

25 September 2023

Fletcher Building Limited (FBU)



The company will hold its Annual Shareholders Meeting at **10.30am Friday 27 October 2023**.

The location is **Grand Hall, Level 5, North Stand, Eden Park, Walters Road, Kingsland, Auckland**.

You can also join the meeting online [here](#).

Company Overview

The company manufactures a wide range of building products from insulation to cement. The company operates businesses from resource extraction, product manufacture and distribution, through to property development and construction. It employs over 14,900 people at 980 sites in New Zealand, Australia, and the South Pacific.

In March 2023, the company announced it was subject to a class action relating to disclosures around its Building and Interiors business in 2016 and 2017.

In June 2023 Sandra Dodds was appointed to the Board as an independent Director. The company has 8 directors, including three based in Australia.

Current Strategy

The company's vision is to be the 'leader in New Zealand and Australian building products and solutions'. Their purpose of '*Improving the world around us through smart thinking, simply delivered*', represent three key themes that shape how they operate.

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Key

The following sections calculate an objective rating against criteria contained within NZSA policies.

Colour	Meaning
G	Strong adherence to NZSA policies
A	Part adherence or a lack of disclosure as to adherence with NZSA policies
R	A clear gap in expectations compared with NZSA policies
n/a	Not applicable for the company

Governance

NZSA assessment against its key policy criteria is summarised below:

Policy Theme	Assessment	Notes
Directors Fees	G	Excellent disclosure.
Director share ownership	A	Not disclosed if Directors are required to own shares.
Executive Remuneration	A	See below.
Golden parachutes/handshakes	A	See below.
Director Independence	G	All Directors are independent.
Board Composition	A	See below.
Director Tenure	G	See below.
ASM Format	G	Hybrid. See below.
Independent Advice for the Board and Risk Management	G	See below.

Director Fees: Disclosure of director remuneration is excellent. However, the company is proposing a 20% increase in the Director Fee pool for FY24 that is not supported by NZSA.

Executive Remuneration: The CEO is paid a base salary, a short-term incentive (STI), comprising 50% in cash and 50% in equity, and is able to earn a long-term incentive (LTI) in equity. We also note that the CEO and senior executives are required to hold a minimum parcel of shares based on their base salaries.

There is excellent disclosure around the functional measures (financial, safety, and personal) that comprise the STI, their weightings, targets, and level of achievement for each measure group. This disclosure is comprehensive and provides a model for other NZX companies.

From a 'target' perspective, we note the STI forms the major portion of the CEO's incentives. NZSA prefers a weighting towards long-term incentives to ensure the CEO and senior executives' interests are aligned with the long-term interests of shareholders. In mitigation, we note that 50% of the STI is awarded in equity and vests over two years.

The CEO can earn a maximum of 168% of base salary in STI (target = 112%). In FY23, the CEO achieved 36% versus the maximum – or approximately 60.5% of his base salary – in STI. This is well down on the previous financial year's achievement.

In practice, we note that the CEO has not achieved an LTI incentive during his employment. This may have created a situation where the CEO and other executives are less motivated to achievement of the LTI thresholds, but have significant focus on the targets and achievement associated with STI.

We note the company statement that *"the CEO, Chief Executives and General Managers will receive no fixed remuneration increases next year"*, with the average STI component for those individuals rising to 110% of base salary (from 100%). The additional 10% will only be awarded should increased financial targets be achieved. There is no change to the maximum STI achievement level (168% of base salary), however the 'target' ratio increases to 123% of base salary (112% x 110%). This may increase

motivation towards short-term target development and achievement and extending the ratio of incentives compared with base salary.

At an 'on-target' rate, total incentives for the CEO now represents a (significant) 2.03x the base salary, with maximum total incentives of 2.48x base salary. NZSA believes that this is some evidence of a lack of motivation as to the achievability of the LTI component, as noted above. We prefer to see a less extreme level of incentive for businesses operating in mature markets.

NZSA does acknowledge the 'Australasian' nature of FBU's recruitment market for its CEO and the market practices common in Australia.

Golden parachutes/handshakes: Fletcher Building offered explicit disclosure around the retention award granted (and vested in 2022) to CEO Ross Taylor as part of his recruitment. NZSA does not generally support the use of recruitment incentives. Again, we recognise that such schemes are commonplace in Australia.

FBU offers no disclosure as to the severance terms associated with the CEO, including whether specific termination payments are offered. NZSA expects these to be disclosed in the interests of transparency for shareholders.

Board Composition: The company does not participate in the IoD's Future Director programme designed to develop and mentor the next generation of Directors. NZSA expect NZX50 companies to participate as part of a responsibility to develop and mentor the next generation of Directors.

We note that many Board members maintain other significant directorships.

- Doug McKay is the Chair-elect of NZX-listed Vector, the Chair of the BNZ and a director of IAG New Zealand and the National Australia Bank. With his recent nomination as Vector Chair, McKay now falls beyond NZSA's workload thresholds. NZSA will look for transparency as to his future plans.
- Barbara Chapman is the Chair of NZX-listed companies NZME and Genesis Energy, and is also a Director of BNZ. This is above NZSA's workload threshold; we have discussed with Chapman our expectation of transparency as to her ability to manage her workload and/or a future plan.
- Cathy Quinn is the Chair of NZX-listed Tourism Holdings and is also on the Boards NZX-listed Fonterra (as is Fletcher Building Chair Bruce Hassall) and USX-listed Rangatira. This places Cathy on the boundary of NZSA's workload threshold.
- New appointee Sandra Dodd is also on the boundary of NZSA's workload threshold, with directorships at NZX-listed Contact Energy, TSX-listed OceanaGold Corporation and significant NZ unlisted businesses Snowy Hydro Limited and Beca Group Limited.

Whilst the Annual Report contains a skills matrix it does not attribute skill sets to individual Directors to demonstrate how they contribute to the governance of the company. The Board notes a strong-very strong collective rating within Fletcher Building's relevant industry (Building Products, Construction). However, this does not appear to match the biographies provided in the Annual Report.

NZSA continues to challenge FBU to provide an individual breakdown of the Board skills relevant to govern the company as they apply to individual Board members.

This is particularly relevant given the company’s ongoing poor share price performance. We acknowledge, however, the scale and long-term nature of the legacy issues inherited by the Board in 2018 and the significant events (including the ICC fire) that followed. We also note the sustained improvement in underlying EBIT (excluding significant items) and non-financial operations performance over the last two years.

Business context	Capability	Key elements	Director expertise
Product and market knowledge	Industry	Manufacturing and distribution / land and property development / construction and infrastructure	🟡
		New Zealand / Australia building products sector	🟢
Functional Expertise	Financial expertise	Prior CFO, Audit and Risk Committee Chair experience, financial risk management	🟢
	Commercial depth	Business operations at scale, commercialisation of research-based innovation	🟢
	Technology and digital innovation	Cybersecurity, data analytics, disruptive technology, digital platforms	🟡
	Sales and go-to-market	Marketing, retail, service delivery, customer engagement, omnichannel	🟡
	M&A, divestments, corporate restructuring	M&A, divestments, corporate and balance sheet structuring	🟢
	Environmental, social and governance	Shareholder engagement, sustainability frameworks, ESG indexes and reporting	🟡
	Government, legal, regulatory	Engagement with government stakeholders, legal, policy and regulatory environments, NZX/ASX experience	🟢
	Health and safety	Safety standards and best practice	🟢
People, culture transformation	Leading transformation / cultural turnaround, talent management and remuneration	🟢	

Key: 🟢 Very strong 🟡 Strong 🟠 Solid 🟤 Some gaps

This key represents the assessment of the strength of the skills and experience of the Board as a whole.

Director Tenure: NZSA looks for evidence of ongoing succession or ‘staggered’ appointment dates that reduce the risks associated with effective knowledge transfer in the event of succession. We also prefer a term maximum of 9-12 years, unless there are exceptional circumstances that may apply.

All Directors have served less than 9 years. We note that of the seven Directors, the Chair was appointed in 2017, five were appointed in 2018 and one in 2019 and one in 2023. The Board will need to carefully manage succession planning to ensure appropriate rotation whilst retaining institutional knowledge and experience. The recent appointment of Sandra Dodds (subject to shareholder vote) indicates that this process may be underway.

Independent Advice for the Board & Risk Management: NZSA looks for evidence, through disclosures, that a Board has access to appropriate internal and external expertise to support board assurance activities. We also look for evidence that Boards are across their risk management responsibilities.

In both cases there are comprehensive disclosures. Fletcher Building offers clear disclosure of strategic, business, and financial risks, as well as the processes that support risk management.

The [Board Charter](#) notes that “*Directors have access to counsel and advice from the Chair, the Company Secretary and the Group General Counsel, and are able to seek independent professional advice at Fletcher Building’s expense, after consultation with the Chair.*”

We also note the statements in the Annual Report that Board members undertake site visits and are able to observe and assess on-site risks.

Audit

NZSA assessment against its key policy criteria is summarised below:

Policy Theme	Assessment	Notes
Audit independence	G	Good disclosure.
Audit rotation	A	See below.

Audit Rotation: Whilst the company ensures the Lead Audit Partner is rotated at 5 years as required by the NZX Listing Rules, it does not disclose if the Audit Firm is rotated at 10 years. NZSA also expects disclosure of the appointment dates of the Lead Audit Partner and Audit Firm to improve transparency for investors.

Environmental Sustainability

NZSA assessment against its key policy criteria is summarised below:

Policy Theme	Assessment
Approach	G
Sustainability Governance	G
Strategy and Impacts	G
Risk and Opportunity	G
Metrics and Targets	G
Assurance	A

Overall approach: Fletcher Building appears to be an early adopter of Sustainability reporting among NZX-listed companies. They have been publishing Sustainability Reports since 2015, incorporated within their Annual Reports since 2019. Since 2018, Fletcher Building have been producing separate emissions inventory and energy consumption statements as well as producing their inaugural climate-risk related disclosure in 2023.

Sustainability Governance: In the Corporate Governance statement of Fletcher Building’s 2023 Annual Report, they disclose a Board Skills Matrix that shows the varying degrees of collective experience that the Board demonstrates in 10 capabilities, including environmental, social and governance (ESG).

Strategy and Impact: In FY22 Fletcher Building conducted an assessment of the impacts of environmental-related risks on their business, strategy and financial planning, which is disclosed. They have also developed a carbon reduction roadmap to identify areas they can achieve the most significant reductions.

Risk and Opportunity: In their Climate-related Disclosure, Fletcher Building provides a good level of their climate-related and wider existential risks, opportunities, and mitigation strategies. These risks are grouped in transitional and physical risks.

Metrics and Targets: Fletcher Building disclose their Scope 1-3 GHG emissions for 2023, with comparative showing their Scope 1&2 emissions from 2018, where it appears a sustained reduction in emissions has been achieved.

They also disclose incorporating ESG targets into STI scorecards for senior leadership although we note that there appears to be no reference to this in the STI weightings disclosed within the remuneration report. In response, FBU has noted that is due to different leaders having different targets. It remains unclear for disclosures as to the weighting ascribed to environmental sustainability achievement for CEO Ross Taylor.

FBU utilises [ESG World](#) to cross-reference their milestones, metrics and achievements to existing disclosures.

Assurance: While Fletcher Buildings’ GHG emissions profile has been externally verified by Toitū Envirocare and EY provides pre-assurance over non-financial metrics, NZSA expects limited assurance review for all claims made within their sustainability reporting to fully meet this criteria.

Ethical and Social

NZSA assessment against its key policy criteria is summarised below:

Policy Theme	Assessment	Notes
Whistleblowing	G	Good disclosure.
Political donations	G	No donations were made.

Political Donations: We note the Annual Report “*political donations are not permitted without approval of the Board.*”

Financial & Performance

Policy Theme	Assessment	Notes
Capital Management	G	There was no capital raising. Good disclosure around dividend policy and rationale.
Takeover or Scheme	n/a	<i>n/a if no takeover</i>

Fletcher Building's share price fell from \$4.98 to \$4.60 (as of 26th September 2023) over the last 12 months – an 8% decline. This compares unfavourably with the NZX 50 which rose by 1% in the same period. The capitalisation of FBU is \$3.6b placing it 13th out of 128 companies on the NZX by size and makes it a large company.

Metric	2021	2022	2023	Change
Revenue	\$8,120m	\$8,498m	\$8,469	n/c
EBIT ³	\$668m	\$756m	\$798m	5.5%
NPAT ²	\$305m	\$432m	\$235m	-46%
Gross Margin Pct	29%	30%	31%	5%
Inventory Turnover	4.81	4.45	3.73	-22%
EPS ¹	\$0.371	\$0.552	\$0.300	-45%
PE Ratio	20	9	15	
Capitalisation	\$5.9b	\$4.0b	\$3.6b	-10%
Current Ratio	1.59	1.52	1.51	n/c
Debt Equity	1.15	1.24	1.47	19%
Operating CF	\$879m	\$592m	\$388m	-34%
NTA Per Share ¹	\$3.23	\$3.38	\$3.10	-8%
Dividend Per Share ¹	\$0.30	\$0.40	\$0.34	-15%

¹ per share figures based off actual shares at balance date (not weighted average)

² NPAT reflects the profitability available to shareholders – excluding non-controlling interests of \$19m

³ underlying – excludes significant items

After a solid year in FY22, FBU had a tough year in 2023, albeit mainly driven by its key legacy project (the NZ International Conference Centre). A further provision was the key driver behind the NPAT reduction versus FY22 – but it is also worth highlighting the consistently increasing underlying EBIT, up a further 5.5% in FY23.

Revenues were flat at \$8,469m and a slightly increased Gross margin of 31% saw them increase Gross Margin by 5% to \$2,631m.

However, expenses, (most notably \$301m of significant items), increased by 18% to \$2,134 which meant a much-reduced NPAT of \$254m was reported. EPS attributable to shareholders of the company fell by 45% to \$0.30. Subsequently the company reduced the fully imputed dividend by 15% to \$0.34.

Inventory turnover declined further to 3.73 from 4.81 and inventory levels rose further to \$1,624m. This impacted operating cashflows which decreased another 34% to \$388m – over the last two years, this means that operating cashflows have reduced from \$889m (-56%). Some of this change is driven by increasing taxation outflows.

The company is in reasonably sound financial position with a solid current ratio of 1.51 and an increased debt equity of 1.47. We note the company took on an additional \$739m of long-term debt

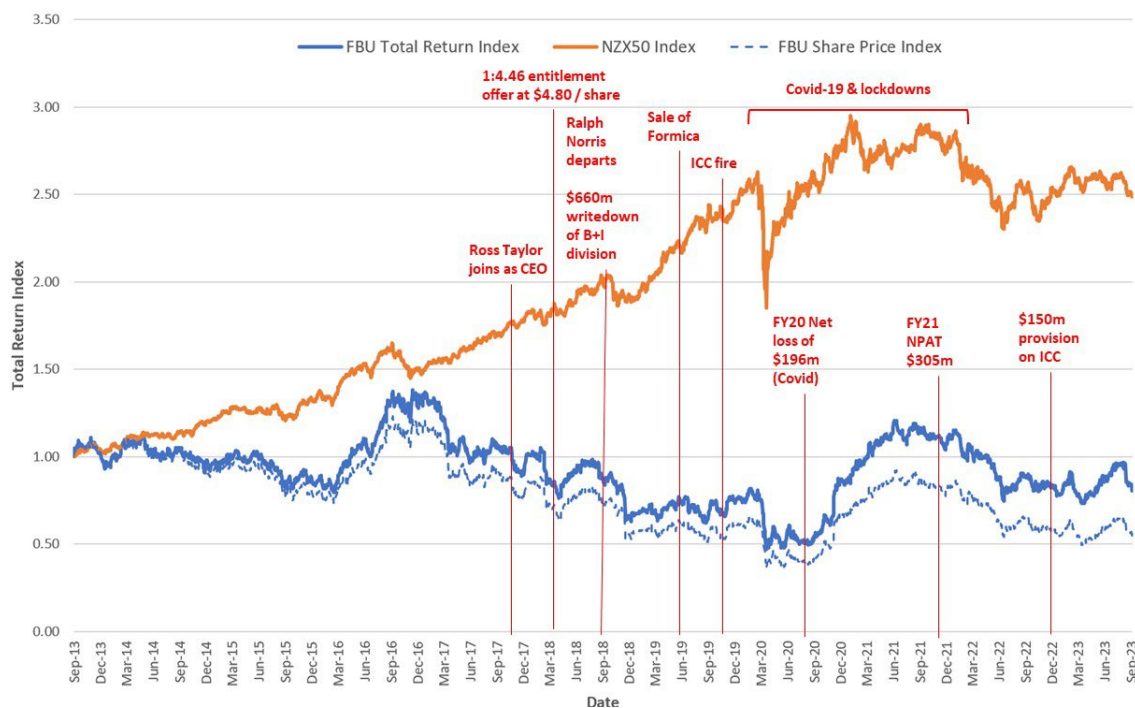
during the year and total non-current debt stands at \$1.7b. The overall weighted average interest rate is 5.74%. Net interest expenses rose from \$36m to \$82m and are expected to be higher in FY 24.

NTA per declined slightly to \$3.10 and the company trade at a 49% premium to NTA. The PE ratio is at 15.

Page 22 of an [investor presentation](#) released to market on the 16th August, in conjunction with their annual results, highlights some non-quantifiable forward looking statements where the company essentially say they are “Well positioned for cycle, disciplines & culture driving performance, with clear pathway for growth”.

Notwithstanding the short-term outlook, NZSA notes the long-term, systemic decline in shareholder value. The following graph shows the total shareholder return for FBU shareholders, compared with the NZX, since 2013.

Fletcher Building Total Returns vs NZX50 Index



We note that the company has not ‘closed the gap’ since the appointment of the new Board during 2018. An investment of \$10,000 into FBU would now be worth around \$8,300 (assuming dividend reinvestment) while the same amount invested in the NZ50 would be worth approximately \$24,300.

Resolutions

1. To re-elect Bruce Hassall as an Independent Director.

Bruce Hassall was appointed to the Board 1 March 2017 and is the Chair. He is a former senior partner and CEO of PwC New Zealand. Bruce is the Chair of The Farmers' Trading Company Limited and Profile Group Holdings Limited and is a director of Fonterra Co-operative Group Limited.

We will vote undirected proxies **IN FAVOUR** of this resolution.

2. To re-elect Barbara Chapman as an Independent Director.

Barbara Chapman was appointed to the Board 1 September 2018. She is formerly CEO and Managing Director of ASB Bank for seven years and having held a number of senior executive roles responsible for marketing, communications, human resources, life insurance and retail banking in New Zealand and Australia. She was named New Zealand Herald's 2017 Business Leader of the Year. In 2019, Barbara was made a Companion of the New Zealand Order of Merit for services to business. She is the Chair of Genesis Energy Limited and NZME (New Zealand Media and Entertainment) Limited, Deputy Chair of The New Zealand Initiative and is a Director of Bank of New Zealand.

As noted in our earlier statements related to Board Composition, we are conscious that Chapman is also the Chair of NZX-listed companies NZME and Genesis, and is also a Director of BNZ. While supporting her re-election on this occasion, we will continue to seek a clear plan for her to reduce her future workload.

We will vote undirected proxies **IN FAVOUR** of this resolution.

3. To re-elect Martin Brydon as an Independent Director.

Martin Brydon was appointed to the Board 1 September 2018. He has more than 40 years' experience in the Australian building products sector. He joined Cockburn Cement Limited in 1981, where he then served as CEO from 1998-1999. Following Cockburn Cement's merger into Adelaide Brighton in 1999, he held a number of senior management roles before his appointment as CEO and managing director in 2014. Martin retired from Adelaide Brighton in January 2019. He is Chair of ASX listed company Duratec Limited.

We will vote undirected proxies **IN FAVOUR** of this resolution.

4. To elect Sandra Dodds as an Independent Director.

Sandra Dodds was appointed to the Board 1 September 2023 and is therefore required to offer herself for election. She has a broad and diverse industrial background with over 30 years of operational and financial experience as an executive leader in complex infrastructure businesses across New Zealand, Australia, and Asia. Until recently Sandra led the infrastructure sector team at Broadspectrum. Sandra is a Director of Contact Energy Limited, OceanaGold Corporation, Snowy Hydro Limited and Beca Group Limited.

We will vote undirected proxies **IN FAVOUR** of this resolution.

5. That the Board is authorised to fix the auditor’s remuneration for the coming year.

This is an administrative resolution.

We will vote undirected proxies **IN FAVOUR** of this resolution.

6. To increase the Directors Fee Pool by \$500,000 (25%) from \$2,000,000 to \$2,500,000.

The current Fee Pool was approved 12 years ago at the Annual Shareholders’ Meeting in October 2011. The intention is to seek approval for a new maximum limit that will not require increasing again for some time. Directors Fees budgeted for FY24 are \$1.79 million.

There is no independent Report to justify the increase. NZSA policy is that where Boards seek to increase Fees, they should present independent evidence to shareholders to justify the increase and that Fees should be review on a regular basis to ensure they are appropriate.

NZSA’s own data shows a theoretical fee pool far below the **current** level approved by shareholders, let alone supportive of any further increase. Furthermore, we fail to comprehend how a fee pool increase can be justified in the context of sustained, long-term share price decline.

Given this, and in the absence of an independent report, we will vote undirected proxies **AGAINST** this resolution.

We would ask the FBU Board to reconsider any proposal at a time when shareholders are not at risk of paying in advance for yet-to-be-delivered performance.

Proxies

You can vote online or appoint a proxy at <https://www.investorvote.com.au/>

Instructions are on the Proxy/voting paper sent to you.

Voting and proxy appointments close **10.30am Wednesday 25 October 2023.**

Please note you can appoint the Association as your proxy. We will have a representative attending the meeting.

The Team at NZSA