FORSYTH BARR

Mainfreight

NEUTRAL

1H20 Preview — Mixed Expectations

Mainfreight (MFT) will report robust earnings growth in its 1H20 result on 13 November 2019, in our view, but a step down from the strong organic rates experienced in recent periods. We forecast underlying NPAT growth of ~+11% against the prior year driven by +7% revenue growth. Margin expansion will likely remain a feature in the US and Europe but less so in Australasia given more subdued volume growth. MFT is trading at ~25x one year forward PE; a small premium to the market. While we recognise MFT's superior growth outlook, we are wary of consensus downside risk given the softer trading backdrop. NEUTRAL.

Key things to look for in the 1H20 result

- **Revenue momentum:** We expect constant currency revenue growth to slow to +6% in 1H20 from +11% in FY19. Lower growth reflects slowing cyclical conditions in all regions. New customer wins and cross-selling will continue to feature strongly, and will likely more than offset the impact of the less supportive macro environment.
- **Australian performance:** Management acknowledged at its July 2019 annual meeting that Australian activity had slowed materially. Domestic transport operations had been hardest hit.
- **Cross-selling advances:** In FY19 ~73% of MFT's top 500 customers used two or more of its services. We expect this to increase through FY20 given management's heavy focus on selling to existing customers.
- **Capex:** MFT lowered its capex guidance at its annual meeting to NZ$90m in FY20 (vs. NZ$213m at the time of the FY19 result). However, it is guiding to NZ$430m over the next two years; therefore, ~NZ$340m in FY21.

Figure 1. Earnings forecasts (NZ$m)

	1H19	1H20E	Change
Sales revenue	1,431.0	1,530.9	7.0%
EBITDA	108.3	118.2	9.1%
Net interest	(4.0)	(3.6)	-9.2%
Taxation	(22.3)	(24.7)	10.7%
Reported NPAT	55.7	61.9	11.2%
Underlying NPAT	**55.9**	**61.9**	**10.8%**
Underlying EPS (cents)	55.5	61.5	10.8%
Interim DPS (cents)	22.0	24.5	11.4%

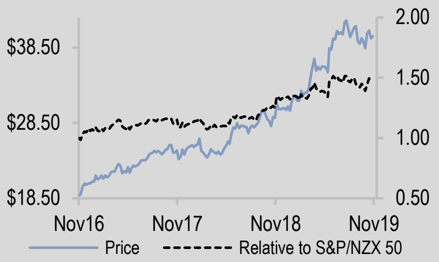
Source: Forsyth Barr analysis

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$39.98
Target price	NZ$37.00
Risk rating	Medium
Issued shares	100.7m
Market cap	NZ$4,026m
Average daily turnover	48.0k (NZ$1,765k)

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	16.3	14.9	13.8	12.6
EV/EBIT	20.5	18.6	17.4	15.7
PE	28.5	25.8	23.9	21.4
Price / NTA	7.1	6.2	5.5	n/a
Cash dividend yield (%)	1.4	1.5	1.7	1.9
Gross dividend yield (%)	1.9	2.2	2.3	2.6

*Historic and forecast numbers based on underlying profits

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Mainfreight Ltd (MFT) Priced as at 05 Nov 2019: NZ$39.98 March year end

Forsyth Barr valuation			
Valuation methodology		Average of DCF and sum-of-the-parts	
12-month target price (NZ$)*	**37.00**	**Spot valuations (NZ$)**	
Expected share price return	-7.5%	1. DCF	32.47
Net dividend yield	1.6%	2. PE relative	38.11
Estimated 12-month return	-5.8%	3. n/a	n/a
Key WACC assumptions		**DCF valuation summary (NZ$m)**	
Risk free rate	2.00%	Total firm value	3,403
Equity beta	1.09	(Net debt)/cash	(133)
WACC	8.4%	Value of equity	3,270
Terminal growth	2.0%	Shares (m)	101

Profit and Loss Account (NZ$m)	**2018A**	**2019A**	**2020E**	**2021E**	**2022E**
Sales revenue	2,619	2,954	3,204	3,422	3,681
Normalised EBITDA	**215**	**257**	**282**	**305**	**335**
Depreciation and amortisation	(48)	(53)	(57)	(62)	(66)
Normalised EBIT	**168**	**204**	**225**	**243**	**269**
Net interest	(7)	(7)	(7)	(8)	(6)
Associate income	-	-	-	-	-
Tax	(43)	(53)	(62)	(67)	(75)
Minority interests	-	-	-	-	-
Normalised NPAT	**112**	**141**	**156**	**168**	**188**
Abnormals/other	4	3	-	-	-
Reported NPAT	**108**	**138**	**156**	**168**	**188**
Normalised EPS (cps)	111.4	140.1	154.9	167.1	186.6
DPS (cps)	45.0	56.0	61.9	66.8	74.6

Growth Rates	**2018A**	**2019A**	**2020E**	**2021E**	**2022E**
Revenue (%)	12.2	12.8	8.5	6.8	7.6
EBITDA (%)	9.1	19.3	9.6	8.3	9.7
EBIT (%)	8.9	21.7	10.2	8.2	10.6
Normalised NPAT (%)	8.8	25.7	10.5	7.9	11.7
Normalised EPS (%)	8.6	25.7	10.5	7.9	11.7
DPS (%)	9.8	24.4	10.6	7.9	11.7

Cash Flow (NZ$m)	**2018A**	**2019A**	**2020E**	**2021E**	**2022E**
EBITDA	**215**	**257**	**282**	**305**	**335**
Working capital change	-	-	-	-	-
Interest & tax paid	(53)	(61)	(69)	(75)	(81)
Other	(23)	2	(7)	(7)	(7)
Operating cash flow	**140**	**197**	**206**	**223**	**247**
Capital expenditure	(69)	(103)	(213)	(170)	(100)
(Acquisitions)/divestments	4	14	5	5	5
Other	0	0	-	-	-
Funding available/(required)	**76**	**108**	**(2)**	**58**	**152**
Dividends paid	(43)	(48)	(62)	(67)	(75)
Equity raised/(returned)	-	-	-	-	-
Increase/(decrease) in net debt	**(32)**	**(60)**	**65**	**9**	**(76)**

Balance Sheet (NZ$m)	**2018A**	**2019A**	**2020E**	**2021E**	**2022E**
Working capital	67	74	81	86	93
Fixed assets	582	667	805	888	897
Intangibles	274	270	283	303	323
Other assets	78	62	62	62	62
Total funds employed	**1,001**	**1,073**	**1,230**	**1,339**	**1,375**
Net debt/(cash)	190	123	195	204	128
Other non current liabilities	92	104	104	104	104
Shareholder's funds	712	838	929	1,028	1,141
Minority interests	-	-	-	-	-
Total funding sources	**994**	**1,066**	**1,228**	**1,337**	**1,372**

Valuation Ratios	**2018A**	**2019A**	**2020E**	**2021E**	**2022E**
EV/EBITDA (x)	19.6	16.3	14.9	13.8	12.6
EV/EBIT (x)	25.2	20.5	18.6	17.4	15.7
PE (x)	35.9	28.5	25.8	23.9	21.4
Price/NTA (x)	9.2	7.1	6.2	5.5	4.9
Free cash flow yield (%)	1.8	2.3	-0.2	1.3	3.6
Net dividend yield (%)	1.1	1.4	1.5	1.7	1.9
Gross dividend yield (%)	1.6	1.9	2.2	2.3	2.6
Imputation (%)	100	100	100	100	100
Pay-out ratio (%)	40	40	40	40	40

Capital Structure	**2018A**	**2019A**	**2020E**	**2021E**	**2022E**
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
Net debt/ND+E (%)	21.1	12.8	17.3	16.6	10.1
Net debt/EBITDA (x)	0.9	0.5	0.7	0.7	0.4

Key Ratios	**2018A**	**2019A**	**2020E**	**2021E**	**2022E**
Return on assets (%)	12.2	13.6	13.6	13.6	14.6
Return on equity (%)	15.8	16.8	16.8	16.4	16.5
Return on funds employed (%)	7.7	8.5	9.9	11.7	12.1
EBITDA margin (%)	8.2	8.7	8.8	8.9	9.1
EBIT margin (%)	6.4	6.9	7.0	7.1	7.3
Capex to sales (%)	2.6	3.5	6.6	5.0	2.7
Capex to depreciation (%)	145	194	374	275	152

Operating Performance	**2018A**	**2019A**	**2020A**	**2021A**	**2022A**
Revenue (NZ$m)					
New Zealand	609.2	666.2	718.8	754.7	784.9
Australia	568.1	675.2	760.8	786.6	838.4
USA	615.3	610.9	725.2	844.4	932.6
Asia	89.3	117.3	109.3	124.1	136.4
Europe	451.7	549.3	639.9	694.2	729.5
Total	**2,333.6**	**2,618.9**	**2,954.1**	**3,203.9**	**3,421.8**
Sales growth (%)					
New Zealand	8.2	9.3	7.9	5.0	4.0
Australia	4.0	18.9	12.7	3.4	6.6
USA	-8.9	-0.7	18.7	16.4	10.5
Asia	28.7	31.3	-6.8	13.5	9.9
Europe	4.9	21.6	16.5	8.5	5.1
Total	**2.1**	**12.2**	**12.8**	**8.5**	**6.8**
EBITDA (NZ$m)					
New Zealand	91.0	98.6	110.6	116.9	122.3
Australia	44.9	54.0	59.3	62.6	68.4
USA	26.2	26.9	38.3	47.2	54.6
Asia	8.8	6.9	9.3	10.5	11.6
Europe	26.6	29.0	39.6	44.4	48.1
Total	**197.5**	**215.4**	**257.0**	**281.7**	**305.1**
EBITDA margin (%)					
New Zealand	14.9	14.8	15.4	15.5	15.6
Australia	7.9	8.0	7.8	8.0	8.2
USA	4.3	4.4	5.3	5.6	5.9
Asia	9.9	5.8	8.5	8.5	8.5
Europe	5.9	5.3	6.2	6.4	6.6
Total	**8.5**	**8.2**	**8.7**	**8.8**	**8.9**
NZDAUD	0.94	0.92	0.92	0.94	0.93
NZDUSD	0.71	0.71	0.68	0.64	0.63
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

1H20 preview

Figure 2. MFT 1H20 forecasts (NZ$m)

	1H19	1H20E	Change
Profit and loss account			
Sales revenue	**1,431.0**	**1,530.9**	**7%**
New Zealand	45.4	47.9	6%
Australia	24.4	25.0	2%
The Americas	16.0	19.5	22%
Asia	4.6	5.6	21%
Europe	17.9	20.2	13%
EBITDA	**108.3**	**118.2**	**9%**
Depreciation and amortisation	(26.1)	(28.0)	7%
Abnormals (pre-tax)	(0.3)	0.0	n/a
Interest expense	(4.0)	(3.6)	-9%
Profit before tax	78.0	86.6	11%
Taxation (incl. abnormal tax)	(22.3)	(24.7)	11%
Reported NPAT	**55.7**	**61.9**	**11%**
Abnormals (post tax)	0.2	0.0	n/a
Underlying NPAT	**55.9**	**61.9**	**11%**
Underlying EPS (cents)	55.5	61.5	11%
Interim DPS (cents)	22.0	24.5	11%
Divisional sales growth (local currency)			
New Zealand	8.3%	5.0%	n/a
Australia	16.7%	3.0%	n/a
The Americas	16.8%	8.7%	n/a
Asia	7.2%	6.0%	n/a
Europe	12.2%	8.0%	n/a
Margin analysis			
New Zealand	13.2%	13.3%	7bps
Australia	6.6%	6.7%	11bps
The Americas	4.6%	4.9%	30bps
Asia	7.9%	8.5%	64bps
Europe	5.7%	6.0%	29bps
EBITDA margin	7.6%	7.7%	15bps
EBIT margin	5.7%	6.0%	27bps

Source: Forsyth Barr analysis

Investment summary

Mainfreight (MFT) is a leading New Zealand business international 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.

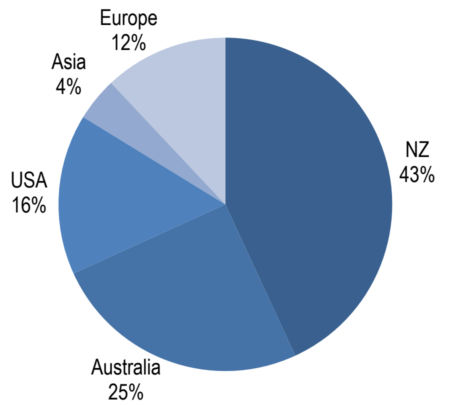
Risks factors

- **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

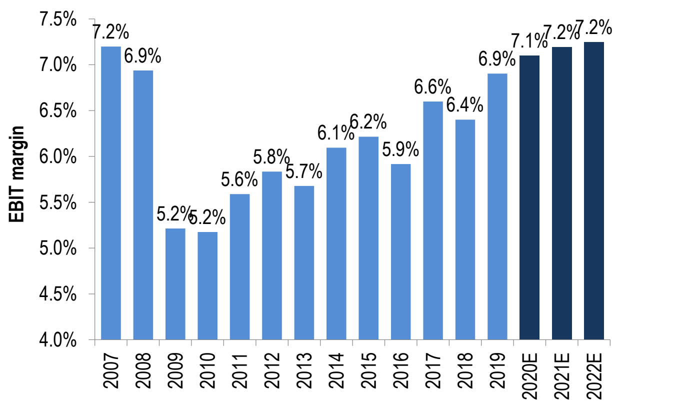
MFT is a global logistics provider offering its customers domestic and international freight forwarding and managed warehousing services. The company was founded in 1978 by Bruce Plested, who remains the largest shareholder and is Executive Chairman. MFT has more than 250 branches across 21 countries 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 3. EBITDA split (FY19)



Source: Company reports, Forsyth Barr analysis

Figure 4. Group EBIT margin development



Source: Company reports, Forsyth Barr analysis

Figure 5. Substantial Shareholders

Shareholder	Latest Holding
Rorohora No. 2 Trust	16.3%

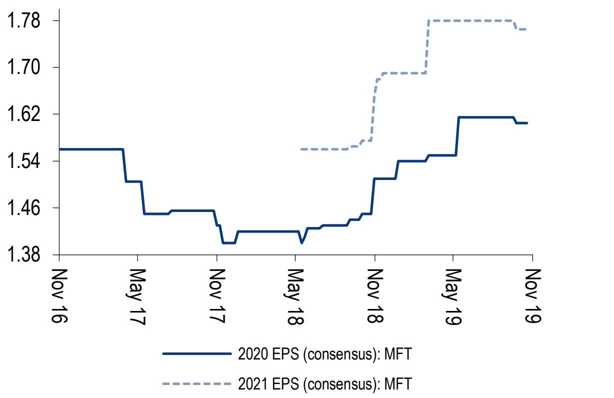
Source: NZX, Forsyth Barr analysis, NOTE: based on SSH notices only

Figure 6. 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)			(m)	2020E	2021E	2020E	2021E	2020E	2021E	2021E
Mainfreight	**MFT NZ**	**NZ$39.98**	**NZ$4,026**	**25.8x**	**23.9x**	**14.7x**	**13.6x**	**18.5x**	**17.1x**	**1.7%**
Freightways *	FRE NZ	NZ$7.90	NZ$1,228	19.6x	18.1x	12.0x	11.3x	14.2x	13.4x	4.2%
Expeditors International of Washington Inc	EXPD US	US$74.72	US$12,756	20.9x	19.7x	13.7x	13.0x	14.6x	13.9x	1.4%
Panalpina Welttransport Holding AG	PWTN SW	CHF249.80	CHF5,933	>50x	46.1x	19.6x	17.9x	42.7x	35.3x	1.7%
Old Dominion Freight Line Inc	ODFL US	US$188.98	US$15,117	23.9x	21.9x	13.4x	12.5x	17.5x	16.3x	0.4%
DSV PANALPINA A/S	DSV DC	kr725.00	kr170,375	30.4x	26.0x	17.6x	14.9x	27.8x	22.7x	0.5%
CH Robinson Worldwide Inc	CHRW US	US$75.41	US$10,207	17.0x	16.9x	12.0x	12.1x	13.5x	13.5x	2.9%
Kuehne + Nagel International AG	KNIN SW	CHF159.90	CHF19,188	24.1x	22.6x	12.1x	11.6x	19.7x	18.4x	4.0%
			Compco Average:	**22.6x**	**24.5x**	**14.4x**	**13.3x**	**21.4x**	**19.1x**	**2.2%**
EV = Current Market Cap + Actual Net Debt			**MFT Relative:**	**+14%**	**-2%**	**+3%**	**+2%**	**-14%**	**-11%**	**-23%**

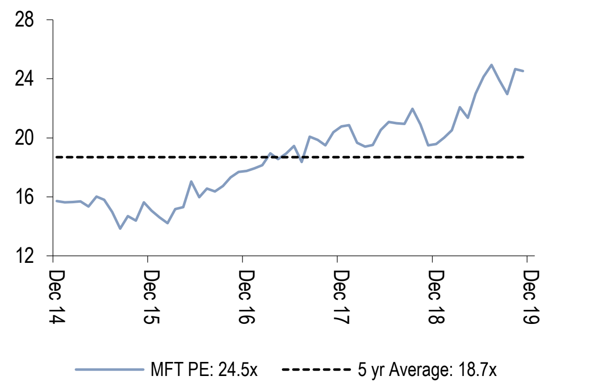
Source: *Forsyth Barr analysis, Bloomberg Consensus, Compco metrics re-weighted to reflect headline (MFT) companies fiscal year end

Figure 7. Consensus EPS Momentum



Source: Forsyth Barr analysis, Bloomberg

Figure 8. 12 Month Forward PE



Source: Forsyth Barr analysis