

Freightways

NEUTRAL

Warm Feel from Cool Deal

Freightways (FRE) is to acquire temperature controlled transport player Big Chill, in a deal that highlights a more aggressive, yet still disciplined, acquisitive approach. While there are some similarities between its existing Express Package operations, Big Chill represents diversification into an attractive transport segment with favourable margins, defensive characteristics and secular growth. Financially the deal is attractive: (1) meaningful EPS accretion, and (2) a growth pathway to achieve a ROIC in excess of WACC within 2–3 years, in our view. While we exclude the deal from our modelling at this stage, given lack of information on Big Chill, we believe it will provide modest valuation upside.

Deal summary

- Initial price of NZ\$117m, representing 80% of EV, 20% deferred to 2022
- EV/EBITDA multiple of 7.9x forward
- Completion in 2H20 subject to OIO and other non-specified conditions

Attractive strategic asset

Big Chill operates in an attractive market segment offering secular growth and a duopoly market structure (competition on a national network basis is limited to just Halls). It has nine modern and purpose built facilities across New Zealand including a chilled/frozen warehouse in Auckland.

EPS accretion should be more than mid-single digits in FY21 and FY22

Management suggest that the deal will be modestly EPS accretive in FY20 but rising to mid-single digits thereafter. Notwithstanding synergies being limited, we expect EPS accretion in FY21 and FY22 could be closer to double digits (pre-IFRS 16 changes), in light of the deal funding costs only being applicable for the initial purchase price.

Return on capital discipline

We estimate deal ROIC (return on invested capital) will be ~7% in year one after completion. While sub-WACC, we acknowledge the growth opportunity that Big Chill offers and therefore believe a ROIC > WACC outcome is realistic within 2–3 years. Management has historically demonstrated M&A discipline and appears to be doing so again.

Balance sheet capacity

FRE will fund the transaction through bank debt. This will increase its net debt/pro-forma EBITDA to 1.9x–2.0x. Management suggest this will fall to ~1.75x in the short term; driven by underlying earnings growth and a potential DRP (dividend reinvestment plan). While we are comfortable with this level of gearing it may limit management's ability to pursue other M&A opportunities near term.

Investment View

FRE is a well-managed company with a leading position in the domestic courier market. It also has a material presence in the domestic and Australian information management markets. Historically, it has been able to achieve above average earnings growth through a combination of organic and acquisitive means; however, its exposure to a number of sunset industries will drag on long-term growth, in our opinion. We have a NEUTRAL rating on FRE.

NZX Code	FRE
Share price	NZ\$7.95
Target price	NZ\$8.30
Risk rating	Medium
Issued shares	154.8m
Market cap	NZ\$1,231m
Average daily turnover	173.5k (NZ\$1,333k)

Share Price Performance



Financials: June	19A	20E	21E	22E
NPAT* (NZ\$m)	61.0	66.5	73.7	79.9
EPS* (NZc)	39.4	43.0	47.6	51.6
EPS growth* (%)	2.4	9.0	10.9	8.3
DPS (NZc)	30.5	32.2	35.7	38.7
Imputation (%)	100	100	100	100

Valuation (x)	19A	20E	21E	22E
EV/EBITDA	12.3	11.4	10.6	10.0
EV/EBIT	14.3	13.5	12.4	11.6
PE	20.2	18.5	16.7	15.4
Price / NTA	n/a	n/a	n/a	n/a
Cash dividend yield (%)	3.8	4.1	4.5	4.9
Gross dividend yield (%)	5.3	5.6	6.2	6.8

*Historic and forecast numbers based on underlying profits

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Forsyth Barr is acting as a financial adviser to Freightways in respect of its acquisition of Big Chill.

Freightways Ltd (FRE)

Priced as at 30 Oct 2019: NZ\$7.95

June year end

Forsyth Barr valuation					Valuation Ratios						
Valuation methodology					2018A 2019A 2020E 2021E 2022E						
DCF and sum-of-the-parts					EV/EBITDA (x)	12.9	12.3	11.4	10.6	10.0	
					EV/EBIT (x)	14.7	14.3	13.5	12.4	11.6	
12-month target price (NZ\$)*	8.30	Spot valuations (NZ\$)			PE (x)	20.6	20.2	18.5	16.7	15.4	
Expected share price return	4.4%	1. DCF		8.05	Price/NTA (x)	n/a	n/a	n/a	n/a	n/a	
Net dividend yield	4.2%	2. Sum-of-the-parts		7.83	Free cash flow yield (%)	4.7	4.3	4.7	5.2	5.7	
Estimated 12-month return	8.6%	3. n/a		n/a	Net dividend yield (%)	3.7	3.8	4.1	4.5	4.9	
					Gross dividend yield (%)	5.2	5.3	5.6	6.2	6.8	
					Imputation (%)	100	100	100	100	100	
					Pay-out ratio (%)	77	77	75	75	75	
Key WACC assumptions					DCF valuation summary (NZ\$m)						
Risk free rate	2.00%	Total firm value			1,390	Capital Structure					
Equity beta	0.97	(Net debt)/cash			(144)	2018A	2019A	2020E	2021E	2022E	
WACC	7.8%	Value of equity			1,246	Interest cover EBIT (x)	9.8	10.1	11.5	14.5	18.2
Terminal growth	1.5%	Shares (m)			155	Interest cover EBITDA (x)	11.1	11.7	13.6	17.0	21.2
					Net debt/ND+E (%)	37.4	35.6	33.7	31.1	28.3	
					Net debt/EBITDA (x)	1.4	1.3	1.2	1.0	0.9	
Profit and Loss Account (NZ\$m)					Key Ratios						
2018A	2019A	2020E	2021E	2022E	2018A	2019A	2020E	2021E	2022E		
Sales revenue	581	616	646	676	714	Return on assets (%)	16.8	16.6	17.2	18.4	19.2
Normalised EBITDA	108	112	121	130	138	Return on equity (%)	23.1	22.3	23.5	24.7	25.2
Depreciation and amortisation	(16)	(18)	(19)	(19)	(20)	Return on funds employed (%)	13.0	14.4	0.0	0.0	0.0
Normalised EBIT	94	97	102	111	118	EBITDA margin (%)	18.5	18.2	18.7	19.2	19.3
Net interest	(10)	(10)	(9)	(8)	(6)	EBIT margin (%)	16.2	15.8	15.8	16.4	16.6
Associate income	-	-	-	-	-	Capex to sales (%)	3.2	3.8	3.5	3.5	3.5
Tax	(23)	(24)	(27)	(30)	(32)	Capex to depreciation (%)	131	151	137	140	143
Minority interests	-	-	-	-	-	Operating Performance					
Normalised NPAT	60	61	66	74	80	2018A	2019A	2020E	2021E	2022E	
Abnormals/other	3	2	-	-	-	Revenue (NZ\$m)					
Reported NPAT	62	63	66	74	80	Express Package & Business Mail	427	451	472	493	517
Normalised EPS (cps)	38.5	39.4	43.0	47.6	51.6	Information Mgmt	154	164	174	184	197
DPS (cps)	29.8	30.5	32.2	35.7	38.7	Other/Inter company	-	-	-	-	-
					Total Sales	581	616	646	676	714	
					Revenue growth (%)						
Growth Rates	2018A	2019A	2020E	2021E	2022E	Express Package & Business Mail	6.5	5.7	4.5	4.5	5.0
Revenue (%)	6.5	6.0	4.9	4.8	5.6	Information Mgmt	6.7	6.9	6.0	5.4	7.2
EBITDA (%)	6.7	4.2	7.6	7.7	6.1	Total	6.5	6.0	4.9	4.8	5.6
EBIT (%)	7.6	2.9	5.2	8.7	6.7	Volumes	n/a	n/a	n/a	n/a	n/a
Normalised NPAT (%)	5.4	2.4	9.0	10.9	8.3	Pricing	n/a	n/a	n/a	n/a	n/a
Normalised EPS (%)	5.2	2.4	9.0	10.9	8.3	Acquisitions	n/a	n/a	n/a	n/a	n/a
DPS (%)	7.2	2.5	5.6	10.9	8.3	Net new business	n/a	n/a	n/a	n/a	n/a
					Total EBITDA	108	112	121	130	138	
					EBITDA margin (%)						
					Express Package & Business Mail	75	80	86	93	98	
					Information Mgmt	35	35	38	40	43	
					H/Office	(2)	(3)	(3)	(3)	(4)	
					Total EBITDA	108	112	121	130	138	
					EBITDA margin (%)						
					Express Package & Business Mail	17.5	17.7	18.3	18.9	19.0	
					Information Mgmt	23.0	21.5	21.7	22.0	22.0	
					Group EBITDA margin	18.5	18.2	18.7	19.2	19.3	
					EBITA (NZ\$m)						
					Express Package & Business Mail	68	72	78	85	90	
					Information Mgmt	30	29	31	34	36	
					H/Office	(4)	(5)	(5)	(5)	(5)	
					Total EBITA	94	97	104	113	121	
					NZDAUD	0.92	0.94	0.94	0.94	0.91	
Balance Sheet (NZ\$m)					2018A	2019A	2020E	2021E	2022E		
Working capital	20	24	19	19	20	Cash Flow (NZ\$m)					
Fixed assets	103	107	109	112	115	EBITDA	108	112	121	130	138
Intangibles	358	365	369	373	377	Working capital change	0	-	-	-	-
Other assets	5	4	4	4	4	Interest & tax paid	(32)	(34)	(36)	(37)	(38)
Total funds employed	486	500	500	508	516	Other	0	(3)	(5)	(5)	(5)
Net debt/(cash)	154	151	144	135	125	Operating cash flow	76	76	80	88	95
Other non current liabilities	74	74	74	74	74	Capital expenditure	(18)	(23)	(23)	(24)	(25)
Shareholder's funds	258	274	283	299	317	(Acquisitions)/divestments	(6)	(9)	-	-	-
Minority interests	-	-	-	-	-	Other	(0)	(1)	-	-	-
Total funding sources	486	500	500	508	516	Funding available/(required)	51	43	58	64	70
					Dividends paid	(45)	(47)	(50)	(55)	(60)	
					Equity raised/(returned)	1	1	-	-	-	
					Increase/(decrease) in net debt	(6)	3	(8)	(9)	(10)	

* Forsyth Barr target prices reflect valuation rolled forward at cost of equity less the next 12-months dividend

Big Chill acquisition

FRE is acquiring Big Chill on a deal multiple of 7.9x forward EBITDA. In light of the initial purchase price of NZ\$117m (80% of EV), this implies that Big Chill will generate EBITDA of ~NZ\$18.5m in FY21. Transaction costs will likely be expensed in FY20.

We estimate that the deal will be initially EPS accretive to the tune of ~+10% as illustrated in Figure 1. However, accretion will be adversely impacted by the incremental funding costs associated with the effective earn-out payment (20% of FY22 EV) payable in FY23.

Figure 1. Our assumptions around EPS accretion pre- IFRS 16 (NZ\$m)

	Current FY21E EPS	Big Chill	Pro-forma FY21E EPS	Change
EBITDA	130.1	18.5	148.6	14.2%
Depreciation & amortisation	(19.1)	(4.0)	(23.1)	20.9%
EBIT	110.9	14.5	125.4	13.1%
Interest	(7.7)	(4.7)*	(12.3)	61.1%
PBT	103.3	9.8	113.1	9.5%
Tax	(29.5)	(2.8)	(32.3)	9.3%
NPAT	73.7	7.1	80.8	9.6%
Shares on issue (m)	154.8		154.8	0.0%
EPS (cents)	47.6		52.2	9.6%

Source: Forsyth Barr analysis *4% funding costs on NZ\$117m

We further calculate that the deal ROIC in FY21E will be ~7.1%. This compares to our WACC estimate of ~7.8%.

Figure 2. Deal ROIC in FY21E (NZ\$m)

	Amount
EBIT	14.5
Cash taxes	(4.1)
NOPAT	10.4
Invested capital (100% of EV)	146.3
ROIC	7.1%
vs. WACC	7.8%

Source: Forsyth Barr analysis

Investment summary

Freightways (FRE) offers investors exposure to courier and records management businesses that enjoy high cashflow generation, scale benefits, barriers to entry and leading market positions. While parcel volume growth is slowing, FRE's pricing for effort initiative will deliver a material step-up in Express Package margins in FY20, which will drive an acceleration in group earnings growth. NEUTRAL.

Business quality

- **Management track record:** Impressive longer term organic growth coupled with valued accretive business building in its Information Management division through M&A.
- **Competitive advantage:** FRE's dominant share of the NZ courier market profit pool and its high ROIC generation are a function of its strong market leadership in the B2B (business to business) channel.

Earnings and cash flow outlook

- **Correlation to economic growth:** FRE's Express Package volume growth is correlated to New Zealand's GDP growth. Organic growth of existing customers is typically a more important driver than customer wins.
- **E-commerce:** E-commerce is providing additional volumes for the courier industry with rising B2C (business to consumer) activity. FRE's business is, however, more exposed to higher margin B2B.
- **Strong cashflow generation:** FRE offers investors exposure to courier and record management businesses which offer strong cashflow generation.

Company description

FRE was formed in 1964 and operates in the New Zealand courier market and Australasian records management industry. The company operates a multi-brand strategy, but has recently consolidated its Information Management brands (except Shred-X) into TIMG. Each brand services a different segment/geography of its targeted markets. Brands include NZ Couriers, Post Haste, Castle Parcels, Sub 60, NOW Couriers, DX Mail, TIMG and Shred-X. FRE's major courier competitor is NZ Post's Courier Post business, but it also competes against smaller players including PBT Couriers and Fastway Couriers.

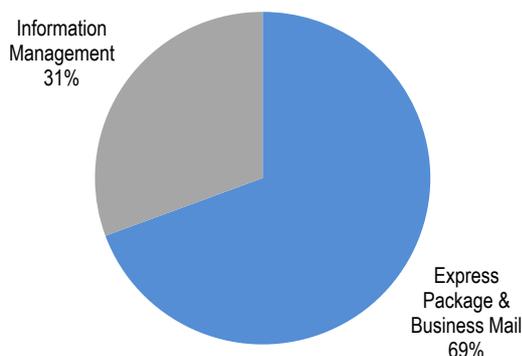
Financial structure

- **Conservative gearing:** FRE has a conservative balance sheet which provides scope for internally funded M&A.

Risk factors

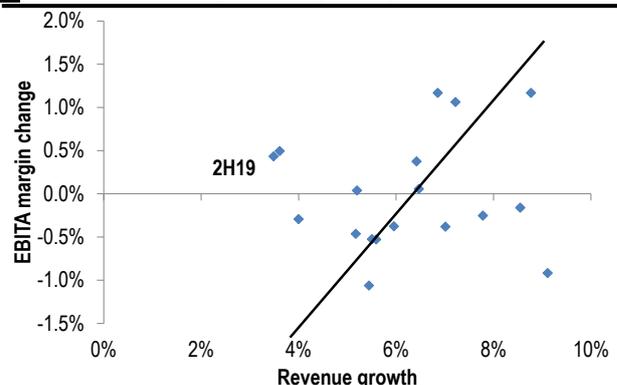
- **Cyclical environment:** FRE is exposed to the cyclical environment and therefore any sustained downturn will have an adverse impact on its performance.
- **Wage inflation:** The NZ courier industry largely uses a contractor model for its last mile deliveries. These owner drivers are outside minimum wage legislation, though competition for labour will create cost inflation.
- **Paperless offices:** FRE is exposed to the structural threat of less paper usage in its records management and document destruction businesses.

Figure 3. EBITDA divisional split (FY19)



Source: Forsyth Barr analysis

Figure 4. Express Package operating leverage (HYs: FY10 to 2H19)



Source: Forsyth Barr analysis

Figure 5. Substantial Shareholders

Shareholder	Latest Holding
Fisher Funds Management	6.9%
ANZ NZ Investments	6.5%
Investment Services Group	5.8%
Mawer Investment Mgmt	5.0%

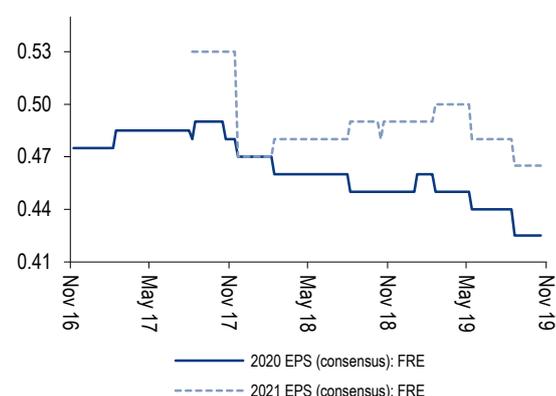
Source: NZX, Forsyth Barr analysis, NOTE: based on SSH notices only

Figure 6. International Compcoos

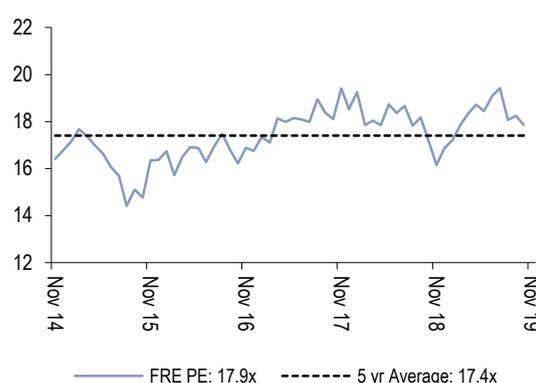
Company	Code	Price	Mkt Cap	PE		EV/EBITDA		EV/EBIT		Cash D/Yld
<i>(metrics re-weighted to reflect FRE's balance date - June)</i>										
			(m)	2020E	2021E	2020E	2021E	2020E	2021E	2021E
Freightways	FRE NZ	NZ\$7.95	NZ\$1,231	18.5x	16.7x	11.4x	10.6x	13.5x	12.5x	4.5%
Mainfreight *	MFT NZ	NZ\$40.35	NZ\$4,063	25.6x	23.5x	14.6x	13.4x	18.3x	16.8x	1.7%
FedEx Corp	FDX US	US\$158.49	US\$41,352	12.9x	11.3x	9.2x	8.3x	17.1x	14.9x	1.8%
United Parcel Service Inc	UPS US	US\$117.32	US\$100,686	15.0x	14.0x	10.9x	10.1x	13.8x	12.7x	3.5%
Deutsche Post AG	DPW GR	€32.09	€39,673	14.1x	12.7x	6.8x	6.3x	12.3x	11.1x	4.2%
Aramex PJSC	ARMX UH	AED4.00	AED5,856	10.4x	9.6x	6.3x	5.9x	9.2x	8.5x	5.6%
Iron Mountain Inc	IRM US	US\$33.84	US\$9,717	25.2x	23.8x	13.4x	12.5x	24.5x	22.1x	7.7%
			Compco Average:	17.2x	15.8x	10.2x	9.4x	15.9x	14.4x	4.1%
			FRE Relative:	+8%	+6%	+12%	+13%	-15%	-13%	+10%

EV = Current Market Cap + Actual Net Debt

Source: *Forsyth Barr analysis, Bloomberg Consensus, Compco metrics re-weighted to reflect headline (FRE) companies fiscal year end

Figure 7. Consensus EPS Momentum


Source: Forsyth Barr analysis, Bloomberg

Figure 8. 12 Month Forward PE


Source: Forsyth Barr analysis

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