

Mainfreight

NEUTRAL

Q3 Peer Read-through — Industry Slowdown Continues

Third quarter earnings results from Mainfreight's (MFT) key global peers continue to highlight a slowing trend in the freight industry, with revenue growth now negative year on year. At ~25x one year forward PE, MFT is valued towards the top of its global peers and a small premium to the domestic market. While we acknowledge its material long term growth prospects, we are wary of near term earnings downside risk associated with softer industry trading conditions, particularly in Australasia. NEUTRAL.

Listed peer Q3 highlights

- **Revenue growth:** Average of -1% against the prior year, albeit the less-than-truckload (LTL) sector generated positive growth
- **EBITDA growth:** Margins have firmed with EBITDA growth of +9% over 3Q18, albeit this is artificially inflated by the introduction of IFRS 16 (lease accounting)

Revenue growth turns negative

Following strong growth between 3Q16 and 2Q18, growth rates in the global freight industry have consistently slowed. MFT's global listed peers are now experiencing negative revenue growth. On average revenue declined -1% in 3Q19. Revenue declined across the air and sea forwarding sub-sectors, and logistics, whilst LTL was the only freight segment to grow revenue, up +3% on the prior year quarter.

Margins continue to grow

Margin expansion in the quarter is supported by (1) the mix benefit of LTL revenue growth, which provides a high incremental margin, (2) cost initiatives being implemented across a number of MFT's peers, and (3) the introduction of IFRS 16, which artificially boosts margins, particularly logistics, given the prevalence of leases.

Implications for MFT

Although MFT's service mix and geographic exposure is different to many of its global peers, its growth is reliant on many of the same cyclical influences. The financial performance of its peers is, therefore, a useful indicator of market conditions. After analysing the 3Q19 reports of its key global competitors we expect MFT to report a slowing of its growth trend in 1H20, which it reports on 13 November 2019. Near term earnings risks are weighted to the downside.

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\$40.00
Target price	NZ\$37.00
Risk rating	Medium
Issued shares	100.7m
Market cap	NZ\$4,028m
Average daily turnover	48.9k (NZ\$1,801k)

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	5.6	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 08 Nov 2019: NZ\$40.00					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)	19.6	16.3	14.9	13.8	12.6
12-month target price (NZ\$)*						Spot valuations (NZ\$)	EV/EBIT (x)	25.2	20.5	18.6	17.4	15.7
Expected share price return	-7.5%	1. DCF	32.50			PE (x)	35.9	28.5	25.8	23.9	21.4	
Net dividend yield	1.6%	2. PE relative	38.13			Price/NTA (x)	9.2	7.1	6.2	5.6	4.9	
Estimated 12-month return	-5.9%	3. n/a	n/a			Free cash flow yield (%)	1.8	2.3	-0.2	1.3	3.6	
Key WACC assumptions						DCF valuation summary (NZ\$m)	Net dividend yield (%)	1.1	1.4	1.5	1.7	1.9
Risk free rate	2.00%	Total firm value	3,405			Gross dividend yield (%)	1.6	1.9	2.2	2.3	2.6	
Equity beta	1.09	(Net debt)/cash	(133)			Imputation (%)	100	100	100	100	100	
WACC	8.4%	Value of equity	3,273			Pay-out ratio (%)	40	40	40	40	40	
Terminal growth	2.0%	Shares (m)	101			Capital Structure						
Profit and Loss Account (NZ\$m)						2018A	2019A	2020E	2021E	2022E		
Sales revenue	2,619	2,954	3,204	3,422	3,681	Interest cover EBIT (x)	23.8	29.7	33.7	30.5	42.7	
Normalised EBITDA	215	257	282	305	335	Interest cover EBITDA (x)	30.5	37.4	42.2	38.2	53.1	
Depreciation and amortisation	(48)	(53)	(57)	(62)	(66)	Net debt/ND+E (%)	21.1	12.8	17.3	16.6	10.1	
Normalised EBIT	168	204	225	243	269	Net debt/EBITDA (x)	0.9	0.5	0.7	0.7	0.4	
Net interest	(7)	(7)	(7)	(8)	(6)	Key Ratios						
Associate income	-	-	-	-	-	Return on assets (%)	12.2	13.6	13.6	13.6	14.6	
Tax	(43)	(53)	(62)	(67)	(75)	Return on equity (%)	15.8	16.8	16.8	16.4	16.5	
Minority interests	-	-	-	-	-	Return on funds employed (%)	7.7	8.5	9.9	11.7	12.1	
Normalised NPAT	112	141	156	168	188	EBITDA margin (%)	8.2	8.7	8.8	8.9	9.1	
Abnormals/other	4	3	-	-	-	EBIT margin (%)	6.4	6.9	7.0	7.1	7.3	
Reported NPAT	108	138	156	168	188	Capex to sales (%)	2.6	3.5	6.6	5.0	2.7	
Normalised EPS (cps)	111.4	140.1	154.9	167.1	186.6	Capex to depreciation (%)	145	194	374	275	152	
DPS (cps)	45.0	56.0	61.9	66.8	74.6	Operating Performance						
Growth Rates						2018A	2019A	2020A	2021A	2022A		
Revenue (%)	12.2	12.8	8.5	6.8	7.6	Revenue (NZ\$m)						
EBITDA (%)	9.1	19.3	9.6	8.3	9.7	New Zealand	609.2	666.2	718.8	754.7	784.9	
EBIT (%)	8.9	21.7	10.2	8.2	10.6	Australia	568.1	675.2	760.8	786.6	838.4	
Normalised NPAT (%)	8.8	25.7	10.5	7.9	11.7	USA	615.3	610.9	725.2	844.4	932.6	
Normalised EPS (%)	8.6	25.7	10.5	7.9	11.7	Asia	89.3	117.3	109.3	124.1	136.4	
DPS (%)	9.8	24.4	10.6	7.9	11.7	Europe	451.7	549.3	639.9	694.2	729.5	
Cash Flow (NZ\$m)						2018A	2019A	2020A	2021A	2022A		
EBITDA	215	257	282	305	335	Total						
Working capital change	-	-	-	-	-	2,333.6	2,618.9	2,954.1	3,203.9	3,421.8		
Interest & tax paid	(53)	(61)	(69)	(75)	(81)	Sales growth (%)						
Other	(23)	2	(7)	(7)	(7)	New Zealand	8.2	9.3	7.9	5.0	4.0	
Operating cash flow	140	197	206	223	247	Australia	4.0	18.9	12.7	3.4	6.6	
Capital expenditure	(69)	(103)	(213)	(170)	(100)	USA	-8.9	-0.7	18.7	16.4	10.5	
(Acquisitions)/divestments	4	14	5	5	5	Asia	28.7	31.3	-6.8	13.5	9.9	
Other	0	0	-	-	-	Europe	4.9	21.6	16.5	8.5	5.1	
Funding available/(required)	76	108	(2)	58	152	Total	2.1	12.2	12.8	8.5	6.8	
Dividends paid	(43)	(48)	(62)	(67)	(75)	EBITDA (NZ\$m)						
Equity raised/(returned)	-	-	-	-	-	New Zealand	91.0	98.6	110.6	116.9	122.3	
Increase/(decrease) in net debt	(32)	(60)	65	9	(76)	Australia	44.9	54.0	59.3	62.6	68.4	
Balance Sheet (NZ\$m)						2018A	2019A	2020E	2021E	2022E		
Working capital	67	74	81	86	93	Total						
Fixed assets	582	667	805	888	897	197.5	215.4	257.0	281.7	305.1		
Intangibles	274	270	283	303	323	EBITDA margin (%)						
Other assets	78	62	62	62	62	New Zealand	14.9	14.8	15.4	15.5	15.6	
Total funds employed	1,001	1,073	1,230	1,339	1,375	Australia	7.9	8.0	7.8	8.0	8.2	
Net debt/(cash)	190	123	195	204	128	USA	4.3	4.4	5.3	5.6	5.9	
Other non current liabilities	92	104	104	104	104	Asia	9.9	5.8	8.5	8.5	8.5	
Shareholder's funds	712	838	929	1,028	1,141	Europe	5.9	5.3	6.2	6.4	6.6	
Minority interests	-	-	-	-	-	Total	8.5	8.2	8.7	8.8	8.9	
Total funding sources	994	1,066	1,228	1,337	1,372	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

Industry backdrop

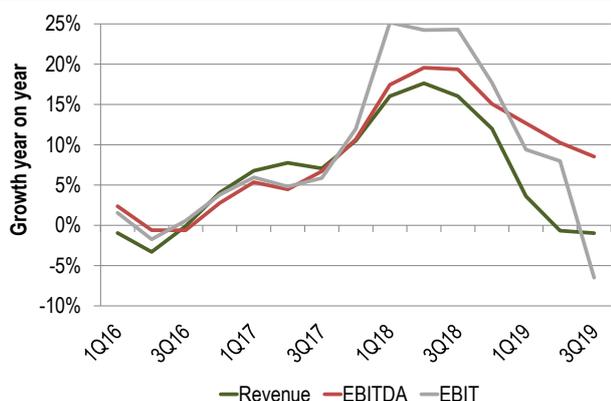
Results for the calendar year third quarter show overall revenue growth for the sector down from 2Q19 levels as activity in the market continues to slow. The average industry growth (average of the headline number provided by MFT's listed peer companies) was -1% in 3Q19, marginally worse than 2Q19, and far below the +16% experienced in 3Q18.

Revenue growth decline continues

After the strong revenue growth experienced by the industry from late 2016 to its peak in mid 2018, growth has consistently slowed and has now become negative, with both 2Q19 and 3Q19 having experienced revenue decline. The weaker revenue growth is a common feature across most of MFT's global industry peers.

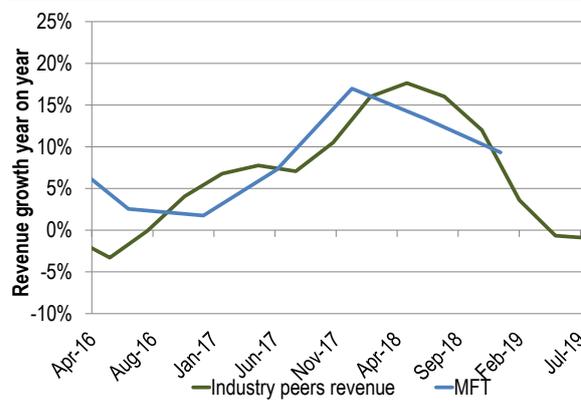
Despite MFT having a larger Australasian presence whilst its key global peers are exposed more to US and European markets, we can observe that it has broadly tracked the general revenue growth trend of its peers in recent years (Figure 2). This suggests MFT may have experienced the same industry headwinds through 1H20, and therefore, growth in revenue may be lower than recent periods.

Figure 1. Average quarterly revenue growth of listed peers



Source: Company reports, Forsyth Barr analysis

Figure 2. MFT vs industry peers



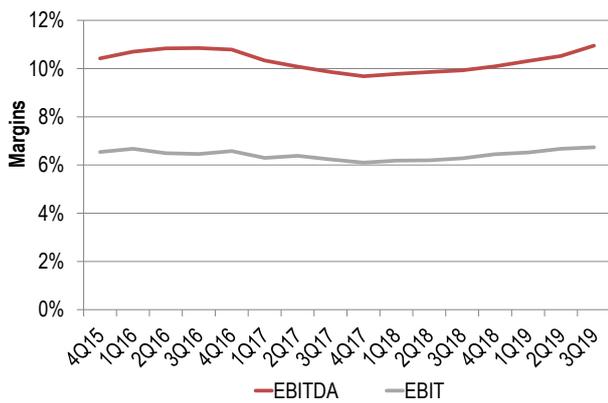
Source: Company reports, Forsyth Barr analysis

Margins increasingly robust

MFT's global peers have continued to report strong margins despite industry revenue growth slowing. Margins have been gradually increasing over the past two years across all reported divisional sectors (Figure 4). Less-than-truckload (LTL) continues to be the sector with the most appealing margins.

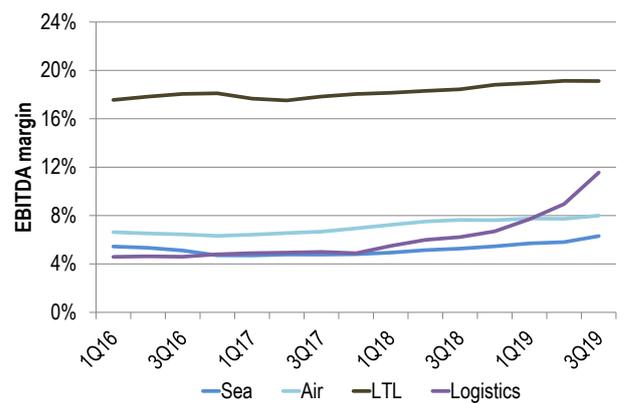
EBITDA margins in the logistics sector (warehousing) have benefitted (disproportionately so) from implementation of IFRS 16. This transition will impact like-for-like comparison for at least the next 12 months.

Figure 3. 12-month rolling peer group margins



Source: Company reports, Forsyth Barr analysis

Figure 4. 12-month rolling margins by industry sector



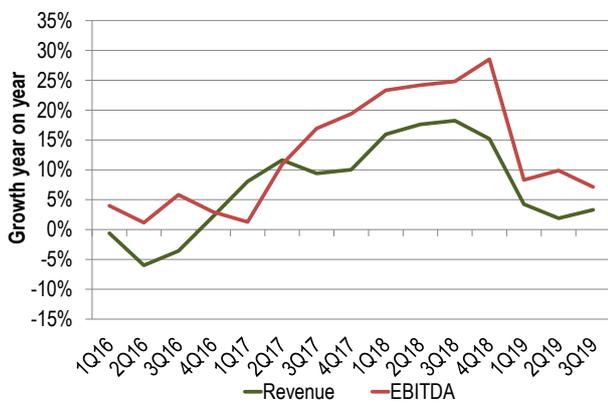
Source: Company reports, Forsyth Barr analysis

LTL revenue grows despite market trend

The less-than-truckload (LTL) sector continues to be the best performing freight segment, with +3% revenue growth in 3Q19 across MFT's industry peers broadly on par with the growth rate in the previous two quarters (Figure 5), despite decelerating price growth.

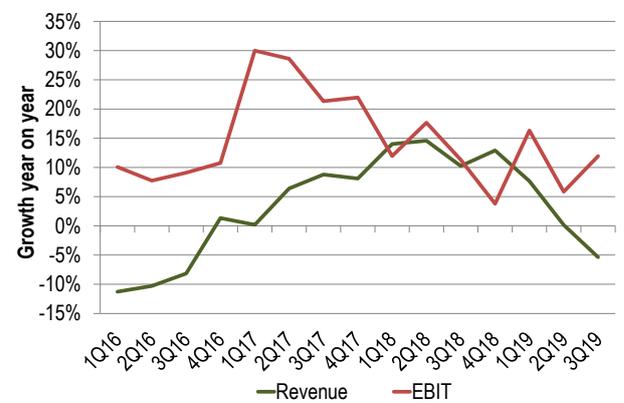
Following four consecutive quarters of declining growth, air and sea freight forwarding sectors are now reporting negative revenue growth, down -5% and -1% respectively. However, EBITDA margins for air and sea freight firmed over the period (Figure 6), although the DSV acquisition of Panalpina has had a material impact on aggregate margins.

Figure 5. Growth in LTL sector



Source: Company reports, Forsyth Barr analysis

Figure 6. Growth in air and sea sector



Source: Company reports, Forsyth Barr analysis

Our analysis

We have analysed the 3Q19 results reported by relevant global listed peers of MFT. We have made an effort to remove impacts of material M&A in order to ensure a like-for-like comparison between companies and periods. IFRS 16 has had a material impact on some margins, especially in the logistics sector, and we factor this in to our conclusions.

Where divisional disclosure allows we segment each company's results to provide a view on each market sector.

Listed industry peers included in our analysis are:

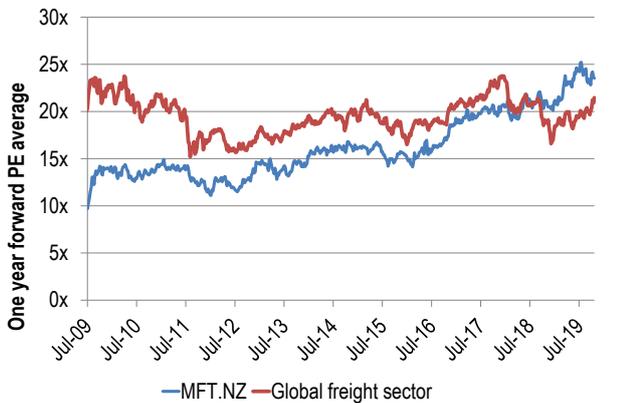
- Old Dominion Freight Line (ODFL.O)
- ArcBest (ARCB.O)
- Saia (SAIA.O)
- DSV (DSV.CO)

- Kuehne und Nagel (KNIN.S)
- Expeditors International (EXPD.O)
- CH Robinson (CHRW.O)
- JB Hunt (JBHT.O)
- Forward Air Corp (FWRD.O)
- XPO Logistics (XPO)
- Hub Group (HUBG.O)
- Ryder Systems (R)
- Landstar System (LSTR.O)

Valuation comparison

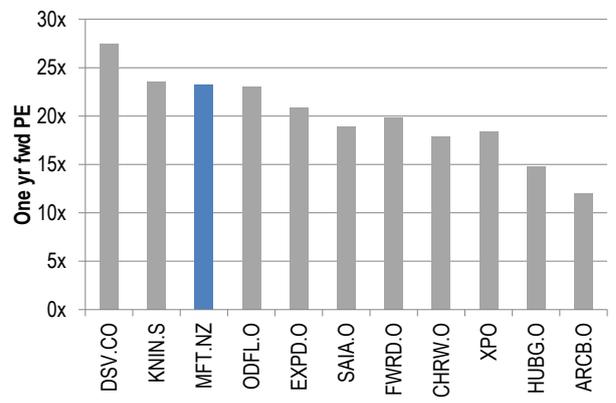
MFT is currently trading at ~25x one year forward PE, placing it above the combined average of its global industry peers (Figure 7). This premium reflects its high quality characteristics, track record, and recent growth trends. However, we are wary about the near term earnings outlook which may have valuation consequences.

Figure 7. MFT vs average of industry peers



Source: Eikon, Forsyth Barr analysis

Figure 8. MFT global peer valuations



Source: Eikon, 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.

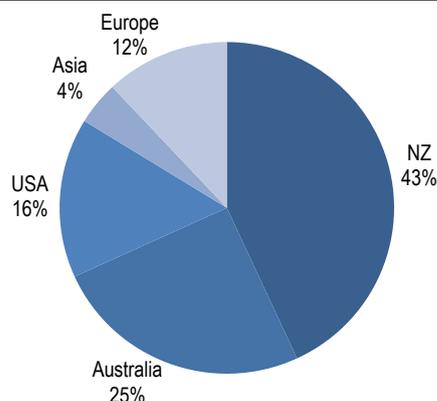
Risks factors

- **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

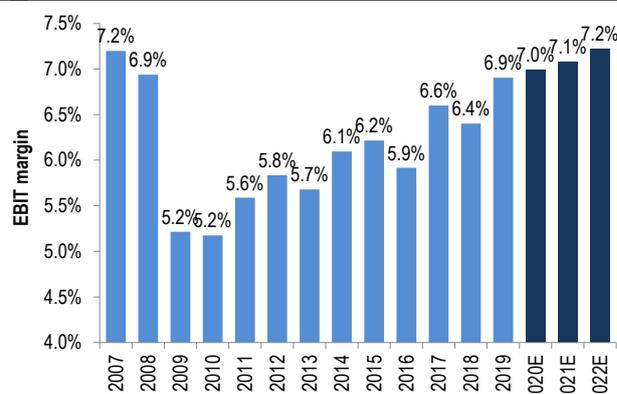
MFT is a global logistics provider offering its customers domestic and international freight forwarding and managed warehousing services. The company was founded in 1978 by Bruce Plested, who remains the largest shareholder and is Executive Chairman. MFT has more than 250 branches across 21 countries 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 9. EBITDA split (FY19)



Source: Company reports, Forsyth Barr analysis

Figure 10. Group EBIT margin development



Source: Company reports, Forsyth Barr analysis

Figure 11. Substantial Shareholders

Shareholder	Latest Holding
Rorohora No. 2 Trust	16.3%

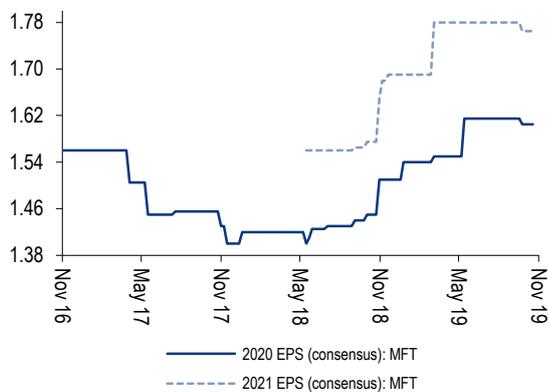
Source: NZX, Forsyth Barr analysis, NOTE: based on SSH notices only

Figure 12. International Compcos

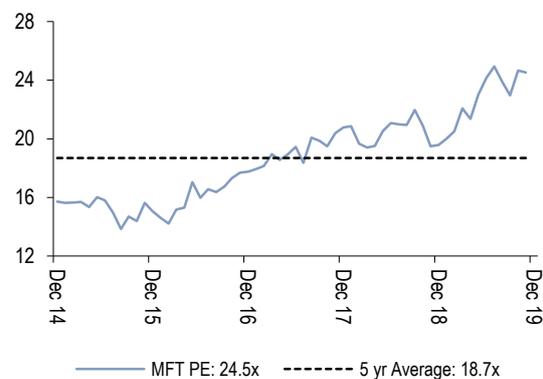
Company	Code	Price	Mkt Cap	PE		EV/EBITDA		EV/EBIT		Cash D/Yld
<i>(metrics re-weighted to reflect MFT's balance date - March)</i>										
			(m)	2020E	2021E	2020E	2021E	2020E	2021E	2021E
Mainfreight	MFT NZ	NZ\$40.00	NZ\$4,028	25.8x	23.9x	14.7x	13.6x	18.5x	17.1x	1.7%
Freightways *	FRE NZ	NZ\$7.87	NZ\$1,223	19.5x	18.0x	12.0x	11.3x	14.2x	13.3x	4.2%
Expeditors International of Washington Inc	EXPD US	US\$77.20	US\$13,147	21.7x	20.4x	14.3x	13.6x	15.3x	14.5x	1.4%
Old Dominion Freight Line Inc	ODFL US	US\$194.42	US\$15,519	24.6x	22.6x	13.9x	12.8x	18.0x	16.9x	0.4%
DSV PANALPINA A/S	DSV DC	kr720.80	kr169,388	30.2x	25.7x	17.5x	14.7x	27.6x	22.4x	0.5%
CH Robinson Worldwide Inc	CHRW US	US\$79.14	US\$10,704	17.8x	17.7x	12.5x	12.6x	14.0x	14.1x	2.7%
Kuehne + Nagel International AG	KNIN SW	CHF163.45	CHF19,614	24.6x	23.1x	12.4x	11.8x	20.1x	18.8x	4.0%
Compcos Average:				23.1x	21.3x	13.7x	12.8x	18.2x	16.7x	2.2%
MFT Relative:				+12%	+13%	+7%	+6%	+1%	+2%	-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 13. Consensus EPS Momentum


Source: Forsyth Barr analysis, Bloomberg

Figure 14. 12 Month Forward PE


Source: Forsyth Barr analysis

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