Credit Outlook

9 December 2021

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PEMEX’s liability management transactions will reduce debt and refinancing risk

Originally published on 07 December 2021

On 7 December, Petroleos Mexicanos (PEMEX, Ba3 negative) announced an offer to exchange existing notes due 2024-30 for new notes plus a cash payment, and an offer to tender a portion of notes due 2044-60. PEMEX’s liability management transactions are credit positive because they reduce debt and refinancing risk.

The transactions are not a distressed exchange because creditors are not experiencing any losses relative to the original promises embedded in the debt being exchanged.

As of September 2021, the company’s total debt was $113 billion. Funding for the proposed transactions will come from the government of Mexico (Baa1 negative) in the form of a $3.5 billion capital injection, plus about $1 billion in PEMEX’s new notes due 2032.

The government has been supporting PEMEX for several years and we assume this will remain the case in the next three years. By year end, the government will have supported PEMEX with more than $19 billion in tax reductions and capital injections for capital investments and debt payments in 2021. The government has said that it intends to continue supporting PEMEX’s debt payment obligations in 2022 and 2023.

The government's support will allow PEMEX to reduce its debt in 2021-23 by about $20 billion, which is equivalent to the long-term debt maturing in the period. However, we expect that PEMEX's cash flow generation and credit metrics will remain weak in the next three years as the company increases fuel production while grappling with limited capital investment ability, high debt maturities, and volatile oil and fuel prices.

Founded in 1938, PEMEX is Mexico's national oil company, with fully integrated operations in oil and gas exploration and production, refining, distribution, and retail marketing as well as petrochemicals. PEMEX is also a leading crude oil exporter, exporting around 60% of its crude to various countries, mainly to the US and Asia. In the nine months that ended 30 September 2021 the company produced an average of 1,745 thousand barrels of per day of crude oil (excluding partners' production).

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Saint-Gobain continues to strengthen construction chemicals business with acquisition

Originally published on 07 December 2021

On 6 December, French building materials company Compagnie de Saint-Gobain (SGB, Baa2 stable) announced the acquisition of GCP Applied Technologies Inc. (GCP, Ba3 stable), a US-based public company engaged in construction chemicals. The acquisition's enterprise value of $2.3 billion (around €2 billion) corresponds to a multiple of 16.3x reported EBITDA for the last 12 months (as published by SGB: 13.2x estimated 2022 EBITDA and 8.8x post run-rate synergies). SGB will fully finance the acquisition with cash and expects the deal to close by year-end 2022.

We expect the acquisition will have a manageable effect on SGB's credit metrics and support its business profile by positioning it more strongly in the fast-growing market for construction chemicals and increasing its presence in the attractive North American market, a credit positive.

The acquisition builds on SGB's efforts to become the global leader in construction chemicals following its €1 billion acquisition of France-based Chryso in May 2021. While Chryso will add around €0.4 billion in construction chemicals sales, GCP adds more than twice as much at €0.9 billion, bringing combined group sales together with the company's existing construction chemicals business (Weber) to more than €4 billion. With 56% of sales in North America, GCP also enhances the regional footprint of SGB's construction chemicals business, given that the group previously lacked a significant presence in the US.

We expect the market for construction chemicals to grow more rapidly than the global construction market - around 6-7% CAGR through 2025. Construction chemicals products and solutions will help decarbonise construction, a major trend and a key challenge for the industry, with concrete admixtures and cement additives helping to create low-carbon cement and concrete while improving the sector's cost effectiveness and productivity. GCP is a market leader in concrete admixtures in North America and a global leader in cement additives. We also expect this business to be more profitable than the rest of the group, ultimately improving SGB's margins.

Although we view GCP's valuation multiple as expensive, the acquisition has growth and synergetic potential for SGB. The company expects to realise $85 million in synergies by year five following the acquisition that would restrict the valuation multiple to 8.8x. Most will take the form of cost synergies ($72 million) that SGB expects to capture through eliminating GCP's public company costs, procurement/manufacturing/logistics cost optimisation and reduced SG&A costs. The company also expects the enlarged commercial platform, with cross-selling opportunities in multiple geographies, to drive further topline synergies.

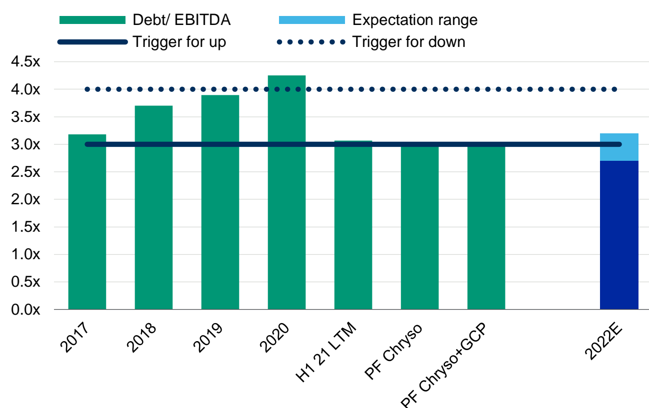
SGB had very strong liquidity at the end of 2020, with €8.4 billion in cash and cash equivalents. As a result, spending €3 billion in cash on the acquisitions (the Chryso acquisition was already closed in September 2021 and GCP is expected to be closed by the end of 2022), also considering ongoing positive free cash flow generation, does not present a challenge. We expect the acquisitions to add around 0.5x to the group's Moody's adjusted net leverage (Chryso +0.2x, GCP +0.3x) and that gross leverage will decline slightly (-0.1x) on a pro forma basis as of the first half of 2021, given the additional earnings of the acquired companies (Exhibit 1). The impact is limited because both acquisitions (€400 million Chryso sales and €900 million GCP sales) are relatively small compared with SGB's overall size (€42.5 billion in the last 12 months ended H1 2021).

SGB's gross leverage and retained cash flow/net debt metrics are both currently strong following the rapid earnings recovery that started in the second half of 2020 (Exhibits 1 and 2). However, the latter ratio may underestimate the group's creditworthiness compared with some peers, as retained cash flow only considers dividend distribution and does not take into account the €2 billion of share buybacks that SGB plans to implement by 2025.

Exhibit 1

We expect gross leverage to remain relatively low for the rating category despite the acquisitions

Moody's adjusted gross debt/EBITDA

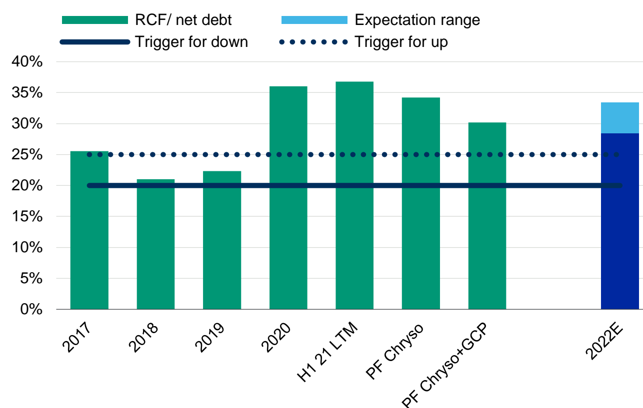


Source: Moody's Investors Service

Exhibit 2

RCF/net debt will also remain strong, but does not take account of €2 billion of share buybacks

Moody's adjusted retained cash flow/net debt



Source: Moody's Investors Service

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Weibo Corporation's Hong Kong secondary listing is credit positive

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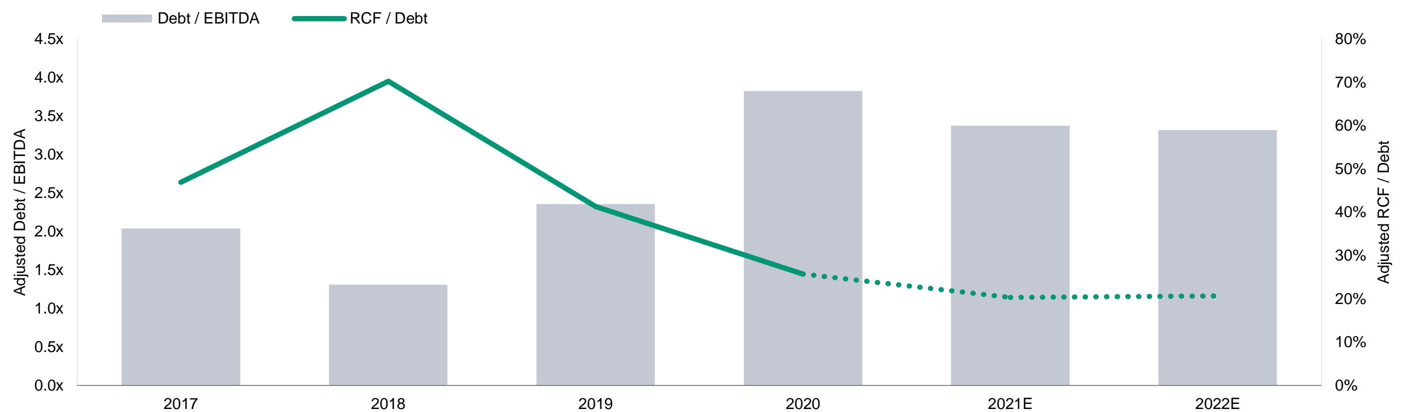
On 2 December, Weibo Corporation (Baa2 negative) announced the final pricing for its initial public offering on the Hong Kong Stock Exchange at HKD272.8 per share. Total proceeds amount to around $193 million and will be used for business expansion, product and services development and other general corporate purposes. The secondary listing is credit positive for Weibo because it enhances its equity capital base, adds a new funding channel and provides further buffers for potential capital requirements in the near to medium term.

In the two quarters ended 30 September, Weibo invested around $738 million of cash in new assets. We expect the company will need to incur further capital spending for the new assets it has started investing in. New funding from the secondary listing in Hong Kong SAR, China (Aa3 stable) provides Weibo with additional cash resources, which it can use to fund ongoing investments, reducing the need for debt.

The new funding channel also enhances Weibo's equity base and helps it prepare in the face of regulatory uncertainties both within and outside China (A1 stable). In China, the new funding provides additional buffers as the regulator tightens its scrutiny of internet platforms. Externally, the secondary listing provides Weibo with increased equity funding access apart from its listing in the US (Aaa stable).

Weibo's excellent liquidity will be further enhanced, with an estimated net cash position of around $500 million, once the transaction completes. The company had around $2.7 billion in cash and cash-like assets as of 30 September 2021. We expect Weibo's operating cash flow of $500-$550 million and cash on hand to adequately cover its short-term debt, planned capital spending and investments (see exhibit).

Weibo's leverage and cash flow coverage metrics



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

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Increased stevedore charges are credit positive for Zhejiang Port

Originally published on 06 December 2021

On 1 December, Ningbo Zhoushan Port Company Limited announced that it will raise stevedore charges by around 10% for handling both empty and laden container cargoes, effective 1 January 2022 (see Exhibit 1). The increase in stevedoring charges is credit positive for parent company Zhejiang Provincial Seaport Investment & Operation Group (Zhejiang Port, A1 stable) because it will improve its credit metrics, underpinned by higher revenue and profitability.

Exhibit 1
Comparison of stevedoring charges adjustment

RMB/unit	Before adjustment		After adjustment	
	Twenty-foot unit	Forty-foot unit	Twenty-foot unit	Forty-foot unit
Empty	429	643	472	707
Laden	490	751	539	826

Source: Company

The decision to raise the charges was prompted by increasing costs of production over the past few years, mainly driven by higher costs for labor and raw materials, and additional costs for coronavirus pandemic prevention and containment at ports. The gross profit margin of Zhejiang Port's cargo handling segment was around 38% in 2018-19, and declined slightly to 37% in 2020.

Stevedoring charges are part of the overall cargo handling charges by a port operator to shipping companies and are adjusted based on market demand and supply, competition and operating costs. In principle, the price increase does not require regulatory approvals.

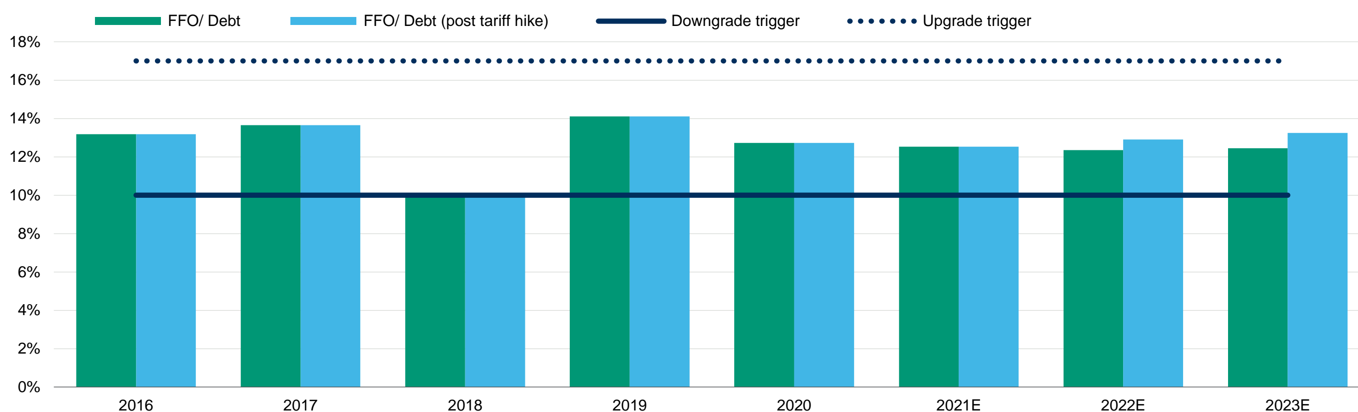
The higher charges will directly benefit Zhejiang Port's credit metrics because of Ningbo Zhoushan Port's large contribution to its overall revenue and cash flow. Ningbo Zhoushan Port is 75.26% owned by Zhejiang Port and accounted for 64% of its total reported assets, 72% of its revenue and 93% of its gross profit at the end of 2020.

We expect the tariff hike will increase Zhejiang Port's cargo handling segment revenue and overall gross profit margin, thereby improving its operating cash flow and credit metrics. We estimate that the gross profit margin of the company's cargo handling segment will rise to around 39%-40% over the next 12-18 months. Moreover, we expect the tariff hike will not result in a significant decline in the port's container throughput or reduce the competitiveness of Zhejiang Port because of high demand for Chinese exports amid lockdowns in other countries.

However, we do not expect the improvement in the company's credit metrics to be substantial as revenue and gross profit from the container handling segment accounted for around 15% and 29% of Zhejiang Port's total revenue and gross profit, respectively, in 2020. As Exhibit 2 shows, we expect Zhejiang Port's adjusted funds from operations (FFO)/debt will slightly improve to around 13% in 2022-23 from the previously projected 12.3%-12.5%, after the tariff hikes are implemented.

Exhibit 2

Comparison of FFO/debt with upgrade/downgrade triggers for Zheijang Port's Baseline Credit Assessment of baa1 before and after the tariff hikes



All ratios are based on "adjusted" financial data and incorporate Moody's Global Standard Adjustments for nonfinancial corporations.
Sources: Moody's Financial Metrics and Moody's Investors Service estimates

Additionally, we expect that shipping companies will be able to absorb the increased stevedoring charges because the container shipping industry is experiencing record levels of profitability amid surging demand. Shipping companies' profitability and credit strength have benefited from high freight rates, driven by high demand for shipping from China to other destinations and a shortage of container ships since the pandemic began.

Compared with some ports in China and other countries, the current stevedoring charges per container box at Ningbo Zhoushan Port are relatively low, even after considering the 10% increase. Certain ports in China could follow the tariff hike as they are facing similar challenges in respect of rising operational costs.

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Hungarian banks will benefit from higher interest rates

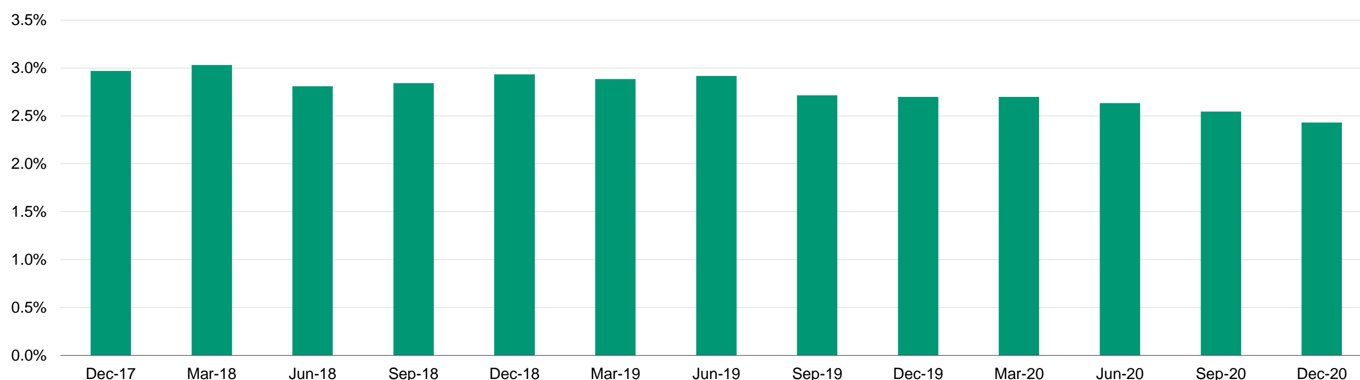
Originally published on 08 December 2021

On 2 December, Magyar Nemzeti Bank, Hungary's central bank, increased the interest rate on its one-week deposit facility 20 basis points to 3.1%. The increase followed the monetary council's decision two days earlier to make the interest rate corridor asymmetrical by raising the interest rate on the central bank's overnight deposit facility by 45 basis points to 1.60% and the interest rate on its overnight and one-week secured loan facility by 105 basis points to 4.10%. The move signaled to the market that it can expect further tightening as the central bank continues its efforts to contain strong inflationary pressures.

The interest rate increases are credit positive for Hungarian banks, whose large amounts of deposits with the central bank, investments in floating rate securities and variable rate loans will reprice imminently. We expect the banks' funding costs relating to the their large deposit base, will increase gradually and to a smaller extent, boosting their strong profitability.

The banks are mainly funded by domestic deposits, which funded around 81% of total assets as of June 2021. Most of these deposits are from domestic retail and corporate clients and are mainly unremunerated current account deposits. While we expect some movement to term deposits, which will increase banks' funding costs, the benefit from higher lending rates will outweigh this increase, benefiting banks' net interest income and net interest margins and boosting their strong profitability. The sector's net interest margin was 2.4% as of December 2020, down from 2.7% a year earlier (Exhibit 1), according to central bank data[1]. Banks' return on assets[2] was a strong 1.3% as of June 2021, up from 0.4% as of June 2020, mainly reflecting lower credit costs and high new business volumes.

Exhibit 1
Hungarian banks' net interest margin evolution

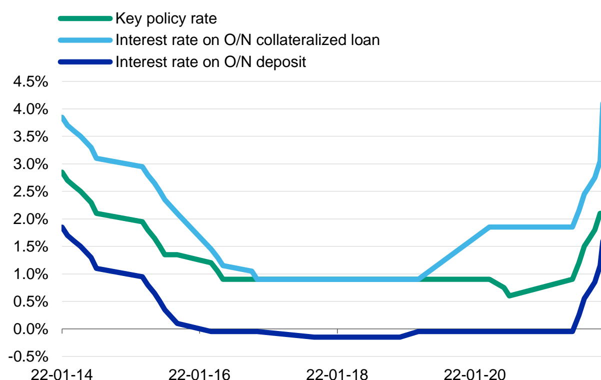


Source: Magyar Nemzeti Bank

Hungary's central bank was the first central bank among Central Eastern European countries to tighten its monetary policy as economic activity rebounded strongly following the coronavirus-induced downturn[3], doing so at its 23 June meeting. Since then, it has increased its key policy rate by 150 basis points to 2.1%, the highest level since July 2014 (Exhibit 2), as it aims to contain inflation, which surged to 6.5% in September 2021, well above its tolerance band of 3% plus or minus one percentage point (Exhibit 3).

Exhibit 2

Hungary's key policy rates have increased significantly...

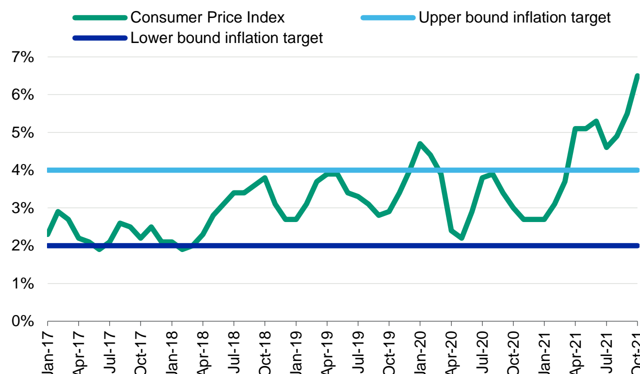


Source: Magyar Nemzeti Bank

Exhibit 3

...as the central bank tries to contain inflation

Consumer Price Index



Sources: Hungarian Statistics Agency and Magyar Nemzeti Bank

In addition to increasing the base rate at its 16 November monetary policy meeting, the central bank took a number of steps to reduce excess liquidity in the banking system, including ending the use of a swap facility providing forint (local currency) liquidity to banks and introducing a new limited, ad hoc and short-term central bank discount bond to absorb liquidity from the financial system.

In addition, the central bank has progressively tapered its quantitative easing plan. The monetary council further reduced the weekly target for the central bank's sovereign debt purchase programme to HUF40 billion (€110 million) from the HUF50 billion target set in August this year. For the week of 22-26 November, it bought HUF29 billion in government debt on the secondary market, below the weekly target and far below the peak levels of HUF90 billion. The central bank governor told a parliamentary hearing that the market should expect additional tapering.

The changing composition of Hungarian banks' loan books, with an increased exposure to fixed rate loans in recent years, reduces the benefit to their profitability from the interest rate hikes because these fixed rate assets will not reprice imminently. This increased allocation to fixed rate loans has mainly occurred over the last two years owing to a central bank campaign to promote fixed-rate mortgages and through lending to small and midsize enterprises via government schemes that include fixed-rates as part of their terms. However, the increased proportion of fixed rate loans also reduced the risk that asset quality would deteriorate owing to the sharp increase in interest rates.

Fixed-rate mortgages have been particularly prominent in the past two years following the central bank's 2019 campaign. As of September, the share of mortgage loans with a fixed rate lasting more than a year grew to 65% of total mortgages.

For most of the loans that will reprice imminently, the increased interest rate payment is affordable. According to the central bank, a 100-basis-point increase in interest rates will raise the monthly payment on around half the mortgages repricing within a year by an insignificant HUF1,500.

Endnotes

1 Consolidated data that include banks' foreign operations.

2 Annualised profit for 1H 2021 and 1H 2020.

3 GDP had already exceeded 2019 levels as of the second quarter of 2021.

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Allianz Life's fixed-index annuity reinsurance deal is credit negative

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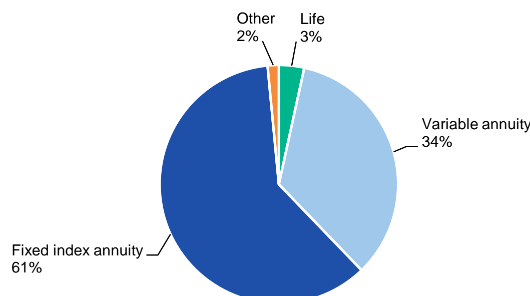
On 3 December, Allianz Life Insurance Co of North America (insurance financial strength A1 stable) announced that it is reinsuring $35 billion of fixed-index annuities (FIAs) to affiliates of Resolution Life Group Holdings Ltd and Talcott Resolution Life, Inc. (Ba3 positive). Allianz Life will free up around $4.1 billion and improve its return on equity by 6%, but the reinsurance agreement is credit negative because it removes a stable earnings stream and ultimately reduces the company's statutory capital because transaction proceeds will go to its parent, Allianz SE (Aa3 stable).

Bermuda-based Resolution Re Ltd. (insurance financial strength A3 stable) will acquire $26 billion of FIAs with $12 billion of the reinsured liabilities retroceded to an affiliate of Talcott. Separately, Talcott Resolution Life Insurance Company (insurance financial strength Baa3 positive) will reinsure $8 billion FIAs directly from Allianz Life.

The deal is Allianz Life's largest FIA reinsurance transaction and is in line with its parent's goal of unlocking value in its balance sheet via increased capital efficiency. The transaction, which the parties expect will close this year, should generate approximately $4.1 billion of deployable capital for Allianz Life through a ceding commission and the release of capital backing the business. We expect most of the freed resources will be paid as a dividend to parent Allianz SE. The reinsurance deal covers approximately 30% of Allianz Life's FIA reserves; the company will continue to write new FIA business. Allianz Life's distribution of insurance reserves are primarily in FIAs at year-end 2020 (see exhibit).

Allianz Life reserves led by FIAs
US statutory reserves at year-end 2020 (including general account and separate account)



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Allianz Life will maintain policy administration, in-force management, claims, and hedging for the block. Allianz SE asset management units PIMCO and Allianz Global Investors will manage investments for most of the assets using conservative investment guidelines and counterparty risk protections.

FIA writers are negatively affected by declining interest rates as more of the block hits the guaranteed minimum interest rate on the policies. Completion of the transaction will greatly reduce Allianz Life's exposure to FIA product risks and improve its prospective return on equity to the high double-digit range. However, the company will give up a stable stream of earnings of approximately $135 million. For Allianz SE, the reduction in future Allianz Life earnings will be mitigated by increased growth in asset management earnings, an area in which we expect Allianz SE to invest as it seeks capital optimization.

During its capital markets day, Allianz SE also announced targets for the upcoming strategic cycle for 2022-24. Allianz SE intends to further grow its earnings base, improve margins and optimize capital efficiency. In combination with the reinsurance transaction, we view these announcements as supportive of Allianz SE's credit profile.

This transaction is in line with other life insurers transferring risks from legacy exposures. A wave of mergers and acquisitions and divestitures is sweeping US life insurers as stakeholders pressure management teams to shed interest-rate sensitive businesses in a prolonged period of low interest rates, despite the recent rise in rates.

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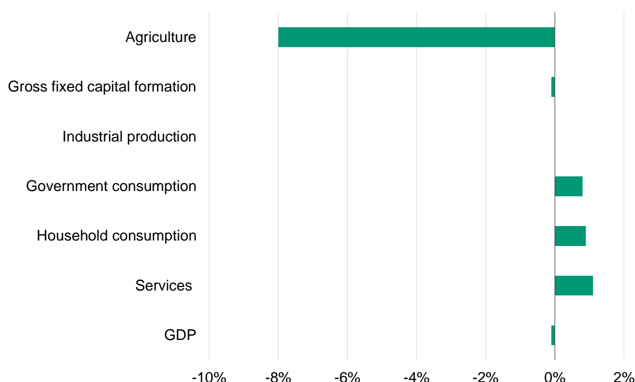
Brazil's second consecutive quarterly GDP contraction is credit negative, despite ongoing fiscal consolidation

On 2 December, Brazil's (Ba2 stable) Instituto Brasileiro de Geografia e Estatística (IBGE) announced that third-quarter GDP contracted 0.1%, after contracting 0.4% in the second quarter. The second consecutive quarterly contraction is credit negative, prompting us to revise our forecast for real GDP growth to 4.8% in 2021 from 5.2% and to 0.6% in 2022 from 2.1%. Still, fiscal consolidation efforts support Brazil's credit profile.

Agriculture contracted 8% on a quarterly basis, with coffee, cotton and corn leading the decline. But the services sector grew by 1.1% as household consumption increased 0.9% and government consumption increased 0.8% in the same period. Overally, industrial production stayed constant with construction sector growing by 3.9% on a quarterly basis while electricity, gas and sewage services dropped by 1.1% (Exhibit 1). Our revised GDP 2022 forecast (Exhibit 2) reflects our view that household and government consumption will drive growth. Brazil's high rate of vaccinations relative to other Latin American countries will support service sector activity next year as well.

Exhibit 1

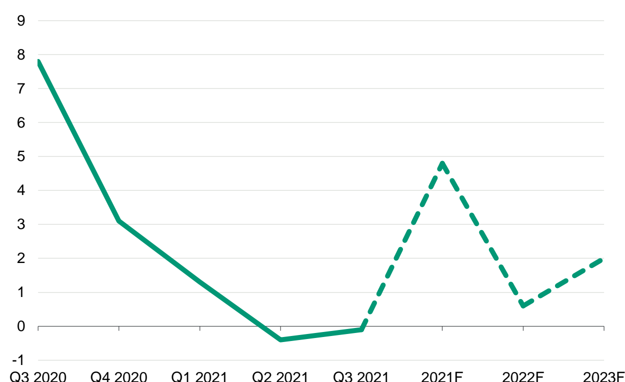
Agriculture drove the decline in the third quarter...
Quarterly change, seasonally adjusted



Sources: Instituto Brasileiro de Geografia e Estatística, Moody's Investors Service

Exhibit 2

... negatively affecting growth for 2022
%, period change



Forecast years are annual change
Sources: Instituto Brasileiro de Geografia e Estatística and Moody's Investors Service

We expect a strong rebound in revenue collection and a drop in pandemic-related spending will significantly reduce Brazil's fiscal deficit to 6% of GDP this year and next, from 13% in 2020, despite planned increases in social expenditure. At the same time, we expect Brazil's debt burden to remain around 85% of GDP in 2022 after peaking at almost 89% of GDP in 2020. However, weaker growth and still high inflation will weigh on private consumption and add downside risk to government revenue performance, which may weaken fiscal performance.

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CREDIT IN DEPTH

Latin American and Caribbean tourism will recover unevenly through 2024, but region offers solid business prospects

Originally published on 07 December 2021

- **Pent-up demand for tourism offers good prospects for Latin America and the Caribbean's travel-related sectors in 2022 and beyond.** Despite a lingering uneven recovery and the unknown implications of the Omicron variant, rekindled demand for travel to the broader region will persist through 2022, with infection rates in the region declining through November 2021 and vaccinations accelerating in large markets.
- **Positive business prospects will keep investment strong for lodging companies and cruise operators in the Latin America/ Caribbean region as capacity returns through 2024.**Playa Resorts Holding B.V.'s (Caa1 positive) emphasis on all-inclusive upscale coastal resorts in Mexico and the Caribbean places it ahead of the recovery, but competition in the region will stiffen from 2022 onward.
- **Growth is set to accelerate for airlines serving Latin America and the Caribbean in 2022.** Airlines have stepped up direct flights, with more routes connecting European cities with Latin American and Caribbean resort destinations; regional low-cost airlines will expand their market share. The vaccines' widening reach in Brazil supports low-cost carriers Azul SA (B3 stable) and Gol Linhas Aereas Inteligentes SA (B3 stable), though both will need to contend with cash needs to fund the recovery and payments deferred during the pandemic.
- **Air traffic is slowly recovering at Latin American and Caribbean airports, and will improve more quickly in countries without severe travel restrictions serving major tourist destinations.** With a few exceptions, traffic levels will not return to 2019 levels until 2023-24, however. The strength and speed of recovery will depend on the duration of travel restrictions, which may be extended or re-introduced from new coronavirus variants and influenced by vaccination rates.
- **The speed of recovery in Caribbean tourism will directly affect the pace of fiscal consolidation within the tourism-dependent parts of the region.** The Caribbean countries most vulnerable to slowdowns in tourism activity have especially high debt burdens and larger financing needs that increase their liquidity risk. Easing travel restrictions elsewhere, including Canada and the UK, will support a further acceleration in tourism through the winter months of early 2022.
- **Latin American banks' limited exposure to tourism will be manageable, and a consistent rebound would lower credit costs.** Tourism's recovery will reduce the risk of future problem loans and new provisioning needs, but a surge in infections would increase loan delinquencies and compel governments to extend support beyond 2022.

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- Enhanced multilateral support for St. Vincent and the Grenadines will mitigate volcano recovery costs
- Barbados' smooth transition to a parliamentary republic is credit positive

CREDIT IN DEPTH

- US consumer loans' strong asset quality starts to deteriorate modestly
- Deforestation intensifies reputational risk for companies operating in Brazil

MOODY'S MACRO MONDAY

- COVID-19 variants amid inflation pressures test US consumer resilience

Click here for last Monday's Credit Outlook.

Editors

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