ORD MINNETT
RESEARCH

Private Client Research

6 November 2019

James Hardie Industries

Louisiana Pacific result read-through

Louisiana Pacific, a key competitor of James Hardie Industries (JHX) in the US siding market, reported strong volume growth and softer pricing for its siding division in its third-quarter CY19 result. We estimate Louisiana Pacific has a 9% share of the North America siding market (excluding sheds) versus James Hardie at 18%.

We believe Louisiana Pacific's retail channel for siding is mostly sheds, but management did not break out growth rates for lap and trim versus sheds. Total siding volumes rose 11.5% year-on-year (YoY), with strand product up 14%, fibre down 10% and CanExel up 91%. Management noted the quarter benefited from *"selling more into retail relative to what we've done in the past from a growth standpoint"*.

SmartSide, Louisiana Pacific's key siding line, achieved an average gross price increase of 1% for strand products and 3% for fibre product in the quarter versus a year ago. A catch-up with rebates and adverse product mix (for example, panel growing faster than lap and trim) lowered net pricing to -1% for strand product. James Hardie's management team has guided to a 2% average price increase for the North America division in FY20.

The other relevant result we have on hand is Elementia, which reported 6% volume growth in the quarter for its US fibre cement business.

On Thursday we expect James Hardie to report 2.5% volume growth for the September quarter, with exteriors up 3.5%. We will also be interested in the volume performance from Cornerstone Building Solutions' vinyl siding line PlyGem in the quarter.

We maintain our Accumulate rating on James Hardie with a $27.00 target price.

Recommendation
Accumulate
Risk
Higher
Target price
$27.00
Last price
$24.72

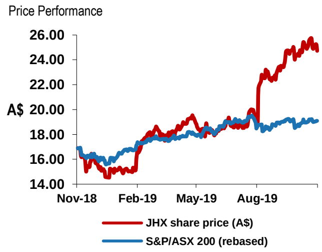
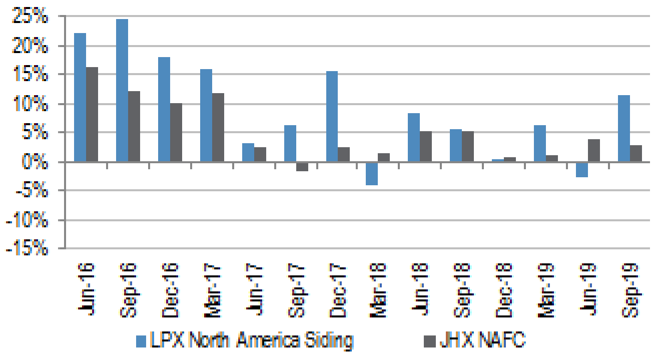
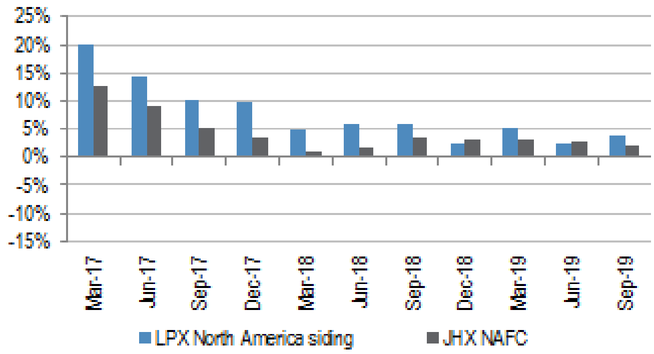


Figure 1: Quarterly volume growth: LPX vs JHX



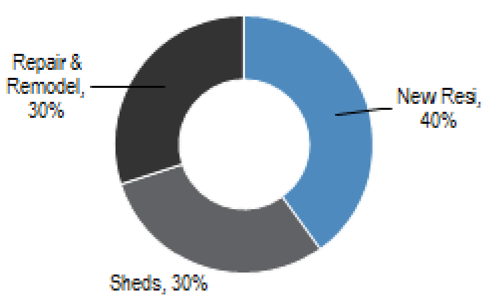
Source: Ord Minnett estimates

Figure 2: Rolling 4Q volume growth: LPX vs JHX



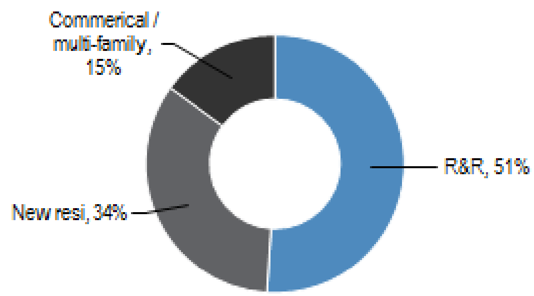
Source: Ord Minnett estimates

Figure 3: LPX SmartSide end market exposure



Source: Ord Minnett estimates

Figure 4: JHX North America end market exposure



Source: Ord Minnett estimates

Further comments from the Louisiana Pacific management

With respect to converting further OSB mills to siding, management noted, *"I think we'll be in a position late next year to talk specifically about location. And then, as Alan mentioned, in the capex guidance, we would currently think we'll begin spending capital on the conversion in 2021 for late 2021, early 2022 production."*

"We continue to grow SmartSide Strand revenue and volume at rates meaningfully above that of the underlying market."

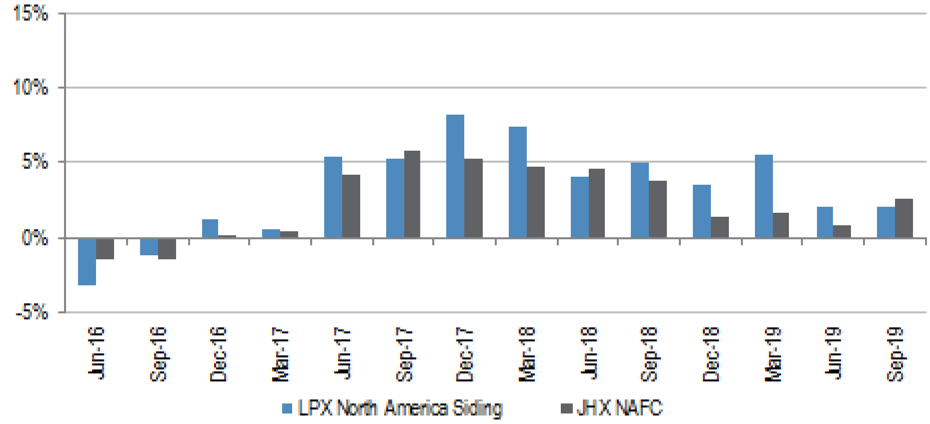
"We've had really good growth in retail (i.e. sheds) this year, and relative to what we're seeing on overall housing growth. There's a little bit of a skew towards selling more into retail relative to what we've done in the past from a growth standpoint". Note the growth rate for sheds was not called out specifically."

"Address the competitive situation through rebates and incentives… the way you get competitive against vinyl is not necessarily always by price but by offering a product that can be beneficial to a homeowner in a starter home and thus the move into prefinished and some of the other specialty SKUs that we're working on in our SmartSide business. "

"Well, I mean market dynamics haven't significantly changed. I mean the rebate. The majority of the rebate in the third quarter was actually sort of a catch up on year-to-date basis, so the pricing and the rebate impact if you take Q3 as a discrete quarter, was a little better than it looks."

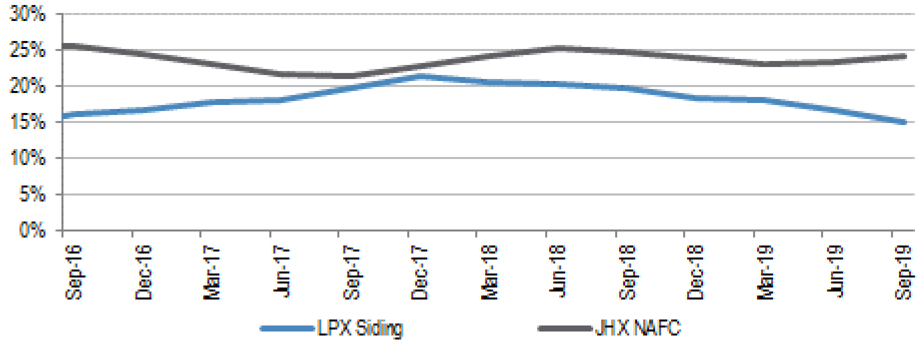
"We definitely spend more in the R&R channel. Then in the new construction channel or the retail channel, without a doubt, that's a more of a consumer sale. And then what we've seen in new home construction, but I will say also there's probably a little richer mix because there is going to be much more lap and trim compared to panel. We do benefit on the margin and pricing standpoint because of mix. And as we move into prefinished we get to retain the incremental margin associated with a prefinished solution…and the repair and remodel opportunity, we look at repair remodel as a higher cost to serve, but also higher margin at the end of the day because of the prefinished opportunities that exist there."

Figure 5: LPX SmartSide vs JHX NAFC quarterly pcp price growth



Source: Company reports, Ord Minnett estimates.

Figure 6: LPX siding margins vs JHX NAFC (rolling 4Q)



Source: Company reports, Ord Minnett estimates

Investment Thesis, Valuation and Risks

Investment Thesis

James Hardie has been a strong performer year-to-date, but we remain positive given favourable trends in key data points (e.g. US housing starts; pulp; freight) and internal initiatives (i.e. PDG has gained clear traction). Our FY21E EPS is 5% above Bloomberg consensus and suggests the stock is trading on a P/E of 20x blended FY20–21E.

Valuation

Our $27.00 Dec-20 price target is based on a combination of our Mar-20 sum-of-the-parts (SoP) DCF and relative multiple valuations. We calculate our SoP valuation based on the individual cash flow streams of each discrete business segment. Our multiple valuation is based on James Hardie's historical P/E ratio relative to the broader market. Our group post-tax WACC is 8.7%. The key figures that make up this discount rate are a cost of equity of 8.8% and a post-tax cost of debt of 4.2%. We apply a beta of 1.05 within this.

JHX – DCF-based SoP valuation

Segment	Valuation methodology / Comment	US$m	$/share
North America Fibre Cement	DCF-based valuation (ex. Changes in working capital and provisions)	9,323	31.01
APAC Fibre Cement	DCF-based valuation (ex. Changes in working capital and provisions)	1,386	4.61
Europe	DCF-based valuation (ex. Changes in working capital and provisions)	1,024	3.41
Less: Corporate and R&D	DCF-based valuation (incl. Capex, group changes in working capital and provisions)	-2,033	-6.76
Enterprise Value		**9,700**	**32.26**
Less: Net Debt	Group net debt as at year-end: FY20	-1,310	-4.36
Less: Asbestos	Based on JHX financial statements at FY20	-440	-1.46
Less: Provisions	Based on JHX financial statements at FY20	-108	-0.36
Estimated equity value	**Group SoP valuation**	**7,843**	**26.08**

Source: Ord Minnett estimates

Risks to Rating and Price Target

Downside risks to our OW rating and price target include a strengthening AUD/USD exchange-rate, weaker-than-expected housing construction growth in the US (including the repair & remodel segment), strengthening pulp price and/or transportation costs, PDG falling short of our targeted levels.

Further potential catalysts include higher growth rates in the US or Australian housing markets, a material decline in the pulp price and/or transportation costs, faster-than-expected penetration of the US siding market, and depreciation of the $.

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Please contact your Ord Minnett Adviser for further information on our document.

Guide to Ord Minnett Recommendations

Our recommendations are based on the total return of a stock – nominal dividend yield plus capital appreciation – and have a 12-month time horizon.

SPECULATIVE BUY	We expect the stock's total return (nominal yield plus capital appreciation) to exceed 20% over 12 months. The investment may have a strong capital appreciation but also has high degree of risk and there is a significant risk of capital loss.
BUY	The stock's total return (nominal dividend yield plus capital appreciation) is expected to exceed 15% over the next 12 months.
ACCUMULATE	We expect a total return of between 5% and 15%. Investors should consider adding to holdings or taking a position in the stock on share price weakness.
HOLD	We expect the stock to return between 0% and 5%, and believe the stock is fairly priced.
LIGHTEN	We expect the stock's return to be between 0% and negative 15%. Investors should consider decreasing their holdings.
SELL	We expect the total return to lose 15% or more.
RISK ASSESSMENT	Classified as Lower, Medium or Higher, the risk assessment denotes the relative assessment of an individual stock's risk based on an appraisal of its disclosed financial information, historical volatility of its share price, nature of its operations and other relevant quantitative and qualitative criteria. Risk is assessed by comparison with other Australian stocks, not across other asset classes such as Cash or Fixed Interest.

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