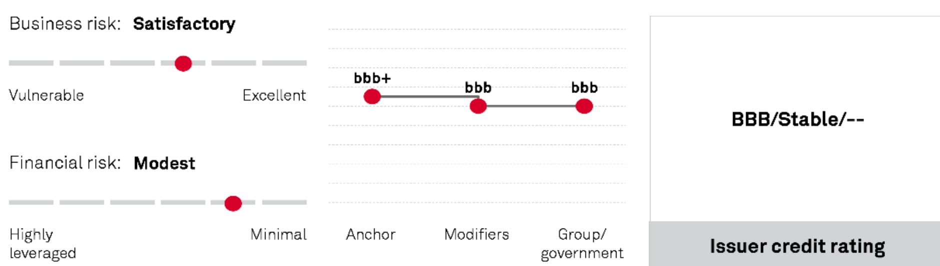
Strabag SE

December 20, 2021

Ratings Score Snapshot



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Credit Highlights

Overview

Key strengths	Key risks
Leading positions in the construction markets in Central Europe and some parts of Eastern Europe.	Exposure to the cyclical and competitive construction industry, which is 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 S&P Global Ratings-adjusted EBITDA margins than the industry average, driven by Strabag's exposure to low-risk countries.
A high standing in the credit markets and solid financial stability, underpinned by a reported net cash position.	Sustained capital expenditure (capex) and working capital requirements from 2021, which we expect to reduce discretionary cash flows.

Strabag had strong results in the first nine months of 2021. As of Sept. 30, 2021, Strabag's output volume increased by 4% compared to the same period in 2020, the continuation of a positive trend. Support came from strong market conditions in Austria, combined with the execution of large infrastructure projects in the U.K. The order backlog stood at €21.6 billion as of Sept. 30, 2021, marking a 14% increase compared with the previous year. In line with management's view, we expect that output volume in 2021 will exceed that in 2020, standing above €15.4 billion.

We expect Strabag to benefit from positive trends in the construction industry and to continue to post a resilient operating performance in most of its regions over 2021-2022. Strabag's reported EBITDA was up 35% in the first half of 2021 versus 2020, and we forecast that the company's operating performance will remain robust in the second part of 2021 and in 2022 in most of its regions. This reflects both volume growth and Strabag's focus on cost efficiency amid rising inflation. We also take a positive view of business conditions for the construction industry in most of the regions where Strabag operates, particularly Germany, Austria, and continental Europe. We foresee sufficient headroom at the current rating, considering the supportive business conditions, strong order backlog, and resilient margins. Given Strabag's project-execution efficiency, these factors should all help offset the impact from an increase in working capital, a special dividend, and rising cost inflation.

Our ratings on Strabag remain unaffected by the pandemic thanks to the company's resilient performance. Strabag has benefited from its superior end-market diversification and strong order backlog. Resilient market conditions in Germany have helped the company fully offset the declines in pandemic-hit markets like Austria, where its operations have faced disruption. As a result, Strabag's adjusted sales decline in 2020 remained moderate at negative 5.8%. Strabag's timely efforts to implement efficiency programs, along with its timely project execution, helped improve its EBITDA margin by 110 basis points. The company did not face any payment-collection problems, and hence working capital remained positive, supporting solid free operating cash flow (FOCF) generation.

Strabag's balanced capital structure, solid cash flow generation, and high cash balance support a strong liquidity profile. Strabag's cash build-up has been strong since 2017, thanks to working capital-related inflows and very solid FOCF driven by resilient earnings. By the end of June 2021, the company's reported net cash position had declined to about €814 million from about €1.7 billion at the end of 2020. This followed the distribution of an increased dividend totaling € 707.94 million for 2020 from retained earnings, and the absorption of a working capital-related outflow of about €450 million. Nevertheless, Strabag's liquidity profile remains strong, and the special dividend did not have a material impact on the company's rating headroom because it still had zero net debt.

Outlook

The stable outlook on Austria-based construction company Strabag reflects our view that the company will continue to post an adjusted EBITDA margin of about 7.0%-7.5% in 2021 and 2022. We think that Strabag has some headroom in its leverage metrics to absorb the negative impact of increasing cost inflation, as well as some expansionary investments and selected bolt-on acquisitions. Furthermore, we believe that in 2021-2022, Strabag's financial metrics could absorb a likely reversal of the exceptionally favorable working capital trend that boosted its gross cash from 2017 to 2020. We expect that the company's 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 rises to more than 2.0x and FFO to debt drops to less than 45% over a sustained period. We believe that a downgrade is unlikely in 2021-2022 since there is headroom for a potential weakening of the credit metrics at the current rating. However, we believe that the credit metrics could deteriorate to these downgrade trigger levels if:

- Strabag experiences meaningfully weaker operating performance and a materially adverse trend in its working capital needs.
- There is markedly high debt, owing for instance to sizable acquisitions or increased shareholder returns that we do not reflect in our base-case scenario.

Upside scenario

We could raise the ratings if we observed a track record of materially positive discretionary cash flows, with FFO to debt more than 60% and debt to EBITDA less than 1.5x. Strabag's financial metrics are generally significantly weaker than this for most of the year, mainly reflecting seasonal working capital requirements. We expect that 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

- A recovery to real GDP growth in Germany of 3.1% in 2021 and 5% by 2022. Austria and Central and Eastern Europe (CEE) are also set to see their real GDP growth recover to 2.5% and 4.4% in 2021 and 3.2% and 4.7% in 2022, respectively.
- Output volume above €15.4 billion in 2021, supported by a positive business environment in the company's low-risk regions, such as Germany and Poland. Hence, we expect modest revenue growth of about 2%-3% in 2021 and about 1%-2% from 2022.
- Slightly lower adjusted EBITDA margins than in 2020, at about 7.0%-7.5%, mostly due to input-cost inflation and higher operating expenses.
- A reversal of the trend in advance payments from this year, resulting in higher working capital outflow in 2021 and weaker FOCF for the year. Thereafter, we expect working capital requirements to normalize to €50 million-€150 million per year, which should result in solid positive FOCF.
- About €100 million for bolt-on acquisitions annually from 2021.
- Maintenance of the dividend policy, which stipulates a payout of 30%-50% of net income.

Key metrics

Strabag --Key Metrics*

Mil. €	2019a	2020a	2021e	2022f	2023f
Revenue growth (%)	2.6	(5.6)	2-3	1-2	1-2
EBITDA margin (%)	6.7	7.7	7-7.5	7-7.5	7-7.5
Funds from operations (FFO)	881.7	944.4	850-870	860-880	870-890
Capital expenditure	647.4	451.0	450-470	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 a continuous recovery in the economy and market demand, but higher margin pressure. The moderating EBITDA margins from 2021 reflect significantly higher raw material costs this year, which cost-control measures will only partly offset.

Strong credit metrics will offer leeway to increase spending on investments, acquisitions, and shareholder distributions. Our base-case scenario for 2021-2022 is driven by higher spending on working capital, capex, acquisitions, and dividends. These will partially reduce rating headroom, but we continue to forecast zero adjusted net debt in 2021-2022, providing material leeway to absorb the negative effects of cost inflation and continued market uncertainty.

We expect lower FOCF in 2021, mostly due to normalizing earnings due to cost inflation and an increase in working capital and capex. The reversal of the favorable working capital trend and sustained capex will reduce FOCF generation in 2021, but debt to EBITDA and FFO to debt should remain well away from the rating downside triggers. We also anticipate that Strabag's liquidity will remain strong, supported by its cash balance and undrawn bank lines.

Company Description

With annual output volume of about €15.4 billion in 2020, Strabag is one of Europe's largest construction groups. It operates in following three segments:

- North and West (51% of 2020 output volume, with an EBIT margin of 5.4%), mainly including Germany, Poland, Belgium, the Netherlands, Luxembourg, and Scandinavia, and the Ground Engineering segment;
- South and East (30% of 2020 output volume, with an EBIT margin of 3.8%), 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 (18% of 2020 output volume, with an EBIT margin of 2%), 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 strengthening its risk management policies. We also expect that Strabag will continue to focus on both organic and inorganic growth opportunities, although we understand that management does not see many opportunities outside Europe that meet the company's requirements in terms of risk management and profitability. Therefore, the company will continue to focus on its existing markets.

Strabag is publicly listed, with a free float of 14.4%. Its core shareholders are the Haselsteiner family (28.3%), Raiffeisen/UNIQA (29.5%), and MKAO Rasperia Trading Ltd. (27.8%).

Peer Comparison

Our peer analysis includes construction companies Actividades de Construccion y Servicios S.A. (ACS), the largest construction company in Europe, and VINCI S.A., a diversified infrastructure company with a significant portion of revenues from more stable concession businesses. Webuild SpA is a midsize construction company focused on infrastructure construction contracts, with a substantial presence in the U.S. and high-risk countries. Strabag is a smaller player compared to ACS and Vinci, and its margins are lower, mainly due to its revenue concentration in European countries. However, Strabag has historically displayed consistently lower leverage and more resilient margins than its rated peers.

Strabag SE--Peer Comparisons

	Strabag SE	Webuild S.p.A.	ACS, Actividades de Construccion	VINCI
Foreign currency issuer credit rating	BBB/Stable/--	BB-/Stable/--	BBB-/Stable/A-3	A-/Stable/A-2
Local currency issuer credit rating	BBB/Stable/--	BB-/Stable/--	BBB-/Stable/A-3	A-/Stable/A-2
Period	Annual	Annual	Annual	Annual
Period ending	2020-12-31	2020-12-31	2020-12-31	2020-12-31
Mil.	EUR	EUR	EUR	EUR
Revenue	14,703	4,463	34,823	43,176
EBITDA	1,131	179	1,665	6,298
Funds from operations (FFO)	944	47	872	4,757
Interest	32	91	459	541
Cash interest paid	31	83	431	489
Operating cash flow (OCF)	1,233	119	1,846	6,908
Capital expenditure	451	184	413	1,986
Free operating cash flow (FOCF)	782	(65)	1,433	4,922

Strabag SE--Peer Comparisons

Discretionary cash flow (DCF)	676	(95)	943	3,865
Cash and short-term investments	2,802	2,455	8,529	11,434
Gross available cash	2,802	2,455	8,529	11,434
Debt	0	1,851	9,278	18,637
Equity	4,108	2,085	4,276	18,501
EBITDA margin (%)	7.7	4.0	4.8	14.6
Return on capital (%)	15.0	(5.1)	3.3	7.5
EBITDA interest coverage (x)	35.0	2.0	3.6	11.6
FFO cash interest coverage (x)	31.1	1.6	3.0	10.7
Debt/EBITDA (x)	0.0	10.3	5.6	3.0
FFO/debt (%)	NM	2.6	9.4	25.5
OCF/debt (%)	NM	6.4	19.9	37.1
FOCF/debt (%)	NM	(3.5)	15.4	26.4
DCF/debt (%)	NM	(5.1)	10.2	20.7

Business Risk

Strabag benefits from leading positions in the CEE's engineering and construction markets. Strabag's strong order backlog of about €18.4 billion, at Dec. 31 2020, usually covering about one year of earnings, provides good visibility, although it is smaller than some peers' backlogs, mainly reflecting the lower average size of the 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. Strabag's profitability is slightly below the industry average, but it is less volatile and has proved resilient amid the pandemic. This reflects the competitive landscape in the countries and segments where the company operates, but also the less risky nature of its projects than those in emerging markets. That said, Strabag's strengthening risk management systems and its streamlining of parts of its organization have delivered operational improvements. The reported EBIT margin was 4.3% in 2020, a slight improvement from 3.8% in 2019. Strabag aims to post EBIT margins exceeding 4% from 2022, supported by its ability to manage risk and improvements in strategic procurement and digitalization.

The industry's above-average operating risk constrains Strabag'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 contractor's liability. In civil engineering, competitive tenders and large projects with little insight into contract risk and performance heighten operating risk.

Financial Risk

Strabag's modest financial risk profile reflects its robust balance-sheet structure and relatively strong core credit metrics. We expect that Strabag will maintain careful control over its debt because inherent industry risk can lead to a significant deterioration in metrics in a relatively short period. In our view, the company will continue to maintain strong liquidity even after absorbing the major portion of its working capital outflow and distributing a special dividend during the first half of 2021. We expect working capital-related outflows to normalize to €50 million-€150 million per year from 2022, which should improve Strabag's FOCF to 2019 levels and help sustain its financial flexibility, which we regard as positive for its financial risk profile. Support comes from Strabag's ability to execute its projects in a timely manner and obtain progressive payments from customers.

Strabag has had a reported net cash position since 2014; at the end of 2020, net cash stood at about €1.7 billion, leading to no adjusted debt. Strabag was able to report a net zero debt position at the end of 2020, and we expect that this will be the case for year-end 2021 as well, despite higher dividend payments and working capital outflow. We expect Strabag to sustain its net cash position over the next two years, supported by a progressive improvement in its FOCF.

Strabag has a track record of expansionary spending and debt-financed acquisitions. After the outbreak of COVID-19, which led to double-digit sales declines in April and May 2020, management reacted quickly, cutting operating costs and capex and maintaining a sufficient liquidity buffer. This effectively reduced the hit from the pandemic on operating profits and boosted cash flow and liquidity. Strabag's strong liquidity and credit metrics offer leeway to increase spending on investments, working capital, and dividends, and resume its pipeline of bolt-on acquisitions.

We expect that Strabag's credit metrics and rating headroom will continue to improve gradually over the next two years. We continue to forecast that the company's adjusted net debt will continue to be zero for the next two years. However, a reversal of the favorable working capital trend and sustained capex should lead to relatively weaker FOCF generation in 2021. In our base case, we incorporate this reversal and capex at 3%-4% of consolidated sales. As a result, we expect rating headroom to increase only when the requirement for working capital normalizes.

When calculating our adjusted credit ratios, we add to reported debt €304 million of reported lease liabilities and €551 million related to pension liabilities. Our surplus cash figure incorporates a haircut of about €300 million from cash and short-term liquid 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 that Strabag will provide financial support to these concessions if they need it.

Strabag SE--Financial Summary

Period ending	Dec-31-2015	Dec-31-2016	Dec-31-2017	Dec-31-2018	Dec-31-2019	Dec-31-2020
Reporting period	2015a	2016a	2017a	2018a	2019a	2020a
Display currency (mil.)	EUR	EUR	EUR	EUR	EUR	EUR
Revenues	13,123	12,400	13,509	15,222	15,613	14,703
EBITDA	948	960	946	960	1,041	1,131
Funds from operations (FFO)	764	622	864	811	882	944
Interest expense	98	73	68	67	45	32
Cash interest paid	82	63	57	59	37	31
Operating cash flow (OCF)	1,188	205	1,270	673	1,020	1,233
Capital expenditure	396	412	458	643	647	451
Free operating cash flow (FOCF)	793	(207)	812	30	373	782
Discretionary cash flow (DCF)	736	(277)	711	(80)	259	676
Cash and short-term investments	2,711	1,983	2,769	2,344	2,415	2,802
Gross available cash	2,711	1,983	2,769	2,344	2,415	2,802
Debt	0	43	0	0	0	0
Common equity	3,321	3,265	3,398	3,654	3,856	4,108
Adjusted ratios						
EBITDA margin (%)	7.2	7.7	7.0	6.3	6.7	7.7
Return on capital (%)	10.6	13.4	13.8	15.5	15.2	15.0
EBITDA interest coverage (x)	9.7	13.1	13.9	14.4	23.3	35.0
FFO cash interest coverage (x)	10.3	10.8	16.1	14.6	25.1	31.1
Debt/EBITDA (x)	0.0	0.0	0.0	0.0	0.0	0.0
FFO/debt (%)	NM	1,462.1	NM	NM	NM	NM

Strabag SE--Financial Summary

OCF/debt (%)	NM	482.6	NM	NM	NM	NM
FOCF/debt (%)	NM	(487.2)	NM	NM	NM	NM
DCF/debt (%)	NM	(652.2)	NM	NM	NM	NM

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

	Debt	Shareholder equity	Revenue	EBITDA	Operating income	Interest expense	S&PGR adjusted EBITDA	Operating cash flow	Dividends	Capital expenditure
Financial year	Dec-31-2020									
Company reported amounts	852	4,086	14,750	1,175	631	28	1,131	1,280	106	451
Cash taxes paid	-	-	-	-	-	-	(155)	-	-	-
Cash interest paid	-	-	-	-	-	-	(31)	-	-	-
Lease liabilities	304	-	-	-	-	-	-	-	-	-
Postretirement benefit obligations/ deferred compensation	551	-	-	0	0	4	-	-	-	-
Accessible cash and liquid investments	(2,502)	-	-	-	-	-	-	-	-	-
Dividends from equity investments	-	-	-	36	-	-	-	-	-	-
Deconsolid./ consolid.	(597)	0	(47)	(47)	(47)	0	0	0	0	0
Income (expense) of unconsolid. cos.	-	-	-	(32)	-	-	-	-	-	-
Nonoperating income (expense)	-	-	-	-	16	-	-	-	-	-
Noncontrolling/ minority interest	-	22	-	-	-	-	-	-	-	-
EBITDA: other	-	-	-	(1)	(1)	-	-	-	-	-
OCF: other	-	-	-	-	-	-	-	(47)	-	-
Total adjustments	(2,244)	22	(47)	(45)	(32)	4	(186)	(47)	0	0

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

	Debt	Shareholder equity	Revenue	EBITDA	Operating income	Interest expense	S&PGR adjusted EBITDA	Operating cash flow	Dividends	Capital expenditure
S&P Global Ratings adjusted	Debt	Equity	Revenue	EBITDA	EBIT	Interest expense	Funds from Operations	Operating cash flow	Dividends	Capital expenditure
	0	4,108	14,703	1,131	599	32	944	1,233	106	451

Liquidity

We consider Strabag's liquidity strong and estimate that its liquidity sources will exceed its needs by more than 1.5x in 2021 and 2022. The company enjoys solid relationships with its banks. Stability in the financial markets and prudent financial risk management further support our strong liquidity assessment.

Principal liquidity sources

For the 12 months from June 30, 2021, we estimate that the company's main liquidity sources include:

- About €1.9 billion in cash as of June 30;
- Access to a fully undrawn €400 million syndicated loan maturing in 2026; and
- Cash FFO of around €910 million.

Principal liquidity uses

For the same period, we estimate that the company's main liquidity uses are:

- Capex of €450 million-€550 million annually over the next two years;
- Working capital outflows of up to €50 million-€150 million per year over the next two years;
- Bolt-on acquisitions of about €100 million annually; and
- Ordinary dividends of 30%-50% of net income.

Covenant Analysis

Compliance expectations

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

Environmental, Social, And Governance

ESG Credit Indicators

E-1	**E-2**	E-3	E-4	E-5	S-1	**S-2**	S-3	S-4	S-5	G-1	**G-2**	G-3	G-4	G-5

ESG credit indicators provide additional disclosure and transparency at the entity level and reflect S&P Global Ratings' opinion of the influence that environmental, social, and governance factors have on our credit rating analysis. They are not a sustainability rating or an S&P Global Ratings ESG Evaluation. The extent of the influence of these factors is reflected on an alphanumerical 1-5 scale where 1 = positive, 2 = neutral, 3 = moderately negative, 4 = negative, and 5 = very negative. For more information, see our commentary "ESG Credit Indicators: Definition And Applications," published Oct. 13, 2021.

Environmental and social factors have a neutral influence overall on our credit rating analysis of Strabag. A significant portion of its backlog is in transportation infrastructure, 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. Governance factors have a neutral influence overall on our credit rating analysis. Strabag has a track record of significantly fewer litigations than other companies operating in the same industry, which has helped preserve its creditworthiness.

Issue Ratings--Subordination Risk Analysis

Capital structure

As of June 30, 2021, Strabag had one bond outstanding, maturing in 2022, and amounting to €200 million. The bond represents 23.5% of total consolidated debt and is issued at the parent level. Bank borrowings represent the remaining part of the financial debt.

Analytical conclusions

The issue rating on Strabag's bond is 'BBB', the same as the issuer credit rating, because we believe that the company's leverage is sufficiently low to offset any subordination risk.

Rating Component Scores

Foreign currency issuer credit rating	**BBB/Stable/--**
Local currency 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+**
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)
Stand-alone credit profile	**bbb**

Related Criteria

- 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
- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities, Nov. 13, 2012
- Principles Of Credit Ratings, Feb. 16, 2011

RatingsDetail

Ratings Detail (as of December 20, 2021)*

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.