FitchRatings

RATING ACTION COMMENTARY

Fitch Revises Deutsche Post's Outlook to Positive; Affirms IDR at 'BBB+'

Wed 27 Apr, 2022 - 1:21 PM ET

Fitch Ratings - Warsaw - 27 Apr 2022: Fitch Ratings has revised Deutsche Post AG's (DP) Outlook to Positive from Stable and affirmed its Long-Term Issuer Default Rating (IDR) and senior unsecured rating at 'BBB+'. A full list of rating actions is detailed below.

The Outlook revision follows DP's stronger-than-expected 2021 performance, which was driven by structural improvements in the main business segments. We thus expect the strong performance to be maintained over the rating horizon to 2024.

Assuming DP will perform as we expect, we may upgrade the rating to 'A-' from 'BBB+' if its financial policy supports leverage and coverage metrics as well as free cash flow (FCF) generation commensurate with the higher rating for the foreseeable future.

RATING ACTIONS

ENTITY / DEBT	RATING			PRIOR
Deutsche Post Finance B.V.				
senior unsecured	LT	BBB+	Affirmed	BBB+
Deutsche Post AG	LT IDR	BBB+ Rating Outlook Positive	Affirmed	BBB+ Rating Outlook Stable
	ST IDR	F2	Affirmed	F2
senior unsecured	LT	BBB+	Affirmed	BBB+

VIEW ADDITIONAL RATING DETAILS

KEY RATING DRIVERS

Strong Performance: DP reported record results in 2021, with reported EBIT up 65% yoy at EUR8 billion and all five business segments posting stronger profitability. The results were driven by a significant increase in global trade and continued strong e-commerce, with ongoing structural changes accelerated by the Covid-19 pandemic.

Express Segment Most Profitable: The express segment, DP's largest business unit by EBIT, continued to grow in 2021, fuelled by rising time-definite international (TDI) express shipments and an increase in average weight per shipment. Express has the highest EBIT margin among DP's segments at 17.4% in 2021 (up from 14.4% in 2020) compared with DP's total reported EBIT margin of 9.8% (up from 7.3% in 2020).

Solid Post & Parcel Profits: The segment comprising German parcel and mail incumbent operations increased its reported EBIT by 10% in 2021, while its EBIT margin of 10% was close to 2020 level. The growing parcel business continues to mitigate the impact of structurally declining conventional mail.

GFF Benefits from Stronger Environment: A tight supply-demand balance for ocean and air freight services driven by a recovery in global trade in 2021 and rigid supply led to high freight rates, particularly for ocean freight, and improved margins in DP's global forwarding, freight (GFF) division. The segment more than doubled its reported EBIT in 2021. However, we do not expect the record rates to be maintained in our rating case.

Hillebrand Strengthens Market Position: In March 2022, DP completed its acquisition of a 100% stake in ocean freight forwarding company J. F. Hillebrand Group AG at an equity value of EUR1.5 billion. This bolt-on acquisition has strengthened DP's position in the logistics of beverages, beer, wine and spirits, and non-alcoholic beverages and other bulk liquids.

Solid Results Expected to Continue: We expect DP's operating and financial results in 2022-2024 to remain solid as the company is well-positioned to benefit from growth in global trade and e-commerce, which is likely to continue, albeit at a slower rate than in 2021. Despite cuts to our global economic growth forecasts driven by higher energy prices and a faster pace of US interest-rate hikes, we expect the world and eurozone's growth to remain supportive.

Exogenous Risks: We do not expect DP's results to be substantially directly affected by Russia's invasion of Ukraine as the company's revenue in Ukraine, Russia and Belarus are less than 1% of total revenue. DP addresses inflation risk, including fuel price risk, through yield and contract management with fuel surcharges, although EBIT margin hit is possible should fuel prices hit record levels.

Increased Capex and Shareholder Distributions: Strong operating cash flows in 2021 allowed DP to increase capex and shareholder returns and still report improved credit metrics, which we expect to continue. A record gross capex of EUR3.9 billion in 2021 was mainly allocated to the express division's aircraft fleet modernisation and expansion of the domestic and international parcel infrastructure.

With expected strong cash flows in 2022-2024 DP plans to maintain a high level of capex in this period, totalling EUR12 billion. Part of the excess cash flow will be used for increased shareholder returns in the form of increased dividends (proposed EUR2.2 billion to be paid in 2022, up from EUR1.7 billion in 2021) and an up to EUR2 billion share buy-back programme for 2022-2024, which remains discretionary.

Solid Credit Metrics: Funds from operations (FFO) adjusted net leverage (excluding IFRS 16 impact and based on lease capitalisation) improved to 2x in 2021 from 2.5x in 2020. We forecast this ratio to average 2.2x in 2022-2024, which is within our positive sensitivity. FFO fixed charge coverage also improved to 4.5x in 2021 from 3.2x in 2020 and we project it to remain within positive sensitivity of above 3.5x by 2024. We expect positive Fitch-calculated FCF and a solid EBIT margin, further supporting the Positive Outlook.

Updated Finance Strategy: DP's financial policy is driven by a publicly stated target of maintaining a standalone rating of between 'BBB+' and 'A-', which was updated in January 2022 from the previous target of 'BBB+' rating.

DP has clear priorities regarding the use of available liquidity. It will first be allocated to fund business operations, finance organic investments and regular dividend payments of between 40% and 60% of net profit. Thereafter, additional dividend payments or share buybacks as well as inorganic growth may be considered. Further confidence in the updated policy may support an upgrade.

Balanced Business Profile: The ratings reflect DP's global scale, geographic and operational diversity, market leadership in the areas of its operation. DP has a balanced business risk profile between its high-growth express and parcel businesses, fuelled by ecommerce, and its contracted supply chain operations as well as the highly cyclical GFF segment and structural decline in conventional mail.

DERIVATION SUMMARY

DP has strong credit metrics compared with peers'. Its global scale of operations, leading market positions and operationally diversified business provide a competitive advantage versus peers such as FedEx Corp. and government-related operators La Poste (A+/Stable, Standalone Credit Profile (SCP) of bbb+) and Poste Italiane SpA.

La Poste's Long-Term IDR is two notches below the French state (AA/Negative), according to Fitch's top-down rating approach. If the sovereign IDR is downgraded, the SCP would be four notches away from the sovereign's and La Poste would be rated based on a top-down minus-one-notch approach instead of the current top-down minus-two-notch approach. This will leave La Poste's IDRs unchanged, which drives the Stable Outlook.

Poland-based InPost S.A. (BB/Stable) compared with DP has significantly smaller scale, a weak international presence and lack of service offering diversification resulting in a substantially lower debt capacity.

KEY ASSUMPTIONS

Fitch's Key Assumptions Within Our Rating Case for the Issuer:

- Post & parcel division to see steady decline in mail volumes and growth for parcel over 2022-2024

- Express segment's volumes to increase in 2022-2024, albeit at a slower rate than in 2021

- GFF division to see EBIT growth in 2022, fuelled by the Hillebrand acquisition, before a decline in 2023-2024 due to market normalisation

- Stable growth in the e-commerce solutions and supply chain segments

- Excluding IFRS 16 and capitalising lease expenses using the multiples for each asset class based on the useful lives of the assets

- Capex close to the company's assumptions at about EUR4.2 billion in 2022 and about EUR4 billion a year in 2023-2024

- Dividend pay-out ratio at 40%-60%, in line with the company's guidance

- Share buyback programme in line with company's guidance at about EUR2 billion in total across 2022-2024

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to positive rating action/upgrade:

- FFO adjusted net leverage below 2.5x and total adjusted net debt/EBITDAR below 2.3x on a sustained basis

- FFO fixed charge coverage above 3.5x and EBITDAR/(interest paid plus rents) above 4x on a sustained basis

- Positive Fitch-calculated FCF and Fitch-calculated EBIT margin above 7.5%

Factors that could, individually or collectively, lead to negative rating action/downgrade:

- Fitch does not anticipate a downgrade given the Positive Outlook on DP's IDR

- Failure to maintain FFO adjusted net leverage below 2.5x, total adjusted net debt/EBITDAR below 2.3x and FFO fixed charge coverage above 3.5x and EBITDAR/(interest paid plus rents) above 4x would lead to a revision of Outlook to Stable

- FFO adjusted net leverage above 3.5x and total adjusted net debt/EBITDAR above 3.3x on a sustained basis, together with significant deterioration in business fundamentals due to a protracted economic downturn or structural changes leading to significant volume and margin reduction and consistently negative FCF would lead to a downgrade

BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Non-Financial Corporate issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of four notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit https://www.fitchratings.com/site/re/10111579.

LIQUIDITY AND DEBT STRUCTURE

Solid Liquidity: DP has maintained solid liquidity. At end-2021, it had EUR1.6 billion of unrestricted cash and cash equivalents. This was complemented by a EUR2 billion committed and undrawn syndicated credit line (with 2025 maturity) and EUR3.1 billion of current financial assets, the majority of which are short-term investments. At end-2021 DP had short-term debt of EUR1.3 billion excluding lease liabilities of EUR2 billion. Its debt maturities in the following three years are evenly balanced.

In March 2022, the company closed the Hillebrand acquisition using about EUR1.5 billion from its own funds. We forecast DP to be FCF positive in 2022-2024.

ISSUER PROFILE

DP is a global logistics company, which operates two brands: Deutsche Post, which is Europe's leading postal service provider, and DHL, which offers a range of international express, freight transport and supply chain management services as well as e-commerce logistics solutions.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

ESG CONSIDERATIONS

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg

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APPLICABLE CRITERIA

Corporate Hybrids Treatment and Notching Criteria (pub. 12 Nov 2020)

Corporates Recovery Ratings and Instrument Ratings Criteria (pub. 09 Apr 2021) (including rating assumption sensitivity)

Corporate Rating Criteria (pub. 15 Oct 2021) (including rating assumption sensitivity)

APPLICABLE MODELS

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

Corporate Monitoring & Forecasting Model (COMFORT Model), v7.9.0 (1)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

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