Fletcher Building Ltd
FBU: XNZE (NZL)

View Stock Summary

Morningstar Rating for Stocks	Fair Value	Economic Moat	Capital Allocation
★★	NZD 2.70	None	Poor

Fletcher Still Waiting for a Recovery in New Zealand

Esther Holloway •
Feb 19, 2025

Share

Stock Analyst Note

Fletcher Earnings: New Zealand's Housing Sector Slow to Recover

Esther Holloway •
Feb 19, 2025

Stock Analyst Note

Fletcher: Navigating Another Challenging Year

Esther Holloway •
Jan 30, 2025

Business Strategy and Outlook

Fletcher Building is a New Zealand building supplies company. We estimate about 65% of its revenue is tied to residential construction, 25% commercial, and about 10% infrastructure.

Its largest segments are building products and distribution, contributing about 40% of midcycle group EBITDA. These businesses manufacture plasterboard, insulation, laminate benchtops and materials, pipes, steel, and frame and truss. These are sold through the firm's distribution channels, which include the direct-to-customer channel and its retail store network, mainly to small and midsize construction-related businesses and homebuilders.

The firm invests in increasing its production capacity and improving vertical integration by incorporating upstream businesses into its fold. Recent examples include a new glass-wool insulation plant and the acquisition of two wood mills supplying the building products business.

The concrete and Australia businesses each contribute about one fifth of midcycle group EBITDA. Fletcher is the only domestic cement producer in New Zealand, with all other cement imported. This business has the group's highest midcycle EBITDA margins, although with high fixed costs to run a kiln, operating margins are volatile and vary by about 500 basis points through the economic cycle.

The Australian segment is in a state of flux. Following market share loss, the Tradelink plumbing business was sold in fiscal 2025. Further, Fletcher's Iplex brand has been accused by Perth builders of producing leaky pipes and has been served legal action by homeowners and the main affected building company, BGC. In early fiscal 2025, Fletcher and the Western Australian government announced a scheme to fund repairs in Western Australian homes.

The construction business incurred significant cost overruns over the past few years, as it completed 80 major construction projects, many on fixed- or low-margin contracts. Nowadays, Fletcher's new strategy is to mostly participate in government road projects. We think it has more ability in this area and can leverage the use of its own concrete in these projects.

Bulls Say, Bears Say

Bulls

An improvement in the Australia and commercial construction businesses is likely to lift ROIC.

Cyclicality aside, New Zealand and Australia’s undersupply of housing should provide a steady longer-term demand for Fletcher’s products and services, which are primarily targeted at new residential construction.

New management is expected to address historical misallocation of capital. It may divest underperforming businesses and improve returns on investment.

Bears

Fletcher operates in cyclical and competitive markets with minimal differentiation and is prone to periods of operating deleverage and structural margin compression.

Commoditized building products are not expected to generate any durable shareholder value in the long run.

Attempts to turn around underperforming segments distracts management from focusing on enhancing returns in performing businesses.

Financial Strength

The firm has incurred significant cost overruns in past construction projects, including the New Zealand International Convention Centre, which required repairs after a fire in 2019, and the rectification of the carpark at Wellington International Airport. Fletcher's net debt was NZD 1.1 billion at the end of December 2024. Net debt/adjusted EBITDA was 1.4 times at the end of December 2024, aroud the midpoint of the firm's target of 1.0 to 2.0 times. However, there remains headroom to the covenant, which is 3.5 times senior net debt/adjusted EBITDA, and senior net debt/adjusted EBITDA was 1.6 times at the end of December 2024.

The company entered into two new agreements with its lenders in June 2024, with the new, more generous short-term covenants and longer loan terms providing extra leeway if needed. This includes refinancing of about one third of its drawn debt, with the repayments now in mid-2027 and 2029, from late 2025 previously. Consequently, the firm now has no material debt repayments until fiscal 2027. Second, Fletcher has reached more favorable covenant terms with its lenders. From June 2024 until December 2025, senior leverage covenants are 3.5 times from 3.25 times previously. Senior interest coverage is 2.25 times from 2.5 times.

The underperforming Tradelink plumbing business was sold in fiscal 2025.

Economic Moat

Fletcher Building does not possess an economic moat. About three fourths of group revenue is derived from the manufacture and distribution of building products that lack material differentiation in the marketplace, and 15% from construction activities in which Fletcher lacks durable competitive advantages. Fletcher has a number one or two position in most of the markets its businesses operate, at about 20%-45% market share. However, it doesn't generate excess economic profits. This demonstrates the intense competition from other players and imported products. Fletcher's historical returns on invested capital averaged 9% for the past five years and 10% over the past decade, around its cost of capital, estimated at 9.4%. Our midcycle ROIC forecast is 13%.

Building Products

The main products in this segment are plasterboard, frame and truss, insulation, plumbing pipes, benchtop and decorative engineered stone and laminate, and steel. These appear to have strong brands due to the length of time in the market including about 100 years for Gib, and 60 years for Pink Batts insulation. However, this segment lacks an economic moat. Most of these products are easily substituted and while Fletcher's brands have good awareness in the market, brand equity is not sufficient to provide Fletcher with pricing power.

We think the Gib plasterboard product is moaty with an intangible asset advantage. But the EBIT contribution of Gib is less than half of the building products segment EBIT and so we assign a no-moat rating to the division overall. Gib is the main plasterboard brand in New Zealand, with an estimated 96% market share. We do not consider imports a threat because the product does not ship well due to its fragility.

With such a high market share comes regulatory scrutiny regarding competitive behavior. The Gib brand has been subject to three New Zealand Commerce Commission investigations—in 2013, and over 2021 and 2022. Following the latest investigation, which suggested Fletcher's rebate program was anticompetitive, Fletcher voluntarily removed its rebate pricing for customers who buy at volume. Although we expect this did not affect Fletcher's earnings, future regulations are a risk.

Fletcher had about 75% market share in insulation in New Zealand until about a decade ago when German building product company Knauf entered the market. Fletcher now has about 45% market share in insulation. Knauf's insulation is imported, demonstrating Fletcher's susceptibility to competition from imports in some products.

The Laminex brand was acquired by Fletcher some 20 years ago. Its main product is benchtops made of gypsum or engineered stone. It has been gradually improving margins through research and development to create higher-value designs and alternative uses. We do not think the firm has any cost advantage in the procuring of material inputs including gypsum and paper, but we expect some cost benefits from the integration of a wood business purchased in 2023.

In concrete and plastic pipes Fletcher has about 35% market share and the number two position. In steel it has about 25% market share and the number one and two position for its various finished steel products. We do not think it has any competitive advantage in these products that are commoditized, and face threat from imports. A new steel processing and distribution center is to be completed in fiscal 2026 and the firm's strategy is to increase sales of painted flat steel for products like garage doors and sheds. However, narrow-moat BlueScope already has a dominant market share position with its prepainted Colorbond products, and we expect Fletcher to be a small player.

From fiscal 2023, frame and truss has been manufactured by Fletcher after it acquired a wood mill. Most New Zealand houses are constructed with wooden framing and the firm uses frame and truss to attract customers. Management states for every NZD 1 customers spend on frame and truss, they spend NZD 3-NZD 4 on other Fletcher products. There is no evidence of this occurring yet, with fiscal 2023 revenue from the distribution segment flat with the previous corresponding period. Furthermore, we do not think the firm is unique in this strategy, with the firm's four retail competitors also selling frame and truss, in addition to independent manufacturers. Consequently, we do not think the firm has any competitive advantage in frame and truss.

Distribution

The distribution segment lacks an economic moat. Although the firm has the number one or two market position in the retail channel, the segment is very competitive. Fletcher's main retail brand is PlaceMakers and there are four other large hardware store brands in New Zealand serving the same market. PlaceMakers has about 30%

small and midsize enterprise market share, ITM and Carters each have about 25%, and Bunnings and Mitre 10 comprise about 10% each, per the New Zealand Commerce Commission. Although Fletcher's has high market share, we estimate it has been declining as tradespeople shop around for the best deals and competitors employ the same strategy of selling frame and truss at low margins to draw the customer in.

The segment is vertically integrated through selling its own building products in addition to other brands' products. However, the overall impact of competition erodes any cost advantage from vertical integration. This is demonstrated by low EBIT margins, averaging 7% over the past five years versus Bunnings, which does not have vertical integration, with an average EBIT margin of 12% for its Australia and New Zealand earnings over the same period.

Concrete

We do not assign a moat for Fletcher's concrete business. Fletcher is the only domestic cement producer in New Zealand, with all other cement imported. It owns strategically located quarries in addition to the country's only kiln. Nonetheless, there are many small family owned quarries supplying aggregates to make concrete using imported cement. The segment's downstream activities include ready mix and bagged dry concrete. Fletcher has also introduced higher-margin products including textured cement, pavers, and retaining walls, but these are a small part of segment earnings. Fletcher has about 45% market share in concrete and about 60% in cement. Due to its high fixed costs, operating margins are volatile and vary by about 500 basis points through the economic cycle, whereas importers can vary supply to match demand.

We think the economics of importing cement are strong, with most New Zealand towns having close access to a port, short land transportation distances, and many small quarries that can supply sand and aggregates. The segment's major competitor, Holcim, has switched to an all-import model after shuttering its local production facilities in 2016.

As the only domestic producer, Fletcher produces 80% less carbon than imported cement because under New Zealand regulations the transport involved in importing cementitious materials counts toward its carbon footprint. Fletcher actively markets the product around this messaging. Other environmental, social, and governance initiatives include powering the plant with recycled tires, reducing coal use and emissions. Although we think this should appeal to customers, we have no quantitative evidence of a competitive advantage. Almost half of revenue is exposed to the residential sector, which we think favors a low price, quality, and convenience of delivery/service above ESG concerns.

Australia

We do not assign the Australia segment an economic moat. The Australian business has three main building product brands: Iplex pipes, Laminex benchtops and materials, and Fletcher insulation, in addition to a steel business. It has number one or two positions in its brands and market share ranging from 20% to 40%. However, all this is offset by a very competitive building products industry. The Tradelink plumbing supply business was sold in fiscal 2025.

We think there is more competition in the building products segment in Australia than New Zealand and Fletcher does not have strong brand recognition in Australia, which is dominated by larger Australian building product companies including CSR, James Hardie, BlueScope Steel, Boral, Brickworks, Reece, Reliance, and Adbri. Additionally, pipes, insulation, laminates, and steel are largely commoditized. These products require limited research and development, and we think barriers to entry are low. We think imports are also a threat.

With segment EBIT margins averaging low single digits over the past decade, we think the Australian segment is challenged. We estimate significant items before tax, including impairments, of some NZD 800 million over the past decade relate to the Australian business, compared with EBIT before significant items of NZD 1.3 billion over the same period. Significant items include multiple restructures, the sale of unprofitable businesses, and write-downs of Iplex and Tradelink.

Residential and Development

We do not assign an economic moat to the residential construction and development segment. Property development is easily replicable and the barriers to entry are low. Fletcher builds less than 5% of New Zealand's new house volume. EBIT margins in this segment have historically been high, averaging 19% over the past decade. This is mostly due to land costs on the balance sheet at historical costs.

This segment builds low-cost housing for first-homebuyers, or low-income households in the high-growth regions of Auckland and Christchurch. The group uses its balance sheet to acquire large parcels of land near urban centers, as well as recycling surplus land from discontinued industrial operations to develop planned residential communities. Fletcher has benefited materially from rising land prices and the shortage of new homes given New Zealand's relatively high population growth levels of 1.8% over the past decade, driven by migration.

These homes are typically priced about 10% below average house prices, which makes them attractive to first-homebuyers and low-income households, leading to strong demand. We estimate sales of about 950 units annually over the next decade, from an anticipated 900 units in fiscal 2024.

The segment strategy has changed several times over recent years. Fletcher was initially targeting about 1,400 annual home builds including apartments, but has since paused apartment builds. As with an earthquake-prone geography and following the catastrophic earthquakes in Christchurch in 2010 and 2011, building restrictions have tightened over recent years. Consequently, apartment towers in Christchurch and some parts of Auckland are generally restricted to seven stories or less, reducing economic profits from higher-density apartment construction. The firm also builds prefabricated homes in over-age-50s retirement communities and has completed two communities to date.

Construction

The construction business is cyclical and subject to fluctuations in size of orders and backlog. The business has low barriers to entry and Fletcher competes with smaller local players and national firms. The construction companies act as project managers, with much of the work subcontracted out, so there is little ability to differentiate versus competitors or to dictate the use of Fletcher's internally manufactured building materials.

Former management (two CEOs prior) signed 80 major building works contracts, many at fixed cost or low margin. The last of these is the New Zealand Convention Centre, to complete at the end of calendar year 2024, with cost overruns of about NZD 400 million. Henceforth, the firm's strategy is for only "horizontal construction", which is mainly road projects. Nonetheless, this is a very low-margin business with management projecting low- to mid-single-digit midcycle EBIT margins.

Fair Value and Profit Drivers

Our fair value estimate for no-moat Fletcher Building is NZD 2.70 (AUD 2.40).

We think most of Fletcher's revenue is exposed to the middle stage of a new house build, which occurs six to 12 months after construction begins. Consequently, we anticipate a a recovery commencing from the second half of fiscal 2025, as demand works through the system. Our fiscal 2025 adjusted EBIT forecast is NZD 410 million, 20% below fiscal 2024 based on a 3% decline in revenue growth from lower volumes, margin compression, and limited price increases.

Longer-term, we forecast a revenue compound annual growth rate of 2%. Our longer-term outlook is underpinned by our midcycle assumption for new residential construction. We expect the current cyclical slowdown and subsequent bounce back in construction activity across Australia and New Zealand to normalize toward the middle of our 10-year forecast horizon. We forecast terminal fiscal 2034 underlying EBIT margin of 9% from 7% in fiscal 2024.

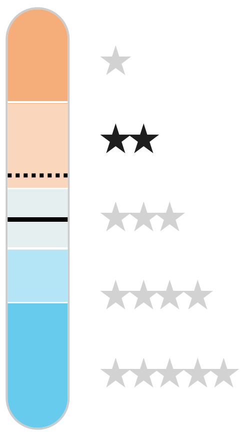
Price vs Fair Value View History >

FBU is trading at a 21% premium.

Price
NZD 3.28
Feb 26, 2025

Fair Value
NZD 2.70
Feb 19, 2025

Uncertainty
High



1-Star Price	NZD 4.19
5-Star Price	NZD 1.62
Economic Moat	None
Capital Allocation	Poor

Terms

Risk and Uncertainty

Our Morningstar Uncertainty Rating is High. Fletcher's six businesses are mostly exposed to residential construction, which leads to significant earnings cyclicality.

New Zealand and Australia have an undersupply of housing, which we think underpins long-term demand for Fletcher's products. But housing affordability is affected by interest rates and inflation, causing material cyclicality in demand. We estimate about two thirds of Fletcher's revenue is exposed to the residential market.

Fletcher operates in a competitive market, with many other companies and imports producing similar products. The company has a number one or two position in most of its operating markets, yet it doesn't generate excess economic profits. This is due to intense competition from other players and imports.

Other risks include future regulations. Recently, the Gib plasterboard brand was subject to three New Zealand Commerce Commission investigations. Following the latest investigation in 2022, which suggested Fletcher's rebate program was anticompetitive, Fletcher voluntarily removed its rebate pricing for customers who buy at volume. Although we expect this did not affect Fletcher's earnings, future regulations are a risk.

Building product companies are also exposed to risk from faulty building products. In fiscal 2024, Fletcher's Iplex pipes have been accused of causing leaks by a Perth construction company. Although Fletcher says it is not at fault, in August 2025 it announced a fund in conjunction with the Western Australian government to rectify leaky homes. However, the main affected building company, BGC, has not joined the scheme and is pursuing legal action.

The company is exposed to ESG risks mainly due to greenhouse gas emissions from manufacturing. The concrete segment is the most exposed, due to its reliance on coal to run its kiln. However, as at the end of June 2023, the firm had reduced coal use by about half by substituting coal with waste wood and used tires.

Capital Allocation

We allocate Fletcher Building a Poor Morningstar Capital Allocation Rating based on our assessment of the firm's balance sheet, capital investments, and shareholder distributions.

Fletcher's balance sheet is weak and in fiscal 2025 it turned to an equity raise to improve it. Fletcher's revenue is highly cyclical and its balance sheet is currently stretched due to legacy costs to complete the New Zealand International Convention Centre. Leverage, measured as net debt/adjusted EBITDA, was 1.4 times at the end of December 2024, around the midpoint of the company's 1-2 times target range.

However, this is below the firm's covenant limit, which is 3.5 times senior net debt/adjusted EBITDA, and senior net debt/adjusted EBITDA was 1.6 times at the end of December 2024. Additionally, major cost overruns from the New Zealand International Convention Centre are now absorbed and we expect an improving residential sector outlook in New Zealand and Australia over the second half of 2025.

In our view, the firm's investment efficacy is poor. Fletcher has experienced value destruction through acquisitions in the past and we believe the appetite for future large-scale acquisition activity is rightly low.

We estimate NZD 800 million to be spent on growth capital investments over fiscal 2023 to 2026, leading to a midcycle EBIT uplift of about NZD 120 million per year. In our view, these investments are unlikely to improve the firm's overall return on invested capital, or ROIC, and we expect group ROIC to remain around our cost of capital over our forecast period, averaging about 10% over our 10-year forecast period, compared with a weighted average cost of capital of 9.4%.

From fiscal 2023, frame and truss has been manufactured by Fletcher after it acquired a wood mill. Most New Zealand houses are constructed with wooden framing and the firm uses frame and truss to attract customers. However, as an essential building product, with limited innovation required, New Zealand's ready supply of timber, and other building product companies following a similar strategy, we do not think the firm has a competitive advantage in frame and truss. Management's adage is that for every NZD 1 spent on frame and truss NZD 3-NZD 4 is spent on other Fletcher building products. There is no evidence of this occurring yet, with fiscal 2024 distribution segment revenue lower than the prior year. To support this strategy, the firm has acquired a wood mill, six frame and truss and building product stores, and an automated frame and truss manufacturing plant.

Other large investments include a new insulation manufacturing and distribution plant, to be fully operational from fiscal 2027. From 2023, the New Zealand government has mandated about twice as much insulation is to be used in new home builds. While we expect Fletcher to supply a share of these volumes, its insulation business is experiencing market share declines. As such, we estimate increased volume demand from the building code change will be offset by market share declines as competitors grow share in the insulation category.

The firm is also investing in its steel business and Laminex plant. For the latter it has acquired a second wood mill to supply timber for the manufacturing of laminate products, in line with its vertical integration strategy.

We view Fletcher's historical distributions to shareholders as mixed. We support Fletcher's intention to distribute capital to shareholders in the form of dividends and share buybacks. On-market buybacks can be appropriate provided they are undertaken at a discount to fair value. The risk with a cyclical business such as Fletcher is that cash flows sufficient to facilitate buybacks are generated during cycle highs, which generally coincide with elevated share prices. However, it has cut dividends on two occasions in recent years, and we expect it to pay no dividends in fiscal 2025 while the residential sector outlook is uncertain.