MAERSK

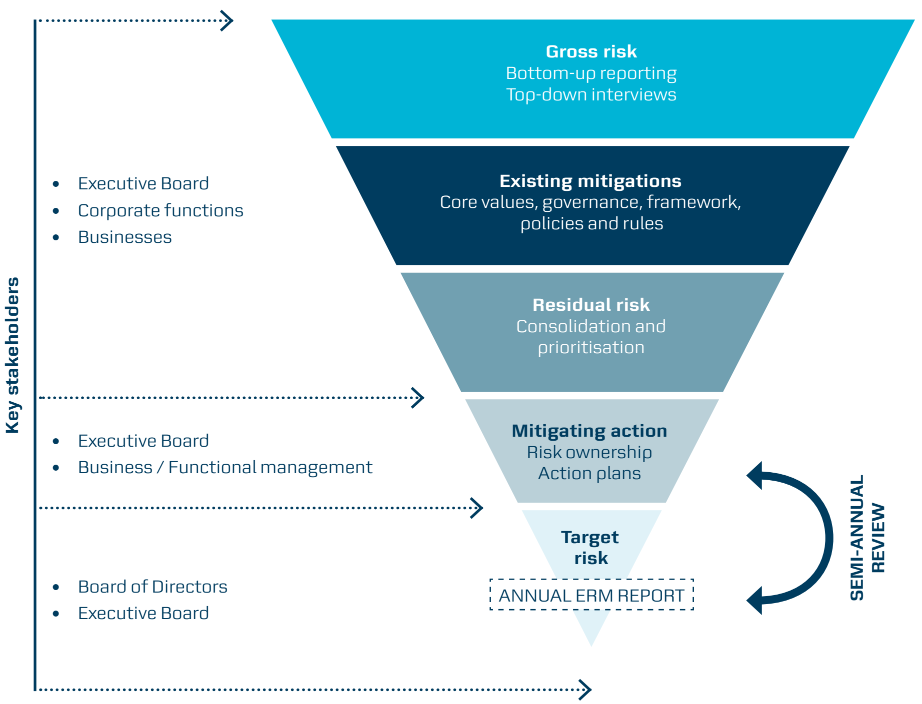
2017
Risk management

A.P. Møller - Mærsk A/S

Risk management

Risk management at A.P. Moller - Maersk is strategically focused and designed to contribute to the achievement of business objectives in the medium term and ensure the longevity of A.P. Moller - Maersk in the long term.

ENTERPRISE RISK MANAGEMENT GOVERNANCE STRUCTURE AND PROCESS



The purpose of A.P. Moller - Maersk's risk management is to identify and assess the risks to operations as well as strategic goals, and to immediately mitigate them to acceptable risk levels. A structured Enterprise Risk Management process ensures that risks across multiple categories are regularly identified, assessed and reported, and that decisions are made on the treatment of such risks.

Part of the process is to continuously monitor the development of the main risks through established Key Risk Indicators, which enable the Executive Board and the Board of Directors to decide on any additional risk treatment required to keep the risks within acceptable limits.

The established process is supported by a defined Enterprise Risk Management framework, which ensures that it is performed consistently and captures the full array of risks across A.P. Moller - Maersk. Risk officers are appointed across the organisation to continuously identify, assess, manage and monitor risks. As part of the process, the risk officers document and report the risks identified, together with the mitigating measures in place to manage the risk.

Risks

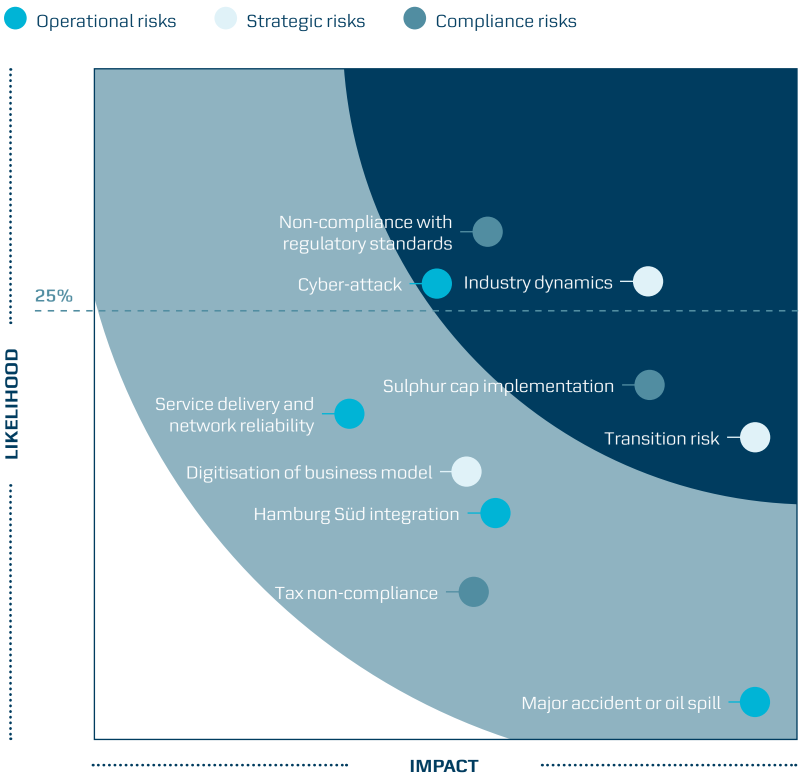
Certain key risks and their potential impact on the performance of A.P. Moller - Maersk are illustrated and commented on in the following:

Operational risks

Cyber-attack

A.P. Moller - Maersk fell in June 2017 victim to a major cyber-attack caused by the NotPetya malware, which affected many companies globally. As a result, operations in transport and logistics businesses were disrupted, leading to unwarranted impact on customers. The recovery was fast, but within a brief period A.P. Moller - Maersk suffered losses in the order of USD 250-300m covering, among other things, loss of revenue, IT restoration costs and extraordinary costs related to operations. To further enhance cyber resilience, many immediate and long-term initiatives have been implemented and planned to secure the digital business, strengthen the IT infrastructure platform, enhance IT service continuity and recovery as well as reinforce business continuity plans. Additionally, a cyber insurance has been purchased to mitigate some of the potentially negative financial impact of repeated successful cyber-attacks in the future.

RISKS TO A.P. MOLLER - MAERSK'S STRATEGIC OBJECTIVES



Hamburg Süd integration

The acquisition of Hamburg Süd was completed at the end of November 2017. An acquisition of this size exposes A.P. Moller - Maersk to integration risks and other challenges. The acquisition was premised on a number of factors, including expected synergies and the overall fit with the broader strategic ambitions. The ability to harvest synergies and the value from the transaction will, in part, be dependent on the ability to successfully integrate Hamburg Süd, without disruption to A.P. Moller - Maersk's, nor Hamburg Süd's, existing business and operations. If these synergies fail to materialise, it could result in future impairments and pressure on key financials. The integration challenges and the mitigating activities are being coordinated and supervised with anchoring in senior management, including a process to manage integration risks, with a view to ensuring that the integration challenges are adequately met. To protect the business volume and the Hamburg Süd brand, the front-line customer facing commercial organisation have been maintained, ensuring uninterrupted customer interactions. IT platforms are kept separate, while full integration of networks is being pursued. Together with vendor contract efficiencies, network integration is the biggest synergy contributor and is expected to be concluded in 2018.

Service delivery and network reliability

Persistent challenges regarding the schedule reliability of the network could test the customers' patience, and possibly result in valuable customers being lost. The reliability of service delivery could, for instance, be affected by down time or lower productivity (e.g. due to labour conflicts) at hub terminals, or by a lack of operational control of cargo transported by network partners under vessel sharing agreements. Because of the cyber-attack, A.P. Moller - Maersk saw a temporary reduction in reliability, resulting in lower volumes for a period. Operations continuously reviews the network to reduce unwarranted dependency on certain hubs to handle large cargo flows, and strives to secure continuous alignment with vessel sharing agreement partners in respect of schedule reliability.

Major accident or oil spill

Operational safety is synonymous with the license to operate. Major naval or operational accidents such as collisions or groundings, as well as potential oil spills from vessels, continue to be inherent in operational risks. Pending separation of the energy businesses, A.P. Moller - Maersk also continues to carry the risk of major oil-related accidents such as explosions or a blow-out on a drilling rig. A high-severity accident in any of the businesses would first and foremost present a risk to the safety of people as well as potentially to the environment. Additionally, it could result in a large-scale impact on assets, liquidity position and reputation, and could put the license to operate at risk. The risks associated with operational accidents are mitigated through safety and maintenance standards, response preparedness, continuous training and rigorous monitoring. Also, people, assets and activities remain comprehensively insured against personal injuries, physical damage and liabilities (with some level of self-insurance).

Strategic risks

Transition risk

A.P. Moller - Maersk embarked in 2016 on a strategic journey towards a structurally reshaped company. The strategy entails separating out the energy businesses and focusing on the transport and logistics space, with the aim of vertically integrating the existing brands into a global end-to-end transport and logistics operator. A transition of such magnitude comes with certain execution risks, including the risk of overloading resources and directing the focus inwards at the expense of customer service. Also, different organisational capabilities are needed to transform and support businesses in new strategies and new business environments with increased digitisation etc.

The transition away from the energy businesses is progressing as planned, with the separation of Maersk Oil and Maersk Tankers completed, and with strategic solutions for Maersk Drilling and Maersk Supply Service expected over the next 12 months. Furthermore, a roadmap for the integration of the existing transport and logistics brands has been launched, starting with a new and strengthened management structure to lead the integration.

As the portfolio narrows, the threat of a credit rating deterioration constitutes a separate risk. This is due to the loss of business diversification and higher volatility in returns and cash flow. A deterioration in credit worthiness leading to a credit rating down-grade could result in higher funding costs and a weakened ability to raise funding in the debt capital markets. Applying part of the proceeds from the separation of the energy businesses to reduce debt, tightened financial planning and rigorous discipline in respect of capital expenditure serve as risk-reducing measures. Further, increasing end-to-end solutions and diversification within transport and logistics could lead to lower volatility over time.

Industry dynamics

Maersk Line's profitability is strongly impacted by supply and demand developments. With Maersk Line being the largest contributor to volatility in earnings, the overall profitability of A.P. Moller - Maersk remains highly dependent on freight rates. A change in the freight rates of +/- 100 USD/FFE compared to forecast will cause a change in EBIT of USD 1.3bn. The freight rate risk is mitigated through designing a competitive network, pursuing cost leadership in the industry, optimising network utilisation through alliances and vessel sharing agreements, and, through the acquisition of Hamburg Süd, driving industry consolidation and geographically diversifying A.P. Moller - Maersk's earnings. Further, in line with the strategy of offering end-to-end solutions online, A.P. Moller - Maersk seeks to expand its presence outside ocean freight in order to diversify and stabilise earnings from adjacent revenue streams.

Although the portfolio may eventually disconnect from the direct exposure to the energy markets through separation of the A.P. Moller - Maersk energy businesses, it will remain vulnerable to the effect that commodity prices continue to have in certain markets. APM Terminals has suffered difficulties in certain commodity-dependent markets, particularly in the North-South trades. This risk is exacerbated by the addition of Hamburg Süd's trades, as these focus on Latin America. APM Terminals is conducting a review of its portfolio to strengthen overall profitability.

Digitisation of business model

The strategy suggests exploring new opportunities through digital innovation. The shipping industry remains very transactional and technologically lacking compared to other industries, and could as such be prone to disruption. Hence, without active participation, digitisation may prove a risk, as online sales and logistics channels increasingly become relevant players in the traditional transport and logistics space. The establishment of a digital organisation and the announced agreement with IBM on a joint venture to create a digitised trade platform is the response to and a token of awareness of the disruptive risks and opportunities emerging on the industry's virtual horizon.

Compliance risks

Sulphur cap implementation

Being a leading global shipping operator, A.P. Moller - Maersk remains exposed to regulatory changes within the industry. One such change takes effect in 2020, with a global sulphur emission cap. From a sustainability point of view, the initiative is welcomed, but there are risks associated with the introduction of the new global standards. Sub-par enforcement mechanisms may skew the playing field, leaving those complying with the new legislation at a disadvantage, as the price of compliant fuel is likely to exceed that of the heavy fuel oil currently in use. A strategy to operate in compliance with the new sulphur threshold from 2020 has been developed. At this stage, a deliberate choice has been made not to invest in the instalment of scrubbers on vessels

Mexico City, pictured, is one of the world's largest cities and capital of a large and expanding market.

(to enable the continued use of heavy fuel oil), and to maintain a dialogue with refineries to secure a sufficient supply of compliant fuel by the time the regulations come into force.

Non-compliance with regulatory standards

Its global span and presence exposes A.P. Moller - Maersk to many different jurisdictions and regulatory environments. APM Terminals and Damco have a substantial presence in countries with difficult business conditions from an anti-corruption perspective. One example is the compliance issues that surfaced in Latin America following APM Terminals' acquisition of the Spanish Grup Marítim TCB in 2016 (see page 38). Maersk Line is continuously exposed to competition law scrutiny, as evidenced by the US Department of Justice's investigation into the container liner industry initiated in March 2017. With the latest addition of Hamburg Süd's trades, the focus remains on complying with applicable laws and standards. This includes the deployment of consistent rules and standards within the company wide governance framework, COMMIT, awareness campaigns, continuous assessments of compliance risks and cooperation with authorities concerning investigations.

Tax non-compliance

Much like the regulatory compliance risk, the diversified nature of A.P. Moller - Maersk's activities and its cross-border presence entails an exposure to a wide range and variety of tax environments. Part of the risk stems from potential changes in regulations or challenges to historic tax positions, resulting in differing interpretations. Additionally, local tax authority investigations, especially in regions with national fiscal positions under strain, remain an area with a continuous need for collaboration and monitoring.

The latter dynamic can be exacerbated by changes in public opinion on what is regarded as 'good corporate citizenship'. As with other regulatory standards, the tax-related risk is mitigated through an upright approach, collaboration with the authorities in respect of investigations and enquiries, as well as ensuring that the necessary competencies and an efficient organisation of specialists is in place to best meet the requirements and tax regulations relevant to operations. Tax exposures are monitored systematically on an ongoing basis. •