Summary:

Hapag-Lloyd AG

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Table Of Contents

Rationale
Outlook
Standard & Poor's Base-Case Scenario
Business Risk
Financial Risk
Liquidity
Ratings Score Snapshot
Recovery Analysis
Related Criteria And Research
### Summary:

**Hapag-Lloyd AG**

<table>
<thead>
<tr>
<th>Business Risk: <strong>WEAK</strong></th>
<th>Financial Risk: <strong>AGGRESSIVE</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td>Vulnerable</td>
<td>b+</td>
</tr>
<tr>
<td>Excellent</td>
<td>b+</td>
</tr>
<tr>
<td>High</td>
<td>b+</td>
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<tr>
<td>Business Risk: Weak</td>
<td>Financial Risk: Aggressive</td>
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<tr>
<td>Low revenue visibility because fixed contracts are limited in number and predominantly short term.</td>
<td>High adjusted debt and resulting core credit measures, consistent with our &quot;aggressive&quot; financial risk profile assessment, which reflects the industry's high capital intensity.</td>
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<tr>
<td>Exposure to fluctuations in prices of bunker fuel.</td>
<td>Fairly low committed capital expenditures and our expectations of Hapag-Lloyd's investment strategy, linked to favorable industry prospects, which we expect will support credit measures consistent with an &quot;aggressive&quot; financial risk profile.</td>
</tr>
<tr>
<td>Vulnerable profitability, in our view, which reflects Hapag-Lloyd's returns on capital and operating margins, tied to the industry's cyclical swings and fairly low short-term flexibility to adjust its operating cost base.</td>
<td></td>
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<tr>
<td>Leading market positions and coverage through a broad and strategically-located route network.</td>
<td></td>
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<tr>
<td>An attractive fleet profile and diverse customer base.</td>
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<tr>
<td>Management's track record of achieving operational efficiencies and its proactive efforts to steadily reduce the company's cost base.</td>
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**CORPORATE CREDIT RATING**

B+/Stable/--

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**MAY 11, 2015**  **2**

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Outlook: Stable

Standard & Poor's Ratings Services outlook on the Germany-based container liner operator Hapag-Lloyd AG is stable. The outlook reflects our view that, despite our expectation of sustained competitive pressure on freight rates, Hapag-Lloyd will continue to generate sufficient operating cash flows to maintain its credit metrics and liquidity that is commensurate with the current rating. This should be supported by the company's ongoing realization of cost efficiencies, ability to sustainably improve and maintain its reported EBITDA margin of more than 5% over the coming 12-18 months, and prudent capital investments tied to favorable industry prospects. We view a ratio of adjusted funds from operations (FFO) to debt of more than 12% as appropriate for the 'B+' rating on Hapag-Lloyd. Furthermore, given the inherent volatility of the sector in which Hapag-Lloyd operates and associated swings in earnings and cash flow, we consider that maintaining liquidity as "adequate" is a critical and stabilizing rating factor.

Downside scenario

We could lower the rating if Hapag-Lloyd experiences larger decline in freight rates and/or higher bunker fuel price than we forecast in our base case. This would likely be coupled by the company being unable to adjust its cost base to achieve a reported EBITDA margin of more than 5%, in the context of volatile industry conditions that we anticipate will continue. If this occurs, it would weaken the company's cash flow generation and liquidity. Under our base-case scenario, we estimate that the company's adjusted FFO to debt will improve and remain at more than 12%. Furthermore, we forecast that Hapag-Lloyd's ratio of liquidity sources versus liquidity uses will remain at more than 1.2x for the upcoming 12 months on a rolling basis. Nevertheless, we might consider lowering the rating if we see clear signs that credit ratios and liquidity coverage are performing below our base-case expectations.

Upside scenario

We could raise the rating if Hapag-Lloyd delivers sustained EBITDA growth, pursues a balanced investment strategy, reduces its financial leverage, and improves its credit ratios to the level that we consider commensurate with the higher rating, such as a ratio of adjusted FFO to debt of about 20% on a sustainable basis.

Standard & Poor's Base-Case Scenario
Assumptions

- Diverging global economic conditions, for key contributors to trade flows, with Europe improving, the U.S. and Asia stable, and Latin America lagging (see "Global Credit Conditions Diverge, With Europe Improving, The U.S. And Asia Stable, And Latin America Lagging," published on April 2, 2015, on RatingsDirect).

- Lower growth of about 3% in trade volumes for HapagLloyd in 2015, due to slowing trade from China and congestion on the U.S. West coast, followed by about 5% in 2016, linked to the gradually recovering global economy. This compares with trade volume growth of 4.7% for Hapag-Lloyd (excluding CSAV) in 2014.

- A mid-single-digit decline in freight rates in 2015, mainly reflecting lower prices for bunker fuel and the ensuing pass through to customers, and a change in route mix following the merger with CSAV's container liner shipping activities. We assume flat freight rates in 2016.

- Realization of efficiency gains from the cost-saving program, Octave, which Hapag-Lloyd estimates should permanently reduce the company's cost base by a low three-digit million dollar figure, and synergies unlocked from the takeover of CSAV, estimated by Hapag-Lloyd to represent a further $300 million.

- Benefits from low bunker fuel prices (Hapag-Lloyd's main cost item) flowing directly to the company's bottom-line earnings in 2015. We estimate that Hapag-Lloyd will spend $425 per ton in 2015, against $575 per ton in 2014, and $500 per ton in 2016. This largely follows our estimates for crude oil prices, which are typically a good indicator of bunker prices (see "Standard & Poor's Revises Its Crude Oil And Natural Gas Price & Recovery Assumptions," published on March 26, 2015).

- Improvement of reported EBITDA margin to about 5%-7% in 2015-2016 (after a contraction to about 3% last year, if adjusted for one-off items).

- Prudent capital investments tied to favorable industry prospects. In 2015, total investment volume will likely amount to about €650 million; including €300 million for outstanding installments for the

<table>
<thead>
<tr>
<th>Key Metrics</th>
<th>2013a</th>
<th>2014a</th>
<th>2015e</th>
<th>2016e</th>
</tr>
</thead>
<tbody>
<tr>
<td>Reported EBITDA margin (%)*</td>
<td>5.2</td>
<td>3.1</td>
<td>5.0-7.0</td>
<td>5.0-7.0</td>
</tr>
<tr>
<td>FFO/debt (%)</td>
<td>13.8</td>
<td>About 7.0</td>
<td>14-18</td>
<td>15-19</td>
</tr>
<tr>
<td>Debt/EBITDA (x)</td>
<td>5.1</td>
<td>About 8.0</td>
<td>4.0-5.0</td>
<td>4.0-5.0</td>
</tr>
</tbody>
</table>

a--Actual. e--Estimate. FFO--Funds from operations.

*Reported EBITDA excluding gains from sale of assets, foreign exchange gains, and one-off items related to the merger with CSAV, and including foreign exchange losses and dividends from equity-accounted investees.
remaining three ships on order to be delivered this year, €130 million for containers, €100 million for the initial installment for new vessels designated for Latin America trades, and €120 million for drydocking/maintenance. In 2016, we forecast capital expenditures of about €250 million for new vessels, containers, and maintenance.

Business Risk: Weak

Our "weak" business risk assessment for Hapag-Lloyd incorporates our view of the shipping industry's "high" risk. In our opinion, this stems from the industry's capital intensity, high fragmentation, frequent imbalances between demand and supply, lack of meaningful supply discipline, and volatility in freight rates and vessel values. A key consideration in our assessment of the company's "weak" competitive position is its low revenue visibility because fixed contracts are limited in number and predominantly short-term. Another main factor in our assessment is the company's profitability, which we view as vulnerable. This assessment reflects Hapag-Lloyd's operating margins and returns on capital tied to the industry's cyclical swings, heavy exposure to fluctuations in prices of bunker fuel and often limited ability to recover cost inflation, and fairly low short-term flexibility to adjust its operating cost base.

These weaknesses are partly mitigated by Hapag-Lloyd's leading market positions and coverage through a broad and strategically located route network, broad customer base, and attractive fleet profile, supported by a large and fairly diverse fleet. Our business risk profile assessment incorporates the company's track record of achieving operational efficiencies and its proactive efforts to steadily reduce its cost base, which we assume will support earnings.

Financial Risk: Aggressive

Our assessment of the financial risk profile as "aggressive" incorporates Hapag-Lloyd's high adjusted debt, which reflects the underlying industry's high capital intensity and the company's track record of growth/replacement investments. Hapag-Lloyd performed operationally below our expectations in 2014, mainly because of lower freight rates than we previously forecast that have not been offset by achieved cost savings, while its credit ratios weakened to below our rating guidelines. We project, however, that the ratios will improve and remain consistent with the "aggressive" financial risk profile in 2015-2016.

Based on the assumptions mentioned above, we arrive at the following credit measures for Hapag-Lloyd:

- A weighted average ratio of Standard & Poor's-adjusted FFO to debt of about 15%-16% in 2015-2016, up from about 7% in 2014.
- A weighted average ratio of adjusted debt to EBITDA of 4.0x-5.0x in 2014-2015, down from about 8.0x in 2014.
Liquidity: Adequate

We view Hapag-Lloyd's liquidity as "adequate" under our criteria. We note, however, that Hapag-Lloyd's liquidity is susceptible to the company performing below our base-case scenario outlined above.

We note that the company's most recent capital transactions, notably the November 2014 bond issue (with €250 million proceeds used for early redemption of the bond due October 2015) and the December 2014 €370 million equity injection by shareholders, were essential to the stability of Hapag-Lloyd's liquidity profile. We believe that further proactive treasury measures, such as the enlargement and extension of the existing revolving credit facilities, are essential to preserving "adequate" liquidity. We understand that the company is in advanced stages to finalize transactions by the end of June 2015.

Furthermore, our base-case liquidity assessment as of Dec. 31, 2014, reflects the following factors and assumptions:

- We expect the company's sources of liquidity to be 1.2x or more over the coming 12 months. In particular, the upcoming debt maturities are manageable, in our view.
- Liquidity sources will continue to exceed uses over the coming 12 months, even if EBITDA declines by 30%.
- The company appears to have sound relationships with its lenders, as demonstrated by uninterrupted access to secured bank lending during difficult industry conditions.
- We consider Hapag-Lloyd's financial risk management to be generally prudent, as the demonstrated by the company's proactive actions to ensure continued adequate liquidity during difficult industry conditions.
### Principal Liquidity Sources

We estimate liquidity sources for the 12 months started Dec. 31, 2014, to mainly include:

- On-balance-sheet surplus cash of about €430 million. We exclude from Hapag-Lloyd's available liquidity sources a $300 million minimum cash requirement as per its bank covenant.
- Availability of €147 million (about $162 million) under undrawn revolving credit facilities maturing in October 2017 and September 2016.
- Availability of €55 million ($60 million) under the asset-backed-security facility maturing in 2018.
- Proceeds of about €70 million from the disposal of old vessels.
- Committed bank funding for new vessels and containers on order of about €270 million.
- Operating cash flows (after interest paid and dividends received) of about €550 million, as in our base-case forecast.

### Principal Liquidity Uses

For the same period, we estimate liquidity uses will mainly include:

- Short-term debt of about €500 million.
- Committed capital expenditures for vessels and containers on order and maintenance of about €520 million.
- Cash outflow from reversal of provisions, related to restructuring and purchase price allocation of about €170 million.

### Covenants

We understand that Hapag-Lloyd passed its financial covenant tests as of Dec. 31, 2014. Its bank loans contain maintenance financial covenants, which require limits such as a minimum ratio of fair-market vessel or container value to debt, as well as a minimum equity amount (a threshold of the higher value of 30% of total assets and €2.75 billion, compared with €4.17 billion as of Dec. 31, 2014). Furthermore, debt facilities include covenants that stipulate that the company should hold a minimum amount of liquid funds (a threshold of $300 million compared with €711 million or $867 million as of Dec. 31, 2014). We expect the company will manage the covenant tests in 2015. There are no leverage ratio and interest coverage covenants.

### Ratings Score Snapshot

**Corporate Credit Rating**

B+/Stable/--

**Business risk:** Weak

- **Country risk:** Low
- **Industry risk:** High
- **Competitive position:** Weak

**Financial risk:** Aggressive
• Cash flow/Leverage: Aggressive

Anchor: b+

Modifiers
• Diversification/Portfolio effect: Neutral (no impact)
• Capital structure: Neutral (no impact)
• Financial policy: Neutral (no impact)
• Liquidity: Adequate (no impact)
• Management and governance: Satisfactory (no impact)
• Comparable rating analysis: Neutral (no impact)

Recovery Analysis

Key Analytical Factors
• Our 'B-' issue and '6' recovery ratings on Hapag-Lloyd's senior unsecured notes reflects their unsecured, unguaranteed, and structurally subordinated nature, with slight protection against additional debt issuance. The rating is further constrained by the strong security company best assets and ahead of the notes, as well as the risk of multijurisdictional insolvency proceedings.
• In our hypothetical default scenario, we assume a weakening in economic conditions, and consequently transport volumes, as well as freight rates, which would lead to rapidly falling vessel values and result in a payment default.
• In our view, Hapag-Lloyd would continue to have a viable business model if it were to default, given existing commercial customer bases. However, we use a discrete asset value methodology given the valuable ship asset base, where individual ships could be sold off to provide recovery.
• We value the company's vessels at about 50% of their current book value.

Simulated Default Assumptions
• Year of default: 2018
• Jurisdiction: Germany

Simplified Waterfall
• Gross enterprise value at default: about €3,293 million
• Priority liabilities (administrative costs, priority claims, and secured debt): €3,750 million
• Net value available to creditors: €0 million
• Unsecured debt claims: about €890 million
• --Recovery expectation: 0-10% (lower half of the range)
## Related Criteria And Research

- Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Key Credit Factors For The Transportation Cyclical Industry, Feb. 12, 2014
- Corporate Methodology, Nov. 19, 2013
- Corporate Methodology: Ratios And Adjustments, Nov. 19, 2013
- Group Rating Methodology, Nov. 19, 2013
- Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- Criteria Guidelines For Recovery Ratings On Global Industrials Issuers' Speculative-Grade Debt, Aug. 10, 2009

## Business And Financial Risk Matrix

<table>
<thead>
<tr>
<th>Business Risk Profile</th>
<th>Financial Risk Profile</th>
</tr>
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<tbody>
<tr>
<td></td>
<td>Minimal</td>
</tr>
<tr>
<td>Excellent</td>
<td>aaa/aa+</td>
</tr>
<tr>
<td>Strong</td>
<td>aa/aa-</td>
</tr>
<tr>
<td>Satisfactory</td>
<td>a/a-</td>
</tr>
<tr>
<td>Fair</td>
<td>bbb/bbb-</td>
</tr>
<tr>
<td>Weak</td>
<td>bb+</td>
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<tr>
<td>Vulnerable</td>
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### Additional Contact:
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