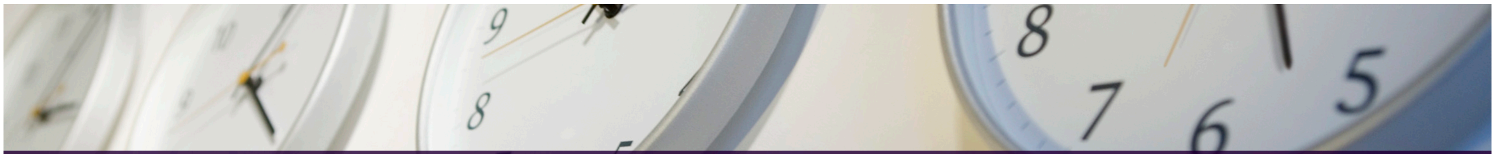

Credit Outlook

3 August 2020

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Advanced Micro Devices' strong second-quarter results and outlook are credit positive

Originally published on 29 July 2020

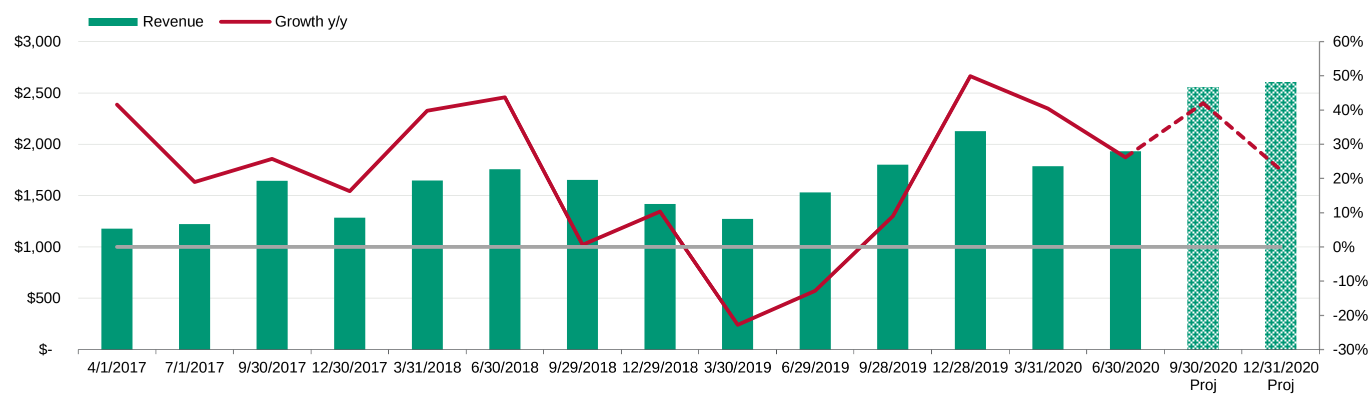
On 28 July, semiconductor maker Advanced Micro Devices, Inc. (Ba2 positive) reported a 26% year-over-year revenue increase to $1.93 billion for second quarter (30 June), above its $1.85 billion guidance three months ago. The company also forecast a 42% year-over-year increase in revenue to $2.55 billion for third quarter, citing strength in semi-custom chips (for next generation Xbox and Playstation gaming consoles) as well as growth in Ryzen (desktop) and EPYC (server) chips. For second quarter, AMD said there was strength in chip demand throughout its portfolio with notable growth in notebook chips for the commercial market and doubling revenue in the server end markets, where the company estimates its EPYC server chips contributed over 20%, or about $400 million, of total revenue, and have now achieved a 10% market share. The better-than-expected results and outlook are credit positive.

AMD's projected 42% year-over-year revenue increase for the September quarter and 32% revenue growth for the full year implies a 23% increase in the December quarter, driven by ongoing strength in chips for servers, notebooks and desktops, as well chips for next generation Xbox and Playstation gaming consoles. For the full year, AMD's projected revenue of $8.9 billion exceeds our previous forecast of 25% growth to $8.4 billion. The projected full year results are driven by the introduction and strong market uptake of new and higher end desktop and notebook chips, graphics chips, further market share gains for server chips, as well as strong growth in custom chips for game consoles in the second half of the year (see Exhibit 1).

Exhibit 1

Strong revenue growth supported by broad array of new chips in 2020

Quarterly revenue growth, year-over-year; $ in millions



Sources: Moody's Financial Metrics™ and Moody's Investors Service projections

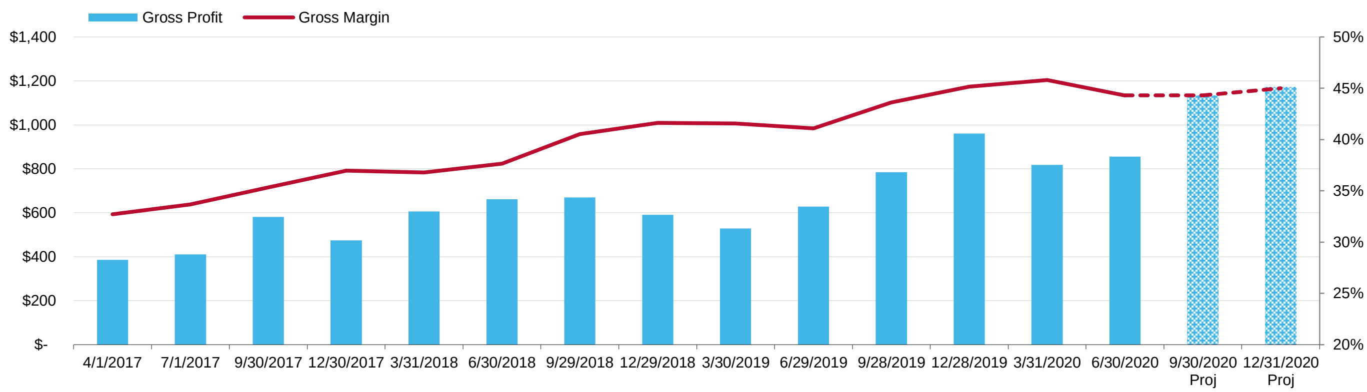
Despite the coronavirus-driven economic downturn, we expect AMD will grow EBITDA, and expand profit margins for the fourth consecutive year. Excluding working capital investment to support strong growth, we project full year cash flow after capital spending will increase for the fourth straight year. In 2019 AMD achieved 43% adjusted gross margins and, in March 2020, AMD increased its long term gross margin target to 50% from the 40%-44% range that was set mid-2018, which itself was up from previous targets of 36%-40%.

The new, expanded long term target is primarily driven by higher performance and higher margin Ryzen (notebook and desktop personal computers) and EPYC (server) processor sales, as well as datacenter CPU/GPU sales. With a steady cadence of new product launches with higher price points and growing volume, AMD has expanded gross margins steadily since early 2016 (see Exhibit 2). Reflecting strong and improving product mix and despite what we expect to be strong growth in lower margin game console chips (new Xbox and PS5 consoles in Q3), we project 45% gross margins in 2020.

Exhibit 2

Gross margins set to rise further

Quarterly gross margins; $ in millions



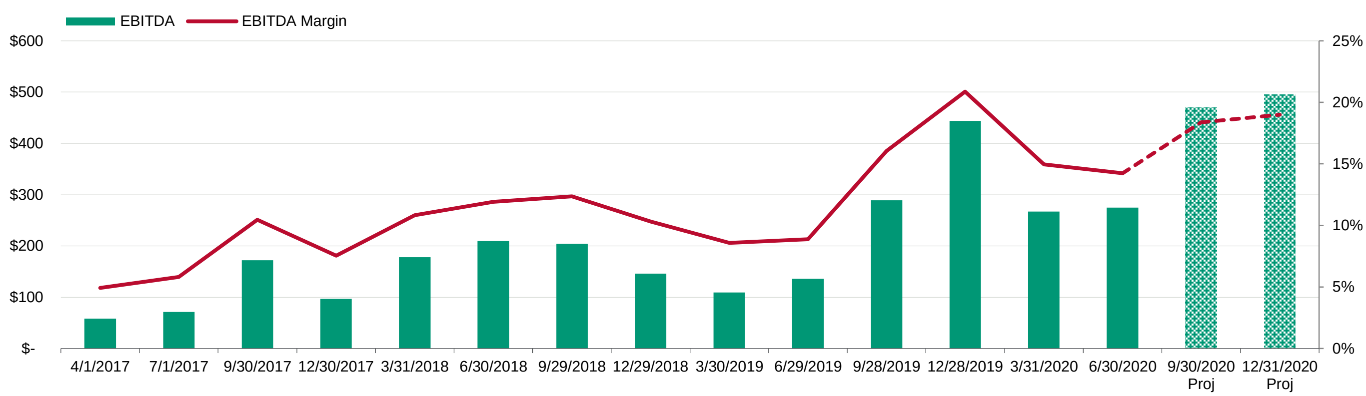
Sources: Moody's Financial Metrics™ and Moody's Investors Service projections

Combined with continued good cost controls, we project AMD's quarterly EBITDA will average $480 million during the rest of calendar 2020 (up from our previous $450 million estimate) while average EBITDA margins of about 19% (see Exhibit 3) compare very favorably to 7% in 2017.

Exhibit 3

EBITDA $ and margins will continue to expand in 2020

Quarterly EBITDA $ and margins; $ in millions



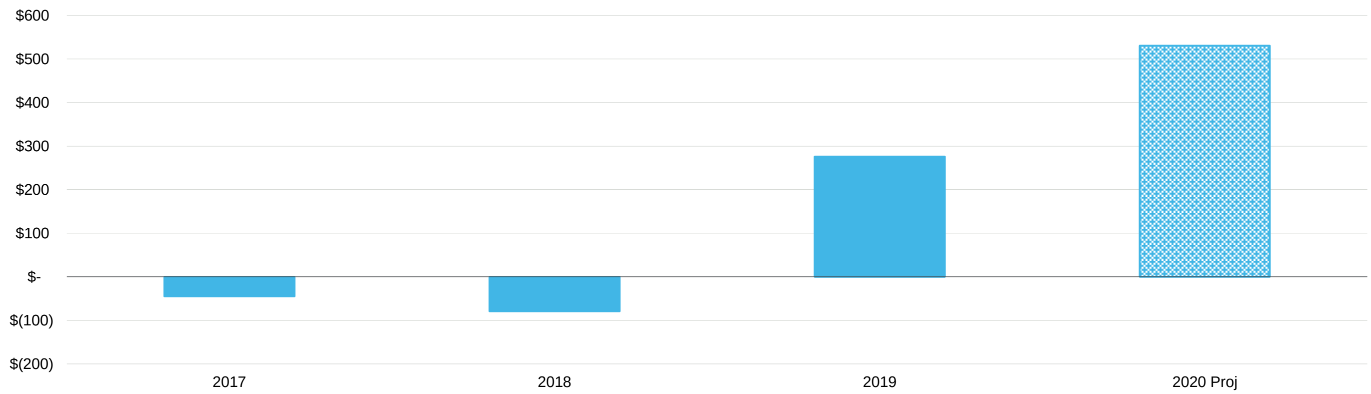
Sources: Moody's Financial Metrics™ and Moody's Investors Service projections

Given our outlook for strong revenue growth and margin expansion, we forecast AMD will generate over $500 million of cash flow after capital spending in fiscal 2020 (see Exhibit 4). The downside to our cash flow forecast would likely come from stronger than expected growth and the need to position/build inventory to meet strong demand.

Exhibit 4

Cash flow from operations less capital spending $ and margins will double

$ in millions



Sources: Moody's Financial Metrics™ and Moody's Investors Service projections

Throughout 2020, AMD will maintain an excellent liquidity profile. As of June 2020, AMD had cash and short-term investments of $1.8 billion, well in excess of gross adjusted debt of $1.0 billion. AMD has no debt maturities until $312 million comes due in August 2022. Given the improving cash flow generating outlook, access to a $500 million secured revolving credit facility ($200 million drawn at June 2020 and already repaid in July) and our expectations that management will maintain at least $1 billion of cash and short-term investments, we view the company's liquidity profile as excellent.

Under these assumptions, leverage will continue to improve, with adjusted gross debt to EBITDA around 0.5x in December 2020, down from 0.8x at December 2019. Similarly, the company's free cash flow to adjusted gross debt is projected to improve to over 60% at December 2020, up from 34% at December 2019. At year-end 2020, we project AMD's cash of $2.1 billion would exceed the company's $809 million of gross adjusted debt by $1.2 billion

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Lam posts strong second-quarter results strong second-quarter results amid robust demand and normalizing supply chains

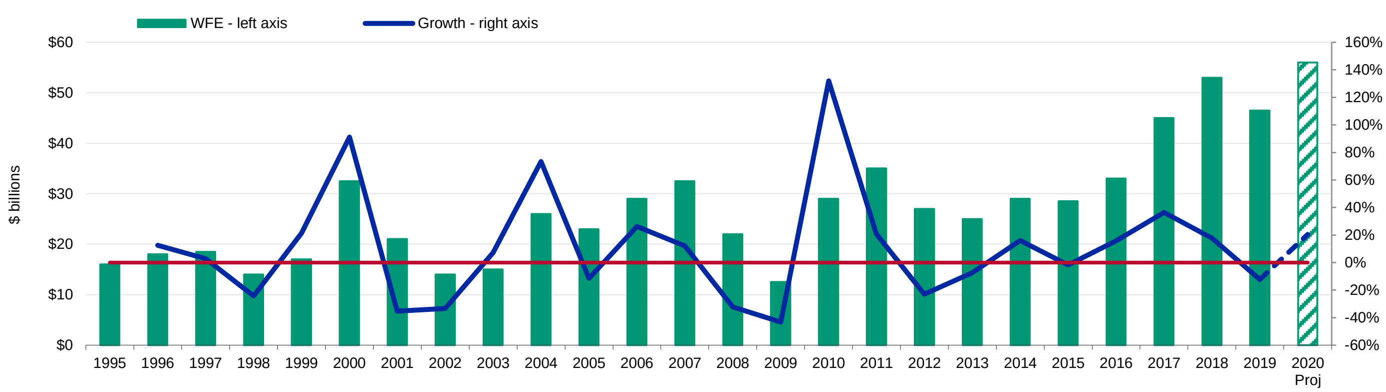
Originally published on 30 July 2020

On 29 July, semiconductor equipment maker Lam Research Corp. (A3 stable) reported credit- positive quarterly revenue of $2.8 billion, up 18% from a year earlier. It was the third consecutive quarter of accelerating year-over-year revenue growth after a sector downturn in 2019 and despite COVID-19 macroeconomic challenges.

Revenue the second quarter, ended 30 June, was 8% higher than our expectations, driven by strength in the memory market with NAND up an estimated 27% sequentially and DRAM up 13%. The company guided third-quarter revenue to grow 43% year-over-year to $3.1 billion contributing to a near record trailing 12-month revenue of $10.98 billion.

Lam noted strong order momentum, driven by ongoing strength in foundry and logic semiconductor spending and a progressive recovery in memory spending. The solid outlook is supported by the company's industry-leading positions across various equipment markets and the demand momentum that has continued for both technology development and capacity growth in advanced logic nodes. Lam expects demand to support advanced logic nodes to remain healthy through 2020 and in 2021, driven by accelerating investment in extreme ultra violet lithography (EUV), competitive dynamics and new capacity additions. With this positive market outlook, we expect wafer fabrication equipment spending will grow by about 20% to $56 billion in 2020, which would exceed the previous record of $53 billion in 2018 (see Exhibit 1).

Exhibit 1
Wafer fabrication equipment spending projected to set record in 2020



Sources: Moody's Financial Metrics and Moody's Investors Service projections

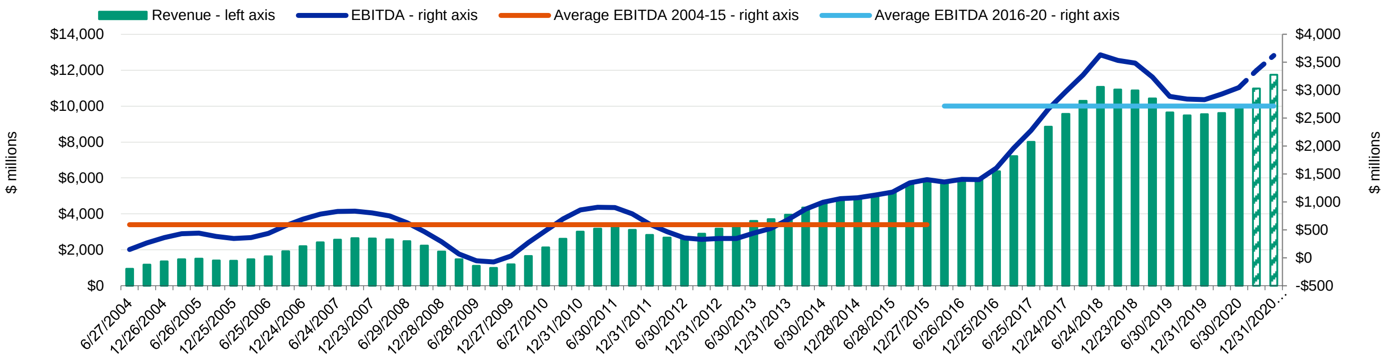
We expect the semiconductor equipment sector will remain subject to cyclical demand, however, the magnitude of cycles will be less dramatic because of the broadened end market demand for semiconductors (data center, mobile devices, artificial intelligence, autonomous driving, internet of things, etc.) and the consolidation within the customer base, which limits irrational capacity additions that have contributed to historical boom and bust cycles.

Despite coronavirus-related challenges, Lam's EBITDA is structurally higher than several years ago, driven by the increasing importance of deposition and etch equipment to the making of more advanced chips (see Exhibit 2). Lam's longer term EBITDA margin expansion since buying Novellus in June 2012 reflects the strong value add that Lam's solutions provide to semiconductor customers as well as a flexible cost structure.

Exhibit 2

Structurally higher profitability

Trailing 12 months



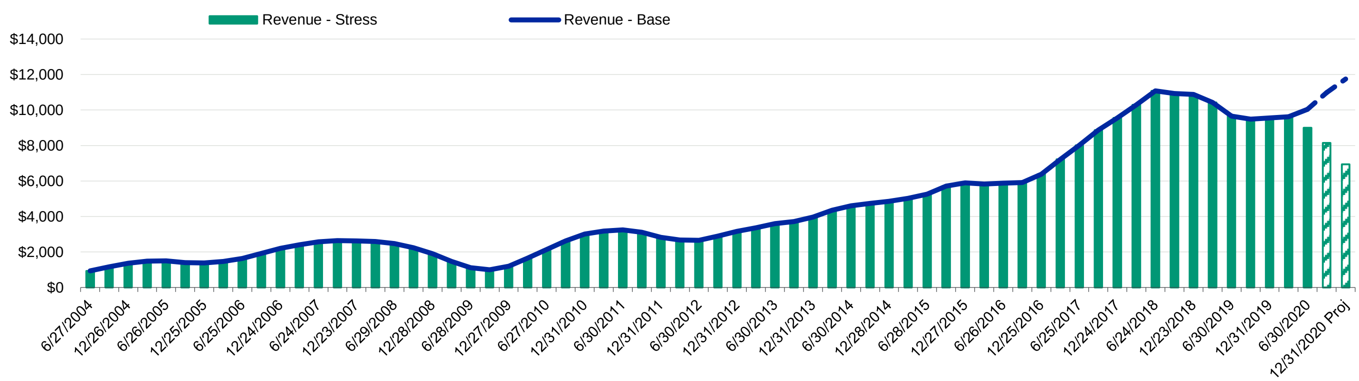
Sources: Moody's Financial Metrics and Moody's Investors Service projections

When Lam suspended guidance on 17 March amid uncertainty around the inability to fully assemble equipment, our stress case scenario assumed a 40% reduction from our earlier calendar year 2020 revenue expectations of $11.4 billion to approximately $6.9 billion (hyperlink to March 17 piece). With ongoing solid demand within a growing $56 billion wafer fabrication equipment market, we now project Lam's revenue at approximately $11.7 billion in 2020, up 23% from 2019 (see Exhibit 3). Lam's services business (mostly spare parts) represented 33% of total revenue in the June quarter and is very steady through cycles.

Exhibit 3

Revenue forecast to grow in 2020

Trailing 12 months



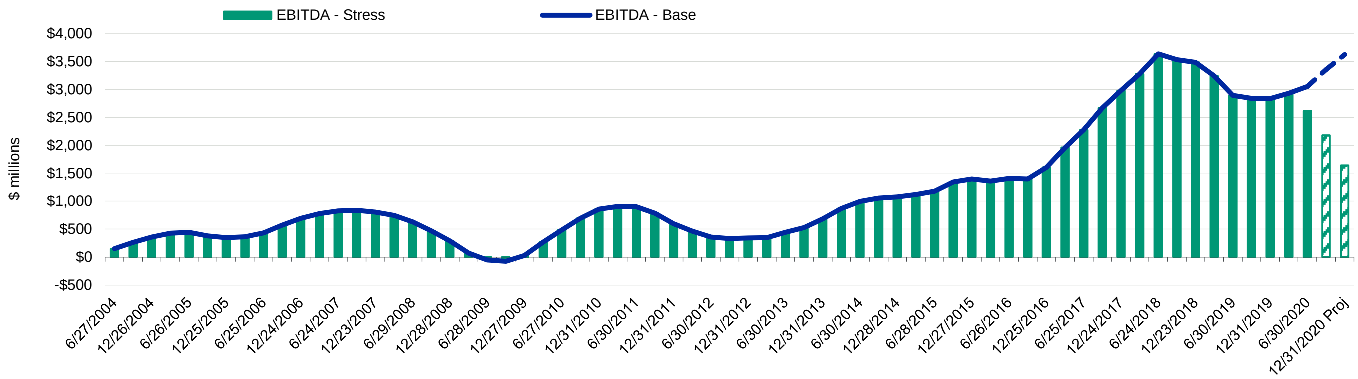
Sources: Moody's Financial Metrics and Moody's Investors Service projections

At the start of the second quarter, driven by uncertainties related to the COVID-19, Lam saw potential capacity limitations both from its supply chain partners and its own internal production capability. As the June quarter progressed, however, Lam was able to increase its production efficiency and the resulting expansion in production volumes drove better factory performance that enhanced gross margins (46% in June) from original expectations. We now project EBITDA to grow to $4.3 billion in calendar 2020, up notably from our earlier $3.3 billion estimation in April, and up from the $2.8 billion achieved in 2019 (see Exhibit 4).

Exhibit 4

EBITDA resumes growth after bottoming in calendar 2019

Trailing 12 months



Sources: Moody's Financial Metrics and Moody's Investors Service projections

Our projections indicate that leverage will decline in 2020, with adjusted gross debt to EBITDA declining to about 1.8x in December while free cash flow to adjusted gross debt approximates 35%. Throughout 2020, we project Lam's cash will exceed funded debt of $5.8 billion. The company's next debt maturity is $800 million in June 2021 and then no public debt matures until 2025.

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Zebra's acquisition of Reflexis reduces liquidity and increases leverage

Originally published on 29 July 2020

On 29 July, Zebra Technologies Corporation (Ba1 stable) announced that it had entered an agreement to acquire Reflexis Systems, Inc., a privately held provider of intelligent workforce management, execution, and communication solutions for businesses in retail, food service, hospitality, and banking for $575 million in cash. Zebra will fund the acquisition with net proceeds from a new 364-day term loan of up to $200 million, revolver advances, and excess cash.

The transaction is credit negative for Zebra because of reduced liquidity and the increase in Moody's-adjusted leverage to around 2.0x (partial credit for planned synergies) compared to 1.7x as of March 2020.

Revenue for Reflexis was $66 million in 2019 compared to Zebra's reported revenue of $4.3 billion for the 12 months to June 2020. The acquisition will not have a material effect on revenue and cash flow until after year one as the acquired business is scaled and potential revenue and cost synergies are realized.

Despite the increase in adjusted leverage to 2.0x, Zebra remains solidly positioned in its Ba1 Corporate Family Rating given our expectations for a return to revenue growth as the global recession abates. Adjusted leverage will remain well below our 3x downgrade guidance with adjusted free cash flow to debt exceeding 20% over the next year, allowing adjusted leverage and free cash flow metrics to return to pre-acquisition levels in one year, consistent with the proposed 364-day credit facility.

Based in Lincolnshire, Illinois, Zebra is a provider of rugged handheld computers, barcode scanners, and specialized printers serving retail/e-commerce, manufacturing, transportation and logistics, healthcare, and other industries. We expect that Zebra will maintain its leading market position, benefiting from good revenue diversification across end-customers and geographic regions, sizable free cash flow, and a commitment to debt repayment to reduce adjusted leverage from its pro forma peak of 2x at the acquisition's close. We expect revenue to remain above $4 billion over the next year.

Leading up to the COVID-19 crisis, Zebra's topline growth was supported by the ongoing transition from Microsoft CE-based mobile scanning products to Android-based products in enterprise mobile computing, an innovative new suite of industry-specific products across several vertical segments, and technology tailwinds including growing demand for offerings related to the Internet of things, enterprise mobility, cloud computing, and intelligent automation.

For the six months that ended June 2020, net sales for Zebra decreased 7% to $2.0 billion from $2.2 billion primarily because of the effects of COVID-19 and the global recession. Adjusted EBITDA margins declined to 19% through June 2020, compared to 21.3% for the same six months in 2019, as unfavorable business mix, additional costs related to freight, and COVID-19 precautions were only partially offset by lower operating expenses such as reduced discretionary spending and temporary reductions in employee compensation. Looking forward we expect total revenue will decline in the mid-single digit percentage range for full year 2020 with EBITDA margins (including Moody's standard adjustments) remaining above 19%.

Zebra has ample liquidity with more than $900 million of availability under its $1.0 billion revolver facility due 2024. Although balance sheet cash totaled just over $60 million as of June 2020, we expect the company will generate more than $400 million of free cash flow over the next year despite the effect of pandemic on the global economy. Zebra's leadership in hand-held devices position the company well when IT demand recovers.

Reflexis provides intelligent work platforms that measure improvement in customer engagement as well as associate productivity and retention. These platforms enable managers to schedule hours against projected traffic demand and task requirements, as well as provide store associates with a single place to view assigned tasks from multiple levels of the organization and monitor for completion. Combining Reflexis' platform with Zebra's complementary software will help enable front-line workers to be more effective. Reflexis is available for use on Android, iOS, and Windows devices, and Zebra indicates that there should be no compatibility issues given Reflexis' applications are currently used on Zebra devices. The transaction is subject to customary closing conditions, including regulatory approval, and is expected to close in the fourth quarter of 2020.

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VTR Finance's acquisition of Telefónica assets strengthens Costa Rican business for parent LLA

Originally published on 31 July 2020

On 30 July, Liberty Latin America Ltd. (LLA), the parent of VTR Finance N.V. (Ba3 stable), announced a $500 million deal to acquire Telefónica S.A.'s (Baa3 stable) subsidiary Telefónica Costa Rica. LLA intends to include Telefónica Costa Rica in the VTR credit pool, which will also include Cabletica, LLA's existing fixed-line business in Costa Rica. Pending regulatory approvals, VTR expects the acquisition to close in the first half of 2021. LLA will increase its market share in Costa Rica, and cost synergies will improve the combined group's EBITDA margin in the next two to three years, credit positives for LLA.

The all-cash transaction implies a $500 million enterprise value for Telefónica Costa Rica on a cash- and debt-free basis, equivalent to a 6.0x EBITDA multiple based on Telefónica Costa Rica's 2019 EBITDA, including projected annual run-rate synergies. But LLA also intends to finance the acquisition with some borrowing from local lenders and from VTR Finance N.V. The deal's credit implications for the VTR credit pool will depend in part on how much new debt it takes on for the transaction.

The acquisition of Telefónica Costa Rica and its combination with Cabletica will create an integrated telecom operator that will provide a full suite of fixed and mobile services. Buying Telefónica Costa Rica would give LLA ownership of Costa Rica's second-largest mobile operator, with a market share of around 24%, on top of its number-two fixed-services operator, with Cabletica's roughly 20% market share for broadband and 25% for pay TV.

We expect that the combination will also result in cost synergies, improving the combined group's EBITDA margin during the next two to three years. The synergies that LLA expects to generate will effectively reduce the EBITDA multiple of the purchase price to 6.0x from 7.4x based on 2019 data, or an improvement in the target's EBITDA to about $80 million, including synergies, from $68 million in 2019.

In addition to borrowings in Costa Rica and at VTR Finance N.V., LLA would finance the remainder using its own liquidity and other sources of capital. Although LLA has not confirmed the exact funding mix, the group said that it is targeting about 4x debt on the acquired asset's EBITDA including synergies, according to LLA's calculations, implying about $300 million of incremental debt at VTR.

VTR's Ba3 rating already reflects the contribution of Cabletica, which LLA anticipated to take place in the first quarter of 2021, and an adjusted gross debt/EBITDA ratio that will decline to close to 4x by the end of 2021 from 4.6x in 2019. Once the funding mix is confirmed and more data become available about Telefónica Costa Rica's contribution to VTR, we will assess whether the deleveraging trend for VTR remains in line with what we had expected before this acquisition.

Telefónica Costa Rica is Costa Rica's second largest mobile service provider. As of 30 June 2020, the business had 2.3 million subscribers, and its mobile network currently has approximately 90% LTE population coverage.

Cabletica, which LLA acquired in 2018, is a leading fixed-line operator in Costa Rica, offering broadband, Pay TV and fixed telephony services, with about 600,000 homes passed and 430,000 revenue generating units as of March 2020, and revenue of CRC77 billion ($130 million) in 2019.

VTR provides broadband and wireless communications services in Chile and is a wholly owned subsidiary of LLA. As of March 2020, VTR's network passed 3.72 million homes and served about 2.97 million fixed revenue generating units. The company also served around 304,900 mobile subscribers as a mobile virtual network operator. The company reported revenue of CLP663 billion (around $800 million) for the 12 months to March 2020.

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Despite BAT's positive first-half results, limited contribution from reduced-risk products is credit negative

Originally published on 31 July 2020

On 31 July, British American Tobacco p.l.c. (BAT, Baa2 stable) announced its first-half 2020 revenue grew 2.4% to £12.4 billion and profit grew 3.3% to £5.4 billion,[1] mainly reflecting a positive 8.5% price/mix effect in combustible products. Revenue and efficiency gains more than offset higher investments in reduced-risk non-combustible products, resulting in an adjusted operating margin of 43.7%. Despite the positive results amid pandemic-related challenges, the company's reduced-risk non-combustible product portfolio contributed only a modest 5.1% to total net revenue in the first half.

The still limited revenue from reduced-risk products is credit negative because they replace combustible cigarettes, whose sales are in structural decline, and will ensure the long-term viability of the tobacco industry. Although we expect low single-digit percentage growth in total net revenue and stable to higher EBITDA, growth in reduced-risk products will likely remain subdued and contribute £1.25-1.75 billion, or 5%-6%, of total net revenue in 2020. The contribution is modest compared with Philip Morris International Inc.'s (PMI, A2 stable) $5.6 billion or 18.7% of total 2019 revenue. We expect reduced-risk product sales growth to slow this year because of the pandemic and US regulators' new authorisation process for vaping products. However, growth should return to a more usual level in 2021.

We estimate BAT's leverage (Moody's-adjusted debt/EBITDA) increased to 4.3x as of 30 June 2020 from 3.9x at the end of 2019 because of higher debt after early refinancing measures in the first half and unfavourable currency effects. Gross reported debt rose to around £50.5 billion as at 30 June from £45.4 billion in December. BAT had cash and cash equivalents of £4.8 billion as at 30 June and £1.4 billion bonds maturing in 2020 and £3.0 billion bonds ,maturing in 2021. It has already repaid a €600 million bond as well as a £1.9 billion term loan in July.

We expect BAT's Moody's-adjusted leverage to decrease to 3.3x-3.7x over the next 12-18 months, assuming constant currency rates, moving leverage to the lower end of our 3.5x-4.0x guidance for the Baa2 rating. The company's deleveraging capacity is constrained by a high and unchanged dividend payout policy, set at 65% of adjusted diluted reported earnings, which translated to dividends of £4.8 billion in 2019.

We estimate capital spending will remain low in 2020 at around £1.0 billion on a Moody's-adjusted basis. We believe the company will continue to rely on partners to develop its reduced-risk products portfolio, limiting its investment needs particularly in research and development. Still, it has invested around £500 million more in the new categories over the past 12 months (in science, digital, design and consumer research), part of which is included in capital spending and part expensed in the profit & loss account.

Management's target of £5 billion net revenue from new categories by 2024 seems ambitious at the current (modest) levels of growth. The company is trying to create a global brand in heated tobacco but net revenue from the category fell 8.7% in the first half of 2020 to £286 million. More positively and despite regulatory headwinds for the category in the US, vapour revenue increased by 40.8% to £265 million. Modern oral tobacco products, although promising, remain a small niche, generating only £77 million in the same period. BAT has recently launched a new heated tobacco product in Japan, the largest market of the category, which is so far dominated by PMI's IQOS brand. In vapour, it has submitted Premarket Tobacco Product Applications (PMTA) in the US for three products and will submit PMTA applications for its remaining US vapour portfolio before the September regulatory deadline.

Endnotes

1 Results are company adjusted and at constant currencies.

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Lockdown boosts Iceland VLNCo's first quarter, a credit positive amid rising competition

Originally published on 31 July 2020

On 30 July, Iceland Topco Limited, the ultimate parent company of Iceland VLNCo Limited (B2 negative), published stronger-than-expected first-quarter fiscal 2021 (ending March 2021), results, with revenue growth well ahead of the total grocery market.

The stronger-than-expected first-quarter results, the first since management bought out Brait's shareholding revenue growth, are credit positive, as is management commentary that the company continues to outperform the market in its fiscal second quarter, even as demand levels have returned to more normal levels as lockdown restrictions have eased.

In the three months to 19 June 2020 Iceland's revenue were up by 27% to £893 million, from £702 million in the corresponding period in fiscal 2020. Moreover, reported EBITDA rose to £47 million from £20 million a year earlier, driving an improvement in EBITDA margin to 5.3% from 2.8%. We note that the company has treated £11 million operating costs related to the coronavirus pandemic as exceptional items, but it has also treated £10 million business rate relief as exceptional. As such, the net boost to reported EBITDA from these items is only £1 million.

We calculate that leverage, measured as Moody's-adjusted gross debt to EBITDA, improved to 5.5x from 6.2x in March 2020. The company's liquidity position remains solid, with the Q1 cash balance of £140 million in line with the fiscal 2020 year end despite a net debt repayment of £20 million in the quarter and £60 million outflow related to the initial consideration for the purchase of Brait's shareholding.

Data from Kantar Worldpanel shows the UK grocery market has experienced exceptional growth because of the coronavirus crisis, with year-on-year growth of 16.9% in the 12 weeks to 12 July. Frozen food has been second only to alcohol in the rate of growth since the crisis started and so Iceland's focus here will have fuelled its outperformance. In addition, consumers recent preference to shop locally - especially in the early weeks of the crisis - will have also benefited the company. Ultimately, these dynamics, coupled with good execution in the period, as well as new store openings (net 40 in fiscal 2020 and four new Food Warehouse in first quartere) has resulted in strong growth in the company's market share relative to its much larger competitors: according to Kantar's latest figures Iceland's market share has grown to 2.5%, compared to 2.2% three months ago.

However, in contrast to the credit positive recent performance and market share gains, Iceland's credit quality is constrained by the highly competitive industry dynamics which have seen the company's profit margins under pressure for several years. We have seen signs of the competitive tensions increasing recently in both the in-store and online channels.

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CIMIC's Thiess sale would be credit positive if it uses proceeds for debt reduction

Originally published on 30 July 2020

On 29 July, Australian multinational contractor CIMIC Group Limited (Baa2 stable) announced that its exclusive negotiations to sell a 50% stake in its subsidiary, Thiess Pty Ltd, to funds advised by Elliott Advisors (UK) Limited. The sale would transfer joint control of Thiess to CIMIC and Elliott. CIMIC expects that negotiations will conclude in the coming weeks with a share purchase agreement, subject to customary conditions and regulatory approvals.

The sale would be credit positive for CIMIC if it applies proceeds to debt reduction and are commensurate with the associated reduction in EBITDA. The credit effect would also depend upon the ultimate capital structure at Thiess, the world's largest contract miner, and the dividend policy that would be put in place by the shareholders. However, CIMIC has not yet announced the amount of expected proceeds from the transaction or how the proceeds would be deployed. Thiess is a large company, therefore, we expect that cash proceeds from the potential sale to be significant.

A sale of a 50% stake in Thiess would reduce CIMIC's scale and diversification. However, we see the impact of the potential transaction on CIMIC's business profile as relatively neutral because the sale would also reduce the company's exposure to the cyclicality in the mining sector. It would also reduce the significant amount of capital required to support the ongoing operations of the business. Mining services is a capital-intensive business, and we understand that over recent years the segment accounted for the majority of capital spending at CIMIC's group level.

CIMIC's debt has increased recently because of costs required to exit its underperforming BICC business. Not incorporating this latest potential transaction, we had expected that CIMIC's gross debt/EBITDA would increase in 2020 from the 2.5x in 2019, which would lessen the capacity available under its 3.0x gross debt/EBITDA threshold for the Baa2 rating. In the past, CIMIC has used asset sales to reduce debt and strengthen its balance sheet, as well as recycle proceeds to new acquisitions or returns to shareholders via share buybacks.

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Record consumer indebtedness and rising delinquencies are credit negative for Brazilian banks

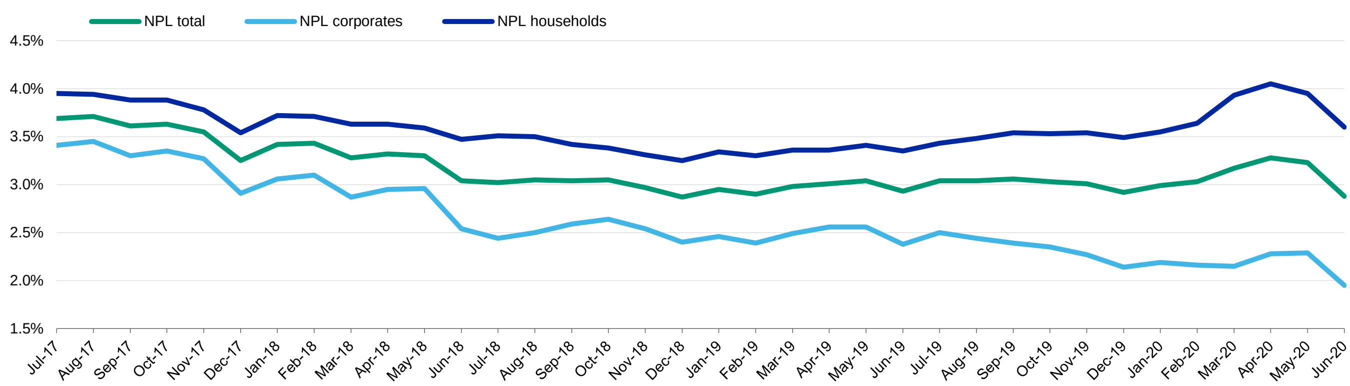
Originally published on 31 July 2020

On 28 July, Brazil's Confederação Nacional do Comércio de Bens, Serviços e Turismo (the national confederation of commerce of goods, services and tourism or CNC) published its July survey which showed that consumer indebtedness had reached record levels and that delinquency pressures have intensified. The rise in household indebtedness is credit negative for Brazilian banks with significant consumer lending exposures, mainly large retail banks, because it will lead to higher asset risk on banks' balance sheets and be reflected in rising problem loan levels as well as renegotiations and restructurings. The increase also illustrates the challenges Brazilian consumers face in managing their loan exposures.

The record level of indebtedness is particularly credit negative for Brazilian banks with large exposures to unsecured consumer lending. Such banks include Caixa Economica Federal (Ba2 stable, ba3[1]), Banco do Brasil S.A. (Ba2/(P)Ba2 stable, ba2), Banco Bradesco S.A. (Ba2 stable, ba2), Itau Unibanco S.A. (Ba2 stable, ba2) and Banco Santander (Brasil) S.A. (Ba1 stable, ba2), which combined account for the lion's share of consumer lending in Brazil.

Higher indebtedness indicates rising asset risk, particularly amid challenging economic conditions in Brazil because of the coronavirus pandemic. We expect Brazil's economy to contract by 6.2% this year, with high unemployment negatively affecting household income. Since the onset of pandemic, banks' problem loans ticked up to 3.3% in April from 2.9% in December 2019, driven largely by rising problem loans for consumers, which rose to 4.1% in April from 3.6% in December 2019 (see Exhibit 1). However, 90-day problem loans have since ticked down to 2.9% for the system as of June 2020 and to 3.6% for consumer loans as banks began renegotiating their loan exposures amid rising asset risk.

Exhibit 1
Brazilian banks' problem loans rose this year, but have receded from April highs following loan renegotiations



Source: Central Bank of Brazil

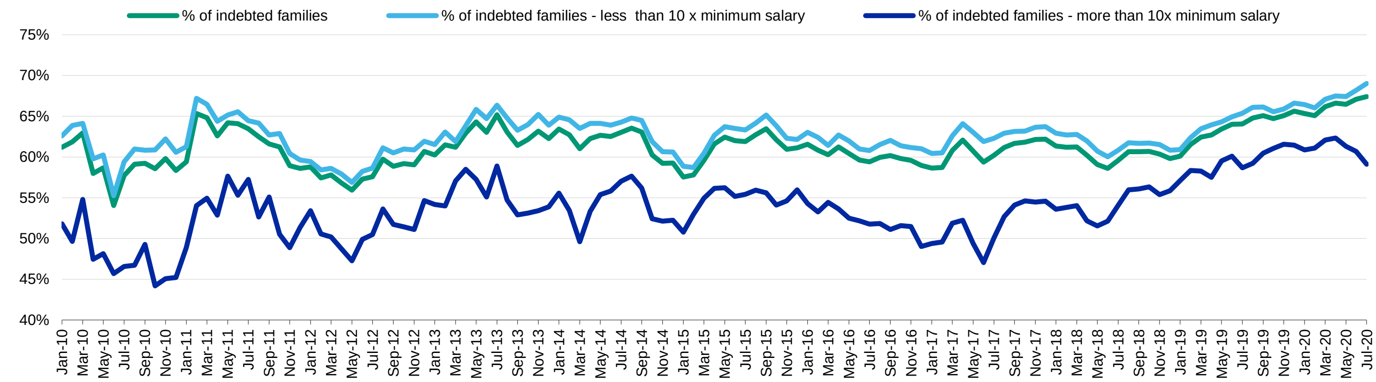
Based on available central bank data, BRL594 billion of loans were renegotiated and received loan payment extensions due to the pandemic between 16 March and 29 May, which equates to about 16.5% of total systemwide loans as of June 2020. Loans to households and small and midsize enterprises (SMEs) comprised 91% of these renegotiated loans. The payments were deferred for of up to 180 days and equal 11% of the sum of all renegotiated contracts (principal plus interest), most of which supported SMEs and households.

At the onset of the coronavirus crisis, the central bank eased provisioning requirements for any accruing loans being renegotiated until September 2020. The measures that postpone provisioning will likely delay credit losses, requiring banks to reinforce reserve coverage levels during the third and fourth quarters. In this context, rising household indebtedness to a record level in July is a sign that asset risk pressures will continue to build on banks' balance sheets

The results of CNC's survey showed that 67.4% of all Brazilian families have debt outstanding, the highest level on record since 2010. The levels of indebtedness were driven by lower income households, defined by those who earn up to 10x the minimum wage, of which 69% of families were indebted. For households earning over 10x the minimum wage, the level was at 59% as of July, elevated compared with historical levels (see Exhibit 2).

Exhibit 2

Brazilian households' indebtedness has risen to record levels
% of families with debt outstanding



Source: Confederação Nacional do Comércio de Bens, Serviços e Turismo

The CNC survey also showed that the percentage of families in the lower income group with debt payments in arrears rose 260 basis points from a year ago to 29.7%, while for higher income groups the level was 11.2% versus 10.6%, indicating rising delinquency pressures. The percentage of households unable to pay off their debts also rose in July across both income levels – up 240 basis points to 13.7% for lower income households and up 150 basis points to 4.9% for higher income households.

For indebted households, 21.6% have more than 50% of their monthly earnings dedicated to debt service, and the largest type of exposure is credit card debt, according to the survey. Following that category is payment by installments via booklets. Both categories are unsecured consumer loan classes, highlighting that banks are particularly susceptible to a deterioration in borrower repayment capacity.

Endnotes

1 The bank ratings shown in this report are the bank's deposit rating, senior unsecured debt rating (where available) and Baseline Credit Assessment.

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Loan originations boost Brazilian banks' interest income, but high provisions hurt profitability

Originally published on 31 July 2020

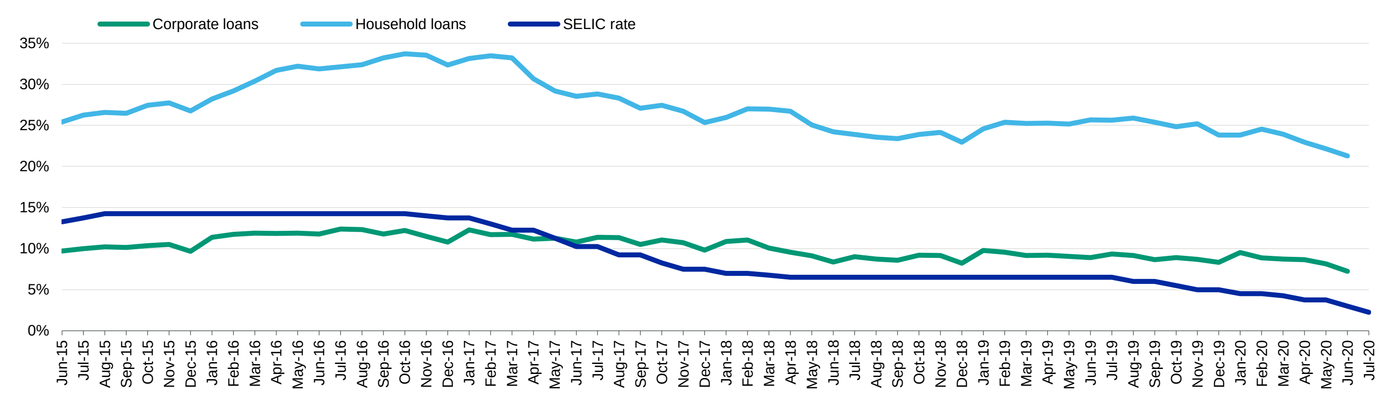
On 29 July, the Central Bank of Brazil released data showing that bank loan originations grew 2.5% in June 2020 after declining the preceding two months. The pickup in lending occurred largely among households, particularly in credit cards (44.8%), mortgages (25.1%) and vehicle financing (13.8%). The increased loan origination is credit positive for Brazilian banks because it will strengthen their net interest income (NII) despite the historically low 2.25% SELIC benchmark policy rate in July 2020. However, banks boosted loan provisioning in the first quarter in anticipation of increasing loan delinquencies, a move that has materially reduced profitability.

New originations were mainly household lending, up a seasonally adjusted 10.4% from May, while originations to companies fell by a seasonally adjusted 2.4% in the same period. Large banks focused on retail lending will likely benefit most from stronger NII, including Banco Bradesco S.A. (Ba2/(P)Ba2 stable, ba2[1]), Itau Unibanco S.A. (Ba2/(P)Ba2 stable, ba2), Banco do Brasil S.A. (Ba2/(P)Ba2 stable, ba2), Banco Santander (Brasil) S.A. (Ba1/(P)Ba1 stable, ba2), Caixa Economica Federal (Ba2/(P)Ba2 stable, ba1) and Banco Safra S.A. (Ba2/(P)Ba2 stable, ba2).

The increased NII supports banks' profitability, but more relaxed loan underwriting standards and borrowers' still-weak repayment capacity are likely to increase loan provisioning and hurt second-half profitability. In their late July earnings releases, Santander Brasil and Bradesco reported additional provision expenses as a prudential measure. We expect that other banks' financial reports will show similar provisioning measures in the second quarter. Santander Brasil added BRL3.2 billion ($617 million) in provisions for the second quarter, up 90.8% compared with the first quarter, while Bradesco's provisions jumped 32.5% to BRL8.9 billion over the same period. According to central bank data, the aggregate problem loan ratio in the system fell to 2.9% in June from 3.2% in March, but high unemployment and the volume of loan restructuring suggests a rising ratio in the fourth quarter.

Despite credit origination growth's positive effect on banks' profitability, the reduction in average lending spreads to 15.6% in June from 16.5% in May (see Exhibit 1), in line with the low SELIC rate, will dampen the benefit. Additionally, the net effect on NII will depend on how sustainable loan origination is in future quarters.

Exhibit 1
Decline in the SELIC rate have contributed to drop in spreads to household loans
Average lending spreads, per segment



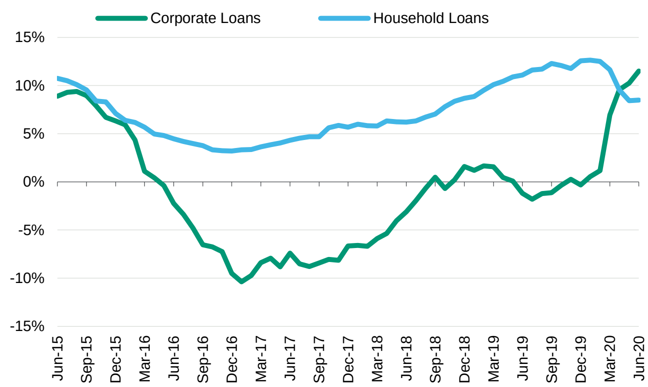
Sources: Central Bank of Brazil and Moody's Investors Service

Since the coronavirus crisis began in Brazil in mid-March, loan demand from individuals fell materially, resulting in a 0.4% decline in the volume of loans to households between March and June (see Exhibit 2). During the same period, large companies borrowed significantly to meet working capital needs, resulting in a 1.1% increase in aggregate loan volume over the same period. The recent recovery in new credit origination (see Exhibit 3), appears to reflect the effects of supportive government measures to household income and businesses.

Exhibit 2

Corporate borrowers supported loan growth in the system in past four months

Annual growth in loan volumes, per segment

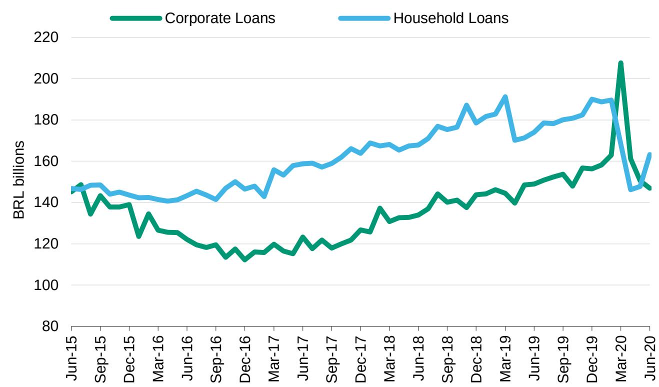


Sources: Central Bank of Brazil and Moody's Investors Service

Exhibit 3

Despite high unemployment, slow economic activity, loan demand from households recovers

New loans originated, seasonally adjusted, by segment



Sources: Central Bank of Brazil and Moody's Investors Service

Endnotes

1 The bank ratings shown in this report are the bank's domestic deposit rating, senior unsecured debt rating (where available) and Baseline Credit Assessment.

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Deutsche Bank's second-quarter strengths in core businesses help offset coronavirus disruption

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On 29 July, Deutsche Bank AG (DB, A3/A3, negative, ba1[1]) reported second-quarter net profit of €61 million, following a net loss of €3.2 billion one year ago.[2] DB's positive result compares well with trends seen elsewhere in the industry and underscores DB's continued progress following its strategic repositioning, helping it to withstand the various effects of the coronavirus-driven shock. The net profit was supported by an 11% positive operating leverage at group level, allowing DB to put away €761 million of additional loan loss charges and €289 million of litigation and regulatory costs, as well as €280 million of restructuring and transformation charges in the quarter.[3]

Strong investment bank and asset management boost revenue as costs remain well contained. DB reported total group revenues of €6.3 billion[4] in second-quarter 2020, up 3% year-over-year and more than offsetting the negative effects of the persistently ultra-low interest-rate environment and recent business perimeter changes. At the same time, adjusted costs[5] declined 8% to €4.9 billion, reaping the benefits of DB's 2019 cost reduction measures and continued cost containment in 2020. In particular, the Investment Bank's revenue increased 52%,[6] driven by a strong fixed income and origination result. Asset Management also reported a 6% sequential improvement in revenue, driven by a recovery in market values and related fees during second-quarter 2020. All core bank segments were profitable, supporting an 11% growth in DB's core bank adjusted pretax profit year over year to €935 million.[7]

Capital and leverage improve sequentially. DB reported a Common Equity Tier 1 (CET1) capital ratio of 13.3% for the quarter, up from 12.8% in first-quarter 2020 and virtually flat year-over-year. The firm's fully loaded leverage ratio improved 20 basis points sequentially and 30 basis points year-over-year to 4.2%. The improvement was largely owing to lower credit assets as a result of higher repayments on credit facilities provided to clients during the coronavirus shock in March and April this year, and was also driven by lower derivative volumes. During 2020, we expect the CET1 ratio to stay above the 12.5% guidance level, although we anticipate DB will be unlikely to meet its 4.5% leverage ratio target for this year. During second-quarter 2020, risk-weighted assets declined 5% year-over-year and 3% sequentially to €331 billion (in second-quarter 2019, it was €347 billion and in first-quarter 2020 it was €341 billion), while leverage exposures were €1.192 billion (in second-quarter 2019, they were €1.304 billion and in first-quarter 2020, they were €1.248 billion).

Liquidity metrics improved, driven by lower lending volumes and continued deposit growth. DB reported an excess of €64 billion over its requirements stipulated by the liquidity coverage ratio, which was 144% as of the end of June 2020, versus 147% a year earlier. The bank's total liquidity reserves were €232 billion as of the same date, providing a sequentially improved and sufficient leeway to navigate through the current environment.

Click here for the full report.

Endnotes

1 The bank ratings shown in this report are the bank's deposit rating, senior unsecured debt rating and Baseline Credit Assessment.

2 All figures in this report relate to second-quarter 2020 and comparisons are made to second-quarter 2019, unless otherwise indicated.

3 In 2019 and first-quarter 2020, DB booked €5.6 billion and €172 million of restructuring- and transformation-related charges, respectively. Total charges and effects are expected to accumulate to €8.0 billion until 2022.

4 Excluding specific items as per DB definition.

5 As per DB definition.

6 All segment figures here exclude specific items.

7 Adjusted as per DB disclosures.

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Credit Suisse's strong second-quarter capital markets businesses offsets COVID-19 disruption

Originally published on 30 July 2020

On 29 July, Credit Suisse Group AG (CS, Baa2 positive), the parent holding company of Credit Suisse AG (A1 positive/A1 positive, baa2[1]), reported[2] second-quarter 2020 pretax profits of CHF1.6 billion, up 19% year over year, and second-quarter 2020 net profit of CHF1.2 billion, up 24% year-over-year.

These strong results were supported by 11% positive operating leverage at group level, allowing CS to put away CHF296 million of additional loan loss provisions – offset by reversals on earlier write-downs on loans and underwriting commitments (approximately CHF188 million across the segments) and a CHF134 million one-time gain on an equity investment. The net return on tangible equity (ROTE) was 11.0% versus 9.7% in second-quarter 2019, while the annualized return on assets was 0.56% versus 0.48% for second-quarter 2019. The results underscore CS' improved resilience following its 2015-18 restructuring program, helping it withstand the various effects of the coronavirus-driven shock, and show the benefits of its favourable business mix including lower exposure to unsecured lending.

Renewed strategic refinements aim to preserve current capital and return levels. CS today announced various internal reorganizations, the most important being the formation of a globally integrated Investment Bank (IB) targeted to consume about one third of group risk-weighted assets, similar to today's levels. CS will also combine its risk and compliance function to improve controls; reduce fragmentation; and simplify the operating model in this important area. The group will also establish a new board-level function focusing on developing sustainability, research and investment (SRI) solutions. Following these strategic refinements, which will burden the bank with CHF300-CHF400 million of restructuring charges over the next 12 months, CS expects to maintain its ROTE at 10%-12% and uphold a 12% Common Equity Tier 1 (CET1) capital ratio. We view the reorangization announcements as credit neutral, although they carry heightened execution risks in uncertain times.

Structurally lower cost base and revenue stability support profits. CS reported an underlying 12% revenue growth year-over-year, driven by strong capital markets-related businesses (including Asia Pacific Markets, Global Markets and Investment Banking & Capital Markets) and stability in its Swiss and Asset Management businesses. Total adjusted operating expenses only increased 2%, delivering positive operating leverage of 11%[3] in the second quarter.

Capital and liquidity metrics increased sequentially. CS reported a BIS fully applied CET1 capital ratio of 12.5% in the second quarter, up 40 basis points from the first quarter and flat year over year. Higher retained earnings and contained risk-weighted assets supported the bank's CET1 ratio above the group's revised 12% target level.[4] CS reported the CET1 leverage ratio was 4.0%, versus 4.1% a year earlier, and a 5.5% Tier 1 leverage ratio, versus 5.3% a year earlier[5] and liquidity coverage ratio of 196% in second-quarter 2020, up from 182% in first-quarter 2020 and 193% in second-quarter 2019.

Click here for the full report.

Endnotes

1 The ratings shown are Credit Suisse AG's long-term deposit rating and outlook, its long-term senior unsecured debt rating and outlook and its Baseline Credit Assessment (BCA).

2 Unless indicated otherwise, figures displayed in this report are on a Credit Suisse Group AG adjusted basis and relate to second-quarter 2020 with comparisons to second-quarter 2019, unless otherwise indicated.

3 Numbers may not add up because of rounding differences.

4 By the end of 2020, before final impact of Basel III reforms.

5 The ratios include CHF104 billion of cash held at central banks, ignoring the temporary exclusion of these amounts by the Swiss regulator for the computation of the CET1 and Tier 1 leverage ratios. Ratios would be 4.5% and 6.2%, respectively, if excluding.

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UAE's four largest banks' first-half profits decline amid higher provisioning, a credit negative

Originally published on 31 July 2020

On 29 July, Abu Dhabi Commercial Bank (ADCB, A1/A1 negative, baa3[1]) was the last of the United Arab Emirates' (UAE) four largest banks, which together accounted for 74% of UAE banking assets as of March, to publish first-half 2020 results. Together, First Abu Dhabi Bank PJSC (Aa3/Aa3 stable, a3), Emirates NBD PJSC (A3/A3 negative, ba1), ADCB and Dubai Islamic Bank PJSC (A3 negative, ba2) reported an aggregate net profit of $3.4 billion, down 36% from $5.3 billion a year earlier.

The first-half profit declines mainly reflect a pandemic-related 167% provisioning increase in anticipation of higher credit losses this year, and the negative effect of lower interest rates on the banks' net interest income.

We expect the banks' asset quality to deteriorate significantly, as pandemic-related containment actions, the global economic shock, low oil prices and preexisting economic challenges weigh on economic growth and borrowers' repayment capacity. The four banks' combined cost of risk, computed as total impairment charge for the period divided by gross loans, increased to 160 basis points in first-half 2020 from 83 in full-year 2019.

Borrowers in the trade, transportation, and construction and real estate sectors will be the most affected, with small and midsize enterprises particularly vulnerable to the economic shocks. As of March, credit to the wholesale and retail trade sectors was 9% of systemwide lending, while credit to the transport, storage and communication sectors was 5% and credit to the construction and real estate sectors (including hospitality) was 19%. Personal loans for business purposes (including credit to high-net-worth Individuals) was 6%.

The central bank's Targeted Economic Support Scheme will mitigate the extent of asset quality deterioration by keeping some borrowers' liquidity issues from becoming solvency issues. UAE banks pandemic-related payment relief defers borrowers' interest and principal payments for one to six months. As of June, the four banks' total deferred instalments equaled 2.4% of their combined gross loans, and the total outstanding balances of customers with loan deferrals was 16.2% of the banks' gross loans. After the deferral period, we expect the banks to revise the repayment schedules of some of clients that have had lower revenue or salaries, which will limit problem loans formation.

Nonetheless, we expect problem loans to increase during the second half given that some borrowers that have deferred loan instalments will become delinquent, despite support. Systemwide problem loans were 4.6% of gross loans as of December 2019.

The four banks preserved their strong capital buffers, with a combined Common Equity Tier 1 (CET1) ratio of 13.6% as of June, compared to 13.7% as of December 2019. The stable capital ratio primarily reflects the first-half profit generation combined with a partial reversal of mark-to-market losses on securities holdings (because of credit spreads tightening), which together offset annual dividend payment for 2019 and interests on hybrid securities.

The banks' combined return on assets declined to 1.1% in the first half, from 1.7% in full-year 2019. As UAE banks face a sizeable deterioration in asset quality and profitability, their ability to retain and/or restore capital throughout the next several years, take on particular importance in our assessment of their credit profiles.

Endnotes

1 The bank ratings shown in this report are the bank's deposit rating (issuer rating for Dubai Islamic Bank), senior unsecured rating (where available) and Baseline Credit Assessment.

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Humana's investment in home health provider Heal is credit positive

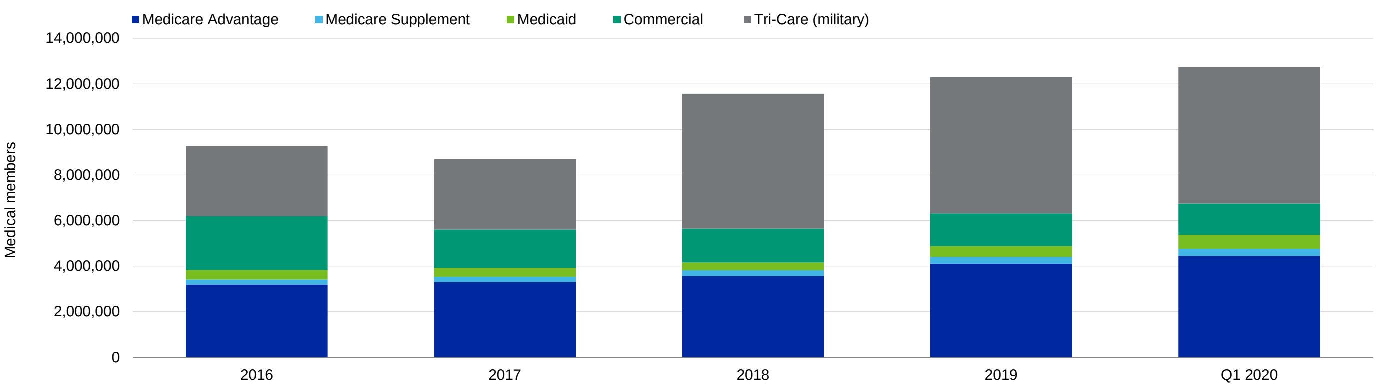
Originally published on 31 July 2020

On 29 July, Humana Inc. (Baa3 stable) announced that it is making a $100 million investment in Heal, a provider of house-call-based primary care to patients in seven states[1] and Washington, D.C. Under the terms of the partnership, Humana and Heal will expand Heal's current footprint to new geographical markets including Chicago, Charlotte and Houston. Humana's Segment president for the Home Business unit will join Heal's board of directors as part of Humana's investment in Heal.

Humana's investment is credit positive because by deploying Heal's scale and expertise in home healthcare, we expect that Humana will be better equipped to control the growing medical costs of its Medicare Advantage insured population. Heal offers in-person physician-based primary care services to patients in the privacy of their homes, a differentiated service that will complement Humana's existing home service offering. We believe a successful partnership with Heal will help translate into greater Medicare Advantage sales.

Humana is a market leader in Medicare Advantage, a key growth area in the health insurance industry, which is being fueled by the ongoing aging of the baby boomer generation. Humana's organic membership growth in Medicare Advantage has almost tripled over the past 10 years, while its near-term performance in 2019 was also strong at 15.5% organic membership growth (see exhibit). Medicare Advantage business accounts for approximately 80% of Humana's premium and fee revenue, reflecting its specialization in the sector.

Humana's medical membership
Medicare Advantage shows strong growth



Note: While TriCare (military) membership growth has been strong, the business accounted for less than 1% of total premium and fee revenue in 2019.
Sources: Company filings and Moody's Investors Service

Outside of hospitals, the traditional site of care for many years was a doctor's office and house calls were only available to a small segment of the population. Over the past five years, Heal has delivered more than 200,000 home visits. Heal's differentiated approach to providing primary care in the home is particularly powerful in a post-coronavirus environment characterized by less frequent travel, even across short distances, because of shelter-in-place directives issued by states and localities and a shift in consumer preferences reflecting the greater health risk associated with public spaces.

This shift in consumer preferences is even more pronounced among elderly populations, particularly those that suffer from multiple chronic medical conditions. These populations have complex care needs, resulting in higher use frequency of qualified medical services, including prescription management and adherence monitoring and environmental risk monitoring. By having more frequent medical care touchpoints in the home, doctors can better monitor a more holistic set of healthcare cost determinants such as fall risks, food insecurity and other risks that are not easily observable when meeting patients in a doctor's office.

We expect that Humana will use cash on hand, which totaled $6 billion as of first-quarter 2020, to pay for its $100 million investment in Heal. Cash levels are at a historic high because Humana raised liquidity during the first quarter to deal with potential coronavirus related contingencies, such as accelerating claims payments to providers and extending grace periods for client premium payments. As the year progresses, we expect high financial leverage, as measured by debt/capital of 40.5% as of first-quarter 2020, to fall to the low 30% range, in line with normal historical levels, as the company repays debt with cash on hand.

Endnotes

1 New York, New Jersey, Washington, California, Georgia, Virginia and Maryland.

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CECL reserves buttress US credit card bank bondholders during pandemic uncertainty

Originally published on 31 July 2020

During the second-quarter earnings season, the six major credit card banks again added to a growing mountain of reserves against future credit losses, a credit positive. The adoption of the Current Expected Credit Losses (CECL) accounting regime (see blue box below), combined with the provisioning in response to the coronavirus-induced economic downturn, has increased loan-loss reserves during 2020 at the credit card banks – American Express Company (AXP, A3 negative), Bank of America Corporation (BAC, A2 stable), Capital One Financial Corporation (COF, Baa1 negative), Citigroup Inc. (C, A3 stable), Discover Financial Services (DFS, Baa3 STA), JPMorgan Chase & Co. (JPM, A2 stable).

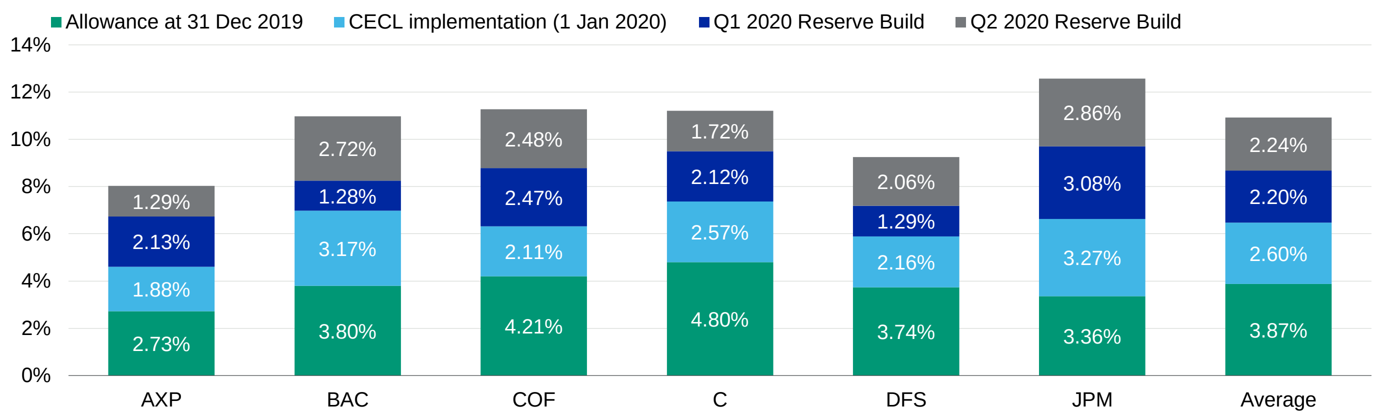
The reserve builds have sharply reduced profitability at the banks, which have all also stopped share repurchases. Each bank has faced the challenge of estimating future losses as well as the effectiveness of government support programs during this time of uncertainty, giving rise to comparability issues across firms. Nonetheless, all six firms have substantially increased reserves, which is positive for their bondholders.

A large percentage of the reserve build at the six banks is driven by their exposure to credit cards, which are unsecured consumer obligations that typically have higher charge-offs than most other bank lending asset classes. Additionally, longer average loan life also drives higher than average CECL loss reserves for credit cards.

Exhibit 1

JPM has been most aggressive in building reserves, while DFS and AXP lag peers

Evolution of credit loss reserves as a % of credit card loans outstanding, year-end 2019 to second-quarter 2020



AXP = American Express Company, BAC = Bank of America Corporation, COF = Capital One Financial Corporation, C = Citigroup Inc., DFS = Discover Financial Services, JPM = JPMorgan Chase & Co.

Source: Company disclosures

On average, the allowance for credit card loan losses for the six US credit card banks has almost tripled from just under 4.0% of credit card loans outstanding as of year-end 2019 to just under 11% as of the end of second-quarter 2020 (Exhibit 1), a credit positive. The buildup came in three waves. First came the initial increase due to CECL adoption on 1 January 2020. This was followed by two additional rounds of reserve builds in each of the first two quarters of 2020, as banks revised their models to incorporate and estimate coronavirus effects.

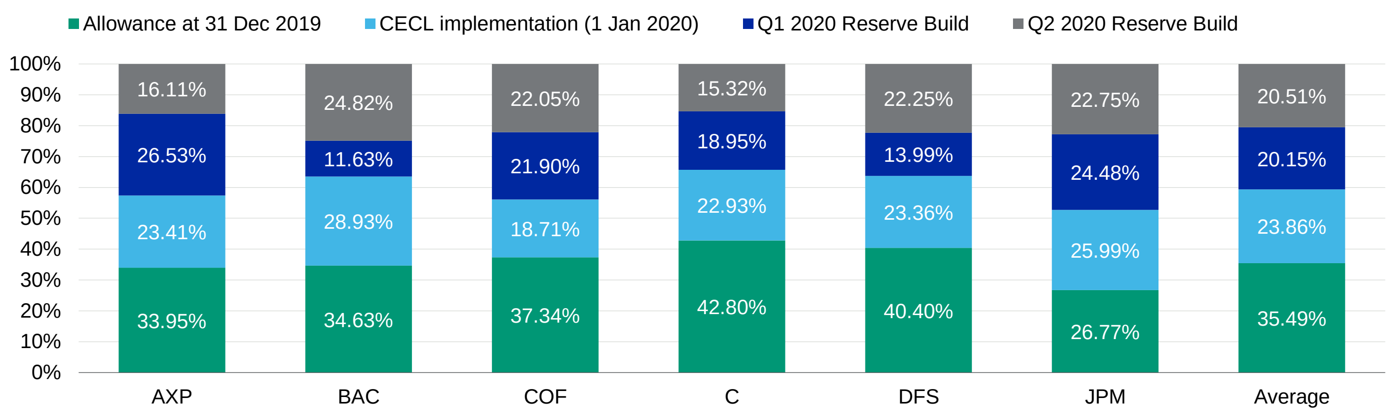
JPM was the most aggressive, almost quadrupling reserves from 3.36% of credit card loans as of year-end 2019 to 12.57% as of the end of second-quarter 2020. The other five banks on average built up reserves by slightly more than 2.5x. At 8.03% and 9.25% of credit card loans outstanding, AXP and DFS lag the six-bank average of 10.92%. AXP's historical industry low charge-off rate drives its lower than average reserve ratio.

On average, the reserve increases from CECL implementation as well as the coronavirus-driven first and second quarter increases were essentially evenly split at around 20% to 23% of the current second-quarter average credit card reserve percent (Exhibit 2). However, comparability is somewhat challenging at this stage, given the differing credit quality of the portfolios and significant variations in the pattern of reserve buildup among the six banks, reflecting the rapidly changing environment and expectations along with uncertainty due to the newness of the CECL accounting regime. For example, BAC had the largest initial CECL build at 28.93% of its second-quarter reserve balance, followed by the smallest first-quarter increase (11.63%) and then the largest second-quarter increase (24.82%). DFS also had a much larger second-quarter reserve build than in the first quarter, while AXP's second-quarter reserve build was much lower than the first quarter.

Exhibit 2

Pace of reserve builds among the six banks reflects portfolio composition as well as a rapidly changing environment and uncertainty

Components of credit card loss reserve as a % of credit card loans outstanding at 30 June 2020



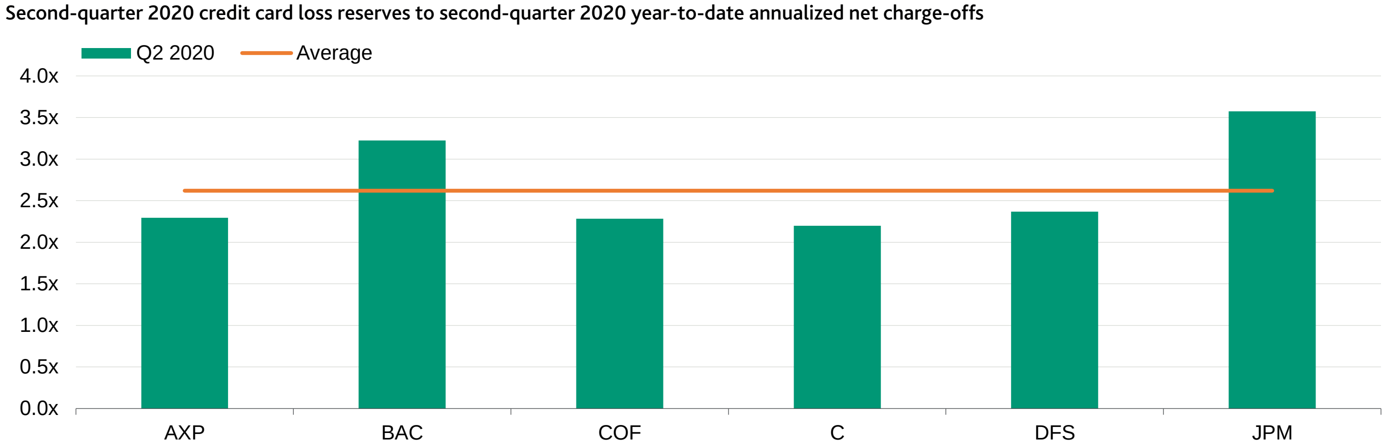
Source: Company disclosures

Exhibits 3 and 4 compare the adequacy of the second-quarter 2020 loss reserve to possible charge-off scenarios. Exhibit 3 shows years of coverage using current charge-off rates (annualized charge-offs year-to-date through second-quarter 2020) relative to current charge-offs. BAC and JPM had the highest ratios at 3.2x and 3.6x, respectively, with the other four peers falling between 2.2x and 2.4x.

Exhibit 3

BAC and JPM have highest ratio of credit card reserves to net charge-offs, a credit positive

Second-quarter 2020 credit card loss reserves to second-quarter 2020 year-to-date annualized net charge-offs



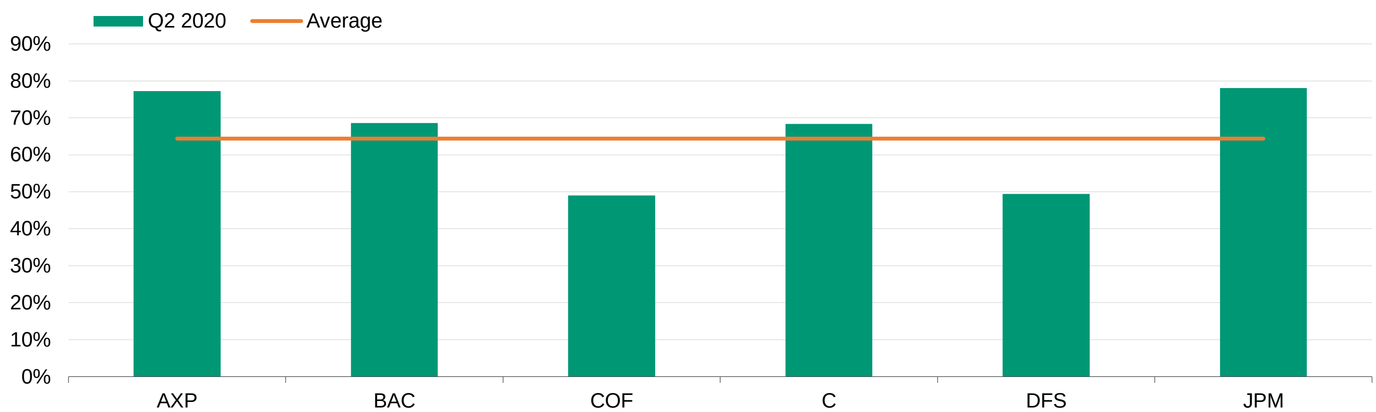
Source: Company disclosures

Exhibit 4 compares the adequacy of second-quarter reserves to the total losses projected for credit cards over the nine-quarter DFAST severely adverse scenario. At just under 80%, AXP and JPM have the highest ratio of credit card reserves to DFAST's forecast losses, a credit positive, with COF and DFS below peers at around 50%.

Exhibit 4

AXP and JPM have highest ratio of second-quarter credit card loss reserves to DFAST's severely adverse loss projection

Second-quarter 2020 credit card loss reserves to DFAST severely adverse credit cards losses



Source: Company disclosures, Federal Reserve

While CECL reserve builds have been credit positive so far, the shape and pace of the recovery will ultimately determine how much of these reserves will be needed to absorb charge-offs and whether additional reserve building will be needed. Several banks reported seeing stable and even lower delinquencies in the second quarter, due in part to the banks' own consumer relief offerings and massive government support for the economy. However, as borrowers leave forbearance and stimulus programs abate, we expect performance will rapidly deteriorate. With unemployment likely to remain very elevated well into 2021, we expect credit card charge-offs to peak in 2021 at around double 2019 levels.

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Toll roads' recovery linked to COVID-19 infection rates, movement restrictions and strength of mass transit

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Traffic recovery on US toll roads has not been uniform as COVID-19-related travel restrictions are reduced or removed in some areas. Passenger traffic has recovered more slowly than commercial traffic after suffering much steeper declines after the virus emerged in the US in March. Total revenue on facilities mostly serving passenger cars reflect the same trends in their passenger traffic volumes given limited commercial revenues. Monthly revenue trends may differ from monthly transaction trends given uncollectible transactions.

» **Commuter-based crossings and managed lanes in metropolitan areas suffered the largest traffic losses at the peak of the initial COVID-19 outbreak.** Traffic volume on the major city crossings we rate plunged 65%, on average, in April compared to 2019 levels. Passenger traffic nationally dropped as telecommuting and home-schooling materially reduced traffic and congestion during peak travel times.

» **Toll roads in regions with high infection rates and stringent stay-at-home orders suffered the largest traffic losses, but increased knowledge of how to limit the virus spread should limit future outbreak related traffic losses.** In April, total vehicle miles traveled (VMT) in the Northeast declined by about 47%, on average, the most of any US region. VMT in the South Gulf region declined the least, by 36% on average. VMT recovery remains susceptible to future movement restrictions as new COVID-19 cases arise, but not to the same magnitude experienced during the initial outbreak.

» **Facilities in metropolitan areas that compete with public transit benefit from users mode switching away from mass transit, offsetting some of the permanently lost commuter traffic.** Traffic in metropolitan areas has recovered faster than mass transit ridership as commuters avoid public transportation. However, total commuter traffic post-COVID-19 will be lower as working from home becomes permanent for some, leading to a structural traffic decline.

» **Tolled facilities with leisure traffic may benefit from increased local vacations while roads and bridges providing airport access will remain depressed by the slower forecast recovery of air travel.** Tolled facilities with significant leisure traffic may benefit from increased local vacations because of air travel restrictions and user perception of risk of flying versus driving. Roads, bridges and tunnels that provide access to airports were hit hard and their recovery is likely to slower than typical commuter assets as air travel remains depressed for several years.

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