

Rating Action: Moody's changes the outlook on Hapag-Lloyd AG to positive; Ba2 ratings affirmed

22 Jun 2022

Stockholm, June 22, 2022 -- Moody's Investors Service (Moody's) has today affirmed the Ba2 corporate family rating (CFR) and the Ba2-PD probability of default rating (PDR) of Hapag-Lloyd AG ("Hapag-Lloyd"). The senior unsecured rating was upgraded to Ba3 from B1. The outlook on all ratings changed to positive from stable.

A full list of debt can be found in the end of the press release.

"The change in outlook to positive from stable follows continued profitability improvements and reduction in financial leverage as well as an increase in unencumbered assets, supported by more favourable industry conditions as well as management's performance improvement measures and more prudent financial policy" says Daniel Harlid, the lead analyst for Hapag-Lloyd. "While we expect freight rates to normalise over the next quarters, we expect that Hapag-Lloyd's strong balance sheet provides for a good cushion for a weaker market in 2023 and 2024, even considering substantial dividend payouts", Mr. Harlid continues.

A continued robustness of Hapag-Lloyd's operating performance and sustained credit metrics improvements in a more challenging market environment are key drivers for further positive rating pressure.

RATINGS RATIONALE

The Ba2 CFR rating with a positive outlook reflects Hapag-Lloyd's continued focus on reducing leverage, showcased by paying down EUR 818 million of debt over the last 12 months that ended March 31, 2022. This has increased its unencumbered assets ratio to 47% from 29% during the same time period. While some of the prepayments have been a result of a very strong market environment, the rating action also incorporates Hapag-Lloyd's commitment to maintain a conservative financial policy which incorporates a net debt / EBITDA target of below 3.0x. As a reference, the Moody's-adjusted gross and net debt / EBITDA stood at 0.4x and negative 0.4x (the company had a net cash position) respectively as of 31 March 2022.

We note that the next two years (2023-24) could potentially prove to be two challenging years for the industry as the global fleet is poised to grow by around 8% annually and the macroeconomic environment is likely to weaken. The capacity growth is considerably higher than market projections for demand growth of around 3%-4%. Such demand supply / gap has historically put negative pressure on freight rates and carrier profitability. Nevertheless, the Ba2 rating is well positioned to defend these downside risks, as the current capital structure provides cushion for a weaker market environment. The positive outlook indicates that a higher rating is possible should such a weakening in the environment be less severe than what the industry has experienced in the past. It also assumes that Hapag-Lloyd maintains its prudent financial policy, including a dividend policy in balance with its free cash flow generation ability, supporting sustained credit metrics in line with the requirements for the Ba1 rating category.

The upgrade of the senior unsecured bond rating to Ba3 from B1 reflects the improved asset coverage, considering the higher proportion of unencumbered assets on Hapag-Lloyd's balance sheet.

RATIONALE FOR POSITIVE OUTLOOK

The positive outlook reflects the potential for further positive rating pressure, assuming that recent performance improvements in the industry and Hapag-Lloyd's disciplined actions to improve its capital structure will be sustained, leading to a Moody's-adjusted debt / EBITDA of 1.9x - 2.0x and an EBIT margin of 9-10% for the next 12-18 months.

STRUCTURAL CONSIDERATIONS

Hapag-Lloyd's bond rating is one notch below its CFR, reflecting the contractual subordination to the secured debt existing within the group (primarily vessel and container financing). The upgrade to Ba3 from B1 reflects: (1) an increased proportion of unencumbered assets; (2) a higher rating level; (3) a reduction of secured debt

vs unsecured debt and (4) the expectation that the trend in lower recourse to secured debt is likely to continue.

LIQUIDITY PROFILE

We view Hapag-Lloyd's liquidity as good. The company had \$12.9 billion of cash and access to \$723 million in revolving credit facilities, all undrawn as of 31 March 2022. Given the high volatility typical for container shipping, the company's covenants include minimum equity and minimum liquidity, but no leverage or coverage ratios. Hapag-Lloyd has a number of unencumbered vessels and containers that could be pledged to raise additional liquidity if needed. Although maintenance capex needs are limited, the company has outstanding orders of 17 new vessels with a total capacity of 350,000 TEUs which Moody's assumes will be financed with a combination of cash and debt. For the next 12 months (starting from June 31 this year), the company has around \$560 million in debt coming due.

FACTORS THAT COULD LEAD TO AN UPGRADE OR DOWNGRADE OF THE RATINGS

An upgrade requires sustained leverage and profitability improvements, reflected in (1) Moody's-adjusted debt/EBITDA remaining comfortably below 3.0x, (2) sustained EBIT-Margin in the high single digit in percentage terms and (3) sustaining RCF / net debt at least in the high twenties in percentage terms. In addition, a prerequisite for positive ratings pressure is that the company maintains the good liquidity profile at all times.

Negative ratings pressure could arise if credit metrics weaken on a sustained basis: (1) if the company's debt/EBITDA exceeds 3.0x for a prolonged period, (2) EBIT-margin falls below 5% over the cycle and (3) retained cash flow (RCF)/net debt falling toward 15%. Additionally, negative free cash flow and a weakened liquidity profile would cause negative pressure on ratings.

LIST OF AFFECTED RATINGS:

..Issuer: Hapag-Lloyd AG

Affirmations:

... LT Corporate Family Rating, Affirmed Ba2

... Probability of Default Rating, Affirmed Ba2-PD

Upgrades:

...Senior Unsecured Regular Bond/Debenture, Upgraded to Ba3 from B1

Outlook Actions:

...Outlook, Changed To Positive From Stable

PRINCIPAL METHODOLOGY

The principal methodology used in these ratings was Shipping published in June 2021 and available at <https://ratings.moodys.com/api/rmc-documents/72792>. Alternatively, please see the Rating Methodologies page on <https://ratings.moodys.com> for a copy of this methodology.

COMPANY PROFILE

Hapag-Lloyd AG, headquartered in Hamburg, Germany, is the fifth-largest container liner globally based on market share by volume. As of March 31, 2022, it operated a fleet comprising 248 ships, including 116 owned and 132 chartered-in vessels. For the last twelve months that ended March 31 this year, the company reported revenue of EUR 26.2 billion and EBIT of EUR 12.4 billion. Hapag-Lloyd was established in 1970 as a result of the merger of Hapag (1847) and North German Lloyd (1857).

REGULATORY DISCLOSURES

For further specification of Moody's key rating assumptions and sensitivity analysis, see the sections Methodology Assumptions and Sensitivity to Assumptions in the disclosure form. Moody's Rating Symbols and Definitions can be found on <https://ratings.moodys.com/rating-definitions>.

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