

Strengthening Skanska's risk management

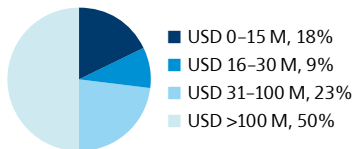
Identifying, managing and pricing project risks are of fundamental importance to the Group's profitability. Risks are normally of a technical, legal and financial nature, but risk analysis also includes ethical, social and environmental aspects.

Skanska's risk management system does not imply avoidance of all risks, but instead aims at identifying, managing and pricing them.

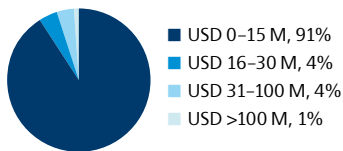
For some years, Skanska has carried out a systematic risk assessment of new projects, which is clearly reflected in declining project losses. Continuous monitoring and improvements in execution also result in fewer loss-making projects. This contributes directly to improved earnings, since a single loss-making project can wipe out the earnings from many profitable projects.

Order backlog SEK 137 bn

Project size



Number of projects



Skanska is continuously refining its risk management instruments, improving processes both at the corporate level and in business units, among other things through expanded project monitoring in close collaboration with local units. Experience shows that good project planning is crucial to project execution. By identifying and addressing problems at an early stage, Skanska improves the potential for profitability in its projects.

By focusing on selected home markets, Skanska's local business units become thoroughly familiar with each market and can analyze them continuously. These analyses are an integral element of the Senior Executive Team's work.

Many markets, many segments

Construction investment in a country normally follows the trend of GDP, with a time lag of one to three quarters. The amplitude of these fluctuations varies between different markets, but is generally larger for construction investments than for GDP. On average, changes in construction investments in Skanska's markets are estimated at 2.5 times the change in GDP.

Economic cycles are not the same in all markets and segments. Some are more volatile than others. Skanska works in many markets and many segments for both public sector and private customers, which reduces the risk to its overall business.

Projects the primary revenue source

The construction business is largely about risk management. Practically every project is unique. Size, shape, environment – most of these vary for each new assignment. The construction industry differs in this way from a typical manufacturing company that operates in permanent facilities and with long production runs.

Projects are Skanska's primary source of revenue. The Group's profitability is dependent on the earnings of individual projects. Unforeseen risks can cause losses. One characteristic of the construction business is that risks and opportunities are not symmetrical. A well-executed project can mean that the margin in the project may increase by one or more percentage points. A large loss-making project, however, may have a considerably large adverse impact on earnings.

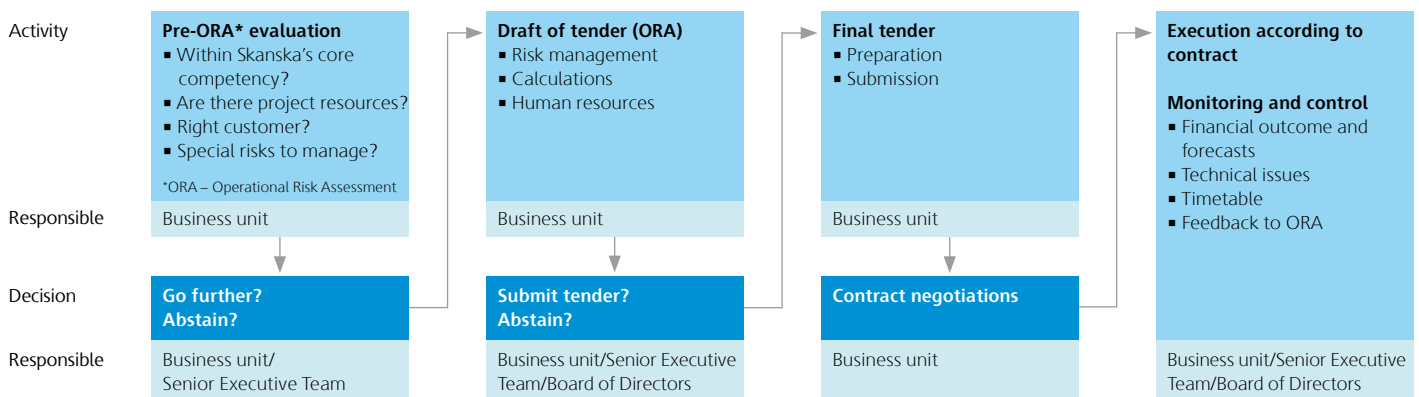
Uniform risk management procedures

Well-implemented identification and management of risks and opportunities during tender preparation lay the groundwork for successful projects.

Skanska uses a Groupwide system for identifying and managing potential risks, the Skanska Tender Approval Procedure (STAP) and the Operational Risk Assessment (ORA). It evaluates construction projects during tender preparation with regard to technical, legal and financial risks. It also analyzes a number of general "public exposure" issues – among them ethical, social and environmental aspects. During the execution period, it monitors and updates these issues as the project progresses.

Analyses indicate that shortcomings in project organization, the local expertise of business units and/or the customer

Skanska Tender Approval Procedure (STAP)



relationship often underlie poor outcomes. Experience also shows that initial profitability problems tend to worsen rather than diminish over time. The ORA process systematizes the preparation of tenders. Possible new projects are analyzed in light of the core strengths of business operations in terms of expertise, geographic market, contract type and size and available project resources. This core competence has been mapped for each local unit. Potential projects must match a unit's established expertise profile.

A matrix to choose the right projects

The fundamental risk analysis for new project opportunities is based on the Skanska Heat Map – a matrix of the Company's core competence. This instrument is used in order to select the "right" projects for tender-related work.

Conceivable new projects are examined on the basis of various general parameters – product type, personnel, geography, customer and contract/assignment – which are crucial to the success of a project, in Skanska's experience. The Heat Map is used before time and energy are devoted to a tender. If a unit receives the go-ahead to begin tender preparation, it then follows the ORA process, which is a more specific, thorough risk analysis.

SRT strengthens risk management

During 2009 Skanska established a specialist unit, the SET Risk Team (SRT), which examines and analyzes conceivable

tender proposals, investment or divestments before the Senior Executive Team (SET) makes a decision. SRT handles 40–50 tender proposals per month, for a total of about 500 per year.

A business unit carries out a risk assessment and identifies specific measures for limiting risks. Then, in some cases after approval by the Senior Executive Team, it decides whether a tender should be submitted.

Aside from analyzing tenders, SRT is entrusted with strengthening the Group's risk management, providing backup for risk assessment work and disseminating knowledge and experience between business units. In its future work, SRT will focus on developing uniform processes for all business units and ensuring that at least one project manager participates in tender-related work at business units. The aim is also to perform a risk analysis of all future potential projects in the Operational Risk Assessment system of local units. There should also be feedback to SRT before project start-up.

Operational risks

In the construction business, operational risks are substantially higher than financial risks. Skanska's ability to foresee and manage operational risks is crucial in achieving good earnings.

Projects are accounted for using the percentage of completion method; earnings are recognized as costs are accrued.

Each project is evaluated on a quarterly basis, with adjustments in the percentage of completion being made for any changes in the estimated project completion cost. Estimated losses in ongoing projects are recognized in their entirety on the date the estimate is made. A loss-making project that previously reported a profit must expense all previously recognized profit. The entire estimated loss must also be recognized on the same occasion. If no further changes occur, the project will then recognize zero gross income during the remainder of the construction period.

Risks related to material prices

In Skanska's operations there are many types of contractual mechanisms. The degree of risk associated with the prices of goods and services varies greatly, depending on the contract type.

In cases where Skanska works on a cost-plus basis, any price increases are passed on directly to the customer. In assignments for public sector customers, Skanska often has fixed-price contracts.

Certain contracts contain indexing clauses that allow an upward revision of the contract value, equivalent to price increases.

Financial risks

The Skanska Financial Services support unit is used for evaluating risks related to credit risks, payment flows, customers, subcontractors and joint venture partners. In all types of major projects that continue over a long period, Skanska conducts regular follow-up of its risk assessment. The SET carries out quarterly reviews of major projects, altogether equivalent to about one third of total project volume, and performs similar monitoring of loss-making projects and those projects deemed to involve special risks.

Foreign exchange risks

Project revenue and costs are normally denominated in the same currency. Transaction risks from exchanges between different currencies are thus limited. Known and budgeted financial flows are hedged. The foreign exchange risk that arises because portions of the Group's equity are invested long-term in foreign subsidiaries is normally not fully hedged, but to some extent Skanska hedges its equity in markets/currencies where it has a relatively large proportion of its equity invested. At the end of 2009, about 30 percent of the equity in Skanska's American, Norwegian, Polish and Czech subsidiaries was currency hedged. Investments in development business streams are hedged, since the intention is to sell these assets over time.

Interest rate risks

Interest rate risk is the impact on earnings arising from a change in interest rate. Interest-bearing assets currently exceed interest-bearing liabilities, so net financial items are adversely affected by an interest rate cut. At year-end 2009, the average interest refixing period for interest-bearing assets, SEK 17.6 billion, was 0.2 (0.1) years and on interest-bearing liabilities excluding pension liabilities, SEK 2.9 billion, it was 1.5 (0.6) years. The size of Skanska's interest-bearing pension liability, SEK 2.2 (3.1) billion, is largely connected to the interest rate on long-term central government debt. An increase or decrease in long-term interest rates leads to a decrease or increase in pension liability. Such changes are recognized directly in Group comprehensive income (see Note 28, page 117).

Refinancing risks and liquidity

Refinancing risk is the risk caused by lack of liquidity or by difficulty in obtaining or rolling over external loans. At year-end 2009, the Group's unutilized credit facilities totaled SEK 8.4 (8.9) billion and the average maturity of the borrowing portfolio, including the maturity of unutilized credits, was 4.5 (5.5) years.

Impact on the Group of a change in SEK against all currencies and a change in USD against SEK, based on the 2009 income statement and statement of financial position

SEK bn	+/-10%	of which USD +/-10%
Revenue	+/- 10.9	+/- 4.4
Operating income	+/- 0.4	+/- 0.2
Equity	+/- 1.5	+/-0.3

The above sensitivity analysis shows in SEK the Group's sensitivity to a 10 percent unilateral change in SEK.

Interest-bearing liabilities and assets

SEK bn	Dec 31, 2009	Dec 31, 2008
Interest-bearing gross liabilities	-5.1	-5.9
Cash and cash equivalents and interest-bearing receivables	17.6	15.1
Interest-bearing net receivables	12.5	9.2

Sensitivity of pension obligation to change in discount rate

SEK bn	Sweden	Norway	U.K.	Total
Pension obligation, December 31, 2009	5.2	2.6	4.6	12.4
Discount rate increase/decrease of 0.25 percent ¹	+/-0.2	+/-0.1	+/-0.2	+/-0.5

¹ Estimated change in pension obligation/pension liability if the discount rate changes. If pension liability increases, the Group's equity is reduced by about 75 percent of the increase in pension liability, after taking into account deferred tax and social insurance contributions.