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NEW ZEALAND EQUITY RESEARCH | TRANSPORT | FREIGHT FORWARDING & LOGISTICS
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Mainfreight
Q4 Peer Read-through — Margins Robust Despite Revenue Decline

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NEUTRAL

Fourth quarter earnings results from Mainfreight's (MFT) key global listed peers highlight reduced industry activity, with revenue declines being reported for the third consecutive quarter, however, margins across all segments remain robust. MFT is currently trading at a one year forward PE of ~21x, towards the top of the range of its listed global peers. In light of growing cyclical/industry headwinds from the coronavirus outbreak, we see near term earnings risk being weighted to the downside. NEUTRAL.

NZX Code	MFT	Financials: Mar/	19A	20E	21E	22E	Valuation (x)	19A	20E	21E	22E
Share price	NZ$36.75	NPAT* (NZ$m)	141.1	157.8	173.7	191.9	EV/EBITDA	15.0	13.6	12.5	11.4
Target price	NZ$39.00	EPS* (NZc)	140.1	156.7	172.5	190.6	EV/EBIT	18.9	17.0	15.5	14.1
Risk rating	Medium	EPS growth* (%)	25.7	11.8	10.1	10.5	PE	26.2	23.5	21.3	19.3
Issued shares	100.7m	DPS (NZc)	56.0	62.7	69.0	76.2	Price / NTA	6.5	6.0	5.3	4.6
Market cap	NZ$3,701m	Imputation (%)	100	100	100	100	Cash div yld (%)	1.5	1.7	1.9	2.1
Avg daily turnover	59.8k (NZ$2,360k)	*Based on normalised profits					Gross div yld (%)	2.1	2.4	2.6	2.9

Global peer 4Q19 highlights:

- **Revenue growth**: MFT's global listed peers reported average revenue growth of -3%, a further deterioration from recent quarters, however, both less-than-truckload (LTL) and logistics (warehousing) segments experienced growth.
- **EBITDA growth**: Margins remain strong across the sector, with EBITDA growth of +3% against the prior year, although we recognise the impact of IFRS 16 (lease accounting) will be artificially inflating this number, particularly in the logistics segment.

Industry revenue growth decline continues

The freight industry has been slowing consistently since 3Q18, following strong growth experienced from 3Q16 to 2Q18. For the third consecutive quarter industry revenue growth has been negative, with MFT's key peers reporting revenue growth of -3% for 4Q19. Revenue declined in both the air and sea freight segments, whilst revenue in the LTL and logistics segments grew +4% and +5% respectively against 4Q18.

Margins remain robust

Despite the slower industry backdrop, margins continue to be strong through the fourth quarter, with LTL margins remaining the most attractive. Air and sea freight margins are down slightly from the record third quarter but remain in line with historic levels. The logistics segment margins continue to grow; however, it is worth noting that the logistics segment is disproportionately affected by the adoption of IFRS 16 given the relatively higher level of leases, and this is inflating reported margins.

Implications for MFT

Despite MFT having slightly different geographic and business mix exposures to many of its key global peers, it remains reliant on many of the same cyclical influences, therefore, the financial performance of its peers provides a useful indication of the broader industry backdrop for MFT. The analysis of MFT's global peers would suggest that MFT will have a soft revenue result in 2H20, compensated by robust margins (similar to the 1H20 oucome) when it reports on 27 May 2020. Near term earnings risk is weighted to the downside, in our opinion.

Mainfreight Ltd (MFT)

Priced as at 02 Mar 2020 (NZ$)	36.75

12-month target price (NZ$)*	39.00
Expected share price return	6.1%
Net dividend yield	1.9%
Estimated 12-month return	8.0%

Key WACC assumptions	
Risk free rate	2.00%
Equity beta	1.09
WACC	8.4%
Terminal growth	2.0%

Profit and Loss Account (NZ$m)	2018A	2019A	2020E	2021E	2022E
Sales revenue	2,618.9	2,954.1	3,148.1	3,380.8	3,632.4
Normalised EBITDA	**215.4**	**257.0**	**283.7**	**310.0**	**338.8**
Depreciation and amortisation	(47.8)	(53.1)	(56.9)	(59.7)	(64.3)
Normalised EBIT	**167.6**	**203.9**	**226.8**	**250.4**	**274.5**
Net interest	(7.1)	(6.9)	(6.2)	(7.4)	(6.1)
Associate income	0	0	0	0	0
Tax	(42.6)	(53.0)	(62.9)	(69.2)	(76.5)
Minority interests	0	0	0	0	0
Normalised NPAT	**112.2**	**141.1**	**157.8**	**173.7**	**191.9**
Abnormals/other	4.3	3.5	0	0	0
Reported NPAT	**107.9**	**137.6**	**157.8**	**173.7**	**191.9**
Normalised EPS (cps)	111.4	140.1	156.7	172.5	190.6
DPS (cps)	45.0	56.0	62.7	69.0	76.2

Growth Rates	2018A	2019A	2020A	2021A	2022A
Revenue (%)	12.2	12.8	6.6	7.4	7.4
EBITDA (%)	9.1	19.3	10.4	9.3	9.3
EBIT (%)	8.9	21.7	11.2	10.4	9.7
Normalised NPAT (%)	8.8	25.7	11.8	10.1	10.5
Normalised EPS (%)	8.6	25.7	11.8	10.1	10.5
Ordinary DPS (%)	9.8	24.4	11.9	10.1	10.5

Cash Flow (NZ$m)	2018A	2019A	2020E	2021E	2022E
EBITDA	**215.4**	**257.0**	**283.7**	**310.0**	**338.8**
Working capital change	0	0	0	0	(0.0)
Interest & tax paid	(52.5)	(61.4)	(69.1)	(76.6)	(82.6)
Other	(22.7)	1.7	(7.0)	(7.0)	(7.0)
Operating cash flow	**140.2**	**197.4**	**207.7**	**226.4**	**249.2**
Capital expenditure	(69.2)	(103.3)	(170.0)	(190.0)	(100.0)
(Acquisitions)/divestments	4.3	14.0	5.0	5.0	5.0
Other	0.2	0.1	0	0	0
Funding available/(required)	**75.5**	**108.3**	**42.7**	**41.4**	**154.2**
Dividends paid	(43.3)	(48.3)	(63.1)	(69.5)	(76.8)
Equity raised/(returned)	0	0	0	0	0
(Increase)/decrease in net debt	**32.2**	**59.9**	**(20.4)**	**(28.1)**	**77.4**

Balance Sheet (NZ$m)	2018A	2019A	2020E	2021E	2022E
Working capital	66.7	74.5	79.3	85.2	91.5
Fixed assets	582.3	666.6	761.7	867.0	877.8
Intangibles	274.3	270.0	283.0	303.0	323.0
Right of use asset	0	0	0	0	0
Other assets	77.5	61.7	61.7	61.7	61.7
Total funds employed	**1,000.9**	**1,072.8**	**1,185.8**	**1,317.0**	**1,354.0**
Net debt/(cash)	190.3	123.5	170.9	199.0	121.6
Lease liability	0	0	0	0	0
Other liabilities	98.2	111.0	111.0	111.0	111.0
Shareholder's funds	712.4	838.3	903.9	1,007.0	1,121.5
Minority interests	0	0	0	0	0
Total funding sources	**1,000.9**	**1,072.8**	**1,185.8**	**1,317.0**	**1,354.0**

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

Spot valuations (NZ$)	
1. DCF	33.76
2. PE relative	40.25
3. n/a	n/a

DCF valuation summary (NZ$m)	
Total firm value	3,534
(Net debt)/cash	(134)
Less: Capitalised operating leases	0
Value of equity	3,399

Valuation Ratios	2018A	2019A	2020E	2021E	2022E
EV/EBITDA (x)	18.1	15.0	13.6	12.5	11.4
EV/EBIT (x)	23.3	18.9	17.0	15.5	14.1
PE (x)	33.0	26.2	23.5	21.3	19.3
Price/NTA (x)	8.4	6.5	6.0	5.3	4.6
Free cash flow yield (%)	1.9	2.5	1.0	1.0	4.0
Net dividend yield (%)	1.2	1.5	1.7	1.9	2.1
Gross dividend yield (%)	1.7	2.1	2.4	2.6	2.9

Capital Structure	2018A	2019A	2020E	2021E	2022E
Interest cover EBIT (x)	23.8	29.7	36.7	33.8	45.1
Interest cover EBITDA (x)	30.5	37.4	45.9	41.9	55.6
Net debt/ND+E (%)	21.1	12.8	15.9	16.5	9.8
Net debt/EBITDA (x)	0.9	0.5	0.6	0.6	0.4

Key Ratios	2018A	2019A	2020E	2021E	2022E
Return on assets (%)	12.2	13.6	14.0	14.1	14.9
Return on equity (%)	15.8	16.8	17.5	17.3	17.1
Return on funds employed (%)	7.7	8.5	10.1	12.3	12.5
EBITDA margin (%)	8.2	8.7	9.0	9.2	9.3
EBIT margin (%)	6.4	6.9	7.2	7.4	7.6
Capex to sales (%)	2.6	3.5	5.4	5.6	2.8
Capex to depreciation (%)	145	194	299	318	156
Imputation (%)	100	100	100	100	100
Pay-out ratio (%)	40	40	40	40	40

Operating Performance	2018A	2019A	2020E	2021E	2022E
Revenue (NZ$m)					
New Zealand	666	719	758	796	836
Australia	675	761	798	856	938
USA	611	725	797	882	919
Asia	117	109	105	118	125
Europe	549	640	690	729	815
Total	**2,619**	**2,954**	**3,148**	**3,381**	**3,632**
EBITDA (NZ$m)					
New Zealand	98.6	110.6	114.6	121.1	127.8
Australia	54.0	59.3	61.3	66.9	74.7
USA	26.9	38.3	48.0	56.6	62.1
Asia	6.9	9.3	8.7	10.0	10.6
Europe	29.0	39.6	51.1	55.4	63.6
Total	**215.4**	**257.0**	**283.7**	**310.0**	**338.8**
NZDAUD	0.9	0.9	0.9	0.9	0.9
NZDUSD	0.7	0.7	0.6	0.6	0.7
NZDEUR	0.6	0.6	0.6	0.6	0.6

Industry backdrop

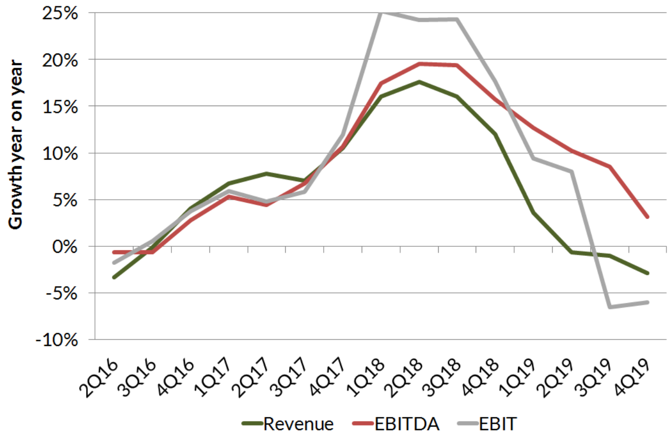
Results from fourth quarter 2019 calendar year show a continued decline in activity across the listed global freight sector, with a further sequential deceleration following a weak 3Q19. The average industry revenue growth (average of the headline result provided by MFT's listed peer companies) was -3% in 4Q19, down from -1% in 3Q19.

Third consecutive quarter of negative growth

Following the consistent revenue growth experienced from late-2016 to early-2018, industry growth has continued to decelerate, with 4Q19 being the third consecutive quarter of negative revenue growth in the sector. The air and sea forwarding segments have experienced the largest decline in revenue in the fourth quarter, down -6% and -5% respectively against the same quarter in the prior year. Average revenue growth in the logistics segment was negative year on year in the third quarter, however, growth has rebounded with an industry average growth rate of +5% year on year reported in 4Q19.

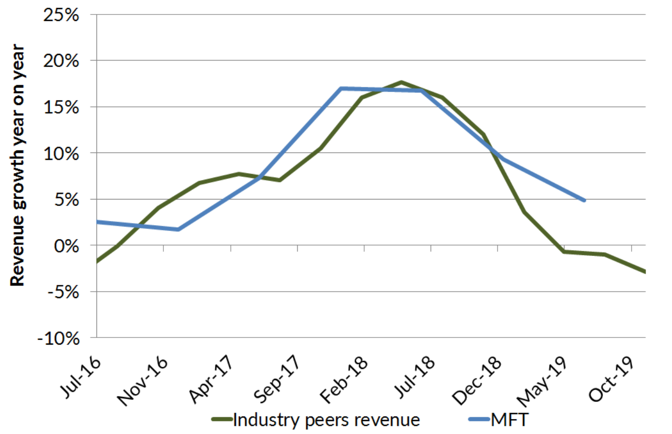
Although MFT's business mix and geographic exposure is different to that of its key global peers, it is subject to the same global macro drivers. Figure 2 shows that MFT has broadly tracked the performance of the average of its listed industry global peers. This suggests that MFT will have encountered similar headwinds in its 2H20.

Figure 1. Average quarterly revenue of listed peers



Source: Company reports, Forsyth Barr analysis

Figure 2. MFT vs industry peers

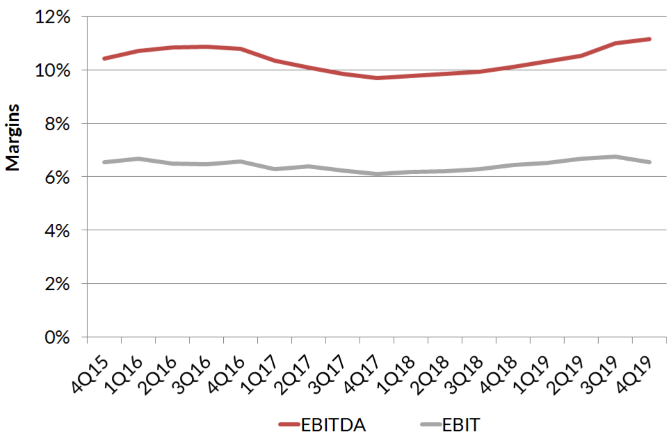


Source: Company reports, Forsyth Barr analysis

Margins remain strong despite industry slowdown

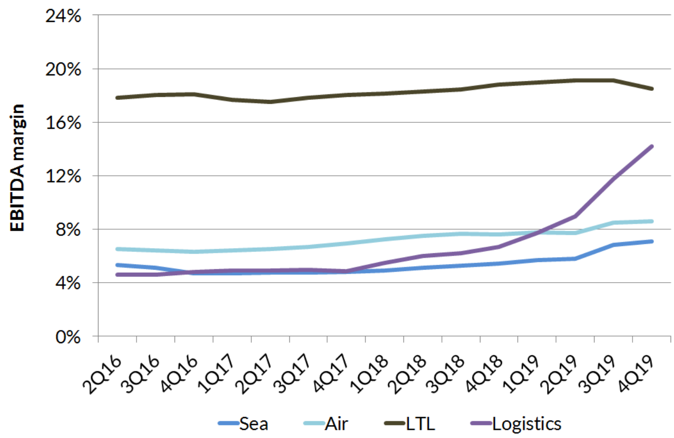
MFT's global listed peers continue to report strong margins despite the slowdown in activity. Following two years of gradual margin expansion, 4Q19 has seen marginal decline from 3Q19. Less-than-truckload (LTL) margins continue to remain the most attractive, relative to other industry sectors. EBITDA margins in the logistics sector (warehousing) have benefited (disproportionately so) from implementation of IFRS 16. This transition will impact like-for-like comparison for at least the next 12 months. MFT reported robust margins when it released its 1H20 results in November 2019.

Figure 3. 12-month rolling peer group margins



Source: Company reports, Forsyth Barr analysis

Figure 4. 12-month rolling margins by industry sector



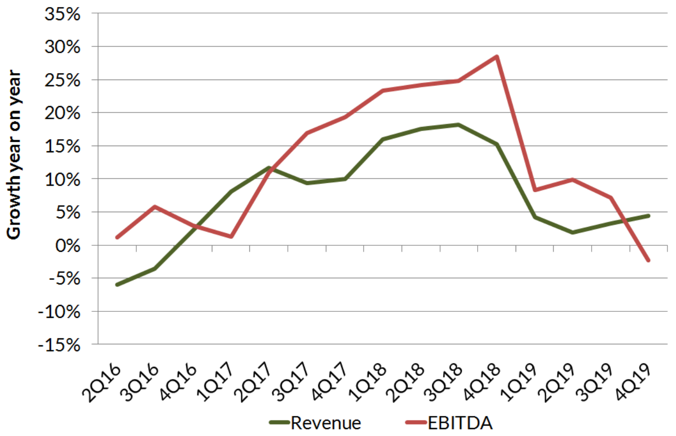
Source: Company reports, Forsyth Barr analysis

Air and sea sector margins flat despite revenue decline

The air and sea forwarding sectors have experienced a deteriorating revenue backdrop since 4Q18 (Figure 6), yet average industry margins have remained relatively flat quarter to quarter, and the air and sea freight segments have experienced year on year EBIT growth of +12% in the fourth quarter.

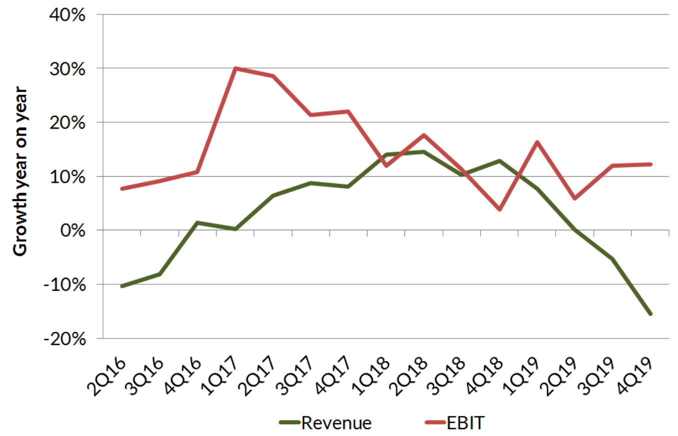
The less-than-truckload (LTL) segment has continued to outperform the industry, with MFT's global peers reporting modest LTL revenue growth in the fourth quarter, despite the broader freight industry revenue decline.

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 4Q19 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 into our conclusions.

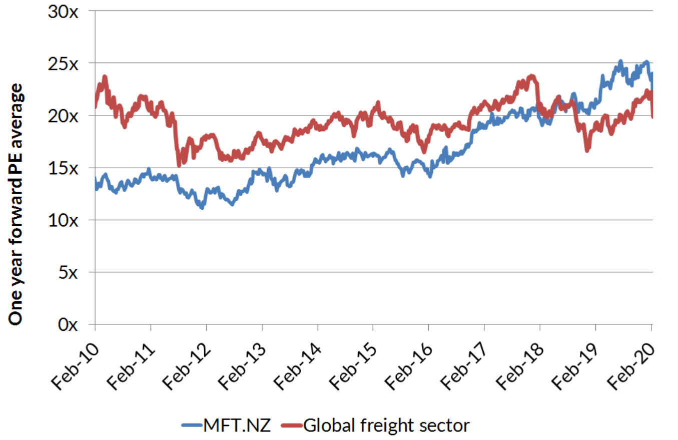
Where divisional disclosure allows we segment each company's results to provide a view on each market sector.
Listed industry peers included in our analysis are:

- 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

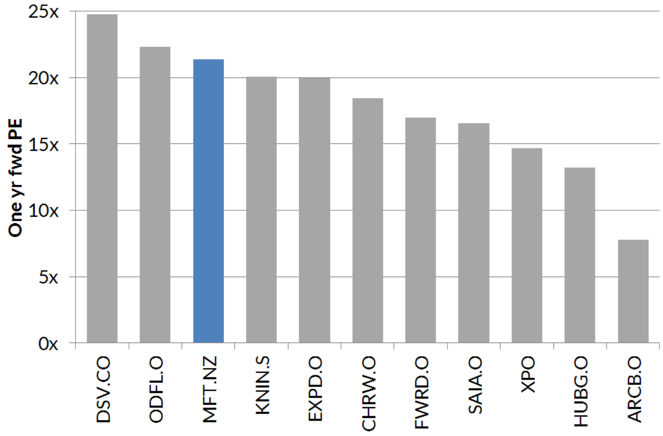
MFT is currently trading at ~21x one year forward PE, placing it above the combined average of its global industry peers (Figure 7). This premium reflects its high quality characteristics, track record, and recent growth trends. However, we are wary about the near term earnings outlook which may have 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 cashflow 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.

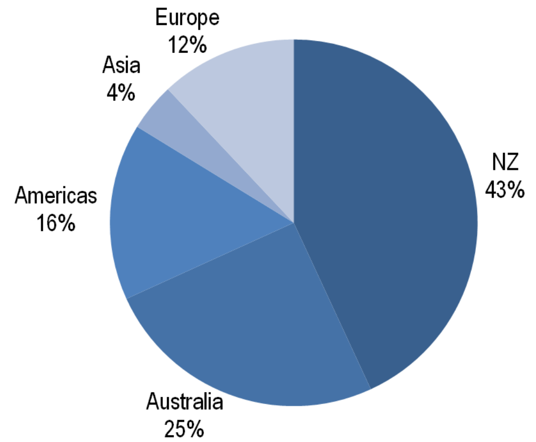
Financial structure

- **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.

Risk factors

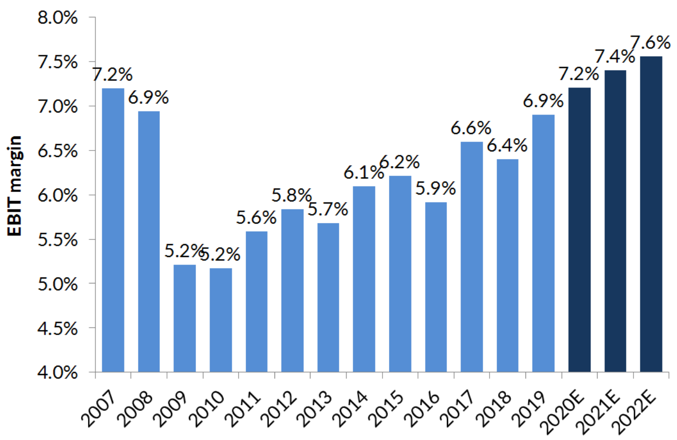
- **Acquisitions**: History suggests that MFT is not as good at due diligence as it is at operating a freight and logistics business.
- **Disruptive technology**: Freight forwarders leverage the inefficiencies in the freight supply chain. New technologies may lower supply chain costs, therefore, increasing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

Figure 9. EBITDA split (FY19)



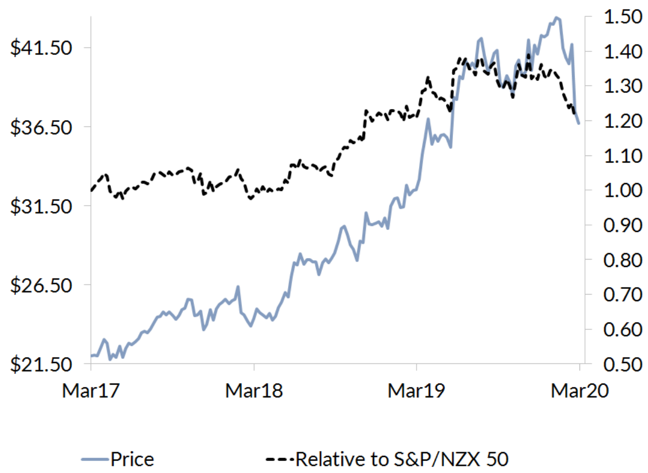
Source: Company reports, Forsyth Barr analysis

Figure 10. Group EBIT margin development



Source: Company reports, Forsyth Barr analysis

Figure 11. Price performance



Source: Forsyth Barr analysis

Figure 12. Substantial shareholders

Shareholder	Latest Holding
Rorohora No. 2 Trust	16.3%
Harbour Asset Management & Jarden Securities Limited	5.6%

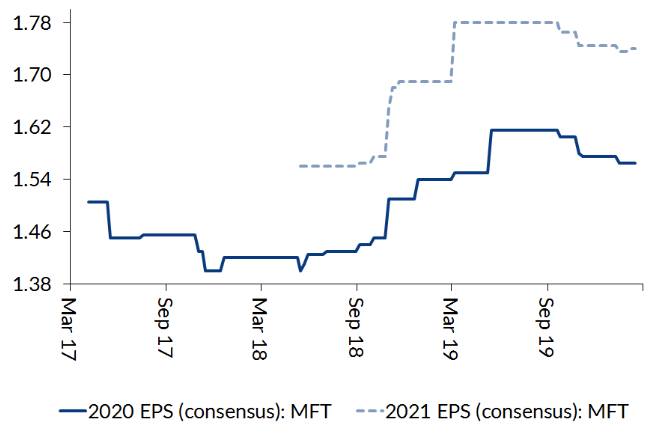
Source: NZX, Forsyth Barr analysis, NOTE: based on SSH notices only

Figure 13. International valuation comparisons

Company	Code	Price	Mkt Cap	PE		EV/EBITDA		EV/EBIT		Cash Yld
(metrics re-weighted to reflect MFT's balance date - March)			(m)	2020E	2021E	2020E	2021E	2020E	2021E	2021E
Mainfreight	**MFT NZ**	**NZ$36.75**	**NZ$3,701**	**23.5x**	**21.3x**	**13.5x**	**12.3x**	**16.9x**	**15.3x**	**1.9%**
Freightways *	FRE NZ	NZ$7.25	NZ$1,127	19.3x	18.2x	9.5x	8.5x	13.1x	12.3x	4.2%
EXPEDITORS INTL WASH INC	EXPD US	US$70.42	US$11,955	20.4x	20.0x	12.7x	13.4x	14.4x	13.9x	1.5%
OLD DOMINION FREIGHT LINE	ODFL US	US$193.80	US$15,445	24.7x	22.5x	13.7x	12.7x	18.1x	16.6x	0.4%
DSV PANALPINA A/S	DSV DC	kr681.80	kr160,223	33.9x	24.6x	16.6x	13.7x	25.6x	20.9x	0.5%
C.H. ROBINSON WORLDWIDE INC	CHRW US	US$68.90	US$9,294	17.1x	18.6x	11.5x	13.1x	13.8x	15.1x	3.0%
KUEHNE + NAGEL INTL AG-REG	KNIN SW	CHF140.55	CHF16,866	20.9x	20.0x	10.1x	10.1x	17.1x	16.3x	4.6%
			Compco Average:	**22.7x**	**20.6x**	**12.3x**	**11.9x**	**17.0x**	**15.9x**	**2.4%**
EV = Current Market Cap + Actual Net Debt			**MFT Relative:**	**3%**	**3%**	**9%**	**4%**	**-1%**	**-4%**	**-21%**

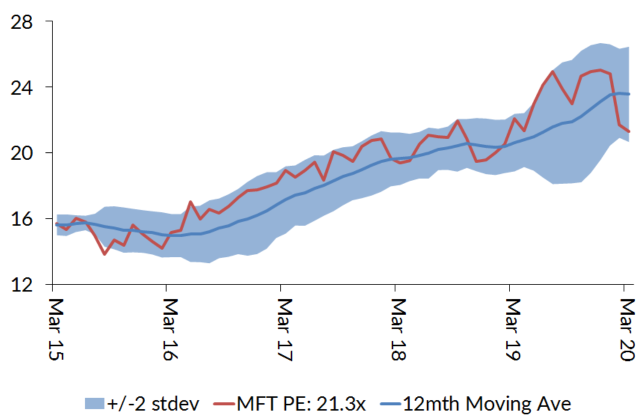
Source: *Forsyth Barr analysis, Bloomberg Consensus, Compco metrics re-weighted to reflect headline (MFT) companies fiscal year end

Figure 14. Consensus EPS momentum (NZ$)



Source: Forsyth Barr analysis, Bloomberg

Figure 15. One year forward PE (x)



Source: Forsyth Barr analysis

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