

Fletcher Building

Likely Be Relatively Resilient; Up to NEUTRAL

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NEUTRAL

Fletcher Building (FBU) has withdrawn guidance and cancelled payment of its interim dividend — no surprise whatsoever. Clearly, at this time, for the majority of companies near-term forecasts are largely guesswork. That said, when we look beyond the New Zealand lockdown, we do believe construction activity is likely to recover more quickly and be more resilient than other cyclical sectors in the economy. FBU's balance sheet is in a strong position to navigate the crisis. The stock is trading materially below our assessment of fundamental value; upgrade to NEUTRAL.

NZX Code	FBU	Financials: Jun/	19A	20E	21E	22E	Valuation (x)	19A	20E	21E	22E
Share price	NZ\$3.37	NPAT* (NZ\$m)	367.0	117.1	154.7	219.3	EV/EBITDA	4.2	4.7	4.4	3.8
Target price	NZ\$3.90	EPS* (NZc)	43.1	14.0	18.8	26.7	EV/EBIT	5.5	10.3	9.1	7.3
Risk rating	Medium	EPS growth* (%)	n/a	-67.6	34.7	41.8	PE	7.8	24.1	17.9	12.6
Issued shares	821.7m	DPS (NZc)	23.0	11.0	14.0	19.0	Price / NTA	1.0	1.1	1.1	1.1
Market cap	NZ\$2,769m	Imputation (%)	0	0	64	63	Cash div yld (%)	6.8	3.3	4.2	5.6
Avg daily turnover	1,320k (NZ\$6,533k)	*Based on normalised profits					Gross div yld (%)	6.8	3.3	5.2	7.0

Extreme uncertainty

The NZ economy has been put in lockdown for the next four weeks. Australia seems on track to follow. Countries like China, South Korea and Singapore have shown that through vigilant quarantining, social-distancing and travel restrictions it is possible to contain the virus. If NZ's measures are successful then the domestic economy could be reopened in a relatively short period of time.

It is clearly nonsensical to rely on near-term earnings forecasts or valuation multiples in this environment. There are a massive number of unknowns that will influence most companies' near and medium-term earnings, including (to name but a few) the length and effectiveness of COVID-19 containment measures, the magnitude and effectiveness of fiscal and monetary policies including wage subsidies, impacts on credit availability, a company's ability and willingness to reduce costs and/or investment. We acknowledge that our short-term forecasts are merely guesswork.

We expect construction to be more resilient than other cyclical sectors

We believe construction activity is likely to recover more quickly and be more resilient than other cyclical sectors in the economy. Construction projects that have shut down during the lockdown will resume immediately after it is lifted. It is a domestic focussed industry, not hugely reliant on international supply chains. There is a healthy pipeline of consented projects. Government will look to accelerate its considerable investment plans in transport and social (health, schools etc.) infrastructure. Continued tight housing supply and (even lower) record low interest rates should help insulate, at least some of, the impacts on consumers' confidence and financial position.

Upgrade to NEUTRAL

Like equity prices everywhere, FBU's share price has plunged. It now trades materially below our assessment of fundamental value. After an equity raising and the sale of Formica in the past 24 months, FBU's balance sheet is in a very strong position to navigate the crisis. We see lower medium-term risk to earnings than other cyclical sectors such as tourism, retail, gaming, media and manufacturing. Upgrade to NEUTRAL.

Fletcher Building (FBU)

Priced as at 25 Mar 2020 (NZ\$) **3.37**

12-month target price (NZ\$)*	3.90
Expected share price return	15.7%
Net dividend yield	3.9%
Estimated 12-month return	19.7%

Key WACC assumptions	
Risk free rate	2.00%
Equity beta	1.31
WACC	8.8%
Terminal growth	2.0%

Spot valuations (NZ\$)	
1. DCF	3.59
0	0.00
0	0.00

DCF valuation summary (NZ\$m)	
Total firm value	5,100
(Net debt)/cash	(325)
Less: Capitalised operating leases	(1,823)
Value of equity	2,952

Profit and Loss Account (NZ\$m)	2018A	2019A	2020E	2021E	2022E
Sales revenue	9,471.0	9,307.0	6,922.5	7,194.7	7,892.5
Normalised EBITDA	264.0	830.0	682.3	787.3	907.7
Depreciation and amortisation	(214.0)	(199.0)	(369.7)	(408.5)	(437.3)
Normalised EBIT	50.0	631.0	312.6	378.9	470.4
Net interest	(157.0)	(118.0)	(144.6)	(142.9)	(142.9)
Associate income	0	0	0	0	0
Tax	58.0	(133.0)	(40.5)	(66.1)	(91.7)
Minority interests	11.0	13.0	10.4	15.1	16.4
Normalised NPAT	(60.0)	367.0	117.1	154.7	219.3
Abnormals/other	(130.0)	(203.0)	(25.0)	0	0
Reported NPAT	(190.0)	164.0	92.1	154.7	219.3
Normalised EPS (cps)	(8.3)	43.1	14.0	18.8	26.7
DPS (cps)	0	23.0	11.0	14.0	19.0

Growth Rates	2018A	2019A	2020E	2021E	2022E
Revenue (%)	0.8	-1.7	-25.6	3.9	9.7
EBITDA (%)	-63.7	>100	-17.8	15.4	15.3
EBIT (%)	-90.5	>100	-50.5	21.2	24.2
Normalised NPAT (%)	n/a	n/a	-68.1	32.1	41.8
Normalised EPS (%)	n/a	n/a	-67.6	34.7	41.8
Ordinary DPS (%)	-100.0	n/a	-52.2	27.3	35.7

Cash Flow (NZ\$m)	2018A	2019A	2020E	2021E	2022E
EBITDA	264.0	830.0	682.3	787.3	907.7
Working capital change	430.0	(404.0)	(92.5)	(53.1)	(48.9)
Interest & tax paid	(243.0)	(156.0)	(172.9)	(279.6)	(306.0)
Other	(55.0)	(117.0)	(15.0)	0	0
Operating cash flow	396.0	153.0	401.9	454.6	552.8
Capital expenditure	(304.0)	(348.0)	(387.0)	(405.0)	(390.0)
(Acquisitions)/divestments	76.0	1,262.0	0	0	0
Other	0	0	(164.7)	(166.7)	(168.6)
Funding available/(required)	168.0	1,067.0	(149.8)	(117.1)	(5.8)
Dividends paid	(123.0)	(68.0)	(219.7)	(41.1)	(131.5)
Equity raised/(returned)	893.0	(81.0)	(147.0)	0	0
(Increase)/decrease in net debt	938.0	918.0	(516.5)	(158.2)	(137.3)

Balance Sheet (NZ\$m)	2018A	2019A	2020E	2021E	2022E
Working capital	1,641.0	1,384.0	1,219.5	1,207.7	1,270.8
Fixed assets	2,231.0	1,754.0	1,936.5	2,118.5	2,256.9
Intangibles	1,696.0	1,129.0	1,129.0	1,129.0	1,129.0
Right of use asset	0	0	1,502.4	1,504.7	1,507.1
Other assets	765.0	817.0	745.0	745.0	745.0
Total funds employed	6,333.0	5,084.0	6,532.3	6,704.9	6,908.8
Net debt/(cash)	1,273.0	325.0	796.0	891.6	974.4
Lease liability	0	0	1,822.8	1,843.8	1,863.3
Other liabilities	918.0	586.0	329.0	264.1	278.3
Shareholder's funds	4,118.0	4,141.0	3,552.6	3,673.4	3,760.7
Minority interests	24.0	32.0	32.0	32.0	32.0
Total funding sources	6,333.0	5,084.0	6,532.3	6,704.9	6,908.8

* Forsyth Barr target prices reflect valuation rolled forward at cost of equity less the next 12-months dividend

Valuation Ratios	2018A	2019A	2020E	2021E	2022E
EV/EBITDA (x)	16.0	4.2	4.7	4.4	3.8
EV/EBIT (x)	84.4	5.5	10.3	9.1	7.3
PE (x)	n/a	7.8	24.1	17.9	12.6
Price/NTA (x)	1.2	1.0	1.1	1.1	1.1
Free cash flow yield (%)	3.3	-7.0	0.5	1.8	5.9
Net dividend yield (%)	0.0	6.8	3.3	4.2	5.6
Gross dividend yield (%)	0.0	6.8	3.3	5.2	7.0

Capital Structure	2018A	2019A	2020E	2021E	2022E
Interest cover EBIT (x)	0.3	5.3	2.2	2.7	3.3
Interest cover EBITDA (x)	1.7	7.0	4.7	5.5	6.3
Net debt/ND+E (%)	23.6	7.3	18.3	19.5	20.6
Net debt/EBITDA (x)	4.8	0.4	1.2	1.1	1.1

Key Ratios	2018A	2019A	2020E	2021E	2022E
Return on assets (%)	0.6	8.2	3.7	4.4	5.3
Return on equity (%)	-1.5	8.9	3.3	4.2	5.8
Return on funds employed (%)	-1.1	8.8	4.6	5.2	6.4
EBITDA margin (%)	2.8	8.9	9.9	10.9	11.5
EBIT margin (%)	0.5	6.8	4.5	5.3	6.0
Capex to sales (%)	3.2	3.7	5.6	5.6	4.9
Capex to depreciation (%)	142	175	105	99	89
Imputation (%)	100	0	0	64	63
Pay-out ratio (%)	0	53	79	74	71

Operating Performance	2018A	2019A	2020E	2021E	2022E
External revenue (NZ\$m)					
New Zealand	5,063	5,220	4,166	4,539	4,933
Australia	3,018	2,944	2,603	2,499	2,800
Rest of World	1,390	1,143	153	156	160
Total external revenue	9,471	9,307	6,923	7,195	7,892

EBIT (NZ\$m)	2018A	2019A	2020E	2021E	2022E
Concrete	90	84	48	74	79
Building Products	132	127	80	107	108
Distribution	104	104	63	92	100
Steel	49	33	(1)	13	22
Construction	(608)	47	38	38	54
Residential / Land Developm't	136	137	103	95	94
Australia	114	57	35	16	71
Divested	78	82	0	0	0
Corporate / other	(45)	(40)	(55)	(56)	(57)
Total EBIT	50	631	313	379	470

EBIT (NZ\$m)	2018A	2019A	2020E	2021E	2022E
New Zealand	(180)	467	268	353	385
Australia	123	54	28	9	64
Rest of World	9,528	8,786	6,627	6,833	7,444
Total EBIT	9,471	9,307	6,923	7,195	7,892

Investment Summary

Like equities prices everywhere FBU's share price has plunged. It now trades materially below our assessment of fundamental value. After an equity raising and the sale of Formica in the past 24 months, FBU's balance sheet is in a very strong position to navigate the crisis. We see lower medium-term risk to earnings than other cyclical sectors such as tourism, retail, gaming, media and manufacturing. NEUTRAL.

Business quality

- **Competition pressuring NZ franchises:** Whilst FBU's NZ businesses typically maintain leading market positions, over the past decade the strength of these positions has generally deteriorated with increased domestic and import competition pressuring margins and market share (a trend we expect will continue).
- **Low quality Australian portfolio:** FBU's poor performing Australian businesses currently earn a c.1-2% EBIT return on the c.NZ\$3b acquisition cost. FBU is aiming to 4x its Australian EBIT (vs. FY19) over the next five years through improved margins and new investment. We are sceptical given competitive constraints and high operating leverage to slowing demand.

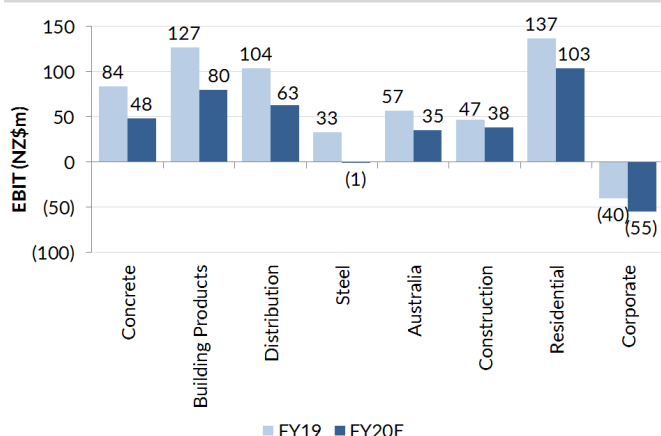
Earnings and cashflow outlook

- **Limited medium-term free cash flow:** Forecast medium-term FCF yield: FY20/21/22E -3%/-2%/2% reflecting crystallisation of construction losses and capex materially ahead of depreciation. Investment may be cut in response to COVID-19.
- **Strong balance sheet and capital management:** Proceeds from the sale of Formica have lowered FBU's net debt to c.1.2x even on our COVID-19 impacted earnings forecasts, below its 1.5–2.5x EBITDA target.

Risk factors

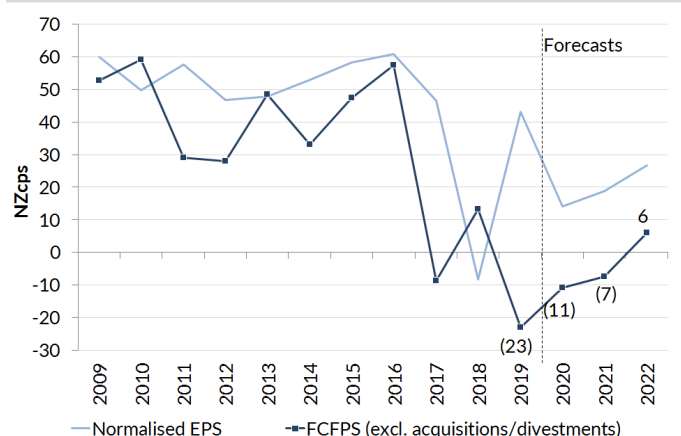
- **COVID-19:** Represents a massive near-term uncertainty for most businesses. We expect construction activity will likely recover more quickly and be more resilient than other cyclical sectors in the economy
- **Construction cycles in NZ and Australia:** FBU is levered to cyclical construction activity in NZ and AU, weighted to residential in both markets.
- **Competitive pressures:** Competition and cost inflation could materially influence FBU's market share and margins.
- **Construction losses:** Consensus view is that company has likely "kitchen sinked" its loss provisions, but the risk will not be extinguished until the projects are complete. Anecdotes of staff losses and project issues persist.

Figure 1. Divisional EBIT

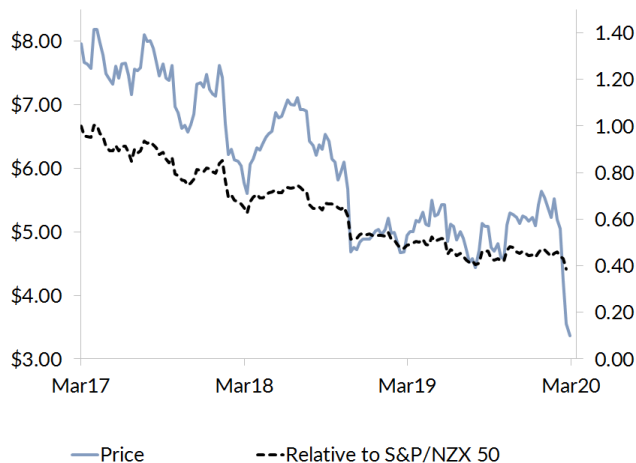


Source: Company reports, Forsyth Barr analysis

Figure 2. EPS and FCFPS



Source: Company reports, Forsyth Barr analysis

Figure 3. Price performance


Source: Forsyth Barr analysis

Figure 4. Substantial shareholders

Shareholder	Latest Holding
Perpetual	10.0%
Schroder Investment Management Group	8.3%
Commonwealth Bank of Australia	6.0%
The Vanguard Group	5.6%
BlackRock Investment Management	5.0%

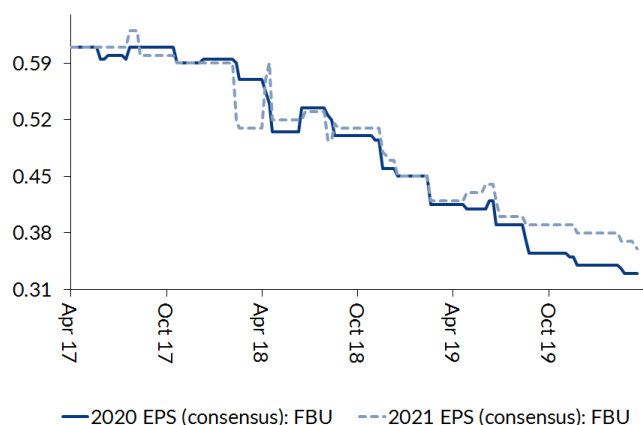
Source: NZX, Forsyth Barr analysis, NOTE: based on SSH notices only

Figure 5. International valuation comparisons

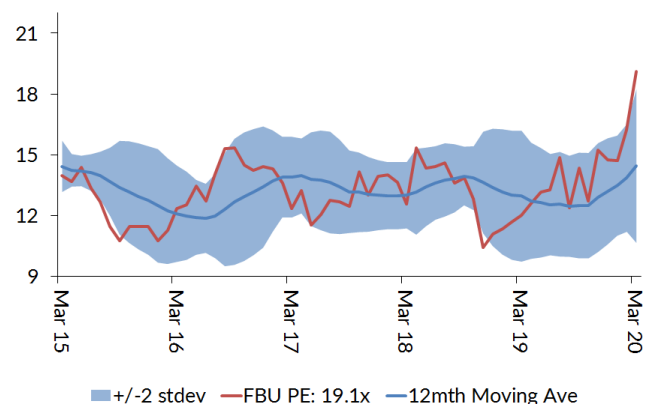
Company	Code	Price	Mkt Cap (m)	PE 2020E	PE 2021E	EV/EBITDA 2020E	EV/EBITDA 2021E	EV/EBIT 2020E	EV/EBIT 2021E	Cash Yld 2021E
(metrics re-weighted to reflect FBU's balance date - June)										
Fletcher Building	FBU NZ	NZ\$3.37	NZ\$2,769	24.1x	17.9x	4.5x	3.9x	9.9x	8.2x	4.2%
Metro Performance Glass *	MPG NZ	NZ\$0.16	NZ\$30	2.5x	2.2x	2.5x	2.6x	4.5x	4.5x	25.5%
Steel & Tube Holdings *	STU NZ	NZ\$0.48	NZ\$80	18.4x	6.9x	2.7x	2.3x	6.7x	4.4x	12.5%
ADELAIDE BRIGHTON	ABC AT	A\$1.92	A\$1,248	18.9x	10.9x	7.2x	6.7x	22.8x	10.3x	6.0%
BORAL	BLD AT	A\$1.79	A\$2,093	7.8x	5.9x	4.9x	4.6x	9.9x	8.7x	11.1%
CSR	CSR AT	A\$2.90	A\$1,408	11.5x	10.7x	5.2x	5.2x	7.8x	7.8x	7.2%
WAGNERS HOLDING CO	WGN AT	A\$0.61	A\$114	24.4x	8.7x	9.8x	6.3x	20.7x	10.7x	4.8%
GWA GROUP	GWA AT	A\$2.55	A\$673	12.9x	12.2x	9.9x	8.8x	10.9x	10.4x	7.0%
JAMES HARDIE INDUSTRIES-CDI	JHX AT	US\$10.40	US\$4,592	12.5x	11.1x	9.4x	8.5x	11.7x	10.4x	5.1%
REECE	REH AT	A\$8.24	A\$4,621	18.4x	16.7x	11.0x	10.6x	15.8x	14.8x	2.6%
CRH PLC	CRH ID	€21.00	€16,458	8.9x	8.7x	5.6x	5.3x	8.9x	8.3x	4.1%
LAFARGEHOLCIM-REG	LHN SW	CHF33.96	CHF20,917	9.1x	8.6x	5.0x	4.6x	8.4x	7.1x	6.2%
Compco Average:				13.2x	9.3x	6.7x	6.0x	11.7x	8.9x	8.4%
FBU Relative:				83%	92%	-32%	-34%	-15%	-8%	-50%

EV = Current Market Cap + Actual Net Debt

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

Figure 6. Consensus EPS momentum (NZ\$)


Source: Forsyth Barr analysis

Figure 7. One year forward PE (x)


Source: Forsyth Barr analysis

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