FletcherBuilding

Annual Meeting of Shareholders 2006

2.00pm Tuesday 14 November
Rangitoto Room
Langham Hotel
83 Symonds St
Auckland
New Zealand

Chief Executive Officer's Address

FLETCHER BUILDING LIMITED

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Good afternoon ladies and gentlemen.

It is a pleasure to be joining you today in my new capacity. Let me take this opportunity to thank those shareholders, and other stakeholders, who have contacted me over the past few weeks to express their support. It is very much appreciated.

This occasion requires me to report on the performance of the business in a period when I was not chief executive, so you can regard my comments on the 2006 year as representing those of the whole senior management team. This highlights a very positive aspect of the way Fletcher Building has evolved – we have a management team that, whilst individually strong, has also worked cohesively and constructively together. I think this is a key factor in the company's performance.

As well as reporting on the past I will also take some time to summarise my views on the likely direction and strategy of the company.

Financial Results

The Chairman has already referred to the softening in residential construction activity, which has a flow-on effect to many of our operations. Whilst the slowdown was a long time coming in some areas, it certainly had an effect right through the 2006 year and is continuing to do so.

It might be helpful to clarify just which areas of our business have been affected and which have not. The residential market was softer overall, and specifically in New Zealand and in Victoria and New South Wales. This affects our Building Products and Laminates & Panels businesses, which are predominantly trans-Tasman by nature, and in particular affects our Distribution business, which operates wholly in New Zealand. The commercial building and infrastructure sectors remained relatively strong in both New Zealand and Australia, and as you will know this is providing an increasing proportion of our revenue.

In terms of financial results, the market conditions were offset by acquisitions and by continued strong internal performance. Sales were $5.5 billion – up from $4.6 billion in the previous year. Operating earnings were $675 million – up 10 percent. The numbers included a full year's contribution from the Amatek group of companies, which were acquired in March 2005 and only had four months' contribution to the 2005 year. After adjusting for that effect, our sales were up 6 percent in the latest year, and operating earnings by 3 percent.

Our earnings translated into a 26 percent return on average funds employed, which was down slightly on the prior year but still well above the pre-tax cost of capital.

Group cashflow from operations was $560 million, notwithstanding an increase of $80 million in working capital. Net capital expenditure was $260 million, of which 55 percent was growth-related. Net debt reduced to just over $1 billion despite our continued investment in the business.

And now to the results for each division in turn.

Building Products

Building Products recorded a 4 percent rise in operating earnings to $235 million. This was a good performance given the demand constraints, higher input commodity costs and the fact that strong Australian and New Zealand currencies limited the opportunity for price increases. The prior year included only four months' results from the Insulation Solutions and Stramit businesses acquired during the year.

Building Products has been organised, and reported in 2006 along six lines of business, and of these the strongest results came from the rollforming & coatings and insulation businesses. For comparative purposes, if adjustment is made for the shorter involvement of Insulation Solutions and Stramit in the previous year, operating earnings for these two businesses increased by 26 percent.

The metal roof tiles business had a very slow first half in its US operations and encountered unfavourable exchange rates for exports from its New Zealand plant through most of the financial year. With overseas sales constituting more than 80 percent of its business, the decline of just on $5 million in operating earnings was a satisfactory performance.

The long steel product business benefited for a second year from high scrap prices in its scrap metal operation, but the strong New Zealand exchange rate and competition from imported products resulted in significant price pressure in the reinforcing bar, rod and wire markets. Pacific Steel commissioned a quenching and tempering production process to reduce exposure to very high vanadium costs, but this required a 10-day shutdown of the mill. These factors combined to produce a decline in operating earnings of $12 million, although the business still achieved returns in excess of its cost of capital.

Plasterboard recorded a decline in operating earnings of 3 percent, which was a reasonable outcome given that sales volumes dropped by 5 percent.

Of the other businesses EasySteel had lower earnings due to the previous year's high steel prices not being sustained. Fletcher Aluminium also had lower earnings due to a rise in aluminium input costs, from around US$1,800 to US$2,500 per tonne.

We have also reviewed the structure of the Building Products division. To better focus on potential growth opportunities it was considered appropriate to split the steel operations out as a separate division reporting to me. For financial reporting purposes this separation will be effective from 1 July 2006. As we have previously announced, Chris Ellis has been appointed Chief Executive of the Building Products division. He has engineering qualifications from Canterbury and Stanford Universities and had a successful career within the group in Construction and more latterly as manager of our Winstone Aggregates business.

We are still engaged in an international search for the chief executive of the Steel division.

Infrastructure

Infrastructure sales and earnings increased for the fifth year in a row. Sales were up 27 percent to $1.8 billion, and operating earnings increased 30 percent to $255 million. This included a full year of trading from the Rocla pipeline and quarry businesses in Australia – but, even with these excluded, sales and operating profit were both ahead by 15 percent.

Operating earnings from the cement business improved in line with expectations. Sales volumes were ahead of those for the previous year, assisted by the benefits of its significant capital upgrade programme, which is now complete. The plant is now performing ahead of expectations.

Aggregates had continued growth in earnings, with strong conditions in Auckland roading providing the most significant improvement in performance.

Volumes in the key readymixed concrete market were marginally ahead of those for the previous year, but the contribution per cubic metre was marginally lower, with margins in the Auckland area coming under pressure. Masonry volumes were down on the previous year.

The pipe market remained strong and operating earnings improved significantly over those for the 2005 year. While market conditions in the second half were weaker than anticipated, the market outlook is still good.

The Rocla businesses in Australia performed well during the year. Operating earnings were marginally below budget in the quarry products business, largely due to more difficult market conditions in Sydney. The pipeline products business exceeded expectations, with strong growth in earnings.

Construction had another strong year, with operating earnings improving by 27 percent and all operations contributing to the growth. Earnings from the engineering division were up 100 percent, supported by solid growth from the New Zealand commercial building and South Pacific operations. The residential market in Auckland was relatively strong, allowing Fletcher Residential to again record improved earnings and margins.

The construction backlog at year-end was $802 million, including work on the Wellington Hospital, the Stamford Plaza refurbishment and extension on the North Shore Busway in Auckland. With a healthy backlog and continued strong market conditions it is likely that workload will remain strong in the commercial building operations. Sales in the engineering division will be dependent to some extent on success in securing infrastructure projects during the year.

The construction backlog of $802 million does not include any allowance for work on a new stadium for the Rugby World Cup.

Distribution

While overall market activity was reasonably consistent with the previous year, sales increased by 4 percent, enhanced by new store openings and an expanded product range.

The performance was pleasing in view of the significant increase in retail competition from Bunnings and Mitre 10 Mega. Nevertheless, the decline in cash sales as a proportion of the total had a slight negative impact on gross margin. This flowed on to operating earnings, which were down 7 percent. An additional factor affecting earnings was the incidence of higher operating costs from the refurbishment of six stores and the opening of new facilities in Kerikeri, Invercargill, Hamilton and Twizel.

The branch development program continues, with a further four new stores scheduled to be opened by December this year. The results from this program have been very encouraging, with the new stores performing strongly compared to older stores.

Since balance date the company has announced the acquisition of the Maddren Timber business, comprising three stores which will improve our representation in the region to the northwest of Auckland. We also acquired the Hammer Hardware store in Mangawhai Heads, north of Auckland.

Laminates & Panels

Laminates & Panels again performed strongly, increasing sales and earnings despite generally difficult market conditions and increased costs for some of its major inputs. Trading conditions varied regionally as I have already mentioned, but overall housing industry activity was down on the prior year. Activity levels in the commercial sector remained strong, except in New Zealand and New South Wales.

A number of innovative new product initiatives were undertaken. This included the launch of the Green First range of products, which have been independently certified as environmentally preferable by the Australian Ecolabelling Association – and also *Diamond Gloss* high-pressure laminate and *Formica* flooring. In addition, resources were committed to grow the kitchen componentry business and to launch a number of new products such as the innovative *Essa Stone* range. These initiatives are now positioned to contribute to results.

Laminates & Panels incurred increased costs for wood fibre, gas and electricity, especially in New Zealand; and in logistics, freight and resin as the result of rises in the price of oil. These increased costs offset gains from operational efficiencies on both sides of the Tasman.

The results included two months contribution from the Dunedin based benchtop manufacturer O'Brien Laminates, which was acquired in May this year. The division's two joint ventures – Wespine, the major pine saw miller in Western Australia; and Dynea, the supplier of resins to the Western Australian manufacturing operations – both continued to perform strongly.

That concludes my review of the divisional results. I'd now like to give you a brief overview of our strategic position and the way I see the company evolving over the next few years.

Strategic Direction

In essence, Fletcher Building is a collection of building-related businesses linked by a vertically integrated structure, with strong market positions, ownership of channels to market, and a stable of strong and respected brands. This proposition has served the company well, and been enhanced by changes made over recent years.

There is no reason to change the recipe, but of course we must continue to enhance and adapt the business mix through investment and operational changes.

Our recent growth has been built on a three-point strategy that could be summarised as follows:

- improve the reliability of earnings
- maintain and improve internal capabilities
- and take up external growth options where they meet our acquisition criteria.

We have already referred to our expansion in Australia and the consequent benefits to earnings. The Chairman mentioned that the portion of our sales to customers outside New Zealand is now 42 percent. It is worth noting that Australian revenues of the continuing businesses at the time of listing in 2001 would have been less than 3 percent.

The company has committed this year to $144 million of growth oriented capital expenditure to increase production capacity and efficiency, and develop new products. This brings total capital expenditure to around $2.1 billion since 2001.

We will continue to invest in both internal and external opportunities, although there may be changes in emphasis from time to time. For example, we are now looking more seriously at potential acquisitions outside Australia and New Zealand. This is partly a function of the scale of our existing positions – particularly in New Zealand – partly about the pricing of assets as they become available, and partly about the fact that our existing positions in the United States, Malaysia, Hong Kong and the Pacific Islands contribute successfully and enhance the overall value of the company.

We will also continue to expand in Australia and New Zealand. The larger Australian marketplace will produce opportunities, and there remain opportunities in New Zealand in market segments where we currently have little presence, but which are a natural extension of an existing business, as illustrated by the recent acquisition of O'Brien's Group.

Our financial position, with moderate gearing and strong cash flows, means we have capacity to make acquisitions where they meet our criteria. These criteria have served us well over the past five years and we will continue to be disciplined in the way in which we pursue potential acquisitions.

We also expect to continue investing within the business, with a roughly even split of growth-oriented and stay-in-business investments. Our major internal investments of the past couple of years – in the Golden Bay Cement plant and the Kumeu particleboard plant – have been completed on time and on budget, and are now contributing to growth. The Dardanup particleboard plant upgrade is well underway, with three of the four stages now complete. Full benefits of this investment will arise on completion next year.

We will have a major decision to make on the nature of the investment required to restore the Taupo medium density fibreboard plant, which was damaged extensively by fire in September this year. At a minimum, the plant will be out of action for the rest of the year. Last month we reported the machinery failure at our Pacific Steel mill. I am pleased to advise that a temporary transformer has now been installed and the plant will be operational shortly, well in advance of our initial thoughts that it might be closed until Christmas. We also confirm that the upgrade to the plant will proceed early next year.

Perhaps the most important challenge will be to preserve and build on the performance-oriented culture developed over recent years. Core elements in this culture are the identification and strengthening of leadership, the training and development to assist employees to achieve their full potential, and close linkage of financial rewards to the creation of economic value.

A key element is the promotion and nurturing of senior management talent through the creation of new opportunities and challenges. My own role shift has facilitated other movements, and as I have already noted there will be further change with the reorganization of the Building Products division. Such changes enable senior executives to gain new and broader experience, to their benefit and the company's.

As I have said in the annual report, our strategy will unfold against a background of considerable change in markets, but we are confident we will have the broad positioning and culture needed for continued performance. It seems likely that we will see continued strength in development of infrastructure, whilst residential and commercial building might be more subject to cyclical influences, but still reasonably good overall. We will definitely not be short of opportunities for further growth.

Thank you.