STOCKS DOWN UNDER

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ASX Top 200 Stocks Down Under

> *Build yourself, brick by brick.*
>
> **- Nassim Nicholas Taleb (b. 1976), Co-founder of Quest Nutrition**

BRICKWORKS

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Stocks Down Under rating: ★★

ASX: BKW
Market cap: A$3.2BN

52-week range: A$17.00 / A$25.13
Share price: A$20.96

At first glance, Brickworks (ASX:BKW) might seem like a no-brainer. It has not cut its dividend for nearly five decades, is trading at cheap multiples and has solid businesses in Australia and North America not to mention a 26% stake in listed investment company WHSP and extensive industrial property holdings. But even though it is a good company, we don't think it is the right time to invest.

Share price chart

Source: Tradingview

Living up to its name and then some

Brickworks supplies building products to the Australian residential and commercial markets, especially bricks. It operates brands including Austral Bricks, Austral Masonry, Bristile Roofing and Austral Pre-Cast concrete walls. Brickworks is the largest company of its kind in Australia, with 30 brickmaking and masonry plants Down Under. It has been listed since 1962.

Brickworks also has an investment segment, including its WHSP stake and industrial properties. It has a joint venture industrial property trust with Goodman Group (ASX:GMG), offering warehousing for Ecommerce companies, the flagship property being Amazon's distribution centre at Oakdale West in Sydney. The company told investors at its latest AGM that $1,000 invested in Brickworks in 1968 would be $566,000 today. If you can find a company with a better performance over that time span, let us hear about it.

Solid FY22 results, but will they be repeated?

In FY22 (the 12 months to 31 July 2022) the company generated $1.09bn in revenue (up 28%), $1.06bn in underlying EBITDA and a $746m underlying profit (up 159%) - the latter figure being a record for the company. It paid 41c per share in dividends, which implies a modest yield of 1.8%, but has either maintained or increased normal dividends for 46 consecutive years.

We note that EBITDA was significantly inflated by a number of things, including industrial property revaluations, the merger of WHSP and Milton Corporation, plus a profit on the deemed disposal of WHSP shares that was partially offset by Brickworks' share of a goodwill impairment incurred by WHSP. In the past couple of years, Brickworks has also benefited from the construction boom, driven by government stimulus.

Indeed, you can see last year's impacts and uncertainty about the year ahead reflected in consensus estimates. For FY23, these call for $1.14bn in revenue and $472.3m in EBITDA, which would be up 1% and down 56% from FY22 respectively. In FY24, the consensus calls for $1.11bn in revenue and $424.7m in EBITDA, which would be down 2% and 10%. Why are analysts not optimistic? We think they fear the headwinds outlined in the next section.

The company's multiples look reasonable at 11.6x P/E and 8.8x EV/EBITDA for FY23, but it is never a good look for earnings to more than halve. At its results presentation, Brickworks told shareholders that it expects the group's NPAT not to be significantly impacted excluding any potential revaluation or development profits, but there may be some impacts, especially to certain divisions that will bear the brunt of a lack of valuation hikes or lower development profits.

An uncertain future

Brickworks is facing a number of headwinds in the coming months. Obviously, inflation generally and rising interest rates cannot be ignored. But the company has conservative gearing of only 15% and has not reported an impact yet, even though it has lifted the price of bricks by roughly 10%. What's more critical for Brickworks is that the construction sector is facing significant supply chain issues. Oxides and cement are two particular concerns for the company. We note that 30-40% of Australia's cement consumption is imported. So far, the impact is primarily that new homes under contract to be built are being delayed. But we are concerned that anecdotal reports of fewer people looking in display homes may eventually flow through to decreased demand once the backlog is worked through.

The company itself is also concerned about rising energy costs and it fears that the push to Net Zero will make things worse. CEO Lindsay Partridge warned that Victoria's plan to move to almost all renewables by 2035 via a state-owned energy company would have a significant impact – namely higher prices and lower supply and would likely force the company to move operations overseas. Shareholders can take comfort in that the company's current supplies are locked in until 2025. But after that, it faces $20-$30 a gigajoule for gas compared with just $3 per gigajoule in the US.

We also turn out attention to the company's US brick making operations. Currently, these operations are growing, but at a slower pace relative to what investors may have expected. In late 2018, Brickworks bought America's fourth largest brick maker Glen-Gery for $151m and has invested further money to rationalise the plants it acquired. Slowly but surely, the US business is coming together with EBIT of $25m in FY22, but it will still be a slow journey.

There's no time like the right time and that isn't now

We think there is a parallel between Brickworks and the leading ASX REITs. While these entities may be able to weather the market downturn better than smaller peers (both the commercial market and the stock market), they will not be able to escape the market impact entirely.

Until there's more clarity on the industrial property market, energy prices and the equity markets generally, we wouldn't invest in Brickworks and so it is two stars for now. But given this company's long-term track record, we may reconsider this one when the time is right.

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