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Summary:

Strabag SE

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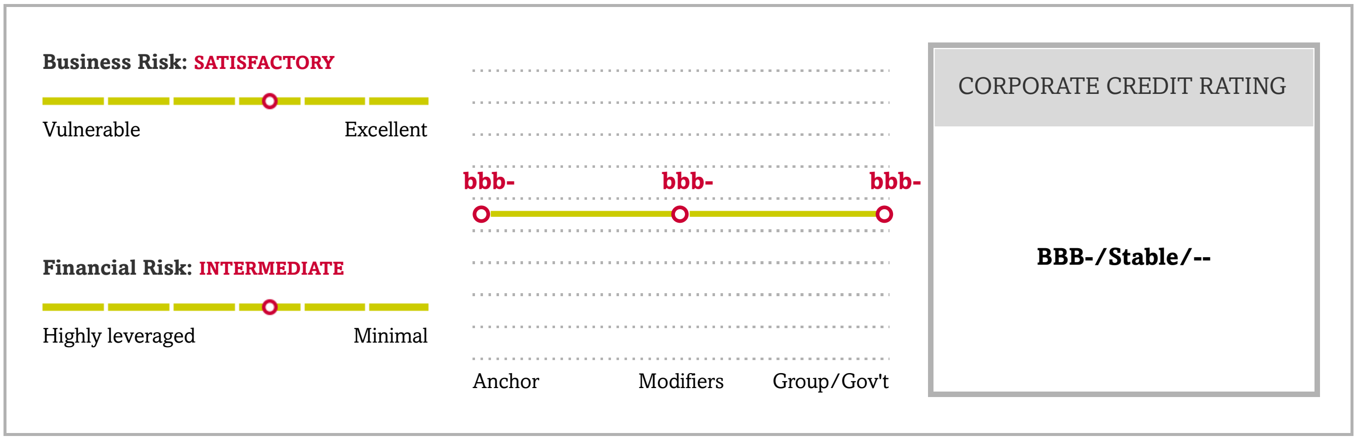

Rationale

Business Risk: Satisfactory

- 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 5.0%-6.5% historically, which is below industry average.

Financial Risk: Intermediate

- Relatively low adjusted debt, translating into very strong core credit ratios at fiscal year-end for our financial risk profile assessment.
- Strong liquidity position.
- Somewhat volatile free cash flow generation with sizable seasonal swings in working capital.
- Growth-oriented and shareholder-friendly financial policy.

Outlook: Stable

The stable outlook on Austria-based engineering and construction group Strabag SE reflects Standard & Poor's Ratings Services' assessment that the group's credit metrics will remain strong for the current rating category. We believe that Strabag's significant headroom can accommodate expansionary investments in working capital, capital expenditures, and selected bolt-on or midsize acquisitions. Additionally, we expect the group's funds from operations (FFO) to debt to exceed 45% and debt to EBITDA to remain below 2.5x at year-end.

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 FFO 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. We would also consider a positive rating action if we observed the company's establishment of a consistent track record of generating consistently positive discretionary cash flows.

Downside scenario

We could consider a negative rating action if Strabag's debt-to-EBITDA ratio rises to more than 2.5x and FFO to debt drops to less than 35%. We believe that there is significant room for the group to show a potential weakening of operating performance at the current rating level. However, ongoing lengthy operating pressure could lead to a downgrade. Additionally, high debt, owing, for instance, to sizable acquisitions, increased shareholder returns, and deteriorating liquidity could also lead to a negative rating action.

Standard & Poor's Base-Case Scenario

Assumptions

- Slow volume growth in 2014 and mid-single-digit percentage growth in 2015 and 2016.
- Performance likely to be shaped by continued intense pricing pressure due to subdued public spending and economic growth patterns, but past restructuring to lead to stable profitability.
- Capital expenditures of about €475 million for 2014, increasing in 2015-2016, coupled with working capital investments, partly shaped by a reversal of advance payment trends, leading to negative free operating cash flow (FOCF) over our 2014-2016 forecast horizon.
- €50 million for bolt-on acquisitions.

Key Metrics

	2013a	2014e	2015e
EBITDA margin (%)	6.1	5.5-6.0	5.5-6.0
FFO/debt (%)	90.1	55-65	45-55
Debt/EBITDA (x)	0.79	1.0-1.5	1.0-1.5

a--Actual. e--Estimate. Data above 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 about 0.7x at current profitability levels. Figures include our operating lease adjustment that in 2013 increased debt by €202 million and operating income and EBITDA by €76 million. We also adjust the ratios for postretirement benefit obligations that add approximately €501 million to debt. We assume about €508 million of cash being not readily available and roughly €20 million in the group's concession business. We exclude non-recourse debt related to the group's concession business amounting to €585 million and related earnings and cash flows from our adjusted numbers.

Business Risk: Satisfactory

The major factors supporting Strabag's "satisfactory" business risk profile are the group's leading market positions 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 underperforming projects impacted 2012 earnings and cash flow generation, we anticipate that the 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. We also consider its cost base to be relatively flexible, which is underpinning the group's credit profile.

The industry's above-average risk profile constrains the group's business risk profile. 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 and we consider its EBITDA margin of between 5.5%-6.5% as below industry average, which also constrains the overall business risk profile assessment.

In our view, the group's profitability is likely to be on a slightly upward trend, including an adjusted EBITDA margin of about 6% in 2014 and 2015, following improvement in 2013 against a weak 2012 when the group's Standard & Poor's adjusted EBITDA margin declined to 5.2%. In our base-case scenario for 2014, we anticipate flat revenues followed by mid-single-digit growth in 2015 and 2016. Operating margins are likely to remain under pressure in a market environment that has become increasingly competitive over recent years. That said, the group's strengthening of risk management systems and streamlining of parts of the organization under its program "task force 2013ff" could result in operational improvements. However, due to the competitive landscape and the inherent project risks in the industry, we believe that significant improvements of the operating margin are rather difficult to achieve.

Financial Risk: Intermediate

Strabag's "intermediate" financial risk profile reflects the group's strong balance sheet structure, with strong core credit metrics 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 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 generates working-capital resources, further supports our assessment.

That said, Strabag's growth oriented and shareholder-friendly financial policy moderate the abovementioned strengths. 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 also led to an increase in financial leverage.

In our base case, we expect FOCF to be negative in 2014, assuming an increase of capital expenditures and a consumption of working capital following the significant inflow in 2013, partly due to the receipt of customer advances. Still, we expect Strabag's credit metrics to remain fairly robust for the current intermediate financial risk profile, at least at fiscal year-end. In the 12 months to Dec. 31 2013, adjusted debt to EBITDA was 0.9x and adjusted FFO to debt was 91%.

Liquidity: Strong

We consider Strabag's liquidity position to be "strong," as defined by our criteria. We estimate that liquidity sources will exceed liquidity needs comfortably by more than 1.5x in 2014 and 2015.

Principal Liquidity Sources	Principal Liquidity Uses
• About €1.7 billion in cash (net of €20 million we consider to be tied subsidiary AKA, a highway concession company in Hungary); • 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; and • Cash FFO generation of €450 million to €500 million.	• Short-term maturities of €369 million, but we note that a large proportion relates to bilateral bank lines that we expect the group to roll over; • Capital spending of €475 million to €500 million in the coming two years; • Bolt-on acquisitions of approximately €50 million annually in the coming years, although we see a risk that this number could be higher if Strabag identifies a large strategic acquisition target; • Dividend payouts of about €46 million for 2014, which represents a rise after the dividend had been cut to about €37 million following the weak performance in 2013. We expect dividend payouts for 2015 to rise on the assumption that operating performance will stabilize; and • Significant cash outflows related to seasonal working needs that can consume €400 million-€500 million by the end of the third quarter, when debt generally peaks.

Other Modifiers

No modifiers affect the ratings.

Ratings Score Snapshot

Corporate Credit Rating

BBB-/Stable/--

Business risk: Satisfactory

- **Country risk:** Low
- **Industry risk:** Moderately high
- **Competitive position:** Satisfactory

Financial risk: Intermediate

- **Cash flow/Leverage:** Intermediate

Anchor: bbb-

Modifiers

- **Diversification/Portfolio effect:** Neutral (no impact)

- **Capital structure:** Neutral (no impact)
- **Liquidity:** Strong (no impact)
- **Financial policy:** Neutral (no impact)
- **Management and governance:** Satisfactory (no impact)
- **Comparable rating analysis:** Neutral (no impact)

Related Criteria And Research

Related Criteria

- Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Jan. 2, 2014
- Corporate Methodology, Nov. 19, 2013
- Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- Key Credit Factors For The Engineering And Construction Industry, Nov. 19, 2013
- Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- 2008 Corporate Criteria: Rating Each Issue, April 15, 2008

Related Research

- Industry Economic And Ratings Outlook: Global Engineering And Construction Firms Are Equipped To Weather Economic Uncertainty, Nov. 14, 2013

Business And Financial Risk Matrix

	Financial Risk Profile					
Business 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-

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