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11 May 2017

ASX Market Announcements
Australian Securities Exchange Limited
Level 4
20 Bridge Street
SYDNEY NSW 2000

CIMIC GROUP UPGRADED TO 'BBB/A-2'; OUTLOOK STABLE BY STANDARD & POOR'S

Standard & Poor's has raised CIMIC Group's rating to BBB/A-2 from BBB-/A-3. The outlook is stable.

The S&P Global Ratings announcement is appended.

Sincerely,

CIMIC GROUP LIMITED
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S&P Global Ratings

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Research Update:

Australian Engineering And Construction Company CIMIC Group Upgraded To 'BBB/A-2'; Outlook Stable

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Research Update:

Australian Engineering And Construction Company CIMIC Group Upgraded To 'BBB/A-2'; Outlook Stable

Overview

- We recently assigned 'BBB/A-2' ratings with a stable outlook to CIMIC's immediate Germany-based parent HOCHTIEF AG and its ultimate Spain-based parent ACS, Actividades de Construcción y Servicios S.A.
- We now consider CIMIC to be a core subsidiary, and expect that it will continue to contribute the majority of its earnings to Hochtief, which in turn represents the majority of ACS group's operating cash flow.
- As a result, we are raising the long-term and short-term issuer credit ratings on CIMIC to 'BBB/A-2' from 'BBB-/A-3', in line with our ratings on Hochtief and ACS.
- The outlook on the CIMIC ratings is stable, reflecting that on ACS. The stable outlook on ACS reflects our view that over 2017 to 2018, ACS will further consolidate its improved performance in 2015-2016, focusing on cash flow generation and disciplined working capital management.

Rating Action

On May 10, 2017, S&P Global Ratings raised its long- and short-term corporate credit ratings on Australian engineering and construction company (E&C) CIMIC Group Ltd. (CIMIC) to 'BBB/A-2' from 'BBB-/A-3'. The outlook is stable.

Rationale

We raised the ratings on CIMIC because we now consider the company to be a core member of the ACS group, from its previously insulated subsidiary status.

Our rating on CIMIC's immediate parent Hochtief is in line with the parent's stand-alone credit profile (SACP) of 'bbb' and our 'BBB' long-term corporate credit rating on ACS. CIMIC is 73% owned by Hochtief, which in turn is 72% owned by ACS. In addition, Hochtief constitutes more than half of ACS consolidated group's assets, earnings, and cash flow. Our rating on CIMIC is lower than its SACP of 'bbb+'.

Since 2011, ACS has gradually increased its share of ownership in Hochtief, and at the same time, Hochtief has increased its ownership in CIMIC. Also, ACS has simplified the corporate structure, enhanced group integration, and aligned the strategy and risk management within the consolidated group. Over the past few years, ACS has significantly reduced debt through noncore asset disposals and group streamlining, particularly in those parts of the group that are outside Hochtief's business purview. As a result, the ACS group's leverage metrics have significantly improved.

We no longer view CIMIC as an insulated subsidiary within the ACS group, even though there are significant minority shareholders. In 2010, CIMIC's immediate parent Hochtief adopted a ring-fencing policy to limit cash transfers to ACS. We understand that since 2017, Hochtief has discontinued this ring-fencing policy and is gradually refinancing the outstanding financial debt by issuing new debt instruments with no ring-fencing terms.

In addition, ACS would likely be able to access Hochtief's cash flow if needed, given its current 72% ownership rate if it achieved a domination agreement. Nevertheless, we believe that given the group's structure, the presence of sizable minority shareholders in Hochtief and CIMIC may to some extent constrain cash movement within the group.

Our SACP on CIMIC group reflects the company's solid market position in Australia's infrastructure construction and contract mining sectors. In addition, it has significant business, industry, project, and geographic diversity. However, it is exposed to competitive and cyclical-heavy E&C sectors and to mining contracts that are inherently large and complex.

Under the Thiess and Sedgman brand names, CIMIC is one of the largest contract miners globally with experience in mineral processing. The CIMIC group has a strong franchise in large infrastructure construction in road and rail via the CPB Contractors and the Leighton Asia brand names. CIMIC undertakes private sponsorship of government infrastructure through CIMIC's Pacific Partnership brand that bids on public-private partnerships (PPP). CIMIC's ownership of UGL and its 50% ownership of Ventia Pty Ltd. also provide the company with access to operations and maintenance activities in road and rail infrastructure, oil and gas, water, defence, renewable energy, and telecommunications infrastructure.

Key to CIMIC's earnings growth is its continued success at tendering and securing new work. As of March 31, 2017, CIMIC's work-in-hand (WIH) had expanded to A$34.1 billion from A$29 billion at Sept. 30, 2016, principally from its acquisition of UGL Ltd.

CIMIC's risk management approach and modest financial risk appetite help to counter the moderately high-risk construction industry, which requires a sufficient buffer to offset performance risks. As part of CIMIC's strategic review, one of the key objectives was to strengthen the balance sheet, resulting in asset sales, capital restructuring, and various working capital initiatives.

CIMIC management will manage a net debt level that is consistent with a strong investment-grade rating. As a result, we expect CIMIC group's gearing (net debt plus operating leases) could rise with major acquisition or investment activity, but not exceed 30%. This more-conservative financial stance supports an improvement in CIMIC's SACP to 'bbb+' from 'bbb'.

We expect CIMIC to maintain its adjusted funds from operations (FFO)-to-debt ratio well above 45% over the next two years, in the absence of any major investment or acquisition. CIMIC purchased UGL in 2016 using its large cash balances and minimal net debt. However, the UGL acquisition and a share buyback weakened our adjusted FFO-to-debt ratio for the company to 73% in the year ended Dec. 31, 2016, from 197% in fiscal 2015.

The financial policy modifier negatively affects the rating by one notch. While we view the company's current drawn debt position as conservative, we do not believe that it inhibits the company's ability to grow its business and execute on its current strategy. Over time, we expect that management will use debt to make bolt-on acquisitions, provide funding for the continued growth in WIH, and meet its capital expenditure needs.

At a CIMIC-measured gearing level of 30%, we expect that the S&P Global Ratings-adjusted credit metrics would be substantially weaker than current levels. If CIMIC were to approach that peak gearing level, we expect its FFO-to-debt would be above 45%, debt-to-EBITDA would be above 2x, and free operating cash flow to debt would be above 25%.

Liquidity

We assess CIMIC's liquidity as strong. This assessment reflects our expectation that the company's liquidity sources will cover its uses by 1.5x over the next 12 months, and by more than 1x over the next 24 months. We expect its net sources and uses of liquidity are likely to remain positive even if EBITDA were to decline by 30%. In addition, we expect the CIMIC group to retain good access to the bank and debt capital markets for upcoming debt maturities.

As of Dec. 31, 2016, the CIMIC group had the following liquidity profile:

Principal liquidity sources

- Sizable cash balance of A$1.6 billion;
- Cash FFO of about A$1.0 billion; and
- About A$1.4 billion of undrawn bank lines beyond 12 months.

Principal liquidity uses

- Our expectation of capital expenditure being about A$350 million;
- Debt maturities of about A$600 million over the next 12 months; and
- Our expectation that the dividend payout will remain at about 60% of underlying net income.

Outlook

The stable outlook on CIMIC reflects that on ACS. We expect that over 2017 to 2018, ACS will consolidate its improved performance in 2015-2016, focusing on cash flow generation and disciplined working capital management.

We forecast the CIMIC group's adjusted EBITDA margins will be 7.0%-7.5% in 2017, underpinned by an already secured backlog and intake of new projects. We expect ACS' adjusted FFO to debt will be at about 30% in 2017-2018. We view positively ACS management's commitment to maintaining a conservative financial policy, with reported net debt to EBITDA not exceeding 1x.

Downside scenario

A downgrade on CIMIC could occur if we lowered our rating on ACS. ACS' credit quality could weaken, for example, if its adjusted FFO to debt fell to below 22% and discretionary cash flow (DCF) to debt declined to about 5% without short-term recovery prospects. In our view, this could result from a significant project setback that might decrease working capital.

Pressure on the ratings may also arise from markedly higher debt owing, for instance, to sizable acquisitions or increased shareholder returns that we do not factor into our base-case scenario for ACS. Weakening of liquidity would also weigh on the ratings.

Upside scenario

In our view, ratings upside potential is currently limited. An upgrade of CIMIC would require an upgrade of ACS.

We could raise the ratings on ACS if it committed to a more conservative financial policy, and we observed a track record of the group maintaining stronger credit metrics, including FFO to debt comfortably above 30% and DCF to debt comfortably above 10%. An upgrade would also require improved integration and cash movement within the group. We view such a scenario as unlikely, however, in 2017-2018.

Ratings Score Snapshot

Corporate Credit Rating: BBB/Stable/A-2

Business risk: Satisfactory
- Country risk: Very low risk
- Industry risk: Moderately high risk
- Competitive position: Satisfactory

Financial risk: Minimal
- Cash flow/Leverage: Minimal

Anchor: a-

Modifiers
- Diversification/Portfolio effect: Neutral (no impact)
- Capital structure: Neutral (no impact)
- Liquidity: Strong (no impact)
- Financial policy: Negative (-1 notch)
- Management and governance: Satisfactory (no impact)
- Comparable rating analysis: Neutral (no impact)

Stand-alone credit profile: bbb+

Group credit profile: bbb

Entity status within group: Core subsidiary

Related Criteria

- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings , April 7, 2017
- Criteria - Corporates - General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Criteria - Corporates - Industrials: Key Credit Factors For The Engineering And Construction Industry, Nov. 19, 2013
- Criteria - Corporates - General: Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- Criteria - Corporates - General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Group Rating Methodology, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009
- Criteria - Corporates - General: 2008 Corporate Criteria: Rating Each Issue, April 15, 2008

Related Research

- Spanish Engineering And Construction Company ACS Actividades de Construccion y Servicios Rated 'BBB/A-2'; Outlook Stable, May 8, 2017
- Germany-Based Engineering And Construction Company HOCHTIEF AG Rated 'BBB/A-2'; Outlook Stable, May 9, 2017

Ratings List

Upgraded

	To	From
CIMIC Group Ltd.		
Corporate Credit Rating	BBB/Stable/A-2	BBB-/Stable/A-3
CIMIC Group Ltd.		
Senior Unsecured	BBB	BBB-
CIMIC Finance (USA) Pty Ltd.		
Senior Unsecured	BBB	BBB-

CIMIC Finance Ltd.		
Senior Unsecured	BBB	BBB-

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