



Build something great™

2017 ANNUAL GENERAL MEETING THURSDAY, 2 NOVEMBER 2017

Remuneration & Nomination Committee Chairman's Address

by Kathryn Fagg

Good morning ladies and gentlemen.

I am pleased to address you as the Chairman of the Board's Remuneration & Nomination Committee.

Beyond advising the Board on remuneration policies and practices, the responsibilities of the Committee include identifying and recommending suitable candidates for Board appointments; recommending strategies to make our Board more representative; and advising the Board on succession planning policy and talent management.

But let me focus on Boral's Remuneration Report. I will first talk through the changes made in 2017, under the five key topics shown on the screen, and then focus on the remuneration outcomes, specifically short-term incentives (STI) and long-term incentives (LTI), against the backdrop of Boral's results for the financial year.

FEEDBACK RECEIVED AND REMUNERATION ITEMS ADDRESSED IN FY2017

At our 2016 Annual General Meeting, 26 per cent of shareholders voted against our Remuneration Report, constituting a first strike under the Corporations Act.

This was a strong message from shareholders, which we took very seriously. In response, we conducted an extended program of constructive discussions with our shareholders and proxy advisors to better understand the issues and concerns.

At the same time, Boral's acquisition of Headwaters required the Committee to make some immediate decisions on remuneration. We did this with a well-informed perspective of shareholders' views.

We listened to the feedback and have addressed the areas of concern. Our Remuneration Report explains more clearly how our policies and practices are aligned with our business priorities and long-term strategy.

Let me explain the five key matters we have addressed. These are also clearly set out in the Remuneration Report.

Number one, in September 2015 we introduced some **one-off targeted retention incentives** for eight of our key executives (excluding the CEO). These executives are in a program to develop and maintain a strong pool of potential candidates for senior level succession, including CEO succession. The executives remain with Boral and are growing in their roles.

The targeted retention incentives were a one-off. There were no retention grants made in 2016 or 2017, and there is no intention to use them in future.

Number two, in FY2017 we transitioned from a **fair value to a face value** allocation methodology for long-term incentives. We have used the face value methodology for the allocation of FY2018 LTI awards. Shareholders view this approach as simpler and more understandable, and the move to face value has been well received in our engagement discussions.

Number three, is the impact of the **Headwaters acquisition** on remuneration. The Board considered the impact of the transaction on existing short-term and long-term incentives and made two important decisions:

- First, the additional EBIT in FY2017 from the Headwaters contribution was not rewarded in the 2017 STI; and was excluded for testing the 2013 LTI grant against the return on funds employed target set for FY2017;
- And second, the existing ROFE targets for LTI awards to be tested in 2018 and 2019 have not been retrospectively adjusted. This is despite the fact that the additional EBIT and increased funds employed associated with the acquisition will dampen the rate of ROFE growth in the early years, prior to the delivery of the full synergy benefits. Again, shareholder feedback in response to this decision has been positive.

The fourth key issue addressed in 2017 was around **CEO remuneration**.

On 21 June we announced changes to the CEO's remuneration arrangements, which are consistent with the fact that Mike Kane is now spending approximately half his time in the USA, 40 per cent of his time in Australia and 10 per cent in Asia.

While Boral is an Australian-listed and Sydney headquartered company, we are now paying Mike Kane out of the USA. This means that since July 2017 we no longer provide Mike with expatriate benefits, and have recommenced his US-based pension contributions. From FY2018 the CEO's remuneration includes a 2% increase on a fixed annual remuneration basis but we have reduced the fixed remuneration costs by 19% by ceasing expatriate benefits and associated fringe benefits tax.

We continue to remunerate the CEO with regard to Australian practice. Specifically, CEO remuneration is benchmarked to Australian listed companies of similar size to Boral in terms of revenue and market capitalisation.

The last significant issue I want to cover is around executive growth and remuneration increases for **Key Management Personnel (KMP)**.

The Remuneration Report shows increases to the fixed annual remuneration of the **KMP** reporting to the CEO. These increases reflect promotions and expanded roles with increased responsibilities and role complexity.

The expansion of these KMP roles enabled us to reduce the number of CEO direct reports by two. This resulted in an annual cost saving exceeding \$1 million after taking into account the salary increases for KMP.

FY2017 PERFORMANCE AND REMUNERATION OUTCOMES

Let me now turn to performance and outcomes for FY2017.

Boral has continued to deliver strong financial improvements and solid returns for shareholders. As a result, the STI and LTI outcomes for executives have been good.

Boral's underlying EBIT for FY2017 of \$460 million was \$62 million, or 16%, above the prior year. Excluding Headwaters, EBIT increased by \$34 million or 9%. This is the measure we use for **short-term incentives** although, as indicated earlier, we excluded the \$28 million contribution from Headwaters.

Significant items – whether positive or negative – are excluded from our calculation of EBIT for remuneration purposes to align the underlying performance of the business with the rewards received by our leadership team.

In FY2017 significant items included acquisition related costs for due diligence, advisers fees, certain change in control payments to Headwaters executives, and integration costs. These costs were partially offset by a net gain on disposal of businesses including Boral's share of the Boral CSR Bricks JV and Boral's US Bricks business moving into the Meridian Brick JV.

Our executives' STI payments are determined by a mix of EBIT at divisional and Group level. On average, 103.7% of target STI was paid out to senior executives, meaning the results delivered were slightly ahead of our targeted performance. Consistent with previous years, 20% of the STI was deferred into equity for two years and 80% paid as cash.

The STI outcome was lower than the past two years, demonstrating the challenging targets that were set.

We continue to grant **long-term incentives** as performance rights and, as I said earlier, we now use a face value methodology to determine the number granted.

However, it is important to remember that the actual value an executive may receive from any LTI is not determined until after the end of the three-year performance period, and then depends on whether the performance hurdles are achieved at that time.

After three years, the targets set by the Board are tested. Two-thirds of the LTI vests if our total shareholder returns are better than peer companies; and the remaining one-third of the LTI vests if ROFE targets are achieved.

The accompanying graph shows that when Boral introduced ROFE as an LTI measure in FY2013, Boral's returns were unacceptably low.

The use of a ROFE as a performance measure was to provide a more direct connection to Boral's long-term strategy; to focus management's attention on the effective use of capital employed and our long-term goal of exceeding the cost of capital through the cycle.

Today, Boral's cost of capital is around 10.5 -11.0% on a ROFE equivalent basis.

The Remuneration Report shows two ROFE numbers for FY2017:

- The 7.6% ROFE calculation reflects the full impact of the Headwaters acquisition. However, this meant only eight weeks of EBIT while funds employed increased from \$4.4 billion to \$7.9 billion over the year.
- The 9.2% ROFE is based on an average monthly funds employed basis for the year to better reflect that timing impact.

As I noted earlier, the existing targets for FY2018 and FY2019 have not been adjusted despite the dampening effect of the Headwaters acquisition in the early years.

The target set for the FY2018 LTI grant is contingent on a demanding ROFE target of 12.5% being reached in FY2020.

Now let me comment on those LTIs that did vest during the year.

The 2013 LTI was tested during the year, with 98 per cent of the LTI vesting based on our TSR performance being at the 73rd percentile of the ASX 100 comparator group and achievement of the stretch ROFE target. This was the first LTI grant subject to the three year testing and two-third / one-third TSR and ROFE performance hurdles.

For awards made prior to 2013, LTIs were tested at different times over a seven-year period based on relative TSR performance. The 2009 LTI grant failed to vest and lapsed on its final test date in November 2016. The 2011 LTI grant partially vested on its second test date in September 2016 with 68 per cent vesting.

The graphs here show a 76.5 per cent TSR for the three-year period to September 2016, just below top quartile performance in the ASX100 group of companies. This is relevant to the 2013 grant. And the second graph, relevant to the five-year testing of the 2011 grant, shows 100.4 per cent total shareholder returns, placing Boral firmly in the chart's second quartile of performance over the period.

A significant portion of actual remuneration received by the CEO and Key Management Personnel in FY2017 relates to vesting of the deferred STI and the vesting of the 2013 and 2011 LTI grants. The increase in value of these equity awards for the executives is in line with shareholder returns over the same period. As shown in the accompanying graph, 57 per cent of the LTI value was due to share price appreciation.

We are pleased that our remuneration arrangements are aligning well with shareholders' interests.

The details of the remuneration outcomes, the structure and the governance framework to determine those outcomes are detailed in the Remuneration Report, along with the fees paid to Non-executive Directors.

CLOSING COMMENTS

Before handing back to the Chairman, let me make some final comments.

I have talked about the financial metrics of EBIT and ROFE as well as TSR that underpin our executive incentives. We use these metrics because they create a clear performance focus for senior executives, and they are relevant and transparent for shareholders.

Non-financial measures, including safety, are not a feature of the incentive schemes, but this is not to diminish the importance of matters such as safety. In fact, managing safety well is considered a fundamental part of everyone's role at Boral, and is taken into consideration in reviewing performance and setting fixed remuneration.

Importantly, the Board retains discretion to adjust the STI outcomes to ensure consistency with Boral's remuneration philosophy, to prevent inappropriate reward outcomes including any seriously negative safety issue, and to maintain alignment with the shareholder experience before the final award is determined.

To reinforce that shareholder alignment, we have a minimum shareholding requirement for executives – a way of ensuring our leaders have some “skin in the game” – and these minimum requirements have all been met.

The Board also has minimum shareholding guidelines to encourage Non-executive Directors to invest in the Group. Again, Directors are all exceeding these minimum guidelines.

The Committee believes that our remuneration practices are sound and competitive; and that the changes we have made are rewarding executives for creating sustainable shareholder value.

I thank you for your continuing support and commend the 2017 Remuneration Report for your adoption.

Kathryn Fagg