Research Update:

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

October 30, 2020

Rating Action Overview

- We expect A.P. Moller – Maersk A/S (Maersk) will report significantly higher EBITDA in 2020 than we previously forecast, due to a less severe decline in global trade and lower bunker fuel prices than we forecast, as well as the company's tight grip on costs and capacity management.
- Maersk's improved free operating cash flow (FOCF) and lower debt will result in stronger-than-expected credit metrics, and we believe the company may achieve less-volatile earnings, further decrease net debt, and increase financial flexibility under the improved credit measures for external growth or potential unforeseen setbacks.
- We are therefore revising our outlook on Maersk to positive from negative, and affirming our 'BBB' long-term issuer credit rating and issue rating on the company's senior unsecured debt.
- The positive outlook reflects that we may upgrade Maersk in the next 12 months, if we believe the company can maintain S&P Global Ratings-adjusted funds from operations (FFO) to debt above 50%, which is our threshold for a 'BBB+' rating, underpinned by a consistent and prudent financial policy.

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Rating Action Rationale

The COVID-19 pandemic and the subsequent recession have had a less severe impact on global trade than we previously anticipated. The most recent reporting by leading industry players indicates a steeper-than-expected demand recovery and firm freight rates. As such, we have revised our base case to incorporate positive industry fundamentals continuing into fourth-quarter 2020. The movement of essential goods, strong pickup in e-commerce, and shift of consumer spending to tangible goods from services have supported the recovery of shipping volumes from June. We now forecast a drop in shipped volumes of 5%-10% in 2020 compared with 2019, versus our previous forecast of up to 15%.

Stringent capacity management and lower-than-expected bunker prices are offsetting sluggish demand. In our view, containership supply growth will continue to be muted in the coming quarters, which is particularly important in times of weak demand. With no incentive to place new large orders amid subdued contracting/ordering activity since late 2015, the containership order book is at a historical low: currently 8.5% of the total global fleet. Combined with funding constraints, more stringent regulation on sulfur emissions (permitting only 0.5% sulfur emission from January 2020), and COVID-19-related disruptions (such as delays in new-build ship deliveries, ship maintenance and repair works, and scrubber retrofits), this has translated into tighter supply conditions, better utilization rates, and healthy freight rates. Following the COVID-19 outbreak, container liners quickly cutback on sailing loops to and from China, and continue to adjust capacities in a timely manner, idle ships, or travel longer routes during the typical slack seasons. These measures signify the reactive supply management by container liners, which we would normally expect from an industry that has been through several rounds of consolidation in recent years. Notably, the five-largest container shipping companies together have a market share of about 65%, up from 30% about 15 years ago.

Maersk will improve EBITDA and credit measures in 2020, despite depressed global trade volumes. Maersk reported strong operating results in the first six months of 2020, with reported EBITDA of $3.2 billion, which represents a marked improvement compared with $2.6 billion in the first six months of 2019. This has been followed by the company's preliminary trading update pointing to EBITDA before restructuring and integration costs of $2.4 billion for third-quarter 2020. Under our base case, we expect this positive trend will continue toward year-end 2020, with S&P Global Ratings-adjusted EBITDA (including recurring dividends from equity investments and after restructuring and integration costs) of $7.6 billion-$7.7 billion for the full year. This is well above the $6.0 billion that Maersk achieved in 2019, and our April 2020 forecast of $5.0 billion-$5.2 billion. Maersk's earnings improvement are supported by higher-than-expected trade volumes and freight rates, lower-than-forecast bunker fuel prices, a solid grip on capacity and cost control, as well as resilient terminal operations and the increasingly profitable logistics business. Furthermore, Maersk's reduced debt thanks to better free cash flow generation will result in much stronger credit metrics than we previously expected. Under our base case, adjusted debt will drop to $11.0 billion-$11.5 billion at year-end 2020 (from about $12.9 billion a year earlier), while adjusted FFO to debt will improve to 50%-55% in 2020, compared with about 36% in 2019 and our April forecast of 30%-35%.

Maersk could achieve less volatile earnings from 2021 despite operational headwinds, but prudent deployment of excess cash flow is essential for an upgrade. The container shipping industry is tied to cyclical supply-and-demand conditions, and the EBITDA growth rate we forecast for Maersk in 2020 is unlikely to be sustainable, in our view. In addition, there is high uncertainty regarding the pandemic and economic recession, and their impact on global trade demand. As such, we consider that a key challenge for Maersk will be maintaining EBITDA at the strong level of $7.5 billion-$8.0 billion that we expect for 2020. This will hinge on container liners' stringent capacity management in line with volume expectations, and Maersk's ability to continue lowering unit costs and managing the swings in fuel prices, while protecting its strategic position in the typically less-volatile terminal business. This will also depend upon Maersk's ability to expand its logistics operations in a profitable manner, while pursuing its strategic transformation of becoming the global integrator of container logistics. Furthermore, given the shipping industry's inherent volatility and the associated swings in cash flows, maintaining a prudent financial policy, underpinned by balanced and EBITDA-margin-accretive expansion via mergers and acquisitions

(M&A), and proactive deployment of FOCF for net debt reduction rather than shareholder returns in times of weak earnings will be key to stabilize the credit quality.

The company has the capacity to increase headroom under the improved credit measures for external growth and potential unforeseen setbacks. We forecast that Maersk's operating cash flow could outpace capital expenditure (capex) requirements and regular/annual dividend distribution (consistent with the stated dividend policy) in 2021 and 2022, creating ample scope for further gradual net debt reduction. This would provide Maersk with more financial leeway under its improved credit measures for envisaged M&A growth and potential unexpected operational challenges. Under our base-case forecast, Maersk could achieve adjusted FFO to debt of 50%-55% in 2020, improving to 55%-60% in 2021. This ratio is consistent with a higher 'BBB+' rating, but with limited headroom. As such, we view further net debt reduction and the resulting increased financial flexibility as critical for an upgrade.

The lack of a track record of maintaining improved credit metrics and a stronger financial risk profile weighs on the possibility of an upgrade at this time. We apply a negative financial policy modifier, which takes down the anchor by one notch to 'bbb'. This is because the improved credit ratios in 2020, which are now consistent with our modest financial risk profile, are a new achievement for the company, meaning there is no track record of Maersk's ability to keep the ratios at the improved levels and its commitment to maintaining this degree of financial risk.

Environmental, social, and governance (ESG) credit factors for this rating action change:

- Health and safety

Outlook

The positive outlook reflects a one-in-three likelihood that we could upgrade Maersk over the next 12 months.

Upside scenario

We could raise the rating if a rebound in trade volumes and the container shipping industry's consistent capacity and pricing discipline enable Maersk to maintain its solid EBITDA performance and FOCF generation, such that adjusted FFO to debt remains above 50%, which is our threshold for a 'BBB+' rating.

Furthermore, we would need to be convinced that management's financial policy does not allow for significant increases in financial leverage from the current lowered levels. This means that the company will not embark on any large debt-financed M&A expansion, and is willing to shift its priority to using FOCF for net debt reduction rather than shareholder returns if annual EBITDA appears to deteriorate below $7 billion.

Downside scenario

We could revise the outlook to stable if we expected Maersk's adjusted FFO to debt to weaken below 50%, with limited prospects for recovery. This could happen, for example, if trade volumes are lower than we anticipate and freight rate conditions deteriorate, the company executes an unexpected, large debt-funded acquisition, or Maersk shifts its financial policy toward aggressive shareholder remuneration, impeding the sustainability of improved credit measures.

Company Description

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

- Maersk Ocean ($4.4 billion EBITDA in 2019): 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 650 ships, of which (as measured by capacity) 65% is owned and 35% chartered from containership owners. Ships sail every major trade lane. The company offers dry, reefer, and special cargo services.
- Terminals and Towage ($1.1 billion EBITDA in 2019), with gateway terminals and Svitzer towage services, provides port and inland infrastructure that supports global commerce. The segment is currently active in 65 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 ($238 million EBITDA in 2019), including supply chain management and intermodal/inland activities. With the acquisition of the warehousing and distribution company Performance Team (2019 estimated EBITDA of $90 million) and KGH Customs Services (2019 recurring EBITDA of $17.2 million) this year, Maersk enhanced its logistics and services offering.
- Manufacturing and Other ($205 million EBITDA in 2019), including mainly Maersk Container Industry, which develops and manufactures refrigerated containers and StarCool refrigeration machines to the intermodal industry, including shipping lines, fruit multinationals, and leasing companies.

Our Base-Case Scenario

S&P Global Ratings acknowledges a high degree of uncertainty about the evolution of the coronavirus pandemic. The current consensus among health experts is that COVID-19 will remain a threat until a vaccine or effective treatment becomes widely available, which could be around mid-2021. We are using this assumption in assessing the economic and credit implications associated with the pandemic (see our research here: www.spglobal.com/ratings). As the situation evolves, we will update our assumptions and estimates accordingly.

At the moment, our 2020-2021 base-case scenario for Maersk factors in these 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 contracting by 3.8% in 2020, after 3.1% growth in 2019, rebounding markedly to 5.2% growth in 2021, but from a depressed level. China's GDP growth slows to 2.1% in 2020 from 6.1% in 2019, followed by a rebound of about 6.9% in 2021. Asia-Pacific's GDP growth

contracts by 1.6% in 2020 from 4.7% in 2019, recovering swiftly to about 6.2% in 2021. The eurozone goes through a recession with negative 7.4% GDP growth in 2020 from positive 1.3% in 2019, before recovering significantly to 6.1% in 2021. U.S. GDP contracts by 4.0% in 2020 from 2.2% growth in 2019, followed by a recovery to 3.9% growth in 2021.

- Annual growth rates in Maersk Ocean's transported volumes of negative 5% in 2020 and positive 5% in 2021 based on global GDP growth trends, compared with negative 0.1% in 2019.
- Deployed capacity in Maersk Ocean to remain flat at about 4 million TEU (20-foot equivalent units) over the forecast period.
- Maersk Ocean's average fixed-bunker freight rate per TEU increasing by 3.5%-4.0% in 2020, as the industry continues to adapt capacities and pricing to sluggish, albeit recovering, trade volumes. We forecast a low-single-digit decline in 2021. Freight rates will ultimately depend on renegotiation of one-year contracts for 2021 (about 50% of volumes) and shipping companies' capacity management, especially if bunker fuel prices increase or volumes remain subdued. The most recent supply measures, such as blank sailings, to curb industry capacity demonstrate such disciplined behavior, in our view.
- A stable crude oil price of $50 per barrel (/bbl) in 2021 and in 2022. We maintain our view that future bunker cost increases or decreases (typically closely 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 volume growth, leading to lower fuel consumption per TEU.
- An annual drop in Maersk Ocean's operating costs (bunker excluded) per TEU of 1%-2% on average.
- Terminal moves (a measure of marine ports' activity) in the Terminals segment mirroring our forecast of global trade volume decline of 5%-10% in 2020 versus 2019, followed by a recovery consistent with global GDP growth of about 5% in 2021. Lower volumes will be offset by higher revenue per move and cost reductions, resulting in steady low-single-digit annual EBITDA growth over the forecast period. This will be complemented by resilient EBITDA performance in the Towage segment (Svitzer).
- EBITDA in the Logistics and Services segment increasing consistently to at least $500 million by 2021 from about $240 million in 2019. In 2020, the decline in volumes will be more than offset by strong air freight forwarding rates due to capacity shortages, margin optimization in intermodal, and the Performance Team's contribution (consolidated in April 2020). Furthermore, the positive earnings trend reflects organic growth potential from Maersk investing in IT solutions, digitalization, and specialized staff, transforming its processes, and selling more products to Maersk Ocean's customers, as well as the contribution of the Performance Team and the recently acquired KGH Custom Services (consolidated from September 2020).
- Gross capex in line with the company's guidance of $3 billion-$4 billion over 2020-2021 cumulatively (from $2 billion in 2019 and $3.2 billion in 2018) to be below depreciation for all segments, except Logistics and Services. Minimal capex to be spent in Terminals and Towage, and Manufacturing and Other segments.
- Ordinary dividends of $430 million and minority dividends of $100 million in 2020, followed by ordinary dividends in line with the stated dividend policy (30%-50% of the underlying net result, but limited to the lower-to-middle part of the range during the transformation phase into an integrated logistics company) in 2021.
- Share repurchases of $750 million in 2020 and $1 billion in 2021, as per S&P Global Ratings'

forecast.

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

- FFO to debt of 50%-55% in 2020 and 55%-60% in 2021, compared with about 36% in 2019.
- Debt to EBITDA of 1.5x-1.6x in 2020 and 1.4x-1.5x in 2021, compared with 2.1x in 2019.

Liquidity

We assess Maersk's liquidity as exceptional. Excluding the share buybacks from uses because we view them as discretionary and do not expect them under a stress scenario, we forecast that Maersk's liquidity sources will cover its uses by about 3.9x over the 12 months started July 1, 2020, and about 3.8x 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 continue having uninterrupted access to capital markets. In our view, management has a proactive approach toward financing planned capital investments and Maersk's debt maturities are well distributed. 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, 2020:

- Cash and bank balances of $4.34 billion, excluding $0.9 billion of restricted cash.
- Undrawn credit facilities with maturity beyond 12 months of $6.15 billion.
- Cash FFO (after working capital outflow) of about $5.0 billion.

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

- Short-term borrowings of about $1.15 billion.
- Capex of $2.0 billion.
- Distributions to shareholders and minority interests of about $600 million.

Issue Ratings - Subordination Risk Analysis

Capital structure

Our rating takes into consideration Maersk's capital structure, which as of Dec. 31, 2019, consisted of about $3.36 billion of secured and unsecured bank debt, about $4.8 billion of unsecured bonds, and about $8.58 billion of finance leases.

Analytical conclusions

We rate Maersk's unsecured notes 'BBB', in line with the issuer credit rating, since no significant elements of subordination risk are present in the capital structure. Furthermore, Maersk's financial risk profile assessment of modest indicates financial leverage that is sufficiently low to offset the potential subordination.

Ratings Score Snapshot

Issuer Credit Rating: BBB/Positive/--

Business risk: Satisfactory

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

Financial risk: Modest

- Cash flow/leverage: Modest

Anchor: bbb+

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
- Criteria | Corporates | Industrials: Key Credit Factors For The Railroad And Package Express Industry, Aug. 12, 2014
- Criteria | Corporates | Industrials: Key Credit Factors For The Transportation Cyclical Industry, Feb. 12, 2014
- Criteria | Corporates | Industrials: Key Credit Factors For The Transportation Infrastructure Industry, Nov. 19, 2013
- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013

- General Criteria: Country Risk Assessment Methodology And Assumptions, 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

Ratings List

Outlook Action; Ratings Affirmed

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

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. A description of each of S&P Global Ratings' rating categories is contained in "S&P Global Ratings Definitions" at https://www.standardandpoors.com/en_US/web/guest/article/-/view/sourceId/504352 Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following S&P Global Ratings numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; Stockholm (46) 8-440-5914; or Moscow 7 (495) 783-4009.

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