

# Freightways

## Parcels Tracking Higher

**ANDY BOWLEY**

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

**SCOTT ANDERSON**

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

### OUTPERFORM

Freightways (FRE) issued a strong first quarter trading update driven by (1) double digit parcel volume growth, (2) 'pricing for effort' gains, (3) cost initiatives in Information Management, (4) Big Chill acquisition accretion, and (5) a weak prior year comparative. We calculate like-for-like EPS (excluding the impact of an additional trading week) was up ~+27% against the prior year, which compares to current FY21 consensus EPS growth of +11%. With soft prior year comparatives to come in 2Q21 (trough in Information Management's earnings) and 4Q21 (COVID-19 impact), we see scope for material consensus upgrades. Business momentum is supportive and helped by the success of key management initiatives. FRE is trading at an attractive ~17x one year forward PE on our revised earnings estimates; this appears inconsistent with the improved growth prospects of the company. We reiterate an OUTPERFORM rating.

NZX Code	FRE	Financials: Jun/	20A	21E	22E	23E	Valuation (x)	20A	21E	22E	23E
Share price	NZ\$8.40	NPAT* (NZ\$m)	56.0	76.3	86.6	93.4	PE	23.7	18.2	16.1	14.9
Target price	NZ\$10.50	EPS* (NZc)	35.5	46.1	52.3	56.4	EV/EBIT	18.5	12.3	11.1	10.4
Risk rating	Medium	EPS growth* (%)	-9.7	30.0	13.5	7.8	EV/EBITDA	10.8	8.5	7.8	7.5
Issued shares	165.6m	DPS (NZc)	15.0	34.6	39.2	42.3	Price / NTA	n/a	n/a	n/a	n/a
Market cap	NZ\$1,391m	Imputation (%)	100	100	100	100	Cash div yld (%)	1.8	4.1	4.7	5.0
Avg daily turnover	194.3k (NZ\$1,379k)	*Based on normalised profits					Gross div yld (%)	2.5	5.7	6.5	7.0

### What's changed?

- **Earnings:** Material lift to near term earnings forecasts to reflect strong start to FY21
- **Target price:** Lifted to NZ\$10.50 from NZ\$9.50

### Strong momentum has continued in Express Package

Express Package revenue growth of +46% was boosted by the first time consolidation of Big Chill and an extra week of trading in 1Q21 compared to 1Q20. Nonetheless, underlying strong parcel growth has continued through the quarter following the encouraging start acknowledged at the FY20 result in August. Parcel volume growth of +11% (driven by strong B2C growth) was supported by 'pricing for effort' gains. By quarter end 'pricing for effort' was up to 87c per parcel vs 73c at year end FY20. The company is targeting a further 50c in FY21; we expect it may get up to 35c.

### Information Management on margin recovery path

Information Management's contribution has recovered in 1Q21 and is now back at peak profit levels of 1Q18 and 1Q19 despite headwinds from government restrictions in Auckland and Victoria during the period. In particular, working from home trends means less paper generation for storage/destruction and reduced activity based work. Key drivers of the improved performance were (1) lower costs, (2) improved productivity, and (3) new revenue streams including digitisation projects and medical waste.

### Valuation appealing

On our revised earnings estimates, FRE is trading at a one year forward PE of just ~17x. We acknowledge this is higher than its international parcel delivery peers UPS, Fedex and Aramex, which it has historically traded at a premium to. However, it appears good value relative to the New Zealand market (~22x), particularly in light of its near term growth prospects and secular growth opportunities in e-commerce originated parcels and temperature controlled distribution.

## Freightways Ltd (FRE)

Priced as at 29 Oct 2020 (NZ\$) **8.40**

<b>12-month target price (NZ\$)*</b>	<b>10.50</b>
Expected share price return	25.0%
Net dividend yield	4.3%
Estimated 12-month return	29.3%

<b>Key WACC assumptions</b>	
Risk free rate	1.30%
Equity beta	1.00
WACC	6.1%
Terminal growth	1.0%

<b>Spot valuations (NZ\$)</b>	
1. DCF	10.43
2. Sum-of-the-parts	9.92
3. n/a	n/a

<b>DCF valuation summary (NZ\$m)</b>	
Total firm value	2,660
(Net debt)/cash	(197)
Less: Capitalised operating leases	(735)
Value of equity	1,728

<b>Profit and Loss Account (NZ\$m)</b>	<b>2019A</b>	<b>2020A</b>	<b>2021E</b>	<b>2022E</b>	<b>2023E</b>
Sales revenue	615.7	630.9	803.1	837.5	874.3
<b>Normalised EBITDA</b>	<b>112.2</b>	<b>144.7</b>	<b>184.3</b>	<b>195.9</b>	<b>205.4</b>
Depreciation and amortisation	(17.5)	(50.4)	(57.3)	(57.3)	(57.5)
<b>Normalised EBIT</b>	<b>97.1</b>	<b>84.7</b>	<b>127.0</b>	<b>138.6</b>	<b>147.9</b>
Net interest	(9.6)	(18.4)	(19.2)	(16.4)	(16.3)
Associate income	0	0	0	0	0
Tax	(24.1)	(18.0)	(31.5)	(35.5)	(38.2)
Minority interests	0	0	0	0	0
<b>Normalised NPAT</b>	<b>61.0</b>	<b>56.0</b>	<b>76.3</b>	<b>86.6</b>	<b>93.4</b>
Abnormals/other	2.4	(8.7)	0	0	0
<b>Reported NPAT</b>	<b>63.4</b>	<b>47.4</b>	<b>76.3</b>	<b>86.6</b>	<b>93.4</b>
Normalised EPS (cps)	39.3	35.5	46.1	52.3	56.4
DPS (cps)	30.5	15.0	34.6	39.2	42.3

<b>Growth Rates</b>	<b>2019A</b>	<b>2020A</b>	<b>2021E</b>	<b>2022E</b>	<b>2023E</b>
Revenue (%)	6.0	2.5	27.3	4.3	4.4
EBITDA (%)	4.2	28.9	27.4	6.3	4.8
EBIT (%)	2.9	-12.7	49.9	9.1	6.7
Normalised NPAT (%)	2.4	-8.2	36.2	13.5	7.8
Normalised EPS (%)	2.2	-9.7	30.0	13.5	7.8
Ordinary DPS (%)	2.5	-50.8	>100	13.5	7.8

<b>Cash Flow (NZ\$m)</b>	<b>2019A</b>	<b>2020A</b>	<b>2021E</b>	<b>2022E</b>	<b>2023E</b>
<b>EBITDA</b>	<b>112.2</b>	<b>144.7</b>	<b>184.3</b>	<b>195.9</b>	<b>205.4</b>
Working capital change	0	0	0	0	0
Interest & tax paid	(33.7)	(28.6)	(41.4)	(42.6)	(45.1)
Other	(2.5)	11.1	(14.0)	(14.0)	(14.0)
<b>Operating cash flow</b>	<b>76.0</b>	<b>127.2</b>	<b>128.9</b>	<b>139.2</b>	<b>146.2</b>
Capital expenditure	(23.3)	(23.6)	(23.3)	(27.6)	(28.9)
(Acquisitions)/divestments	(8.7)	(101.6)	0	0	(38.4)
Other	1.9	(24.0)	(25.0)	(25.0)	(25.0)
<b>Funding available/(required)</b>	<b>46.0</b>	<b>(22.0)</b>	<b>80.7</b>	<b>86.6</b>	<b>54.0</b>
Dividends paid	(47.0)	(47.5)	(28.6)	(65.0)	(70.1)
Equity raised/(returned)	0.7	24.1	0	0	0
<b>(Increase)/decrease in net debt</b>	<b>(0.3)</b>	<b>(45.4)</b>	<b>52.0</b>	<b>21.7</b>	<b>(16.1)</b>

<b>Balance Sheet (NZ\$m)</b>	<b>2019A</b>	<b>2020A</b>	<b>2021E</b>	<b>2022E</b>	<b>2023E</b>
Working capital	23.8	18.7	22.9	23.6	24.4
Fixed assets	106.7	134.6	130.5	130.6	131.7
Intangibles	365.2	499.0	504.3	509.6	528.0
Right of use asset	0	278.1	278.1	278.1	278.1
Other assets	4.0	15.6	15.6	15.6	15.6
<b>Total funds employed</b>	<b>499.7</b>	<b>946.1</b>	<b>951.3</b>	<b>957.5</b>	<b>977.8</b>
Net debt/(cash)	151.4	205.0	153.0	131.3	147.4
Lease liability	0	311.1	311.1	311.1	311.1
Other liabilities	74.3	113.2	113.2	113.2	113.2
Shareholder's funds	273.9	316.7	374.0	401.8	406.0
Minority interests	0.1	0.1	0.1	0.1	0.1
<b>Total funding sources</b>	<b>499.7</b>	<b>946.1</b>	<b>951.3</b>	<b>957.5</b>	<b>977.8</b>

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

<b>Valuation Ratios</b>	<b>2019A</b>	<b>2020A</b>	<b>2021E</b>	<b>2022E</b>	<b>2023E</b>
EV/EBITDA (x)	13.8	10.8	8.5	7.8	7.5
EV/EBIT (x)	15.9	18.5	12.3	11.1	10.4
PE (x)	21.4	23.7	18.2	16.1	14.9
Price/NTA (x)	n/a	n/a	n/a	n/a	n/a
Free cash flow yield (%)	3.8	7.4	7.6	8.0	8.4
Net dividend yield (%)	3.6	1.8	4.1	4.7	5.0
Gross dividend yield (%)	5.0	2.5	5.7	6.5	7.0

<b>Capital Structure</b>	<b>2019A</b>	<b>2020A</b>	<b>2021E</b>	<b>2022E</b>	<b>2023E</b>
Interest cover EBIT (x)	10.1	4.6	6.6	8.4	9.1
Interest cover EBITDA (x)	11.7	7.9	9.6	11.9	12.6
Net debt/ND+E (%)	35.6	39.3	29.0	24.6	26.6
Net debt/EBITDA (x)	1.3	1.4	0.8	0.7	0.7

<b>Key Ratios</b>	<b>2019A</b>	<b>2020A</b>	<b>2021E</b>	<b>2022E</b>	<b>2023E</b>
Return on assets (%)	16.6	8.1	12.0	12.9	13.5
Return on equity (%)	22.3	17.7	20.4	21.6	23.0
Return on funds employed (%)	12.6	12.0	18.2	18.4	18.6
EBITDA margin (%)	18.2	22.9	23.0	23.4	23.5
EBIT margin (%)	15.8	13.4	15.8	16.5	16.9
Capex to sales (%)	3.8	3.7	2.9	3.3	3.3
Capex to depreciation (%)	151	50	44	53	55
Imputation (%)	100	100	100	100	100
Pay-out ratio (%)	78	42	75	75	75

<b>Operating Performance</b>	<b>2019A</b>	<b>2020A</b>	<b>2021E</b>	<b>2022E</b>	<b>2023E</b>
<b>Revenue (NZ\$m)</b>					
Express Package & Bus. Mail	451.3	472.2	635.0	654.1	683.5
Information Mgmt	164.4	158.8	168.1	183.4	190.9
<b>Total Sales</b>	<b>615.7</b>	<b>630.9</b>	<b>803.1</b>	<b>837.5</b>	<b>874.3</b>
<b>EBITDA (NZ\$m)</b>					
Express Package & Bus. Mail	80.0	101.7	136.5	142.6	149.0
Information Mgmt	35.3	47.1	53.8	59.6	63.0
H/Office	(3.1)	(4.1)	(6.0)	(6.3)	(6.6)
<b>Total EBITDA</b>	<b>112.2</b>	<b>144.7</b>	<b>184.3</b>	<b>195.9</b>	<b>205.4</b>

<b>EBITDA margin (%)</b>	<b>2019A</b>	<b>2020A</b>	<b>2021E</b>	<b>2022E</b>	<b>2023E</b>
Express Package & Business Mail	17.7	21.5	21.5	21.8	21.8
Information Mgmt	21.5	29.6	32.0	32.5	33.0
<b>Group EBITDA margin</b>	<b>18.2</b>	<b>22.9</b>	<b>23.0</b>	<b>23.4</b>	<b>23.5</b>

<b>NZDAUD</b>	<b>0.91</b>	<b>0.95</b>	<b>0.91</b>	<b>0.90</b>	<b>0.89</b>
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## 1Q21 trading update; OUTPERFORM

We expected a positive trading update from FRE in light of (1) the strong start to FY21 as outlined in August, and (2) the weak prior year comparative, as 1Q20 NPAT was down -8% on weakening B2B parcel volumes and depressed Information Management margins. However, we didn't quite expect the strength of what FRE announced, as illustrated in our material earnings upgrades outlined below. The investment made in recent years in 'pricing for effort', contractor pay rates, delivery productivity and new growth areas in waste/destruction is paying off. Notwithstanding COVID-19 related risks, we expect business momentum to remain robust through the remainder of FY21, with the business well positioned for above trend growth thereafter. We reiterate our OUTPERFORM rating.

**Figure 1. Summary of 1Q21 performance**

	1Q21	1Q20	Change
Operating revenue	211.7	156.7	35%
EBITDA	49.4	33.6	n/a
EBITA	34.8	23.3	49%
NPATA	21.1	14.0	51%
<b>NPAT</b>	<b>19.2</b>	<b>13.4</b>	<b>43%</b>

Source: FRE, Forsyth Barr analysis

**Figure 2. Like-for-like EPS growth of +27% in 1Q21**

	1Q21	1Q20	Change
NPAT	19.2	13.4	43%
Adjust for additional week	(1.0)	0.0	n/a
Adj NPAT	18.2	13.4	35%
Shares on issue	165.6	155.3	7%
<b>EPS (cps)</b>	<b>11.0</b>	<b>8.6</b>	<b>27%</b>

Source: FRE, Forsyth Barr analysis

Key highlights from 1Q21 include:

- **Express Package & Business Mail (EP&BM) divisional revenue:** First quarter revenue for the EP&BM division has averaged ~24.9% of full year divisional revenue over the past six years. After adjusting for the additional week (revenue of NZ\$11.6m) in 1Q21, this would pro-rate to ~NZ\$640m of revenue for the full year, significantly above our previous forecast (NZ\$575m).
- **Further 'pricing for effort' gains:** FRE has secured a further 14c per parcel from its 'pricing for effort' initiative, which takes its total incremental increase on B2C parcels to 87c over the past 15 months. It continues to target a further 50c in FY21, of which we believe it may realise up to 35c.
- **Big Chill stable to positive:** Management has provided limited detail on Big Chill's progress, however, deconstructing Express Package divisional performance through 1Q21 suggests that Big Chill's contribution is at least on plan with its anticipated annual revenue run-rate of ~NZ\$100m.
- **Information Management (IM) margins:** IM divisional margins were up ~+390 bps helped by cost base initiatives, productivity improvements, higher margin new revenue streams including digitisation projects and medical waste, and government wage subsidy receipts in Australia (~NZ\$0.6m).

**Figure 3. 1Q21 divisional performance (NZ\$m)**

	Reported				Adjusted for extra week			
	EP&BM	IM	Corporate	Total	EP&BM	IM	Corporate	Total
<b>Revenue</b>								
1Q21	168.4	43.8	(0.5)	211.7	156.8	43.0	(0.5)	199.3
1Q20	115.6	41.5	(0.4)	156.7	115.6	41.5	(0.4)	156.7
Change	46%	5%	25%	35%	36%	4%	25%	27%
<b>EBITDA</b>								
1Q21	36.9	14.3	(1.8)	49.4	34.3	14.1	(1.8)	46.6
1Q20	22.5	12.0	(0.9)	33.6	22.5	12.0	(0.9)	33.6
Change	64%	19%	100%	47%	53%	18%	100%	39%
<b>EBITA</b>								
1Q21	28.1	8.9	(2.2)	34.8	26.2	8.7	(2.2)	32.7
1Q20	17.9	6.8	(1.4)	23.3	17.9	6.8	(1.4)	23.3
Change	57%	31%	57%	49%	46%	28%	57%	40%
<b>EBITA margin</b>								
1Q21	16.7%	20.3%	n/a	16.4%	16.7%	20.2%	n/a	16.4%
1Q20	15.5%	16.4%	n/a	14.9%	15.5%	16.4%	n/a	14.9%
Change	120bps	393bps	n/a	157bps	122bps	385bps	n/a	154bps

Source: FRE, Forsyth Barr analysis NOTE: EP&BM = Express Package and Business Mail, IM = Information Management

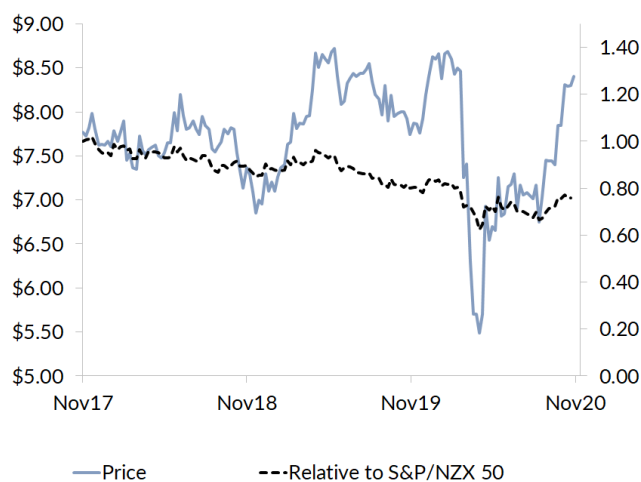
## Earnings revisions

We materially lift our FY21 forecasts as shown in Figure 4 yet retain an element of conservatism relative to the strong 1Q21 trading update, given COVID-19 related economic risks. If FRE can retain current business momentum then further upgrades are possible. We assume that the dividend is reinstated for 1H21 and FY21 at a 75% annualised payout.

**Figure 4. Earnings revisions (NZ\$m)**

	FY21E			FY22E			FY22E		
	Old	New	Chg	Old	New	Chg	Old	New	Chg
Sales revenue	737.1	803.1	9.0%	792.5	837.5	5.7%	827.3	874.3	5.7%
EBITDA	169.8	184.3	8.5%	184.9	195.9	5.9%	196.1	205.4	4.7%
EBITA	147.6	162.1	9.8%	163.0	173.7	6.6%	174.1	183.0	5.1%
<b>Underlying NPAT</b>	<b>67.0</b>	<b>76.3</b>	<b>13.9%</b>	<b>79.9</b>	<b>86.6</b>	<b>8.4%</b>	<b>88.0</b>	<b>93.4</b>	<b>6.1%</b>
Underlying EPS (cents)	40.5	46.1	13.8%	48.3	52.3	8.3%	53.2	56.4	6.0%
Full year DPS (cents)	30.4	34.6	13.8%	36.2	39.2	8.3%	39.9	42.3	6.0%

Source: Forsyth Barr analysis

**Figure 5. Price performance**


Source: Forsyth Barr analysis

**Figure 6. Substantial shareholders**

Shareholder	Latest Holding
ANZ NZ Investments	6.5%
Investment Services Group	5.7%

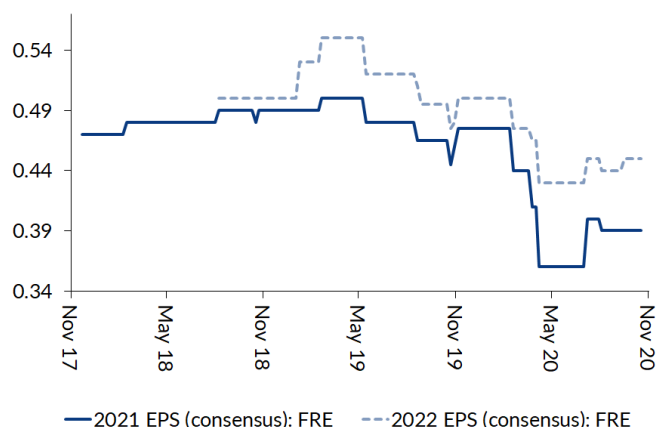
Source: NZX, Forsyth Barr analysis, NOTE: based on SPH notices only

**Figure 7. International valuation comparisons**

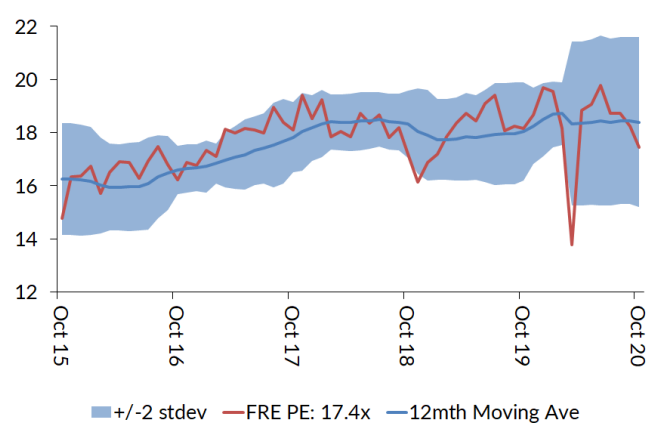
Company	Code	Price	Mkt Cap	PE		EV/EBITDA		EV/EBIT		Cash Yld
(metrics re-weighted to reflect FRE's balance date - June)										
			(m)	2021E	2022E	2021E	2022E	2021E	2022E	2022E
Freightways	FRE NZ	NZ\$8.40	NZ\$1,391	18.2x	16.1x	8.7x	8.1x	12.6x	11.5x	4.7%
MAINFREIGHT *	MFT NZ	NZ\$53.61	NZ\$5,398	29.1x	25.0x	12.1x	10.9x	19.6x	17.1x	1.6%
FEDEX CORP	FDX US	US\$261.48	US\$68,661	16.6x	15.0x	10.8x	10.0x	17.8x	16.1x	1.0%
UNITED PARCEL SERVICE-CL B	UPS US	US\$158.84	US\$137,139	20.8x	18.4x	14.5x	13.0x	19.5x	17.0x	2.7%
DEUTSCHE POST AG-REG	DPW GR	€38.12	€47,233	15.9x	14.2x	7.3x	6.8x	13.2x	11.7x	3.6%
ARAMEX PJSC	ARMX UH	AED3.95	AED5,783	17.2x	13.4x	7.2x	6.4x	10.4x	9.1x	4.2%
IRON MOUNTAIN INC	IRM US	US\$26.43	US\$7,616	21.7x	19.5x	12.4x	11.6x	25.0x	21.5x	9.4%
Compco Average:				20.2x	17.6x	10.7x	9.8x	17.6x	15.4x	3.8%
FRE Relative:				-10%	-9%	-19%	-17%	-28%	-25%	25%
EV = Current Market Cap + Actual Net Debt										

EV = Current Market Cap + Actual Net Debt

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

**Figure 8. Consensus EPS momentum (NZ\$)**


Source: Forsyth Barr analysis

**Figure 9. One year forward PE (x)**


Source: Forsyth Barr analysis

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