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Summary:

Strabag SE

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Summary:

Strabag SE

Credit Rating:	BBB-/Stable/--

Rationale

The ratings on Austria-based engineering and construction company Strabag SE reflect Standard & Poor's Ratings Services' view of its "satisfactory" business risk profile, marked by the group's leading market position in road construction and civil engineering in Central and Eastern Europe. In addition, Strabag benefits from good business diversity and vertical integration that represents a barrier to entry and provides strategic access to raw materials. The company's favorable operational track record and currently sizable contract backlog further underpin the ratings. Strabag's solid capital structure and adequate liquidity offer a cushion against adverse market developments and potential project failures, which is a further rating support.

These strengths are partly offset, in our view, by the company's exposure to high project-execution risks in the construction industry, which is cyclical, competitive, and low margin. Furthermore, the rating is constrained by increasingly difficult industry conditions, given a declining pipeline of infrastructure projects across Eastern Europe, in particular, and the resulting fierce competition. We also believe that because the profitability of Strabag's order book, and therefore its earnings base, will likely decline, the company might find it difficult to continue generating free operating cash flows. Furthermore, Strabag's credit profile is constrained by its track record of growth-oriented and shareholder-friendly financial policies.

S&P base-case operating scenario

We consider the group's order backlog as the main impetus for revenue generation in 2012 because it covers about 1.0x revenues for the 12 months to March 30, 2012. Furthermore, we believe that the companies Strabag has acquired should make some small contributions to revenue expansion in 2012. These projections take into account our economists' base case assumption of a mild recession in Europe this year, compared with a 40% likelihood of a "double dip" (for details see "2012 Midyear Global Credit Outlook: Interconnected Prospects, Interconnected Risks," published on June 8, 2012, on RatingsDirect on the Global Credit Portal).

We anticipate that Strabag will report a mid-single-digit revenue decline in 2012, after the €13.7 billion reported for 2011. We see the risk of further significant revenue declines in 2013, owing to the dependence of the company's infrastructure activities on public spending, which we expect to shrink in light of public austerity measures. We also anticipate intensifying price pressure, in particular, in Strabag's Transportation Infrastructure segment, to impede the company's profitability. As a result, we assume under our base case that Strabag's adjusted EBITDA margin will decline to 3.5%-4.0% in 2012 and remain within this range in 2013. This compares with the 5.3% the company achieved in 2011.

S&P base-case cash flow and capital-structure scenario

Under our base-case operating scenario, we forecast that Strabag will generate moderately negative free operating cash flows in 2012 and 2013. This is despite our assumptions of continuously tight working capital control and a reduction of capital expenditure to about €475 million in 2012 (including €75 million for acquisitions) and €400 million in 2013, from an average of about €580 million in 2010 and 2011. For our base case, we also assume that the company will return to a more cautious stance regarding acquisitions and shareholder payouts, as it did during the cyclical downturn in 2009.

In addition, we anticipate that credit metrics will weaken, but remain consistent with our guidelines for the rating, such as adjusted debt to EBITDA of less than 2.5x. This is owing to the extensive headroom Strabag currently has under the credit measures for the 'BBB-' rating. In the 12 months to March 31, 2012, the ratio of adjusted debt to EBITDA was less than 1x. Our ratio analysis incorporates intrayear fluctuations in credit metrics, which are typical for the highly seasonal construction industry. We note that the company's cash flow generation faces seasonal swings. In 2010 and 2011, toward the end of the third quarter, Strabag faced seasonal working capital buildups of close to €500 million, which however decreased again by the end of the year.

Risks to our base-case operating scenario include a weaker economic environment than we currently forecast, which could result in further cuts in public spending and, potentially, pressure on private investment in engineering and construction. If coupled with possible significant cost overruns on individual projects amid harsher bidding conditions, this could further hamper the company's operating and financial performance.

Liquidity

We consider Strabag's liquidity position to be "adequate" under our criteria. Available liquidity sources should remain sufficient to service near-term debt obligations and working capital swings. We estimate that liquidity sources will exceed liquidity needs by more than 1.2x in 2012 and 2013.

As of March 31, 2012, Strabag had almost €1.6 billion in cash and cash equivalents and €286 million available under short-term revolving credit facilities. Furthermore, Strabag has some capital spending flexibility, which creates a cushion for operating cash flows if markets decline more sharply than we currently expect. The short-term tenor of revolving working capital credit facilities poses a liquidity risk, in our view. This is partly offset by credit lines from various banks with which Strabag has long-standing relationships. Bank and guarantee facilities are subject to financial covenants and material adverse-effect clauses. We expect headroom under the covenants to remain sufficient.

Strabag's liquidity sources for 2012 consist of:

- Surplus cash of about €1.2 billion, excluding about €370 million of cash we consider tied to the operations and the M5 highway concession company AKA in Hungary that Strabag owns. On March 31, 2012, Strabag reported consolidated cash and equivalents of €1,591 million; and
- A €100 million bond that the company issued in the second quarter of 2012.

For our liquidity analysis, we don't assume that the company would be able to rely on its bilateral credit lines, given their short-term nature.

Strabag's liquidity is supported by its undemanding debt-maturity profile. As of March 31, 2012, the company reported

about €1.8 billion in debt, of which about €395 million was short term. Furthermore, the debt structure included the following:

- About €673 million of nonrecourse funding (of which about €44 million was short term) related to an "availability-type" concession at Hungary-based AKA. Both projects have contracted fixed fees that Strabag receives from the local governments; and
- €450 million in unsecured bonds, of which €75 million falls due in 2013.

Outlook

The stable outlook reflects our assessment that Strabag's credit metrics will likely weaken over 2012-2013, but remain commensurate with the rating. This includes debt to EBITDA of less than 2.5x. We assume the group will manage to prevent its EBITDA margin from falling significantly below 4.0% over the next two years. We also view Strabag's disciplined capital investment policy and attention to risk-control management as key to helping it maintain a rating-commensurate financial profile should operating profits decline, as we currently assume. Consequently, we factor into the rating that Strabag will curb its investments if necessary to avoid generating significantly negative free operating cash.

We could consider a negative rating action if Strabag's operating profitability weakened significantly, posing the risk of the group's debt-to-EBITDA ratio rising to more than 2.5x. Downside risks would also arise from highly elevated debt levels, owing for instance to acquisitions or shareholder returns, and deteriorating liquidity.

We could raise the ratings if Strabag's credit measures stayed above levels we view commensurate with a 'BBB' rating, such as a ratio of funds from operations to debt of more than 45% and debt to EBITDA of less than 1.5x. However, we don't expect this to be the most likely scenario in the deteriorating economic environment. We believe an upgrade would also necessitate an order backlog that gives sufficient visibility for 2013 and 2014, which we think could be a difficult year for late-cyclical companies like Strabag.

Related Criteria And Research

- 2012 Midyear Global Credit Outlook: Interconnected Prospects, Interconnected Risks, June 8, 2012
- Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Sept. 28, 2011
- Criteria Methodology: Business Risk/Financial Risk Matrix Expanded, May 27, 2009
- 2008 Corporate Criteria: Ratios And Adjustments, April 15, 2008
- 2008 Corporate Criteria: Analytical Methodology, April 15, 2008

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