RATING ACTION REPORT

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Dagong Global Affirms the 'BB+' Long-Term Credit Rating of Salini Impregilo S.p.A., Outlook 'Evolving'

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Dagong Global has affirmed the 'BB+' Long-Term Credit Rating of Salini Impregilo S.p.A. (Salini) and changed the Outlook from 'Stable' to 'Evolving'.

RATING RATIONALE

The rating reflects Salini Impregilo's strong business profile and the developments within the last 12 months: The integration of Lane Industries Inc. (Lane) is well advanced resulting in increased business opportunities in the robust US infrastructure market, better project portfolio and pipeline diversification and a strengthened overall competitive position. Also with the larger group set-up, Salini Impregilo demonstrates solid operational performance, strong project management, and a high implementation level of its risk management framework.

In 2017 and the first three quarters of 2018 the company has continued to show success in acquiring new orders in all covered sectors and a well-balanced outstanding order backlog that allows good predictability of future performance. The rating is supported by Salini Impregilo's stable global leading position in hydro and dam construction and strong position in the transportation segment.

But operating cash flow generation was weaker in 2017; less than expected advanced payments and an increase in work in progress related to some large mandates in the Middle East and Africa left its marks. In addition, FX movements (especially USD/EUR) affected negatively Salini Impregilo's cash flow and also net financial position. Nevertheless, the financial profile is supported by good profitability, sound liquidity, an extended debt maturity profile and further reduced cost of debt due to the refinancing of its corporate debt in 2017 and bond repayment in August 2018.

Salini's Long-Term Rating of 'BB+' is aligned to its Standalone Credit Assessment (SACA) of 'bb+' since the entity does not have any parent company, is not related to any government or local authorities where we could expect a direct governmental support in a case of financial distress and we perceive the likelihood of any external support provided by a third-party as very low.

The main considerations for the SACA are laid out below.

Development strategy

We assess Salini Impregilo's development strategy as strong, supported by the realised acquisitions to increase scale and quickly improve its competitive position, a comprehensive risk-based commercial planning process and an outstanding order backlog, covering already continuously large portions of next year's revenue targets.

Besides maintaining and extending its relationships in its existing core regions the company is implementing a multi-domestic strategy, becoming domestic not only in the US, which is the biggest single market of the group with 23% of 1H2018 revenues and expected medium-term share target of 40%, but also in the Middle East and Australia.

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Competitive position and diversification

We consider Salini Impregilo's diversification as strong, reflecting the increased geographic business coverage, enjoying the increasing urbanisation and the growing economic and infrastructure importance of the middle class in emerging markets, while at the same time the company benefits with a growing share of lower-risk/mature markets from the need to replace aging infrastructure and facilities in line with demographic requirements.

Salini Impregilo intends to be a niche player in the global infrastructure market and therefore further strengthened its focus on large and complex infrastructure projects. The track record of successful project accomplishments in recent years supports the strong competitive position already achieved being able to compete successfully in covered sectors even in competition with larger competitors. We have seen a prudent selection of projects and limitation of project concentrations.

Satisfactory financial profile

Salini Impregilo's satisfactory financial profile reflects its stable operating performance with an adjusted EBIT margin of about 8.9% in FY17. The refinancing exercise of its long and medium term corporate debt in 2017 has reduced the company's cost of debt down to 2.5% as of 1H18 and extended its debt maturities to 3.95 years.

Weaker operating cash flow generation

In 2017, the company's working capital absorbed larger portions of its cash flow due to the postponement of some advanced payments and an increase in work in progress related to some large mandates in the Middle East and Africa. In addition FX movements (especially USD/EUR) affected negatively Salini Impregilo's cash flow and also net financial position. We expect that the working capital management will be further optimised even though the planned revenue growth will result in higher working capital needs.

Leverage still relatively high

The leverage, which has increased due to the Lane acquisition in 2016, has been reduced slightly since then. But, the debt level is still relatively high compared to its peers. The company announced that it is evaluating several investment opportunities. In case of any potential major acquisition in the next months (eg Astaldi assets concerning activities connected to the construction sector) the company communicated its intention to maintain the focus on deleveraging and decide on financing options accordingly. We believe that working capital and Capex will continue to absorb substantial cash flow generation and a material debt reduction is unlikely. To which extent the proceeds from the sale of Lane's plants and paving business unit in 4Q18 will be used to fund further growth in the core activities of the group and to reduce gross debt remains to be seen.

RATING OUTLOOK

We expect Salini to further reinforce its competitive position and to realise additional synergy effects, economies of scale and scope leveraging all resources within the group. But due to the downward revision of its financial targets for 2018/19, the uncertainties regarding the still outstanding updated new business plan reflecting the refocused strategy, the sale of the plants & paving unit of Lane, the integration of GLF Construction USA and SELI Overseas acquired from Grandi Lavori Fincosit mainly related to US assets and business as well as specific tunnelling technical skills with an expected backlog of EUR 230Mn we changed the outlook to 'Evolving'.

The 'Evolving' outlook reflects in our view also on the other side Salini Impregilo's sustained positive development of its business profile, accelerated by the quick integration of Lane and a resulting noticeable growth in new orders especially from the US supporting the achieved high construction backlog level. Furthermore, the reduced project concentration, improved diversification, and reduced volatility regarding profitability.

RATING SENSITIVITIES

The Long-Term Credit Rating could be upgraded if Salini Impregilo demonstrates to generate positive FCF on a sustainable basis, delivers an updated, consistent growth plan while maintaining its solid profitability and further reduces the risk profile of the project portfolio. Besides, it manages to de-leverage closer to its peers, decreasing its Gross Debt to EBITDA consistently close to or below 3.5x on an adjusted basis and Debt to Debt plus Equity closer to 60% or below.

A positive rating action could additionally be triggered by Salini Impregilo continuing to demonstrate a strong operating performance on its projects, successfully acquiring new orders to further improve size and composition of the backlog and reinforcing its competitive position and realising additional synergy effects and economies of scale/scope leveraging all group resources including new investments made during 2019.

The high sophistication of Salini Impregilo's risk management, its project-by-project pre-bid risk-return evaluations and the close monitoring of project developments, support the current rating. But, we would consider a downgrade if Salini Impregilo's profitability levels weaken significantly. Furthermore, a return to persistent negative FCF, arising from weak receivable collection, excessive investments, sizable debt-funded acquisitions or shareholder remuneration could put negative pressure on the rating. We would also consider a negative rating action if we see a sharp increase in leverage or a high level maintained for a prolonged period as a consequence of any acquisition. Any concerns over the current still comfortable liquidity position or material financial charges resulting from geo-political risks could also trigger a downgrade.

COMPANY PROFILE

Salini Impregilo is an Italian-based multinational construction company with a strong family background listed on the Milan Stock Exchange, in the MTA segment. It operates in a niche construction segment specialising in large complex infrastructure projects such as hydro-power plants, railways, highways and underground constructions. Salini Impregilo is a pure infrastructure construction company and one of the leading global players in its segment. In water infrastructure it is a global leader, having built 260 dams and hydroelectric plants. Salini Impregilo operates in more than 50 countries on 5 continents and has over 35,000 employees. Salini Impregilo Group expects revenues to be about EUR 6.9Bn in 2018.

Salini Impregilo operates in the global construction market, which is estimated to be worth EUR 22.8Tn in 2018-2020. The infrastructure construction segment is less volatile compared to other construction segments like residential building. Given the large-scale and knowledge-intensive nature of infrastructure projects, the sector has not seen any major slowdown during the global economic downturn, as it is driven mainly by long-term urbanisation and industrialisation developments.

FULL LIST OF SOLICITED RATINGS

Salini Impregilo S.p.A.

Long-Term Credit Rating (FC&LC)	BB+
Outlook	Evolving
Standalone Credit Assessment (SACA)	bb+
External Support Analysis (ESA)	Not applicable

FC&LC: Foreign Currency and Local Currency

RATING HISTORY

Salini Impregilo S.p.A.	BB+/Positive (24 November 2017)
Salini Impregilo S.p.A.	BB+/Positive (29 November 2016)
Salini Impregilo S.p.A.	BB+/Stable (2 December 2015)

CRITERIA APPLIED

Criteria for Rating Non-Financial Corporates (5 September 2018)
Accounting Adjustments to Financial Statements of Non-Financial Corporates (5 September 2018)
General Rating Framework (14 August 2018)

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