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China Ratings

Chinese Couriers Under COVID-19 and Beyond: Analysis of Parcel Delivery Companies' Indicative Issuer Credit Quality

August 3, 2020

Key Takeaways

- Benefiting from changing consumer behavior amid COVID-19, we expect the volume of the express delivery sector to maintain steady growth for a period of time.
- The financial risk of the companies sampled in this study is, in our view, controllable. Lower leverage and good interest coverage ratios should help them maintain good financial positions.
- Fierce market competition may lead to declining profitability among our sampled companies. However, these firms, in our view, have a relatively good buffer in their credit metrics, and could maintain their financial risk profile to some extent, despite their falling profits and ongoing capital investment.
- Within our sample, we see China Post as having the strongest indicative issuer credit quality, closely followed by SF Holdings. However, Best Group's indicative issuer credit quality is at a weaker level.

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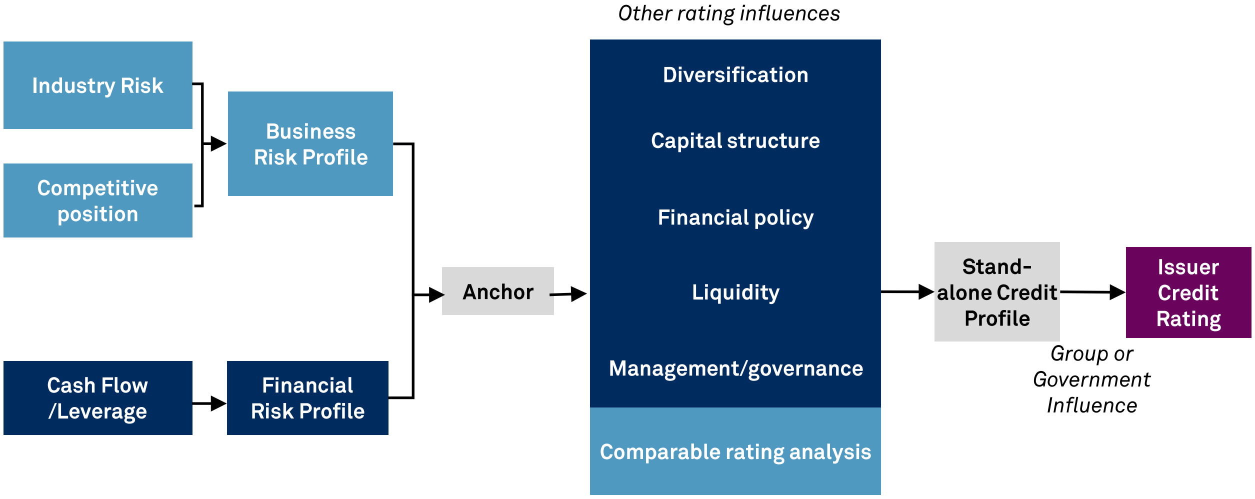
Overview

We have selected eight representative enterprises from the logistics industry and carried out a desktop analysis by applying our relevant methodology to public information. Through our analysis, we have arrived at a preliminary view of the credit quality of these enterprises, or their "indicative issuer credit quality".

The eight companies are China Post Group Co., Ltd. ("China Post"), SF Holding Co., Ltd. ("SF Holdings"), ZTO Express (Cayman) Inc ("ZTO"), Shentong Express Co., Ltd. ("STO"), Shanghai Yuantong Jiaolong Investment Development (Group) Co., Ltd. ("YTO"), Yunda Holding Co., Ltd. ("Yunda"), Best Inc. ("Best Group") and Deppon Logistics Co., Ltd. ("Deppon"). These eight enterprises cover most of the business formats currently operating in the industry, and they are relatively large in scale.

According to our credit rating methodology framework for corporates, when we analyze the credit quality of non-financial enterprises we usually begin with analysis of the entity's business risk profile, before looking at its financial risk profile and other factors to arrive at its Stand-alone Credit Profile (SACP). We then analyze the external support that enterprises can obtain, including group or government support, to arrive at the Issuer Credit Rating (ICR). In this research we have adopted the same methodology to analyze the indicative issuer credit quality of the relevant entities.

Chart 1



About This Article

S&P Ratings (China) Co., Ltd. (S&P China) has conducted a desktop analysis of a selection of entities, which we have chosen based on their asset sizes, representativeness of most regions and availability of public information. The analysis contained herein has been performed using S&P China Methodologies. S&P China Methodologies and analytical approaches are intended specifically for use in China only, and are distinct from those used by S&P Global Ratings. An S&P China opinion must not be equated with or represented as an opinion by S&P Global Ratings, or relied upon as an S&P Global Ratings opinion.

This desktop analysis has been conducted using publicly available information only, and is based on S&P China's methodologies for corporates. The analysis involves a desktop application of our methodologies to public information to arrive at a potential view of credit quality across sectors. It is important to note that the opinions expressed in this report are based on public information and are not based on any interactive rating exercise with any particular entity. The opinions expressed herein are not and should not be represented as a credit rating, and should not be taken as an indication of a final credit rating on any particular entity, but are initial insights of potential credit quality based on the analysis conducted. This desktop analysis does not involve any surveillance. The opinions expressed herein are not and should not be viewed as recommendations to purchase, hold, or sell any securities or to make any investment decisions, and do not address the suitability of any security.

We have conducted this desktop analysis on individual corporates and present the results contained herein at an aggregate group level. The different sections of this research show the statistics and performance of different groups of entities and the market more broadly against the metrics we generally consider most relevant under our methodologies.

Given the desktop nature of this analysis, and that we have not conducted an interactive review with any particular entity, we may have made certain assumptions in lieu of confirmed information and where relevant we may also have attempted to consider any possibility of parent, group, government or other forms of potential support, to inform our view of potential credit quality. S&P China is not responsible for any losses caused by reliance on the content of this desktop analysis.

Business Risk Profile

In general, we assess a corporate enterprise's business risk profile by considering its industry risk and competitive position.

Industry Risk

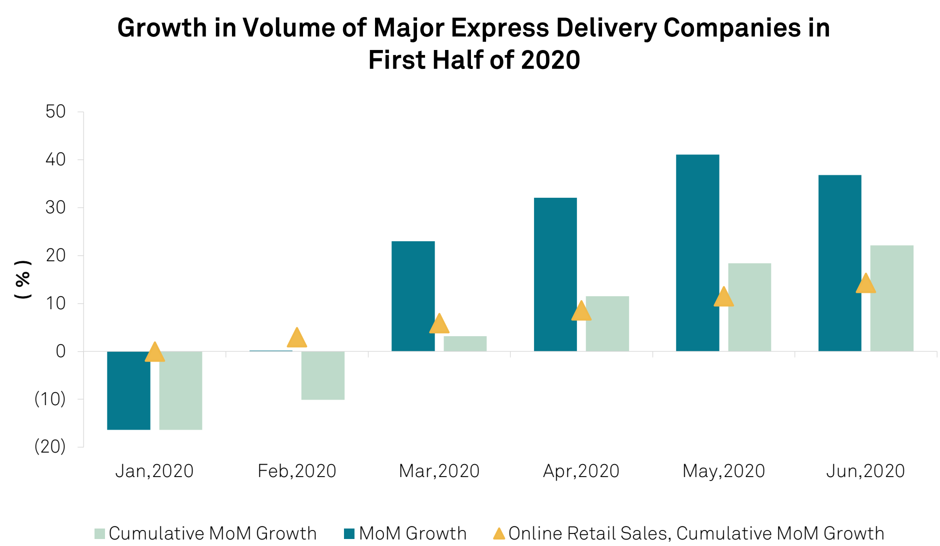
In our opinion, the industry risk ranking of this sector is "intermediate" (3). This indicates that the industry risk is at a mid-to-lower level in our six-tier ranking. Typically, we judge an industry's risk ranking by looking at its competitive environment and cyclicality. We regard this industry as very competitive, but it has relatively low cyclicality. For this reason, we view this industry's risk as being at an intermediate level.

The express delivery sector suffered little impact from the COVID-19 outbreak. Following a large-scale decline in January and tepid recovery in February, March and April saw the industry's volume increase year-over-year by 23% and 32% respectively. This rate of increase has already matched peak levels seen last year.

The logistics industry has played a strong supportive role in the fight against COVID-19. Its deliveries of PPE (personal protective equipment) and other preventative materials nationwide as well as support to the daily needs of consumers means the sector has been one of the few outliers to gain from the epidemic period. We believe that changing consumer habits have played an important role in the industry's return to rapid growth over this period. COVID-19 has seen online consumer habits change, with orders tending towards lower-cost daily necessities and food, in a shift away from higher-priced clothing and other non-essentials. Similar amounts of money are being spent on more individual items, and the resulting uptick in packages and deliveries has boosted the delivery volume of logistics service providers.

The changing consumer habits brought about by mitigation measures under COVID-19 should, in our opinion, continue to support the steady growth of the express delivery sector's volume. However, it should also be noted that the epidemic has had an impact on overall consumption. In addition, the penetration rate of online shopping in retail is already at a high level. After the effect of the change in consumer habits levels off, growth in volume of express delivery parcels may come under some pressure in the future.

Chart 2



Note: 1. Data applies to express delivery firms with annual revenue in excess of two million RMB. 2. No data available for January Online Sales MoM Cumulative Growth.
Source: State Post Bureau, National Bureau of Statistics, S&P Global (China) Ratings.

We generally consider a company's competitive position from four aspects: competitive advantage, scale scope and diversity, operating efficiency and profitability. In the logistics industry, all of the above four aspects are important. Companies in this industry, in our view, adopt two different competitive strategies. One is to provide differentiated services with good quality that can enable them some pricing power. The other is to provide relatively homogeneous services and compete on costs. Companies can manage costs by either lowering transportation costs through capital investment, or through economies of scale that reduces the unit cost.

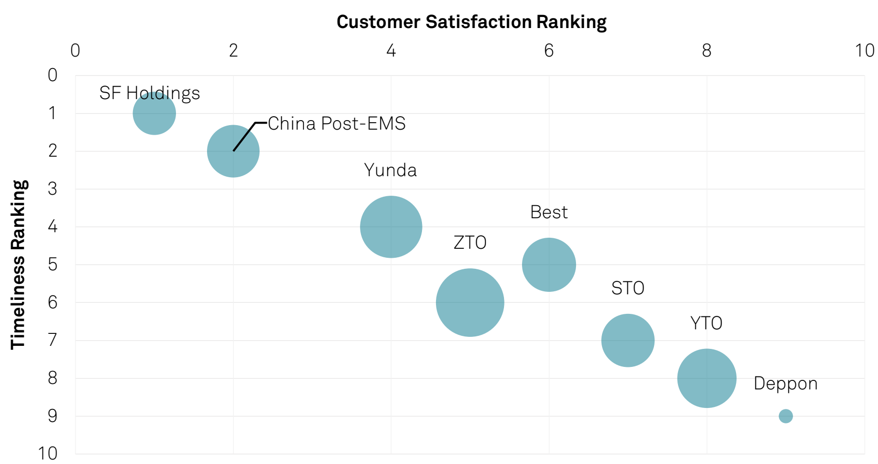
Competitive Advantages

In our opinion, the competitive advantages of delivery service companies are mainly reflected in their service standards and reputation, transportation network and pricing power. Firms with competitive advantages can typically be described as having: good service standards and reputation; competitive or exclusive services; good R&D ability which can enhance service quality; advantages in route network; stronger pricing power enabled by good quality services, which underpins their roles as price-setters in the market.

Customer satisfaction and service timeliness can typically offer some insight into the firms' service standards. According to the "Notice on the Results of the 2019 Express Delivery Service Satisfaction Survey" and the "Notice on the Timeliness Rate of Express Delivery Service 2019 Test Results" issued by the State Post Bureau, SF Holdings and the EMS (express mail service) business of China Post are the top performers in terms of timeliness and customer satisfaction. Among the delivery franchise companies, Yunda, ZTO and Best Group perform better. Deppon is a relatively late entrant to the express delivery sector, and its timeliness and customer satisfaction indicators are weaker than its peers.

Chart 3

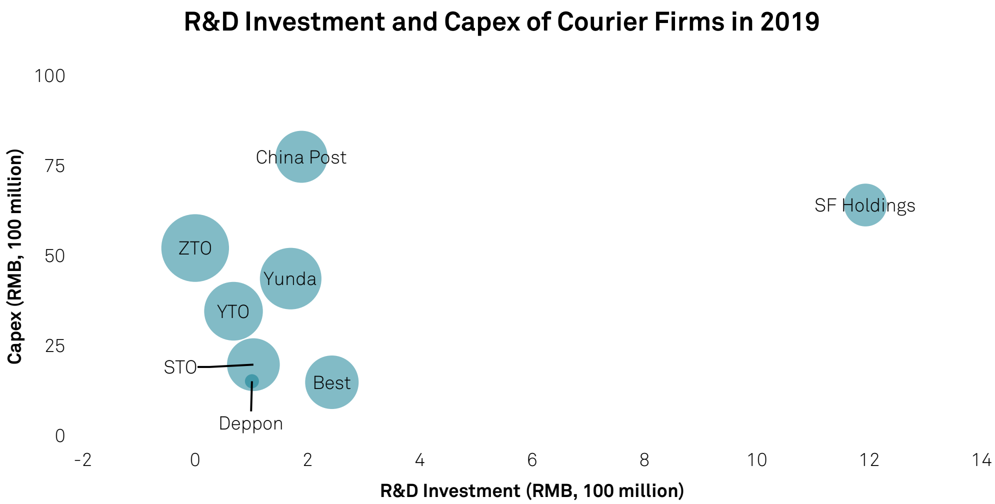
Major Couriers' Customer Satisfaction and Timeliness Rankings, 2019



Note: 1. Bubble size represents express delivery business volume. 2. Data only applicable to each logistic firm's express delivery business.
Source:State Post Bureau.

We view R&D and capital investment as important foundations for firms looking to maintain their service quality and improve customer experience while their delivery volume grows. Greater technological expertise can enable companies to better operate their logistics networks and improve delivery efficiency. The chart below shows both the R&D and capital expenditures of SF Holdings are at a high level among the sample enterprises. STO and Best Group are relatively asset-light businesses, and this may affect their control over transportation and the delivery process to a certain extent, leading to a knock-on effect to service quality.

Chart 4



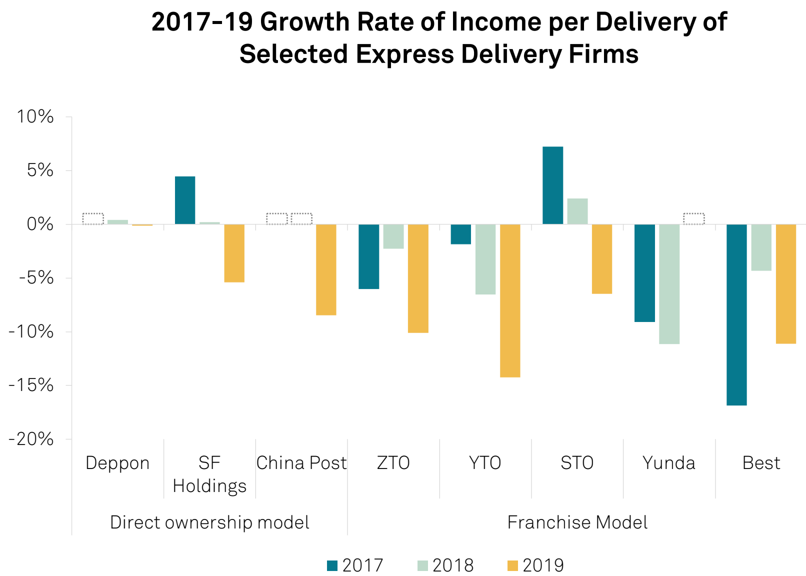
Note: 1. Bubble size represents express delivery business volume. 2. Data only applies to firms' express delivery business. 3. ZTO R&D investment not fully disclosed. 4. China Post data adjusted to remove influence of Postal Savings Bank.
Source: Company annual reports, company announcements, adjusted by S&P Global (China) Ratings.

In terms of their transportation networks, the service coverage of the companies in our sample is similar, but China Post is the only firm that can cover all villages and towns in China. And its standard parcel service covers all of China's county regions. This comprehensive network highlights China Post's policy role and gives the firm an important competitive advantage. In some remote areas, China Post is the only choice. The company has worked with other departments, such as tax bureaus and the police, through relying on its extensive network.

Among the sample firms, China Post enjoys several strong exclusive advantages. Beyond express delivery, China Post also offers other services such as standard postal services, stamp services and freight logistics, and handles classified communications and distribution of newspapers and periodicals on behalf of the government. At the same time, through its cooperation with Postal Savings Bank, China Post receives a regular annual service charge, which helps it reduce operating risk. In contrast, the other enterprises in our sample have little exclusivity to gain.

Pricing power is, in our view, a key indicator of a logistics company's competitive advantage. Amid fierce pricing competition, income per delivery has declined in the past two years among all our sampled companies. However, delivery companies under a direct-ownership model, such as SF Holdings, Deppon and China Post have stronger pricing power, while that of franchise-model firms is weaker. In the first three quarters of 2019, the average price per delivery in the sector was 12 RMB. SF Holdings has stronger pricing power thanks to its quality services. In 2019, SF Holdings' price per delivery reached 22.2 RMB, a level significantly higher than the industry average. The changes seen in the companies' price per delivery from 2017 to 2019, as shown in the chart below, suggest a sustained and relatively large decline in pricing among delivery franchises. In contrast, SF Holdings, Deppon and China Post have only seen relatively smaller declines in their price per delivery, reflecting the stronger pricing power that can be obtained through offering differentiated services.

Chart 5



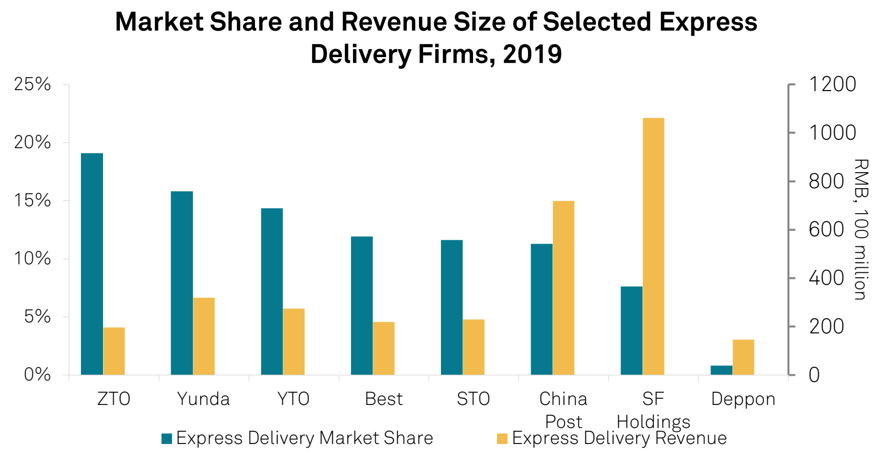
Note: 1. Dot bar represent data unavailable for that year. 2. This chart only reflects changes in the unit price of express delivery firms. 3. Data derived from public information and adjusted by S&P Global (China) Ratings.
Source: Company annual reports, company announcements, adjusted by S&P Global (China) Ratings.

Scale, Scope and Diversity

We generally consider business size, market share and range of services when looking at a logistics company's scale, scope and diversity.

Scale is very important for logistics enterprises, with higher volume and revenue scale reflective of a firm's market position amid fierce competition. At the same time, scale is the basis for realizing economies of scale, reducing delivery costs and expanding gross profit per delivery. In terms of market share, ZTO and Yunda's businesses handle the largest number of parcels. The two enterprises have achieved their high market share thanks to their lower prices and ability to control trunk line transportation costs.

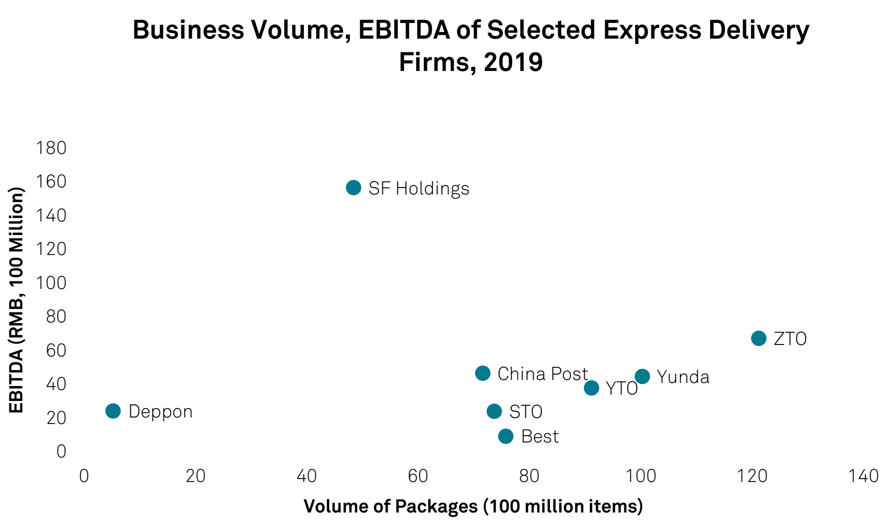
Chart 6



Note: Business volume, revenue based on companies' data.
Source: Company annual reports, company announcements, adjusted by S&P Global (China) Ratings.

While SF Holdings has a lower market share in terms of delivery volume than franchise-model firms, its revenue scale is far ahead of its peers. Delivery firms under direct ownership take the bulk of express delivery fees in the industry, and income per delivery is much higher than that of delivery franchises.

Chart 7



Note: EBITDA data for China Post adjusted to account for influence of Postal Savings Bank of China.
Source: Company annual reports, company announcements, adjusted by S&P Global (China) Ratings.

In addition to express delivery of packages and parcels, logistics companies also engage in another traditional area of business, namely express freight delivery. Compared with express parcel delivery, the goods transported by express freight delivery are usually heavier in weight and larger in size. Deppon is one of China's leading less-than-truckload (LTL) delivery companies. It has been deeply engaged in express freight delivery for many years and leads the sector in terms of transportation volume and market share. However, overall competition in the express freight delivery sector is more intense than express parcel delivery, and market concentration is low. Deppon was a late entrant to the express parcel delivery sector, and while it has developed rapidly, its market share is still at a smaller level when compared to companies with traditional advantages in express parcel delivery. Therefore, we consider Deppon's scale as average.

In addition to considering the business scale of enterprises in their respective fields, we also look at the diversity of services and products provided. If a company can diversify its business while maintaining a good performance in its original field, this could improve its risk resilience. As far as the logistics industry is concerned, after years of rapid development, market competition for express parcel delivery is becoming increasingly fierce, while express freight delivery and cold chain logistics currently have lower industrial concentration and considerable potential market size.

Major logistics companies are currently looking to develop their own integrated logistics systems. However, only SF Holdings and China Post have been able to gain a significant market position in more than two subsectors. This is mainly because standard express delivery systems, distribution equipment and transportation are not suitable for large, heavy LTL and cold chain transportation goods. To develop express freight delivery and cold chain transportation business, companies need to purchase specialized equipment, an outlay which demands significant capital expenditure.

Table 1

Overview of Services Provided by Express Delivery Firms

	Business Files and Letters	Standard Express Delivery	Express Freight Services	Cold Chain Transportation
ZTO	□	■	□	□
Yunda	□	■	□	□
SF Holdings	■	■	■	▲
Best Group	□	■	▲	□
Deppon	□	▲	■	□
STO	□	■	□	□
YTO	□	■	□	□
China Post	■	■	▲	□

Note: ■ represents the company already having an established position in this sector, ▲ represents the company occupying some market share in this sector, □ represents the company being new to or not having yet entered this sector.

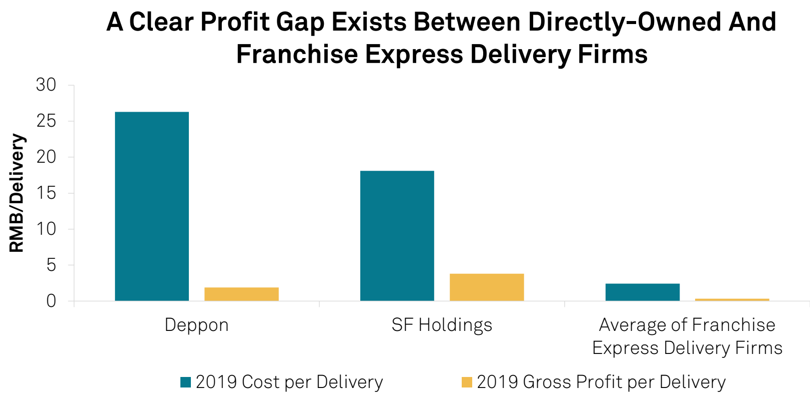
Source: Company annual reports, company announcements, adjusted by S&P Global (China) Ratings.

Operational Efficiency and Profitability

When we consider a logistics companies' operational efficiency and profitability, we mainly look at factors including cost per delivery, gross profit per delivery, cost structure, EBITDA and ROE.

We believe that the profitability of logistics companies depends largely on their ability to control costs. Given the fierce competition, lower pricing is one of the more effective ways of gaining market share for express delivery providers with homogeneous services. In such an environment, it is difficult to effectively pass on rising costs to the customer. For delivery franchises, cost control is even more critical, because gross profit per delivery for these firms is far lower than that of directly owned enterprises.

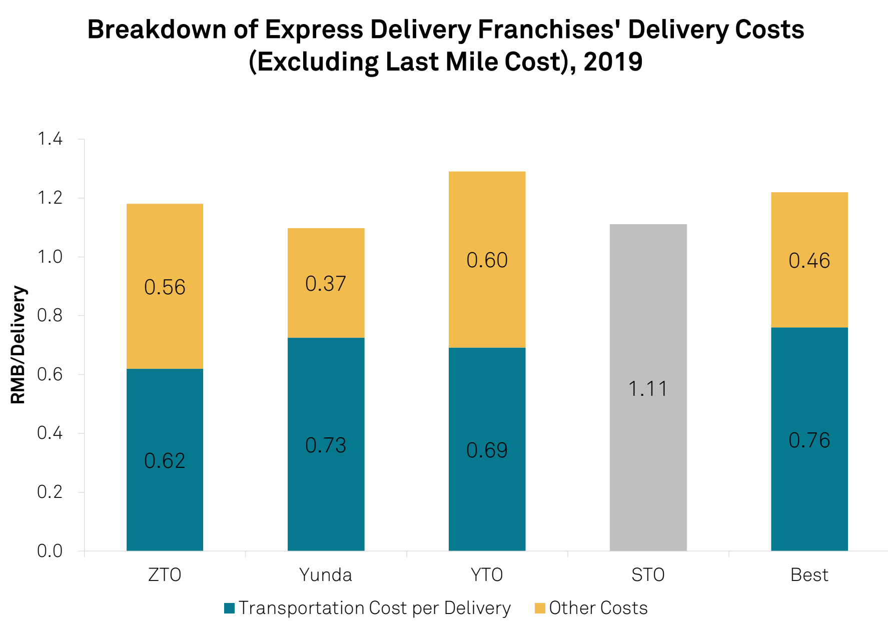
Chart 8



Note: 1. Franchise Express Delivery Firms are ZTO, YTO, STO, Yunda and Best. 2. Data derived from public information and adjusted by S&P Global (China) Ratings.
Source: Company annual reports, company announcements, adjusted by S&P Global (China) Ratings.

Among the costs borne by logistics franchises, we regard transportation and sorting hub cost as the key factors affecting profitability per delivery. In terms of transportation cost per delivery, ZTO's costs are at a lower level, while those of Best Group are higher. For other related costs, ZTO and Yunda have relatively good ability to control their cost per delivery.

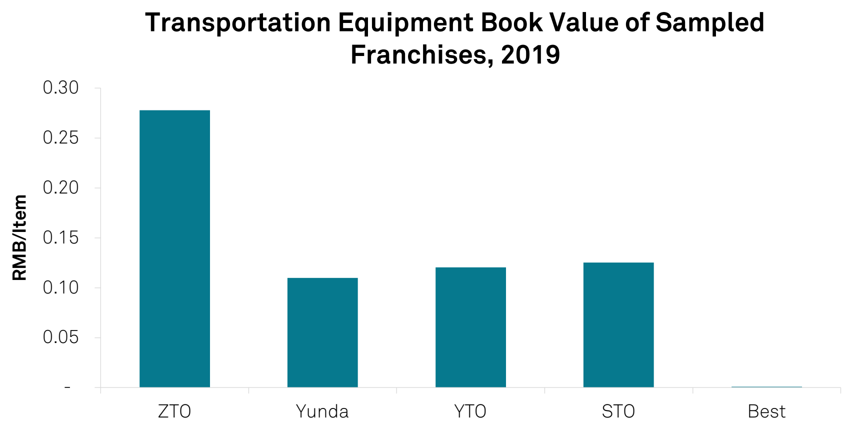
Chart 9



Note: 1. To ensure comparability of costs, last-mile fees have been excluded. 2. STO does not split its transportation cost, gray column represents total costs excluding last-mile fees. 3. STO delivery transfer cost only includes those in its own delivery centers, and may not reflect full related costs. 4. Data all from public information, adjusted by S&P Global (China) Ratings.
Source: Company annual reports, company announcements.

In our opinion, differences in transportation costs per delivery for these companies may be attributable to the size and types of investments they have made into transportation equipment. By looking at the unit book value of transportation equipment per waybill for each company, ZTO has invested more in transportation equipment, while Best Group, in contrast, mainly leases its transportation equipment. This is reflected by less transportation equipment booked on its balance sheet.

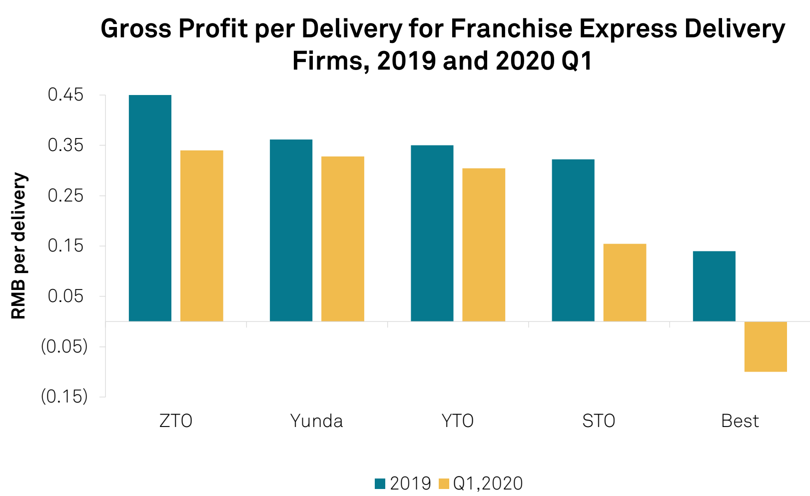
Chart 10



Note: Transportation Equipment Book Value=Net Transportation Equipment Value/Waybill Volume
Source: Company annual reports, company announcements, adjusted by S&P Global (China) Ratings.

Because of their good ability to control costs, ZTO and Yunda have been able to achieve higher gross profit per delivery. As a result, this gives the two companies greater room to maneuver in terms of offering more competitive prices, which may enable them to obtain a larger market share. Higher market share may bring about an economies of scale effect, reducing cost per delivery and increasing profit per delivery. STO and Best Group have lower profit per delivery, and Best Group even occurred some losses per delivery, which may limit their ability to match the pace of the industry's pricing competition.

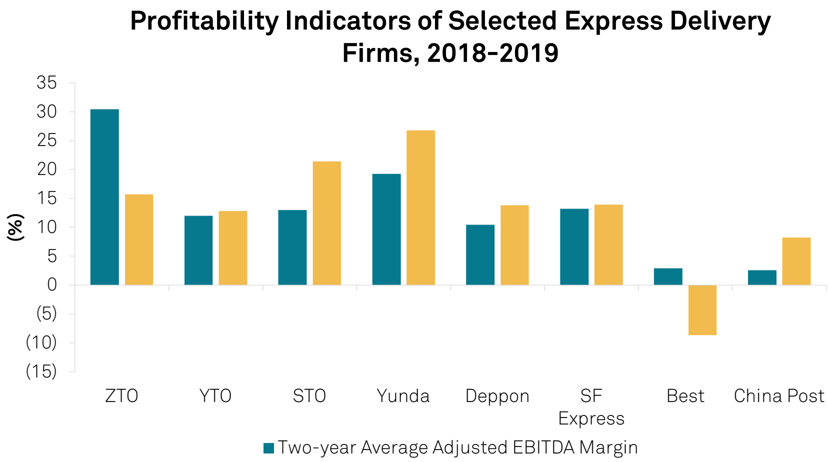
Chart 11



Note: Data from public information, adjusted by S&P Global (China) Ratings.
Source: Company annual reports, company announcements, adjusted by S&P Global (China) Ratings.

By analyzing the companies' EBITDA profit margin and ROE, we can also see differences in profitability across the sample. Overall, ZTO's profitability is good among the sample companies, while that of China Post and Best Group is weaker. Pressure on China Post's profitability may, in our opinion, be related to it being mandated with not-for-profit or limited profit services. Best Group's profitability is weaker than its peers, which may be due to the company's relatively late entry into the market. It has had to lower its unit price and increase the scale of its network and provision of subsidies to franchisees in exchange for market share. Another factor behind Best Group's lower profitability may be its long-term asset-light model which brings cost control challenges.

Chart 12



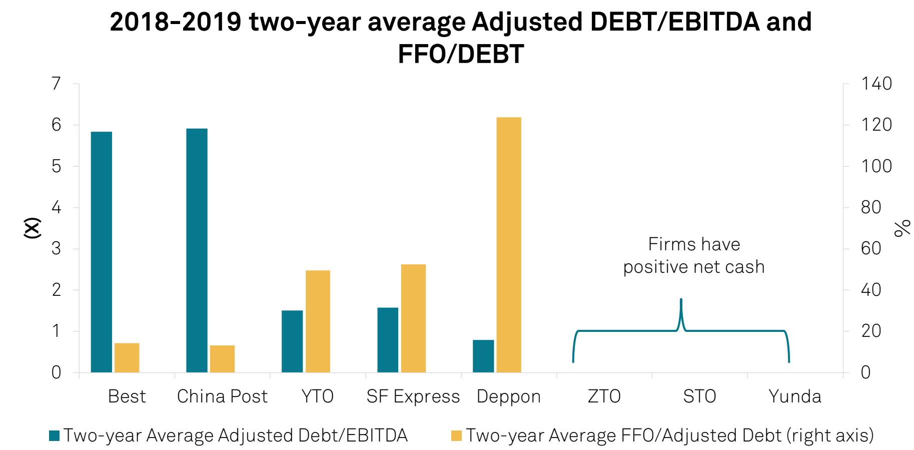
Note: China Post data adjusted to remove influence from Postal Savings Bank.
Source: Company annual reports, company announcements, adjusted by S&P Global (China) Ratings.

Financial Risk Profile

Our analysis of a company's financial risk typically focuses on its cash flow coverage of debt obligations. To gauge a company's financial risk, we typically look at the enterprise's adjusted debt to EBITDA multiple and funds from operations (FFO) to adjusted debt ratio.

We have found that the leverage ratios of our sampled logistics companies are, overall, not high. Their interest coverage is good, and overall financial risk is controllable. As they mainly use equity to fund growth, leading to relatively low debt levels in our sample. Best Group's higher adjusted debt to EBITDA ratio is mainly because of its low EBITDA. When compared to credit metrics from different industries, the median adjusted total debt to EBITDA ratio and interest coverage ratio of the parcel delivery sector is at a good level among all industries, and its overall financial risk is relatively low.

Chart 13

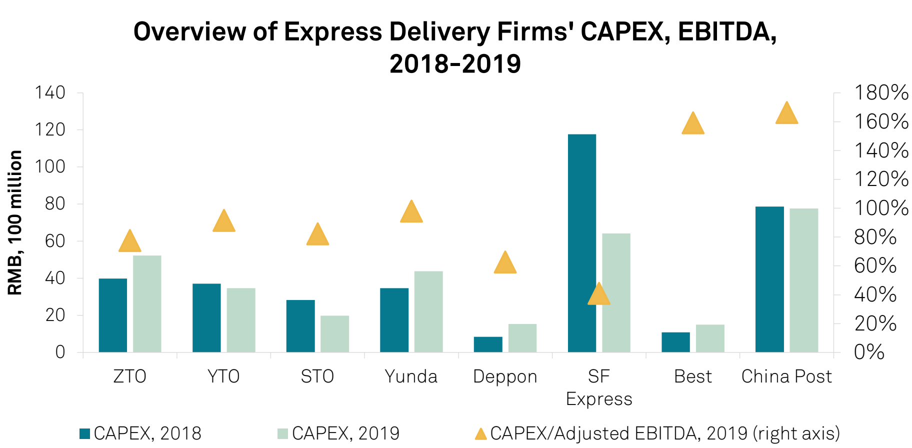


Note: China Post data adjusted to remove influence from Postal Savings Bank.
Source: Company annual reports, adjusted by S&P Global (China) Ratings.

Amid increasingly fierce competition, we expect the EBITDA profit margin of the logistics companies in our sample to come under some pressure. Express delivery franchises have a high degree of business homogenization and compete on pricing. Meanwhile, SF Holdings and other companies are gradually laying out an "economic express delivery" service with lower prices. Therefore, the price per delivery among the sampled companies is on a downward trend overall. The decrease in unit price may, in our view, offset the positive impact brought by increasing package volume, and eventually lead to downward pressure on the EBITDA profit margin of each enterprise.

However, we also regard the sample companies as having sufficient financial flexibility to cope with declining profitability and ongoing capital investment, while maintaining financial stability to some extent. In our opinion, their financial buffer may be due to the industry's fast turnover. The delivery companies generally do not have a large amount of working capital requirements over a long period. Historical data show us that most of the sample companies' capital expenditure could be funded by their EBITDA, with the proportion of capital expenditure over EBITDA at a level lower than 1.

Chart 14

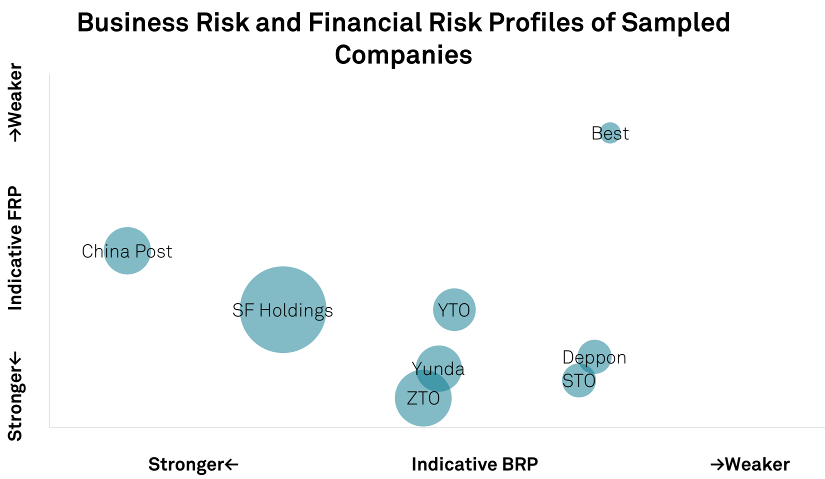


Note: China Post data adjusted to remove influence from Postal Savings Bank.
Source: Company annual reports, company announcements, adjusted by S&P Global (China) Ratings.

Distribution of Indicative Business Risk and Financial Risk Profiles

We have arrived at an overview of the sampled companies' indicative business risk profiles and financial risk profiles, the distribution of which is displayed in the chart below:

Chart 15



Note: Bubble size represents adjusted EBITDA.
Source: S&P Global (China) Ratings.

External Support

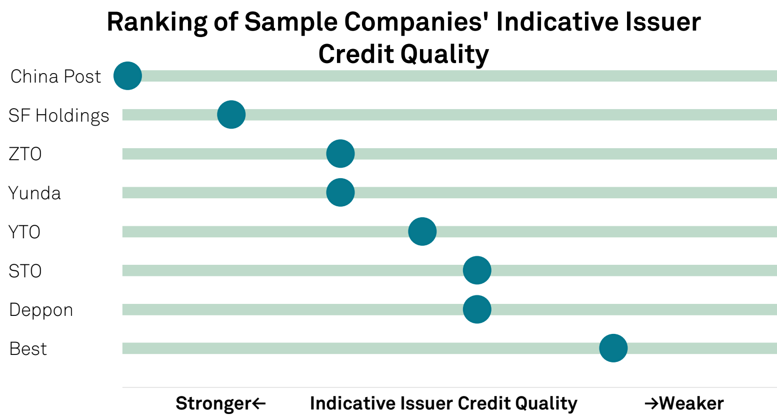
When considering the stand-alone credit profile of a company, we will also gauge the influence of government or group support on the firm's credit situation.

We believe that China Post is of critical importance to the central government. China Post is a large enterprise with 100% of its shares held by the Ministry of Finance. As an agency mandated with the task of providing postal services on behalf of the state, China Post has long played an important role in promoting national economic and social development, and other responsibilities. At the same time, it has also undertaken the task of handling confidential communications, in accordance with state regulations. China Post provides postal services on behalf of the State Post Bureau across its wide network. Services are provided at low prices with the aim of providing access to every Chinese citizen to postal services. Other functions it carries out include dissemination of culture and public service information at discounted prices. By the end of 2019, China Post had set up 54,000 post offices, 73.8% of which were in rural areas. 100% of China's rural villages and towns are covered by China Post's services, making it the country's most extensive network.

Distribution of Indicative Issuer Credit Quality

After analyzing their business risk profiles, financial risk profiles and levels of government support, we have arrived at a ranking of the eight sampled companies' indicative issuer credit quality, as shown in the chart below.

Chart 16



Note: The chart only displays a relative ranking of indicative issuer credit quality.
Source: S&P Global (China) Ratings.

This report does not constitute a rating action.

This document is prepared in both English and Chinese. The English translation is for reference only, and the Chinese version will prevail in the event of any inconsistency between the English version and the Chinese version.