Deutsche Post AG (FWB:DPW) Recommendation

Deutsche Post AG (FWB:DPW), or the Deutsche Post DHL Group, is a global logistics company based in Bonn, Germany. It was formed from the 1995 privatization of the previous German national postal service and acquired DHL from 1998-2002. (The German government still retains indirect ownership of about a fifth of Deutsche Post through KfW Bankengruppe.) It operates through five segments: Post & Parcel Germany, Express, Global Forwarding & Freight, Supply Chain, and eCommerce Solutions (the last of which is the youngest). It has a market capitalization around $43b and revenues in the LTM ending Q1 2020 of approximately $71b (all figures USD, converted from EUR).

Comparable Companies Analysis

We first performed a comparable companies analysis on Deutsche Post ("DP"). We compared DP to fourteen logistics companies of varying sizes (market capitalizations ranging from below $1b to above $100b), with about half of the chosen companies being European and the other half North American, and many offering services globally (as Deutsche Post does). We analyzed the typical ratios in addition to means weighted by market capitalization, equity value, and revenue (so that larger companies or companies with larger market share are more strongly represented in the means). Deutsche Post offered generally satisfactory ratios, with solid coverage and leverage ratios, P/E multiple below all means and the median, and a historical dividend payout ratio above all means and the median.

Discounted Cash Flow Analysis

Cash Flow Projections

As Deutsche Post is a large and mature company, we chose an explicit forecast period of only 5 years.

Revenue was projected by division, and by service or geography within each division where possible. For each service or division, revenue was projected for a given year by multiplying the previous year's revenue by the CAGR (compounded annual growth rate) between the previous year and 2015. Historical figures were converted from EUR to USD at the average exchange rate for their respective year. The total revenue for each year was then summed. 2020 revenues were multiplied by a factor of 90%, to account for general economic distress resulting from the COVID-19 pandemic.

EBITDA was projected by using the average EBITDA margin from 2015-19 multiplied by the revenue for each year. Income-statement and CFS depreciation as well as capital expenditures were both projected using CAGRs similarly to above. We hope that capital expenditures will actually decrease in the future, but an increase was projected in the interest of conservatism. The average total tax rate for the past five years of 20.09% was used. The average COWC (change in operating working capital) for 2015-19 was used.

Cost of Capital Calculations

We used Damodaran's industry betas and conducted a weighted average of industry betas for transportation, transportation (railroads), trucking, and software (internet), weighted by coefficients of 30%, 30%, 30%, and 10% (with the last of these four representing the young eCommerce Solutions division). We found this average for both European companies. The European industry betas had sample sizes of 30, 37, 5, and 26 companies, respectively. The resulting beta (0.56) was relevered at Deutsche Post's current capital structure (to 0.74). (As a curiosity, we also explored the results using global rather than European betas.)

Since we performed this DCF in US dollars, we can use the risk-free rate from US Treasury bonds. We used the 1-year average return on 10-year bonds of 1.34%.

We used Damodaran's equity risk premium for Germany of 5.23%.

To calculate the cost of debt, we took the most conservative (the first) of the following:

1. Interest expense over total debt (3.36%)
2. Risk-free rate plus default spread corresponding to Moody's credit rating (1.47%)
3. Risk-free rate plus default spread corresponding to Fitch credit rating (1.56%)

The weighted average cost of capital was then found using Deutsche Post's current capital structure.

Terminal Value Assumptions

For both methods, Deutsche Post's current net debt and diluted share count were used.

For the Gordon growth method, a terminal free cash flow growth rate of 1.5% was assumed, based on the most recent rate of German GDP growth. This resulted in an implied share price of $52.67.

For the exit multiple method, the median EV/EBITDA multiple from the comparable companies of 14.4x was used, resulting in an implied share price of $38.91.

The median of these two values is $45.79, implying an upside from its current share price of $43.25.

Concerns

We had mild concerns about Deutsche Post's historically high capital expenditures (CapEx). However, the vast majority of these expenditures are spent in the Express division, where a large portion can be ascribed to the non-recurring recent update of Deutsche Post's airline fleet. Further, many of its industry peers also displayed high ratios of CapEx to net income. Given Deutsche Post's strong global market position, we do not believe Deutsche Post's high CapEx will lead to serious financial distress in the near future.

Conclusion

Though our projections estimate a rather modest upside, we believe that the overall conservatism of our assumptions as well as Deutsche Post's maturity and size suggest reasons to anticipate stability or modest growth in the near future. Further, we are attracted by Deutsche Post's history of strong dividend payouts.

As such, we have taken a LONG position on Deutsche Post AG.

---*Wasim Rahaman*