

Freightways

1H21 — Picked-Up and Delivered

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OUTPERFORM

Freightways (FRE) reported a very strong 1H21 result, highlighting its enhanced quality characteristics and more attractive growth profile than yesteryear. The repositioning to take advantage of profitable secular growth in B2C (business-to-consumer) parcels, medical waste and temperature controlled freight, is being rewarded. We believe FRE is now a higher growth business, strategically rational but more willing to take risks. It has justifiably re-rated over the past six months yet at ~20x one year forward PE it still trades at a material discount to the domestic market. We believe it is now a higher quality business (enhanced competitive positioning, better growth potential, improved M&A track record, and lower exposure to sunset industries) that deserves a higher multiple. We retain an OUTPERFORM rating.

NZX Code	FRE	Financials: Jun/	20A	21E	22E	23E	Valuation (x)	20A	21E	22E	23E
Share price	NZ\$10.63	NPAT* (NZ\$m)	59.5	81.7	90.1	97.7	PE	28.2	21.6	19.6	18.0
Target price	NZ\$11.00	EPS* (NZc)	37.7	49.3	54.3	59.0	EV/EBIT	24.7	21.6	16.9	15.6
Risk rating	Medium	EPS growth* (%)	-7.3	31.0	10.2	8.5	EV/EBITDA	14.5	12.0	11.3	10.7
Issued shares	165.8m	DPS (NZc)	15.0	37.0	40.7	44.2	Price / NTA	n/a	n/a	n/a	n/a
Market cap	NZ\$1,762m	Imputation (%)	100	100	100	100	Cash div yld (%)	1.4	3.5	3.8	4.2
Avg daily turnover	210.7k (NZ\$1,591k)	*Based on normalised profits					Gross div yld (%)	2.0	4.8	5.3	5.8

What's changed?

- **Earnings forecasts:** +2% to +3% NPATA (NPAT before acquisition related amortisation) upgrades over the next three years
- **Target price:** Lifted to NZ\$11.00 from NZ\$10.50

Impressive volume growth

FRE is enjoying unprecedented organic revenue growth. We estimate after accounting for Big Chill and the since completed trans-Tasman airfreight operations, its Express Package operations (excluding DX Mail) grew revenues by +11% against the prior year, partly boosted by an additional week of trading. This strong growth more than made up for more pedestrian growth across Information Management (+3%), which experienced subdued handling activity within storage facilities.

Parcel margin uplift

The adverse margin mix headwind from higher growth but lower margin B2C (business-to-consumer) parcels that has dogged FRE's Express Package business appears to have passed an inflection point. We point to two key reasons which have more than offset the consolidation of slightly lower margin Big Chill in the period: (1) 'Pricing for Effort' has allowed FRE to account for the higher last mile cost of residential deliveries and generate an adequate margin. (2) Double digit parcel network growth, driven by stellar B2C and modest B2B increases, has helped drive operating leverage benefits.

M&A boost

FRE has always been an acquisitive company, yet the average deal size before Big Chill was tiny. Moreover, its troubled LitSupport deal in FY15 had created reasonable investor caution as to its M&A pedigree. Since Big Chill was announced it hasn't missed a beat, despite the early COVID-19 challenges. Big Chill has outperformed, for which FRE will pay the vendors for, in its larger earn-out due August 2022. Management appears hungry for larger deals offering greater rewards and history suggests it will remain rational.

Freightways Ltd (FRE)

Priced as at 22 Feb 2021 (NZ\$) **10.63**

12-month target price (NZ\$)*	11.00
Expected share price return	3.5%
Net dividend yield	3.7%
Estimated 12-month return	7.2%

Key WACC assumptions	
Risk free rate	2.30%
Equity beta	1.00
WACC	6.4%
Terminal growth	1.5%

Spot valuations (NZ\$)	
1. DCF	10.90
2. Sum-of-the-parts	10.33
3. n/a	n/a

DCF valuation summary (NZ\$m)	
Total firm value	2,742
(Net debt)/cash	(201)
Less: Capitalised operating leases	(735)
Value of equity	1,807

Profit and Loss Account (NZ\$m)	2019A	2020A	2021E	2022E	2023E
Sales revenue	615.7	630.9	796.3	837.2	877.5
Normalised EBITDA	112.2	144.7	191.6	203.7	215.0
Depreciation and amortisation	(17.5)	(50.4)	(66.5)	(66.6)	(66.8)
Normalised EBIT	97.1	84.7	105.9	137.1	148.2
Net interest	(9.6)	(18.4)	(22.2)	(19.6)	(20.0)
Associate income	0	0	0	0	0
Tax	(24.1)	(18.0)	(28.7)	(35.0)	(38.0)
Minority interests	0	0	0	0	0
Normalised NPAT	63.1	59.5	81.7	90.1	97.7
Abnormals/other	0.3	(12.1)	(26.8)	(7.6)	(7.6)
Reported NPAT	63.4	47.4	54.9	82.5	90.1
Normalised EPS (cps)	40.6	37.7	49.3	54.3	59.0
DPS (cps)	30.5	15.0	37.0	40.7	44.2

Growth Rates	2019A	2020A	2021E	2022E	2023E
Revenue (%)	6.0	2.5	26.2	5.1	4.8
EBITDA (%)	4.2	28.9	32.5	6.3	5.6
EBIT (%)	2.9	-12.7	25.0	29.5	8.1
Normalised NPAT (%)	2.5	-5.7	37.4	10.2	8.5
Normalised EPS (%)	2.4	-7.3	31.0	10.2	8.5
Ordinary DPS (%)	2.5	-50.8	>100	10.2	8.5

Cash Flow (NZ\$m)	2019A	2020A	2021E	2022E	2023E
EBITDA	112.2	144.7	191.6	203.7	215.0
Working capital change	0	0	0.0	0.0	0
Interest & tax paid	(33.7)	(28.6)	(39.7)	(43.4)	(46.8)
Other	(2.5)	11.1	(38.0)	(18.8)	(18.8)
Operating cash flow	76.0	127.2	113.9	141.4	149.4
Capital expenditure	(23.3)	(23.6)	(22.3)	(27.6)	(29.0)
(Acquisitions)/divestments	(8.7)	(101.6)	0	0	(47.0)
Other	1.9	(24.0)	(30.6)	(32.0)	(32.0)
Funding available/(required)	46.0	(22.0)	61.0	81.8	41.4
Dividends paid	(47.0)	(47.5)	(30.7)	(67.6)	(73.3)
Equity raised/(returned)	0.7	24.1	0	0	0
(Increase)/decrease in net debt	(0.3)	(45.4)	30.3	14.3	(31.9)

Balance Sheet (NZ\$m)	2019A	2020A	2021E	2022E	2023E
Working capital	23.8	18.7	22.7	23.6	24.4
Fixed assets	106.7	134.6	129.6	129.9	131.2
Intangibles	365.2	499.0	504.3	509.6	530.9
Right of use asset	0	278.1	348.1	348.1	348.1
Other assets	4.0	15.6	15.6	15.6	15.6
Total funds employed	499.7	946.1	1,020.4	1,026.8	1,050.2
Net debt/(cash)	151.4	205.0	174.7	160.4	192.3
Lease liability	0	311.1	381.1	381.1	381.1
Other liabilities	74.3	113.2	113.2	113.2	113.2
Shareholder's funds	273.9	316.7	351.3	371.9	363.5
Minority interests	0.1	0.1	0.1	0.1	0.1
Total funding sources	499.7	946.1	1,020.4	1,026.8	1,050.2

Valuation Ratios	2019A	2020A	2021E	2022E	2023E
EV/EBITDA (x)	17.1	14.5	12.0	11.3	10.7
EV/EBIT (x)	19.7	24.7	21.6	16.9	15.6
PE (x)	26.2	28.2	21.6	19.6	18.0
Price/NTA (x)	n/a	n/a	n/a	n/a	n/a
Free cash flow yield (%)	3.0	5.9	5.2	6.5	6.8
Net dividend yield (%)	2.9	1.4	3.5	3.8	4.2
Gross dividend yield (%)	4.0	2.0	4.8	5.3	5.8

Capital Structure	2019A	2020A	2021E	2022E	2023E
Interest cover EBIT (x)	10.1	4.6	4.8	7.0	7.4
Interest cover EBITDA (x)	11.7	7.9	8.6	10.4	10.7
Net debt/ND+E (%)	35.6	39.3	33.2	30.1	34.6
Net debt/EBITDA (x)	1.3	1.4	0.9	0.8	0.9

Key Ratios	2019A	2020A	2021E	2022E	2023E
Return on assets (%)	16.6	8.1	9.4	12.0	12.7
Return on equity (%)	23.0	18.8	23.3	24.2	26.9
Return on funds employed (%)	12.6	12.0	19.6	19.5	19.8
EBITDA margin (%)	18.2	22.9	24.1	24.3	24.5
EBIT margin (%)	15.8	13.4	13.3	16.4	16.9
Capex to sales (%)	3.8	3.7	2.8	3.3	3.3
Capex to depreciation (%)	151	50	38	47	49
Imputation (%)	100	100	100	100	100
Pay-out ratio (%)	75	40	75	75	75

Operating Performance	2019A	2020A	2021E	2022E	2023E
Revenue (NZ\$m)					
Express Package & Bus. Mail	451.3	472.2	625.0	650.0	682.5
Information Mgmt	164.4	158.8	171.3	187.2	195.0
Total Sales	615.7	630.9	796.3	837.2	877.5
EBITDA (NZ\$m)					
Express Package & Bus. Mail	80.0	101.7	140.3	146.9	154.9
Information Mgmt	35.3	47.1	54.3	59.9	63.4
H/Office	(3.1)	(4.1)	(3.0)	(3.2)	(3.3)
Total EBITDA	112.2	144.7	191.6	203.7	215.0

EBITDA margin (%)	2019A	2020A	2021E	2022E	2023E
Express Package & Business Mail	17.7	21.5	22.5	22.6	22.7
Information Mgmt	21.5	29.6	31.7	32.0	32.5
Group EBITDA margin	18.2	22.9	24.1	24.3	24.5

NZDAUD	0.93	0.95	0.93	0.92	0.91
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* Forsyth Barr target prices reflect valuation rolled forward at cost of equity less the next 12-months dividend

A better business; OUTPERFORM

Freightways' (FRE) 1H21 result was boosted by several secular trends which have accelerated as a result of COVID-19 (ecommerce parcels and medical waste growth). That said, FRE must take credit for positioning the business to take advantage of these drivers. The 'Pricing for Effort' initiative has transformed its appetite for residential parcel deliveries. A further secular growth trend that FRE can now access is temperature controlled freight, given its value accretive acquisition last year of Big Chill. This business is outperforming expectations at the time of the deal.

In addition to secular growth, the 1H21 result also demonstrates three other key characteristics of FRE's model. First, its competitive positioning, with service quality orientated market share gains across most, if not all, business streams. Second, its operational focus with clear productivity and efficiency gains evident. Third, its ability to add value from M&A. LitSupport aside, FRE has a long history of accretive deal making.

We lift our target price to NZ\$11.00 from NZ\$10.50. The uplift is driven by a combination of (1) earnings upgrades as referenced below, and (2) a higher market multiple, which drives the Express Package part of our sum-of-the-parts, partly offset by the impact of a higher risk free rate assumption within our WACC estimate (which moves to 6.4% from 6.1%).

Result summary

FRE reported a strong 1H21 result with underlying NPATA up +48% driven by a combination of (1) parcel volume growth accelerating with greater B2C mix, (2) pricing for effort gains, (3) the first time consolidation of the accretive Big Chill acquisition (performing well as acknowledged in the significant increase in the provision for the earn-out by NZ\$19.2m to NZ\$46.8m), and (4) margin recovery in Information Management. This is an impressive interim result that backs up the strong start to FY21 as evidenced in the Annual Shareholder Meeting update in October 2020. FRE is now leveraging its leading parcel operations to strategically target the higher growth B2C market, which should allow the company to sustain a higher level of earnings growth in future. An interim dividend of 15.5c is lower than anticipated but management suggests that the full year pay-out will be 75%-80% of NPATA.

Figure 1. Summary of 1H21 result (NZ\$m)

	1H20	1H21	Change	Forbar
Sales revenue	318.9	410.3	29%	409.7
EBITDA	71.3	99.8	40%	95.9
EBITA	50.1	71.0	42%	67.9
Reported NPAT	29.2	22.0	-25%	41.4
Underlying NPATA	30.3	45.0	48%	45.1
Underlying EPS (cents)	18.8	27.1	44%	27.2
Interim DPS (cents)	15.0	15.5	3%	18.0

Source: FRE, Forsyth Barr analysis Note: 1H21 includes one extra trading week

Figure 2. Segmental split of 1H21 result (NZ\$m)

	1H20	1H21	Change	Forbar
Express Package	236.6	325.3	37%	324.9
Information Mgmt	82.3	85.0	3%	84.8
Total revenue	318.9	410.3	29%	409.7
Express Package	49.8	74.4	49%	71.4
Information Mgmt	23.0	26.5	15%	27.4
Corporate & Other	(1.6)	(1.1)	-28%	(3.0)
Total EBITDA	71.3	99.8	40%	95.9

Source: FRE, Forsyth Barr analysis

Earnings revisions

We make modest upgrades to our earnings estimates as summarised in Figure 3. The upgrades principally stem from higher margin expectations in the Express Package and Business Mail division. FRE has several EBITDA run-rate headwinds in 2H21 in the form of (1) the end of its trans-Tasman operations, and (2) employee/contractor rate increases, which were deferred due to the six-month wage freeze as a result of COVID-19. These in combination amount to ~NZ\$8.5m. However, we expect the company can partly mitigate these headwinds with further pricing for effort gains, the ramp up of its digitisation project work, and better utilisation and activity levels in its Australian storage business.

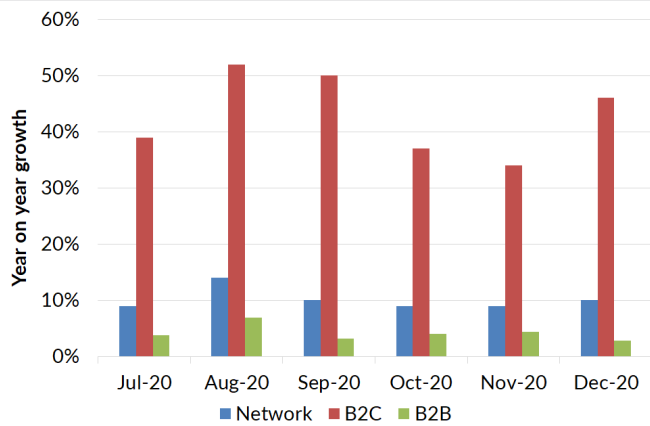
Figure 3. Earnings revisions (NZ\$m)

	FY21E			FY22E			FY23E		
	Old	New	Chg	Old	New	Chg	Old	New	Chg
Sales revenue	803.1	796.3	-0.8%	837.0	837.2	0.0%	874.1	877.5	0.4%
EBITDA	186.9	191.6	2.5%	197.0	203.7	3.4%	205.4	215.0	4.7%
EBITA	165.0	169.6	2.8%	173.7	181.6	4.5%	183.0	192.7	5.3%
Underlying NPATA	79.5	81.7	2.8%	88.6	90.1	1.7%	95.1	97.7	2.8%
Underlying EPS (cents)	48.0	49.3	2.7%	53.4	54.3	1.7%	57.4	59.0	2.7%
Full year DPS (cents)	36.0	37.0	2.7%	40.1	40.7	1.6%	43.0	44.2	2.8%

Source: Forsyth Barr analysis

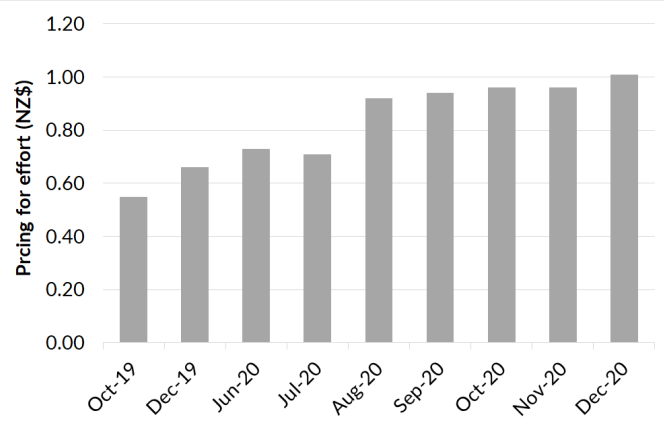
Key charts following FRE's 1H21 result

Figure 4. Express Package: volume growth by channel. Back-solving from company data suggests B2B volumes grew ~+4% in the period



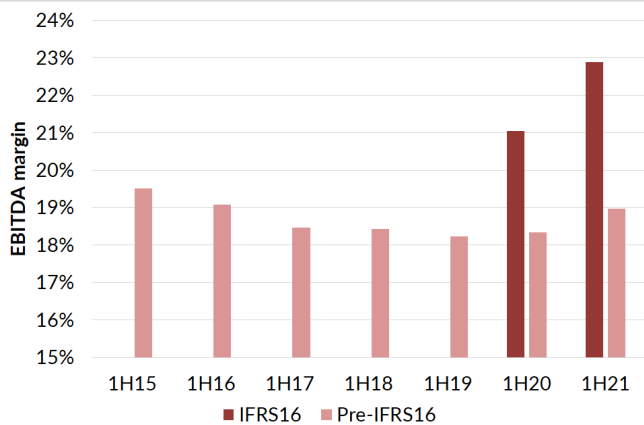
Source: FRE, Forsyth Barr analysis

Figure 5. Express Package: Pricing for Effort progress has slowed through 1H21, but FRE has moved again in Feb 2021 with a further 50c lift



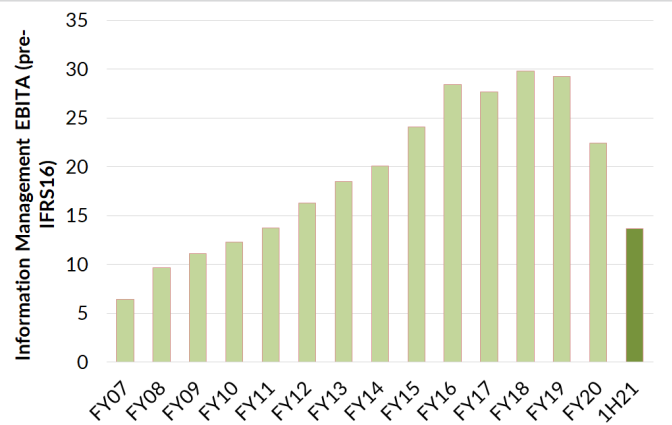
Source: FRE, Forsyth Barr analysis

Figure 6. Express Package: Margins are turning the corner after years of pressure from adverse mix



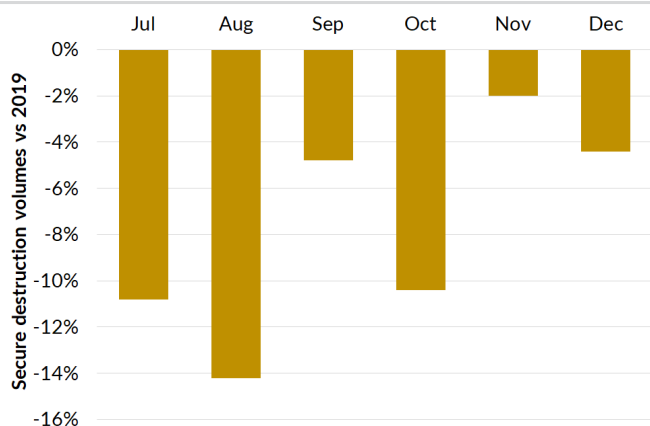
Source: FRE, Forsyth Barr analysis

Figure 7. Information Management: Profitability improving through cost initiatives in absence of revenue growth



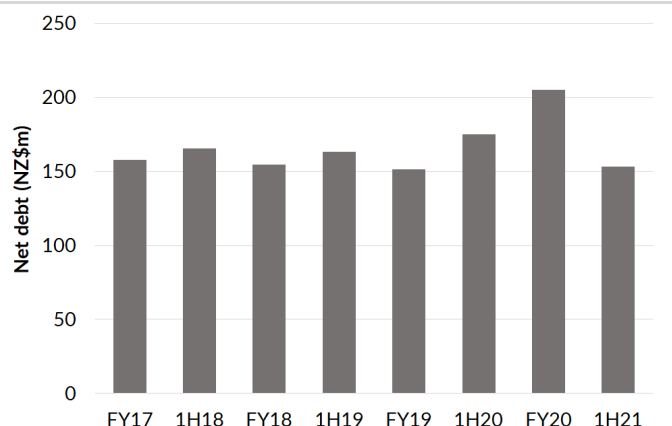
Source: FRE, Forsyth Barr analysis

Figure 8. Information Management: Destruction volumes held back by lockdowns through 1H21



Source: FRE, Forsyth Barr analysis

Figure 9. Balance sheet: Net debt back to pre COVID-19 and pre-Big Chill levels



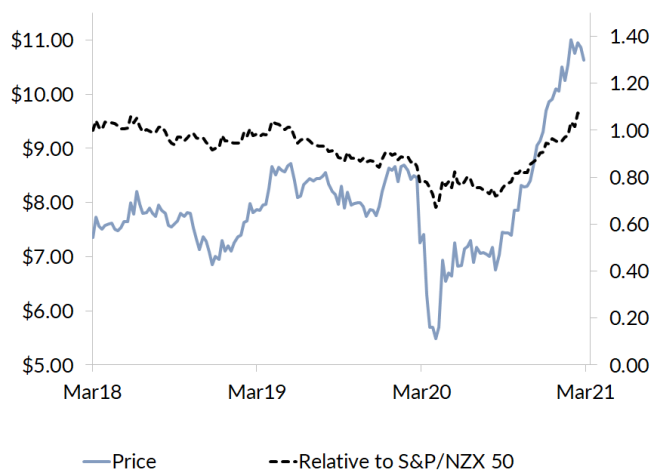
Source: FRE, Forsyth Barr analysis

Result analysis

Figure 10. 1H21 result summary (NZ\$m)

	1H20	1H21	Chg	Comments
Profit and loss account				
Sales revenue	318.9	410.3	28.7%	Organic growth and pricing gains, as well as all segments taking market share
Express Package & Business Mail	49.8	74.4	49.5%	B2C pricing for effort gains of NZ\$1.01 per item by Dec. B2C volumes up +46%
Information Management	23.0	26.5	15.0%	NZ storage utilisation at 83%, Aus 70%. Very strong Medical Waste growth.
Corporate & Other	(1.6)	(1.1)	-27.6%	Prior year included Big Chill deal costs
EBITDA	71.3	99.8	40.0%	
Depreciation and amortisation	(8.5)	(10.8)	27.4%	FY21 guidance of NZ\$22m
Lease depreciation	(12.7)	(18.0)	n/a	FY21 lease depreciation guidance of NZ\$37m for FY21
Acquisition amortisation	(1.2)	(3.8)	229.4%	
One-time items	0.0	(19.2)	n/a	Strong performance of Big Chill has led to an +NZ\$19.2m increase of earn-out price
Interest expense	(4.5)	(5.7)	26.3%	
Lease interest	(4.0)	(5.5)	n/a	
Profit before tax	40.4	36.8	-9.0%	
Taxation	(11.2)	(14.8)	31.9%	Effective rate of ~25%
Reported NPAT	29.2	22.0	-24.7%	
Adjustments	1.2	23.0	n/a	
Underlying NPATA	30.3	45.0	48.2%	
Underlying EPS (cents)	18.8	27.1	44.3%	Shares on issue of 166m
Interim DPS (cents)	15.00	15.50	3.3%	Fully imputed. Payout ratio of 57%, will lift to 75%-80% for full year
Cashflow and net debt				
Operating cashflow	61.4	103.6	69%	Operating cash flow boosted by acquisition of Big Chill
Maintenance capex = depn	(8.5)	(10.8)	27%	FY21 capex guidance of NZ\$20m-NZ\$22m (FY20 NZ\$23m)
Disposals	0.1	0.1	4%	
Free cash flow	53.0	92.9	75%	
Acquisitions	(7.5)	0.0	-100%	
Net debt	(174.9)	(153.2)	-12%	Gearing of 30% as at Dec 2020 (57% taking in to account IFRS 16 lease liabilities)
Margin analysis				
Express Package & Business Mail	18.3%	19.0%	63 bps	Volume driven operating leverage and 'Pricing for Effort'
Information Management	28.0%	31.2%	316 bps	Cost measures compensating for subdued revenue growth
Group EBITDA margin	22.4%	24.3%	197 bps	
Group EBITA margin	15.7%	17.3%	159 bps	
Divisional sales growth				
Express Package & Business Mail	1.7%	37.5%	3574 bps	Market share gains and Big Chill (revenue up +10% on pre deal levels). Postal revenue down -9%
Information Management	0.1%	3.3%	315 bps	+11% growth in destruction activities, -4% storage & handling

Source: FRE, Forsyth Barr analysis

Figure 11. Price performance


Source: Forsyth Barr analysis

Figure 12. Substantial shareholders

Shareholder	Latest Holding
ANZ NZ Investments	6.5%

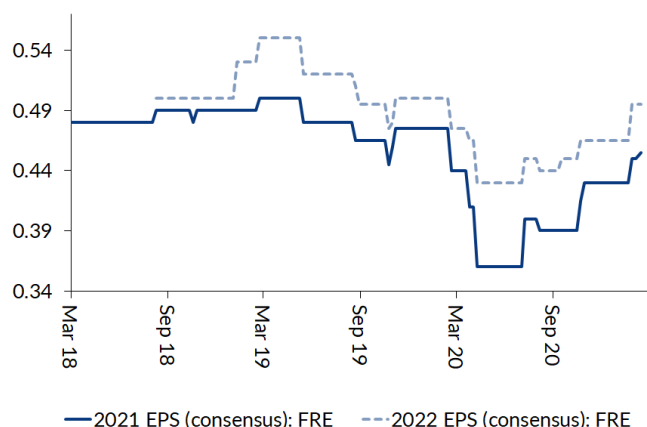
Source: NZX, Forsyth Barr analysis, NOTE: based on SPH notices only

Figure 13. International valuation comparisons

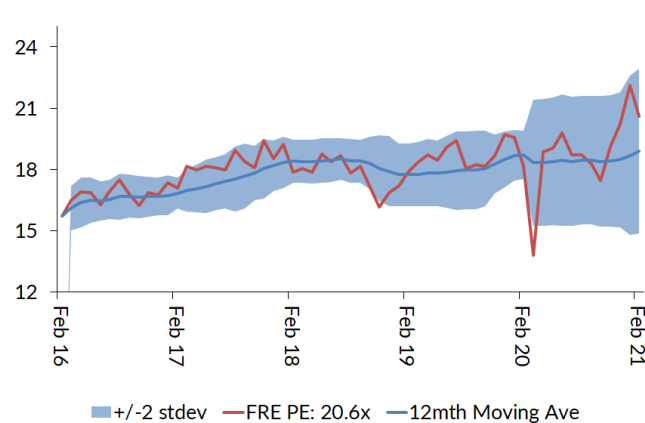
Company	Code	Price	Mkt Cap (m)	PE 2021E	PE 2022E	EV/EBITDA 2021E	EV/EBITDA 2022E	EV/EBIT 2021E	EV/EBIT 2022E	Cash Yld 2022E
(metrics re-weighted to reflect FRE's balance date - June)										
Freightways	FRE NZ	NZ\$10.63	NZ\$1,762	21.6x	19.6x	10.3x	9.7x	18.6x	14.4x	3.8%
MAINFREIGHT *	MFT NZ	NZ\$68.14	NZ\$6,862	37.3x	33.2x	15.2x	14.1x	25.2x	22.8x	1.2%
FEDEX CORP	FDX US	US\$254.06	US\$67,365	14.2x	13.4x	10.0x	9.2x	16.3x	14.7x	1.1%
UNITED PARCEL SERVICE-CL B	UPS US	US\$160.85	US\$139,127	>50x	17.4x	14.1x	12.6x	18.6x	16.1x	2.7%
DEUTSCHE POST AG-REG	DPW GR	€42.17	€52,251	16.1x	14.7x	7.5x	7.0x	13.0x	11.9x	3.4%
ARAMEX PJSC	ARMX UH	AED4.14	AED6,061	17.4x	12.8x	6.8x	6.4x	10.2x	9.8x	4.2%
IRON MOUNTAIN INC	IRM US	US\$32.79	US\$9,448	28.3x	23.4x	13.6x	12.7x	26.1x	23.4x	7.6%
Compco Average:				22.6x	19.1x	11.2x	10.3x	18.2x	16.4x	3.4%
FRE Relative:				-5%	2%	-8%	-7%	2%	-13%	14%

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 14. Consensus EPS momentum (NZ\$)


Source: Forsyth Barr analysis

Figure 15. One year forward PE (x)


Source: Forsyth Barr analysis

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	46.2%	36.5%	17.3%

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