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Credit Opinion: A.P. Møller-Maersk A/S

Global Credit Research - 13 Nov 2015

Copenhagen, Denmark

Ratings

Category	Moody's Rating
Outlook	Positive
Issuer Rating -Dom Curr	Baa1
Senior Unsecured	Baa1

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Key Indicators

[1]**A.P. Møller-Maersk A/S**

	9/30/2015(L)	12/31/2014	12/31/2013	12/31/2012	12/31/2011
Revenues (USD Billion)	$42.9	$47.6	$47.4	$49.5	$60.3
EBIT Margin	12.3%	15.9%	14.8%	14.9%	16.6%
ROA (NPATBUI / Total Assets)	4.7%	4.4%	3.5%	4.0%	2.8%
Debt / EBITDA	1.7x	1.5x	1.8x	1.8x	1.9x
RCF / Net Debt	52.3%	53.8%	47.3%	43.5%	30.5%
(FFO + Interest) / Interest Expense	18.7x	14.1x	12.0x	11.1x	8.4x

[1] All ratios are based on 'Adjusted' financial data and incorporate Moody's Global Standard Adjustments for Non-Financial Corporations. Source: Moody's Financial Metrics

Note: For definitions of Moody's most common ratio terms please see the accompanying User's Guide.

Opinion

Rating Drivers

- A large and diversified group with solid market positions but exposed to cyclical activities

- Stable shareholding and disciplined management; some recent shareholder-friendly actions

- Softer container shipping performance in 2015 amidst more subdued demand and sustained overcapacity

- Lower oil price affecting Maersk Oil's profits; execution risks related to oil and gas activities

- Strong drilling performance in 2015, but weakening expected in 2016-17; terminals business indirectly affected by lower oil price

- Strong credit metrics with moderate leverage

Corporate Profile

A.P. Møller - Mærsk A/S (Maersk) is a global enterprise headquartered in Copenhagen, with some 90,000 employees in around 130 countries. The group is a diversified conglomerate whose main business areas stretch across (1) energy and services (exploration, production, drilling rigs); (2) the container transport industry (container shipping, logistics and forwarding); (3) port terminals and (4) tankers and support vessels. The company has grouped its main activities along strategic sub-groups that provide a disciplined framework to define business development priorities and allocate capital.

In 1904 the Møller family founded the group, which has now become one of the largest Danish companies listed on the Nasdaq-OMX Copenhagen, with a current market capitalisation of around $30 billion. Most of the company shares (41.5% of the share capital and 51.2% of voting rights) are owned by A.P. Møller Holding A/S, a subsidiary established by the foundation which is known as A.P. Møller og Hustru Chastine Mc-Kinney Møllers Fond til almene Formaal (the Foundation), which together with the family foundation, the A.P. Møller og Hustru Chastine Mc-Kinney Møllers Familiefond, own 50.1% of the group's share capital and 64.2% of the voting rights.

SUMMARY RATING RATIONALE

The main drivers of Maersk's Baa1 rating are (1) its leadership in the global container shipping sector and its solid market positions in a large number of its other business lines, notably oil and gas, terminals and drilling; (2) a very diversified business profile; (3) its strong credit metrics; (4) a focused and disciplined management team with a good track record; (5) stable and supportive shareholders; and (6) a solid liquidity profile.

However, Maersk's rating is constrained by several factors such as (1) the execution risk related to the oil and gas business, as management invests over the next few years to return to sustainable production growth; (2) the low and/or volatile return from some of its activities (e.g. container and tanker shipping segments); (3) the fact that a number of business segments in which Maersk operates are cyclical; (4) the substantial capital investments of the group; and (5) a degree of structural subordination within Maersk, albeit we recognise that Maersk's financial policy should moderate this over time.

Recent Developments

End of October, Maersk made a profit warning which was related to weaker performance at its container shipping business, Maersk Line. Maersk revised its guidance for 2015 underlying result to $3.4 billion from $4.0 billion. The weaker performance at Maersk Line was driven by continuing pressure on freight rates, itself due to a large increase in overcapacity with supply growing much faster than demand. We project that growth in supply will outpace growth in demand by around 4-6% during 2015. The outlook for 2016 remains challenging for container shipping. In addition, the oil price, which we expect to remain low in 2016 and to only very gradually increase in 2017, will continue to affect Maersk Oil's performance. Maersk recently announced cost-cutting initiatives at several of its divisions (e.g. Maersk Line, Maersk Oil and Maersk Drilling), as well as capacity cuts at Maersk Line, which will help mitigate the weaker performance.

DETAILED RATING CONSIDERATIONS

A LARGE AND DIVERSIFIED GROUP WITH SOLID MARKET POSITIONS BUT EXPOSED TO CYCLICAL ACTIVITIES

The company is a large and diversified group present in eight core business lines, namely, (1) Maersk Line (container shipping); (2) Maersk Oil (independent oil and gas production and exploration); (3) APM Terminals (port terminals); (4) Maersk Drilling (drilling rigs); (5) Maersk Supply Service (services to offshore and associated industries); (6) Maersk Tankers; (7) Damco (freight forwarding and supply chain management); and (8) Svitzer (harbour and terminal towage).

It is the largest player in several of the industries in which it operates, in particular in container shipping, where it possesses the world's largest fleet capacity, followed by Mediterranean Shipping Company (MSC, unrated) and by CMA CGM (B1 positive). In its other businesses, Maersk has solid market positions.

As part of its active portfolio management, Maersk divested in 2014 its 68% ownership in Dansk Supermarked (DSG) for DKK17 billion ($3.2 billion). Maersk retains a 19% share ownership, subject to a put and a call option, both exercisable in 2019 and held respectively by Maersk and the company purchasing DSG. In April 2015, the group divested a 18.4% stake in Danske Bank and distributed $5.2 billion as a special dividend to shareholders, representing the value of Maersk's total 20% stake. The group retains a 1.6% stake in Danske Bank following the transaction.

The company exhibits a material exposure to cyclical industries, in particular container shipping, in which operating margins can swing significantly year-on-year. In 2014, this business segment represented approximately 57% of the group's revenues and 35% of its reported EBITDA. Its exposure to cyclical sectors is mitigated by its exposure to some very profitable activities which have displayed a more stable operating performance over the past years, notably the group's port terminals, drilling business, and to some extent the oil and gas business. Nevertheless, the oil and gas business has been affected since late 2014 by the lower oil price, which is also expected to challenge the drilling business performance in 2016-17 when contracts expire. In addition, the performance of Maersk's port terminals business has been weaker in 2015 due to its exposure to oil-exporting countries. Altogether, the oil and gas, drilling and terminals businesses represented approximately 32% of the group's revenues and around 59% of its EBITDA in 2014.

STABLE SHAREHOLDING AND DISCIPLINED MANAGEMENT; SOME RECENT SHAREHOLDER-FRIENDLY ACTIONS

Maersk is indirectly owned (through A.P. Møller Holding A/S) by the Foundation headed by the founder's family. The Foundation is historically attached to the stability and long-term security of Maersk's operations. In addition, Maersk benefits from management's good track record, which has adjusted the group's leverage and corporate development to changes in its economic environment. Despite its exposure to cyclical activities, Maersk has demonstrated an ability to operate with limited leverage, even in a more challenging environment, particularly in 2010 and 2011.

In the past year, Maersk has started to make share repurchases through the launch of a first $1 billion share buyback programme in September 2014, then renewed for another $1 billion in September 2015. When Maersk divested its stake in Danske Bank, it returned the cash proceeds to shareholders via a special dividend. We have considered as credit negative both actions, which took place when the operating environment of some of the group's business units had started to weaken. However, the group has maintained a solid financial profile.

SOFTER CONTAINER SHIPPING PERFORMANCE IN 2015 AMIDST MORE SUBDUED DEMAND AND SUSTAINED OVERCAPACITY

Maersk Line is the world's leading container shipping operator. Market conditions in container shipping have been challenging: we forecast that capacity supply in the industry will exceed the demand for container transportation by a high 4-6% in 2015 and still expect around 1-2% overcapacity increase in 2016. This has resulted in increased pressure on freight rates during 2015 compared to 2014.

While Maersk Line continues to exhibit an EBIT margin well above that of its peers (Maersk Line's target is to maintain an EBIT margin at least 5%-points higher than the average of its peers), its performance has weakened since Q3 2015, resulting in the company revising downwards its profit expectations for the full-year. This was followed by the announcement of efficiency initiatives (SG&A reduction of $250 million by 2017), the non-exercise of options to acquire some vessels and capacity cuts on east-west trades, where competition has been most intense.

In January 2015, Maersk Line started the 2M vessel-sharing agreement with competitor MSC. The 10-year agreement is intended for East-West trade lanes and allows each participating company to benefit from its partner's loops and rationalise their vessel cost-to-sales ratios by optimising their use in terms of capacity filling and reducing some of their individual frequencies. Maersk Line estimates that 2M will lead to $350 million of annual cost benefits.

LOWER OIL PRICE AFFECTING MAERSK OIL'S PROFITS; EXECUTION RISKS RELATED TO OIL AND GAS ACTIVITIES

Maersk Oil is a medium-sized independent oil and gas operator with an entitlement production of 300 thousands of barrels of oil equivalent a day (Mboe/d) in Q3 2015 and proved plus probable (2P) reserves of 510 million boe as at year-end 2014. Maersk Oil's production is concentrated in Qatar (40% of entitlement production in Q3 2015), the UK (22%) and Denmark (20%). In Qatar, Maersk Oil was awarded the exploration rights for the Al Shaheen field until 2017 and had completed more than 75% of the drilling as of September 2015. Maersk Oil has been operating in this field since 1992 together with Qatar Petroleum (Aa2 stable) and is participating in a tender process to extend this licence.

Maersk Oil's reserves have been declining in recent years, with 2P reserves of 619 million boe at the end of 2012, 599 million at the end of 2013 and 510 million at the end of 2014. We expect Maersk Oil to pursue its investments to increase its proved reserves and ensure growing entitlement production over the long term. Maersk Oil intends to grow through organic as well as external growth. We caution that a large debt-financed acquisition, combined with the currently more challenging operating conditions in several of Maersk's business units, could result in pressure on its rating and/or outlook.

Maersk Oil is currently heavily affected by the lower oil price and its 9 months 2015 EBITDA declined by around 50% compared to 9 months 2014. For 2015, Maersk Oil's latest guidance is for a positive underlying result for 2015 significantly below 2014 ($1.0bn) at oil prices in the range of $45-55 per barrel.

STRONG DRILLING PERFORMANCE IN 2015, BUT WEAKENING EXPECTED IN 2016-17; TERMINALS BUSINESS INDIRECTLY AFFECTED BY LOWER OIL PRICE

Maersk Drilling's current drilling fleet consists of 22 rigs, with one additional jack-up rig to be delivered in 2016. Maersk Drilling increased its EBITDA to $1.1 billion in 9 months 2015 from $0.6 billion in 9 months 2014, due to high contract coverage and an increased number of rigs in operations. As of September 2015, Maersk Drilling's contract coverage amounted to 85% for 2015, 70% for 2016 and 49% for 2017. However, low oil prices have aggravated overcapacity in the offshore contract drilling industry and we project that day rates will continue to decline in 2016 and remain low in 2017: we expect Maersk Drilling to have a negative impact from lower day rates in 2016-17 when some contracts expire, but recognize that drilling is only a small portion of the group's total profits.

APM Terminals (APMT) has a large and geographically diversified terminal network (61 terminals as of September 2015), albeit with some concentration on oil-exporting countries. These countries having been affected by the decline in oil price, this is weighing on APMT's revenues and profits, which will be lower in 2015 compared to 2014. As of 2014, APMT represented approximately 9% and 8% of Maersk's consolidated revenues and EBITDA, respectively.

STRONG CREDIT METRICS WITH MODERATE LEVERAGE

In June 2015, Moody's changed its approach for capitalizing operating leases, which has resulted in a large improvement in Maersk's financial metrics: based on 2014 financial statements, our debt adjustment related to operating leases declined to $9.0 billion from $23.9 billion (using a multiple of 3x instead of 8x), resulting in an improvement in leverage (i.e. debt/EBITDA) to 1.5x from 2.5x and an improvement in the group's funds from operations (FFO) interest coverage to 14.1x from 7.7x.

While during 2014 Maersk improved its leverage to 1.5x from 1.8x in 2013, we expect 2015 leverage to increase to close to 2x on account of the low oil price which has reduced Maersk Oil's profits, and greater pressure on rates in H2 2015 which is affecting Maersk Line's profits. The majority of the announced efficiency initiatives will only bear fruit in 2016-17.

Liquidity Profile

Maersk's liquidity position is satisfactory and underpinned by (1) a cash balance amounting to $3.2 billion as of September 2015 (including $1.2 billion of trapped cash); (2) cash flow generation from operations which amounted to around $8.3 billion in the last twelve months to September 2015; and (3) available committed credit facilities of approximately $9 billion. These liquidity sources cover Maersk's financing needs, which are spread between capital expenditure commitments, dividend payment ($1.1 billion ordinary and minority dividend in 2015), share repurchases ($1 billion programme which started in September) and financial debt liabilities. At the end of September 2015, Maersk's current financial debt liabilities amounted to $1.1 billion and Maersk has guided to capex of around $7 billion in 2015.

Rating Outlook

The positive outlook reflects the improvement in Maersk's financial metrics due to the material reduction in the debt adjustment related to operating leases (multiple changed to 3x from 8x). While 2014 credit metrics positioned the group very strongly in its rating category, the recently weaker operating performance will result in 2015 credit metrics providing less flexibility to the group, although it will remain comfortably positioned at Baa1.

What Could Change the Rating - Up

Upward pressure could arise if (1) Maersk sustainably reduces its debt/EBITDA ratio below 1.75x and increases its funds from operations (FFO) interest coverage above 12x; and (2) Maersk Oil stabilises and increases its oil reserves and production levels over time.

What Could Change the Rating - Down

Downward pressure on the rating could result if Maersk's debt/EBITDA ratio increases above 2.25x and FFO interest coverage decreases to below 10x over a prolonged period of time. In addition, any significant change in the group structure could put negative pressure on the issuer rating if over time this results in less favourable access to cash flow and assets for the unsecured creditors.

Other Considerations

Maersk is a conglomerate, operating in different industries.

After having allocated the debt of the parent company, A.P. Møller - Mærsk A/S, to each business line on the basis of the invested capital, we used the Moody's industry rating methodology corresponding to each business line, as well as a peer comparison with relevant competitors, to estimate credit quality for each business line.

- For Maersk Line and Damco, as well as the other shipping activities (e.g. Maersk Tankers and Svitzer), we used Moody's Global Shipping rating methodology. Key rating drivers for Maersk Line and the other shipping businesses are leading market positions balanced by weaker credit metrics and difficult market conditions.

- For Maersk Drilling and Maersk Supply Service, we used the Global Oilfield Services rating methodology. Maersk Drilling benefits from a good earnings visibility, as well as a high quality fleet with low average age, while at the same time it has limited geographic diversification.

- For Maersk Oil, we used the Global Independent Exploration and Production Industry rating methodology. Maersk Oil has a long track record of solid organic growth and currently low production costs. This is mitigated by (1) oil production levels, which had been declining, but have recently stabilized; (2) execution risk of Maersk Oil's capex plan; and (3) limited diversification of production base and pending renewal of the Al Shaheen concession.

- For APM Terminals, we used the Privately Managed Port Companies rating methodology. APM Terminals' key rating drivers comprise (1) a diversified portfolio of efficient terminals; (2) a stable revenue base as a result of its strong relationship with Maersk Line; (3) execution risk of its capex plan; and (4) concentration on containers.

We complemented this analysis by assessing Maersk against a number of additional qualitative factors (such as management strategy and discipline, financial policy, corporate governance and group transparency). Overall, these combined assessments positioned Maersk in the middle of the Baa rating category.

Finally, we consider that Maersk's level of business diversification, together with the group's scoring on qualitative factors, justified a one-notch uplift of the issuer rating from mid-Baa. This is because the company is involved in a number of sectors with low to moderate correlation, as evidenced by the historical resilience of its consolidated performance through difficult economic and business conditions.

The presence of debt at the subsidiary level means that the senior unsecured debt issued by the holding company has a degree of structural subordination. However, we have not notched down the issuer rating, as we expect the debt held by the operating companies, as well as secured debt, to diminish over time in line with the group's financial policy.

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