



# COMPANY STRATEGY AND GENERAL BUSINESS CONTEXT IN 2008

## General

TNT N.V., through its two divisions, Express and Mail, is part of the global transportation and distribution industry, and dedicated to providing delivery solutions to its customers. The global transportation and distribution industry is a vast industry whose market size is estimated to be over US\$3,500 billion. TNT serves more than 200 countries and employs around 163,000 people. Over 2008, TNT reported €11,152 million in revenues, an operating income of €982 million and cash from operating activities of €923 million. TNT N.V. is listed and traded on Euronext Amsterdam by NYSE Euronext (ticker "TNT").

TNT is strongly committed to responsible corporate citizenship and implements various international standards in order to retain its "licence to operate" in the broadest sense. TNT measures, benchmarks and reports its performance. Simultaneously with this annual report, TNT is publishing its corporate responsibility report. Corporate responsibility is also included in this annual report, see chapter 3.

On 11 April 2008, TNT held its annual general meeting of shareholders at Schiphol-Rijk, the Netherlands. The attendance rate was 48% of the total outstanding share capital, up from 32% in 2007. During the annual general meeting of shareholders all proposed resolutions were adopted, including the extension of authority to issue shares.

## Mission and strategy

### Mission statement

TNT's mission is to exceed its customers' expectations in the transfer of their goods and documents around the world. TNT delivers value to its clients by providing the most reliable and efficient solutions through delivery networks.

TNT aims to lead the industry by:

- instilling pride in its people,
- creating value for its shareholders, and
- sharing responsibility for the world in which it operates.

### Business description

TNT is in the business of transferring goods and documents around the world tailored to its customers' requirements with a focus on time-certain and/or day-certain pick up and delivery. It is TNT's business to deliver the "business" of its customers at the right time and at the right place.

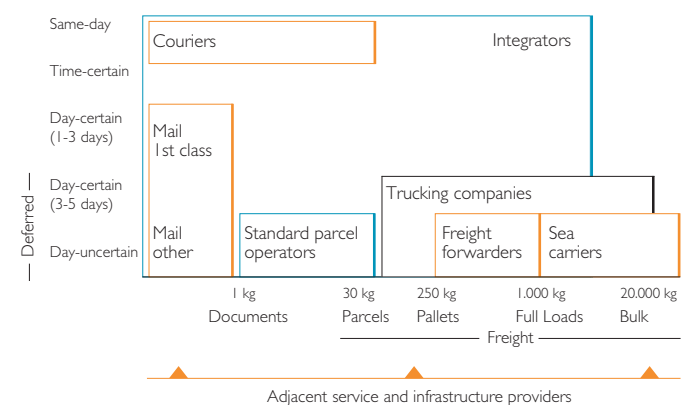
TNT picks up, transports, sorts, handles, stores and delivers documents, packets, parcels, and freight by combining physical infrastructures such as depots and trucks, electronic infrastructures such as billing and track-and-trace systems, and commercial infrastructures to attract, serve and retain customers.

Goods and documents have different weights, shapes and sizes. They can be as light and small as a postcard or they can be as heavy and big as the engine of a jumbo jet. They can also change shape, such as when several parcels are combined into a single pallet, and they can have different requirements in terms of speed of delivery, security and point of delivery. Goods and documents can have very different distance characteristics, ranging from domestic to cross-border/regional to intra-continental to intercontinental.

In general, weight and speed are most commonly used to characterise different kinds of customer requirements. This is illustrated in two-dimensional charts such as the one shown below, where the weight categories are below one kilogramme (documents), between one and 30 kilogrammes (parcels) and above 30 kilogrammes (pallets, full loads and bulk) and the speed categories are same-day, time (and day) certain (e.g. 10:00 next day), day-certain/1-2 days, day-certain/3-5 days and day-uncertain.

### Global transportation industry – segmentation

Market size: approximately US\$ 3,500 billion



Source – R.W. Baird, report 'global Integrators', January 2007

All these different types of requirements need different delivery networks and are served by different operators (see chart above). These range from very efficient and time-sensitive (air and road) express networks operated by *integrators* to less expedited *sea carriers*. *Freight forwarders* operate virtual networks, using block space on other operators' planes, ships and (to a lesser extent) trucks, and their own depots and sites in harbours and at airports. *Couriers* focus on same and (intercontinental) next day delivery with a focus on light weights. Finally, in the widest sense, peripheral operators such as infrastructure providers (*port authorities*, *airport operators*, *motorway owners*), *consultants* and *software companies* can also be considered as participants in this sector.

### Focus on Networks strategy

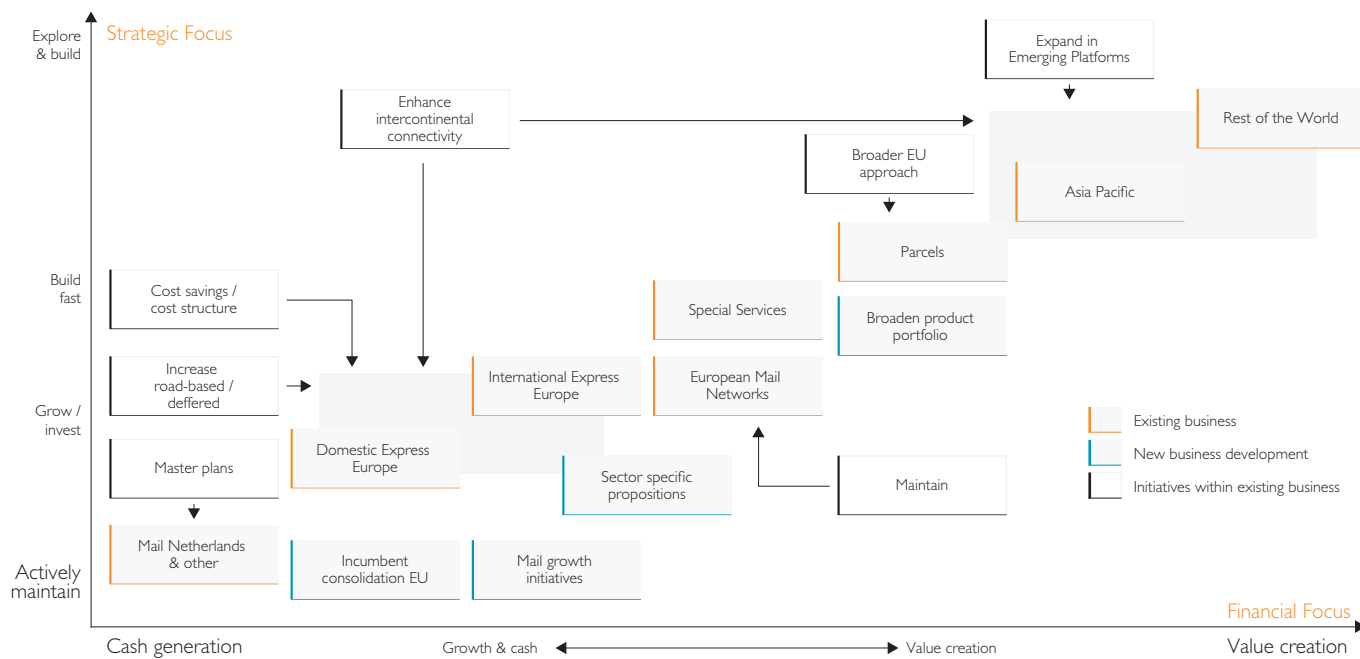
TNT's strategy is to focus on providing delivery solutions by expertly managing delivery networks. TNT calls its strategy "Focus on Networks". This strategy was first presented in the fourth quarter of 2005, contains manageable execution risks, and is based on TNT's core strengths, with the objective of achieving profitable growth. For more information on risks, see chapter 13.

In the first phase of its Focus on Networks strategy, TNT concentrated on transforming its foundations by exiting its logistics and freight management activities, concentrating on (Mail and Express) multi user networks and optimising its capital structure.

Since the start of the second phase (called "Grow and Build Value") in December 2007, the emphasis is now on further strengthening and actively maintaining the core of the portfolio (Express Europe and Mail Netherlands) and accelerating the build-up of the emerging platforms in European Mail and

Parcels and Express emerging businesses. In addition, other “delivery solution opportunities” such as deferred services and niche solutions for specific client sectors are being actively developed (see chart below).

### TNT's portfolio of networks



TNT's networks are in different development phases and offer a range of growth opportunities. TNT's most mature business is its Mail network in the Netherlands, where TNT actively seeks to maintain its market leadership in a declining market with increasing competition. TNT's Express networks in Asia, in particular in India, China and South-east Asia, and in selective other emerging markets, such as Brazil, are at the other end of the spectrum and are among the least mature networks in its portfolio. In these geographies TNT can be leading in shaping the market by strongly growing its road networks and so attain market leadership. In Europe, TNT continues to grow its Express and Mail networks by building on its existing strong position. TNT aims to accelerate growth in its networks organically, as well as through selected acquisitions.

TNT has a portfolio of delivery solution businesses and it leverages its strong brand across all activities around the world.

The essence of TNT's business model is to operate multi-client delivery networks. TNT's aim in each of these networks is to achieve cost and service leadership through scale and continuous network optimisation. In addition, largely dedicated networks, for instance for Fashion, Health and Document express deliveries, are managed and further developed.

## Industry context

### General

TNT believes the following trends will be increasingly relevant to its business over the next five to ten years:

#### Economy

The global economic crisis will affect the overall consumption in the world, leading to lower volumes being transported.

#### Environment

There is growing consensus amongst the general public, politicians and others that climate change is threatening the environment. Increasing levels of carbon dioxide (CO<sub>2</sub>) in the atmosphere are trapping more heat, thus increasing global temperatures. This phenomenon, referred to as global warming, will give rise to all sorts of measures and regulations that try to abate the CO<sub>2</sub> emissions around the globe. Since transport and distribution contribute nearly one-fifth to these emissions, the transport and distribution industries will be affected significantly by any measures or regulations. TNT has responded pro-actively to this challenge by launching its Planet Me initiative. More details on Planet Me can be found in TNT's 2008 corporate responsibility report.

### Demographic trends

Demographic trends are changing the composition of the population across the globe. For example, in the largest Western European countries it is estimated that between 20% and 25% of the population will be above the age of 65 by 2020. Also, people will live increasingly in cities with more than five million inhabitants (so-called megacities), posing significant distribution challenges.

As a result of the ageing population, spending on healthcare will increase significantly. In addition, there is a trend towards more biopharma products and an increased need for special handling services in healthcare.

These trends have several implications for the transportation and distribution industry, such as accelerated growth of healthcare product flows, an increasing demand for to-consumer distribution networks, and possibly more challenges in attracting and retaining staff.

### Restructuring of global supply chains

Driven by globalisation, multinationals continue to move their manufacturing to countries with low-cost labour such as China. With an increasing middle class in the emerging countries, spending in those markets will rise, driving regional transportation and global flows as well. In contrast, environmental concerns may eventually lead to a renewed regionalisation of manufacturing and regional "self sufficiency" models.

### Digitisation

Digitisation is a trend that TNT has faced for quite some time. As a result of continuously improving technologies, documents can be digitised, transmitted and reproduced without requiring delivery of the printed material. Digitised design of goods and services as well as globalisation of product development and promotion will also influence delivery requirements.

## Express markets

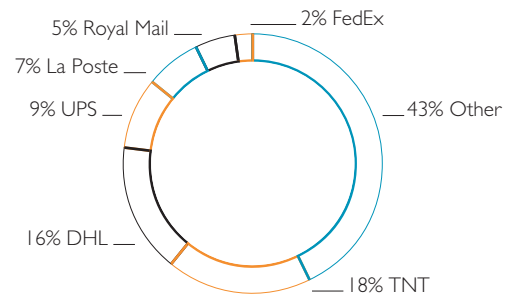
Competition in the express market focuses on network coverage, speed, reliability, quality of customer service as well as price. There are essentially two types of express players: the global integrators and the local/regional express players. The four global integrators are UPS, FedEx, DHL, and TNT. Standard parcels operators (often related to postal incumbents) and Less-Than-Truckload (LTL) operators can be seen as potential new sub-regional entrants. Larger players can achieve attractive margins through economies of scale and (to a lesser extent) scope. Local and regional players focus on high local network density.

The express sector has significant barriers to entry, mainly the required scale and network reach, ICT capabilities, investments in fixed assets, brand name, and reputation. New entrants may come from the parcel and freight sectors where companies might improve their offerings to day-definite products. This could increase price competition.

TNT uses a clear express market definition to clarify its position within the sector. This express market definition encompasses time-certain, next-day and fastest by air or road day-certain delivery for business-to-business consignments transported through a scheduled network, with door-to-door track-and-trace of individual items/consignments. For 2007, TNT estimated the size of this market in Europe to be approximately €21 billion. TNT consolidated its market leadership in Europe with a market share of 18%, followed by DHL (16%), UPS (9%) and La Poste (7%).

European express market (excluding intercontinental):

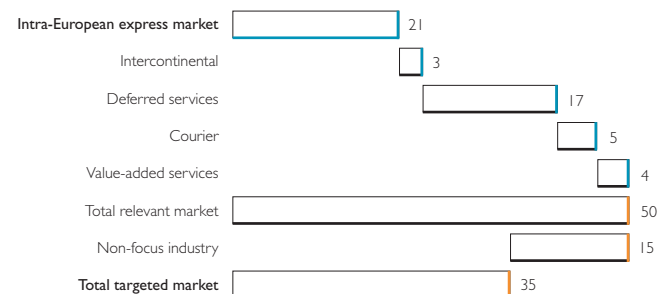
### Market shares Europe



Based on information and analysis of competitors across several market segments in various countries during five years, TNT estimates the potential addressable market in Europe at approximately €50 billion. In addition to the European express market, this potential addressable market includes a wider range of services such as intercontinental flows between Europe and the rest of the world, deferred services, courier services and value-added services. The total size of TNT's targeted market within this broader market is €35 billion, which excludes industry segments that are non-focus to TNT (e.g. chemicals and base materials). TNT can expand in the targeted industries with extended service offers (see chart).

### Size of European B2B Market 2007

in € billion



Based on information and analysis during 5 years of 423 unique competitors, across 29 market segments and 31 countries.

Key value drivers for the express market can be broken down into three categories: growth, pricing, and cost. The main drivers for growth in the express market are in principle GDP development and increasing globalisation of supply chains. Important pricing drivers are consolidation, intensifying competition and costs of fuel through surcharges. Key cost drivers are rounds and stops in pick-up and delivery, kilometres travelled in linehaul and manhours in hubs and warehouses. Most of these costs are adjustable over time as they are in the majority subcontracted, but cost developments will depend on volumes, autonomous increases, network optimisation possibilities and required step-ups in investment.

## Mail markets

The mail sector has its historical roots in a national service that was provided by government organisations to assure communication in a country. In most countries the sector is highly regulated, with an incumbent in a protected, monopoly position. However, in Europe the sector is being liberalised step by step. On 20 February 2008 the EU published a new Postal Directive, confirming that the main part of the market should be liberalised by 2011, with a fully liberalised market throughout the EU in 2013 at the latest. At this moment, the United Kingdom, Germany and Finland have formally liberalised their mail markets. However, in practice, regulation makes it difficult for new market players to actually enter these markets.

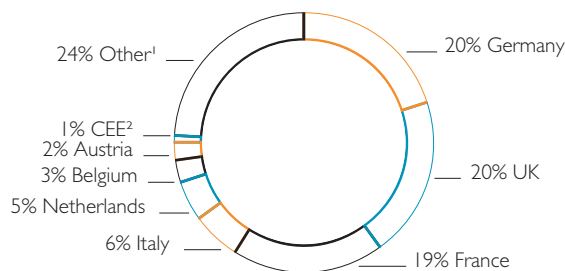
As the mail sector has no natural barriers to entry, competition is developing rapidly in countries where real liberalisation is taking place. In particular in the Netherlands, two nationwide postal competitors are active next to the historical incumbent TNT Post. However, in most countries governments

have moved to protecting their national operator one way or the other, and create regulatory barriers to entry (see chapter 11 for more details). As a result, many European markets still continue to be dominated by the incumbent, with challengers holding a small, but slowly growing, market share.

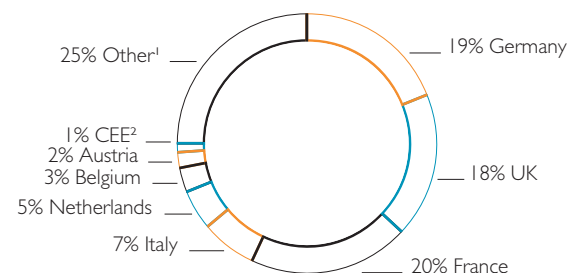
As a result of new communication technologies, the mail market as a whole is in decline. Volumes are dropping in most countries in Europe, with the strongest decline in those countries that have the highest level of internet penetration in households. The dependence on mail for communication, and as a result the demand from customers for a next-day mail delivery service, is changing. This makes way for new market players, offering a less frequent but more economical service than the historical daily delivery the incumbents are legally required to provide. The mail market environment is in a phase of fundamental transformation.

### European addressed mail market

Volume 102 billion pieces



Revenue € 56 billion



1 – Other includes other (to be) EU countries, Norway and Switzerland  
2 – Central and Eastern Europe

TNT takes different positions in these markets, the size of which is estimated at 102 billion items and at €56 billion revenue for Europe (see chart). In the Netherlands, TNT is the historical incumbent that has to manage the decline of its market share, which market share is estimated at 86% in 2008. In other European countries, TNT takes the challenger position. TNT estimates its market share in volume in the addressed mail market at 3% in Germany, 12% in the United Kingdom and 2% in Italy. For the smaller countries in which TNT is active (Austria, Belgium, Czech Republic and Slovakia), the market share is around 1%. In unaddressed mail, TNT's market share is around 7% in Germany, 13% in the United Kingdom, 31% in Italy and around 55% in mentioned smaller countries.

## Business context, vision and strategy

### Express

The Express business is one of high but cyclical growth. Several market trends shape the future of Express:

- significantly above-GDP growth rates in most segments of this market due to continuous off-shoring to low-cost countries, and further outsourcing of in-house transportation, value-added services and logistical activities.
- a structural shift towards deferred/economy products (road, rail-based) due to increased environmental focus, stronger cost focus, and increased energy costs. The current economic climate amplifies this structural trend.
- increased demand for global door-to-door delivery and integration of total supply chains (across different modes of transport).

The vision for the TNT Express cluster of businesses is to achieve a sustainable leading position in Europe and the emerging markets by expanding and cost optimising the dense domestic and regional pick-up and delivery and regional linehaul networks, whilst continuing to strengthen the business through extending the service windows in all weight classes and for all sectors.

The TNT Express strategy follows this vision, focusing on the following four elements:

- seek higher-than-market growth by expanding to an offering that encompasses a range of time-based service windows for a full range of weight classes,
- manage the costs down through optimising the networks and overhead costs to cater for the current poor economic environment and lower volumes in the network, in particular in the air network in Europe,
- gain market share and scan for local acquisition opportunities to strengthen the core whilst at the same time redesigning TNT's own networks to deal with the changing demand patterns of its customers, and
- continue to expand the unique domestic (road based) positions in the largest emerging markets.

*More details on Express can be found in chapter 4.*

## Mail

The Mail business is a mature-to-declining cluster of businesses that constantly needs to adjust itself to changing volumes and emerging competition. Three market trends define the future of the Mail business:

- changing communication patterns following digitisation,
- increasing competition in Europe due to liberalisation, and
- consolidation as a result of liberalisation.

Whilst the first trend results in volume decline, the other two trends create growth opportunities for TNT outside the Netherlands.

The vision for the TNT Mail cluster of businesses is to become a leading European mail company that leverages its core strengths in cost and regulation management for mail and related activities and that grows new businesses in core geographical markets building on assets, brand and capabilities.

The TNT Mail strategy follows this vision, focusing on five elements in parallel:

- manage cost and sales in the Dutch operations through Master Plans and prepare for alternative business models to adjust to the changing market situation,
- where regulation allows, grow the challenger position of TNT Post outside the Netherlands through European Mail Networks,
- use TNT's deep expertise in cost efficiently running mail networks as an opportunity for other incumbent mail operators,
- more than doubling Parcels revenue from 2008's €420 million by 2014 with a 10-12% operating margin by building from TNT's successful Benelux model and by cooperating with Express, and
- leverage TNT's brand and reputation to capture the digitisation trend by offering new products in e-commerce fulfilment, digital products, and financial services.

*More details on Mail can be found in chapter 5.*

## Financial strategy

TNT's financial strategy is based on three pillars:

- driving business performance by using value-based performance measures and standardisation of business processes,
- maintaining the right financial flexibility to support growth platforms via capital expenditure and mergers and acquisitions, and
- keeping the capital structure efficient and strong, at an investment grade long term credit rating of "around BBB+".

These three key components of the financial strategy directly relate to:

- effective risk management, internal control, integrity and compliance,
- financial risk management and risk insurance structures,
- aligned legal and funding structures, and
- a balance in short and medium term shareholder returns through profitable growth, dividends and incidental share repurchases or other shareholder returns from medium term excess cash.

TNT's current capital structure is based on and managed along the following components:

- maintaining a credit rating at investment grade "around BBB+",
- availability of at least €500 million of undrawn committed facilities,
- structural funding via a combination of public and bank debt, with a risk-weighted mix of fixed and floating interest,
- cash pooling systems facilitating optimised cash requirements for the group by facilitating centralised funding and surplus cash concentration at group level, and
- a tax optimal internal and external funding focused at optimising the cost of capital for the group, within long term sustainable boundaries.

TNT's current long term credit ratings are BBB+ (stable outlook) for Standard & Poor's Ratings Services (S&P) and A3 (negative outlook) for Moody's Investors Services (Moody's). These credit ratings result from an evaluation and analysis of many different factors. As mentioned, TNT focuses on maintaining an investment grade credit rating of "around BBB+". For this purpose it monitors the development of the key credit ratios which are used by rating agents and which may vary from time to time:

- Funds From Operations (FFO) / Debt, whereby the FFO is based on operating profits from continuing operations, after tax, corrected for, among other things, depreciation and amortisation and other major non-cash items, and Debt is defined as total interest-bearing borrowings of the company, adjusted for on and off-balance sheet debt-like components and surplus cash (as used by S&P),
- Debt / EBITDA, whereby EBITDA is defined as operating profits before interest and taxes, corrected for, among other things, depreciation and amortisation as well as operating leases (as used by both S&P and Moody's),
- FFO / Interest, whereby Interest is corrected for, among other things, pensions and leases (as used by Moody's),
- Retained Cash Flow (RCF) / Debt, whereby the RCF is defined as FFO less dividend (as used by Moody's), and
- Free Cash Flow (FCF) / Debt, whereby the FCF is defined as the RCF corrected for capital expenditures and changes in working capital (as used by Moody's).

The weighted mix of the ratios above forms an important building block in TNT's financial parameter framework, whereby the current credit ratings are roughly based on the following ranges for the S&P ratios: an FFO / Debt

between 30%-35% and a Debt / EBITDA of 2.0x-2.5x. Moody's has not published a rating report on the basis of its new rating methodology that was introduced in December 2008. Therefore, at the moment, indicative ranges are not available under this new framework for the mentioned four ratios. Its most recent rating report is based on the old framework and gives a range for Debt / EBITDA below 3.0x and an RCF / Debt above 17%. These ranges per ratio as indicated by the rating agents may change over time, depending on market conditions and analytical considerations.

For its financial requirements in the context of its capital structure components, TNT works with approximately nine relationship banks. This number is influenced by financial service requirements of TNT related to its global spread in activities, businesses and legal entities.

Cash requirements for capital expenditure fluctuate from year to year, depending on the extent of strategic capital projects, but have been well covered by operating cash flows. The ratio of cash from operating activities to net capital expenditure was 3.2 in 2008, 2.6 in 2007 and 3.1 in 2006. This ratio is calculated as follows: net cash provided by operating activities plus interest received, divided by the sum of capital expenditure on other intangible assets, disposals of other intangible assets, capital expenditure on property, plant and equipment and disposals of property, plant and equipment, all as stated in TNT's consolidated cash flow statements. TNT expects these operating cash flows to continue to cover its capital expenditure requirements in the foreseeable future. TNT believes its businesses also generate sufficient liquidity to cover its working capital requirements.

TNT aims to grow its Free Cash Flow in the medium term. TNT defines its FCF as the net Cash From Operating Activities plus interest received, minus capital expenditure on property, plant, equipment and intangible assets, plus proceeds from sale of smaller assets.

Part of the cash flow is used for paying dividends that result after the appropriation to the reserves of (part of) the profit. TNT tries to meet shareholders' return requirements long term through growth in the value of the company, and short term through dividends and, incidentally, tax exempt share repurchases or other returns from excess cash. Following its dividend guidelines, TNT intends to pay interim and final dividends annually in cash and/or shares. The TNT Reserves and Dividend Guidelines can be viewed on TNT's corporate website, [group.tnt.com](http://group.tnt.com). In 2007, TNT announced its intention to increase the dividend pay-out from around 35% over 2006 of normalised net income to around 40% by 2010, barring any unforeseen circumstances. Normalised net income is defined as profit attributable to the equity holders of the parent adjusted for significant one time and special items.

For any acquisitions that exceed the company's immediate cash resources, the company would seek to raise capital in the financial markets by means of bank borrowings and private or publicly traded debt. For very substantial

transactions, if required TNT would also consider issuing hybrid debt or equity in order to maintain an investment grade "around BBB+". Given the strength of TNT's financial position, credit ratings, and bank relationships, TNT under normal market circumstances does not foresee an inability to access a wide range of capital markets including equity, public debt, private debt and bank borrowing. TNT monitors and manages key financial ratios that are consistent with a strong credit rating. There are no aspects of TNT's current capital structure that TNT believes would trigger a material increase in the cost of its debt or the inability to access capital markets.

For details on the interest rates charged on TNT's more significant long term loans as well as the maturity of TNT's long term loans and commitments, see notes 12 and 28 to the consolidated financial statements of TNT N.V.

TNT does not hold or issue financial instruments for trading purposes, nor does TNT allow its subsidiaries to do so. For details on TNT's use of financial instruments, see notes 3, 6, 12, 13, 29 and 30 to the consolidated financial statements of TNT N.V.

TNT operates a comprehensive insurance policy covering its operational risk profile as appropriate, using a mix of self insurance, reinsurance, and direct external insurance.

As frequency losses (such as cargo and vehicle claims) are of an operational and customer service nature, TNT believes that for part of these losses self insurance is the best method to motivate operational units to address the underlying causes of these losses. TNT's total self insured frequency claims are structured via an in-house captive insurance company and capped on an annual basis via reinsurance. During 2008, TNT's total annual retention cap on these losses was €5 million.

TNT's "catastrophe exposures" are insured in the traditional insurance markets. These include aviation, property and business interruption, general liability, fraud, and director and officers' liability insurance. TNT has a strict policy to transfer risks only to insurers with a rating of A- or higher, and this is monitored on an ongoing basis.

Attention is being given to adjust TNT's insurance protection to the ever-changing legal and regulatory environment in which it operates, and all insurance policies are therefore tailor-made to TNT's unique requirements. In addition, current insurance arrangements also need to support strategic developments and the changing risk profile of the company.

TNT's financial strategy and actions will take into account the key components of its financial solidity requirements as mentioned.

sure *we can*



Annual report 2008