

Freightways

Post More Reliant on Parcels (and Price?)

ANDY BOWLEY

 andy.bowley@forsythbarr.co.nz
 +64 4 495 8246

SCOTT ANDERSON

 scott.anderson@forsythbarr.co.nz
 +64 4 914 2219

OUTPERFORM

NZ Post's (NZP) recently released six months result to December 2020 highlights strong parcel revenue growth, though a decline in parcel margins. The company says that the key challenge for its parcel business is "ensuring we balance volume growth, pricing and service to ensure profitability". With profit flat through the first half, despite strong volume growth and high quality measured delivery performance, we believe current financial performance provides scope for further positive pricing initiatives in 2021. We continue to expect the parcel industry pricing dynamic to be a driver of a growing industry profit pool. This is supportive to Freightways' (FRE) 'Pricing for Effort' programme, which is closing in on its ~NZ\$1.50 per B2C parcel targeted increase. A favourable pricing environment is a key driver of our OUTPERFORM rating on FRE.

NZX Code	FRE	Financials: Jun/	20A	21E	22E	23E	Valuation (x)	20A	21E	22E	23E
Share price	NZ\$10.99	NPAT* (NZ\$m)	59.5	81.7	90.1	97.7	PE	29.2	22.3	20.2	18.6
Target price	NZ\$11.00	EPS* (NZc)	37.7	49.3	54.3	59.0	EV/EBIT	25.4	22.2	17.3	16.0
Risk rating	Medium	EPS growth* (%)	-7.3	31.0	10.2	8.5	EV/EBITDA	14.9	12.3	11.6	11.0
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\$1,822m	Imputation (%)	100	100	100	100	Cash div yld (%)	1.4	3.4	3.7	4.0
Avg daily turnover	210.6k (NZ\$1,599k)	*Based on normalised profits					Gross div yld (%)	1.9	4.7	5.1	5.6

A commercial focus

NZ Post is undergoing a significant investment in expanding its parcel processing network. We expect it will seek to generate an adequate return on this investment, particularly given its increased focus on having a "commercial mindset". Simplistically, we think this means margins need to rise. Its legacy pricing in the higher cost to serve B2C (residential delivery) channel remains a key hurdle for its desire for margin expansion. In recent years NZP has pursued and led the industry with a number of sizeable CPI+ price increases, which have helped offset cost pressures from system and contractor (higher rates being paid) investment. Last year its ~+20% increase in local delivery rates highlighted a different tack from its standard annual price adjustments and possibly paves the way for more differentiated pricing ahead.

Letters continue to drag

Letter volumes continue to fall at a rapid pace. NZP's mail revenue declined -17% year on year, and EBIT margins did well to break-even in the period. The company says that "it is not commercially sustainable for NZ Post to continue to provide the mail service in its present form". It currently provides letter deliveries three days a week in urban areas and five days a week in rural areas. NZP will continue to engage with the government about the future of mail. This may have implications for FRE's DX Mail business.

Figure 1. NZ Post 1H21 parcel segment result summary (NZ\$m)

	1H20	1H21	Change
Revenue	229	271	18%
EBITDA	26	26	0%
Depreciation & amort.	(14)	(14)	0%
EBIT	12	12	0%
EBITDA margin	11.4%	9.6%	-180 bps
EBIT profit margin	5.2%	4.4%	-80 bps

Source: NZP, Forsyth Barr analysis

Figure 2. NZ Post's overall 1H21 result (NZ\$m)

	1H20	1H21	Change
Revenue	491	493	0%
EBITDA	58	40	-31%
Depreciation & amort.	(30)	(31)	3%
EBIT	28	9	-68%
EBITDA margin	11.8%	8.1%	-370bps
EBIT profit margin	5.7%	1.8%	-390 bps

Source: NZP, Forsyth Barr analysis

Freightways Ltd (FRE)

 Priced as at 02 Mar 2021 (NZ\$) **10.99**

12-month target price (NZ\$)*	11.00	Spot valuations (NZ\$)	
Expected share price return	0.1%	1. DCF	10.92
Net dividend yield	3.6%	2. Sum-of-the-parts	10.34
Estimated 12-month return	3.7%	3. n/a	n/a

Key WACC assumptions		DCF valuation summary (NZ\$m)	
Risk free rate	2.30%	Total firm value	2,745
Equity beta	1.00	(Net debt)/cash	(201)
WACC	6.4%	Less: Capitalised operating leases	(735)
Terminal growth	1.5%	Value of equity	1,810

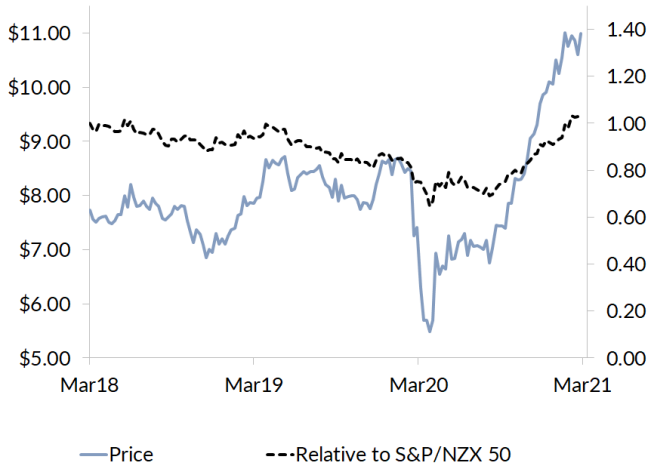
Profit and Loss Account (NZ\$m)	2019A	2020A	2021E	2022E	2023E	Valuation Ratios	2019A	2020A	2021E	2022E	2023E
Sales revenue	615.7	630.9	796.3	837.2	877.5	EV/EBITDA (x)	17.6	14.9	12.3	11.6	11.0
Normalised EBITDA	112.2	144.7	191.6	203.7	215.0	EV/EBIT (x)	20.3	25.4	22.2	17.3	16.0
Depreciation and amortisation	(17.5)	(50.4)	(66.5)	(66.6)	(66.8)	PE (x)	27.1	29.2	22.3	20.2	18.6
Normalised EBIT	97.1	84.7	105.9	137.1	148.2	Price/NTA (x)	n/a	n/a	n/a	n/a	n/a
Net interest	(9.6)	(18.4)	(22.2)	(19.6)	(20.0)	Free cash flow yield (%)	2.9	5.7	5.0	6.2	6.6
Associate income	0	0	0	0	0	Net dividend yield (%)	2.8	1.4	3.4	3.7	4.0
Tax	(24.1)	(18.0)	(28.7)	(35.0)	(38.0)	Gross dividend yield (%)	3.9	1.9	4.7	5.1	5.6
Minority interests	0	0	0	0	0						
Normalised NPAT	63.1	59.5	81.7	90.1	97.7	Capital Structure	2019A	2020A	2021E	2022E	2023E
Abnormals/other	0.3	(12.1)	(26.8)	(7.6)	(7.6)	Interest cover EBIT (x)	10.1	4.6	4.8	7.0	7.4
Reported NPAT	63.4	47.4	54.9	82.5	90.1	Interest cover EBITDA (x)	11.7	7.9	8.6	10.4	10.7
Normalised EPS (cps)	40.6	37.7	49.3	54.3	59.0	Net debt/ND+E (%)	35.6	39.3	33.2	30.1	34.6
DPS (cps)	30.5	15.0	37.0	40.7	44.2	Net debt/EBITDA (x)	1.3	1.4	0.9	0.8	0.9

Growth Rates	2019A	2020A	2021E	2022E	2023E	Key Ratios	2019A	2020A	2021E	2022E	2023E
Revenue (%)	6.0	2.5	26.2	5.1	4.8	Return on assets (%)	16.6	8.1	9.4	12.0	12.7
EBITDA (%)	4.2	28.9	32.5	6.3	5.6	Return on equity (%)	23.0	18.8	23.3	24.2	26.9
EBIT (%)	2.9	-12.7	25.0	29.5	8.1	Return on funds employed (%)	12.6	12.0	19.6	19.5	19.8
Normalised NPAT (%)	2.5	-5.7	37.4	10.2	8.5	EBITDA margin (%)	18.2	22.9	24.1	24.3	24.5
Normalised EPS (%)	2.4	-7.3	31.0	10.2	8.5	EBIT margin (%)	15.8	13.4	13.3	16.4	16.9
Ordinary DPS (%)	2.5	-50.8	>100	10.2	8.5	Capex to sales (%)	3.8	3.7	2.8	3.3	3.3

Cash Flow (NZ\$m)	2019A	2020A	2021E	2022E	2023E	Operating Performance	2019A	2020A	2021E	2022E	2023E
EBITDA	112.2	144.7	191.6	203.7	215.0	Revenue (NZ\$m)					
Working capital change	0	0	(0.0)	(0.0)	0	Express Package & Bus. Mail	451.3	472.2	625.0	650.0	682.5
Interest & tax paid	(33.7)	(28.6)	(39.7)	(43.4)	(46.8)	Information Mgmt	164.4	158.8	171.3	187.2	195.0
Other	(2.5)	11.1	(38.0)	(18.8)	(18.8)	Total Sales	615.7	630.9	796.3	837.2	877.5
Operating cash flow	76.0	127.2	113.9	141.4	149.4	EBITDA (NZ\$m)					
Capital expenditure	(23.3)	(23.6)	(22.3)	(27.6)	(29.0)	Express Package & Bus. Mail	80.0	101.7	140.3	146.9	154.9
(Acquisitions)/divestments	(8.7)	(101.6)	0	0	(47.0)	Information Mgmt	35.3	47.1	54.3	59.9	63.4
Other	1.9	(24.0)	(30.6)	(32.0)	(32.0)	H/Office	(3.1)	(4.1)	(3.0)	(3.2)	(3.3)
Funding available/(required)	46.0	(22.0)	61.0	81.8	41.4	Total EBITDA	112.2	144.7	191.6	203.7	215.0
Dividends paid	(47.0)	(47.5)	(30.7)	(67.6)	(73.3)						
Equity raised/(returned)	0.7	24.1	0	0	0	EBITDA margin (%)					
(Increase)/decrease in net debt	(0.3)	(45.4)	30.3	14.3	(31.9)	Express Package & Business Mail	17.7	21.5	22.5	22.6	22.7

Balance Sheet (NZ\$m)	2019A	2020A	2021E	2022E	2023E	Group EBITDA margin	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	Express Package & Business Mail	17.7	21.5	22.5	22.6	22.7
Intangibles	365.2	499.0	504.3	509.6	530.9	Information Mgmt	21.5	29.6	31.7	32.0	32.5
Right of use asset	0	278.1	348.1	348.1	348.1	Total	18.2	22.9	24.1	24.3	24.5
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						
						NZDAUD	0.93	0.95	0.93	0.92	0.91

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

Figure 3. Price performance


Source: Forsyth Barr analysis

Figure 4. Substantial shareholders

Shareholder	Latest Holding
ANZ NZ Investments	6.5%

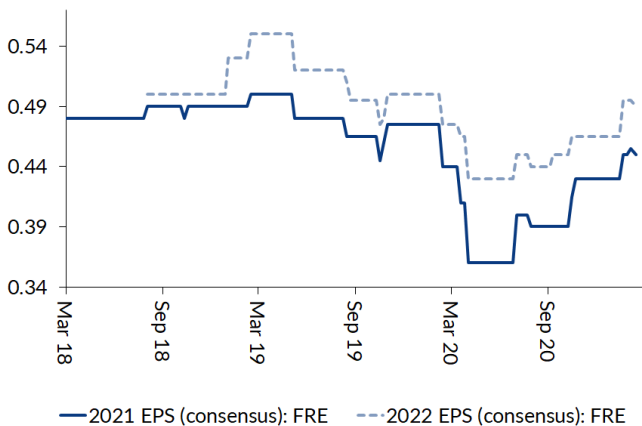
Source: NZX, Forsyth Barr analysis, NOTE: based on SPH notices only

Figure 5. International valuation comparisons

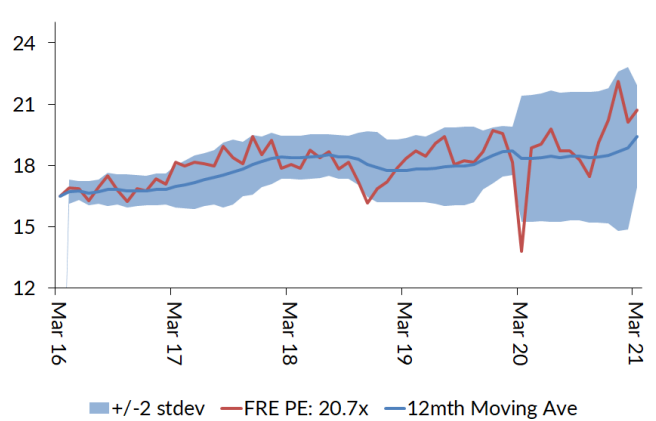
Company (metrics re-weighted to reflect FRE's balance date - June)	Code	Price	Mkt Cap (m)	PE		EV/EBITDA		EV/EBIT		Cash Yld 2022E
				2021E	2022E	2021E	2022E	2021E	2022E	
Freightways	FRE NZ	NZ\$10.99	NZ\$1,822	22.3x	20.2x	10.6x	10.0x	19.1x	14.8x	3.7%
MAINFREIGHT*	MFT NZ	NZ\$65.22	NZ\$6,568	35.7x	31.8x	14.5x	13.5x	24.1x	21.9x	1.3%
FEDEX CORP	FDX US	US\$263.68	US\$69,894	14.8x	13.9x	10.3x	9.5x	16.8x	15.0x	1.1%
UNITED PARCEL SERVICE-CL B	UPS US	US\$161.14	US\$139,715	>50x	17.5x	13.8x	12.6x	18.9x	16.1x	2.7%
DEUTSCHE POST AG-REG	DPW GR	€42.48	€52,635	16.0x	14.7x	7.4x	7.0x	12.9x	11.8x	3.4%
ARAMEX PJSC	ARMX UH	AED3.82	AED5,593	16.2x	12.1x	6.4x	6.0x	9.5x	9.1x	4.6%
IRON MOUNTAIN INC	IRM US	US\$35.48	US\$10,233	27.9x	25.3x	12.0x	13.0x	24.8x	24.9x	7.0%
			Compco Average:	22.1x	19.2x	10.7x	10.3x	17.8x	16.5x	3.3%
			FRE Relative:	1%	5%	-1%	-3%	7%	-10%	11%

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 6. Consensus EPS momentum (NZ\$)


Source: Forsyth Barr analysis

Figure 7. One year forward PE (x)


Source: Forsyth Barr analysis

Analyst certification: The research analyst(s) primarily responsible for the preparation and content of this publication ("Analysts") are named on the first page of this publication. Each such Analyst certifies (other than in relation to content or views expressly attributed to another analyst) that (i) the views expressed in this publication accurately reflect their personal views about each issuer and financial product referenced and were prepared in an independent manner, including with respect to Forsyth Barr Limited and its related companies; and (ii) no part of the Analyst's compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed by that Analyst in this report.

Analyst holdings: The following Analyst(s) have a threshold interest in the financial products referred to in this publication: N/A. For these purposes, a threshold interest is defined as being a holder of more than \$50,000 in value or 1% of the financial products on issue, whichever is the lesser.

Ratings distributions: As at 2 Mar 2021, Forsyth Barr's research ratings were distributed as follows:

	OUTPERFORM	NEUTRAL	UNDERPERFORM
	42.3%	40.4%	17.3%

Forsyth Barr's research ratings are OUTPERFORM, NEUTRAL, and UNDERPERFORM. The ratings are relative to our other equity security recommendations across our New Zealand market coverage and are based on risk-adjusted Estimated Total Returns for the securities in question. Risk-adjusted Estimated Total Returns are calculated from our assessment of the risk profile, expected dividends and target price for the relevant security.

Disclosure: Forsyth Barr Limited and its related companies (and their respective directors, officers, agents and employees) ("Forsyth Barr") may have long or short positions or otherwise have interests in the financial products referred to in this publication, and may be directors or officers of, and/or provide (or be intending to provide) investment banking or other services to, the issuer of those financial products (and may receive fees for so acting). Forsyth Barr is not a registered bank within the meaning of the Reserve Bank of New Zealand Act 1989. Forsyth Barr may buy or sell financial products as principal or agent, and in doing so may undertake transactions that are not consistent with any recommendations contained in this publication. Other Forsyth Barr business units may hold views different from those in this publication; any such views will generally not be brought to your attention. Forsyth Barr confirms no inducement has been accepted from the issuer(s) that are the subject of this publication, whether pecuniary or otherwise, in connection with making any recommendation contained in this publication. In preparing this publication, non-financial assistance (for example, access to staff or information) may have been provided by the issuer(s) being researched.

Investment banking engagements: Other than confidential engagements, Forsyth Barr has not within the past 12 months been engaged to provide investment banking services to the issuer that is the subject of this publication. For information about whether Forsyth Barr has within the past 12 months been engaged to provide investment banking services to any other issuer referred to in this publication, please refer to the most recent research report for that issuer's financial products.

Not personalised financial advice: The recommendations and opinions in this publication do not take into account your personal financial situation or investment goals. The financial products referred to in this publication may not be suitable for you. If you wish to receive personalised financial advice, please contact your Forsyth Barr Investment Adviser. The value of financial products may go up and down and investors may not get back the full (or any) amount invested. Past performance is not necessarily indicative of future performance. Disclosure statements for Forsyth Barr Investment Advisers are available on request and free of charge.

Disclaimer: This publication has been prepared in good faith based on information obtained from sources believed to be reliable and accurate. However, that information has not been independently verified or investigated by Forsyth Barr. Forsyth Barr does not make any representation or warranty (express or implied) that the information in this publication is accurate or complete, and, to the maximum extent permitted by law, excludes and disclaims any liability (including in negligence) for any loss which may be incurred by any person acting or relying upon any information, analysis, opinion or recommendation in this publication. Forsyth Barr does not undertake to keep current this publication; any opinions or recommendations may change without notice to you. Any analyses or valuations will typically be based on numerous assumptions; different assumptions may yield materially different results. Nothing in this publication should be construed as a solicitation to buy or sell any financial product, or to engage in or refrain from doing so, or to engage in any other transaction. This publication is not intended to be distributed or made available to any person in any jurisdiction where doing so would constitute a breach of any applicable laws or regulations or would subject Forsyth Barr to any registration or licensing requirement within such jurisdiction.

Terms of use: Copyright Forsyth Barr Limited. You may not redistribute, copy, revise, amend, create a derivative work from, extract data from, or otherwise commercially exploit this publication in any way. By accessing this publication via an electronic platform, you agree that the platform provider may provide Forsyth Barr with information on your readership of the publications available through that platform.