

Fletcher Building

FY20 Result — Last Week's News

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NEUTRAL

There were no surprises in Fletcher Building's (FBU) result given last week's pre-announcement. While NZ's lockdown makes it difficult to delineate operating trends, we see little in the result to materially change market expectations with the forward looking picture clouded by macro uncertainty. That said, given the strength of the NZ residential market, we see potential for near-term earnings to surprise in FY21 before fading in FY22 as activity recedes. Whilst FBU's share price remains down sharply from pre COVID-19 levels, it's not at a level where we see clear value. We lower our target price to NZ\$3.60 and maintain our NEUTRAL rating.

NZX Code	FBU	Financials: Jun/	20A	21E	22E	23E	Valuation (x)	20A	21E	22E	23E
Share price	NZ\$3.40	NPAT* (NZ\$m)	3.0	243.7	191.3	223.0	EV/EBITDA	6.0	4.4	4.8	4.5
Target price	NZ\$3.60	EPS* (NZc)	0.4	29.7	23.3	27.2	EV/EBIT	19.9	8.0	9.2	8.3
Risk rating	Medium	EPS growth* (%)	-99.2	n/a	-21.5	16.6	PE	n/a	11.5	14.6	12.5
Issued shares	821.2m	DPS (NZc)	0.0	18.0	17.0	20.0	Price / NTA	1.2	1.2	1.1	1.1
Market cap	NZ\$2,792m	Imputation (%)	n/a	0	0	0	Cash div yld (%)	0.0	5.3	5.0	5.9
Avg daily turnover	1,893k (NZ\$7,934k)	*Based on normalised profits					Gross div yld (%)	n/a	5.3	5.0	5.9

Strong rebound from lockdown

With the lockdown shutting activity for 6 weeks it is hard to make any definitive comment around the quality or performance of FBU's NZ businesses, with the exception of Steel where competitive pressures remain evident. Management comments aligned with anecdotes of strong post-lockdown activity. However, the outlook remains highly uncertain as highlighted by FBU's expectations for a significant reduction in activity over FY21. Further lockdowns may weigh on productivity as well as demand. That said, we see residential as potentially being more resilient near-term given low interest rates and tight supply.

Australia remains challenging

The headline Australian result was soft: sales -7%, EBIT -57%. Some progress has been made on Laminex, and Insulation (potentially aided by lower input costs, particularly resin) was more than offset by market volumes declines and continued challenging performances from Rocla and IPLEX (despite recent restructuring). FBU intends to divest Rocla in FY21. FBU expects AU activity to decline by 20% in FY21 which highlights the importance of cost out initiatives given the low margins and high operating leverage.

What is the base earnings level?

With FY20 taken ill by the pandemic it is difficult to assess a base level of EBIT. Our assessment, although clouded by a number of items and assumptions, is NZ\$425-440m, down c. 20% yoy. FBU has painted a forward picture of significant declines across all markets, however, given the strength of NZ residential activity post lockdown we see potential for near-term earnings to surprise in FY21 before fading in FY22 as activity comes off. Free cash flow remains anaemic with construction and restructuring outflows.

Risk remains that COVID causes further underlying deterioration in FBU's business

There remains risk, both around the magnitude of the downturn, and more significantly, of further underlying deterioration in FBU's businesses. Competition may continue (or compound) margin pressures. Falling demand exacerbates the challenges of executing on turnaround initiatives. And a pullback in capex may starve the business of necessary investment. Our concern is FBU may emerge from the downturn weaker than when it went in. We remain cautious on the medium-term implications for FBU.

Fletcher Building (FBU)

Priced as at 19 Aug 2020 (NZ\$) **3.40**

12-month target price (NZ\$)*	3.60
Expected share price return	5.9%
Net dividend yield	5.2%
Estimated 12-month return	11.1%

Key WACC assumptions

Risk free rate	1.30%
Equity beta	1.31
WACC	7.5%
Terminal growth	2.0%

Spot valuations (NZ\$)

1. DCF	3.46
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DCF valuation summary (NZ\$m)

Total firm value	6,345
(Net debt)/cash	(325)
Less: Capitalised operating leases	(3,179)
Value of equity	2,841

Profit and Loss Account (NZ\$m)	2019A	2020A	2021E	2022E	2023E
Sales revenue	9,307.0	7,309.0	7,713.1	7,612.4	7,954.6
Normalised EBITDA	830.0	530.0	788.6	739.6	790.7
Depreciation and amortisation	(199.0)	(370.0)	(354.6)	(351.4)	(360.1)
Normalised EBIT	631.0	160.0	434.0	388.1	430.7
Net interest	(118.0)	(149.0)	(110.0)	(106.6)	(106.1)
Associate income	0	0	0	0	0
Tax	(133.0)	4.0	(65.5)	(78.8)	(90.9)
Minority interests	13.0	12.0	14.8	11.4	10.6
Normalised NPAT	367.0	3.0	243.7	191.3	223.0
Abnormals/other	(203.0)	(199.0)	(90.0)	0	0
Reported NPAT	164.0	(196.0)	153.7	191.3	223.0
Normalised EPS (cps)	43.1	0.4	29.7	23.3	27.2
DPS (cps)	23.0	0	18.0	17.0	20.0

Growth Rates	2019A	2020A	2021E	2022E	2023E
Revenue (%)	-1.7	-21.5	5.5	-1.3	4.5
EBITDA (%)	>100	-36.1	48.8	-6.2	6.9
EBIT (%)	>100	-74.6	>100	-10.6	11.0
Normalised NPAT (%)	n/a	-99.2	>100	-21.5	16.6
Normalised EPS (%)	n/a	-99.2	>100	-21.5	16.6
Ordinary DPS (%)	n/a	-100.0	n/a	-5.6	17.6

Cash Flow (NZ\$m)	2019A	2020A	2021E	2022E	2023E
EBITDA	830.0	530.0	788.6	739.6	790.7
Working capital change	(404.0)	(58.0)	(291.9)	(59.3)	(22.8)
Interest & tax paid	(156.0)	(215.0)	(176.1)	(169.8)	(211.0)
Other	(117.0)	84.0	(90.0)	0	0
Operating cash flow	153.0	341.0	230.6	510.4	557.0
Capital expenditure	(348.0)	(240.0)	(200.0)	(300.0)	(425.0)
(Acquisitions)/divestments	1,262.0	6.0	0	0	0
Other	0	(171.0)	(163.7)	(156.8)	(150.1)
Funding available/(required)	1,067.0	(64.0)	(133.1)	53.6	(18.1)
Dividends paid	(68.0)	(128.0)	(147.8)	(139.6)	(164.2)
Equity raised/(returned)	(81.0)	(147.0)	0	0	0
(Increase)/decrease in net debt	918.0	(339.0)	(280.9)	(86.0)	(182.4)

Balance Sheet (NZ\$m)	2019A	2020A	2021E	2022E	2023E
Working capital	1,384.0	1,158.0	1,276.9	1,250.2	1,275.0
Fixed assets	1,754.0	1,555.0	1,579.7	1,696.6	1,919.4
Intangibles	1,129.0	1,133.0	1,133.0	1,133.0	1,133.0
Right of use asset	0	1,413.0	1,326.0	1,244.4	1,167.8
Other assets	817.0	1,317.0	1,251.5	1,172.6	1,126.0
Total funds employed	5,084.0	6,576.0	6,567.1	6,496.8	6,621.2
Net debt/(cash)	325.0	687.0	909.5	944.1	1,092.2
Lease liability	0	1,549.0	1,477.6	1,407.4	1,338.7
Other liabilities	586.0	633.0	460.0	374.0	376.0
Shareholder's funds	4,141.0	3,500.0	3,513.0	3,564.2	3,607.3
Minority interests	32.0	35.0	35.0	35.0	35.0
Total funding sources	5,084.0	6,404.0	6,395.1	6,324.8	6,449.2

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

Valuation Ratios	2019A	2020A	2021E	2022E	2023E
EV/EBITDA (x)	4.2	6.0	4.4	4.8	4.5
EV/EBIT (x)	5.5	19.9	8.0	9.2	8.3
PE (x)	7.9	>100x	11.5	14.6	12.5
Price/NTA (x)	1.0	1.2	1.2	1.1	1.1
Free cash flow yield (%)	-7.0	3.6	1.1	7.5	4.7
Net dividend yield (%)	6.8	0.0	5.3	5.0	5.9
Gross dividend yield (%)	6.8	n/a	5.3	5.0	5.9

Capital Structure	2019A	2020A	2021E	2022E	2023E
Interest cover EBIT (x)	5.3	1.1	3.9	3.6	4.1
Interest cover EBITDA (x)	7.0	3.6	7.2	6.9	7.5
Net debt/ND+E (%)	7.3	16.4	20.6	20.9	23.2
Net debt/EBITDA (x)	0.4	1.3	1.2	1.3	1.4

Key Ratios	2019A	2020A	2021E	2022E	2023E
Return on assets (%)	8.2	1.8	5.1	4.6	5.1
Return on equity (%)	8.9	0.1	6.9	5.4	6.2
Return on funds employed (%)	8.8	6.2	7.5	5.5	6.0
EBITDA margin (%)	8.9	7.3	10.2	9.7	9.9
EBIT margin (%)	6.8	2.2	5.6	5.1	5.4
Capex to sales (%)	3.7	3.3	2.6	3.9	5.3
Capex to depreciation (%)	175	65	56	85	118
Imputation (%)	0	n/a	0	0	0
Pay-out ratio (%)	53	0	61	73	74

Operating Performance	2019A	2020A	2021E	2022E	2023E
External revenue (NZ\$m)					
New Zealand	5,220	4,466	5,436	5,273	
Australia	2,944	2,740	2,569	2,605	
Rest of World	1,143	103	(292)	(266)	
Total external revenue	9,307	7,309	7,713	7,612	7,955

EBIT (NZ\$m)	2019A	2020A	2021E	2022E	2023E
Concrete	84	74	93	77	
Building Products	160	87	115	107	
Distribution	104	85	105	81	
Steel	0	0	0	0	
Construction	47	(147)	40	53	
Residential / Land Developm't	137	65	114	96	
Australia	57	33	24	31	
Divested	82	0	0	0	
Corporate / other	(40)	(37)	(57)	(58)	
Total EBIT	631	160	434	388	

EBIT (NZ\$m)	2019A	2020A	2021E	2022E	2023E
New Zealand	467	110	401	342	
Australia	54	42	16	24	
Rest of World	110	8	17	22	
Total EBIT	631	160	434	388	

Result summary

Figure 1. Divisional breakdown

NZ\$m	FY19 pro forma	FY20	% chg vs. pro forma	Forbar	% diff	
Revenue						
Concrete	549	503	-8.4%	499	0.8%	Cement volumes -5%, aggregates -13%, RMC -9%.
Building Products	1,013	922	-9.0%	876	5.3%	Plasterboard -4%, insulation -10%, pipes -11%, steel -15%.
Distribution	1,552	1,440	-7.2%	1,440	0.0%	PlaceMakers -7%, Mico -8%
Construction	1,622	1,261	-22.3%	1,252	0.7%	Paving, earthworks, civil works halted in lockdown, impacting revenues.
Residential and Land Development	639	460	-28.0%	450	2.2%	Residential revenue -27%. Total units sold -14% to 666.
Australia	2,933	2,723	-7.2%	2,627	3.7%	Laminex -7%, Distribution AU -4%, Steel +4%
Divested	999	0	nm	0	nm	Formica divested 3 June 2019.
Total revenue	9,307	7,309	-21.5%	7,143	2.3%	
EBIT						
Concrete	89	74	-16.9%	61	22.1%	Down -17% excl. NZ\$(13)m impact from lower headcount and property rationalisation.
Building Products	132	101	-23.5%	95	5.9%	Winstone, Tasman, Laminex all delivered margin improvement pre-lockdown
Distribution	115	85	-26.1%	80	6.9%	Division gross margins remained steady despite competitive intensity.
Steel	35	(14)	nm	(7)	nm	Margin pressured by inventory devaluation from declining global steel prices.
Construction	51	(147)	nm	(123)	19.6%	B+I legacy pipeline weighs on division
Residential and Land Development	137	65	-52.6%	65	0.0%	EBIT lower due to timing of settlements, post lockdown sales flowing into FY21.
Australia	77	33	-57.1%	25	31.4%	Laminex EBIT increased due to market share gains from new products, e-com volumes, and cost-out benefits. Steel and Distribution impacted by margin and price pressures.
Divested	82	0	nm	0	nm	
Other	(38)	(37)	-2.6%	(35)	5.7%	
EBIT (before significant items)	680	160	nm	161	-0.4%	
EBIT (ex. B&I losses + divestments)	598	310	nm	311	-0.2%	

Source: Forsyth Barr analysis, Company reports

Figure 2. Result summary

NZ\$m	FY19	FY20	% chg	Forbar	% diff
Revenue	9,307	7,309	-21.5%	7,143	2.3%
EBIT	631	160	-74.6%	161	-0.4%
Reported profit	164	(196)	-219.5%	(206)	-4.8%
Underlying profit	367	3	-99.2%	60	-95.0%
Underlying EPS (cps)	43.1	0.4	nm	7.2	-95.0%
Dividend (cps)	23.0	0.0	nm	0.0	nm

Source: Forsyth Barr analysis, Company reports

Earnings changes

Figure 3. FBU earnings changes

NZ\$m	FY21E			FY22E			FY23E		
	Old	New	% chg	Old	New	% chg	Old	New	% chg
Revenue	7,449	7,713	3.5%	7,369	7,612	3.3%	7,648	7,955	4.0%
EBITDA	786	789	0.3%	762	740	-2.9%	800	791	-1.1%
EBIT	419	434	3.5%	375	388	3.5%	397	431	8.5%
Underlying NPAT	234	244	4.3%	180	191	6.5%	194	223	15.0%
Underlying EPS (cps)	28.4	29.7	4.4%	21.9	23.3	6.5%	23.6	27.2	15.1%
Dividend (cps)	17.0	18.0	5.9%	16.0	17.0	6.3%	17.0	20.0	17.6%

Source: Forsyth Barr analysis

Investment Summary

Unfortunately, Fletcher Building (FBU) did not enter the COVID-19 crisis in fighting shape. NZ margins have long been under pressure. Australian turnaround efforts have delivered little tangible reward. Necessary reinvestment has elevated capex. The risk is this downturn is not only cyclical, but leads to a further erosion in the business's underlying quality. Whilst FBU's share price remains down sharply from pre COVID-19 levels, it's not at a level where we see clear value. 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.

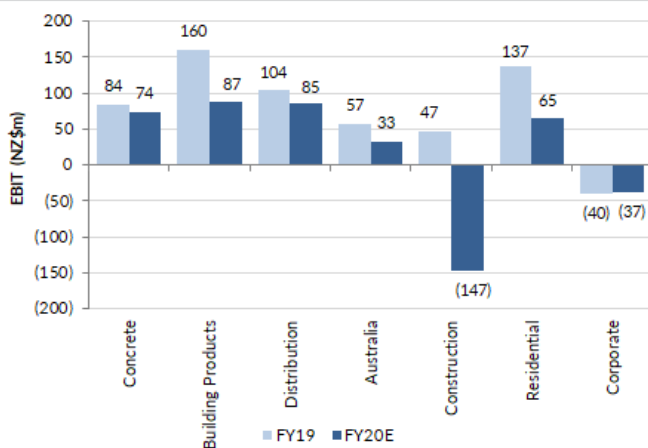
Earnings and cashflow outlook

- **Limited medium-term free cash flow:** Reflecting crystallisation of construction losses and capex materially ahead of depreciation.
- **Strong balance sheet and capital management:** Proceeds from the sale of Formica have lowered FBU's net debt to c.1.0x even on our COVID-19 impacted earnings forecasts, below its 1.5-2.5x EBITDA target.

Risk factors

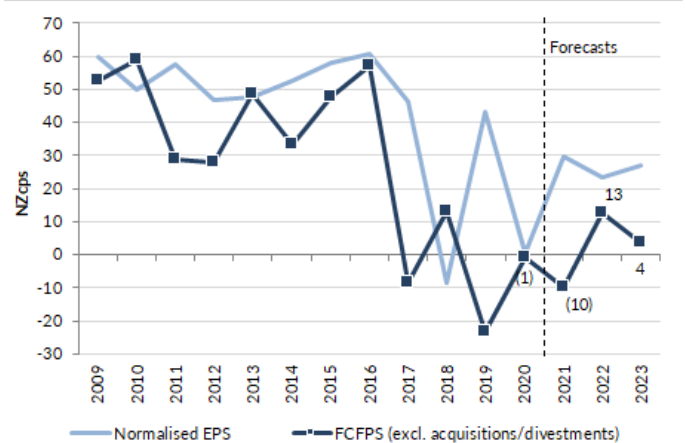
- **COVID-19:** Represents a massive near-term uncertainty for most businesses. We anticipate construction activity will bounce back once lockdown restrictions are fully lifted, but fade as current projects are completed and the pipeline empties.
- **Construction cycles in NZ and Australia:** FBU is 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 4. Divisional EBIT

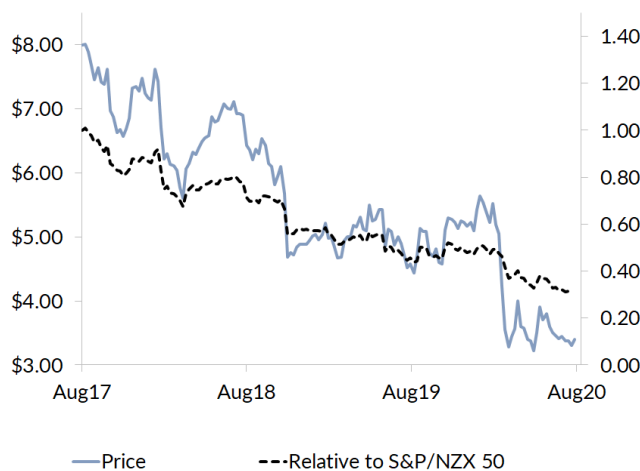


Source: Company reports, Forsyth Barr analysis

Figure 5. EPS and FCFPS



Source: Company reports, Forsyth Barr analysis

Figure 6. Price performance


Source: Forsyth Barr analysis

Figure 7. Substantial shareholders

Shareholder	Latest Holding
Perpetual	8.9%
Schroder Investment Management Group	8.3%
Commonwealth Bank of Australia	6.0%
The Vanguard Group	5.6%
Allan Gray Group	5.1%

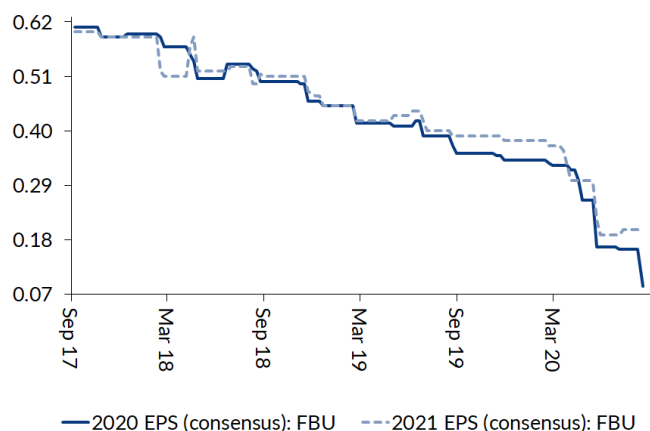
Source: NZX, Forsyth Barr analysis, NOTE: based on SPH notices only

Figure 8. International valuation comparisons

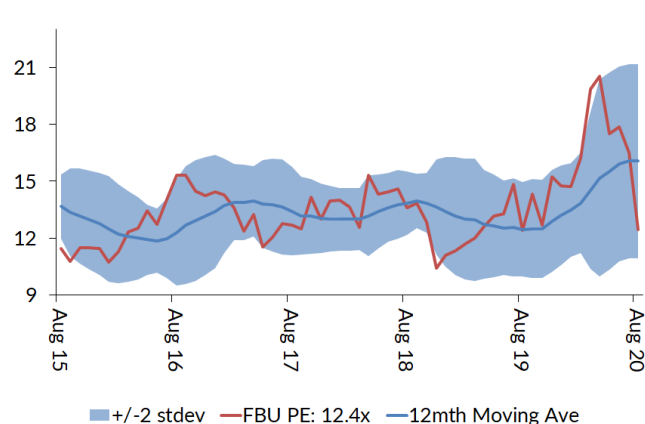
Company	Code	Price	Mkt Cap (m)	PE 2021E 2022E	EV/EBITDA 2021E 2022E	EV/EBIT 2021E 2022E	Cash Yld 2022E
(metrics re-weighted to reflect FBU's balance date - June)							
Fletcher Building	FBU NZ	NZ\$3.40	NZ\$2,792	11.5x 14.6x	4.4x 4.7x	8.0x 9.0x	5.0%
METRO PERFORMANCE GLASS	MPG NZ	NZ\$0.21	NZ\$39	14.4x 21.4x	5.5x 6.1x	15.3x 18.1x	0.6%
STEEL & TUBE HOLDINGS *	STU NZ	NZ\$0.55	NZ\$91	21.0x 8.0x	3.1x 2.6x	7.5x 5.0x	10.9%
ADBRI	ABC AT	A\$2.32	A\$1,513	16.1x 16.1x	8.4x 8.3x	13.8x 14.0x	5.0%
BORAL	BLD AT	A\$3.68	A\$4,510	23.3x 25.7x	8.6x 8.8x	20.8x 22.7x	1.9%
CSR	CSR AT	A\$3.61	A\$1,752	15.2x 16.2x	6.6x 6.8x	10.2x 10.9x	4.1%
WAGNERS HOLDING CO	WGN AT	A\$1.04	A\$195	>50x 26.0x	14.6x 9.8x	37.4x 19.4x	1.2%
GWA GROUP	GWA AT	A\$2.45	A\$647	15.0x 14.2x	10.3x 9.6x	13.0x 11.8x	5.7%
JAMES HARDIE INDUSTRIES-CDI	JHX AT	US\$22.62	US\$10,024	25.6x 22.3x	16.3x 14.6x	20.4x 18.2x	2.4%
REECE	REH AT	A\$10.84	A\$7,002	27.8x 28.7x	14.8x 14.7x	22.5x 24.1x	1.1%
CRH PLC	CRH ID	€33.41	€26,225	18.9x 16.0x	9.2x 8.5x	15.7x 13.8x	2.5%
LAFARGEHOLCIM-REG	LHN SW	CHF43.75	CHF26,947	14.9x 12.8x	6.6x 6.3x	11.1x 9.9x	4.7%
Compc Average:				19.2x 18.8x	9.5x 8.7x	17.1x 15.3x	3.6%
FBU Relative:				-40% -23%	-53% -46%	-53% -41%	38%

EV = Current Market Cap + Actual Net Debt

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

Figure 9. Consensus EPS momentum (NZ\$)


Source: Forsyth Barr analysis

Figure 10. One year forward PE (x)


Source: Forsyth Barr analysis

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