DFDS A/S
Denmark, Transportation/Logistics

SCOPE BBB- STABLE

Key metrics

			Scope estimates	
Scope credit ratios	**2020**	**2021**	**2022E**	**2023E**
Scope-adjusted EBITDA/interest cover	9.9x	12.2x	10.8x	11.0x
Scope-adjusted debt (SaD)/Scope-adjusted EBITDA	4.3x	4.0x	3.6x	2.9x
Funds from operations/SaD	21%	23%	24%	30%
Free operating cash flow/SaD	4%	7%	0%	6%

Rating rationale

The rating is primarily driven by DFDS's operating profit recovery since FY 2021 and the expected deleveraging, despite expectation of some increase in cash outlays for capex and shareholder returns. We expect the issuer to sustain financial leverage as measured by Scope-adjusted debt/Scope-adjusted EBITDA (SaD/EBITDA) of below 3.0x.

Outlook and rating-change drivers

The Stable Outlook on the issuer incorporates the expectation that the issuer will show financial leverage of below 3.0x in the next year or so, driven by rebounding passenger volumes and continued stability and slight improvement of profit margins, while maintaining its market leadership in the North Sea and the Mediterranean/Türkiye routes and expanding its logistics presence. The Outlook also reflects the assumption that the issuer will maintain and follow its financial policy, which includes its leverage target, a moderate dividend payout policy, and that it will maintain adequate liquidity, notably via cash and committed loan facilities.

A positive rating action could be triggered if Scope-adjusted debt/EBITDA were sustained at significantly below 2.5x, particularly in connection with a more conservative financial policy regarding shareholder returns, M&A, and capex. This could also be driven by a swift recovery of the global economy in combination with continued accelerated growth in Logistics.

A negative rating action might be warranted if Scope-adjusted debt/EBITDA were sustained at 3.5x or above, particularly due to a more aggressive financial policy prioritising shareholder returns and/or M&A. It could also be triggered by external factors such as a worse-than-expected slowing of the global economic environment or a prolonged disruption in the global freight markets, reflecting current macroeconomic trends.

Rating history

Date	Rating action/monitoring review	Issuer rating & Outlook
30 August 2022	New rating	BBB-/Stable

Ratings & Outlook

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

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Related Methodology and Related Research

Corporate Rating Methodology; July 2022

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Positive rating drivers	Negative rating drivers
• In Ferry Division, strong/leading market positions in Northern Europe and Türkiye • Diversification in customer segments (freight/passenger) and in geographies • Logistics division providing growth and complementary or cross-sell opportunities to the Ferry division and its established routes • Low cyclicality of passenger business	• Growth dependent on M&A, involving some execution risk • Deleveraging delayed due to aforementioned M&A, dividends • High capital expenditure inherent in the upkeep of business model and assets • Freight business linked to macro-economic environment and potential slowdowns

Positive rating-change drivers	Negative rating-change drivers
• SaD/EBITDA sustained at significantly below 2.5x, in connection with a more conservative financial policy regarding shareholder returns, M&A, and capex	• SaD/EBITDA 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 part loads for dry cargo, cold chains and contract logistics for selected industries). Passenger ferries are also offered in transport corridors. The company has about 11,000 full-time equivalent employees in 21 countries. DFDS generated revenues of over DKK 17bn in 2021.

Financial overview

				Scope estimates		
Scope credit ratios	**2019**	**2020**	**2021**	**2022E**	**2023E**	**2024E**
Scope-adjusted EBITDA/interest cover	12.8x	9.9x	12.2x	10.8x	11.0x	11.6x
SaD/Scope-adjusted EBITDA	3.3x	4.3x	4.0x	3.6x	2.9x	2.6x
Funds from operations/SaD	27%	21%	23%	24%	30%	33%
Free operating cash flow/SaD	-1%	4%	7%	0%	6%	6%
Scope-adjusted EBITDA in DKK m						
EBITDA	3,633	2,731	3,411	4,052	4,839	5,121
Operating lease payments	0	0	0	0	0	0
Other items						
Scope-adjusted EBITDA	**3,633**	**2,731**	**3,411**	**4,052**	**4,839**	**5,121**
Funds from operations in DKK m						
Scope-adjusted EBITDA	3,633	2,731	3,411	4,052	4,839	5,121
less: (net) cash interest paid	-260	-273	-276	-375	-440	-442
less: cash tax paid per cash flow statement	-46	3	-52	-149	-233	-268
less: pension interest	-6	-2	-2	0	0	0
add: depreciation component of operating leases	0	0	0	0	0	0
Funds from operations	**3,321**	**2,459**	**3,081**	**3,528**	**4,166**	**4,410**
Free operating cash flow in DKK m						
Non-operating cash flow	2,999	2,498	3,209	3,313	4,007	4,273
less: capital expenditure (net)	-2,457	-1,388	-1,403	-2,426	-2,161	-2,450
less: operating lease payments	-706	-602	-834	-950	-950	-950
Scope-adjusted free operating cash flow	**-164**	**508**	**972**	**-63**	**896**	**873**
Net cash interest paid in DKK m						
Interest paid per cash flow statement	284	280	307	388	456	462
Interest received per cash flow statement	-6	-5	-29	-13	-16	-19
Interest expense, pensions	6	2	2	-	-	-
add: interest component, operating leases	-	-	-	-	-	-
Net cash interest paid	**284**	**277**	**280**	**375**	**440**	**442**
Scope-adjusted debt in DKK m						
Reported gross financial debt	12,773	12,654	14,337	15,246	14,843	14,294
less: cash and cash equivalents	-840	-1,261	-902	-836	-1,023	-958
add: non-accessible cash	108	147	167	200	200	200
add: pension adjustment	69	88	14	15	15	16
add: operating lease obligations	-	-	-	-	-	-
Scope-adjusted debt	**12,110**	**11,628**	**13,616**	**14,624**	**14,036**	**13,552**

Table of Content

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)	
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)	
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)	
Physical risks (e.g. business/asset vulnerability, diversification)		Regulatory and reputational risks		Stakeholder management (shareholder payouts and respect for creditor interests)	

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

Regarding DFDS's ESG strategy, we are not aware of any sub-standard behaviour or lack of transparency with regards to environmental, social and governance areas. We highlight the issuer'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 energy sources such as methanol, ammonia and hydrogen, as well as battery power for shorter routes. Its financial policy includes guidance on dividend policy 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

Geographic and customer segment diversification with leading market positions in North Sea and the Mediterranean

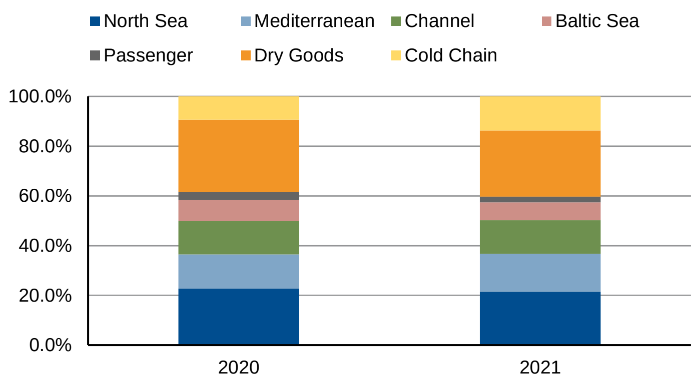
Our blended industry risk profile reflects both Ferry operations/infrastructure and Logistics industries. It is mainly driven by the medium-to-high entry barriers of the ferry operator segment and constrained by the low-to-medium barriers to entry in some logistics segments.

Our overall assessment of DFDS's competitive position is driven by its strong, established position in freight ferry, where achievement of high capacity and high utilization depends on individual routes and regions, not necessarily across all parts of Europe. The company is a market leader in North Sea and Türkiye 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.

The global markets for freight logistics and supply chain logistics have a much lower concentration than the regional and sector-specific markets. The 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 given the fragmented market, focusing on certain sectors such as automotive and cold chain (meat, seafood, dairy).

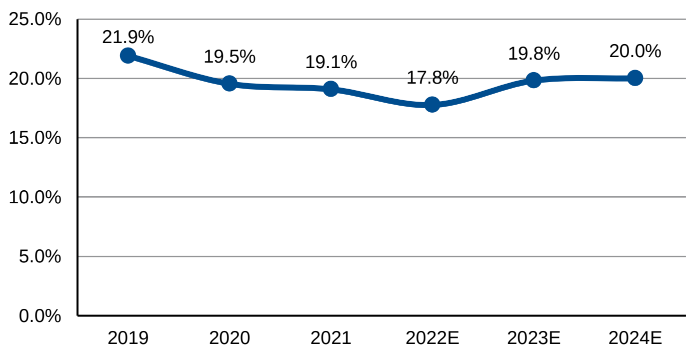
DFDS's business model benefits from diversification in terms of geographical outreach, end-customers, and business segments. Its footprint across routes in several European regions combined with door-to-door transport solutions in both dry goods and cold chain is credit positive.

Figure 1: Segment diversification by revenue



Sources: DFDS, Scope (estimates)

Figure 2: Scope-adjusted EBITDA margin



Sources: DFDS, Scope (estimates)

The company's EBITDA margin has been quite stable historically, even amid the Covid-19 pandemic in 2020-2021. This underscores the stability of passenger-related pricing and profitability, as well as the balancing effect of the high-growth, low-margin Logistics division and the slow-growth, high-margin Ferry division.

In addition, volatility in margins is prevented via the bunker-adjustment-factor hedge mechanism, meaning increased bunker prices have a limited impact on earnings. DFDS offsets prices increases by passing on bunker price risk to customers through the bunker-adjustment-factor surcharge, which kicks in for marine gas oil prices above 350 EUR/t and increases as the marine gas oil price increases. DFDS's costs decrease as a result of lower prices when the marine gas oil price decreases below the threshold.

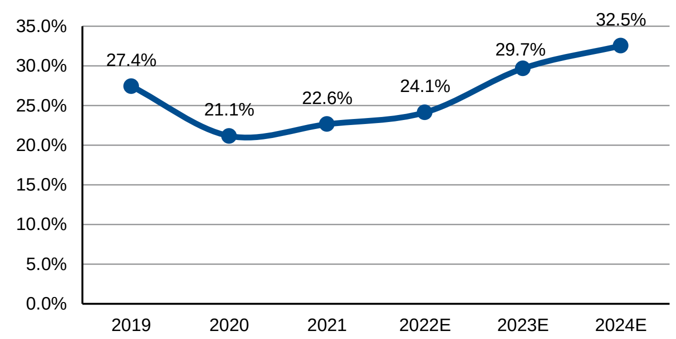
Financial risk profile: BB+

The financial risk profile is focused on the forward-looking, forecasted trajectory. Increasing profitability is expected to lead to a deleveraging profile and boost cash flow, on the back of recovery in passenger volumes and established stability in pricing and profitability in this segment.

Our rating scenario assumes the following:

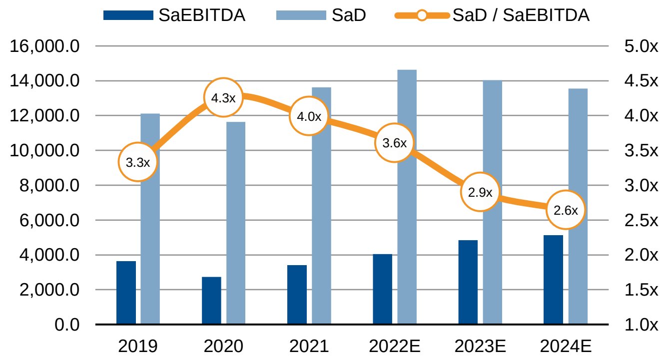
- Revenue growing by over 20% in 2022, incorporating the full-year impact of the 2021 HSF Logistics Group acquisition, as the post-Covid-19 recovery continues, then mid-single digit growth per year from 2023 to 2025
- Margin improvement to over 20% over the forecast period to 2025, as acquisition integration is completed and profitable passenger volumes return
- Increased capex of up to approximately DKK 4bn slightly above company guidance, related to investment in green vehicles and vessels primarily.
- Resumption of dividend payments after a pause in 2020 and 2021 due to the Covid-19 recession/lockdowns. We expect dividends to continue as a result of the financial strategy communicated by management and the expected free cash flow, though share buybacks are not expected to occur again unless there is more significant, sustained deleveraging.
- No material M&A transactions assumed, though DFDS has a track record of using them for growth, particularly in Logistics. Some bolt-on M&A.

Figure 3: Funds from operations/SaD



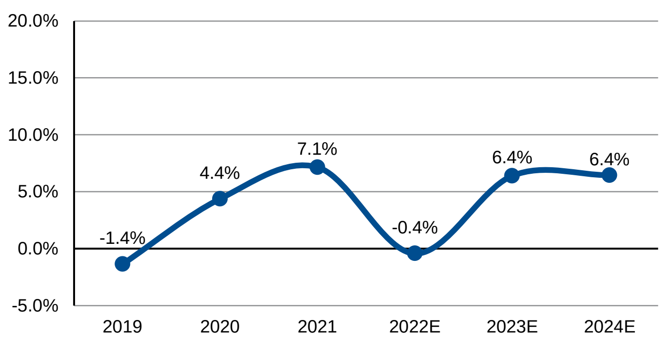
Sources: DFDS, Scope (estimates)

Figure 4: SaD/EBITDA (in DKK m, LHS)



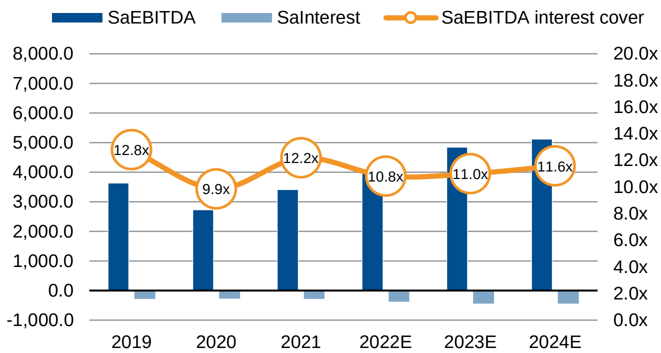
Sources: DFDS, Scope (estimates)
Sa : Scope-adjusted

Figure 5: Free operating cash flow/SaD



Sources: DFDS, Scope (estimates)

Figure 6: Interest cover (in DKK m, LHS)



Sources: DFDS, Scope (estimates)

As noted earlier, the Covid-19 pandemic and related travel restrictions led to high leverage as EBITDA dropped in 2020 and 2021. We note that EBITDA rebound and strong cash flow generation will drive a decrease in leverage over the forecasted period of 2022 to 2025, barring any transformative M&A. This view is based on the company's guidance of leverage in the range of 2.0x-3.0x net interest-bearing debt/EBITDA as representative of its target capital structure over a business cycle. Leverage based on SaD/EBITDA would then also fall under 3.0x in the next couple of years.

Interest coverage is expected to stay high, driven by improved EBITDA. We have already incorporated rising interest costs in the forecast.

We expect high capex of over DKK 2bn and up to nearly DKK 4bn per year in 2022 to 2024, considering the substantial investments needed for new vessels, conversions to make the fleet greener and the buildout of terminal and logistics capabilities. These levels include all growth capex; maintenance levels would be about half that, should they need to be pared back, which would raise free operating cash flows. In addition, material cash outflows to shareholders are expected to resume in the form of dividends, though share buybacks may occur after more significant deleveraging.

Recent 2Q22 earnings have been supportive, reflecting a trajectory of improving profitability and subsequent deleveraging, with YoY EBITDA growth of nearly 24% on an LTM basis and debt levels remaining relatively constant since 2021 year-end. Against the backdrop of strong performance, the company has accordingly also planned to use its increased cash flows in part on discretionary spending on capex/investments and M&A.

Adequate liquidity

Liquidity is adequate given the sufficient coverage of short-term financial maturities by unrestricted cash, available loan facilities, and to a lesser extent free operating cash flow, as outlined in the table below.

Balance in DKK m	2021	2022E	2023E
Cash and equivalents (t-1)	1,261	902	836
Restricted cash (t-1)	-147	-167	-200
Free operating cash flow	972	-63	896
Open committed credit lines (t-1)	1,400	2,550	1,250
Short-term debt (t-1)	934	2,512	1,711
Coverage, internal	**239%**	**33%**	**101%**
Coverage, internal + external	**389%**	**135%**	**174%**

Supplementary rating drivers: +/- 0 notches

No supplementary rating drivers apply to the rating.

Long-term and short-term debt ratings

Senior unsecured debt rating: BBB-

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

Short-term debt rating: S-2

Based on adequate liquidity and DFDS's BBB-/Stable issuer rating, we have assigned a short-term rating of S-2. The short-term rating reflects our perception of the company's sustainable liquidity profile in terms of short-term debt coverage and good access to external corporate funding. Including all internal and external sources of liquidity, coverage of short-term debt is projected at over 100% each year over the forecast period of 2022E to 2025E.

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