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Strabag SE

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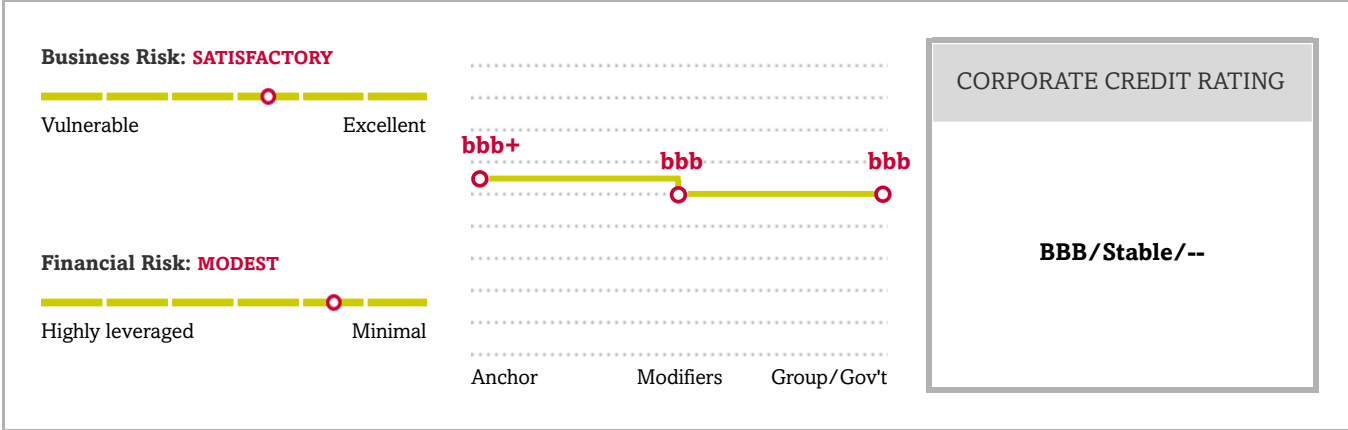
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Strabag SE



Rationale

Business Risk: Satisfactory	Financial Risk: Modest
<ul style="list-style-type: none"> • Leading 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, but also less volatile, adjusted EBITDA margins compared with the industry average. 	<ul style="list-style-type: none"> • High standing in the credit markets and solid perceived financial stability, underpinned by a reported net cash position. • Our forecast of credit ratios weakening in our base case, mainly due to the reversal of a positive trend in working capital observed over the past few years, and the acquisition of minority shareholdings at Zublin. • Volatile free cash flow generation during the year, with sizable seasonal swings in working capital. • Strong liquidity position.

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 about 7% in 2016 and 2017. We think that Strabag has some headroom in its leverage metrics to absorb some expansionary investments and selected bolt-on acquisitions, even after the acquisition of minority shares at Zublin. We expect Strabag's S&P Global Ratings-adjusted funds from operations (FFO) to debt will comfortably exceed 45%, with adjusted debt to EBITDA remaining below 2x and liquidity staying strong 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 room for a potential weakening of credit metrics at the current rating level. However, a significantly weaker operating performance and materially adverse trend in working capital needs could put pressure on the ratings. Pressure on the ratings may also arise from materially 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 FFO to debt and debt to EBITDA were more than 60% and less than 1.5x, respectively. This would likely be the result of Strabag's commitment to a more conservative financial policy than we currently reflect in our base-case scenario.

Standard & Poor's Base-Case Scenario

Assumptions	Key Metrics			
<ul style="list-style-type: none"> No significant volume growth is expected over the next few years. However, we believe that renewed infrastructure spending in Germany over that period may provide a certain tailwind to Strabag's performance. Strabag's order backlog, unlike that of some of its rated peers, has provided lower visibility of activity levels over the past few years, but this also reflects the company's focus on comparatively smaller projects. Operating margins should continue benefiting from previous restructuring and Strabag's risk management program, which should offset the negative impact of continued intense pricing pressure. Capital expenditure (capex) of about 3.5%-4% of sales between 2016 and 2017, coupled with significant working capital investments, largely shaped by a reversal of advance payment trends. About €210 million to acquire Zublin minority shares on top of about €50 million-€100 million for bolt-on acquisitions annually over the next few years. 				
		2015A	2016E	2017E
	EBITDA margin (%)*	7.2	7.0-7.5	7.0-7.5
	FFO to debt (%)*	N.M.	>60	>60
Debt/EBITDA(x)*	0	<1.5	<1.5	
<p>*Fully adjusted by S&P Global Ratings. Data represent year-end figures when Strabag's net working capital position is at the lowest level. Figures include several adjustments (see also the reconciliation table below). N.M.--Not meaningful. A--Actual. E--Estimate.</p>				

Company Description

With annual output of more than €14.3 billion in 2015, Strabag is one of Europe's largest construction groups. It reports on the following three segments:

- North and West (45% of 2015 output volume with an EBIT margin of 1.8%), mainly including Germany, Poland, Belgium, the Netherlands, Luxembourg, and Scandinavia, and the Ground and Hydraulic Engineering segment;
- South and East (32% of 2015 output volume with an EBIT margin of 4.5%), 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 (23% of 2015 output volume with an EBIT margin of 1.7%), comprising International, Tunneling, Construction Materials (except asphalt), Property & Facility Services, Real Estate, and Infrastructure Development (concessions).

We think the company's medium-term strategy will continue to focus on increasing margins by implementing efficiency improvements under the "task force 2013ff" program, which has been evaluating Strabag's operations since mid-2012, and through the strengthening of risk management policies. We also expect Strabag will continue to focus on both organic and inorganic growth opportunities, with the aim of increasing the proportion of non-European operations.

Strabag is publicly listed with a free float of 13%. Core shareholders are the Haselsteiner family (25.5%), UNIQA/Raiffeisen (26.5%), and Rasperia Trading Ltd. (25.0% plus one share). Rasperia is a subsidiary of Basic Element Holding, which is owned by Russian businessman Oleg Deripaska. The remaining 10% are treasury shares.

Business Risk: Satisfactory

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, 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, although likely to improve somewhat over the next few years, 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 has resulted in operational improvements. The reported EBIT margin improved to 2.6% in 2015, up from 2.3% in 2014 and 2.1% in 2013, and Strabag is targeting a 3% EBIT margin in 2016.

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.

S&P Base-Case Operating Scenario

S&P Global Ratings' base-case scenario for Strabag indicates a slight improvement in profitability metrics in 2016. Key assumptions for our base case are:

- Sluggish GDP growth in the eurozone of about 1.5% in 2016 and 1.6% in 2017.
- Strabag's order backlog covering about 1.x of revenues at year-end 2015, which should underpin revenue generation in 2016.
- No significant volume growth is expected over the next few years. However, we believe that renewed infrastructure spending in Germany over that period may provide a certain tailwind to Strabag's performance.
- Performance that will likely be shaped by continued intense pricing pressure, due to subdued public spending and economic growth patterns, but previous restructuring and Strabag's risk management program should lead to modestly improving profitability, with adjusted EBITDA margins of about 7.0%-7.5% over the next three years.

Peer comparison

Our peer analysis includes construction companies such as CIMIC Group Ltd. (formerly Leighton Holdings). The rating on CIMIC Group is influenced by our view of the credit quality of parent companies Hochtief AG and Grupo ACS. We also include Vinci S.A., a diversified infrastructure company with a significant portion of revenues coming from more stable concession businesses. Ferrovial S.A., in addition to its construction business, also has exposure to the services sector, which is less cyclical. Salini Impregio SpA is a midsize construction company mostly focused on infrastructure construction contracts, with substantial presence in the U.S. and high-risk countries.

Table 1

Strabag SE--Peer Comparison					
Industry Sector: Engineering & Construction					
	Strabag SE	CIMIC Group Ltd.	Salini Impregio SpA	Ferrovial S.A.	VINCI S.A.
Rating as of July 5, 2016	BBB/Stable/--	BBB-/Stable/A-3	BB+/Stable/--	BBB/Stable/A-2	A-/Stable/A-2
--Fiscal year ended Dec. 31, 2015--					
(Mil. €)					
Revenues	13,123	8,892	4,739	9,197	38,678
EBITDA	942	1,135	526	1,275	6,199
Funds from operations (FFO)	712	954	408	1,068	4,418
Net income from cont. oper.	156	349	77	720	2,046
Cash flow from operations	1,218	1,130	450	935	4,815
Capital expenditures	396	189	278	268	1,651
Free operating cash flow	822	941	172	667	3,164
Discretionary cash flow	766	683	149	91	2,120
Cash and short-term investments	820	363	299	596	1,000
Debt	0	194	1,090	0	16,399
Equity	3,321	2,757	1,217	2,789	15,006
Adjusted ratios					
EBITDA margin (%)	7.2	12.8	11.1	13.9	16.0
Return on capital (%)	10.5	18.2	12.6	24.6	11.4
EBITDA interest coverage (x)	9.6	6.9	4.7	24.3	8.8
FFO cash int. cov. (X)	12.0	8.2	4.8	3.2	9.6
Debt/EBITDA (x)	0.0	0.2	2.1	0.0	2.6
FFO/debt (%)	N.M.	490.7	37.5	N.M.	26.9
Cash flow from operations/debt (%)	N.M.	581.3	41.3	N.M.	29.4
Free operating cash flow/debt (%)	N.M.	484.2	15.8	N.M.	19.3
Discretionary cash flow/debt (%)	N.M.	351.1	13.7	N.M.	12.9

N.M.--Not meaningful.

Financial Risk: Modest

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 generate working-capital resources, further supports our assessment.

Strabag has displayed a reported net cash position since 2014, which at year-end 2015 stood at €1.1 billion; therefore FFO to debt is not meaningful and debt to EBITDA is nil. This also reflects a very positive and unusual trend in working capital in 2014 and 2015. We expect operating cash flow and leverage metrics will weaken over the next few years, mainly due to the reversal of this trend.

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. In 2016, Strabag reached an agreement to acquire minority shares in Zublin for consideration of €210 million to be paid in 2016, with a potential deferred price of up to €114 million to be paid over the next few years.

As is typical in the engineering and construction industry, Strabag has substantial seasonal working capital swings, 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.

S&P Base-Case Cash Flow And Capital Structure Scenario

- In our base-case scenario, we anticipate that credit metrics will worsen in 2016-2017, mainly reflecting the acquisition of Zublin minority shares, reversal of the positive working capital trend we saw in 2014 and 2015, and still-sustained capex, which will result in negative FOCF over our forecast horizon.
- Still, we expect Strabag's credit metrics will remain fairly robust and commensurate with a modest financial risk profile.
- The core ratio of adjusted FFO to debt will remain, however, above 60% in both 2016 and 2017.
- Capex will stand at about 3.5%-4% of sales between 2016 and 2017.
- We consider about €210 million spent to acquire Zublin minorities, on top of about €50 million-€100 million for bolt-on acquisitions annually over the next few years.

Financial summary

Table 2

Strabag SE--Financial Summary

Industry Sector: Engineering & Construction

(Mil. €)	--Fiscal year ended Dec. 31--				
	2015	2014	2013	2012	2011
Revenues	13,123	12,476	12,476	12,983	13,714
EBITDA	942	809	765	681	824

Table 2

Strabag SE--Financial Summary (cont.)

Industry Sector: Engineering & Construction

(Mil. €)	--Fiscal year ended Dec. 31--				
	2015	2014	2013	2012	2011
Funds from operations (FFO)	712	646	596	527	701
Net income from continuing operations	156	128	114	61	195
Cash flow from operations	1,218	854	716	288	510
Capital expenditures	396	346	387	458	477
Free operating cash flow	822	508	329	(170)	32
Dividends paid	57	58	38	70	67
Discretionary cash flow	766	450	291	(240)	(35)
Cash and short-term investments	820	548	508	350	350
Debt	0	522	655	744	364
Equity	3,321	3,144	3,239	3,163	3,150
Adjusted ratios					
EBITDA margin (%)	7.2	6.5	6.1	5.2	6.0
Return on capital (%)	10.5	8.2	7.3	6.5	11.1
EBITDA interest coverage (x)	9.6	8.2	7.3	6.0	7.7
FFO cash int. cov. (x)	12.0	12.0	10.8	8.9	13.5
Debt/EBITDA (x)	0.0	0.6	0.9	1.1	0.4
FFO/debt (%)	N.M.	123.7	90.9	70.9	192.5
Cash flow from operations/debt (%)	N.M.	163.6	109.2	38.7	139.9

N.M.--Not meaningful.

Liquidity: Strong

We consider Strabag's liquidity to be strong, and we estimate that liquidity sources will exceed needs comfortably, by more than 1.5x in 2016 and 2017.

Principal Liquidity Sources	Principal Liquidity Uses
<ul style="list-style-type: none"> • About €2.7 billion in cash at year-end 2015. • Access to a fully undrawn €400 million syndicated loan facility maturing in 2021. • Annual cash FFO generation of €600 million-€700 million. 	<ul style="list-style-type: none"> • Short-term debt maturities of €286 million, although a large proportion relates to bilateral bank lines that we expect will be rolled over. • Capex of about €450 million-€500 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 by the end of the third quarter, when debt generally peaks. • Working capital outflows that reverse the positive trend we observed in fourth-quarter 2015 of €300 million-€400 million per year over the next two years • Acquisition of minority shareholdings at Zublin for about €210 million and other bolt-on acquisitions of about €50 million-€100 million annually for the next two years. • Dividends of about €70 million-€80 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 Strabag's business risk profile is weaker than that of some peers we assess as having satisfactory business risk, reflecting its comparatively lower geographic diversification and profitability. Consequently, our comparable ratings analysis modifier for Strabag is negative.

We align our ratings on the senior unsecured debt with the long-term rating on Strabag. We estimate that the group's priority liabilities considerably exceed 20% of its total adjusted assets. However, there are significant factors mitigating this proportion of priority liabilities, such as the considerable geographic and business diversity of the group's operations.

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)

Reconciliation

Table 4

Reconciliation Of Strabag SE Reported Amounts With Standard & Poor's Adjusted Amounts (Mil. €)							
--Fiscal year ended Dec. 31, 2015--							
Strabag SE reported amounts							
	Debt	Shareholders' equity	EBITDA	Operating income	Interest expense	EBITDA	Cash flow from operations
Reported	1,580	3,039	816	341	70	816	1,240
Standard & Poor's adjustments							
Interest expense (reported)	--	--	--	--	--	(70)	--
Interest income (reported)	--	--	--	--	--	49	--
Current tax expense (reported)	--	--	--	--	--	(171)	--
Operating leases	221	--	79	15	15	64	64
Postretirement benefit obligations/deferred compensation	548	--	--	--	14	(23)	29
Surplus cash	(1,891)	--	--	--	--	--	--
Dividends received from equity investments	--	--	81	--	--	81	--
Nonrecourse debt	(490)	--	--	--	--	--	--
Non-operating income (expense)	--	--	--	49	--	--	--
Reclassification of interest and dividend cash flows	--	--	--	--	--	--	(81)
Non-controlling Interest/Minority interest	--	282	--	--	--	--	--
EBITDA - Other	--	--	(35)	(35)	--	(35)	--
OCF - Other	--	--	--	--	--	--	(35)

Table 4

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

--Fiscal year ended Dec. 31, 2015--

Strabag SE reported amounts							
	Debt	Shareholders' equity	EBITDA	Operating income	Interest expense	EBITDA	Cash flow from operations
Total adjustments	(1,612)	282	126	29	28	(104)	(23)
Standard & Poor's adjusted amounts							
	Debt¶	Equity	EBITDA	EBIT	Interest expense	Funds from operations	Cash flow from operations
Adjusted	--	3,321	942	370	98	712	1,218

Related Criteria And Research

Related Criteria

- Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Methodology: Industry Risk, Nov. 19, 2013
- Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- Key Credit Factors For The Engineering And Construction Industry, Nov.19, 2013
- Group Rating Methodology, Nov. 19, 2013
- Corporate Methodology, Nov. 19, 2013
- Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- Use Of CreditWatch And Outlooks, Sept. 14, 2009
- 2008 Corporate Criteria: Rating Each Issue, April 15, 2008

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-

Ratings Detail (As Of July 5, 2016)

Strabag SE

Corporate Credit Rating BBB/Stable/--
Senior Unsecured BBB

Corporate Credit Ratings History

22-Jun-2015 BBB/Stable/--

Ratings Detail (As Of July 5, 2016) (cont.)

14-Nov-2007	BBB-/Stable/--
25-May-2007	BB+/Positive/--

*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. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.

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