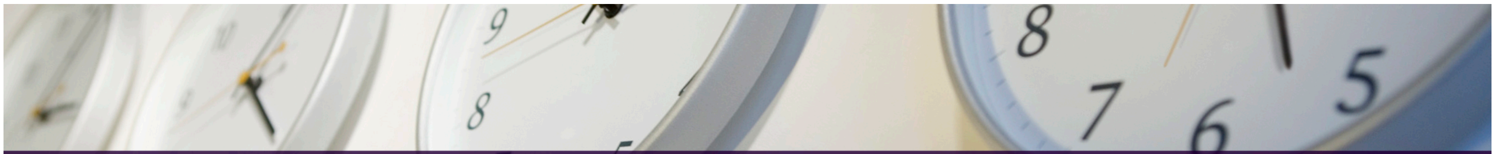

Credit Outlook

14 October 2021

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Austria's leadership change likely ensures policy continuity, but underlines governance issues

Originally published on 12 October 2021

On 11 October, Alexander Schallenberg was sworn in as Austria's (Aa1 stable) new chancellor after Sebastian Kurz had resigned on 9 October. The resignation came in response to corruption allegations that had threatened to derail the governing coalition between his People's Party of Austria (ÖVP) and its junior partner, the Green Party. Schallenberg's appointment will likely ensure policy continuity, but corruption allegations at the highest level of government are emblematic of governance issues that weigh on Austria's creditworthiness.

The Central State Prosecutor for Economic Crime and Corruption (WKStA) announced on 6 October that it was investigating Kurz and nine others on suspicion of abetting bribery and perjury. The WKStA suspects that Ministry of Finance budgetary resources were used to finance partisan media coverage between 2016 and 2018. The latest investigation follows the WKStA's May 2021 judicial investigation of Kurz for allegedly making false statements in a parliamentary committee political graft inquiry. Last week's inquiry prompted the Green Party to threaten ending its support for the government coalition, triggering a political crisis. While Kurz resigned to appease the Green Party and to ensure the coalition's majority in parliament ahead of any no-confidence motion, he did not admit any wrongdoing.

The Greens describe Schallenberg as someone with whom they have a "very constructive" relationship. Because Schallenberg shares many of Kurz's policy views, and because Kurz will remain head of ÖVP and lead the party's parliamentary group following his resignation as chancellor, we expect government policy to be largely unchanged. We also expect parliament will agree to the 2022 budget by mid-October. Schallenberg has already said that he views the corruption allegations to be false and that he will collaborate closely with Kurz.

However, the corruption allegations are emblematic of Austrian governance issues. The previous government, a coalition of the conservatives with the right-wing Freedom Party, collapsed in 2019 when the former vice chancellor and head of the Freedom Party Heinz-Christian Strache was filmed offering government contracts in return for political support. Although Austria's institutions and governance strength aa2 score is strong, it is slightly weaker than for almost all of its Aa1- and Aaa-rated rated peers. Finland (Aa1 stable), the Netherlands (Aaa stable) and Denmark (Aaa stable), for instance, all have an aaa institutions and governance strength score, and only the US (Aaa stable) has the same score as Austria.

Austria actively supports civil society engagement and has a robust legal framework that complies with international standards and provides effective access to justice. Law enforcement is also highly predictable and consistent, which is reflected in Austria's Worldwide Governance Indicator rankings. Austria is in the 96th percentile of the sovereigns we rate for the rule of law, the 88th for control of corruption and the 94th for voice and accountability. However, Austria's scores for control of corruption and rule of law have declined slightly over the past year, and it is roughly in the middle of its Aaa-, Aa1- and Aa2-rated peers (see exhibit).

Judiciary and civil society indicators position Austria roughly in the middle of Aaa-, Aa1- and Aa2-rated peers
Standard normal units ranging from -2.5 [weak] to 2.5 [strong]

	Control of corruption	Rule of Law	Voice and Accountability
Denmark (Aaa stable)	2.27	1.86	1.52
Finland (Aa1 stable)	2.20	2.08	1.62
Singapore (Aaa stable)	2.15	1.88	-0.20
New Zealand (Aaa stable)	2.15	1.88	1.60
Sweden (Aaa stable)	2.13	1.81	1.50
Norway (Aaa stable)	2.10	1.98	1.73
Switzerland (Aaa stable)	2.08	1.83	1.54
Luxembourg (Aaa stable)	2.06	1.79	1.50
Netherlands (Aaa stable)	2.03	1.76	1.53
Germany (Aaa stable)	1.86	1.56	1.38
Australia (Aaa stable)	1.67	1.65	1.30
Canada (Aaa stable)	1.60	1.66	1.48
Austria (Aa1 stable)	1.51	1.81	1.40
France (Aa2 stable)	1.15	1.33	1.07
United Arab Emirates (Aa2 stable)	1.11	0.92	-1.18
United States of America (Aaa stable)	1.07	1.37	0.87
Korea (Aa2 stable)	0.73	1.18	0.82

Sources: Worldwide Governance Indicators and Moody's Investors Service

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FIRST READS

Modern Land's proposal to extend maturity of its $250 million bond is credit negative

On 11 October, Modern Land (China) Co. Limited (Caa2 review for downgrade) announced that it has solicited consent from bondholders to amend its indenture to extend the maturity date of its outstanding $250 million bond to 25 January 2022 from 25 October 2021. The company also sought to shorten the notice period of optional redemption to redeem the bond and redeem $87.5 million (equivalent to around 35% of the outstanding principal) of the bond on the maturity date of 25 October 2021.

The announcement is credit negative for Modern Land and prompted us to downgrade its Corporate Family Rating to Caa2 from B2 stable, and put all of the company's ratings on review for downgrade..

Modern Land's announced consent solicitation will require delivered consent from noteholders of not less than 90% of the aggregate principal amount of the outstanding notes, and will expire on 20 October 2021.

The consent solicitation reflects Modern Land's very tight liquidity position despite its reported unrestricted cash on hand of RMB13.6 billion as of the end of June 2021.

We expect that the company's cash holdings and operating cash flow will be insufficient to cover its debt maturities and committed land premiums over the next 12-18 months, given our expectation of a deterioration in its operations amid weak market conditions, as reflected in declining nationwide property sales. The sharp declines in the company's bond and share prices recently also limit its access to capital market funding for refinancing.

Modern Land's credit quality reflects the company's niche in marketing and selling comfortable and eco-friendly homes. However, the rating is constrained by the company's weak liquidity and financial metrics, as well as its limited funding access and significant exposure to nonbank borrowings.

Modern Land has said that its controlling shareholders, Zhang Lei and Zhang Peng, plan to provide a shareholder loan of around RMB800 million within the next two to three months. The proposed shareholder loan demonstrates the shareholders' support and will alleviate part of the company's liquidity pressure, if completed. However, the timing of executing the support is uncertain.

Our credit assessment of Modern Land also considers the company's concentrated ownership by its key shareholders including Zhang, who is founder and chairmand and held around a 66.1% stake in Modern Land as of the end of June 2021.

Modern Land's Caa3 senior unsecured debt rating is one notch lower than the company's Caa2 Corporate Family Rating because of structural subordination risk. The subordination risk refers to the fact that a majority of Modern Land's claims are at its operating subsidiaries and have priority over claims at the holding company in a bankruptcy scenario. In addition, the holding company lacks significant mitigating factors for structural subordination. Consequently, the expected recovery rate for claims at the holding company will be lower.

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Syniverse's five-year-long security incident reflects cybersecurity gaps

Originally published on 12 October 2021

On 8 October, mobile and wireless technology services provider Syniverse Holdings, Inc. (Caa1 review for upgrade) in its earnings call provided a verbal update on a security incident that went undetected for five years. Syniverse's investigation of unauthorized access to databases within its corporate computer network revealed that login information allowing access to or from its electronic data transfer (EDT) environment was compromised for approximately 235 of its customers, and that attackers gained access to the EDT multiple times starting in May 2016.

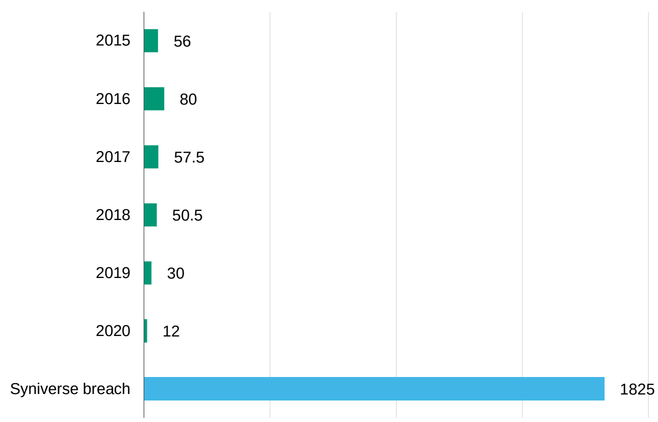
The incident points to gaps in Syniverse's cybersecurity and internal controls that allowed the unauthorized access to its database to go undetected between May 2016 and May 2021. The revelation of a five-year-long security incident is an unwelcome development at a time when the company is on the final stretch of its transaction with M3-Brigade Acquisition II Corp. (MBAC), a publicly traded special purpose acquisition company (SPAC) and Twilio Inc (Ba3 stable). And although Syniverse management said that it did not expect the incident would have any material effect on its daily operations or its ability to access/process data, security incidents can lead to financial, reputational, and legal costs that may take time to unfold.

Five years is a very long time for an attack to go undetected. According to research by cybersecurity company Fireeye Mandiant, global median dwell time – the length of time an attacker spends undetected in a victim's environment – has declined significantly in the past few years. The time it took for companies to find attackers in their networks declined from a high of 80 days in 2016 to a low of 12 days in 2020 (Exhibit 1). The approximately 1,825 days it took Syniverse to detect this breach puts it in the far right tail of attack length distributions, with only 5% of the incidents FireEye Mandiant investigated in 2020 lasting more than 1,000 days (Exhibit 2).

Exhibit 1

Syniverse took much longer to detect unauthorized access than is typical

Median amount of time in days to detect a data breach, by year

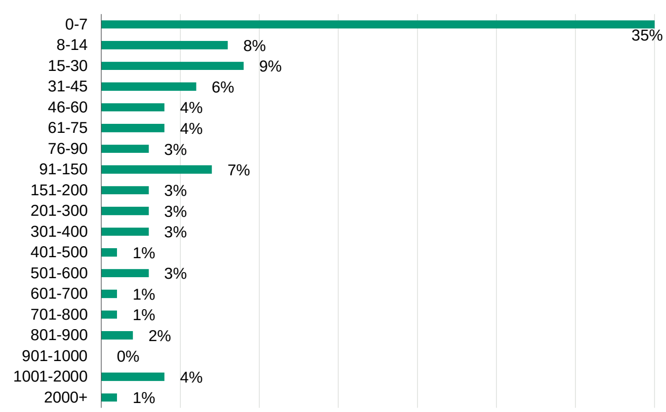


Source: FireEye Mandiant

Exhibit 2

Only 5% of FireEye's 2020 cases remained undetected for more than 1,000 days. Many were detected within a week.

Percentage of FireEye's 2020 investigations detected within the corresponding time interval, measured in days



Source: FireEye Mandiant

Despite the lengthy period of unauthorized access, the security incident's effect was contained to the company's EDT environment with limited database access. The company clarified during its earnings call that no real-time data within the EDT environment and no messaging traffic, messaging content, or signaling traffic, including Internet work Packet Exchange (IPX) traffic was compromised. Syniverse also reported that there were no attempts by the attackers to disrupt its operations or those of its customers or to hold the company to ransom.

Syniverse has taken steps to remediate the incident. Immediately after learning about the security incident, Syniverse launched an internal investigation, notified law enforcement, and engaged the services of cybersecurity professionals. Syniverse began notifying customers of the security incident in early August and, to date, has communicated with all EDT customers about this incident. The company expects its cyber insurance to cover a substantial portion of the costs of investigating and responding to this incident. If the scope of damage from this incident broadens beyond current expectations, or if such intrusions become more frequent, we believe that cyber threats would have a more significant effect on Syniverse's operations and reputation.

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Pathway Vet's proposed $250 million term loan add-on will delay deleveraging

Originally published on 12 October 2021

On 12 October, Pathway Vet Alliance, LLC (B3 stable) announced a $250 million add-on to its existing senior secured first lien term loan. Proceeds from the transaction will be added to the balance sheet and earmarked to fund future acquisitions. The increase in debt without the immediate addition of any earnings of acquisitions will raise leverage, but we expect leverage will decline once acquisitions are executed.

Pathway has been highly acquisitive. Over the last three and a half years, the company's scale increased roughly fourfold to over $1 billion of revenue as of 30 June 2021 (from about $281 million for fiscal 2017), largely through numerous tuck-in acquisitions. We expect Pathway to maintain its acquisitive posture, given its position as a consolidator in a highly fragmented industry. Assuming the incremental debt is used to fund acquisitions at average cash enterprise-to-EBITDA multiples of 12x-14x (similar to recent transactions), we estimate that pro forma adjusted debt-to-EBITDA will increase to 7.7x from 7.2x for the trailing 12 months that ended 30 June 2021. We expect leverage will remain at over 7.5x over the next 12-18 months as the company continues to make acquisitions. However, the management's track record of successfully integrating acquisitions is a supporting factor for its credit profile despite the aggressive acquisition pace. Further, we believe that the vet industry will benefit from tailwinds, such as increasing pet ownership, which will drive solid organic growth.

We expect that Pathway will maintain a good liquidity profile over the next 12-18 months. Pathway will have approximately $547 million of cash pro forma for the term loan add-on. We expect the company's liquidity to be supported by free cash flow of about $55-$65 million over the next 12 months, as well as Pathway's $80 million revolving credit facility expiring in 2025, which will be undrawn at the close of the transaction.

Headquartered in Austin, Texas, Pathway Vet Alliance, LLC is a national veterinary hospital consolidator, offering a full range of medical products and services. It operates over 331 general, specialty and emergency practice locations, and 115 Thrive Affordable Vet Care locations. It also operates a membership organization for veterinary practice owners, Veterinary Growth Partners, which supports nearly 6,024 affiliated and unaffiliated member hospitals throughout the United Sates. The company generated revenue of approximately $1,043 million for the 12 months that ended 30 June 2021. Pathway is majority owned by private equity firm TSG Consumer Partners.

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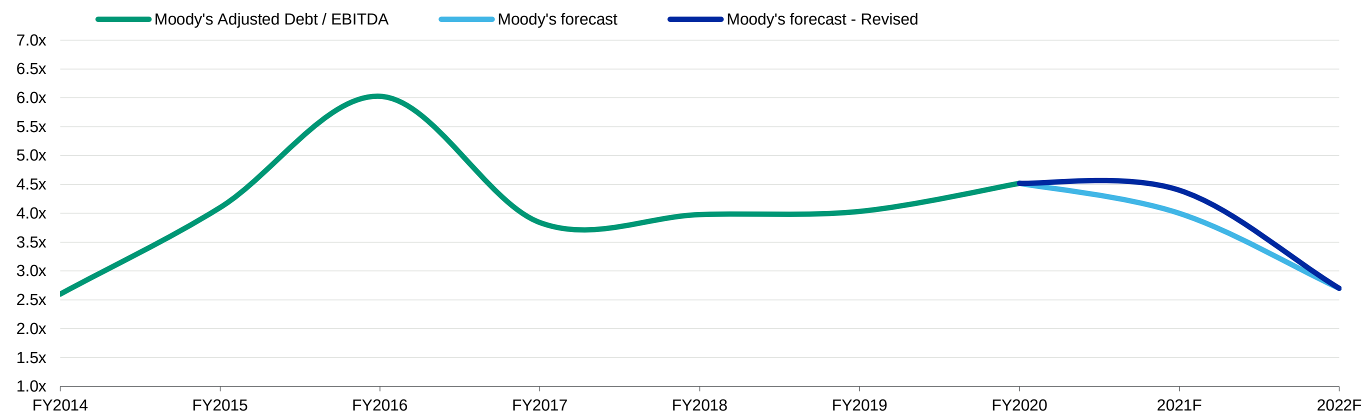
Ransomware attack will reduce Weir Group's 2021 profit and increase leverage

Originally published on 12 October 2021

On 7 October, Weir Group Plc (Baa3 stable) announced that it had been the subject of an attempted ransomware attack. The incident will reduce profit for 2021 by between £25 million and £40 million, comprising mostly revenue slippage and overhead under-recoveries, while we estimate that Moody's-adjusted debt/EBITDA will temporarily rise by up to 0.4x this year, a credit negative. However, we continue to expect meaningful deleveraging in 2022 as a result of both profit growth and debt reduction to well within our expectations for the rating (Exhibit 1).

Exhibit 1
Leverage is likely to be above our previous expectation for 2021, but our view on 2022 remains unchanged



Revised forecast assumes the maximum stated profit impact from the cyber incident.
Source: Moody's Investors Service

Weir also announced strong order trends for the third quarter of 2021, with orders from continuing operations up 31% year-over-year. Growth came from both the minerals segment (30%) and the company's ESCO segment (36%). Original equipment orders recorded the strongest growth, at 71%, while aftermarket orders also grew by 21%.

The incident occurred in the third week of September. Weir immediately powered down its IT systems and applications, including its enterprise resource planning and engineering applications, cut links between applications and systems, and reverted to manual and paper processes. The company has begun to restart core functions and expects core platforms to be fully operational by the end of October, with the remainder becoming fully functional over the rest of this year. According to the company, so far there is no evidence that any personal or other sensitive data has been exfiltrated or encrypted and the direct cost of the incident was £5 million. Accordingly, the incident appears unlikely to have financial repercussions into 2022 at this stage.

Weir was two years into a three-year IT infrastructure upgrade when the incident occurred, which, according to the company, helped contain the attack. Remaining upgrades are now being accelerated into the fourth quarter of 2021.

Weir's ability to detect and contain the attack by powering down its affected systems is credit positive, particularly considering that the broader sector appears to have lagging cybersecurity risk management practices compared with other nonfinancial corporate sectors. Based on issuer data we collected as part of a global cybersecurity survey, the manufacturing sector on average reported less developed cybersecurity mitigation practices across the three primary categories analysed, namely cybersecurity risk governance, operational management and risk transfer.

For example, from a cyber risk governance standpoint, while 73% of EMEA-based manufacturing companies reported having experienced a cybersecurity incident to its board of directors in the previous 24 months, compared with 54% globally, chief information security officers had only briefed the board of directors on average once over the past year compared with twice globally. In addition, an average 32% of EMEA-based manufacturers tied cybersecurity objectives to their CEO's compensation package, compared with 45% globally (Exhibit 2).

Exhibit 2

EMEA-based manufacturers' cyber risk governance practices appear weaker than global peers

	Manufacturing Global	Manufacturing EMEA
Has your organization reported any cybersecurity incidents it has experienced to the board of directors over the past 24 months?	54%	73%
How many times per year does the CISO report on cybersecurity to the entire Board of Directors?	2x	1x
Does your organization have defined cybersecurity performance objectives for the CEO?	45%	32%

CISO = chief information security officer. Survey results reflect medians for each question.
Sources: Company data and Moody's Investors Service

The manufacturing sector also reported weaker results for cyber risk operational management and risk transfer. For example, EMEA manufacturers allocated less than 5% of their overall IT budget to cybersecurity, compared with more than 5% for global corporate peers. Moreover, while the share of respondents with a developed incident response plan was below 90% for EMEA manufacturers, it was closer to 100% for global electric utilities and global technology firms, for example. Advanced cybersecurity risk management practices such as completing so-called red team testing, were also far less prevalent across the broader manufacturing sector than other corporate peers. From a risk transfer standpoint, the adoption rate of stand-alone cyber insurance exceeded 70% for global electric utilities and technology firms, but was only 65% for global manufacturers and 43% for EMEA-based manufacturers (Exhibit 3).

Exhibit 3

Global manufacturing responses suggest weaker cyber risk operational management and risk transfer practices than other non-financial corporate sectors

	Manufacturing Global	Manufacturing EMEA	Electric Utilities Global	Technology Global
% of IT budget allocated to cybersecurity in 2020	5%	3%	10%	6%
% that have an IRP	93%	86%	96%	97%
% that have completed a tabletop simulation in last 12 months	65%	48%	78%	83%
% of online applications subject to a penetration test in the last 12 months	50%	5%	85%	99%
% that have completed red team testing in the last 12 months	39%	24%	61%	57%
% with stand-alone cyber insurance	65%	43%	71%	77%

IRP = incident response plan. Survey results reflect medians for each question.
Sources: Company data and Moody's Investors Service

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Antitrust penalties and mandated changes to business practices are credit negative for Meituan

Originally published on 11 October 2021

On 8 October, China's State Administration for Market Regulation (SAMR) announced a RMB3.4 billion fine against online shopping platform Meituan (Baa3 negative) for anticompetitive behavior, and ordered the company to refund customer deposits totaling RMB1.3 billion associated with such behavior. The government also required Meituan to rectify its business practices to ensure future compliance with antitrust regulations. SAMR started an antitrust investigation into Meituan in late April 2021.

The mandated changes are credit negative for Meituan because full compliance will slow Meituan's revenue growth and raise its operating costs.

SAMR said Meituan has used its dominant market position in the food delivery industry to compel merchants and restaurants to select its platform as their exclusive distribution channel since 2018. This practice limited market competition and infringed on merchants' and consumers' rights, SAMR said. Meituan can no longer do this.

This will encourage competition because food delivery platforms competing with Meituan can now expand partnerships with merchants and restaurants. And merchants and restaurants are no longer limited to working only with Meituan on its commission terms. These changes will slow Meituan's revenue growth and compress its margins the next two to three years.

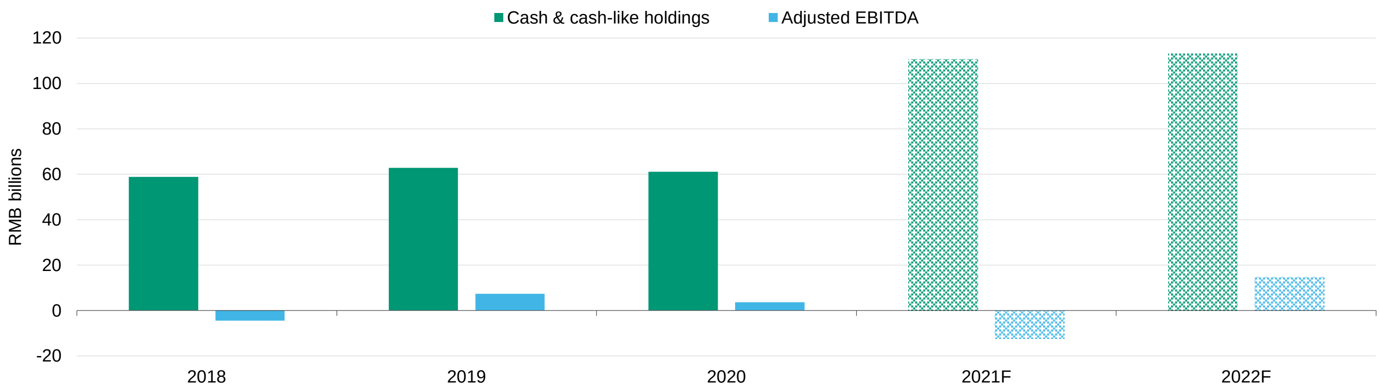
Still, beyond this period, we expect Meituan will gradually cement its position as the industry leader because it will continue to invest in diversified services and products, improve supply chain services for merchants and restaurants, and improve service to consumers.

The recently announced government requirement of improved insurance coverage for food delivery riders will also increase Meituan's operating costs. Food delivery rider costs accounted for 42% of its total revenue in 2020. We estimate that such costs will rise in the next one to two years, assuming the added insurance costs are shared by third-party hiring agencies and Meituan.

However, the effect of these costs on Meituan's credit quality is mitigated by Meituan's strong net cash position and improved capital structure, following the completion of an approximately $7 billion equity issuance on 27 April 2021. Meituan will use the new equity issuance and the $3 billion convertible bonds it issued the same day for research and development in technology that supports the company's business growth.

This new funding will increase Meituan's financial buffer against its high investment needs and rising regulatory uncertainty. An enhanced equity base will also support Meituan's investments aimed at diversifying its revenue streams and strengthen its competitive edge over the next two to three years. Meituan had a net cash position of RMB69 billion as of 30 June 2021, as shown in the exhibit.

Meituan's solid net cash position provides a buffer against operating loss arising from new business initiatives



[1] All figures and ratios are based on adjusted financial data and incorporate Moody's Global Standard Adjustments for Non-Financial Corporations.
[2] 2021F and 2022F forecasts represent Moody's forward view, not the view of the issuer, and do not incorporate significant acquisitions and divestitures.
Sources: Moody's Financial Metrics and Moody's Investors Service estimates

In addition, Meituan's operating loss has narrowed. Its consolidated operating margin was negative 7.4% in the second quarter compared with negative 12.9% in the first quarter. The improvement was primarily driven by increased profitability in its core food delivery business as growing scale continues to bring benefits. And reflecting the company's expanded service offerings, Meituan's annual transacting users increased to 628 million in the second quarter from 569 million in the first quarter and 511 million in the four quarter of 2020.

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AAC Technologies' profit warning for third quarter 2021 is credit negative

Originally published on 12 October 2021

On 7 October, China-based AAC Technologies Holdings Inc. (Baa2 stable), a maker of miniature acoustic, electromagnetic drives and optical components, issued a profit warning on the Stock Exchange of Hong Kong, announcing that its net profit is likely to decline by 51%-61% for the quarter ended 30 September 2021, from a net profit of RMB430 million for the same period a year earlier.

The profit warning is credit negative because lower earnings could delay AAC Technologies' ability to reduce leverage. We estimate the company's leverage, as measured by adjusted debt/EBITDA, will increase to about 2.6x in 2021 from 2.5x in the 12 months ended 30 June 2021 because debt will rise faster than EBITDA.

The expected net profit decline in the third quarter of 2021 is mainly driven by substantially lower currency-exchange gains. Other factors include pandemic-related global supply chain disruptions, an increase in operating costs in China (A1 stable), and weaker demand from domestic customers on the back of a semiconductor chip shortage that has caused delays and cancellations of certain phone models.

While AAC Technologies' credit quality will weaken in 2021, we expect it to recover over the next 12-18 months, with debt/EBITDA improving to about 2.4x, driven by revenue growth and better profitability.

We expect AAC Technologies' revenue to grow 11%-13% over the next 12-18 months compared with 2020, after it posted 10% revenue growth in the first six months of 2021 compared with the same period a year earlier. Its revenue growth will be supported by customers' new product launches, the company's rising share in the Android customer market, expansion into new end markets and the growth of its optics business.

AAC Technologies' EBITA margin will remain relatively stable at 13.0%-13.5% over the next 12-18 months from 13.9% in the 12 months ended 30 June 2021, as the company continues to implement stringent cost controls and improve operational efficiency.

AAC Technologies' liquidity is excellent. We expect its cash holdings of RMB7.8 billion as of 30 June 2021 and projected operating cash flow over the next 12 months to be sufficient to cover its short-term debt of RMB2.7 billion, capital spending and dividend payments over the same period.

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Motherson Sumi Systems' recent acquisitions will increase its business scope, a credit positive

Originally published on 12 October 2021

On 8 October, Motherson Sumi Systems Limited (Ba1 stable), an India-based global auto parts supplier, announced that it will acquire a 55% stake in CIM Tools Private Limited, a component manufacturer for the aerospace industry, for $21.5 million. Motherson also announced the acquisition of a 60% stake in Nanchang JMCG Mekra Lang Vehicle Mirror Co. Ltd. through its joint venture in China for around $5.2 million. The company will fund the two acquisitions using its large cash balance of $570 million as of June 2021. While the transactions are comparatively small, they increase Motherson's business scope by furthering its end-market diversification and cementing ties with its customers, a credit positive.

The CIM acquisition adds to Motherson's diversification strategy, which is aimed at reducing its exposure to the cyclical automotive industry by growing its non-auto business to 25% by 2025. While the acquisition will benefit Motherson's business plan, CIM's overall prospects are closely aligned with the recovery of global economies and the effect of subsequent coronavirus outbreaks on air travel and, hence, aircraft sales.

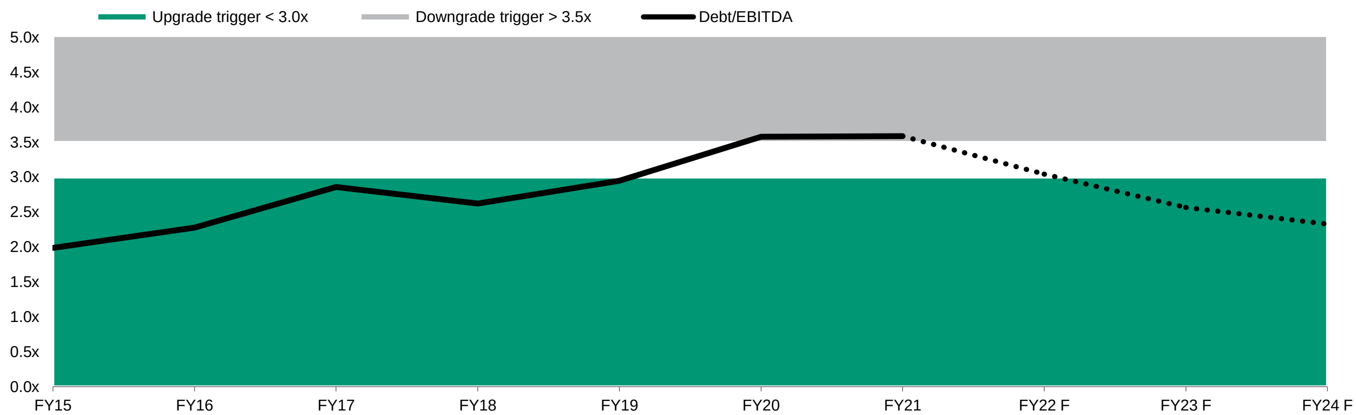
Bangalore-based CIM manufactures structural machine products, including parts for doors, wings, tails and fuselage of aircraft. It caters directly to aerospace original equipment manufacturers (OEMs) and top aerospace suppliers. While CIM's revenue declined to $17 million in fiscal 2021, which ended 31 March 2021, pre-pandemic revenue of $27 million in fiscal 2020 and a present order book of $200 million made it an attractive opportunity for Motherson. Moreover, gaining marquee customers such as Airbus SE (A2 negative) and The Boeing Company (Baa2 negative), along with CIM's 20% EBITDA margin (on a reported basis) are credit strengths for Motherson. The company's relatively less profitable existing operations generated an 8.4% EBITDA margin in fiscal 2021.

Nanchang JMCG, which has a manufacturing facility in Jiangxi province, produces mirrors for automotive OEMs in the passenger vehicle, pickup truck and light and heavy commercial vehicle segments in China. Its operations will complement Motherson's five existing China-based facilities, allowing Motherson to cater to the rearview mirror requirements of leading auto OEMs across China, the largest auto market globally.

However, a semiconductor chip shortage poses risks to our earlier forecast of 7% growth in global light vehicles sales in 2021. Light vehicle sales growth is being driven by solid demand as economies recover from the pandemic shock and consumers' preference for personal mobility vehicles over public transportation.

Motherson's consolidated credit metrics will continue to improve, with leverage – as measured by debt/EBITDA – steadily declining to less than 3x by March 2022 (see exhibit), supported by a 10% increase in revenue and profitability gradually returning to a pre-pandemic level of 10% EBITDA margin and 6% EBITA margin.

Motherson's leverage, as measured by debt/EBITDA, will continue to improve



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

Motherson's strong record of growth, both organic and inorganic, coupled with prudent financial discipline, is a mainstay of its Ba1 stable rating. Its success in integrating its 27 prior acquisitions support our expectation of the continued success of business synergies following the acquisition of these two companies.

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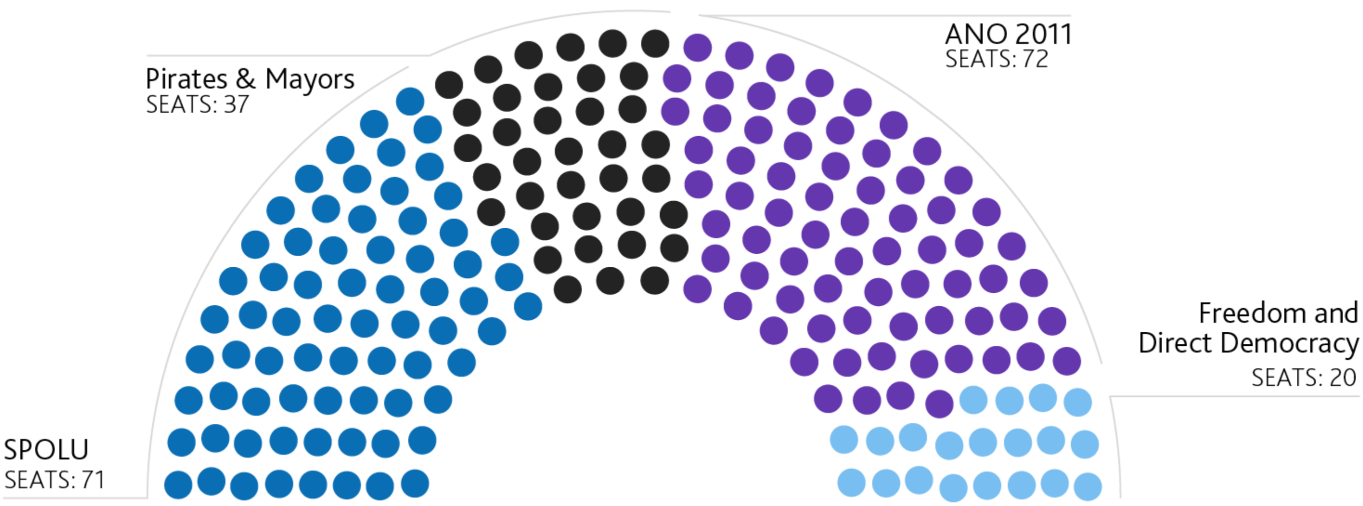
Opposition victory points to tighter fiscal stance and improved EU relations, a credit positive for Czech Republic

Originally published on 13 October 2021

On 10 October, elections in the Czech Republic (Aa3 stable) produced a clear parliamentary majority for the right-wing Together coalition (SPOLU) and the centre-liberal Pirates and Mayors (PirStan) coalition, beating Prime Minister Andrej Babiš' ruling ANO party. Although the government formation process could be protracted and complicated by President Miloš Zeman's admission to hospital on the day of the elections, we expect SPOLU and PirStan will ultimately form the next governing coalition, leading to a tighter fiscal stance and a likely improvement in relations with the European Union (EU, Aaa stable), a credit positive.

SPOLU and PirStan won a combined 108 out of 200 parliamentary seats. The result is a surprise and reflects a decline in support for ANO, as well as the failure of both the former communist and social democrat parties, which had respectively provided parliamentary support to and formed part of Babiš' coalition, to reach the minimum threshold of votes to remain in parliament.

The SPOLU and PirStan coalitions won 108 of the 200 seats in parliament
Distribution of seats in incoming parliament by party



Source: The Czech Statistical Office

We expect that a governing coalition led by Petr Fiala of SPOLU as prime minister would adopt a tighter fiscal stance than the outgoing government, notably amending the 5.9% deficit budget plan proposed by Babiš immediately before the elections. Considering that SPOLU has pledged to provide subsidies to small and medium-sized enterprises and to not raise taxes during its term, while enshrining the Fiscal Responsibility Law[1] in the constitution and lowering the headline deficit to 1.5% of GDP (PirStan advocates a reduction of 3.0%) by 2025, the amendments are likely to focus on cutting substantial increases in state employees' salaries and pensions in the outgoing government's budget. Our pre-election forecast projects a deficit of 5.4% of GDP in 2022 and a continued increase in debt to 45.5% of GDP by the end of 2022.

We also expect that the SPOLU and PirStan coalitions' relatively pro-EU stance would improve the Czech Republic's relations with Brussels. Tensions increased after OLAF, the EU's anti-fraud office, and the European Commission accused Babiš of conflicts of interest and misuse of EU funds in relation to funds disbursed to a company he founded. In addition, we expect that a SPOLU-PirStan coalition would refrain from the kind of open criticism of the Czech central bank that the Babiš government has recently leveled.

The process of forming a new government is complicated by the fact that Zeman, who will appoint the new prime minister to form a government, was taken into intensive care on the day of the elections. Zeman has also previously expressed an open dislike of the multiparty coalition structure of the opposition and stated that the single party that has won the most votes (in this case ANO) will get the first chance to form a new government. However, even if Babiš is given the first chance to do so, the election outcome means that his only way is through an unlikely coalition with either SPOLU or PirStan, or by joining forces with the far-right Freedom and Direct Democracy (SPD) while trying to win over at least nine MPs from either SPOLU or PirStan. While the government formation process could consequently be protracted, SPOLU and PirStan's clear combined parliamentary majority and stated commitment not to negotiate with other parties mean they will most likely emerge as the governing parties.

Endnotes

1 The Act on Fiscal Responsibility (2017) defines the fiscal rule based on the medium-term objective (MTO), which is a structural deficit of 1% of GDP.

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Iraq's election outcome dims prospects for faster reforms

Originally published on 13 October 2021

Preliminary results from Iraq's (Caa1 stable) general election on 10 October point to another fragmented parliament and a protracted period of coalition building and government formation. Established political parties have retained their dominance amid record low voter turnout, setting the stage for further policy paralysis and limited progress on structural reforms during the new parliament's term.

Higher global oil prices will bolster government revenue and significantly narrow the budget deficit this year and next, but momentum on reforms that would reduce the vulnerability of public finances to future oil price declines is likely to remain slow.

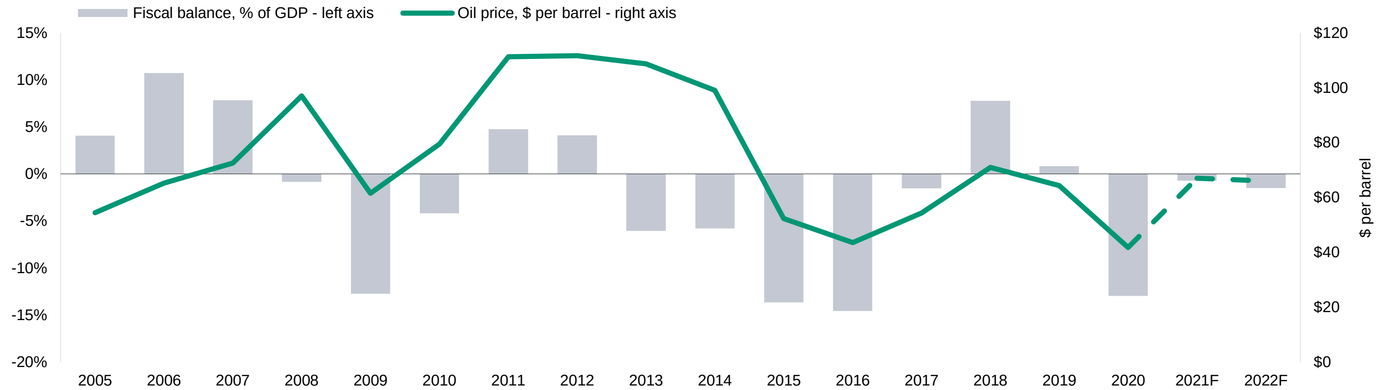
The election was moved forward by six months in response to widespread youth-led protests that began in 2019, prompting the collapse of the government at that time. The transitional government of Prime Minister Mustafa Al Kadhimi approved electoral law reform in a bid to soften the established political elites' dominance. The reform divided the country into smaller voting districts and allowed voters to choose their representatives at the local level rather than by voting for party lists. A United Nations election-monitoring mission and European Union observers were deployed to oversee this month's vote. However, established parties' supporters intimidated new parties and independent candidates, leading many to abstain from participating in the election. At 41%, voter turnout was the lowest for any election since 2003, continuing a decline in participation over the years (2018 was 44%; 2014 was 62%).

The new parliament remains fragmented. Preliminary results released by Iraq's Independent High Electoral Commission as of 12 October suggest that Muqtada Al Sadr's movement made the most gains, winning more than 70 of the 329 available seats. As in prior elections, the fractured Iraqi political system means that no single bloc has been able to garner sufficient votes to form a government by itself. Consequently, a protracted period of government formation is likely. The 2018 parliamentary election produced a functioning cabinet only after more than five months of political negotiations between the various factions.[1]

Whoever emerges as prime minister after this month's election is likely to lead a coalition bringing together many of the established parties, likely perpetuating Iraq's weak track record of appetite or ability to enact change. This will lead to very slow implementation of the White Paper structural reform proposals outlined in October 2020 that target improvements to public finance management, a reduced public sector wage bill and measures to develop the oil and gas industry. The time it takes to form a new government will also delay the start of potential negotiations with the International Monetary Fund on a new stand-by arrangement to support Iraq's fiscal policy adjustment and reforms.

Higher global oil prices, increases in oil production under the current Organization of Petroleum Exporting Countries Plus (OPEC+) agreement, and significantly lower government funding needs since the domestic debt restructuring of 2020 will also reduce the impetus to advance reforms.[2] With oil accounting for 91% of government revenue in the first half of this year, we expect the fiscal deficit will narrow significantly to an average of 1.1% of GDP in 2021-22, from 13% of GDP in 2020. A narrower deficit and higher nominal GDP will support a reduction in Iraq's debt burden to around 58% of GDP by the end of 2022 (from 86% of GDP in 2020). However, structural fiscal improvements that would reduce the public finances' vulnerability to future oil market fluctuations are unlikely given the balance of political power implied by the election result.

Government finances are very sensitive to fluctuations in oil prices
Fiscal balance and average Brent oil price



Sources: Haver Analytics and Moody's Investors Service

Endnotes

1 Parliamentary confidence in the cabinet was secured in October 2018, but eight of 22 ministries remained unfilled until the following year because no consensus was reached on the proposed candidates. A recount in 2018 added to the delay.

2 We forecast Brent to average $66/barrel in 2022, broadly in line with the average for 2021. Over the medium term, oil will remain within the range of $50-$70/barrel.

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Fiji's border reopening heralds start of tourism recovery, a credit positive

Originally published on 13 October 2021

On 10 October, Fiji's (B1 negative) Prime Minister Frank Bainimarama announced an end to quarantine requirements for vaccinated travelers from "green list" countries with high vaccination rates or low COVID-19 caseloads, starting on 11 November. Fiji Airways, the national carrier, will resume services from 1 December. The reopening of Fiji's borders is credit positive, because it will start the revival of its all-important tourism sector, following more than 18 months of tight restrictions and a sharp economic recession that we forecast to have deepened over 2021.

Fiji's borders have been heavily restricted since the onset of the coronavirus pandemic in March 2020. The tourism sector, which the World Travel and Tourism Council estimates directly or indirectly contributed to 32.0% of Fiji's GDP in 2019, essentially ceased to operate, with monthly visitor arrivals averaging less than 2% of 2019 levels from April 2020 to August 2021. This drove real GDP to shrink 15.7% in 2020, one of the largest contractions among the sovereigns we rate. Even factoring in the November reopening, the near total absence of tourists so far in 2021 has led us to forecast a further contraction in real GDP in 2021 of just over 1%.

The pandemic shock has also severely weakened Fiji's fiscal strength, with tourism-related activities contributing around 30% of total government revenue. We estimate the government's fiscal deficit widened to around 11% of GDP in fiscal year 2021 (which ended July 2021), from an average of 3.9% over the previous five years.

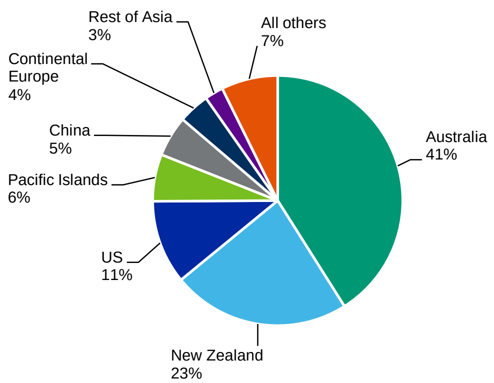
Sovereigns included in the 11 November reopening include Australia (Aaa stable), New Zealand (Aaa stable), the US (Aaa stable), UK (Aa3 stable), United Arab Emirates (Aa2 stable), Canada (Aaa stable), Qatar (Aa3 stable), Germany (Aaa stable), Spain (Baa1 stable), France (Aa2 stable), Korea (Aa2 stable), Singapore (Aaa stable), Switzerland (Aaa stable), Japan (A1 stable) and several Pacific Island countries and territories. Collectively these accounted for more than 80% of visitor arrivals in 2019 (see Exhibit 1). Critically, Australia, which accounted for more than 40% of visitor arrivals in 2019, will also be reopening its borders for vaccinated travelers in November, making it likely Fiji will see a small influx of tourists before the end of the year. Fiji Airways has scheduled flights throughout the Asia-Pacific region from 1 December, in time for school summer holidays in Australia and New Zealand.

Our baseline forecast is for visitor arrivals to jump in December 2021 to around 20% of pre-pandemic levels. From there, we expect the bulk of the recovery to take place over 2022, and for visitor arrivals to finally return to 2019 levels on a monthly basis by mid to late 2023 (see Exhibit 2). This, in turn, will drive robust real GDP growth of more than 16% in 2022 and 12% in 2023, before growth steadily returns to our long-run estimate of 3.5%.

Exhibit 1

The reopening includes all of Fiji's key sources of international visitors

Origin of international visitors, 2019, % of total

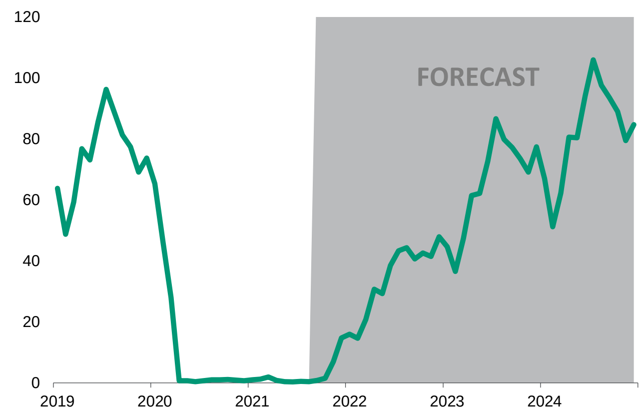


Sources: Reserve Bank of Fiji and Moody's Investors Service

Exhibit 2

We expect the bulk of the recovery of Fiji's tourism sector to occur over 2022 and 2023

Visitor arrivals, index, December 2019 = 100



Sources: Reserve Bank of Fiji and Moody's Investors Service

Key risks to the recovery largely pertain to developments related to the global coronavirus pandemic. In particular, New Zealand, the source of 23% of visitor arrivals in 2019, slightly lags its developed economy peer group in vaccination rates (50% as of 11 October) and has no immediate plans for quarantine-free travel. Our baseline forecast assumes that New Zealand will reopen in early 2022, however this most likely depends on a rapid increase in vaccination numbers, as well as the success of other countries in containing outbreaks following reopening. A sharp resurgence in cases following reopening in Fiji, or a key partner country such as Australia, that led to the reimposition of travel restrictions or hurt consumer confidence, would also weigh on the recovery of Fiji's tourism sector.

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China's power cuts add to stress on economic growth, certain sectors and supply chains

Originally published on 11 October 2021

China's electricity cuts and the resulting disruptions to production across industrial sectors are credit negative but will have limited effect on domestic economic growth and the companies we rate - if they are temporary. The costs will be borne unevenly across sectors, however.

Chinese authorities in some provinces have curtailed power in recent weeks to companies in energy-intensive sectors such as chemicals, steel, nonferrous metals, coal mining, cement and building materials. The curtailments reflect a power supply-demand imbalance driven by a variety of factors including economic recovery, high coal prices and the central government's carbon neutrality objectives.

Power demand has increased rapidly since summer, driven by economic recovery following last year's pandemic-driven disruptions. Supply has not kept pace, however, because of tight coal supply and a resulting rise in coal prices. Most of China's power plants run on coal, and most of that coal is mined domestically. The government's efforts to reduce carbon emissions have slowed coal production during the past few years. As a result of these factors, coal prices are at record highs. Without a clear cost pass-through mechanism in electricity tariffs, generators have little incentive to run. And the supply of renewable power is not enough to fill the gap.

China's economic growth was slowing before the disruptions for several reasons: the partial withdrawal of policy support as the impact of the pandemic has receded, broad regulatory tightening and the resulting uncertainty, and the financial distress of China Evergrande Group (Ca negative), one of China's largest property developers. Evergrande's troubles and the slowing property sales nationwide are likely to trim economic growth, given the property sector's large contribution to GDP and the possibility that real estate may not recover as strongly as in previous cycles. But the authorities do have fiscal and monetary headroom to respond.[1]

Electricity cuts will add to these stresses. These negative factors will weigh on GDP growth for 2022, reflected in the recent downward revision of our forecast. Power outages, along with supply chain disruptions and the slowdown of the property sector pose downside risks to our current growth forecasts.

We expect the power cuts and resulting production disruptions will be temporary. But if they continue for an extended period, such as in to winter, the effects will spread across the domestic - and potentially global - economy. More companies will need to disrupt production because of electricity or input shortages, or both. This has the potential to disrupt supply chains across Asia-Pacific given prevailing linkages, which will also increase prices along the chain. And some companies will pass higher power costs along to their customers, dampening consumer purchasing power.

Over the next year, supply chain disruptions and lower growth in China could further dampen prospects for the regional growth outlook in the context of an uneven recovery from the pandemic across countries thus far. Over the longer-term, constraints to stable power supply could exacerbate the impact of other pressures, such as geopolitics and labor supply and costs, in driving the restructuring of supply chains to diversify risks and lessen exposures to China.

We believe the Chinese government has policy tools to support the economy to ensure growth remains broadly in line with our forecasts (8.3% for 2021 and revision down to 5.5% for 2022), and the continued supply of essential goods and services. These tools include monetary and fiscal policies, subsidies to certain sectors such as power generators, tariff increases that allow power generators to pass costs along to their customers, and prioritizing power for essential goods and services.

Some sectors will need to bear at least some of the costs such as coal-fired power generators – to maintain a certain level of electricity supply even with high coal prices. For directly affected companies, we expect capacity utilization will remain below typical levels while the power restrictions are in place. The resulting strain on companies' financials resulting from reduced production and higher electricity costs will be offset by high commodity prices, which will likely decrease from their current high levels but remain elevated in the coming months. Companies will pass the high commodity prices and other price increases from supply disruptions along the supply chain. Companies that cannot pass along costs will see their profit margin squeezed.

Larger and financially stronger companies, including those we rate, will fare better operationally and financially than smaller and weaker companies. Any hit to their revenue and cash flow will be less pronounced given strengths such as scale, vertical integration, and geographic and business diversity. These companies also have more negotiating power with suppliers for payment terms, local governments for power use terms, and customers for passing along cost increases.

The electricity cuts reflect the Chinese government's continued effort to balance its policy objectives - environmental targets, economic growth and social stability – with other objectives. In particular, achieving environmental targets entails transition costs, given the time required to develop additional renewable energy capacity and reduce reliance on coal. Geopolitical tensions, such as with Australia, and the interconnectedness of the global supply chain complicate this balance.

The cuts will likely harden China's resolve to boost its supply of renewable power, nuclear power and power storage infrastructure, to reduce the country's reliance on coal power, especially for provinces that rely on coal which are mostly in northern China. The cuts will also focus the government's attention on effective electricity tariff reforms as the benchmark coal tariff adjustment mechanism currently lacks an effective cost pass-through for coal volatility. At the same time, the cuts signal that thermal power, which is more predictable than renewable power, will remain a core component of China's power mix for at least the next decade even as authorities seek to reduce carbon emissions.

Endnotes

1 See Credit Conditions – China: Government actions on Evergrande likely to avoid financial, social instability but not preclude economic costs, 27 September 2021.

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REPORT NUMBER 1306446

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