

# Fletcher Building

## Building a Head of Steam

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### NEUTRAL

Fletcher Building (FBU) has provided 1H21 EBIT guidance of NZ\$305–320m at its annual shareholders meeting. This guidance is in line with our expectations of NZ\$308m. We have lifted our EBIT forecasts to reflect a sustained period of robust NZ residential activity continuing over CY2021. Given current levels of activity may require extra cost-in, we suspect that FBU's ability to sustain current margins may be hindered. Additionally, we are cautious of the level of non-residential activity on both sides of the Tasman, with forward indicators and anecdotes suggesting a thinning pipeline. We remain NEUTRAL rated, with near-term momentum now largely factored into consensus and the medium-term tempered by macro uncertainty, persistent competitive pressures, and execution risks.

NZX Code	FBU	Financials: Jun/	20A	21E	22E	23E	Valuation (x)	20A	21E	22E	23E
Share price	NZ\$5.88	NPAT* (NZ\$m)	3.0	357.8	307.8	327.0	PE	n/a	13.5	15.7	14.8
Target price	NZ\$5.85	EPS* (NZc)	0.4	43.6	37.5	39.8	EV/EBIT	37.4	11.6	12.4	11.8
Risk rating	Medium	EPS growth* (%)	-99.2	n/a	-14.0	6.2	EV/EBITDA	11.3	7.3	7.6	7.3
Issued shares	821.2m	DPS (NZc)	0.0	15.0	27.0	29.0	Price / NTA	2.0	1.8	1.8	1.7
Market cap	NZ\$4,829m	Imputation (%)	n/a	100	52	52	Cash div yld (%)	0.0	2.6	4.6	4.9
Avg daily turnover	1,800k (NZ\$7,261k)	*Based on normalised profits					Gross div yld (%)	n/a	3.5	5.5	5.9

#### What's changed?

- **Earnings:** FY21–23 EBIT +7%/+5%/+1%
- **Target price:** +4% to NZ\$5.85

#### NZ residential the bright spot in a mixed macro

Management continues to remain cautious on the medium term given limited order book visibility beyond early CY21. We expect robust NZ residential activity to sustain well into CY2020 underpinned by low interest rates, tight supply, and a historic under build. In Australia, while residential activity for the September quarter was at its lowest level since 2014, record low interest rates, stabilisation of house prices, and government stimulus bode well for detached housing, but closed borders and lower inner city rents present challenges for the apartment construction pipeline. The thinning non-residential pipeline on both sides of the Tasman will likely weigh on activity over CY2021 and the timing of larger government backed infrastructure investment remains uncertain.

#### Excitement tempered by uncertainty and track record

Our thinking on FBU's earnings track (albeit with stronger-for-longer NZ residential activity) remains unchanged; a solid FY21 supported by a robust operating environment that tempers over FY22 as activity slows and competitive pressures and cost-in sees FBU give back some margin. We note that benefits from prior cost out initiatives have never clearly materialised into earnings, because either they were not delivered or the savings were consumed by inflation and/or margin pressures. As such, we are cautious on the sustainability of FBU's lower cost base/higher margins. We lift our target price to NZ\$5.85, driven principally by upgrades to our near-term earnings forecasts. We retain a NEUTRAL rating.

**Fletcher Building (FBU)**

Priced as at 25 Nov 2020 (NZ\$)						5.88						
<b>12-month target price (NZ\$)*</b>						5.85	<b>Spot valuations (NZ\$)</b>					
Expected share price return						-0.5%	1. DCF					
Net dividend yield						3.4%						
Estimated 12-month return						2.9%						
<b>Key WACC assumptions</b>						<b>DCF valuation summary (NZ\$m)</b>						
Risk free rate						1.30%	Total firm value					8,234
Equity beta						1.31	(Net debt)/cash					(325)
WACC						7.5%	Less: Capitalised operating leases					(3,179)
Terminal growth						2.0%	Value of equity					4,730
<b>Profit and Loss Account (NZ\$m)</b>						<b>Valuation Ratios</b>						
Sales revenue	2019A	2020A	2021E	2022E	2023E	2019A	2020A	2021E	2022E	2023E		
9,307.0	7,309.0	7,858.7	7,804.2	8,084.2	EV/EBITDA (x)	6.6	11.3	7.3	7.6	7.3		
<b>Normalised EBITDA</b>	<b>830.0</b>	<b>530.0</b>	<b>947.8</b>	<b>902.9</b>	<b>936.7</b>	EV/EBIT (x)	8.7	37.4	11.6	12.4	11.8	
Depreciation and amortisation	(199.0)	(370.0)	(354.6)	(351.4)	(360.1)	PE (x)	13.6	>100x	13.5	15.7	14.8	
<b>Normalised EBIT</b>	<b>631.0</b>	<b>160.0</b>	<b>593.2</b>	<b>551.5</b>	<b>576.6</b>	Price/NTA (x)	1.7	2.0	1.8	1.8	1.7	
Net interest	(118.0)	(149.0)	(109.4)	(105.1)	(104.6)	Free cash flow yield (%)	-4.0	2.1	3.2	7.7	3.2	
Associate income	0	0	0	0	0	Net dividend yield (%)	3.9	0.0	2.6	4.6	4.9	
Tax	(133.0)	4.0	(110.3)	(125.0)	(132.2)	Gross dividend yield (%)	3.9	n/a	3.5	5.5	5.9	
Minority interests	13.0	12.0	15.8	13.6	12.9	<b>Capital Structure</b>						
<b>Normalised NPAT</b>	<b>367.0</b>	<b>3.0</b>	<b>357.8</b>	<b>307.8</b>	<b>327.0</b>	Interest cover EBIT (x)	5.3	1.1	5.4	5.2	5.5	
Abnormals/other	(203.0)	(199.0)	(90.0)	0	0	Interest cover EBITDA (x)	7.0	3.6	8.7	8.6	9.0	
<b>Reported NPAT</b>	<b>164.0</b>	<b>(196.0)</b>	<b>267.8</b>	<b>307.8</b>	<b>327.0</b>	Net debt/ND+E (%)	7.3	16.4	14.5	13.6	16.9	
Normalised EPS (cps)	43.1	0.4	43.6	37.5	39.8	Net debt/EBITDA (x)	0.4	1.3	0.7	0.7	0.9	
DPS (cps)	23.0	0	15.0	27.0	29.0	<b>Key Ratios</b>						
<b>Growth Rates</b>						2019A	2020A	2021E	2022E	2023E		
Revenue (%)	-1.7	-21.5	7.5	-0.7	3.6	Return on assets (%)	8.2	1.8	6.7	6.3	6.5	
EBITDA (%)	>100	-36.1	78.8	-4.7	3.7	Return on equity (%)	8.9	0.1	9.5	8.0	8.3	
EBIT (%)	>100	-74.6	>100	-7.0	4.6	Return on funds employed (%)	8.8	6.2	10.0	8.2	8.3	
Normalised NPAT (%)	n/a	-99.2	>100	-14.0	6.2	EBITDA margin (%)	8.9	7.3	12.1	11.6	11.6	
Normalised EPS (%)	n/a	-99.2	>100	-14.0	6.2	EBIT margin (%)	6.8	2.2	7.5	7.1	7.1	
Ordinary DPS (%)	n/a	-100.0	n/a	80.0	7.4	Capex to sales (%)	3.7	3.3	2.5	3.8	5.3	
<b>Cash Flow (NZ\$m)</b>						2019A	2020A	2021E	2022E	2023E		
<b>EBITDA</b>	<b>830.0</b>	<b>530.0</b>	<b>947.8</b>	<b>902.9</b>	<b>936.7</b>	Capex to depreciation (%)	175	65	56	85	118	
Working capital change	(404.0)	(58.0)	(330.1)	(63.5)	(14.8)	Imputation (%)	0	n/a	100	52	52	
Interest & tax paid	(156.0)	(215.0)	(175.4)	(168.3)	(341.6)	Pay-out ratio (%)	53	0	34	72	73	
Other	(117.0)	84.0	(90.0)	0	0	<b>Operating Performance</b>						
<b>Operating cash flow</b>	<b>153.0</b>	<b>341.0</b>	<b>352.3</b>	<b>671.1</b>	<b>580.3</b>	<b>External revenue (NZ\$m)</b>						
Capital expenditure	(348.0)	(240.0)	(200.0)	(300.0)	(425.0)	New Zealand	5,220	4,466	5,542	5,470	5,537	
(Acquisitions)/divestments	1,262.0	6.0	0	0	0	Australia	2,944	2,740	2,613	2,608	2,817	
Other	0	(171.0)	(163.7)	(156.8)	(150.1)	Rest of World	1,143	103	(297)	(275)	(270)	
<b>Funding available/(required)</b>	<b>1,067.0</b>	<b>(64.0)</b>	<b>(11.4)</b>	<b>214.3</b>	<b>5.2</b>	<b>Total external revenue</b>	<b>9,307</b>	<b>7,309</b>	<b>7,859</b>	<b>7,804</b>	<b>8,084</b>	
Dividends paid	(68.0)	(128.0)	0	(229.9)	(229.9)	<b>EBIT (NZ\$m)</b>						
Equity raised/(returned)	(81.0)	(147.0)	0	0	0	Concrete	84	74	110	99	93	
<b>(Increase)/decrease in net debt</b>	<b>918.0</b>	<b>(339.0)</b>	<b>(11.4)</b>	<b>(15.6)</b>	<b>(224.7)</b>	Building Products	160	87	170	157	147	
<b>Balance Sheet (NZ\$m)</b>						Distribution	104	85	112	96	91	
Working capital	1,384.0	1,158.0	1,315.1	1,292.5	1,309.3	Steel	0	0	0	0	0	
Fixed assets	1,754.0	1,555.0	1,579.7	1,696.6	1,919.4	Construction	47	(147)	32	53	59	
Intangibles	1,129.0	1,133.0	1,133.0	1,133.0	1,133.0	Residential / Land Developm't	137	65	133	120	140	
Right of use asset	0	1,413.0	1,326.0	1,244.4	1,167.8	Australia	57	33	92	82	105	
Other assets	817.0	1,317.0	1,206.7	1,081.7	1,126.0	Divested	82	0	0	0	0	
<b>Total funds employed</b>	<b>5,084.0</b>	<b>6,576.0</b>	<b>6,560.5</b>	<b>6,448.2</b>	<b>6,655.5</b>	Corporate / other	(40)	(37)	(55)	(56)	(57)	
Net debt/(cash)	325.0	687.0	641.0	607.5	800.2	<b>Total EBIT</b>	<b>631</b>	<b>160</b>	<b>593</b>	<b>551</b>	<b>577</b>	
Lease liability	0	1,549.0	1,477.6	1,407.4	1,338.7	<b>EBIT (NZ\$m)</b>						
Other liabilities	586.0	633.0	460.0	374.0	376.0	New Zealand	467	110	491	454	456	
Shareholder's funds	4,141.0	3,500.0	3,774.9	3,852.3	3,933.7	Australia	54	42	85	75	98	
Minority interests	32.0	35.0	35.0	35.0	35.0	Rest of World	110	8	17	22	22	
<b>Total funding sources</b>	<b>5,084.0</b>	<b>6,404.0</b>	<b>6,388.5</b>	<b>6,276.2</b>	<b>6,483.5</b>	<b>Total EBIT</b>	<b>631</b>	<b>160</b>	<b>593</b>	<b>551</b>	<b>577</b>	

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

## Earnings changes and divisional forecasts

Figure 1. FBU forecast changes

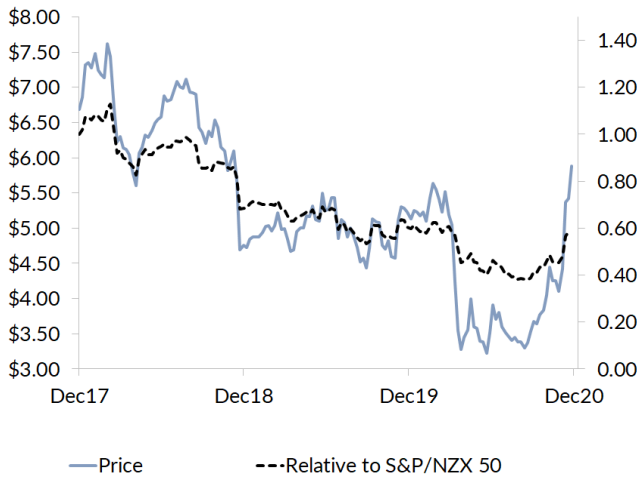
NZ\$m	FY21			FY22			FY23		
	Old	New	% chg	Old	New	% chg	Old	New	% chg
Revenue	7,820	7,859	0.5%	7,752	7,804	0.7%	8,098	8,084	-0.2%
EBITDA	907	948	4.5%	878	903	2.8%	931	937	0.6%
<b>EBIT</b>	<b>552</b>	<b>593</b>	<b>7.4%</b>	<b>527</b>	<b>551</b>	<b>4.7%</b>	<b>571</b>	<b>577</b>	<b>1.1%</b>
Underlying NPAT	328	358	8.9%	290	308	6.1%	323	327	1.3%
Underlying EPS (cps)	40.0	43.6	8.9%	35.3	37.5	6.1%	39.3	39.8	1.3%
Dividend (cps)	14.0	15.0	7.1%	25.0	27.0	8.0%	28.0	29.0	3.6%

Source: Forsyth Barr analysis

Figure 2. FY21 divisional forecasts

NZ\$m	1H21E	2H21E	FY21E
Concrete	61	49	110
Building Products	85	85	170
Distribution	59	53	112
Australia	49	43	92
Construction	12	20	32
Residential + Development	72	61	133
Corporate	(29)	(26)	(55)
<b>EBIT (before significant items)</b>	<b>308</b>	<b>285</b>	<b>593</b>
Significant items			(90)
<b>EBIT</b>			<b>503</b>
Net interest			(109)
<b>Pre-Tax Profit</b>			<b>394</b>
Taxation			(110)
<b>Post Tax Profit</b>			<b>284</b>
Less Minority Interest			(16)
<b>Profit Attributable – NPAT</b>			<b>268</b>

Source: 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%

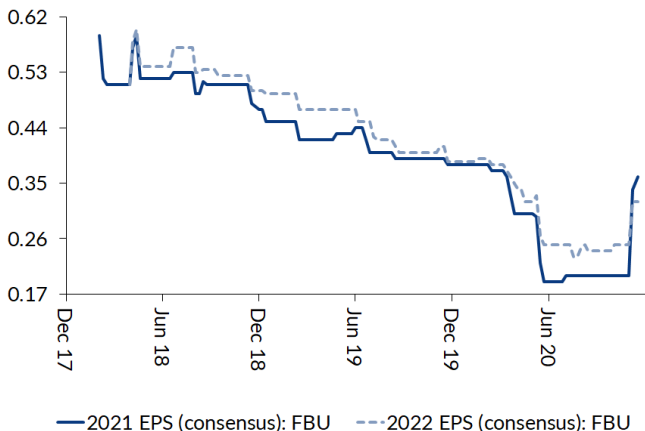
Source: NZX, Forsyth Barr analysis, NOTE: based on SPH notices only

**Figure 5. International valuation comparisons**

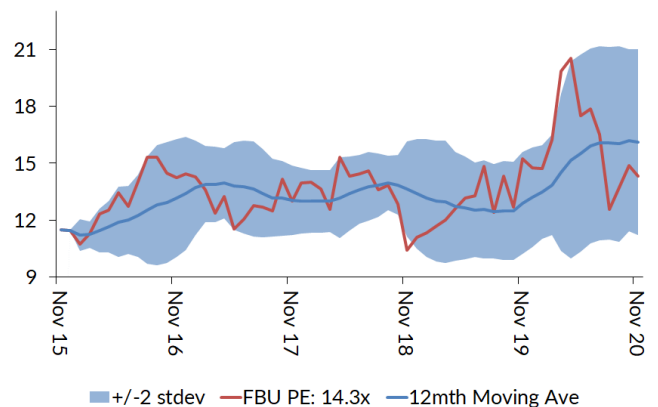
Company	Code	Price	Mkt Cap (m)	PE 2021E	PE 2022E	EV/EBITDA 2021E	EV/EBITDA 2022E	EV/EBIT 2021E	EV/EBIT 2022E	Cash Yld 2022E
<b>Fletcher Building</b>	<b>FBU NZ</b>	<b>NZ\$5.88</b>	<b>NZ\$4,829</b>	<b>13.5x</b>	<b>15.7x</b>	<b>5.8x</b>	<b>6.1x</b>	<b>9.3x</b>	<b>10.0x</b>	<b>4.6%</b>
METRO PERFORMANCE GLASS	MPG NZ	NZ\$0.44	NZ\$81	20.3x	26.6x	6.4x	7.2x	16.4x	19.1x	0.3%
STEEL & TUBE HOLDINGS *	STU NZ	NZ\$0.69	NZ\$115	33.9x	16.7x	4.0x	3.6x	11.0x	7.6x	4.3%
ADBRI	ABCAT	A\$3.00	A\$1,957	19.7x	19.6x	9.8x	9.7x	16.2x	16.2x	3.9%
BORAL	BLD AT	A\$5.01	A\$6,141	27.4x	20.1x	9.9x	9.0x	21.8x	18.4x	3.0%
CSR	CSR AT	A\$4.74	A\$2,301	16.0x	17.1x	7.4x	7.7x	10.5x	11.3x	3.9%
WAGNERS HOLDING CO	WGN AT	A\$1.60	A\$299	n/a	27.0x	12.0x	10.9x	24.0x	20.4x	1.8%
GWA GROUP	GWA AT	A\$2.93	A\$774	19.4x	17.7x	12.3x	11.0x	15.7x	13.8x	4.4%
JAMES HARDIE INDUSTRIES-CDI	JHX AT	US\$28.60	US\$12,697	29.3x	25.5x	18.6x	16.6x	22.8x	20.3x	2.1%
REECE	REH AT	A\$12.97	A\$8,378	33.0x	30.5x	15.0x	14.4x	22.9x	21.6x	1.4%
CRH PLC	CRH ID	€33.55	€26,338	17.4x	15.8x	8.8x	8.4x	14.4x	13.4x	2.4%
LAFARGEHOLCIM-REG	LHN SW	CHF46.57	CHF28,684	14.6x	12.8x	6.7x	6.4x	11.0x	10.0x	4.4%
<b>Compco Average:</b>				<b>23.1x</b>	<b>20.8x</b>	<b>10.1x</b>	<b>9.5x</b>	<b>17.0x</b>	<b>15.7x</b>	<b>2.9%</b>
<b>FBU Relative:</b>				<b>-42%</b>	<b>-25%</b>	<b>-42%</b>	<b>-36%</b>	<b>-45%</b>	<b>-36%</b>	<b>58%</b>

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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