Freightways

FREIGHTWAYS LIMITED

Full Year Report
June 2019

FULL YEAR REVIEW
From the Chairman and Chief Executive Officer

The Directors are pleased to present the consolidated financial results of Freightways Limited (Freightways) for the year ended 30 June 2019. This report discusses the results for each division and outlines the key strategies and the outlook for the year ahead.
Highlights of the year include:

- Overall year-on-year revenue, earnings and dividend growth.
- In the express package & business mail (EP&BM) division:
  - Completing a number of business-critical IT projects to enable our new Pricing For Effort initiative for residential deliveries;
  - Improving route density, in residential areas in particular, and using the benefits to reinvest into the contractor fleet, which resulted in an average increase in contractor earnings of 7% above the previous year, and
  - Expanding our business mail network to take on new customers and once again demonstrating growth year-on-year.
- In the information management (IM) division:
  - Improving utilisation in our Australian document storage footprint by 10% (from 61% to 67%). While this was short of our goal of 70%, it reflected a strong step forward in generating improved returns in our document storage business;
  - The completion of another large data collection/transformation contract win, supporting the growth of the division's suite of digital IM services, and
  - Strong growth in our secure destruction business, which is successfully diversifying into complementary waste streams which require efficient logistics and processing.
- Sustained strong cash generation from both divisions, leading to reduced gearing levels.

Operating performance
The below table presents the reported 2019 result compared to the prior comparative period (pcp), both before and after the inclusion of non-recurring items:

	Note	Jun-19 $M	Jun-18 $M	Increase %
Revenue		615.7	580.9	6.0%
EBITA, before non-recurring items	i.	96.7	93.7	3.2%
Non-recurring items		2.4	2.6	
EBITA	ii.	99.1	96.3	2.9%
NPAT, before non-recurring items	iii.	61.0	59.6	2.3%
Non-recurring items after tax		2.4	2.6	
NPAT	iv	63.4	62.2	1.9%
Basic EPS (cents), before non-recurring items		39.3	38.4	

Notes:
i. Operating profit before interest, tax and amortisation, before non-recurring items.
ii. Operating profit before interest, tax and amortisation.
iii. Net profit after tax (NPAT), before non-recurring items.
iv. Profit for the year attributable to shareholders.

The results discussed throughout this commentary exclude the impact of the following non-recurring items that the Directors believe should not be included when assessing underlying trading performance:

- 2019: Non-recurring benefits before tax totalling $2.4 million (no tax applicable) in respect of reversing $0.5 million of previously accrued acquisition payables that are no longer expected to be required and a $1.9 million gain upon recording the replacement of earthquake-related damaged racking funded by insurance proceeds.

- 2018: Non-recurring benefits before tax totalling $2.6 million (no tax applicable) in respect of reversing $1.6 million of a previously accrued final acquisition payable that is no longer expected to be required and a $1.0 million gain upon recording the replacement of earthquake-related damaged racking funded by insurance proceeds. The gain on the racking replacement arises from the insurance proceeds for new racking ($3.0 million) exceeding the $2.0 million written down book value of the structurally-compromised racking written-off.

Dividend
The Directors have declared a final dividend of 15.5 cents per share, fully imputed at a tax rate of 28%, being a 2% increase above the pcp final dividend of 15.25 cents per share. This represents a payout of approximately $24.1 million compared with $23.7 million for the pcp. The dividend will be paid on 1 October 2019. The record date for determination of entitlements to the dividend is 13 September 2019. The total dividend payout in respect of the year ended 30 June 2019 will be 30.5 cents, being 2.5% above the pcp of 29.75 cents.

The Dividend Reinvestment Plan (DRP) will not be offered in relation to this dividend. As a capital management tool, the application of the DRP will be reviewed for each future dividend.

DIVISIONAL PERFORMANCE
Divisional results for the year ended 30 June 2019 are provided below for each division.

Express Package & Business Mail (EP&BM) Division

2019 Result
Operating revenue of $453 million was 5.6% higher than the pcp. EBITA of $72.2 million was 6.3% higher than the pcp.

2019 was a year of two halves with respect to organic growth levels within the EP&BM division. The first half was characterised by solid organic growth (circa 2.5%), whereas same-customer volume flattened off noticeably in the second half of the year. Some hard calls were also made on low margin business during the year, with pricing reviews for customers where margins were unacceptably low for the value provided through our networks. The results were pleasing for the year when these factors, alongside material contractor earnings and wage increases, were also taken into account. Freightways has consistently paid above minimum wage in its freight sorting operations and to ensure it continues to do so, wages were lifted at the lower levels by around 6% to maintain that premium. Volume growth, and consequently revenue and earnings, were stronger in the first half of the year than the second half.

Freightways' small postal business, DX Mail, has come under direct attack from NZ Post's new zonal pricing structure for bulk mail, which effectively offers the cheapest rates to those areas that DX Mail delivers into, and more expensive rates to those areas where DX Mail does not deliver. Freightways is assisting the NZ Commerce Commission with its preliminary investigation into NZ Post's pricing tactics. DataPrint, Freightways' mailhouse business, expanded its range of services during the year and is well positioned to help customers transition to digital communications augmented by high quality physical delivery through DX Mail.

The EP&BM division delivered a sound full year result, and has positioned itself well to avoid the pitfalls of many express package operators that appear to have thrown themselves into residential deliveries at what we view as unsustainably low margins. Freightways is confident that its brands will be able to provide higher quality delivery services to residential areas, sustainable courier remuneration and ultimately generate returns from the growing B2C market.

Key Strategies in 2020

Pricing for Effort: Differential pricing was introduced from 1 July 2019 for items travelling to residential addresses as the first of a two-step process to generate higher remuneration for couriers performing residential deliveries and to begin to recover the higher costs associated with low density deliveries. This strategy has been enabled by significant investment in geo-mapping and coding of addresses as either business, residential or rural, as well as the introduction of systems to enable billing for residential delivery. As this strategy unfolds, Freightways expects to achieve a higher quality final mile delivery, with couriers earning superior returns for their efforts and Freightways' brands also generating positive margins. This will motivate the EP&BM division to invest further into service quality initiatives for the growing residential delivery sector.

Residential Network Review: In 2019 good progress was made to better collaborate across the courier brands to improve the division's delivery efficiency in residential areas. This strategy has now become business-as-usual, with the use of a number of analytical tools to continually monitor and evolve residential runs so as to drive better productivity and lower direct costs for couriers through the need to travel fewer kilometres each day.

Customer Visibility and Data Analytics: New scanning technology was rolled-out during 2019 which positions the business well to provide value-added services to customers and receivers by improving visibility and ultimately the final-mile delivery experience.

Information Management (IM) Division

2019 Result
Operating revenue of $164.5 million was 6.9% higher than the pcp. EBITA of $29.3 million was 1.9% lower than the pcp.

While utilisation of facilities improved in Australia and New Zealand, the margins generated from data transformation were slightly lower. In 2019, the Shred-X business invested in growing its fleets through New South Wales, Victoria and Queensland in response to demand from medical waste and product destruction customers. Shred-X also incurred transition costs while merging its Western Australia site with a recently-acquired document destruction business. This business was fully integrated by May 2019.

Australian IM annual earnings marginally exceeded those of New Zealand IM for the first time in 2019. Given the larger scale of the Australian market, and the broader range of opportunities, including in the medical waste industry, it is expected that Australia will widen its lead on New Zealand's earnings into the future.

Key Strategies in 2020:
Facility Utilisation: Despite solid growth in the Australian IM facilities, there were a number of new customers secured that had not transitioned their volume into TIMG (The Information Management Group) by the end of the financial year, meaning the division fell 3% short of its 70% utilisation target. The focus for 2020 is to on-board and maintain double digit revenue growth in this line of business.

Digital Services Growth: In Australia, TIMG will focus on its capability with respect to large digitalisation jobs. In 2019, it completed a significant job which required data extraction, electronic discovery and delivery of data within tight timeframes (mirroring the capability used for the NZ Census by the NZ TIMG business in 2018). There are scale opportunities in the Australian market for quality providers of digitalisation and e-discovery services.

Secure Destruction and Medical Waste: Additional investment was made in teams, fleets and facilities in 2019 to support the growth of Shred-X's document destruction, medical waste and product processing capabilities. It is planned to continue the investment and management focus on revenue streams in related markets that complement the physical footprint established by Shred-X in the secure destruction market. These related markets present an opportunity to apply Shred-X's consistent and high-quality national service standards and sales methodologies to grow through a number of niches, including eDestruction, medical waste, product destruction and other high value recycling.

Acquisitions and Alliances:
Freightways continues to actively explore and investigate acquisition and alliance opportunities for synergistic and complementary service offerings. Freightways completed three small acquisitions early in the 2019 financial year and these have been successfully integrated into the Australian IM division. The businesses acquired included a records storage business, a secure destruction business and a majority stake in the software company that provides the online back-up service for TIMG's customers.

Corporate
Corporate costs increased by $0.7 million compared to the pcp, primarily due to the reclassification of certain managers from the divisions into newly-created corporate roles, but also as a result of an uplift in consulting costs relating to internal audit, external reporting and ESG initiatives.

Net debt decreased by approximately $3 million to $151 million during the year, driven by strong cash flows from operations, offsetting investment in operating capacity and a number of small acquisitions. Debt to debt & equity gearing levels have decreased further below 40%.

OUTLOOK

Freightways has observed a slowdown in New Zealand in terms of same-customer trade over the second half of 2019 in its express package businesses. Despite this headwind, management remains optimistic that pricing and efficiency initiatives in express package and Freightways' diversification strategy in information management will provide growth opportunities in 2020. Freightways is once again targeting year-on-year earnings growth in 2020.

Within the EP&BM division, indications are that organic volume growth will be lower in 2020 than it was in 2019. There will be a strong focus on maintaining and improving margins, along with improving visibility to customers and receivers for express package deliveries. Focus on continuing to build courier remuneration through intensification of their runs and improved residential delivery pricing will also be a priority.

Within the IM division, there will be a continued drive on expanding storage and handling margins through improved facility utilisation. Leveraging digital capability to attract new customers will also be a key platform for growth in 2020. Within the secure destruction business, the division will look to leverage the networks it has invested in to provide medical waste and product destruction services to both new and existing customers.

Overall capital expenditure for the 2020 financial year is expected to be between $22-24 million. Operating cash flows are expected to remain strong throughout 2020.

Strategic growth opportunities, including acquisitions and alliances that are synergistic or complementary to our existing capabilities, will be executed where they make commercial sense.

CONCLUSION

Freightways has continued to innovate and invest in its businesses to achieve market-leading service quality and return on investment. The results for 2019 were impacted in the latter half of the year by modest to flat organic growth as the New Zealand economy slowed. Despite these headwinds, Freightways expects to continue to demonstrate its long-held disciplines in terms of managing margins, investing appropriately for growth and exploring new service opportunities. There are opportunities for all of the group's business activities to continue to grow and evolve their service offerings to meet customers' demands. Freightways' agility and entrepreneurial outlook should see it continue to adapt to changing markets and conditions and continue to be resilient in the face of external factors. Freightways is committed to improving the long-term sustainability of its business for the benefit of its teams of people, its customers, its shareholders and the environments in which it operates.

The Directors acknowledge the outstanding work and ongoing dedication of the Freightways teams of people throughout New Zealand and Australia.

Mark Verbiest	**Mark Troughear**
Chairman	**Chief Executive Officer**

26 August 2019

FREIGHTWAYS LIMITED
CONSOLIDATED INCOME STATEMENT
for the year ended 30 June 2019

	2019 $000	2018 $000	Percentage Variance
Operating revenue	**615,692**	**580,886**	**6%**
Other income	1,252	2,572	(51%)
Transport and logistics expenses	(241,907)	(229,812)	5%
Employee benefits expenses	(174,537)	(159,161)	10%
Occupancy expenses	(28,912)	(26,385)	10%
General and administration expenses	(58,119)	(57,798)	1%
Other expenses	(1,252)	(2,572)	(51%)
Non-recurring items	2,354	2,556	(8%)
Operating profit before interest, income tax, depreciation and software amortisation and amortisation of intangibles	**114,571**	**110,286**	**4%**
Depreciation and software amortisation	(15,438)	(14,000)	10%
Operating profit before interest, income tax and amortisation of intangibles	**99,133**	**96,286**	**3%**
Amortisation of intangibles	(2,071)	(1,954)	6%
Profit before interest and income tax	**97,062**	**94,332**	**3%**
Net interest and finance costs	(9,566)	(9,666)	(1%)
Profit before income tax	**87,496**	**84,666**	**3%**
Income tax	(24,119)	(22,505)	7%
Profit for the year	**63,377**	**62,161**	**2%**
Profit for the year is attributable to:			
Owners of the parent	63,367	62,161	2%
Non-controlling interests	10	-	100%
	63,377	**62,161**	**2%**

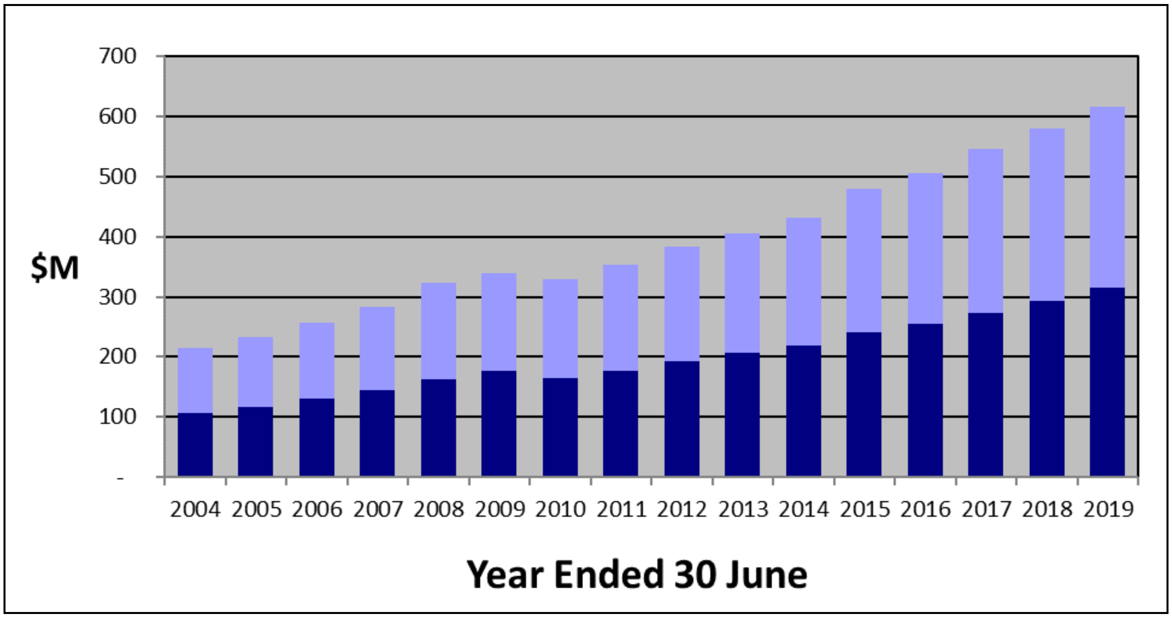
FREIGHTWAYS LIMITED
CONSOLIDATED BALANCE SHEET
as at 30 June 2019

	2019 $000	2018 $000
Current assets		
Cash and cash equivalents	15,986	7,410
Trade and other receivables	87,805	82,150
Inventories	5,009	4,804
Total current assets	**108,800**	**94,364**
Non-current assets		
Trade receivables and other non-current assets	3,984	4,803
Property, plant and equipment	106,710	103,102
Intangible assets	365,152	358,419
Total non-current assets	**475,846**	**466,324**
Total assets	**584,646**	**560,688**
Current liabilities		
Trade and other payables	68,967	66,887
Finance lease liabilities	127	126
Income tax payable	6,429	5,525
Provisions	860	710
Derivative financial instruments	880	451
Contract liability	15,664	15,864
Total current liabilities	**92,927**	**89,563**
Non-current liabilities		
Trade and other payables	3,137	3,446
Borrowings (secured)	167,394	161,800
Deferred tax liability	37,762	37,506
Provisions	4,750	4,465
Finance lease liabilities	129	286
Derivative financial instruments	4,537	5,399
Total non-current liabilities	**217,709**	**212,902**
Total liabilities	**310,636**	**302,465**
NET ASSETS	**274,010**	**258,223**
EQUITY		
Contributed equity	126,440	125,260
Retained earnings	157,226	140,861
Cash flow hedge reserve	(3,901)	(4,229)
Foreign currency translation reserve	(5,879)	(3,669)
	273,886	258,223
Non-controlling interests	124	-
TOTAL EQUITY	**274,010**	**258,223**

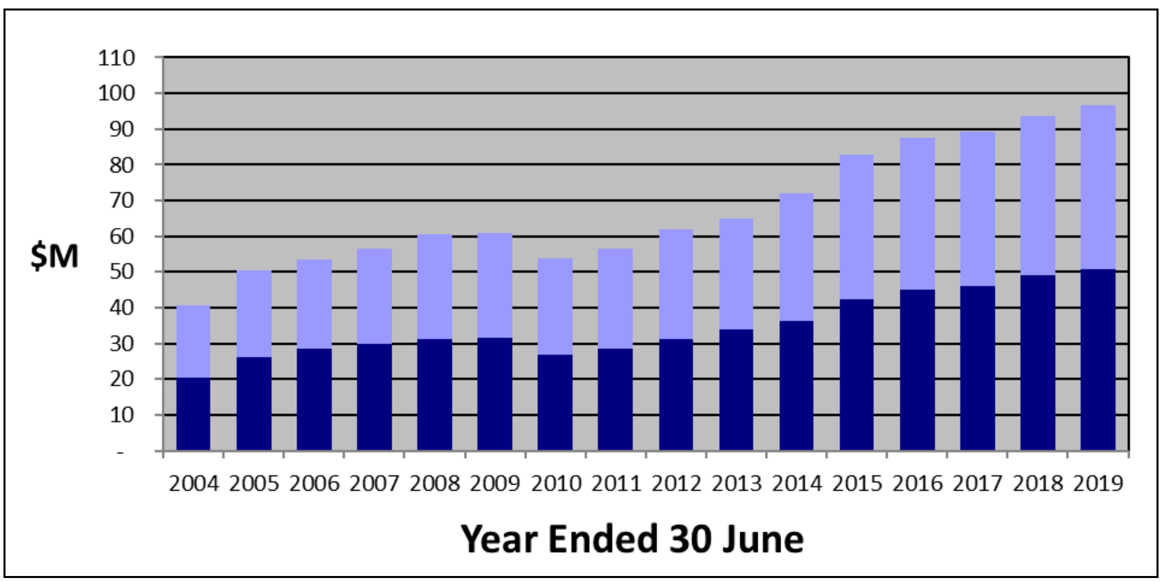
FREIGHTWAYS LIMITED
CONSOLIDATED STATEMENT OF CASH FLOWS
for the year ended 30 June 2019

	2019 $000 Inflows (Outflows)	2018 $000 Inflows (Outflows)
Cash flows from operating activities		
Receipts from customers	609,744	575,864
Payments to suppliers and employees	(501,203)	(471,175)
Cash generated from operations	**108,541**	**104,689**
Interest received	137	182
Interest and other costs of finance paid	(9,379)	(9,710)
Income taxes paid	(23,292)	(19,451)
Net cash inflows from operating activities	**76,007**	**75,710**
Cash flows from investing activities		
Payments for property, plant and equipment	(16,844)	(14,062)
Payments for software	(6,429)	(4,343)
Proceeds from disposal of property, plant and equipment	2,450	1,160
Payments for businesses acquired (net of cash acquired)	(11,111)	(7,865)
Receipts from joint venture	2,478	464
Cash flows from other investing activities	(470)	(218)
Net cash outflows from investing activities	**(29,926)**	**(24,864)**
Cash flows from financing activities		
Dividends paid	(47,002)	(45,372)
Increase (decrease) in bank borrowings	9,512	(7,521)
Proceeds from issue of ordinary shares	748	704
Finance lease liabilities repaid	(91)	(114)
Net cash outflows from financing activities	**(36,833)**	**(52,303)**
Net increase (decrease) in cash and cash equivalents	9,248	(1,457)
Cash and cash equivalents at beginning of year	7,410	8,423
Exchange rate adjustments	(672)	444
Cash and cash equivalents at end of year	**15,986**	**7,410**

Freightways Operating Revenue



Freightways EBITA*



* This EBITA graph represents the operating results of the company, exclusive of any non-recurring items.

1st half 2nd half