

Mainfreight Recession Proof

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OUTPERFORM

Mainfreight's (MFT) Annual Shareholder Meeting trading update highlights an outstanding recovery in profitability following a tough COVID-19 impacted start to FY21. Profit before tax (PBT) is up ~+20% for the first four months of the year on revenue growth of ~+8%. This implies a very strong result for June and July, given early COVID-19 trading challenges through April and May. While performance of all regions has improved in recent months, the key driver of the profit uplift is Australia, where robust revenue growth and very impressive margin expansion is evident. Elsewhere Asia has also grown earnings year on year, albeit from a lower base. In contrast New Zealand, Europe and the Americas have all seen PBT and margins decline. MFT's approach to branch autonomy enables cost and margin management at a local level. Its greater focus on sales is evident, which in contrast to competitors that have shed headcount, is helping to drive market share gains. While the outlook retains an element of uncertainty, MFT has demonstrated that it can successfully navigate a challenging industry backdrop better than its competitors. We lift our target price to NZ\$47 (from NZ\$40). Reiterate OUTPERFORM.

NZX Code	MFT	Financials: Mar/	20A	21E	22E	23E	Valuation (x)	20A	21E	22E	23E
Share price	NZ\$43.60	NPAT* (NZ\$m)	156.1	167.6	198.3	231.6	EV/EBITDA	16.1	10.4	9.3	8.4
Target price	NZ\$47.00	EPS* (NZc)	155.0	166.5	196.9	230.0	EV/EBIT	20.3	17.4	14.8	13.0
Risk rating	Medium	EPS growth* (%)	10.6	7.4	18.3	16.8	PE	28.1	26.2	22.1	19.0
Issued shares	100.7m	DPS (NZc)	59.0	65.0	78.8	92.0	Price / NTA	6.4	5.7	4.4	3.5
Market cap	NZ\$4,391m	Imputation (%)	100	100	100	100	Cash div yld (%)	1.4	1.5	1.8	2.1
Avg daily turnover	74.9k (NZ\$2,810k)	*Based on normalised profits					Gross div yld (%)	1.9	2.1	2.5	2.9

Whats changed?

- **NPAT:** FY20 upgraded by +35%, FY22 +19%
- **Target price:** Increased from NZ\$40 to NZ\$47

Australia booming ; Asian uplift

Australian PBT is up +167% on revenue growth of +13% for the first four months of FY21, driven principally by its Transport operations, which are benefiting from strong share gains and the continued movement of freight despite government restrictions. Network expansion continues into regional Australia, which together with favourable freight mix is supportive to margin expansion.

New Zealand recovering; other regions lagging

The domestic business experienced a significant decline in activity during April but ramped up performance as government restrictions eased through Alert Levels 3, 2 and 1. Given current business momentum management expects the New Zealand business to be back to flat earnings year on year for 1H21. Recoveries in Europe and the Americas are lagging, albeit both regions are showing sequential improvement.

Valuation: rewarding resilience

MFT's ability to gain strength from adversity is an exception in its industry. Performance year to date is a relative anomaly, which should be rewarded accordingly. We raise our target price to NZ\$47 from NZ\$40 to reflect our material earnings upgrades. While its far from cheap at ~24x one year forward PE, its trading at a discount to comparable (albeit larger) international peers.

Mainfreight Ltd (MFT)

Priced as at 30 Jul 2020 (NZ\$) **43.60**

12-month target price (NZ\$)*	47.00
Expected share price return	7.8%
Net dividend yield	1.6%
Estimated 12-month return	9.4%

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

Spot valuations (NZ\$)	
1. DCF	42.72
2. PE relative	44.71
3. n/a	n/a

DCF valuation summary (NZ\$m)	
Total firm value	6,491
(Net debt)/cash	(159)
Less: Capitalised operating leases	(2,029)
Value of equity	4,302

Profit and Loss Account (NZ\$m)	2019A	2020A	2021E	2022E	2023E
Sales revenue	2,954.1	3,095.4	3,334.2	3,632.4	3,967.3
Normalised EBITDA	257.0	281.0	432.4	480.7	533.2
Depreciation and amortisation	(53.1)	(57.9)	(174.3)	(179.5)	(190.5)
Normalised EBIT	203.9	223.2	258.1	301.2	342.7
Net interest	(6.9)	(5.7)	(22.1)	(18.2)	(12.9)
Associate income	0	0	0	0	0
Tax	(53.0)	(29.4)	(66.8)	(79.0)	(92.3)
Minority interests	0	0	0	0	0
Normalised NPAT	141.1	156.1	167.6	198.3	231.6
Abnormals/other	3.5	(11.2)	0	0	0
Reported NPAT	137.6	167.3	167.6	198.3	231.6
Normalised EPS (cps)	140.1	155.0	166.5	196.9	230.0
DPS (cps)	56.0	59.0	65.0	78.8	92.0

Growth Rates	2019A	2020A	2021E	2022E	2023E
Revenue (%)	12.8	4.8	7.7	8.9	9.2
EBITDA (%)	19.3	9.3	53.9	11.2	10.9
EBIT (%)	21.7	9.4	15.7	16.7	13.8
Normalised NPAT (%)	25.7	10.6	7.4	18.3	16.8
Normalised EPS (%)	25.7	10.6	7.4	18.3	16.8
Ordinary DPS (%)	24.4	5.4	10.2	21.2	16.8

Cash Flow (NZ\$m)	2019A	2020A	2021E	2022E	2023E
EBITDA	257.0	281.0	432.4	480.7	533.2
Working capital change	0	17.0	17.3	18.2	19.1
Interest & tax paid	(61.4)	(68.1)	(88.9)	(97.2)	(105.2)
Other	1.7	(29.8)	(24.3)	(25.2)	(26.1)
Operating cash flow	197.4	200.2	336.5	376.5	421.0
Capital expenditure	(103.3)	(160.0)	(80.0)	(165.0)	(135.0)
(Acquisitions)/divestments	14.0	5.0	5.0	5.0	5.0
Other	0.1	0	(105.7)	(111.0)	(116.5)
Funding available/(required)	108.3	45.1	155.9	105.5	174.5
Dividends paid	(48.3)	(59.4)	(65.5)	(79.3)	(92.6)
Equity raised/(returned)	0	0	0	0	0
(Increase)/decrease in net debt	59.9	(14.3)	90.4	137.2	198.4

Balance Sheet (NZ\$m)	2019A	2020A	2021E	2022E	2023E
Working capital	74.5	81.3	97.9	106.6	116.4
Fixed assets	666.6	776.6	774.2	853.2	896.8
Intangibles	270.0	284.7	299.7	314.7	329.7
Right of use asset	0	615.3	646.0	678.3	712.2
Other assets	61.7	91.1	88.3	88.3	88.3
Total funds employed	1,072.8	1,848.9	1,906.0	2,041.1	2,143.5
Net debt/(cash)	123.5	151.6	67.0	(70.2)	(268.6)
Lease liability	0	626.9	658.2	691.1	725.7
Other liabilities	111.0	104.1	104.5	104.5	104.5
Shareholder's funds	838.3	966.3	1,076.3	1,315.7	1,581.9
Minority interests	0	0	0	0	0
Total funding sources	1,072.8	1,848.9	1,906.0	2,041.1	2,143.5

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

Valuation Ratios	2019A	2020A	2021E	2022E	2023E
EV/EBITDA (x)	17.7	16.1	10.4	9.3	8.4
EV/EBIT (x)	22.3	20.3	17.4	14.8	13.0
PE (x)	31.1	28.1	26.2	22.1	19.0
Price/NTA (x)	7.7	6.4	5.7	4.4	3.5
Free cash flow yield (%)	2.1	0.9	5.8	4.8	6.5
Net dividend yield (%)	1.3	1.4	1.5	1.8	2.1
Gross dividend yield (%)	1.8	1.9	2.1	2.5	2.9

Capital Structure	2019A	2020A	2021E	2022E	2023E
Interest cover EBIT (x)	29.7	39.4	11.7	16.6	26.6
Interest cover EBITDA (x)	37.4	49.6	19.6	26.5	41.5
Net debt/ND+E (%)	12.8	13.6	5.9	-5.6	-20.5
Net debt/EBITDA (x)	0.5	0.5	0.2	n/a	n/a

Key Ratios	2019A	2020A	2021E	2022E	2023E
Return on assets (%)	13.6	9.7	10.9	11.9	12.9
Return on equity (%)	16.8	16.2	15.6	15.1	14.6
Return on funds employed (%)	8.5	9.0	13.6	14.0	14.3
EBITDA margin (%)	8.7	9.1	13.0	13.2	13.4
EBIT margin (%)	6.9	7.2	7.7	8.3	8.6
Capex to sales (%)	3.5	5.2	2.4	4.5	3.4
Capex to depreciation (%)	194	277	46	92	71
Imputation (%)	100	100	100	100	100
Pay-out ratio (%)	40	38	39	40	40

Operating Performance	2019A	2020A	2021E	2022E	2023E
Revenue (NZ\$m)					
New Zealand	719	753	776	834	897
Australia	761	797	913	1,007	1,089
USA	725	762	788	858	947
Asia	109	95	129	153	172
Europe	640	689	729	780	862
Total	2,954	3,095	3,334	3,632	3,967

EBITDA (NZ\$m)	2019A	2020A	2021E	2022E	2023E
New Zealand	110.6	115.9	144.0	156.7	169.6
Australia	59.3	65.0	135.0	151.6	166.4
USA	38.3	43.3	53.2	60.4	69.6
Asia	9.3	6.0	12.8	16.1	18.9
Europe	39.6	50.8	87.5	95.9	108.7
Total	257.0	281.0	432.4	480.7	533.2
NZDAUD	0.92	0.95	0.92	0.90	0.89
NZDUSD	0.68	0.65	0.64	0.65	0.65
NZDEUR	0.59	0.58	0.56	0.57	0.56

NOTE: IFRS 16 implemented from FY21

A COVID-19 outlier

Mainfreight (MFT) has enjoyed a remarkable recovery over recent months having been significantly impacted by COVID-19 through April and May. We deduce that over the past 10 weeks, MFT's profit before tax (PBT) is up +54% against the prior year, led by Australia, which is up +153% but supported by New Zealand (+50%) and Asia (+52%). While Europe and the Americas are some way behind, their respective profit outcomes relative to the prior year are improving sequentially.

Figure 1. FY20 profit before tax analysis year to date

	First 7 weeks			First 17 weeks			Last 10 weeks			
	FY20	FY21	Change	FY20	FY21	Change	FY20	FY21	Change	Change (%)
New Zealand (NZ\$m)	7.0	0.0	(7.0)	18.1	16.7	(1.4)	11.1	16.7	5.6	50%
Australia (A\$m)	2.0	6.0	4.0	6.7	17.9	11.2	4.7	11.9	7.2	153%
Americas (US\$m)	3.0	1.0	(2.0)	5.8	3.8	(2.0)	2.8	2.8	0.0	0%
Asia (US\$m)	0.6	1.1	0.5	1.6	2.6	1.0	1.0	1.5	0.5	52%
Europe (€m)	1.0	0.0	(1.0)	4.7	4.1	(0.6)	3.7	4.1	0.4	10%
Group (NZ\$m)	15.6	9.1	(6.5)	44.2	53.2	9.0	28.6	44.1	15.5	54%

Source: MFT, Forsyth Barr analysis

Earnings revisions

We materially increase our earnings forecasts as summarised in Figure 2 to reflect the strong year to date performance. Our revised FY21 NPAT forecast of NZ\$167.6m assumes +7% growth against FY20. We recognise (1) that there remains a moderate margin for error in our forecasts, and (2) that we air on the side of caution, given the uncertainty that prevails from COVID-19 fall-out, however we believe MFT is well placed to consolidate its performance year to date and maintain impressive underlying business momentum.

Figure 2. Earnings revisions (NZ\$m)

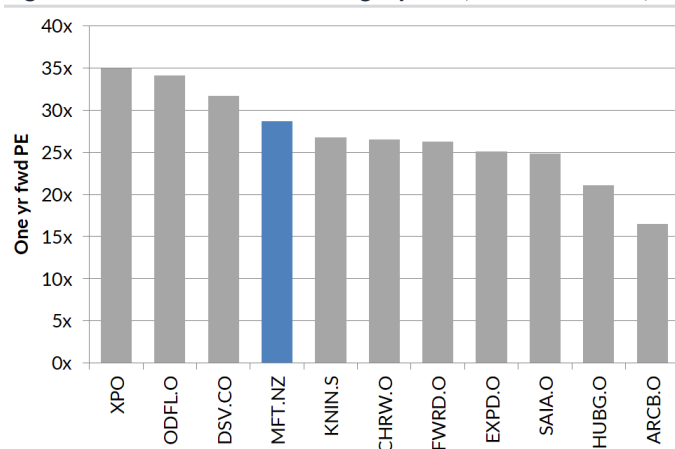
	FY21E			FY22E			FY23E		
	Old	New	Chg	Old	New	Chg	Old	New	Chg
Sales revenue	3,306.5	3,334.2	0.8%	3,558.6	3,632.4	2.1%	3,899.7	3,967.3	1.7%
EBITDA	371.9	432.4	16.3%	434.3	480.7	10.7%	492.7	533.2	8.2%
Underlying NPAT	124.0	167.6	35.1%	166.4	198.3	19.2%	206.3	231.6	12.2%
Underlying EPS	123.2	166.5	35.1%	165.2	196.9	19.2%	204.9	230.0	12.2%
Full year DPS	59.0	65.0	10.2%	66.1	78.8	19.2%	82.0	92.0	12.2%

Source: Forsyth Barr analysis

Target price raised to NZ\$47

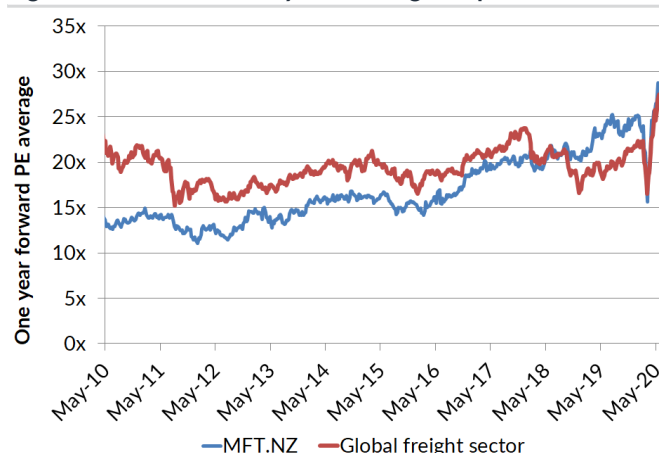
MFT is trading at ~24x one year on our forward revised earnings forecasts. While prima facie this doesn't sound cheap, it is a discount to its higher quality international peers ODFL and DSV (Figure 3). We raise our target price to NZ\$47 from NZ\$40 due to our earnings upgrades.

Figure 3. MFT vs international freight peers (consensus based)



Source: Eikon, Forsyth Barr analysis

Figure 4. Timeseries history of MFT vs global peers



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. 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.

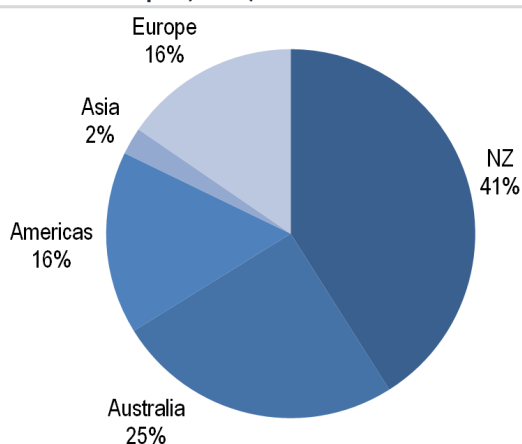
Financial structure

- **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

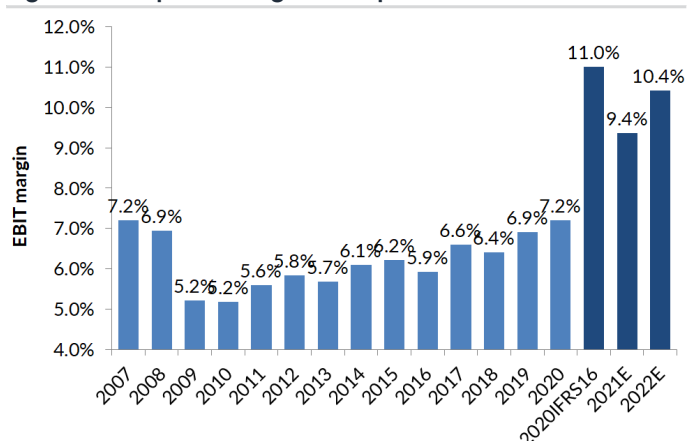
- **Acquisitions:** History suggests that MFT is not as good at due diligence as it is at operating a freight and logistics business.
- **Disruptive technology:** Freight forwarders leverage the inefficiencies in the freight supply chain. New technologies may lower supply chain costs, therefore, increasing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

Figure 5. EBITDA split (FY20)

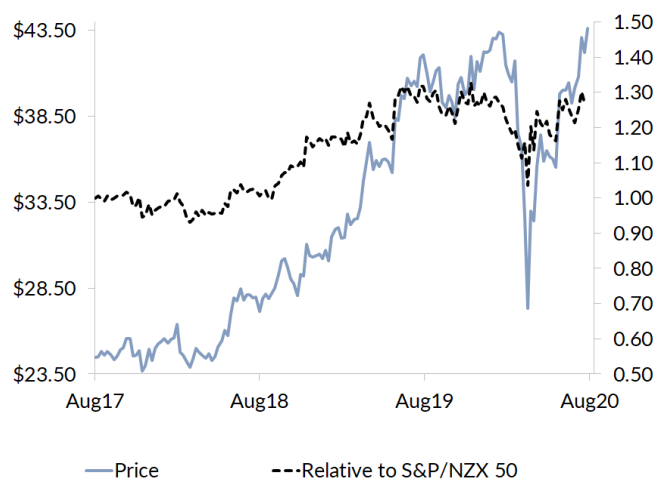


Source: Forsyth Barr analysis

Figure 6. Group EBIT margin development



Source: Forsyth Barr analysis

Figure 7. Price performance


Source: Forsyth Barr analysis

Figure 8. Substantial shareholders

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

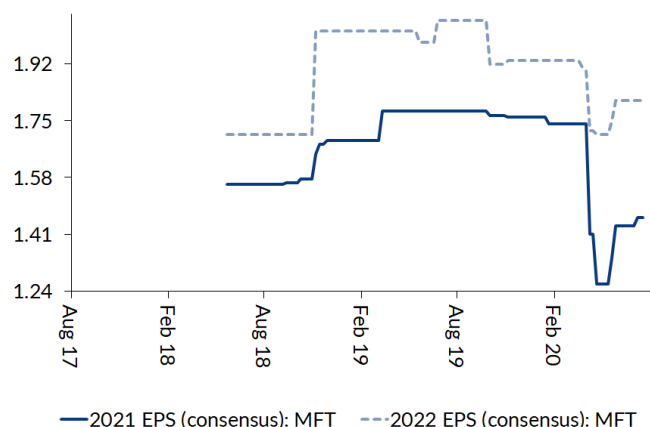
Source: NZX, Forsyth Barr analysis, NOTE: based on SPH notices only

Figure 9. International valuation comparisons

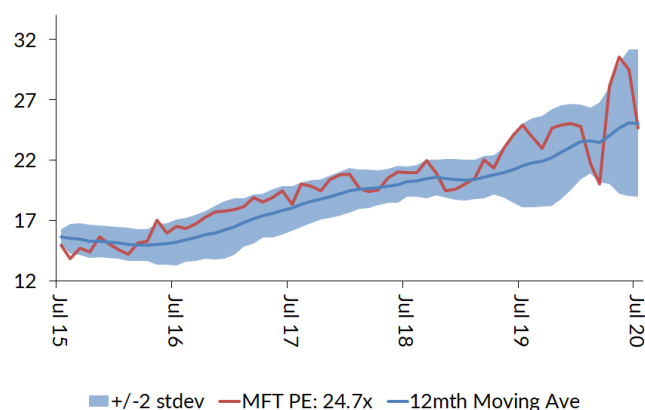
Company	Code	Price	Mkt Cap (m)	PE 2021E	PE 2022E	EV/EBITDA 2021E	EV/EBITDA 2022E	EV/EBIT 2021E	EV/EBIT 2022E	Cash Yld 2022E
(metrics re-weighted to reflect MFT's balance date - March)										
Mainfreight	MFT NZ	NZ\$43.60	NZ\$4,391	26.2x	22.1x	10.5x	9.4x	17.6x	15.1x	1.8%
FREIGHTWAYS *	FRE NZ	NZ\$7.05	NZ\$1,166	20.2x	17.1x	8.9x	8.1x	13.2x	11.5x	4.4%
OLD DOMINION FREIGHT LINE	ODFL US	US\$182.32	US\$21,504	37.2x	30.6x	20.3x	17.5x	27.5x	23.3x	0.4%
DSV PANALPINA A/S	DSV DC	kr876.80	kr201,664	34.9x	28.0x	17.7x	15.4x	26.5x	21.7x	0.5%
C.H. ROBINSON WORLDWIDE INC	CHRW US	US\$95.28	US\$12,826	29.9x	24.5x	20.3x	17.3x	23.2x	19.6x	2.3%
KUEHNE + NAGEL INTL AG-REG	KNIN SW	CHF160.45	CHF19,254	29.4x	24.4x	12.4x	11.4x	22.8x	19.2x	2.7%
EXPEDITORS INTL WASH INC	EXPD US	US\$83.82	US\$13,950	26.3x	23.3x	17.5x	15.9x	18.9x	16.6x	1.3%
Compco Average:				29.7x	24.7x	16.2x	14.2x	22.0x	18.7x	1.9%
MFT Relative:				-12%	-10%	-35%	-34%	-20%	-19%	-6%

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 10. Consensus EPS momentum (NZ\$)


Source: Forsyth Barr analysis

Figure 11. One year forward PE (x)


Source: Forsyth Barr analysis

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