Research Update:

Strabag Upgraded To 'BBB+' From 'BBB' On Solid Credit Metrics; Outlook Stable

September 17, 2024

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Rating Action Overview

- Strabag's risk management and financial policy, alongside a supportive business context, have kept the company's operating results and financial conditions very solid.
- Strabag boasts a diversified business model, strengthened market position in core countries, high vertical integration, and a solid order backlog.
- Strabag's adjusted net cash position has significantly increased after the COVID-19 pandemic, and we forecast credit metrics to remain very solid in 2024-2025, despite higher capital expenditure and shareholder remuneration.
- We therefore raised our long-term ratings on Strabag to ‘BBB+’ from ‘BBB’.
- The outlook is stable, reflecting our expectations that EBITDA margins will stand at 7.1%-7.3% in 2024-2025 and that Strabag will maintain a net cash position, notwithstanding our anticipation of reversal of working capital cash-inflows occurred in past few years and sustained capex.

Rating Action Rationale

Strabag has sustained resilient operating performance on the back of a continued healthy backlog and order intake. The company's sales rose 7.3% and its EBITDA margins expanded 40 basis points (bps) year on year in 2023. These improvements stemmed from positive momentum in non-residential and infrastructure segments, as well as cost-saving initiatives that offset persisting high cost inflation and low residential demand in Europe. Specifically in the first half of 2024, although revenue declined 3% year on year, margins improved 20 bps, thanks to the stable performance from the company's home markets, especially in Germany and Poland, and in transportation infrastructures in Romania and persistent cost-saving initiatives, partly offset by slow residential construction market in Austria. However, Strabag has solid order backlog of about €25.2 million as of mid-2024, representing a 3.7% increase from the level at end-2023, with order intakes focusing on refurbishment works and projects related to energy transition, owing to increasing market demand in the coming years.

Strabag's business risk profile benefits from the higher vertical integration and diversified business model. With its leading market position in Germany and Austria, Strabag has sustained financial stability over the past few years with strong credit metrics. This was mainly supported by the company's higher degree of vertical integration services along the entire construction value chain and diversified exposure in both size and nature of contracts. We see Strabag's contracts are well diversified with 12,828 projects at end-2023. Of these projects, the 10 largest projects represent only 21% of the order backlog, and the remaining were spread between small and midsized orders. In our view, Strabag is well aligned with sustainable growth trajectory, once the market recovers from the prevailing high interest rate and weak macro-economic environment, to advance toward green energy initiatives in Europe.

Strabag has a good track record of high order backlogs that will likely continue to support its credit metrics. At end-2023, the biggest contributions to the order backlog were from home markets in Germany (53%) and Austria (10%), followed by Central and Eastern Europe (19%), the rest of Europe (12%), and the rest of the world (6%). The company's order backlog has grown steadily in the past decade, reaching €22.5 billion in 2021, when the company recorded a sizable year-over-year increase of 22.5%, supported by major contracts in Germany and Austria, then €24.3 billion in 2023, from €14.4 billion in 2014.

Strabag's market-leading position in its core markets further underpins its business risk profile, in our view. As one of the largest construction companies in its eight core markets, Strabag holds the no. 1 market position in terms of output volume in Germany, Austria, the Czech Republic, Slovakia and Croatia. It ranks no. 2 in Poland and no. 4 in Hungary and Romania.

We think Strabag will maintain a net cash position over the coming years, despite elevated shareholder remuneration and sizable capital expenditure (capex), alongside our anticipation of reversal of working capital cash inflow reported in past years. In the first half of 2024, the company recorded a net cash position of €1.6 billion, with a reported cash balance of €2.4 billion, naturally leading to zero adjusted debt. Strabag adjusted net cash position has significantly increased after the COVID-19 pandemic, reflecting exceptional working-capital-related cash inflow trend that boosted its gross cash.

Strabag's liquidity remains strong. With higher exposure to tender based public sector projects (64% as of end-2023), Strabag maintains a strong liquidity position enabling flexibility to participate in bidding contracts and other bolt-on acquisitions. As of end-June 2024, Strabag held about €2.2 billion of cash and cash equivalents. The company also reported full availability of its €400 million revolving credit facility (RCF).

We see the lawsuit filed by MKAO Rasperia Trading Ltd. against Strabag and core shareholders as rating neutral for the time being. Rasperia claims that Strabag's response to EU sanctions have cost the investment holding company about €1.9 billion, which it demands to be collected from AO Raiffeisenbank in Russia (naturally impossible from EU counterparties). Strabag has taken diverse actions in the past couple of years to limit the impact from, and be compliant with, the sanctions against Rasperia, including the reduction of shares to 24.1% (below 25.0% blocking minority), exclusion from control exercise, and complete freezing of dividends. We recognize that all the actions taken by Strabag so far have been successful in preserving its reputation, ensuring new business, and sustaining growth, which we can see via the strong order backlog. At this stage, our base case does not include any negative impact from this litigation on the company's financial metrics, and we will continue to monitor its developments.

Outlook

The stable outlook reflects our view that Strabag should continue to post an S&P Global Ratings-adjusted EBITDA margin of 7.1%-7.3% in 2024-2025. We also think Strabag will keep a net cash position notwithstanding our anticipation of a reversal of the exceptionally favorable working capital trend that boosted its gross cash from 2017 to 2021, and some expansionary investments and selected bolt-on acquisitions. We expect adjusted funds from operations (FFO) to debt will comfortably exceed 45% over the next two years, with adjusted debt to EBITDA remaining below 2.0x and liquidity staying strong.

Downside scenario

We could consider a negative rating action if Strabag's debt-to-EBITDA ratio, as adjusted by S&P Global Ratings, exceeds 2.0x and FFO to debt drops to less than 45% over a sustained period. This could occur, for example, if Strabag:

- Pursues sizable acquisitions or increased shareholder returns translate into debt much higher than our base-case projection;
- Experiences a meaningfully weaker operating performance or unfavorable trend in its working capital needs due to a material project setback or cost overruns; or
- Sees its profitability margin sustainably reduce from current level due for example to increased competition or renewed inflation pressure.

However, we assume that the company's ample headroom in its credit metrics will keep rating pressure at bay in 2024-2025.

Upside scenario

We could raise the ratings if we observe a track record of materially positive discretionary cash flow in the business cycle and if Strabag sustains FFO to debt above 60% and debt to EBITDA under 1.5x, with a commitment to keep those metrics through the cycle. We see this scenario as unlikely in 2024-2025 considering our projections of negative discretionary cash flow driven by a reversal of working capital and high capex.

Company Description

With annual output volume of about €19.1 billion in 2023, Strabag is one of Europe's largest construction groups. It operates in the following three segments:

- North and West (43% of 2023 output volume, with an EBIT margin of 8.9%), mainly including Germany, Switzerland, Benelux, Scandinavia, and the Ground Engineering segment.
- South and East (40% of 2023 output volume, with an EBIT margin of 5.3%), mainly including Austria, Poland, Hungary, Czech Republic, Slovakia, Adriatic, Rest of Europe, and the Environmental Engineering and Construction Materials segments; and
- International and Special Divisions (16% of 2023 output volume, with an EBIT margin of -4.4%), comprising International, Tunneling, Services, Real Estate Development, and Infrastructure Development.

About 68% of Strabag’s output volume in 2023 comes from Building construction and Transportation infrastructure, equally split between the two segments, whereas Civil engineering accounts for 9%. Construction materials and Services account for 6% each, Tunneling and International sector account for 5% each, and Project development accounts for 1%.

Strabag is a publicly listed company, with a free float of 10.9%. Its core shareholders are the Haselsteiner family (30.7%), Raiffeisen/UNIQA (31.9%), and MKAO Rasperia Trading Ltd. (24.1%).

Our Base-Case Scenario

Assumptions

- We expect GDP growth in Germany of 0.3% in 2024, 1.2% in 2025, and 1.2% in 2026; and in the eurozone of 0.7%, 1.4%, and 1.4% for the same years.
- We expect revenue growth of 3.9%-4.0% for 2024, supported by continued execution of strong order backlog, along with positive business momentum in its home markets of Germany followed by Poland and Romania. The growth is partially offset by Austria's weak residential construction sector. We expect a moderate growth of 4.0%-4.5% from 2025 on, supported by the expected market recovery in the construction market.
- Adjusted EBITDA margin is expected to stabilize at 7.0%-7.6% in our forecast period, supported by its strong presence in its home markets and continued cost-cutting measures and effective cost-price models. Higher degree of vertical integration and ongoing efficiency enhancements supports Strabag to control its operating costs and manage operational risk efficiently.
- Capex of about €750 million for 2024 in line with the management guidance.
- Annual working capital outflow of €400 million-€500 million for 2024-2025 and €180 million-€200 million for 2026, based on the continued execution of strong order backlogs and expected construction output.
- Acquisitions of €100 million-€130 million in 2024 as we expect management to continue its bolt-on acquisitions.
- Negative FOCF of €90 million-€140 million expected for each year in 2024-2025 owing to higher capex and working capital outflows.
- We expect dividend payout of 40%-41% of previous year’s earnings, in line with the dividend policy, where net dividend to Rasperia is deducted. Overall, this results negative discretionary cash flow of €360 million-€400 million for 2024-2025.
- Cash haircut of about €300 million, representing cash not immediately available as located in subsidiaries or joint ventures, or held as performance guarantees by tender awarders.

Key metrics

Strabag SE--Forecast summary

Period ending	Dec-31-2020	Dec-31-2021	Dec-31-2022	Dec-31-2023	Dec-31-2024	Dec-31-2025	Dec-31-2026
(Mil. EUR)	2020a	2021a	2022a	2023a	2024e	2025f	2026f
Revenue	14,703	15,243	16,967	17,594	18,200-18,400	18,900-19,100	19,800-20,000
EBITDA	1,131	1,426	1,168	1,292	1,200-1,300	1,300-1,400	1,400-1,500
Adjusted ratios							

Strabag SE--Forecast summary

Debt/EBITDA (x)	--	--	--	--	--	--	--
FOCF/debt (%)	NM	NM	NM	NM	NM	NM	NM
DCF/debt (%)	NM	NM	NM	NM	NM	NM	NM
EBITDA margin (%)	7.7	9.4	6.9	7.3	7.0-7.1	7.2-7.4	7.4-7.6

All figures are adjusted by S&P Global Ratings, unless stated as reported. a--Actual. e--Estimate. f--Forecast. EUR--euro. NM--not meaningful.

Liquidity

We assess Strabag's liquidity as strong as the liquidity sources exceed needs by more than 1.5x over next 24 months starting from July 1, 2024. The company enjoys solid relationships with its banks. Stability in the financial market and prudent financial risk management further support our strong liquidity assessment.

For the 12 months started July 1, 2024, we estimate that Strabag's principal liquidity sources include:

- Available cash and cash equivalent of about €2.4 billion at end of June 2024, out of which we consider unavailable approximately €390 million set as a liquidity reserve related to Rasperia.
- Access to a fully undrawn €400 million syndicated loan facility maturing in March 2026.
- Annual cash FFO of €1.0 billion-€1.1 billion.

For the same period, we estimate the following principal liquidity uses:

- Capex of around €750 million.
- Significant cash outflows related to seasonal working needs--due to the nature of the business--of €400 million-€500 million.
- Working capital outflows of €400 million-€500 million.
- Dividends of approximately €200 million, where net dividend of Rasperia is deducted.
- Bolt-on acquisition of €100 million-€130 million for next 12 months.

Environmental, Social, And Governance

Environmental, social, and governance factors are an overall neutral consideration in our credit rating analysis of Strabag. A significant portion of its backlog is in transportation infrastructure, building construction, and civil engineering, which we see as neutral in terms of environmental risk. Strabag's backlog is not exposed to the metals and mining or oil and gas end-markets. In addition, Strabag has a track record of significantly fewer litigations than other companies operating in the same industry, which has helped preserve its creditworthiness.

We recognize Strabag's focus on sustainability by setting a target of becoming climate neutral by 2040. In fact, in 2020 Strabag established a separate entity, Sustainability Management, to manage and coordinate its strategy for achieving the zero emissions goals.

Moreover, we see Strabag involving its management at different levels, the so-called four-tier governance structure, in promoting the group's strategic orientation towards sustainable business practices.

Rating Component Scores

Rating Component Scores

Issuer credit rating	BBB+/Stable/--

Rating Component Scores

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/Undiversified
Capital structure	Neutral
Financial policy	Neutral
Liquidity	Strong
Management and governance	Neutral
Comparable rating analysis	Neutral
Stand-alone credit profile	bbb+

Related Criteria

- Criteria | Corporates | General: Sector-Specific Corporate Methodology, April 4, 2024
- Criteria | Corporates | General: Corporate Methodology, Jan. 7, 2024
- Criteria | Corporates | General: Methodology: Management And Governance Credit Factors For Corporate Entities, Jan. 7, 2024
- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- 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
- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Related Research

- Global Engineering And Construction: 2024 outlook update, July 24, 2024

Ratings List

Ratings list

Upgraded

	To	From
Strabag SE		
Issuer Credit Rating	BBB+/Stable/--	BBB/Stable/--