

Mainfreight

Flight to Quality

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OUTPERFORM

Mainfreight (MFT) reported a preliminary 1H21 result in tandem with its Tauranga investor day, which suggests an upgrade to full year consensus estimates given market share wins and strong margin performance, particularly in Australia. It is a best-in-class operator that has strengthened its competitive position through COVID-19. Profit performance has improved through the half and the strong business momentum has continued through early October. Management is *"cautiously optimistic"* for the near term trading outlook, despite some supply chain challenges and ongoing government imposed restrictions in various geographies. However, it is also wary that the peak of the pre-Christmas seasonal uplift may not be as high as in recent years. We make material upgrades to our near term earnings estimates to reflect stronger than anticipated first half performance and reiterate our OUTPERFORM rating. MFT is due to report its full 1H21 result on 11 November 2020.

NZX Code	MFT	Financials: Mar/	20A	21E	22E	23E	Valuation (x)	20A	21E	22E	23E
Share price	NZ\$51.30	NPAT* (NZ\$m)	156.1	178.9	210.3	233.8	PE	33.1	28.9	24.6	22.1
Target price	NZ\$60.00	EPS* (NZc)	155.0	177.6	208.8	232.1	EV/EBIT	23.8	19.3	16.5	14.9
Risk rating	Medium	EPS growth* (%)	10.6	14.6	17.6	11.2	EV/EBITDA	18.9	11.8	10.5	9.6
Issued shares	100.7m	DPS (NZc)	59.0	70.0	83.5	92.9	Price / NTA	7.6	6.6	5.1	4.1
Market cap	NZ\$5,166m	Imputation (%)	100	100	100	100	Cash div yld (%)	1.2	1.4	1.6	1.8
Avg daily turnover	78.3k (NZ\$3,021k)	*Based on normalised profits					Gross div yld (%)	1.6	1.9	2.3	2.5

What's changed?

- Earnings:** +6% and +5% upgrades to FY21 and FY22 NPAT estimates respectively
- Target price:** Lifted to NZ\$60 from NZ\$47 to reflect (1) earnings upgrades, (2) cost of capital adjustment with revised WACC inputs, and (3) the material re-rating of MFT's key global freight peers

A 'phenomenal' first half

MFT reported preliminary 1H21 pre-tax profit (PBT) growth of +23% on revenue growth of +7%. In comparison, at its Annual Shareholder Meeting in July, the company reported revenue and PBT growth of +8% and +20% respectively for the first 17 weeks of the year. Profit growth remains strong and has continued into October. The demand backdrop has been better than previously feared (consistent with feedback from a host of international freight peers in recent weeks) and healthily supported by new customer wins.

Regionally robust

All regions except Europe (suffering from low warehouse inventory levels) experienced strong profit (PBT) growth through August/September: in particular we calculate that New Zealand grew +28%, Australia +46%, Americas +18%, Asia +59% and Europe -11%. While revenue growth was subdued at a group level (+5% for the same two month period on a constant currency basis), strong cost control, improved utilisation, and a favourable freight mix has helped expand margins.

Strong pipeline of new business; outlook improving

MFT is winning new business globally due to (1) its continued investment in sales, (2) a resurgent outsourcing trend, (3) competitor responses to COVID-19, and (4) its improving recognition by the market for service quality. Every region is experiencing high levels of new business (and record levels of inbound enquiries), which sets MFT up for a robust 2H21, irrespective of cyclical/COVID-19 headwinds.

Mainfreight Ltd (MFT)

Priced as at 14 Oct 2020 (NZ\$) **51.30**

12-month target price (NZ\$)*					60.00	Spot valuations (NZ\$)				
Expected share price return					17.0%	1. DCF				
Net dividend yield					1.5%	2. PE relative				
Estimated 12-month return					18.5%	3. n/a				
Key WACC assumptions						DCF valuation summary (NZ\$m)				
Risk free rate						Total firm value	8,135			
Equity beta						(Net debt)/cash	(195)			
WACC						Less: Capitalised operating leases	(2,029)			
Terminal growth						Value of equity	5,911			
Profit and Loss Account (NZ\$m)					Valuation Ratios	2019A	2020A	2021E	2022E	2023E
Sales revenue					EV/EBITDA (x)	20.7	18.9	11.8	10.5	9.6
Normalised EBITDA					EV/EBIT (x)	26.1	23.8	19.3	16.5	14.9
Depreciation and amortisation					PE (x)	36.6	33.1	28.9	24.6	22.1
Normalised EBIT					Price/NTA (x)	9.1	7.6	6.6	5.1	4.1
Net interest					Free cash flow yield (%)	1.8	2.7	5.2	4.3	5.0
Associate income					Net dividend yield (%)	1.1	1.2	1.4	1.6	1.8
Tax					Gross dividend yield (%)	1.5	1.6	1.9	2.3	2.5
Minority interests					Capital Structure					
Normalised NPAT					2019A	2020A	2021E	2022E	2023E	
Abnormals/other					Interest cover EBIT (x)	29.7	39.4	12.5	17.8	20.1
Reported NPAT					Interest cover EBITDA (x)	37.4	49.6	20.4	27.8	31.1
Normalised EPS (cps)					Net debt/ND+E (%)	12.8	13.6	5.3	-6.7	-19.0
DPS (cps)					Net debt/EBITDA (x)	0.5	0.5	0.1	n/a	n/a
Growth Rates					Key Ratios	2019A	2020A	2021E	2022E	2023E
Revenue (%)					Return on assets (%)	13.6	9.7	11.6	12.6	13.0
EBITDA (%)					Return on equity (%)	16.8	16.2	16.5	15.8	14.7
EBIT (%)					Return on funds employed (%)	8.5	14.2	14.1	14.5	14.5
Normalised NPAT (%)					EBITDA margin (%)	8.7	9.1	13.5	13.7	13.9
Normalised EPS (%)					EBIT margin (%)	6.9	7.2	8.2	8.7	9.0
Ordinary DPS (%)					Capex to sales (%)	3.5	5.2	2.4	4.5	4.2
Capex to depreciation (%)					Capex to depreciation (%)	194	277	46	92	86
Cash Flow (NZ\$m)					Imputation (%)	100	100	100	100	100
EBITDA					Pay-out ratio (%)	40	38	39	40	40
Working capital change					Operating Performance	2019A	2020A	2021E	2022E	2023E
Interest & tax paid					Revenue (NZ\$m)					
(61.4)					New Zealand	719	753	783	830	880
Other					Australia	761	797	922	1,029	1,095
Operating cash flow					USA	725	762	773	847	926
Capital expenditure					Asia	109	95	113	130	148
(Acquisitions)/divestments					Europe	640	689	732	795	852
Other					Total	2,954	3,095	3,323	3,631	3,900
Funding available/(required)					EBITDA (NZ\$m)					
Dividends paid					New Zealand	110.6	115.9	146.1	154.8	166.1
Equity raised/(returned)					Australia	59.3	65.0	149.1	167.6	178.5
(Increase)/decrease in net debt					USA	38.3	43.3	58.8	67.7	77.4
					Asia	9.3	6.0	13.6	15.6	17.7
					Europe	39.6	50.8	80.5	91.4	102.2
					Total	257.0	281.0	448.0	497.2	542.0
Balance Sheet (NZ\$m)					NZDAUD	0.92	0.95	0.91	0.87	0.88
Working capital					NZDUSD	0.68	0.65	0.65	0.66	0.67
Fixed assets					NZDEUR	0.59	0.58	0.56	0.55	0.55
Intangibles					NOTE: IFRS 16 implemented from FY21					
Right of use asset										
Other assets										
Total funds employed										
Net debt/(cash)										
Lease liability										
Other liabilities										
Shareholder's funds										
Minority interests										
Total funding sources										

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

Investor day upgrades

COVID-19 has brought many challenges to the freight industry, but for MFT it has also brought focus. Focus on customer relationships, focus on costs, focus on onboarding new customers, focus on cash collection and focus on the bigger picture. MFT has strengthened its competitive position and is well set to continue its track record of accelerated growth.

Over the past six months MFT has provided three separate trading updates: (1) for the first seven weeks of FY21, (2) for the first 17 weeks, and (3) for the 26 week full first half. These updates enable analysis of the sequential performance by division through COVID-19, which we summarise in Figure 1. This analysis tells us that:

- Profit growth has remained strong through August and September
- Australia has been the key contributor to profit growth but supported by New Zealand and Asia
- The Americas experienced a PBT decline in 1H21 but a sequential improvement during the half

Figure 1. Analysis of MFT's 1H21 by division

	PBT			Revenue	PBT margin
	First 7 wk	Next 10 wk	Last 9 wk		
1H20					
New Zealand (NZ\$m)	7.0	11.1	16.1	34.2	362.6
Australia (A\$m)	2.0	4.7	8.6	15.3	360.4
Americas (US\$m)	3.0	2.8	4.0	9.8	244.0
Asia (US\$m)	0.6	1.0	0.9	2.5	36.0
Europe (€m)	1.0	3.7	3.3	8.0	193.8
Group (NZ\$m)	15.6	28.6	38.6	82.8	1,500.5
1H21					
New Zealand (NZ\$m)	0.0	16.7	20.6	37.3	378.7
Australia (A\$m)	6.0	11.9	12.6	30.5	403.0
Americas (US\$m)	1.0	2.8	4.7	8.5	247.5
Asia (US\$m)	1.1	1.5	1.4	4.0	43.6
Europe (€m)	0.0	4.1	3.0	7.1	194.1
Group (NZ\$m)	9.1	44.1	49.0	102.2	1,609.1
Change					
New Zealand (NZ\$m)	-100%	50%	28%	9%	4%
Australia (A\$m)	200%	153%	46%	99%	12%
Americas (US\$m)	-67%	0%	18%	-13%	1%
Asia (US\$m)	83%	50%	59%	61%	21%
Europe (€m)	-100%	11%	-9%	-11%	0%
Group (NZ\$m)	-42%	54%	27%	23%	7%

Source: MFT, Forsyth Barr analysis

Earnings revisions

We lift our earnings forecasts as summarised in Figure 2. While we are wary that the margin boost in Australia could be temporary and reflective of unusual trading patterns through COVID-19 (the rate of margin expansion is exceptional relative to revenue growth), however, we also accept that (1) MFT has historically had step changes in divisional margins following successive periods of relatively stable margins, and (2) Australian PBT margins (1H21: 7.6%) are still lower than New Zealand (9.9%). We, therefore, assume that Australian margins are stable from FY22 at around the FY21 level.

Figure 2. Earnings revisions (NZ\$m)

	FY21E			FY22E			FY23E		
	Old	New	Chg	Old	New	Chg	Old	New	Chg
Sales revenue	3,339.8	3,322.7	-0.5%	3,646.8	3,631.0	-0.4%	3,972.2	3,900.1	-1.8%
EBITDA	433.2	448.0	3.4%	482.5	497.2	3.0%	533.8	542.0	1.5%
PBT	233.3	250.2	7.2%	285.2	294.1	3.1%	329.5	327.0	-0.8%
Underlying NPAT	168.2	178.9	6.3%	199.6	210.3	5.4%	232.0	233.8	0.7%
Underlying EPS	167.0	177.6	6.3%	198.2	208.8	5.4%	230.4	232.1	0.7%
Full year DPS	65.0	70.0	7.7%	79.3	83.5	5.4%	92.2	92.9	0.7%

Source: Forsyth Barr analysis

Figure 3. Price performance

Figure 4. Substantial shareholders

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

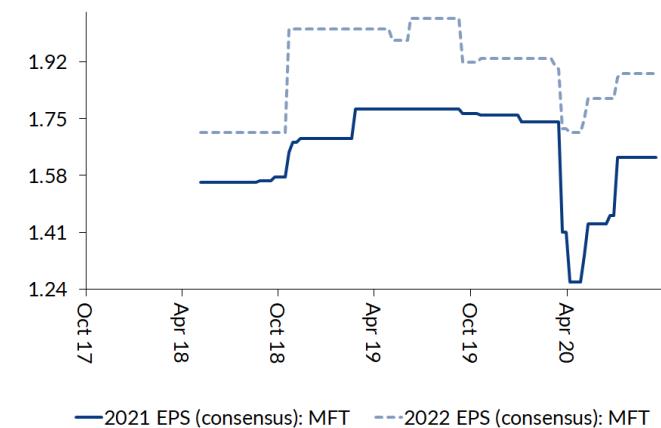
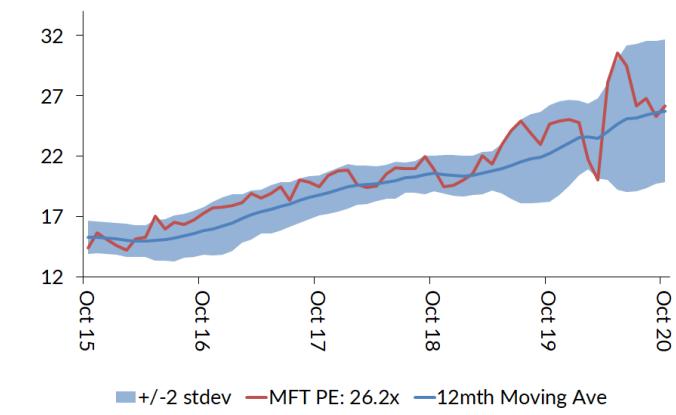
Source: NZX, Forsyth Barr analysis, NOTE: based on SPH notices only

Figure 5. International valuation comparisons

Company (metrics re-weighted to reflect MFT's balance date - March)	Code	Price	Mkt Cap (m)	PE		EV/EBITDA		EV/EBIT		Cash Yld		
				2021E	2022E	2021E	2022E	2021E	2022E			
Mainfreight	MFT NZ	NZ\$51.30	NZ\$5,166	28.9x	24.6x	11.9x	10.7x	19.4x	16.7x	1.6%		
FREIGHTWAYS*	FRE NZ	NZ\$8.35	NZ\$1,381	21.3x	18.1x	9.7x	8.8x	15.1x	12.7x	4.2%		
OLD DOMINION FREIGHT LINE	ODFL US	US\$201.85	US\$23,683	36.6x	30.8x	20.3x	17.7x	26.8x	23.2x	0.3%		
DSV PANALPINA A/S	DSV DC	kr1093.50	kr251,505	39.0x	30.6x	20.1x	17.7x	30.0x	24.5x	0.4%		
C.H. ROBINSON WORLDWIDE INC	CHRW US	US\$105.33	US\$14,201	28.3x	24.4x	19.7x	17.4x	22.7x	19.7x	2.1%		
KUEHNE + NAGEL INTL AG-REG	KNIN SW	CHF185.00	CHF22,200	32.1x	27.8x	14.0x	13.0x	25.0x	21.7x	2.4%		
EXPEDITORS INTL WASH INC	EXPD US	US\$93.34	US\$15,648	24.9x	23.9x	16.7x	16.4x	17.8x	17.4x	1.2%		
				Compco Average:		30.4x	25.9x	16.8x	15.2x	22.9x	19.9x	1.8%
				MFT Relative:		-5%	-5%	-29%	-29%	-15%	-16%	-8%

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 6. Consensus EPS momentum (NZ\$)

Figure 7. One year forward PE (x)


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