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Ratings

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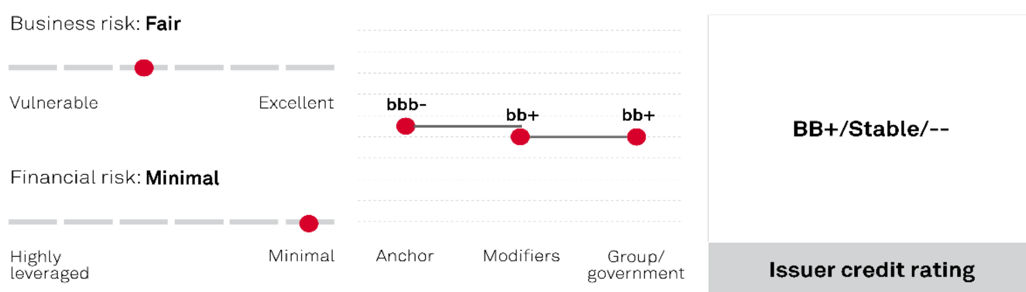
Hapag-Lloyd AG

February 3, 2023

Ratings Score Snapshot



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Credit Highlights

Overview

Key strengths	Key risks
Leading market positions, broad coverage through a far-reaching and strategically located route network, and a large customer base.	Exposure to the cyclical, capital-intensive, and highly competitive container liner industry.
Track record of proactive and effective measures to steadily reduce unit costs, achieving operational efficiencies, and industry-leading EBIT margins.	Sharply corrected freight rates and limited short-term flexibility to adjust operating costs, which will hamper this year's operating profits.
Strong free operating cash flow (FOCF) and resulting net cash position, as well as ample financial leeway under the rating for normalization in freight rates, rising investment to strengthen fleet efficiency, and other discretionary spending, including shareholder remuneration.	Uncertainties related to increasingly stringent environmental regulation, cooling economic growth, and trade disputes.

The correction in freight rates has been faster and steeper than expected, but we still think rates will remain above pre-pandemic levels. Global container shipping boomed during the second half of 2020, through 2021, and the first half of 2022, with container liners posting record results. After plunging from all-time highs in late 2022, average freight rates over 2023-2024 might ultimately stabilize above pre-pandemic levels, allowing container liners to (at least) recover the operating costs that have escalated since 2019. Our base case assumes industry players will implement timely and sufficient capacity containing measures. Hapag-Lloyd reported a significant rise in ex-fuel operating expenses in 2022, compared with 2019. As inflation lingers, we expect operating costs per container shipped to stay elevated in the coming quarters.

The hefty new vessel deliveries will put a strain on shipping rates. Accelerating containership supply growth on the back of the currently sizable orderbook (accounting for 29% of the total global fleet as compared with an all-time low of 8% in October 2020, according to Clarkson Research) will likely surpass demand growth in the coming quarters. Macroeconomic headwinds and the expected sluggish global container trade will aggravate the overcapacity situation. That said, we believe that the industry is now more disciplined when managing excess supply, with tested tools such as blank sailings, slow steaming, re-routing, and swift capacity reallocation, and perhaps some potential deferral of new vessel deliveries.

Macroeconomic uncertainties could weigh on global container shipping demand. Trade volumes will remain subdued in 2023 given macroeconomic challenges such as energy and other cost inflation, interest rate hikes, and dwindling disposable incomes. Geopolitical risks and uncertainties persist given the ongoing conflict in Ukraine and China's abrupt end to its zero-COVID policy triggering a surge in infections across the country. Sluggish commodity imports and consumption from China, in particular, would cause additional harm to capacity utilization rates.

Hapag-Lloyd's extraordinarily high EBITDA in 2021-2022 is not sustainable on the back of the normalization of freight rates, as we anticipated. We still believe the company will be able to turn its present EBITDA strength into sustainable EBITDA value clearly above €2 billion, which compares with €2.7 billion in 2020, €10.8 billion in 2021, and the €19.4 billon it reported on a preliminary basis for 2022. Our base case assumes that industry players will implement stringent capacity management to stabilize rates despite new ships hitting the water, and that Hapag-Lloyd will also adhere to consistent cost controls. The container liner industry remains tied to cyclical supply-and-demand conditions, which will likely translate into fluctuations in Hapag-Lloyd's EBITDA performance under normalized industry conditions. That said, we still believe, because of industry consolidation and container liners' more rationale behavior, the swings in freight rates will be flatter and their peak-to-trough periods shorter than they were before the pandemic.

Extraordinarily strong 2021-2022 operating cash flows have translated into a net adjusted cash position for Hapag-Lloyd. This compares with adjusted debt of €4.8 billion at year-end 2020 and €6.7 billion at year-end 2019. Supported by strong cash flows in 2022, we expect Hapag-Lloyd has sustained its net cash position as of Dec. 31, 2022. According to our base case, the liner's credit metrics stayed commensurate with our minimal financial risk profile category, providing ample rating headroom for a normalization in freight rates, rising investment to strengthen fleet efficiency, and other discretionary spending, including shareholder remuneration. Our financial profile assessment in general also reflects the company's consistent leverage target of maximum 3x net debt to EBITDA, as defined by Hapag-Lloyd.

Outlook

The stable outlook reflects our expectation that Hapag-Lloyd will maintain adjusted FFO to debt above 35%, our threshold for a 'BB+' rating, in the context of an abrupt normalization of freight rates. We think this will be underpinned by the company's adjusted EBITDA ultimately stabilizing at well above the 2019 pre-pandemic level, and its adherence to a prudent financial policy.

Downside scenario

Although unlikely in the near term, we could lower the rating if Hapag-Lloyd's EBITDA plunged lastingly below €2 billion. This would stem from an unexpectedly sharper-than-we-foresee deterioration in demand for tangible goods, coupled with severe and prolonged cost inflation, insufficiently counterbalanced by the industry's capacity containment measures and Hapag-Lloyd's cost savings measures.

We could also lower the rating if the company adopted a more aggressive financial policy, resulting in credit metrics falling short of our rating guidelines.

Upside scenario

We could raise the rating if adjusted FFO to debt remained above 50% once freight rates normalized, and the company commits to a financial policy to ensure this ratio is sustainable.

Our Base-Case Scenario

Assumptions

- Global trade to remain strongly correlated with economic growth, namely that of major contributors to trade volumes. We believe that global container shipping demand will remain subdued in 2023 on the back of macroeconomic challenges.
- GDP growth in China of 3.2% in 2022 followed by 4.8% in 2023 and 4.7% in 2024. This compares with 8.1% in 2021 and 2.2% in 2020. Asia-Pacific's GDP expanded 4.0% in 2022 and will grow 4.4% in 2023 and 4.5% in 2024, after 6.5% growth in 2021. Eurozone GDP grew by 3.3% in 2022, to be followed by flat growth in 2023 and 1.4% in 2024, after growing by 5.3% in 2021. North American GDP expanded 1.9% in 2022 and will remain broadly flat in 2023 and then grow by 1.4% in 2024, after growing 5.8% in 2021. Latin America's GDP will grow by 1.1% in 2023 and 2.4% in 2024, after 3.2% in 2022. Global GDP grew 3.5% in 2022, after growing 6.1% in 2021, and will expand by 2.5% in 2023 and 3.3% in 2024.
- Annual growth rates in Hapag-Lloyd's transported volumes in line with, or slightly above, industry averages, reflecting its global presence. We believe global trade volumes could expand by the low single digits (at best) in 2023 and 2024 after shrinking by 3%-4% in 2022 year-on-year, as forecast by Clarkson Research.
- Average freight rates in 2023-2024 could ultimately stabilize at levels above the pre-pandemic base, allowing Hapag-Lloyd to (at least) recover the operating costs that have escalated since 2019. Our base case assumes that industry players will implement timely and sufficient capacity containing measures.
- Crude oil price of $90 per barrel (/bbl) in 2023 and $80/bbl in 2024, compared with $100/bbl in 2022 and $75/bbl in 2021. 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.
- Operating costs (bunker excluded) per TEU in 2023 staying at the inflated levels of 2022 with potential cost efficiency improvements absorbed by lingering inflation.
- Our forecast of average annual capital expenditure (capex) in 2022-2024 of up to €2 billion.
- A dividend payout of 50%-70% of the previous year's net income, which is at the higher end of the stated dividend policy of at least 30% payout ratio. That said, we understand that, depending on the cash flow performance, Hapag-Lloyd has flexibility to adjust its shareholder remuneration.

Key metrics

Company Name--Key Metrics*

Mil. $	2020a	2021a	2022e	2023f	2024f
Adjusted EBITDA (bil. €)	2.7	10.8	19.4	4.0-5.0	3.0-3.5
Debt to EBITDA (x)	1.8	n.m	n.m	below 1.0	below 2.0
FFO to debt (%)	48.6	n.m	n.m	above 100	above 50%

*All figures adjusted by S&P Global Ratings. a--Actual. e--Estimate. f--Forecast.

Company Description

Hapag-Lloyd is a leading global container liner, with 252 modern ships, 11.8 million twenty-foot equivalent units (TEUs) of cargo transported per year, and about 14,500 employees in more than 400 offices spanning 137 countries. The company has a fleet with a total capacity of approximately 1.8 million TEUs, as well as container stock of approximately 3 million TEUs, including one of the world's largest and most modern refrigerated container fleets. Its global network provides connections between more than 600 ports on every continent.

Hapag-Lloyd is owned by CSAV Germany Container Holding GmbH (30.0%), Klaus Michael Kühne (including Kühne Holding AG and Kühne Maritime GmbH) (30.0%), HGV Hamburger Gesellschaft für Vermögens- und Beteiligungsmanagement mbH (13.9%), Qatar Investment Authority (12.3%), and Saudi Arabia's Public Investment Fund (10.2%), with a 3.6% free float.

Financial Risk

Hapag-Lloyd AG--Financial Summary

Period ending	Dec-31-2016	Dec-31-2017	Dec-31-2018	Dec-31-2019	Dec-31-2020	Dec-31-2021
Reporting period	2016a	2017a	2018a	2019a	2020a	2021a
Display currency (mil.)	EUR	EUR	EUR	EUR	EUR	EUR
Revenues	7,734	9,973	11,515	12,608	12,772	22,274
EBITDA	1,107	1,403	1,537	1,960	2,694	10,840
Funds from operations (FFO)	825	1,029	1,134	1,533	2,356	10,589
Interest expense	284	393	429	429	344	243
Cash interest paid	273	362	374	397	316	225
Operating cash flow (OCF)	667	935	1,159	1,661	2,618	10,211
Capital expenditure	341	410	329	426	534	1,253
Free operating cash flow (FOCF)	326	525	830	1,235	2,084	8,958
Discretionary cash flow (DCF)	320	518	713	1,195	1,881	8,325
Cash and short-term investments	558	585	642	499	668	7,701
Gross available cash	558	585	642	499	668	7,701
Debt	5,240	7,310	7,203	6,733	4,848	0
Common equity	5,058	6,058	6,259	6,621	6,723	16,162
Adjusted ratios						
EBITDA margin (%)	14.3	14.1	13.3	15.5	21.1	48.7
Return on capital (%)	1.9	3.8	3.6	5.9	11.4	67.8
EBITDA interest coverage (x)	3.9	3.6	3.6	4.6	7.8	44.6

Hapag-Lloyd AG--Financial Summary

FFO cash interest coverage (x)	4.0	3.8	4.0	4.9	8.5	48.1
Debt/EBITDA (x)	4.7	5.2	4.7	3.4	1.8	0.0
FFO/debt (%)	15.7	14.1	15.7	22.8	48.6	NM
OCF/debt (%)	12.7	12.8	16.1	24.7	54.0	NM
FOCF/debt (%)	6.2	7.2	11.5	18.3	43.0	NM
DCF/debt (%)	6.1	7.1	9.9	17.8	38.8	NM

Reconciliation Of Hapag-Lloyd AG Reported Amounts With S&P Global Adjusted Amounts (Mil. EUR)

	Debt	Shareholder Equity	Revenue	EBITDA	Operating income	Interest expense	S&PGR adjusted EBITDA	Operating cash flow	Dividends	Capital expenditure
Financial year	Dec-31-2021									
Company reported amounts	3,074	16,149	22,274	10,825	9,362	241	10,840	10,410	634	1,253
Cash taxes paid	-	-	-	-	-	-	(26)	-	-	-
Cash interest paid	-	-	-	-	-	-	(225)	-	-	-
Lease liabilities	2,423	-	-	-	-	-	-	-	-	-
Postretirement benefit obligations/ deferred compensation	318	-	-	1	1	3	-	-	-	-
Accessible cash and liquid investments	(7,701)	-	-	-	-	-	-	-	-	-
Share-based compensation expense	-	-	-	1	-	-	-	-	-	-
Dividends from equity investments	-	-	-	26	-	-	-	-	-	-
Nonoperating income (expense)	-	-	-	-	50	-	-	-	-	-
Reclassification of interest and dividend cash flows	-	-	-	-	-	-	-	(199)	-	-
Noncontrolling/ minority interest	-	13	-	-	-	-	-	-	-	-

Reconciliation Of Hapag-Lloyd AG Reported Amounts With S&P Global Adjusted Amounts (Mil. EUR)

	Debt	Shareholder Equity	Revenue	EBITDA	Operating income	Interest expense	S&PGR adjusted EBITDA	Operating cash flow	Dividends	Capital expenditure
Debt: Put options on minority stakes	2	-	-	-	-	-	-	-	-	-
EBITDA - Gain/(loss) on disposals of PP&E	-	-	-	(13)	(13)	-	-	-	-	-
D&A: Impairment charges/ (reversals)	-	-	-	-	(3)	-	-	-	-	-
Total adjustments	(4,958)	13	-	15	35	3	(251)	(199)	-	-
S&P Global Ratings adjusted	**Debt**	**Equity**	**Revenue**	**EBITDA**	**EBIT**	**Interest expense**	**Funds from Operations**	**Operating cash flow**	**Dividends**	**Capital expenditure**
	-	16,162	22,274	10,840	9,398	243	10,589	10,211	634	1,253

Liquidity

We assess Hapag-Lloyd's liquidity as adequate, with sources exceeding uses by more than 1.5x in the 12 months from Sept. 30, 2022, and more than 1.5x in the following 24 months. Our assessment is underpinned by forecast available cash of about €14.2 billion at Sept. 30, 2022, which significantly exceeds Hapag-Lloyd's $1.1 billion minimum liquidity reserve target.

Principal liquidity sources

- Our cash forecast of about €14.2 billion, after deducting $350 million of minimum cash requirements under a bank covenant.
- Availability of about $725 million under undrawn credit lines maturing beyond 12 months.
- Operating cash flows (after interest paid and lease amortization) of €7.0 billion-€7.5 billion, as in our base-case forecast.

Principal liquidity uses

- Short-term maturities and scheduled amortizations of about €560 million.
- Our cash-funded capex forecast of €1.9 billion-€2.0 billion.
- Cash outflow for dividends under the stated dividend policy of at least 30% of the previous year's net income.

Covenant Analysis

Requirements

We expect Hapag-Lloyd passed its financial covenant tests as of Dec. 31, 2022, with ample headroom. Maintenance financial covenants on bank debt stipulate limits such as a minimum ratio of fair-market vessel or container value to debt, and the higher value of 30% of total assets and equity of €2.75 billion. The company had about €27.2 billion in equity as of the latest reporting date, Sept. 30, 2022. Other covenants stipulate minimum liquid funds of $350 million. We expect the company will pass the next covenant test in 2023. There are no leverage-ratio and interest-coverage covenants.

Environmental, Social, And Governance

ESG Credit Indicators

E-1	E-2	**E-3**	E-4	E-5	S-1	**S-2**	S-3	S-4	S-5	G-1	**G-2**	G-3	G-4	G-5
- Climate transition risks					- N/A					- N/A				

N/A—Not applicable. ESG credit indicators provide additional disclosure and transparency at the entity level and reflect S&P Global Ratings' opinion of the influence that environmental, social, and governance factors have on our credit rating analysis. They are not a sustainability rating or an S&P Global Ratings ESG Evaluation. The extent of the influence of these factors is reflected on an alphanumerical 1-5 scale where 1 = positive, 2 = neutral, 3 = moderately negative, 4 = negative, and 5 = very negative. For more information, see our commentary "ESG Credit Indicator Definitions And Applications," published Oct. 13, 2021.

Environmental factors are a moderately negative consideration in our credit rating analysis of Hapag-Lloyd, as the global shipping industry faces a large regulatory workload. This is reflected in increasingly stringent emissions targets, demanding lumpy capital investments, for example in new vessels powered by alternative fuels, and more expensive emissions-complaint bunkers. Hapag-Lloyd is proactively investing in dual-fuel gas vessels operated with LNG, a transitional fuel that, in addition to reducing air pollution, produces up to 20% less CO_2 emissions than traditional fuels. These vessels also have the technical capability to use carbon-neutral synthetic natural gas in the future instead of LNG. Hapag-Lloyd currently has 12 ultra-large dual-fuel-engine vessels (23,500+ TEU) on order with deliveries starting in 2023. This is equivalent to about 16% of its current fleet size of 1,779 TTEU. In 2020, Hapag was the first shipping company to retrofit a conventional vessel to become LNG-powered.

Issue Ratings--Recovery Analysis

Key analytical factors

- The issue rating on the company's senior unsecured notes is 'BB+'. The recovery rating of '3' indicates our expectation that lenders would receive meaningful recovery (50%-70%; rounded estimate: 65%) of the principal in the event of a payment default.
- As per our criteria, we cap the recovery rating at '3' given the unsecured nature of debt. The recovery rating benefits from the estimated residual at-default value of the company's assets after satisfying the prior-ranking and secured creditors ahead of the unsecured claims.
- Our hypothetical default scenario envisions a prolonged downturn in the container shipping industry amid weak general economic conditions due to sustained lower demand from exporting countries and falling fleet utilization and freight rates. We believe that this, combined with a chronic oversupply situation and depressed vessel values, would weaken Hapag-Lloyd's ability to downsize its fleet to generate liquidity and would trigger a payment default in 2028.
- We value the company as a going concern because we believe the business would retain more value as an operating entity than otherwise and would be reorganized in a bankruptcy scenario. This view is underpinned by the company's scale and size, leading market positions, and broad diversity. Individual ships, however, could be readily sold to other operators to generate liquidity, and consequently we use a discrete asset valuation to evaluate the recovery prospects associated with the underlying assets.

Simulated default assumptions

- Year of default: 2028
- Jurisdiction: Germany

Simplified waterfall

- Gross enterprise value at default: €5.3 billion
- Administrative expenses: 10%
- Net value available to creditors: €4.8 billion

- Priority claims and secured debt: €3.2 billion*
- Unsecured debt claims: €312 million*
- Recovery expectation: 50%-70% (rounded estimate: 65%)

*Priority claims and secured debt include our assumption of 85% drawing under the existing RCFs in a distressed scenario. All debt amounts include six months of prepetition interest.

Rating Component Scores

Foreign currency issuer credit rating	BB+/Stable/--
Local currency issuer credit rating	BB+/Stable/--
Business risk	Fair
Country risk	Intermediate
Industry risk	High
Competitive position	Satisfactory
Financial risk	Minimal
Cash flow/leverage	Minimal
Anchor	bbb-
Diversification/portfolio effect	Neutral (no impact)
Capital structure	Neutral (no impact)
Financial policy	Negative (-1 notch)
Liquidity	Adequate (no impact)
Management and governance	Satisfactory (no impact)
Comparable rating analysis	Neutral (no impact)
Stand-alone credit profile	bb+

Related Criteria

- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- Criteria | Corporates | General: Recovery Rating Criteria For Speculative-Grade Corporate Issuers, Dec. 7, 2016
- Criteria | Corporates | Recovery: Methodology: Jurisdiction Ranking Assessments, Jan. 20, 2016
- 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

Ratings Detail (as of February 03, 2023)*

Hapag-Lloyd AG	
Issuer Credit Rating	BB+/Stable/--
Senior Unsecured	BB+
Issuer Credit Ratings History	
04-Feb-2022	BB+/Stable/--
23-Mar-2021	BB/Stable/--
05-Oct-2020	BB-/Positive/--
27-Apr-2020	B+/Stable/--
29-Nov-2019	B+/Positive/--

*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings credit ratings on the global scale are comparable across countries. S&P Global Ratings credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.