

Mainfreight

Flight to Quality

ANDY BOWLEY

andy.bowley@forsythbarr.co.nz
+64 4 495 8246

SCOTT ANDERSON

scott.anderson@forsythbarr.co.nz
+64 4 914 2219

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
Expected share price return	17.0%
Net dividend yield	1.5%
Estimated 12-month return	18.5%

Spot valuations (NZ\$)	
1. DCF	58.70
2. PE relative	57.57
3. n/a	n/a

Key WACC assumptions	
Risk free rate	1.30%
Equity beta	0.94
WACC	6.3%
Terminal growth	1.0%

DCF valuation summary (NZ\$m)	
Total firm value	8,135
(Net debt)/cash	(195)
Less: Capitalised operating leases	(2,029)
Value of equity	5,911

Profit and Loss Account (NZ\$m)	2019A	2020A	2021E	2022E	2023E
Sales revenue	2,954.1	3,095.4	3,322.7	3,631.0	3,900.1
Normalised EBITDA	257.0	281.0	448.0	497.2	542.0
Depreciation and amortisation	(53.1)	(57.9)	(174.3)	(179.5)	(191.6)
Normalised EBIT	203.9	223.2	273.8	317.7	350.3
Net interest	(6.9)	(5.7)	(22.0)	(17.9)	(17.4)
Associate income	0	0	0	0	0
Tax	(53.0)	(29.4)	(71.3)	(83.8)	(93.2)
Minority interests	0	0	0	0	0
Normalised NPAT	141.1	156.1	178.9	210.3	233.8
Abnormals/other	3.5	(11.2)	0	0	0
Reported NPAT	137.6	167.3	178.9	210.3	233.8
Normalised EPS (cps)	140.1	155.0	177.6	208.8	232.1
DPS (cps)	56.0	59.0	70.0	83.5	92.9

Valuation Ratios	2019A	2020A	2021E	2022E	2023E
EV/EBITDA (x)	20.7	18.9	11.8	10.5	9.6
EV/EBIT (x)	26.1	23.8	19.3	16.5	14.9
PE (x)	36.6	33.1	28.9	24.6	22.1
Price/NTA (x)	9.1	7.6	6.6	5.1	4.1
Free cash flow yield (%)	1.8	2.7	5.2	4.3	5.0
Net dividend yield (%)	1.1	1.2	1.4	1.6	1.8
Gross dividend yield (%)	1.5	1.6	1.9	2.3	2.5

Capital Structure	2019A	2020A	2021E	2022E	2023E
Interest cover EBIT (x)	29.7	39.4	12.5	17.8	20.1
Interest cover EBITDA (x)	37.4	49.6	20.4	27.8	31.1
Net debt/ND+E (%)	12.8	13.6	5.3	-6.7	-19.0
Net debt/EBITDA (x)	0.5	0.5	0.1	n/a	n/a

Growth Rates	2019A	2020A	2021E	2022E	2023E
Revenue (%)	12.8	4.8	7.3	9.3	7.4
EBITDA (%)	19.3	9.3	59.4	11.0	9.0
EBIT (%)	21.7	9.4	22.7	16.0	10.3
Normalised NPAT (%)	25.7	10.6	14.6	17.6	11.2
Normalised EPS (%)	25.7	10.6	14.6	17.6	11.2
Ordinary DPS (%)	24.4	5.4	18.6	19.3	11.2

Key Ratios	2019A	2020A	2021E	2022E	2023E
Return on assets (%)	13.6	9.7	11.6	12.6	13.0
Return on equity (%)	16.8	16.2	16.5	15.8	14.7
Return on funds employed (%)	8.5	14.2	14.1	14.5	14.5
EBITDA margin (%)	8.7	9.1	13.5	13.7	13.9
EBIT margin (%)	6.9	7.2	8.2	8.7	9.0
Capex to sales (%)	3.5	5.2	2.4	4.5	4.2
Capex to depreciation (%)	194	277	46	92	86
Imputation (%)	100	100	100	100	100
Pay-out ratio (%)	40	38	39	40	40

Cash Flow (NZ\$m)	2019A	2020A	2021E	2022E	2023E
EBITDA	257.0	281.0	448.0	497.2	542.0
Working capital change	0	(26.6)	17.3	18.2	19.1
Interest & tax paid	(61.4)	(53.2)	(93.3)	(101.7)	(110.6)
Other	1.7	99.6	(24.3)	(25.2)	(26.1)
Operating cash flow	197.4	300.8	347.8	388.5	424.3
Capital expenditure	(103.3)	(160.0)	(80.0)	(165.0)	(165.0)
(Acquisitions)/divestments	14.0	5.0	5.0	5.0	5.0
Other	0.1	(101.6)	(105.7)	(111.0)	(116.5)
Funding available/(required)	108.3	44.1	167.1	117.5	147.8
Dividends paid	(48.3)	(59.4)	(70.5)	(84.1)	(93.5)
Equity raised/(returned)	0	0	0	0	0
(Increase)/decrease in net debt	59.9	(14.3)	96.6	144.4	170.8

Operating Performance	2019A	2020A	2021E	2022E	2023E
Revenue (NZ\$m)					
New Zealand	719	753	783	830	880
Australia	761	797	922	1,029	1,095
USA	725	762	773	847	926
Asia	109	95	113	130	148
Europe	640	689	732	795	852
Total	2,954	3,095	3,323	3,631	3,900

EBITDA (NZ\$m)	2019A	2020A	2021E	2022E	2023E
New Zealand	110.6	115.9	146.1	154.8	166.1
Australia	59.3	65.0	149.1	167.6	178.5
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
NZDAUD	0.92	0.95	0.91	0.87	0.88
NZDUSD	0.68	0.65	0.65	0.66	0.67
NZDEUR	0.59	0.58	0.56	0.55	0.55

NOTE: IFRS 16 implemented from FY21

Balance Sheet (NZ\$m)	2019A	2020A	2021E	2022E	2023E
Working capital	74.5	0	97.5	106.6	114.5
Fixed assets	666.6	0	774.2	853.2	925.8
Intangibles	270.0	0	299.7	314.7	329.7
Right of use asset	0	0	646.0	678.3	712.2
Other assets	61.7	0	88.3	88.3	88.3
Total funds employed	1,072.8	0	1,905.7	2,041.1	2,170.5
Net debt/(cash)	123.5	0	60.8	(83.6)	(254.4)
Lease liability	0	0	658.2	691.1	725.7
Other liabilities	111.0	0	104.5	104.5	104.5
Shareholder's funds	838.3	0	1,082.2	1,329.0	1,594.7
Minority interests	0	0	0	0	0
Total funding sources	1,072.8	0	1,905.7	2,041.1	2,170.5

* 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	Total	Total	Total
1H20						
New Zealand (NZ\$m)	7.0	11.1	16.1	34.2	362.6	9.4%
Australia (A\$m)	2.0	4.7	8.6	15.3	360.4	4.2%
Americas (US\$m)	3.0	2.8	4.0	9.8	244.0	4.0%
Asia (US\$m)	0.6	1.0	0.9	2.5	36.0	6.9%
Europe (€m)	1.0	3.7	3.3	8.0	193.8	4.2%
Group (NZ\$m)	15.6	28.6	38.6	82.8	1,500.5	5.5%
1H21						
New Zealand (NZ\$m)	0.0	16.7	20.6	37.3	378.7	9.9%
Australia (A\$m)	6.0	11.9	12.6	30.5	403.0	7.6%
Americas (US\$m)	1.0	2.8	4.7	8.5	247.5	3.4%
Asia (US\$m)	1.1	1.5	1.4	4.0	43.6	9.2%
Europe (€m)	0.0	4.1	3.0	7.1	194.1	3.7%
Group (NZ\$m)	9.1	44.1	49.0	102.2	1,609.1	6.4%
Change						
New Zealand (NZ\$m)	-100%	50%	28%	9%	4%	+42bps
Australia (A\$m)	200%	153%	46%	99%	12%	+332bps
Americas (US\$m)	-67%	0%	18%	-13%	1%	-57bps
Asia (US\$m)	83%	50%	59%	61%	21%	+231bps
Europe (€m)	-100%	11%	-9%	-11%	0%	-47bps
Group (NZ\$m)	-42%	54%	27%	23%	7%	+83bps

Source: MFT, Forsyth Barr analysis

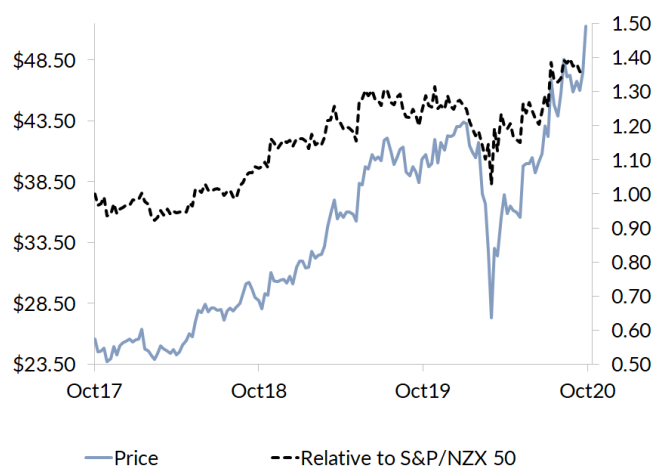
Earnings revisions

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


Source: Forsyth Barr analysis

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%

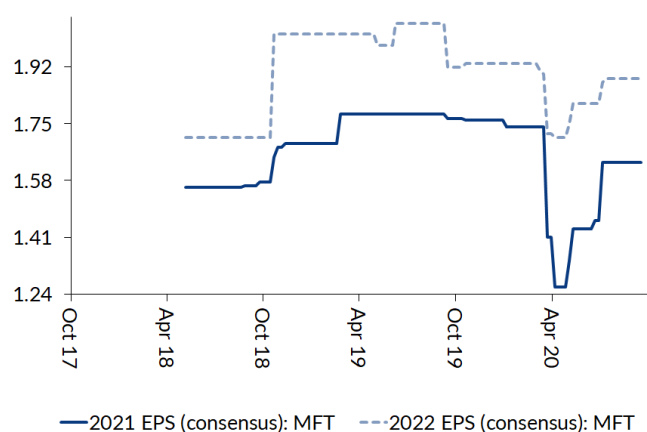
Source: NZX, Forsyth Barr analysis, NOTE: based on SPH notices only

Figure 5. International valuation comparisons

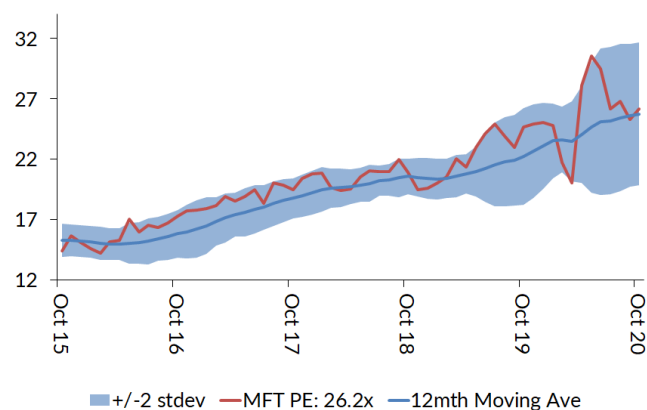
Company	Code	Price	Mkt Cap	PE		EV/EBITDA		EV/EBIT		Cash Yld	
(metrics re-weighted to reflect MFT's balance date - March)											
			(m)	2021E	2022E	2021E	2022E	2021E	2022E	2022E	
Mainfreight	MFT NZ	NZ\$51.30	NZ\$5,166	28.9x	24.6x	11.9x	10.7x	19.4x	16.7x	1.6%	
FREIGHTWAYS *	FRE NZ	NZ\$8.35	NZ\$1,381	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%	
EV = Current Market Cap + Actual Net Debt				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\$)


Source: Forsyth Barr analysis

Figure 7. One year forward PE (x)


Source: Forsyth Barr analysis

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