BRICKWORKS LIMITED

21 March 2019

Australian Securities Exchange

Attention: **Companies Department**

BY ELECTRONIC LODGEMENT

Dear Sir / Madam

Please find attached the Brickworks Limited Review of Results for the half year ended 31 January 2019, for immediate release to the market.

Yours faithfully

BRICKWORKS LIMITED

Susan Leppinus

Company Secretary

Brickworks Limited
ABN 17 000 028 526

738 - 780 Wallgrove Road, Horsley Park NSW 2175
PO Box 6550, Wetherill Park NSW 1851

T +61 (2) 9830 7800
F +61 (2) 9830 1328

info@brickworks.com.au
brickworks.com.au

BRICKWORKS

LIMITED

REVIEW OF RESULTS

1ST HALF ENDED 31 JANUARY 2019

Released: 21st March 2019

BRICKWORKS LIMITED - REVIEW OF RESULTS

1st HALF ENDED 31 JANUARY 2019

PROPERTY EARNINGS UNDERPIN RECORD FIRST HALF UNDERLYING NPAT[1]

$ MILLIONS	Jan 19 6 mths	Jan 18 6 mths[2]	Variance %
REVENUE (CONTINUING OPERATIONS)			
Building Products Australia	375	376	-
Building Products North America	26	-	NA
Property & Other	42	1	>500%
Total	**442**	**377**	**17%**
SEGMENT EBIT (CONTINUING OPERATIONS)			
Building Products Australia	26	41	(35%)
Building Products North America	(1)	-	NA
Property	132	50	167%
Investments	61	61	-
Group Administration & Other	(7)	(7)	-
Total EBIT (before significant items)	**211**	**145**	**46%**
Total EBITDA (before significant items)	**227**	**158**	**44%**
Borrowing costs	(11)	(6)	(77%)
Underlying tax expense	(41)	(22)	(90%)
Underlying NPAT – Continuing Operations	**160**	**117**	**37%**
Significant items (net of tax)	(12)	(18)	NA
NPAT – Continuing Operations	**148**	**99**	**50%**
Discontinued Operations (net of tax)	(34)	(2)	NA
Statutory NPAT	**115**	**97**	**18%**
PER SHARE ANALYSIS			
Underlying earnings – continuing operations (cents)	107	78	37%
Statutory earnings (cents)	77	65	18%
Interim ordinary dividend (cents)	**19**	**18**	**6%**
Share price 31 Jan 19 vs Jul 18	16.47	15.58	6%
Net tangible assets (NTA) vs Jul 18	13.04	12.42	5%
Share price / NTA (times)	1.26	1.25	1%

[1] All Group underlying profit and earnings measures exclude significant items and results from discontinued operations, unless otherwise stated

[2] Restated, on a consistent basis with1H2019, to account for discontinued operations

PROPERTY EARNINGS UNDERPIN RECORD FIRST HALF UNDERLYING NPAT

Highlights

- Statutory NPAT including significant items up 18% to $115 million
- Underlying NPAT from continuing operations, before significant items up 37% to $160 million
    - Building Products Australia EBIT down 35% to $26 million, EBITDA $41 million
    - Building Products North America EBIT ($1 million), EBITDA $0.3 million
    - Property EBIT up 167% to $132 million, net trust assets up $87 million
    - Investments EBIT steady, at $61 million, WHSP market value up $250 million
- Operating cash flow down 12% to $65 million
- Gearing reduced to a conservative 11%
- Total shareholder's equity up $62 million since 31 July 2018, to $2.134 billion
- Interim dividend of 19 cents per share, up 6%

Overview

Brickworks Group (ASX: BKW) posted a Statutory Net Profit After Tax (**'NPAT'**) of $115 million for the half year ended 31 January 2019, up 18% on the previous corresponding period. Underlying NPAT from continuing operations was $160 million, up 37% on the prior period.

On sales revenue of $375 million, **Building Products Australia** Earnings Before Interest and Tax from continuing operations ('**EBIT**') was $26 million, down 35% on the previous corresponding period (EBITDA was $41 million). The decline in earnings was primarily due to the impact of increasing energy prices, costs associated with maintenance of brick kilns, and reduced sales volume in New South Wales.

Within **Building Products North America**, the integration of Glen-Gery has proceeded well since the acquisition on 23 November 2018. Sales revenue was $26 million for the period to 31 January 2019, ahead of internal forecasts. Although the EBIT contribution was negative, due to plants being shut down over the winter period, the result was ahead of expectations, as a result of profit generated on the sale of surplus clay material.

Property EBIT was $132 million for the first half, including a significant revaluation profit within the Joint Venture Industrial Property Trust[3] ('Property Trust'), and the completion of the Punchbowl property sale. Brickworks' share of the net asset value within the Property Trust increased by $87 million during the period and now stands at $625 million.

Investments EBIT was steady at $61 million, with WHSP benefitting from strong underlying contributions from New Hope Corporation, TPG Telecom and property transactions during the period.

[3] The Joint Venture Industrial Property Trust is a 50/50% partnership between Brickworks and Goodman Industrial Trust

Statutory Earnings Per Share ('**EPS**') was 77 cents, up 18% on the previous corresponding period. Underlying EPS from continuing operations was 107 cents, up 37%.

Directors have declared a fully franked interim **dividend** of 19 cents per share for the half year ended 31 January 2019, up 6% from 18 cents. The record date for the interim dividend will be 9 April 2019, with payment on 30 April 2019.

Financial Analysis

Gearing (net debt to equity) was 11% at 31 January 2019, down from 15% at 31 July 2018. Total interest-bearing debt was $330 million at the end of the period, including the USD bridge facility utilised to finance the acquisition of Glen-Gery. A re-financing is planned during the second half, incorporating a new syndicated facility with separate AUD and USD tranches.

After including cash on hand, **net debt** at the end of the period was $242 million, a reduction of $62 million during the half. This follows the sale of 7.9 million WHSP shares in December, at a weighted average price of $26.37 per share, delivering total cash proceeds of $208 million. These proceeds more than offset the total Glen-Gery acquisition costs of $141 million.

Total borrowing costs increased to $11 million, due primarily to non-cash movements in the mark to market valuation of interest rate swaps.

Net working capital was $264 million at 31 January 2019, including **finished goods inventory** of $182 million, up significantly due to the Glen-Gery acquisition ($48 million impact). Excluding the impact of the acquisition, finished goods inventory in continuing operations was up $6 million during the half, due primarily to Austral Bricks Victoria inventory being restored to typical operating levels over the Christmas period.

Total **cash flow from operating activities** was $65 million, down from $74 million in the previous corresponding period, due primarily to the decreased earnings from Building Products Australia.

Capital expenditure was $18 million during the period, with major project spend including a mill upgrade at the Golden Grove brick plant in South Australia, and the progressive replacement of kiln cars at Horsley Park Plant 3 in New South Wales.

Statutory **income tax** from continuing operations was $84 million for the period. The underlying income tax expense from continuing operations was $41 million, up significantly from $22 million in the prior corresponding period. The increase was due primarily to the much higher profit generated from property revaluations in the first half of 2019.

Net tangible assets ('NTA') per share was $13.04 at 31 January 2019, up from $12.42 at 31 July 2018 and total shareholders' equity was up $62 million to $2.134 billion.

Significant items reduced NPAT from continuing operations by $12 million for the period. This comprised:

- A $71 million gain (net of tax) on the sale of 7.9 million WHSP shares, due to the weighted average selling price of $26.37 per share, being significantly above the book value.
- A non-cash goodwill impairment of $52 million in relation to Bristile Roofing and Austral Masonry, reflecting the cashflow forecasts of these businesses, in accordance with AASB 136.
- Transaction costs of $8 million in relation to the Glen-Gery acquisition.

- Restructuring costs of $5 million (net of tax), including redundancies and asset impairments, primarily associated with the mothballing of Horsley Park Plant 2 in New South Wales.
- Costs of $10 million in relation to WHSP significant items.
- A $7 million cost due to the income tax expense in respect of the equity accounted WHSP profit, less the franking credits associated with the dividends received during the period, and adjusted for the movements in the franking account and the circular dividend impact.

Significant Items ($m) – Continuous Operations	**Gross**	**Tax**	**Net**
Gain on sale of WHSP Shares	110	(38)	71
Bristile Roofing and Austral Masonry goodwill impairment	(52)	-	(52)
Acquisition costs	(8)	-	(8)
Restructuring activities	(7)	2	(5)
Significant items relating to WHSP	(10)	-	(10)
Income tax arising from the carrying value of WHSP		(7)	(7)
Total (Continuing Operations)	**31**	**(43)**	**(12)**

Portfolio Management

Brickworks is focussed on actively managing its portfolio of assets to maximise returns to shareholders and build asset value over the long term. During the period, the company took a number of significant steps to refocus its portfolio of assets, enhance growth prospects and further strengthen the balance sheet.

As previously noted, in November Brickworks completed the acquisition of Glen Gery, a leading United States based brick manufacturer. This investment represents the company's first major overseas expansion, and is consistent with the Building Products strategy, to deliver growth by investing in affiliated businesses.

Brickworks has a long and proud history as a brick maker, its heritage business. Austral Bricks delivers strong returns on capital across the cycle, having established a competitive advantage within the industry on the back of its scale, unrivalled technical expertise and relationships with key suppliers and partners. Brick operations, through vast associated land holdings, also provide the legacy land assets that have supported the growth of the company's Property business.

Brickworks is now one of the largest brick makers in the world, and the leading manufacturer in Australia. With limited opportunities available in Australia, expansion into new markets overseas represents the only meaningful growth opportunity available within bricks.

The sale of WHSP shares in November and December was the first sale by Brickworks since the initial investment in 1969. In addition to providing funds for the purchase of Glen-Gery, this sale strengthened the balance sheet and partially rebalanced the Group portfolio. As previously noted, Brickworks has no plans to sell any further shares in WHSP at this stage.

A portfolio review within Building Products Australia has also resulted in the reclassification of the hardwood operations of Auswest Timbers as held for sale.

Despite significant restructuring initiatives, Auswest hardwood operations, based in Greenbushes (Western Australia) and East Gippsland (Victoria) have delivered unsatisfactory returns on invested capital. These businesses are faced with a number of structural challenges, and require significant investment in plant and equipment to materially improve performance.

Following the strategic review, Brickworks has determined that further investment in these assets is not justified, given other capital priorities across the Group. Brickworks is now focussed on realising the maximum value possible from these assets, through an orderly exit, including the initiation of a sale process. As a result, these assets have been reclassified as held for sale, and are not reported in underlying continuing operations.

On the reclassification, an after-tax impairment of $30 million to Auswest Timbers hardwood assets was recorded. This comprises an impairment of $15 million to the carrying value of inventory and an impairment of $15 million to buildings, plant and equipment.

The strategic review process re-affirmed that Auswest Timbers' softwood mill in Fyshwick (ACT) remains a core strategic asset for the company. This asset delivers acceptable returns on invested capital, and provides vertical integration, through supply of roof-tile battens to Bristile Roofing (and other customers). The financial performance of the softwood operation is now reported as part of Bristile Roofing, however it continues to operate under separate management, as a stand-alone business unit.

To ensure consistency, first half 2018 financials have been restated on the same basis.

Building Products Australia

Summary of Housing Commencements – 6 Months to December 2018

Estimated Starts[4]	Detached Houses			Other Res			Total		
	Dec 18	Dec 17	Change	Dec 18	Dec 17	Change	Dec 18	Dec 17	Change
New South Wales	15,436	15,885	(3%)	18,367	20,390	(10%)	33,803	36,275	(7%)
Queensland	12,771	13,623	(6%)	9,400	7,592	24%	22,171	21,215	5%
Victoria	18,623	19,487	(4%)	12,451	16,011	(22%)	31,074	35,498	(13%)
Western Australia	6,673	7,300	(9%)	1,933	2,972	(35%)	8,606	10,272	(16%)
South Australia	4,048	4,104	(1%)	1,516	2,384	(36%)	5,564	6,488	(14%)
Tasmania	1,277	993	29%	148	371	(60%)	1,425	1,364	5%
Total Australia[5]	**59,910**	**62,230**	**(4%)**	**47,357**	**52,171**	**(9%)**	**107,267**	**114,401**	**(6%)**

Total dwelling commencements for Australia were down 6% to 107,267 for the six months ended 31 December 2018. Despite the decline, this level of building activity remains elevated compared to historical averages.

The decline in activity was caused primarily by a 9% reduction in other residential commencements, following unprecedented growth in this segment in recent years. Detached housing, where Brickworks products have the greatest exposure, were down a more modest 4%.

Detached housing commencements in **New South Wales** remain relatively strong, albeit down by 3% on the prior corresponding period. However, following a sustained period of high growth, other residential construction is now passed the peak, with a decline of 10% recorded for the six months to 30 December 2018.

Queensland was the only major state to experience an increase in overall activity, with commencements up 5% on the prior corresponding period. Driving growth in this state was other residential activity, up 24%.

In **Victoria**, building activity remains elevated, despite the decrease in total commencements for the 6 months to 31 December 2018. Compared to the prior corresponding period, detached houses were down 4%, and other residential activity declined by 22%.

Weakness in **Western Australia** persisted during the period, with both detached houses and other residential activity continuing to decline. Building activity in this state is now down by over 40% in the past three years, and detached house commencements are at their lowest level for over 15 years.

The value of approvals in the **non-residential** sector in Australia decreased by 15% to $21.946 billion for the six months to 31 December 2018. Within the non-residential sector, **Commercial** building approvals decreased by 15% to $8.298 billion for the period and **Industrial** building approvals decreased 11% to $2.650 billion. The **Educational** sub-sector, an important driver for bricks and masonry demand, was down 15% to $2.475 billion.

[4] Original data sourced from ABS, Cat. 8752.0 (Sep 18 quarter). December 18 quarter estimate from BIS Shrapnel
[5] Includes Northern Territory and ACT, not shown separately on table

Overview of Building Products Australia Result (Continuing Operations)

Half Year Ended January		2019	2018	Change %
Revenue	$mill	**375**	376	-
Segment EBITDA	$mill	**41**	55	(25%)
Segment EBIT	$mill	**26**	41	(35%)
Capital Expenditure	$mill	**18**	26	(31%)
EBITDA margin	%	**11**	14	(21%)
EBIT margin	%	**7**	10	(30%)
Net Tangible Assets	$mil	**689**	665	4%
Return on Net Tangible Assets	%	**8**	12	(33%)
FTE Employees[6] (vs. Jul 18)		**1,471**	1,485	(1%)
Safety (TRIFR)[7] (vs. Jul 18)		**20.6**	20.4	1%
Safety (LTIFR)[8] (vs. Jul 18)		**1.4**	1.7	(18%)

Revenue from continuing operations, for the half year to 31 January 2019, was approximately in line with the prior period, at $375 million. An increase in revenue in Austral Masonry and Austral Precast was offset by lower revenue in Austral Bricks and Bristile Roofing.

EBIT from continuing operations was $26 million, down 35% on the prior corresponding period, and **EBITDA** was $41 million. Margins declined on the prior corresponding period, particularly within Austral Bricks, where price increases were insufficient to recover increasing energy costs. In addition, the opportunity was taken during the period to complete necessary maintenance work on several brick kilns that had been operating continuously for up to 8 years.

Lower sales volume, particularly in New South Wales and Western Australia also impacted earnings within Austral Bricks. During the first 2 months of the financial year, sales volume more broadly was adversely impacted by tightening credit availability that caused widespread project delays in housing construction.

Full-time equivalent **employee** numbers were 1,471 at 31 January 2019, down by 14 compared to 31 July 2018. The decrease was primarily due to the mothballing of Horsley Park Plant 2 in New South Wales, in response to lower production requirements.

There were 2 Lost Time **Injuries** (‘LTIs’) during the half. This translates to a Lost Time Injury Frequency Rate (‘LTIFR’) of 1.4, down from 1.7 for the year to July 2018. The Total Reportable Injury Frequency Rate (‘TRIFR’) remained relatively steady at 20.6.

Austral Bricks earnings decreased by 23% for the six months ended 31 January 2019, with sales revenue down marginally to $208 million.

[6] Excludes casual employees
[7] Total Reportable Injury Frequency Rate (TRIFR) is the total number of reportable injuries per million hours worked
[8] Lost Time Injury Frequency Rate (LTIFR) is the number of lost time injuries per million hours worked

Sales volume was down around 6%, approximately in line with the overall decline in residential building activity across the country. Volume declines in New South Wales and Western Australia were partially offset by increases in other states. The increase in volume in Victoria was particularly pleasing, given the decline in building activity in that state.

An increase in manufacturing costs, primarily due to higher energy prices and plant maintenance activities, resulted in margins decreasing in all states. The impact of higher energy prices across the east coast, resulted in a $6 million cost increase on the prior corresponding half. This incorporates the impact of a gas price increases of between 29-45%, depending on the state, that took effect on 1 January 2019.

The impact of higher energy costs is being partially mitigated by a sustained investment program, to replace older inefficient kilns, with modern plants. Following significant investments in Victoria, Western Australia and Queensland in recent years, the focus for capital investment has now turned to New South Wales, where there has been limited investment for three decades. A review of the future operational footprint within the Horsley Park precinct has been completed, and plans for a new face brick plant at the current Horsley Park Plant 2 site are being developed.

Bristile Roofing, now including the Fyshwick roof batten mill, delivered higher earnings for the half, despite a 7% decrease in sales revenue to $63 million.

Demand remained resilient in Victoria, with price increases in that state supporting an increase in revenue and earnings. In the other major east coast markets, sales were adversely impacted by reduced detached house construction activity, and margins were impacted by strong competition.

In Western Australia sales revenue was down, however earnings improved due to lower costs, with this state now being serviced by high quality imported terracotta tiles from La Escandella in Spain, supplemented by bought-in concrete roof tiles.

The Fyshwick batten mill delivered higher earnings, on the back of an increase in sales volume and improved unit production costs, due to the mill operating at capacity for the entire period.

Austral Masonry earnings were lower, despite a 6% increase in sales revenue to $55 million for the half. Excluding UrbanStone sales (acquired in November 2017), revenue was down 6%, on a like-for-like basis.

An improved result was delivered in South East Queensland, due to higher other residential activity in that state, and a significant increase in sales of higher margin block, retaining wall and paving products in both the residential and commercial sectors. A full six-month contribution from Urbanstone also boosted the result. However, these gains were more than offset by a decline in earnings in New South Wales, due primarily to the slowdown in apartment construction in Sydney.

In New South Wales, preliminary earthworks are now underway, in preparation for the construction of a highly advanced masonry plant, to be located on Property Trust land at Oakdale East. This plant is scheduled for commissioning in mid-2020.

Austral Precast earnings were in line with the prior corresponding period, with revenue increasing by 14% to $40 million for the half.

In New South Wales, extended delays in the commencement of some major projects resulted in lower sales revenue and earnings. However, demand in this state remains strong, with a balanced pipeline of work in place, including increasing exposure to the infrastructure and industrial sector, offsetting lower sales to multi-residential developments. To meet demand, and improve the efficiency of the automated plant, a second production line to cater for specialised panels is being installed at Wetherill Park, and is expected to be completed in April.

Earnings increased significantly in Queensland, with the Salisbury plant operating at capacity for the entire period, to supply the Clarence Correctional Centre project.

Some major multi-residential projects drove increased revenue in Western Australia, however the short-term outlook is poor in this state due to a limited pipeline of committed work at the end of the half.

Construction of the **Southern Cross Cement** terminal has progressed well during the period. Civil works are scheduled for completion this month, with work on mechanical and electrical installation, and the erection of silos, now underway. Commissioning of the terminal, and the first shipment of cement to shareholders, is expected in early financial year 2020.

Building Products North America

Brickworks completed the acquisition of Glen-Gery on 23 November 2018. Sales revenue for the initial period, to 31 January 2019, was $26 million, ahead of internal forecasts. EBIT, although negative, was also ahead of expectations, due primarily to profits on the sale of surplus clay material from the Capitol site. EBITDA was marginally positive for the period.

Due to harsh winter conditions, the December-February months are characterised by reduced sales volume, and plant shutdowns. During the period, all plants were closed for extended periods.

A differentiated brick business – a north-east, architecturally focussed player

Glen-Gery has a unique market position within the US brick industry, holding a leading position in the north-east, mid-west and mid-atlantic states. This region, incorporates major cities such as New York, Washington DC, Boston, Philadelphia, Baltimore, Pittsburgh, Chicago and Detroit, each with a long heritage of brick construction in commercial and residential buildings.

In many cases, building covenants are in place, mandating the use of brick, in order to maintain the heritage of the region. In other cases, Glen-Gery bricks are specified, in the construction of buildings such as schools, hospital and retail outlets.

Glen-Gery's product mix reflects the traditional building styles of this region, with higher margin architectural products into the non-residential, multi-residential and paving segments making up 65% of total Glen-Gery sales. This compares to the wider US brick industry, where sales into these sectors make up around 25% of the total.

Glen-Gery has established a strong reputation within the industry for premium products, and has a plant network that is well equipped to service this market. Across its nine brick plants, it is able to offer a range of specialty moulded, handmade and glazed bricks, in addition to a full range of the more common extruded bricks. It also operates a thin brick production line, a product category that is gaining traction in the US, and offered by Glen-Gery as part of the "Thin Tech" façade system.

Integration progress

Since the acquisition, significant progress has been made to integrate the business, including the relocation of two senior executives from Australia, the implementation of a range of branding and marketing initiatives, and advanced planning for the transition of critical IT infrastructure.

Progress is underway on key strategic initiatives, in support of Glen-Gery's focus on high margin architectural products, including:

- Securing exclusive agreements with Brickworks European partners, for the supply of premium imported products into the United States;
- The development of plans to renovate the existing New York design studio and to establish a new studio in central Philadelphia; and
- As part of the operational improvement plan, the company is investigating a new state of the art plant at the Mid-Atlantic site, in addition to a heavy refit of the existing plant at the same location. This 600-acre site in Pennsylvania is ideally located to service the north-eastern region of the United States. By investing in the country's largest and most efficient single production line, the company will be well placed to service this key region for decades to come.

Property

Overview of Property Result

Half Year ended January ($million)	2019	2018	Change %
Net Trust Income	12	11	9%
Revaluation of properties	67	7	>500%
Development Profit	19	34	(44%)
Property Trust	**99**	**51**	**94%**
Property Sales	35	-	NA
Property Admin and Other	(2)	(2)	-
Total	**132**	**50**	**167%**

Property delivered EBIT of $132 million for the half year ended 31 January 2019, up 167% on the prior corresponding period, due primarily to land sales and increased revaluation profits within the Property Trust.

The settlement of the Punchbowl property sale in August, resulted in a EBIT contribution from **land sales** of $35 million.

The **Property Trust** delivered an EBIT contribution of $99 million, up 94%.

Net trust income was $12 million, an increase of 9% on the prior corresponding period. In addition to rental growth across the portfolio, rental income was received from three new facilities at Oakdale South.

A revaluation profit of $67 million was recorded during the half. This was driven by continued industry-wide capitalisation rate compression for prime industrial property assets. A New South Wales portfolio review was completed in December 2018, resulting in a 50-basis point reduction in capitalisation rates across the portfolio.

A $19 million development profit was also recorded, following the completion of three new assets at Oakdale South.

Property administration **expenses** totalled $2 million, in line with the prior half. These expenses include holding costs, such as rates and taxes on properties awaiting development.

Property Trust Assets

The total value of leased assets held within the Property Trust was $1.406 billion, as at 31 January 2019. The entire Property Trust portfolio consists of “A grade” facilities, each less than nine years old, with long lease terms and stable tenants. The annualised gross rent from the Property Trust is $79 million, average capitalisation rates are 5.4% and there are currently no vacancies.

Summary of Leased Property Trust Assets

Estate	Asset Value ($m)	Gross Lettable Area (m^2)	Gross Rental ($m p.a.)	WALE[9] (yrs)	Cap. Rate
M7 Hub (NSW)	149	64,180	8	2.8	5.6%
Interlink Park (NSW)	412	192,207	24	4.0	5.6%
Oakdale Central (NSW)	565	245,205	30	5.4	5.3%
Oakdale South (NSW)	102	46,430	5	11.3	5.3%
Rochedale (QLD)	178	95,636	10	12.6	5.8%
Total	**1,406**	**643,658**	**79**	**6.0**	**5.4%**

Including $308 million worth of land to be developed, the total value of assets held within the Property Trust was $1.715 billion at the end of the period. Borrowings of $466 million are held within the Property Trust, giving a total net asset value of $1.249 billion. Brickworks' 50% share of net asset value was $625 million at 31 January 2019, up $87 million (or 16%) over the 6-month period since 31 July 2018. This uplift was due to the revaluation of the New South Wales portfolio, and the completion of three new facilities.

As a result of the increased valuation, gearing on leased assets decreased to a conservative 32% at the end of the period.

The total return on the leased property assets in the Trust, including the revaluation profit, was 22% during the first half of 2019.

$million	Jan 2019	Jul 2018	Change %
Leased properties	1,406	1,168	20%
Land to be developed	308	360	(14%)
Total Property Trust assets	**1,715**	**1,527**	**12%**
Borrowings on leased assets	(456)	(451)	(1%)
Borrowings on developments	(10)	-	-
Net Property Trust assets	**1,249**	**1,076**	**16%**
Brickworks 50% share	**625**	**538**	**16%**
Rental return on leased assets[10]	6%	6%	-
Revaluation return on leased assets[11]	16%	7%	129%
Total return on leased assets	**22%**	**13%**	**69%**
Gearing on leased assets[12]	32%	39%	(18%)

[9] Weighted average lease expiry (by income)
[10] Based on annualised Net Trust Income of $24m (2 x 1H19), divided by $425m. This represents Brickworks share of leased properties (net of borrowings), less $51 million of newly completed assets that did not contribute any rent during the period
[11] Methodology as above, but assuming annualised revaluation profit of $67 million (in line with 1H19)
[12] Borrowings on leased assets / total leased assets

Investments

The EBIT from Investments was steady at $61 million in the half year ended 31 January 2019.

Washington H. Soul Pattinson Limited ('WHSP')

ASX Code: SOL

The investment in WHSP returned an underlying contribution of $60 million for the half year ended 31 January 2019, down slightly from $61 million in the previous corresponding period. Strong underlying contributions were delivered by New Hope Corporation, TPG Telecom and property transactions during the period.

Brickworks sold 7.9 million WHSP shares in November and December, at a weighted average price of $26.37 per share, delivering total cash proceeds of $208 million. This transaction enabled Brickworks to take advantage of the increased demand for WHSP shares upon inclusion in the MSCI index, and allowed the company to reduce debt soon after the acquisition of Glen-Gery.

Including dividends received, this parcel of shares has delivered a return of 13.7% compounded annually for 49 years, since the initial purchase in 1969[13].

Brickworks now holds 94.3 million WHSP shares; equivalent to a 39.4% interest in WHSP. This shareholding in WHSP is an important source of earnings and cashflow diversification for the company, and has been a key contributor to Brickworks' success for more than four decades.

The market value of Brickworks shareholding in WHSP was $2.481 billion at 31 January 2019 (39.4%), up $250 million from $2.231 billion at 31 July 2018 (42.7%).

During the period cash dividends of $34 million were received, up 3% on the prior period.

WHSP has delivered outstanding returns over the long term, outperforming the ASX All Ordinaries Accumulation Index by 5.4% p.a. over fifteen years.

WHSP holds a significant investment portfolio in a number of listed companies including Brickworks, TPG Telecom, New Hope Corporation and Australian Pharmaceutical Industries.

[13] Total return assumes re-investment of dividends and other special shareholder distributions

Outlook

Building Products Australia

Market fundamentals remain supportive for new housing construction, with employment levels healthy, low interest rates and high immigration levels.

However, the banking royal commission and tighter lending controls imposed by APRA have impacted credit availability, and this has led to financing constraints, causing delays and cancellations of home building contracts. The initial impact of this credit squeeze was felt early in the first half. Since then detached housing activity on the east coast (and Austral Bricks sales volume) has been relatively resilient, due to a strong pipeline of work being in place.

Decreasing consumer confidence due to declining house prices is now exacerbating the impact of the tighter credit controls. Some east coast builders are reporting that new house sales are down 20-40% from their peak, and reports are also emerging of a decrease in land sales to developers. These reports indicate that the existing pipeline of work will be progressively built out. As a result, sales volume is expected to decline in the last quarter of the financial year.

Meanwhile, in the more volatile high-rise apartment segment, approvals on the east coast have been in steep decline for 12 months, and this is now translating into a rapid slowdown in construction activity in that sector.

On the other side of the country in Western Australia, conditions remain very difficult, with building activity at cyclical low levels, and brick volumes and selling prices continuing to fall.

In January 2019, gas price increases of 29-45% took effect in east coast states. This follows increases of 20-65% the previous year. The full impact of energy price increases over 2018 and 2019 will result in additional annual costs of $24 million per annum. Due to the timing of the price increases, this impact is being progressively felt over financial years 2018, 2019 and 2020. The estimated impact in financial year 2019 is a $12 million increase compared to the prior year.

In a declining market, cost increases of this magnitude are beyond the company’s ability to recover through price rises, and will therefore have an adverse impact on the full year result.

From 1 January 2020, the company will get some relief, with a new wholesale gas supply arrangement to take effect at lower prices. This will offset some of the energy cost increases currently being incurred.

On the back of the exorbitant energy price increases, caused by a lack of pro-active government policy, any additional imposts placed on business and consumers will threaten the viability of domestic investment. For example, the proposed changes by the federal opposition to industrial relations regulation will reduce workplace flexibility, and changes to tax policy will adversely impact housing construction activity. Ultimately, business investment will be driven offshore.

Building Products North America

Brickworks considers the United States to be an attractive country to invest, with pro-business policies that support investment, efficient building approval processes and well-established transport infrastructure.

The outlook for construction activity in the United States is relatively positive in the short term, with steady growth anticipated in non-residential and residential activity forecast over the coming years[14]. Looking further ahead, the current level of housing starts remains significantly below the historical average, indicating that further growth in building activity is likely over the longer term. Glen-Gery currently has a healthy forward order book, with a particularly large number of school development projects.

With a focus on premium architectural products, Glen-Gery has a broad end-market exposure, including non-residential building, multi-residential and detached housing. Geographically, sales are concentrated primarily in the north-east and mid-west states.

With a strong platform now established following the Glen-Gery acquisition, Brickworks is well placed to pursue growth in the United States, and participate in the ongoing industry consolidation that is underway. Unlike Australia, the United States brick industry is highly fragmented, with significant over-capacity, and consists of numerous players operating at sub-optimal factory utilisation. As a result, Brickworks is actively investigating bolt-on acquisition opportunities in the United States, that will drive cost savings through realisation of operational and administrative synergies. Any additional acquisitions are expected to be funded from existing debt facilities.

Consistent with our strategy, Brickworks will bring a long-term focus to operations in North America, and opportunities will be evaluated with a disciplined and methodical assessment process. It is anticipated that the transition to a highly efficient and fully utilised plant network, incorporating bolt-on acquisitions, plant upgrades and rationalisation of facilities, will take approximately three to five years to complete.

Property Trust

The outlook for the Property Trust remains strong, with developments at Oakdale in New South Wales and Rochedale in Queensland expected to drive growth in rent and asset value over both the short and longer term.

At **Oakdale South**, development of a 33,000m^2 facility for DHL is proceeding well, with completion forecast in September 2019. A pre-commitment for a 31,400m^2 warehouse to Linfox has recently been secured, and construction of this facility will commence soon. An additional 30,000m^2 speculative development will also commence in the current period. The last land sale at Oakdale South, consisting of 51,000m^2 of developable land at the southern end of the Estate, is due to complete in April 2019.

The pre-commitment of the Coles Group to a 66,000m^2 facility at **Oakdale West** provides significant impetus to the development of this Estate. Whilst the agreement is still conditional on several approvals, progress has been made on the development application which is expected to be secured by mid-2019. This will support the Property Trust’s construction of a new access road into the Estate by mid-2020. Development will then continue for up to a decade, including delivery of the Coles facility in early 2022.

Plans are now in place for the development of 10 hectares of surplus land at the 88-hectare Plant 3 site, known as **Oakdale East** (subject to approvals). The proposed sale of this land into the Property Trust in late 2019 will facilitate the pre-commitment of Austral Masonry to a long-term lease for its new manufacturing operations at this site, with construction of further warehouse facilities to follow.

At **Rochedale**, the southern section of the Estate is now fully occupied, and activity is focussed on the remaining 6-hectare lot, where over 35,000m^2 of mixed-use buildings will be developed.

[14] BIA Annual Report (July 2018) - Industry Insights market forecast.

Property Sales

Aside from the sale of the 10 hectares at Oakdale East into the Property Trust, there are limited major land sales opportunities for Brickworks in the short term. The company is considering a range of strategies to generate earnings from property sales, and development activities, to supplement the strong earnings outlook of the Property Trust.

Investments

The earnings, dividends and market value of WHSP are expected to grow over the long term, albeit the contribution to Brickworks will be impacted by the reduced shareholding to 39.4% (from 42.7%), following the recent sale of 7.9 million shares.

LINDSAY PARTRIDGE
MANAGING DIRECTOR