

McEwen 547

INVESTMENT REPORT

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The active investors advantage

Why Mainfreight will move the world

I don't remember writing it but once upon a time I expressed doubt that Mainfreight (MFT) would ever achieve its stated objective of generating over \$1b in revenues.

I may have forgotten but the logistics company's long-serving CEO Don Braid hasn't, and it was the first thing he reminded me of when I visited the company a few days ago.

The reason for his satisfaction is that MFT produced revenue of \$1.26b for the 12 months to 31 March, up an impressive 39% on the previous year's \$911m and double what it achieved five years ago.

Revenue was boosted by a significant acquisition in the US and by moving to 100% ownership of its Asian operation.

Its bottom line has not matched revenue growth, with EBIT from continuing operations down to \$60.4m from \$63.7m in the previous year (although this is a pretty good result given the state of the world economy in the past

year).

Normalised EPS was 41c, down from 42.6c in the previous year.

It is interesting to note MFT's profit from NZ operations was up strongly for the year, which means its offshore operations (the bulk of its revenues these days) are the ones feeling the pressure.

But much more interesting than the bare numbers is what sort of company Mainfreight is.

It has the most remarkable corporate culture I have ever come across.

It has more than 3,000 staff in 165 branches across four countries but no job descriptions. Despite having grown to over \$1 billion a year in revenue, it does not have a budget or a strategic plan.

This approach stems directly from co-founder Bruce Plested in 1978 (with \$2700 and a 1969 Bedford truck).

A working man rather than a profes-

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The Big Picture

The share markets are said to anticipate the economy by several months and recent statistics seem to be vindicating the second quarter rebound in markets.

Retail sales are picking up in many countries, property prices are stabilising and interest rates are bottoming. Some countries which were officially in recession have now exited that unhappy position and GDP growth is now anticipated for the future, albeit relatively muted.

Despite this, if history is any guide, the market rally is likely to run out of steam soon, according to UK company Capital Economics.

It notes it is commonplace to see a substantial re-rating of the stock market both prior to, and at the outset of, economic recovery. Looking back at downturns over the past 80 years or so, the S&P 500 index had risen by an average of 20% from its low point by the time recession had officially ended. In the following six months the market moved up on average by a further 16%.

But that has tended to be as good as it gets. On average, gains in the second six months of an economic recovery have been paltry. In the past 15 US recessions, the market rose on average by just 2% during this second phase.

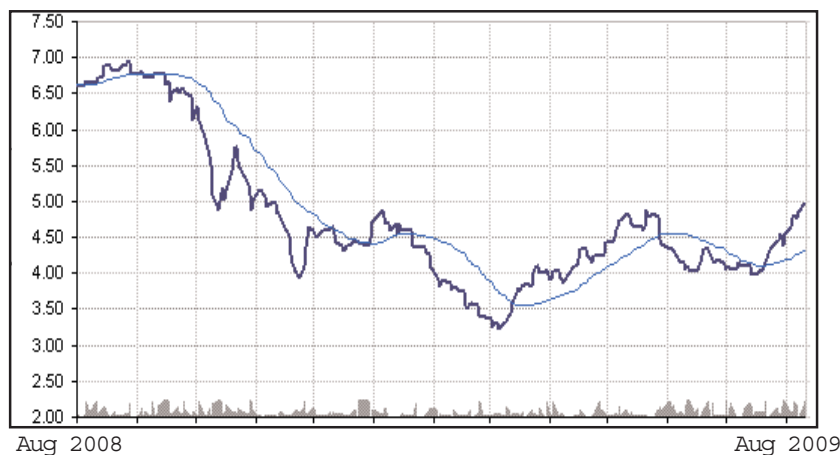
Capital notes the S&P has already climbed by more than a third since its low point in March, which means all the usual recovery-related upturn has taken place. The scope for a further re-rating is therefore limited.

Of course, if the stock market were fundamentally undervalued, then we might expect to see a

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Mainfreight



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sional manager, Plested built a company that was by and for the workers, rather than relying on the traditional management techniques of the day.

This culture and unrelenting focus on all staff being part of a 'family', permeates the company and Braid is a prominent cheerleader for the concept.

Other features that differ from most companies includes: No offices, not even for the CEO (this improves communication, Braid says).

All staff sit at a single long table in the lunch room (breaks down hierarchies).

All staff share in the company's profits (staff in each office get an equal share of 10% of the gross profit generated by that office every year).

The lack of formalised plans and management strata do not mean MFT is a cruisy place to work.

The company is big on measuring performance of offices and staff. Key performance indicators for each employee are posted up on boards for review and as a reminder.

Another feature of Mainfreight is its insistence that it is a New Zealand company and will remain so, even though it is increasingly becoming a global player.

MFT also is a rarity in that it generates income overseas without any reference to NZ. For example, it moves goods directly between the USA and China for non-NZ clients, yet the profits come back to this country.

If only we had 100 more companies like that NZ would be a very prosperous place and Braid encourages companies to expand offshore. "It's not as scary as it seems."

How has MFT managed to crack the huge and competitive markets of America and Asia?

Braid points out that, while big markets may be very competitive there also are lots of opportunity.

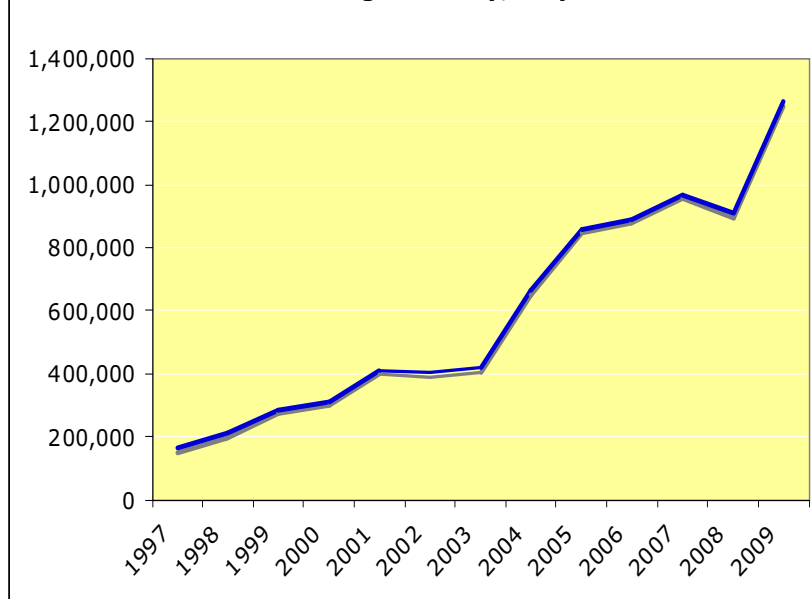
In a small market you have to fight for every market share. In a big market you only have to pick up a small part of the available business to do very well.

Nor should it be assumed that big, competitive markets automatically lead to outstanding results. The NZ share market is littered with companies that thought they could not go wrong in the much bigger markets abroad, only to learn the hard way that it doesn't work that way.

Braid cites as an example when MFT purchased a business in Huston, Texas several years ago.

A meeting was held with the man-

Mainfreight Sales (\$000)



agement team, which was informed of MFT's practice of reporting figures to head office every week.

The Huston executives looked blank and stated that such a task could not be done and to the best of their knowledge was not done by any logistics company in the USA.

Needless to say, it was done and the continual reporting assists the company to be responsive to customer needs.

Another story: When MFT bought an Australian business in 1999, it wanted to put in a new cafeteria. Staff and unions were upset because they thought the Kiwis were trying to poison them.

Braid thinks this attitude reflected a major problem between management and staff at that place - and the former were to blame.

He acknowledges that expanding into Australia was not easy. One mistake was trying to bring in the company's NZ culture. MFT now allows different cultures to evolve in each territory.

Yet another point of difference between MFT and other companies is its insistence that all senior positions are filled from within the company.

"We want to give our people a career, not just a job"

The company has a graduate program but also makes it possible for someone in an entry level job to become a sales person or manager over time. This means the company's special culture is not diluted.

A glance at the list of senior managers in the latest annual report testifies

to this with the vast majority having been with the company for more than 10 years and some having been there two or even three decades.

Part of why the company is different can be explained in its vision building a 100-year company.

After 32 years it is well on the way and every decision made today is done with a view to helping the company last another century.

From a single truck to \$1.2b in revenues in a little over three decades is a remarkable step but the company wants to maintain its aggressive growth rate.

From an investment perspective, the company is trading at around 14 times earnings, which is in line with its historical average.

Earnings growth of around 10% is forecast for the next year, bringing the p/e down to 12.8 and dividend yield of 6% including imputation credits.

MFT has improved its standing relative to IRG's nine key criteria and it is a mystery why it hasn't been added to our Watch List until now.

That will be rectified at our next review.

The global logistics market is huge and MFT has only a tiny fraction of it. The company cannot think of a reason why it cannot end up dominating the world market.

Mainfreight has set itself the goal of making \$2b in revenues by 2012.

I for one am NOT going to suggest that they won't achieve this.

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