



Trafikministeriet



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Results of the initial analysis regarding
a reduction of the Danish State's
shareholding in Post Danmark A/S

May 2003



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The analysis has been conducted in accordance with a Contract between the Danish Ministry of Finance and the Sub-contract with the Danish Ministry of Transport signed in October 2002.

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1. EXECUTIVE SUMMARY

1.1 Background

This document summarises the results of the initial analysis regarding a possible reduction of the Danish State's shareholding in Post Danmark A/S (Post Danmark or the Company). Rothschild conducted the analysis between October 2002 and February 2003. The contents of this study have been discussed with representatives of the Ministry of Transport, the Ministry of Finance and Post Danmark's senior management. The views and opinions in this report are those of Rothschild and based on the information made available.

This document addresses the following topics:

- the present economic status of Post Danmark (Chapter 2),
- market trends (Chapter 3), and
- disposal methods and the proposed procedure (Chapter 4)

1.2 Economic Status of Post Danmark

Post Danmark derives 80% of its revenues (2002) from mail products, 10% from parcels, 10% from additional branch activities (BG-Bank and third party products) and from other products such as facility services. 54% of revenues are from competitive areas (28.5% including a USO element). Overall, until now it has been a profitable business with a solid track record with returns on capital exceeding their respective costs and a strong balance sheet.

Financial performance

DKK m	1997	1998	1999	2000	2001	2002	Group '02
Total revenue	9,722	10,097	10,817	10,936	10,832	10,741	10,799
Revenue growth	3.8 %	3.9 %	7.1 %	1.1 %	-1.0 %	-0.8 %	n.a.
EBITDA	1,164	1,201	1,256	1,246	1,217	1,287	1,406
EBITDA margin	12.0 %	11.9 %	11.6 %	11.4 %	11.2 %	12.0 %	13.0 %
EBIT	503	480	508	490	454	600	621
EBIT margin	5.2 %	4.8 %	4.7 %	4.5 %	4.2 %	5.6 %	5.8 %
Capital employed (year end)	3,649	3,473	3,453	2,943	2,788	3,191	3,191
RoCE (EBIT/Capital employed)	13.8 %	13.8 %	14.7 %	16.6 %	16.3 %	18.8 %	19.5 %

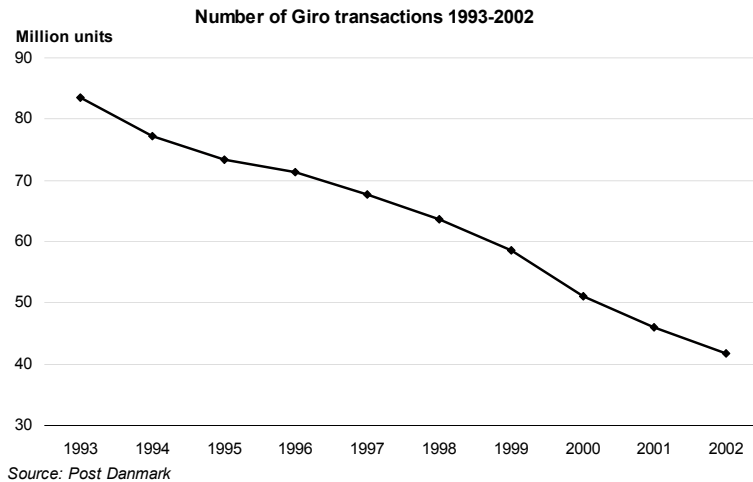
Note: EBITDA = Earnings before interest, tax, depreciation and amortisation; EBIT = Earnings before interest and tax; Capital employed = total equity + net debt; net debt = mortgage debt and other credit institutions – cash and securities 2001 and 2002 EBIT(DA) before non-recurring items of DKK –549m and DKK –466m
Source: Post Danmark; Rothschild analysis

Benchmarking analysis indicates that Post Danmark's productivity in the mail business is comparable with that of TPG (the Dutch incumbent postal operator) and Deutsche Post (DPWN), the only listed European postal operators. Nevertheless, efficiency and productivity improvements to reduce costs and introduce cost flexibility, especially in relation to staff, are required in light of increased competition from liberalisation and substitution.

The Company currently operates in line with European Union (EU) requirements, principally consisting of a reserved area for letters of up to 100g or 3x the basic tariff. This reserved area compensates Post Danmark for the provision of a universal service at uniform prices for letter products up to 2kg and parcels up 20kg as well as the provision of a nationwide branch network. Any changes to the existing regulatory framework could have a significant impact on the competitive positioning as well as the profitability of Post Danmark and should therefore be agreed prior to commencing a sales process.



Whilst the network of nearly 1,100 branches has a high density due to the desire for a wide geographic coverage, the revenue contribution to Post Danmark is limited in relation to its cost base and hence the network is loss making. Revenues from banking related activities are likely to continue to decline.



The figure on the left illustrates the drop in the number of giro transactions from 1993 to 2002. Over that period the number of giro transactions has fallen by almost 50%.

Further optimisation of the network size, including the transition of branches into postal agencies (currently nearly 400 branches are owned by Post Danmark), is therefore strongly recommended.

Apart from the indirect funding of the universal service through the reserved area, Post Danmark receives a direct subsidy for the distribution of newspapers and magazines in the order of DKK 465m (2002). The Government should decide on the future of the magazine subsidy prior to a sale of a shareholding in Post Danmark.

Nearly 50% of the 23,203 staff (on a full-time equivalent or FTE basis for 2002) are former and current civil servants. Despite a reduction in pension contributions to 12% of the base salary, the total cost of former and current civil servants remains relatively high, which could present a competitive disadvantage to Post Danmark. The Company continues to review its processes and improve its productivity. As a result, a restructuring provision of DKK 466m was created in 2002 to reduce the number of former and current civil servants by approximately 300-400. Further staff optimisation is also achieved through natural attrition, but the productivity gains currently achievable are not sufficient to compensate for the difference between Post Danmark's low revenue growth vs. wage inflation.

1.3 Market trends

Two important market trends characterise the postal services industry – liberalisation and substitution. The European Union has adopted a set of rules establishing the basis for full liberalisation of the industry with reductions in the reserved area in 2003 and 2006 and a possible full abolition in 2009. Liberalisation and substitution, especially through electronic communication, threaten Post Danmark's core business and hence its ability to maintain the Universal Service – at least in its current format as defined by the Concession. The precise rules for Denmark within this framework are currently being established and should be agreed prior to the commencement of a sales process.

The second key trend is electronic substitution. Even in the presence of a reserved area, Post Danmark is competing against other media and modes of distribution, including fax, e-mail, courier, radio and television. The growth of electronic media and related substitution is already reflected in slowing or even falling volumes for certain mail products in Denmark and other countries. As a



defensive measure, certain larger postal operators have engaged in diversification strategies, mainly express and logistics. To date, this strategy has not generated attractive returns; investors also generally prefer focussed businesses.

The key challenge for Post Danmark will be the provision of a universal service at uniform prices in the light of their competitor's ability to choose their customers and tariffs. All liberalised and regulated utility industries are affected by so-called "cream skimming" or "cherry picking". Postal operators are therefore aiming to raise their productivity further, simultaneously introducing a more flexible cost base to respond to future revenue developments to secure the profitability and future of their business.

1.4 Disposal methods and proposed procedure

Prior to launching a sales process, the regulatory framework should be clearly established and it should provide a stable basis at least for the medium-term (3-5 years). Regulatory uncertainty but also increased levels of liberalisation will reduce Post Danmark's attractiveness to investors.

Sector trends of liberalisation and substitution provide a significant challenge in creating an attractive *Equity Story* for the investing public in Post Danmark. Even if market conditions made a listing by means of an initial public offering (IPO) possible, the lack of an attractive *Equity Story* for the investing public is likely to generate lower proceeds than a private sale. Moreover, the relative size (especially on a free-float basis) of Post Danmark on the stock exchange could present liquidity problems given the focus of investors in large-cap stocks.

A financial and especially a strategic investor (through synergies) could add value to Post Danmark and therefore potentially generate a higher return for the Danish State than an IPO. In order to generate the best possible outcome for the Company and the selling shareholder, the bidder universe should include both types of investor. It may thus also be possible to provide for consortia of financial and strategic investors. Investments by a range of investors directly in Post Danmark is not recommended given the complexity this would entail.

The process should be structured to allow maximum initial participation in the tender but reduce the number of bidders quickly to the strongest candidates, who will be provided data room access and invited to negotiate transaction documentation. The bids should be assessed on the basis of both the consideration as well as their terms. Whilst the privatisation relates to shares in Post Danmark, the Company also wishes to seek the bidders' views in relation to Pan Nordic Logistics AB (PNL), including their interest in acquiring a shareholding in PNL.

Finally, it should be noted that strategic and financial investors will require certain rights and investment protections as well as an exit mechanism and a strategic investor in particular will also wish to understand future privatisation steps. The privatisation may also include the establishment of a staff incentivisation system to ensure their commitment to the future success of Post Danmark.



2. POST DANMARK

2.1 Overview

Post Danmark is a profitable DKK 11bn business employing some 23,200 FTE staff. It provides a universal mail (up to 2kg) and parcel (up to 20kg) service at uniform prices (excluding business-to-business parcels on contract). The Company also maintains a network of postal access points (10,000 letter boxes in 9,400 locations and some 400 owned branches).¹ A sole right to deliver letters weighing up to 100g (excluding outbound international mail) is granted as compensation for the imposition of the universal service obligation (USO). Post Danmark also provides other products not subject to a universal service, including unaddressed items, business-to-business delivery, or facility services.

Liberalisation and substitution, especially through electronic communication, threaten Post Danmark's core business and hence its ability to maintain the Universal Service – at least in its current format as defined by the Concession (see Appendix A.1.1). Whilst the Company produces solid financials with a healthy balance sheet at present, there are significant uncertainties and financial challenges in the medium to long-term.

Recognising these trends, Post Danmark has undertaken a number of initiatives and measures to improve its competitiveness. These have resulted in increased staff productivity and a reduction in the workforce.

2.2 Economic Status of Post Danmark

2.2.1 Profitability

2.2.1.1 Revenue

The combined total of the respective product revenues show a drop in 2001 and 2002 following positive growth rates in previous years. This is mainly attributable to falls in volumes not fully offset by increases in tariffs. The relative importance of the various products has remained constant over the past few years. Mail products account for 80%, parcels for 10%, branches and other business activities for the remaining 10%. Nearly 54% of revenues (parent company) are generated in areas of competition, consisting of 28.5% for products subject to the USO and 25.1% for other competitive products.

The table below highlights the Company's high dependence on the mail-related business (80%).

Post Danmark revenue development

DKK m	1997	1998	1999	2000	2001	2002	Group '02
Letters	6,160	6,338	6,836	7,009	7,017	7,009	7,009
Parcels	1,128	1,221	1,244	1,149	1,046	1,167	1,225
Newspapers & magazines	902	899	932	869	888	883	883
Unaddressed items and local papers	613	713	788	808	803	751	751
Other income incl. branches	927	974	1,034	1,136	1,103	968	965
Total Revenue (incl. other operating income)	9,730	10,145	10,835	10,971	10,857	10,778	10,833
<i>Growth rate p.a.</i>		4.3 %	6.8 %	1.3 %	-1.0%	-0.7%	n.a.

Source: Post Danmark; Rothschild analysis

¹ The branch network consists of an additional ~700 agencies



The development in underlying volumes summarised in the table below lends support to the sector trends identified in Chapter 3.

Post Danmark volume development

Million items	1997	1998	1999	2000	2001	2002	Group '02
Letters	1,302	1,353	1,414	1,444	1,415	1,367	1,367
<i>Growth rate p.a.</i>		3.9 %	4.5 %	2.1 %	-2.1 %	-3.4 %	n.a.
Parcels	35	35	34	32	32	30	30
<i>Growth rate p.a.</i>		0.5 %	-3.5 %	-6.1 %	0.7 %	-5.3 %	n.a.
Newspapers & magazines	287	290	296	280	271	271	271
<i>Growth rate p.a.</i>		1.1 %	2.1 %	-5.4 %	-3.5 %	-0.1 %	n.a.
Unaddressed items and local papers	1,073	1,044	1,080	1,072	1,048	983	983
<i>Growth rate p.a.</i>		-2.7 %	3.5 %	-0.8 %	-2.2 %	-6.2 %	n.a.
Payments at post offices	71	64	59	51	46	42	42
<i>Growth rate p.a.</i>		-9.9 %	-8.1 %	-12.7 %	-9.7 %	-9.3 %	n.a.

Source: Post Danmark; Rothschild analysis

2.2.1.2 Staff

Post Danmark employs 23,203 staff (2002) as measured on a full-time equivalent basis for the Group. The figure includes 10,921 civil servants and staff employed on terms similar to those of civil servants. The total number of staff (persons) is approximately 28,300. Post Danmark is therefore one of the largest employers in Denmark.

Staff costs

Staff costs absorb 61.5% of Post Danmark's revenues (2002). They are by far the most important cost driver and any profit improvements crucially depend on future staff management – numbers, productivity (including automation) and wage agreements. These figures are consistent with the European average of 62%. TPG and DPWN have lower ratios due to outsourcing of activities, their logistics businesses with lower labour cost/intensity and in the case of Deutsche Post also the banking activities recording gross interest income as revenue.²

Development of staff costs

DKK m	1997	1998	1999	2000	2001	2002	Group '02
FTE (#)	25,981	25,472	25,714	24,867	23,895	23,112	23,203
<i>Growth rate p.a.</i>		-2.0 %	1.0 %	-3.3 %	-3.9 %	-3.3 %	n.a.
Average cost (DKK '000)	236	244	258	270	284	286	286
<i>Growth rate p.a.</i>		3.5 %	5.8 %	4.3 %	5.4 %	0.6 %	n.a.
Total staff costs	6,131	6,221	6,644	6,702	6,790	6,606	6,636
<i>Growth rate p.a.</i>		1.5 %	6.8 %	0.9 %	1.3 %	-2.7 %	n.a.
Share of total revenue	63.1 %	61.6 %	61.4 %	61.3 %	62.7 %	61.5 %	61.5 %

Source: Post Danmark; Rothschild analysis

The number of FTE's at Post Danmark has been reduced by 11% since 1997. Despite these reductions, total staff costs have risen as the average wage increased at a faster rate. In 2002 total costs were reduced due to the reduction in the pension contributions for (former) civil servants, although average costs have remained constant. Additional efficiency improvements for further staff reductions are necessary. Given the requirement for physical delivery, the scope for substantial reductions is, however, limited despite efficiency improvements and investment in sophisticated technology (e.g. optical character recognition, sequence sorting, routing software). Experience at other postal operators has shown that improvements in staff productivity can be achieved across all business areas.

² The percentage of staff costs to revenue alone is not an indication of productivity or efficiency. For example, outsourced services would show as other expenses even if the same number of staff were involved.



Staff productivity

Several key factors determine the profitability achievable by a mail business. These include:

- demographics, such as population and household density
- service levels (USO) required by the respective legislation/regulator
- behaviour, such as per capita mail volumes and product mix
- pricing and regulation, and
- staff productivity.

The above factors will determine the overall mail productivity, often presented by the term Volume/FTE. A benchmarking analysis indicates that the lower mail profitability of Post Danmark compared to Deutsche Post and TPG is largely attributable to lower average prices (approximately 20%) than to lower levels of productivity. Volume/FTE is similar in the three companies despite a much lower household density and household coverage (households/FTE) in Denmark. Given the comparable levels of productivity, Post Danmark's ability to maintain or even improve the current margins will depend significantly on being able to maintain relatively high volumes (measured on a *per capita* basis), which are under threat from substitution and competition. It is however expected that it will be possible to continue to obtain efficiency improvements through enhanced planning and resource allocation in relation to mail volumes, standardisation of working methods and continuous improvements which Post Danmark's employees contribute to through work in self managing teams.

2.2.1.3 Operating expenses

As mentioned above, staff costs are the largest cost component for a postal operator. This is reflected in the table below.

Development of operating expenses

DKK m	1997	1998	1999	2000	2001	2002	Group '02
Staff costs	6,131	6,221	6,644	6,702	6,790	6,606	6,636
Other operating expenses	2,435	2,723	2,935	3,024	2,851	2,885	2,791
Total operating expenses	8,566	8,944	9,579	9,725	9,640	9,491	9,427
Growth rate p.a.		4.4 %	7.1 %	1.5 %	-0.9 %	-1.5 %	n.a.
Share of total revenue	88.1 %	88.6 %	88.6 %	88.9 %	89.0 %	88.4 %	87.3 %

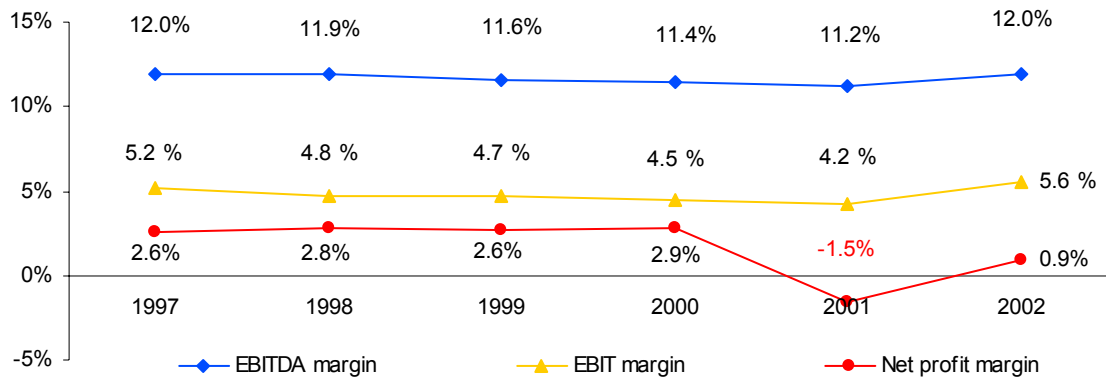
Source: Post Danmark; Rothschild analysis

2.2.1.4 Profit margin development

The historic development of margins is illustrated in the chart below. In 2001 and 2002, non-recurring items of DKK -549m and DKK -466m reduced net margins by 3.5% and 3%, respectively (after tax).



Profit margin development



2.2.2 Capital structure and dividend policy

The capital structure of a business drives the cost of capital. Generally speaking and within certain limitations (especially liquidity considerations), debt capital has a lower cost than equity capital³. On this basis, the target gearing of Post Danmark should in theory be high whilst simultaneously sustaining sufficient interest coverage to ensure liquidity, allowing for unforeseen circumstances, which might have a significant negative impact on cash flow. The level of gearing should also allow sufficient strategic flexibility. In the case of Post Danmark this is particularly important given that its ability to raise equity capital at short notice is limited, amounting in effect to either a further privatisation or obtaining political support for the injection of additional State funds.

Given the uncertainty over sector prospects and in particular, the regulatory framework, the Company should be endowed with a strong equity base going forward.

Capital structure compared to DPWN and TPG

Measure (2002)	Post Danmark	DPWN	TPG
Equity ratio	28%	19%	34%
Book gearing	41%	40%	33%
Market gearing	n.a.	25%	17%
Net debt / EBITDA	1.0x	0.9 x	0.9 x
EBIT / net interest	13.0x	14.4 x	9.8 x

Equity ratio = total equity / balance sheet total; book gearing = net debt / (net debt + total equity);

market gearing = net debt / (net debt + market capitalisation); Post Danmark EBIT(DA) before non-recurring items

Source: Post Danmark, DPWN, TPG annual reports, Rothschild analysis

Post Danmark's current capital structure is broadly in line with that of TPG and Deutsche Post. Whilst it appears that Post Danmark has a higher gearing, it should be noted that Deutsche Post has substantial amounts of unfunded pension provisions not included in the headline figures. If pension provisions are included in net debt, TPG's market gearing rises to 24% and Deutsche Post's to

³ The investment risk for shareholders (equity) is higher than for lenders (debt) as a company in the event of insolvency would first have to pay its creditors and then its shareholders (residual claimant). Investors will therefore require a higher return on their investment in shares (an equity risk premium). Further to that there is a tax shield element for debt as the company can deduct interest before its profits are taxed.



52%.⁴ The net debt/EBITDA ratio rises to 1.4x for TPG and 2.5x for Deutsche Post. Deutsche Post's net interest cover falls to approximately 3.7x.

Increasing Post Danmark's gearing would not only reduce the Company's cost of capital (WACC) but also the equity value of the business (as some of the equity portion in the enterprise value is swapped for debt). This would lower the price per share on entry and thereby enhance the potential return on equity for an investor .

Capital structure can be managed through dividend policy, which is the method preferred by Post Danmark and facilitates a dynamic adjustment of the capital structure, providing flexibility in relation to business developments. In any case, a decision in relation to capital structure and dividend policy should not be made until the future regulatory framework has been agreed.

Given that the value impact today of future dividend policy is not significant, it should only be determined once the privatisation model has been agreed. In the case of a transaction with a strategic and/or financial investor(s), the policy should be mutually agreed.

⁴ For ratios including pension provisions, Deutsche Post EBIT(DA) has been adjusted for interest costs of pension provisions included in personnel expenses. TPG does not require such an adjustment, as the interest cost is reported as a financial item.



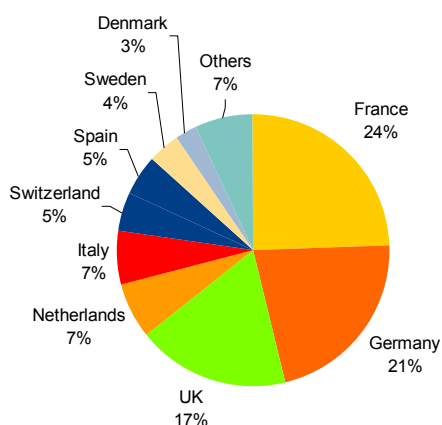
3. MARKET TRENDS

3.1 Overview of the postal services market

The postal services market is undergoing unprecedented levels of change. Liberalisation, coupled with the advent of new technologies and increasing customer demands, has put intense pressure on traditional operators in the postal services market. Mail operations remain the most important cash driver for all European post offices, however, most operators are now pursuing alternative avenues to strengthen and enlarge their positions in the domestic, and often also the international, marketplace through acquisitions, joint ventures and alliances.

With estimated revenues of Euro 127bn globally and Euro 80bn in Europe, broadly split between mail (approximately Euro 50bn) and express/parcels (approximately Euro 30bn), postal services is an important economic sector typically representing 1% of GDP. Consolidation is most evident in the competitive (and fully liberalised) express/parcels market (CEP), with an increasing trend towards transactions involving equity (underlining the commitment of the partner). There is consolidation pressure in mail markets, however, this specific part of the market has not to date witnessed significant consolidation activity.

West European Domestic Mail Market Shares (2001)



Source: Pitney Bowes Research, Rothschild analysis

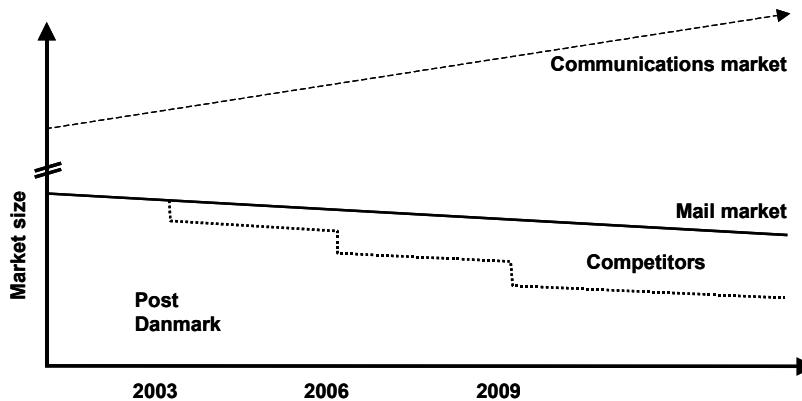
In volume terms, the largest mail markets are France, Germany, the United Kingdom and the Netherlands with approximately 26bn, 23bn, 19bn and 7bn items per annum, respectively. The Danish mail market is significantly smaller, with annual volumes of approximately 2.7bn. The largest four markets together account for 75% of western European domestic mail volumes. By way of comparison, Denmark's volumes account for only 2.5%.

3.2 Mail Trends

Whilst the communications market as a whole continues to grow, the share of mail is declining as mail volume and revenue growth have slowed or even decline. The traditional relationship between GDP growth and volume development no longer holds. Two major trends affect the future development of the mail business for postal operators: liberalisation and electronic substitution. The market shrinks with substitution and liberalisation reducing the market share for the incumbents.

Schematic illustration of potential impact from substitution and liberalisation

Substitution reduces the size of the mail market; competition the incumbent's share



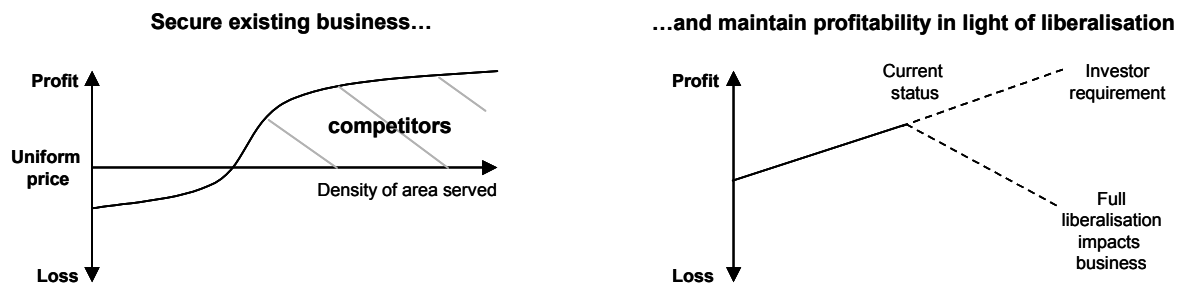
Source: Rothschild

A third trend affects the composition of mail revenues as a result of shifts in the product mix. Analysts are forecasting average growth in mail volumes at approximately 2% p.a. over the next five years in all major economies, corresponding to 1-2% for correspondence and transaction mail and 3-5% for direct mail.^{5,6} Certain operators are, however, already recording falling addressed mail volumes, such as TPG, which expects annual declines of 2.5% up to 2010 (a total of 20%).⁷

3.2.1 Liberalisation

Within the liberalised market, competitors are likely to focus on the most attractive, i.e. most profitable, mail segments. This is generally urban rather than rural as high population densities generate economies of scale.

The liberalisation challenge for incumbents



Source: Rothschild

Competitors will also focus on high volume customers (bulk mail or mail by series), such as financial institutions with regular mail flows. Within this segment, they are likely to focus on business-to-business traffic in order to economise on sorting and delivery. Studies of European universal service providers (USPs) have shown that on average 55% of total operating costs (excluding management and internal services) are incurred by delivery and a further 24% in

⁵ Source: Pitney Bowes Research, October 2002

⁶ Direct Mail is usually defined as addressed mail with marketing content.

⁷ Source: TPG analyst presentation, 20th February 2003



sorting.⁸ Such a “cherry-picking” strategy leaves an incumbent subject to a USO with uniform tariffs at a competitive disadvantage, as the USP would typically cross-subsidise the unprofitable USO areas and customers with revenues from attractive customers. The USO and its funding model are therefore challenged.

3.2.2 Substitution

Whilst mail volumes have continued to grow, even with the introduction of fax machines and the arrival of the internet, there are now signs in many European countries that mail substitution is beginning to have a significant and accelerating negative impact on volumes. To this end, even – or especially - the mail within the exclusive licence can be seen as already being subject to competition.

Serial mail which includes financial statements and invoices/bills, representing a significant share of Post Danmark’s total domestic letter volume, is one of the most likely products to transfer to e-mail or internet download. Other communication, especially business-to-business/consumer, representing generally over 90% of total volumes is increasingly being conducted through the internet.

3.2.3 Volume and Product Mix

Mail volumes are generally driven by the business community who typically generate some 90% of the total. Around 60% of volumes are business-to-consumer, 30% are business-to-business and 10% are consumer-to-consumer/business in major European and US markets.⁹

Whilst no significant changes in the above composition are expected, shifts in the product mix are already apparent across Europe. Going forward, direct mail is expected to account for much of the growth in European mail markets. This product may even benefit from e-commerce, as mail is a highly attractive, personal advertising medium. It also provides opportunities in the value added services sector. Within direct mail, unaddressed mail already takes a larger share than the addressed segment. The unaddressed market is generally already subject to significant competition, with incumbent operators generally only holding a small market share.

3.3 CEP Trends

The courier, express and parcels (CEP) sector across Europe is characterised by intense competition and many operators are thought to be making losses. Competition is particularly intense for the express sub-segment, which generates the highest margins from largely business customers. Part of the consolidation process has been motivated not only by customer demand but also the desire to acquire market share in order to become price leader. Profitability has generally not improved as operators who raise their tariffs often discover that their competitors do not raise their prices in the hope that they will be able to acquire additional market share. This strategy also reflects the capital intensity required for IT and logistics systems and the associated scale economies. Track-and-trace has become a product standard; speed and time definite delivery gaining importance.

Expansion in online trade, including lean inventory management and just-in-time delivery have resulted in greater global commerce of products requiring transport and delivery. While customers can order goods through the internet, the fact remains that physical products require physical

⁸ Source: CTCon study for the European Commission, August 1998

⁹ Source: Pitney Bowes Research, October 2002



distribution. In this manner, postal operators act as the physical “element” of e-commerce and will benefit from it.

3.4 Cost and productivity measures

Mail operations remain the most important cash driver for all European post offices. With growth opportunities from mail being limited, focus has shifted towards raising productivity, cost reductions and improving cost flexibility. This has meant investments in IT systems, automation, network restructuring (modernising and reducing the number of sorting centres), process optimisation (e.g. routing and sequence sorting) and staff training, as well as outsourcing.

3.4.1 Personnel

Personnel generally represent the largest cost component for all incumbents and absorb approximately 60% to 70% of total costs. This reflects the personnel intensity of the postal value chain, especially in delivery (more than 50% of Post Danmark’s staff are in delivery). Postal operators generally have a highly unionised workforce and collective bargaining agreements. Reductions in the number of staff and productivity improvements prove challenging. Staff reductions have therefore often been achieved through natural attrition, which typically runs at up to 5% p.a., as well as voluntary redundancy measures, increased use of outsourcing and staff transfers. Productivity improvements mainly relate to raising the volume per FTE. They have been supported by investments in infrastructure, such as automation (see below), and training.

Despite these measures, USPs will need to achieve further reductions in staff through reduced staff numbers (productivity), lower wage inflation and further efficiency improvements. These should lead to reductions in total costs rather than merely a shift from staff to other operating expenses (unless this permits increased flexibility such as outsourcing). Staff levels are also affected by the regulatory regime, with minimum service requirements (the USO) implicitly defining minimum staff levels.

3.4.2 Automation

Post businesses have become highly technologically sophisticated in recent years, though there are still significant differences between the levels achieved across Europe, as illustrated in the table below. The widespread automation has been accompanied by network redesign, reducing the number of sorting centres to a few high-tech facilities.

Degree of automation* (2000)

Low	Medium	High
Greece	Austria	Denmark
	Belgium	Finland
	Ireland	France
	Italy	Germany
	Portugal	Luxembourg
	Spain	Netherlands
	UK	Sweden

* Categorisation based on the automation level at the sorting stage of the value chain:

0-39% of volumes automated = "Low", 40-60% of volumes automated = "Medium", 61-100% of volumes automated = "High"

Source: Employment Trends in the EU Postal Sector, October 2002

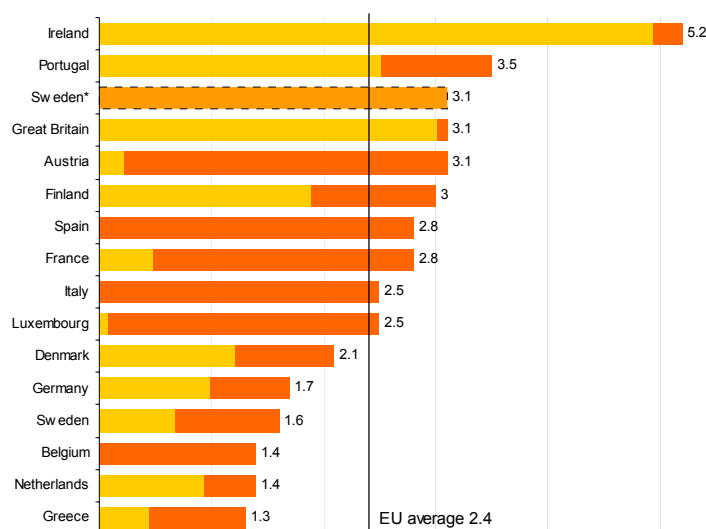


Automation is a key factor in enhancing overall productivity. It is also critical to improving delivery quality, as this is an important competitive factor, especially in the face of instant delivery by e-communication. Post Danmark is one of the most technologically advanced USPs.

3.4.3 Branch network

The branch network generally incurs significant losses for postal operators. The two key measures adopted by postal operators across Europe to reduce costs are reductions in the network size and increasing the proportion of agencies.

Branches per 10,000 population (incl. share of agencies)



* Sweden Post reorganises its postal outlet network. Planned figure as at 9/02.
Source: CT Con study for the European Commission, July 2001

Own branches ■ Agencies ■

The business potential for the postal branch network is very limited given the restricted range of low value products sold. Attempts in various countries to generate additional business have generally not been very successful – the reverse model of establishing postal counters in other retail facilities is financially more attractive. It can be argued that it is more probable that a person will buy a postal product at a supermarket, which (s)he will visit on a more regular basis.

The sale of financial products, such as credit and insurance, would require considerable staff training and would only partly address the profit gap. Moreover, given the existing size of the banking networks in Denmark and the existing agreement with BG-Bank, such a strategy is unlikely to prove successful and is currently prohibited by the exclusivity agreement with BG-Bank (up to 2009).

An agency network is, however, not necessarily a final, nor indeed an interim solution, to the burden imposed by a network's size and cost. In the UK, for example, Royal Mail owns only 3% of its total network of 17,584 post offices (March 2002).¹⁰ Rural network losses are currently estimated at approximately £3m (DKK 32m) a week.¹¹ In December 2002, Royal Mail secured a grant of £450m (DKK 4.8bn), which it will receive over three years, to subsidise rural post offices and prevent branch closures.¹²

¹⁰ Source: Postcomm, 30 September 2002

¹¹ Source: Royal Mail Group, 2 December 2002

¹² Source: Department of Trade and Industry, 2 December 2002



4. SALE OF THE SHAREHOLDING OF THE STATE

4.1 Introduction

This chapter examines the privatisation options of Post Danmark through the sale of a 25% shareholding by any of the following methods:

- Initial Public Offering (IPO),
- Sale to a financial investor,
- Trade sale to a strategic partner.

Prior to commencing any sales process, it is crucial to agree the future regulatory framework and ensure stability for at least the next three to five years. The regulatory framework has an important impact on the future profitability and hence the value of Post Danmark. Generally speaking, the more liberal the market access and/or the more onerous the requirements on Post Danmark (USO and tariff regulation), the lower the value of the shares. Uncertainty in relation to the regulatory framework has a negative impact on the valuation as well – stability of the framework reduces the risk factor applied to the valuation.

4.2 Initial Public Offering

Globally, only three postal operators providing a universal service have been listed on the stock exchange, Deutsche Post, TPG and Singapore Post. Only one of them – Deutsche Post – was listed directly.¹³ The shares of Deutsche Post and TPG trade significantly below their original listing value, which is disappointing but not the consequence of the sales method chosen. It is more a result of the interaction of corporate performance and investor expectations since listing, as well as the general capital market conditions.

An Initial Public Offering of shares in Post Danmark requires a listing on the Copenhagen Stock Exchange (CSE). The CSE sets rules for listing of securities in line with the *Securities Trading, etc Consolidated Act*.¹⁴ Most importantly, the following requirements should be noted:

- financial statements for three years, audited by two accountants (at least one of whom is a state-authorized public accountant),
- at least 500 shareholders upon listing,
- free float of 25% (the CSE may grant exemptions from this requirement),
- the Articles of Association may not contain provisions aimed at limiting the free negotiability of the shares to be listed.

Post Danmark is expected to meet all technical pre-requisites for a listing (e.g. a minimum free float of 25%), but legal advisers should confirm this prior to taking any decision in favour of an IPO.

Current market conditions and the relatively small size of Post Danmark do not, however, favour an IPO at present.

¹³ TPG was listed by demerger from KPN in June 1998; Singapore Post was listed by a spin-off from Singapore Telecom by means of an IPO in May 2003.

¹⁴ Rules Governing Securities Listing on the Copenhagen Stock Exchange A/S of 6 November 2001, last amended on 4 October 2002; Consolidated Act No. 587 of 9 July 2002 issued by the Ministry of Economic and Business Affairs

4.3 Sale to financial investor or strategic partner (private sale)

The process of selling a shareholding to a financial investor or to a strategic partner is the same, though the valuation achievable for Post Danmark may differ given the respective contributions made by the two types of investor.

4.3.1 *Financial investor*

Post Danmark exhibits many of the characteristics, which make it attractive to financial investors:

- the Company holds a leading position in its markets (mail and parcels),
- “Post Danmark” is a strong brand name,
- the Company has an experienced management team,
- Post Danmark’s gearing has increased in recent years; an outright acquisition to endorse a new capital structure should not be necessary,
- the Company has a strong, stable cash flow, which according to the business plan reduces the financial debt over time; it also permits the payment of an attractive dividend.

4.3.2 *Strategic partner*

In the case of Post Danmark, it is expected that postal operators could be interested in investing in Post Danmark in order to expand their regional offering in their core business. Logistics and other transportation or even communication companies could view Post Danmark as an opportunity to diversify into related activities.

Strategic investors are particularly well placed in furthering Post Danmark’s strategic objectives. On the customer and revenue side, a strategic investor could, for example, provide access to an enlarged customer base (economies of scale), an extended product range (one-stop-shopping), or assist in product innovation (to offset substitution). On the operational side, the partner could strengthen the IT platform – an essential competitive element in logistics – and utilise his own expertise in optimising the production network. Cost synergies may also be realised if duplicate assets and operations are combined.

4.3.3 *Investor requirements*

One of the key distinctions of a private sale from an IPO relates to the rights attached to the investment. This is a direct consequence of the lack of liquidity for single or a very limited number of investors, who will therefore request certain investment protections. In the case of an IPO, the sale of 25% as provided for in the current legislation can be effected with the standard rights attached to each share (one vote at the shareholder meetings, dividend entitlement as residual claimant on a company’s profits); unsatisfied investors can exercise their right to vote or ultimately sell their shares, even at short notice.

A financial investor or strategic partner cannot easily sell his/their shareholding. Moreover, he should be able to enhance value as each of them can contribute to the business. It is therefore in the Government’s and the Company’s interest to provide for limited rights and investor protection over and above the standard rights attached to the shareholding, including a definition of possible exit mechanism, voting rights and management influence, as well as representations & warranties.

4.4 Proposed procedure

The private sale provides a considerable degree of flexibility in designing and managing the process and in relation to the timing. This is an important aspect in a negotiated transaction. Based on



experience from similar transactions, it is advisable to conduct a limited auction process with four phases: preparation, indications of interest, preliminary offers and formal offers. The process should be agreed with legal advisers to ensure compliance with existing domestic and European legislation.

Prior to launching the formal marketing process, it is advisable that the Financial Adviser makes informal enquiries with the key parties who are considered likely to be interested and discusses the terms they may require. This will help to identify any themes for rights, which may have to be offered in order to secure sufficient interest and hence ensure competition.

Careful preparation of the process is a critical component in ensuring a successful transaction. The following three principles should be adhered to. In following these principles, the Government also ensures transparency and accountability for the outcome.

Clarity

Prior to launching the sales process, the criteria for the selection of the potential investor(s) to be approached should be clearly defined and a list agreed. This ensures political transparency in the objectives. For instance, for a strategic partner, the criteria might be that he ought to be active in the postal, transportation or communications markets in order to generate the synergy benefits desired from a strategic partner. For a financial investor, the criteria might be the commitment to a minimum investment period.

Focus

What is being offered to the investors and what may be offered at a later stage in negotiations (the maximum position) should be clearly defined and summarised as key transaction terms. This relates to the percentage to be sold, the rights offered, protections provided, exit mechanism etc. The terms offered are important to the success of a private sale, especially as the potential universe of interested parties is very limited.

Competition

In order to achieve the best possible outcome for the selling shareholder (and Post Danmark), the process should ensure an element of competitive tension. It is therefore important to have at least two parties competing at an advanced stage of the process. The process should therefore be designed as a competitive auction rather than a “rifle-shot” approach to only one or two particular parties. It will strengthen the position of the Government in relation to the terms it has to offer to the investor.

A. APPENDIX

A.1 The Concession & Regulation

A.1.1 The Concession

In accordance with the *Act on Post Danmark*, Post Danmark has been granted a concession by means of an Executive Order (the Concession).¹⁵ The Concession grants an exclusive licence in return for the provision of universal services.

A.1.1.1 Universal Service Obligation (USO)

Post Danmark has to provide a universal service covering the following domestic mail and parcel products for delivery on six working days:

- addressed letters up to 2kg,
- other addressed items with uniform, printed contents up to 2kg,
- daily, weekly and monthly papers, magazines and periodicals up to 2kg,
- addressed parcels up to 20kg,
- literature for the blind up to 7kg.

According to the Concession, Post Danmark has to provide a network of post offices. Whilst the number and ownership are not stated explicitly, it states, that “the Minister [for Transport] may demand that the principles laid down by the concession holder for the development of the post office network be altered”.

The USO also covers international mail, the Faroe Islands and Greenland.

A.1.1.2 Sole right (exclusive licence)

In return for the provision of the universal service, Post Danmark has been granted the sole right to convey letters in its territory, except:

- addressed catalogues, brochures, papers, magazines and periodicals,
- mail with uniform, printed contents placed in transparent packaging,
- international outbound mail.

The sole right is restricted to items weighing less than 100g and costing less than three times the postage required for an ordinary domestic letter of the lowest weight category.¹⁶ Outgoing cross-border mail, which is also subject to EU-wide liberalisation, has already been liberalised in Denmark in 1996.

A.1.1.3 Cross-subsidisation

Cross-subsidisation must not take place from the sole rights area to competitive areas where Post Danmark is not subject to a universal service obligation. For USO activities outside the exclusive licence, cross-subsidisation must not exceed what is necessary to provide the services in question in all parts of the country, at uniform prices and high quality, and must not result in distortion of competition.

¹⁵ Executive Order no 84 of 7 February 1999, changed by Executive Order no 1149 of 13 December 2002

¹⁶ Directive 2002/39/EC of the European Parliament and of the Council of 10 June 2002 amending Directive 97/67/EC with regard to the further opening to competition of Community postal services



A.1.1.4 The European framework

According to the new EC Postal Service Directive, the maximum permissible reserved area was reduced from January 2003. Under the new Directive, Member States will have to open up to competition the following market segments:

- from 2003:
 - delivery of letters weighing more than 100g (or costing more than three times the price of a standard letter),
 - all outgoing cross-border mail (but Member States which need the revenue from this market segment to enable them to continue to provide their universal service could reserve it),
- from 2006:
 - delivery of letters weighing more than 50g (or costing more than two and a half times the price of a standard letter).

The new Postal Services Directive requires the Commission to complete, in the course of 2006, a study assessing, for each Member State, the impact on universal service of full accomplishment of the Internal Market for postal services in 2009. On the basis of the results of that study, the Commission would make a proposal to the European Parliament and Council confirming, if appropriate, full accomplishment of the internal market for postal services in 2009 or determine any other step.

The Danish USO requires delivery six days a week while the Postal Services Directive only requires five days a week delivery. In addition, the Danish USO prescribes a maximum limit of 20kg on domestic parcels, whereas the Directive has minimum demand of 10kg, but allows a limit of 20kg.

The Danish Postal Act also requires uniform tariffs within the service obligation area. The EC Directive permits uniform pricing but does not impose it on incumbents. In Denmark, letter delivery quality results are published four times a year. The Directive prescribes that this is only required once a year. Additionally, there is a demand for Post Danmark to ensure that the calculation system is quality certified in accordance with a generally recognised international standard.

Whilst TPG and DPWN have stated that they are in favour of competition, they also insist on the principle of reciprocity. As a result, German legislation to liberalise the postal market has been reversed, bringing it into line with the EU requirements and new Dutch rules also provide for market opening in line with other postal markets.

A.1.2 Regulation

The regulatory functions are currently performed by the Postal Supervisory Authority (PSA or Posttilsynet), and the Ministry of Transport in certain cases.

A.1.2.1 The Ministry of Transport

The Minister of Transport must approve the rates inside the reserved area and develop the model for calculating the subsidy for papers and magazines. The model must be revised every third year. Furthermore, the Minister of Transport must approve the rates relating to the subsidy for papers and magazines which is made by the PSA.



A.1.2.2 The Postal Supervisory Authority

In 1995, Posttilsynet was set up as an independent authority under the Ministry of Transport to supervise the Danish postal services sector. Postal service operators are defined as companies that operate commercial conveyance of letters and other addressed consignments up to 20kg. All postal operators are required to file a notification of their operations with the PSA. The arrangement constitutes a listing scheme under which the companies are registered, so that the PSA can ensure among other things that the companies establish adequate procedures, for example the handling of undeliverable items. In 1999 1,842 postal service operators were registered with the PSA. It serves as the first instance of complaint in cases concerning compliance with the competition guidelines for Post Danmark.

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