FINANCIAL REVIEW

Chanticleer

Troubled Fletcher gets its quick cash, but problems don’t disappear

It’s good that companies can raise equity quickly. But it is also a long road back.

Building materials group Fletcher Building is displaying the best and worst of listed equity markets.

The sole large-cap survivor in a sector raided in the past 12 months (CSR, Boral, AdBri all gone) and carrying too much debt in a housing construction downturn, Fletcher Building can send its bankers to market [https://www.afr.com/link/follow-20180101-p5kc61] and over one weekend arrange a chunky equity bailout.

A quick equity injection will help Fletcher in the near-term, but it’s always a long road back from such raisings. **David Rowe**

The result is a $NZ700 million ($641 million) underwritten deal. Australian fund managers will buy the bulk of the stock, willing to look past Fletcher’s issues for

the chance to buy cheap stock at what looks like the bottom of the cycle.

If a Band-Aid can fix Fletcher's problems, here it is.

The Band-Aid can be applied pretty much overnight, cuts leverage to the bottom half of the board's targeted range and buys the new management team time to cut costs and try to ride out the cycle.
That's the best of listed capital markets – there is almost always a deal at a price, even when it is raising equity to cover past mistakes, pay down debt, get through a tough spot or all three, in Fletcher's case.

The problem is, we've seen this before.

Over the past 20 years, the dual-listed Fletcher has raised about $NZ3.5 billion for recapitalisation and acquisitions on stockbroker Forsyth Barr's numbers, which is not far off the amount it has returned to shareholders via dividends and buybacks ($NZ4 billion).

Net debt has also increased $NZ150 million, and it has written off $NZ2.5 billion in significant items. The last time it bought back shares, three years ago, it paid an average $NZ6.70 a share for 5 per cent of the company. Monday's raising was at $NZ2.40, a 17 per cent discount to the last close.

So, Fletcher's capital allocation history is terrible, which begs the question: where will Monday's $NZ700 million go? Will it also disappear? Is this time really different?

All that will get swept under the rug in the rush for cheap stock.

Buying in hope

It is really hard for a fund manager to pass up shares at a 17 per cent discount to the last close or 12.9 per cent to TERP, which accounts for dilution, when the average ASX-listed large-cap industrial company is trading at 22 times FY25 earnings per share and the S&P/ASX200 is at a record high. Stocks are generally expensive.

Fund managers will buy the shares hoping that housing construction markets on both sides of the Tasman cannot get much worse, and that Fletcher's incoming chairman (yet to be determined) and new management team can stem the company-specific issues.

They also know that participating in discounted equity issues usually works.

So, Fletcher will get its quick bailout – that's the best of capital markets – and not be forced into more asset fire sales at depressed prices or dispatched into junk credit rating territory. Underwriter Jarden told fund managers the deal was "covered" when the market opened on Monday morning [https://www.afr.com/street-talk/books-covered-for-fletcher-building-s-nz700m-equity-raise-20240923-p5kcmd].

But Fletcher will emerge from the raising with 292 million more shares on issue, or 37.5 per cent more shares than it had last week.

That is 292 million more calls on the company's earnings, 292 million more dividends to be paid (not that it paid any dividends last year) and 292 million shares to be bought back, probably at higher prices, if it is to ever be as lean and mean as it was last week.

That's the worst of listed equites markets.

It is great that Fletcher can raise capital so quickly, but Monday's raising will not automatically boost its earnings capacity, fix the NZ or Australian housing cycles, help it sell more Laminex kitchen benches/cupboards or solve its capital allocation problems. All those problems are still there.

It will be interesting to see whether Fletcher continues to seek to sell a stake in its residential and development division.

Life as a listed company is much easier and better for shareholders if you can avoid these sorts of raisings – just as Commonwealth Bank of Australia, the stingiest and easily most valuable of the big four banks, has, or Washington H Soul Pattinson & Co, which shocked investors with its first secondary equity raising last month.

One good thing for Fletcher is that its three big listed peers – cement groups Boral and AdBri and plasterboard company CSR [https://www.afr.com/link/follow-20180101-p5jlqu] – are all gone, having fallen to strategic suitors this year. If you view listed markets as a competition for investor capital, which it is, that should mean more money available to Fletcher, should it get its house in order, and fellow top-100 stock James Hardie.

Fletcher's hefty recapitalisation has been speculated for months, and it was a surprise it took as long as it did.

The trigger was finally working out a way to deal with its Iplex pipes issue [https://www.afr.com/link/follow-20180101-p5d0yc] in Western Australia, where Fletcher agreed in late August to a $155 million deal to fix plumbing failures, and appointing industry stalwart Andrew Reding as CEO. Reding was supposed to start on September 30 but was front and centre on Monday's equity raising call.

It will be interesting to see whether Fletcher continues to seek to sell a stake in its residential and development division. Reding told analysts on Monday morning's call that the company was still talking to interested parties, but it was unlikely to be a "quick project".