

Mainfreight

Q1 Peer Read-through — Beginning to Show Symptoms

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OUTPERFORM

First quarter results from Mainfreight's (MFT) key global peers highlight continued robust margins despite sluggish revenue performance. MFT is currently trading at a two year forward PE of ~20x, on par with an average of its global peers. Its peers highlighted an early impact of COVID-19, and cautioned that performance would deteriorate sharply through the second quarter. While we're wary of the impact of government restrictions on MFT's trading and the potential enduring economic effect, it is well positioned to strengthen its competitive position through the recovery, in our opinion. OUTPERFORM.

NZX Code	MFT	Financials: Mar/	19A	20E	21E	22E	Valuation (x)	19A	20E	21E	22E
Share price	NZ\$36.30	NPAT* (NZ\$m)	141.1	156.8	127.3	167.0	EV/EBITDA	14.8	13.5	15.9	13.0
Target price	NZ\$37.50	EPS* (NZc)	140.1	155.7	126.4	165.8	EV/EBIT	18.7	16.9	20.8	16.1
Risk rating	Medium	EPS growth* (%)	25.7	11.2	-18.8	31.2	PE	25.9	23.3	28.7	21.9
Issued shares	100.7m	DPS (NZc)	56.0	50.0	50.0	66.3	Price / NTA	6.4	5.8	5.3	4.7
Market cap	NZ\$3,656m	Imputation (%)	100	100	100	100	Cash div yld (%)	1.5	1.4	1.4	1.8
Avg daily turnover	77.7k (NZ\$2,917k)	*Based on normalised profits					Gross div yld (%)	2.1	1.9	1.9	2.5

Global peer 1Q20 highlights:

- **Revenue growth:** MFT's key global listed peers reported an average revenue decline of -1% in 1Q20, a sequential improvement from 4Q19. Less-than-truckload (LTL) and logistics (warehousing) were again the only industry segments to report revenue growth.
- **EBIT decline:** EBIT fell sharply in the quarter, with an average decline of -13% across MFT's peers. This decline was largely due to the logistics and sea freight industry segments experiencing reductions of -26% and -16% respectively.
- **Consensus estimates cut:** Consensus forecasts for MFT's listed peers have been cut dramatically since December 2019, with FY20 forecasted revenue and EBIT down an average of -11% and -33% respectively.

Industry revenue decline persists

Industry revenue growth has been decelerating since 3Q18, and had been negative since 2Q19. Growth in 1Q20 was down -1% on on the prior year. Air and sea freight industry segments experienced another quarter of revenue decline, whilst the LTL and logistics segments reported revenue growth against 1Q19 of +8% and +1% respectively.

Margins remain robust

Reported margins were broadly flat in the first quarter against 1Q19 despite the sluggish trading performance. The logistics and LTL industry segments continue to report the most attractive margins, although both experienced sequential declines in the first quarter compared to 4Q19 (-14bps and -4bps respectively). Air and sea freight margins were unchanged.

Implications for MFT

Despite MFT having different geographic and business exposures to 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 it will have experienced more subdued revenue growth in its second half (six months to March 2020) as a result of both a pre-virus slowdown and the beginning of COVID-19 related supply chain disruption.

Mainfreight Ltd (MFT)

Priced as at 21 May 2020 (NZ\$)

36.30

12-month target price (NZ\$)*	37.50
Expected share price return	3.3%
Net dividend yield	1.5%
Estimated 12-month return	4.8%

Spot valuations (NZ\$)	
1. DCF	33.76
2. PE relative	36.59
3. n/a	n/a

Key WACC assumptions	
Risk free rate	2.00%
Equity beta	0.94
WACC	8.1%
Terminal growth	2.0%

DCF valuation summary (NZ\$m)	
Total firm value	3,570
(Net debt)/cash	(171)
Less: Capitalised operating leases	0
Value of equity	3,400

Profit and Loss Account (NZ\$m)	2018A	2019A	2020E	2021E	2022E
Sales revenue	2,618.9	2,954.1	3,130.5	3,004.7	3,348.9
Normalised EBITDA	215.4	257.0	282.2	240.1	294.3
Depreciation and amortisation	(47.8)	(53.1)	(56.9)	(56.5)	(57.7)
Normalised EBIT	167.6	203.9	225.3	183.6	236.6
Net interest	(7.1)	(6.9)	(5.9)	(5.5)	(3.0)
Associate income	0	0	0	0	0
Tax	(42.6)	(53.0)	(62.5)	(50.7)	(66.6)
Minority interests	0	0	0	0	0
Normalised NPAT	112.2	141.1	156.8	127.3	167.0
Abnormals/other	4.3	3.5	0	0	0
Reported NPAT	107.9	137.6	156.8	127.3	167.0
Normalised EPS (cps)	111.4	140.1	155.7	126.4	165.8
DPS (cps)	45.0	56.0	50.0	50.0	66.3

Valuation Ratios	2018A	2019A	2020E	2021E	2022E
EV/EBITDA (x)	17.9	14.8	13.5	15.9	13.0
EV/EBIT (x)	23.0	18.7	16.9	20.8	16.1
PE (x)	32.6	25.9	23.3	28.7	21.9
Price/NTA (x)	8.3	6.4	5.8	5.3	4.7
Free cash flow yield (%)	1.9	2.6	1.0	2.4	3.8
Net dividend yield (%)	1.2	1.5	1.4	1.4	1.8
Gross dividend yield (%)	1.7	2.1	1.9	1.9	2.5

Capital Structure	2018A	2019A	2020E	2021E	2022E
Interest cover EBIT (x)	23.8	29.7	38.0	33.2	78.2
Interest cover EBITDA (x)	30.5	37.4	47.5	43.4	97.3
Net debt/ND+E (%)	21.1	12.8	14.8	10.7	3.7
Net debt/EBITDA (x)	0.9	0.5	0.6	0.5	0.1

Growth Rates	2018A	2019A	2020A	2021A	2022A
Revenue (%)	12.2	12.8	6.0	-4.0	11.5
EBITDA (%)	9.1	19.3	9.8	-14.9	22.5
EBIT (%)	8.9	21.7	10.5	-18.5	28.8
Normalised NPAT (%)	8.8	25.7	11.2	-18.8	31.2
Normalised EPS (%)	8.6	25.7	11.2	-18.8	31.2
Ordinary DPS (%)	9.8	24.4	-10.7	0.0	32.7

Key Ratios	2018A	2019A	2020E	2021E	2022E
Return on assets (%)	12.2	13.6	13.9	11.3	14.0
Return on equity (%)	15.8	16.8	17.1	13.0	15.4
Return on funds employed (%)	7.7	8.5	8.4	6.8	8.3
EBITDA margin (%)	8.2	8.7	9.0	8.0	8.8
EBIT margin (%)	6.4	6.9	7.2	6.1	7.1
Capex to sales (%)	2.6	3.5	5.4	3.0	2.4
Capex to depreciation (%)	145	194	299	159	139
Imputation (%)	100	100	100	100	100
Pay-out ratio (%)	40	40	32	40	40

Cash Flow (NZ\$m)	2018A	2019A	2020E	2021E	2022E
EBITDA	215.4	257.0	282.2	240.1	294.3
Working capital change	0	0	0	0	0
Interest & tax paid	(52.5)	(61.4)	(68.4)	(56.3)	(69.6)
Other	(22.7)	1.7	(7.0)	(7.0)	(7.0)
Operating cash flow	140.2	197.4	206.7	176.9	217.7
Capital expenditure	(69.2)	(103.3)	(170.0)	(90.0)	(80.0)
(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	41.7	91.9	142.7
Dividends paid	(43.3)	(48.3)	(50.3)	(50.3)	(66.8)
Equity raised/(returned)	0	0	0	0	0
(Increase)/decrease in net debt	32.2	59.9	(8.6)	41.5	75.9

Operating Performance	2018A	2019A	2020E	2021E	2022E
Revenue (NZ\$m)					
New Zealand	666	719	757	682	760
Australia	675	761	790	786	882
USA	611	725	791	755	822
Asia	117	109	104	108	119
Europe	549	640	688	674	765
Total	2,619	2,954	3,130	3,005	3,349

EBITDA (NZ\$m)					
New Zealand	98.6	110.6	114.4	93.6	110.7
Australia	54.0	59.3	60.7	58.2	67.1
USA	26.9	38.3	47.6	39.0	50.4
Asia	6.9	9.3	8.6	7.6	10.2
Europe	29.0	39.6	50.9	41.8	55.8
Total	215.4	257.0	282.2	240.1	294.3

NZDAUD	0.9	0.9	1.0	1.0	0.9
NZDUSD	0.7	0.7	0.6	0.6	0.6
NZDEUR	0.6	0.6	0.6	0.6	0.5

Balance Sheet (NZ\$m)	2018A	2019A	2020E	2021E	2022E
Working capital	66.7	74.5	78.9	75.7	84.4
Fixed assets	582.3	666.6	761.7	775.2	777.4
Intangibles	274.3	270.0	283.0	298.0	313.0
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	1,185.3	1,210.6	1,236.5
Net debt/(cash)	190.3	123.5	159.1	117.6	41.7
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	915.2	982.0	1,083.9
Minority interests	0	0	0	0	0
Total funding sources	1,000.9	1,072.8	1,185.3	1,210.6	1,236.5

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

Industry backdrop

Industry activity continues to decline, exacerbated by COVID-19 related disruptions towards the end of the first quarter. This comes as the industry backdrop was beginning to show signs of improvement. First quarter results from MFT's global listed peers show another consecutive quarter of industry revenue decline (average of the headline result provided by MFT's listed peer companies), albeit falling only -1%, which is an improvement from -3% in 4Q19.

COVID-19 quotes and commentary

In their first quarter earnings releases, MFT's key global peers provided commentary around the impacts of COVID-19 on 1Q20 financial performance, as well as a near-term outlook for their respective companies and the freight industry as a whole. This commentary highlights a modest impact being felt late in the first quarter, followed by a material slowdown in activity through April and the beginning of May 2020.

Figure 1. MFT peers COVID-19 quotes from 1Q20 earnings releases and conference calls

	1Q20 quotes and commentary	Outlook quotes and commentary
Old Dominion Freight Line	► Demand for our services declined in the last half of March due to the widespread effects of the COVID-19 pandemic on the domestic economy.	► Now it seems like some of it's coming under control and some markets are talking about reopening, you'd like to think the worst is behind us and we've hit a floor.
ArcBest	► The COVID-19 pandemic did not have a significant impact on our financial results in first quarter 2020.	► In April we experienced significant business declines in all operating segments.
Saia	► We experienced a quick and meaningful downturn in business volumes across our network, as a result of the COVID-19 pandemic.	
DSV	► COVID-19 was primarily impacting the volumes out of China in February. But it turned to be a global impact in March as the more and more of our customers were shutting down and got affected, both in Europe and in North America.	► The market for air freight in April could fall as much as 30% and sea freight up to 20% in terms of volume in April.
Expeditors International	► Our Q1 performance was better than we might have expected, given the contraction in demand across geographies, as well as the severity and suddenness of the collapse in air carrier belly space and reduction in containership sailings.	
JB Hunt	► COVID-19 volume related disruptions began to materialize in March and escalated through the end of the quarter.	► As we've come out of March and we're into April, we're experiencing meaningful declines in volume probably to the tune of mid- to high-single digits...but certainly for the next three to four weeks, I would expect that trend to continue.
CH Robinson	► COVID-19 and shelter-in-place drove market disruption, and we saw commerce outside of critical industries virtually draw to a halt. This seemed to hit small businesses first and the hardest, and had an outsized impact to LTL compared to truckload.	
Forward Air Corp	► COVID-19 has impacted all of our modes given our networks exposure to non-essential freight with heavy ties to air and ocean freight from Asia and the retail mall business. Volumes fell sharply in March and April.	► The signs of a slow recovery are emerging as we enter May, but visibility is limited.
Hub Group		► We've got visibility for April now, but we'll kind of take it as it goes. And we certainly hope things recover by the second half. We think it will, but not sure.
Ryder Systems		► But if you look at what is going to be the lasting impact of COVID on the business I would say look, primarily our small customers may see an impact. Our big accounts, which represent a good portion of the business, we're not seeing that much of an impact on many of those.
Landstar System	► Dispatched truck load volume in the final week of the 2020 first quarter decreased significantly from the previous week as a result of actions taken by governmental authorities and businesses to reduce the spread of the coronavirus	► Shelter-at-home mandates and closing of manufacturing facilities significantly affected demand for transportation by many industry segments we service. We expect those conditions to persist throughout the 2020 second quarter.

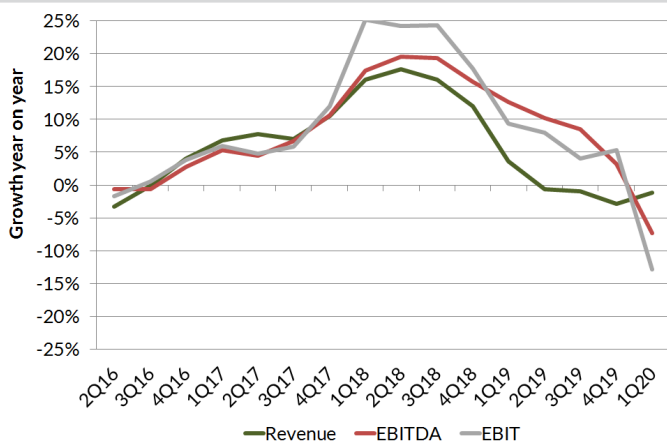
Source: Company reports, Eikon, Forsyth Barr analysis

Peers 1Q20 results

Revenue growth decline continued in 1Q20, making this the fourth consecutive quarter of negative growth. The -1% industry revenue decline is an improvement from 4Q19 which was down -3%. Average industry EBIT and EBITDA both also fell sharply in the first quarter, down -7% and -13% respectively. Since late 2018 industry revenue growth has continued to decline, with this being the first improvement in this trend in six consecutive quarters.

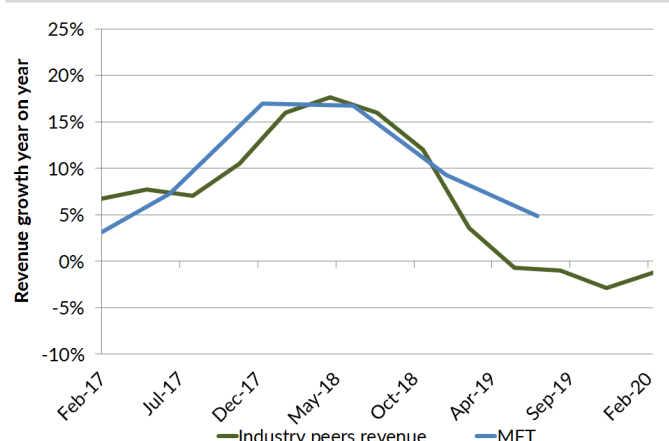
Although MFT's business mix and geographic exposure is different to that of its key global peers, it is subject to the same global macro drivers. Figure 2 shows that MFT has broadly tracked the performance of the average of its listed industry global peers. This suggests that MFT will have encountered similar headwinds in the first quarter of calendar year 2020.

Figure 2. Average quarterly revenue of global listed peers



Source: Company reports, Forsyth Barr analysis

Figure 3. MFT vs global industry peers



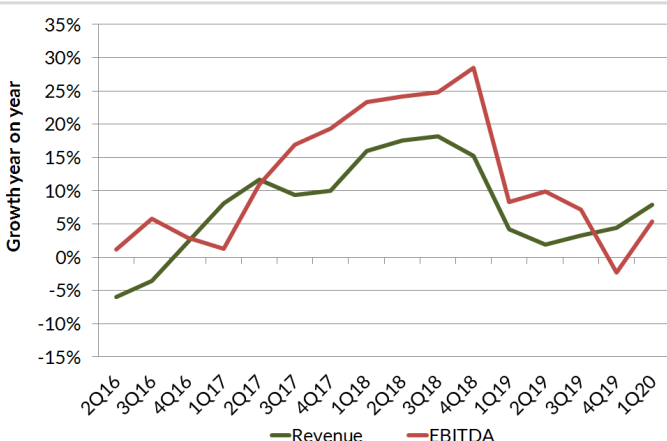
Source: Company reports, Forsyth Barr analysis

Air and sea sector margins flat despite revenue decline

Air and sea forwarding sectors reported an improving revenue backdrop in 1Q20 (Figure 4), following continued decline since 4Q18. However, segment EBIT growth, which has remained relatively strong in recent years, fell to -3%, largely due to sea freight margins declining sharply in the quarter.

The less-than-truckload (LTL) segment continues to report revenue growth, up +8% in 1Q20, again outperforming the rest of the industry. LTL EBITDA also bounced back in the quarter, with average growth across MFT's global peers of +5%, up from -2% in 4Q19.

Figure 4. Growth in LTL sector



Source: Company reports, Forsyth Barr analysis

Figure 5. Growth in air and sea sector

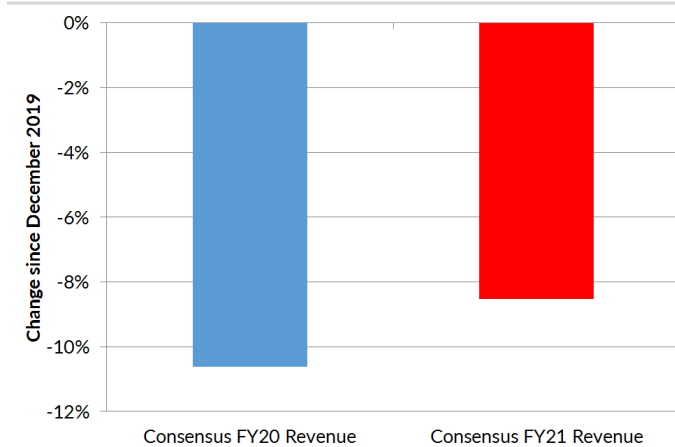


Source: Company reports, Forsyth Barr analysis

Global peers consensus cuts

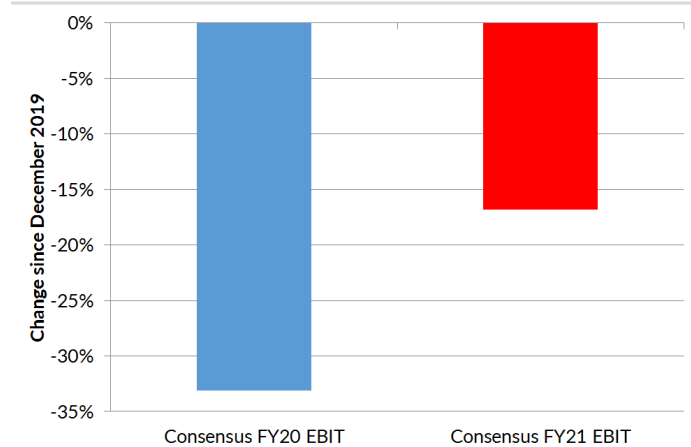
Consensus estimates for MFT's key listed peers have changed dramatically since late 2019. Revenue forecasts fell an average of -11% for FY20 and -9% for FY21 over the six month period, whilst consensus EBIT estimates were cut even further, with average declines of -33% and -17% for FY20 and FY21 respectively.

Figure 6. Change in consensus revenue



Source: Bloomberg, Forsyth Barr analysis

Figure 7. Change in consensus EBIT

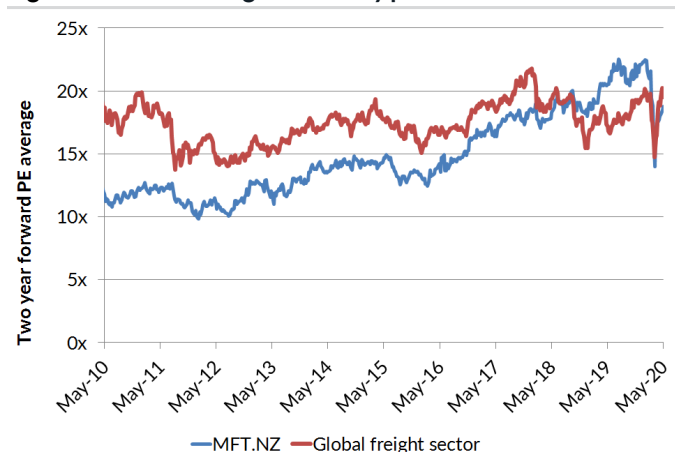


Source: Bloomberg, Forsyth Barr analysis

Valuation comparison

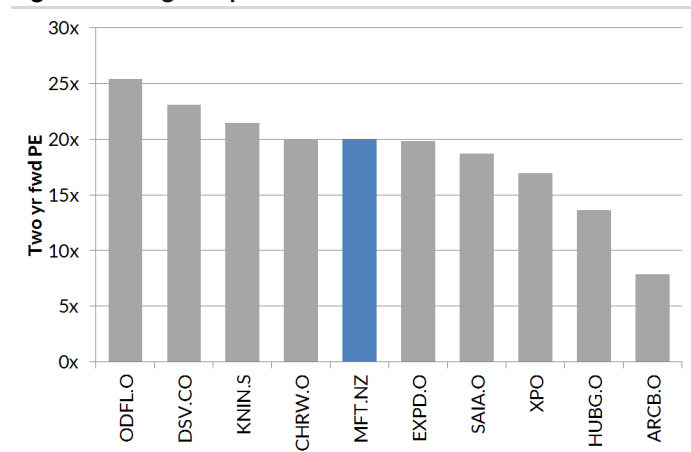
MFT is currently trading at ~20x two year forward PE, placing it broadly in line with the combined average of its global industry peers (Figure 8). We acknowledge the volatility in this measure given the current environment.

Figure 8. MFT vs average of industry peers



Source: Eikon, Forsyth Barr analysis

Figure 9. MFT global peer valuations



Source: Eikon, Forsyth Barr analysis

Our analysis

We have analysed the 1Q20 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 (ODFLO), 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), and Landstar System (LSTR.O).

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. MFT will face significant headwinds as a result of the COVID-19 pandemic, however, we believe its operational strengths and current business momentum will help it recover strongly and gain market share out the other side. **OUTPERFORM.**

Business quality

- **The Mainfreight Way:** MFT does things its way. It has a strong culture of 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.

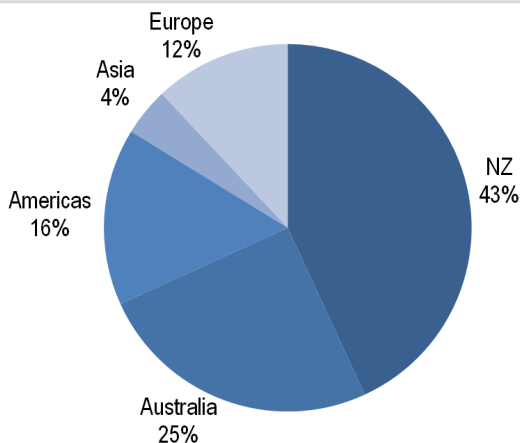
Financial structure

- **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

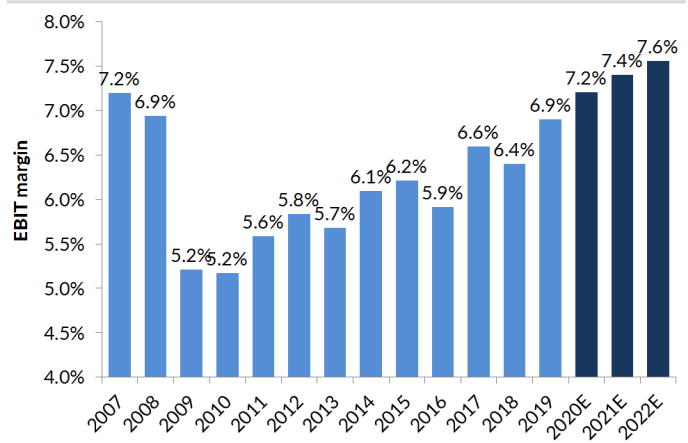
- **Acquisitions:** History suggests that MFT is not as good at due diligence as it is at operating a freight and logistics business.
- **Disruptive technology:** Freight forwarders leverage the inefficiencies in the freight supply chain. New technologies may lower supply chain costs, therefore, increasing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

Figure 10. EBITDA split (FY19)

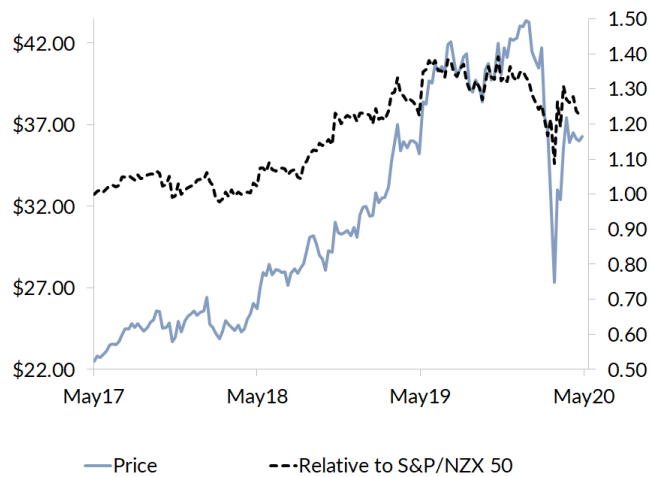


Source: Company reports, Forsyth Barr analysis

Figure 11. Group EBIT margin development



Source: Company reports, Forsyth Barr analysis

Figure 12. Price performance


Source: Forsyth Barr analysis

Figure 13. Substantial shareholders

Shareholder	Latest Holding
Rorohora No. 2 Trust	16.3%
Harbour Asset Management & Jarden Securities Limited	5.6%
Fisher Funds Management	5.1%

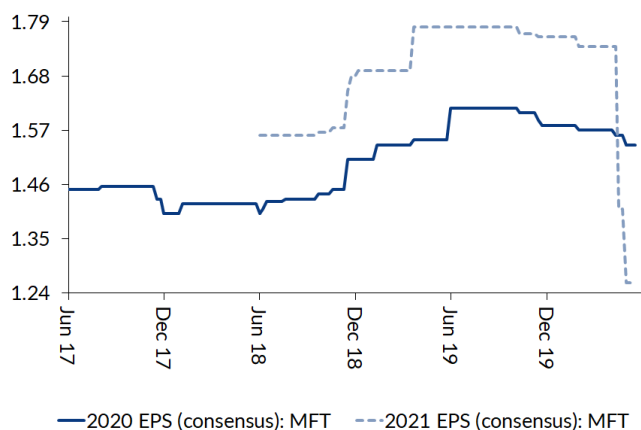
Source: NZX, Forsyth Barr analysis, NOTE: based on SSH notices only

Figure 14. International valuation comparisons

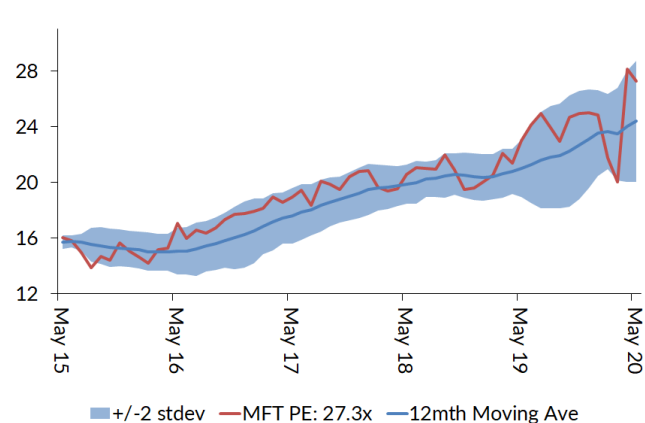
Company	Code	Price	Mkt Cap (m)	PE		EV/EBITDA		EV/EBIT		Cash Yld
(metrics re-weighted to reflect MFT's balance date - March)				2020E	2021E	2020E	2021E	2020E	2021E	2021E
Mainfreight	MFT NZ	NZ\$36.30	NZ\$3,656	23.3x	28.7x	13.4x	15.7x	16.8x	20.6x	1.4%
Freightways *	FRE NZ	NZ\$7.02	NZ\$1,161	21.4x	20.1x	10.2x	8.9x	14.5x	13.1x	3.7%
EXPEDITORS INTL WASH INC	EXPD US	US\$71.51	US\$11,901	21.4x	22.7x	13.1x	14.9x	15.1x	16.1x	1.5%
OLD DOMINION FREIGHT LINE	ODFL US	US\$149.05	US\$17,580	30.0x	31.0x	16.2x	16.6x	21.7x	22.5x	0.4%
DSV PANALPINA A/S	DSV DC	kr685.80	kr157,734	36.4x	32.6x	17.3x	16.1x	27.2x	25.8x	0.4%
C.H. ROBINSON WORLDWIDE INC	CHRW US	US\$72.50	US\$9,759	19.2x	23.8x	13.1x	16.5x	15.7x	19.1x	2.9%
KUEHNE + NAGEL INTL AG-REG	KNIN SW	CHF133.25	CHF15,990	21.6x	25.2x	9.9x	10.9x	17.6x	20.5x	2.9%
Compco Average:				25.0x	25.9x	13.3x	14.0x	18.6x	19.5x	2.0%
MFT Relative:				-7%	11%	1%	13%	-10%	5%	-30%

EV = Current Market Cap + Actual Net Debt

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

Figure 15. Consensus EPS momentum (NZ\$)


Source: Forsyth Barr analysis, Bloomberg

Figure 16. One year forward PE (x)


Source: Forsyth Barr analysis

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