DFDS A/S
Kingdom of Denmark, Transportation/Logistics

SCOPE BBB- STABLE

Key metrics

			Scope estimates	
Scope credit ratios	**2021**	**2022**	**2023E**	**2024E**
Scope-adjusted EBITDA interest cover	12.3x	14.7x	7.1x	6.4x
Scope-adjusted debt/EBITDA	4.0x	2.9x	3.0x	2.8x
Scope-adjusted funds from operations/debt	22%	31%	28%	29%
Scope-adjusted free operating cash flow/debt	7%	6%	10%	8%

Rating rationale

The rating is driven by DFDS' good business risk profile of BBB, which reflects its diversified and profitable business model within European ferry and logistics operations. The business risk profile is backed by leading market shares on routes in the North Sea and the Mediterranean/Turkey. After a recovery in operating performance during 2022, the company has deleveraged during the past 12 months and the Scope-adjusted debt/EBITDA ratio is around 3.0x currently. This was a prerequisite for the unchanged financial risk profile of BB+. We expect the company to maintain a financial leverage of around 2.5x-3.0x as measured by the Scope-adjusted debt/EBITDA ratio, over the next years. But we note that temporary leverage spikes above this range could occur in connection with large investments.

Outlook and rating-change drivers

The Stable Outlook incorporates our expectation that the company will show financial leverage of around 3.0x or below, while maintaining its market leadership in its North Sea and the Mediterranean/Turkey routes and expanding its logistics presence. In addition, the Outlook reflects our assumption that DFDS will maintain and follow its financial policy, including its leverage target of 2.0x-3.0x over a business cycle, a moderate dividend payout policy, and that it will keep adequate liquidity, notably through cash and committed loan facilities.

A positive rating action could be warranted if the Scope-adjusted debt/EBITDA ratio was sustained at significantly below 2.5x. This would likely require a more conservative financial policy with respect to growth ambitions and shareholder returns.

A negative rating action could be triggered if the Scope-adjusted debt/EBITDA ratio was sustained at 3.5x or above, particularly due to a more aggressive financial policy prioritising shareholder returns and/or growth capex and M&A. It could potentially also be triggered by external factors such as a worse-than-expected slowing of the global economic environment.

Rating history

Date	Rating action/monitoring review	Issuer rating & Outlook
6 Sep 2023	Affirmation	BBB-/Stable
30 Aug 2022	New rating	BBB-/Stable

Ratings & Outlook

Issuer	BBB-/Stable
Short-term debt	S-2
Senior unsecured debt	BBB-

Analysts

Per Haakestad
+47 92 29 78 11
p.haakestad@scoperatings.com

Related Methodologies

General Corporate Rating Methodology; July 2022

Scope Ratings GmbH

Karenlyst allé 53
N-0279 Oslo

Phone +47 21 09 38 35

Headquarters

Lennéstraße 5
10785 Berlin

Phone +49 30 27891 0
Fax +49 30 27891 100

info@scoperatings.com
www.scoperatings.com

Bloomberg: RESP SCOP

Rating and rating-change drivers

Positive rating drivers	Negative rating drivers
• In the Ferry division, strong/leading market positions in Northern Europe and Turkey • Diversification in customer segments (i.e. freight and passenger) and geographies • Logistics division provides growth and complementary or cross-selling opportunities to the Ferry division and its established routes • Low cyclicality of passenger business • Expected to have capacity to deleverage, leading to flexibility in financial planning	• Growth depends on M&A, entailing some execution risk • Active M&A strategy could result in temporary spikes in leverage to above the company's stated target range of 2.0x-3.0x over the business cycle • High capital expenditure inherent in the upkeep of business model and assets • Freight business linked to macroeconomic environment and potential slowdowns

Positive rating-change drivers	Negative rating-change drivers
• Scope-adjusted debt/EBITDA ratio sustained at significantly below 2.5x, in connection with a more conservative financial policy regarding shareholder returns, M&A and capex	• Scope-adjusted debt/EBITDA ratio sustained at 3.5x or above, particularly due to more aggressive financial policy prioritising shareholder returns and/or M&A

Corporate profile

DFDS operates specialised transport corridors combining ferry infrastructure (including port terminals and rail connections) and logistics solutions (including door-to-door full and partial loads for dry cargo, cold chain and contract logistics for selected industries). Passenger ferries are also offered in transport corridors. The company has about 12,800 full-time equivalent employees in 21 countries. DFDS generated revenues of DKK 26.9bn (approximately EUR 3.6bn) in 2022.

Financial overview

				Scope estimates		
Scope credit ratios	**2020**	**2021**	**2022**	**2023E**	**2024E**	**2025E**
Scope-adjusted EBITDA/interest cover	9.9x	12.3x	14.7x	7.1x	6.4x	7.5x
Scope-adjusted debt/EBITDA	4.3x	4.0x	2.9x	3.0x	2.8x	2.6x
Scope-adjusted funds from operations/debt	20%	22%	31%	28%	29%	32%
Scope-adjusted free operating cash flow/debt	4%	7%	6%	10%	8%	11%
Liquidity	Adequate	Adequate	Adequate	Adequate	Adequate	Adequate
Scope-adjusted EBITDA in DKK m						
EBITDA	2,730	3,411	4,954	4,965	5,260	5,640
Other items	-	-	-	-	-	-
Scope-adjusted EBITDA	**2,730**	**3,411**	**4,954**	**4,965**	**5,260**	**5,640**
Funds from operations in DKK m						
Scope-adjusted EBITDA	2,730	3,411	4,954	4,965	5,260	5,640
less: (net) cash interest paid	(273)	(276)	(338)	(701)	(825)	(748)
less: cash tax paid per cash flow statement	3	(52)	(109)	(125)	(131)	(159)
less: pension interest	(2)	(2)	1	1	1	1
Other items	(107)	(20)	(33)	-	-	-
Funds from operations (FFO)	**2,351**	**3,061**	**4,475**	**4,140**	**4,304**	**4,733**
Free operating cash flow in DKK m						
Scope-adjusted FFO	2,351	3,061	4,475	4,140	4,304	4,733
Change in working capital	148	148	6	-	-	-
less: capital expenditure (net)	(1,458)	(1,465)	(2,709)	(1,600)	(2,000)	(2,100)
less: operating lease payments	(602)	(834)	(963)	(1,050)	(1,050)	(1,100)
Free operating cash flow (FOCF)	**439**	**910**	**809**	**1,490**	**1,254**	**1,533**
Net cash interest paid in DKK m						
Interest paid per cash flow statement	276	302	388	741	868	790
Interest received per cash flow statement	(3)	(26)	(50)	(40)	(43)	(42)
Interest expense, pensions	2	2	(1)	(1)	(1)	(1)
Net cash interest paid	**275**	**278**	**337**	**700**	**824**	**747**
Scope-adjusted debt in DKK m						
Reported gross financial debt	12,654	14,337	15,535	15,686	15,896	15,703
less: cash and cash equivalents	(1,261)	(902)	(1,189)	(1,043)	(1,156)	(1,146)
add: non-accessible cash	147	167	175	-	-	-
add: pension adjustment	88	14	32	32	32	32
Scope-adjusted debt	**11,628**	**13,616**	**14,553**	**14,675**	**14,772**	**14,590**

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Environmental, social and governance (ESG) profile[1]

Environment		Social		Governance	
Resource management (e.g. raw materials consumption, carbon emissions, fuel efficiency)		Labour management		Management and supervision (supervisory boards and key person risk)	Grey leaf
Efficiencies (e.g. in production)		Health and safety (e.g. staff and customers)		Clarity and transparency (clarity, quality and timeliness of financial disclosures, ability to communicate)	Grey leaf
Product innovation (e.g. transition costs, substitution of products and services, green buildings, clean technology, renewables)		Clients and supply chain (geographical/product diversification)		Corporate structure (complexity)	Grey leaf
Physical risks (e.g. business/asset vulnerability, diversification)		Regulatory and reputational risks		Stakeholder management (shareholder payouts and respect for creditor interests)	Grey leaf

Legend

Green leaf (ESG factor: credit positive)
Red leaf (ESG factor: credit negative)
Grey leaf (ESG factor: credit neutral)

We are not aware of any substandard behaviour or lack of transparency with regard to environmental, social and governance areas in DFDS' ESG strategy. We highlight the company's clear policies regarding the reduction of carbon emissions as well as its demonstrated willingness and ability to invest in green technology, e.g. via more fuel-efficient vessels and non-fossil fuel sources such as methanol, ammonia and hydrogen, as well as battery power for shorter routes. Its financial policy includes guidance on its dividend policy, capital structure and rating commitment. Transparency on financial and other disclosures is high.

[1] These evaluations are not mutually exclusive or exhaustive as ESG factors may overlap and evolve over time. We only consider ESG factors that are credit-relevant, i.e. those that have a discernible, material impact on the rated entity's cash flow and, by extension, its credit quality.

Business risk profile: BBB

Ferry business benefits from medium-to-high entry barriers

The blended industry risk profile for DFDS is based on EBITDA contribution. It is mainly driven by the medium-to-high entry barriers of ferry operations while being constrained by low entry barriers in some of its logistics segments.

Strong market shares on ferry routes in North Sea and Turkey

Our overall assessment of DFDS's competitive position is driven by its strong and proven position in freight ferry, where achieving high capacity and utilisation depends to a larger extent on individual routes and regions, not necessarily across all parts of Europe. The company is a market leader in the North Sea and Turkey with a capacity share of over 75% on a number of routes. Passenger transport also tends to be quite stable and not correlated with economic cycles, which helps stabilise some volatility in freight.

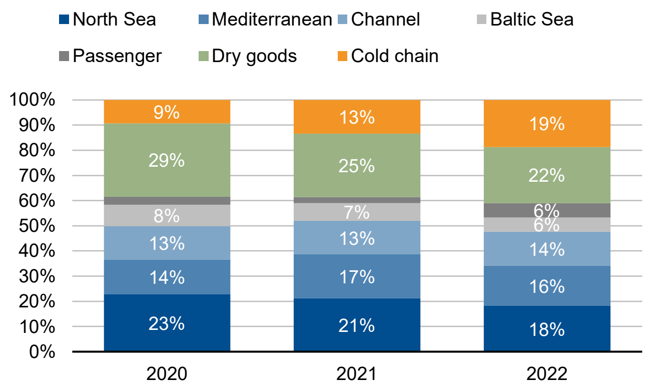
Logistics market is fragmented with low entry barriers

Global markets for freight logistics and supply chain logistics have a much lower concentration than regional and sector-specific markets. Barriers to entry can also be lower in logistics as there is relatively little regulation in place (e.g. there is no universal service obligation). Nevertheless, DFDS has established several strong regional market positions despite the fragmented market by focusing on specific sectors, such as automotive and cold chain (e.g. meat, seafood and dairy products). In addition, the logistics division provides growth and complementary services to the ferry division and its established routes, resulting in cross-selling opportunities.

Diversified business model

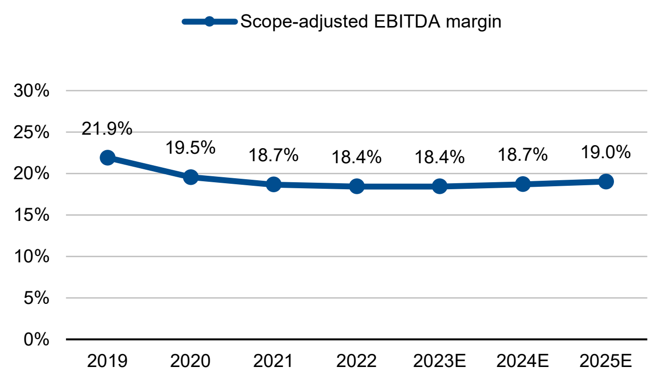
DFDS' business model benefits from diversification in terms of geographical outreach, end customers and business segments. It has an established footprint across routes in several European regions with combined ferry and logistics operations, including door-to-door transport solutions in both dry goods and cold chain.

Figure 1: Segment diversification by revenue



Sources: DFDS, Scope

Figure 2: Development of EBITDA margin



Sources: DFDS, Scope estimates

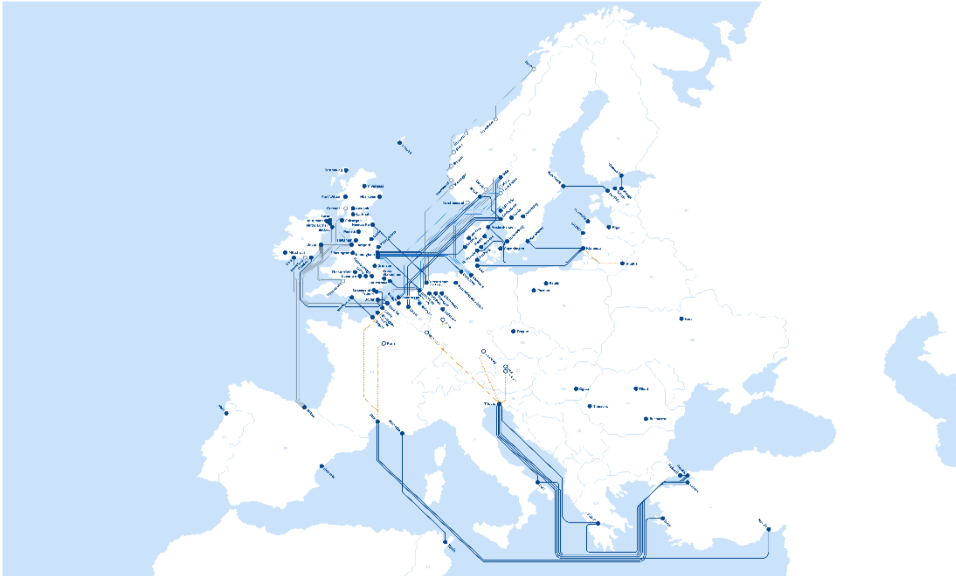
Stable operating margins

The company's EBITDA margin has been quite stable historically, even amid the Covid-19 pandemic in 2020-21. This underscores the benefit of diversified operations across segments and geographies relative to more concentrated peers, and the stability of passenger-related pricing and profitability. In addition, there is a balancing effect from the high-growth, low-margin logistics division and the slow-growth, high-margin ferry division.

Bunker price volatility largely passed through to customers

Margin volatility is also prevented via the bunker-adjustment-factor hedge mechanism, ensuring that increased bunker prices have a limited impact on earnings. The mechanism enables DFDS to largely pass on bunker price risk to customers through the bunker-adjustment-factor surcharge, which is activated at marine gas oil prices above EUR 350/t.

Figure 3: DFDS' route network



Source: DFDS

Financial risk profile: BB+

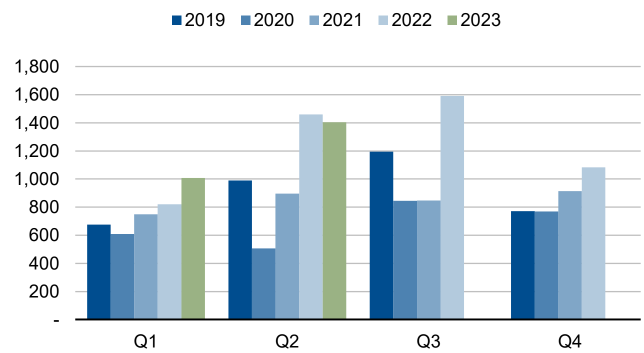
Financial risk profile unchanged at BB+ as deleveraging has materialised

The unchanged financial risk profile of BB+ reflects that the deleveraging assumed in our rating update from August 2022 now has materialised – with the Scope-adjusted debt/EBITDA ratio standing around 3.0x currently.

Annual EBITDA of DKK 5.0bn-5.6bn expected in 2023-25

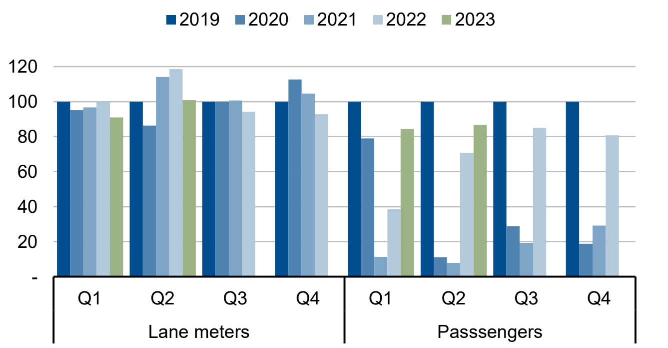
After having been negatively impacted by the Covid-19 response and related travel restrictions in 2020-21, DFDS' operating performance has seen a recovery with Scope-adjusted EBITDA of DKK 5.0bn for FY 2022. The recovery in passenger volumes has continued into 2023 and is now close to pre-pandemic levels. Freight volumes have seen a slight decline in the first half of 2023, also after adjusting for additional volumes in the Channel last year due to the suspension of a competitor, and for the impact of the war in Ukraine on ferry routes in the Baltic Sea, as the war did not materially impact volumes until Q3 2022. Based on updated Q2 2023 guidance and our expectation that freight volumes will stabilise in H2 2023, Scope-adjusted EBITDA is expected to remain at around DKK 5.0bn in 2023 and increase to more than DKK 5.5bn by 2025. Nevertheless, there is still a risk of further deterioration in the macroeconomic environment and a recession, which could threaten freight volumes and by extension forecasted EBITDA growth.

Figure 4: Reported group EBITDA, DKK m



Sources: DFDS, Scope

Figure 5: Development of reported lane meters and number of passengers (indexed to 2019)

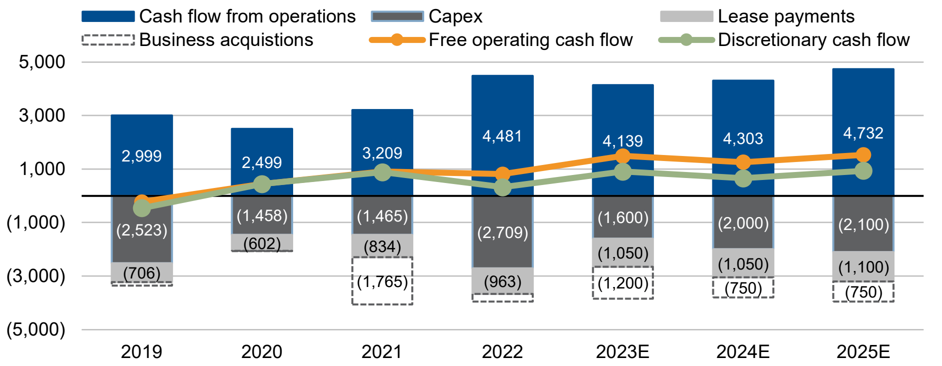


Sources: DFDS, Scope

Progressive capex programme towards 2025 and beyond

We expect the company's capex programme can be fully funded by operating cash flow over 2023-25, with total growth and maintenance capex assumed to increase from around DKK 1.6bn in 2023 to DKK 2.1bn-2.2bn in 2024-25. In addition, there are annual lease payments of around DKK 1.0bn. Higher capex is expected after 2025 driven by investments into green newbuildings intended to gradually replace the existing fleet.

Figure 6: Cash flow profile, DKK m

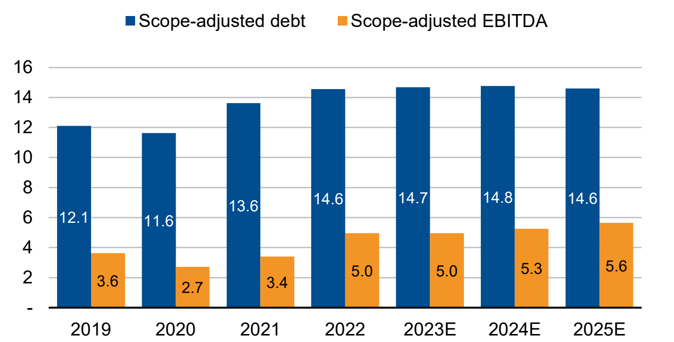


Sources: DFDS, Scope estimates

External funding could be needed for M&A

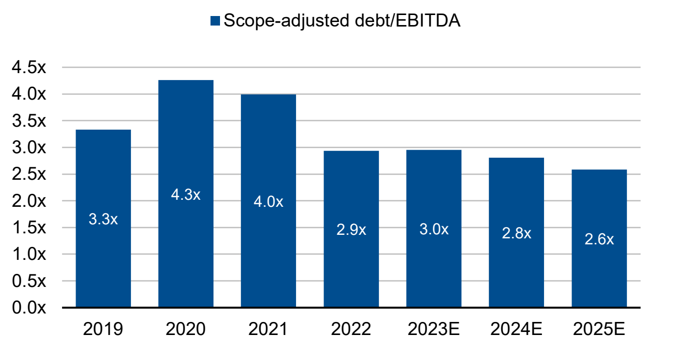
While internally generated funds are projected to amply cover capex and lease payments, as illustrated by estimates of Scope-adjusted FOCF in the range of DKK 1.3bn-1.5bn, discretionary spending on shareholder remuneration and bolt-on acquistions could potentially require external funding. This would likely be the case in the event of one or more large investments, such as the potential acquisition of Turkish logistics group Ekol Logistics' international road haulage activities. Additional acquisition targets may also be identified in the next years as part of the company's active growth strategy through M&A.

Figure 7: Indebtedness and EBITDA development, DKK bn



Sources: DFDS, Scope estimates

Figure 8: Leverage development



Sources: DFDS, Scope estimates

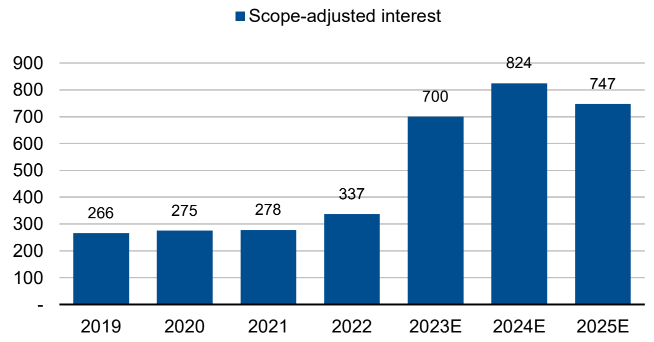
Leverage of around 3.0x or below expected but spikes could occur in connection with large investments

In our rating base scenario, the Scope-adjusted debt/EBITDA ratio is expected to improve to around 2.5x in 2025 from around 3.0x in 2023. Accordingly, there is additional headroom for higher discretionary spending than forecasted. This supports the current assessment of DFDS' financial profile. High deleveraging capacity in the absence of growth investments and dividend payments is viewed positively as it provides flexibility in financial planning, which should enable DFDS to adapt the level of cash outflows if needed (e.g. in the event of a deeper economic slowdown than assumed). The company has publicly stated that a net interest-bearing debt/EBITDA ratio in the range of 2.0x-3.0x over a business cycle is representative of its target capital structure. It is therefore not expected that the Scope-adjusted debt/EBITDA ratio will stay above 3.0x on a sustained basis. Nevertheless, we have incorporated the possibility of temporary spikes in connection with large investments.

History of adapting shareholder remuneration to capital structure target

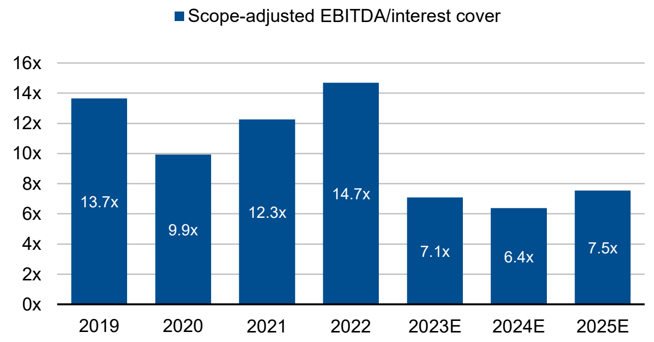
The company suspended dividends and share buybacks both in 2018 after the acquisition of U. N. Ro-Ro and in 2020-21 following Covid-19 and related travel restrictions. Thus, its stated dividend policy that capital distribution to shareholders is based on its leverage target is also exercised in practice. This is deemed supportive for credit quality as it builds upon our view that DFDS will adapt cash outflows to maintain financial flexibility.

Figure 9: Development in net interest paid, DKK m



Sources: DFDS, Scope estimates

Figure 10: Development in debt protection



Sources: DFDS, Scope estimates

Strong debt protection despite increasing interest rates

Debt protection as measured by Scope-adjusted EBITDA/interest coverage is expected to weaken to around 7.0x in the next few years, driven mainly by an increase in interest cost on the back of higher interest rates. At end-2022, the company's reported share of fixed-rate debt was around 40%, including interest rate derivatives. Thus, around 60% of gross debt is exposed to floating rates.

Significant vessel value for unsecured creditors

As of Q1 2023, the company had a total ship value of DKK 15.5bn while DKK 5.3bn of its debt was pledged. This leaves significant excess vessel value of around DKK 10bn available for unsecured creditors.

Adequate liquidity

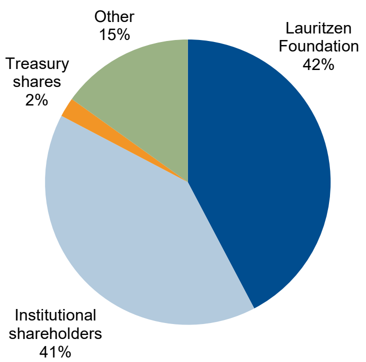
Liquidity remains adequate. At end-2022, the company had DKK 1.0bn of cash and cash equivalents and DKK 1.7bn of undrawn committed credit lines. Combined with forecasted annual free operating cash flow of DKK 1.3bn-1.5bn in 2023-24, the company should be able to comfortably cover its upcoming debt maturities.

Balance in DKK m	2022	2023E	2024E
Cash and cash equivalents (t-1)	902	1,189	1,043
Restricted cash (t-1)	(167)	(175)	-
FOCF (t)	809	1,490	1,254
Open committed credit lines (t-1)	1,400	1,722	1,722
Short-term debt (t-1)	1,791	2,349	2,790
Coverage	**164%**	**180%**	**144%**

Refinancing should not be an issue

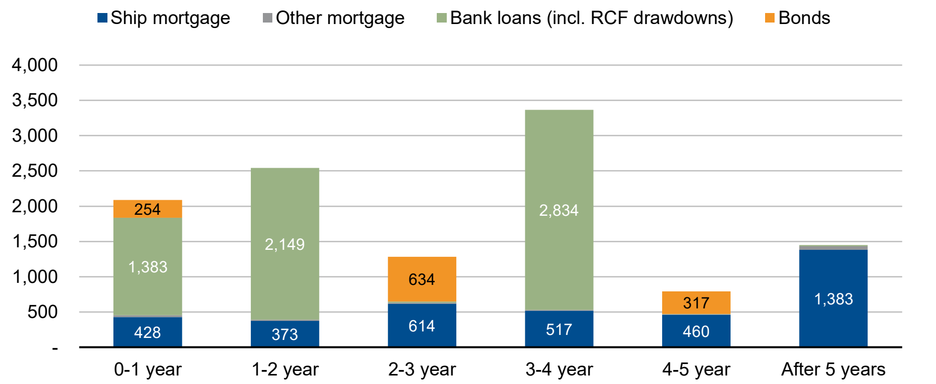
Refinancing is not considered to be an issue given DFDS' investment-grade credit profile, good banking relationships and access to diverse funding sources. This is backed by recent activity in debt capital markets, with the issue of two bonds totalling NOK 1.5bn in H1 2023 and the refinancing of a significant amount of bank loans in H2 2022. The company's RCFs are committed with maturities above one year and therefore included in bank loans maturing within the next one to two years in the maturity profile displayed in figure 12. However, we expect these will continue to be renewed.

Figure 11: Shareholder structure as of end-2022



Sources: DFDS, Scope

Figure 12: Debt maturity profile excluding operating leases as of Q2 2023, DKK m



Sources: DFDS, Scope

Supplementary rating drivers: +/- 0 notches

No impact from supplementary rating drivers

There is no rating impact from financial policy, peer context, parent support or ESG.

Long-term and short-term debt ratings

Senior unsecured debt rating: BBB-

We have affirmed the BBB- instrument rating on senior unsecured debt, in line with the issuer rating. The instrument rating is applicable to all senior unsecured debt issued or guaranteed by DFDS.

Short-term debt rating: S-2

The short-term debt rating of S-2 is driven by the issuer rating of BBB-/Stable and the company's adequate liquidity, good banking relationships and access to a diverse set of funding sources.

Scope Ratings GmbH

Headquarters Berlin

Lennéstraße 5
D-10785 Berlin

Phone +49 30 27891 0

Frankfurt am Main

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

Phone +49 69 66 77 389 0

Paris

10 avenue de Messine
FR-75008 Paris

Phone +33 6 6289 3512

Oslo

Karenslyst allé 53
N-0279 Oslo

Phone +47 21 09 38 35

Madrid

Paseo de la Castellana 141
E-28046 Madrid

Phone +34 91 572 67 11

Milan

Via Nino Bixio, 31
20129 Milano MI

Phone +39 02 30315 814

Scope Ratings UK Limited

London

52 Grosvenor Gardens
London SW1W 0AU

Phone +44 20 7824 5180

info@scoperatings.com
www.scoperatings.com

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