Freightways

FREIGHTWAYS LIMITED

Half Year Report
December 2018

HALF 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 six months ended 31 December 2018. This report discusses the results, reviews the operations of each division and provides an outlook for the year ahead.

Highlights of the half year include:

- Overall year-on-year revenue, earnings and dividend growth
- In the express package & business mail (EP&BM) division:
  - Strong revenue and volume growth;
  - Productivity gains through improving the number of items per courier delivered in residential areas, and
  - Development of IT capability to enable 'pricing for effort' initiatives to be implemented
- In the information management (IM) division:
  - Three further acquisitions;
  - Pleasing progress in improving utilisation in the Australian storage footprint:
  - A major data digitisation contract win at the end of the half year, and
  - Solid growth in both secure destruction and medical waste revenue in Australia.
- Sustained cash generation from both divisions, maintaining debt headroom to pursue further growth initiatives and acquisitions.

Operating performance

The below table presents the reported half year result compared to the pcp, both before and after the inclusion of non-recurring items that were reported in the pcp:

	Note	Dec-18 $M	Dec-17 $M	Increase %
Revenue		314.8	292.1	7.7%
EBITA, before non-recurring items	i.	50.7	49.2	3.0%
Non-recurring items		1.4	-	
EBITA	ii.	52.1	49.2	5.8%
NPAT, before non-recurring items	iii.	32.0	31.4	2.0%
Non-recurring items after tax		1.4	-	
NPAT	iv	33.4	31.4	6.3%
Basic EPS (cents), before non-recurring items		20.6	20.3	

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 half year attributable to shareholders.

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

- 2018: Non-recurring benefit before tax totalling $1.4 million (no tax applicable) in respect of the gain arising during the half year upon the progressive recording of the replacement of earthquake-related damaged racking funded by insurance proceeds. A gain on the racking replacement arises because the overall insurance proceeds for new racking will exceed the written down book value of the structurally-compromised racking written-off.

Dividend

The Directors have declared an interim dividend of 15 cents per share, fully imputed at a tax rate of 28%, being a 3% increase above the pcp interim dividend of 14.5 cents per share. This represents a payout of approximately $23.3 million compared with $22.5 million for the pcp. The dividend will be paid on 1 April 2019. The record date for determination of entitlements to the dividend is 15 March 2019.

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.

REVIEW OF OPERATIONS

Divisional results for the half year ended 31 December 2018 are provided below for the EP&BM division and the IM division.

Express Package & Business Mail Division

The EP&BM division operates a multi-brand strategy in the domestic market through New Zealand Couriers, Post Haste, Castle Parcels, NOW Couriers, SUB60, Security Express, Kiwi Express, Stuck, Pass The Parcel, DX Mail and Dataprint.

Operating revenue of $233.5 million was 7.8% higher than the pcp. EBITA of $38.6 million was 6.1% higher than the pcp.

Strong revenue growth in the first half was driven by a combination of organic growth in volumes from existing customers, which largely tracked as it had done in the financial year ended 30 June 2018 (FY18), market share gains and improved pricing. The ParcelAir Limited joint venture, that provides Freightways' airfreight capacity, leased a 4th Boeing 737 and operated it as part of the network from November until the end of December to assist with peak volumes. This aircraft will become a permanent fixture in the network in FY20, but is not expected to result in any material increase in operating costs for Freightways. Labour costs stepped-up throughout the half year as a result of the tight labour market and planned increases to wage rates.

Freightways' smaller postal businesses, DX Mail and Dataprint, grew combined revenue in the half. DX Mail lifted its EBITA by over 7% compared to the pcp while expanding its network, however Dataprint's earnings were down on the pcp as customers continued the shift from physical mail to digital communications.

The EP&BM division delivered a sound half year result, while positioning itself well to implement its B2C strategies.

Key Strategies in 2019

Residential Network Review: The programme of residential network intensification resulted in 28 fewer courier runs by December. Given higher volumes than the pcp and fewer courier runs, our productivity increased as a result. An exercise using advanced data analytics will take place in the second half of FY19 to assess further opportunities for improved delivery efficiency and increased contractor earnings. This initiative is expected to have a positive impact on a number of Freightways' environmental, social & governance (ESG) initiatives, including, ongoing strategies to improve courier earnings & service levels, as well as reducing carbon emissions.

Pricing for Effort: The strategy to appropriately price B2C express package (EP) services to ensure both the company and its contractors are motivated to facilitate profitable e-commerce revenue growth is being actively pursued. The EP brands have been testing the pricing approach with both new and existing business customers during the half year and are now rolling the programme out to all new business opportunities and it will form part of our 2019 uprates in July this year. It is expected e-commerce will continue to drive increased volumes to Freightways year on year and the group is committed to ensuring this growth is both profitable and sustainable and that the B2C services provided meet customers' expectations.

Visibility and Data Analytics: New scanning technology for the EP businesses was successfully piloted in November and December and will be rolled out for the wider courier fleets over the remainder of the financial year. The technology enables improved visibility for customers and their receivers. This will complement improved reporting capabilities which will allow the EP teams to better analyse every aspect of their operations so as to help deliver improved efficiency, profit margins and service standards.

Information Management Division

This division operates under the brands of The Information Management Group (TIMG), Shred-X and, following the recent acquisition of a business in the Medical Waste industry, Med-X.

Operating revenue of $82.2 million was 7.6% higher than the pcp. EBITA of $14.7 million was 0.5% higher than the pcp.

Compared to the pcp, revenue growth was achieved by all businesses within this division. A number of additional costs relating to acquisitions and an increase in sales, marketing and IT labour were incurred during the period. Utilisation of IM facilities across New Zealand and Australia continued to improve as storage volumes increased. Secure destruction revenues increased across the suite of paper grades sold, eDestruction and medical waste services. Approximately 10% of IM revenues are now generated by digital services, of which some are annuity services, and some are project-based. Growth in these digital services, while at an early stage of development, has been positive and in 2019 has been boosted by the winning of a large data collection & digital transformation project in Australia.

TIMG's Porirua document storage facility, that was damaged in the North Canterbury earthquake, has now had its racking fully replaced. This was a significant project completed by the business during December 2018 and was accomplished on time and with no disruption to customer service. Freightways carries comprehensive insurance for events such as this. The $2 million write-off of the written down book value of the structurally-compromised racking in the division's FY18 result and its progressive replacement with new racking since have been funded by insurance proceeds received during the project, resulting in a non-recurring accounting gain of $1 million in the FY18 result and a further $1.4 million in this half year result. These gains have been disclosed as non-recurring items in the respective income statements.

Key Strategies in 2019:
Facility Utilisation: Utilisation of IM facilities in Australia has improved steadily throughout the half year and is on track for 70% by the end of the financial year, despite taking on a small additional warehouse in Queensland. This improvement has been achieved through an equal mix of market share gains and organic growth in the volume of records stored by existing customers.

Digital Services Growth: The increased investment in sales & marketing is beginning to pay off, with a number of new digital opportunities won toward the end of the period. Growing the division's existing digital services and exploring opportunities for adjacent digital offerings will continue to be a focus for the business in 2019.

Secure Destruction and Medical Waste: These markets present an opportunity to apply Shred-X's consistent and high-quality national service standards and sales methodologies to grow in a number of adjacent niche markets. The business has demonstrated particularly strong revenue growth in all lines of business during the half year. Growth has been generated from a number of smaller bolt-on acquisitions completed at the beginning of the half year, as well as through new business acquired in the 2nd quarter. Management will continue to focus on both the integration of these acquisitions, as well as closing additional opportunities in the pipeline.

Acquisitions and Alliances: Freightways will continue to explore and investigate acquisition and alliance opportunities for both current and future complementary service offerings.

Freightways is pleased to announce the recent acquisition of a number of small businesses in Australia that operate in the IM and Medical Waste industries. Three businesses were acquired early in the half year for a total of $10.3 million. These businesses are expected to be contributing annualised EBITDA of $1.6 million by the end of the financial year, as the businesses become fully integrated. Related capital expenditure will be approximately $0.5 million. These acquisitions will be immediately EPS positive.

Corporate

Corporate costs increased by $0.8 million compared to the pcp, primarily due to the reclassification of certain managers from the divisions into newly-created corporate roles, in addition to an uplift in consulting costs relating to internal audit, external reporting and ESG initiatives.

Net debt increased by approximately $9 million to $163 million during the year. While cash flows from operations remained strong and adequately covered all planned expenditures, an additional $10 million was invested in three small acquisitions. Freightways continues to have excellent support from its lenders and sufficient headroom in facilities and gearing levels to continue actively pursuing its solid pipeline of acquisition opportunities.

OUTLOOK

The markets in which Freightways operates in both New Zealand and Australia continue to remain positive, albeit the company will continue to closely monitor indicators for any adverse changes in economic activity in New Zealand, in particular. Growth opportunities leveraging the current customer base and through acquisitions exist in both New Zealand and Australia and will be actively pursued. Subject to factors beyond its control, Freightways is once again targeting year-on-year earnings growth for the full year.

Within the EP&BM division, the company expects that its strategies to better align price and efficiency will gain further traction, particularly in the faster-growing B2C market. The inflationary cost of operating in a tight labour market, along with a generally higher cost of doing business, is expected to be offset by increased pricing, including pricing related to higher fuel costs. Freightways will continue to monitor employment law reform.

Within the IM division, increased utilisation of existing capacity will continue to be a key focus. Freightways is encouraged by recent digital services wins and will continue to invest in this capability. The group's entry into the Medical Waste industry has tracked to expectation, with a presence now in both New South Wales and Victoria.

Overall capital expenditure for the 2019 financial year is still expected to be in the range of $20-22 million. Operating cash flows are expected to remain strong throughout 2019.

CONCLUSION

Freightways has continued to invest in the future of both divisions, while returning a sound result for the first half of the 2019 financial year. The key EP&BM strategies are critical to generating both growth and improved returns from the growing B2C sector. In Information Management, the group will continue to grow scale in existing revenue lines and will be alert to new opportunities which can leverage the group's existing customer relationships and core competencies. 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
Chairman

Mark Troughear
Chief Executive Officer

25 February 2019

FREIGHTWAYS LIMITED
CONSOLIDATED INCOME STATEMENT
for the half year ended 31 December 2018 (unaudited)

	6 mths ended 31 Dec 2018 $000	**6 mths ended 31 Dec 2017 $000**	**Variance %**
Operating revenue	**314,769**	**292,133**	**8%**
Other income	1,194	2,913	(59%)
Transport and logistics expenses	(125,990)	(115,158)	9%
Employee benefits expenses	(83,982)	(79,233)	6%
Occupancy expenses	(14,403)	(13,124)	10%
General and administrative expenses	(32,174)	(28,490)	13%
Other expenses	(1,194)	(2,913)	(59%)
Non-recurring items	1,373	-	-
Operating profit before interest, income tax, depreciation and software amortisation and amortisation of intangibles	**59,593**	**56,128**	**6%**
Depreciation and software amortisation	(7,492)	(6,895)	9%
Operating profit before interest, income tax and amortisation of intangibles	**52,101**	**49,233**	**6%**
Amortisation of intangibles	(1,004)	(979)	3%
Operating profit before interest and income tax	**51,097**	**48,254**	**6%**
Net interest and finance costs	(5,009)	(5,127)	(2%)
Profit before income tax	**46,088**	**43,127**	**7%**
Income tax	(12,686)	(11,718)	8%
Profit for the period attributable to shareholders	**33,402**	**31,409**	**6%**

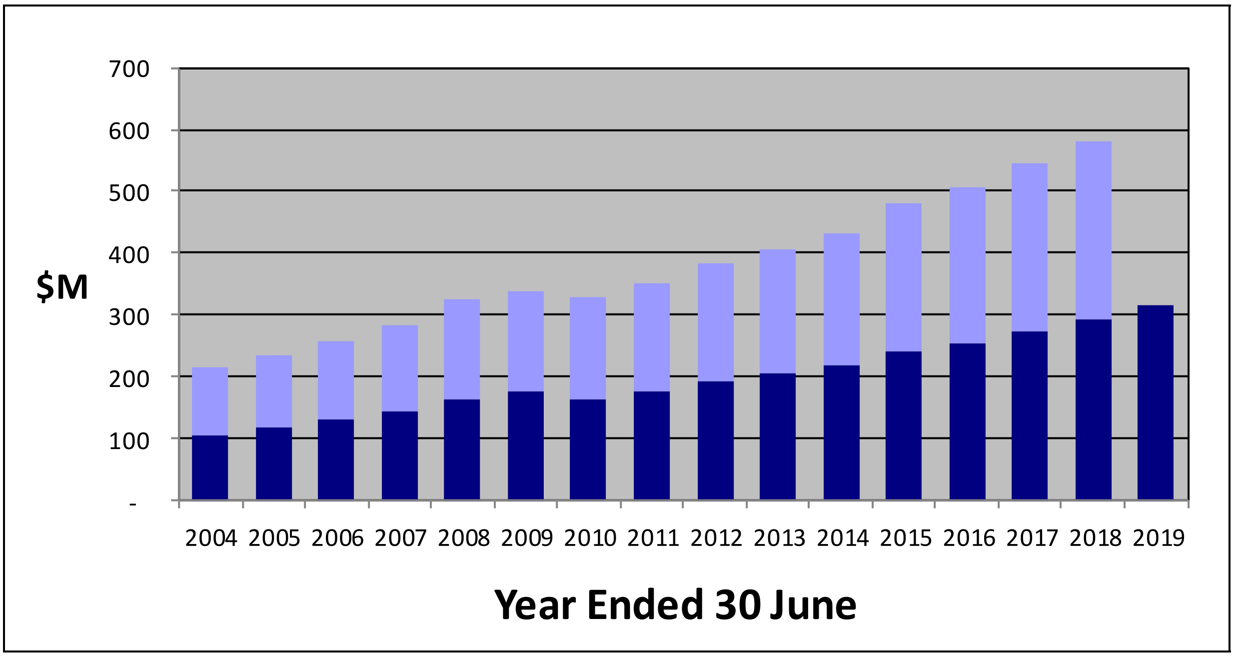
FREIGHTWAYS LIMITED
CONSOLIDATED BALANCE SHEET
as at 31 December 2018 (unaudited)

	As at 31 Dec 2018 $000	As at 31 Dec 2017 $000
ASSETS		
Current assets		
Cash and cash equivalents	3,441	10,450
Trade and other receivables	95,199	89,234
Inventories	5,327	4,848
Income tax receivable	-	657
Total current assets	**103,967**	**105,189**
Non-current assets		
Trade receivables and other non-current assets	3,390	2,158
Property, plant and equipment	106,531	103,002
Intangible assets	363,532	357,817
Total non-current assets	**473,453**	**462,977**
Total assets	**577,420**	**568,166**
LIABILITIES		
Current liabilities		
Trade and other payables	72,718	71,878
Finance lease liabilities	119	118
Income tax payable	3,687	1,791
Provisions	745	795
Derivative financial instruments	617	1,343
Unearned income	15,548	15,633
Total current liabilities	**93,434**	**91,558**
Non-current liabilities		
Trade and other payables	3,201	4,887
Borrowings (secured)	166,487	175,778
Deferred tax liability	37,394	36,168
Provisions	4,720	4,268
Finance lease liabilities	208	142
Derivative financial instruments	4,806	6,308
Total non-current liabilities	**216,816**	**227,551**
Total liabilities	**310,250**	**319,109**
NET ASSETS	**267,170**	**249,057**
EQUITY		
Contributed equity	126,440	125,110
Retained earnings	150,568	132,601
Cash flow hedge reserve	(3,905)	(5,484)
Foreign currency translation reserve	(6,042)	(3,170)
	267,061	249,057
Non-controlling interests	109	-
TOTAL EQUITY	**267,170**	**249,057**

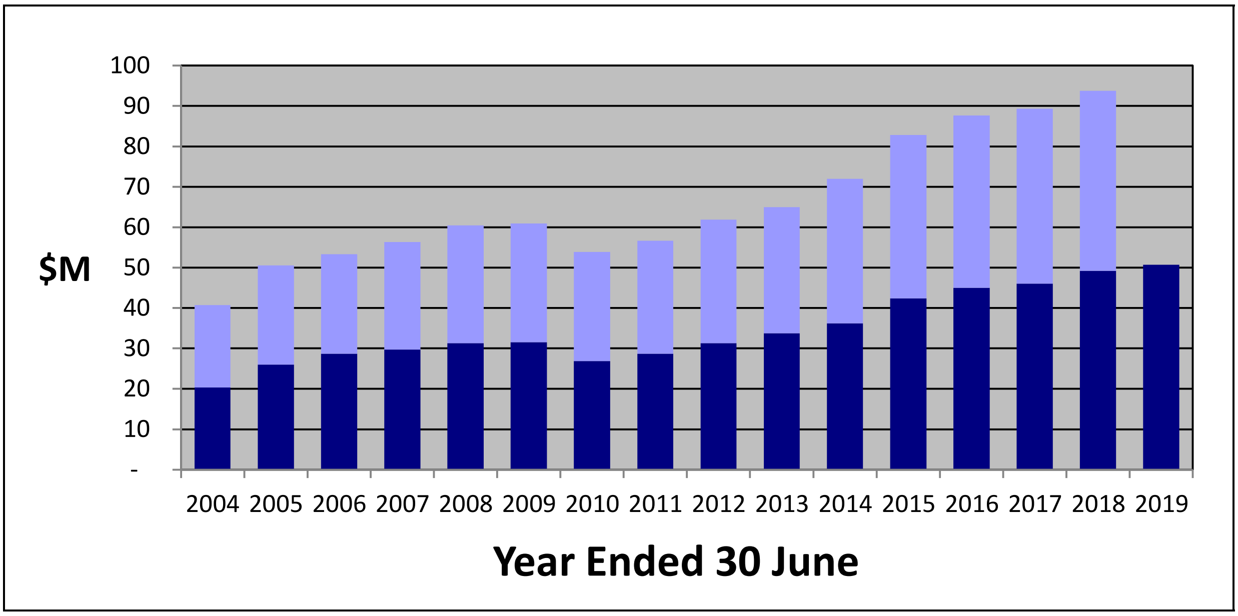
FREIGHTWAYS LIMITED
CONSOLIDATED STATEMENT OF CASH FLOWS
for the half year ended 31 December 2018 (unaudited)

	6 mths ended 31 Dec 2018 $000	6 mths ended 31 Dec 2017 $000
	Inflows (Outflows)	**Inflows (Outflows)**
Cash flows from operating activities		
Receipts from customers	304,469	284,333
Payments to suppliers and employees	(252,636)	(230,720)
Cash generated from operations	**51,833**	**53,613**
Interest received	51	41
Interest and other costs of finance paid	(4,610)	(5,002)
Income taxes paid	(14,925)	(13,831)
Net cash inflows from operating activities	**32,349**	**34,821**
Cash flows from investing activities		
Payments for property, plant & equipment	(10,199)	(7,402)
Payments for software	(1,972)	(2,953)
Proceeds from disposal of property, plant & equipment	507	33
Payments for businesses acquired (net of cash acquired)	(10,516)	(5,374)
Receipts from associate	1,709	-
Payments for other investing activities	(204)	(203)
Net cash outflows from investing activities	**(20,675)**	**(15,899)**
Cash flows from financing activities		
Dividends paid	(23,695)	(22,880)
Increase in bank borrowings	8,193	5,594
Proceeds from issue of ordinary shares	390	330
Finance lease liabilities repaid	(68)	(93)
Net cash outflows from financing activities	**(15,180)**	**(17,049)**
Net increase in cash and cash equivalents	(3,506)	1,873
Cash and cash equivalents at the beginning of the period	7,410	8,423
Exchange rate adjustments	(463)	154
Cash and cash equivalents at the end of the period	**3,441**	**10,450**

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