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Ratings

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Strabag SE

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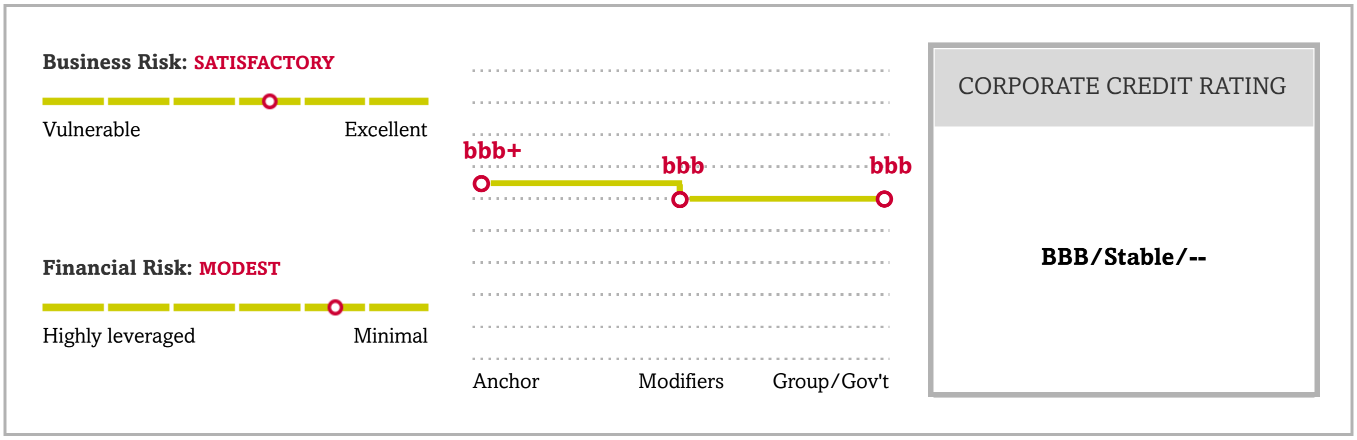

Rationale

Business Risk: Satisfactory	Financial Risk: Modest
• Leading positions in construction markets in Central Europe and some parts of Eastern Europe. • Renewed infrastructure spending in Germany and Central and Eastern Europe (CEE), which improves volumes. • Vertical integration that provides barriers to entry and strategic access to raw materials. • A track record of largely stable operating margins, which indicates generally good project execution and cost management. • A cyclical and competitive industry that is inherently exposed to project risk. • Relatively low, but less volatile, adjusted EBITDA margins compared with the industry average.	• High standing in the credit markets and solid perceived financial stability, underpinned by a reported net cash position. • Likely weakening of credit ratios, mainly due to the reversal of a positive trend in working capital over the past few years, and sustained capital expenditure (capex). • Volatile free cash flow generation during the year, with sizable seasonal swings in working capital. • A strong liquidity position.

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 7% in 2017 and 2018. We think that Strabag has some headroom in its leverage metrics to absorb some expansionary investments and selected bolt-on acquisitions. We expect our adjusted ratio of funds from operations (FFO) to debt for Strabag will comfortably exceed 45%, with adjusted debt to EBITDA remaining below 2x and continued strong liquidity 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 2x and FFO to debt drops to less than 45% over a sustained period of time. We believe that there is room for potential weakening of credit metrics at the current rating level. However, a significantly weaker operating performance and materially adverse trend in working capital needs could put pressure on the ratings. Downside pressure on the ratings may also arise from materially 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, while at the same time 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, while at the same time the company's discretionary cash flow will likely be fairly weak over the next few years.

Our Base-Case Scenario

Assumptions

- The German building construction and civil engineering business should contribute positively to Strabag's output volumes, fueled by renewed infrastructure spending in Germany.
- We also believe the Eastern European construction market will improve in 2017-2018 compared with 2016.
- Operating margins should continue benefiting from previous restructuring and Strabag's risk management program, which should offset the negative impact of continued intense pricing pressure.
- Capex in the range of €400 million-€500 million each year in 2017 and 2018, coupled with moderate working capital investments, largely shaped by a reversal of advance payment trends.
- About €100 million for bolt-on acquisitions annually over the next few years.

Key Metrics

	2016a	2017e	2018f
EBITDA margin (%)*	7.7	7.0-7.5	7.0-7.5
FFO to debt (%)*	1,869.9	>60	>60
Debt to EBITDA (x)*	0	<1.5	<1.5

*Fully adjusted by S&P Global Ratings. Data represent year-end figures when Strabag's net working capital position is at the lowest level. Figures include several adjustments (see the reconciliation table below). a--Actual. e--Estimate. f--Forecast.

Company Description

With annual output of about €13.5 billion in 2016, Strabag is one of Europe's largest construction groups. It reports on the following three segments:

- North and West (47% of 2016 output volume with an EBIT margin of 2.9%), mainly including Germany, Poland, Belgium, the Netherlands, Luxembourg, and Scandinavia, and the Ground and Hydraulic Engineering segment;
- South and East (30% of 2016 output volume with an EBIT margin of 4.8%), mainly including Austria, Switzerland, the Czech Republic, Slovakia, Hungary, southeastern Europe, Russia, and neighboring countries, and the Environmental Engineering segment; and
- International and Special Divisions (23% of 2016 output volume with an EBIT margin of 1.8%), 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 efficiency improvements under the "task force 2013ff" program, which has been evaluating Strabag's operations since midyear 2012, 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 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 Mr. Deripaska. The remaining 6.7% are treasury shares. In 2016, Strabag increased its stake in Zublin to 100% from 57.26%.

Business Risk: Satisfactory

The major factors supporting Strabag's satisfactory business risk profile remain the company's leading market positions in Central and Eastern Europe's engineering and construction markets. Strabag's good order backlog, usually covering about one year of earnings, provides decent forward 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. At the same time, profitability is a bit below the industry average. This reflects the competitive landscape in countries and segments where the company operates, but also that Strabag's projects are less risky than those in emerging markets. That said, the company's strengthening of risk management systems and streamlining of parts of the organization under the task force 2013ff program has resulted in operational improvements. The reported EBIT margin improved to 3.4% in 2016, up from 2.6% in 2015 and 2.3% in 2014, and Strabag aims to continue posting EBIT margins exceeding 3% in 2017.

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.

Our Base-Case Operating Scenario

We anticipate resilient profitability metrics for Strabag in 2017, assuming:

- Significant GDP growth in CEE of about 3.2% in 2017 and 2.9% in 2018.
- Strabag's first-quarter 2017 order backlog generates revenues equivalent to about 1.3x of total revenues at year-end 2016, which should underpin revenue generation in 2017.
- Output volume will increase by around 4% in 2017, driven mainly by German transport infrastructure business and the recovery of Eastern European infrastructure markets.
- Performance will likely be shaped by continued intense pricing pressure, but previous efficiency measures should lead to resilient profitability, with adjusted EBITDA margins stabilizing at about 7.0%-7.5% over the next few years.

Peer comparison

Our peer analysis includes construction companies such as ACS, the largest construction company in Europe. We also include Vinci S.A., a diversified infrastructure company with a significant portion of revenues from more stable concession businesses. Ferrovial S.A., in addition to its construction business, also has exposure to the services sector, which is less cyclical. Salini Impreglio SpA is a midsize construction company mainly focused on infrastructure construction contracts, with a substantial presence in the U.S. and high-risk countries.

Table 1

Strabag SE--Peer Comparison					
Industry Sector: Engineering & Construction					
	Strabag SE	**ACS, Actividades de Construccion y Servicios SA**	**Ferrovial S.A.**	**Salini Impregilo SpA**	**VINCI S.A.**
Rating as of July 3, 2017	BBB/Stable/--	BBB/Stable/A-2	BBB/Stable/A-2	BB+/Stable/--	A-/Stable/A-2
(Mil. €)	**--Fiscal year ended Dec. 31, 2016--**				
Revenues	12,400	31,975	10,280	5,884	38,203
EBITDA	960	2,469	1,264	588	6,605
Funds from operations (FFO)	795	1,697	1,082	432	4,628
Net income from cont. oper.	278	330	376	81	2,505
Cash flow from operations	231	1,559	862	309	4,651
Capital expenditures	412	581	249	260	1,509
Free operating cash flow	(182)	978	613	49	3,142
Discretionary cash flow	(252)	652	45	6	2,058
Cash and short-term investments	1,983	6,519	3,301	1,603	6,678
Debt	43	5,583	530	1,524	17,930
Equity	3,265	4,982	1,909	1,361	17,006
Adjusted ratios					
EBITDA margin (%)	7.7	7.7	12.3	10.0	17.3
Return on capital (%)	11.4	10.7	13.5	12.5	11.8
EBITDA interest coverage (x)	13.1	3.9	17.6	4.5	9.6
FFO cash int. cov. (x)	17.6	3.9	3.0	3.9	9.5
Debt/EBITDA (x)	0.0	2.3	0.4	2.6	2.7
FFO/debt (%)	1,869.9	30.4	204.0	28.4	25.8
Cash flow from operations/debt (%)	542.1	27.9	162.5	20.3	25.9
Free operating cash flow/debt (%)	(427.7)	17.5	115.6	3.2	17.5
Discretionary cash flow/debt (%)	(592.7)	11.7	8.5	0.4	11.5

Financial Risk: Modest

Strabag's modest financial risk profile reflects the company's 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 2016 stood at about €450 million, resulting in adjusted net debt of €42.5 million; therefore FFO to debt is not meaningful and debt to EBITDA is close to nil. We expect operating cash flow and leverage metrics will weaken over the next few years, mainly due to sustained capex of €400 million-€500 million per year. We also expect working capital will be a drain on cash in the next few years, due to the reversal of the unusual positive trend in 2014-2015.

Strabag has a track record of expansionary spending and debt-financed acquisitions, which have frequently resulted in negative free operating cash flow (FOCF). In 2016, Strabag finalized the acquisition of minority shares in Zublin, and this year, the group intends to finalize the acquisition of minority shares in Strabag AG Cologne, in which Strabag currently holds a 93.6% stake.

We do not include on- and off-balance-sheet nonrecourse debt relating to concessions for the AKA project in Hungary 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.

Our Base-Case Cash Flow And Capital Structure Scenario

In our base-case scenario, we anticipate that Strabag's credit metrics will worsen in 2017-2018, mainly reflecting the reversal of the positive working capital trend we saw in 2014 and 2015, and still-sustained capex, which will result in negative FOCF for 2017 before improving gradually thereafter. Still, we expect Strabag's credit metrics will remain fairly robust and commensurate with a modest financial risk profile.

We forecast that, in 2017 and 2018, the core ratio of adjusted FFO to debt will remain substantially above 60% and capex will stand at about 3.5% of sales. We anticipate about €100 million for bolt-on acquisitions annually over the next few years.

Financial summary

Table 2

Strabag SE--Financial Summary

Industry Sector: Engineering & Construction

	--Fiscal year ended Dec. 31--				
(Mil. €)	**2016**	**2015**	**2014**	**2013**	**2012**
Revenues	12,400	13,123	12,476	12,476	12,983
EBITDA	960	942	809	765	681
Funds from operations (FFO)	795	712	646	596	527
Net income from continuing operations	278	156	128	114	61
Cash flow from operations	231	1,218	854	716	288
Capital expenditures	412	396	346	387	458
Free operating cash flow	(182)	822	508	329	(170)
Discretionary cash flow	(252)	766	450	291	(240)

Table 2

Strabag SE--Financial Summary (cont.)

Industry Sector: Engineering & Construction

	--Fiscal year ended Dec. 31--				
(Mil. €)	**2016**	**2015**	**2014**	**2013**	**2012**
Cash and short-term investments	1,983	2,711	1,903	1,692	1,348
Debt	43	0	522	655	744
Equity	3,265	3,321	3,144	3,239	3,163
Adjusted ratios					
EBITDA margin (%)	7.7	7.2	6.5	6.1	5.2
Return on capital (%)	11.4	9.1	6.9	6.2	5.0
EBITDA interest coverage (x)	13.1	9.6	8.2	7.3	6.0
FFO cash int. cov. (x)	17.6	12.0	12.0	10.8	8.9
Debt/EBITDA (x)	0.0	0.0	0.6	0.9	1.1
FFO/debt (%)	1,869.9	N.M.	123.7	90.9	70.9
Cash flow from operations/debt (%)	542.1	N.M.	163.6	109.2	38.7
Free operating cash flow/debt (%)	(427.7)	N.M.	97.2	50.1	(22.8)
Discretionary cash flow/debt (%)	(592.7)	N.M.	86.2	44.4	(32.2)

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 2017 and 2018.

Principal Liquidity Sources	Principal Liquidity Uses
• About €2.0 billion in cash at year-end 2016. • Access to a fully undrawn €400 million syndicated loan facility maturing in 2022. • Cash FFO generation of around €640 million.	• Short-term debt maturities of €202 million. • Capex of €400 million-€500 million annually over the next two years. • Significant cash outflows of about €500 million by the end of the third quarter, related to seasonal working needs due to the nature of the business. • Working capital outflows of up to €200 million. • Bolt-on acquisitions costing about €100 million annually. • Dividends of about €100 million-€120 million annually.

Covenant Analysis

Strabag's syndicated loan facility is subject to some financial covenants, but headroom is currently ample and we assume no tightening in our base case.

Other Credit Considerations

We align our ratings on Strabag's senior unsecured debt with the long-term rating on Strabag. We estimate that the group's priority liabilities considerably exceed 20% of its total adjusted assets. However, there are significant factors mitigating this proportion of priority liabilities, such as the considerable geographic and business diversity of the group's operations.

Ratings Score Snapshot

Corporate 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)

Reconciliation

Table 3

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

	--Fiscal year ended Dec. 31, 2016--						
Strabag SE reported amounts							
	Debt	**Shareholders' equity**	**EBITDA**	**Operating income**	**Interest expense**	**EBITDA**	**Cash flow from operations**
Reported	1,426	3,186	855	425	46	855	264
S&P Global Ratings adjustments							
Interest expense (reported)	--	--	--	--	--	(46)	--

Table 3

Reconciliation Of Strabag SE Reported Amounts With S&P Global Ratings Adjusted Amounts (Mil. €) (cont.)							
Interest income (reported)	--	--	--	--	--	41	--
Current tax expense (reported)	--	--	--	--	--	(124)	--
Operating leases	174	--	76	14	14	62	62
Postretirement benefit obligations/deferred compensation	567	--	--	--	14	(22)	25
Surplus cash	(1,686)	--	--	--	--	--	--
Dividends received from equity investments	--	--	85	--	--	85	--
Nonrecourse debt	(439)	--	--	--	--	--	--
Non-operating income (expense)	--	--	--	41	--	--	--
Reclassification of interest and dividend cash flows	--	--	--	--	--	--	(85)
Non-controlling Interest/Minority interest	--	79	--	--	--	--	--
EBITDA - Income (expense) of unconsolidated companies	--	--	(21)	(21)	--	(21)	--
EBITDA - Other	--	--	(36)	(36)	--	(36)	--
EBIT - Finance/Interest income	--	--	--	(41)	--	--	--
OCF - Other	--	--	--	--	--	--	(36)
Total adjustments	(1,384)	79	104	(43)	27	(60)	(34)
S&P Global Ratings adjusted amounts							
	Debt	**Equity**	**EBITDA**	**EBIT**	**Interest expense**	**Funds from operations**	**Cash flow from operations**
Adjusted	43	3,265	960	382	73	795	231

Related Criteria

- 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 - Industrials: Key Credit Factors For The Engineering And Construction Industry, Nov. 19, 2013
- Criteria - Corporates - General: Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- 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: 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
- Criteria - Corporates - General: 2008 Corporate Criteria: Rating Each Issue, April 15, 2008

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 July 3, 2017)

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

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