Spotlight Research

STRABAG SE

March 2, 2020

Construction & Materials/Austria

Price 01.03.20*	27.30
Year high/low	32.30/27.30
Currency	EUR
EUR/EUR	1.00
GDR rate	n.a.
Shares outstanding eoy in mn	102.60
Market capitalisation (total shares) in EUR mn	2,801.0
Free float	13.5%
Free float in EUR mn	378.1
Avg. daily turnover (12 m) in EUR mn	0.27
Index	ATX Prime
ISIN code	AT000000STR1
Bloomberg	STR AV
Reuters	STRV.VI
www.strabag.com	

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Reaping the benefits of the construction boom

Company Highlights & Investment Case

- STRABAG ranks among Europe's largest construction firms, offering services from all areas of the business. Its activities are grouped into Building Construction & Civil Engineering, Transportation Infrastructures and Special Divisions.
- The company holds leading positions in its core countries. In its two most important markets Germany (nearly 50% of group output) and Austria (~15% output contribution) STRABAG claims #1 positions. In Poland (#2), Hungary (#1), the Czech Republic (#2) and Slovakia (#1) it is also among the top contractors. Generally, markets are still very fragmented.
- Capitalising on the very favourable trading conditions of recent years, reflecting strong demand both from private and public clients, the group has grown nicely and was able to improve its profitability (to >3% since FY 16 compared to the FY 11-15 median of 2.3%).
- The structure is determined by a high level of vertical integration. The group owns some 90% of the equipment/machinery and produces ca. 50% of the required raw materials internally.
- Despite being a "traditional" industry, digitalisation has become a powerful force, especially in handling complex projects. With its digital planning tool BIM 5D®, STRABAG is at the forefront of the "digital construction site".

What's hot: recent developments and financial performance

- For FY 19 STRABAG released preliminary output of EUR 16.62 bn, thereby delivering on the guidance of reaching at least the prior year's level of EUR 16.3 bn. Order backlog stood at a new year-end record high of EUR 17.41 bn.
- FY 19 earnings figures will only be published with the full financial statements on April 29, but the wording on profitability became more confident, suggesting that the EBIT margin should be better than the >3.3% so far assumed.
- The financial targets for FY 20e call for output of more than EUR 16 bn and an improvement of the EBIT margin to more than 3.5%.
- The company has a sound balance sheet. At YE 18 its equity ratio was 31.4% and its net cash position (company definition) amounted to roughly EUR 1.2 bn. Due to seasonal reasons these values were lower in 1H 19: at 29.9% and EUR 241 mn, respectively.
- The group's dividend policy foresees a payout ratio of 30-50% of net profit after minorities.

Income statement (EUR mn)	***2017***	***2018***	***1-2Q 2019***
Consolidated sales	13,508	15,222	6,979
EBITDA	835	953	295
EBIT	448	558	61
EBT	421	531	42
Net profit after min.	279	354	11

Per share data (EUR)	***2017***	***2018***	***1-2Q 2019***
EPS	2.72	3.45	0.10
Operating cash flow	13.1	7.2	-3.1
Book value	32.9	35.3	34.4
Dividend	1.30	1.30	n.a.
Payout ratio	48%	38%	n.a.

Balance sheet	***2017***	***2018***	***1-2Q 2019***
Total assets	11,054	11,621	11,804
Shareholders' equity	3,370	3,621	3,533
Goodwill	455	452	n.a
NIBD	-1,335	-1,218	-241

Cash flows	***2017***	***2018***	***1-2Q 2019***
Operating cash flow	1,345	736	-321
Investing cash flow	-333	-588	-299

Valuation (x, 12m)	***2017***	***2018***	***1-2Q 2019***
PE	12.5	7.4	n.a.
Price cash flow	2.6	3.6	n.a.
Price book value	1.0	0.7	n.a.
Dividend yield	3.8%	5.1%	n.a.
FCF yield	28.7%	7.8%	n.a.
EV/EBITDA	3.0	2.2	n.a.
EV/EBIT	5.6	3.8	n.a.
EV/operating CF	1.9	2.9	n.a.

Source: Company, Raiffeisen Centrobank estimates; Past performance is not a reliable indicator for future results.

Company profile & market outlook in brief

One of the largest construction companies in Europe

Vienna-headquartered STRABAG ranks number 7 in the Construction Europe magazine's 2019 list of biggest contractors. The group employs more than 75,000 people and covers the entire value chain and its activities can be grouped into Building Construction & Civil Engineering (comprises among others commercial and industrial facilities, bridge building, housing, environmental technology), Transportation Infrastructures (includes e.g. road, railway and waterway construction, sewer and traffic engineering, sports facilities as well as construction materials) and Special Divisions (such as international business, real estate development, PPP projects, tunnelling and property & facility management).

Market leader in Germany and Austria, which account for >60% of output; largest contractor in CEE

Accounting for 48% and 15% of output in 2018, Germany and Austria are STRABAG's single most important markets. Moreover, the company has sizeable operations in CEE (slightly above 20% of output), particularly in Poland, the Czech Republic, Hungary and Slovakia. The company holds leading positions in its key markets. For example, it claims #1 positions in Germany, Austria, Hungary, Slovakia and #2 in the Czech Republic. Its activities are divided into three reporting segments, according to regions: North + West (Germany, Poland, Benelux and Scandinavia), South + East (Austria, Eastern Europe excl. Poland, Switzerland) and International + Special Divisions (non-European market, tunnelling, concessions, real estate businesses. The company is characterised by a high degree of vertical integration as it not only owns most of its equipment/machinery, but also covers more than 50% of its raw material needs through its own quarries, gravel pits and asphalt and concrete mixing plants.

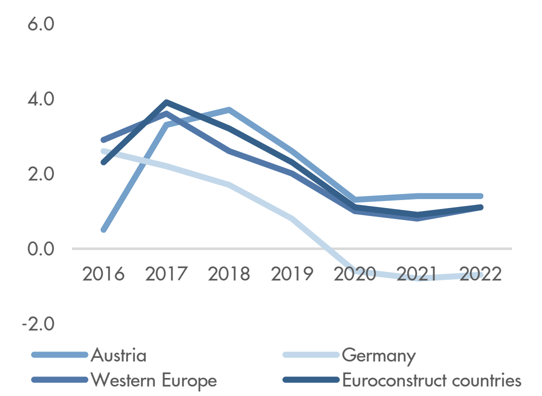
Market outlook

European construction output forecast to grow further throughout 2022 albeit at lower pace

In its most recent mid-term outlook presented in November 2019, Euroconstruct pointed towards a further expansion of the European construction market albeit growth rates should be lower than in previous years. Coming from growth of 3.2% in 2018, total construction output increased by 2.3% in 2019 and growth should stabilise at around 1% in the period 2020-22.

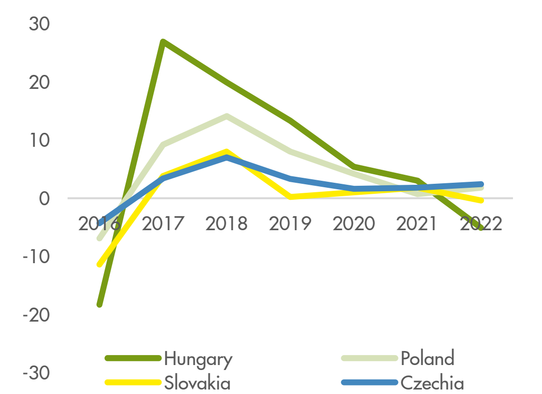
According to the industry association, all main construction sectors should display lower average annual growth. Civil engineering is expected to grow by 2.2%, non-residential by 1.0% and residential construction by only 0.5%. Looking at STRABAG's main markets we note that while total construction activity in Austria should continue to expand modestly, the German market is expected to post a cumulative decline by slightly above 2% in the period 2020-22. The prospects for the core CEE markets are encouraging as both Hungary and Poland should deliver growth rates well in the double digits. Forecasts are also reasonably upbeat for the Czech Republic, while for Slovakia a small decline is envisaged for 2022.

Total construction output WE*



*Source: Euroconstruct, * % change in real terms*

Total construction output CEE*



*Source: Euroconstruct, * % change in real terms*

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SWOT Analysis

Strengths/Opportunities	*Weaknesses/Threats*
▪ Largest contractor in Germany and Austria with leading positions in several CEE markets ▪ Extensive own raw materials base (asphalt/concrete mixing plants, quarries, gravel pits) covers roughly half of its demand internally ▪ High level of public infrastructure spending in single largest market Germany safeguarded by "Bundesverkehrswegeplan 2030" ▪ Substantial net cash position and comfortable equity ratio ▪ Sound financial basis allows to pursue external growth opportunities ▪ Rising penetration of digital building solutions and efficiency gains from new technological solutions favouring large players ▪ Push into related business fields (facility management, PPP projects) to diversify revenue streams ▪ Highly experienced management team	▪ Late-cyclical industry with significant seasonal swings ▪ Warranty and liability risk, construction time delays, miscalculations, default risk of consortium partners ▪ Many markets are characterised by a high degree of fragmentation and competitive pressure ▪ High dependence on the traditional home markets Germany and Austria, accounting for more than 50% of the group output ▪ Construction boom of recent years has resulted in material cost inflation for labour, subcontractors and raw materials ▪ Oleg Deripaska (owner of Rasperia Trading) still subject to US sanctions ▪ Low share liquidity ▪ Looming fine from ongoing cartel investigations in Austria (price fixing allegations in road construction projects)

Corporate governance

Stock-exchange listed since 2007

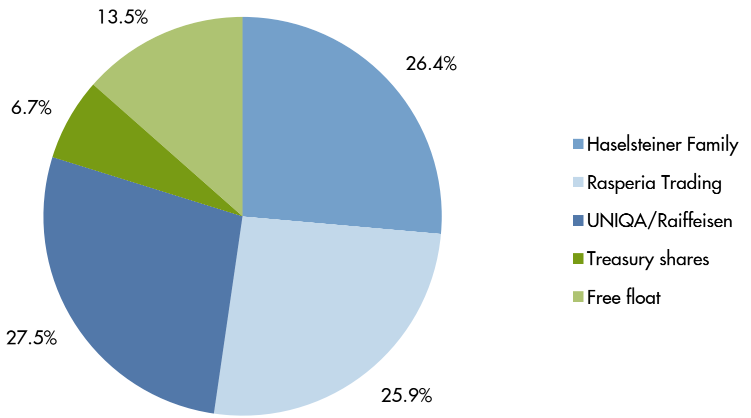
The IPO of STRABAG SE took place in October 2007, when 114 mn shares were listed at the Vienna Stock Exchange. The initial price was set at EUR 47 per share. The offering comprised ca. 28.2 mn shares and was made up of a capital increase via the issuance of 19 mn new shares and the placement of ca. 9.2 mn shares from the holdings of the previous shareholders.

Shareholder structure dominated by syndicate

The shareholder structure is dominated by a syndicate that consists of four large groups: 1) the Haselsteiner Family, 2) Raiffeisen Landesbank NÖ-Wien, 3) UNIQA and 4) Rasperia Trading Limited (an investment vehicle owned by Russian Oleg Deripaska).

The free float, which initially stood at ~25%, has been reduced to currently 13.5% as the company executed a 10% share buyback programme and cancelled 4 mn shares (in 2016) that were bought back. Thus, STRABAG holds 6.7% of the capital as treasury shares. In total, the group has 110 mn shares, of which three registered shares. Registered shares No. 1 and No. 3 are reserved for the Haselsteiner Group and registered share No. 2 for Rasperia Trading Limited.

Shareholder structure

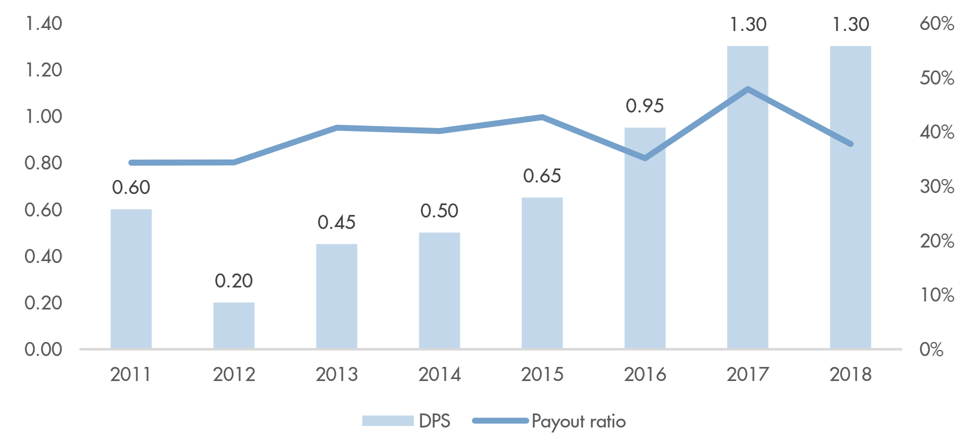


Source: STRABAG

Dividend policy

The management pursues a clearly defined shareholder remuneration policy, which stipulates the distribution of 30-50% of net profit after minorities as dividends. The chart below depicts the track record. In the FY 17 and FY 18 the group paid a dividend of EUR 1.30 per share

Dividend & payout ratio (in EUR/%)



Source: STRABAG

Management

The management team is headed by Thomas Biertel (b. 1954), who joined the group in 1996, became board member in January 2006 and was appointed CEO in June 2013. CFO Christian Harder was appointed in January 2013, he has been with the group since 1994. Alfred Watzl was appointed board member responsible for the segment North + West in January 2019. Peter Krammer has served on the board since January 2010 and heads the division South + East. The segment International & Special Divisions is headed by Siegfried Wanker, who became board member in January 2011. Since January 2020, Klemens Haselsteiner has been Chief Digital Officer. The contracts of all board members expire on December 31, 2022.

The supervisory board consists of 11 members, five of whom were delegated by the works council. Although considered as independent according to the Austrian Corporate Government Codex, the other six members are in fact nominated by the main shareholders as, among others (e.g. restriction of transfer of shares), the syndicate agreement stipulates rights to nominate supervisory board members.

Highlight topics

Reaping the benefits of the construction boom

4% output CAGR in the last five years

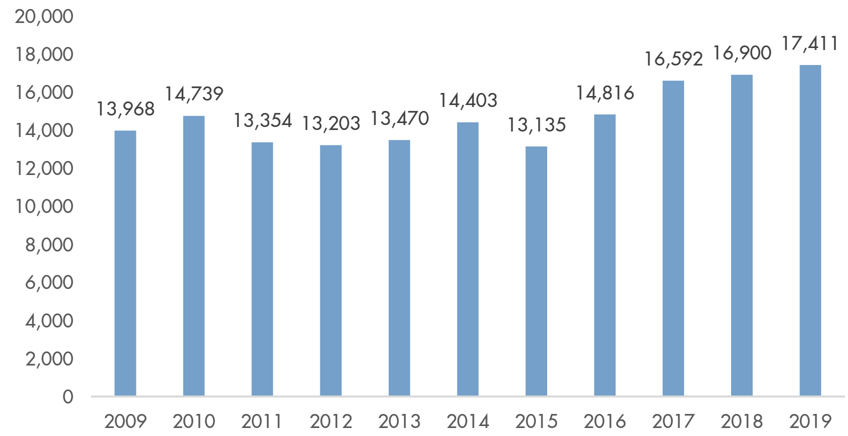
Capitalising on the construction boom in most of its relevant markets, STRABAG has displayed compelling top-line growth in recent years. Since 2011 we have calculated an output CAGR of 2%, with North + West growing at 3% on average and an about sideways performance of South + East. The rather volatile CAGR of International & Special Divisions was in line with the overall group. However, limiting the time frame to the last five years, the expansion rate stands at some 4%, driven by strong North + West (CAGR 6%), while the other two divisions grew at 2% on average.

Record year-end order book provides good visibility

Good visibility thanks to full order books

According to its preliminary figures, the group's order backlog stood at EUR 17.41 bn at the end of FY 19, which is 3% above the prior year level and marks a new year-end record level. As regards individual segments, North + West developed sideways yoy and came in at ca. EUR 8.81 bn, whereas South + East (+4% to EUR 4.49 bn) and International + Special Divisions (+9% to EUR 4.11 bn) were the drivers of the increase.

Long-term development of order book (EUR mn)



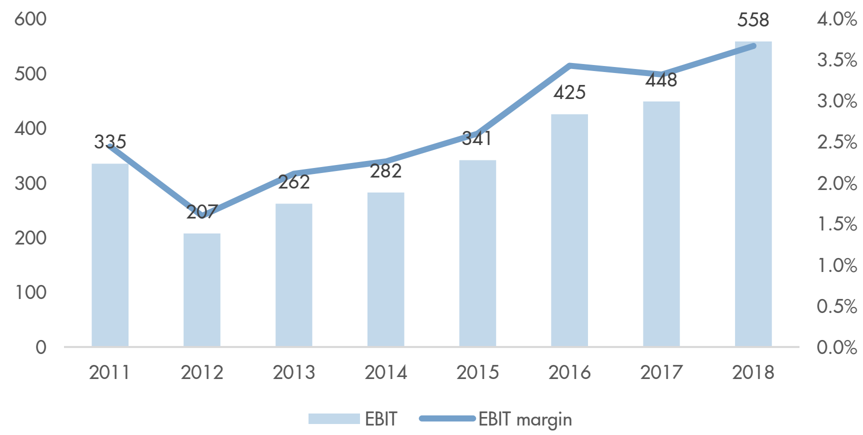
Source: STRABAG

"Faster Together 2022" - further profitability improvement targeted

4% EBIT margin targeted

In May 2019 the company announced an upbeat mid-term EBIT margin target of 4%, which should be reached by 2022e. The measures captured by the "Faster Together 2022" roadmap are manifold but the main margin drivers are, among others, an improved risk management and cost control, pricing discipline in tenders, new technologies (digital construction solutions such as BIM 5D®) as well as procurement synergies. Against the backdrop of these internal triggers and bearing in mind the advanced stage of the construction cycle it seems that reaching the profitability objective is not contingent to sustained top-line growth.

EBIT and EBIT margin development (EUR mn)



Source: STRABAG

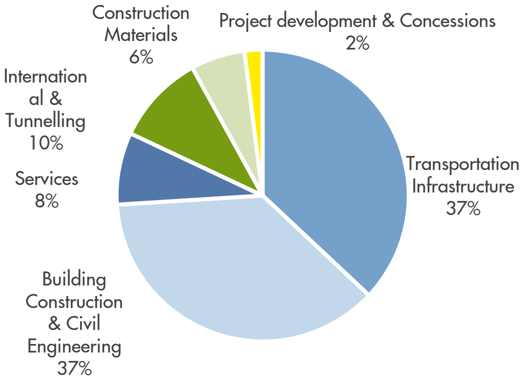
A well-diversified player

We believe that STRABAG's size and diversification both in terms of construction type and regions is a considerable advantage in an industry which is generally determined by low margins and rather high project-related risks. Although it is usually the large-scale multi-year projects that make the headlines, the group processes some 12,000 construction sites, which implies a much smaller average contract size.

We have already outlined that the group is characterised by a broad vertical integration, which also includes an extensive own construction material network (for an illustrative map please refer to the Appendix section), especially in Germany, Austria and key CEE countries. The highest share of self-supply is reached for asphalt (around 80%, STRABAG owns 30% in a joint venture with LafargeHolcim), while for concrete (nearly 30%), cement (~25%) and stone/gravel (ca. 15%) the degree of self-supply is lower.

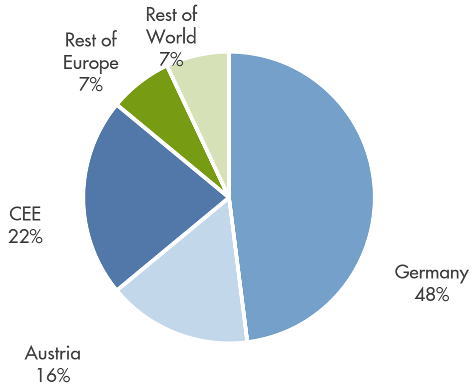
Moreover, the value share of subcontracting varies greatly depending on the type of construction. While for transportation and infrastructure projects on average some 30% of the contract value is sourced out to subcontractors, the share amounts to approximately 60% in the building construction/civil engineering area.

Output breakdown by business field (2018)



Source: STRABAG

Output breakdown by region (2018)



Source: STRABAG

Rising digitalisation

The "digital construction site"

Project management and risk control are essential pillars of successful construction projects. In this respect, the "digital construction site" has become more than a buzzword and, despite being deemed a rather traditional business, digitalisation has increasingly penetrated the industry with the aim to improve the visibility and reliability of costs, time and design.

As an industry-leader, STRABAG has been early in adopting new technologies. Its Building Information Modelling tool BIM 5D® is a multidimensional data model, capturing and linking all relevant data over the lifecycle of a construction project. This helps to avoid expensive construction errors and to plan improvements without impacting the scheduled construction time. Issues can be identified in the model before causing distortions at the actual construction sites, changes and their impact are much easier to determine, and cost can be more accurately calculated.

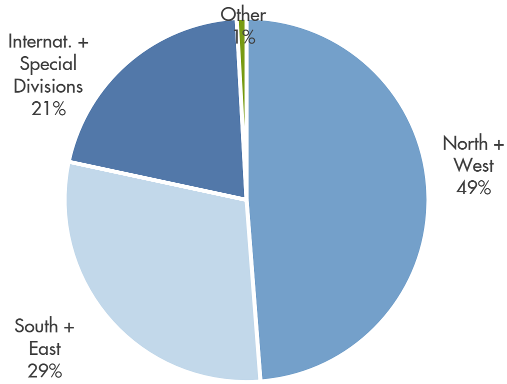
Financials

Company delivered on output guidance

FY 19 output in line and very confident wording on margin

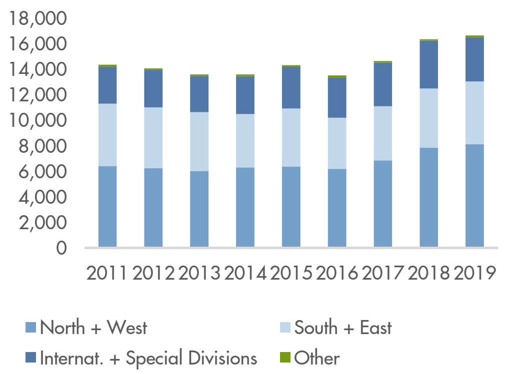
As regards FY 19 output the group reported an increase by 2% to EUR 16.62 bn, which lived up to the guidance of reaching at least the prior year's level of EUR 16.3 bn. Except for the more volatile International + Special Divisions segment (-8% to EUR 3.45 bn), growth was recorded at North + West (+4% to EUR 8.11 bn) and South + East (+6% to EUR 4.92 bn). More importantly, the wording on the margin target of at least 3.3% was more upbeat, as STRABAG noted that it expects to exceed this level.

Output by segment (2019)



Source: STRABAG

Output development by segment (EUR mn)



Source: STRABAG

Further margin improvement envisaged in 2020

Output >EUR 16 bn and EBIT margin >3.5% targeted

With regards to FY 20e, the group's output indication calls for more than EUR 16 bn. At face value this is below the last year but one has to consider that the 1H base still includes the DeTe facility management contract and also the usual uncertainty around weather conditions might play a role. More importantly, the EBIT margin guidance of at least 3.5% sounds reasonably confident. Admittedly the yearly profitability improvements are small, but we think that given substantial cost inflation this lends credibility to the management track record and the efforts to improve risk/project management. Moreover, it also suggests a good underlying margin profile of the existing backlog.

Management remarks – statements that even after the recent years' strong dynamics demand in the most important markets DE, AT and PL should remain at sound levels – foster our view. We understand that the pressure from cost inflation in PL (above all, but also in DE) has peaked, which heralds rising earnings in the North + West segment in FY 20e after two years of declines. The company pointed towards slightly weaker earnings from the facility management and real estate arms, whereas the raw material business should continue to fare well.

Balance sheet

Equity ratio of 31.4% comfortably above target level of at least 25%

STRABAG has a sound balance sheet determined by an equity ratio of 31.4% at the end of the business year 2018. The company considers an equity ratio above 25% as a suitable yardstick. Over the last several years it has been comfortably above the threshold, hovering around 30-32%. As the construction industry is determined by substantial intra-year seasonality, these values were lower in 1H 19, at 29.9% and EUR 241 mn, respectively.

Net cash position

Having generated compelling cash flow in recent years, the group had a net cash position of approximately EUR 1.2 bn at YE 18, just marginally below the YE 17 level of ca. EUR 1.3 bn. We note that the group's definition of net debt/cash includes provisions for severance and pension obligations but excludes non-recourse debt.

BBB investment-grade rating

STRABAG's sound financial standing is mirrored by the group's BBB investment-grade rating by S&P. The rating agency has assigned a "stable" outlook and confirmed its rating in September 2019.

Income statement (EUR mn)	*12/2016*	*12/2017*	*12/2018*	*1-2Q 2019*
Consolidated sales	**12,400.5**	**13,508.7**	**15,221.8**	**6,979.1**
Changes in inventories & own work capitalised	55.6	-48.1	-33.1	-40.8
Other operating income	385.9	423.8	363.4	179.9
Total revenues	**12,842.0**	**13,884.4**	**15,552.2**	**7,118.9**
Material costs	-7,980.0	-8,839.9	-10,125.8	-4,607.5
Personnel expenses	-3,210.9	-3,367.2	-3,618.9	-1,834.4
Other operating expenses	-795.9	-842.8	-854.9	-81.5
EBITDA	**855.2**	**834.6**	**952.6**	**294.7**
Depreciation of PPE and intangibles	-425.4	-384.6	-392.7	-233.7
EBITA	**429.8**	**450.0**	**559.9**	**61.0**
Amortisation, impairment of goodwill	-4.9	-1.6	-1.7	0.0
EBIT	**424.9**	**448.4**	**558.2**	**61.0**
Adjusted EBIT	424.9	448.4	558.2	61.0
Investment income	0.0	0.0	0.0	0.0
Net interest income	-3.8	-27.1	-27.4	-19.5
Other financial result	0.0	0.0	0.0	0.0
Financial result	**-3.8**	**-27.1**	**-27.4**	**-19.5**
Earnings before taxes	**421.1**	**421.2**	**530.8**	**41.5**
Taxes on income	-139.1	-128.8	-168.0	-27.6
Extraordinary result	0.0	0.0	0.0	0.0
Net profit before minorities	**282.0**	**292.4**	**362.8**	**13.9**
Minority interests	-4.3	-13.5	-9.2	-3.3
Net profit after minorities	**277.7**	**278.9**	**353.5**	**10.7**

Cash flow statement (EUR mn)	*12/2016*	*12/2017*	*12/2018*	*1-2Q 2019*
Cash flow from result	**690.4**	**633.8**	**654.4**	**229.3**
Change in working capital	-426.2	711.4	81.8	-550.0
Operating cash flow	**264.2**	**1,345.2**	**736.2**	**-320.7**
Investing cash flow	**-434.4**	**-333.3**	**-587.9**	**-298.6**
Financing cash flow	**-564.2**	**-234.5**	**-534.2**	**-183.3**

Source: STRABAG SE, Raiffeisen Centrobank estimates

Balance sheet (EUR mn)	*12/2016*	*12/2017*	*12/2018*	*1-2Q 2019*
Current assets	**6,949.2**	**7,677.0**	**7,436.6**	**7,704.6**
Liquid funds	2,003.3	2,790.4	2,385.8	1,590.1
Receivables	3,763.1	3,748.8	2,877.8	3,493.6
Inventories	1,182.8	1,137.8	890.2	938.7
Other assets	0.0	0.0	1,282.9	1,682.2
Fixed assets	**3,183.4**	**3,188.1**	**4,037.9**	**3,939.2**
Property, plant & equipment	1,935.7	1,942.3	2,745.1	2,552.6
Intangible assets	47.1	43.5	40.9	41.7
Goodwill	449.3	455.3	452.5	452.5
Financial assets	751.3	747.0	799.4	892.4
Deferred tax assets	**245.8**	**189.0**	**146.9**	**160.2**
Total assets	**10,378.4**	**11,054.1**	**11,621.4**	**11,804.0**
Current liabilities	**4,692.5**	**5,431.1**	**4,613.1**	**4,658.6**
Short-term borrowings	593.6	824.4	668.5	408.2
Notes & trade payables, payments received	2,817.1	3,402.4	2,615.3	2,810.1
Other current liabilities	1,281.8	1,204.4	1,329.3	1,440.3
Long-term liabilities	**2,399.9**	**2,201.1**	**3,257.5**	**3,503.3**
Long-term borrowings	1,287.3	960.6	1,166.4	1,115.9
Long-term provisions	1,111.7	1,240.5	1,116.6	1,146.2
Other long-term liabilities	0.9	0.0	974.6	1,241.2
Hybrid & other mezzanine capital	**0.0**	**0.0**	**0.0**	**0.0**
Shareholders' equity	**3,186.0**	**3,370.5**	**3,620.7**	**3,500.1**
Minority interests	**78.6**	**27.2**	**33.1**	**32.5**
Deferred tax liabilities	**21.4**	**24.2**	**97.1**	**109.5**
Total liabilities	**10,378.4**	**11,054.1**	**11,621.4**	**11,804.0**

Source: STRABAG SE, Raiffeisen Centrobank estimates

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