Thursday 28 November 2019

FLETCHER BUILDING LIMITED

2019 Annual Shareholders' Meeting

Chief Executive's Address

Good morning Ladies and Gentlemen.

As Bruce has outlined, we got through a lot in the last financial year and we've made considerable progress on our strategy while continuing to deliver a mostly solid business performance. But we were however very disappointed at our safety performance through last year.

Tragically, the year was marked by five fatalities within our business. Through this we ensured that our sympathies, and support have been provided to their colleagues, friends and families. We also made sure we learned all we could from what happened, so incidents like these are not repeated.

Following on from these incidents, we are now well into a multi-year reset of our safety approach to ensure we have both; safe work practices, and safe work places across every corner of Fletcher Building. To help us achieve this as quickly as possible we have partnered with Dupont, an international safety organisation. Our target is be at industry best practice in safety within the next 3 years.

Firmly focused on our future

Having achieved our aim through the FY19 financial year of getting the business both focused and stabilised we now have a good foundation for taking Fletcher Building into the future.

Our overall aim remains unchanged and that is, "To be the undisputed leader in NZ and Australian building solutions – with products and distribution at our core". We continue to believe this vision is; compelling, achievable, and will create shareholder value over the medium term. Through my presentation this morning I will outline both, why we believe this, and how we are now going about achieving it.

Positions us well to drive shareholder returns into the futures

Firstly I'd like to highlight why we feel why our strategy positions us well to drive shareholder returns into the future. It brings focus. It provides consistency – we are trying to do similar things in similar markets. It is leveraged to upside as we have multiple opportunities for growth and are not dependent on a single bet – we have growth opportunities in our NZ core businesses, we have a significant turnaround opportunity and prize in Australia, our NZ residential business has a number of growth opportunities in adjacencies around its present core, and Construction, once clear of the legacy projects and refocused for consistent performance – will provide a further NZ growth opportunity.

All of this is underpinned by a very strong Balance sheet, and strong underlying cash flows. And we are positioned well for key macro trends. The combination of our scale "in market" positions, and the relative geographic isolation of NZ and Australia, means we can be a "fast follower" and identify and take advantage of these trends ahead of the competition in our home markets.

We continue to believe this strategy can achieve above market revenue growth and a material lift in profitability over the next few years.

Medium term market outlook is forecast to be supportive

On a positive note, the medium term outlook looks set to remain supportive with economic forecasters expecting our key markets to grow for the next few years at least.

In New Zealand, our key sectors by and large are forecast to remain pretty robust. In Australia the combination of the residential market returning to growth from FY21, and increasing levels of infrastructure spend, have resulted in forecasters predicting a relatively strong outlook in the medium term.

And finally, with population continuing to grow in both NZ and Australia, underpinned by continued immigration, we should see a supportive backdrop for ongoing GDP growth in both countries.

Focus now on driving consistent performance and setting up for growth

As I mentioned in my introduction we have a very strong set of businesses that we now need to ensure are performing consistently and well and are doing things now, that will set us up to achieve growth in future years.

The graphic on the screen brings to life this ambition, and recognises the different starting point for each of our key business areas. The broad themes outlined here are; a focus through this financial year on fixing performance issues where we have them and then, from FY21 onwards deliver both performance improvements, and growth.

I will go through this in a bit more detail in the coming slides.

Executive Team well positioned to drive and lift performance

Against this backdrop, I have continued to evolve the Executive Team. We now have in place a team that is a blend of proven long term Fletcher Executives, combined with some more recent additions. I believe this combination sets us up well to achieve our goals and aspirations for the company.

Hamish, Bruce, Ian, Steve and Dean have all been here for many years, have all led businesses successfully, all have deep sector knowledge and importantly all continue to demonstrate strong performances in the businesses they are now leading. Peter, has made a big impact since joining as our Construction Chief Executive a year ago, has steadily re-established a strong go forward Construction team, and quickly got his arms around the overall construction reset.

Bevan and Claire have continued to be instrumental in the overall Fletcher Building reset and the additions of Andrew, and Wendi have been important in supporting what we need to achieve across; governance, risk management, and the overall safety reset I mentioned in my introduction. David continues to lead Technology while we work through an internal and external recruitment process for this role.

Most of the team are here today, and if they could please stand up so you can see where they are. They, like me, will be available after the formal part of the meeting, so I would encourage you to seek them out for a chat.

NZ core has good market positions, but margins under pressure

In the next part of my presentation today, I will provide more detail on each of our key operational areas. I'll start here in NZ, with our core operating businesses - Concrete, Building Products, and Distribution. These businesses are a unique set of assets and all have strong market positions, great brands, and, established and complementary channels to market.

Across all these businesses, revenue has grown through the last few years. However, in recent years we have experienced some margin compression. This has been predominantly a result of; above average input cost rises, competition limiting price increases and, if we are honest with ourselves, the distractions of the last 2 to 3 years have caused us to lose focus on; driving product innovation, and looking for sensible adjacent opportunities.

Positioning the NZ core for margin improvement and growth

We are focused on turning this tide, by focusing on four consistent themes.

Firstly, driving operational excellence across; manufacturing, pricing, logistics and customer performance in each and every business. A good example is that delivery tracking is now possible for our customers across the plasterboard and concrete businesses and will soon be live for Distribution.

Our second focus area is to reboot innovation and new product development across the businesses, and we are already seeing some exciting recent examples: such as the Iplex, mobile pipe extrusion plant in the South Island – which not only has an extremely competitive manufacturing price point, but allows us to move the plant to where the bigger projects are occurring; and the recent Laminex range update which also allowed us the efficiency benefit of reducing the number of SKU's we offer.

Thirdly, we're also making significant investments across; e-commerce, digitisation and automation. This is particularly focused in our Distribution businesses, where following the digitisation of our customer facing processes, we are now moving into a major push, to get our ecommerce channels, and customer support applications ahead of the competition.

And finally, we'll continue to look at logical adjacencies around our present areas. A good example is Wallboards GIB Weather-line product, which has, allowed them to successfully move into the Cladding product adjacency.

Highly successful Residential and Development Division

Our Residential and Development division has been a real success story over the last 5 years, where we have successfully created New Zealand's number 2 house developer, and also, put in place a strong industrial Land Development capability. The team has; a great customer focus, very strong operating skills and good financial disciplines. All this underpinned 755 sales through FY19, and generated EBIT of $137 million.

Looking forward, we have around 5,000 future lots under our control, and we expect to be able to progressively increase this. Importantly, this gives us a solid base to allow the Residential business to continue to operate at these levels.

Ability to scale Residential further

Looking ahead, our focus is firmly on where we can now take this business. Firstly, we want to grow our base residential business to around 1,000 units per annum. Then we want to see our land development pipeline continue to generate sustainable profits at around $25 million per annum.

Thirdly, we want to scale up the volume through our recently opened housing manufacturing plant both, working on houses for our own business, as well as others. This is a great example of being a fast follower where we have imported world leading practices and localised them for the NZ market. This technology allows us to both increase quality and halve the time to build a house. It also provides a possible future next step into our Australian businesses. This is a very exciting step for us.

And finally, we are also actively working on tapping into the housing densification trend here we are hoping to crack the apartment market through innovative modular construction systems. To this end we are looking at both modular timber, and modular steel construction systems, to see if we can't bring down construction time and price points, to a level that we believe makes investment in this sector compelling.

All in all, this represents an exciting opportunity for Fletcher Building.

Pivoting Construction to a more balanced portfolio

Moving onto Fletcher Construction. This is a business that is well positioned in New Zealand, with circa 10% market share, and it enjoys strong positions across; roading, infrastructure, and vertical construction. While its problems have been well publicised, we are now getting to a position where we can properly focus on the future of this division.

A key part of this future is to focus on winning a mix of projects that will ultimately position the overall business with a more balanced portfolio of work 1/3rd risk, 1/3rd alliance, and 1/3rd maintenance.

The benefits of this approach are shown on the graph on the slide. As the legacy, and nil margin risk projects are completed we should see this business have a pretty clean revenue stream by FY21 and by the time we get to FY23 we would expect to see the division with a well balanced and sustainable revenue profile.

Growing Construction in profitable sectors

To ensure we achieve this we are working across four key areas. Firstly, rebuilding the talent and skills across the business, through training and development, as well as selective recruitment from the external marketplace.

Secondly, improving all elements of; our operating disciplines, our governance, and our risk management. This is quite holistic and covers all elements of a projects lifecycle; from the bid, through construction, and to the ultimate handover and commissioning process.

Then we want to ensure we build the revenue and work profile I outlined on the previous slide.

Pleasingly we are making good progress, and with wins like $2.4 billion, ten year Watercare partnership contract, we are on track to achieve this transition.

And finally, we remain focused to completing the legacy projects within the provisions we raised back in February 2018.

Update on NZICC

It's appropriate at this point, to provide a brief update on the status of the Convention Centre, following the fire a few weeks ago.

Firstly, and very importantly, all our staff and subcontractors on site were evacuated safely and without any injuries. And, I also want to again express our gratitude to the fire and emergency teams, who did a great job over a number of days to bring the fire under control.

Also in recent days, the insurers for the project have now formally confirmed that both the Contracts Works, and the Third Party Liability insurance policies, will respond to damage and claims caused by the fire.

We have now had access to the site for two weeks, and are actively working on making the site safe. And in parallel to this, we are also developing the rebuild plan and timetable, which we expect to have finalised by February next year.

Based on the information we have available at this point in time, we have confirmed we remain within the Construction provisions announced in February 2018. And in line with completing the rebuild plans and timetable, we expect to be in a position to update the market on this at our half year results in February 2020.

Intervened in Australia and dealing with market downturn

As we have discussed extensively, while our Australian businesses generally enjoy strong market positions, they have not been performing well. And last year, this issue was exacerbated by the combination of the sharp declines in the Australian residential market, and generally higher input costs across all of our businesses.

Against this backdrop we made decisive intervention last year to; materially reset the cost base, lift the talent and bench strength of the team, and continue to support growth and efficiency investments.

These programmes remain on track, with most of the identified initiatives now implemented. That said there will be a larger first/second half imbalance in our profits than usual, as we do not get the full run-rate benefits of the "cost out" initiatives until the second half of FY20.

While the residential market downturn has impacted our plans, our sense is the downturn will bottom out at the 150,000 to 160,000 level this financial year, and then grow from there. As such, we continue to target getting the Australian business to profit levels in the 6% to 7% range in the medium term.

Australia cost out and growth investment progressing well

Looking forward, our Australian core businesses are focused on the same four themes as we are in NZ.

Firstly, driving operational excellence across every business. In truth, this is where the majority of our recent focus has been, as it has involved a significant reset some examples include: the rationalisation of our; stores, distribution centres, and loss-making businesses; the consolidation of manufacturing facilities, to get costs to a sustainable and competitive level the picture on the slide shows one example where we consolidated of our Insulation manufacturing, to Dandenong in Victoria only; and the merger of Rocla and Iplex which provides both operational efficiencies and allows us to better serve our numerous joint customers.

Secondly, the reboot of innovation and new product development and like NZ we are already seeing some exciting recent examples: such as the recent Laminex range update, which was led by the Australian business, and has been very well received by our Australian customer base; and the packaging and product update across our full insulation range which again has been well received by our customers.

Then like NZ, there is a significant focus across e-commerce, digitisation and automation. An exciting early success in this space is the launch of the Laminex digital platform, this has been well embraced by our customers, and is an integral part in the performance improvements we are already seeing in the Laminex business.

And finally, we'll continue to look at logical adjacencies around our present areas. Good initial example's include; starting an Iplex "direct to site" Civil business, the focus Stramit is putting into the garage door sector, and the own brand products we continue to introduce into Tradelink

Continued focus on our key enablers to drive performance

Beyond what I have already talked about, there are a number of key themes and enablers we are working on across all the businesses, and these will be just as critical to our success over the next few years:

- Delivering a complete reset of our safety culture and performance;
- Continuing to focus on our key resource our people, improving; engagement, talent, diversity, and the overall skills in the organisation;
- Getting ourselves firmly positioned with our customer facing, ecommerce and digital systems, and at the same time getting our backbone IT systems fit for purpose;
- Continuing to lift our operational performance across all businesses;
- Bringing innovation and local adaption to life truly being the global fast follower we need to be; and
- Finally continuing to advance on our customer service and customer promise across all businesses, channels and segments.

We will continue to bring our progress against all of these to life for shareholders, and regularly report against them alongside our key financial metrics.

Market and trading update – New Zealand

So now to give some context on the market, and how we are seeing things this year so far beginning with New Zealand.

In our Core divisions finishing trade volumes remain strong, supporting a good performance in plasterboard, insulation and laminates however civil, infrastructure and early trade works are trending slightly lower. This is flowing through to a slight easing in demand for; concrete and pipes And, as has been well signalled, the steel market remains highly competitive.

In Residential & Land Development, strong demand remains for houses in the mid price point range, and margins have held up. The first of two Land Development transactions were completed in July, with a second site scheduled to complete either in late December or early January.

In Construction, Higgins asphalt works were impacted by a wet first quarter, but more recently has returned to normal volumes.

Looking forward for the rest of the year in New Zealand we expect: residential consents to ease slightly off peaks; commercial activity to remain steady; and in Infrastructure we expect to see spending ease in major roading, but see increased spend in; road safety, water, and rail.

Market and trading update - Australia

And in Australia: our cost-out programme is progressing to plan; we're seeing good turnaround momentum in Laminex and Fletcher Insulation; high competitive intensity continues to place pressure on price and margin in Stramit and Tradelink; and infrastructure project delays are expected to have some near-term impact on Iplex-Rocla in FY20.

And looking forward for the rest of the year in Australia we expect: the contraction in Residential to continue to the levels we'd previously forecast; we expect commercial activity to remain steady; and while we are less exposed to Infrastructure work, project activity is expected to remain lumpy, with an expected lift in calendar 2020.

FY20 outlook

Finally, we see little change to the FY20 outlook we forecast in both June and August this year. We expect EBIT before significant items for the full 2020 financial year, to be in the range of $515 million to $565 million.

In providing this outlook, I would restate the following points from my presentation. In New Zealand core earnings remain solid overall, with Steel impacted by ongoing high competitive intensity. Residential will grow slightly on the prior period and we expect Land Development to return to a $25m p.a. EBIT run-rate. Construction earnings will be broadly stable driven mainly by the upcoming roading season. And in Australia, earnings will be weighted to the second half, as benefits of the cost out programmes ramp up and also we expect the pipelines businesses to be impacted through the year by lower civil and project activity. It's also worth noting that the outlook includes higher year on year; depreciation and corporate costs, and the full impacts of the new accounting standard IFRS16.

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