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What else lurks in Fletcher's leaky wood-work?

A $700m capital raise announced weeks after reassuring words on the balance sheet at the annual result could suggest further bad news behind the scenes.

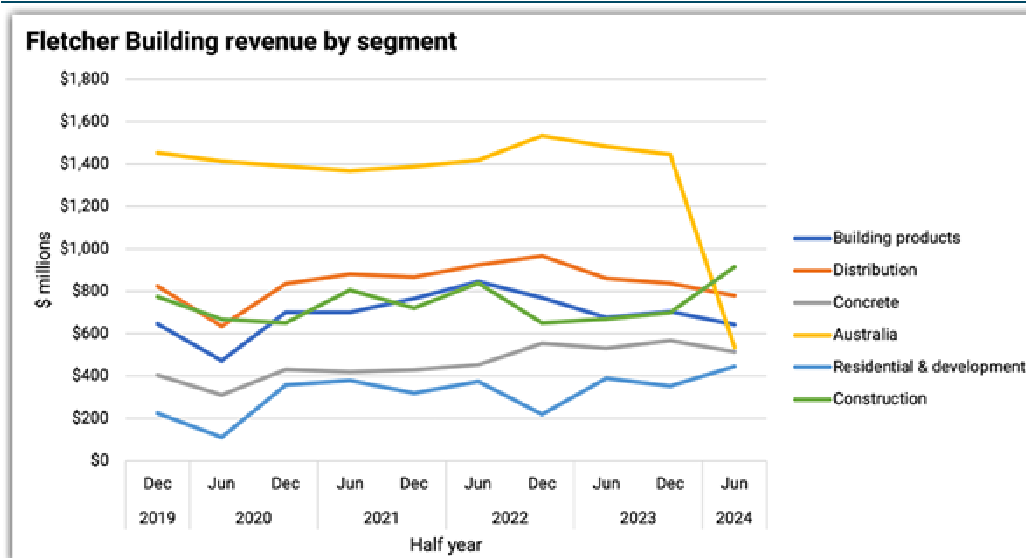
Fletcher Building's provisioning for leaky pipes in Australia went from A$2m to A$155m in 18 months.

Journalist: Tim Hunter

After all the leaks at Fletcher Building, both watery and informational, it's only fair to mention an unconfirmed report that an individual is regularly seen rushing through corridors at head office screaming "don't panic, don't panic!"

The $700 million discounted capital raise announced by the building materials and construction group on Monday, following a leak to *The Australian* on Friday, certainly has an air of urgency about it.

Not only was the raise fully underwritten, it was preceded weeks earlier at Fletcher's annual results by soothing remarks about its balance sheet and liquidity position.



What changed? Well, one thing was the ascension to Fletcher's board of Andrew Reding on August 22, the day after the results announcement.

Reding is also taking an executive role and will formally become managing director on September 30 but, until then, the company has essentially been run by caretakers.

It has an acting chair, Barbara Chapman; an acting CEO, Nick Traber; and a chief financial officer who resigned in April and leaves on October 4.

It's not easy, or necessarily appropriate, for caretaker managers to make big strategic decisions, yet it seems that's exactly what they were prepared to do before Reding came on board.

Alongside the result, the company announced it had appointed investment bank Jarden "to explore options with both local and international investors" for its profitable, cyclical, Residential and Development division – the bit that buys land and builds houses on it.

Andrew Reding.

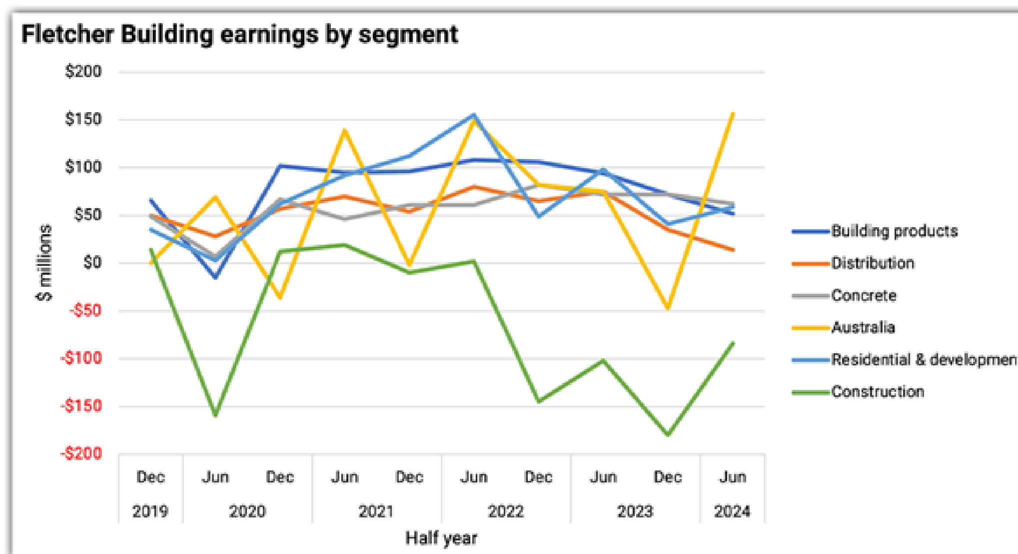
'Right time'

The potential transaction was pitched as an opportunity.

"We think it is the right time to explore capital partnership options for Residential and Development, to invest in and drive the next phase of the business's success," said Fletcher.

However, when it was leaked to *The Australian* three weeks earlier, the reporting was focused on its potential to avert an equity raise, which was probably the message imparted by the leaker.

The idea in that scenario involved selling half of its land bank for about $500m, although investors were already on record opposing anything along those lines.



"As shareholders, we would not want to see the value we own in this business being diluted by some knee jerk asset sales at rock bottom prices," said Sudhir Kissun, an analyst for Aussie fund manager Allan Gray, Fletcher's biggest shareholder.

"Our view is that, given where the company is currently – there's no CEO, there's no chair, the board has been whittled down to four people, the CFO has resigned and is on his way out, the cycle is posing major challenges for the business – everything that could be going wrong is going wrong at the moment.

"So, if you were to put yourself in the shoes of somebody who would buy one of these businesses that people think should be sold, as a buyer, you'd be thinking: 'This is a fire sale, because this company is not selling stuff from a position of strength'," he said.

It's a sensible point of view, which underlines the oddness of Fletcher's announcement.

Media report

Ironically, back in early February, Fletcher issued a notice to the NZX responding to a story in, natch, *The Australian*.

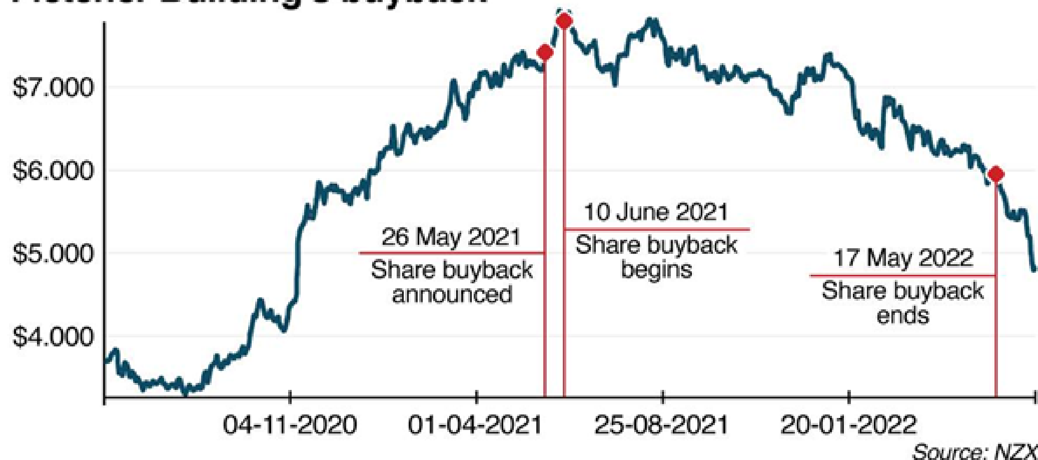
"Fletcher Building Ltd is aware of a news media report stating that it is weighing up an equity raise. This is inaccurate and Fletcher Building is seeking to have the story removed," it said.

The story wasn't removed – and it's a fair bet it was indeed accurate.

The question then is why Fletcher waited more than six months to raise equity while its shares fell from $4.17 to $2.89.

Could it be the board couldn't bear being confronted with another of its poor decisions?

In May 2022, Fletcher concluded an on-market share buyback acquiring 41.2 million shares at prices between $7.91 and $5.86.

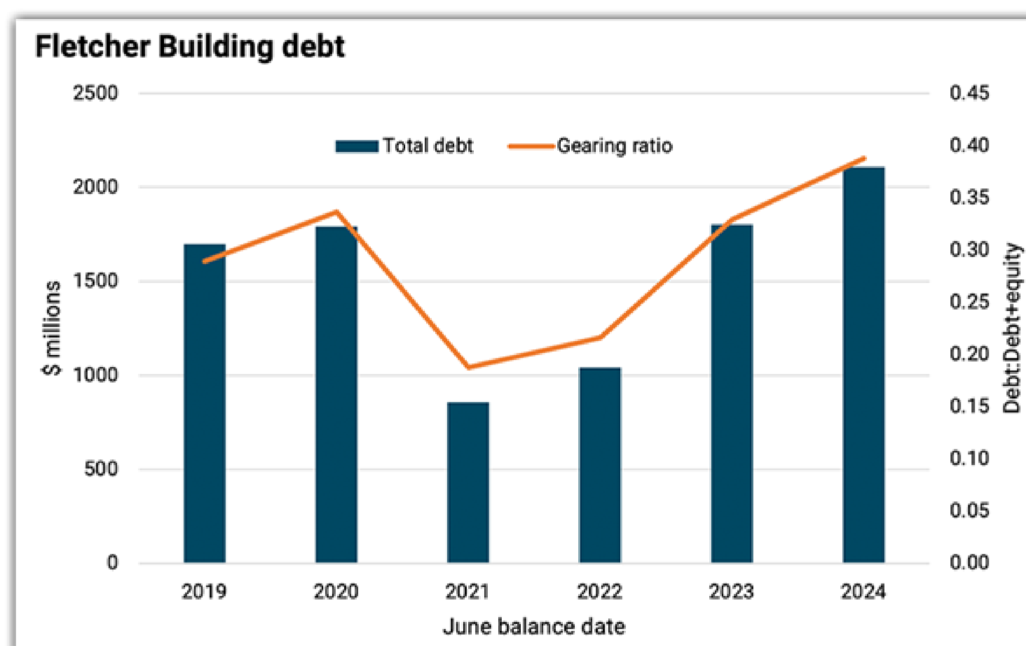


Joining the dots, Fletcher spent $273.7m buying its own shares at an average of $6.64 and then raised $700m from investors at $2.40. Buying high and selling low is not smart, so you can understand why a board would try to avoid being tarred with that brush.

Regular readers may recall this column criticised Fletcher's board in December 2019 and again in June 2022 for failing to understand that an on-market buyback is an investment in its own stock and therefore to be done only at advantageous prices.

Unfortunately for shareholders, the buyback – kicked off when the stock was at a year high – was followed by further huge losses at its Construction division and more capital expenditure, which combined to force Fletcher's debt back into the billions and the stock to record lows.

As of June this year, the company's total debt was $2.1 billion, double its level in June 2022.



Pre-emptive steps

It seems the company realised things were getting out of hand and on June 3 announced a deal with lenders to ease its covenants through to December 2025.

This was characterised by Traber as "pre-emptive steps to reinforce the company's resilience for the medium-term to position ourselves to navigate the tougher trading conditions".

The words "resilience for the medium term" imply Fletcher had no great concern about the short term, yet shareholders are now having to stump up to ensure the company can, as Reding put it, "better endure near-term market headwinds".

Accepting that Fletcher's position is what it is, the capital raise is probably the right thing to do.

Fletcher's track record shows frequent negative surprises so it needs a buffer against covenant breaches, particularly with intransigent US private placement debt on its books.

Pro-fit provisioning

The concern here must be the potential for more nasty stuff to emerge.

It didn't take long after Reding's arrival on the board for the position to move from medium term resilience to urgent capital raise.

Let's remember the Australian Iplex Pro-fit pipes debacle, which emerged out of the blue in early 2023 with Fletcher noting complaints of leaks after it withdrew the polybutylene plumbing product from the market in 2022, apparently because it was unprofitable.

Fletcher played the problem down, initially provisioning A$2m, then raising it to A$15m, then matters escalated until the company announced a A$155m ($169.4m) provision last month.

Iplex piping.
The capital raise itself is not structured as a routine ‘let’s prepare for the future’ sort of balance sheet strengthening.
There’s a dilutionary $282m placement to institutions on top of a rights issue at one new share for 4.49 shares owned.
Both are underwritten at a cost of $13.3m.
The rights issue is also non-renounceable, so shareholders who don’t have the readies have no opportunity to sell their rights to those who do.
Fletcher and its adviser Jarden argue this means the offer can be priced at a lower discount of 12.9% to the theoretical ex-rights price, which benefits non-participating shareholders.
This may be true but, if there was genuinely no time or transaction pressure on a capital raise, a standard renounceable pro rata rights issue is generally seen as fairer. Ironically, the NZ Shareholders’ Association, previously chaired by Reding, advocates this option.
One conclusion is, therefore, that there was indeed some urgency about the capital raise.
But don’t panic – how much worse can it get?
** Disclosure: Interests associated with Tim Hunter own shares in Fletcher Building.*

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