

9 November 2018

Fletcher Building Ltd (FBU)

The company will hold its Annual General Meeting **10.30am 20 November 2018**.

The location is **Level 4 Lounge, South Stand, Eden Park, Reimers Avenue, Kingsland, Auckland**.

You can also join or follow the meeting on a variety of devices as per the Guide:

<http://nzx-prod-s7fsd7f98s.s3-website-ap-southeast-2.amazonaws.com/attachments/FBU/325559/288918.pdf> .

The company had its beginnings in 1908 as Fletcher Brothers. The company went on to build the first State Houses in 1937 and then morphed into Fletcher Challenge in 1981. This split into various components in 2001, one of which was Fletcher Building.

The company has experienced significant governance and management problems over the past few years. In our view, some of these were the result of its expansion into various businesses without having Directors with appropriate executive backgrounds to provide the necessary oversight of the Managing Director and senior management.

In addition, the role of Managing Director proved problematic. Members will be aware that the Association does not favour the CEO also being a Director. This is to allow for a clear separation of the governance and management functions. In the case of FBU, the Managing Director sat as a first amongst equals at the Board table rather than reporting to the Board.

NZSA's Board met with the then FBU Chairman in early 2015 to outline our concerns based on internal and external sources reporting to us that there were various problems within the company. The FBU Chair dismissed our concerns as rumour and speculation, nonetheless we continued to engage with the Chair and other directors in a constructive manner as can be seen in the timeline of key events from 2012. This was sent to members in February this year in a paper titled:

Fletcher Losses; the legacy of loose governance

<https://www.nzshareholders.co.nz/pdf/correspondence/Media%20release%20re%20FBU%2015%20Feb%202018.pdf>

Since then we have seen:

- A capital raising of \$750 million to repay debt at \$4.80, a 23% discount on the then share price.
- A new standby banking facility of \$500 million.
- Sir Ralph Norris standing down as Chair and being replaced by Bruce Hassall.
- The appointment of 5 new Directors in September (more below under Board Composition)
- The retirement of one Director in September and the announcement of another retiring at the Annual Meeting.
- An abortive raid on Steel and Tube that we considered to be opportunistic and poorly timed given the problems FBU faces.

- The sale of Roofing Tile Group for \$59.8 million resulting in a loss on disposal of between \$15 million and \$20 million.

The company's share price has slumped from \$10.30 at 16th December 2016 (a market capitalisation of \$8.79 billion) to a low of \$5.71 (a market cap of \$4.87 billion) at 25th October 2018 to recover to \$5.94 (\$5.06 billion) at the time of writing. Couple this with a loss from the B&I Division of \$817 million over FY17 and FY18 and these losses total \$4.55 billion, surely a record for a New Zealand company.

The results for FY18 were Revenue \$9.47 billion up 1%, EBIT loss of \$118 million down from an EBIT profit of \$273 million and a Net Loss \$190 million down from a Net Profit of \$94 million. Unsurprisingly there was no dividend, however the Board is hopeful of paying a dividend in FY19.

In June the Board announced its strategy would be to focus on New Zealand and Australia and its core building products and distribution business and exit its other operations. Whilst Ross Taylor who was appointed CEO in November 2017 has a solid background in the operations to be disposed of, we are concerned that the Board still lacks sufficient recent executive experience to be able to provide the required oversight during the disposal period, as well as for ongoing core operations.

Board Composition

This Board has undergone significant changes with only 3 of the 8 Directors having served prior to 1 September 2018. Following the Annual Meeting it will comprise an Independent Chair and 7 Independent Directors.

When assessing Boards' strength, we consider the backgrounds of the Directors to ensure there is a diversity of thinking around the Board table and particularly in this case, the core competencies and skills to ensure these are balanced and relevant to the business.

The Board is comprised of 2 women and 6 men. As regards executive experience in the construction business we note only one Director, Martin Brydon, brings this skill set to the Board table and that is primarily in horizontal construction and quarrying. The other Directors have executive experience in accounting (2), banking, law, IT, manufacturing and distribution and FMCG.

We are concerned that given the recent problems only one of the 5 new appointments brings the core business skill set to the table. We acknowledge they all have governance skills, but that should be a given for any Director appointed to the Board of a company of this size and complexity.

In our view, past mistakes in setting the overall composition of the board have been repeated and an opportunity to bring on directors deeply skilled in FBU's operational needs has been lost. We believe that at least 2 or 3 of the 5 new appointments should have had solid recent executive experience in the company's core business in order to provide the necessary oversight of the CEO and senior management, both in the planned disposal of operations and in the continuing operations.

We are aware that institutional proxy advisors are recommending supporting the election of all the new directors and after considerable reflection, we have decided to do so as well with one possible exception (see below).

The reasons are two-fold. Firstly, FBU needs a period of stability to re-set its business. Secondly, all the appointees are generally well regarded, and they should be given some time to demonstrate that they can bring value to FBU. However, one is in our view over committed and needs to reduce their workload.

In this regard, we expect each director standing for election to explain to the annual meeting what their ambition is for Fletchers going forward and how they can personally add value to that process.

While at least initially supporting the appointments, we expect the Board to strengthen the core skill set at the next opportunity which will be in 2019 if not before.

At the last annual meeting the Board announced it would reduce directors' fees by 20% for the following 12 months. While the current board is quite different, it is also inexperienced and unproven. Consequently, bearing in mind the huge losses suffered by investors, we believe the board should extend this for at least a further 12 months or until results justify a review.

Resolutions

1. To 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, having started his career as an engineering cadet with BHP. He progressed to general management roles with Cockburn Cement Limited and was chief executive officer from 1998-1999. Martin joined Adelaide Brighton Limited an ASX100 building products company in 1999 and held several general management roles before his appointment as chief executive officer and managing director in 2014. He retired from that role in May 2018.

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

2. To elect Barbara Chapman as an Independent Director.

Barbara Chapman was appointed to the Board 1 September 2018. She was formerly chief executive and managing director of ASB Bank. She has recently become chair of Genesis Energy Limited and is a director of New Zealand Media and Entertainment (NZME).

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

To elect Rob MacDonald as an Independent Director.

Rob MacDonald was appointed to the Board 1 September 2018. He is Chairman of the Audit and Risk Committee and a member of the Nominations Committee. He was previously CFO at Air New Zealand. He is the new chairman of Contact Energy Limited and is a director of the Chartered Accountants of Australia and New Zealand and Sovereign Assurance Company Limited.

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

3. To elect Doug McKay as an Independent Director.

Doug McKay was appointed to the Board 1 September 2018. He is a former chief executive of Lion Nathan, Carter Holt Harvey, Goodman Fielder, Sealord and Independent Liquor. He was the inaugural chief executive of the amalgamated Auckland Council until the end of 2013. He is the chairman of Bank of New Zealand and Eden Park Trust Board, a director of Genesis Energy Limited, IAG New Zealand Limited and National Australia Bank.

We are concerned that Mr McKay's workload is too heavy, given the time commitment that will be required to turn FBU around. He will need to convince us at the annual meeting that he can handle the load or alternatively explain how he will be reducing his commitments in order to give FBU the time needed.

If we receive a satisfactory response, we will vote undirected proxies **IN FAVOUR**.

If not, then we will vote **AGAINST** even though it will likely be a token gesture.

4. To elect Cathy Quinn as an Independent Director.

Cathy Quinn was appointed to the Board 1 September 2018. Cathy is a very experienced commercial lawyer specialising in mergers and acquisitions. She was formerly the chair of MinterEllisonRuddWatts for eight years. She is a director of Tourism Holdings Limited (appointed in September 2017), and a board member of New Zealand Treasury and the New Zealand China Council.

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

5. To re-elect Steve Vamos as an Independent Director.

Steve Vamos was appointed to the Board in July 2015. At that time the Association expressed its concerns that he would be able to justice to this role due to his other appointments notably as CEO of Xero Limited. Since that time, Mr Vamos has resigned as a director of Telstra leaving only FBU as a listed directorship. He is also a member of the Advisory Board of the University of Technology Sydney Business School.

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

6. 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.

Proxies

You can vote online or appoint a proxy at www.investorvote.co.nz.

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

Voting and proxy appointments close **10.30am 18 November 2018**.

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

IF YOU FIND NZSA PROXY VOTING INTENTION PAPERS HELPFUL, PLEASE MAKE SURE YOU SPREAD THE WORD AND ENCOURAGE OTHERS TO JOIN NZSA AND SHARE THE BENEFITS.

REMEMBER YOUR NZSA MEMBERSHIP NOW INCLUDES ACCESS TO *SHARECLARITY* WHERE YOU WILL FIND A WEALTH OF INFORMATION AND ANALYSIS OF OVER 270 NEW ZEALAND AND AUSTRALIAN COMPANIES.

The Team at NZSA