

MARKET COMMENTARY

Freightways set to benefit from recovery

17 August 2009

The Freightways' ("FRE") result typifies the problems faced by business in the current tough economic conditions. Faced with slowing revenue growth the company has controlled costs, however the operating earnings result is lower than last year (after adjusting for the sale and lease-back). You can't cut costs to prosperity. True earnings growth needs to come from revenue growth and that will only come with a revived economy.

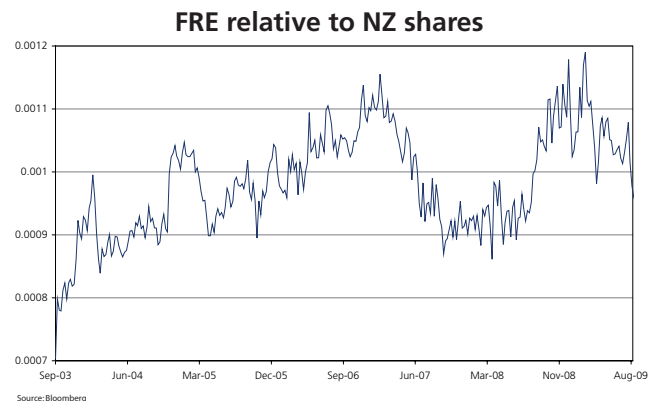
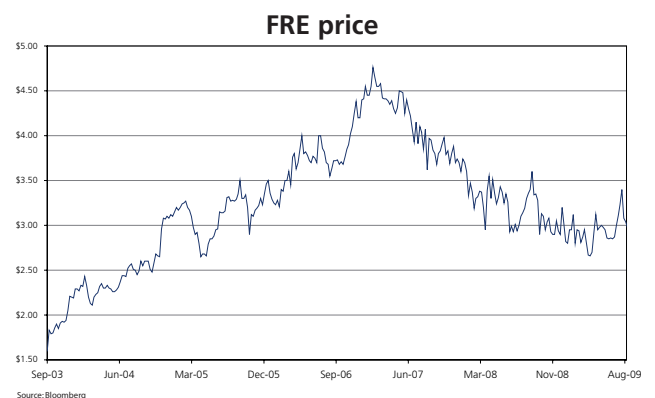
NZ Funds Management believes that the strength of Freightways is that it has a surprising ability to control costs when economic conditions are tough and yet it is superbly positioned for earnings growth when the economy turns. Widely regarded as a cyclical company that benefits when the domestic economy is growing strongly, the company has demonstrated over the recent economic slowdown that its business can be structured to be defensive.

In this result, earnings in its key express package division which accounts for around 80% of revenue, were lower than last year's result on slightly higher revenues. However express package operating margins were still strong at 17%. This operating margin is less than 2% below last year and demonstrates how Freightways business model, which is based on contracted owner-drivers who are paid on a per-delivered parcel basis, enables Freightways to drop costs in line with demand.

On an EBIT multiple of 10x, which implies a pre-tax operating yield of 10% for existing owners (or acquirers) the stock looks reasonable value. However this valuation ignores Freightways impressive growth record (18% compound annual profit growth over the last 5 years). Moreover, a significant chunk of the yield accruing to owners is in the form of dividends (16.5cps, a yield of 5%).

At current prices investors are purchasing a partially defensive stock with a good yield and strong cash earnings. In addition they're receiving a call option on future growth as economic conditions improve. Given that Freightways, like all companies

in recent times, have been in strong cost reduction mode, the growth in the future will come off a lower cost base and has the potential to be very strong.



Background Information

NZ Funds manages \$90 million in New Zealand Equities using an investment strategy which focuses on high dividend yielding stocks. To see a complete breakdown of the Dividend Yield Portfolio please visit our website at www.nzfunds.co.nz

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