Corporate Methodology, Nov. 19, 2013
- Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- 2008 Corporate Criteria: Rating Each Issue, April 15, 2008

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Business And Financial Risk Matrix

Business Risk Profile	Financial Risk Profile					
	Minimal	**Modest**	Intermediate	Significant	Aggressive	Highly leveraged
Excellent	aaa/aa+	aa	a+/a	a-	bbb	bbb-/bb+
Strong	aa/aa-	a+/a	a-/bbb+	bbb	bb+	bb
Satisfactory	a/a-	**bbb+**	bbb/bbb-	bbb-/bb+	bb	b+
Fair	bbb/bbb-	bbb-	bb+	bb	bb-	b
Weak	bb+	bb+	bb	bb-	b+	b/b-
Vulnerable	bb-	bb-	bb-/b+	b+	b	b-

Additional Contact:
Industrial Ratings Europe; Corporate_Admin_London@standardandpoors.com

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