S&P Global
Ratings

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Strabag SE

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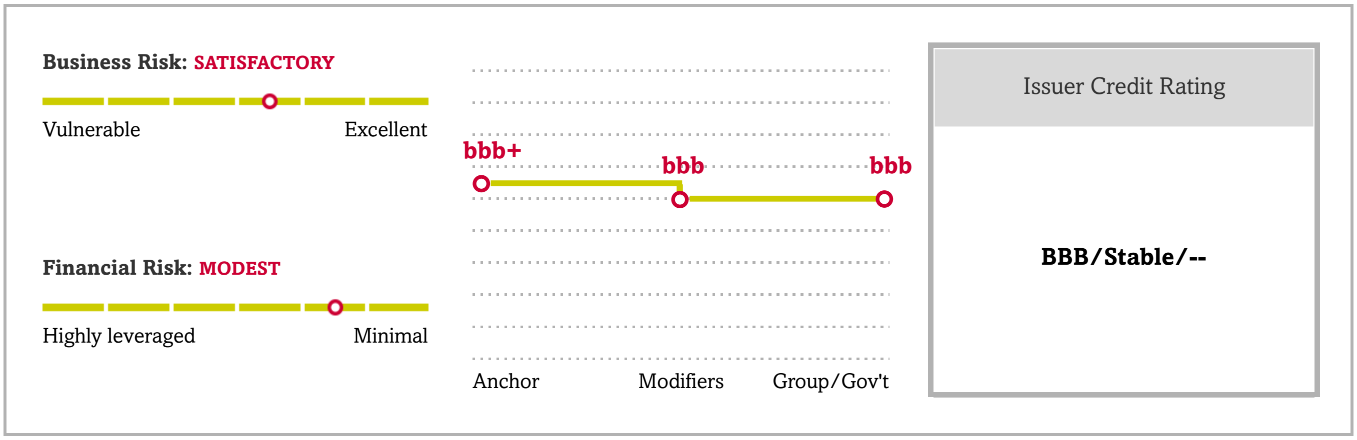


Credit Highlights

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 than industry average, as a result of 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) from 2021, which we expect will reduce discretionary cash flows.

S&P Global Ratings anticipates the construction industry will suffer in 2020 from the pandemic-related recession and then progressively recover in 2021. During first-half 2020, a large number of construction projects slowed or were suspended in several countries in the world. However, since the end of lockdowns, construction activity has resumed. Unlike for other businesses, the civil infrastructure construction sector currently benefits from a healthy order backlog, which supports a quick return to production. However, due to ongoing social-distancing rules, the sector is not yet at full capacity. For most of the construction companies we rate, this means revenue decline in the mid-teens in terms of percentage. However, there is a high degree of uncertainty regarding the COVID-19 pandemic, therefore risks remain.

Stable profitability, even under challenging economic conditions, demonstrates the resilience of Strabag's business. Strabag reported solid margins during the first half of 2020, and we expect the company will have sufficient rating headroom to face the difficult market environment due to the lockdown experience related to the Covid-19 outbreak. Despite the output decreased by 10% and revenues by 9% in the first half of 2020, reported EBITDA increased by 2% during the same period. This highlights Strabag's ability to control its operating costs and manage operational risk efficiently. We expect that Strabag will be able to maintain its operating margins based on its good track record of successful completion of projects on schedule.

Outlook: Stable

The stable outlook on Austria-based construction group Strabag reflects our view that the company will continue to post an adjusted EBITDA margin of about 6%-7% in 2020 and 2021. We think that Strabag has some headroom in its leverage metrics to absorb the negative impact of the COVID-19 outbreak on the business, as well as some expansionary investments and selected bolt-on acquisitions. Furthermore, we believe that in 2020-2021 its financial metrics could absorb a likely reversal of the exceptionally favorable working capital trend that boosted its gross cash from 2017 to 2019. 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 a downgrade is unlikely in 2020-2021, since there is room for a potential weakening of credit metrics at the current rating level. However, we believe that credit metrics could deteriorate to these trigger levels if:

- The effects of the pandemic and resulting global recession do not ease, but extend in 2021, with prolonged shutdowns and suspension of construction projects.
- Strabag experiences meaningfully weaker operating performance and a materially adverse trend in working capital needs.
- There is 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 was more than 60%, and debt to EBITDA less than 1.5x. 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) will 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

- Real GDP growth in Germany to drop by 6.2% in 2020, partially recovering by 4.4% in 2021; in Austria to drop by 6.7% in 2020 increasing by 4.1% in 2021; and in Central and Eastern Europe (CEE) to drop by 5.9% in 2020 increasing by 4.9% in 2021.
- Construction activity to gradually recover in the second half of 2020 and 2021, after a pause during the first half of 2020 in some developed markets. This translates into a revenue decline of 10%-11% in 2020.

- We expect output volume at about €15 billion in 2020. A solid order intake across Strabag's key markets, such as Germany and Poland, where COVID-19 related restrictions did not have a material impact, supports a more resilient performance in 2020 than other construction players.
- We expect Strabag will maintain operating margins, thanks to cost-containment measures and efficiency improvements. This results in an expected EBITDA margin of 6.0%-7.0% and EBIT of 3.3%-3.5% in 2020 and 2021.
- A reversal of the positive working capital trend, which continued in 2019, and still-sustained capex, at about 3.5-4.0% of sales, which will result in negative FOCF in 2020-2021.
- We anticipate about €30 million for bolt-on acquisitions in 2020, resuming to €100 million annually from 2021.

Key Metrics

Strabag SE--Key Metrics*

	--Fiscal year ended Dec. 31--				
(Mil. €)	**2018a**	**2019a**	**2020e**	**2021f**	**2022f**
Revenue growth (%)	12.7	2.9	(9)-(12)	8-10	1.5
EBITDA margin (%)	6.3	7.4	6.5-7.5	7-7.5	7-7.5
Funds from operations (FFO)	810.5	1,000.6	840-850	850-950	950-1000
Capital expenditure	643.4	647.4	430-450	450-550	450-550
Debt to EBITDA (x)	N.M.	N.M.	N.M.	N.M.	Below 1.5
FFO to debt (%)	N.M.	N.M.	N.M.	N.M.	Above 60

*All figures adjusted by S&P Global Ratings. a--Actual. e--Estimate. f--Forecast. N.M.--Not meaningful.

We expect credit metrics to remain strong in 2020-2021, notwithstanding the negative impact of COVID-19. We continue to forecast S&P Global Ratings-adjusted net debt to be zero in 2020, which leads to material headroom to absorb the negative impact from COVID-19 and a potential slowdown in demand. We note that a reversal of the working capital trend and still-sustained capex is likely to lead to negative FOCF generation in 2020-2021, but debt to EBITDA and FFO to debt should remain well away from the level of the downside triggers.

S&P Global Ratings acknowledges a high degree of uncertainty about the evolution of the coronavirus pandemic. The current consensus among health experts is that COVID-19 will remain a threat until a vaccine or effective treatment becomes widely available, which could be around mid-2021. We are using this assumption in assessing the economic and credit implications associated with the pandemic (see our research here: www.spglobal.com/ratings). As the situation evolves, we will update our assumptions and estimates accordingly.

Company Description

With annual output of about €16.6 billion in 2019, Strabag is one of Europe's largest construction groups. It operates in following three segments:

- North and West (49% of 2019 output volume with an EBIT margin of 4.1%), mainly including Germany, Poland, Belgium, the Netherlands, Luxembourg, and Scandinavia, and the Ground Engineering segment;
- South and East (29% of 2019 output volume with an EBIT margin of 2.5%), mainly including Austria, Switzerland, the Czech Republic, Slovakia, Hungary, south eastern Europe, Russia, and neighboring countries, and the Environmental Engineering segment; and

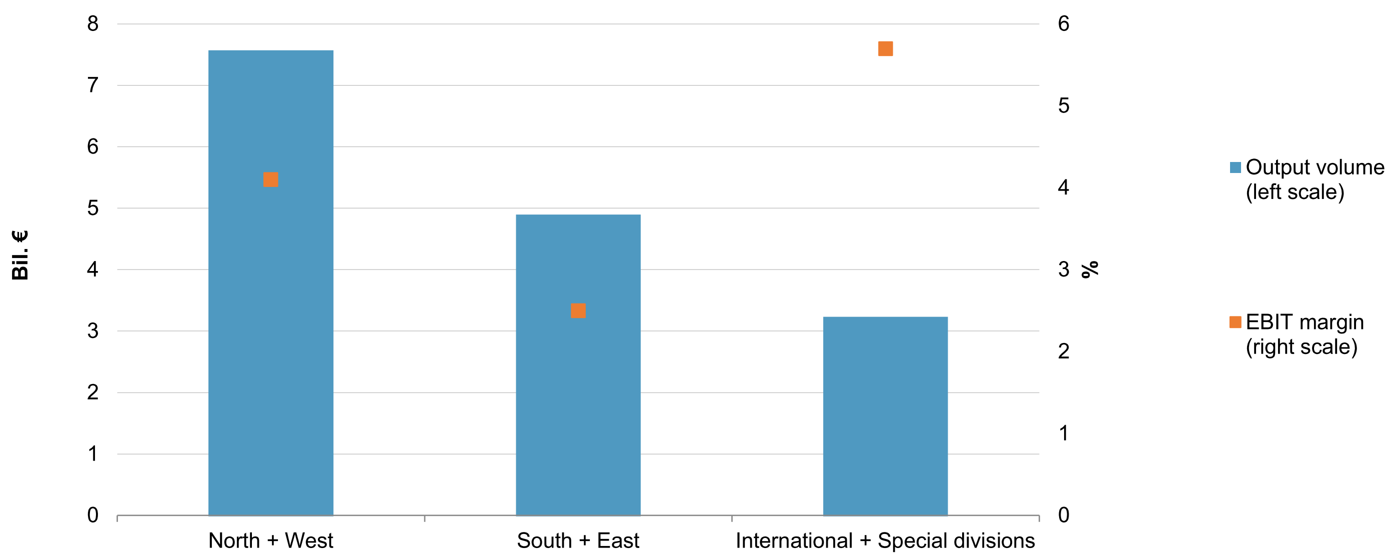
- International and Special Divisions (21% of 2019 output volume with an EBIT margin of 5.7%), comprising International, Tunneling, Construction Materials (except asphalt), Property & Facility Services, Real Estate, and Infrastructure Development (concessions).

We think the company's medium-term strategy will continue to focus on increasing margins by implementing 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.

The shareholder structure of the company did not change in 2019. 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 MKAO "Rasperia Trading Ltd." (25.9%). The remaining 6.7% are treasury shares.

Chart 1

Strabag's 2019 Output Volume And EBIT Margin By Business Segment



Source: S&P Global Ratings.

Peer Comparison

Table 1

Strabag SE--Peer Comparison

Industry sector: Engineering and construction

	Strabag SE	Webuild S.p.A.	ACS, Actividades de Construccion y Servicios SA	VINCI S.A.
Ratings as of Oct. 6, 2020	BBB/Stable/--	BB-/Watch Neg/--	BBB/Stable/A-2	A-/Stable/A-2
	--Fiscal year ended Dec. 31, 2019--			
(Mil. €)				
Revenue	15,668.6	5,130.0	39,048.9	47,554.3
EBITDA	1,159.9	517.7	3,225.2	8,948.9
Funds from operations (FFO)	1,000.6	347.2	2,514.2	6,870.4
Interest expense	44.7	85.1	509.8	619.6
Cash interest paid	36.5	89.4	502.8	572.2
Cash flow from operations	1,020.2	95.7	2,399.1	6,697.3
Capital expenditure	647.4	98.9	783.0	2,164.7
Free operating cash flow (FOCF)	372.7	(3.2)	1,616.1	4,532.6
Discretionary cash flow (DCF)	259.1	(9.3)	1,130.5	1,858.6
Cash and short-term investments	2,414.9	1,020.9	8,533.1	8,016.9
Debt	0.0	1,976.2	7,794.5	23,228.0
Equity	3,855.9	1,504.1	5,495.9	17,490.0
Adjusted ratios				
EBITDA margin (%)	7.4	10.1	8.3	18.8
Return on capital (%)	16.7	6.2	18.1	14.0
EBITDA interest coverage (x)	26.0	6.1	6.3	14.4
FFO cash interest coverage (x)	28.4	4.9	6.0	13.0
Debt/EBITDA (x)	0.0	3.8	2.4	2.6
FFO/debt (%)	N.M.	17.6	32.3	29.6
Cash flow from operations/debt (%)	N.M.	4.8	30.8	28.8
FOCF/debt (%)	N.M.	(0.2)	20.7	19.5
DCF/debt (%)	N.M.	(0.5)	14.5	8.0

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 revenue from more stable concession businesses. Webuild S.p.A. 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 than ACS and Vinci, and its margins are comparatively lower mainly due to its revenue concentration in European countries. However, Strabag has historically displayed consistently lower leverage compared with rated peers.

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 less volatile profitability 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 3.8% in 2019, slightly improving from 3.7% in 2018. Strabag aims to post EBIT margins exceeding 4% from 2022, supported by recent risk management measures, improvements in strategic procurement, digitalization, and corporate programs related to employee development.

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.

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 2019 stood at about €1.1 billion, leading to zero 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 from 2017 to 2019. We anticipate that this favorable trend of working capital will likely revert in 2020-2021, leading to significant cash absorption. We believe that capex will be sustained in 2020-2021, at about 3.5-4.0% of sales. As a result, the company's FOCF will likely be fairly weak over the next few years.

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, taking its ownership to 100%. In April 2019, Strabag took over the property management business of CORPUS SIREO Real Estate GmbH. This was followed in June by the purchase of PORREAL Polska sp. z o.o. of Warsaw and PORREAL Cesko s.r.o. of Prague, which provide services in technical and infrastructural facility management. This is well in line with the company's strategy of focusing on rounding off the existing business and, following a slowdown in mergers and acquisitions in 2020 due to COVID-19, the company will resume its pipeline of bolt-on acquisitions from 2021.

Financial summary

Table 2

Strabag SE--Financial Summary

Industry sector: Engineering and construction					
	--Fiscal year ended Dec. 31--				
	2019	**2018**	**2017**	**2016**	**2015**
(Mil. €)					
Revenue	15,668.6	15,221.8	13,508.7	12,400.5	13,123.5
EBITDA	1,159.9	960.3	945.9	959.7	947.6
Funds from operations (FFO)	1,000.6	810.5	864.0	621.8	764.4
Interest expense	44.7	66.5	68.0	73.5	98.0
Cash interest paid	36.5	59.4	57.4	63.3	82.2
Cash flow from operations	1,020.2	672.9	1,269.7	205.3	1,188.3
Capital expenditure	647.4	643.4	457.6	412.5	395.8
Free operating cash flow (FOCF)	372.7	29.6	812.1	(207.2)	792.6
Discretionary cash flow (DCF)	259.1	(80.4)	711.4	(277.4)	736.0
Cash and short-term investments	2,414.9	2,344.3	2,769.3	1,982.7	2,710.9
Gross available cash	2,414.9	2,344.3	2,769.3	1,982.7	2,710.9
Debt	0.0	0.0	0.0	42.5	0.0
Equity	3,855.9	3,653.8	3,397.7	3,264.6	3,320.6
Adjusted ratios					
EBITDA margin (%)	7.4	6.3	7.0	7.7	7.2
Return on capital (%)	16.7	15.5	13.8	13.4	10.6
EBITDA interest coverage (x)	26.0	14.4	13.9	13.1	9.7
FFO cash interest coverage (x)	28.4	14.6	16.1	10.8	10.3
Debt/EBITDA (x)	0.0	0.0	0.0	0.0	0.0
FFO/debt (%)	N.M.	N.M.	N.M.	1,462.1	N.M.
Cash flow from operations/debt (%)	N.M.	N.M.	N.M.	482.6	N.M.
FOCF/debt (%)	N.M.	N.M.	N.M.	(487.2)	N.M.
DCF/debt (%)	N.M.	N.M.	N.M.	(652.2)	N.M.

N.M.--Not meaningful

Reconciliation

Table 3

Strabag SE--Reconciliation Of Reported Amounts With S&P Global Ratings' Adjusted Amounts (Mil. €)

	--Fiscal year ended Dec. 31, 2019--						
Strabag SE reported amounts							
	Debt	**Shareholders' equity**	**EBITDA**	**Operating income**	**Interest expense**	**S&P Global Ratings' adjusted EBITDA**	**Cash flow from operations**
Reported	1,121.9	3,822.2	1,113.3	602.6	35.1	1,159.9	1,075.9
S&P Global Ratings' adjustments							
Cash taxes paid	--	--	--	--	--	(122.7)	--
Cash interest paid	--	--	--	--	--	(36.5)	--

Table 3

Strabag SE--Reconciliation Of Reported Amounts With S&P Global Ratings' Adjusted Amounts (Mil. €) (cont.)							
Reported lease liabilities	300.3	--	--	--	--	--	--
Postretirement benefit obligations/deferred compensation	560.6	--	--	--	9.5	--	--
Accessible cash and liquid investments	(2,119.1)	--	--	--	--	--	--
Dividends received from equity investments	--	--	88.1	--	--	--	--
Deconsolidation/consolidation	(666.8)	--	--	--	--	--	--
Income (expense) of unconsolidated companies	--	--	(41.4)	--	--	--	--
Nonoperating income (expense)	--	--	--	23.7	--	--	--
Noncontrolling interest/minority interest	--	33.7	--	--	--	--	--
EBITDA: Business divestments	--	--	(0.1)	(0.1)	--	--	--
Operating cash flow: Other	--	--	--	--	--	--	(55.8)
Total adjustments	(1,925.0)	33.7	46.6	23.6	9.5	(159.3)	(55.8)
S&P Global Ratings' adjusted amounts							
	Debt	**Equity**	**EBITDA**	**EBIT**	**Interest expense**	**Funds from operations**	**Cash flow from operations**
Adjusted	--	3,855.9	1,159.9	626.2	44.7	1,000.6	1,020.2

When calculating our adjusted credit ratios, we add to reported debt €300 million of reported lease liabilities and €560 million related to pension liabilities. 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 would provide financial support to these concessions if they were in need.

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 2020 and 2021. 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
For the 12 months from June 30, 2020, these include: • About €2.0 billion in cash as of June 30, 2020; • Access to a fully undrawn €400 million syndicated	For the same period, we estimate that the group's main liquidity uses are: • Capex of €450 million-€550 million annually over the next two years;

loan facility maturing in 2025; and • Cash FFO generation of about €890 million.	• 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 €30 million for 2020, reverting to €100 million annually thereafter; and • Dividends of about €100 million-€150 million annually.

Covenant Analysis

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

Issue Ratings - Subordination Risk Analysis

Capital structure

Strabag had two bonds outstanding maturing between 2020 and 2022, amounting to €400 million on Dec. 31, 2019. The bonds represent 28% of total consolidated debt, and are all issued at the parent level. The remaining part of the financial debt is represented by bank borrowings. We note that Strabag repaid one of the two bonds of €200 million in the second quarter of 2020.

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.

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

Related Criteria

- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- Criteria - Corporates - General: Reflecting Subordination Risk In Corporate Issue Ratings, March 28, 2018
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, 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

	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-

Ratings Detail (As Of October 7, 2020)*	
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.