Fletcher Building

## Annual Shareholders' Meeting 2011

10.30 am Wednesday 16 November 2011

SkyCity Convention Centre
Auckland

## Chief Executive Officer's Address

**FLETCHER BUILDING LIMITED**

**Annual Shareholders' Meeting 2011**

Good morning ladies and gentlemen, it is a pleasure to be here with you once again.

This morning I will briefly review our business performance for the 2011 financial year, and then discuss the trading update we provided to the market last month.

Despite our expectations that we would see an improvement in business conditions in New Zealand in 2011, this was not the case. While the year started strongly, this momentum was not sustained. The first earthquake in Canterbury in September last year, had a significant impact on the broader New Zealand economy throughout the remainder of the year. In Australia we experienced a strong first half, but as we noted at our full year earnings announcement, conditions deteriorated in the second half. There was no improvement in European markets or in the United States.

## Building Products

There was a decline in earnings in the Building Products division in 2011. This was due to soft market conditions in the residential market in New Zealand which impacted the wallboards and insulation businesses, while the Australian market for insulation continued to be extremely depressed as a result of the abrupt termination of the government's insulation subsidy scheme in the prior year.

With no recovery in the market likely in the near term, we wrote down the value of surplus inventory and the value of our Sydney insulation plant, along with the goodwill of the Australian insulation business. This is a disappointing outcome, and reflects the significant disruption in the market as a result of the inadequacies of the Australian government's insulation subsidy scheme, which ultimately led to it being abruptly terminated last year.

## Distribution

Our PlaceMakers business experienced an early spike in sales as customers procured supplies ahead of the GST increase from 1 October last year. Subsequent to the GST increase, however, low levels of new house building activity and the after-effects of the Canterbury earthquakes impacted sales.

## Infrastructure

The Infrastructure division reported a 13 per cent lift in earnings in 2011. Both the New Zealand and Australian concrete businesses recorded growth in operating earnings. In New Zealand this was due to operational efficiency gains notwithstanding lower volumes, while in Australia continued volume growth and a favourable product and margin mix assisted earnings. Our construction businesses recorded a modest decline in earnings for the year, with lower activity levels particularly in commercial construction. We were delighted to be part of the winning consortium to build the $1.3 billion Waterview connection tunnels and Great North Road interchange.

**Laminates & Panels**

Performance in the Laminates & Panels division was up strongly, with operating earnings up 19 per cent. In Australia, Laminex experienced strong trading in the first half driven by the new education building investment programme and robust new house building activity.

Formica recorded a further year of solid performance improvement with operating earnings up 65 per cent. Both North America and Europe delivered sharply better results despite very difficult markets, while Asia continued to see strong growth in volumes and earnings. With our plant in Shanghai now almost at capacity after just four years of operation, we have announced that we will be building a second plant in China and planning is now well advanced for this.

**Steel**

Earnings in the Steel division were up slightly on the prior year. Strong performances in our rolled steel and distribution businesses were largely offset by weak conditions in the long steel business. Domestic demand was weak, and exports by Pacific Steel to Australia were at compressed margins due to the high currency coupled with a global excess of capacity. These conditions have persisted into the current financial year.

**Crane**

The integration of Crane into the Fletcher Building group has gone extremely well. The two cultures have a very strong fit, and I have been delighted with the positive response and enthusiasm I have had from Crane employees to being part of Fletcher Building.

Since our acquisition of Crane, we have closed the head office, and relocated what is now a small divisional leadership team to our existing premises in Chatswood in North Sydney. This has enabled us to realise approximately $20 million in on-going savings per annum. We are working with management to refine the trade distribution businesses in New Zealand so as to lift earnings and returns. In the plastic pipelines business – Iplex – we have been very pleased to win two significant contracts to supply pipes to coal seam gas projects in Queensland, with these contracts totalling 180 million Australian dollars.

**Health and Safety**

This year we have continued to see an improvement in our health and safety performance. The total recordable injury frequency rate – the measure of the total injuries per million employee and contractor hours – fell to 10.57 from 14.09.

Interestingly, in 2006 this measure was over 60, so we have made significant progress. We are committed to maintaining our focus and continuing with the initiatives we have underway with the goal of further reducing this figure substantially.

**Management Changes**

We have over the last few years had the benefit of continuity in our experienced and long standing executive team. However, this year has seen some changes, in the executive management team.

Kate Daly joined in July as Group General Manager of Human Resources, replacing Peter Merry who retired from Fletcher Building.

Tim Richards has been appointed as chief executive of the Building Products division, having successfully run our Stramit business in Australia for a number of years. He will be relocating with his family to Auckland from Sydney at the end of the year. Tim is replacing Chris Ellis, who was appointed to run the Brightwater Group during the year.

Mark Binns, chief executive of the Infrastructure division, is to leave Fletcher Building at the end of the year to take up a new role as Chief Executive Officer of Meridian Energy. With Mark's departure, the Infrastructure division will be split into two, with chief executive roles established for each of the new Construction and Concrete divisions.

Graham Darlow has been appointed as chief executive of the Construction division, which encompasses our engineering, general construction, South Pacific, and house building activities, as well as Fletcher EQR which is managing residential repairs for the Earthquake Commission in Canterbury. Graham has been with Fletcher Construction since 1988 and has been general manager of the engineering business since 2001. We are in the process of recruiting for the chief executive of the Concrete Division.

At this point I would like to publicly thank Mark Binns for his enormous contribution to Fletcher Building over the past twenty two years, and wish him every success at Meridian Energy.

David Worley who was previously the chief executive of The Laminex Group took up the role as chief executive of Crane in April. With this move, the opportunity has been taken to combine the leadership of both Laminex and Formica under Mark Adamson who was previously chief executive of Formica.

These changes have ensured that we continue to have a very strong executive leadership team. It has been a mark of the depth of talent within Fletcher Building that we have been able to promote several of our general managers to new senior executive roles.

## Canterbury

I have been extraordinarily proud of how our people have responded to the challenges posed by the earthquake in Canterbury.

Despite the personal hardships faced by many of our people in the Canterbury region, they have without exception done what was necessary to get our businesses back up and running, and looking after the needs of our customers.

The team at Fletcher EQR have successfully scaled up to service the Canterbury region from a standing start a year ago, and have made huge progress in managing repairs for the Earthquake Commission.

To date EQR have completed some twenty eight thousand emergency repairs, installed nearly twelve thousand heat pumps and solid fuel burners as part of the winter heat replacement programme, and completed or have underway approximately twenty three thousand permanent repairs. The volume of work being carried out by EQR has been continually increasing and the value of that work is now running at approximately $40 million per month. This work is being carried out by the 950 accredited contracting firms with the total number of trades people involved now around eight thousand.

There is much still to be done, and the continued earthquakes and aftershocks have frustrated the pace of the rebuilding, but we are nonetheless proud of the progress we have made so far.

## Sustainability

Earlier this month, we released our first sustainability report on our corporate website. It covers a multitude of areas including carbon emission, waste management, and environmental issues. I invite all shareholders to have a look online at this new report.

This year we saw the finalisation of the Australian government's Clean Energy Future Plan. This will result in the introduction of a carbon pricing mechanism from 1 July 2012. We expect this to result in higher energy costs for our Australian businesses once this scheme is introduced which in some cases should be able to be recouped through higher prices. We expect Laminex will be granted free emission units as a trade exposed business for two thirds of its emissions.

## Trading Update

Ladies and gentlemen, let me now turn to the trading update we provided to the market last month.

Having received the results for September, and for the first quarter, it became apparent that trading was falling behind plan. Furthermore, the forecasts provided by our business units for the half year to December, and the full year to June, were below our internal budgets and the market consensus. Accordingly, we deemed it necessary to immediately update the market as to our likely financial performance for the half and full financial year.

There are a number of reasons for the lower earnings expectations.

Firstly, the magnitude 5.5 earthquake recorded in Canterbury on 9 October has further delayed rebuilding work. We had been expecting that there would be a major lift in rebuilding activity from early in calendar 2012. With this latest earthquake event, however, we are now not factoring in a pickup in rebuilding activity until the second half of calendar 2012, on the basis of Treasury estimates.

Secondly, the rapid deterioration in new housing activity in Australia concurrent with the completion of the government's education building programme have had a major impact on our Laminex businesses. Laminex is also exposed to residential additions and alterations sectors, and this sector has slowed considerably in recent months. The Stramit steel sheds and roofing business has also been impacted by softer conditions in Australia.

Thirdly, as I mentioned earlier, international long steel margins have been under intense pressure due to a combination of the high Australian dollar and excess manufacturing capacity globally. This has led to returns on our long steel exports to Australia falling dramatically, concurrent with weak domestic New Zealand demand.

Finally, we have witnessed two of the weakest quarters for new housing consents in New Zealand – with the March quarter the lowest since records began. This weakness has had a direct impact on our New Zealand residential exposed businesses such as PlaceMakers, Tasman Insulation and Winstone Wallboards. At the same time, we have also seen the volume of new construction work decline in the commercial sector.

In response to this disappointing start to the year, we are further reviewing our manufacturing capacity requirements and overall cost base. Regrettably we have had to make a number of staff redundant in both Australia and New Zealand, including in our construction business.

We are well advanced in the reviews of our manufacturing and distribution footprints in both the Laminates & Panels and Steel divisions.

Shareholders can be assured that we are focussed on matching our productive capacity to demand, and to ensure we are right-sized for current conditions. However, with high fixed cost businesses, there is a natural constraint on cost reductions beyond which we must look to the cycle to bring about a measure of relief.

**Working Capital and Capital Expenditure**

In this context of subdued trading conditions we are looking hard at our working capital levels. During 2011 we increased our inventory levels to ensure we were well-placed to respond to the rebuilding work in Christchurch, but this has proven to be premature. Accordingly, in the short term, we don't foresee any further growth in inventory levels beyond what occurred in 2011.

This year we intend to maintain routine capital expenditure in line with depreciation. The new Formica plant to be built in China and any material acquisitions would be over and above the routine capital expenditure forecast.

**Balance Sheet**

Managing conservatively and focusing on cash is a prudent course to take in times such as these. Shareholders can be assured that the balance sheet of the company remains sound. Gearing – the ratio of net debt to net debt plus equity – at 34 per cent has continued to remain comfortably below our target range of 40 to 50 per cent.

**Strategy**

Whilst economic conditions are difficult, and our immediate priority is to manage our businesses accordingly, we nevertheless continue to pursue our broader strategic agenda.

The strong growth in operating earnings achieved in 2011 is fitting testament to our success over the past ten years of seeking earnings diversification and reliability.

The acquisition of Crane earlier this year also reflected our strategic priority of growing our presence in Australia in building products and distribution.

We will continue to seek out opportunities to grow in both Australia and New Zealand, although delivering the full value from the Crane acquisition remains the highest priority in the short term.

The new Formica plant to be built in China is an important next step as we seek to leverage Formica's brand and product innovation in that high growth market.

Ladies and gentlemen, before concluding, I would like now to speak to you briefly in support of my re-election to the board. You have just heard me speak at length about the performance of Fletcher Building and our future strategy. Let me simply add that it has been an absolutely privilege to lead this company for the past five years and to serve as a director. Given my continuing role as chief executive officer, I believe it is essential that I also remain a director on the board, and I therefore seek your endorsement to be re-elected as a director of the company.

Thank you very much for your attention.