Posten Norge AS
Norway, Postal Services

A+ STABLE

Corporate profile

Posten Norge AS (Posten) is a postal and logistics company with origins in Norway. The group is a universal service provider fulfilling a universal service obligation (USO) in Norway. The group operates under two brands: Posten, which concentrates on private customers in Norway, and Bring, which focuses on the corporate market in the Nordic region and private customers outside of Norway. The company's operations are divided into four main divisions: E-commerce and Logistics, Network Norway, Mail, and International Logistics. For financial reporting, the group is split into two segments, logistics and mail. In Norway, postal deliveries are regulated by the Norwegian Postal Services Act, which lies under the Norwegian Ministry of Transport and Communication. Posten is 100% owned by the Norwegian government through the country's Ministry of Trade, Industry and Fisheries.

Key metrics

			Scope estimates	
Scope credit ratios	**2019**	**2020**	**2021F**	**2022F**
EBITDA/interest cover (x)	14.3x	23.7x	15.0x	20.1x
Scope-adjusted debt (SaD)/EBITDA	2.4x	0.7x	1.4x	0.9x
Scope-adjusted funds from operations/SaD	36%	132%	62%	112%
Free operating cash flow (adj. for lease payment)/SaD	21%	56%	-2%	41%

Rating rationale

Scope Ratings has assigned an issuer rating of A+/Stable to Norwegian postal services company Posten Norge AS. Scope has also assigned a senior unsecured debt rating of A+.

The issuer rating reflects Posten's standalone credit quality of A- and a two-notch uplift based on the capacity and willingness of the Norwegian government as owner to provide support to the rated entity, assessed in accordance with our Government Related Entities Methodology.

With regard to Posten's business risk profile, we note positively the company's strong position in Norway due to its long-held monopoly-like position over traditional letter posting services. This industry, however, is undergoing a clear structural decline. Even so, the risk to Posten is manageable, as government procurement grants cover all net costs the company incurs for non-commercially viable obligations under the Postal Services Act. The parcel business, on the other hand is seeing higher competition, but is growing significantly with profitability rising.

Posten's geographical diversification is adequate for a postal services company, with operations across the Nordic region, although it relies heavily on its home market of Norway, which accounts for about two-thirds of its revenues. Diversification is further influenced by Posten's continued effort to improve its sales channels, with physical branches (primarily within supermarkets and grocery stores), self-service pick-up boxes, home delivery and digital solutions. Its customer base is truly diverse, ranging from large clients such as government bodies and corporates to individual retail clients across the Nordic region. A less tangible risk, is political risk related to the future regulatory frame-

Ratings & Outlook

Corporate issuer rating A+/Stable

Senior unsecured rating A+

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Related Methodologies

Corporate Rating Methodology, February 2020

Government Related Entities Methodology, July 2020

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work and government procurements to be implemented in its mail business.

Posten's financial risk profile is supported by strong credit metrics that followed the record high operating result during 2020. Although this could be partially ascribed to the one-off effect from pandemic lockdowns, we consider the upward trend in parcel to be more permanent, with group EBITDA margins to average above 10% in the medium term. In our base case, we expect Posten not to recover lost mail volume, resulting in yearly double-digit percentage declines for this segment going forward, but we expect the logistics business (parcels in particular) to have single-digit growth rates in the medium term. The overall improvement in profitability will help to keep a more conservative capital structure as well.

With respect to future investments, we anticipate capex ambitions to increase, based on the company's improved financial flexibility and aim to withstand the increased competition in logistics. Given these assumptions, we expect solid Scope-adjusted leverage (Scope-adjusted debt to EBITDA) of around 1.0x-1.5x in the medium term and a funds from operations/Scope-adjusted debt ratio of well above our 45% guideline for the A category rating. Interest cover is also expected to be strong, although free cash flow cover is expected to be more volatile.

Our only adjustment for supplementary rating drivers is for parent support. Still, we recognise Posten's conservative financial policy, aimed at high financial flexibility and low financing costs. We also note that the Norwegian state has set the dividend ambition at 50% of the group's profit (after tax). Even so, any pay-out should not put Posten in financial jeopardy and is therefore determined with reference to equity and liquidity targets and is thus seen as prudent by Scope.

Outlook

The Stable Outlook reflects our expectation that Posten will continue to hold a leading position in the Nordic parcel market and remain Norway's traditional mail service provider. The Outlook also assumes that the Norwegian state will remain the company's sole owner, as well as no significant adverse change to the regulatory framework and government procurement agreements with the Norwegian Ministry of Transport and Communication. Financially, we expect free operating cash flow to fluctuate somewhat due to increased investment ambitions, but with Scope-adjusted leverage averaging in the lower-range of the 1-2x area.

A positive rating action is possible if profitability margins and discretionary cash flow improve, resulting in a Scope-adjusted leverage sustained at well below 1x.

A negative rating action is possible if the Norwegian state reduces its ownership and/or if the regulatory framework governing Posten's role as Norway's mandatory postal service provider changes adversely. A downgrade is also possible if overall market conditions weaken, leading to negative credit ratio effects exemplified by a Scope-adjusted leverage moving towards 2x (or higher) on a sustained basis.

Rating drivers

Positive rating drivers	Negative rating drivers
• Norway's postal services company, backed by a supportive regulatory framework • Leading Scandinavian market shares within the parcel market • Strong credit metrics and liquidity bolstering financial flexibility • 100% owned by the Norwegian state, which has a strong capacity and willingness to support the company	• High competition in the parcel business, with previously lower margins • Structural decline of mail business that will require ongoing restructuring • Some longer-term uncertainty surrounding the future regulatory framework and government procurements for mail business

Rating-change drivers

Positive rating-change drivers	Negative rating-change drivers
• Improved profitability margins and discretionary cash flow, resulting in a Scope-adjusted leverage sustained at well below 1x	• Reduced Norwegian state ownership and/or adverse change in regulatory framework governing Posten's role as Norway's mandatory postal services provider • Weakening market conditions resulting in a Scope-adjusted leverage moving towards 2x (or higher) on a sustained basis

Financial overview

			Scope estimates	
Scope credit ratios	**2019**	**2020**	**2021F**	**2022F**
EBITDA/interest cover	14.3x	23.7x	15.0x	20.1x
Scope-adjusted debt (SaD)/EBITDA	2.4x	0.7x	1.4x	0.9x
Scope-adjusted funds from operations/SaD	36%	132%	62%	112%
Free operating cash flow/SaD*	21%	56%	-2%	41%
Liquidity in NOK m	**2019**	**2020**	**2021F**	**2022F**
Unrestricted cash position	3,912	4,633	2,191	3,497
Committed unused bank facilities	3,500	3,500	2,800	-
Liquidity ratio (%) (internal and external)	983%	476%	437%	446%
Scope-adjusted funds from operations in NOK m	**2019**	**2020**	**2021F**	**2022F**
EBITDA	1,881	3,005	2,243	2,386
less: (net) cash interest as per cash flow statement	-147	-104	-150	-119
less: cash tax paid as per cash flow statement	-92	-165	-137	-3
add: other cash items	-12	-86	36	56
Scope-adjusted funds from operations	**1,630**	**2,650**	**1,992**	**2,320**
Scope-adjusted debt in NOK m	**2019**	**2020**	**2021F**	**2022F**
Reported gross financial debt (including leases)	7,567	5,659	4,659	4,849
less: cash and cash equivalents	-3,912	-4,633	-2,191	-3,497
add: cash not accessible	-	-	-	-
add: pension adjustment	900	975	725	725
Other	-	-	-	-
Scope-adjusted debt	**4,555**	**2,001**	**3,193**	**2,077**

*Adjusted for payment/amortization for lease liabilities

Business risk profile

Industry risk

Different industry dynamics – blended industry risk of BBB

Posten Norge has two main business segments, mail and logistics; the latter includes parcels. We consider these segments to have substantially different business dynamics. For that reason, we apply a blended industry risk assessment for Posten, separating the mail, parcels, and logistics segments. With a normalised EBITDA contribution estimate of 20%, 70% and 10% respectively, we have assigned a BBB blended industry risk for Posten.

Figure 1: Blended industry risk rating grid

	Mail	Parcels	Logistics
Industry risks	A	BBB	BB
Revenue %, normalised	25%	35%	45%
Operating profit %, normalised	20%	70%	10%
Blended industry risk	**BBB**		

Source: Scope Ratings

Cyclicality

The mail delivery industry has low cyclicality and has historically shown a low correlation with GDP. However, the industry is in structural decline in terms of mail volume. Despite this, the declines in the industry's revenues and earnings are less severe, with effects counteracted by providers increasing prices and reducing costs. We also highlight that in Europe governments oblige postal providers to ensure all citizens have access to a basic level of postal services. Compared with traditional mail, the parcel and express delivery industry has a slightly higher, but still moderate, cyclicality, as it depends more on retail spending. We consider global and domestic logistics services to have medium cyclicality due to their close ties to global and domestic trade and general economic activity.

Market entry barriers

We assess medium to high entry barriers for classic end-to-end nationwide mail delivery, due to the need for large staff numbers as well as comprehensive infrastructure such as sorting stations, distribution centres and vehicle fleets across the country. For parcel and express deliveries, we assess entry barriers to be medium. This business is not as capital-intensive as nationwide mail delivery, and establishing a well-functioning route network is easier. Global and domestic logistics services, including freight transportation, freight forwarding, and supply chain services, have significantly lower entry barriers, in our view, as contracts can be closed locally and/or bilaterally and do not require own capacities nationwide.

Substitution risks

Considerable substitution risk has materialised in mail delivery in the last years with the increasing digitisation of information exchange, which has led to a reduction in the overall volume of physical mail deliveries. Within the parcel and express segment, we see a medium substitution risk. We regard the substitution risk in global freight forwarding and supply chain services as lower, particularly because services in those segments primarily relate to brokerage and consulting, which are in demand regardless of the form of transport chosen by the customer.

Competitive positioning

Posten's overall competitive position is positively affected by the following:

- Position as Norway's postal services company in a supportive regulatory framework, under which the Norwegian government fully covers the net costs of holding the USO provider licence.
- Market leader in Norwegian B2C parcels and the second largest in Scandinavia (behind PostNord)
- Stable and favourable service territory in the Nordics (Norway, Sweden, and Denmark – all rated AAA by Scope)
- Strong integration with the Norwegian government through its 100% ownership and market regulator

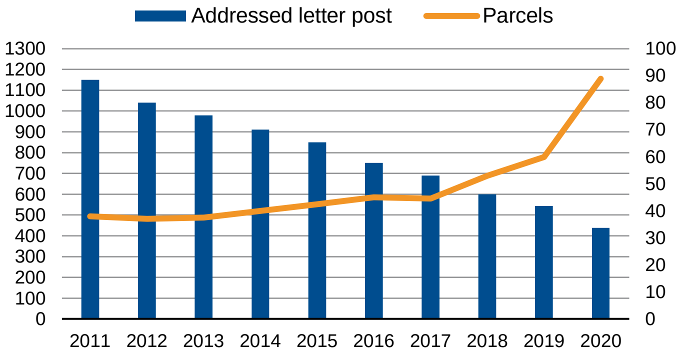
Posten's overall competitive position is negatively affected by the following:

- High competition in the parcel business, with previously lower margins
- Structural decline of mail business (stronger volume decline than in many European countries) that will require more restructuring and generate less cash flow going forward.

Monopolistic market position in traditional mail

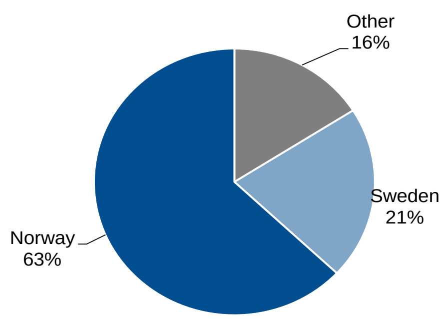
Posten's market position in traditional letter postal services in Norway is very strong. Although the market was fully liberalised in 2016, Posten's operations remain monopoly-like due to high entry barriers and a low willingness among competitors to enter the market. Posten's market position is further strengthened by Norway's supportive regulatory framework for postal services, under which the net costs of holding a USO licence is fully compensated for. The decrease in postage letter volume in Norway has been much greater than in most European countries during recent years. In response, Posten transitioned to one mail stream in 2018 and less frequent weekly deliveries in 2020 (from five to 2.5 days). Going forward, we believe a declining need for nationwide mail delivery could result in further changes to regulations and the USO content, but without any significant negative impact on Posten's market position.

Figure 2: Posten's delivery volumes of addressed letter post (left axis) and parcels (right axis), in millions at YE



Source: Posten Norge, Scope estimates

Figure 3: Share of geographical revenues from for Posten Norge AS



Source: Posten Norge, Scope estimates

Second largest player in the Nordic parcel market

In the parcel business, Posten operates across the Nordic region. The company expanded its parcel delivery network during 2020 to now comprise approximately 7,000 delivery points in Norway, Sweden, and Denmark. Compared to traditional letter post, the parcels market is characterised by higher competition and larger pricing pressure. Posten is the market leader for parcel deliveries (B2C and B2B) in its home market of Norway and the second largest in Scandinavia, surpassed only by PostNord. B2B is more fragmented than B2C due to a larger presence of international carriers. We expect

Posten to remain a key player in the Nordic parcel market, and possibly even grow market shares given that the segment is a core area for the company.

Fragmented market in other logistics segments

In other logistics segments, which include freight/goods transport, global freight forwarding, thermo transport and supply chain solutions, Posten benefits from its extensive network across the Nordic region. However, as this market is more fragmented, Posten's position is weaker than in mail and parcels. Also, the presence of more global logistics companies and lower entry barriers result in tougher competition and tighter margins.

Adequate geographical diversification with multiple sales channels

Posten's geographical diversification is adequate for a postal services company, although the company relies heavily on its home market, where it collects about two-thirds of its revenues. With regards to sales channels, the company pursues a diverse strategy consisting of physical branches, primarily within supermarkets and grocery stores, and various digital solutions.

Decreasing product diversification driven by declining letter post volumes and growing parcels segment

Letter postal deliveries are becoming less important for the company as it can no longer compensate for declining volumes with higher prices. At same time, parcel volumes and revenues are growing rapidly, resulting in a more focused product portfolio. Posten's disposals of its thermo transport subsidiaries Bring Frigo AS and its planned disposal of its subsidiary Bring Frigo Sverige AB will further reduced product diversification.

Diverse customer and supplier base across the Nordics

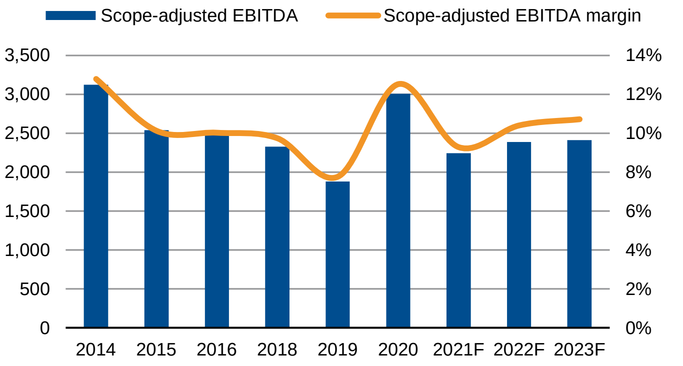
Posten has a truly diverse customer base, ranging from large clients such as government bodies and corporates to individual retail clients across the Nordic region. With regards to suppliers, we see little dependency on individual companies as most products and services purchased by Posten are offered by many companies in competitive markets such as IT consulting, automotive original equipment manufacturers, and vehicle providers.

Increased B2C parcel volumes due to pandemic has led to improved profitability

Posten's Scope-adjusted EBITDA margins have declined in the past years to 7.8% in 2019 from 12.8% in 2014 (see figure 5). Much of the downward pressure has come from falling letter post volumes and the low margins in parcels and logistics. The increase in margins to 12.5% in 2020 is largely driven by higher B2C parcel volumes due to pandemic-induced changes in consumer behaviour, but also by cost efficiencies gained from the significant operational restructuring (such as the reduced frequency of weekly letter post deliveries).

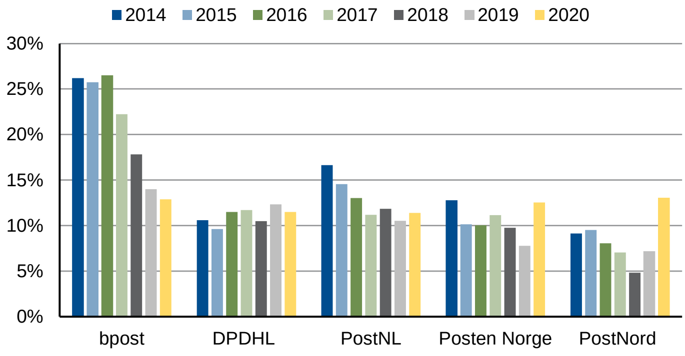
Posten previously had lower margins than those of selected European peers, which could be explained by the large decline in domestic mail volumes as well as the higher per unit delivery costs due to the challenging geographic features and lower population density in Norway. Today, after years of structural optimisations, Posten has lately caught up with peers' margins.

Figure 4: Scope-adjusted EBITDA in NOK m (LHS) and margin development (RHS)



Source: Posten Norge, Scope estimates

Figure 5: Scope-adjusted EBITDA margin, selected peers



Source: Company reports, Scope estimates

More stable margins going forward with less downward pressure

Going forward, we expect the Scope-adjusted EBITDA margin to stabilise at or above 10% in the medium term, driven primarily by increased profitability in parcels. Although B2C parcel volumes may decline slightly once pandemic-related restrictions are relaxed, the general trend is upward, and any such decline could be partly offset by a recovery in B2B volumes. In addition, we highlight the further cost efficiencies anticipated from the recent restructuring of the company's mail operations.

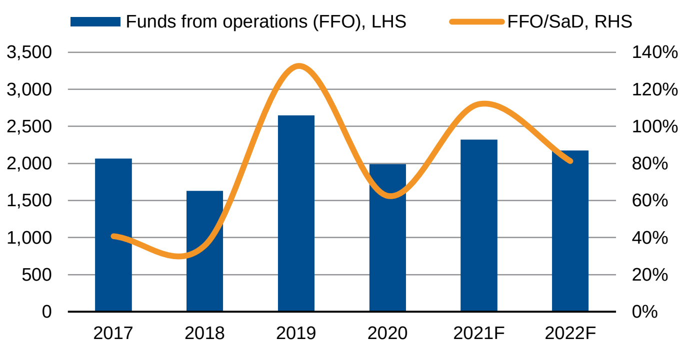
Financial risk profile

Record 2020 operating results led to more conservative capital structure at YE 2020

With the operating result at a record high during 2020, Posten ended the year with a more conservative capital structure. With a Scope-adjusted leverage of below 1x, down from the recent average of around 2x, the company is even more financially flexible. The improvement was enabled by the strong cash flow from parcels, though volumes continue to decline in traditional mail. Increased demand and the effects of the pandemic resulted in 48% growth in parcels last year, driven by e-commerce, a clear sign that the pandemic has been accelerating the digital transition.

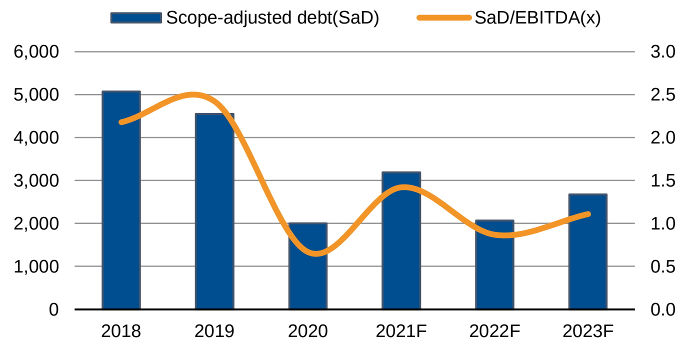
Despite the long decline in its mail business, the company has been prudently restructuring to reduce costs and adapt to new needs. Thus, we also highlight that credit metrics have remained solid through past years and that the company is expected to reignite its investment ambitions to be well prepared for the changing industry dynamics.

Figure 6: Funds from operations/SaD development



Source: Scope estimates

Figure 7: SaD (NOK m, LHS) and leverage ratio (RHS)



Source: Scope estimates

Our base case expects yearly double-digit percentage declines in mail volumes into the medium term, but single-digit growth rates in logistics. The record profitability margin in 2020 is unlikely to be sustainable, but we still expect group EBITDA margins to average at or above 10% in the medium term.

Further restructuring and cost cutting in mail segment expected

In the long term, we acknowledge that the restructuring of the mail segment will have to continue, as cost savings from the reduced frequency of mail deliveries are unlikely to offset the estimated decline in demand. The future long-term procurement agreement between Posten and governmental authorities is uncertain, but in the short-to-medium term we believe Posten can fulfil all that will be required.

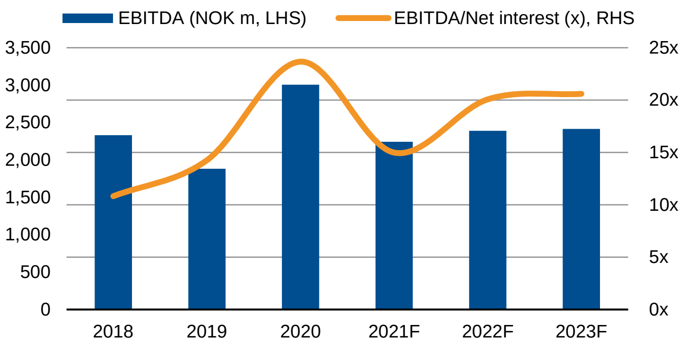
Debt adjusted for pensions, while free operating cash flow adjusted for lease payments

Our base case also includes an assumption on the company's right-of-use assets, most of which concern group leases for the Posthuset headquarters, warehouse buildings, thermo warehouses, and vehicles. These leases are recognised on the balance sheet and represent a large part of gross reported debt (55%). We have adjusted for the payment of these leases, to be included in free operating cash flows, and assume the company will renew expired leases (i.e. the amount will be constant from 2020 onwards). Scope-adjusted debt also includes an adjustment for pension liabilities, added to Posten's reported debt.

Increased investment ambitions, but it remains flexible

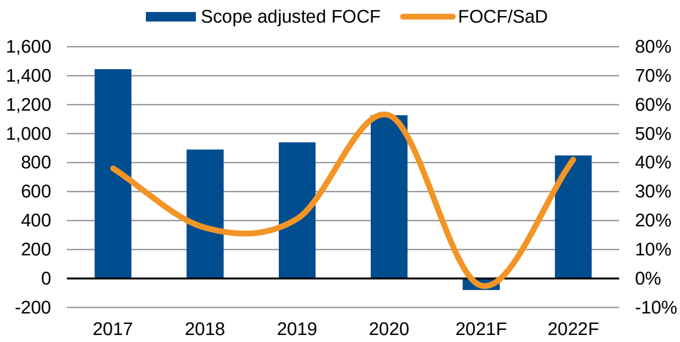
With respect to future investments, we anticipate that the company will increase its capex ambition, based on its improved financial flexibility and desire to maintain its market position in the more competitive logistics landscape. We estimate that investments already decided on will be well covered by operating cash flow, and we understand that any future expansion investments will be executed only if the capital structure allows. In 2021, we have assumed a relatively large investment amount, while we thereafter have assumed more evenly distributed capex. We have also assumed the company is open for small to medium acquisitions and venture companies to invest in. This year is also expected to be higher for absolute divided distributions than in recent years, due to the guideline of distributing 50% of net income to the sole owner.

Figure 8: Scope adjusted EBITDA and interest cover development



Source: Scope estimates

Figure 9: Scope-adjusted Free operating cash flow (FOCF) on LHS (in NOKm) and SaFOCF/SaD (%) on RHS



Source: Scope estimates

Solid credit ratios and healthy liquidity expected in the medium term

Given the assumptions above, we expect solid Scope-adjusted leverage of around 1.0x-1.5x in the medium term and funds from operations/Scope-adjusted debt ratios of well above our 45% guideline for the A category financial risk profile rating. Interest cover is also expected to be strong. However, we expect free cash flow cover to be more volatile as we assume more volatile capex this year, but this does not change our overall expectation of sufficient positive free operating cash flow over time.

The liquidity position is also strong, and the company has good access to bank and domestic bond markets. As of YE 2020, the company had NOK 4.6bn in cash and marketable securities and NOK 3.5bn in undrawn credit lines. Liquidity is therefore sufficient to cover the NOK 2.0bn in short-term debt several times over.

Supplementary rating drivers

Financial policy

Sound and prudent financial policy, but no rating adjustment

We make no adjustment for Posten's generally conservative financial policy, which is aimed at high financial flexibility and low financing costs. The company also has prudent interest rate hedging, and its financial planning closely follows several credit metrics that include leverage, equity and liquidity ratios.

Posten's sole owner, the Norwegian state, expects to receive 50% of after-tax profits as dividends. Even so, the annual dividend level cannot place Posten in financial jeopardy and is paid with reference to the group's equity and liquidity targets and is thus seen as prudent by Scope.

Ownership and parent support

100% Norwegian State ownership – gives a two-notch rating uplift

The Norwegian state (rated AAA/Stable by Scope) owns Posten through the country's Ministry of Trade, Industry and Fisheries. The owner provides no explicit guarantees, but Posten's role in Norway as USO provider in a supportive regulatory framework makes a tight dependence. Applying our government-related entities rating methodology using the bottom-up approach, we assess the Norwegian state's capacity to provide potential support to Posten as high and its willingness as medium. Our assessment was based on Posten's strategic importance, ease of substitution and default implications. Specifically, the Norwegian government must ensure postal services are accessible to the state and society. The overall assessment warrants a two-notch uplift to the A- standalone rating, resulting in an issuer rating of A+.

Long-term and short-term debt ratings

Senior unsecured debt rating: A+

No short-term debt rating assigned

The senior unsecured debt rating is in line with the issuer rating. Posten Norge AS is also the bond-issuing entity. Posten has two outstanding NOK bonds totalling NOK 1.35bn, maturing in 2021 and 2022.

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