

Mainfreight

NEUTRAL

Cyclical Gear Change

Mainfreight's (MFT) successful structural growth profile is not immune to cyclical downturns; after a phase of strong earnings growth we expect a slower pace ahead. Industry data and peer feedback point to softening conditions in all of MFT's geographic regions. However, 'a slower pace' for MFT is still attractive relative to the wider market, in our opinion. MFT is trading broadly consistent with the NZX50 on a one year forward PE of ~24x. We retain a NEUTRAL rating.

What's changed?

- **Earnings:** FY20 NPAT cut by -4% and FY21 by -8%
- **Target Price:** Lifted to NZ\$37.00 to reflect further market rerating and lower WACC estimate, which more than offset our earnings cuts

Three core drivers; one slowing, two at full pace

MFT's growth is a function of three drivers. First, the economic environment, which impacts same customer growth. Second, the company's ability to win new customers. Third, its ability to cross-sell products and geographies to existing customers. All three of these drivers have influenced MFT's above trend revenue growth over the past two years. However, the first is now slowing. Given this backdrop, continued successful execution on cross selling and winning new customers becomes more important to MFT. We are wary these may become more challenging in time, even with sales team investments, if others are fighting to hang on to volume should the environment deteriorate further.

Consensus downgrades likely

We assume MFT activity levels are subdued through FY20 and FY21, but that the company continues to grow, given cross-selling and customer win opportunities. Our revised FY22 NPAT forecast is now -8% below market consensus. However, our estimates still imply a three year compound annual NPAT growth rate of ~+9% through to FY22, versus the NZX50 at ~+5%. In light of building macro headwinds we expect consensus downgrades to be a feature through the upcoming 1H20 result on 13 November 2019.

Valuation on par with the market; fair

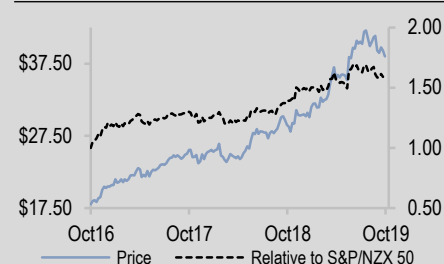
At ~24x one year forward PE MFT is not priced for a cyclical downturn. Yet, earnings risks are weighted to the downside, in our opinion. So why aren't we more negative? Three reasons: (1) MFT is trading broadly at par with the NZX50, on our reduced estimates, yet still provides a more attractive growth profile over the next three years. (2) Its track record and quality attributes are difficult to ignore. (3) Since the GFC management has worked hard to create a more defensive customer mix with greater FMCG (fast moving consumer goods) and DIY exposure.

Investment View

MFT is a global supply chain logistics provider with a difference. Its cultural identity, quality focus and dual obsessions of growth and network intensity have allowed it to successfully export its approach to Australia, the US, Asia and Europe. We like its key longer term attributes: (1) it has a high marginal return on capital; (2) well above average earnings growth, albeit lumpy at times; (3) it has proven to be adept to changes in market conditions; and (4) it has substantial global growth prospects. However, these positives are factored into its current share price. NEUTRAL.

NZX Code	MFT
Share price	NZ\$38.50
Target price	NZ\$37.00
Risk rating	Medium
Issued shares	100.7m
Market cap	NZ\$3,877m
Average daily turnover	52.4k (NZ\$1,850k)

Share Price Performance



Financials: March	19A	20E	21E	22E
NPAT* (NZ\$m)	141.1	155.9	168.2	187.9
EPS* (NZc)	140.1	154.9	167.1	186.6
EPS growth* (%)	25.7	10.5	7.9	11.7
DPS (NZc)	56.0	61.9	66.8	74.6
Imputation (%)	100	100	100	100

Valuation (x)	19A	20E	21E	22E
EV/EBITDA	15.7	14.3	13.3	12.2
EV/EBIT	19.8	18.0	16.7	15.1
PE	27.5	24.9	23.0	20.6
Price / NTA	6.8	6.0	5.3	n/a
Cash dividend yield (%)	1.5	1.6	1.7	1.9
Gross dividend yield (%)	2.0	2.2	2.4	2.7

*Historic and forecast numbers based on underlying profits

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Mainfreight Ltd (MFT)					Priced as at 10 Oct 2019: NZ\$38.50					March year end				
Forsyth Barr valuation					Valuation Ratios					2018A	2019A	2020E	2021E	2022E
Valuation methodology		Average of DCF and sum-of-the-parts			EV/EBITDA (x)		18.9	15.7	14.3	13.3	12.2			
					EV/EBIT (x)		24.3	19.8	18.0	16.7	15.1			
12-month target price (NZ\$)*		37.00	Spot valuations (NZ\$)			PE (x)		34.5	27.5	24.9	23.0	20.6		
Expected share price return		-3.9%	1. DCF		32.28	Price/NTA (x)		8.9	6.8	6.0	5.3	4.7		
Net dividend yield		1.7%	2. PE relative		37.90	Free cash flow yield (%)		1.8	2.4	-0.2	1.4	3.8		
Estimated 12-month return		-2.2%	3. n/a		n/a	Net dividend yield (%)		1.2	1.5	1.6	1.7	1.9		
						Gross dividend yield (%)		1.6	2.0	2.2	2.4	2.7		
Key WACC assumptions		DCF valuation summary (NZ\$m)			Imputation (%)		100	100	100	100	100			
Risk free rate		2.00%	Total firm value		3,384	Pay-out ratio (%)		40	40	40	40	40		
Equity beta		1.09	(Net debt)/cash		(133)									
WACC		8.4%	Value of equity		3,251	Capital Structure		2018A	2019A	2020E	2021E	2022E		
Terminal growth		2.0%	Shares (m)		101	Interest cover EBIT (x)		23.8	29.7	33.7	30.5	42.7		
						Interest cover EBITDA (x)		30.5	37.4	42.2	38.2	53.1		
Profit and Loss Account (NZ\$m)		2018A	2019A	2020E	2021E	2022E	Net debt/ND+E (%)		21.1	12.8	17.3	16.6	10.1	
Sales revenue		2,619	2,954	3,204	3,422	3,681	Net debt/EBITDA (x)		0.9	0.5	0.7	0.7	0.4	
Normalised EBITDA		215	257	282	305	335								
Depreciation and amortisation		(48)	(53)	(57)	(62)	(66)	Key Ratios		2018A	2019A	2020E	2021E	2022E	
Normalised EBIT		168	204	225	243	269	Return on assets (%)		12.2	13.6	13.6	13.6	14.6	
Net interest		(7)	(7)	(7)	(8)	(6)	Return on equity (%)		15.8	16.8	16.8	16.4	16.5	
Associate income		-	-	-	-	-	Return on funds employed (%)		7.7	8.5	9.9	11.7	12.1	
Tax		(43)	(53)	(62)	(67)	(75)	EBITDA margin (%)		8.2	8.7	8.8	8.9	9.1	
Minority interests		-	-	-	-	-	EBIT margin (%)		6.4	6.9	7.0	7.1	7.3	
Normalised NPAT		112	141	156	168	188	Capex to sales (%)		2.6	3.5	6.6	5.0	2.7	
Abnormals/other		4	3	-	-	-	Capex to depreciation (%)		145	194	374	275	152	
Reported NPAT		108	138	156	168	188								
Normalised EPS (cps)		111.4	140.1	154.9	167.1	186.6	Operating Performance		2018A	2019A	2020A	2021A	2022A	
DPS (cps)		45.0	56.0	61.9	66.8	74.6	Revenue (NZ\$m)							
						New Zealand		609.2	666.2	718.8	754.7	784.9		
Growth Rates		2018A	2019A	2020E	2021E	2022E	Australia		568.1	675.2	760.8	786.6	838.4	
Revenue (%)		12.2	12.8	8.5	6.8	7.6	USA		615.3	610.9	725.2	844.4	932.6	
EBITDA (%)		9.1	19.3	9.6	8.3	9.7	Asia		89.3	117.3	109.3	124.1	136.4	
EBIT (%)		8.9	21.7	10.2	8.2	10.6	Europe		451.7	549.3	639.9	694.2	729.5	
Normalised NPAT (%)		8.8	25.7	10.5	7.9	11.7	Total		2,333.6	2,618.9	2,954.1	3,203.9	3,421.8	
Normalised EPS (%)		8.6	25.7	10.5	7.9	11.7								
DPS (%)		9.8	24.4	10.6	7.9	11.7	Sales growth (%)							
						New Zealand		8.2	9.3	7.9	5.0	4.0		
Cash Flow (NZ\$m)		2018A	2019A	2020E	2021E	2022E	Australia		4.0	18.9	12.7	3.4	6.6	
EBITDA		215	257	282	305	335	USA		-8.9	-0.7	18.7	16.4	10.5	
Working capital change		-	-	-	-	-	Asia		28.7	31.3	-6.8	13.5	9.9	
Interest & tax paid		(53)	(61)	(69)	(75)	(81)	Europe		4.9	21.6	16.5	8.5	5.1	
Other		(23)	2	(7)	(7)	(7)	Total		2.1	12.2	12.8	8.5	6.8	
Operating cash flow		140	197	206	223	247	EBITDA (NZ\$m)							
Capital expenditure		(69)	(103)	(213)	(170)	(100)	New Zealand		91.0	98.6	110.6	116.9	122.3	
(Acquisitions)/divestments		4	14	5	5	5	Australia		44.9	54.0	59.3	62.6	68.4	
Other		0	0	-	-	-	USA		26.2	26.9	38.3	47.2	54.6	
Funding available/(required)		76	108	(2)	58	152	Asia		8.8	6.9	9.3	10.5	11.6	
Dividends paid		(43)	(48)	(62)	(67)	(75)	Europe		26.6	29.0	39.6	44.4	48.1	
Equity raised/(returned)		-	-	-	-	-	Total		197.5	215.4	257.0	281.7	305.1	
Increase/(decrease) in net debt		(32)	(60)	65	9	(76)								
Balance Sheet (NZ\$m)		2018A	2019A	2020E	2021E	2022E	EBITDA margin (%)							
Working capital		67	74	81	86	93	New Zealand		14.9	14.8	15.4	15.5	15.6	
Fixed assets		582	667	805	888	897	Australia		7.9	8.0	7.8	8.0	8.2	
Intangibles		274	270	283	303	323	USA		4.3	4.4	5.3	5.6	5.9	
Other assets		78	62	62	62	62	Asia		9.9	5.8	8.5	8.5	8.5	
Total funds employed		1,001	1,073	1,230	1,339	1,375	Europe		5.9	5.3	6.2	6.4	6.6	
Net debt/(cash)		190	123	195	204	128	Total		8.5	8.2	8.7	8.8	8.9	
Other non current liabilities		92	104	104	104	104								
Shareholder's funds		712	838	929	1,028	1,141	NZDAUD		0.94	0.92	0.92	0.94	0.93	
Minority interests		-	-	-	-	-	NZDUSD		0.71	0.71	0.68	0.64	0.63	
Total funding sources		994	1,066	1,228	1,337	1,372	NZDEUR		0.65	0.61	0.59	0.58	0.59	

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

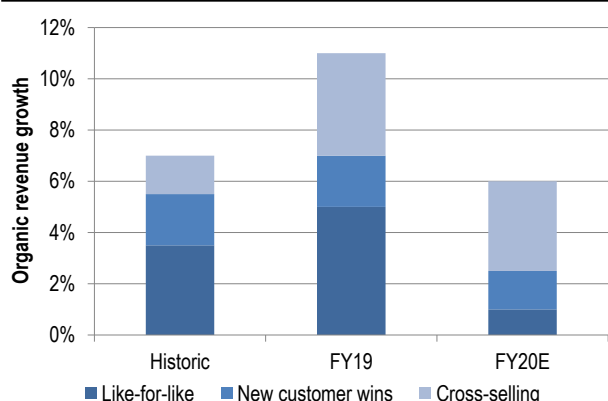
Three growth drivers

Mainfreight's (MFT) above average organic revenue (and profit) growth profile over the longer term and its recent history reflects three principle drivers:

- The economic backdrop
- Customer wins
- Cross-selling to existing customers

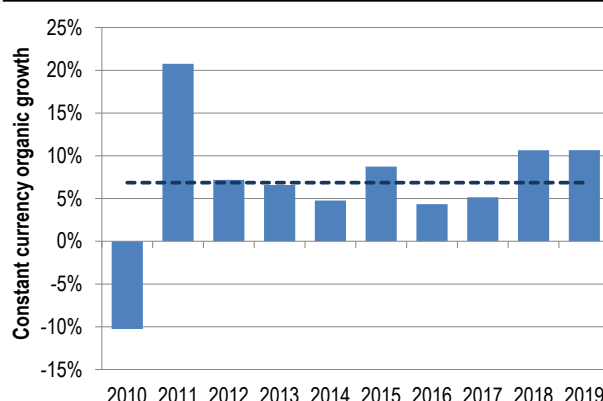
Constant currency organic revenue CAGR over the past 10 years has averaged ~+7%, and EBITDA growth ~+10%. While mix (both geographic and product) can influence margins in any one year, MFT has a long history of generating operating leverage.

Figure 1. Constant currency revenue growth



Source: Forsyth Barr analysis

Figure 2. MFT's organic revenue growth 10-year history



Source: MFT, Forsyth Barr analysis

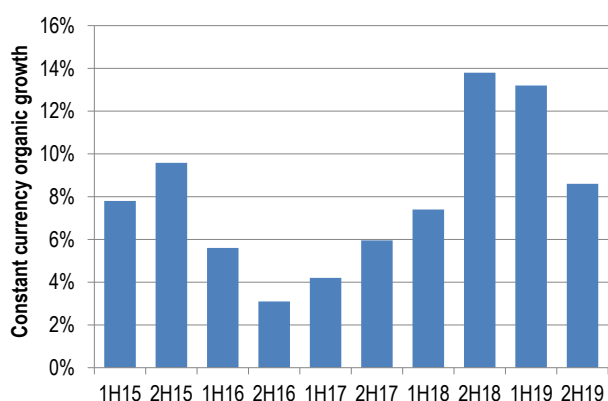
Growth outlook has deteriorated; but still above market

Slowing revenue growth through 2H19 (Figure 3) is a consistent pattern across global freight industry players and observable market data. Our revised earnings estimates assume constant currency revenue growth of ~+6% in both FY20 and FY21. MFT's significant emphasis on cross-selling will be the largest contributor to near term revenue growth, in our opinion.

We expect operating leverage benefits to slow due to: (1) flat margin expectations in NZ and Australia given slower volume growth and cost inflation, and (2) the adverse margin mix from higher growth/lower margin contributions from Americas, Europe and Asia. As a result we expect constant currency EBITDA growth of +8% in both FY20 and FY21.

This will drive NPAT growth of +9% on average over FY20-FY21, which compares to consensus of +13%. While we recognise that consensus earnings are at risk, our downgraded earnings growth assumptions remain attractive relative to the NZX50.

Figure 3. Revenue growth slowed through 2H19



Source: MFT, Forsyth Barr analysis

Figure 4. Outlook period earnings forecasts vs consensus (NZ\$m)

	FY20E	FY21E	FY22E
Revenue			
Forsyth Barr	3,204	3,422	3,681
FB Implied growth	8.5%	6.8%	7.6%
Consensus growth	9.4%	9.0%	9.0%
EBITDA			
Forsyth Barr	282	305	335
FB Implied growth	9.6%	8.3%	9.7%
Consensus growth	12.9%	12.1%	11.3%
NPAT			
Forsyth Barr	156	168	188
FB Implied growth	10.5%	7.9%	11.7%
Consensus growth	14.8%	11.6%	13.0%
NZX50 EPS growth			

Source: Eikon, Forsyth Barr analysis NOTE: growth rates above are not constant currency

Earnings revisions

We lower our earnings forecasts for each of the next three years as summarised in Figure 5. Forecast reductions reflect lower revenue growth expectations in all geographies reflective of deteriorating cyclical conditions. Our revised constant currency revenue growth estimates are +6% for each of FY20 and FY21. Updated NZD assumptions help offset the underlying profit downgrades by c.1%.

Figure 5. Earnings revisions (NZ\$m)

	Old	FY20E New	Chg	Old	FY21E New	Chg	Old	FY22E New	Chg
Sales revenue	3,254.9	3,203.9	-1.6%	3,571.7	3,421.8	-4.2%	3,819.6	3,681.1	-3.6%
EBITDA	290.3	281.7	-3.0%	326.7	305.1	-6.6%	359.0	334.8	-6.7%
Underlying NPAT	163.1	155.9	-4.4%	183.3	168.2	-8.2%	205.9	187.9	-8.8%
Underlying EPS	162.0	154.9	-4.4%	182.1	167.1	-8.2%	204.5	186.6	-8.8%
Full year DPS	64.8	61.9	-4.4%	72.8	66.8	-8.2%	81.8	74.6	-8.8%

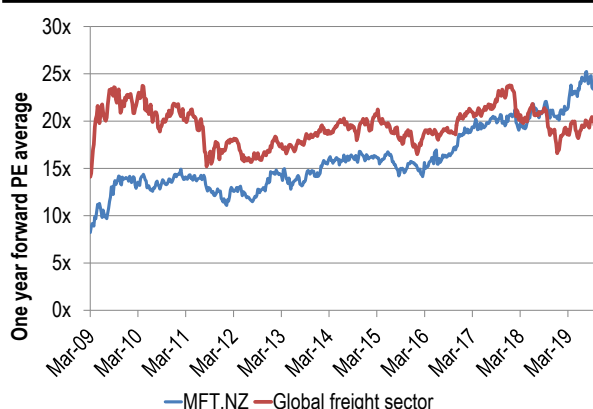
Source: Forsyth Barr analysis

Valuation

On our revised estimates MFT is trading at ~24x one year forward PE, close to its recent historic high but still broadly consistent with the NZX50. Over the past 10 years MFT has traded at an average ~4% discount to the NZX50 (Figure 8).

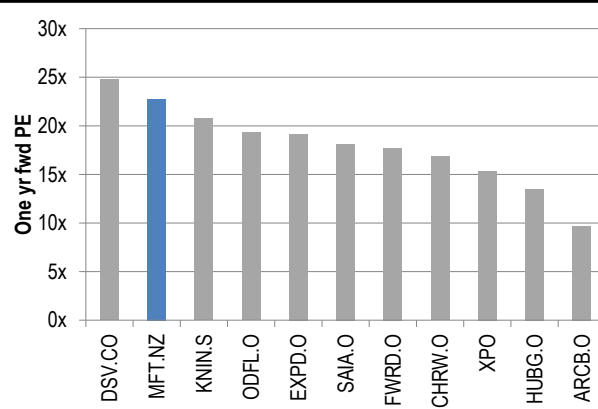
Despite our earnings downgrades, we raise our target price to NZ\$37.00 from NZ\$36.00 to reflect (1) the reduction in our WACC estimate to ~8.4% from ~8.9% due to recent changes to our risk free rate and market risk premium assumptions across our research coverage; and (2) the further rerating of the NZX50, which we use as the basis for our updated PE relative valuation.

Figure 6. Timeseries forward PE: MFT vs international peers



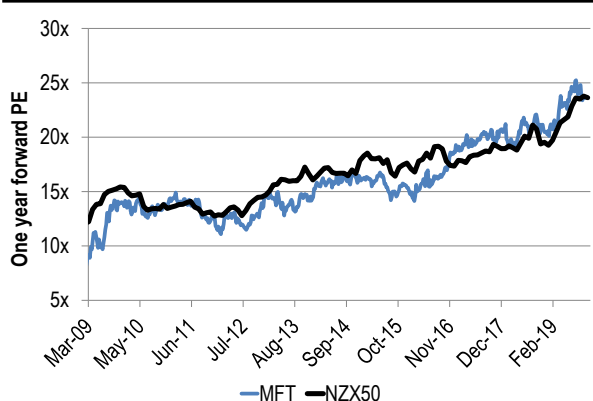
Source: Eikon, Forsyth Barr analysis

Figure 7. Current forward PE: MFT vs international peers



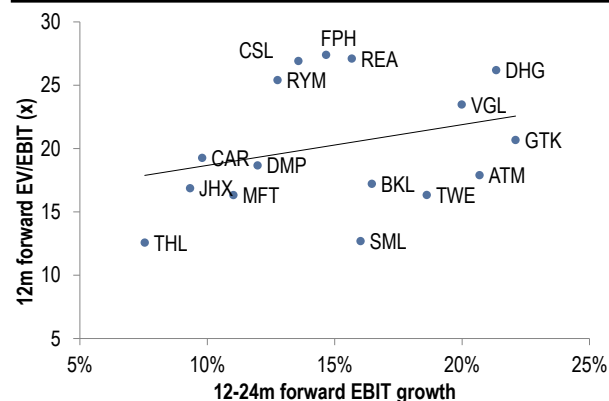
Source: Eikon, Forsyth Barr analysis

Figure 8. Timeseries forward PE: MFT vs NZX50



Source: Eikon, Forsyth Barr analysis

Figure 9. EV/EBIT vs EBIT growth for Australasian growth stocks



Source: Bloomberg, Forsyth Barr analysis

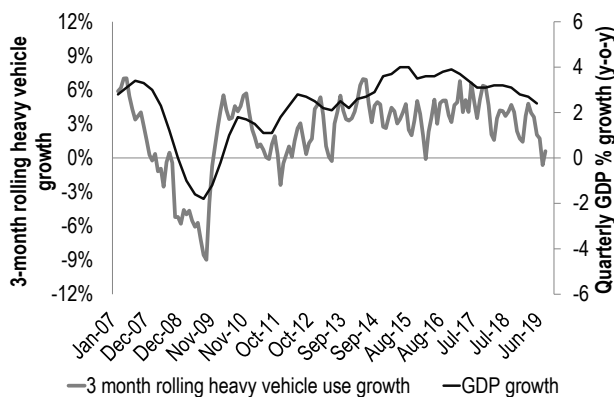
One slowing; two still growing

The economic backdrop has deteriorated and is now impacting freight volumes

The global economic growth story has softened through 2019. Consequently the international freight market is being challenged across multiple geographies that will impact MFT's same customer volumes. In particular we note that:

- Freight activity growth in New Zealand is slowing as evidenced by heavy vehicle traffic data and anecdotal feedback from a variety of industry participants
- The Australian freight market has been challenging through 2019 as highlighted by MFT
- US freight indices (including the Cass Freight Index, ATA's less-than-truckload Index and Freight Transportation Index) are indicating a broad slowdown
- Global airfreight volumes have been in decline through 2019 following strong growth through 2016-2018

Figure 10. NZ heavy vehicle traffic growth has fallen in recent months



Source: NZTA, Forsyth Barr analysis

Figure 11. Recent MFT comments on Australia

28 May 2019: MFT FY19 Result "Conscious of a slowing [Australian] economy; slower revenue growth last quarter"

31 July 2019: MFT ASM "Its gone quite quiet in Australia"

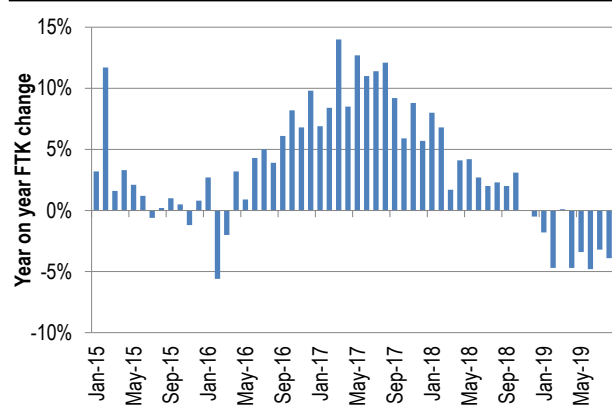
Source: MFT, Forsyth Barr analysis

Figure 12. North American less-than-truckload index well in the red



Source: ATA, Forsyth Barr analysis

Figure 13. Global airfreight has contracting for most of 2019



Source: IATA, Forsyth Barr analysis

While the slowing cyclical backdrop will have an impact on MFT's same customer (or like-for-like) revenue growth, should it deteriorate markedly (this is not our base case) it may also have an impact on (1) margins — as competitors scramble for volume by using price as a lever, and (2) new customer wins — as lower cost supply chains become more attractive than higher quality supply chains.

Cross-selling initiatives are delivering

Existing customers can be sticky. They can also offer new growth opportunities. Cross-selling other product/services into existing customers means:

- Additional revenue streams
- Customers become more dependent on MFT, and are therefore more locked-in

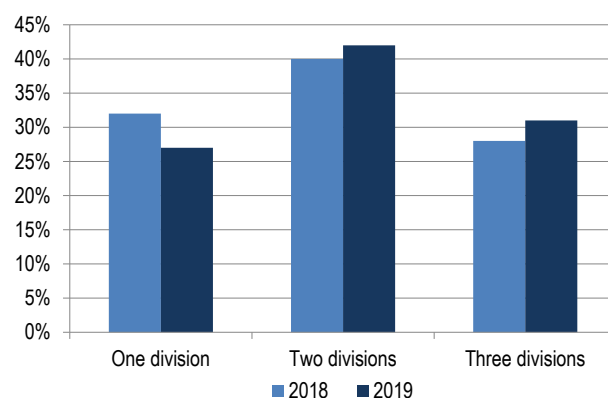
MFT is increasingly able to cross-sell different products in the same market, but also across different geographies. For example a relationship with a customer in New Zealand may help germinate a relationship with the same customer elsewhere in the world.

In recent years MFT has strategically driven wider client relationships and enhanced divisional integration through its cross-selling initiatives. In FY19 ~73% of its top 500 customers used two or more of MFT's three core products — warehousing, transport and air & ocean. This was up from ~68% in FY18.

Assuming all business is equally weighted this uplift would have accounted for FY19 revenue growth of ~+4%, and therefore would have been a key driver for MFT's above trend revenue growth rate. We expect cross-selling to remain a key driver of growth through FY20 and FY21 contributing to +3% to +4% revenue growth in each year.

Management suggest that it no longer accepts warehousing customers in certain jurisdictions (including New Zealand) unless the customer uses one or more of its other products.

Figure 14. Use of MFT's divisions by top 500 customers



Source: MFT, Forsyth Barr analysis

Customer wins will continue but could slow in more challenging environment

Net customer wins has been a historic driver of MFT's success. We estimate that in recent years net customer wins have accounted for +2% to +3% of its global revenue growth. We expect net customer wins to continue to drive revenue growth in FY20 and FY21 at a rate of ~+2%, given management's significant focus on continuing to lift its sales capability. However, we recognise that in a severe cyclical downturn new customer wins become more challenging given competitors fight more aggressively to hang on to customers.

Every customer and every potential customer is different. They have different needs, ship different freight from different locations to different locations, and have differing views on the price/quality trade-off of their freight requirements. The approach to winning new customers depends to a large extent on the size of business being pursued:

- Large customers – win through a formal tender process
- Small to medium-sized customers – obtain via relationship building.

The barriers to entry to smaller customers are lower than for contracted customers, given they can switch suppliers at any time. However, smaller customer can still be very sticky assuming they are happy with the service being provided to them.

Investment summary

Mainfreight (MFT) is a leading New Zealand corporate success story. As a result, it is an attractive growth company that has an enviable track record and significant opportunities ahead to further expand its market presence internationally. However, MFT's operational strengths and current business momentum are fully priced in; we, therefore, rate it as NEUTRAL.

Business quality

- **The Mainfreight Way:** MFT does things its way. It has a strong culture — promotion from within, sharing bonuses, open plan offices, whiteboard openness, weekly profits, and an endless emphasis on quality. It is a heavy investor in its people.
- **Quality focus:** MFT is a best-in-class operator with a commitment to quality, and a history of market share gains in multiple geographies.
- **Owner-drivers:** MFT operates an owner-driver (OD) model in most of its freight forwarding operations (ex-Europe). OD is an asset light model which tends to benefit from high driver productivity.

Earnings and cash flow outlook

- **Economic growth:** Local economic conditions dictate market growth levels, excess capacity and industry pricing dynamics. Notwithstanding market share gains as a key driver of growth, it is still a cyclical business.
- **Operating leverage:** Increasing levels of network intensity offer margin benefits from scale economies and network expansion opportunities.
- **Offshore:** Above average earnings growth will be increasingly driven from offshore businesses in the US, Europe and Australia, given MFT's domestic operations are maturing.

Financial structure

- **Capital management:** MFT is a growth business that likes to reinvest profit. Its dividend pay-out has been consistently ~40% for the past 20 years. The company will lift its capex outlay over the next few years as it secures strategic land and buildings in key sites across Australasia.

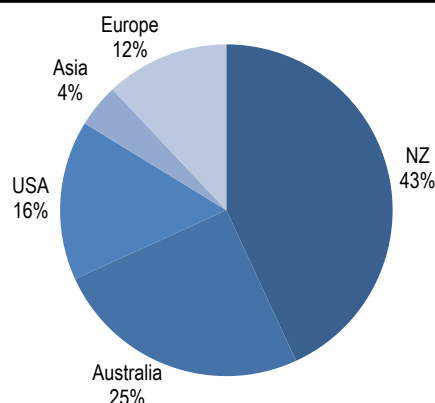
Risks factors

- **Acquisitions:** History suggests that MFT is not as good at due diligence as it is at operating a freight and logistics business.
- **Disruptive technology:** Freight forwarders leverage the inefficiencies in the freight supply chain. New technologies may lower supply chain costs, therefore, increasing competition.

Company description

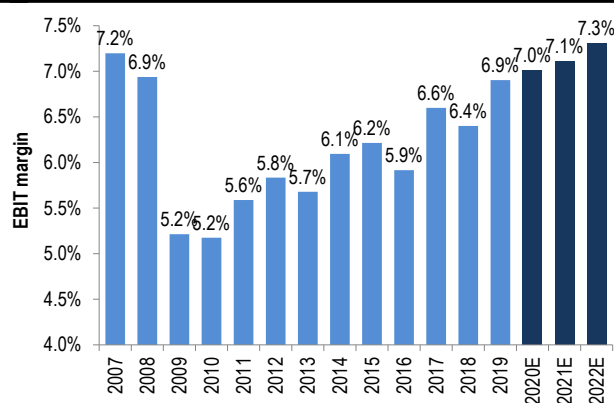
MFT is a global logistics provider offering its customers domestic and international freight forwarding and managed warehousing services. The company was founded in 1978 by Bruce Plested, who remains the largest shareholder and is Executive Chairman. MFT has more than 250 branches across 21 countries through New Zealand, Australia, Asia, Europe, and the United States. It continues to expand its global footprint through an organic and acquisitive expansion strategy. The company operates a strong people, customer and results focussed culture which helps to differentiate it from its competitors.

Figure 15. EBITDA split (FY19)



Source: Company reports, Forsyth Barr analysis

Figure 16. Group EBIT margin development



Source: Company reports, Forsyth Barr analysis

Figure 17. Substantial Shareholders

Shareholder	Latest Holding
Rorohora No. 2 Trust	16.3%

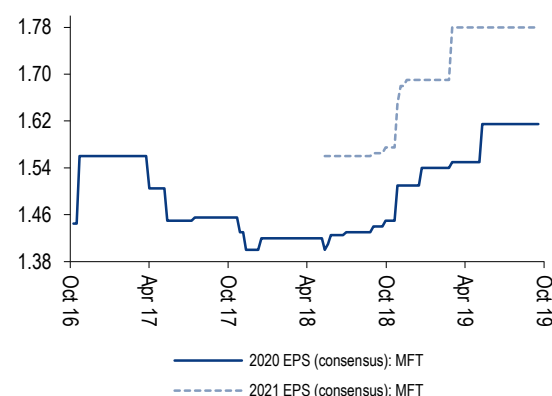
Source: NZX, Forsyth Barr analysis, NOTE: based on SSH notices only

Figure 18. International Compcos

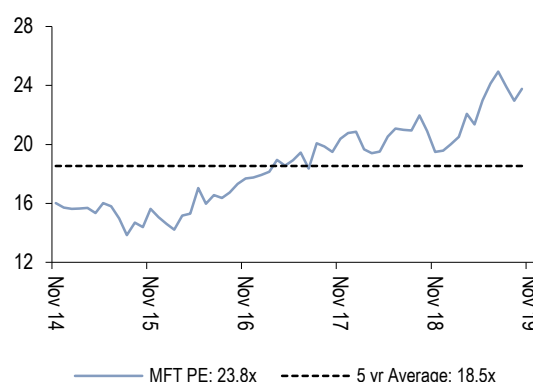
Company	Code	Price	Mkt Cap	PE		EV/EBITDA		EV/EBIT		Cash D/Yld	
(metrics re-weighted to reflect MFT's balance date - March)											
Mainfreight	MFT NZ	NZ\$38.50	NZ\$3,877	24.9x	23.0x	14.2x	13.1x	17.8x	16.4x	1.7%	
Freightways *	FRE NZ	NZ\$8.00	NZ\$1,244	19.0x	17.3x	11.8x	10.9x	13.8x	12.8x	4.4%	
Expeditors International of Washington Inc	EXPD US	US\$70.39	US\$12,020	19.7x	18.5x	12.9x	12.2x	13.7x	13.0x	1.5%	
Panalpina Welttransport Holding AG	PWTN SW	CHF215.00	CHF5,106	>50x	40.3x	17.2x	15.6x	37.7x	30.8x	2.0%	
Old Dominion Freight Line Inc	ODFL US	US\$165.53	US\$13,243	20.6x	19.1x	11.6x	11.0x	15.1x	14.3x	0.5%	
DSV Panalpina A/S	DSV DC	kr628.00	kr151,679	26.6x	23.0x	16.0x	13.8x	24.6x	20.6x	0.5%	
CH Robinson Worldwide Inc	CHRW US	US\$83.15	US\$11,256	17.5x	16.8x	12.4x	12.1x	13.6x	13.3x	2.6%	
Kuehne + Nagel International AG	KNIN SW	CHF146.55	CHF17,586	22.1x	20.5x	11.6x	10.9x	18.6x	17.2x	4.4%	
Compcos Average:				20.9x	22.2x	13.3x	12.4x	19.6x	17.4x	2.3%	
EV = Current Market Cap + Actual Net Debt				MFT Relative:	+19%	+4%	+6%	+6%	-9%	-6%	-24%

EV = Current Market Cap + Actual Net Debt

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

Figure 19. Consensus EPS Momentum


Source: Forsyth Barr analysis, Bloomberg

Figure 20. 12 Month Forward PE


Source: Forsyth Barr analysis

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