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Strabag SE

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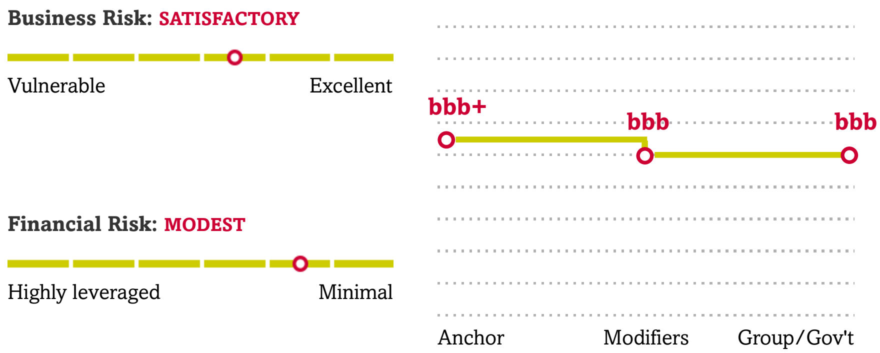


Issuer Credit Rating

BBB/Stable/--

Credit Highlights

Overview

Key Strengths	Key Risks
Leading positions in construction markets in Central Europe and some parts of Eastern Europe.	Exposure to the cyclical and competitive construction industry, which is inherently subject to project risk.
Vertical integration that provides barriers to entry and strategic access to raw materials.	Volatile free cash flow generation during the year, with sizable seasonal swings in working capital.
A track record of largely stable operating margins, which indicates generally good project execution and cost management.	Lower adjusted EBITDA margins compared to industry average, driven by Strabag's exposure mainly to low risk countries.
High standing in the credit markets and solid perceived financial stability, underpinned by a reported net cash position.	Sustained capital expenditure (capex), which led to negative discretionary cash flows in 2018.

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 2019 and 2020. 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 in 2019-2020 its financial metrics could absorb a likely reversal of the exceptionally favorable working capital trend that boosted its gross cash in 2017 and 2018. We expect S&P Global Ratings-adjusted funds from operations (FFO) to debt will comfortably exceed 45%, with adjusted debt to EBITDA remaining below 2.0x and liquidity staying strong 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 2.0x and FFO to debt drops to less than 45% over a sustained period. We believe there is room for a 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, and 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. We expect free operating cash flow (FOCF) to remain fairly weak over the next two years, driven by a reversal of working capital and still-high capex. We would need to see a material and sustainable improvement in FOCF before considering an upgrade.

Our Base-Case Scenario

Assumptions

- We expect real GDP growth in Germany to slow to 0.6% in 2019 and 1.1% in 2020; in Austria to 1.7% in 2019 and 1.6% in 2020; and in CEE to 3.6% in 2019 and 3.0% in 2020.
- The construction outlook for 2019-2020 shows slower development than 2018 amid softer economic expansion. The German building construction and civil engineering business is expected to slow compared to 2018, while construction output in CEE countries should continue to grow well above GDP in 2019-2020, in particular in Hungary and Poland.
- We expect output volume to slightly exceed €16 billion in 2019, underpinning 0.0%-0.5% revenue growth in 2019-2020.
- Operating margins likely to remain stable in the next few years, with S&P Global Ratings-adjusted EBITDA margin at 6%-7% and an EBIT margin around 3.3%.
- A reversal of the positive working capital trend seen in 2017 and 2018, and still-sustained capex, at around 4.0% of sales, which will result in negative FOCF in 2019-2020.
- We anticipate about €100 million for bolt-on acquisitions annually over the next few years.

Key Metrics

	2018A	2019E	2020E
EBITDA margin (%)*	6.3	6-7	6-7
FFO to debt (%)*	N.M.	N.M.	Above 60
Debt to EBITDA (x)*	0	0	Below 1.5

*All figures are fully adjusted by S&P Global Ratings. A--Actual. E--Estimate. N.M.--Not meaningful. FFO--Funds from operations.

Base-case projections

We expect credit metrics to remain strong in 2019-2020, with FFO to debt well above 60%. However, rating headroom should slightly decrease. We also forecast S&P Global Ratings-adjusted net debt to be zero in 2019. However, a reversal of the working capital trend of 2017-2018 and still-sustained capex should lead to negative FOCF generation in 2019-2020. In our base case we incorporate a cash-out from working capital of €400 million-€500 million in 2019, decreasing to around €200 million-€300 million in 2020, and capex at around 4% of consolidated sales. As a result, we expect rating headroom to be slightly lower in future.

Company Description

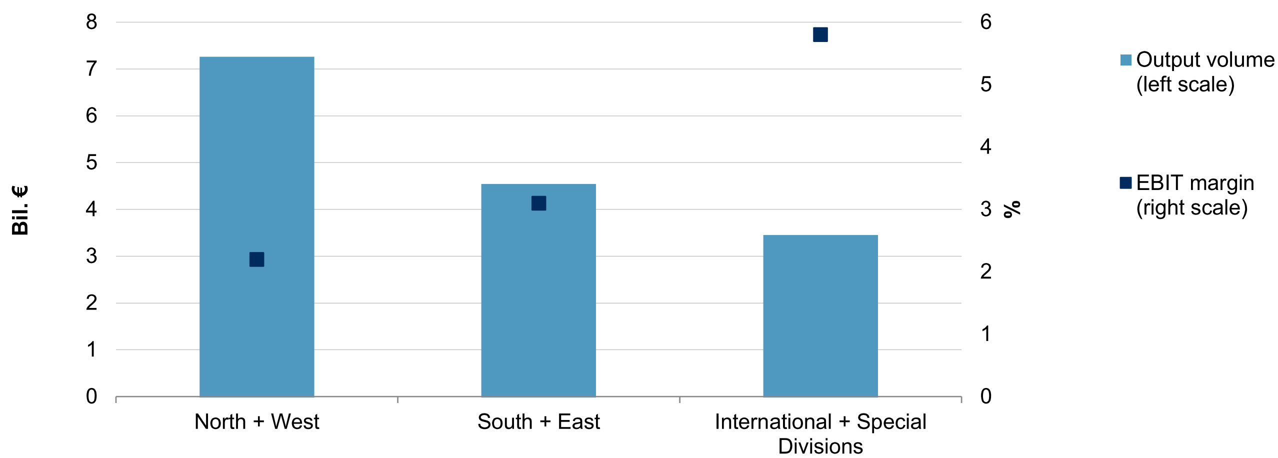
With annual output of about €16.3 billion in 2018, Strabag is one of Europe's largest construction groups. It operates in following three segments:

- North and West (48% of 2018 output volume with an EBIT margin of 2.2%), mainly including Germany, Poland, Belgium, the Netherlands, Luxembourg, and Scandinavia, and the Ground and Hydraulic Engineering segment;

- South and East (28% of 2018 output volume with an EBIT margin of 3.1%), mainly including Austria, Switzerland, the Czech Republic, Slovakia, Hungary, south eastern Europe, Russia, and neighboring countries, and the Environmental Engineering segment; and
- International and Special Divisions (24% of 2018 output volume with an EBIT margin of 5.8%), comprising International, Tunneling, Construction Materials (except asphalt), Property & Facility Services, Real Estate, and Infrastructure Development (concessions).

Chart 1

2018 Output Volume And EBIT Margin By Business Segment



Source: S&P Global Ratings.

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. Its profitability is slightly below the industry average. This reflects the competitive landscape in countries and segments where the company operates, but also that its projects are less risky than those in emerging markets. That said, its strengthening risk management systems and streamlining of parts of the organization have delivered operational improvements. The reported EBIT margin was 3.7% in 2018, up from 3.3% in 2017. However, adjusting 2018 EBIT for the €55.3 million step-up profit related to the full consolidation of PANSUEVIA--the German concession company now fully owned by Strabag--EBIT margin would be 3.3%, in line with 2017. Strabag aims to continue posting EBIT margins exceeding 3.3% in 2019, supported by recent risk management measures and the continued strong contribution from the property and facility services and real estate projects, which boosted the International and Special Divisions segment's EBIT 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

Table 1

Strabag SE--Peer Comparison

Industry sector: Engineering and construction				
	Strabag SE	**ACS, Actividades de Construccion y Servicios SA**	**Salini Impregilo SpA**	**VINCI S.A.**
Ratings as of Aug. 1, 2019	BBB/Stable/--	BBB/Stable/A-2	BB-/Negative/--	A-/Positive/A-2
	--Fiscal year ended Dec. 31, 2018--			
(Mil. €)				
Revenue	15,221.8	36,658.5	5,747.7	43,721.0
EBITDA	960.3	2,536.6	465.1	7,966.0
Funds from operations (FFO)	810.5	1,963.0	299.7	6,166.5
Interest expense	66.5	475.3	97.9	651.5
Cash interest paid	59.4	455.8	89.9	577.5
Cash flow from operations	672.9	1,227.1	(274.1)	5,447.5
Capital expenditure	643.4	793.1	120.5	2,025.0
Free operating cash flow (FOCF)	29.6	433.9	(394.7)	3,422.5
Discretionary cash flow (DCF)	(80.4)	118.1	(449.1)	1,339.5
Cash and short-term investments	2,344.3	7,165.2	1,107.3	7,960.0
Debt	0.0	7,080.0	2,101.9	19,878.5
Equity	3,653.8	6,055.7	932.1	19,818.0
Adjusted ratios				
EBITDA margin (%)	6.3	6.9	8.1	18.2
Return on capital (%)	15.5	17.0	3.0	13.4
EBITDA interest coverage (x)	14.4	5.3	4.8	12.2

Table 1

Strabag SE--Peer Comparison (cont.)

Industry sector: Engineering and construction

	Strabag SE	ACS, Actividades de Construccion y Servicios SA	Salini Impregilo SpA	VINCI S.A.
FFO cash interest coverage (x)	14.6	5.3	4.3	11.7
Debt/EBITDA (x)	0.0	2.8	4.5	2.5
FFO/debt (%)	N.M.	27.7	14.3	31.0
Cash flow from operations/debt (%)	N.M.	17.3	(13.0)	27.4
FOCF/debt (%)	N.M.	6.1	(18.8)	17.2
DCF/debt (%)	N.M.	1.7	(21.4)	6.7

N.M.--Not meaningful.

Our peer analysis includes construction companies ACS, Actividades de Construccion y Servicios SA, 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. Salini Impregilo SpA is a midsize construction company mainly focused on infrastructure construction contracts, with a substantial presence in the U.S. and high-risk countries. Strabag is a smaller player compared to ACS and Vinci, and its margins are comparatively lower mainly due to its revenue concentration in European countries. However, Strabag has historically displayed a consistently lower leverage compared to rated peers.

Financial Risk: Modest

Strabag's modest financial risk profile reflects its 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 2018 stood at about €1.0 billion, leading to nil adjusted debt. As such, S&P Global Ratings-adjusted debt to EBITDA is nil. We consider such a high net cash position to be extraordinary and temporary, driven by exceptional working-capital-related cash inflow in 2017 and 2018. We anticipate that this favorable trend of working capital will likely revert in 2019-2020, leading to significant cash absorption. We believe that capex will be sustained in 2019-2020, at around 4.0% of sales. As a result, the company's FOCF will likely be fairly weak over the next few years. We also expect that reported operating lease liabilities post implementation of IFRS 16 in 2019 will be higher than the current adjustment we add to reported debt, thereby increasing reported and S&P Global Ratings-adjusted net debt. However, we expect adjusted net debt to remain nil in 2019, then €60 million-€70 million in 2020.

Strabag has a track record of expansionary spending and debt-financed acquisitions. In 2018, Strabag finalized the acquisition of an additional 50% stake in PANSUEVIA, concession company operating the Ulm-Augsburg section of the A8 motorway in Germany, in which the company already had a 50% share, and in doing so reached full ownership.

Financial summary

Table 2

Strabag SE--Financial Summary

Industry sector: Engineering and construction					
	--Fiscal year ended Dec. 31--				
	2018	**2017**	**2016**	**2015**	**2014**
(Mil. €)					
Revenue	15,221.8	13,508.7	12,400.5	13,123.5	12,475.7
EBITDA	960.3	945.9	959.7	947.6	829.0
Funds from operations (FFO)	810.5	864.0	621.8	764.4	661.7
Interest expense	66.5	68.0	73.5	98.0	99.2
Cash interest paid	59.4	57.4	63.3	82.2	76.5
Cash flow from operations	672.9	1,269.7	205.3	1,188.3	832.5
Capital expenditure	643.4	457.6	412.5	395.8	346.5
Free operating cash flow (FOCF)	29.6	812.1	(207.2)	792.6	486.0
Discretionary cash flow (DCF)	(80.4)	711.4	(277.4)	736.0	428.4
Cash and short-term investments	2,344.3	2,769.3	1,982.7	2,710.9	1,903.3
Gross available cash	2,344.3	2,769.3	1,982.7	2,710.9	1,903.3
Debt	0.0	0.0	42.5	0.0	522.1
Equity	3,653.8	3,397.7	3,264.6	3,320.6	3,144.3
Adjusted ratios					
EBITDA margin (%)	6.3	7.0	7.7	7.2	6.6
Return on capital (%)	15.5	13.8	13.4	10.6	8.3
EBITDA interest coverage (x)	14.4	13.9	13.1	9.7	8.4
FFO cash interest coverage (x)	14.6	16.1	10.8	10.3	9.7
Debt/EBITDA (x)	0.0	0.0	0.0	0.0	0.6
FFO/debt (%)	N.M.	N.M.	1,462.1	N.M.	126.7
Cash flow from operations/debt (%)	N.M.	N.M.	482.6	N.M.	159.4
FOCF/debt (%)	N.M.	N.M.	(487.2)	N.M.	93.1
DCF/debt (%)	N.M.	N.M.	(652.2)	N.M.	82.0

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 2019 and 2020. The company enjoys solid relationships with banks. Perceived stability in the financial markets and prudent financial risk management further support our strong liquidity assessment.

Principal Liquidity Sources	Principal Liquidity Uses
• About €2.4 billion in cash as of Dec. 31, 2018; • Access to a fully undrawn €400 million syndicated loan facility maturing in 2024; and • Cash FFO generation of around €800 million.	• Short-term debt maturities of €276 million in 2019; • Capex of €550 million-€600 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 €300 million-€500 million per year over the next two years; • Bolt-on acquisitions of about €100 million annually; and • Dividends of about €130 million-€150 million annually.

Covenant Analysis

Compliance expectations

Headroom under financial covenants is currently ample and we assume no tightening in our base case.

Issue Ratings - Subordination Risk Analysis

Capital structure

Strabag has two bonds outstanding maturing between 2020 and 2022, amounting to €400 million at Dec. 31, 2018. The bonds represent 29% of total consolidated debt, and are all issued at the 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, 2018--							
Strabag SE reported amounts								
	Debt	**Shareholders' equity**	**EBITDA**	**Operating income**	**Interest expense**	**S&P Global Ratings' adjusted EBITDA**	**Cash flow from operations**	**Capital expenditure**
Reported	1,363.3	3,620.7	952.6	558.2	43.9	960.3	736.2	645.0
S&P Global Ratings' adjustments								
Cash taxes paid	--	--	--	--	--	(90.4)	--	--
Cash taxes paid: Other	--	--	--	--	--	--	--	--
Cash interest paid	--	--	--	--	--	(45.6)	--	--
Operating leases	176.6	--	63.8	12.2	12.2	(12.2)	51.6	--
Postretirement benefit obligations/deferred compensation	535.0	--	--	--	8.8	--	--	--
Accessible cash and liquid investments	(2,039.5)	--	--	--	--	--	--	--
Capitalized interest	--	--	--	--	1.6	(1.6)	(1.6)	(1.6)
Dividends received from equity investments	--	--	70.5	--	--	--	--	--
Deconsolidation/consolidation	(730.8)	--	--	--	--	--	--	--
Income (expense) of unconsolidated companies	--	--	(84.0)	--	--	--	--	--
Nonoperating income (expense)	--	--	--	19.2	--	--	--	--
Reclassification of interest and dividend cash flows	--	--	--	--	--	--	(70.5)	--
Noncontrolling interest/minority interest	--	33.1	--	--	--	--	--	--
EBITDA: Other	--	--	(42.7)	(42.7)	--	--	--	--
Operating cash flow: Other	--	--	--	--	--	--	(42.7)	--
Total adjustments	(2,058.7)	33.1	7.7	(11.3)	22.6	(149.8)	(63.2)	(1.6)
S&P Global Ratings' adjusted amounts								
	Debt¶	**Equity**	**EBITDA**	**EBIT**	**Interest expense**	**Funds from operations**	**Cash flow from operations**	**Capital expenditure**
Adjusted	--	3,653.8	960.3	546.9	66.5	810.5	672.9	643.4

When calculating our adjusted credit ratios, we add to reported debt €535 million of pension liabilities and €177 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 and to the PANSUEVIA motorway concession in Germany 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.

Ratings Score Snapshot

Issuer 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
- **Liquidity:** Strong (no impact)
- **Management and governance:** Satisfactory (no impact)
- **Comparable rating analysis:** Negative (-1 notch)

Related Criteria

- Corporate Methodology: Ratios And Adjustments, April 1, 2019
- 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, 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

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 September 9, 2019)*

Strabag SE	
Issuer Credit Rating	BBB/Stable/--
Senior Unsecured	BBB
Issuer 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.