MOODY'S INVESTORS SERVICE

Moody's 2019 Outlooks

Construction – Global

2019 Outlook

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Contents

2019 Global construction outlook - stable

Robust economies, low interest rates stimulate output

NEGATIVE

What could change outlook to negative

» Signs of slowing organic revenues over the next 12-18 months

» Shrinking order backlog (book-to-bill below 1.0x)

» Lower infrastructure spending and/or slowdown of existing construction works

STABLE

Drivers of the stable outlook

» Organic revenue growth flat to 6%; book-to-bill of at least 1.0x

» Many projects under construction support revenue growth; competition constrains margins

POSITIVE

What could change outlook to positive

» Organic revenue growth in excess of 6% over the next 12-18 months

» Growing order backlog (book-to-bill at least 1.25x)

» Stable or improving operating margins (e.g. accelerating infrastructure spending, construction works)

Industry outlooks reflect our view of fundamental business conditions for an industry over the next 12-18 months. Since outlooks represent our forward-looking view on business conditions that factor into our ratings, a negative (positive) outlook suggests that negative (positive) rating actions are more likely on average. However, the industry outlook does not represent a sum of upgrades, downgrades or ratings under review, or an average of the rating outlooks of issuers in the industry, but rather our assessment of the main direction of business fundamentals within the overall industry.

Global Construction Outlook 2019

GROWTH

- Economic growth will decelerate in some key regions for rated construction companies in 2019, including the euro area, the US and China. However, a still robust economic environment should continue to support output growth, albeit at a lower level than in 2018
- Companies with meaningful exposure to less stable emerging markets where growth will slow in 2019 (e.g. Mexico, Argentina or Turkey) could face difficulties in replacing existing construction projects, defending profitability or coping with volatile currencies

FINANCIAL STABILITY

- Global financial conditions will continue to tighten as monetary policy normalizes
- Rising interest rates could weigh on consumer confidence and construction spending across all industry segments
- Rising risks of tightening liquidity for some lower-rated construction companies which will face upcoming debt maturities and high cash flow volatility

ESG RISKS

- Exposure to environmental risk is low for construction companies, besides some indirect exposure to land use restrictions or carbon-emitting industries (e.g. oil & gas). Tightening environmental regulation could increase cost of construction projects, but this is typically borne by customers. Regulation also often increases demand for services that are rendered by construction companies, such as more efficient buildings

Market conditions remain intact in 2019

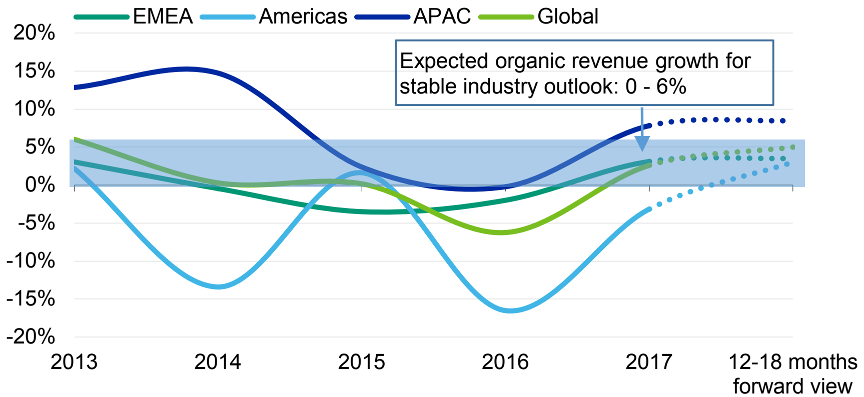
Sustained buoyant activity in US, APAC will drive growth

Key credit themes

- Around 5% sector-wide revenue growth forecast over the next 12-18 months, supported by high confidence, attractive financing conditions and increased infrastructure spending in several regions
- Order backlogs support revenue, but require careful management
- APAC is the growth engine, led by China, with growth of up to 10%
- Healthy residential and increased non-residential activity combined with government infrastructure projects underpin North America
- Order books suggest sustainable moderate revenue growth in Europe, while Brexit constrains UK construction spending
- Rated issuers to maintain broadly stable credit quality in 2019, although some lower-rated companies could face challenges

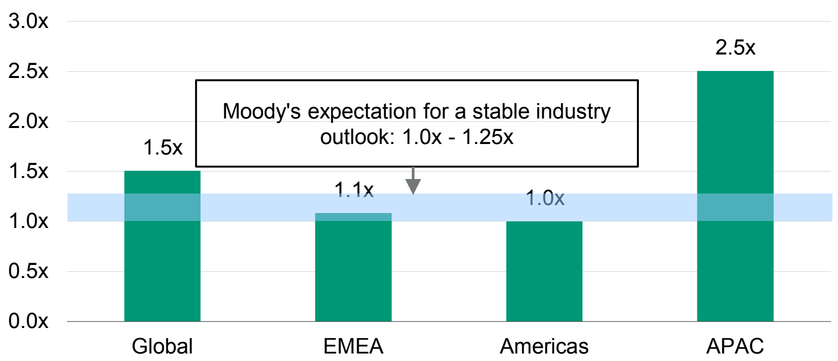
Strong order intake supports revenue growth

Sector revenue to grow 5% in 2019



Source: Company data, Moody's Investors Service estimates

Book-to-bill ratios suggest good growth potential



Source: Company data, Moody's Investors Service

» 5% revenue growth forecast in 2019, the upper end of our range for a stable outlook

» Global book-to-bill ratio of 1.5x suggests solid growth, forecast to moderate towards 1.2x next year

» Strong APAC order intake signals above-average growth, especially in China. Steady US order growth, but weak LatAm demand squeezes the Americas' ratio

» Increased order backlogs add visibility on earnings, cash flow

» Companies with high backlogs depend less on winning new orders and can focus on profitability

Moderately higher volumes in Europe

Robust demand with high backlogs and strong confidence

» High order backlogs and record confidence support growth

» Upside potential more limited with euro area GDP growth slowing to 1.8% in 2019

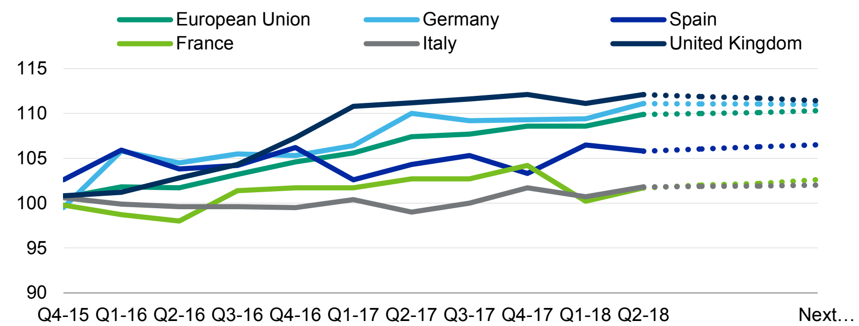
» Activity by country is uneven:

– Stabilizing volumes in Germany, modest growth in France and vigorous activity in Spain

– Continued sluggish demand in Italy; Genoa bridge collapse might fuel public works activity

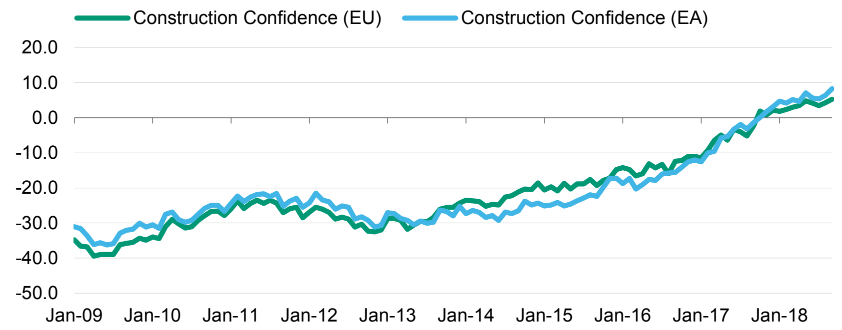
– UK construction output to stagnate at best amid Brexit uncertainty

Construction output will expand slightly…



Source: EuroStat, monthly production in construction, seasonally adj., 2015=100

…but confidence may have reached a peak

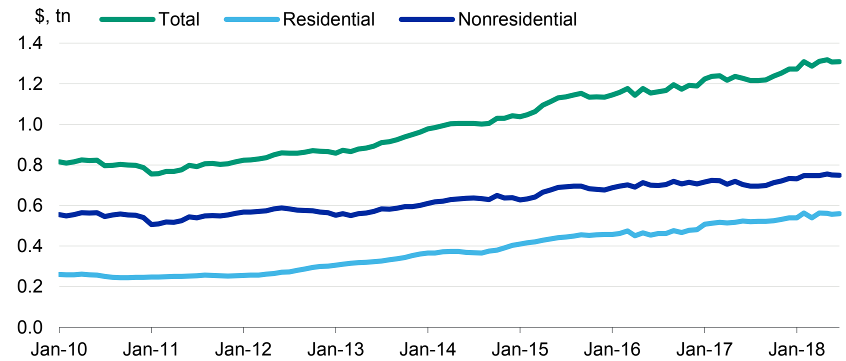


Source: EuroStat

Moderate growth expectations in the US

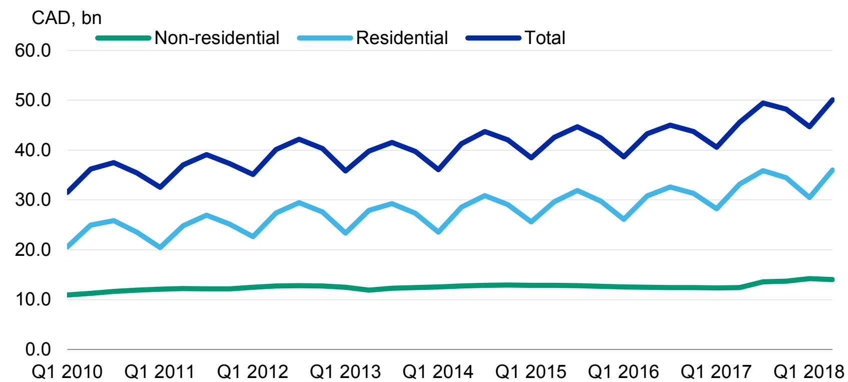
- US: Low- to mid-single-digit growth, competitive conditions limit margin upside
  - Residential construction will grow modestly due to low unemployment, steady wage gains and low housing inventories. Rising interest rates and tax law changes limit the upside
  - Nonresidential construction to gradually improve, supported by the $305 billion Fixing America's Surface Transportation (FAST) Act, plus state funding measures and a recovery in tax receipts
- Canada: Growth in the mid-single-digit range

US construction spending



Source: US Census, seasonally adjusted annual rate

Canada construction spending



Source: Statistics Canada; non-residential is seasonally adjusted, residential is unadjusted

Activity in LatAm will remain weak in 2019

Key challenges faced by LatAm construction companies

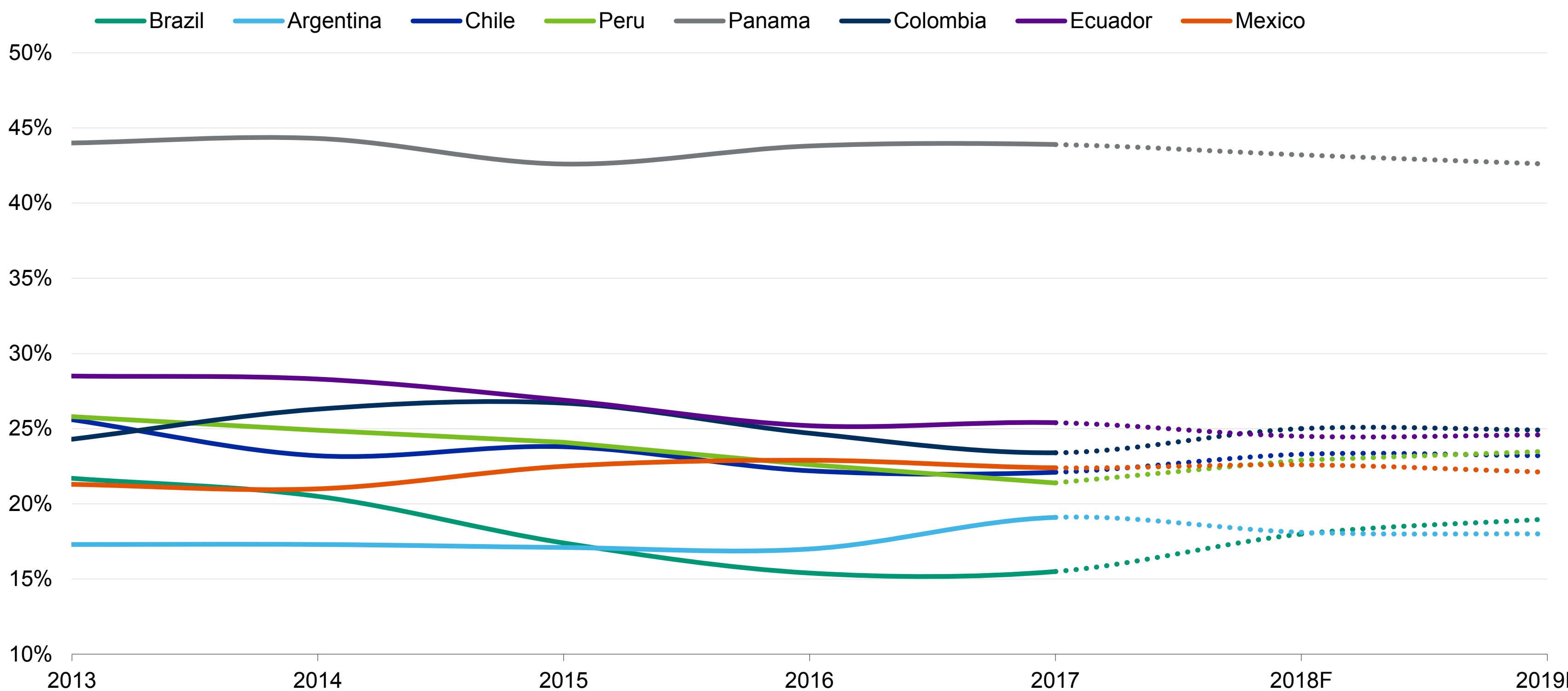
- In Latin America, revenue growth will remain weak through 2019 as reflected in the main countries' gross investment to GDP ratios
- The Car Wash investigations in Brazil highlighted the sector's corporate governance risks and project cancellations
- Liquidity remains weak across the sector
  - Slowdown in construction affected cash generation
  - Delays in cash collections for those with higher exposure to government
  - Higher reputational risk has also tightened credit conditions for the sector

Investments in LatAm will be below 2015 levels

Several years of declining investment drive low activity

Engineering and construction activity weak across most major Latin American economies

Gross investment as percentage of GDP



Source: Moody's Investors Service

Demand will remain strong in China

Infrastructure investments will drive solid revenue growth

- Leverage stable as earnings growth offsets higher debt to fund investments
- Strong revenue growth supported by Chinese and overseas infrastructure investments
  - Revenue growth modest in metallurgical sector and low for domestic power and property development projects
- Margins stable or contracting slightly due to price competition; offset by continued cost controls, and investments in build-operate-transfer, public-private partnership and real estate development projects with higher margins

Developments to monitor

- Potential for higher leverage with debt-funded investments
- The Chinese government’s focus on reducing state-owned enterprises’ leverage is likely to keep investments in check

China construction leverage to remain stable

Higher earnings growth will offset higher debt for rated companies

Revenue growth to slow but remain strong

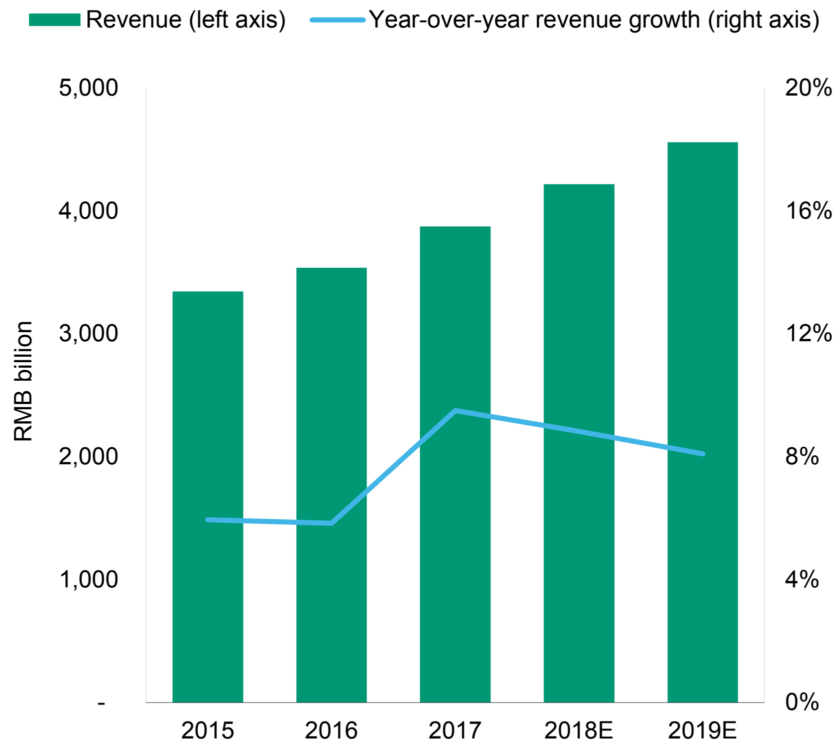


Exhibit shows averages for the eight rated Chinese construction and engineering parent companies.
Sources: Company information, Moody's Investors Service estimates

Leverage will remain stable despite higher debt

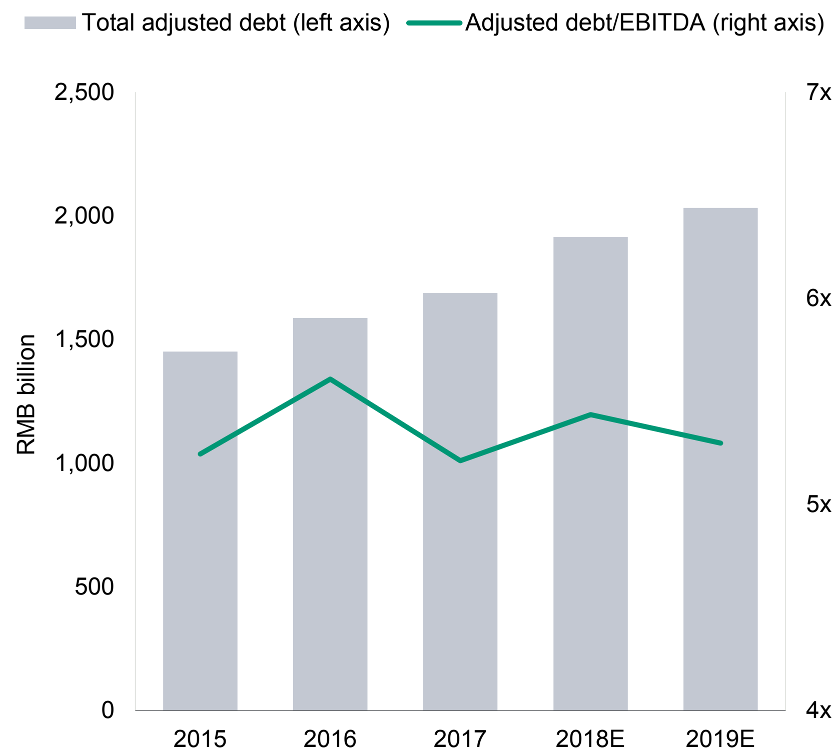
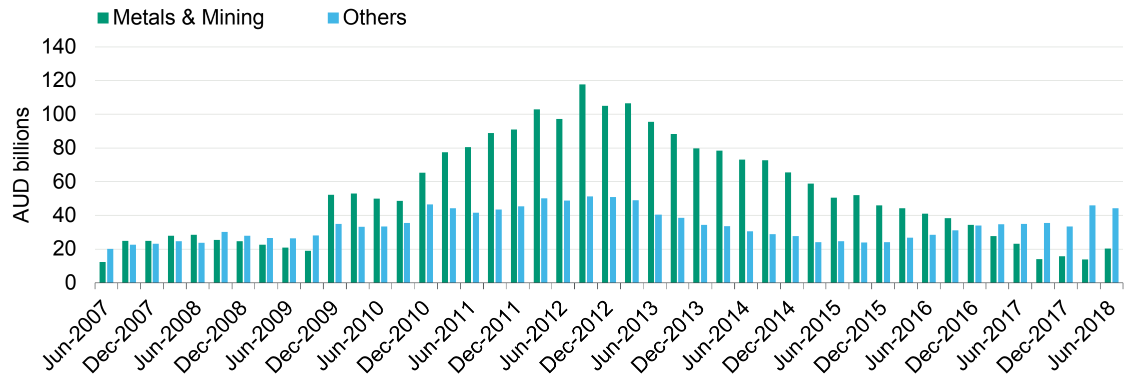


Exhibit shows averages for the eight rated Chinese construction and engineering parent companies.
Sources: Company information, Moody's Investors Service estimates

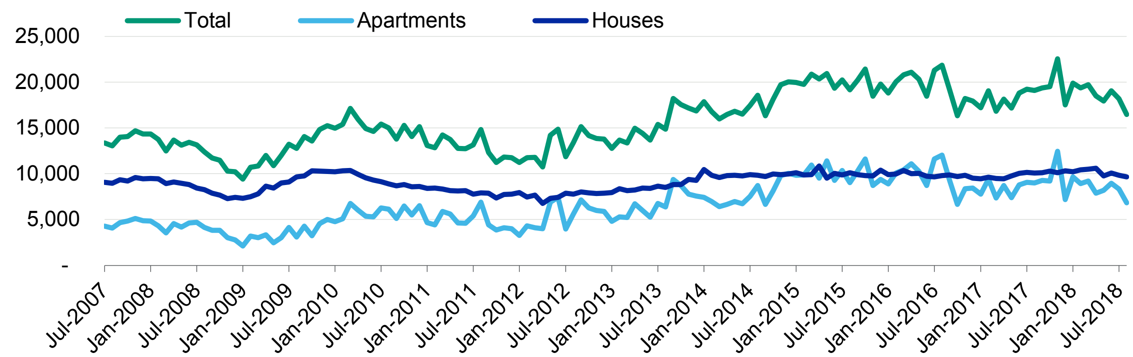
Australian road and rail spending supports stable outlook

- Earnings will be broadly flat as residential building activity declines from historic highs but road and rail infrastructure spending will remain high
- Good contract execution, with avoidance of write-downs, will remain key
- Metals and mining related spending to pick up modestly from low levels

Engineering and construction activity



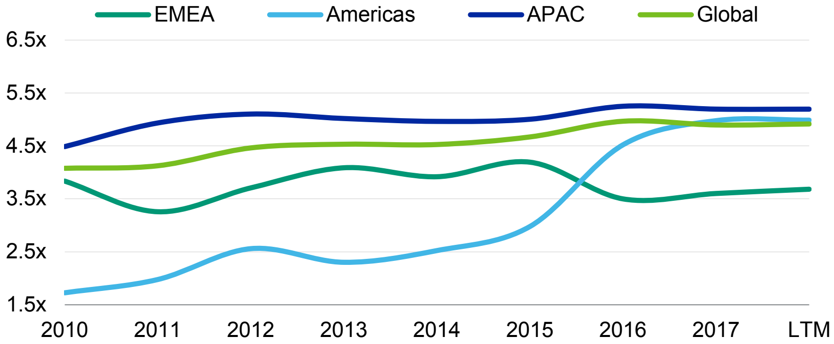
Australia housing approvals



Source: Australian Bureau of Statistics

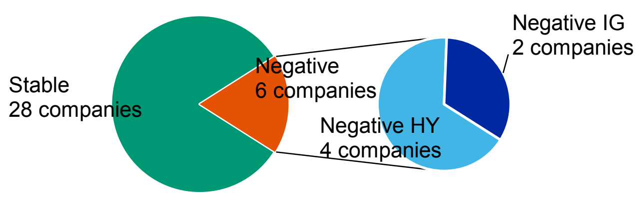
Overall stable credit profiles, while lower rated issuers face higher risks

Debt / EBITDA has stabilized at a high level



All ratios are calculated using Moody's standard accounting adjustments, based on consolidated numbers. Ratios only include rated companies.
Source: Moody's Investors Service

Negative outlooks concentrated on lower ratings



Based on outlooks for 34 construction companies rated by Moody's globally (22 November 2018).
Source: Moody's Investors Service

- » Stable to slightly decreasing leverage across the sector
- » Debt reduction, cash flow improvements remain top priority for many companies
- » Profit margins to be pressured by high input costs, intense competition for new projects
- » Overall stable credit profiles, but 18% of outlooks are negative, mostly in the high-yield category
- » Challenges reflected in weaker positioned ratings are mainly company specific

Credits of Interest

EMEA

» Astaldi S.p.A. (Caa2 negative)
  - Filing for creditor protection under Italian insolvency law in October suggests high risk of a payment default over the next few weeks, hence elevated downgrade risk.

» Obrascon Huarte Lain S.A. (Caa1 stable)
  - Loss-making and cash consuming legacy projects and restructuring will continue to weigh on cash flow generation in 2019.
  - However, still adequate liquidity following the sale of OHL's stake in OHL Concesiones for around €2.8 billion to IFM Investors in April 2018, and a net debt position with no material debt maturities before 2020, support the stable outlook.

Credits of Interest

EMEA

- Bouygues S.A. (A3 stable)
  - Most divisions will benefit from favourable operating conditions in the next 18 months. Although Bouygues issued a profit warning in October, effects on credit quality will be limited since margins will recover in 2019 and the cash effect will be phased out over several years.
- Vinci S.A. (A3 stable)
  - VINCI is the holding company for one of Europe's largest concession and construction groups with a significant market position and scale in its domestic market – France. The company's strategy is to evolve into a more geographically diversified player, which appears relatively challenging in the short term, absent sizeable transformational M&A deals.

Credits of Interest

North America

» Fluor (Baa1 negative)

  – A strong backlog of orders should support near-term revenue generation, but competitive pressures will continue to weigh on profitability. Project execution issues along with an increase in borrowings a few years ago to fund strategic investments and shareholder-friendly actions have put downward pressure on its credit profile.

» AECOM (Ba2 stable)

  – A strong backlog of orders should support a relatively stable operating performance, but its focus on returning cash to shareholders will weigh on its credit profile.

Credits of Interest

China

» China Metallurgical Group Corporation (Baa1, stable)

- CMGC's leverage will continue to improve over the next 12-18 months, driven by an improvement in earnings from strong revenue growth and stable adjusted EBITDA margin. Strong revenue growth will be driven by robust growth in new orders and more business traction in the transportation infrastructure and other engineering construction sectors, and overseas expansion.

Moody's related publications

Industry Outlook:

» Construction - Global: Robust economies, higher confidence and low interest rates keep outlook stable, 16 October 2018

Issuer Comment:

» Astaldi S.p.A: Adjustment of its capital and financial strengthening plan is credit negative, 4 October 2018

» Bouygues S.A.: Profit warning is credit negative, but margins will recover in 2019, 23 October 2018

Macro Profile:

» Global Macro Outlook: Global growth to decelerate amid tightening global liquidity and elevated trade tensions, 8 November 2018

Methodology:

» Construction Industry, 22 March 2017

Global credit conditions to weaken amid slowing growth and rising risks

Credit risks will build in 2019 as economic growth slows, funding costs rise, liquidity tightens and market volatility returns. Trade tensions and growing geopolitical risks will likely escalate and have significant sector and regional impacts. Advances in digital technologies could trigger productivity improvements as well as business disruptions, while the ESG issue that is most likely to materially influence credit in 2019 is carbon transition risk.

Learn more: www.moodys.com/2019outlooks