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Research Update:

Container Liner A.P. Moller-Maersk A/S Upgraded To 'BBB+' On Strengthened Credit Profile; Outlook Stable

September 14, 2021

Rating Action Overview

- A.P. Moller-Maersk A/S (Maersk) will likely reach 2.4x our October 2020 EBITDA forecast in 2021, mainly because of freight rates staying at record highs due to strong demand for tangible goods and limited containership capacity amid infrastructure bottlenecks.
- We expect elevated, albeit somewhat lower, EBITDA in 2022, underpinned by our assumption of moderating freight rates from the second half of next year.
- Strong earnings will result in S&P Global Ratings-adjusted funds from operations (FFO) to debt continuing to exceed 50%, which is our threshold for a 'BBB+' rating, while strong free operating cash flow (FOCF) will increase Maersk's financial flexibility for discretionary spending.
- We therefore raised our long-term issuer credit rating on Maersk and issue rating on the company's senior unsecured debt to 'BBB+' from 'BBB'.
- The stable outlook reflects our view that Maersk's EBITDA will start moderating from second-half 2022 to a more sustainable annual run rate of about $8.0 billion by 2023, allowing the company to maintain adjusted FFO to debt above 50%, underpinned by a consistent and prudent financial policy.

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Rating Action Rationale

Freight rates are unlikely to moderate in second-half 2021, contrary to our previous expectations. Uninterrupted strong demand for tangible goods, accompanied by prolonged congestion in major maritime ports and disruption of logistical supply chains, are tying up containership capacity and boosting freight rates. In particular, freight rates on the main container liner trades--Transpacific and Asia-Europe--remain at record highs. According to Clarksons Research, the Shanghai Containerized Freight Index (SCFI) reached a new high at Aug. 31, 2021, of 4,500 points, more than 3x the elevated average in 2020 and more than 4x the prepandemic 10-year average of 950 points.

Short-to-medium-term freight rate conditions should be supportive and underpin Maersk's cash flow. The movement of essential goods, strong pickup in e-commerce, and shift in consumer spending to tangible goods from services have supported shipping volume recovery and container-liner freight rates since June 2020. Trade momentum remained solid in first-half 2021, despite the usual seasonal slowdown. As a result, we forecast a rebound in shipped volumes largely consistent with global GDP growth of 5%-6% in 2021, particularly fueled by flourishing Transpacific trade, following a 1%-2% contraction in 2020 compared with 2019. Despite the spike in new ship orders in first-half 2021 (lifting the containership order book to slightly above 20% of the total global fleet at Aug. 31, 2021, from a historical low of about 8% in October 2020), containership supply growth is unlikely to surpass demand growth in the coming quarters, propping up freight rates. We believe that increasingly stringent regulation on sulfur emissions and broader considerations about greenhouse gas emissions in general--particularly in the context of decarbonization--will likely result in uncertainties over the costs and benefits of various technologies and fuel, and should constrain orders to some extent in the short term. We also note that lead times between placing orders for ships and the ability for shipyards to deliver currently stands at 18 months-24 months. We now forecast that freight rates could start normalizing only from year-end 2021 at the earliest, as the pandemic's impact on container shipping eases.

We anticipate the container liner industry will remain disciplined in deploying capacity, as demonstrated since the pandemic began. Soon after the initial COVID-19 outbreak last year, there was a withdrawal of sailings from China, and container liner operators continued to adjust capacity to demand trends in a timely manner throughout 2020. These measures demonstrate industry players' reactive supply management, which we consider normal in a sector that has been through several rounds of consolidation in recent years. The five largest container shipping companies now have a combined market share of about 65%, up from 30% about 15 years ago.

Fueled by continuously strong freight rates in the Ocean segment, Maersk's EBITDA should significantly outperform our October 2020 base case. We now expect Maersk to raise its average freight rate per 40-foot equivalent unit (FEU) in the largest Ocean segment 35%-40% in 2021, compared with our previous forecast of a low-single-digit decline. This, supported by robust trade volume growth and strong trading in the Terminals and Logistics and Services segments, should translate into S&P Global Ratings-adjusted EBITDA (including recurring dividends from equity investments and after restructuring and integration costs) of about $19 billion, which is 2.4x our previous forecast, and follows $9.2 billion achieved in first-half 2021. We believe the slower normalization of freight rates than we previously expected will not only boost Maersk's EBITDA in 2021, but also strongly support its 2022 earnings.

We expect EBITDA will also be inflated in 2022, but less than in 2021. Our 2022 base case incorporates likely persistently strong freight rates, benefiting from the elevated base we expect at year-end 2021. In view of ongoing supply chain disruptions, customers will be keen to secure containership space for longer durations than usual, which should also support Maersk's earnings next year. That said, as infrastructure bottlenecks start loosening, we expect freight rates to normalize but remain profitable, with the industry's prudent capacity deployment continuing. According to our base case, we expect Maersk's EBITDA to normalize from second-half 2022 to a more sustainable annual run rate of about $8.0 billion by 2023, which compares with $8.4 billion in 2020. In our view, Maersk's consistent strategy, aimed at becoming a container logistics integrator by 2025, should lead to improved stickiness with its top customers, increased share of contracted business, more cross-selling opportunities, and a positive effect on earnings overall. Moreover, the expanding Logistics and Services segment will contribute to lower earnings volatility over time.

Stronger FOCF than expected, combined with reduced debt, should increase room under the improved credit metrics for discretionary spending and unforeseen operational setbacks. According to our base case, Maersk will generate strong discretionary cash flow (after leases, capital expenditure [capex], dividends, and share buybacks) of up to $8.5 billion in 2021. This performance should provide ample financial leeway for future external growth in the Logistics and Services segment, shareholder remuneration (including the $5 billion share buyback program starting in autumn 2021), and likely moderation of EBITDA, while allowing the company to operate in line our adjusted FFO-to-debt threshold for a 'BBB+' rating of more than 50% over the next two years. In 2021, we expect adjusted debt to decrease to $3 billion-$4 billion from $10.5 billion at Dec. 31, 2020, and $12.9 billion a year earlier, supported by strong excess cash flows. This translates into adjusted FFO to debt of well above 60%, compared with about 68% in 2020, and falls within the range for the minimal financial risk profile category (versus modest previously).

Maersk lacks a track record of operating with the lower financial leverage we forecast in our base case. We apply a negative financial policy modifier to our 'a-' anchor for Maersk, resulting in an overall rating of 'BBB+', because we note that the strongly improved credit ratios we forecast in 2021 and 2022 would be a new achievement for the company. This means that there is no track record of Maersk operating at such a leverage level or commitment to maintain this degree of financial risk, which weighs on the rating. At the same time, we note Maersk's sizeable shareholder returns in the past. We also capture a lower degree of credit ratio predictability, beyond what can be reasonably built into our forecasts, and the risk that adjusted leverage could be materially higher than our base case, given Maersk's strategy to expand its logistics footprint and potential large cash outflows, which are impossible to forecast at this time. That said, we believe if the company pursued cash/debt-funded mergers or acquisitions, it would adjust its shareholder remuneration to limit a potential deterioration in financial risk profile to one category lower.

Outlook

The stable outlook reflects our view that Maersk's EBITDA will start moderating from second-half 2022 to a more sustainable annual run rate of about $8.0 billion by 2023, allowing the company to maintain adjusted FFO to debt above 50%. We think this will be underpinned by the sustained supply discipline of industry players and Maersk's balanced financial policy.

Upside scenario

We could raise the rating if Maersk expands its logistics business, resulting in an enlarged and less volatile earnings base and an upward revision of our business risk profile assessment. We could also upgrade Maersk if adjusted FFO to debt stays above 60% once freight rates normalize, and the company commits to a financial policy to ensure this ratio level is sustainable.

Downside scenario

We could downgrade Maersk if we expect adjusted FFO to debt to fall below 50%, with limited prospects for recovery, for example, due to a significant plunge in trade volumes along with industry players' unexpected shift to aggressive capacity management depressing freight rates. A large cash/debt-funded acquisition, resulting in credit measures falling short of our guidelines on a sustainable basis, would also pressure the rating.

Company Description

Maersk is one of the world's largest transportation companies, with the following main operating segments:

- Maersk Ocean ($6.5 billion EBITDA in 2020): activities in the Maersk Line business and Hamburg Süd, and six hub terminals (plus three hubs in joint ventures). The world's largest container liner with about 17% global market share of capacity. The company operates in over 130 countries around the world and has a fleet of about 700 ships, of which (as measured by capacity) 55% are owned and 45% chartered from containership owners. Ships sail every major trade lane. The company offers dry, reefer, and special cargo services.
- Terminals and Towage ($1.2 billion EBITDA in 2020), with gateway terminals and Svitzer towage services, provides port and inland infrastructure that supports global commerce. The segment is currently active in 66 ports and terminals across 58 countries, with one new terminal now under construction, along with more than 100 inland services operations across the world. Svitzer has provided safety and support at sea since 1833. With a fleet of 440 vessels and operations all over the world, Svitzer is the global leader in towage operations, servicing 34 terminals and 120 ports.
- Logistics and Services ($454 million EBITDA in 2020), including supply chain management and intermodal/inland activities. In 2020, the segment's offering was enhanced by the acquisition of warehousing and distribution companies Performance Team and KGH Customs Services. This year, Maersk pursued inorganic growth, acquiring two e-commerce logistics companies Visible Supply Chain Management (estimated 2021 EBITDA of $65 million) and B2C Europe (estimated 2021 EBITDA of $8 million, expected to close in fourth-quarter 2021).
- Manufacturing and Others ($165 million EBITDA in 2020), including mainly Maersk Container Industry, which develops and manufactures refrigerated containers and StarCool refrigeration machines for the intermodal industry, including shipping lines, fruit multinationals, and leasing companies.

Our Base-Case Scenario

Assumptions

- Worldwide economic growth will remain vital to the shipping industry. Given the global nature of shipping sector demand, we consider the GDP growth of all major contributors to trade volumes.
- Global GDP rebounds markedly to 5.9% growth in 2021, after contracting 3.2% in 2020, and a further 4.3% growth in 2022. China's GDP growth rebounds to 8.3% in 2021, after slowing to 2.3% in 2020, moderating at 5.1% growth in 2022. Asia-Pacific's GDP growth recovers swiftly to 6.7% in 2021, after contracting 1.4% in 2020, moderating at 4.9% growth in 2022. Eurozone GDP recovers to 4.4% growth in 2021, after a 6.7% contraction in 2020, sustaining at 4.5% growth in 2022. U.S. GDP recovers to 6.7% growth in 2021, after contracting 3.5% in 2020, decelerating to 3.7% growth in 2022.

- Annual growth rates in Maersk Ocean's transported volumes of 7% in 2021, after a 5% decline in 2020, followed by about 4% growth in 2022, aligning with global GDP growth trends.
- Deployed capacity in Maersk Ocean to remain flat at 4.0 million–4.3 million 20-foot equivalent units over the forecast period.
- Maersk Ocean's average fixed-bunker freight rate increases 35%-40% in 2021, with overproportionate increases on the Transpacific and Asia-Europe routes, following a 7% increase in 2020. This is fueled by prolonged infrastructure bottlenecks and healthy demand fundamentals. In 2022, as the pandemic's impact eases, average freight rates will decline but remain above 2020 levels, supported by contracted freight rates benefitting from the elevated 2021 base (about 45% of Maersk's carried volumes are on long-term contracts). Thereafter, as overall industry capacity increases and vessels on order are delivered from 2023, freight rates will reduce and stabilize at close to the profitable 2019 and 2020 levels.
- The higher crude oil price of $65 per barrel (/bbl) in 2021 after $43/bbl in 2020, decreasing to $60/bbl in 2022. We maintain our view that future bunker cost increases or decreases (typically linked to crude oil price movements) will either be passed through or returned to customers via higher or lower freight rates with a time lag of a few months. Furthermore, we expect increasing fuel efficiency to offset the effect of volume growth, leading to lower fuel consumption.
- Largely flat Maersk Ocean operating costs (bunker excluded) per unit over 2021-2022.
- Extraordinarily strong growth in terminal moves (a measure of marine ports' activity) in the terminals segment of 15%-20% in 2021, paired with increased revenue per move, due to congestion and higher storage revenue share, and supported by efficient cost management. This, complemented by positive performance in the resilient Towage segment (Svitzer), is expected to translate to EBITDA of $1.7 billion-$1.8 billion. In 2022, EBITDA is expected to normalize to about $1.5 billion, amid moderating terminal revenue.
- EBITDA in the Logistics and Services segment increases to close to $1 billion in 2021 from $454 million in 2020, fueled by strong activity across all product offerings and cross-selling opportunities with Maersk Ocean's customers, as well as full-year consolidation of Performance Team and KGH Custom Services. The acquisitions of Visible Supply Chain Management (completed in August 2021) and B2C Europe (expected to be completed in fourth quarter 2021) in the fast-expanding e-commerce logistics sector, along with continuous investment in information technology solutions, digitalization, and specialized staff to leverage growth potential with Maersk Ocean, will support estimated EBITDA of $1 billion in 2022, once business activity starts moderating. Maersk has a clear strategy to expand the Logistics and Services segment inorganically, whereas our forecasts exclude contributions from potential acquisitions, which are impossible to assess at this time.
- Gross capex in line with the company's guidance of $7 billion over 2021-2022 cumulatively (up from $1.3 billion in 2020 and $2 billion in 2019). The capex includes prepayments for eight methanol powered vessels (with an option for four more in 2025) ordered in August 2021 as part of its fleet renewal and decarbonization program, with the first delivery scheduled at the beginning of 2024.
- Ordinary dividends for 2021 and 2022 in line with the stated dividend policy (30%-50% of the underlying net result), after $1 billion of dividends for 2020 paid in 2021.
- Completion of the existing $1.6 billion share repurchase program by Sept. 30, 2021 (with $500 million bought back by April 30, 2021), followed by the new $5 billion program implemented over the next two years.

Key metrics

Based on our base-case assumptions, we arrive at the following adjusted credit measures:

- FFO to debt significantly above 60% in 2021-2022, compared with about 68% in 2020 and about 36% in 2019.
- Debt to EBITDA significantly below 1.5x in 2021-2022, compared with 1.2x in 2020 and 2.1x in 2019.

Liquidity

We assess Maersk's liquidity as exceptional. Our assessment considers the new share buyback program of up to $5 billion over the next two years (likely to start in fourth-quarter 2021) and our dividend assumptions consistent with the lower end of the 30%-50% pay-out range. We forecast that Maersk's liquidity sources will cover its uses by about 2.2x over the 12 months started June 30, 2021, and about 2.6x in the following 12 months.

Maersk's liquidity sources on hand provide an ample liquidity cushion and include cash and cash equivalents supplemented with several committed credit lines maturing beyond 12 months. We expect Maersk will retain uninterrupted access to capital markets. In our view, management has a proactive approach toward financing planned capital investments, with the lion's share of debt maturities in the next 12-24 months prepaid. Furthermore, Maersk benefits from flexibility through its large, unencumbered asset pool and well-established sound banking relationships. We understand that there are no financial covenants in any corporate loan documentations.

We calculate the following cash sources for the 12 months started July 1, 2021:

- Cash and bank balances of $7 billion, excluding $1.1 billion of restricted cash.
- Undrawn credit facilities with maturity beyond 12 months of $6 billion.
- Cash FFO (after working capital outflows) of about $11.5 billion.

For the same period, we calculate the following cash needs:

- Nonmaterial short-term borrowings.
- Capex of up to $3.5 billion.
- About a $1 billion cash outflow for the acquisition of two e-commerce companies, Visible SCM and B2C Europe.
- Our assumption of dividends and share buybacks totaling about $6.5 billion.

Issue Ratings - Subordination Risk Analysis

Capital structure

Our rating takes into consideration Maersk's capital structure, which as of Dec. 31, 2020, consisted of about $2.8 billion of secured and unsecured bank debt, about $3.8 billion of unsecured bonds, and about $8.7 billion of leases.

Analytical conclusions

We rate Maersk's unsecured notes 'BBB+', in line with the issuer credit rating. This is because Maersk's financial risk profile assessment of minimal indicates financial leverage that is sufficiently low to offset potential subordination.

Ratings Score Snapshot

Issuer credit rating: BBB+/Stable/--

Business risk: Satisfactory

- Country risk: Intermediate
- Industry risk: Moderately high
- Competitive position: Satisfactory

Financial risk: Minimal

- Cash flow/leverage: Minimal

Anchor: a-

Modifiers

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

Stand-alone credit profile: bbb+

Related Criteria

- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- Criteria | Corporates | General: Reflecting Subordination Risk In Corporate Issue Ratings, March 28, 2018
- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate

Entities, Nov. 13, 2012

- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Related Research

- Container Liner A.P. Moller - Maersk A/S Outlook Revised To Positive On Stronger Financials; Affirmed At 'BBB', Oct. 30, 2020

Ratings List

Upgraded; Outlook Action

	To	From
A.P. Moller - Maersk A/S		
Issuer Credit Rating	BBB+/Stable/--	BBB/Positive/--
Senior Unsecured	BBB+	BBB