

Corporate Outlook 2019/Postal Services: Robust operating profits but growing price pressure in booming e-commerce

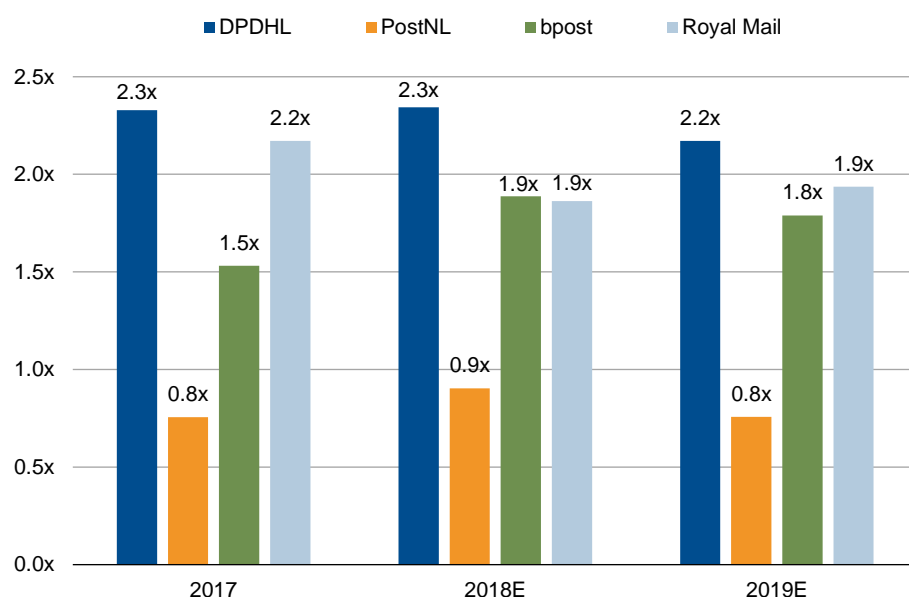


Scope
Ratings

Scope's credit outlook for the postal services and road logistics sector remains stable for 2019. The sector's robust credit quality proved steady throughout 2018 with low average leverage.

Based on the Scope-adjusted debt/EBITDA multiples of major European postal services sector peers, we expect low operating leverage to continue and see further room for de-leveraging for some players.

Figure 1: Scope-adjusted debt/EBITDA leverage of selected European firms



Source: Scope, company reports

Letters – volume and price developments

The trend of shrinking letter mail volumes throughout the European postal sector, caused by the substitution of letters by e-mail and other electronic communication over the last 10 years, accelerated in major markets in 2018. In 2014 to 2016 the average annual letter mail volume decline had stabilised at around 5%. In 2017 this number decreased to 4%-4.5%, fuelling hopes that the secular decline of the industry had begun to 'bottom out'.

However, the most recent volume data from major European postal services providers (1H/ 9M 2018 numbers) point to a slight re-acceleration of the decline in mail volumes. Better news for operators comes in the form of postal rate increases implemented during 2018. All in all, declining volumes may be offset by increasing efficiency and higher postage rates to yield stable operating profit contributions for the classic letter mail business at fairly low, but stable, margins.

Analyst

Denis Kuhn
+49 69 6677389 83
d.kuhn@scoperatings.com

Media

André Fischer
+49 30 27891 147
a.fischer@scopegroup.com

Scope Ratings GmbH

Neue Mainzer Straße 66-68
60311 Frankfurt am Main
Tel. +49 69 6677389 0

Headquarters

Lennéstraße 5
10785 Berlin
Phone +49 30 27891 0
Fax +49 30 27891 100
info@scoperatings.com
www.scoperatings.com



Bloomberg: SCOP

Increasing pricing power of large online retailers

Insourcing trend for delivery operations at large e-tailers

Selective acquisitions of innovative e-commerce players

Capex needs due to digitisation

Parcels – surging e-commerce increases both volumes and competition

E-commerce is booming. As of 2017, 10% of global retail sales were already being made online. This has led to a steep volume growth in parcels for the parcel delivery and postal operators. In total, the global parcel volume has doubled over the past decade. Nevertheless, at roughly 8%-10%, parcel volume growth in Western Europe in recent years has been lagging the soaring growth of e-commerce turnover, which has been approx. 20% p.a. on average over the past decade. This is due to several reasons: first, the average price per item sold online has increased. Second, many lightweight items are being sent as (oversize) letters and are therefore not included in the parcel statistics. But the third and probably most important factor is the growing competition, both among parcel delivery providers on a local, regional and global scale and from e-commerce companies investing in last-mile delivery infrastructure and click-and-collect delivery models. Examples include Amazon.com investing in its own delivery services or recent moves by food retailers to establish a proprietary delivery fleet.

In addition, the growing scale of the top e-commerce players like Amazon or Zalando SE has increased their bargaining power over the parcel-delivery operators. The overall boom in the parcel industry is also very likely to further boost staff costs throughout the industry, as evidenced by recent strikes and wage negotiations in several European countries.

These are the main factors limiting operating profits in the parcel segment. We nevertheless see this segment as the most important for large players because of its large growth potential and margins which are still much higher than in the classic USO/letter-mail business.

We regard substantial investments in existing and additional infrastructure as necessary to gain and maintain a leading market position. This trend has already been visible in recent years via increased capex levels as well as numerous acquisitions of mostly smaller, innovative players in parcel delivery and e-commerce solutions by leading postal services players in Europe.

Summary

Robust margin development and ongoing investments in digitisation expected

We expect the main trends of declining mail volumes and stable operating profits in this segment to continue throughout 2019. In the parcels segment, we similarly see further volume increases and slightly higher cash profits.

Significant investment in automation and digitisation remains key for European operators to maintain leading market positions in the years ahead. Selective acquisitions of smaller, innovative e-commerce and logistics companies by the big players are also set to continue in our view.

The overall financial situation of the major European postal services players remains robust. The main positive business driver is still the boom in e-commerce, though capturing the full benefit of the shift to online retailing requires shrewd positioning and significant investment. Factors weighing on the cash flow situation within the sector remain the structural decline in the letter mail business, fiercer price competition in the parcel segment and continued capital expenditure needed to defend market share, particularly in e-commerce driven business.



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Scope Ratings GmbH

Headquarters Berlin

Lennéstraße 5
D-10785 Berlin

Phone +49 30 27891 0

London

Suite 301
2 Angel Square
London EC1V 1NY

Phone +44 203-457 0 4444

Oslo

Haakon VII's gate 6
N-0161 Oslo

Phone +47 21 62 31 42

Frankfurt am Main

Neue Mainzer Straße 66-68
D-60311 Frankfurt am Main

Phone +49 69 66 77 389 0

Madrid

Paseo de la Castellana 95
Edificio Torre Europa
E-28046 Madrid

Phone +34 914 186 973

Paris

1 Cour du Havre
F-75008 Paris

Phone +33 1 8288 5557

Milan

Via Paleocapa 7
IT-20121 Milan

Phone +39 02 30315 814

info@scoperatings.com
www.scoperatings.com

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Scope Ratings GmbH, Lennéstraße 5, 10785 Berlin, District Court for Berlin (Charlottenburg) HRB 192993 B, Managing Director: Torsten Hinrichs.