PROPERTY AND TRADING UPDATE (released 24 April 2018)
CONFERENCE CALL SCRIPT for 1 May 2018 at 9.00 am

MIKE:

- Thank you for joining the call.
- I have Ros Ng and David Mariner joining me today, although we are all in different locations.
- I'm currently in Florida having spent the last few weeks touring operations in California and Florida. David is in Atlanta, and Ros is in Sydney, but flying out this afternoon to join us for a US management session later this week.
- I will ask Ros and David to join the conversation at the appropriate time, and at the end of our comments, we will answer any outstanding questions.
- Last week we announced the completion of a property transaction that will see this year's **contribution from Property** being in the order of $55 to $65 million. A significant lift from our previous guidance which was for Property to contribute earnings towards the lower end of the historic range of $8-$46 million.
- The sale of the Prospect property was completed ahead of our earlier expectation and we were very pleased with its contribution of $56 million to this year's earnings.
- I know some of you discount property as a one-off but despite the lumpiness of earnings from our property group, this is an ongoing and important contributor to Boral's earnings.
- As previously discussed we will be releasing more detail about our current property pipeline at our Boral Australia site visit on 16 May.
- Coinciding with the completion of this property transaction was our internal review of March quarter results and our subsequent re-forecasting of full year earnings.
- While the intention of our **trading update** was to provide transparency around some key issues impacting our March quarter and to provide an update on how we now see our full year earnings for Boral Australia and Boral America playing out, we recognise some of you may have additional questions. While this is not a full results announcement and briefing, we will try to provide further clarity and respond to any outstanding questions where we can.
- So turning to the **trading update**.
- Clearly we needed to revise our full year guidance for **Boral Australia** to incorporate the higher property earnings.
- Including property we are expecting earnings to be 10-20% higher year on year in FY2018. We have provided that range to incorporate both EBIT and EBITDA, which mathematically means EBITDA will increase at the lower end of that range while EBIT should be at the higher end.
- Many of you have observed the favourable weather conditions experienced in Sydney and Melbourne, which indeed has been good for business. In NSW however, we did have some of our strong performance offset by the impacts of a one-off unscheduled kiln **outage at Berrima**, which saw us lose 8 days of production from late February into early March.

- The kiln outage was the result of a small piece of bearing shaft dislodging and scoring the shaft and bearing, which then caused high temperatures due to consequent loss of lubricant. This failure was not something that can be predicted through condition monitoring and we were fortunate to have captured it quickly, avoiding catastrophic failure of the bearing assembly.
- The Berrima outage resulted in unbudgeted repair costs, unrecovered fixed costs and higher costs to bring cement by road from Victoria as well as imported clinker into Port Kembla, which was then transported to Maldon for milling. Not ideal from a cost perspective but we were able to maintain volumes.
- Some of you have estimated a $4 or $5m impact from the Berrima outage. We estimate slightly less than that.
- Given the focus on the very dry conditions in NSW and Victoria, it was also prudent to highlight that our March quarter earnings were impacted by much **wetter conditions in Queensland** during the period. We had five more rain affected days than average in SEQ. So we effectively lost a week of activity compared with our expectations and incurred higher costs associated with that.
- We have been asked why the benefits of drier weather in NSW and Victoria did not more than offset the wet weather in South East Queensland?
- In **NSW** we were impacted by the Berrima outage. But yes, NSW has been benefiting from good weather conditions as we continue to experience significant strength in infrastructure work coupled with some moderation in multi-res activity, as we expected.
- Let me give you some more colour around **Queensland and Victoria**, which may help you reconcile why an extra wet day in Queensland is not offset by an extra dry day in Victoria when it comes to Boral's earnings.
- For Boral, Queensland delivers around 24% of our Australian revenue and asphalt underpins a lot of Queensland's earnings because it's an asphalt state. In fact, one half of Boral asphalt's earnings nationally are from Queensland. And asphalt and rain do not mix well. So when it rains in Queensland we feel the impacts.
- For Boral, Queensland is a larger contributor than Victoria. Around 15 to 20% of divisional revenue comes from Victoria. And importantly in Victoria, we have landfill royalties which is a large contributor and generally unaffected by weather.
- So taking these things into account, a wet weather impacted day has a far greater impact on our earnings if it's in Queensland than if it's in Victoria. And conversely, an extra dry day in Victoria is not as helpful as an extra dry day in Queensland.
- We also flagged that **WA has been performing below our expectation**. We had expected to see activity pick up in WA but we haven't as yet. The housing market remains depressed and we have seen some delays in project work.
- For the three key issues that we have called out as contributing to missing our internal targets for the March quarter, if we had to put them in order of size it would be Queensland weather, the WA performance gap and then the Berrima outage.
- Let me make **some additional comments about Boral Australia.**
- Underlying demand is strong, pricing is improving and we are seeing strengthening infrastructure volumes. The previously flagged headwinds of higher electricity and gas costs are impacting, multi-residential work is moderating slowly, and some of the margin pressures we saw in Victoria in the first half are persisting but our improvement programs are progressing well.
- As we look to the full year, we are working to claw back the March quarter shortfalls in Australia in the June quarter. If we can't claw it all back, we will see a second half result slightly below last year, bearing in mind of course that we had an outstanding June quarter last year.

- Turning now to the **Trading Update for Boral North America**, which focuses on some short-term issues impacting the business.
- I want to stress that there are no concerns with the fundamentals of the North American business. **Synergy delivery is progressing well and we are very pleased with the successful integration of the two businesses.** We remain highly confident about what the business can and will deliver.
- But as you know, the **March quarter** takes in winter in North America when construction activity is at its lowest. We usually see the spring bounce coming through by the end of March and last year it came early in March after a mild winter.
- This year, we have seen a **harsh winter**. It's been much colder and it's snowed more than it usually does. The winter extended well into March and even April in some parts. There was significant rain in the Texas region and up through the mid-west, particularly in February. This slowed construction activity, and as a result, volumes for the March quarter were below our expectation.
- I am pleased to say though that we have seen an expected stronger end to April, with better weather, pent up demand and a strong order book reminding us we are now into the spring building season. Florida has been looking good for a while, and now, other states are joining in. I will ask David to comment further on this shortly.
- In the announcement we also referred to two of the **operational issues** raised in the first half.
- We have not found any new operational issues nor are they tracking worse than expected but we have reminded people that there have been impacts in the March quarter – as we expected.
- At the half year I said that I expected to see the majority of the operational issues resolved during the second half and that's still the case. Importantly, no new plant performance hurdles have been identified beyond those previously reported. Our network of plants and assets is enviable and in good working order. With better weather, demand will continue to rise and with it, earnings.
- We did say that the **Oceanside Metal Roofing plant** in California will take time to be resolved and that remains true. It will impact through the second half and we expect to see continued improvements in operating efficiencies over time. I was at the Oceanside plant last week and I was encouraged by the progress being made. The state of the plant has improved significantly, with LEAN manufacturing being introduced. Production volumes and OEE have substantially improved but there is more room for improvement.
- The commissioning of the **new stone plant at Greencastle** was broadly completed in April but up until March we had continued costs associated with running the old plant while the new plant was being commissioned.
- In last week's announcement, we did not raise the other operational issues that we cited in the first half including the upgrade of the Lake Wales roof tile plant, the new line in the Kleer trim plant and the integration issues at Okeechobee - because they are all largely resolved, as we expected.
- Finally, in the announcement we commented on the closure of the Texas power utilities impacting during the period. We said we have experienced higher costs associated with **repositioning fly ash supply** to customers as a result of the closure of three of the four planned closures. We have called this a short-term impact because eventually we will recover the higher costs through price but this will take time.
- We reported 8% per annum average price increases in fly ash in the first half, and we have gone out with similar 8-10% increases in the current period. We are confident of recovering the higher costs but it won't happen overnight. It is also fair to say that the costs incurred in the March quarter were higher than we expected, but we will effectively rebalance the supply and demand in and around Texas, it will just take time.

- The good news is we have accelerated our **storage activities**, both fixed and mobile, as well as our **reclamation planning**. In some markets we have dramatically decreased the landfilling of good ash and we will soon be operational in Pennsylvania with our initial reclamation project, with further projects to follow. We have about five potential candidate sites for landfill reclamation that we are progressing. We will provide a further update at our full year results announcement.
- For the March quarter, we have not put numbers around the impacts of weather, fly ash repositioning or the improving operational issues, but we have factored them into the full year guidance provided. Previously we indicated that we expected a substantial skew to the second half and we have now said we expect an earnings lift in the second half of around 10-25% compared with the first half result. Again, mathematically that means the EBITDA increase should be at the lower end of that range and EBIT at the higher end.
- That is probably a good point for me to ask David to add his comments.

DAVID:

- Thanks Mike. Let me comment on a few points and try to address the questions we have been receiving.
- Probably best to continue with **Fly Ash** first up.
- As Mike said, we have now seen three of the four utility closures in Texas, which is impacting us in the second half. The fourth closure is expected to happen around June or July of this year. We still have 8 utilities we source from in Texas, several sources in neighbouring states plus we have several fly ash terminals in the region.
- Texas is a large fly ash state, with considerable volumes being land-filled. In total, the four utilities in Texas contribute a combined volume of around 400 to 500k tons of fly ash sold each year out of our total sales of roughly 7.5 million tons. Reducing supply of fly ash by 400 or 500k tons may sound like a lot, but there is still a considerable volume of fly ash being land-filled in Texas and in neighbouring regions which we are shifting to cover the plant closures.
- The combined Headwaters and Boral fly ash business means we are very well placed to maintain our sales as we have a broader network to call on. We are continuing to supply our customers by bringing volumes from further afield. But this of course adds costs and the complexity of repositioning supply arrangements was made a little more challenging in the March quarter because of a temporary outage at one utility plant in the region. Temporary shuts happen from time to time, it’s the nature of the business, so it’s these variables we need to accommodate and react to as we reconfigure supply arrangements.
- We are calling the impact of the Texas closures a short-term impact, because we are confident that margins will fully recover over time as prices strengthen and the higher cost base is recovered. We currently have solid 8-10% price increases in the market, but Texas is a competitive market, where as I said there is still a lot of ash going to landfill, so we need to be patient about recovering costs.
- We are not intending to forfeit share, we prefer to instead wear some softer margins in the short term. To fully recover margins it may take us a few rounds of price increases but we are continuing to move in the right direction.
- More broadly across fly ash, weather impacts aside, the business remains an exciting and strong growth story. Our strategy to free up supply of fly ash through network optimisation, additional storage capacity and ultimately landfill reclamation, is progressing well. We will give you an update around this in August at results and in September at our US site visits.
- So let me now comment on the **weather impacts in the March quarter**. We have been asked why Boral is citing weather as an issue while the home builders appear to be unaffected, enjoying good growth in the March quarter.

- This is a good question and let me try to interpret things.
- It first depends on the markets you are playing in. For example, we have enjoyed great conditions in Florida, and California has been good too, so these regions have generally been performing well for us through most of the winter.
- To varying degrees, we have seen some other building products and materials players refer to March volumes being impacted by a later spring start, while the home builders have enjoyed good results, apparently unaffected by weather.
- Apart from potential geographic differences, we believe the answer lies in the fact that for the Home Builders this is typically a period where orders are taken, deposits paid and preparations made to start building as the weather allows. In places like Florida, they have been building and we have been supplying them. But in weather affected states the order book has been building however it has not translated into construction where we participate. For materials suppliers, we don't get paid until the product goes out the door or the job is done.
- Clearly though, the strength of the work that the builders are reporting is a very good sign for us. There is a lot of pent up demand and we are now starting to enjoy it.
- The follow-on question to this is, given the strong pent up demand, does that mean the June quarter will be ahead of our expectations as the market moves to complete the back log. That's possible I guess. But we aren't factoring that in. We expect that the current constraints around labour as well as transportation will mean that the work in the pipeline will be carried out with orderly growth rates built in. The main construction season was simply delayed and with constraints around trades and installers, we think activity will simply be pushed out further.
- My final comments are to reiterate what Mike has said about the **operational issues** flagged in the first half. We are pleased with the progress being made. Most of the issues have now been resolved.
- The upgrades at the Lake Wales Roofing plant, and the Kleer trim plant are now complete. The Greencastle Stone plant has fully transitioned to its new location and is in its final commissioning phase, with all progressing well. The problems at the Okeechobee roofing operations in Florida have largely been resolved although this is another operation where I expect to see continued improvements over time. And similarly, improvements have been made to the Magnolia Windows operation in Georgia, which will be more fully tested as the market grows in the June quarter.
- We have not identified any new operational issues across the network. And as Mike said, we are very pleased with how integration and synergy delivery is progressing. Safety performance of the Headwaters businesses has substantially improved so that we are now seeing a consistent strong safety culture across the business.
- Mike back to you.

MIKE:

- Ros do you have something you would like to add before we see if there are any unanswered questions, perhaps comment on the tax guidance we have provided.

ROS:

- Yes thanks Mike.
- Given the higher contribution from property this year, which will have a small capital gains tax associated with it, we have lowered our FY2018 tax guidance from 22-24% to now be 19-22%. It will then revert back to around 21-23% as we had previously guided for FY2019.

- And let me also remind everyone that the revised earnings guidance for Boral Australia and Boral North America is intended to apply to both EBIT and EBITDA for those divisions. So as Mike said earlier, this mathematically means EBITDA is expected to be towards the lower end of the ranges and EBIT at the higher end. We apologise if we have caused you some confusion about that.
- In terms of D&A for North America and Boral Australia, broadly speaking you can double the first half D&A for each division. Although there may be some small adjustments as we finalise the purchase price adjustments for North America, and Boral Australia is likely to see a small lift in depreciation following the recent quarry upgrade investments and some additional depreciation associated with the Waurn Ponds cement facility following the planned closure when the new Geelong facility is built; but these adjustments will not be material changes from the first half.
- Thanks Mike.

MIKE

Thank you Ros.

That's what we wanted to cover. Any questions on the line?