

# Freightways

## 1H20 Preview – Volume Hangover

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**NEUTRAL** 

We expect Freightways (FRE) to report a subdued set of numbers for its 1H20 period on 24 February 2020, reflecting a hangover of the mid-calendar year 2019 domestic activity slowdown and margin pressure in Information Management. Our estimates are prior to the introduction of IFRS 16 (accounting for leases), which may also act as (a non-cash) headwind to earnings growth. Our existing forecasts for FY20 imply a vastly improved operating performance (2H20 NPAT +8%), but suggests earnings risk remains to the downside.

NZX Code	FRE	Financials: Jun/	19A	20E	21E	22E	Valuation (x)	19A	20E	21E	22E
Share price	NZ\$8.40	NPAT* (NZ\$m)	61.0	62.9	69.5	75.0	EV/EBITDA	13.0	12.5	11.6	11.0
Target price	NZ\$8.10	EPS* (NZc)	39.4	40.6	44.9	48.5	EV/EBIT	15.0	14.9	13.7	12.9
Risk rating	Medium	EPS growth* (%)	2.4	3.1	10.6	7.9	PE	21.3	20.7	18.7	17.3
Issued shares	154.8m	DPS (NZc)	30.5	30.5	33.7	36.4	Price / NTA	n/a	n/a	n/a	n/a
Market cap	NZ\$1,300m	Imputation (%)	100	100	100	100	Cash div yld (%)	3.6	3.6	4.0	4.3
Avg daily turnover	123.7k (NZ\$1,015k)	*Based on normalised profits					Gross div yld (%)	5.0	5.0	5.6	6.0

### Key issues to consider at FRE's 1H20 result

- **B2B (business-to-business) volumes:** 1Q20 Express Package volumes were down -1.5%. While we expect an improved performance through 2Q20 we still expect a subdued volume backdrop for the half.
- **Big Chill acquisition:** We have yet to consolidate Big Chill into our earnings estimates given limited financial information provided and uncertainty over deal completion timing. We look forward to an update.
- **Pricing for effort:** FRE has been disciplined in its enforcement of B2C (business-to-consumer) price increases with some margin benefit likely as a result, however, volume momentum will be impacted.
- **Information management margins:** The first quarter trading update highlighted a -600bps drop in margins over the past two years. Management is targeting a +20% increase in improvement in Australian utilisation over the next two years, which should assist margin recovery.

### Conference call details

FRE will host an analyst briefing at 11am on 24 February 2020, at our offices – Level 23, Lumley Centre, 88 Shortland Street, Auckland. Dial-in for those unable to attend in person: NZ – 0800 452 937; Australia – 1 800 803 167; passcode: 195 664 5013

**Figure 1. Earnings revisions (NZ\$m)**

	1H19	1H20E	Change
Sales revenue	314.8	323	3%
EBITDA	58.2	59.1	2%
EBITA	50.7	51.2	1%
<b>Reported NPAT</b>	<b>33.4</b>	<b>32.5</b>	<b>-3%</b>
Adjusted NPAT	33	32.5	-2%
Underlying EPS (cents)	21.3	21	-2%
Interim DPS (cents)	15	15	0%

Source: Forsyth Barr analysis

**Figure 2. Divisional breakdown (NZ\$m)**

	1H19	1H20E	Change
Express Package & Business Mail	232.6	238.4	2%
Information Management	82.2	84.6	3%
<b>Total revenue</b>	<b>314.8</b>	<b>323</b>	<b>3%</b>
Express Package & Business Mail	42.4	44.1	4%
Information Management	17.6	16.5	-16%
Corporate & Other	-1.8	-1.5	-16%
Total EBITDA	58.2	59.1	2%

Source: Forsyth Barr analysis

**Freightways Ltd (FRE)**

Priced as at 18 Feb 2020 (NZ\$)						<b>8.40</b>						
<b>12-month target price (NZ\$)*</b>						<b>8.10</b>	<b>Spot valuations (NZ\$)</b>					
Expected share price return						-3.6%	1. DCF	7.59				
Net dividend yield						3.9%	2. Sum-of-the-parts	7.94				
Estimated 12-month return						0.3%	3. n/a	n/a				
<b>Key WACC assumptions</b>							<b>DCF valuation summary (NZ\$m)</b>					
Risk free rate						2.00%	Total firm value	1,346				
Equity beta						0.97	(Net debt)/cash	(171)				
WACC						7.8%	Less: Capitalised operating leases	0				
Terminal growth						1.5%	Value of equity	1,175				
<b>Profit and Loss Account (NZ\$m)</b>	<b>2018A</b>	<b>2019A</b>	<b>2020E</b>	<b>2021E</b>	<b>2022E</b>	<b>Valuation Ratios</b>	<b>2018A</b>	<b>2019A</b>	<b>2020E</b>	<b>2021E</b>	<b>2022E</b>	
Sales revenue	580.9	615.7	635.2	662.5	694.9	EV/EBITDA (x)	13.5	13.0	12.5	11.6	11.0	
<b>Normalised EBITDA</b>	<b>107.7</b>	<b>112.2</b>	<b>115.8</b>	<b>124.2</b>	<b>131.2</b>	EV/EBIT (x)	15.4	15.0	14.9	13.7	12.9	
Depreciation and amortisation	(16.0)	(17.5)	(18.7)	(19.0)	(19.5)	PE (x)	21.8	21.3	20.7	18.7	17.3	
<b>Normalised EBIT</b>	<b>94.3</b>	<b>97.1</b>	<b>97.1</b>	<b>105.1</b>	<b>111.7</b>	Price/NTA (x)	n/a	n/a	n/a	n/a	n/a	
Net interest	(9.7)	(9.6)	(8.9)	(7.7)	(6.6)	Free cash flow yield (%)	4.4	4.1	4.2	4.6	5.0	
Associate income	0	0	0	0	0	Net dividend yield (%)	3.5	3.6	3.6	4.0	4.3	
Tax	(22.5)	(24.1)	(25.3)	(27.9)	(30.0)	Gross dividend yield (%)	4.9	5.0	5.0	5.6	6.0	
Minority interests	0	0	0	0	0	<b>Capital Structure</b>	<b>2018A</b>	<b>2019A</b>	<b>2020E</b>	<b>2021E</b>	<b>2022E</b>	
<b>Normalised NPAT</b>	<b>59.6</b>	<b>61.0</b>	<b>62.9</b>	<b>69.5</b>	<b>75.0</b>	Interest cover EBIT (x)	9.8	10.1	10.9	13.6	17.0	
Abnormals/other	2.6	2.4	0	0	0	Interest cover EBITDA (x)	11.1	11.7	13.0	16.1	19.9	
<b>Reported NPAT</b>	<b>62.2</b>	<b>63.4</b>	<b>62.9</b>	<b>69.5</b>	<b>75.0</b>	Net debt/ND+E (%)	37.4	35.6	33.9	31.5	28.9	
Normalised EPS (cps)	38.5	39.4	40.6	44.9	48.5	Net debt/EBITDA (x)	1.4	1.3	1.2	1.1	1.0	
DPS (cps)	29.8	30.5	30.5	33.7	36.4	<b>Key Ratios</b>	<b>2018A</b>	<b>2019A</b>	<b>2020E</b>	<b>2021E</b>	<b>2022E</b>	
<b>Growth Rates</b>	<b>2018A</b>	<b>2019A</b>	<b>2020A</b>	<b>2021A</b>	<b>2022A</b>	Return on assets (%)	16.8	16.6	16.4	17.5	18.2	
Revenue (%)	6.5	6.0	3.2	4.3	4.9	Return on equity (%)	23.1	22.3	22.3	23.5	24.0	
EBITDA (%)	6.7	4.2	3.2	7.3	5.6	Return on funds employed (%)	12.9	12.6	12.5	13.1	13.4	
EBIT (%)	7.6	2.9	0.0	8.3	6.2	EBITDA margin (%)	18.5	18.2	18.2	18.7	18.9	
Normalised NPAT (%)	5.4	2.4	3.1	10.6	7.9	EBIT margin (%)	16.2	15.8	15.3	15.9	16.1	
Normalised EPS (%)	5.2	2.4	3.1	10.6	7.9	Capex to sales (%)	3.2	3.8	3.5	3.5	3.5	
Ordinary DPS (%)	7.2	2.5	0.0	10.5	7.9	Capex to depreciation (%)	131	151	135	138	141	
<b>Cash Flow (NZ\$m)</b>	<b>2018A</b>	<b>2019A</b>	<b>2020E</b>	<b>2021E</b>	<b>2022E</b>	Imputation (%)	100	100	100	100	100	
<b>EBITDA</b>	<b>107.7</b>	<b>112.2</b>	<b>115.8</b>	<b>124.2</b>	<b>131.2</b>	Pay-out ratio (%)	77	77	75	75	75	
Working capital change	0.0	0	0	0	(0.0)	<b>Operating Performance</b>	<b>2018A</b>	<b>2019A</b>	<b>2020E</b>	<b>2021E</b>	<b>2022E</b>	
Interest & tax paid	(32.2)	(33.7)	(34.2)	(35.6)	(36.6)	<b>Revenue (NZ\$m)</b>						
Other	0.2	(2.5)	(5.0)	(5.0)	(5.0)	Express Package & Bus. Mail	427.1	451.3	464.8	483.4	505.1	
<b>Operating cash flow</b>	<b>75.7</b>	<b>76.0</b>	<b>76.6</b>	<b>83.6</b>	<b>89.5</b>	Information Mgmt	153.8	164.4	170.4	179.1	189.7	
Capital expenditure	(18.4)	(23.3)	(22.2)	(23.2)	(24.3)	<b>Total Sales</b>	<b>580.9</b>	<b>615.7</b>	<b>635.2</b>	<b>662.5</b>	<b>694.9</b>	
(Acquisitions)/divestments	(6.2)	(8.7)	0	0	0	<b>Revenue growth (%)</b>						
Other	(0.3)	(0.6)	0	0	0	Express Package & Bus. Mail	6.5	5.7	3.0	4.0	4.5	
<b>Funding available/(required)</b>	<b>50.7</b>	<b>43.5</b>	<b>54.3</b>	<b>60.4</b>	<b>65.2</b>	Information Mgmt	6.7	6.9	3.6	5.1	5.9	
Dividends paid	(45.4)	(47.0)	(47.2)	(52.2)	(56.3)	<b>Total</b>	<b>6.5</b>	<b>6.0</b>	<b>3.2</b>	<b>4.3</b>	<b>4.9</b>	
Equity raised/(returned)	0.7	0.7	0	0	0	<b>EBITDA (NZ\$m)</b>						
<b>(Increase)/decrease in net debt</b>	<b>6.1</b>	<b>(2.8)</b>	<b>7.1</b>	<b>8.2</b>	<b>8.9</b>	Express Package & Bus. Mail	74.8	80.0	84.1	90.4	95.0	
<b>Balance Sheet (NZ\$m)</b>	<b>2018A</b>	<b>2019A</b>	<b>2020E</b>	<b>2021E</b>	<b>2022E</b>	Information Mgmt	35.4	35.3	34.9	37.3	39.8	
Working capital	20.1	23.8	18.3	18.9	19.6	H/Office	(2.5)	(3.1)	(3.3)	(3.5)	(3.6)	
Fixed assets	103.1	106.7	108.5	110.8	113.8	<b>Total EBITDA</b>	<b>107.7</b>	<b>112.2</b>	<b>115.8</b>	<b>124.2</b>	<b>131.2</b>	
Intangibles	358.4	365.2	369.2	373.2	377.2	<b>EBITDA margin (%)</b>						
Right of use asset	0	0	0	0	0	Express Package & Business Mail	17.5	17.7	18.1	18.7	18.8	
Other assets	4.8	4.0	4.0	4.0	4.0	Information Mgmt	23.0	21.5	20.5	20.8	21.0	
<b>Total funds employed</b>	<b>486.4</b>	<b>499.7</b>	<b>499.9</b>	<b>506.9</b>	<b>514.6</b>	<b>Group EBITDA margin</b>	<b>18.5</b>	<b>18.2</b>	<b>18.2</b>	<b>18.7</b>	<b>18.9</b>	
Net debt/(cash)	154.4	151.4	144.3	136.1	127.1	NZDAUD	0.92	0.94	0.94	0.94	0.91	
Lease liability	0	0	0	0	0							
Other liabilities	73.8	74.3	74.3	74.3	74.3							
Shareholder's funds	258.2	273.9	281.4	296.5	313.2							
Minority interests	0	0	0	0	0							
<b>Total funding sources</b>	<b>486.4</b>	<b>499.6</b>	<b>499.9</b>	<b>506.9</b>	<b>514.6</b>							

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

## 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 value 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.

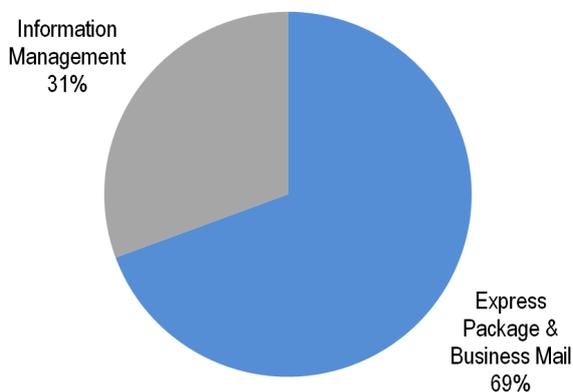
### Financial structure

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

### Risk factors

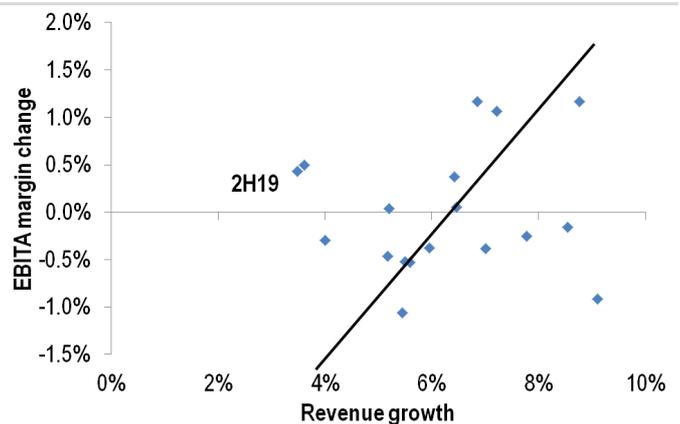
- **Cyclical environment:** FRE is exposed to the cyclical environment and therefore any sustained downturn will have an adverse impact on its performance.
- **Wage inflation:** The NZ courier industry largely uses a contractor model for its last mile deliveries. These owner drivers are outside minimum 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)

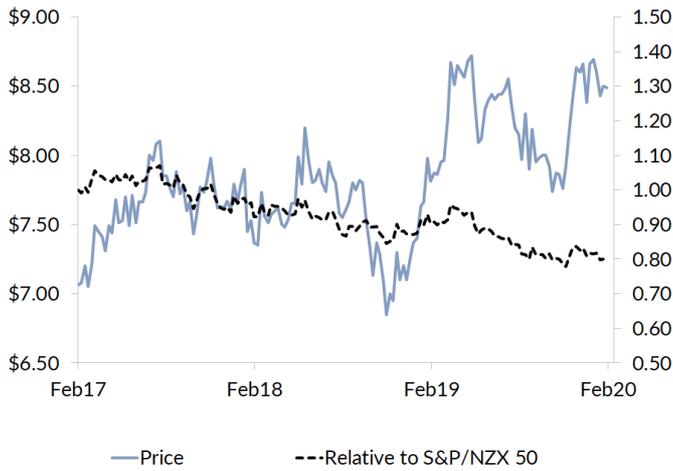


Source: Forsyth Barr analysis

Figure 4. EP division operating leverage (HY: FY10 to FY19)



Source: Forsyth Barr analysis

**Figure 5. Price performance**


Source: Forsyth Barr analysis

**Figure 6. Substantial shareholders**

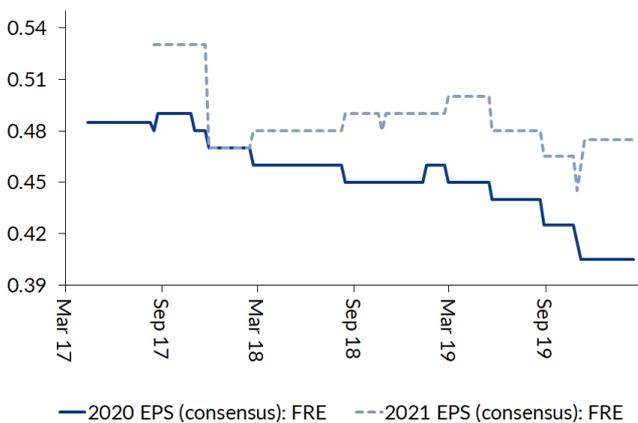
Shareholder	Latest Holding
ANZ NZ Investments	6.5%
Fisher Funds Management	5.8%
Investment Services Group	5.8%
Mawer Investment Mgmt	5.0%

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

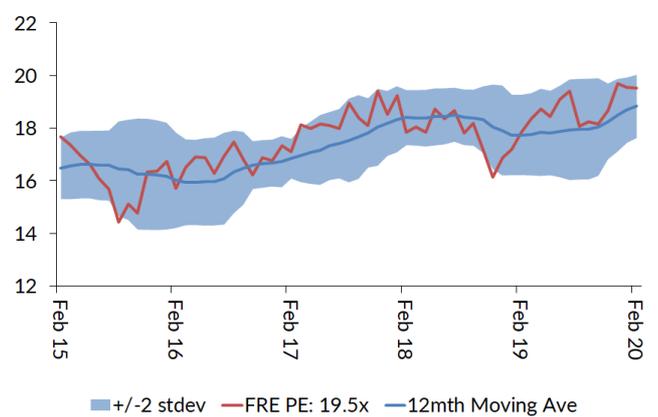
**Figure 7. International valuation comparisons**

Company (metrics re-weighted to reflect FRE's balance date - June)	Code	Price	Mkt Cap (m)	PE		EV/EBITDA		EV/EBIT		Cash Yld 2021E	
				2020E	2021E	2020E	2021E	2020E	2021E		
<b>Freightways</b>	<b>FRE NZ</b>	<b>NZ\$8.40</b>	<b>NZ\$1,300</b>	<b>20.7x</b>	<b>18.7x</b>	<b>12.5x</b>	<b>11.7x</b>	<b>15.0x</b>	<b>13.8x</b>	<b>4.0%</b>	
Mainfreight *	MFT NZ	NZ\$40.82	NZ\$4,111	25.5x	23.1x	14.6x	13.4x	18.2x	16.5x	1.7%	
FedEx Corp	FDX US	US\$158.62	US\$41,419	14.5x	12.5x	10.0x	9.0x	19.6x	16.5x	1.7%	
United Parcel Service Inc	UPS US	US\$105.95	US\$90,886	17.0x	12.9x	10.2x	9.5x	13.3x	12.4x	3.9%	
Deutsche Post AG	DPW GR	€33.03	€40,842	14.4x	12.9x	6.9x	6.4x	12.4x	11.1x	4.1%	
Aramex PJSC	ARMX UH	AED3.58	AED5,241	9.9x	9.0x	5.8x	5.0x	7.4x	7.1x	6.5%	
Iron Mountain Inc	IRM US	US\$33.14	US\$9,523	27.8x	22.5x	12.0x	12.6x	24.9x	n/a	7.6%	
<b>Compcpo Average:</b>				<b>18.2x</b>	<b>15.5x</b>	<b>9.9x</b>	<b>9.3x</b>	<b>16.0x</b>	<b>12.7x</b>	<b>4.2%</b>	
<b>EV = Current Market Cap + Actual Net Debt</b>				<b>FRE Relative:</b>	<b>14%</b>	<b>21%</b>	<b>26%</b>	<b>26%</b>	<b>-6%</b>	<b>9%</b>	<b>-6%</b>

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

**Figure 8. Consensus EPS momentum (NZ\$)**


Source: Forsyth Barr analysis

**Figure 9. One year forward PE (x)**


Source: Forsyth Barr analysis

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