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# Strabag SE

**Primary Credit Analyst:**
Izabela Listowska, Frankfurt (49) 69-33-999-127; izabela_listowska@standardandpoors.com

**Secondary Credit Analyst:**
Anna Stegert, Frankfurt (49) 69-33-999-128; anna_stegert@standardandpoors.com

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# Strabag SE

## Major Rating Factors

| Corporate Credit Rating |
| --- |
| BBB-/Stable/-- |

**Strengths:**

- Leading market positions in road construction 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 relatively stable, albeit industry-specific thin profitability, which indicates overall good project execution and cost management.
- Solid capital structure.

**Weaknesses:**

- Aggressive financial policies and limited transparency in corporate governance practices.
- Cyclical and competitive industry, inherently exposed to project risk.
- High exposure to the difficult German construction sector.
- Track record of negative free operating cash flows.

## Rationale

The ratings on Austria-based engineering and construction company Strabag SE reflect Standard & Poor's Ratings Services' view of its "satisfactory" business risk profile, according to our classifications, as a leader in road construction and civil engineering in Central and Eastern Europe (CEE). In addition, Strabag benefits from good business diversity and vertical integration, which provides barriers to entry and strategic access to raw materials. The company's favorable operational track record and sizable contract backlog despite the current industry downturn further underpin the ratings. What's more, Strabag's solid capital structure offers a cushion against adverse market conditions and potential project failures.

These strengths are offset by the company's exposure to high project-related execution risks in the construction industry, which is cyclical, competitive, and low margin. Furthermore, Strabag's credit profile is constrained by its track record of aggressive financial policies and negative free operating cash flows, as well as limited transparency concerning the group's evolving corporate governance issues.

### Key business and profitability developments

In our view, Strabag's operating performance in 2009 should withstand well the tough environment and remain largely consistent with the previous year. In the first nine months of 2009, Strabag's reported revenues of about €9.1 billion were up by 9% year on year, mostly helped by acquisitions. In the 12 months to Sept. 30, 2009, the company's EBITDA margin remained relatively stable, albeit thin, at about 5.5%.

We believe that Strabag's order backlog of about €14.6 billion on Sept. 30, 2009, improves near-term prospects providing there are no delays or cancellations in major projects. Nevertheless, near to medium term visibility, as well as a degree of pressure on profitability, is limited owing to a severe decline in European private construction (that is, industrial and commercial), in particular. This increases Strabag's reliance on the European infrastructure sector,



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which is likely to benefit from local government stimulus packages and EU-sponsored investment programs directed mainly toward the CEE region. Consequently, Strabag's ability to maintain its positive operating trend in the road sector will be an important factor in helping to moderate the general industry decline. Nevertheless, operating margins are likely to be adversely affected by intensive competition and will largely depend on the company's ability to align its fixed-cost base to falling workloads.

### Key cash flow and capital structure developments

Following a period of extensive expansion through several acquisitions and heavy capital expenditure (capex), Strabag's free operating cash flows turned positive in the 12 months to Sept. 30, 2009. Based on public statements, the company will cut back its capex substantially in 2009 from a peak of €877 million in 2008. This, combined with stringent working capital controls, is likely to result in moderate free operating cash flows for the year. We view this positively for credit quality, particularly in the context of declining markets.

Strabag's reported net cash position (excluding nonrecourse debt and cash in the Alföld Koncessizios Autopalya AKA concession in Hungary) was about €118 million as of Sept. 30, 2009. We believe that Strabag is likely to build up its net cash position toward the end of 2009 because the fourth quarter is generally a cash-generative quarter due to seasonality and that, according to the company, public entities pay their bills normally in December.

Strabag's absolute debt levels fluctuate throughout the year, as do credit measures. Therefore, we believe the most favorable point-in-time for Strabag is year-end. That said, adjusted FFO to debt and adjusted debt to EBITDA (both excluding nonrecourse debt) are likely to strengthen on Dec. 31, 2009, from about 79% and 1.2x, respectively, in the 12 months to Sept. 30, 2009. Although credit measures are above guidelines we consider typical for the ratings, we believe that Strabag will use some of this headroom for acquisitions and/or other expansionary investments over the near to medium term.

### Liquidity

Liquidity is adequate, in our view. As of Sept. 30, 2009, Strabag had about €984 million in cash and cash equivalents, and €600 million availability under short-term revolving credit facilities. Available liquidity sources should remain sufficient to service near-term debt obligations and working capital swings. Furthermore, Strabag has some capex flexibility, which creates a cushion to operating cash flows if markets decline more sharply than expected.

The short-term tenor of revolving working capital credit facilities poses a liquidity risk, in our opinion. This risk is partly offset by credit lines granted by various banks with which Strabag has longstanding relationships. We believe that the company would refinance or roll over its existing revolving lines well ahead of their maturities, and to actively seek to secure a longer term working capital financing over the near term. Bank and guarantee facilities include financial covenants and material adverse effect clauses. Headroom under the covenants is expected to remain sufficient.

Strabag's liquidity is supported by its undemanding debt-maturity profile. As of Sept. 30, 2009, the company reported debt of €1.64 billion, of which about €333 million was short term, with about one-quarter related to drawings under the short-term working-capital credit lines. Furthermore, the debt structure included the following:

- €777 million of nonrecourse funding (of which €41 million was short term) related to an "availability-type" Hungary-based AKA concession, which is secured by a fixed fee in exchange for service paid to Strabag by the local government;



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- €300 million in unsecured bonds (of which €75 million was short term);
- €108 million in liabilities from finance leases (of which €19 million was short term); and
- Debt related to project financings, which is served by cash flows generated by respective projects.

## Outlook

The stable outlook reflects our opinion that, despite difficult markets, Strabag's satisfactory business profile, marked by its leading market positions and good operating track record, will continue to support its current credit profile. We view Strabag's disciplined capital investment policy and its attention to risk control management as key factors in helping the company to maintain a rating-commensurate financial profile if operating profits come under pressure. Its prudent bidding strategy is even more essential in a cyclical downturn, which is characterized by more aggressive competition.

Furthermore, we expect Strabag's future corporate governance practices to be executed in a way that sustains Strabag's credit profile. We believe the company will be able to maintain adjusted debt to EBITDA at less than 2.5x, positive free operating cash flows (before expansionary capex), and adequate liquidity, which are commensurate with metrics at the 'BBB-' rating level.

Downside risks to the rating would primarily be weaker-than-expected conditions in the company's major markets, in particular the infrastructure sector; excessive debt levels from more-aggressive-than-expected acquisition activity or shareholder returns; and/or deteriorating liquidity. Upside rating potential is currently constrained by our view of Strabag's commitment to its existing financial policy, evolving corporate governance issues, and weak market conditions.

## Business Description

With annual output of about €13.7 billion in 2008, Strabag is one of the largest construction groups in Europe. The company is structured around three divisions:

- Building Construction & Civil Engineering. This division encompasses commercial and industrial building, public works, general and residential building, and various civil engineering projects.
- Transportation Infrastructures. This division covers asphalt and concrete road construction, railway construction, and the production of building materials for internal and external supply.
- Special Divisions & Concessions. This division handles tunneling works, project development, concessions, and facilities management.

Following recent changes, the current shareholder structure is as follows:

- Raiffeisen/UNIQA Group (43%);
- Haselsteiner Group (34%); and
- Free float (23%).



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## Business Risk Profile: Satisfactory, Broad Supply Network Underpinning Leading Market Positions In Risky, Low-Margin, And Cyclical Markets

The major supports for the satisfactory business risk profile are:

- Leading market positions across the CEE region. Strabag is the market leader in road construction in Austria and Germany. It is also one of the three largest construction companies in Hungary, the Czech Republic, Slovakia, and Poland. The company enjoys a solid presence in other Eastern European markets, as well as in Italy and Switzerland.
- Vertical integration, which yields a competitive edge. Strabag operates an extensive network of asphalt- and concrete-mixing plants (with a self sufficiency of 75% in asphalt and 30% in concrete) and gravel quarries and pits (self sufficiency of 20%), which provides direct access to strategic raw material supplies. This creates effective barriers to entry, given that customers frequently require constructors to offer in-house-produced raw materials and that environmental regulation is strict for the establishment of new quarry sites.
- Relatively stringent risk control processes, in our view, to monitor work-in-progress, with individual projects forming their own profit centers. Group-wide, remuneration for employees is based on profits as opposed to volumes. Board members exert ongoing control on a monthly basis with a help of detailed reporting tools. There is a standardized approval process for new projects depending on the business segment and project value. Nevertheless, visibility on individual contractual exposures, delays, or progress is low, and we rely principally on publicly disclosed information.
- A long track record of relatively stable profitability. Strabag's EBITDA margins are about 5.5%, while its return on capital is about 12% on average over the past six years--broadly in line with industry averages--despite meaningful business expansion and integration of lower-margin companies. We believe that the long operating track record and fairly stable, albeit thin, margins reflect reasonably effective risk management. Besides, Strabag has the flexibility to adjust its cost base (third-party services and outsourcing account for 45% of revenues, raw materials 25%, and labor 20%) if operating profits were to come under pressure. Flexibility to shift construction resources from one segment to the other is fairly limited, however. Specialized skills in general building cannot be easily deployed in infrastructure works (and vice versa).

These supports, however, may be challenged by:

- Above-average industry risk. Low barriers to entry (particularly for general building), litigation and cost-overrun risks, cyclicality, and seasonality characterize the sector. The combination of fixed-cost contract pricing and the risk 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-size projects heighten operating risks.
- Low operating margins. Despite overall consistency in profitability measures, Strabag's margins are thin, which is typical for the industry, and could deteriorate if there are cost overruns or delays on major projects. In the near term, the group's profitability could come under pressure from the industry downturn and, subsequently, more intense competition.
- Limited presence outside Europe. We understand that Strabag will continue to focus on its key European markets, where it generates good operating results. To partly counterbalance this focus, Strabag will continue to engage in single projects on opportunistic basis outside its core markets, such as in Africa, the Middle East, and India, where it can capitalize on its expertise and special skills (particularly in infrastructure construction). Also, the company's good diversity of order backlog by contract size, client, and industry segment offsets to a degree the



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high concentration on European markets.
- Exposure to the fragmented, very competitive, and low-margin German construction market. Strabag is the leading player in the German market, which accounts for about one-third of company output volume. We consider that this material share constrains geographic diversity.

## Financial Risk Profile: Intermediate, Aggressive Financial Policies Offset By Solid Capital Structure

The main strengths of Stabag's intermediate financial risk profile are:

- Solid capital structure and adequate liquidity following two major capital transactions in 2007. These comprised an IPO, with net proceeds of €850 million; and the sale of Strabag's 30% equity interest to the Russia-based Rasperia Trading (Rasperia), a subsidiary of Basic Element Holding, a conglomerate owned by Mr. Deripaska, for €1.04 billion. In 2008, Rasperia was forced to transfer its stake to Strabag's core shareholders, retaining a call option expiring October 2010.
- Credit measures above the levels commensurate for the 'BBB-' rating. However, we believe that Strabag will use some of this headroom for acquisitions and/or other expansionary investments over the near to medium term.
- Structurally good operating cash flows to fund maintenance capex, but not expansionary spending.
- A track record in receiving progress payments from customers. This generates working capital resources and supports operating cash flows.

These strengths are moderated by:

- A track record of aggressive financial policies and expansionary spending. In our view, debt-financed acquisitions are likely to remain a core part of the company's growth strategy in the near to medium term. Nevertheless, we believe that expansionary policies will be implemented in a manner that preserves the company's credit quality, in particular in a context of softer market conditions. As a consequence, we anticipate that Strabag will likely maintain adjusted debt to EBITDA at less than 2.5x, positive free operating cash flows (before expansionary capex), and adequate liquidity, which are commensurate with the 'BBB-' rating level.
- Limited transparency concerning the group's corporate governance practices and its evolving ownership structure.
- Historically negative free operating cash flows. Strabag's expansionary investments have resulted in negative free operating cash flows over the past few years, with capex spending reaching a peak of about €877 million in 2008 against depreciation of about €350 million. At the same time, acquisitions were largely balanced by disposals. We view positively Strabag's cash preservation policy implemented in 2009 as a reaction to the difficult industry conditions. However, we believe that the company is likely to resume its expansionary policy once markets recover.

## Financial Statistics/Adjustments

Strabag reports under International Financial Reporting Standards. It recognizes its revenues from construction projects according to the percentage-of-completion method. Although this is less conservative than recognition on delivery, expected losses are immediately reported as expenses, and we expect Strabag to continue to have the expertise and resources needed to measure costs and track potential overruns accurately. We believe there are risks, however, in not disclosing progress on individual contracts (even on the largest ones); although we note that this is



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typical for the industry.

Although Strabag's proportional share of total nonrecourse debt in public-private partnership (PPP) projects is material (€1.3 billion at Dec. 31, 2008), the debt is spread over 26 concessions, which are unlikely to fail simultaneously. Furthermore, if a project faced operational problems leading to a major liquidity shortfall, we would not expect Strabag to provide financial support unless it was contractually obliged to do so. There is little precedent in this regard, however, and Strabag could decide to financially support its PPP projects beyond the contractual requirements to avoid tarnishing its reputation, or to protect its investment. Accordingly, we consider on- and off-balance-sheet nonrecourse debt relating to such investments in our liquidity analysis, but do not include it in any of our reported financial ratios.

As a common industry practice, Strabag must issue bank guarantees, performance bonds, and customer payment bonds to support its contract obligations. As of Sept. 30, 2009, these obligations were about €3.9 billion. We do not add these contingent liabilities to debt for ratio calculation because there should be limited impact from them as long as Strabag maintains its work and product quality.

In calculating Strabag's financial metrics for the 12 months to Sept. 30, 2009, we make the following adjustments to reported figures (as shown in table 1):

- We capitalize operating leases as of Dec. 31, 2008, using the net present value method. This increases the group's debt by €143 million.
- We make an adjustment for unfunded postretirement benefit obligations as of Dec. 31, 2008, adding about €472 million to Strabag's reported debt.
- We reduce total cash of €984 million by €365 million, which we consider as structurally encumbered and therefore not available for other purposes, about €65 million of which is sitting in the AKA concession. Therefore, we adjust gross debt for surplus cash of about €619 million.
- We reduce total reported debt of €1.64 billion by €777 million of nonrecourse debt in the AKA concession.

## Related Research

- Business Risk/Financial Risk Matrix Expanded, May 27, 2009
- Principles Of Corporate And Government Ratings, June 26, 2007

**Table 1**

**Reconciliation Of Strabag SE Reported Amounts With Standard & Poor's Adjusted Amounts***

| | --Rolling 12 months ended Sept. 30, 2009-- | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| **Strabag SE reported amounts** | | | | | | | | | |
| **(Mil. €)** | **Debt** | **Shareholders' equity** | **Operating income (before D&A)** | **Operating income (before D&A)** | **Operating income (after D&A)** | **Interest expense** | **Cash flow from operations** | **Cash flow from operations** | **Capital expenditures** |
| Reported | 1,642.5 | 2,898.9 | 705.3 | 705.3 | 304.1 | 44.0 | 940.6 | 940.6 | 489.8 |
| **Standard & Poor's adjustments** | | | | | | | | | |
| Operating leases | 143.1 | -- | 34.8 | 7.2 | 7.2 | 7.2 | 27.7 | 27.7 | 44.7 |
| Postretirement benefit obligations | 471.5 | -- | -- | -- | -- | 20.8 | 12.9 | 12.9 | -- |



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**Table 1**

**Reconciliation Of Strabag SE Reported Amounts With Standard & Poor's Adjusted Amounts* (cont.)**

| | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| Surplus cash and near cash investments | (618.7) | -- | -- | -- | -- | -- | -- | -- | -- |
| Nonrecourse debt | (777.2) | -- | -- | -- | -- | -- | -- | -- | -- |
| Reclassification of nonoperating income (expenses) | -- | -- | -- | -- | 63.8 | -- | -- | -- | -- |
| Reclassification of working-capital cash flow changes | -- | -- | -- | -- | -- | -- | -- | (296.7) | -- |
| Minority interests | -- | 136.4 | -- | -- | -- | -- | -- | -- | -- |
| Total adjustments | (781.3) | 136.4 | 34.8 | 7.2 | 70.9 | 28.0 | 40.5 | (256.1) | 44.7 |

**Standard & Poor's adjusted amounts**

| | Debt | Equity | Operating income (before D&A) | EBITDA | EBIT | Interest expense | Cash flow from operations | Funds from operations | Capital expenditures |
|---|---|---|---|---|---|---|---|---|---|
| Adjusted | 861.2 | 3,035.4 | 740.1 | 712.5 | 375.0 | 72.0 | 981.1 | 684.5 | 534.5 |

*Please note that two reported amounts (operating income before D&A and cash flow from operations) are used to derive more than one Standard & Poor's-adjusted amount (operating income before D&A and EBITDA, and cash flow from operations and funds from operations, respectively). Consequently, the first section in some tables may feature duplicate descriptions and amounts.

**Table 2**

**Strabag SE Peer Comparison***

| (Mil. €) | Strabag SE¶ | Leighton Holdings Ltd. | Technip¶ | SNC-Lavalin Group Inc. |
|---|---|---|---|---|
| Corporate credit rating§ | BBB-/Stable/-- | BBB/Stable/A-2 | BBB/Positive/A-2 | BBB+/Stable/-- |
| | --Average of past three fiscal years-- | | | |
| Revenues | 10,512.3 | 6,724.3 | 7,449.9 | 3,805.7 |
| EBITDA | 562.3 | 748.8 | 619.4 | 198.2 |
| Net income from continuing operations | 172.9 | 302.3 | 258.1 | 106.3 |
| Funds from operations (FFO) | 513.6 | 877.5 | 456.3 | 188.4 |
| Capital expenditures | 626.6 | 803.0 | 383.2 | 231.3 |
| Free operating cash flow | (137.0) | (57.5) | 406.6 | (60.5) |
| Debt | 458.6 | 1,370.6 | 240.0 | 253.9 |
| Equity | 2,370.4 | 1,033.2 | 2,365.0 | 659.0 |
| **Adjusted ratios** | | | | |
| Operating income (before D&A)/revenues (%) | 5.5 | 13.2 | 8.8 | 5.9 |
| EBIT interest coverage (x) | 3.6 | 3.8 | 5.5 | 12.4 |
| EBITDA interest coverage (x) | 5.8 | 6.2 | 7.4 | 16.6 |
| Return on capital (%) | 13.5 | 21.5 | 16.4 | 17.7 |
| FFO/debt (%) | 112.0 | 63.7 | 190.1 | 76.2 |
| Debt/EBITDA (x) | 0.8 | 1.8 | 0.4 | 1.2 |
| Total debt/debt plus equity (%) | 16.2 | 57.0 | 9.2 | 27.7 |



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**Table 2**

## Strabag SE Peer Comparison* (cont.)

*Fully adjusted (including postretirement obligations). ¶Excess cash and investments netted against debt.§On Dec. 16, 2009.

**Table 3**

## Strabag SE Financial Summary*

| | | --Fiscal year ended Dec. 31-- | | | | |
|---|---|---|---|---|---|---|
| **(Mil. €)** | **--Rolling 12 months ended Sept. 30, 2009--** | **2008** | **2007** | **2006** | **2005** | **2004** |
| Rating history | BBB-/Stable/-- | BBB-/Stable/-- | BBB-/Stable/-- | BB+/Stable/-- | BB/Positive/-- | BB/Positive/-- |
| Revenues | 13,004.8 | 12,227.8 | 9,878.6 | 9,430.6 | 6,955.8 | 5,222.9 |
| EBITDA | 712.5 | 636.4 | 568.0 | 482.6 | 340.1 | 305.1 |
| Net income from continuing operations | 144.9 | 157.0 | 170.2 | 191.4 | 49.9 | 33.7 |
| Funds from operations (FFO) | 684.4 | 652.3 | 463.8 | 424.9 | 324.6 | 301.3 |
| Capital expenditures | 534.5 | 921.5 | 588.2 | 370.1 | 277.3 | 212.7 |
| Free operating cash flow | 446.6 | (191.1) | (70.6) | (149.2) | 5.2 | (95.0) |
| Debt | 861.2 | 399.8 | 0.0 | 975.9 | 989.2 | 862.6 |
| Equity | 3,035.4 | 2,979.0 | 3,096.5 | 1,035.9 | 905.5 | 802.3 |
| **Adjusted ratios** | | | | | | |
| Operating income (before D&A)/revenues (%) | 5.7 | 5.4 | 5.9 | 5.3 | 5.1 | 6.1 |
| EBIT interest coverage (x) | 5.2 | 3.9 | 3.9 | 3.1 | 2.9 | 2.5 |
| EBITDA interest coverage (x) | 9.9 | 6.9 | 5.9 | 4.7 | 4.7 | 5.4 |
| Return on capital (%) | 9.2 | 10.9 | 14.5 | 16.3 | 11.6 | 9.5 |
| FFO/debt (%) | 79.5 | 163.2 | N.M. | 43.5 | 32.8 | 34.9 |
| Free operating cash flow/debt (%) | 51.9 | (47.8) | N.M. | (15.3) | 0.5 | (11.0) |
| Debt/EBITDA (x) | 1.2 | 0.6 | 0.0 | 2.0 | 2.9 | 2.8 |
| Debt/debt and equity (%) | 22.1 | 11.8 | 0.0 | 48.5 | 52.2 | 51.8 |

*Fully adjusted (including postretirement obligations). Excess cash and investments netted against debt. N.M.--Not meaningful.

## Ratings Detail (As Of December 16, 2009)*

| **Strabag SE** | |
|---|---|
| Corporate Credit Rating | BBB-/Stable/-- |
| Senior Unsecured (2 Issues) | BB+ |
| Senior Unsecured (1 Issue) | BBB- |
| **Corporate Credit Ratings History** | |
| 14-Nov-2007 | BBB-/Stable/-- |
| 25-May-2007 | BB+/Positive/-- |
| 30-May-2006 | BB+/Stable/-- |
| 18-May-2005 | BB/Positive/-- |
| 15-Feb-2005 | BB/Stable/-- |
| **Business Risk Profile** | Satisfactory |
| **Financial Risk Profile** | Intermediate |



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**Ratings Detail** (As Of December 16, 2009)***(cont.)**

**Debt Maturities**

On Sept. 30, 2009:
2010: €333 mil.
Thereafter: €1.3 bil.

*Unless otherwise noted, all ratings in this report are global scale ratings. Standard & Poor's credit ratings on the global scale are comparable across countries. Standard & Poor's credit ratings on a national scale are relative to obligors or obligations within that specific country.

**Additional Contact:**
Industrial Ratings Europe; CorporateFinanceEurope@standardandpoors.com

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