

Mainfreight

Ready, Fire, Aim; Upgrade to OUTPERFORM

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OUTPERFORM 

We upgrade Mainfreight (MFT) to OUTPERFORM from NEUTRAL given the opportunity to access a high quality New Zealand growth story with significant long term opportunities across its global platform, at a reasonable price. We acknowledge that MFT is exposed to cyclical risks, but these are often overstated by investors. The GFC showed that MFT (1) is adversely impacted by recessionary conditions, but not overly so given its focus on 'every day freight', and (2) that it can recover strongly. There is little balance sheet risk and uncommitted capex has been deferred. It is by no means cheap (it trades on a FY22 PE multiple of ~21x) and we acknowledge that the environment ahead is very uncertain and the range of potential near term outcomes is wide. However, its trading update covering the lead up to FY20 year end and the first week of April was surprisingly good. While one week of data can't be extrapolated, the impact of activity restrictions from lock-down and social distancing measures across MFT's markets, has had a mixed yet only modest impact on group revenues and has been helped by the weaker NZD. Near term challenges aside, MFT's competitive approach means share gains and cross-selling will remain key drivers.

NZX Code	MFT	Financials: Mar/	19A	20E	21E	22E	Valuation (x)	19A	20E	21E	22E
Share price	NZ\$34.20	NPAT* (NZ\$m)	141.1	156.8	127.3	167.0	EV/EBITDA	14.0	12.7	15.0	12.2
Target price	NZ\$37.50	EPS* (NZc)	140.1	155.7	126.4	165.8	EV/EBIT	17.7	15.9	19.6	15.2
Risk rating	Medium	EPS growth* (%)	25.7	11.2	-18.8	31.2	PE	24.4	22.0	27.1	20.6
Issued shares	100.7m	DPS (NZc)	56.0	50.0	50.0	66.3	Price / NTA	6.1	5.4	5.0	4.5
Market cap	NZ\$3,444m	Imputation (%)	100	100	100	100	Cash div yld (%)	1.6	1.5	1.5	1.9
Avg daily turnover	75.9k (NZ\$2,846k)	*Based on normalised profits					Gross div yld (%)	2.3	2.0	2.0	2.7

Uncertain outlook

The wide range of revenue outcomes for MFT regionally (NZ -40% year-on-year, Australia +9%, US and Europe both -8%, and Asia flat) during the first week of April against the prior year highlight the difficulty in having any degree of confidence in forecasting the remaining 51 weeks of FY21. Nonetheless, we assume that group revenue will decline by -4% over the year in NZD terms (-6% in constant currency terms). MFT will be at least partially able to offset the cyclical challenges with new customer wins and further cross-selling. The distressed nature of some competitors will provide opportunities, in our opinion.

Operating leverage and margin mix

MFT's cost base has a material degree of flex given the highly variable nature of its transport operations (both in-house, contractors and external third parties). We estimate around two thirds of its PBT (profit before tax) cost base is variable. In addition, we expect the company to variablise some fixed costs that will mitigate the pressure on earnings from lower revenues.

GFC illustration shows shallow trough and rapid recovery

MFT navigated the global financial crisis extremely well. The trough in profitability differed by market (between 2H09 and 1H10) but the overall recovery was rapid. FY11 earnings were above all prior years. MFT's ability to pick-up new customers to offset cyclical pressures, and variablise fixed costs, helped counter the earnings impact. Since the GFC, it has also increased its exposure to more defensive 'every day freight' sectors with a particular emphasis on food and beverages, and DIY.

Mainfreight Ltd (MFT)

 Priced as at 08 Apr 2020 (NZ\$) **34.20**

12-month target price (NZ\$)*	37.50
Expected share price return	9.6%
Net dividend yield	1.5%
Estimated 12-month return	11.2%

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

Spot valuations (NZ\$)	
1. DCF	33.44
2. PE relative	35.79
3. n/a	n/a

DCF valuation summary (NZ\$m)	
Total firm value	3,537
(Net debt)/cash	(170)
Less: Capitalised operating leases	0
Value of equity	3,367

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)	16.9	14.0	12.7	15.0	12.2
EV/EBIT (x)	21.7	17.7	15.9	19.6	15.2
PE (x)	30.7	24.4	22.0	27.1	20.6
Price/NTA (x)	7.9	6.1	5.4	5.0	4.5
Free cash flow yield (%)	2.1	2.7	1.1	2.5	4.0
Net dividend yield (%)	1.3	1.6	1.5	1.5	1.9
Gross dividend yield (%)	1.8	2.3	2.0	2.0	2.7

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

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

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

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

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

Operating Performance Revenue (NZ\$m)	2018A	2019A	2020E	2021E	2022E
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)	2018A	2019A	2020E	2021E	2022E
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

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

Upgrade to OUTPERFORM

We lower our target price for Mainfreight (MFT) to NZ\$37.50 to reflect earnings forecast reductions, partially offset by the time value of money, since our last update. Valuing any company impacted by COVID-19 is a challenge given the wide range of potential near and medium term outcomes. While the volume hit to COVID-19 is likely to be greatest during periods of government intervention (i.e. lock-down), we expect softer trading conditions to remain a feature once these are removed given economic headwinds. Thereafter we expect MFT to recover strongly – it's never one to miss an opportunity. We expect its rate of market share gains to continue through the downturn and potentially increase given the scope for distressed competitors that potentially fail or do not provide their customers with an adequate service. Consequently, we think one year forward valuation multiples are misleading and opt for a two year forward multiple in our peer comparable valuation approach.

Trading update surprisingly good

MFT's trading update highlights current top-line challenges across the group but also that the business remains profitable. In light of the extreme measures governments are taking around the world, the update was surprisingly good. Revenue growth for the first week of April was down -7% (constant currency -12%) with activity mixed by geography, albeit the company cautions that April trading will likely deteriorate. New Zealand has been hardest hit of its five regions given the strict national lock-down. In contrast, Australia has generated strong growth. Europe, the US and Asia are somewhere in between.

Cost measures have been implemented, but are not particularly radical relative to measures being employed by other corporates, reflecting its confidence that supply chains will resume back to some resemblance of normality relatively quickly.

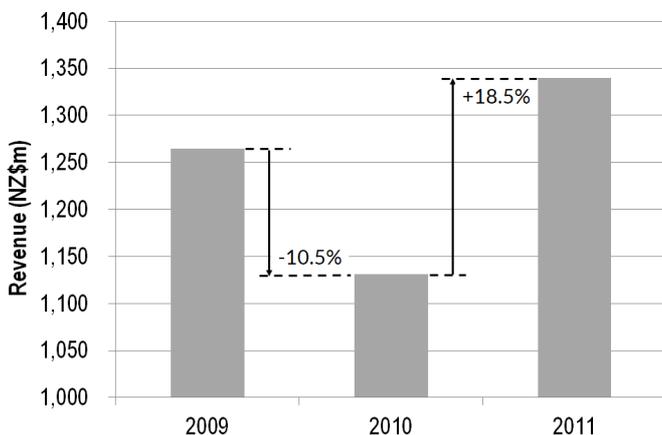
MFT is well placed to ride the COVID-19 downturn with its relatively healthy balance sheet and modest exposure to operating leases given a wide degree of property ownership. Net debt is NZ\$160m at March 2020. It has NZ\$230m of undrawn debt facilities and is deferring capex with only NZ\$78m committed in FY21.

What happened through the GFC?

While MFT was negatively impacted by the GFC (global financial crisis), the trough it endured in FY10 was modest and it grew strongly through the economic recovery that followed. Margin contraction was geographically limited (both New Zealand and Australian margins expanded at the trough) to the Americas and Asia.

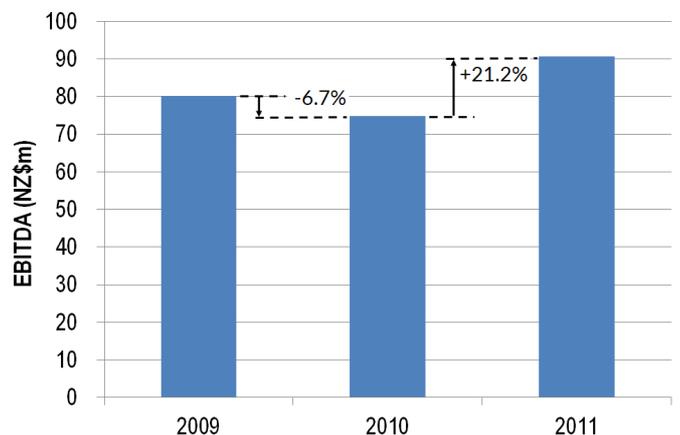
MFT's ability to respond to sudden changes in its operating environment is enhanced by two key factors; (1) its decentralised operating structure, with branch managers having the autonomy and experience to make quick decisions to protect branch profitability. (2) The quality of its timely performance data given the availability of weekly branch P&Ls.

Figure 1. Revenue decline during the GFC



Source: Forsyth Barr analysis

Figure 2. Revenue decline during the GFC



Source: Forsyth Barr analysis

Earnings revisions

We materially lower our earnings forecasts for FY21 and FY22 as summarised in Figure 3. We expect FY21 revenue to fall -4% (or -6% on a constant currency basis) and EBITDA to fall -15%.

We expect some operating deleverage in FY21, given (1) MFT's margin mix (NZ will likely see the largest revenue decline and generates the highest margins) and (2) its levels of maturity in key markets (in particular New Zealand), where it's less likely to be able to offset cyclical revenue pressures from market share gains. However, MFT's sector vertical exposures are now more defensive than during the GFC, given a concerted effort by management to increase its exposure to 'every day freight'.

We cut MFT's final FY20 dividend to 25c, the same amount as its interim dividend. This would follow the board's decision to cut its own remuneration (by -50%), and ensure shareholders are impacted along with other stakeholders.

Figure 3. Earnings revisions (NZ\$m)

	FY20E			FY21E			FY22E		
	Old	New	Chg	Old	New	Chg	Old	New	Chg
Sales revenue	3,148.1	3,130.5	-0.6%	3,380.8	3,004.7	-11.1%	3,632.4	3,348.9	-7.8%
EBITDA	283.7	282.2	-0.5%	310.0	240.1	-22.5%	338.8	294.3	-13.1%
Underlying NPAT	157.8	156.8	-0.6%	173.7	127.3	-26.7%	191.9	167.0	-13.0%
Underlying EPS	156.7	155.7	-0.6%	172.5	126.4	-26.7%	190.6	165.8	-13.0%
Full year DPS	62.7	50.0	-20.2%	69.0	50.0	-27.5%	76.2	66.3	-13.0%

Source: 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.

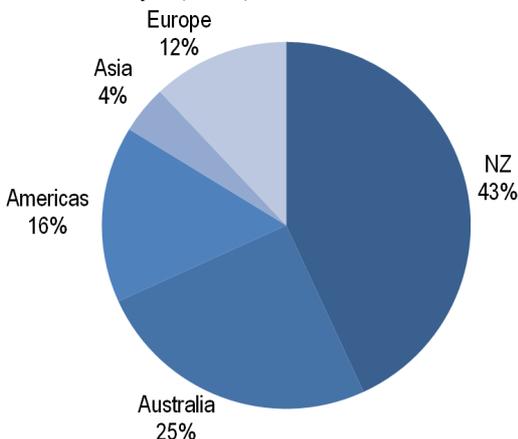
Financial structure

- **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

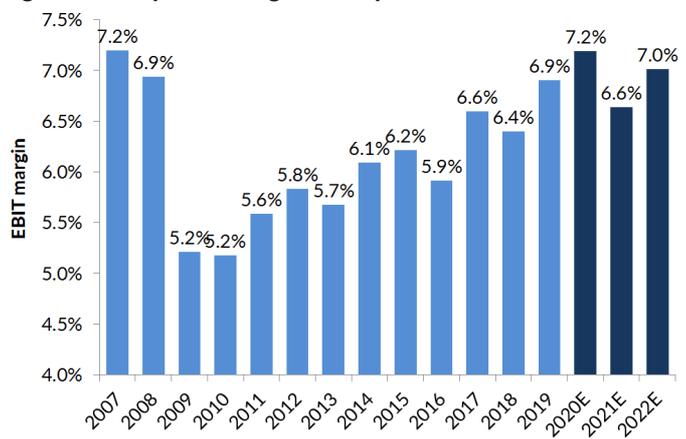
- **Acquisitions:** History suggests that MFT is not as good at due diligence as it is at operating a freight and logistics business.
- **Disruptive technology:** Freight forwarders leverage the inefficiencies in the freight supply chain. New technologies may lower supply chain costs, therefore, increasing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

Figure 4. EBITDA split (FY19)



Source: Forsyth Barr analysis

Figure 5. Group EBIT margin development



Source: Forsyth Barr analysis

Figure 1.

Price performance



Source: Forsyth Barr analysis

Figure 2.

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 3.

International valuation comparisons

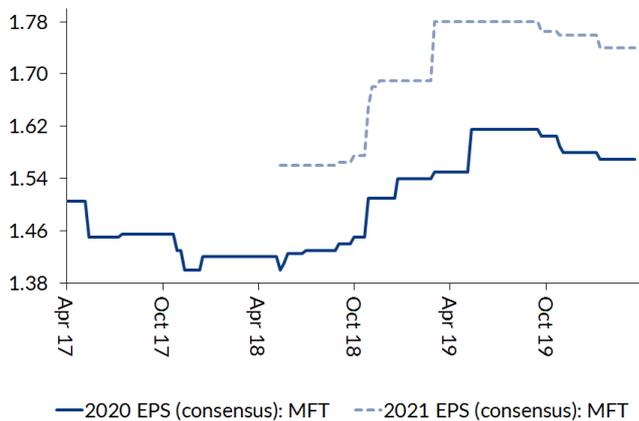
Company	Code	Price	Mkt Cap (m)	PE		EV/EBITDA		EV/EBIT		Cash Yld
(metrics re-weighted to reflect MFT's balance date - March)										
				2020E	2021E	2020E	2021E	2020E	2021E	2021E
Mainfreight	MFT NZ	NZ\$34.20	NZ\$3,444	22.0x	27.1x	12.6x	14.9x	15.8x	19.4x	1.5%
Freightways*	FRE NZ	NZ\$5.62	NZ\$874	17.2x	16.1x	8.0x	6.9x	11.3x	10.2x	4.7%
EXPEDITORS INTL WASH INC	EXPD US	US\$60.55	US\$10,210	17.7x	17.5x	10.7x	11.5x	12.2x	12.0x	1.7%
OLD DOMINION FREIGHT LINE	ODFL US	US\$179.86	US\$14,334	31.8x	21.1x	12.8x	12.1x	16.9x	15.8x	0.5%
DSV PANALPINA A/S	DSV DC	kr518.60	kr121,871	26.0x	19.5x	13.1x	11.1x	20.3x	17.0x	0.7%
C.H. ROBINSON WORLDWIDE INC	CHRW US	US\$64.04	US\$8,605	15.9x	17.4x	10.8x	12.3x	12.9x	14.3x	3.3%
KUEHNE + NAGEL INTLAG-REG	KNIN SW	CHF132.45	CHF15,894	19.9x	19.6x	9.5x	9.4x	16.2x	15.7x	4.7%
Compcpo Average:				21.4x	18.5x	10.8x	10.5x	15.0x	14.2x	2.6%
MFT Relative:				3%	46%	17%	41%	6%	37%	-43%

EV = Current Market Cap + Actual Net Debt

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

Figure 4.

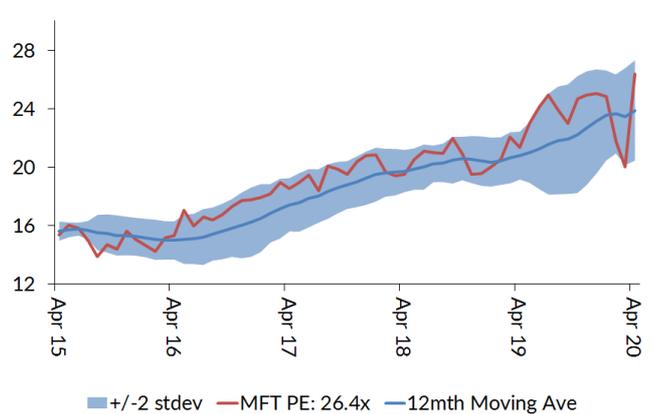
Consensus EPS momentum (NZ\$)



Source: Forsyth Barr analysis

Figure 5.

One year forward PE (x)



Source: Forsyth Barr analysis

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OUTPERFORM	NEUTRAL	UNDERPERFORM
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