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Strabag SE

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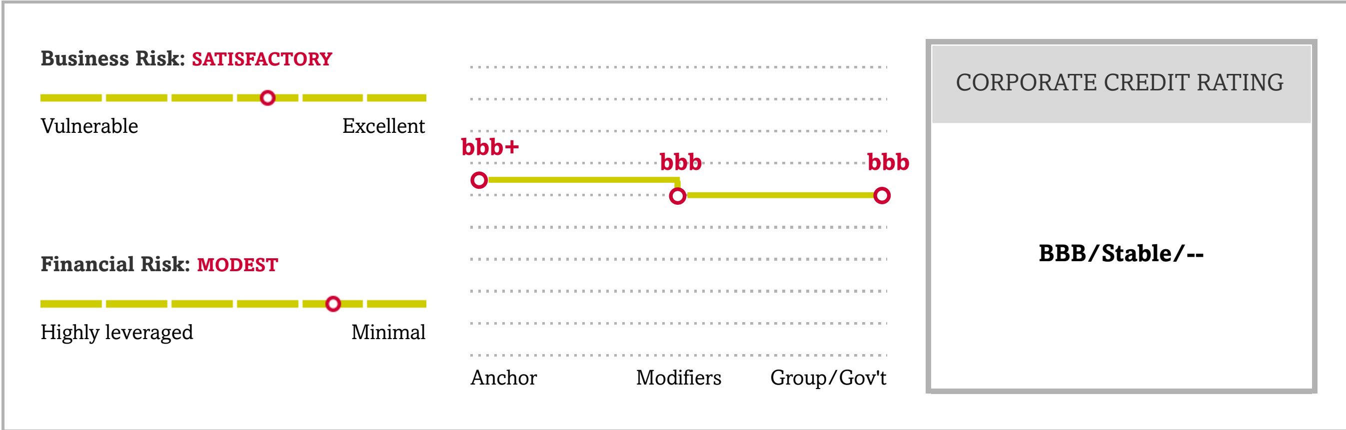


Rationale

Business Risk: Satisfactory	Financial Risk: Modest
• Leading positions in construction markets in Central Europe and some parts of Eastern Europe. • Renewed infrastructure spending in Germany and Central and Eastern Europe (CEE), which improves volumes. • Vertical integration that provides barriers to entry and strategic access to raw materials. • A track record of largely stable operating margins, which indicates generally good project execution and cost management. • A cyclical and competitive industry that is inherently exposed to project risk. • Lower, but less volatile, adjusted EBITDA margins than the industry average.	• High standing in the credit markets and solid perceived financial stability, underpinned by a reported net cash position. • Nil S&P Global Ratings-adjusted debt in 2017, mainly driven by exceptionally favorable working capital trend that we expect to revert in 2018-2019. • Sustained capital expenditure (capex). • Volatile free cash flow generation during the year, with sizable seasonal swings in working capital. • Strong liquidity.

Outlook: Stable

The stable outlook on Austria-based construction group Strabag SE reflects S&P Global Ratings' view that the company will post an adjusted EBITDA margin of around 6%-7% in 2018 and 2019. We think that Strabag has some headroom in its leverage metrics to absorb some expansionary investments and selected bolt-on acquisitions. Furthermore, we believe that financial metrics have headroom to absorb in 2018-2019 a likely reversal of the exceptionally favourable working capital trend that boosted the company gross cash in 2017. We expect our adjusted ratio of funds from operations (FFO) to debt for Strabag will comfortably exceed 45%, with adjusted debt to EBITDA remaining below 2x and continued strong liquidity over the next two 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 room for potential weakening of credit metrics at the current rating level. However, a meaningfully weaker operating performance and materially adverse trend in working capital needs could constrain the ratings. Rating pressure may also arise from markedly high debt, owing, for instance, to sizable acquisitions or increased shareholder returns that are not reflected in our base-case scenario.

Upside scenario

We could raise the ratings if we observed a track record of materially 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 during the year are generally significantly weaker, mainly reflecting seasonal working capital requirements. At the same time, the company's discretionary cash flow will likely be fairly weak over the next few years.

Our Base-Case Scenario

Assumptions

- We expect real GDP in Germany to grow by 2.0% in 2018 and 1.9% in 2019; in Austria by 2.6% in 2018 and 2.0% in 2019; and in CEE by 3.7% in 2018 and 3.2% in 2019.
- The German building construction and civil engineering business, fueled by renewed infrastructure spendinglikely to contribute positively to Strabag's output volumes, well in excess of GPD growth.
- Strabag's first-quarter 2018 order backlog generates revenues equivalent to about 1.3x of total revenues at year-end 2017, which should underpin revenue generation in 2018 at 3%-5%.
- Operating margins likely to remain stable in the next few years, with an EBITDA margin between 6% and 7% and an EBIT margin at around 3%.
- A reversal of the positive working capital trend seen in 2017, and still-sustained capex, at around 3.5%-4.0% of sales, which will result in negative free operating cash flow (FOCF) in 2018-2019 before improving gradually thereafter.
- We forecast that S&P Global Ratings-adjusted debt to remain nil in 2018 and 2019.
- We anticipate about €100 million for bolt-on acquisitions annually over the next few years.

Key Metrics

	2017A	2018E	2019E
EBITDA margin (%)*	7	6-7	6-7
FFO to debt (%)*	N.M.	Above 60	Above 60
Debt to EBITDA (x)*	0	Below 1.5	Below 1.5

Note: All figures are fully adjusted by S&P Global Ratings.

A--Actual. E—Estimate. N.M.--Not meaningful.

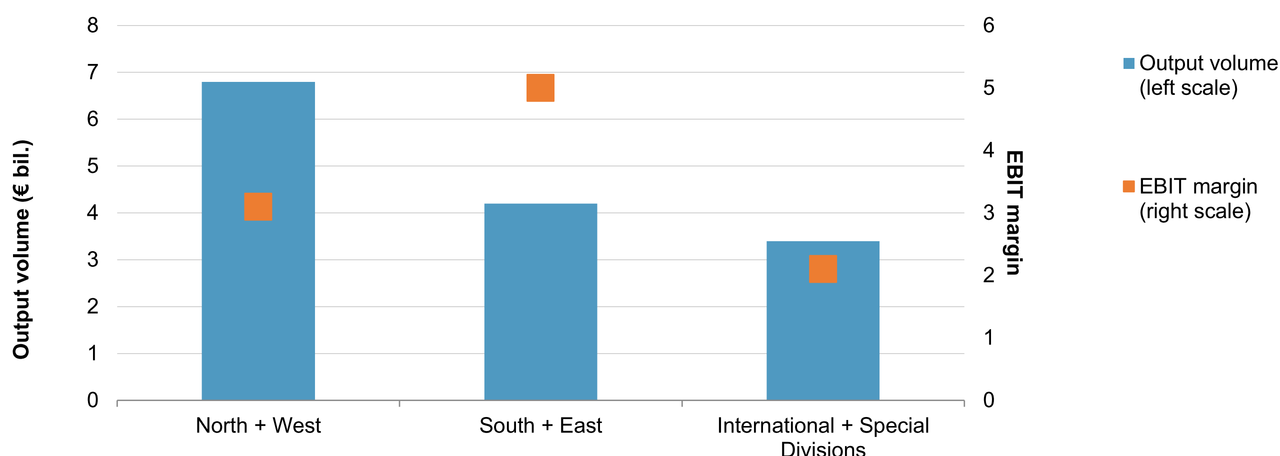
Company Description

With annual output of about €14.6 billion in 2017, Strabag is one of Europe's largest construction groups. It reports on the following three segments:

- North and West (47% of 2017 output volume with an EBIT margin of 3.1%), mainly including Germany, Poland, Belgium, the Netherlands, Luxembourg, and Scandinavia, and the Ground and Hydraulic Engineering segment;
- South and East (29% of 2017 output volume with an EBIT margin of 5%), mainly including Austria, Switzerland, the Czech Republic, Slovakia, Hungary, southeastern Europe, Russia, and neighboring countries, and the Environmental Engineering segment; and
- International and Special Divisions (24% of 2017 output volume with an EBIT margin of 2.1%), comprising International, Tunneling, Construction Materials (except asphalt), Property & Facility Services, Real Estate, and Infrastructure Development (concessions).

Chart 1

2017 Output Volume And EBIT Margin By Business Segment



Source: S&P Global Ratings.

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We think the company's medium-term strategy will continue to focus on increasing margins by implementing cost efficiency improvements and through the strengthening of risk management policies. We also expect Strabag will continue to focus on both organic and inorganic growth opportunities, although we understand management does not see many opportunities outside Europe that meet the group's requirements in terms of risk management and profitability; therefore, the company will continue to focus mainly on existing markets.

Strabag is publicly listed with a free float of 13.5%. Its core shareholders are Raiffeisen/UNIQA (27.5%), the Haselsteiner family (26.4%), and Rasperia Trading Ltd. (25.9%). Rasperia is a subsidiary of Basic Element Holding, which is owned by Russian businessman Mr. Oleg Deripaska. The remaining 6.7% are treasury shares.

Business Risk: Satisfactory

Strabag benefits from leading market positions in the CEE's engineering and construction markets. Strabag's good order backlog, usually covering about one year of earnings, provides good visibility, although it is smaller than some peers' mainly reflecting the lower average size of projects. 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 lower volatility in profitability metrics than the industry average over the past few years. At the same time, profitability is a bit below the industry average. This reflects the competitive landscape in countries and segments where the company operates, but also that Strabag's projects are less risky than those in emerging markets. That said, the company's strengthening of risk management systems and streamlining of parts of the organization under the task force 2013ff program have fueled operational improvements. The reported EBIT margin was 3.3% in 2017, as in 2016, up from 2.6% in 2015. Strabag aims to

continue posting EBIT margins exceeding 3% in 2018.

The industry's above-average risk constrains the group's business risk profile. Fixed-cost contract pricing and the potential for 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 into contract risk and performance heighten operating risk.

Peer comparison

Our peer analysis includes construction companies ACS, the largest construction company in Europe, and Vinci S.A., a diversified infrastructure company with a significant portion of revenues from more stable concession businesses. Ferrovial S.A., in addition to its construction business, has exposure to the services sector, which is less cyclical, and owns significant concession assets in Europe and North America. Salini Impreglio SpA is a midsize construction company mainly focused on infrastructure construction contracts, with a substantial presence in the U.S. and high-risk countries.

Table 1

Strabag SE -- Peer Comparison

Industry Sector: Engineering & Construction

	Strabag SE	ACS, Actividades de Construccion y Servicios SA	Ferrovial S.A.	Salini Impregilo SpA	VINCI S.A.
Rating as of July 9, 2018	BBB/Stable/--	BBB/Stable/A-2	BBB/Stable/A-2	BB/Stable/--	A-/Positive/A-2
	--Fiscal year ended Dec. 31, 2017--				
(Mil. €)					
Revenues	13,508.7	34,898.2	11,757.0	6,107.2	40,448.0
EBITDA	945.9	2,466.7	1,295.0	616.7	7,205.5
Funds from operations (FFO)	836.3	1,773.1	1,205.2	468.5	5,001.8
Net income from cont. oper.	278.9	802.0	454.0	(105.0)	2,747.0
Cash flow from operations	1,295.6	1,684.7	1,149.2	(139.2)	4,555.8
Capital expenditures	457.6	621.5	178.0	171.3	1,834.0
Free operating cash flow	837.9	1,063.2	971.2	(310.5)	2,721.8
Discretionary cash flow	737.2	766.0	402.2	(370.0)	1,473.8
Cash and short-term investments	2,769.3	6,609.8	4,138.0	1,320.2	6,807.0
Debt	0.0	5,434.7	135.7	1,919.2	17,761.5
Equity	3,397.7	5,164.0	1,340.5	1,085.3	18,383.0
Adjusted ratios					
EBITDA margin (%)	7.0	7.1	11.0	10.1	17.8
Return on capital (%)	12.0	13.1	20.2	6.6	12.3
EBITDA interest coverage (x)	13.9	4.4	23.9	4.8	10.0
FFO cash int. cov. (X)	20.0	4.6	4.7	4.5	10.3
Debt/EBITDA (x)	0.0	2.2	0.1	3.1	2.5
FFO/debt (%)	N.M.	32.6	888.1	24.4	28.2

Table 1

Strabag SE -- Peer Comparison (cont.)					
Cash flow from operations/debt (%)	N.M.	31.0	846.8	(7.3)	25.6
Free operating cash flow/debt (%)	N.M.	19.6	715.7	(16.2)	15.3
Discretionary cash flow/debt (%)	N.M.	14.1	296.4	(19.3)	8.3

N.M.--Not meaningful.

Financial Risk: Modest

Strabag's modest financial risk profile reflects the company's robust balance-sheet structure and relatively strong core credit metrics. 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. In our view, the company has strong liquidity and good financial flexibility, which we regard as positive for its financial risk profile. Strabag's demonstrated ability to obtain progress payments from customers, which generate working-capital resources, further supports our assessment.

Strabag has displayed a reported net cash position since 2014, which at year-end 2017 stood at about €1.3 billion, leading to a nil adjusted debt. As such, FFO to debt is not meaningful and debt to EBITDA is nil. We consider such a high net cash position to be extraordinary and temporary, driven by an exceptional working capital related cash inflow due to high advanced payments received in the fourth quarter of 2017. We anticipate that this favorable trend of working capital will revert in 2018-2019, leading to a significant cash absorption. At the same time, we believe that capex will remain sustained in 2018-2019, at around 3.5%-4.0% of sales. As result, the company's discretionary cash flow will likely be fairly weak over the next few years. However, we expect the company's adjusted debt to remain nil in 2018-2019.

Strabag has a track record of expansionary spending and debt-financed acquisitions. In 2017, Strabag finalized the acquisition of minority shares in Strabag AG, Germany, which is now a 100% owned subsidiary of Strabag Group.

When calculating our adjusted credit ratios, we add to reported debt €551 million of pension liabilities and €172 million related to capitalized operating leases. Our surplus cash figure incorporates a haircut of about €300 million to cash and liquid short-term investments, which we believe would not be immediately available for debt repayment. We do not include on- and off-balance-sheet nonrecourse debt relating to the AKA motorway concessions in Hungary in any of our adjusted leverage ratios. This is because we do not expect Strabag will provide financial support to these concessions if they are in need.

Financial summary

Table 2

Strabag SE -- Financial Summary					
Industry Sector: Engineering & Construction					
	--Fiscal year ended 31--				
(Mil. €)	**2017**	**2016**	**2015**	**2014**	**2013**
Revenues	13,508.7	12,400.5	13,123.5	12,475.7	12,475.7

Table 2

Strabag SE -- Financial Summary (cont.)					
Industry Sector: Engineering & Construction					
	--Fiscal year ended 31--				
(Mil. €)	**2017**	**2016**	**2015**	**2014**	**2013**
EBITDA	945.9	959.7	941.7	808.8	765.2
Funds from operations (FFO)	836.3	795.3	711.9	645.7	596.1
Net income from continuing operations	278.9	277.7	156.3	128.0	113.6
Cash flow from operations	1,295.6	230.6	1,217.8	854.0	716.0
Capital expenditures	457.6	412.5	395.8	346.5	387.4
Free operating cash flow	837.9	(181.9)	822.1	507.5	328.6
Discretionary cash flow	737.2	(252.1)	765.5	449.9	290.9
Cash and short-term investments	2,769.3	1,982.7	2,710.9	1,903.3	1,692.4
Debt	0.0	42.5	0.0	522.1	655.4
Equity	3,397.7	3,264.6	3,320.6	3,144.3	3,238.8
Adjusted ratios					
EBITDA margin (%)	7.0	7.7	7.2	6.5	6.1
Return on capital (%)	12.0	11.4	9.1	6.9	6.2
EBITDA interest coverage (x)	13.9	13.1	9.6	8.2	7.3
FFO cash int. cov. (x)	20.0	17.6	12.0	12.0	10.8
Debt/EBITDA (x)	0.0	0.0	0.0	0.6	0.9
FFO/debt (%)	N.M.	N.M.	N.M.	123.7	90.9
Cash flow from operations/debt (%)	N.M.	542.1	N.M.	163.6	109.2
Free operating cash flow/debt (%)	N.M.	(427.7)	N.M.	97.2	50.1
Discretionary cash flow/debt (%)	N.M.	(592.7)	N.M.	86.2	44.4

N.M.--Not meaningful.

Liquidity: Strong

We consider Strabag's liquidity to be strong and estimate that its liquidity sources will exceed needs by more than 1.5x in 2018 and 2019. The company enjoys solid relationships with banks, and perceived stability in financial market and prudent financial risk management further support our strong liquidity assessment.

Principal Liquidity Sources	Principal Liquidity Uses
• About €2.8 billion in cash at year-end 2017; • Access to a fully undrawn €400 million syndicated loan facility maturing in 2023; and • Cash FFO generation of around €700 million.	• Short-term debt maturities of €411 million in 2018; • Capex of €500 million-€550 million annually over the next two years; • Significant cash outflows of about €500 million per year related to seasonal working capital needs due to the nature of the business; • Working capital outflows of up to €400 million-€500 million per year over the next two years; • Bolt-on acquisitions of about €100 million annually; and • Dividends of about €120 million-€140 million annually.

Covenant Analysis

Strabag's syndicated loan facility is subject to some financial covenants, but headroom is currently ample and we assume no tightening in our base case.

Other Credit Considerations

We believe that Strabag's displays certain weaknesses compared with other industry peers with the same satisfactory business risk profile. Strabag is smaller than ACS, which is one of the largest construction company in the world. Furthermore, Strabag is less diversified by geography than ACS, as it generates most revenues in Europe. We also believe that Strabag's profitability is somewhat lower compared to other construction companies, reflecting its operations predominantly in the competitive European landscape. We consider these factors to be credit negative for Strabag and reflect it in our overall rating.

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)

Issue Ratings--Subordination Risk Analysis

Capital structure

Strabag has four bonds outstanding maturing between 2018 and 2022, amounting to €675 million at Dec. 31, 2017. The bonds represent 52% of total consolidated debt, and are all issued at parent level. The remaining part of the financial debt is represented by bank borrowings.

Analytical conclusions

We rate Strabag's notes 'BBB', the same as the issuer credit rating, because we believe that its leverage is sufficiently low to offset any potential subordination risk.

Reconciliation

Table 3

Reconciliation Of Strabag SE Reported Amounts With S&P Global Ratings' Adjusted Amounts (Mil. €)

	--Fiscal year ended Dec. 31, 2017--						
Strabag SE reported amounts							
	Debt	**Shareholders' equity**	**EBITDA**	**Operating income**	**Interest expense**	**EBITDA**	**Cash flow from operations**
Reported	1,294.0	3,370.5	834.6	448.4	46.5	834.6	1,345.2
S&P Global Ratings' adjustments							
Interest expense (reported)	--	--	--	--	--	(46.5)	--
Interest income (reported)	--	--	--	--	--	37.2	--
Current tax expense (reported)	--	--	--	--	--	(70.1)	--
Operating leases	172.0	--	68.9	12.1	12.1	56.8	56.8
Postretirement benefit obligations/deferred compensation	551.2	--	--	--	9.4	(18.0)	25.8
Surplus cash	(2,464.6)	--	--	--	--	--	--
Dividends received from equity investments	--	--	97.6	--	--	97.6	--
Nonrecourse debt	(389.8)	--	--	--	--	--	--
Non-operating income (expense)	--	--	--	37.2	--	--	--
Reclassification of interest and dividend cash flows	--	--	--	--	--	--	(97.6)
Non-controlling Interest/Minority interest	--	27.2	--	--	--	--	--
EBITDA - Income (expense) of unconsolidated companies	--	--	(20.5)	(20.5)	--	(20.5)	--
EBITDA - Other	--	--	(34.6)	(34.6)	--	(34.6)	--
EBIT - Finance/Interest income	--	--	--	(37.2)	--	--	--
OCF - Other	--	--	--	--	--	--	(34.6)
Total adjustments	(2,131.2)	27.2	111.3	(43.1)	21.5	1.7	(49.6)
S&P Global Ratings' adjusted amounts							
	Debt	**Equity**	**EBITDA**	**EBIT**	**Interest expense**	**Funds from operations**	**Cash flow from operations**
Adjusted	--	3,397.7	945.9	405.3	68.0	836.3	1,295.6

Related Criteria

- Criteria - Corporates - General: Reflecting Subordination Risk In Corporate Issue Ratings, March 28, 2018
- Criteria - Corporates - General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Criteria - Corporates - General: Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- Criteria - Corporates - General: Corporate Methodology, Nov. 19, 2013

- Criteria - Corporates - Industrials: Key Credit Factors For The Engineering And Construction Industry, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Group Rating Methodology, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Business And Financial Risk Matrix

	Financial Risk Profile					
Business 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-

Ratings Detail (As Of July 12, 2018)

Strabag SE	
Corporate Credit Rating	BBB/Stable/--
Senior Unsecured	BBB
Corporate Credit Ratings History	
22-Jun-2015	BBB/Stable/--
14-Nov-2007	BBB-/Stable/--
25-May-2007	BB+/Positive/--

*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings' credit ratings on the global scale are comparable across countries. S&P Global Ratings' credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.

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