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Fitch Upgrades Deutsche Post's IDR to 'A-'; Outlook Stable

Fitch Ratings - Warsaw - 24 Jul 2024: Fitch Ratings has upgraded Deutsche Post AG's (DP) Long-Term Issuer Default Rating (IDR) and senior unsecured rating to 'A-' from 'BBB+'. The Outlook on the IDR is Stable. A full list of rating actions is detailed below.

The IDR upgrade reflects our reassessment of the company's global market-leading businesses and a sustainable improvement in its financial profile, following a pandemic-driven demand surge as well as a well-managed volume slump of the last 18 months. The upgrade also reflects EBITDAR net leverage stabilising close to 2.5x despite market-driven weakness in 2023 and 1H24 and large capex and shareholder returns.

The Stable Outlook reflects our expectation of continued revenue growth across businesses, resumption of profit growth at two of the company's largest businesses - express and global freight, forwarding (GFF) - from 2025 and positive regulatory developments for postal services. This will support the company's capex and planned shareholder returns while maintaining credit metrics at close to current levels.

Key Rating Drivers

Solid Financial Profile: DP has improved its financial profile significantly from its pre-pandemic levels. This was driven by a structural shift of its revenue mix towards a higher share of its more profitable express, e-commerce and parcel businesses. Even in worsened market conditions in 2023, DP's Fitch-calculated EBIT of EUR5.3 billion sharply exceeded its pre-pandemic performance of EUR3.2 billion in 2019. This underscores structural growth in profits, driven by e-commerce trends and supported by active management of margin through pricing and cost optimisation.

Consolidated Scale; Diversified Business Model: The ratings reflect DP's global scale, geographic and operational diversification, and global market leadership in all areas of its operations. DP has a balanced business risk profile between its high-growth express and parcel businesses, fueled by e-commerce, its contracted supply-chain operations, and its highly cyclical GFF segment and structurally declining conventional mail. Over the last decade, its business model has substantially changed from a postal operator to a global logistics leader, which has led to various upward revisions of its debt capacity by us.

New Postal Law: In July 2024, new legislation for postal services allows application for price increases to accommodate salary increases and inflation from the last two years, which were not previously reflected due to regulatory constraints. Starting next year, the new Postal Act will affect, among other things, mail delivery, allowing longer mail delivery time, which will bring cost efficiencies. We expect this to enhance the profitability of the post & parcel segment in the next three years.

Stable Leverage: We anticipate EBITDAR net leverage to remain at 2.5x in 2024-2025, before it declines to 2.4x in 2026, supported by profit growth and positive free cash flow (FCF) generation from 2025. This is despite the company's current weaker financial performance due to a soft market, substantial capex averaging EUR3.5 billion annually in 2024-2026 and a large share buyback programme (EUR3.0 billion in 2022-2024), which was extended by another EUR1 billion until end-2025. While leverage may decrease with normalisation in freight markets and volumes, we believe DP will prioritise shareholder returns over deleveraging.

2023 Results Close to Expectations: DP's Fitch-calculated EBIT fell in 2023 to EUR5.3 billion (about 30% down from record level in 2022). It was largely driven by a decline in B2B volumes due to a slowdown in industrial production and an excess of inventories. This led to a normalisation of freight rates from record highs and a realignment of transport capacities and supply to meet demand. DP reacted with cost optimisation and by adapting its fleet capacity in its express segment to demand, as well as through capex flexibility. As a result, FCF was positive and EBITDAR net leverage stood at 2.3x at end-2023.

Recovery in Volumes after Delay: B2B volumes have continued to face challenges, which are mostly affecting its express segment while GFF has returned to growth, albeit from a weaker base. We anticipate slight improvements in 2H24 and continued growth in 2025-2026, taking Fitch-calculated EBIT in 2024 to EUR5.2 billion and EUR6.4 billion by 2026. In addition to volume growth, we expect moderate margin expansion during 2024-2026, driven by low-to-mid single-digit price increases and higher network utilisation.

Supply-Chain Division Resilient: DP's supply-chain segment continues to grow, driven by new contract wins and loyal existing customers. The growing complexity of supply chains, accelerated by multiple- source points of key products for customers and development of e-commerce, drives demand for DP's services. The segment's EBIT increased in 2023 and 1Q24, which has proved resilience in a volatile macroeconomic environment. We expect its EBIT to continue to modestly grow over 2024-2026.

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., InPost S.A. (BB/Positive), SGL Group ApS (B/Stable), GXO Logistics, Inc. (BBB/Negative) and government-related operators La Poste (A+/Stable; Standalone Credit Profile (SCP) of bbb+).

La Poste is a mail operator in France. Fitch views La Poste as a government-related entity of the French state and rates the entity one notch below France (AA-/Stable).

GXO is one of the leading providers of contract logistics globally. Relative to DP, which has large operations outside contract logistics, GXO is considerably smaller, generates lower margins and is less diversified operationally.

SGL is an asset-light freight forwarder and logistics provider with a global footprint, particularly active in the Nordics and North America. It is less diversified in operations than DP and is smaller in size, which constraints its debt capacity.

Polish-based InPost operates on higher EBITDA margins than DP. It also has a significantly smaller scale, a weak international presence and lack of product diversification, resulting in a substantially lower debt capacity.

Key Assumptions

- Post & Parcel division to see steady decline in mail volumes but increasing parcel volumes in 2024-2026

- The express segment's volumes to remain broadly flat in 2024 and then to increase in 2025-2026

- GFF's EBIT flat to lower in 2024 and then to increase in 2025-2026

- Stable growth in the supply-chain segment in 2024-2026

- Decrease in EBIT of its e-commerce segment in 2024, followed by modest increases in 2025-2026

- Total capex at EUR10.4 billion in 2024-2026

- Dividend payout ratio at 40%-60%, in line with DP's guidance

- Share buyback in line with DP's guidance at a total EUR2.0 billion across 2024-2025

RATING SENSITIVITIES

Factors That Could, Individually or Collectively, Lead to Positive Rating Action/Upgrade

- Total adjusted net debt/EBITDAR below 1.7x on a sustained basis

- Positive Fitch-calculated FCF on a sustained basis

- Structural improvement of profitability, leading to Fitch-calculated EBIT margin above 8% on a sustained basis

Factors That Could, Individually or Collectively, Lead to Negative Rating Action/Downgrade

- Total adjusted net debt/EBITDAR above 2.7x (previously 2.5x) on a sustained basis

- Significant deterioration in business fundamentals due to a protracted economic downturn or structural changes leading to significant volume decrease and consistently negative FCF

- Fitch-calculated EBIT margin below 6% on a sustained basis

- EBITDAR/(interest paid plus rents) below 3.3x on a sustained basis

Liquidity and Debt Structure

Strong Liquidity: DP has maintained solid liquidity. At end-2023, it had EUR2.1 billion of unrestricted cash and cash equivalents. This was complemented by a EUR2 billion committed and undrawn syndicated credit line and EUR0.4 billion of current financial assets, the majority of which are short-term investments. In 1Q24 its syndicated credit facility was increased to EUR4 billion, with a maturity in 2029.

At end-2023 DP had short-term debt of EUR2.1 billion, excluding lease liabilities of EUR2.3 billion. We expect enough liquidity to cover negative FCF after acquisitions and divestitures of EUR654 million in 2024 and we anticipate positive FCF after acquisitions and divestitures from 2025. Debt maturities in the following three years are evenly balanced.

Issuer Profile

DP is a global logistics company, which operates two brands. DHL offers a range of parcel and international express services, freight transport and supply chain management services as well as e-commerce logistics solutions.

Summary of Financial Adjustments

Lease debt is calculated by capitalising lease expense at a 6.4x multiple.

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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

The highest level of ESG credit relevance is a score of '3', unless otherwise disclosed in this section. A score of '3' 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. Fitch's ESG Relevance Scores are not inputs in the rating process; they are an observation on the relevance and materiality of ESG factors in the rating decision. For more information on Fitch's ESG Relevance Scores, visit https://www.fitchratings.com/topics/esg/products#esg-relevance-scores.

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Rating Actions

ENTITY/DEBT	RATING			RECOVERY	PRIOR
Deutsche Post AG	LT IDR	A-	Upgrade		BBB+
	ST IDR	F2	Affirmed		F2
• senior unsecured	LT	A-	Upgrade		BBB+

RATINGS KEY	OUTLOOK	WATCH
POSITIVE		
NEGATIVE		
EVOLVING		
STABLE		

Applicable Criteria

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

Corporate Rating Criteria (pub.03 Nov 2023) (including rating assumption sensitivity)

Corporates Recovery Ratings and Instrument Ratings Criteria (pub.13 Oct 2023) (including rating assumption sensitivity)

Sector Navigators – Addendum to the Corporate Rating Criteria (pub.21 Jun 2024)

Applicable Models

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

Corporate Monitoring & Forecasting Model (COMFORT Model), v8.1.0 (1)

Additional Disclosures

Solicitation Status

Endorsement Status

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