

Brickworks

Building value

Buy

Important: The above recommendation has been made on a 12 month view and may not suit your investment needs or timeframe. The basis it is prepared on is summarised on the last page of this report. **PLEASE CONTACT YOUR ADVISER TO DISCUSS THIS GENERAL RECOMMENDATION BEFORE ACTING ON IT.**

Low-Mod volatility

Target price
A\$14.24 (from A\$14.35)

Price
A\$10.95

Short term (0-60 days)
n/a

Price performance

	(1M)	(3M)	(12M)
Price (A\$)	11.22	11.20	12.65
Absolute (%)	-2.4	-2.2	-13.4
Rel market (%)	-0.5	-1.5	-10.8
Rel sector (%)	-9.2	-11.5	-31.4



Market capitalisation
A\$1.62bn (US\$1.67bn)

Average (12M) daily turnover
A\$0.66m (US\$0.62m)

Sector: BBG AP Construction
RIC: BKW.AX, BKW.AU
Priced A\$10.95 at close 25 Mar 2011.
Source: Bloomberg

Analysts

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The longer-term outlook for BKW is positive with the change in government in NSW having the potential to see additional land released. BKW will also benefit from its large land bank continuing to be re-zoned and a strong balance sheet to pursue growth opportunities. Buy maintained

Key forecasts

	FY09A	FY10A	FY11F	FY12F	FY13F
EBITDA (A\$m)	98.90	97.40	105.3	143.2	177.1
Reported net profit (A\$m)	305.2	138.8	170.1	166.0	191.7
Normalised net profit (A\$m) ¹	113.7	110.2	114.0	166.0	191.7
Normalised EPS (c) ¹	85.60	78.70	77.40	112.5	129.9
Normalised EPS growth (%)	5.01	-8.13	-1.68	45.50	15.40
Dividend per share (c)	39.00	41.00	43.00	45.00	47.00
Dividend yield (%)	3.56	3.74	3.93	4.11	4.29
Normalised PE (x)	12.80	13.90	14.20	9.73	8.43
EV/EBITDA (x)	20.20	18.90	17.30	12.70	10.10
Price/net oper. CF (x)	11.00	10.50	12.30	16.00	13.30
ROIC (%)	3.04	2.86	2.88	4.07	5.04

Use of % indicates that the line item has changed by at least 5%.

1. Pre non-recurring items and post preference dividends

Accounting standard: IFRS

Source: Company data, RBS Morgans forecasts

year to Jul, fully diluted

Solid 1H11 result ahead of expectations even after wet weather impacts

BKW reported normalised NPAT of A\$61m, which was ahead of our forecast of A\$57m and up 7% on the pcp. The Building Products division delivered EBIT of A\$22.4m, up 2.8% on the pcp. Management estimated that wet weather negatively impacted EBIT by A\$1.7m for the half. BKW's EBIT margin decreased to 7.4% from 8.3% due to a structural shift in the division resulting from the Precast acquisition (August 2010). Property EBIT increased substantially to A\$20.6m (from A\$12.3m) due to the sale of land at the M7 Hub, while SOL's EBIT contribution was down 7.8% to A\$37.9m.

Outlook for building products is steady

Management outlook for the building products division is steady. While we acknowledge that demand for new dwellings remains patchy and varies from state to state. NSW is clearly improving and we believe the change in Government in NSW could act as a catalyst if changes are made to land supply and affordability.

Strategic land bank, SOL investment steady, balance sheet strong

BKW's property division remains difficult to forecast with accuracy due to variability of timing of sales and development. Demand for new site development work has slowed, however, rental returns have stabilised. The final parcels at M7 are earmarked to be sold in 2H11. BKW will continue to rezone surplus land at Craigieburn (VIC) and Rochedale (QLD) in anticipation of further development. All in all we forecast a flat result from the division in FY11. Returns from the investment in SOL are expected to remain solid. Despite a steady outlook for BKW's core division, we maintain our Buy rating due to: 1) leverage to a recovery in VIC and NSW; 2) the strong balance sheet and earnings diversification; 3) valuation upside from future property developments out of the 4,800ha landbank; 4) trading at a discount to shareholder equity per share and 5) valuation support trading at 31% discount to our SOTP.

1H11 result

- **Normalised NPAT** was A\$61m which was ahead of our forecast of A\$57m and up 7% on the pcp. Including non-regular items BKW's headline NPAT was up 33% to A\$117.1m. The non-regular items were A\$56.1m after tax, which related to New Hope's sale of its stake in Arrow Energy. BKW's equity accounted share of this profit was A\$83.4m.
- Total net **cash flow** from operating activities was A\$55.1m, which was down from A\$63.5m on the pcp. This included a reduction in special dividends totalling A\$12.8m received from SOL. Major cash outflows included ordinary dividends paid of A\$39.8m, capex of A\$21.5m and the acquisition of Giroto and Gocrete precast businesses for A\$13.8m.
- **Strong balance sheet** – Net debt to equity has improved from 18.2% as at 31 July 2010 to 17.8%. EBIT interest cover remained comfortable at 7.4x including associate income. Total interest bearing debt was steady at A\$300m while net debt to capital employed rose slightly to 12.8%.
- **Banking facilities & borrowing costs** – BKW has a A\$300m senior debt facility that has now been categorised in current liabilities. This three-year facility is due for maturity in August 2011. BKW also has a A\$100m undrawn working capital facility which is due to be rolled over at the same time. Borrowing costs were down by 12.4% due to lower average debt levels and gains on mark to market valuation of swaps.
- **Working capital** – (excluding assets held for resale) was A\$195.2m which was a reduction of A\$27.1m. Inventory was steady at A\$110.9m.
- **Earnings per share** – normalised EPS was 41.5cps up 2.0% on the pcp.
- **Dividend** – BKW paid a 13.5cps dividend (from 13cps on the pcp), however it was slightly below our expectations of 14cps. The dividend has a record date of 28 April 2011, with payment on 17 May 2011.
- **Significant items since balance** – On the 18 Feb BKW purchased East Coast Masonry which is a producer of concrete masonry products of A\$2.5m.
- **Guidance** – Management stated that BKW is expected to deliver another solid result.

Key takeaways – Divisionals

Building Products

- Building Products produced a A\$22.4m EBIT, up 2.8% on the pcp. The division saw EBIT margins fall from 8.3% to 7.4%. The fall in EBIT margin relates to BKW's acquisition of Precast in August 2010. If the acquisition is excluded then the margin would have slightly increased to 8.5%. Precast has inherently lower margins due to the supply and install nature of the business.
- **Austral Bricks** – brick sales volumes were up 5.5%, while net average selling prices were up 1.9%. Manufacturing volumes increased to match demand and unit costs were held steady despite the increase in energy costs of 6.3% nationally. Progress on the delivery of the BER and Social housing programmes vary across states, however, most states have seen the peak of activity. With the exception of Victoria, which is less than half completed.
- **Austral Masonry** – on a like-for-like basis excluding the Port Kembla acquisition, sales volumes were down 5%, however, when Port Kembla is included sales volumes increased by 20%. Average selling prices were increased by 2.6% on the pcp, assisted by the promotion of a new range of products. Wet weather caused a number of plant closures, resulting in an increase of unit manufacturing costs by 5.9%. In February BKW purchased East Coast Masonry, a Coffs Harbour based business for A\$2.5m.
- **Bristle Roofing** – achieved a solid lift in earnings with sales volumes on the East Coast remaining steady despite the impact of wet weather. The average sales price increased by 3% as customer mix returned to more historically consistent levels as first home owner work diminished. However, production costs rose on lower volumes as production time was lost in QLD due to the wet weather and Dandenong plant in Victoria which was closed for scheduled maintenance.

- **Austral Precast** – provided a positive contribution in the 1H, a positive as BKW had previously announced that the precast business would be at breakeven. Austral Precast is now the only national producer of concrete precast panels after the acquisitions of Giroto and Gocrete businesses for A\$13.8m. These businesses have now been integrated with the previously acquired Sasso Business. BKW has made significant upgrades to the automated carousel plant at Wetherill Park in NSW, while planning for a new automated plant in VIC is progressing well.
- **Auswest Timbers** – delivered a solid result due to increased margins with the growth in average selling prices double the increase in unit manufacturing costs. Average sales prices increased as a result of the continued strategy to reposition the business as a provider of value added products. The dynamics of the timber industry is changing, which could be a positive for Auswest. Also the change in government in VIC may result in a more secure log supply regime and provide certainty to enable reinvestment.
- **Outlook** – BKW anticipates that activity levels in housing construction market will remain at current levels for the year. Demand for new dwellings remains patchy and varies from state to state. NSW and WA will continue to be constrained by a lack of affordable, available land for developments. BKW is hopeful that issues in WA have been addressed and activity will improve in the final quarter of this financial year.

Land & Development

- Land and Development division reported A\$20.6m in EBIT, up 33% on the pcp.
- **Property Sales** – Contributed strongly to the overall profit with a total profit of A\$14.9m. Major transactions for the half included the sale of 14.5 hectares of land at the M7 Hub to Hewlett Packard, which provided BKW A\$18.8m in proceeds.
- **Property Trust** – Delivered EBIT of A\$5.5m up 37.5% on the pcp. Rental distribution decreased slightly to A\$3.0m due to a one-off refinancing cost for the Erskine Trust. Cap rates appear to have stabilised between 8% and 8.5%. The total value of the Property Trust Assets rose to A\$609m, with borrowings of A\$243.5m which gives a net value of A\$365.5m. BKW's share of the net asset value is A\$182.8m up 3.8%.
- **Waste Management** – EBIT of A\$1.1m was up 51.5% on the pcp.
- **Outlook** – Demand for new site development work in the industrial market is improving however, it is from a low base. What is pleasing though is competition is stronger as there is more land available. BKW is continuing to rezone surplus land at Craigieburn in Victoria, with a submission the future use of the land lodged with Victorian government in November 2010 with a response on the submission due by mid 2011. Also the rezoning of Rochedale in QLD to industrial land is expected to be finalised by mid 2011.

Investments

- BKW's investment in SOL contributed A\$36.9m, down 7.8% on the pcp, while EBIT of A\$37.9m was reported, down 7.6% on the pcp.
- The market value of BKW share in SOL was A\$1.26bn, down 5.4%. During the half, fully franked dividend of A\$33.2m was received.
- SOL owns significant investments in New Hope Coal, TPG Telecom, API, BKI Investment Company, Clover, Ruralco and Souls Private Equity.
- **Outlook** – Investment returns are expected to be impacted by interruptions to New Hope Coal earning caused by the floods and API.

Market conditions

On a national level, total dwelling approvals were slightly down for the six months ended 31 January 2011. The detached housing segment showed the greatest signs of weakness, down 16.8% on the pcp. However, dwelling commencements for the six months were up 3.4% to 82,208. The standout is Victoria where multi-unit approvals were up 44.2%, which was due to a combination of strong population and economic growth with good support from the state government through first home owners grants. NSW also showed some long awaited signs of life in part due to the elimination of stamp duty for off-the-plan purchases under A\$0.6m. We could see further stimulation of the NSW market if a change of government occurs at the up coming election.

Table 1 : Dwelling commencements for the six months

State	Dwelling commencements	% change over six months	Comments
VIC	31,061	18.20%	Strong growth in multi-unit dwellings supported by strong population and economic growth
NSW	18,754	5.70%	Showing long awaited signs of life, in part due to the elimination of stamp duty for off the plan purchases under A\$0.6m.
QLD	14,218	-15.70%	Facing significant challenges that are dampening the demand for new dwellings. Interstate migration has reduced and there is an oversupply of apartments on the Gold Coast and other tourist destinations.
WA	10,816	-5.30%	A lack of affordable and titled land for development combined with restrictive lending practices constrained building activity levels in WA.
SA	5,795	2.30%	Remained steady on the pcp
TAS	1,568	-4.10%	n/a
Total (6 mths)	82,208	3.40%	Activity in dwelling commencements is expected to stabilise at an annualised rate of 150,000 to 155,000 for the coming year

Source: Company data

Changes to forecasts

We have made a number of changes to our forecasts. We have accounted for the one-off sale of Arrow Energy and reduced our margins in the Building Products division due to the precast acquisition which has led to a fundamental shift in Building Products margins. The largest impact to our FY11 forecasts has been due to SOL's investment in New Hope Coal which was affected by recent flooding impacting volumes. Please note we have not factored in the proposed carbon tax to our forecasts. BKW believes a carbon tax of A\$20 per tonne would reduce the group's earnings by A\$8m or 15%.

Table 2 : Changes to forecasts

	FY11F			FY12F			FY13F		
	Previous	Revised	% change	Previous	Revised	% change	Previous	Revised	% change
Revenue (A\$m)	664	664	0%	728	728	0%	780	780	0%
EBIT (A\$m)	162	169	5%	206	236	14%	244	271	11%
NPAT (A\$m)	119	170	43%	143	166	16%	170	192	13%
NPAT Adjusted (A\$m)	119	114	-4%	143	166	16%	170	192	13%
EPS © Adjusted	81	77	-4%	97	113	16%	115	130	13%
DPS (c)	43	43	0%	45	45	0%	47	47	0%
Net op cash flow (A\$m)	144	147	2%	96	101	5%	127	122	-4%

Source: RBS Morgans forecasts

Valuation & target price

Our sum-of-the-parts valuation for BKW has decreased slightly to A\$14.24 (from A\$14.35) per share. The value applied to the building products division has increased as we move from average 2010-12 to average 2011-13, expect a recovery in FY12. Our methodology is set out below.

Table 3 : SOTP valuation

Valuation summary	Shares	Price	A\$M	A\$ps	Basis
Washington Soul Patts - 42.85% (SOL)	102.26m	\$12.50	1278.2	\$8.68	Market value 28/03/2011
Non -Listed Assets					
Building Products			620.2	\$4.21	6x EV/EBITDA 2011-2013
Land Bank			281.4	\$1.91	Refer to Property valuation table
BKW's share of Property Trust assets			182.8	\$1.24	Market value of trust assets net of debt 31 January 2011
Less: net debt inc operating lease			-265.9	(\$1.81)	At 31 Jul 2011
Total valuation			2,096.8	\$14.24	

Source: Company data, RBS Morgans forecasts

Table 4 : Property valuation

Property Valuation	A\$m	Details
Est value of Property held for sale, net of CGT	120	M7 Business Hub, Oakdale
Property Trust value (BKW's share, net of debt)	176	
Land sites at book value (not for sale in next 24months)	161	We note that the market value of BKW's land bank, which totals 4,800ha, could be significantly higher than the book value. Hence, we will look to increase this value as developments gain traction and market values are better known.
BKW Total property value	457	

Source: Company data, RBS Morgans forecasts

Investment view

We maintain our Buy rating for: 1) recovery in VIC & NSW; 2) the strong balance sheet and earnings diversification; 3) valuation upside from future property developments out of the 4,800ha landbank held in the accounts at cost; 4) trading at a discount to shareholder equity per share; and 5) valuation support trading at 31% discount to our SOTP valuation.

The key risks to our target price include further delays or cancellation of property settlements, increases in interest rates, a longer-than-currently-anticipated downturn in housing construction activity and the property development profile.

BKW – financial summary

Year to 31 Jul (A\$m)	AIFRS 2009A	AIFRS 2010A	AIFRS 2011F	AIFRS 2012F	AIFRS 2013F	Closing price (A\$)	10.95	Price target (A\$)	14.24		
Income statement	2009A	2010A	2011F	2012F	2013F	Valuation metrics					
Divisional sales	591.3	654.1	664.3	728.4	779.5	Preferred methodology	SOTP	Val'n (A\$)	\$ 14.24		
Total revenue	593.1	659.1	664.3	728.4	779.5	Multiples	2010A	2011F	2012F	2013F	
EBITDA	98.9	97.4	105.3	143.2	177.1	Enterprise value (A\$m)	1842.5	1820.8	1812.6	1787.8	
Associate income	95.4	76.5	91.6	121.6	123.3	EV/Sales (x)	2.8	2.7	2.5	2.3	
Depreciation	-27.7	-25.8	-28.1	-29.2	-29.1	EV/EBITDA (x)	148.0	18.9	17.3	12.7	10.1
EBITA	71.2	71.6	77.3	114.0	148.0	EV/EBIT (x)	25.7	23.6	15.9	12.1	
Amortisation/impairment	0.0	0.0	0.0	0.0	0.0	PE (pre-goodwill) (x)	13.9	14.2	9.7	8.4	
EBIT	71.2	71.6	77.3	114.0	148.0	PEG (pre-goodwill) (x)	0.8	0.8	0.5	0.5	
EBIT (incl associate profit)	166.6	148.1	168.9	235.6	271.3	At target price	2010A	2011F	2012F	2013F	
Net interest expense	-34.1	-22.1	-21.8	-15.1	-15.0	EV/EBITDA (x)	23.9	21.9	16.1	12.8	
Pre-tax profit	132.5	126.1	147.1	220.6	256.3	PE (pre-goodwill) (x)	18.1	18.4	12.7	11.0	
Income tax expense	-18.8	-15.9	-33.1	-54.5	-64.6	Comparable company data (x)	2011F	2012F	2013F		
After-tax profit	113.7	110.2	114.0	166.0	191.7	CSR Ltd	EV/EBITDA	16.4	16.1	14.0	
Minority interests	0.0	0.0	0.0	0.0	0.0	Year to 31 Mar	EV/EBIT	23.7	23.2	19.1	
NPAT	113.7	110.2	114.0	166.0	191.7		PE	17.3	11.7	9.7	
Significant items	191.5	28.6	56.1	0.0	0.0		PEG	-5.5	-3.8	-3.1	
NPAT post abnormals	305.2	138.8	170.1	166.0	191.7	Boral	EV/EBITDA	8.7	7.5	6.1	
						Year to 30 Jun	EV/EBIT	18.3	14.2	10.1	
							PE	19.9	15.6	11.4	
							PEG	0.9	0.7	0.5	
Cash flow statement	2009A	2010A	2011F	2012F	2013F	Per share data	2010A	2011F	2012F	2013F	
EBITDA	98.9	97.4	105.3	143.2	177.1	No. shares	140.1	147.4	147.6	147.6	
Change in working capital	37.9	15.6	-12.2	-11.3	-16.5	EPS (cps)	99.1	115.4	112.5	129.9	
Net interest (pd)/rec	-32.7	-18.8	-21.8	-15.1	-15.0	EPS (normalised) (c)	78.7	77.4	112.5	129.9	
Taxes paid	-13.0	-15.0	-33.1	-54.5	-64.6	Dividend per share (c)	41.0	43.0	45.0	47.0	
Other oper cash items	0.0	0.0	56.1	0.0	0.0	Dividend payout ratio (%)	52.1	55.6	40.0	36.2	
Cash flow from ops (1)	132.0	146.5	131.1	101.1	121.9	Dividend yield (%)	3.7	3.9	4.1	4.3	
Capex (2)	-17.4	-25.2	-35.0	-28.1	-29.2	Growth ratios	2010A	2011F	2012F	2013F	
Disposals/(acquisitions)	78.3	-60.5	-11.7	0.0	0.0	Sales growth	10.6%	1.6%	9.7%	7.0%	
Other investing cash flow	0.0	0.0	0.0	0.0	0.0	Operating cost growth	13.1%	0.4%	4.7%	2.9%	
Cash flow from invest (3)	60.9	-85.7	-46.7	-28.1	-29.2	EBITDA growth	-1.5%	8.1%	35.9%	23.7%	
Inc/(decr) in equity	0.0	174.0	0.0	0.0	0.0	EBITA growth	0.6%	7.8%	47.6%	29.8%	
Inc/(decr) in debt	-161.0	-100.0	0.0	-91.9	8.4	Operating performance	2010A	2011F	2012F	2013F	
Ordinary dividend paid	-51.8	-58.2	-62.7	-64.9	-67.9	Asset turnover (%)	7.4	7.1	7.6	7.9	
Preferred dividends (4)	0.0	0.0	0.0	0.0	0.0	EBITDA margin (%)	14.9	15.9	19.7	22.7	
Other financing cash flow	0.0	-21.2	0.0	0.0	0.0	EBIT margin (%)	11.0	11.6	15.6	19.0	
Cash flow from fin (5)	-212.8	-5.4	-62.7	-156.9	-59.5	Net profit margin (%)	16.8	17.2	22.8	24.6	
Forex and disc ops (6)	0.0	0.0	0.0	0.0	0.0	Return on net assets (%)	4.3	4.4	6.1	7.5	
Inc/(decr) cash (1+3+5+6)	-19.9	55.4	21.7	-83.8	33.2	Net debt (A\$m)	226.6	204.9	196.8	171.9	
Equity FCF (1+2+4)	114.6	121.3	96.1	73.1	92.8	Net debt/equity (%)	13.7	11.7	10.6	8.7	
						Net interest/EBIT cover (x)	3.2	3.5	7.6	9.9	
						ROIC (%)	2.9	2.9	4.1	5.0	
Balance sheet	2009A	2010A	2011F	2012F	2013F	Internal liquidity	2010A	2011F	2012F	2013F	
Cash & deposits	17.9	73.4	95.1	11.3	44.5	Current ratio (x)	3.3	1.7	2.4	2.7	
Trade debtors	68.7	98.8	100.3	110.0	117.7	Receivables turnover (x)	7.8	6.7	6.9	6.8	
Inventory	147.3	139.3	141.4	155.1	166.0	Payables turnover (x)	7.1	8.7	8.8	8.2	
Investments	1133.6	1189.1	1258.1	1340.9	1423.3						
Goodwill	265.2	277.3	277.3	277.3	277.3						
Other intangible assets	6.9	6.6	15.4	15.4	15.4						
Fixed assets	399.8	455.8	476.5	475.4	475.5						
Other assets	95.8	24.7	24.7	24.7	24.7						
Total assets	2135.3	2265.0	2388.9	2410.2	2544.4						
Short-term borrowings	67.0	0.0	120.0	20.8	21.6						
Trade payables	88.3	68.8	60.3	72.4	74.5						
Long-term borrowings	333.0	300.0	180.0	187.3	194.8						
Provisions	224.1	188.9	214.0	214.0	214.0						
Other liabilities	51.4	57.3	57.3	57.3	57.3						
Total liabilities	763.8	615.1	631.6	551.7	562.2						
Preference shares											
Hybrid equity											
Share capital	146.5	322.7	322.7	322.7	322.7						
Other reserves	353.6	367.2	367.2	367.2	367.2						
FCTR											
Unrealised gains/losses											
Retained earnings	871.4	960.1	1067.5	1168.6	1292.4						
Other equity	0.0	0.0	0.0	0.0	0.0						
Total equity	1371.4	1649.9	1757.4	1858.5	1982.3						
Minority interest	0.0	0.0	0.0	0.0	0.0						
Total shareholders' equity	1371.4	1649.9	1757.4	1858.5	1982.3						
Total liabilities & SE	2135.3	2265.0	2388.9	2410.2	2544.4						

Source: Company data, RBS Morgans forecasts

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