Royal Mail PLC

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Royal Mail shares are 'overvalued', says Deutsche Bank as it cuts target price

Royal Mail Group PLC (LON:RMG) shares are "overvalued", Deutsche Bank said as it repeated a 'sell' rating and cut its target price to 150p from 180p.

Deutsche Bank said Royal Mail's shares may look like a 'buy' as the company expects a significant rebound in profits and cash flow as part of its five-year strategic plan.

READ: Royal Mail plans 40% dividend cut to pay for next stage of turnaround
"But in our view there are no easy short-/medium-term fixes for the Royal Mail as the business model is largely a fixed cost business, that is facing a material decline in letter volumes and has a unionised workforce," the bank said.

Last month, Royal Mail posted a 30% drop in adjusted pre-tax profit to £398mln on revenue up 2% to £10.58bn for the year to the end of March.

The UK parcel and letters division, UKPIL, generated flat sales of £7.6bn as parcel revenue rose 7% on volumes up 8%, offset by letter revenue falling 6% as volumes declined 8%.

Dividend yield 'looks expensive' against nearest peers
Royal Mail raised its dividend by 4% to 25p per share but said it could cut the payout to 15p per share from 2019-20 to help pay for its new turnaround strategy.

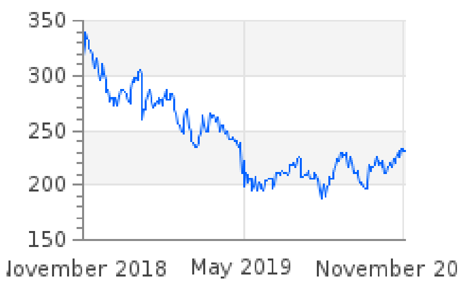
Deutsche Bank noted that setting a 15p dividend for the next five years puts the stock on a circa 7% dividend yield, which in its analysts view looks expensive against the UK firm's nearest peers Bpost and PostNL, with arguably both those companies further down the line in terms of restructuring than Royal Mail.

Royal Mail's new strategy is to broadly double operating profit over the next four years after it has fallen to a range of £300-340mln from £376mln in 2018-19.

Price: 198.237

Market Cap: £1.98 billion

1 Year Share Price Graph



Share Information

Code:		RMG
Listing:		LSE
52 week	**High**	**Low**
	347.5	**186.803**
Sector:		**Business & education services**
Website:		**www.royalmail.com**

Company Synopsis:
As the sole provider of the Universal Service in the UK, Royal Mail Group delivers a six-days-a-week, one-price-goes-anywhere postal service to more than 29 million addresses across the UK. Royal Mail is the preferred delivery company in the UK. We are a vital link connecting communities, businesses and customers.

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Deutsche Bank expects Royal Mail to post an operating profit of £420mln for 2023-24, compared to the company's implied guidance of £600mln.

Union pressures to hamper profits
The investment bank said Royal Mail's discussions with the Communication Workers Union will start shortly and given that management expects a sharp increase in profitability, it may be hard for the company to push back on the union's demands for improved pay and conditions for their members.

"When we look back over history at other European postal operators (e.g., Deutsche Post), we find that when a postal company is in restructuring mode, shareholders are typically not at the top of the stakeholder lists (e.g., Royal Mail dividend cut to 15p) as cash flows get diverted to the employees, complex restructuring/modernisation and M&A,"

Deutsche Bank said.

"This has resulted in periods of material share price underperformance."

'Light-touch' regulations mean Royal Mail could raise prices

On the outlook for Royal Mail, Deutsche Bank said the structural decline in addressed mail volumes will persist as volumes continue to shift to e-commerce channels.

However, the bank believes Royal Mail has a "light-touch regulatory framework" with only 5% of revenues subject to direct price controls.

For this reason, Deutsche Bank thinks the decline in addressed letter volumes needs to be mitigated by stamp price increases, the ability to transform and significantly improve efficiency and growth from both the UK and European parcels businesses.

"But improving cash flow and profitability at the RMG is in our view hard as the business is largely a fixed cost business and unionised," it added.

"We think that it is more difficult to modernise and take costs out of the business in an environment where GDP growth is weak and wage bill pressures persist due to low unemployment rates."

In morning trading, Royal Mail shares were up 3.6% to 201.6p.