Metro Performance Glass
1H16 Interim Results Investor & Analyst Call
10am, 23 November 2015

Speakers:
N = Nigel Rigby
J = John Fraser Mackenzie
K = Kar Yue Yeo (First NZ Capital)
D = Doug Macphillamy (UBS)
NM = Nick Mar (Macquarie)
JB = James Bascand (Forsyth Barr)
DL = Dennis Lee (Craig's Investment Partners)
MH = Matt Henry (Goldman Sachs)

This is PGI, please stand by we are about to begin. Good day everyone, and welcome to the Metro Performance Glass interim results briefing. Your presenters today are Chief Executive Officer, Nigel Rigby and Chief Financial Officer, John Fraser Mackenzie. This conference is being recorded.

At this time for opening remarks, I would like to turn the conference over to your moderator today, Mr Nigel Rigby. Please go ahead.

N Gidday guys, how are you going? I will hook straight into. I am sure you guys will have a tonne of questions. In June we basically completed the start-up of the Auckland plant, and as a result of that the plant was opened by Prime Minister John Key. That sort of signalled the end of the start-up and the optimisation phase and we will cover that in a little bit more detail coming up, but it has gone pretty well. So I am on slide three.

OK, so on slide three we have got strong sales for six months to 30 September of $94 million, which we signalled at the AGM. We have focussed in this half year on delivering strong customer service and improving our glass category share. There is an opportunity in the market that we saw and we went for share, and that is not at all cost, but we went for strong customer service ramping up. When we start up a plant in Auckland you've got to make sure that we hit service leadership positions, and if you do hit service leadership positions with lead times, you end up gaining share as we always used to do, so we have certainly done that in the last six months.

We are pleased with the growth given the constrictions in the commercial market, we've got a strong book of business, and as you can see in future slides that is nearly getting close to $19 million, and we believe that is going to go past $20 million. There is a bit of a challenge in that book as it gets bigger, but we will talk about that when we come to commercial.

The new Auckland plant is performing and ramping up towards expected volumes. It is going well. The key drive for us of course is DIFOT. We as a company have a core strategy about being differentiated at service, so the plant is ramping nicely. Service is in the late 80s. It is higher than it was two years ago, however having said that we are in the Christmas rush period now and that will be challenged. But I think we're going to be fine. We are going to continue to unlock the throughputs that we desired. As we signalled at the AGM, we have hung on to the cost in the plant in labour and operating costs, because we want to drive our service and our share gain as quick as we can, and we saw an opportunity to do that and in quarter four we are going to start focussing on pulling those efficiencies out.

One of the busiest times a glass company has is basically between August and December. I guess it is a building industry thing, where everyone is trying to get everting done before Christmas, and so we thought it prudent to hang on to that operational cost through this period, and then as we get into January we will have been planning to rip it out.

Key growth initiatives in the commercial and retrofit are tracked well. We have got a very good back log, getting close to $19 million. We are expecting that to go $20 million in the next six months. And retrofitting, as you can see in future slides, it is growing at 26%. We think it is going to be, by year end, be somewhere around 30%. So the business is growing very well.

Net profit after tax of $11 million that is the top end of our guidance, but 9.6 below. Our PFI, which obviously we calculated way back in July 2014. We have carried the cost in this quarter in the Auckland plant, mainly it is in labour and operating costs. We have also built a glazing capability in advance of this back log, so it is a bit of a catch 22, but we need glazing capability with that sort of back log. I mean, if you went back to when we did the PFI and there is a slide in here, our back log was below $10 million and it is sort of over doubled. We can't be caught short with glazing, so it is a bit of a chicken and egg. You have to have the cost and that will turn into kinetic once these jobs start dropping. But you can't get outflanked without glazing, so you have actually got a cost challenge in the short term.

And we completed a significant period of capital investment and our financial covenants are just fine, we have got plenty of headroom and financially. I will turn over to John to go through the financials.

J Thank you. So turning to slide 5 in the deck. As Nigel mentioned, we are pleased with our revenue and share performance in the period and we ended up slightly above the PFI and up 8.4% on the prior comparative period from a revenue perspective. That said, our gross profit was lower than the PFI, and the main driver of that being higher factory conversion costs, but it was also impact to an extent by the exchange rate just beginning to drop off from when we built our PFI model, and also we experienced a slightly higher cost of glass. So the cost of glass in international markets has moved around a bit. Going back to the beginning of the year we had a slight increase from one of our main suppliers, but I think that is a moving feast and we anticipate being able to unwind that in the near future.

Additionally, looking at the distribution and glazing line in the table, we are $1 million above the PFI and there the main driver on that is building up our glazing resource in anticipation of our commercial forward order book, as we focus on our customer service and our ability to execute those projects coming towards us.

Most of the other lines on the P&L were in line with the PFI, and no significant differences. In TV and marketing we were at slightly below the PFI estimate on marketing. We did run a television campaign in the beginning part of this period, in April and May, and we have been running one since the end of the prior, and so just a slight timing difference on that. The other comment to make, I think, is on the income tax line. So we do have a favourable effective tax rate for the six months, and that is on account of some of the restructuring costs we incurred around the IPO which we had assumed in March to not be deductible for tax. We have had those confirmed as being deductible, so that has helped us with a favourable tax rate for this period.

So after all of that we achieved an NPAT of $11 million, which is below our PFI of $12.1, but at the top end of the guidance that we gave at our ASM.

Turning to the balance sheet which is on slide 6, kind of taking it from the top, so we have had a growth in working capital since the end of March. As Nigel mentioned the end of September is kind of the beginning of the seasonal peak of the rush towards Christmas, so we did build up working capital in advance of that. On the other side we were below where we'd assumed to be in the PFI, so we have been focussed on maintaining that.

Our property, plant and equipment values have grown $4 million since the end of March, and that is as we've completed the final steps of the main capital expansion investment programme here at Highbrook and with kind of one more step of that to go, but just over $1 million still to go. So really I think we're well placed with a strong balance sheet. We are pleased with our gearing ratio, and we believe we have some good headroom within the balance sheet, so we are pleased with where we are with that.

Turning to the cash flow on page 7, so the first half of this year has been, I suppose, cash flow heavy as we have made payments for the final bits of machinery in the Auckland plant and the phasing of that was slightly different to how we'd assumed in the PFI, so our capital expenditure was $7 million versus an assumption of 4. Also included in that number is the purchase of Mainland Glass in the beginning of April, which is included in that number. So not all to do with Highbrook.

Additionally in the cash flow is we paid an inaugural dividend of $5m *[correction: the dividend payment was $7m]* and we built up our working capital towards the seasonal peak which we are going through now and paid tax and interest, obviously.

Turning to slide 8, so the board have declared a fully imputed interim dividend of 3.6 cents per share, and that is to be paid on the 22nd of January for all shareholders who are registered at the 8th of January. So that pay-out is consistent with our dividend policy where we have paid between 55-75% of the full year NPATA, and the weighting of that as we intend to pay is 40-50% of the full year dividend as an interim, with the balance in the final dividend. So the board have approved that as the interim dividend.

And with that I will hand back to Nigel who will talk to the market trends and the backdrop.

N OK, so I guess Metro lives in a robust backdrop of a very good market. Net migration is great, low interest rates, Christchurch rebuild is still underway and we'll talk a little bit about that in the next few slides, Auckland is ramping up. So from a market perspective and macro trends perspective everything is as it was and has it has been for the last 18 months to two years. If you look at 9 month lag starts, which is sort of a correlation we focus on. If you look at the last four data points on slide 10 on the right hand side you can see the dots are starting to go above the line of best fit. So one of the concerns I guess the market may have had was in the 6 months ending 31 March, that our revenue actually was below the PFI by around 5.5%. As you can see in this six months our sales have recovered and that was a focus for us in the first six months. It just takes a while to get the result. So on a market trend basis we are sitting at a very good market.

If we go to slide 11 we can sort of see that broken down further, 26,000 starts we are running at. And you can look at the left on residential consents. We can see in Christchurch residential starts in Canterbury starting to flatten out, having said that though the rest of the South Island is quite robust and you can see Auckland there now ramping up.

On the right hand side, non-residential, which is an interesting one. You can see the Canterbury rebuild is away and continuing to grow but you can see Auckland is from a consent basis, is growing, but it is pretty flat growth. When you look at some of these notable projects, like the convention centre, like the high-rise that has been talked about, you are not yet seeing that in the consents, so Auckland probably over the next six months we are going to see quite a fair bit of activity in non-residential, so again from a market condition basis, looking very good.

We go to operational highlights. We have got four glass plants and we are positioned to handle these increased volumes well. We have got plenty of upside capacity. Auckland is ramping, there is a couple of final capital initiatives that we planned some ago, which was a digital printer and lamination and some heat treating of glass, and that will go in pre-Xmas. They are fairly chunky but they are fairly simple executions. And then basically we are finished on the site.

Christchurch is improving and we see a real opportunity for this lift in commercial, and we are geared well for it. We have two plants in Bay of Plenty and Wellington and there is a tonne of potential upside. So what we are very conscious of, from a window perspective, is double glazing as not seen a boom market as we're going to experience. We are going to experience it both in commercial and in residential. Most commercial jobs we are now pricing in our book are double glazed, and that is a new phenomenon as well. So double glazing has not only made it to residential to a high penetration rate, but it has also made it in commercial and a very high penetration rate. In commercial that comes with pretty high specification high tech glass. We are sitting in a really nice spot where we have got good capacity and Auckland is ramping pretty well.

You will know our business model is all about customer intimacy and a supply chain operational excellence model. We have always erred on the side of delivering service proposition to our customers and we've got a fair way to go. We have come a long way in the last 9 months in starting up Auckland and dealing with the capacity growth in Christchurch. Average for the first six months was 83%, but if you look at September at 89%, there is a good number. Now, 90% is our target, but most importantly the 10% that we don't deliver on we need speed of recovery. So basically service takes precedent in our business, and obviously we get paid well for it, so service has been a key driver for us. And then service is obviously linked to share. We would have a service leadership position in the market.

Our national health and safety, we are not a dangerous manufacturing company. Having said that, glass and commercial sites and the increased exposure we will have to commercial sites is important for us to also have our safety programme ramping quickly. And we have invested in it over the last two years, and we are seeing those results. Injury, frequency and severity is coming down and we have seen a significant drop in first aids, as you can imagine with glass that can be a problem.

In October 2015 we acquired the assets of a glass processor in Wellington called Ultra. They went into liquidation. I guess from an investor perspective it is probably an interesting case study. Basically this is a 20 year old business that in 2009 decided to invest in furnaces and some automating equipment to basically get into residential double glazing and commercial. And when they got in and made that investment it was a tough road to hoe. It is a little bit about the degree of difficulty to get scale and run cash flow. Even when you do a start-up, and when you make these significant investments, because they are cost hogs. Anyway, we bought the equipment, we will use it to buffer our Wellington operations. As you know the Lower North Island is growing actually fairly well now. Wellington, the market is doing well, so we will be able to use that capacity. We are also going to rebrand that business and compete in the internal fit out market as well.

I go to commercial. We have invested heavily in glazing people and equipment, whether that be measuring equipment or automating how we lift glass into high rise. Windows are getting bigger, they're getting heavier, double glazing is heavier. We need equipment that doesn't involve people doing that, so we have bought some equipment to do that and we're trialling it over the period. There is a lag between confirmed work and site execution, and you can see that in our book of business, it just keeps on growing. So if you look, we haven't taken it right back to PFI when we started announcing it, but it is now at 18.6 and last month it drew a little more and we think it will be $20 million plus in the next six months. Now, those programmes continue to slip, I think that is just a figment of the game we are in at the moment and so we need to invest in glazing and the labour associated with it, because as that book gets bigger it will drop and we need to be ready for it in a planned and structured way.

The last point is that Auckland is now our focus. Although the consents don't show it, Auckland is going to be the commercial hub in the medium term and we need to be prepared and have execution in our ability to transact what we currently do in Christchurch.

So commercially, markets are robust. We have got good internal competencies and we're growing those and it is a very, very good backdrop of a market and certainly, it sort of looks to be a strong 3-5 year window.

Ok, on slide 14, talking about retrofit. We talked about at the AGM we are going to double the size in 3-5 years. We ran a successful TV campaign. Currently for the half year it is growing at 26% year on year. We think that will be about 30% by year end. And we are on a learning curve with retrofit. It is a very emerging part of our business. Auckland and Upper North Island demand is very strong, and we're on a learning curve like anyone else and we have got our fair share of growing pains, but that said we've really been able to jump start retrofitting and get stuck into it. And what we have been very happy about is the amount of demand and the consumer appeal for double glazing as a way to improve the comfort of their home. We will continue on that marketing programme for the next 3-5 years and we're focussing now on the mechanics of delivering it. So retrofit, a very good six months.

From an investor perspective, like all things we've had to do since the IPO and becoming a listed company is a bunch of things. One of them is a long term incentive scheme, which was approved by the board and that programme will be communicated in due course.

Operational priorities for 2016. We are going to continue to drive our top line growth and category share and our supply chain strategy around our customers, which we think is a key differentiator. Basically we have two core strategies drivers; one is the customer intimacy model we have and then we have the second part of it, this operational execution supply chain approach, which is everything from float glass right through to material delivered in short lead leads with complicated product ranges any anywhere New Zealand, of 48-60 hours. And so we are going to continue to invest in that, and obviously we have invested heavily in automation and technology around the tracking of glass, and now we need to invest a lot in our execution. We are going to deliver manufacturing excellence to achieve our desired service and cost leadership positon. Certainly our service leadership position helps us with our domestic competitors, but Metro more worries about what we are doing in an Asia Pacific competitive basis. So we care about having an expansive product range and differentiating that range through high performance glass and glass options. We also care about our cost position to compete with Asia. We are going to see a chunk of the residential market in apartments be constructed by commercial contractors, and we need a cost position and an execution supply chain cost that ensure we are competitive and can make the great returns that Metro make. And we are going to capture an increasing share of the commercial market. It is a capability that we have had inside the business and we continue to invest in it. Yes it is Christchurch and Auckland based, Wellington is looking pretty great. And we have also put apartments in that bucket as well and we run them as we would a commercial building. And we are going to drive our retrofit double glazing replacement business.

So in terms of an outlook, we have got significant growth opportunities ahead of us. We are going to continue to invest in our operating activities around glazing to feed a growing commercial pipeline. We are going to develop an infrastructure around our retrofit business, and that is everything from creating demand to selling in the home, to executing the job and obviously picking the cheque up and creating a really good brand.

And the other part is we need to start ensuring that we have got multiple brands in the market. So when someone is getting a retrofit quote they may well be getting it from 2-3 companies, but they're all backed by Metro.

And then we need to continue to make sure that we are investing in the machinery and the technology at the forefront of the industry, which we are doing. We signalled long term capex is $5 million, $1 million of which we are going to spend on innovating technology and technology that has us as the forefront.

In quarter four, basically we had a decision in this half year to focus on revenue growth and share, and not to aggressively take out cost in our plant. We have continued that strategy and we like where we are because it is a long term gain. Cost is somewhat easier to get, revenue is hard to get. And so revenue has been our focus. But in quarter four, which is January through March, we will be over the Christmas rush. Basically the building industry packs in everything it can between August and December and we are going to start focussing on manufacturing, consolidation and efficiency in that time frame.

We are maintaining our guidance that we gave at the annual shareholders meeting in FY16 of sales in the order of $190 million and NPAT for the full year in the vicinity of $20-22 million. I guess the key risk in FY16 is if the current industry delays in initiating completing commercial projects doesn't improve then the revenues will be deferred and NPAT will be on the lower end of the range. A bit early yet for us to call that, but as you can see our book of business continues to grow and while it is growing it means those jobs aren't getting executed, so it is just a figment of time. We can't continue to build a book of business without actually completing the work, so at some stage that is going to reverse, but right now every month basically our book gets bigger. We have forecasted what we believe is going to get executed and we will just have to keep an eye on that.

OK, so that is the summary. The summary I guess of Metro is, you know, we like everything about the six months except missing the PFI in terms of NPAT. We like our revenue growth, obviously we have got an Auckland plant that is up and running. It is on a ramp, and now we get to optimise it which is a lot more exciting than ramping it up. We have got a good position in Christchurch. We have got a commercial book that is looking good. We have got a retrofit business that is sort of kicking into gear and so we like the position of the business, and we like what the plant has bought. We are still very confident about operational savings and efficiencies we can get out of the plant. There is nothing to suggest that we won't get those and that we're going through all the necessary learning curve in terms of the plant.

When opportunities do come up such as Ultra, we generally grab them. Or Mainland Glass. And we will continue to evaluate them when they come along if they make strategic sense for Metro we will take them on and figure out a way to get them at the right price.

So yeah, generally speaking, we would be pretty comfortable with the six months on a really good industry back drop

OK, any questions?

* Thank you. If you would like to ask a question, please press *1 on your telephone key pad.

Your first question comes from the line of Kar Yue Yeo from First New Zealand Capital. Please go ahead.

K Good morning Nigel, John. A couple of questions from me please, firstly if you can talk about potential price increases to come beyond this 4.5%, or maybe even I guess, broader industry 5% that Viridian we understand have announced, in the context of your FX coverage. And secondly, if you can talk about market share shifts by sort of broad region in Auckland, in Canterbury and Lower North Island Please.

N OK, so first one, in terms of price increases, yeah we would certainly…1 January is a price increase, 4.5%, I think Viridian has gone a little higher than that. We have not confirmed but think it is highly likely, that the industry will have another increase around July. We have not locked and loaded on that. We have certainly discussed it. The procurement of glass, if you are good at it, will present a tonne of opportunities. So yeah, I would envisage for normal glass players they will continue to be effected by increased glass price and exchange rate issues, and that would necessitate recovering that if they could around July, which is sort of the traditional time pricing goes up. We have continued with a 12 month hedge and we will have to re-evaluate that at some stage, because it will start to hurt us, I guess, if the exchange rate was going to turn around. I guess we are never going to be foreign exchange traders, so we are probably going to take a position and take our licks.

Second one, market share gain, yeah look we've enjoyed a pretty good six months and most of that share has come in the North Island. We would be flat in the South Island, and we're looking for better results in the South Island, it would be fair to say. We have been somewhat disappointed that we haven't been making more progress in the South Island, but having said that North Island has been performing very well and we have been having a great run.

K That is great, thank you.

* Your next question comes from the line of Doug McPhillamy from UBS, please go ahead.

D Excellent, thanks guy. Just a quick question, I guess around the costs side of things. You mentioned higher input costs being a feature over the period in terms of the actual glass prices of the raw material input for you. Do you mind just giving us a little more colour around the extent that those glass costs did increase, and also I guess, a little bit more detail around the costs that you held onto from an operational and labour point of view in the first half. I guess what extent that these have been held onto, and I guess hence what extent you expect them to be released into next year.

J John here. I think if you were to look at gross profit and the gap between the actual and the PFI, probably 2/3 of that is a factory conversation costs gap, and the other third of that is an exchange rate / glass costs gaps. That is probably how you would split that. As Nigel mentioned the glass procurement is a moving feast and so some of the cost increases that we have picked up we are looking to unwind, so we think we will unwind those going forward. Obviously the exchange rate, we have put up our prices to offset against the exchange rate.

Going forward on the factory conversation, again as Nigel said, we are holding on to those so we will be working through the fourth quarter and into next year on unwinding those. Again, probably in the fullness of time, we would expect to recover that gap that we've got in factory conversion costs. But we are keen to do the right thing by our customers to make sure we can service them, so we just are conscious that we don't want to unwind that too quickly and jeopardise our service levels.

D Absolutely. Just in terms of capex, I know there was a bit of discussion in the call previously, but just to get a better sense for how CAPEX will come through for the full year of FY16, and then how to think about a more normalised run rate going forward into FY17 and beyond.

J So Doug, your second question first. So we would see a normalised run rate of about $5 million a year on capex. $4 million of that would be kind of routine replacement, safety and minor capital items. Then $1 million would be around new technology, expanding our offering and getting more sophisticated in a market that is moving relatively quickly on product development. So that would be our ongoing target.

For this year we will finish off the high capital period, so we spent obviously $7 million in the first half, which is higher than the PFI. Some of that is a carry over. I think we ended up below the PFI at the end of March, so some of that is a carry over. We would probably be likely to do with the digital printer and some of the laminating and heat treatment equipment, we would probably ending at 4 or 5 in the second half from the top of my head. So this year will be a relatively heavy year, but we will have made a significant step change to the capability we have.

D Got ya. And just a quick question as well, tax rate was considerably lower which has been well explained in the presentation, but is 28% as per the PFI the better number to go off moving forward for that measure?

J Yes.

D OK. Thank you.

* Your next question comes from the line of Nick Mar from Macquarie.

NM Hey guys, just a couple from me, just firstly on the volume side of it. You have talked a lot about focussing on market share. Is that any indication of your view around industry volume growth? You tend to focus on share if you didn't see as much volume growth in the industry, firstly. And secondly, the correlation between the 12 month lagged consents and the revenue number, obviously that is impacted by your other business lines outside of residential, what does that relationship look like between residential revenues and the consent figures?

N OK, so let me tell you the first one. Like any business, we saw an opportunity…in the North Island a few dynamics all collided at once that had an opportunity for us to win share, and our real challenge was we were starting up an Auckland plant in the middle of that. So a couple of three things collided together and produced this, what we thought was a very good opportunity for Metro to double down. And the stars aligned. Now the challenge in that was that we had our plant ramping up. So we tried to do both. And so we changed gears. We would have liked to have signalled we were changing gears, but it is always a little bit hard because you don't want to tell everyone necessary what you are doing. But basically there was a perfect set of stars aligned in the market for us to go out and win share, and that continues to be aligned by the way. And we decided to double down and take share, which meant we changed our programme around our plant in Auckland and devoted everything to customer service and the speed in which we hit to 90%, and secondly the capacity that would be derived from any share gain. We made sure that we had enough capacity ahead of that. So that has sort of answered the first question.

The first question is basically there is a market opportunity, and we think that still exists, and we are always troubled by a plant start up, and that is why we tried to rip that start up as fast as we could and get it up and going and get into optimisation phase for that very reason. And that has worked pretty well.

To the second point, the problem with commercial is our residential mix is actually stable. But the problem is commercial is not growing as fast we need it to be, because our book keeps on getting bigger. It will change, but it will only change when that book comes off. So that is the challenge we face, the book keeps on getting bigger and it goes up in clumps. Some of these projects that are going to come out, there is some pretty meaty ones in there. So your point Nick, our challenge is that at the moment our market is pretty stable from a share perspective. As a company we are a very good residential window company. We have got a fair bit of work to do on internal fit out, so that is the fit out of an existing home or a new home. And that is the showers, splashbacks, balustrades, mirror – that is an area of focus internally for us, and it is probably an area of our business that we need to grow a lot more in. That would be a segment that is effecting our share to some extent, and our revenue growth. But other than that, all things being considered, I hope I have answered your question. So basically commercial is flat as a percentage of our sales, although having said that that is going to change. I am going to say over the next 6-12 months as that pipeline starts dropping.

NM Nigel, just finally, what would your market share be at the moment if you had to kind of estimate a number?

N I knew someone was going to ask that. North of 50.

NM So not too dissimilar to the kind of 55 number you were talking during the prospectus period?

N It would have grown from that. At the moment we are not giving out our share number, but it would have certainly have grown from our PFI stated range.

NM Thanks

* Your next question comes from the line of James Buscan from Forsyth Barr, please go ahead.

JB Thanks moderator and morning Nigel, morning John. A couple of questions from me. Can you give us an indication of the split between your residential work and your commercial revenues? At the PFI we kind of discussed, that was something I guess that was discussed, but can you give us an indication of where they sit relative to each other?

N We still be in our PFI range, we would be not much different. Commercial is still a pretty small part of our business to be honest. And we are getting better about calculating the percentage, but it would be between 20 and 30% of our business would be commercial, and we would be getting better about how we predict the end use of glass manufactured to decide where it ends up.

JB OK, thanks very much.

N But my expectation, a little bit like Nick's question, my expectation is it is going to grow, because that book has to come off. So over the next 18 months I think the mix is going to change.

JB And then maybe on retrofit, around $7.5 million in sales through the first half, and clearly summer will be more challenging as far as getting sales across the line, but as part of that $190 million revenue target, what are you expecting from the retrofit business to contribute to that?

N I think we gave the number out at the PFI of around $10 million. We think it is going to grow 30%. We think we are going to be north of $13 million for the full FY16. Ironically we are carrying quite a book of forward workload in retrofit as well.

JB And on the commercial front Nigel, so there is obviously a lot of volatility potential with regards to projects not coming or coming on line. Are there any sort of particularly large projects that if they were to come on line could see you beat the fiscal 16 earnings target?

N Not now, but there are some large projects that would alter our course. There are some big ones up for tender and being let that we would…we are not going to win every project, let me give you an example, there is a project, Christchurch Hospital, which is the acute centre, that would be a project in excess of $3 million worth of glass, actually be in excess of $4 million when all said and done. So that is a large project and that is starting to come out. So they would alter the course of FY17, I don't think that would alter the course of FY16. We basically know in that $18 million book what we've got. Now what we've got to try and figure out is when they're going to drop. So that is probably more the challenge than anything else, is how those programmes roll in.

JB But the likelihood is that the big ones won't fall into the second half of this year, it will be further out, sort of fiscal 17 or 18.

N Yeah, we're taking a conservative view. You could be right, but we're taking a conservative view the other way. We have taken a more conservative view that actually you will see further programme push off. And we think that is the risk in the $190 million. But it is conceivable, you could be right. But again we don't have an accurate way of predicting that. We are watching the programmes and seeing how they roll, and then we will just have to accommodate accordingly.

I think the good thing though, the book just keeps on getting bigger and it will happen and we have to be prepared for when it does.

JB Yip, OK. One further question from me if I may, you talk about market share gains in the North Island in particular. How have you seen the effect of new competitors? I think it is the Glass Team. Have you noticed them snooping around for business, and obviously that hasn't effected your ability to grow share, even though there has been a new entrant.

N Yeah, that is true. I think new entrants can be a blessing, or they can be an absolute curse. In our case they have provided a dynamic in the market that has opened it up like a tin can, and we have benefited from that. So yeah, at this stage, and it is very early stages, a new entrant has helped our programme.

JB Can you give us some colour around how that has happened, Nigel?

N Oh man, this is difficult. So there is no question that Glass Team coming in the market has changed the dynamics of Auckland, and out of those dynamics Metro has been well positioned to play and turn some tables. Yeah. So no question. Ultra out of Wellington, yeah no question. We competed hard for the Lower North Island market and we would have won a significant amount of the Ultra business. We didn't buy any customers, it was a liquidation so it was pretty much done. All we did was buy assets. By then the cards were played and the customers had gone to wherever they wanted to go. So we have benefited definitely from Ultra's exit, and we have benefited from an Upper North Island share gain, both in customers and our customers getting bigger. And definitely when a customer like Glass Teams comes in the market, it provides a discontinuity that if you're quick enough you can turn to our advantage.

Now the fly in the ointment for Metro in this whole process was, of course, we had Auckland plant ramping up. So where the dynamics were changing, we had Auckland plant starting up. So we were racing to get that plant up on the plane and get the throughput so we could optimise that opportunity. And that has resulted in us having a North Island share in DGU, the best we have experienced in the three years I've been involved in Metro. And that is for two quarters running, so it is not a one quarter flash in the pan, we have enjoyed that over a couple of quarters. So yeah, that is the basic synopsis.

JB Thanks for that guys.

* Your next question comes from the line of Dennis Lee from Craig's Investment Partners, please go ahead.

DL Good morning Nigel, how are you?

N Hi guys, how you going. How you going Dennis?

DL I have this question regarding your DIFOT number. If I look at your PFI you were indicating previously you were getting around between 96-97 % for your DIFOT. And for the average of this half right, your average only 83. What is the difference in these two numbers? Why are you coming down so much?

N We would have had a target of 95. I'll have to look back on the materials. 96 would be a big number for us, we wouldn't have consistently been there. If you look at Auckland Plant, that starts up, that is why we provided two numbers. So you can provide a September number at 88 and it is ramping up. So the problem is when you ramp up a plant and it is 40% of your business it is going to trough your company DIFOT number until it starts hitting its straps, and it sort of started doing that in April through June and then you are trying to optimise it. The first job is to get it over 75 and then get it up in the 80s and then get it to crank. The main reason DIFOT dropped was Auckland plant. And we had a bit of a hiccup in Christchurch so that sort of effected things in the 6 month period. But September number at 88 is a pretty good number.

I will have to look back at the PFI period. 96 98 would have been a bit number for us to hit, I will have to check out what we said there. As a company 90 has always been the sort of benchmark standard we have always tried to hit.

DL And the other question I want to ask is just regarding, you mentioned you are going to wind back your factor conversion costs in the fourth quarter. Are you actually referring to taking of the shift from the Bay of Plenty plant, is that right?

N That's would definitely be part of it. The issue is not about people numbers, I think the Auckland Plant people numbers have come back. The issue in Auckland is about the labour hours we spend to run this plant. That is what we're going to start driving efficiency around. It is not complicated, but basically it is the hours and the hours of overtime that we run and the method by which we run the plant is a pretty high cost way to run a plant, but it is the best way to get service ramping quickly and get your service position lined out. And we will start unwinding that bit by bit. Now, it will take us 18 months to unwind if fully, but over that period we stated in the PFI what savings we would achieve from the plant. We won't get those on day one but over the next 18 months you will see us pull those out bit by bit by bit. And it is more about hours than it is about labour headcount. But yeah, Bay of Plenty will be part of it. No question.

DL And my last question basically is that I'm looking at the financial number, right, you provided in your presentation regarding cost of goods sales and all the other indirect expenses. They are a bit different from the numbers provided in your interim financial statement. Would you please explain why?

J Dennis, John here. In the financial statements, the depreciation is included above operating profit, so the financial statements go to EBIT I guess. Here we wanted to show an EBITDA line, so we have taken the depreciation and amortisation out of the lines above and shown a depreciation and amortisation to get to EBIT.

DL Ok. OK, because if you are to look at the financial statement right, your gross margin is actually lower you see.

J Yeah, that would be obviously deprecation in the factory would be above there, so we probably need to get our terms right between gross profit, gross margin and gross contribution. But that would have factory above related depreciation included in that.

DL The difference $1 million

J Could be. Not too sure. Could be. I will have to get it in front of me. I will have a look Dennis and if you want we can chat about it offline.

DL OK. Thank you.

* Your final question comes from the line of Matt Henry from Goldman Sachs, please go ahead.

MH Morning Nigel and John, just a couple of follows up, just on commercial can you give us some colour around the competitive dynamic there between imports and domestic competitors and just any sort of thoughts on what margins look like in commercial relative to the broader book, if we see an escalation in the percentage of commercial work that should have an impact on margin. And then secondly, just on Ultraglass, do we think about that as an offensive or a defensive acquisition i.e. did you look at it and say we need to pick that up just to keep that kid out of the market, or do you think you can grow revenue on the back of it?

N OK, alright let me take commercial for a start off. So firstly we like commercial margins on glass. We have got pretty reasonable about costing these jobs and we like the margins. The dollar margins are very, very good. And if I look at revenue per hour out of a plant, the revenue is very, very good. So we like the margins. Obviously on the glazing side of it you don't make the margins out of the labour putting the glass in a hole, as you do in manufacturing the glass and providing it. So still reasonable margins, but not as good as manufacturing the glass. One of the things we are trying to enact is more structural glazing, which is basically gluing the glass in a frame in the plant. So we like the margins.

The dynamic of commercial is an interesting one and 50/50 hindsight is a great thing. We would like to be a lot further down the track in the development of our infrastructure. Basically what Metro has to do is partner with companies that are fabricators who have the ability to design shop draw and fabricate frames. We augment that with our glass, and glass is becoming more and more of an important specification in these commercial buildings. We work together, tender a job and win it. Generally speaking, Metro, as opposed to any of our domestic competitors is the only one playing in this deep end of the pool. The alternative to that is that you can be making the frames in New Zealand and you can import the glass already made up, because a lot of the sizes are determined. Our job of course in these specifications is to make them so complicated, which we have an OK job of doing, such that a domestic supplier is required. So that is the basic. It is basically a Metro supply chain with some really good fabricators in New Zealand that we partner up with and we tender together. Christchurch Hospital is a great example of that. I mean that façade, the glass component of that is probably $4 million plus and the façade could be worth anything up to $20 million. I am not saying we are going to win it, I'm just merely saying we are going to compete hard. And that is an example.

We partner with a fabricator and we bid together. We have got to convince them that we are the company to do it, and that is basically how it works. We will be doing the same in Auckland, and we obviously become OK in Christchurch. So that is the supply chain and how it operates.

One of the questions you might ask is can you live with the margins on imports? Yeah you can, because the glass is pretty high specification. It doesn't matter where you are anywhere in the world, the glass that they want to but is hard to process and we have become pretty good at processing it. We haven't got a cost disadvantage. The only thing we are doing is carting glass that you ultimately slice up, so you do cart some waste, but margin wise we can compete with imports. And at this stage in New Zealand, unlike Australia, large Chinese fabrication companies have not come into New Zealand like they have in Australia. It is not to say that they won't, so you get your Uwanda or Jangho who would come in here, supply the frames and the glass and provide Asian installers from China who would install it, so it is a full turnkey solution off shore. Markets are quite weary of that, because you may know a job with Kings Façade and Mainzeal in Parnell that went horribly sideways. I guess it was reported, and I'm not sure whether it was factual or not, of King's façade's role in Mainzeal's problems, but it certainly would be part of it, I'm sure. So that is the dynamics to commercial, and we need to play those dynamics. It is quite a big investment upfront in technical capability, contract administration and glaziers. Unfortunately you have got to train those glaziers before you actually get to work. Our glazing costs would be up 50% over two years ago, just in raw how much we pay. Now that will all be fine when the work hits, but it is the chicken and the egg, you have to have the capacity and the capability pre the market.

Your last point about Ultra is a good one. It is both, if the truth be known. We are going to reopen Ultra up under a brand in Wellington and we are going to focus on the merchant market, which his significantly changing dynamics. So we are going to try and run Wellington as we do in Christchurch. As you know we own Christchurch Glass in Christchurch, we also own Mainland and we own Metro, so it is conceivable in Christchurch you get three quotes on the table and they're all coming from Metro in some shape or form. We don't have that in Wellington and we don't have that in Auckland and it is something we have got a guy running here. So we are going to open Ultra up, we will call it a different name, but we are going to apply that strategy that we have in Christchurch into Wellington.

The other part is that it's got some gear and Wellington, we're bumping up against our capacity in Wellington. It will provide us probably a three year capital deferral, I suppose, in terms of as our Wellington business grows. So it is good from a capital perspective, it will provide us some additional capacity which will defer what we would have spent internally. But yeah, certainly we wouldn't want furnaces rolling around New Zealand that were going loose. But if it was that decision and that decision alone you may not buy it. But you are right, it helps.

So those are the three drivers – capacity, because it will defer some capacity in Wellington. Two, we can open up a Mainland or Wellington's version of Mainland or Christchurch Glass and allow us to innovate in a segment that has got some dynamic shifts going on with imported standardised showers and things. And lastly, yeah it has some capacity that I guess could have got in the wrong hands, I suppose. But that wasn't the main basis of why we bought it.

MH OK, thanks, that is useful.

* We have no further questions. I would now like to hand back for any additional or closing remarks.

N OK, well I guess we are going to be seeing a bunch of you guys over the next week and we will get a chance to put a bit of flavour on where we are going, but thanks for your time. Cheers.

* That concludes todays' conference, thank you for your participation. You may all disconnect.

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