Equity | Australia | Construction Materials

RBS Morgans

Brickworks

Core business still tough

Hold

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$11.15 (from A$10.13)

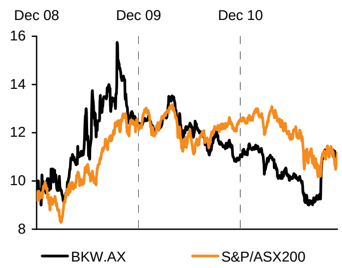
Price
A$10.96

Short term (0-60 days)
n/a

BKW111202

Price performance

	(1M)	(3M)	(12M)
Price (A$)	11.24	9.12	10.83
Absolute (%)	-2.5	20.2	1.2
Rel market (%)	-2.4	22.4	9.8
Rel sector (%)	3.6	38.8	12.3



Market capitalisation
A$1.62bn (US$1.66bn)

Average (12M) daily turnover
A$0.80m (US$0.83m)

Sector: BBG AP Construction
RIC: BKW.AX, BKW AU
Priced A$10.96 at close 1 Dec 2011.
Source: Bloomberg

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Following BKW's AGM and 1Q trading update we have downwardly revised our forecasts for the Building Products division. While BKW's earnings should be somewhat supported through its cross holding in SOLs, we believe market conditions remain challenging. As such we maintain our Hold.

Key forecasts

	FY10A	FY11A	FY12F	FY13F	FY14F
EBITDA (A$m)	97.40	105.9	99.10 ▼	121.2 ▼	128.8
Reported net profit (A$m)	138.8	142.6	102.3 ▼	121.2 ▼	127.5
Normalised net profit (A$m)[1]	110.2	100.8	102.3 ▼	121.2 ▼	127.5
Normalised EPS (c)[1]	78.67	68.35	69.32 ▼	82.14 ▼	86.39
Normalised EPS growth (%)	-8.13	-13.1	1.43	18.50	5.17
Dividend per share (c)	41.00	40.50	42.50	44.50	46.50
Dividend yield (%)	3.74	3.70	3.88	4.06	4.24
Normalised PE (x)	13.93	16.04	15.81	13.34	12.69
EV/EBITDA (x)	18.90	17.60	18.70	15.30	14.30
Price/net oper. CF (x)	10.50	18.10	15.60	17.30 ▲	14.80 ▲
ROIC (%)	2.86	2.96	2.61	3.36	3.53

Use of ▲ ▼ indicates that the line item has changed by at least 5%.
year to Jul, fully diluted
1. Pre non-recurring items and post preference dividends
Accounting standard: IFRS
Source: Company data, RBS Morgans forecasts

1Q update – declining revenue in building products and margin pressure

The 1Q update revealed that sales revenue had declined ~10% on the pcp as a result of declining market conditions. What was more concerning was the 'significant' impact to earnings which BKW commented on. This was caused by increased competition in WA and restructuring activities in the QLD and VIC brick operations. Also plant closures to reduce inventory have impacted manufacturing costs. While BKW believes market conditions may have bottomed in October, we continue to believe housing activity will decline through to early 2012 and forecast a deep cycle bottom of 133k starts by June 2012. We acknowledge that some forward indicators and interest rate reductions provide encouraging signs, but believe it is too early to see improved levels of activity.

Still looking at acquisitions – Gunns saw mill & process centre

BKW announced that it will acquire Gunns Limited's Jarrah sawmill, Manjimup Processing Centre, Welshpol retail operating and stock for A$6m. The acquisition should provide synergies to BKW's existing Auswest Timber assets at Pemberton in WA. In addition the retail outlet should provide a complementary channel to get both existing and new product ranges to market. The acquisition will also increase Auswest Timbers' existing hardwood ranges including Karri and Marri.

Remains fair value compared to peers – Hold maintained

We believe challenging property development sector conditions will result in a tough FY12 for BKW's building division. Key issues include declining housing starts and continued shortage of titled land. BKW remains a quality, well-run company and returns from investments in SOLs are expected to remain solid. However, we believe the stock is likely to tread water until conditions improve. Consequently, we maintain our Hold rating and our SOTP valuation increases to A$11.15 (from A$10.13) as a result of an increase in the value of BKW's stake in SOL.

Changes to forecasts

We have made a few changes to our forecasts. With the tough 1Q we have moderated both our earnings and revenue forecasts in the building division. We have also included BKW's recent acquisition. These changes see our NPAT reduce by 8% in FY12.

Table 1 : Changes to forecasts

	FY12F			FY13F			FY14F		
	Previous	Revised	% change	Previous	Revised	% change	Previous	Revised	% change
Revenue (A$m)	637	619	-3%	665	665	0%	662	686	4%
EBIT (A$m)	163	154	-6%	185	176	-5%	184	184	0%
NPAT (A$m)	111	102	-8%	128	121	-5%	128	127	0%
NPAT Normalised (A$m)	111	102	-8%	128	121	-5%	128	127	0%
EPS © Adjusted	75	69	-8%	87	82	-5%	87	86	0%
DPS (c)	43	43	0%	45	45	0%	47	47	0%
Net op cash flow (A$m)	107	103	-3%	105	94	-10%	117	109	-6%
Segment EBIT									
Building Products	42	32	-22%	54	44	-18%	61	62	0%
Property	39	39	0%	50	50	0%	40	40	0%
Investments	83	83	0%	82	82	0%	82	82	0%

Source: Company data, RBS Morgans forecasts

Valuation and target price

Our sum-of-the-parts valuation for BKW has increased to A$11.15 (from A$10.13) per share . This is due to the higher market value of SOL.

Table 2 : SOTP valuation

Valuation Summary	Shares	Price	A$M	A$ps
Core Listed Investments				
Washington Soul Patts - 42.85% (SOL)	102.26	$13.75	1406.0	$9.55
Non -Listed Assets				
Building Products			149.7	$1.02
Land Bank			200.0	$1.36
BKW's share of Property Trust assets			184.0	$1.25
Less: Net Debt inc operating lease			-298.4	($2.03)
Total Valuation			1,641.4	$11.15

Source: RBS Morgans forecasts

Table 3 : Property valuation

Property Valuation	A$m	Details
Development land at book value	65	We note BKW's current valuation for development land is A$141m. With BKW stating that it is worth a potential A$344m on rezoning and development approvals.
Property Trust value (BKW's share, net of debt)	184	
Book value of operational land	135	BKW believes operational land could be valued at A$300m. However, with land required to operate the underlying BKW business we believe it will not be up for sale in the next 24 months..
BKW Total property value	384	

Source: Company data, RBS Morgans forecasts

Investment view

We see a tough outlook for BKW's building division in FY12, with declining housing starts and continued shortage of titled land. While returns on investment in SOL should remain solid, we believe market conditions will mean another challenging year and maintain our Hold rating.

The key downside risks to our target price include further delays to or cancellations of property settlements, increases in interest rates, a longer-than-currently-anticipated downturn in housing construction activity and the property development profile. Upside risks include greater-than anticipated contributions from SOL, fast ramp up of dwelling commencements and the carbon tax having no impact.

BKW – financial summary

Year to 31 Jul (A$m)	AIFRS	AIFRS	AIFRS	AIFRS	AIFRS
Income statement	**2010A**	**2011A**	**2012F**	**2013F**	**2014F**
Divisional sales	654.1	633.9	619.1	664.8	686.1
Total revenue	659.1	637.4	619.1	664.8	686.1
EBITDA	97.4	105.9	99.1	121.2	128.8
Associate income	76.5	67.9	82.6	82.2	82.5
Depreciation	-25.8	-26.6	-27.5	-27.5	-27.5
EBITA	71.6	79.3	71.6	93.7	101.3
Amortisation/impairment	0.0	0.0	0.0	0.0	0.0
EBIT	71.6	79.3	71.6	93.7	101.3
EBIT(incl associate profit)	148.1	147.2	154.1	175.9	183.8
Net interest expense	-22.1	-19.4	-20.9	-20.3	-20.1
Pre-tax profit	126.1	127.8	133.3	155.6	163.7
Income tax expense	-15.9	-27.0	-31.0	-34.4	-36.2
After-tax profit	110.2	100.8	102.3	121.2	127.5
Minority interests	0.0	0.0	0.0	0.0	0.0
NPAT	110.2	100.8	102.3	121.2	127.5
Significant items	28.6	41.8	0.0	0.0	0.0
NPAT post abnormals	138.8	142.6	102.3	121.2	127.5
Cash flow statement	**2010A**	**2011A**	**2012F**	**2013F**	**2014F**
EBITDA	97.4	105.9	99.1	121.2	128.8
Change in working capital	15.6	-96.5	17.4	-13.7	-6.1
Net interest (pd)/rec	-18.8	-17.8	-20.9	-20.3	-20.1
Taxes paid	-15.0	-1.4	-31.0	-34.4	-36.2
Other oper cash items	0.0	41.8	0.0	0.0	0.0
Cash flow from ops (1)	146.5	89.0	103.5	93.7	109.4
Capex (2)	-25.2	-35.7	-26.3	-27.5	-27.5
Disposals/(acquisitions)	-60.5	-15.6	-6.0	0.0	0.0
Other investing cash flow	0.0	0.0	0.0	0.0	0.0
Cash flow from invest (3)	-85.7	-51.3	-32.3	-27.5	-27.5
Incr/(decr) in equity	174.0	0.0	0.0	0.0	0.0
Incr/(decr) in debt	-100.0	0.0	26.3	-4.9	-4.4
Ordinary dividend paid	-58.2	-59.8	-61.2	-64.2	-67.1
Preferred dividends (4)	0.0	0.0	0.0	0.0	0.0
Other financing cash flow	-21.2	-0.7	0.0	0.0	0.0
Cash flow from fin (5)	-5.4	-60.5	-35.0	-69.1	-71.6
Forex and disc ops (6)	0.0	0.0	0.0	0.0	0.0
Inc/(decr) cash (1+3+5+6)	55.4	-22.7	36.2	-2.9	10.3
Equity FCF (1+2+4)	121.3	53.4	77.2	66.2	81.9
Balance sheet	**2010A**	**2011A**	**2012F**	**2013F**	**2014F**
Cash & deposits	73.4	50.6	86.8	84.0	94.3
Trade debtors	98.8	83.6	93.5	100.4	103.6
Inventory	139.3	153.6	131.8	141.5	146.1
Investments	1189.1	1211.3	1261.0	1302.3	1341.8
Goodwill	277.3	279.3	279.3	279.3	279.3
Other intangible assets	6.6	6.3	6.3	6.3	6.3
Fixed assets	455.8	474.3	473.0	473.0	473.0
Other assets	24.7	19.4	19.4	19.4	19.4
Total assets	2265.0	2278.5	2351.2	2406.3	2463.9
Short-term borrowings	0.0	0.0	32.4	31.9	31.5
Trade payables	68.8	58.9	64.3	67.2	68.9
Long-term borrowings	300.0	297.9	291.8	287.4	283.4
Provisions	188.9	184.0	184.0	184.0	184.0
Other liabilities	57.3	61.9	61.9	61.9	61.9
Total liabilities	615.1	602.7	634.4	632.5	629.7
Preference shares					
Hybrid equity					
Share capital	322.7	325.0	325.0	325.0	325.0
Other reserves	367.2	296.4	296.4	296.4	296.4
FCTR					
Unrealised gains/losses					
Retained earnings	960.1	1054.3	1095.4	1152.4	1212.7
Other equity	0.0	0.0	0.0	0.0	0.0
Total equity	1649.9	1675.7	1716.8	1773.8	1834.2
Minority interest	0.0	0.0	0.0	0.0	0.0
Total shareholders' equity	1649.9	1675.7	1716.8	1773.8	1834.2
Total liabilities & SE	2265.0	2278.5	2351.2	2406.3	2463.9

Closing price (A$)		10.96		Price target (A$)	11.15
Valuation metrics					
Preferred methodology	SOTP			Val'n (A$) $	11.15
Multiples		**2011A**	**2012F**	**2013F**	**2014F**
Enterprise value (A$m)		1864.7	1854.7	1852.7	1838.0
EV/Sales (x)		2.9	3.0	2.8	2.7
EV/EBITDA (x)		17.6	18.7	15.3	14.3
EV/EBIT (x)		23.5	25.9	19.8	18.1
PE (pre-goodwill) (x)		16.0	15.8	13.3	12.7
PEG (pre-goodwill) (x)		0.9	0.9	0.7	0.7
At target price		**2011A**	**2012F**	**2013F**	**2014F**
EV/EBITDA (x)		17.9	19.0	15.5	14.5
PE (pre-goodwill) (x)		16.3	16.1	13.6	12.9
Comparable company data (x)			**2012F**	**2013F**	**2014F**
CSR Ltd	EV/EBITDA		4.0	3.5	2.9
Year to 31 Mar	EV/EBIT		6.4	5.2	4.0
	PE		12.7	10.3	7.7
	PEG		0.8	0.6	0.5
Boral	EV/EBITDA		7.0	5.6	4.7
Year to 30 Jun	EV/EBIT		13.1	9.0	7.0
	PE		12.8	9.5	7.0
	PEG		0.8	0.6	0.4
Per share data		**2011A**	**2012F**	**2013F**	**2014F**
No. shares		147.4	147.6	147.6	147.6
EPS (cps)		96.7	69.3	82.1	86.4
EPS (normalised) (c)		68.3	69.3	82.1	86.4
Dividend per share (c)		40.5	42.5	44.5	46.5
Dividend payout ratio (%)		59.3	61.3	54.2	53.8
Dividend yield (%)		3.7	3.9	4.1	4.2
Growth ratios		**2011A**	**2012F**	**2013F**	**2014F**
Sales growth		-3.1%	-2.3%	7.4%	3.2%
Operating cost growth		-5.1%	-1.5%	4.5%	2.5%
EBITDA growth		8.7%	-6.4%	22.3%	6.2%
EBITA growth		10.7%	-9.7%	31.0%	8.0%
Operating performance		**2011A**	**2012F**	**2013F**	**2014F**
Asset turnover (%)		7.0	6.7	7.0	7.0
EBITDA margin (%)		16.7	16.0	18.2	18.8
EBIT margin (%)		12.5	11.6	14.1	14.8
Net profit margin (%)		15.9	16.5	18.2	18.6
Return on net assets (%)		4.7	4.2	5.3	5.5
Net debt (A$m)		247.3	237.4	235.4	220.6
Net debt/equity (%)		14.8	13.8	13.3	12.0
Net interest/EBIT cover (x)		4.1	3.4	4.6	5.1
ROIC (%)		3.0	2.6	3.4	3.5
Internal liquidity		**2011A**	**2012F**	**2013F**	**2014F**
Current ratio (x)		3.2	2.5	2.5	2.6
Receivables turnover (x)		7.0	7.0	6.9	6.7
Payables turnover (x)		8.3	8.4	8.3	8.2

Source: Company data, RBS Morgans forecasts

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