FORSYTH BARR

NEW ZEALAND EQUITY RESEARCH | TRANSPORT | FREIGHT FORWARDING & LOGISTICS
25 MAY 2020

Mainfreight
FY20 Preview — Undulating Road

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OUTPERFORM

We expect Mainfreight (MFT) to report robust earnings growth in its FY20 result on 27 May 2020, driven by modest sales growth and further margin expansion. We forecast underlying NPAT growth of ~+11% against FY19, implying +11% through 2H19 and a slowdown later in the period from initial COVID-19 activity drop. MFT is currently trading at a ~20x two year forward PE, on par with key larger global peers DSV Panalpina and Old Dominion Freight line. The near-term trading environment is likely to be subdued due to COVID-19 and the resulting economic and supply chain disruption, however, we think MFT is poised to strengthen its competitive position, as it did through the global financial crisis. OUTPERFORM.

NZX Code	MFT
Share price	NZ$35.60
Target price	NZ$37.50
Risk rating	Medium
Issued shares	100.7m
Market cap	NZ$3,585m
Avg daily turnover	77.8k (NZ$2,920k)

Financials: Mar/	19A	20E	21E	22E
NPAT* (NZ$m)	141.1	156.8	127.3	167.0
EPS* (NZc)	140.1	155.7	126.4	165.8
EPS growth* (%)	25.7	11.2	-18.8	31.2
DPS (NZc)	56.0	50.0	50.0	66.3
Imputation (%)	100	100	100	100
*Based on normalised profits				

Valuation (x)	19A	20E	21E	22E
EV/EBITDA	14.6	13.2	15.6	12.7
EV/EBIT	18.3	16.5	20.4	15.8
PE	25.4	22.9	28.2	21.5
Price / NTA	6.3	5.7	5.2	4.7
Cash div yld (%)	1.6	1.4	1.4	1.9
Gross div yld (%)	2.2	2.0	2.0	2.6

Key things to look for in FY20 result

- **Continued revenue growth:** Our expectation of +6% constant currency revenue growth in FY20 is below that of FY19 (+11%). but still indicates new business wins and cross-selling benefits.
- **Resilient margins:** We expect MFT will report another year of robust margins, despite an industry slowdown. Our forecasts imply overall EBITDA margin increasing by +30bps, driven predominantly by the Americas and Europe.
- **Near term outlook:** Management indicated in its April trading update that its New Zealand business had been materially impacted by Alert Level Four. Industry peers have highlighted the challenges in the international forwarding segment.
- **Cost initiatives:** MFT has already announced cost cutting measures, which involve; (1) deferral of salary reviews and a hiring freeze, (2) a cut to directors' fees and the Managing Director's salary, and (3) reduction in unnecessary discretionary spending. Further initiatives are likely.

Outlook

MFT's global peers have experienced further revenue declines in their latest quarterly results. The near term backdrop will deteriorate further into calendar 2Q given COVID-19 disruption, in our opinion.

Figure 1. Earnings forecasts (NZ$m)

	FY19	FY20E	Change	Consensus
Sales revenue	2,954.1	3,130.5	6.0%	3,125.8
EBITDA	257.0	282.2	9.8%	302.8
EBIT	203.9	225.3	10.5%	224.5
Underlying NPAT	141.1	156.8	11.2%	152.8
Underlying EPS (cents)	140.1	155.7	11.2%	151.8
Dividend (cents)	56	50	-10.7%	59

Source: Bloomberg, Forsyth Barr analysis

Figure 2. Divisional EBITDA (NZ$m)

	FY18A	FY19A	FY20E
New Zealand	98.6	110.6	114.4
Australia	54.0	59.3	60.7
USA	26.9	38.3	47.6
Asia	6.9	9.3	8.6
Europe	29.0	39.6	50.9
Total	**215.4**	**257.0**	**282.2**

Source: Forsyth Barr analysis

Mainfreight Ltd (MFT)

Priced as at 22 May 2020 (NZ$)	**35.60**

12-month target price (NZ$)*	**37.50**
Expected share price return	5.3%
Net dividend yield	1.5%
Estimated 12-month return	6.8%

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)	17.6	14.6	13.2	15.6	12.7
EV/EBIT (x)	22.6	18.3	16.5	20.4	15.8
PE (x)	31.9	25.4	22.9	28.2	21.5
Price/NTA (x)	8.2	6.3	5.7	5.2	4.7
Free cash flow yield (%)	2.0	2.6	1.0	2.4	3.8
Net dividend yield (%)	1.3	1.6	1.4	1.4	1.9
Gross dividend yield (%)	1.8	2.2	2.0	2.0	2.6

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**

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**

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

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

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FY20 preview

Figure 3. MFT FY20 forecasts (NZ$m) - excludes IFRS16

	1H19	2H20	FY19	1H20	2H20E	FY20E	1H chg	2H chg	FY chg
Profit and loss account									
Sales revenue	1,431.0	1,523.1	2,954.1	1,500.5	1,630.0	3,130.5	5%	7%	6%
New Zealand	45.4	65.1	110.6	46.8	67.6	114.4	3%	4%	3%
Australia	24.4	35.5	59.9	23.9	36.8	60.7	-2%	4%	1%
The Americas	16.0	22.3	38.3	20.5	27.1	47.6	28%	21%	24%
Asia	4.6	4.6	9.3	4.3	4.4	8.6	-8%	-5%	-7%
Europe	17.9	21.7	39.6	23.7	27.2	50.9	33%	25%	29%
EBITDA	**108.3**	**148.7**	**257.0**	**119.1**	**163.1**	**282.2**	**10%**	**10%**	**10%**
Depreciation and amortisation	(26.1)	(27.0)	(53.1)	(28.5)	(28.4)	(56.9)	9%	5%	7%
Abnormals (pre-tax)	(0.3)	(4.7)	(5.0)	0	0	0	n/a	n/a	n/a
Interest expense	(4.0)	(2.9)	(6.9)	(3.4)	(2.5)	(5.9)	-14%	-13%	-14%
Profit before tax	78.0	114.1	192.1	87.2	132.2	219.3	12%	16%	14%
Taxation (incl. abnormal tax)	(22.)3	(32.2)	(54.5)	(25.0)	(37.6)	(62.5)	12%	17%	15%
Reported NPAT	**55.7**	**81.9**	**137.6**	**62.2**	**94.6**	**156.8**	**12%**	**16%**	**14%**
Abnormals (post tax)	0.2	3.3	3.5	0	0	0	n/a	n/a	n/a
Underlying NPAT	**55.9**	**85.2**	**141.1**	**62.2**	**94.6**	**156.8**	**11%**	**11%**	**11%**
Underlying EPS (cents)	55.5	84.6	140.1	61.8	94.0	155.7	11%	11%	11%
Divisional sales growth (local currency)									
New Zealand	8.3%	7.5%	7.9%	5.7%	5.1%	5.4%	n/a	n/a	n/a
Australia	16.7%	11.4%	13.9%	5.5%	6.2%	5.8%	n/a	n/a	n/a
The Americas	16.8%	9.9%	13.1%	2.9%	3.1%	3.0%	n/a	n/a	n/a
Asia	7.2%	(26.2%)	(11.2%)	(10.8%)	(9.1%)	(10.0%)	n/a	n/a	n/a
Europe	12.2%	11.9%	12.1%	6.3%	5.7%	6.0%	n/a	n/a	n/a
Margin analysis									
New Zealand	13.2%	17.3%	15.4%	12.9%	17.1%	15.1%	34bps	21bps	28bps
Australia	6.6%	8.9%	7.8%	6.5%	9.0%	7.7%	11bps	5bps	12bps
The Americas	4.6%	5.9%	5.3%	5.5%	6.5%	6.0%	87bps	60bps	73bps
Asia	7.9%	9.2%	8.5%	7.8%	8.9%	8.3%	10bps	29bps	17bps
Europe	5.7%	6.6%	6.2%	7.2%	7.6%	7.4%	147bps	97bps	122bps
EBITDA margin	7.6%	9.8%	8.7%	7.9%	10.0%	9.0%	37bps	24bps	31bps
EBIT margin	5.7%	8.0%	6.9%	6.0%	8.3%	7.2%	29bps	28bps	29bps

Source: MFT, 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. 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 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.

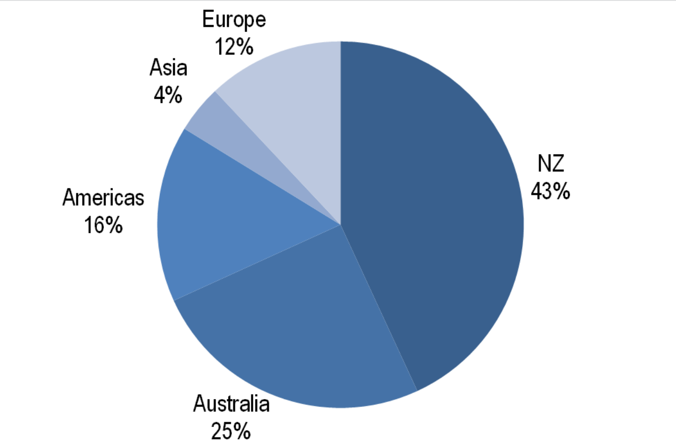
Financial structure

- **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 focus its capex outlay over the medium term on strategic land and buildings in key sites across Australasia.

Risk factors

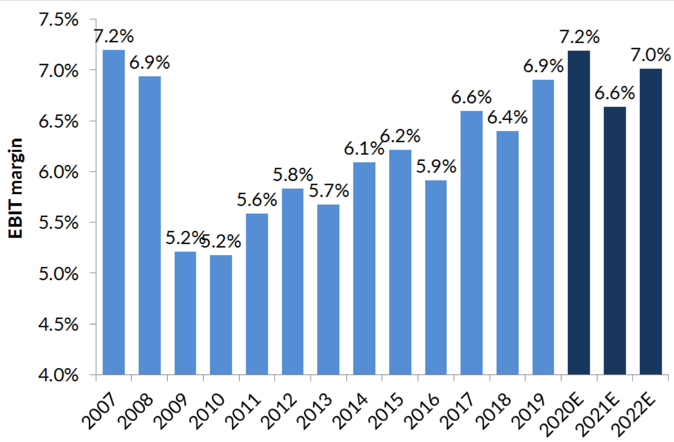
- **Acquisitions**: History suggests that MFT is not as good at due diligence as it is at operating a freight and logistics business.
- **Disruptive technology**: Freight forwarders leverage the inefficiencies in the freight supply chain. New technologies may lower supply chain costs, therefore, increasing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

Figure 4. EBITDA split (FY19)



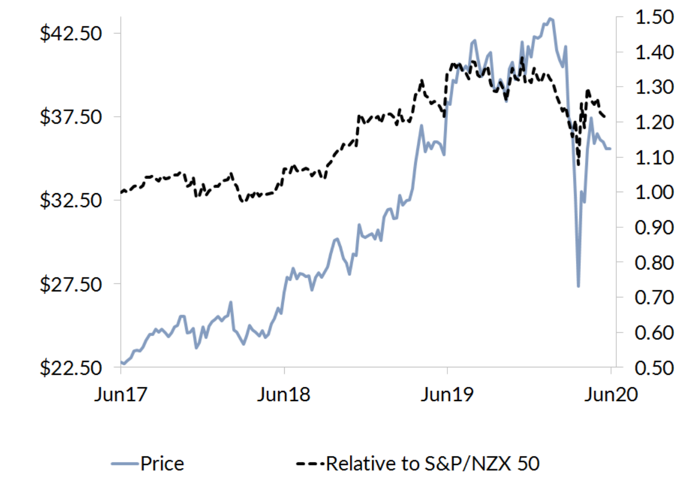
Source: Forsyth Barr analysis

Figure 5. Group EBIT margin development



Source: Forsyth Barr analysis

Figure 6. Price performance



Source: Forsyth Barr analysis

Figure 7. Substantial shareholders

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

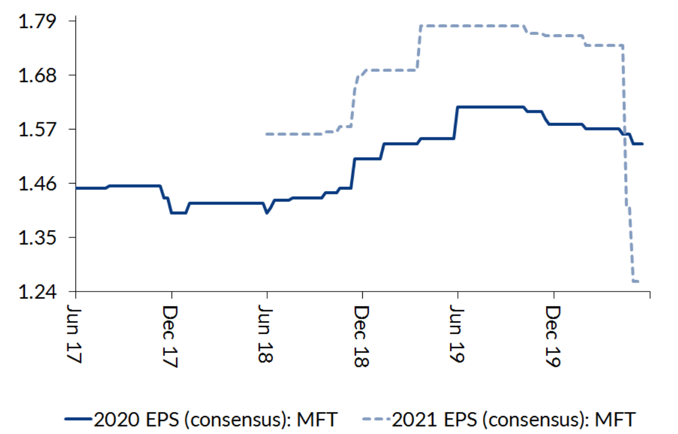
Source: NZX, Forsyth Barr analysis, NOTE: based on SSH notices only

Figure 8. 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$35.60**	**NZ$3,585**	**22.9x**	**28.2x**	**13.1x**	**15.4x**	**16.5x**	**20.2x**	**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%**
EV = Current Market Cap + Actual Net Debt			**MFT Relative:**	**-9%**	**9%**	**-1%**	**11%**	**-12%**	**3%**	**-29%**

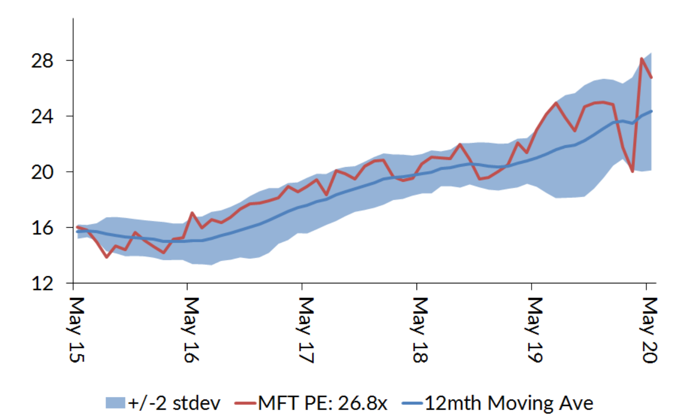
Source: *Forsyth Barr analysis, Bloomberg Consensus, Compco metrics re-weighted to reflect headline (MFT) companies fiscal year end

Figure 9. Consensus EPS momentum (NZ$)



Source: Forsyth Barr analysis

Figure 10. One year forward PE (x)



Source: Forsyth Barr analysis

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