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Research Update:

Strabag SE Proposed €100 Mil. Senior Unsecured Bonds Rated 'BBB-'; Two Existing Senior Unsecured Issues Raised To 'BBB-'

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Research Update:

Strabag SE Proposed €100 Mil. Senior Unsecured Bonds Rated 'BBB-'; Two Existing Senior Unsecured Issues Raised To 'BBB-'

Overview

- We are assigning our 'BBB-' rating to the proposed five-year €100 million senior unsecured bonds to be issued by Strabag SE.
- We are also raising the senior unsecured debt ratings on two senior unsecured debt issues by Strabag, due 2012 and 2013, respectively.
- The upgrade on these two issues reflects that we no longer consider they would be significantly structurally subordinated to priority liabilities at the operating level under a default scenario.
- We are affirming the 'BBB-' corporate credit rating on Strabag. The outlook is stable.

Rating Action

On May 17, 2010, Standard & Poor's Ratings Services assigned its 'BBB-' rating to the proposed five-year €100 million senior unsecured bonds to be issued by Austria-based engineering and construction company Strabag SE. At the same time, we raised to 'BBB-' from 'BB+' the senior unsecured debt ratings on the €75 million notes due 2013 and €75 million notes due 2012 issued by the company. The 'BBB-' long-term corporate credit rating on Strabag was affirmed. The outlook is stable.

Rationale

We have equalized the ratings on Strabag's proposed bonds and on the two other senior unsecured debt issues with the corporate credit rating because we no longer consider that under a default scenario debt at Strabag SE would be significantly structurally subordinated to priority liabilities at the operating level. In our view, structural subordination is mitigated by Strabag's good business diversification, its revenue stream from a large amount of small to midsize projects, strong cash holdings of about €900 million at the holding company level as of Dec. 31, 2009, and intra-group loans to operating subsidiaries. Furthermore, there are more than 250 operating legal entities in the Strabag group, and we consider that the presence of multiple separate business units improves prospects for residual value remaining for holding company creditors under a default scenario.

Strabag significantly reduced its net financial debt in 2009 (excluding nonrecourse debt and guarantees, which is not included in this analysis). As of Dec. 31, 2009, Strabag SE had a net cash position, with cash and cash

equivalents of about €1.8 billion exceeding financial debt of about €0.7 billion. This compares with €1.5 billion cash and equivalents compared with about €0.9 billion of debt a year earlier.

The ratings on Strabag reflect our 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. 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 due to high capital spending, as well as limited transparency concerning the group's evolving corporate governance issues.

Liquidity

Liquidity is adequate, in our view. As of Dec. 31, 2009, Strabag had about €1,783 million in cash and cash equivalents, and about €532 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 capital expenditure 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 would 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.

We consider Strabag's liquidity is supported by its undemanding debt-maturity profile. As of Dec. 31, 2009, the company reported debt of €1.51 billion, of which about €234 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:

- €715 million of nonrecourse funding (of which €42 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;
- €320 million in unsecured bonds (of which €75 million was short term);

- €75 million in liabilities from finance leases (of which €15 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 helping the company to maintain a rating-commensurate financial profile if operating profits come under pressure. We consider that Strabag's 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 its 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.

Related Criteria And Research

- Criteria Methodology: Business Risk/Financial Risk Matrix Expanded, May 27, 2009
- Standard & Poor's Encyclopedia of Analytical Adjustments for Corporate Entities, July 9, 2007.

Ratings List

New Rating

Strabag SE	
€100 mil (proposed) bnds due 2015	BBB-

Ratings Affirmed

Strabag SE	
Corporate Credit Rating	BBB-/Stable/--

Upgraded

	To	From
Strabag SE		
Senior Unsecured (2 issues)	BBB-	BB+

N.B. This list does not include all ratings affected.

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