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Summary:
Strabag SE

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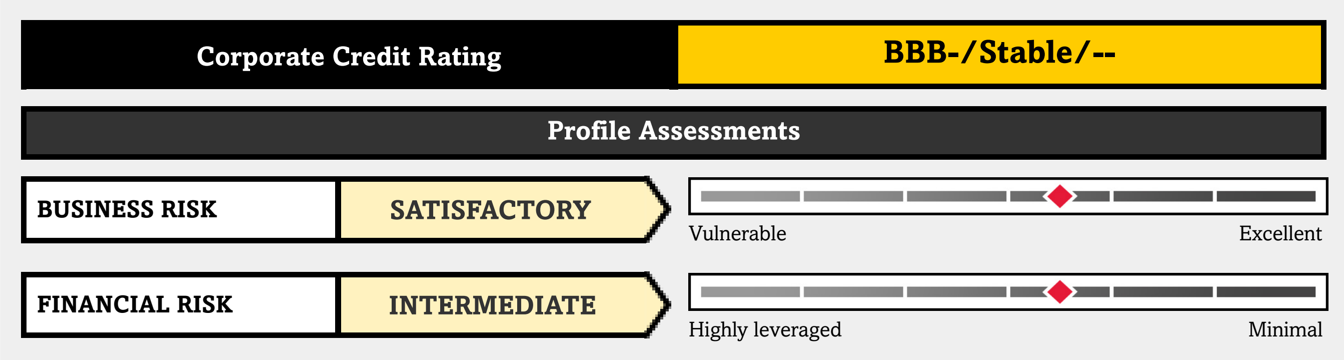
1151549 | 300208363

Summary:

Strabag SE



Rationale

Business Risk: Satisfactory	Financial Risk: Intermediate
• 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 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%-6% historically, which is typical for the industry.	• Solid capital structure. • A somewhat volatile free cash flow generation profile. • Growth-oriented and shareholder-friendly financial policy.

Outlook: Stable

The outlook on Austria-based engineering and construction group Strabag SE is stable, reflecting our assessment that the group's credit metrics will stabilize or improve over the next two years, thereby remaining commensurate with the rating. This includes debt to EBITDA of less than 2.5x. Despite the presently difficult outlook for the European construction market, we assume the group will manage to prevent its EBITDA margin from falling below 4.5% over the next two years. We view Strabag's disciplined capital investment policy and attention to risk-control management as key to helping it maintain a rating-commensurate financial profile. In our opinion, Strabag will improve its free cash flow generation in the coming years, a view that we factor into the rating.

Downside scenario

We could consider a negative rating action if Strabag's operating profitability weakened significantly, creating a risk that the group's debt-to-EBITDA ratio could rise to more than 2.5x. Downside rating risk would also arise from highly elevated debt, owing, for instance, to acquisitions or increased shareholder returns, and deteriorating liquidity.

Upside scenario

We could raise the ratings if Strabag's credit measures remain above levels we view as commensurate with a 'BBB' rating, such as a ratio of funds from operations to debt of more than 45% and debt to EBITDA of less than 1.5x. We note that Strabag's financial metrics within the year, when working capital requirements peak, are significantly weaker. Such an outcome is unlikely in the current economic environment.

Standard & Poor's Base-Case Scenario

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Assumptions

- Flat revenue in 2013 followed by a slow recovery in 2014.
- Performance likely to be shaped by intense pricing pressure due to subdued public spending and economic growth patterns.
- Capital spending in 2013-2014 roughly in line with 2012 (€458 million).
- Slightly positive free operating cash flow (FOCF) in 2013-2014, following negative reported FOCF of about €190 million in 2012.

Key Metrics

	2012A	2013E	2014E
Revenue growth (%)	(5.3)	Nil	3.0
EBITDA margin (%)	4.5	4.5-5.0	4.7-5.2
Debt to EBITDA (x)	1.2	1.0-1.5	1.0-1.5

Fully Standard & Poor's-adjusted. A--Actual. E--Estimated. Figures refer to year-end figures when the group's net working capital position is at the lowest level of the year. For this reason, we believe that debt to EBITDA is understated by close to 1x at current profitability levels. Figures include an operating lease adjustment that in 2012 increased debt by €233 million and operating income and EBITDA by €9 million. We also adjust the ratios for postretirement benefit obligations that add some €510 million to debt. We assume some €327 million of cash tied to ongoing operations and in the group's concession business. Non-recourse debt related to the group's concession business amounting to €630 million and related earnings and cash flows are not included in our adjusted numbers.

Business Risk: Satisfactory

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

Strabag's long track record of generating relatively stable profitability is reflective of the group's generally effective risk management systems. Although 2012 earnings and cash flow generation were impacted by underperforming projects, we anticipate that group's efforts to further sharpen risk policies will lead to somewhat improving, albeit low, profit margins in a difficult market environment.

The group's good order backlog, usually covering about one year of earnings provides decent forward visibility and we consider its cost base to be relatively flexible, which is underpinning the group's credit profile.

The group's business risk profile is constrained by the above-average risk profile of the industry. 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 projects with low insight in terms of contract risk and performance heighten operating risks. Strabag's operating margins are low, but not inconsistent with the overall

sector.

In our view, the group's profitability is likely to remain below historical averages over the next two years, owing to sluggish industry prospects and intense competition. In our base-case scenario for 2013, we anticipate flat revenues followed by a slight pick-up in 2014. Operating margins are likely to remain under pressure in a market environment that became increasingly competitive in 2012. However, as we do not assume the special effects that burdened 2012 earnings will recur in 2013, when we expect a slight improvement in operating margins. We also expect that some operational improvements may come from ongoing restructuring, although transformational charges might offset some of the benefits initially.

Financial Risk: Intermediate

Strabag's "intermediate" financial risk profile reflects the group's strong balance sheet structure, with credit metrics well in line for the intermediate category. This takes into account hefty seasonal working capital swings that can amount to up to €500 million in the first three quarters of a given year. We expect Strabag to keep careful control over its debt levels as inherent industry risk can lead to significant deteriorations of metrics in a relatively short period.

Our assessment of Strabag's financial risk profile incorporates our view that the group has adequate liquidity and good financial flexibility. In our view the group has structurally good operating cash flows (with the exception of 2012), which can fund maintenance capital expenditures. We regard this as a positive rating factor. The financial risk profile is further supported by Strabag's demonstrated ability to obtain progress payments from customers, which generates working-capital resources.

These strengths are moderated by Strabag's growth oriented and shareholder-friendly financial policy. The group has a track record of expansionary spending and debt-financed acquisitions, which have frequently resulted in negative free operating cash flows after acquisition spending. A €237 million share buy-back program in 2011-2013 led to an increase in financial leverage.

In our base case, we expect FOCF to be positive in 2013, assuming stable capital expenditures and limited negative working capital movement. We expect Strabag's credit metrics to remain fairly robust for the current intermediate financial risk profile. In the 12 months to March 31, 2013, adjusted debt to EBITDA was 1.8x and adjusted funds from operations to debt was 40%.

Liquidity: Adequate

We consider Strabag's liquidity position to be "adequate," as defined by our criteria. We estimate that liquidity sources will exceed liquidity needs comfortably by more than 1.2x in 2013-2014.

Principal Liquidity Sources	Principal Liquidity Uses
• About €700 million in cash (net of €366 million we consider to be tied to the operations and subsidiary AKA, a highway concession company in Hungary. On March 31, 2013 Strabag reported cash and cash equivalents of about €1,065 million); and • Access to a fully undrawn €400 million syndicated loan facility maturing at the end of 2017. The facility, arranged in December 2012, replaced uncommitted short-term credit lines, thereby supporting the group's liquidity position. We understand that the facility is subject to a financial leverage covenant, but headroom is currently ample and we assume no tightening in our base case.	• Short-term maturities of €378 million, but we note that the group issued a €200 million bond in May 2013, covering part of the short-term maturities. • Capital spending of about €475 million in the coming two years. • Bolt-on acquisitions of about €50 million a year in 2013-2014, although we see a risk that this number could be higher if Strabag identifies a large strategic acquisition target. • Dividend payouts of about €20 million for 2013, which represents a significant cut against the €70 million the group paid in 2012. We expect dividend payouts for 2014 to rise on the assumption that operating performance will stabilize. • Significant cash outflows related to seasonal working needs that can consume €400 million-€500 million by the end of the third quarter, when debt levels generally peak.

Related Criteria And Research

- Foreign Sales Provide A Fillip For Europe's Beleaguered Capital Goods Firms, April 25, 2013
- Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- Methodology: Business Risk/Financial Risk Matrix Expanded, Sept. 18, 2012
- Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Sept. 28, 2011
- 2008 Corporate Criteria: Ratios And Adjustments, April 15, 2008
- 2008 Corporate Criteria: Analytical Methodology, April 15, 2008

Business And Financial Risk Matrix

	Financial Risk					
Business Risk	Minimal	Modest	Intermediate	Significant	Aggressive	Highly Leveraged
Excellent	AAA/AA+	AA	A	A-	BBB	--
Strong	AA	A	A-	BBB	BB	BB-
Satisfactory	A-	BBB+	BBB	BB+	BB-	B+
Fair	--	BBB-	BB+	BB	BB-	B
Weak	--	--	BB	BB-	B+	B-
Vulnerable	--	--	--	B+	B	B- or below

Note: These rating outcomes are shown for guidance purposes only. The ratings indicated in each cell of the matrix are the midpoints of the likely rating possibilities. There can be small positives and negatives that would lead to an outcome of one notch higher or lower than the typical matrix outcome. Moreover, there will be exceptions that go beyond a one-notch divergence. For example, the matrix does not address the lowest rungs of the credit spectrum (i.e., the 'CCC' category and lower). Other rating outcomes that are more than one notch off the matrix may occur for companies that have liquidity that we judge as "less than adequate" or "weak" under our criteria, or companies with "satisfactory" or better business risk profiles that have extreme debt burdens due to leveraged buyouts or other reasons. For government-related entities (GREs), the indicated rating would apply to the standalone credit profile, before giving any credit for potential government support.

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