
Bullish Fletcher Building

Fletcher Building - WA Pipes Joint Industry Response Finalised

Equity Bottom-Up 188 Views 14 Nov 2024 10:19 Broker

 SMART TAKES ⓘ



Key Takeaways

- Fletcher Building has finalised the joint industry response for Pro-Fit pipe leaks in Western Australia, reducing recall risk but leaving some legal uncertainties unresolved.
- New management and eased balance sheet pressure signal potential stabilisation, along with government efforts to reduce construction sector red tape.
- Despite these positives, caution persists in the market due to unresolved issues with Pro-Fit pipes and the New Zealand International Convention Centre costs.

Bullish Points

- Finalisation of the joint industry response reduces the risk of a product recall, providing some certainty around potential liability for Fletcher Building.
- New management is partially in place and balance sheet pressure has been eased with the recent capital raise.
- Signs of stabilisation in New Zealand construction activity as the government cuts red tape in the construction sector.

Bearish Points

- Outstanding legal claims against Iplex AU still present a challenge, especially with BGC pursuing litigation instead of participating in the JIR.
- Uncertainty remains around the quantum of total remediation, with the extended time to lodge complaints from six to 15 years post construction.
- Market remains cautious due to ongoing uncertainty around the Pro-Fit pipes issue and the final cost of the New Zealand International Convention Centre.

Catalysts Watch

- Resolution of legal claims against Iplex AU, particularly BGC's litigation approach.
- Results of new management's strategic review and its impact on company strategy.
- Further developments in New Zealand's government construction sector reforms.

Is this helpful?

EXECUTIVE SUMMARY

- Fletcher Building (FBU) announced that the joint industry response (JIR) for its Pro-Fit pipe leak issues in Western Australia has been finalised.
- The key terms from the agreement are unchanged from the announcement in August.
- While the finalisation of the JIR does not fully sterilise the issue, with litigious risk and potential cost overrun the key risks from here, this is an important step for FBU to draw a line in the sand on this issue.

DETAIL

Fletcher Building (FBU) announced that the joint industry response (JIR) for its Pro-Fit pipe leak issues in Western Australia has been finalised. The key terms from the agreement are unchanged from the announcement in August. While the finalisation of the JIR does not fully sterilise the issue, with litigious risk and potential cost overrun the key risks from here, this is an important step for FBU to draw a line in the sand on this issue. After a particularly challenging period, things might be starting to move in the right direction for FBU: (1) new management is partially in place, (2) balance sheet pressure has been eased with the recent capital raise, (3) the New Zealand government has started to cut red tape in the construction sector, and (4) we are starting to see signs of a stabilisation in New Zealand construction activity. Given recent history, and the remaining uncertainty around the Pro-Fit pipes issue and final cost of the New Zealand International Convention Centre, we think the market will remain cautious until FBU gets some runs on the board. NEUTRAL.

NZX code	FBU	Financials: Jun/	24A	25E	26E	27E	Valuation (x)	24A	25E	26E	27E
Share price	NZ\$3.20	Rev (NZ\$b)	7.683	7.311	7.472	8.002	PE	13.6	20.5	14.1	10.0
Target price	NZ\$3.10	NPAT* (NZ\$m)	183.0	155.7	243.3	340.6	EV/EBIT	12.1	15.4	11.7	9.0
Risk rating	Medium	EPS* (NZc)	23.6	15.6	22.8	31.9	EV/EBITDA	7.3	8.0	6.5	5.5
C&ESG rating	B+	DPS (NZc)	0.0	0.0	7.5	21.0	Price / NTA	1.1	1.2	1.1	1.1
Market cap	NZ\$3,419m	Imputation (%)	n/a	100	100	100	Cash div yld (%)	0.0	0.0	2.3	6.6
Avg daily turnover	1,297k (NZ\$4,443k)	*Based on normalised profits					Gross div yld (%)	n/a	0.0	3.3	9.1

Joint industry response finalised, BGC still not participating

FBU announced a positive step towards a conclusion on the Western Australia pipes issue. The JIR, which was announced in August, has been finalised, with the key terms unchanged (see our research note *Paying the Piper* dated 2 September 2024). While the finalised JIR does not fully sterilise the issue, it does remove the risk of a product recall, and provide investors a degree of certainty around potential liability for FBU. The key uncertainties remain: (1) outstanding legal claims against Iplex AU, including BGC's seemingly all-or-nothing strategy of taking Iplex AU through the courts instead of participating in the JIR, and (2) the quantum of total remediation given the extended time to lodge complaints from six years to 15 years post construction. With BGC currently outside of the JIR, guidance for FY25 cash outflow has been lowered from A\$40m–\$50m to A\$20m (including A\$5m investigative fund overrun). Some of this will likely flow into FY26 (i.e. leak detector installation) and we have adjusted our cash flow assumptions accordingly. Our assumptions are based on the top end of FBU's guidance range, which reflects BGC in the JIR and a 35% leak rate (currently 18%).

Around the final bend, hitting the hurdles

While FBU has been fighting fires over its elevated debt levels, WA pipes, management and board refresh, and legacy construction projects, the operating backdrop is starting to show signs of stabilisation. Residential consents have been range bound at a solid level between 30k–35k (annualised and seasonally adjusted) for the last year, and ready-mix concrete saw the second consecutive quarter of flat volumes in September 2024. Furthermore, the government is working to cut construction sector red tape through its fast-track legislation and proposed self-verification for large scale home builders. Recent channel checks suggest some large home builders have seen a pick up in enquiry and sales activity over recent months, as mortgage rate pressure has eased. New management's upcoming strategic review is (another) opportunity to delineate the path forward.

ATTACHMENTS



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