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International Postal Entities: Influence of Government Support on Ratings

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This article outlines Standard & Poor's Ratings Services' perspective on the current principles of state support for postal entities, along with Standard & Poor's ratings methodology for the sector, and builds on an earlier article "European Postal Sector's Creditworthiness to Remain Strong in the Medium Term " (published on RatingsDirect, Standard & Poor's Web-based credit analysis system, on Oct. 7, 2002).

In this report, Standard & Poor's examines how the rating of seven postal companies on three continents may or may not be driven or influenced by state support: France-based La Poste (AA+/Negative/A-1+), Netherlands-based TPG N.V. (A/Stable/A-1), Germany-based Deutsche Post AG (A/Stable/A-1), Italy-based Poste Italiane Group (A+/Negative/A-1) in Europe; Singapore Post Ltd. (A+/Developing/A-1) in Asia; and New Zealand Post Ltd. (AA-/Stable/A-1+) and Australian Postal Corp. (AAA/Stable/A-1+) in Australasia.

Despite operating on different continents and within different markets, these companies have much in common: in particular, until a few years ago, they were all fully owned by the state. The main difference between the entities discussed in this report is the level of government support they receive, and Standard & Poor's expectations of how this ownership structure and government support might evolve. All, with the exception of SingPost, have large nonconcentrated customer bases; where they differ is in terms of cash flow generation, which is in turn dependent on the efficiency of their mail divisions and on contributions from other divisions (particularly those engaged in the financial-services industry). They all benefit from limited industry cyclicality on the bulk of their turnover, and high barriers to market entry. There is limited or no competition from other postal entities in their domestic markets, but levels of potential competition vary, particularly for the Europe-based companies.

Analytical Approach of the Postal Companies

In assessing the credit quality of postal operators, Standard & Poor's takes a two-pronged approach, depending on the entity's current and expected future ownership structure. The first is largely based on the rating criteria for government-supported entities, and is particularly pertinent for La Poste and Poste Italiane. The second is based on the analysis of the entity's business- and financial-risk profile (as for any other corporate entity), of notable importance for Deutsche Post, for example.

Three broad categories of government-supported postal companies.

Standard & Poor's criteria identify three broad categories of government-supported enterprises, based on its analysis of the degree of government support that can be factored into the ratings.

Category 1: equalization of ratings with those of the state owner This first category includes those entities that are highly integrated into the mechanisms of government, generally loss making or with poor financial profiles, and extremely unlikely to be privatized--even in the long run--given the nature of their activity, as well as their home country's economic, social, and political environment. None of the postal companies currently rated by Standard & Poor's falls into this category, given the gradual introduction of competition and deregulation, credible alternative postal service providers, and fiscal constraints on state financial support. French postal company La Poste used to come under this first bracket.

Category 2: notching down with respect to the state owner's ratings The second category includes those entities that, while autonomous in their operations, are largely public-policy-based institutions, still in receipt of substantial direct or indirect financial backing from the state. There is, however, a higher level of uncertainty surrounding the level and/or timeliness of this state support. A top-down approach that assumes notching down from the sovereign rating by up to two rating categories (six notches) applies to such postal entities. La Poste and Poste Italiane currently fall within this category.

Category 3: notching up from the postal entity's stand-alone rating A bottom-up approach that does not notch the rating in relation to that on the sovereign, but rather depends on the entity's stand-alone credit quality, this third category assumes state support, although more in the form of policy, or regulation, or the potential for emergency support if required rather than regular direct financial subsidy. The entity's postal activities are still a key public service, but the clear aim of the entity is to achieve a high level of operational and financial independence, either through privatization or commercial autonomy (state ownership, but independent management). Postal operators in New Zealand and Australia typically fall into this category and include some limited notching up from their stand-alone rating for state support.

Finally, for those companies for which privatization is imminent or expected, Standard & Poor's could adopt the corporate methodology (described in the following section) once it believes that the state will no longer offer support.

Rating methodology for non-government supported postal entities.

The second approach to evaluating postal operators' credit quality is based on the analysis of their business- and financial-risk profiles, as for any other corporate entity rating. This was the method used to determine the ratings on SingPost, Deutsche Post, and TPG.

For postal operators that receive no government support, the assessment of the mail segment's business- and financial-risk profiles is key in determining the entity's overall credit quality.

How To Assess State Support

Standard & Poor's analysis of state support focuses on the company in question's status, likelihood of privatization, governance and the regulatory regime to which it adheres.

Status.

Postal entities' status may vary from public-law (La Poste) to private-law companies (Poste Italiane, Australian Postal, NZ Post, Deutsche Post, TPG, SingPost). Private-law companies may exhibit various levels of state control, from 100% ownership (Poste Italiane, Australian Postal, NZ Post) to listed companies (Deutsche Post, TPG, SingPost).

Unlike the credit quality of companies that operate in a commercial manner at arm's length from the government, like SingPost, Deutsche Post or TPG, a major factor underpinning La Poste's robust credit quality is its extremely strong state support. La Poste's legal status confers the ultimate statutory guarantee of the Republic of France (AAA/Stable/A-1+) on its obligations.

For those companies that do not benefit from such a support or that do not enjoy any debt guarantee, Standard & Poor's gauges the existence of incentives for the state to provide support in case of necessity. For instance, NZ Post and Australian Post are considered to be flagship companies in their respective countries. The New Zealand government has some history in providing extraordinary support to other government-owned, commercial flagship enterprises. The ratings on NZ Post and Australian Postal primarily reflect these companies' very strong underlying risk profiles.

Privatization likelihood.

The privatization of national postal companies and liberalization of their services is proceeding slowly but surely in Europe, with the prospect of full liberalization accelerating postal operators' modernization and rationalization.

For those postal operators for which future privatization is expected (e.g. Poste Italiane), Standard & Poor's might shift to a bottom-up analysis approach whereby the entity's stand-alone credit rating is used as the benchmark, with a boost of up to one rating category (three notches) given for government support. Standard & Poor's would attempt to measure the impact that privatization would have on existing state support, taking into consideration any kind of "grandfathering" of the obligations undertaken before privatization, among other factors.

Standard & Poor's considers privatization of La Poste to be highly unlikely in the short to medium term, on the back of its currently weak stand-alone credit quality, and given a broad political consensus in France in favor of maintaining strong state control over a sector that has direct a social and economic influence on the country's postal and financial services. Privatization is also highly unlikely in Australia or New Zealand.

Governance.

State-owned postal companies are subject to extensive controls and supervision. In the case of fully owned entities, governments are generally responsible for the nomination of the board of directors and top executives, and have to approve large capital-investment decisions and set up annual borrowing limits. NZ Post and Australian Postal boards of directors must publish quarterly reports, thereby providing a mechanism to diagnose and respond to financial distress. Medium-term strategic guidelines set between the entity and the state (such as the "contrats de plan" in France) highlight this close relationship and enhance governance.

Standard & Poor's expects to see increasingly sophisticated accounting and financial disclosure from those companies that are gradually de-linking from the state apparatus and gaining more autonomy in their operations. This includes not only privately audited accounts by internationally recognized firms, and implementation of the GAAP (especially should Standard & Poor's rate postal operators in emerging markets), but also compliance with International Accounting Standards--for example, in relation to pensions obligations. Analytical accounting is also expected to gain increasing disclosure and enable a better grasp the stand-alone merits of business lines. As many postal companies simultaneously operate public-service missions and commercial activities, accounting separation is duly required by the European Commission.

Supportiveness of the regulatory regime.

The regulatory framework, and the likelihood of future regulatory developments, are crucial factors in determining the credit quality of postal providers, of which key elements include the level of competition permitted and the tariff-setting mechanisms.

Countries vary in terms of market deregulation and opening up, with Australia and Germany more at the forefront of free-market mechanisms than France or Italy. The French regulatory regime is supportive of the incumbent operator if measured by the level of actual competition and the tariff-setting mechanisms; no operating license has thus far been granted to any aspiring entrant. Conversely, other countries have created conditions to ensure a level playing field, though the outcome may still look limited. SingPost has a license which grants it monopoly rights in the domestic and international letters and postcards business in Singapore until March 31, 2007. However, its license to continue with this business is valid until March 31, 2017, which offers good visibility on its cash flow generation.

Mail segments are the main cash generators for most postal groups; as the size and stability of a company's cash flow and EBITDA in relation to its financial debt and fixed charges are crucial, any postal tariff revision has far-reaching consequences. In Germany, the state transferred its regulatory prerogative to an independent postal authority, which imposed a reduction in the standard postage price, leading to reduction in sales and EBITDA of about €300 million at year-end 2003. Conversely, in France, it is still the government's role to decide on price increases (the one implemented in July 2003 represents about €410 million additional revenues on an annual basis), the main aim of which is to finance the modernization of La Poste's inefficient mail division. Australian Postal's flexibility to increase some prices is inhibited by the need for approval on this matter from the Australian Competition and Consumer Commission and the government, which is far from being a mere formality.

Will Deregulation Jeopardize State Support?

The level of government funding available and ability to provide support for postal entities has come under pressure in recent years, with the weak economic environment leading to state support requirements in other economic areas, and EU scrutiny of state aid. In addition, EU countries' compliance with EU deficit rules have proved challenging for national budgets and have constrained fiscal flexibility.

Although postal services deregulation in Europe is less advanced than in the telecoms or energy sectors, it increasingly constrains state support, both financially legally. Financial backing by taxpayers could prove increasingly difficult to justify as postal operators allocate a growing share of funding resources to competitive activities.

Deregulation is gaining ground.

National postal operators are obliged to provide a "universal postal service" (delivery of standard letters anywhere in the country at a flat rate) and are often (NZ Post does not enjoy a monopoly) compensated for this obligation by having a statutory monopoly over certain ("reserved") domestic mail services, thereby securely underpinning their business profile. Given the deregulation in Europe, postal operators are facing the transition from operating as monopoly services to competing in more liberalized markets, and the turnover generated by reserved activities is bound to decrease. The major risk deriving from EU deregulation is not only a loss in volume, but possible pressure on profit-making niches.

However, despite being partly or fully liberalized, the German, Swedish, and Dutch postal markets have witnessed only marginal competition; for example, in Sweden, the private entrant company is still loss-making after several years of operations, and has only limited market penetration, while the historic operator has retained about 90% market share. Similarly, NZ Post has been exposed to full competition for several years, although the actual market share gained by competitors has been less than initially feared. Yet the entry of a strong operator, like Deutsche Post or TPG, in a liberalized market dominated by a far less-efficient operator remains to be seen and the impact could be more severe than expected for the incumbent operator.

Diversification can help withstand deregulation.

Postal operators find it economical to leverage on their strong brand names, unsurpassed network of outlets and staff to distribute financial products and even grant loans.

La Poste, Deutsche Post, Poste Italiane and NZ Post are among the leading deposit collectors and/or major distributors of financial services in their respective countries. Where they differ is in terms of the efficiency of their financial-services activities, as measured by contributions to EBITDA. While financial services for La Poste are deemed merely to break even, about 80% of Poste Italiane's EBITDA in 2003 stemmed from its subsidiary BancoPosta. Other examples of diversification include tax collection for local governments, payment of utilities bills, and certain administrative procedures.

An important rating consideration is how diversification from historic activities may impair or improve a particular company's consolidated business and financial profile. Earlier this year, SingPost entered the financial services business by offering retail lending. SingPost's financial-services businesses are expected to be subject to higher business or financial risks than are currently presented by SingPost's core postal business. The future direction of SingPost's rating will depend on the scope and scale of the retail lending business, its funding, and the company's credit-risk management abilities. In France, a law to be voted in in early 2005 will broaden the scope of La Poste's financial products. This is likely to sustain La Poste's turnover growth, help lift its performance, and eventually improve its standalone operating profile. It is expected to be a few years, however, before La Poste's bank can boast a cost-to-income ratio in line with that of its peers, given its large fixed costs and gradual take-off of new financial products.

Depending on their level of development, some postal groups' banking subsidiaries have been through a rating process. These ratings depend on various elements, including Standard & Poor's standalone and status quo assessment on the individual entity, and the perception of the entity as core or strategically important to the parent group. Reflecting the guarantee, the rating on Kiwibank Ltd. (AA-/Stable/A-1+) is the same as that on its parent, NZ Post. Deutsche Postbank AG (A/Stable/A-1) does not benefit from any guarantee from its parent but is, nonetheless, considered to be a core subsidiary of Deutsche Post and an integral part of the company's strategy. The ratings on Deutsche Postbank reflect its ownership by Deutsche Post.

Outlook

Creditworthiness among international, rated postal companies is expected to remain strong in the medium term, given the benefits of the relatively slow pace of liberalization and the high barriers to entry in the postal markets, and these companies' proven ability to diversify successfully.

Standard & Poor's believes, however, that those relatively inefficient mail operators will continue to undertake significant restructuring to improve their operating efficiency and financial performance, further to preparing themselves for a complete opening-up of the market, or possible privatization.

Table 1

International Postal Entities Peer Comparisons

	Singapore Post Ltd.	**New Zealand Post Ltd.**	**Australian Postal Corp.**	**Deutsche Post AG**	**TPG N.V.**	**La Poste**	**Poste Italiane Group**
Issuer credit rating	A+/Developing/A-1+	AA-/Stable/A-1+	AAA/Stable/A-1+	A/Stable/A-1	A/Stable/A-1	AA+/Negative/A-1+	A+/Negative/A-1
Sovereign Rating	AAA/Stable/A-1+	AA+/Stable/A-1+	AAA/Stable/A-1+	AAA/Stable/A-1+	AAA/Stable/A-1+	AAA/Stable/A-1+	AA-/Stable/A-1+
Type of activity	Postal services, logistics	Postal services, express & parcels, financial services	Postal services, express & parcels	Postal services, express & parcels, logistics, financial services	Postal services, express & parcels, logistics	Postal services, express & parcels, financial services	Postal services, express & parcels, financial services
Rating approach and notching methodology	Stand alone, no support involved	Stand alone & moderate notching up for government support	Stand alone & moderate notching up for government support	Stand alone, no support involved	Stand alone, no support involved	Top down, one notch below	Top down, one notch below
Business profile	Well above average	Well above average	Well above average	Above average	Above average	Below average	Below average
Regulatory protection	Monopoly on letters and postcards excluding publications and bulk direct mailing	Market fully competitive, but enjoys a very strong market share	Statutory monopoly for letters up to 250 grams and priced less than A$2	Statutory monopoly for letters up to 100 grams (to be reduced to 50 grams from Jan. 1, 2006)	Statutory monopoly for letters up to 100 grams (to be reduced to 50 grams from Jan. 1, 2006)	Statutory monopoly for letters up to 100 grams (to be reduced to 50 grams from Jan. 1, 2006)	Statutory monopoly for letters up to 100 grams (to be reduced to 50 grams from Jan. 1, 2006)
Ownership	Largest owner (31%): Singapore Telecommunications Ltd. (A+/Stable/A-1)	100%-owner: Government of New Zealand (foreign currency AA+/Stable /A-1+, local currency AAA/Stable/A-1+)	100%-owner: Government of Australia (AAA/Stable/A-1+)	Largest owner (63%): Government of Germany (AAA/Stable/A-1+)	The Netherlands (AAA/Stable/A-1+) hold about 35%; state ownership will be reduced to about 19% at the beginning of 2005	100%-owner: Government of France (AAA/Stable/A-1+)	100% state-owned through the Italian Treasury (65%) and the Cassa Depositi i Prestiti (35%)
Potential parent support	None	Mild	Mild	None	None	Very strong	Strong
Financial policy	Conservative to moderate	Conservative	Very conservative	Moderately conservative	Conservative	Aggressive	Aggressive
Year ended	March 31, 2004	June 30, 2003	June 30, 2003	Dec. 31, 2003	Dec. 31, 2003	Dec. 31, 2003	Dec. 31, 2003
Sales	S$368 million	NZ$957 million	A$3.9 billion	€33.9 billion	€11.9 billion	€18.0 billion	€8.150 billion
EBITDA	S$175 million	NZ$123 million	A$723 million	€4.0 billion	€1.8 billion**	€1,059 million	€1.175 billion
NPAT	S$104 million	NZ$27 million	A$331 million	€1,309 million	€300 million	€202 million	€90.3 million
EBITDA interest	25x	6.7x	24.5x	4.0x	8.5x unadjusted for pensions	7.8x	5.4x

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FFO/Net debt*¶	58.0%	109.6%	-218%	25.0%	46% unadjusted for pensions	28.00%	24.20%

*Adjusted for unfunded pension liabilities except in the case of La Poste and TPG N.V. New Zealand Post financial ratios include Kiwibank's net interest and debt; Deutsche Post and La Poste financial ratios do not include any financial institution subsidiary net interest or debt. **Operating income for TPG N.V. ¶Adjusted for operating leases. NPAT—Net profit after tax.

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