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2019

Annual Report

reece
group™

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**To improve
the lives of
our customers
and our people
by striving
for greatness
every day.**

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2019 Financial Highlights

Sales Revenue

\$5,464m

Normalised EBITDA*

\$522m

Statutory NPAT

\$202m

Dividends

20.25c

*excludes business acquisition costs, finance income and fair value inventory un-wind

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Chairman's Report

2019 has been a year of strength for Reece as we explore new growth opportunities.

Financial performance

This year, Reece Group achieved record sales revenue of \$5,464m for FY19, up 103% on the prior year including a full 12-month contribution from MORSCO. Normalised earnings before interest, tax, depreciation and amortisation improved 38% to \$522m and our normalised net operating profit after tax increased 6% to \$238m.

The Board has declared a fully franked dividend of 14.25 cents per share for the second half of the year. A total of 20.25 cents for the 2019 financial year, flat on the previous year.

Sustainable business model

As we enter a more challenging market domestically, we draw strength from our underlying business model. With the Australian economy coming off record highs and housing markets moderating, we continue to focus on helping our customers succeed in a slower economic environment.

In the US, building permits have been volatile. The US economy overall continues to perform as expected, though indicators suggest housing may slow in the medium term.

Looking forward

At a board level we continue to structure the business for long-term success and strong, consistent shareholder returns.

Finally, I extend an invitation to our shareholders to attend our Annual General Meeting, to be held in Melbourne on 30 October 2019.



Alan Wilson
Executive Chairman

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“Reece continues to deliver strong results and long-term value as a global company.”

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CEO's letter

This financial year has seen the Reece Group focus on integrating on a global scale and continuing to grow our market leading position in ANZ, writing our next chapter as a diversified business.

International progress

We are truly global. MORSCO has been part of the Reece Group for a year, and during this time we've started to gain a deeper understanding of the US business.

The MORSCO integration continues to track as planned with a focus on developing the long-term strategy and culture, and positioning the US business to take full advantage of growth in the Sun-Belt region.

Recently, MORSCO's US leadership chose to adopt the Reece purpose and values because they so closely reflect their own – a strong validation of bringing the businesses together.

We also cemented our presence in New Zealand through the integration of Heatcraft NZ and Edward Gibbon into the Reece Group, providing customers with a stronger and more wide-reaching offering in New Zealand - essential to long-term success and growth in the country.

Closer to home

The Australian business has continued to perform well in a slowing environment. Driven by a strong culture, deep experience and focus on the customer, we build on our market leading position while growing into new market segments. We remain focused on our Australian business and continue to invest in the people, products, technology and customer service we are known for.

We launched the latest version of maX, our online business management system exclusive to our account customers. The new app means customers always know what they've ordered and when it's arriving. The latest version of the app builds upon Reece's market-leading online experience in the trade space, pursuing delivery transparency long before it became common in other industries.

Market-leading innovation

Supported by our dedicated innovation team at NEXT, we embrace change and drive world-class, insight-led digital transformation across every part of the business.

We have a remarkable culture of innovating, big and small. Leaders at every level of the Reece Group are empowered and encouraged to make smarter decisions driven by our deep understanding of our customers. This enables a rapid response to evolving customer needs, changing trends and to run our business more efficiently – Ensuring we have customers for life.

Financial results

The Reece Group achieved another record result for the 2019 financial year. Sales revenue was up 103% to \$5,464m, while normalised net profit after tax was also up 6% to \$238m. The strong balance sheet and cash generation gives us confidence to both service and pay down the debt facility used to acquire MORSCO.

I'm proud to deliver long-term value for our shareholders guided by our enduring purpose and values.



Peter Wilson
Chief Executive Officer
& Managing Director

“We have a remarkable culture of innovating to exceed customer expectations.”

We now have a truly global footprint. Extending the length and breadth of Australia, both islands of New Zealand and the Sun-Belt region of the US. We're leveraging our industry leading technology, expertise and service across the Reece Group to build market share.

Branches

800+



Product range

300k+



Customers

200k+



Graduates from 2002

283



Employees

7,800+



Suppliers

7,500+



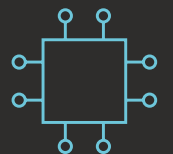
Solar sites installed

63



Used IT equipment saved from landfill

13+ tonnes



Average active account customer

7.3 years



Tenure of longest serving employee

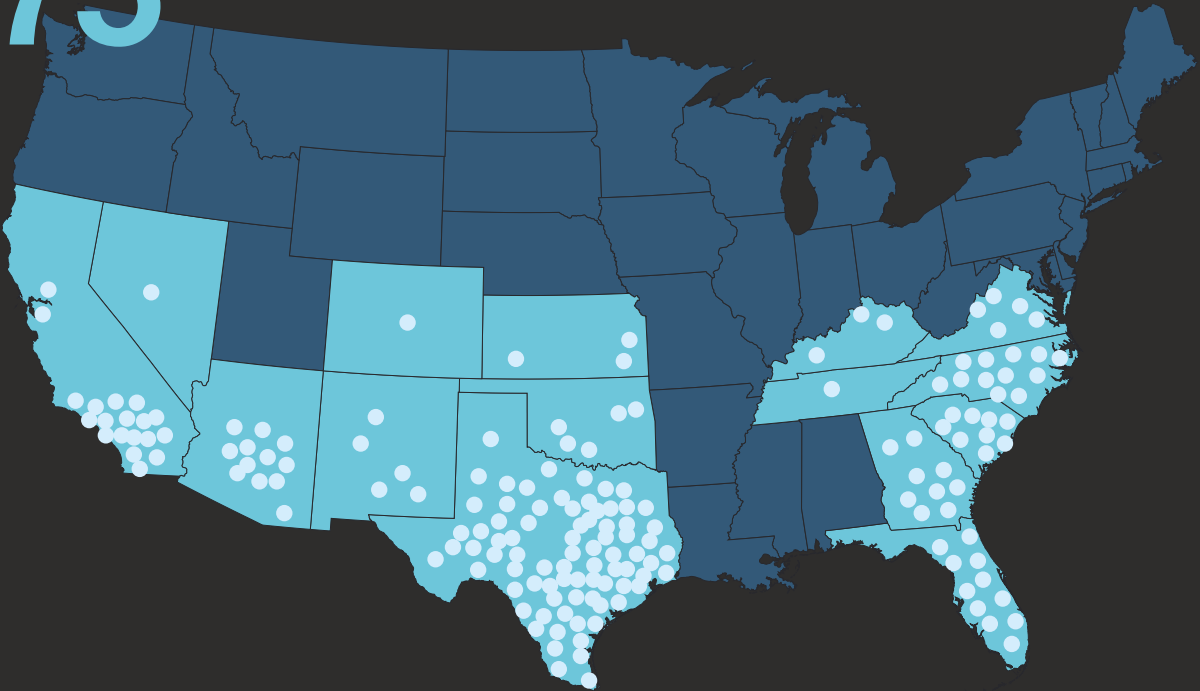
43 years



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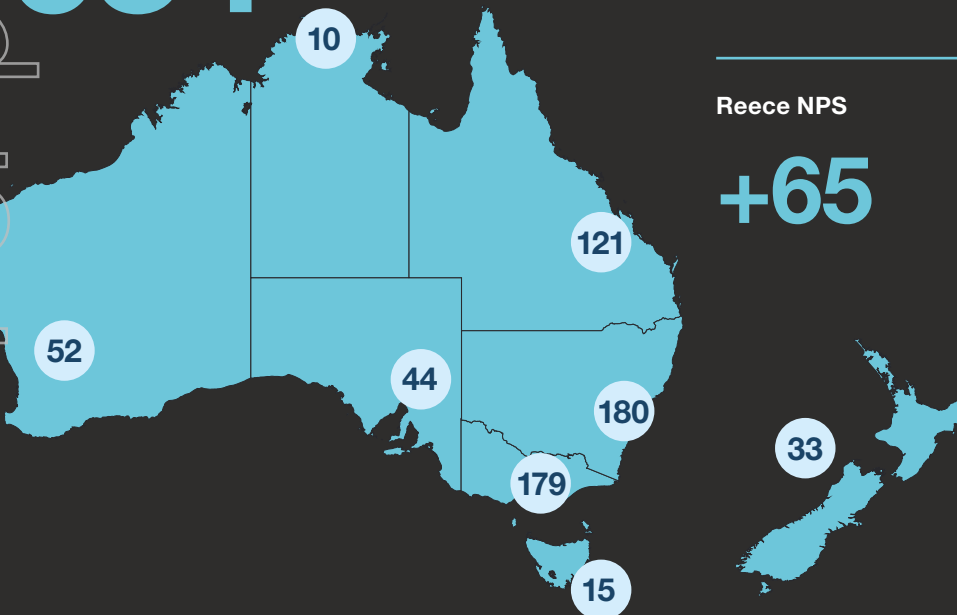
US branches

175



ANZ branches

634



Reece eNPS

+59



eNPS

Reece NPS

+65



NPS

After joining the Morrison Supply Company as a team member 18 years ago, Jesse Reyes (on right) recently had the opportunity to visit Reece in Australia and take part in an exciting and ongoing knowledge sharing program.

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“I can see a lot of value in so many things Reece does that we can apply in the US. The Reece Values are always on display and lived.”

Jesse Reyes, MORSCO

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RISON
COMPANY
brand

MORSCO

Strengthening a global platform for growth.

A unified culture

The MORSCO acquisition was an opportunity to develop a unified culture - not just in the US, but globally. This year, the US team created a new vision for MORSCO that focuses on developing the great people and customer experiences that Reece is known for. With clarity and commitment around the vision and values, MORSCO's leaders have the foundation to build an overall business strategy for long-term success.

Introducing best practice

Key Reece employees have started long-term secondments to the US, sharing operational expertise and relationships across the organisation. Developing standard operating practices, an enhanced focus on the customer, and programs that invest in MORSCO's people have been a priority. The US team is now more aligned, and we are seeing the benefits of greater collaboration.

Delivering on expectations

The Reece Group's investment in the US helps deliver the strong results shareholders expect. At eight times the size of the Australian plumbing market and a growing economy, MORSCO is well positioned to deliver long-term growth.

Being there for our customers

"As a production plumbing company few things impact our bottom line more than material. Product availability, on-time delivery, and unwavering customer service are imperative to our business model. Morrison has gone above and beyond to maintain a standard of excellence that we and our customers expect."

Jeff, Customer of Morrison Supply Company, part of MORSCO

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MORSCO

“Our leadership is even more focused on putting our customers and people first.”

Chip Hornsby
MORSCO's CEO and US plumbing doyenne
(Standing above)

Customer Experience

Experiences tailored to our customer's individual needs are at the heart of the way we approach our business.

Reece quality

Quality and reliability are essential to creating a great customer experience. For the last 10 years our testing lab has ensured products not only meet the relevant regulatory standards, but also our customers' expectations. Due to a growing demand for the same Reece quality assurance across newly acquired businesses, the lab has expanded, providing capacity to test HVAC-R products, pipe and civil valves.

We're problem solvers

Helping customers to nail those tricky jobs is in our DNA. Our people have great product knowledge and take pride in supporting their customers who don't always have time to stay up to date with the latest products and technical data. In addition to over-the-counter coaching, Reece offers technology driven support forums where registered plumbers get product recommendations and advice.

Educating consumers on bathroom design

Our 2018 spring campaign, "Bathroom Lab", culminated in our first ever masterclass event in Sydney. Partnering with realestate.com.au, Three Birds Renovations and Real Living, the event was attended by 200 customers who came to hear about the latest industry trends and products. Customers interacted with Reece Bathroom "dream stations" which allowed participants to create their own vision, plan their bathroom and shop the latest products.

New power to the maX app

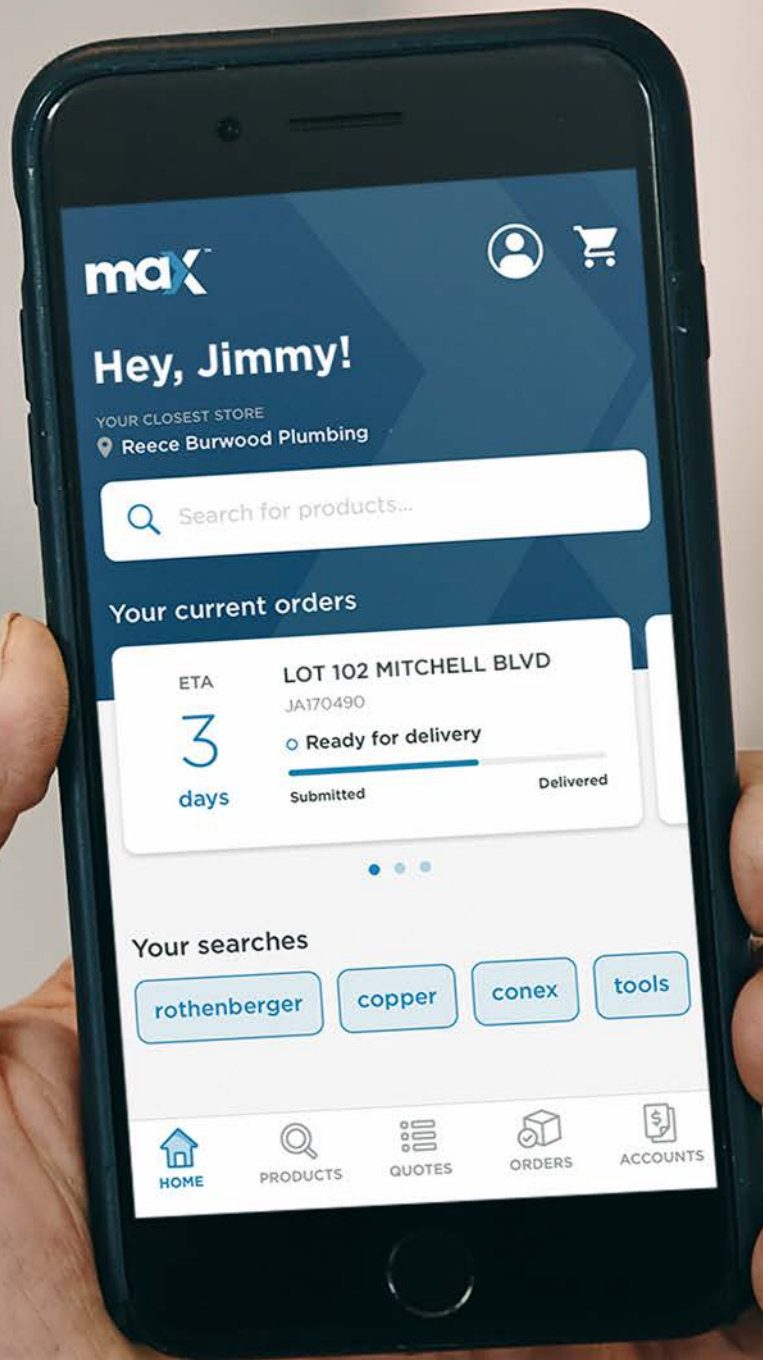
The latest version of the maX app was enhanced this year with input and recommendations from our customers. The platform, developed exclusively for Reece account customers, offers complete visibility on every order. The innovative management system provides access to product pricing, allows customers to build product lists, manage accounts, generate quotes and even order online.

maX integrates with the MYOB and Xero accounting platforms to help tradies operate their business more effectively and efficiently, saving them time and stress. The new maX app builds on Reece's market-leading online experience in the trade space, pioneering delivery transparency well before other industries.

"maX has been great for saving time. Being able to order online and having it ready when I arrive is great."

Jimmy, Plumbing Customer, VIC

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Meet Jimmy

Passionate Collingwood supporter and fan of the never-ending supply of Tim-Tams at Reece Plumbing Burwood, Jimmy has been plumbing for 13 years and running his own business for four years.

Jimmy relies on the maX app to save him time and allow him to focus on the job.

New Zealand

A national presence

The Reece Group has been in New Zealand for over a decade implementing a targeted strategy to expand our footprint within the country. With the acquisition of Edward Gibbon, and Heatcraft NZ, the New Zealand network became national, extending our presence in the North Island and moving into the South Island for the first time. This extended reach allows our customers to leverage accounts between stores and across our network.

Continued focus

2019 has been a year of integration, welcoming the most recent acquisitions Heatcraft NZ, Edward Gibbon and Zip Plumbing Plus. We introduced the Reece Service Standards, back office systems, processes and our online customer tool, maX, across the country. The growing network is also supported by an expanded New Zealand Distribution Centre. Our people have quickly adapted and championed the transformation.

Delivering Reece value

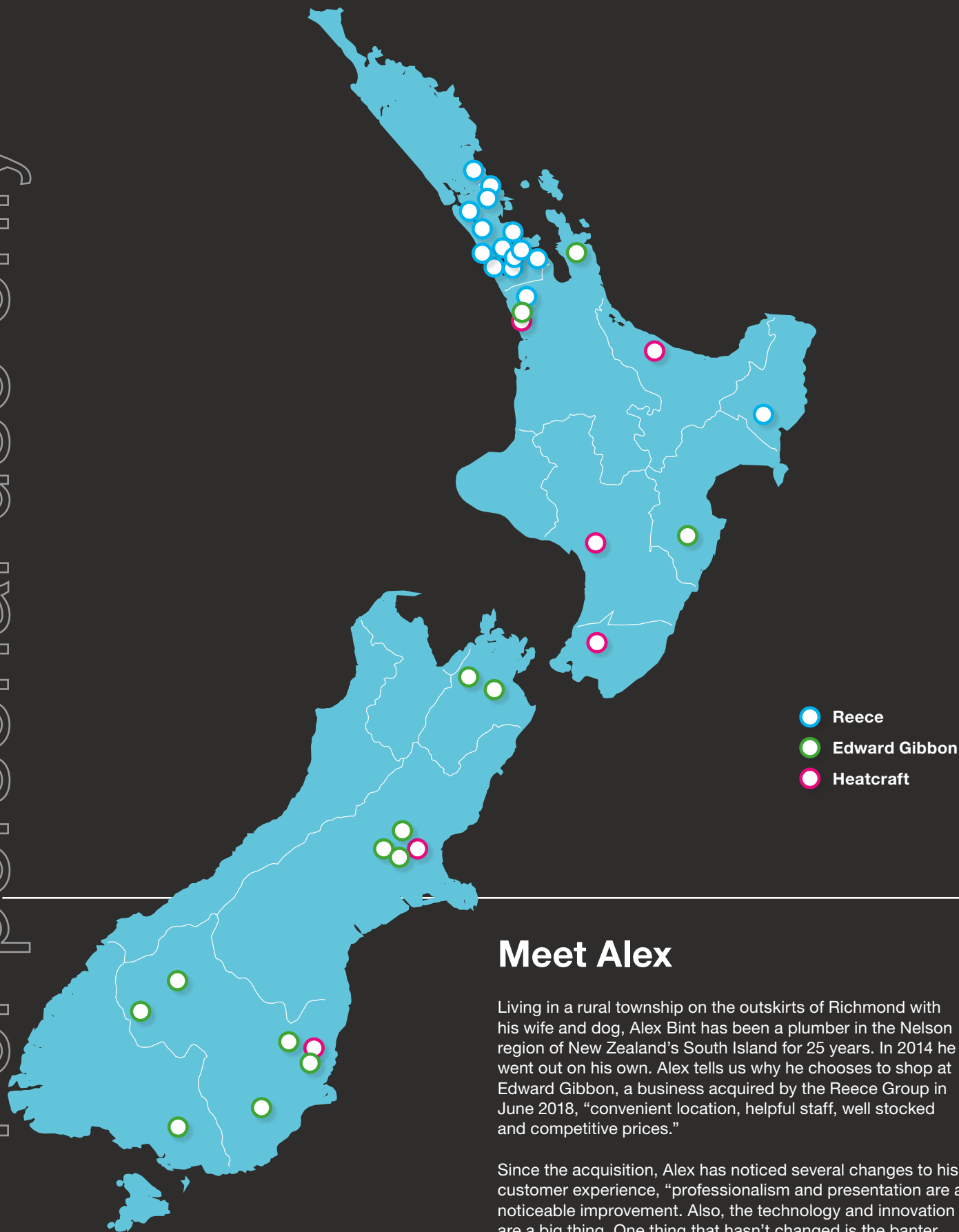
Part of the Reece brand is providing a consistent, quality experience across all branches. A systematic and ongoing program of branch renovations and upgrades has begun to bring this to life. Refurbished and revitalised stores have enabled the introduction of exclusive products to the country. These products are an essential part of delivering value for our customers and developing a lasting relationship based on expertise and support.

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**“Convenient location,
helpful staff, well stocked
and competitive prices.”**

Alex Bint, Plumber, NZ

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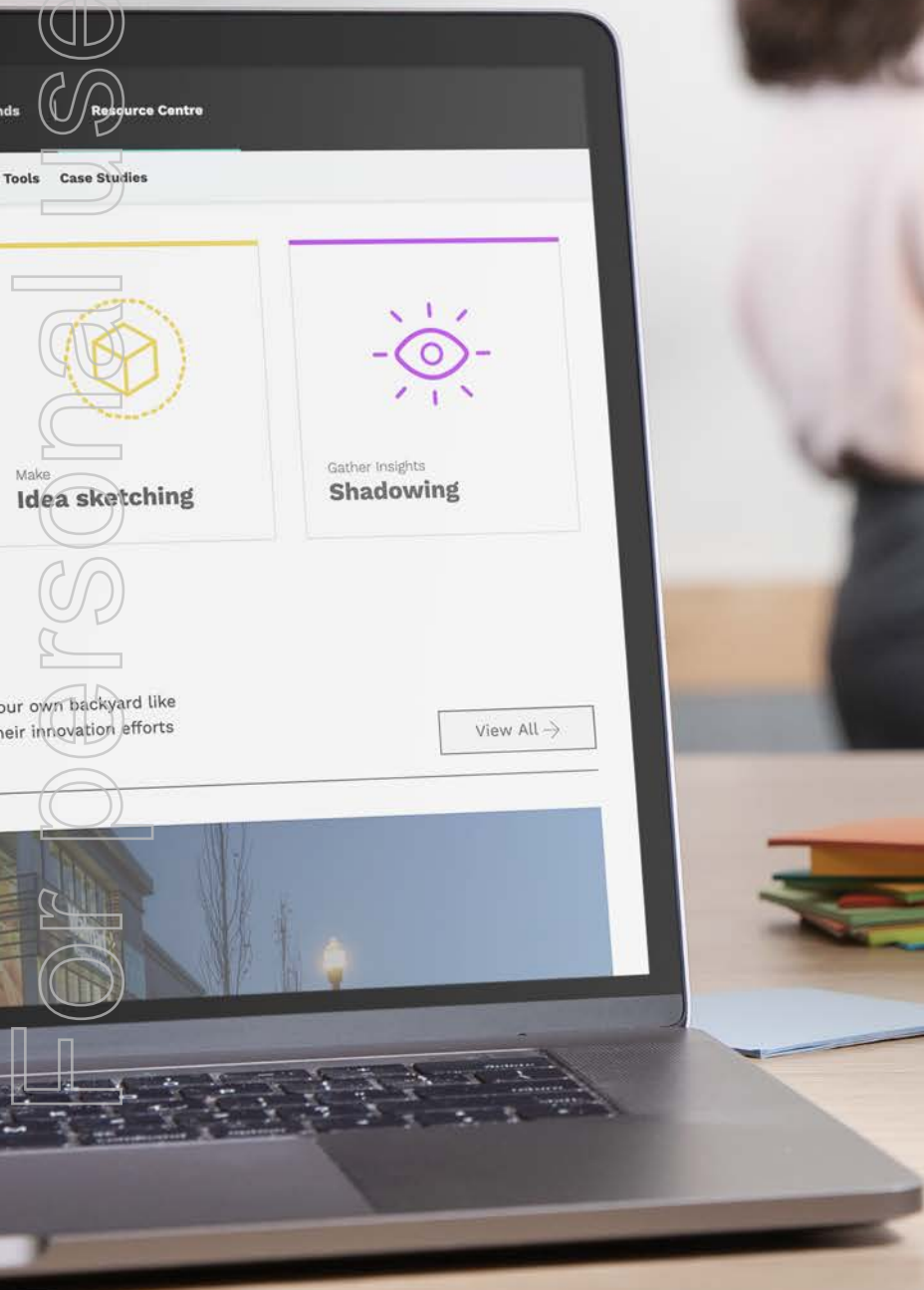


Meet Alex

Living in a rural township on the outskirts of Richmond with his wife and dog, Alex Bint has been a plumber in the Nelson region of New Zealand's South Island for 25 years. In 2014 he went out on his own. Alex tells us why he chooses to shop at Edward Gibbon, a business acquired by the Reece Group in June 2018, "convenient location, helpful staff, well stocked and competitive prices."

Since the acquisition, Alex has noticed several changes to his customer experience, "professionalism and presentation are a noticeable improvement. Also, the technology and innovation are a big thing. One thing that hasn't changed is the banter, and I hope it never does."

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Improving and Inventing

Future proofing by improving and inventing

Reece's commitment to relentless continuous improvement has driven much of its success to date. We are building on that focus through our innovation centre NEXT in Collingwood. NEXT will help secure our future by enhancing our innovation capability, empowering our people to solve problems and create new ideas to improve the way we do things, ultimately driving new opportunities for growth.

The power of many

An important part of our innovation strategy is to harness the power of our people. We run "Innovation Challenges" that focus on specific strategic priorities and reflect our innovation methodology. Challenges can be network-wide involving all our people or targeted to specific groups. These have generated a number of actioned innovations including reducing the use of plastic bags, improving our inwards goods process and creating a business starter app for young plumbers looking to make the move to self-employment.

Just getting started

As we look into a world with new and unexpected competitors, we need to build relationships with a new breed of partners and suppliers to create innovative experiences for our customers and opportunities for our business. Superseed Ventures is our ventures arm which looks for those opportunities. It invests, incubates and partners with start-ups across trade and construction tech. Its first backed start-up, Goodwork, is a network built just for tradies offering members the opportunity to connect, find work and find workers.



Goodwork enables tradies to connect, share jobs and look for temporary resources. The platform is the first commercial app developed through Superseed Ventures and has over 18,000 members across Australia.

“An important part of our innovation strategy is to harness the power of our people.”

Carlo Tarquinio
Brand and Innovation Leader, Reece Group

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Product Innovation

Exclusive brands, quality products, innovation and superior support are key to delivering the value essential to the success of our customers.



GROHE

GROHE is a world-leading global tapware manufacturer and has been exclusive to Reece in Australia for over two years. This year saw the launch of the Essence tapware and accessory collection with GROHE's state-of-the-art physical vapour deposition (PVD) technology. PVD provides a finish unlike any other, delivering a surface three times harder and 10 times more scratch resistant. The unique colour selection has been carefully curated to ensure the customer has a rich array of colours to produce the desired vision.



Thermann 50L Commercial Water Heater

The Thermann 50L model is the largest capacity continuous flow water heater available in the Australian market. Reece identified a growing need for large capacity hot water systems as high-density apartment living continues to increase with population growth in major cities. The unit is quicker to install, uses less material and consumes less space. The unit's condensing technology produces savings for the end user too, delivering a 96.4% heating efficiency and improved emissions and air quality.

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EvoPEX

The new EvoPEX system allows tradies to connect pipe with confidence. Unlike other push-to-connect systems on the market, EvoPEX is internally sealed, substantially reducing the effects of external damage on the seal of connections.



Kaden Ducted Air Conditioner

Ducted air conditioning is the fastest growing heating and cooling category in the Australian market. The Kaden KD offers both efficient and economical whole house comfort.

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“I haven’t had one call back on any of the 80 Kaden units I’ve installed. I use that as a sales point – they’re priced really well, and the backing of Reece helps in selling it to the customers.”

Linden, HVAC Customer

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Our People

We have a proud history of helping our people discover their best at Reece. Surrounding them with opportunities and resources allows them to grow and thrive.

SafeR

The safety of employees and customers is of paramount importance. As an evolution to the Reece Group's approach to safety, the SafeR program is a positive way to promote the right behaviours to reduce risk at work.

Through our internal social media platform, Workplace, employees share examples of the right behaviours in practice and participate proactively in hazard identification. This has led to a significant increase in hazard awareness and consequently a reduction in the lost time injury frequency rate. This culture of safety is also being implemented across the US network with a focus on improving branch standards.

Youth opportunities

We continue to provide opportunities for young people in the community to join our team. With over 60 graduates currently on our in-house program, we also continue to offer career pathways and valuable work experience through the Australian School-based Apprenticeships program.

Preparing for our new home

In preparation for moving the Reece Support Centre from Burwood to the Melbourne tech hub of Cremorne, we're trialling new environments which connect employees and support collaboration. Our aim is to create a place where our people love to work and increase their productivity.

Innovation by our people

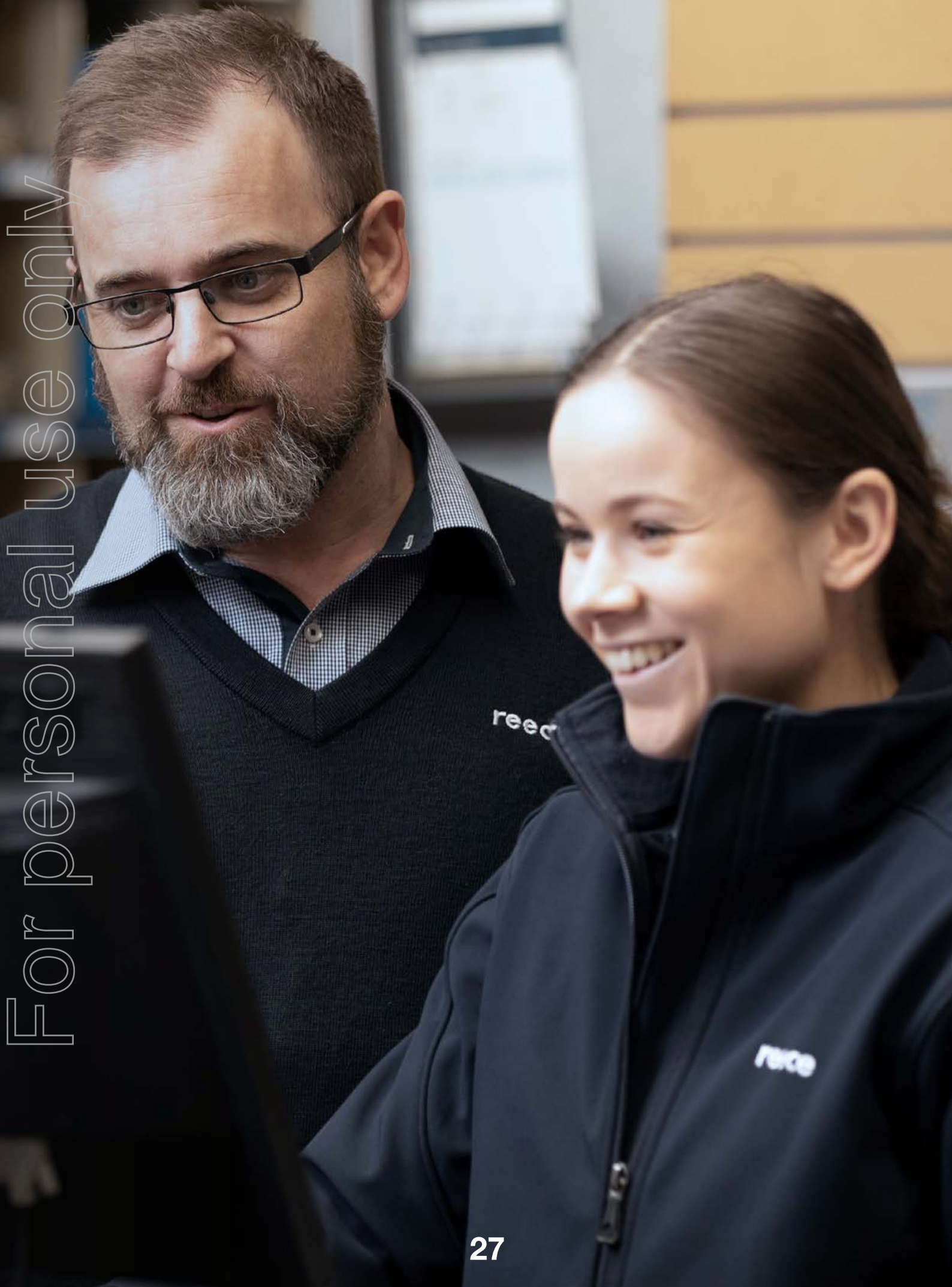
Prime Cyl-Lift is an internally developed invention to remove manual handling from the decanting of refrigerant gasses at our Prime filling centre. Weighing between 10 and 105 kilograms, handling these cylinders exposed our people to a risk we could nearly eliminate.

In October 2018 Prime Cyl-Lift won WorkSafe Victoria's 'Best Solution to a Manual Handling Issue'.

“One of the most rewarding parts is to see the young kids coming through. These kids are the next generation of Reece and I’m passionate to do everything I can to support these future leaders.”

**Kirk Annear, Branch Manager
Plumbing, Caulfield, VIC**

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Reece Cares

Introduced in May this year, our new Corporate Social Responsibility approach, Reece Cares, aligns doing the right thing in the lives of our employees and customers, whilst having a greater positive impact in the broader community.

Reece Cares incorporates Reece Gives, Reece Partners, Reece Reconciliation and Reece Wellness.

Reece Gives

The new online workplace giving platform, Reece Gives, doubles the impact of our employees' charitable donations by matching charitable contributions. Pre-tax donations can be made to the causes and charities that are important to them.

Reece Partners

Charity partners were selected based on their ability to work towards causes that have the greatest impact on our employees and customers - mental health, men's health, disease prevention, supporting rural and regional communities and creating youth employment pathways. Each partner receives financial support over three years, as well as access to the Reece network.

Our charity partners for 2019–2022 are:

- Baker Heart & Diabetes Institute
- REACH
- SANE Australia

Reece Reconciliation

Reece Reconciliation is our two-year Innovate Reconciliation Action Plan (RAP). For the first time, Reece has made a commitment to improve the lives of customers and employees by supporting Aboriginal and Torres Strait Islander Peoples, businesses and communities.

Reece Wellness

Reece Wellness is our approach to mental health and wellbeing, working with partners to support employees and customers.

Ethical labour practices and supplier compliance

The Reece Group has a formal and structured process to onboard new suppliers. Meetings are conducted with senior management to understand how the business operates and ensure core values align. Visits are made to key locations to review work practices, manufacturing methodologies and to ensure compliance with Reece's required standards.

Existing suppliers also participate in ongoing meetings and site visits to ensure standards and processes are being maintained.

Reece also commissions third party audits on our key suppliers to ensure safe and ethical workplaces.

"For us, partners like Reece are critical in delivering our vision to impact the lives of young people."

Sasha Lawrence, CEO of the Reach Foundation

"Without Reece Reconciliation I wouldn't have found out about my family and their culture".

Rhys Jeffs, Branch Manager, Colac, VIC and member of the RAP team.

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The Reece Grant

We care about our customers and what matters to them. The Reece Grant is our way of enabling customers to support causes they care about – projects in local and international communities and helping Australian students gain important skills to benefit their futures.



Devastated by an earthquake in 2010, the people of Petites Desdunes in Haiti were left poor and malnourished with minimal resources and help available.

Sydney plumber and long-time Reece customer, Adrian Lockley teamed up with the Reece Grant, TraumAid International and locals to build water storage systems at a local school. The newly installed tanks, guttering and pipe will store water captured during the wet season. Access to water improves sanitation, community health and provides for potential agriculture. Six months later, locals were able to replicate the system in another village.

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“What we’ve done is going to benefit far more than a village.”

Adrian, Sydney plumber

Financials

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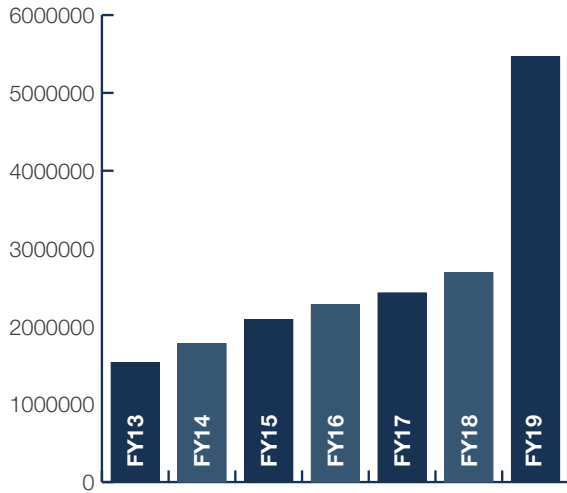
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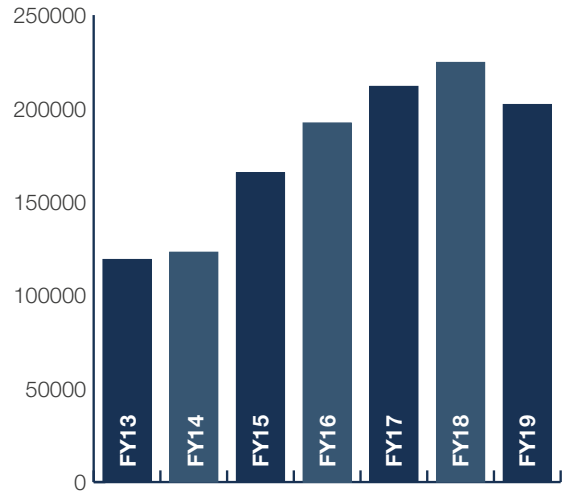
2019 Highlights

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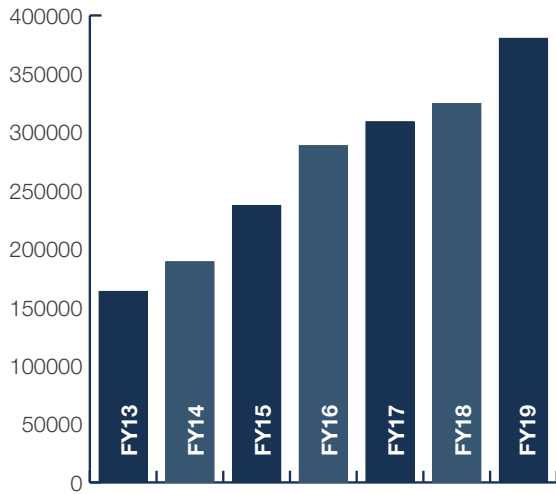
Sales Revenue (\$000s)



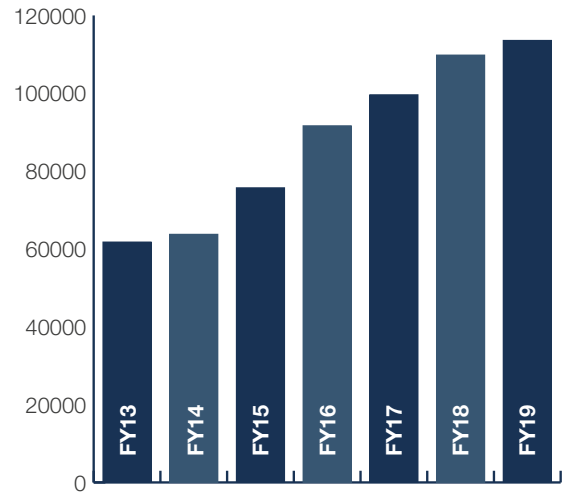
NPAT (\$000s)



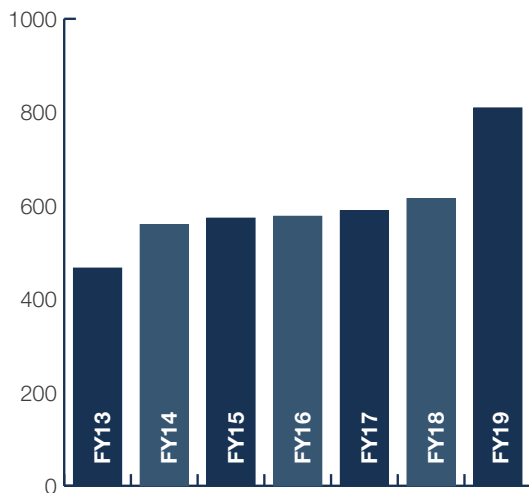
EBIT (\$000s)



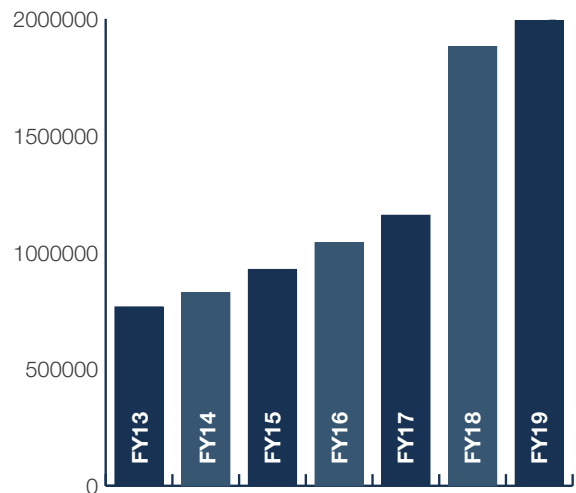
Dividends (\$000s)



Number of Branches



Net Assets (\$000s)



Corporate Governance Statement

The Board of Directors of Reece Limited is responsible for the corporate governance of the Company.

The Corporate Governance Statement has been lodged separately and is available on the Group website.
www.reecegroup.com.au

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Directors' Report

The Directors present their report together with the financial report of the consolidated entity consisting of Reece Limited and the entities it controlled ("the Group"), for the financial year ending 30 June 2019 and auditor's report thereon.

Principal activities

Reece is a leading supplier of plumbing, bathroom, heating, ventilation, waterworks, air conditioning and refrigeration products with operations in Australia, New Zealand and the US. Our activities include importing, wholesaling, distribution, marketing and retailing. Reece supplies customers in the trade, retail, professional and commercial markets.

Results

The consolidated profit for the year attributable to the members of Reece Limited was:

| | 2019 (\$000s) | 2018 (\$000s) | % |
|--|------------------|------------------|---------|
| Normalised EBITDA* | 521,950 | 378,323 | 38.0% |
| Earnings before interest and tax | 380,328 | 324,476 | 17.2% |
| Profit before tax | 297,024 | 319,441 | (7.0)% |
| Income tax expense | (94,924) | (94,821) | - |
| Operating profit after income tax attributable to the members of Reece Limited | 202,100 | 224,620 | (10.0)% |

*Normalised EBITDA is earnings before interest, tax, depreciation, finance income and amortisation, and has been adjusted to exclude the impact of significant items including business acquisition and fair value inventory un-wind costs.

Review of operations

For the year ending 30 June 2019, sales revenue increased by 103% to \$5,464m (2018: \$2,689m), driven by the acquisition of MORSCO, and record sales revenue in ANZ. Profit before tax was down 7% to \$297.0m (2018: \$319.4m) and net profit after tax was \$202.1m, a decrease of 10% on the previous year (2018: \$224.6m). The reduction was impacted by the recognition of business acquisition costs, fair value inventory un-wind, recognition of the amortisation for the US investment and a slowdown in the Australian economy.

In July 2018, the Reece Group completed the acquisition of MORSCO, funded through a debt and equity raising. MORSCO is a leading US-based plumbing, HVAC and waterworks distribution business servicing customers in 16 states in North America. Integration continues to track as planned with a focus on strategy and culture.

Reece has continued to use its strong customer relationships and investment in technology to listen, understand and act on customer needs, leading to the development of new products in plumbing, HVAC-R and waterworks. Additionally, the Company released the latest version of maX. Developed exclusively for Reece account customers, maX provides online access to product pricing, allowing users to build product lists, manage accounts and generate customer quotes and orders.

Creating customers for life is a core value for the Reece Group and the Company has continued to listen to customer feedback and use these insights to improve products and services. The Reece Group has continued to invest in its insight gathering and innovation capability ensuring it will continue to meet and exceed customer expectations into the future through its innovation centre, NEXT.

During the year, the Reece Group has continued to invest in the core business. The cost of doing business excluding depreciation and amortisation increased by 101% to \$1.032m (2018: \$513.6m) due to the acquisition in the US and NZ and the continued investment in people and technology. Employee benefits expense was up 112% to \$635.6m (2018: \$299.7m). This reflects the continued investment in people, related to our acquisition-led growth and investment to develop our technology and service offering. Operating costs have continued to be well managed when taking into account the current economic environment and continued focus on investing in technology and innovation.

Following recent business acquisitions, the Reece Group has grown its international logistics and supply chain network. This logistics capability will continue to support the growing branch network in Australia, New Zealand and the United States. Inventory levels increased to \$955.7m, up 77% on the previous year (2018: \$540.6m), driven by the acquisitions and the introduction of new products and improved service levels. The Group continues to work closely with suppliers to manage and mitigate risk to the supply chain capabilities. Net working capital continues to be a focus for the business with the ratio decreasing from 21.6% to 20.7% at 30 June 2019.

The \$600m equity raising completed in May 2018 and debt raised through the US Term Loan B market was utilised to fund the acquisition of MORSCO. The debt is hedged for interest rate and foreign currency risk. The net debt position at 30 June 2019 was \$1,469m including the impact of derivative instruments. The leverage ratio (net debt divided by normalised EBITDA) decreased from 2.9 at 31 December 2018 to 2.8 at 30 June 2019. Operating cash flow increased from \$181m to \$255m during the year.

Property plant and equipment increased by 17% to \$664.0m (2018: \$568.7m) as a result of the investment in the branch network and assets acquired as part of the acquisitions in MORSCO and New Zealand.

The Reece Group in Australia and New Zealand will continue to focus on investing in people, products, technology and customer service. In the US, the focus is on developing the long-term strategy and culture and positioning the US business to take full advantage of the growth opportunities in the Sun-Belt region. The Reece Group is embracing innovation to drive change to deliver world-class, insight-led digital transformation across the business.

The Board has declared a final dividend of 14.25 cents per share fully franked. The final dividend will be paid on 30 October 2019 with the record date for entitlement of 9 October 2019. Total dividends paid and to be paid relating to the year ended 30 June 2019 will be 20.25 cents per share (2018: 20.25 cents per share), flat on the previous year.

Directors' Report

Significant changes in the state of affairs

In July 2018 the reporting entity acquired Patriot Supply Holdings, Inc and its controlled entities (MORSCO). MORSCO is a leading distributor of plumbing, waterworks and HVAC products operating in 16 states in North America.

After balance date events

No other matters or circumstances have arisen since the end of the financial year that have significantly affected, or may significantly affect, the operations of the Group.

Likely developments

The Group will continue to pursue its operating strategy to create shareholder value.

Environmental regulations

The Group's operations are subject to certain environmental regulations under a law of the Commonwealth or of a State. The Group is not aware of any significant breaches of environmental regulations during the year.

Dividends

Dividends paid or declared by Reece Limited since the end of the previous financial year were:

| | (\$000's) |
|---|-----------|
| Final dividend recommended: | 79,917 |
| The final dividend declared to be paid on 30 October 2019 is an ordinary fully franked dividend of 14.25 cents per share. | |
| Dividends paid during the year: | 33,649 |
| An interim ordinary fully franked dividend of 6 cents per share was paid on 28 March 2019. | |
| In respect of the previous financial year: | 79,917 |
| A final fully franked ordinary dividend of 14.25 cents per share in respect of the year ended 30 June 2018 was paid on 25 October 2018. | |
| | 113,566 |

Share options

No options over unissued shares or interests in the Group were granted during or since the end of the financial year and there were no options outstanding at the end of the financial year.

Indemnification and insurance of Directors, officers and auditors

A deed of indemnity, insurance and access has been entered into with each Director, and with the Company Secretary of the Group.

Reece has not, during or since the financial year, indemnified or agreed to indemnify the auditor of Reece Limited against a liability incurred as auditor.

During the financial year the Group paid a premium for Directors' and Officers' Liability insurance. Further disclosure is prohibited under the terms of the contract.

Proceedings on behalf of the Group

No person has applied for leave of Court to bring proceedings on behalf of the Group.

Reece Cares

Reece Group's new Corporate Social Responsibility strategy, Reece Cares, is the Company's approach to helping employees, customers and the community. Reece Cares takes a focused approach to driving change. Reece Cares empowers our employees to make a difference in four ways: through workplace giving, taking steps towards reconciliation, improving mental health, and through our three new charity partnerships.

Reece Gives

Reece Gives is the Group's workplace giving platform, allowing employees to make pre-tax donations to causes and charities important to them. Reece matches these donations up to \$500 each year per employee.

Reece Partners

The Reach Foundation, Baker Heart and Diabetes Institute and SANE Australia will work with the Company as part of Reece Partners to make a difference over three years.

Reece Wellness

Reece Wellness is the Group's approach to mental health and wellbeing to support employees and customers.

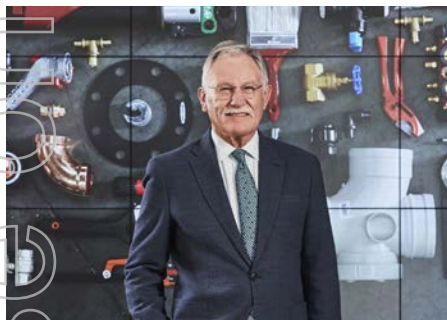
Reece Reconciliation

Reece Reconciliation is the Group's two-year Reconciliation Action Plan to improve the lives of customers and employees by supporting Aboriginal and Torres Strait Islander Peoples, businesses and communities.

Reece Cares works hand-in-hand with The Reece Grant, Reece's external grant program supporting tradies who volunteer their time to give back to community projects locally and abroad. Together the two programs create even more opportunities to make a difference.

Directors' Report

Information on Directors & Company Secretary



Mr L. Alan Wilson

Executive Chairman

Appointed to the Board 1969
 General Manager 1970 – 1974
 Deputy Chairman 1973 – 2001
 Managing Director 1974 – 2008
 Chairman 2001 – 2008
 Appointed Executive Chairman 2008

No other Directorships of listed companies were held at any time during the three years prior to 30 June 2019.



Mr Peter J. Wilson

Chief Executive Officer & Managing Director

B.Comm (Melb), FAIM
 Appointed to the Board 1997
 General Manager Operations 2002 – 2004
 Chief Operating Officer 2005 – 2007
 Appointed Chief Executive Officer / Managing Director 2008

No other Directorships of listed companies were held at any time during the three years prior to 30 June 2019.



Mr Timothy M. Poole

Non-Executive Director

B.Comm (Melb), CA
 Appointed to the Board July 2016

Chairman of Audit Committee
 Chairman of Remuneration Committee

Aurizon Holdings Limited
 McMillan Shakespeare Limited
 Lifestyle Communities Limited
 (ceased August 2019)



Mr Bruce C. Wilson

Non-Executive Director

B.Comm (La Trobe)
 Appointed to the Board September 2016

Member of Audit Committee
 Member of Remuneration Committee

No other Directorships of listed companies were held at any time during the three years prior to 30 June 2019.



Ms Megan L. Quinn

Non-Executive Director

GAICD
 Appointed to the Board 2017

Member of Remuneration Committee

City Chic Collective Limited
 InvoCare Limited
 Zip Co Limited (ceased November 2017)

Directors' Report



Mr Ronald G. Pitcher, AM

Non-Executive Director

FCA, FCPA, ACAA.
Appointed to the Board 2003

Member of Audit Committee
Member of Remuneration Committee

No other Directorships of listed companies were held at any time during the three years prior to 30 June 2019.

Mr. R.G. Pitcher retired effective 31 October 2018.



Mr Bruce W.C. Wilson

Non-Executive Director

B.Comm (Melb).
Appointed to the Board 1970
Secretary 1974 – 1999

Member of Audit Committee
Member of Remuneration Committee

No other Directorships of listed companies were held at any time during the three years prior to 30 June 2019.

Mr. B.W.C Wilson retired effective 31 August 2018.



Ms Georgina Williams

Non-Executive Director

B.Comm, B.A. (Melb)
Appointed to the Board 2017

Member of Audit Committee

Lifestyle Communities Limited
Sunsuper



Mr Andrew W. Wilson

Non-Executive Director

Appointed to the Board September 2018

B.Bus (RMIT)
ACMA / CGMA
GAICD

Member of Remuneration Committee
Member of Audit Committee

No other Directorships of listed companies were held at any time during the three years prior to 30 June 2019



Mr Gavin W. Street

Company Secretary & Chief Financial Officer

B.Bus, B.Comp (Monash), CPA
Appointed Company Secretary & Chief Financial Officer 2008 – 2017
Chief Digital & Data Officer 2017 – 2018
Appointed Company Secretary & Chief Financial Officer 23 July 2018

Directors' Report

Directors' meetings

The number of meetings of the Board of Directors and of each Board Committee held during the financial year and the number of meetings attended by each Director were:

| Director | Number of Directors meetings attended | Number of Directors meetings held whilst in office |
|----------------------------|---------------------------------------|--|
| L.A. Wilson | 11 | 11 |
| P.J. Wilson | 10 | 11 |
| T.M. Poole | 11 | 11 |
| B.C. Wilson | 11 | 11 |
| M.L. Quinn | 11 | 11 |
| G. Williams | 11 | 11 |
| A.W. Wilson | 9 | 9 |
| B.W.C. Wilson (retired) | 2 | 2 |
| R.G. Pitcher, AM (retired) | 4 | 4 |

| Director | Number of audit committee meetings attended | Number of audit committee meetings held whilst in office |
|----------------------------|---|--|
| T.M. Poole | 6 | 6 |
| B.C. Wilson | 6 | 6 |
| G. Williams | 6 | 6 |
| A.W. Wilson | 4 | 5 |
| B.W.C. Wilson (retired) | 1 | 1 |
| R.G. Pitcher, AM (retired) | 1 | 1 |

| Director | Number of remuneration committee meetings attended | Number of remuneration committee meetings held whilst in office |
|----------------------------|--|---|
| T.M. Poole | 7 | 7 |
| B.C. Wilson | 5 | 5 |
| M.L. Quinn | 7 | 7 |
| A.W. Wilson | 4 | 5 |
| B.W.C. Wilson (retired) | 2 | 2 |
| R.G. Pitcher, AM (retired) | 2 | 2 |

Directors' interests in contracts

Directors' interests in contracts are disclosed in the remuneration report.

Auditor's independence declaration

A copy of the auditor's independence declaration as required under section 307C of the *Corporations Act 2001* in relation to the audit for the financial year is provided with this report.

Directors' Report

Non-audit services

Non-audit services are approved by resolution of the Audit Committee to the Board. Non-audit services provided by the auditors of the Group during the year, KPMG, are detailed below. The Directors are satisfied that the provision of the non-audit services during the year by the auditor is compatible with the general standard of independence for auditors imposed by the *Corporations Act 2001*.

Amounts paid or payable to an auditor for non-audit services provided during the year by the auditor to any entity that is part of the Group are detailed below:

| | 2019 \$ | 2018 \$ |
|--|------------|------------|
| Amounts paid and payable to KPMG (2018: Pitcher Partners) for non-audit services: | | |
| Taxation services | 293,110 | 787,565 |
| Other services | - | 328,813 |
| Other services (network firms) | - | 10,645 |
| | 293,110 | 1,127,023 |

Rounding of amounts

The parent entity and the Group have applied the relief available under ASIC Corporations (Rounding in Financial/Directors' Reports) Instrument 2016/191 and accordingly, the amounts in the consolidated financial statements and in the Directors' report have been rounded to the nearest thousand dollars, or in certain cases, to the nearest dollar (where indicated).

Remuneration Report (Audited)

Remuneration report overview

The Directors of Reece Ltd present the Remuneration Report (the Report) for the consolidated entity consisting of Reece Limited and the entities it controlled (the Group) for the year ending 30 June 2019. This report forms part of the Directors' Report and has been audited in accordance with section 300A of the *Corporations Act 2001*. The Report details the remuneration arrangements for the Company's key management personnel (KMP): Non-Executive Directors, Executive Directors and senior executives.

KMP are those persons who, directly or indirectly, have authority and responsibility for planning, directing and controlling the major activities of the Group.

The table below details the KMPs for 2019.

| Name | Position | Term as KMP |
|---------------------------|--|--|
| Directors | | |
| Mr L. Alan Wilson | Executive Chairman | Full financial year |
| Mr Peter J. Wilson | Group Chief Executive Officer (CEO) and Managing Director (MD) | Full financial year |
| Mr Tim M. Poole | Non-Executive Director | Full financial year |
| Mr Bruce C. Wilson | Non-Executive Director | Full financial year |
| Ms Megan L. Quinn | Non-Executive Director | Full financial year |
| Ms Georgina Williams | Non-Executive Director | Full financial year |
| Mr Andrew W. Wilson | Non-Executive Director | Appointed 1 September 2018 |
| Mr Bruce W.C. Wilson | Non-Executive Director | Ceased 31 August 2018 |
| Mr Ronald G. Pitcher (AM) | Non-Executive Director | Ceased 25 October 2018 |
| Executives | | |
| Mr Gavin W. Street | Chief Data and Digital Officer Group Chief Financial Officer (CFO) of Reece Ltd | 1 July 2018 – 23 July 2018 Appointed 23 July 2018 |
| Mr Claude A.S. Hornsby | MORSCO Chief Executive Officer (CEO) | Appointed 2 July 2018 |
| Mr Sasha Nikolic | Chief Financial Officer (CFO) of Reece Ltd | Ceased 23 July 2018 |
| Mr Adrian Palumbo | Chief Marketing and Supply Officer | Ceased 2 July 2018 |

Remuneration policy

Remuneration of the Directors and senior executives is the responsibility of the Remuneration Committee. The remuneration policy is closely aligned to Reece's purpose and business strategy. The key principles are:

- Aligning remuneration packages with Reece's business strategy to achieve beneficial outcomes for customers, shareholders and employees;
- Providing a clear and transparent link between performance and rewards;
- Driving behaviours to create a culture that promotes safety, diversity and employee satisfaction;
- Ensuring remuneration packages attract and retain the right people for the Reece business.

The Remuneration Committee undertakes benchmarking in comparing the Director and senior executives' remuneration levels with a comparative group of companies.

Remuneration Report (Audited)

Remuneration – Non-Executive Directors

Non-Executive Directors fees include base fees and committee fees. The committee fees reflect the additional time commitment required for Board committees which they may serve on from time to time. The maximum aggregate amount of remuneration payable to Non-Executive Directors (other than Managing Director or any Executive Director in the full-time employment of the company) is \$1,000,000. This was approved by the shareholders at the 2016 Annual General Meeting.

Non-Executive Directors are not entitled to receive any performance-based incentives, non-cash benefits or retirement benefits other than statutory superannuation.

There is no scheme to provide Non-Executive Directors with retirement benefits other than statutory superannuation.

The table below sets out the fees for the Non-Executive Directors:

| Base | Annual fee* |
|--|-------------|
| Non-Executive Director – Substantial Shareholder | \$90,000 |
| Non-Executive Director | \$110,000 |
| Committee | |
| Audit Committee Chair | \$40,000 |
| Remuneration Committee Chair | \$30,000 |
| Audit & Remuneration Committees – excluding Substantial Shareholders** | \$15,000 |
| MORSCO Board of Managers | \$50,000 |

* Annual fee is inclusive of superannuation

** Substantial shareholders fees are capped at \$90,000

Remuneration – Executive Chairman

The Executive Chairman receives a salary, non-cash benefits and superannuation contributions. The majority of the non-cash benefits relates to the provision of a motor vehicle. The Executive Chairman does not participate in any performance-based incentive.

Apart from statutory termination benefits, which include accrued leave entitlements, there are no arrangements in place to provide the Executive Chairman with any additional retirement benefits.

Remuneration – Group Chief Executive Officer and other Key Management Personnel

The Group CEO receives short term incentives, non-cash benefits and superannuation contributions. The MORSCO CEO receives short-term incentives, long-term incentives, non-cash benefits, health benefits and superannuation benefits. The Group CFO receives short-term incentives and superannuation contributions.

Remuneration Report (Audited)

Apart from statutory termination benefits, which include accrued leave entitlements, there are no arrangements in place to provide the Group CEO or any other executive with any additional retirement benefits.

The Group CEO and Group CFO have employment contracts with notice periods executable by either party. The Group is required to give the Group CEO 12 months' notice of termination and the Group CEO is required to provide six months' notice on resignation. The MORSCO CEO has a two-year employment contract that will automatically extend for successive one-year periods with either party able to elect to not extend the employment contract. The employment contract requires a 90-day notice on resignation. The employment contracts for the Group CEO, MORSCO CEO and Group CFO all have restraint provisions.

The salary for the CEOs and other executives reflects their roles, experience and level of responsibility. Salaries are reviewed and benchmarked to a comparable group by the Remuneration Committee.

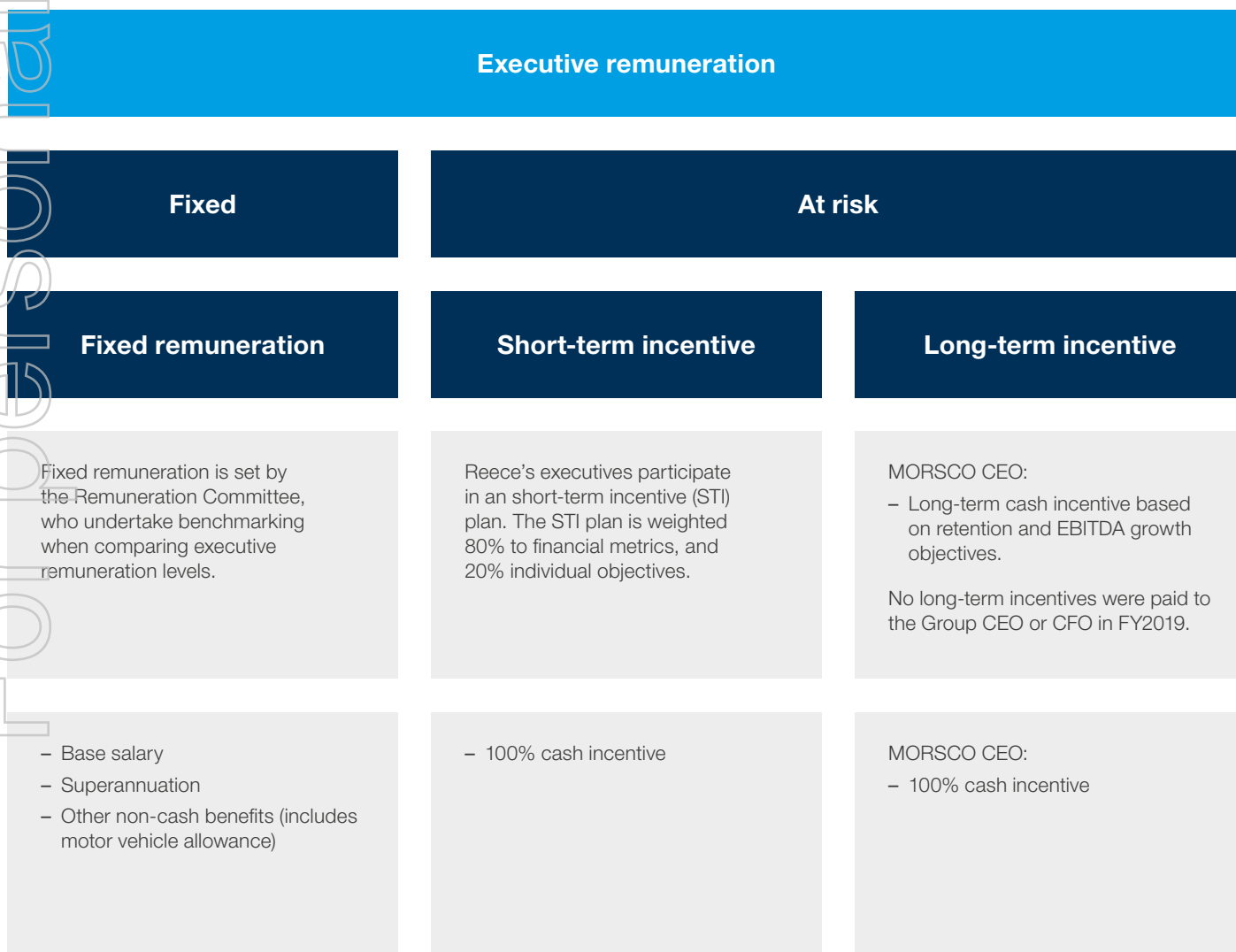
Non-cash benefits were received by the Group CEO and MORSCO CEO. The majority of the benefit related to the provision of a motor vehicle. The Group CFO did not receive any non-cash benefits.

Total reward framework

The Reward Framework is reviewed annually by the Remuneration Committee and presented to the Board for approval.

The core elements of the Group's executive remuneration strategy are outlined below.

Figure 1: Group's remuneration strategy and structure



Remuneration Report (Audited)

Incentives

| Executive | Fixed | STI | LTI | Total |
|------------|-------|-------|-------|-------|
| Group CEO | 50% | 50% | - | 100% |
| Group CFO | 66.7% | 33.3% | - | 100% |
| MORSCO CEO | 33.4% | 33.3% | 33.3% | 100% |

The Group CEO's performance-based short-term incentive is calculated on 100% (2018:100%) of base salary with a ceiling of 150% (2018:150%) for exceptional performance. The scheme provides for no payment in the event the minimum performance targets, as set by the Remuneration Committee annually, are not met. The Board approves the final STIs based on assessment of performance and this is paid within 90 days of the annual report being lodged and finalised.

The Group CFO's performance-based short-term incentive is calculated on 50% (2018:50%) of base salary with a ceiling of 75% (2018:75%) and is structured around the same company performance criteria as the Group CEO, it provides for no payment in the event the minimum performance targets, as set by the Remuneration Committee annually are not met.

Short-term incentives are a cash only payment based on financial and non-financial metrics as assessed by the Board.

The targets are set by the Board at the beginning of the financial year. The metrics include the following measures:

| Measure | Description of measure |
|--------------------|---|
| Business growth | Normalised EBITDA* Performance |
| Financial | Normalised EBITDA* to Sales Net Debt to Normalised EBITDA* Earnings per Share |
| Individual targets | Board assessment against individual targets |

*Normalised EBITDA is earnings before interest, tax, depreciation, finance income, amortisation and has been adjusted to exclude the impact of significant items including business acquisition and fair value inventory un-wind costs.

The Non-Executive Directors and Executive Chairman do not receive any short-term incentives.

Remuneration Report (Audited)

MORSCO acquisition

On 2 July 2018 the Group acquired MORSCO, a leading US distributor of plumbing, waterworks and heating and cooling products. The MORSCO CEO continued in his role post-acquisition and the Remuneration Committee developed short and long-term incentive programs with the dual purpose of employee retention through the transition phase and stretch targets for long-term growth of the MORSCO business.

The MORSCO CEO received a transition short-term incentive which included a calendar year 2018 ("2018 Calendar Year") bonus and a second-half FY 2019 ("2H FY2019") short-term incentive based on the period from 1 January 2019 to 30 June 2019.

1 January 2018 - 31 December 2018

Transition STI - 2018 Calendar Year

1 January 2019 - 30 June 2019

2H FY2019 STI

The 2018 Calendar Year incentive is based on a target bonus amount approved by the Remuneration Committee, calculated on financial targets (75%) based on EBITDA performance and individual objectives as assessed by the Board (25%). The 2018 Calendar Year bonus was capped at the bonus amount agreed by the Remuneration Committee.

The 2H FY2019 short-term incentive plan is calculated on 50% of base salary with a ceiling of 75% of the base salary and provides for no payment in the event the minimum performance targets, as set by the Remuneration Committee annually, are not met. The 2H FY2019 short-term incentive plan was calculated on financial targets (75%) based on EBITDA and sales performance and individual objectives as assessed by the Board (25%). The 2018 Calendar Year bonus was capped at the bonus amount agreed by the Remuneration Committee.

Long-term incentives

Group long-term incentives

The Group CEO and Group CFO did not have a long-term incentive (LTI) plan in FY 2019. The Remuneration Committee has undertaken a review of the Executives' remuneration packages to ensure they remain fit for purpose, aligned to Australian market practice, and reflect the desire to incentivise the Executives to deliver long-term sustainable growth for the Company. The review concluded that it would be appropriate to introduce an annual long-term incentive to better align the remuneration packages to the long-term growth objectives of the Reece Group and shareholders.

The Reece Group LTI plan will be presented at the 2019 Annual General Meeting for shareholder approval. The Key elements of the plan are listed below:

| | |
|-----------------------------|---|
| LTI Award structure | <p>The plan structure will be either performance-based options (Share Options) or Loan Funded shares (Loan Shares).</p> <p>Share Options is an entitlement to receive a share upon the satisfaction of vesting conditions. Share Options have the flexibility to settle in shares or cash.</p> <p>Loan Shares will be fully or partly funded through a limited recourse loan. The Loan is interest free and the acquisition price is the market price of Shares at the time of grant. The Loan Shares will be forfeited if the vesting conditions are not satisfied.</p> |
| Performance measures | <p>The LTI award has an Earnings Per Share (EPS) performance measure. EPS is measured on a compound annual growth rate (CAGR) over a five-year period.</p> <p>Vesting is scaled between the threshold and stretch performance:</p> <ul style="list-style-type: none"> - Below threshold CAGR EPS of 5%: 0% vests. - Threshold CAGR EPS of 5%: 50% vests. - Stretch CAGR EPS of 10%: 100% vests. <p>The Board may, at its discretion, adjust the EPS calculation from time to time to exclude the effects of extraordinary events, material business acquisitions or divestments for certain one-off costs.</p> |
| Vesting period | <p>The LTI Award has a five-year performance period. Any awards that are eligible to vest after the five-year performance period have a further two-year disposal restriction in place that prohibits the Executive from exercising and selling the resulting shares. Once the disposal restriction period ends, the vested Options may be exercised at any time up to the 15-year expiry date (from date of grant) at the election of the Executive.</p> |

Remuneration Report (Audited)

MORSCO long-term cash incentives

The MORSCO CEO's long-term Cash Incentive plan is for a three-year period ending 30 June 2021 and based on 100% of base salary with a ceiling of 150% for exceptional performance. The long-term incentive cash plan is based on financial metrics (50%) and retention (50%). The growth metrics are based on achieving EBITDA and sales revenue targets approved by the Remuneration Committee and Board. The plan provides for no payment in the event the minimum performance targets are not met or the executive resigns from the company prior to the 30 June 2021.

Executive business performance objectives and outcomes for 2019

The individual KPIs and 2019 achievement as determined by the Board for the Group CEO and Group CFO are as below. The metrics are consistent with prior years, and 2019 includes MORSCO as part of the Group results:

| Relationship between remuneration and company performance | 2019 \$(000s) | 2018 \$(000s) | 2017 \$(000s) | 2016 \$000s) | 2015 \$(000s) |
|--|------------------|------------------|------------------|-----------------|------------------|
| Sales revenue | 5,463,787 | 2,688,576 | 2,429,307 | 2,276,353 | 2,085,128 |
| Earnings before interest, tax, depreciation and amortisation | 521,950* | 378,323 | 358,904 | 335,045 | 281,622 |
| Net profit before tax | 202,100 | 224,620 | 211,791 | 192,218 | 165,556 |
| Dividends declared | 113,566 | 109,797 | 99,600 | 91,632 | 75,696 |
| Performance based incentives to KMP | 3,973 | 4,075 | 2,982 | 2,454 | 2,179 |
| | 2019 | 2018 | 2017 | 2016 | 2015 |
| | \$ | \$ | \$ | \$ | \$ |
| Share price at year-end | 9.76 | 12.65 | 8.31 | 7.32 | 6.86 |

*Normalised EBITDA is earnings before interest, tax, depreciation, finance income, amortisation and has been adjusted to exclude the impact of significant items including business acquisition and fair value inventory un-wind costs.

Other transactions and balances with KMP and their related parties

Apart from the details disclosed below, no Director or senior executive has entered into a material contract with Reece or the consolidated entity since the end of the previous financial year and there were no material contracts involving Directors' or senior executives' interests existing at year end.

Director of Reece Ltd., Mr B.C. Wilson has a beneficial interest in an entity that sold plumbing and building supplies to the consolidated entity. All dealings are in the ordinary course of business and on normal terms and conditions. Goods purchased from this entity during the year total \$4,640,240 (2018: \$4,780,263) of which \$355,922 (2018: \$431,937) was owing at year end.

Director of Reece Ltd., Mr. L.A. Wilson has a beneficial interest in entities that lease premises to the consolidated entity. All dealings with these entities are in the ordinary course of business and on normal terms and conditions no more favourable than those which would have been expected if dealing at arm's length in the same circumstances. Lease rentals paid to these entities during the year were \$1,250,164 (2018: \$1,235,029).

Remuneration Report (Audited)

| Directors | Salary & fees | Short-term performance based payment | Long-term performance based payment | Other non-cash benefits | Super contributions | Total | Total performance related |
|--|---------------|--------------------------------------|-------------------------------------|-------------------------|---------------------|-----------|---------------------------|
| | \$ | \$ | \$ | \$ | \$ | \$ | % |
| L.A. Wilson (Executive Chairman) | | | | | | | |
| 2019 | 1,415,736 | - | - | 46,816 | 19,264 | 1,481,816 | 0% |
| 2018 | 1,412,868 | - | - | 50,596 | 22,132 | 1,485,596 | 0% |
| P.J. Wilson (Group Chief Executive Officer) | | | | | | | |
| 2019 | 2,100,846 | 2,444,277 | - | 131,422 | 25,000 | 4,701,545 | 52% |
| 2018 | 1,983,047 | 3,001,209 | - | 125,750 | 25,000 | 5,135,006 | 58% |
| T.M. Poole (Non-Executive) | | | | | | | |
| 2019 | 162,100 | - | - | - | 15,400 | 177,500 | 0% |
| 2018 | 114,155 | - | - | - | 10,845 | 125,000 | 0% |
| B.C. Wilson (Non-Executive) | | | | | | | |
| 2019 | 82,192 | - | - | - | 7,808 | 90,000 | 0% |
| 2018 | 82,192 | - | - | - | 7,808 | 90,000 | 0% |
| M.L. Quinn (Non-Executive) | | | | | | | |
| 2019 | 114,155 | - | - | - | 10,845 | 125,000 | 0% |
| 2018 | 95,129 | - | - | - | 9,037 | 104,166 | 0% |
| G. Williams (Non-Executive) | | | | | | | |
| 2019 | 114,155 | - | - | - | 10,845 | 125,000 | 0% |
| 2018 | 95,129 | - | - | - | 9,037 | 104,166 | 0% |
| A. W. Wilson (Non-Executive) | | | | | | | |
| 2019 | 68,493 | - | - | - | 6,507 | 75,000 | 0% |
| 2018 | - | - | - | - | - | - | - |
| B.W.C Wilson (Non-Executive/retired) | | | | | | | |
| 2019 | 13,699 | - | - | - | 1,301 | 15,000 | 0% |
| 2018 | 82,192 | - | - | - | 7,808 | 90,000 | 0% |
| R.G. Pitcher, AM (Non-Executive/retired) | | | | | | | |
| 2019 | 47,184 | - | - | - | 4,483 | 51,667 | 0% |
| 2018 | 141,553 | - | - | - | 13,448 | 155,001 | 0% |
| A.T. Gorecki (Non-Executive/retired) | | | | | | | |
| 2019 | - | - | - | - | - | - | 0% |
| 2018 | 16,743 | - | - | - | 1,591 | 18,334 | 0% |
| Total Remuneration: Directors | | | | | | | |
| 2019 | 4,118,560 | 2,444,277 | - | 178,238 | 101,453 | 6,842,528 | 36% |
| 2018 | 4,023,008 | 3,001,209 | - | 176,346 | 106,706 | 7,307,269 | 41% |

Remuneration Report (Audited)

| Executives | Salary & fees | Short-term performance based payment | Long-term performance based payment | Other non-cash benefits | Super contributions | Total | Total performance related |
|--|---------------|--------------------------------------|-------------------------------------|-------------------------|---------------------|-----------|---------------------------|
| | \$ | \$ | \$ | \$ | \$ | \$ | % |
| G.W. Street (Company Secretary & Chief Financial Officer) | | | | | | | |
| 2019 | 713,848 | 273,536 | - | - | 27,083 | 1,014,467 | 27% |
| 2018 | 684,114 | 404,116 | - | - | 25,000 | 1,113,230 | 36% |
| C. A.S. Hornsby (MORSCO Chief Executive Officer) | | | | | | | |
| 2019 | 838,809 | 687,668 | 567,693 | 9,202 | 38,376 | 2,141,748 | 59% |
| S. Nikolic (Chief Financial Officer to 2018) | | | | | | | |
| 2019 | 269,863 | - | - | - | 4,167 | 274,030 | 0% |
| 2018 | 489,750 | 367,500 | - | - | 25,000 | 882,250 | 42% |
| A. Palumbo (Chief Marketing & Supply Officer) | | | | | | | |
| 2019 | - | - | - | - | - | - | - |
| 2018 | 468,083 | 301,776 | - | - | 56,983 | 826,842 | 36% |
| Total Remuneration: Executives | | | | | | | |
| 2019 | 1,822,520 | 961,204 | 567,693 | 9,202 | 69,626 | 3,430,245 | 45% |
| 2018 | 1,641,947 | 1,073,392 | - | - | 106,983 | 2,822,322 | 38% |

"Executives" are those persons having authority and responsibility for planning, directing and controlling the activities of the entity, directly or indirectly, including any Director (whether executive or otherwise) of that entity. Being a working Board, decisions and directions are exercised through the Board and accordingly, there are two employees in addition to the Directors who are in this category.

Mr. S. Nikolic held the role of CFO of the Reece Group until 23rd July 2018, when he transferred to MORSCO to take up the role of Chief Transformation Officer reporting to the MORSCO CEO. The payments made to Mr. S. Nikolic in FY 2019 included payout for annual leave and long service leave.

Mr. A. Palumbo was a KMP in FY 2018 and due to change in operations from the acquisition of MORSCO is no longer a KMP in FY19.

Directors' shareholdings as at 30 June 2019

| 2019 Director | Ordinary Shares of Reece Limited | | | | |
|----------------------------|----------------------------------|-------------------------|------------------------------|-------|-----------------|
| | Opening balance | Share split restatement | Non-renounceable right issue | Other | Closing balance |
| L.A. Wilson | 348,182,564 | - | - | - | 348,182,564 |
| P.J. Wilson | 17,334,300 | - | - | - | 17,334,300 |
| T.M. Poole | 7,924 | - | - | - | 7,924 |
| B.C. Wilson | 16,911,800 | - | - | - | 16,911,800 |
| M.L. Quinn | - | - | - | - | - |
| G. Williams | - | - | - | - | - |
| A.W. Wilson | 19,109,638 | - | - | - | 19,109,638 |
| B.W.C. Wilson (retired) | 334,692,138 | - | - | - | 334,692,138 |
| R.G. Pitcher, AM (retired) | 169,774 | - | - | - | 169,774 |

No other KMPs had shareholdings at 30 June 2019.

Remuneration Report (Audited)

| 2018 Director | Ordinary Shares of Reece Limited | | | | |
|----------------------------|----------------------------------|----------------------------|---------------------------------|----------|--------------------|
| | Opening balance | Share split restatement | Non-renounceable right issue | Other | Closing balance |
| L.A. Wilson | 66,625,820 | 333,129,100 | 15,053,464 | - | 348,182,564 |
| P.J. Wilson | 3,466,860 | 17,334,300 | - | - | 17,334,300 |
| T.M. Poole | 1,400 | 7,000 | 924 | - | 7,924 |
| B.C. Wilson | 3,382,360 | 16,911,800 | - | - | 16,911,800 |
| M.L. Quinn | - | - | - | - | - |
| G. Williams | - | - | - | - | - |
| A.W. Wilson | 19,109,638 | - | - | - | 19,109,638 |
| B.W.C. Wilson (retired) | 66,508,320 | 332,541,600 | 2,150,538 | - | 334,692,138 |
| R.G. Pitcher, AM (retired) | 30,000 | 150,000 | 19,774 | - | 169,774 |
| A.T. Gorecki (retired) | 13,000 | 65,000 | 5,538 | (30,538) | 40,000 |

At our most recent Annual General Meeting, resolution to adopt the prior year remuneration was put to the vote and at least 75% of "yes" votes were cast for adoption of the report. No comments were made on the remuneration report requiring consideration at the Annual General Meeting.

This concludes the Remuneration Report (Audited).

Dated at Melbourne on 28 August 2019.

Signed in accordance with a resolution of Directors.



L.A. Wilson
Executive Chairman



P.J. Wilson
Group Chief Executive Officer

Auditor's Independence Declaration

For personal use only



Lead Auditor's Independence Declaration under Section 307C of the Corporations Act 2001

To the Directors of Reece Limited

I declare that, to the best of my knowledge and belief, in relation to the audit of Reece Limited for the financial year ended 30 June 2019 there have been:

- i. no contraventions of the auditor independence requirements as set out in the *Corporations Act 2001* in relation to the audit; and
- ii. no contraventions of any applicable code of professional conduct in relation to the audit.


KPMG

BW Szentirmay

Partner

Melbourne

28 August 2019

For the year ended 30 June 2019

Consolidated Statement of Profit or Loss and Other Comprehensive Income

| Revenue | Notes | Consolidated Entity | |
|---|-------|---------------------|-------------------|
| | | 2019 (\$000's) | 2018 (\$000's) |
| Sales revenue | 4 | 5,463,787 | 2,688,576 |
| Other income | 4 | 8,026 | 2,780 |
| | | 5,471,813 | 2,691,356 |
| Less: Expenses | | | |
| Cost of sales | | 3,926,427 | 1,799,481 |
| Employee benefits expense | | 635,587 | 299,730 |
| Depreciation and amortisation | | 128,072 | 53,847 |
| Business acquisition costs | | 28,516 | - |
| Other expenses | | 396,831 | 213,822 |
| | | 5,115,433 | 2,366,880 |
| Operating profit | | 356,380 | 324,476 |
| Finance income | 14 | 23,948 | - |
| Finance cost | 14 | (83,304) | (5,035) |
| Profit before income tax expense | | 297,024 | 319,441 |
| Income tax expense | 5 | 94,924 | 94,821 |
| Net profit for the year | | 202,100 | 224,620 |
| Other comprehensive income | | | |
| Items that may be reclassified subsequently to profit or loss: | | | |
| Exchange differences on translation of foreign operations, net of tax | | 82,839 | (1,204) |
| Change in fair value of effective cash flow hedges, net of tax | | (61,131) | 5,328 |
| Total comprehensive income | | 223,808 | 228,744 |
| Basic earnings per share | 23 | 36 cents | 45 cents |
| Diluted earnings per share | 23 | 36 cents | 45 cents |

The Consolidated Statement of Profit or Loss and Other Comprehensive Income is to be read in conjunction with the notes to the financial statements set out on pages 56 to 85.

For the year ended 30 June 2019

Consolidated Statement of Financial Position

| | Notes | Consolidated Entity | |
|--------------------------------------|-------|---------------------|-------------------|
| | | 2019 (\$000's) | 2018 (\$000's) |
| Current assets | | | |
| Cash and cash equivalents | 8 | 127,707 | 539,891 |
| Trade and other receivables | 9 | 875,324 | 405,733 |
| Inventories | 10 | 955,711 | 540,564 |
| Derivative financial instruments | 17 | 2,209 | 4,479 |
| Total current assets | | 1,960,951 | 1,490,667 |
| Non-current assets | | | |
| Property, plant and equipment | 11 | 664,009 | 568,714 |
| Intangible assets | 12 | 1,772,166 | 225,741 |
| Deferred tax assets | 5 | 39,263 | 39,125 |
| Derivative financial instruments | 17 | 37,721 | - |
| Total non-current assets | | 2,513,159 | 833,580 |
| Total assets | | 4,474,110 | 2,324,247 |
| Current liabilities | | | |
| Trade and other payables | 13 | 699,893 | 369,557 |
| Interest bearing liabilities | 17 | 16,256 | - |
| Current tax payable | 5 | 1,555 | 7,624 |
| Provisions | 15 | 66,808 | 60,013 |
| Derivative financial instruments | 17 | 8,680 | - |
| Total current liabilities | | 793,192 | 437,194 |
| Non-current liabilities | | | |
| Long-term payables | 13 | 29,335 | 2,212 |
| Interest bearing liabilities | 17 | 1,593,041 | - |
| Deferred tax liabilities | 5 | 43,777 | - |
| Provisions | 15 | 5,008 | 4,003 |
| Derivative financial instruments | 17 | 18,177 | - |
| Total non-current liabilities | | 1,689,338 | 6,215 |
| Total liabilities | | 2,482,530 | 443,409 |
| Net assets | | 1,991,580 | 1,880,838 |
| Equity | | | |
| Contributed equity | 19 | 604,849 | 604,349 |
| Reserves | 20 | 29,580 | 7,872 |
| Retained earnings | | 1,357,151 | 1,268,617 |
| Total equity | | 1,991,580 | 1,880,838 |

The Consolidated Statement of Financial Position is to be read in conjunction with the notes to the financial statements set out on pages 56 to 85.

For the year ended 30 June 2019

Consolidated Statement of Changes in Equity

| | Consolidated Entity | | | |
|---|-----------------------|---------------|----------------------|------------------|
| | Contributed equity | Reserves | Retained earnings | Total equity |
| | (\$000's) | (\$000's) | (\$000's) | (\$000's) |
| Balance as at 1 July 2017 | 9,960 | 3,748 | 1,144,593 | 1,158,301 |
| Profit for the year | - | - | 224,620 | 224,620 |
| Exchange differences on translation of foreign operations, net of tax | - | (1,204) | - | (1,204) |
| Change in fair value of effective cash flow hedges, net of tax | - | 5,328 | - | 5,328 |
| Total comprehensive income for the year | - | 4,124 | 224,620 | 228,744 |
| Transactions with owners in their capacity as owners: | | | | |
| Additional contributed equity | 594,389 | - | - | 594,389 |
| Dividends paid | - | - | (100,596) | (100,596) |
| Total transactions with owners in their capacity as owners | 594,389 | - | (100,596) | 493,793 |
| Balance as at 30 June 2018 | 604,349 | 7,872 | 1,268,617 | 1,880,838 |
| Balance as at 1 July 2018 | 604,349 | 7,872 | 1,268,617 | 1,880,838 |
| Profit for the year | - | - | 202,100 | 202,100 |
| Exchange differences on translation of foreign operations, net of tax | - | 82,839 | - | 82,839 |
| Change in fair value of effective cash flow hedges, net of tax | - | (61,131) | - | (61,131) |
| Total comprehensive income for the year | - | 21,708 | 202,100 | 223,808 |
| Transactions with owners in their capacity as owners: | | | | |
| Additional contributed equity | - | - | - | - |
| Dividends paid | - | - | (113,566) | (113,566) |
| Total transactions with owners in their capacity as owners | - | - | (113,566) | (113,566) |
| Other movements | 500 | - | - | 500 |
| Balance as at 30 June 2019 | 604,849 | 29,580 | 1,357,151 | 1,991,580 |

The Consolidated Statement of Changes in Equity is to be read in conjunction with the notes to the financial statements set out on pages 56 to 85.

For the year ended 30 June 2019

Consolidated Statement of Cash Flows

| | Notes | Consolidated Entity | |
|---|-----------|---------------------|-------------------|
| | | 2019 (\$000's) | 2018 (\$000's) |
| Cash flow from operating activities | | | |
| Receipts from customers | | 5,446,191 | 2,926,274 |
| Payments to suppliers and employees | | (5,018,635) | (2,633,037) |
| Interest received | | 1,637 | 1,987 |
| Finance costs | | (82,376) | (5,753) |
| Income tax paid | | (92,351) | (108,546) |
| Net cash provided by operating activities | 21 | 254,466 | 180,925 |
| Cash flow from investing activities | | | |
| Purchase of property, plant and equipment | | (99,199) | (88,244) |
| Proceeds from sale of property, plant and equipment | | 10,382 | 5,662 |
| Purchase of intangibles | | (5,329) | - |
| Purchase of controlled entities, net of cash acquired | | (2,001,442) | (54,050) |
| Net cash used in investing activities | | (2,095,588) | (136,632) |
| Cash flow from financing activities | | | |
| Proceeds from borrowings | | 1,771,568 | 182,000 |
| Repayments of borrowings | | (230,938) | (282,000) |
| Proceeds from capital raising | | - | 594,389 |
| Dividends paid | | (113,566) | (100,596) |
| Net cash provided by financing activities | | 1,427,064 | 393,793 |
| Net (decrease)/ Increase in cash and cash equivalents | | (414,058) | 438,086 |
| Net foreign exchange translation difference | | 1,874 | - |
| Cash and cash equivalents at the beginning of the year | | 539,891 | 101,805 |
| Cash and cash equivalents at the end of the year | 8 | 127,707 | 539,891 |

The Consolidated Statement of Cash Flows is to be read in conjunction with the notes to the financial statements set out on pages 56 to 85.

To the financial statements for the year ended 30 June 2019

Notes

1. Statement of significant accounting policies

The following is a summary of significant accounting policies adopted by the Group in the preparation and presentation of the financial report. The accounting policies have been consistently applied, unless otherwise stated.

(a) Basis of preparation of the financial report

The financial report is a general purpose financial report that has been prepared in accordance with Australian Accounting Standards, Interpretations and other authoritative pronouncements of the Australian Accounting Standards Board and the *Corporations Act 2001*.

The financial report covers Reece Limited and controlled entities as a Group. Reece Limited is a company limited by shares, incorporated and domiciled in Australia. Reece Limited is a for-profit entity for the purpose of preparing the financial statements.

The financial report was authorised for issue in accordance with a resolution of the Directors on 28 August 2019.

Compliance with IFRS

The consolidated financial statements of Reece Limited also comply with the International Financial Reporting Standards (IFRS) issued by the International Accounting Standards Board (IASB).

Historical Cost Convention

The financial report has been prepared under the historical cost convention, as modified by revaluations to fair value for certain classes of assets as described in the accounting policies.

(B) Principles of consolidation

The consolidated financial statements are those of the Group, comprising the financial statements of the parent entity and of all entities which Reece Limited controlled from time to time during the year and at balance date. The group controls an entity when it is exposed, or has rights to variable returns from its involvement with the entity and has the ability to affect those returns through its power over the entity. Details of the controlled entities are contained in Note 27.

The financial statements of subsidiaries are prepared for the same reporting period as the parent entity, using consistent accounting policies. Adjustments are made to bring into line any dissimilar accounting policies which may exist.

All inter-company balances and transactions, including any unrealised profits or losses have been eliminated on consolidation.

(c) Revenue from contracts with customers

The Reece Group is a distributor of plumbing, waterworks and HVAC-R (heating, ventilation, air conditioning and refrigeration) products. Revenue from the sale of these products is recognised at the point in time when control of the product has transferred to the customer. Control of the product is transferred either when a customer picks up the product directly, or on delivery to the location specified by the customer.

For customers who purchase on credit a receivable is recognised only once the products are either picked up or delivered, when the right to consideration is unconditional.

AASB 15 requires the disclosure of sales revenue disaggregated into categories that depict how the nature, amount, timing and uncertainty of revenue and cash flows are affected by economic factors. The Group believes that the disaggregation of total sales revenue by geographical regions as presented in Note 3 Segment Information satisfies this requirement.

Other revenue

Interest revenue is recognised on a proportional basis taking into account the interest rates applicable to the financial assets.

All revenue is stated net of the amounts of goods and services tax (GST).

(d) Cash and cash equivalents

Cash and cash equivalents include cash on hand and at banks, short-term deposits with an original maturity of three months or less held at call with financial institutions and bank overdrafts. Bank overdrafts are shown within short-term borrowings in current liabilities on the statement of financial position.

(e) Inventories

Inventories are measured at the lower of cost and net realisable value. Cost is based on the first-in first-out principle.

A provision has been recognised for the value of inventory that is likely to be sold below cost or otherwise disposed of at a loss. Management applies past experience and judgement on the likely sell through rates of various items of inventory to identify any excess or obsolete inventory.

(f) Property, plant and equipment

All classes of property, plant and equipment are stated at cost less depreciation and any accumulated impairment losses.

Depreciation

Land is not depreciated. The depreciable amounts of all other fixed assets are amortised on a straight-line basis over their estimated useful lives commencing from the time the asset is held ready for use. Fixtures, fittings and equipment are depreciated over the shorter of either the unexpired period of the lease or the estimated useful lives of the improvements.

The useful lives for each class of assets are:

| | 2019 | 2018 |
|----------------------------------|-----------------|-----------------|
| Freehold Buildings | 25 years | 25 years |
| Fixtures, fittings and equipment | 2.5 to 20 years | 2.5 to 20 years |
| Motor vehicles | 5 to 8 years | 5 to 8 years |

To the financial statements for the year ended 30 June 2019

Notes

(g) Leases

The determination of whether an arrangement is (or contains) a lease is based on the substance of the arrangement at the inception of the lease. The arrangement is, or contains, a lease if fulfilment of the arrangement is dependent on the use of a specific asset (or assets) and the arrangement conveys a right to use the asset (or assets), even if the asset is (or those other assets are) not explicitly specified in the arrangement.

Leases of buildings, plant and equipment under which the parent entity or its controlled entities do not assume substantially all the risks and benefits of ownership, are classified as operating leases.

Group as a lessee

Lease payments for operating leases, where substantially all of the risks and benefits remain with the lessor, are charged as expenses in the period in which they are incurred.

Lease incentives received under operating leases are recognised as a liability and amortised on a straight-line basis over the life of the lease term.

(h) Business combinations

A business combination is a transaction or other event in which an acquirer obtains control of one or more businesses and results in the consolidation of the assets and liabilities acquired. Business combinations are accounted for by applying the acquisition method.

The consideration transferred is determined as the aggregate of fair values of assets given, equity issued and liabilities assumed in exchange for control. Deferred consideration payable is measured at fair value.

Goodwill is recognised initially at cost, being the excess over the aggregate of the consideration transferred, the fair value of the non-controlling interest, and the acquisition date fair value of the acquirer's previously held equity interest (in case of step acquisition), less the fair value of the identifiable assets acquired and liabilities assumed. If the fair value of the net assets acquired is in excess of the aggregate consideration transferred, the Group re-assesses whether it has correctly identified all of the assets acquired and all of the liabilities assumed and reviews the procedures used to measure the amounts to be recognised at the acquisition date. If the reassessment still results in an excess of the fair value of net assets acquired over the aggregate consideration transferred, then the gain is recognised in profit or loss.

Acquisition related costs are expensed as incurred.

(i) Intangibles

Goodwill

After initial recognition, goodwill is measured at cost less any accumulated impairment losses. For the purpose of impairment testing, goodwill acquired in a business combination is, from the acquisition date, allocated to each of the Group's cash-generating units that are expected to benefit from the combination, irrespective of whether other assets or liabilities of the acquiree are assigned to those units.

Goodwill is not amortised but is tested annually for impairment, or more frequently if events or changes in circumstances indicate that it might be impaired.

Brand names

Brand names are acquired through business combination and are initially measured at their fair value at the date of acquisition.

Brand names are not amortised, but are tested for impairment annually, either individually or at the cash-generating unit level. The assessment of indefinite life is reviewed annually to determine whether the indefinite life continues to be supportable. If not, the change in useful life from indefinite to finite is made on a prospective basis.

Customer contract and relationship, tradenames and other intangible assets

Customer contract and relationships, tradenames and other intangible assets are acquired through business combination and are initially measured at their fair value at the date of acquisition.

These intangible assets have finite lives and are amortised over the useful economic life and are assessed for impairment whenever there is an indication that the intangible asset may be impaired. The amortisation period and the amortisation method are reviewed at least at the end of each reporting period. Changes in the expected useful life or the expected pattern of consumption of future economic benefits embodied in the asset are considered to modify the amortisation period or method, as appropriate, and are treated as changes in accounting estimates.

A summary of policies applied to the Group's intangible assets is as follows:

| | 2019 | 2018 |
|-------------------------------------|----------------|------------|
| Goodwill | Indefinite | Indefinite |
| Brand names | Indefinite | Indefinite |
| Customer contract and relationships | 10 to 16 years | - |
| Tradenames | 5 to 20 years | - |
| Other | 1 year | - |

(j) Impairment of non-financial assets

Assets with an indefinite useful life are not amortised but are tested annually for impairment in accordance with AASB 136 Impairment of Assets. Assets subject to annual depreciation or amortisation are reviewed for impairment whenever events or circumstances arise that indicate that the carrying amount of the asset may be impaired.

An impairment loss is recognised where the carrying amount of the asset exceeds its recoverable amount. The recoverable amount of an asset is defined as the higher of its fair value less costs to sell and value in use.

To the financial statements for the year ended 30 June 2019

Notes

(k) Taxes

Current income tax expense is the tax payable on the current period's taxable income based on the applicable income tax rate adjusted by changes in deferred tax assets and liabilities.

Deferred tax assets and liabilities are recognised for temporary differences between the tax bases of assets and liabilities and their carrying amounts in the financial statements.

No deferred tax asset or liability is recognised in relation to temporary differences arising from the initial recognition of an asset or a liability if they arose in a transaction, other than a business combination, that at the time of the transaction did not affect either accounting profit or taxable profit or loss.

Deferred tax assets are recognised for temporary differences and unused tax losses only when it is probable that future taxable amounts will be available to utilise those temporary differences and losses.

Deferred income tax assets and liabilities are measured at the tax rates that are expected to apply to the year when the asset is realised, or the liability is settled, based on tax rates (and tax laws) that have been enacted or substantively enacted at the reporting date.

Current and deferred tax balances attributable to amounts recognised directly in equity are also recognised directly in equity.

Deferred tax assets and liabilities are offset only if a legally enforceable right exists to set off current tax assets against current tax liabilities and the deferred tax assets and liabilities relate to the same taxable entity and the same taxation authority.

Tax consolidation

Reece Limited (parent entity) and its Australian wholly owned subsidiaries have implemented the tax consolidation legislation and have formed an income tax consolidated group under the tax consolidation legislation. The parent entity is responsible for recognising the current tax liabilities and deferred tax assets arising in respect of tax losses for the tax consolidated group. The tax consolidated group has also entered into a tax funding agreement whereby each company in the group contributes to the income tax payable in proportion to their contribution to the net profit before tax of the tax consolidated group.

The tax consolidated group also has a tax sharing agreement in place to limit the liability of subsidiaries in the tax consolidated group arising under the joint and several liability requirements of the tax consolidation system in the event of default by the parent entity to meet its payment obligations.

Goods and services tax (GST)

Revenues, expenses and assets are recognised net of the amount of GST, except where the amount of GST incurred is not recoverable from the Tax Office. In these circumstances the GST is recognised as part of the cost of acquisition of the asset or as part of an item of the expense. Receivables and payables in the statement of financial position are shown inclusive of GST.

Cash flows are presented in the statement of cash flows on a gross basis, except for the GST component of investing and financing activities, which are disclosed as operating cash flows.

(l) Employee benefits

Liabilities arising in respect of wages and salaries, annual leave, and any other employee benefits expected to be settled within twelve months of the reporting date are measured at their nominal amounts based on remuneration rates which are expected to be paid when the liability is settled.

All other employee benefit liabilities are measured at the present value of the estimated future cash outflow to be made in respect of services provided by employees up to the reporting date.

Contributions are made by the economic entity to employee superannuation funds and are charged as expenses when incurred.

(m) Financial Instruments – initial measurement and subsequent measurement

i) Financial assets

Initial recognition and measurement

Financial assets are classified, at initial recognition, as subsequently measured at amortised cost, fair value through other comprehensive income (OCI) or fair value through profit or loss.

The classification of financial assets at initial recognition depends on the financial asset's contractual cash flow characteristics and the Group's business model for managing them. With the exception of trade receivables that do not contain a significant financing component or for which the Group has applied the practical expedient, the Group initially measures a financial asset at its fair value plus, in the case of a financial asset not at fair value through profit or loss, transaction costs.

In order for a financial asset to be classified and measured at amortised cost or fair value through OCI, it needs to give rise to cash flows that are solely payments of principal and interest (SPPI) on the principal amount outstanding. This assessment is referred to as the SPPI test and is performed at an instrument level.

The Group's business model for managing financial assets refers to how it manages its financial assets in order to generate cash flows. The business model determines whether cash flows will result from collecting contractual cash flows, selling the financial assets, or both.

Subsequent measurement

For purposes of subsequent measurement, financial assets are classified in four categories:

- Financial assets at amortised cost (debt instruments)
- Financial assets at fair value through OCI with recycling of cumulative gains and losses (debt instruments)
- Financial assets designated at fair value through OCI with no recycling of cumulative gains and losses upon derecognition (equity instruments)
- Financial assets at fair value through profit or loss

To the financial statements for the year ended 30 June 2019

Notes

Financial assets at amortised cost (debt instruments)

This category is the most relevant to the Group. The Group measures financial assets at amortised cost if both of the following conditions are met:

- The financial asset is held within a business model with the objective to hold financial assets in order to collect contractual cash flows; and
- The contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

Financial assets at amortised cost are subsequently measured using the effective interest (EIR) method and are subject to impairment. Gains and losses are recognised in profit or loss when the asset is derecognised, modified or impaired.

The Group's financial assets at amortised cost includes cash and cash equivalents and trade and other receivables.

Derecognition

A financial asset is derecognised when:

- The rights to receive cash flows from the asset have expired; or
- The Group has transferred its rights to receive cash flows from the asset or has assumed an obligation to pay the received cash flows in full without material delay to a third party under a 'pass-through' arrangement; and either (a) the Group has transferred substantially all the risks and rewards of the asset, or (b) the Group has neither transferred nor retained substantially all the risks and rewards of the asset, but has transferred control of the asset.

When the Group has transferred its rights to receive cash flows from an asset or has entered into a pass-through arrangement, it evaluates if, and to what extent, it has retained the risks and rewards of ownership.

When it has neither transferred nor retained substantially all of the risks and rewards of the asset, nor transferred control of the asset, the Group continues to recognise the transferred asset to the extent of its continuing involvement together with the associated liability.

Impairment of financial assets

Trade receivables

For trade receivables that do not have a significant financing component, the Group applies a simplified approach in calculating expected credit loss (ECL) which requires lifetime expected credit losses to be recognised from initial recognition of the receivables.

Therefore, the Group does not track changes in credit risk, but instead recognises a loss allowance based on lifetime ECLs at each reporting date. The Group has established a provision matrix that is based on its historical credit loss experience, adjusted for forward-looking factors specific to the debtors and the economic environment.

(ii) Financial liabilities

Initial recognition and measurement

Financial liabilities are classified, at initial recognition, at amortised cost unless or at fair value through profit or loss.

All financial liabilities are recognised initially at fair value and, in the case of financial liabilities at amortised cost, net of directly attributable transaction costs.

Financial liabilities are classified as current liabilities unless the Group has an unconditional right to defer settlement of the liability for at least 12 months after the reporting date.

The Group's financial liabilities include trade and other payables, interest bearing liabilities and derivative financial instruments.

Subsequent measurement

Financial liabilities at amortised cost

This category is the most relevant to the Group. After initial recognition, trade and other payables and interest-bearing liabilities are subsequently measured at amortised cost using the EIR method. Gains and losses are recognised in profit or loss when the liabilities are derecognised as well as through the EIR amortisation process.

Amortised cost is calculated by taking into account any discount or premium on acquisition and fees or costs that are an integral part of the EIR. The EIR amortisation is included as finance costs in profit or loss.

Derecognition

A financial liability is derecognised when the obligation under the liability is discharged or cancelled or expires. When an existing financial liability is replaced by another from the same lender on substantially different terms, or the terms of an existing liability are substantially modified, such an exchange or modification is treated as the derecognition of the original liability and the recognition of a new liability. The difference in the respective carrying amounts is recognised in profit or loss.

(iii) Hedge accounting

The Group enters into a variety of derivative financial instruments to manage its exposure to interest rate and foreign exchange rate risks, including foreign exchange forward contracts, cross currency interest rate swaps (vanilla and structured with options) and interest rate swaps.

Derivatives are recognised initially at fair value at the date a derivative contract is entered into and are subsequently remeasured to their fair value at each reporting date.

The resulting gain or loss is recognised in profit or loss immediately unless the derivative is designated and effective as a hedging instrument, in which event, the timing of the recognition in profit or loss depends on the nature of the hedge relationship. The consolidated entity or subsidiary designates certain derivatives as hedging instruments in respect of foreign currency risk and interest rate risk in either:

To the financial statements for the year ended 30 June 2019

Notes

- Cash flow hedges: hedges of a particular risk associated with the cash flows of recognised assets and liabilities and highly probable forecast transactions; or
- Net investment hedges: hedges of a net investment in a foreign operation.

At the inception of the hedging transaction, the consolidated or subsidiary entity documents the relationship between hedging instruments and hedged items, as well as its risk management objective and strategy for undertaking various hedge transactions. The consolidated or subsidiary entity also documents its assessment, both at hedge inception and on an ongoing basis, of whether the derivatives that are used in hedging transactions have been and will continue to be highly effective in offsetting changes in fair values or cash flows of hedged items. As the notional of hedging instruments match that of the hedged items, the hedge ratio is assessed as being 100%.

The fair values of various derivative financial instruments used for hedging purposes are disclosed in this note.

Cash flow hedges

As a portion of the Group's debt is denominated in currencies other than Australian Dollars, and issued at variable interest rates, the consolidated entity entered into cross currency swaps and interest rate swaps to mitigate currency and interest rate exposures. The effective portion of changes in the fair value of derivatives that are designated and qualify as cash flow hedges is recognised in OCI and accumulated in reserves in equity. The gain or loss relating to the ineffective portion is recognised immediately in profit or loss. Subsequent to initial recognition, the effective portion of changes in the fair value of the derivative is recognised in OCI and presented in the cash flow hedge reserve under equity. The amount accumulated in the cash flow hedge reserve is reclassified to profit or loss in the same period that the hedged cash flow affects profit or loss. If the derivative no longer meets the criteria for hedge accounting, for example if it expires, is sold, terminated, exercised or the designation is revoked, then hedge accounting is discontinued prospectively and the balance in equity is reclassified to profit or loss when the forecast transactions occurs.

Net investment hedges

Hedges of net investments in foreign operations are accounted for similarly to cash flow hedges. Any gain or loss on the hedging instrument relating to the effective portion of the hedge is recognised in the foreign currency translation reserve. The gain or loss relating to the ineffective portion is recognised immediately in profit or loss, and is included in the 'finance income or finance cost' line items. Gains and losses on the hedging instrument accumulated in the foreign currency translation reserve are reclassified to profit or loss on the disposal or partial disposal of the foreign operation.

Discontinuation of hedge accounting is not voluntary and is only permitted if:

- The risk management objective has changed;
- There is no longer an economic relationship between the hedged item and the hedging instrument; or
- The credit risk is dominating the hedge relationship.

(n) Borrowing costs

Borrowing costs are expensed as incurred, except for borrowing costs incurred as part of the cost of the construction of a qualifying asset which are capitalised until the asset is ready for its intended use or sale.

(o) Provisions

Provisions are recognised when the Group has a present obligation (legal or constructive) as a result of a past event, if it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation. When the Group expects some or all of a provision to be reimbursed, for example, under an insurance contract, the reimbursement is recognised as a separate asset, but only when the reimbursement is virtually certain. The expense relating to a provision is presented in the statement of profit or loss net of any reimbursement.

If the effect of the time value of money is material, provisions are discounted using a current pre-tax rate that reflects, when appropriate, the risks specific to the liability. When discounting is used, the increase in the provision due to the passage of time is recognised as a finance cost.

Warranty provisions

The Group provides warranties for general repairs of defects that existed at the time of sale, as required by law. Provisions related to these assurance-type warranties are recognised when the product is sold or the service is provided to the customer. Initial recognition is based on historical experience. The initial estimate of warranty-related costs is revised annually.

(p) Foreign currencies

Functional and presentation currency

The financial statements of each group entity are measured using its functional currency, which is the currency of the primary economic environment in which that entity operates. The consolidated financial statements are presented in Australian dollars, as this is the parent entity's functional and presentation currency.

Transactions and balances

Transactions in foreign currencies of entities within the Group are translated into functional currency at the rate of exchange ruling at the date of the transaction.

Foreign currency monetary items that are outstanding at the reporting date (other than monetary items arising under foreign currency contracts where the exchange rate for that monetary item is fixed in the contract) are translated using the spot rate at the end of the financial year.

Differences arising on settlement or translation of monetary items are recognised in profit or loss with the exception of monetary items that are designated as part of the hedge of the Group's net investment in a foreign operation. These are recognised in OCI until the net investment is disposed of, at which time, the cumulative amount is reclassified to profit or loss. Tax charges and credits attributable to exchange differences on those monetary items are also recognised in OCI.

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Notes

Group companies

The financial statements of foreign operations whose functional currency is different from the group's presentation currency are translated as follows:

- Assets and liabilities are translated at year-end exchange rates prevailing at the reporting date;
- Income and expenses are translated at average exchange rates for the period; and
- All resulting exchange differences are recognised as a separate component of equity.

Exchange differences arising on translation of foreign operations are transferred directly to the Group's foreign currency translation reserve as a separate component of equity in the statement of financial position.

(q) Comparatives

Where necessary, comparative information has been reclassified and repositioned for consistency with current year disclosures.

(r) Rounding amounts

The parent entity and the Group have applied the relief available under ASIC Corporations (Rounding in Financial/Directors Report) Instrument 2016/191 and accordingly, the amounts in the consolidated financial statements and in the Directors' Report have been rounded to the nearest thousand dollars, or in certain cases, the nearest dollar (where indicated).

(s) New Accounting standards and interpretations

The Group adopted AASB 15 for the first time. The nature and effect of the changes as a result of the adoption of this new accounting standard is as described below.

Several other amendments and interpretations apply for the first time in the current period, but do not have an impact on the consolidated financial statements of the Group. The Group has not early adopted any standards, interpretations or amendments that have been issued but are not yet effective.

AASB 15 Revenue from Contracts with Customers

AASB 15 supersedes AASB 111 Construction Contracts, AASB 118 Revenue and related Interpretations and it applies, with limited exceptions, to all revenue arising from contracts with its customers. AASB 15 establishes a five-step model to account for revenue arising from contracts with customers and requires that revenue be recognised at an amount that reflects the consideration to which an entity expects to be entitled in exchange for transferring goods or services to a customer.

The Group adopted AASB 15 on 1 July 2018 using the full retrospective method of adoption. The adoption of AASB 15 did not result in a material change in the Group's consolidated financial statements.

(t) Accounting standards issued but not yet operative

The AASB has issued a number of new and amended Accounting Standards and Interpretations that have mandatory application dates for future reporting periods, some of which are relevant to the Group. The Group's assessment of the new and amended pronouncements that are relevant to the Group but applicable in future reporting periods is set out below.

AASB 16 Leases (applicable for annual reporting periods commencing on or after 1 January 2019).

AASB 16 will replace AASB 117 Leases and introduces a single lessee accounting model that will require a lessee to recognise right-of-use assets and lease liabilities for all leases with a term of more than 12 months, unless the underlying asset is of low value. Right-of-use assets are initially measured at their cost and lease liabilities are initially measured on a present value basis. Subsequent to initial recognition:

- Right-of-use assets are accounted for on a similar basis to non-financial assets, whereby the right-of-use asset is accounted for in accordance with a cost model unless the underlying asset is accounted for on a revaluation basis, in which case if the underlying asset is:
 - Investment property, the lessee applies the fair value model in AASB 140 Investment Property to the right-of-use asset; or
 - Property, plant or equipment, the lessee can elect to apply the revaluation model in AASB 116 Property, Plant and Equipment to all of the right-of-use assets that relate to that class of property, plant and equipment; and
- Lease liabilities are accounted for on a similar basis as other financial liabilities, whereby interest expense is recognised in respect of the liability and the carrying amount of the liability is reduced to reflect lease payments made.

AASB 16 substantially carries forward the lessor accounting requirements in AASB 117. Accordingly, under AASB 16 a lessor would continue to classify its leases as operating leases or finance leases subject to whether the lease transfers to the lessee substantially all of the risks and rewards incidental to ownership of the underlying asset, and would account for each type of lease in a manner consistent with the current approach under AASB 117.

The Group will adopt AASB 16 Leases for the annual reporting period beginning 1 July 2019 using the modified retrospective approach. The cumulative effect of adopting the new standard will result in an adjustment to the opening balance of retained earnings at 1 July 2019 and the establishment of a lease right to use asset and a liability for future lease payments with no restatement of comparative information.

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As permitted by AASB 16, on transition the Group has elected:

- To measure the right of use asset at an amount equal to the lease liability on transition
- To not recognise any low value or short-term leases on the balance sheet. Short-term leases are leases where the period is less than 12 months including reasonably certain extension options
- Adjust the right of use asset on transition by the amount of any onerous lease provisions recognised in the Group's balance sheet at 30 June 2019
- To not separate lease and non-lease components for vehicles and equipment. However, for property leases, non-lease components will be separated.

The Group has substantially completed its implementation assessment of the new standard. The Group have applied certain judgements, assumptions and estimates in assessing likelihood of exercising termination or extension options and determination of the incremental borrowing rate for leases liabilities. The indicative range of the financial impacts from adoption for the new standard below allows for these uncertainties. The actual impact on the results at 30 June 2020 will be dependent upon any new leases entered into during the financial year.

The impact on transition is expected to result in an increase in lease liabilities and right of use assets of between \$700m – \$750mill with no impact to equity.

AASB Interpretation 23 Uncertainty over Income Tax Treatment

The interpretation addresses the accounting for income taxes when tax treatments involve uncertainty that affects the application of AASB 112 Income taxes and does not apply to taxes or levies outside the scope of AASB 112. This Interpretation is applicable to the Group from 1 July 2019 and the Group does not expect a material impact on adoption.

2. Significant accounting estimates and judgements

Certain accounting estimates include assumptions concerning the future, which, by definition, will seldom represent actual results. The estimates and assumptions that have a significant inherent risk in respect of estimates based on future events, which could have a material impact on the assets and liabilities in the next financial year, are discussed below.

(a) Impairment of goodwill

Goodwill is allocated to cash generating units (CGU) according to applicable business operations. The recoverable amount of a CGU is based on value in use calculations. These calculations are based on projected cash flows approved by management covering a period of 5 years. Management's determination of cash flow projections and gross margins are based on past performance and its expectation for the future. A terminal value growth rate of 2.5% and the following pre-tax discount rates have been used for each of the CGUs – Actrol 15.3%, Metalflex 14.9%, Viadux 15.4% and MORSCO 9.6%.

(b) Income taxes

Income tax benefits are based on the assumption that no adverse change will occur in the income tax legislation and the anticipation that the company will derive sufficient future assessable income to enable the benefit to be realised and comply with the conditions of deductibility imposed by the law.

(c) Impairment of non-financial assets other than goodwill

All assets are assessed for impairment at each reporting date by evaluating whether indicators of impairment exist in relation to the continued use of the asset by the Group. Impairment triggers include declining product performance, technology changes, adverse changes in the economic or political environment or future product expectations. The recoverable amount of the CGU is determined by value-in-use calculations as described in note 2(a).

(d) Acquisition of MORSCO

The valuation techniques used for measuring the fair value of material assets acquired (Note 7) were as follows.

Intangible assets

Relief-from-royalty method and multi-period excess earnings method: The relief-from-royalty method considers the discounted estimated royalty payments that are expected to be avoided as a result of the brandnames being owned. The multi-period excess earnings method considers the present value of net cash flows expected to be generated by the customer relationships, by excluding any cash flows related to contributory assets.

Inventories

Market comparison technique: The fair value is determined based on the estimated selling price in the ordinary course of business less the estimated costs of completion and sale, and a reasonable profit margin based on the effort required to complete and sell the inventories.

To the financial statements for the year ended 30 June 2019

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3. Segment information

Segment information is presented in a manner which is consistent with the internal reporting to the Group Chief Executive Officer, who is the entity's chief operating decision maker for the purpose of performance assessment and resource allocation. The Group's segments are based on the geographical operations of the business and comprise:

- Australia and New Zealand (ANZ)
- United States of America (USA)

Reece Group is a distributor of plumbing, waterworks and HVAC-R (heating, ventilation, air conditioning and refrigeration) products and these products are consistent in both geographic locations.

| | ANZ | | USA | | Total | |
|------------------------------------|------------------|------------------|------------------|------------------|------------------|------------------|
| | 2019 (\$'000) | 2018 (\$'000) | 2019 (\$'000) | 2018 (\$'000) | 2019 (\$'000) | 2018 (\$'000) |
| Revenue | | | | | | |
| Sales revenue | 2,866,040 | 2,688,576 | 2,597,747 | - | 5,463,787 | 2,688,576 |
| Total revenue | 2,872,699 | 2,691,356 | 2,599,114 | - | 5,471,813 | 2,691,356 |
| Normalised EBITDA* | 372,554 | 378,323 | 149,396 | - | 521,950 | 378,323 |
| Income / (expenses) | | | | | | |
| Depreciation and amortisation | (58,826) | (53,847) | (69,246) | - | (128,072) | (53,847) |
| Business acquisition costs | (25,973) | - | (2,543) | - | (28,516) | - |
| MORSCO fair value inventory unwind | - | - | (8,982) | - | (8,982) | - |
| Finance income | 23,948 | - | - | - | 23,948 | - |
| Finance costs | (48,372) | (5,035) | (34,932) | - | (83,304) | (5,035) |
| Segment profit before tax | 263,331 | 319,441 | 33,693 | - | 297,024 | 319,441 |
| Income tax expense | (86,642) | (94,821) | (8,282) | - | (94,924) | (94,821) |
| Segment profit after tax | 176,689 | 224,620 | 25,411 | - | 202,100 | 224,620 |
| Current assets | 1,044,328 | 1,490,667 | 916,623 | - | 1,960,951 | 1,490,667 |
| Non-current assets | 888,249 | 833,580 | 1,624,910 | - | 2,513,159 | 833,580 |
| Total assets | 1,932,577 | 2,324,247 | 2,541,533 | - | 4,474,110 | 2,324,247 |
| Total liabilities | 1,410,583 | 443,409 | 1,071,947 | - | 2,482,530 | 443,409 |

*Normalised EBITDA is earnings before interest, tax, depreciation, finance income, amortisation and has been adjusted to exclude the impact of significant items including business acquisition and fair value inventory un-wind costs.

There were no inter-segment transactions in the financial year.

To the financial statements for the year ended 30 June 2019

Notes

4. Revenue and other income

| | Consolidated Entity | |
|--|---------------------|-------------------|
| | 2019 (\$000's) | 2018 (\$000's) |
| a) Revenue from contracts with customers | | |
| Revenue from sale of goods | 5,463,787 | 2,688,576 |
| b) Other income | | |
| Interest received or due and receivable from other persons | 1,644 | 1,925 |
| Profit on asset sales | 5,577 | - |
| Bad debts recovered | 805 | 855 |
| | 8,026 | 2,780 |
| Total revenues and other income | 5,471,813 | 2,691,356 |

5. Income tax

(a) The components of tax expense:

Consolidated profit or loss

| | | |
|--|---------|---------|
| Current tax | 88,351 | 99,926 |
| Adjustments for current tax from prior periods | (1,123) | (133) |
| Deferred tax | 7,696 | (4,972) |
| Income tax expense reported in the statement of profit or loss | 94,924 | 94,821 |

(b) Reconciliation of tax expense and accounting profit

| | | |
|---|---------|---------|
| Accounting profit before tax | 297,024 | 319,441 |
| At Australia's statutory income tax rate of 30% (2018: 30%) | 89,107 | 95,833 |
| Adjustments for current tax from prior periods | (1,123) | (133) |
| Non-deductible expenses for tax purposes | 9,972 | (879) |
| Difference in geographical tax rates | (3,032) | - |
| At the effective Income tax rate of 32% (2018: 30%) | 94,924 | 94,821 |

To the financial statements for the year ended 30 June 2019

Notes

5. Income tax (cont'd)

| | Consolidated Entity | |
|---|---------------------|-------------------|
| | 2019 (\$000's) | 2018 (\$000's) |
| (c) Deferred tax relates to the following: | | |
| Employee benefits | 22,794 | 19,366 |
| Depreciation of buildings and rental incentives | 8,826 | 12,054 |
| Losses available for offset against future taxable income | 11,169 | 2,031 |
| Net gain on hedge of the net investment | (5,459) | - |
| Provisions | 6,203 | 5,674 |
| Capital leases | 2,755 | - |
| Goodwill and other intangibles | (68,018) | - |
| Other deferred tax assets | 18,242 | - |
| Other deferred tax liabilities | (1,026) | - |
| Total deferred tax assets / (liability) | (4,514) | 39,125 |
| Movement in deferred tax asset: | | |
| Balance at beginning of year | 39,125 | 34,089 |
| Deferred tax asset from business acquisition | - | 64 |
| Deferred tax liability from business acquisition | (31,045) | - |
| Current tax liability from business acquisition | (946) | - |
| Movement to the statement of financial position | (11,648) | 4,972 |
| Deferred tax balance at end of the year | (4,514) | 39,125 |
| (d) Reconciliation to the statement of financial position: | | |
| Deferred tax balance | (4,514) | 39,125 |
| Set off of DTL that are expected to reverse in a future period | 43,777 | - |
| Deferred tax asset | 39,263 | 39,125 |
| (e) Current tax liability: | | |
| Balance at beginning of the year | 7,624 | 16,171 |
| Current tax | 88,351 | 99,926 |
| Tax instalments paid | (92,351) | (108,546) |
| Over provision in prior year | (1,123) | (133) |
| Acquired provision from business acquisition | (946) | 206 |
| Current tax liability at end of the year | 1,555 | 7,624 |

The Group does not have any unbooked tax losses relating to foreign subsidiaries at 30 June 2019 (2018: \$nil).

There are no income tax consequences attached to the payment of dividends in either 2019 or 2018 by the Group to its shareholders.

To the financial statements for the year ended 30 June 2019

Notes

6. Dividends on ordinary shares

| | Consolidated Entity | |
|---|----------------------------|------------------|
| | 2019 | 2018 |
| | (\$000's) | (\$000's) |
| The following are the dividends paid and/or proposed for the financial year: | | |
| Final dividend of 14.25 cents per share fully franked for the year ended 30 June 2018 (June 2017: 14.2 cents per share fully franked) paid 25 October 2018 (2017: 26 October 2017) | 79,917 | 70,716 |
| Interim dividend of 6 cents per share fully franked for the year ended 30 June 2019 (June 2018: 6 cents per share fully franked) paid 28 March 2019 (2018: 29 March 2018) | 33,649 | 29,880 |
| Dividends declared after the reporting period and not recognised: | | |
| Final dividend of 14.25 cents per share fully franked for the year ended 30 June 2019 (June 2018: 14.25 cents per share fully franked) to be paid 30 October 2019 (2018: 25 October 2018) | 79,917 | 79,917 |
| | 113,566 | 109,797 |
| Dividend franking account | | |
| Balance of franking account at year end adjusted for franking credits arising from payment of income tax and franking debits arising from dividends paid. | 646,860 | 607,401 |
| Impact on the franking account of dividends recommended by the Directors since the year end but not recognised as a liability at year end. | (34,250) | (34,250) |
| | 612,610 | 573,151 |

To the financial statements for the year ended 30 June 2019

Notes

7. Business combination

Acquisitions in the financial period ended 30 June 2019

Effective 2 July 2018, Reece Limited acquired 100% of Patriot Supply Holdings, Inc and its controlled entities (MORSCO), a leading US distributor of plumbing, waterworks, heating and cooling (HVAC) products. MORSCO operates 175 branches in 16 states in the Sun Belt region of North America. The acquisition of MORSCO, provides the platform to diversify and grow Reece's operations into the US market.

Transaction costs of \$28.5m in respect of the MORSCO acquisition have been expensed during the year and are included in the Consolidated Statement of Profit or Loss and OCI.

The fair values of the identifiable assets and liabilities of MORSCO as at the date of acquisition were:

| | (\$'000) |
|--|------------------|
| Assets | |
| Trade and other receivables | 404,793 |
| Inventories | 336,404 |
| Property, plant and equipment | 83,064 |
| Intangible assets (Note 12) | 382,149 |
| Other assets | 19,199 |
| | 1,225,609 |
| Liabilities | |
| Trade and other payables | (334,649) |
| Current tax payable | (946) |
| Deferred Tax payable | (31,045) |
| Other payables (non-current) | (16,232) |
| | (382,872) |
| Total identifiable net assets at fair value | 842,737 |
| Goodwill arising on acquisition (Note 12) | 1,124,508 |
| Cash consideration transferred | 1,967,245 |

Subsequent to reporting a provisional balance sheet at 31 December 2018, the Group has determined the fair values of the assets and liabilities acquired as part of the business combination. This resulted in the identification of intangible assets with finite lives including customer contracts and relationships, trade names and a backlog of customer orders. This has led to a decrease in the provisional goodwill reported at 31 December 2018 from \$1,500m to \$1,124m.

From the date of acquisition, MORSCO contributed revenue of \$2,598m and net profit after tax of \$25.4m to the Group's results.

Goodwill on acquisition is attributable mainly to:

- Expected ability to leverage operational expertise and relationships across Reece and MORSCO;
- Expected opportunity to drive future organic growth; and
- The skills, extensive industry experience and technical talent of MORSCO's employees.

Goodwill is allocated to the MORSCO CGU. None of the goodwill recognised is expected to be deductible for income tax purposes.

| | (\$'000) |
|--|-----------------|
| Analysis of cash flows on acquisition: | |
| Transaction costs of the acquisition (included in cash flows from investing activities) | (28,516) |
| Net cash acquired with the subsidiary (included in cash flows from investing activities) | 11,072 |
| Net cash flow on acquisition | (17,444) |

To the financial statements for the year ended 30 June 2019

Notes

8. Cash and cash equivalents

| | Consolidated Entity | |
|-----------------|---------------------|-------------------|
| | 2019 (\$000's) | 2018 (\$000's) |
| Cash on hand | 817 | 231 |
| Cash on deposit | 126,890 | 539,660 |
| | 127,707 | 539,891 |

9. Trade and other receivables

Current

| | | |
|--|----------------|----------------|
| Trade receivables | 810,658 | 394,246 |
| Less: Allowance for expected credit losses | (9,055) | (5,358) |
| | 801,603 | 388,888 |
| Other receivables | 63,247 | 16,229 |
| Prepayments | 10,474 | 616 |
| Total trade and other receivables | 875,324 | 405,733 |

Set out below is the movement in the allowance for expected credit losses of trade receivables

| | | |
|--|---------|---------|
| Opening balance at 1 July | (5,358) | (4,979) |
| Additions through business combination | (3,577) | - |
| Allowance for expected credit losses | (120) | (379) |
| Closing balance as at 30 June | (9,055) | (5,358) |

The information about credit loss exposures is disclosed in Note 16.

10. Inventories

| | | |
|---|---------|---------|
| Finished goods, at lower of cost and net realisable value | 955,711 | 540,564 |
|---|---------|---------|

11. Property, plant and equipment

| | | |
|--|----------------|----------------|
| Freehold land at cost | 173,467 | 167,331 |
| Freehold buildings at cost | 165,432 | 158,571 |
| Less: Accumulated depreciation | (78,697) | (73,135) |
| | 86,735 | 85,436 |
| Fixtures, fittings and equipment at cost | 716,579 | 539,031 |
| Less: Accumulated depreciation | (409,113) | (291,511) |
| | 307,466 | 247,520 |
| Motor vehicles at cost | 170,578 | 109,736 |
| Less: Accumulated depreciation | (74,237) | (41,309) |
| | 96,341 | 68,427 |
| Total property, plant and equipment | 664,009 | 568,714 |

During 2019, there was a gain on disposal of property, plant and equipment of \$5.6m (2018: loss \$31k).

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Notes

11. Property, plant and equipment (cont'd)

Reconciliations of the carrying amounts of property, plant and equipment at the beginning and end of the current financial year.

| | Consolidated Entity | |
|--|---------------------|--------------------|
| | 2019 (\$'000's) | 2018 (\$'000's) |
| Freehold land | | |
| Carrying amount at beginning of year | 167,331 | 157,674 |
| Additions through business combinations | 429 | 5,543 |
| Additions | 7,595 | 5,573 |
| Disposals | (1,910) | (1,459) |
| Net foreign currency exchange movements | 22 | - |
| Carrying amount at end of year | 173,467 | 167,331 |
| Buildings | | |
| Carrying amount at beginning of year | 85,436 | 86,275 |
| Additions through business combinations | 4,178 | 1,454 |
| Additions | 3,542 | 3,961 |
| Disposals | (890) | (741) |
| Depreciation | (5,745) | (5,513) |
| Net foreign currency exchange movements | 214 | - |
| Carrying amount at end of year | 86,735 | 85,436 |
| Fixtures, fittings & equipment | | |
| Carrying amount at beginning of year | 247,520 | 221,374 |
| Additions through business combinations | 56,558 | 3,287 |
| Additions | 61,866 | 61,251 |
| Disposals | (1,483) | (292) |
| Depreciation | (59,986) | (38,100) |
| Net foreign currency exchange movements | 2,991 | - |
| Carrying amount at end of year | 307,466 | 247,520 |
| Motor vehicles | | |
| Motor vehicles | | |
| Carrying amount at beginning of year | 68,427 | 63,585 |
| Additions through business combinations | 21,899 | 818 |
| Additions | 27,259 | 17,459 |
| Disposals | (3,459) | (3,201) |
| Depreciation | (19,131) | (10,234) |
| Net foreign currency exchange movements | 1,346 | - |
| Carrying amount at end of year | 96,341 | 68,427 |
| Total property, plant and equipment | | |
| Carrying amount at beginning of year | 568,714 | 528,908 |
| Additions through business combinations | 83,064 | 11,102 |
| Additions | 100,262 | 88,244 |
| Disposals | (7,742) | (5,693) |
| Depreciation | (84,862) | (53,847) |
| Net foreign currency exchange movements | 4,573 | - |
| Carrying amount at end of year | 664,009 | 568,714 |

To the financial statements for the year ended 30 June 2019

Notes

12. Intangibles

| | Consolidated Entity | | | | | |
|---|---------------------|-------------|------------------------------------|-------------|-------------------------|-----------|
| | Goodwill | Brand names | Customer contracts & relationships | Trade names | Other intangible assets | Total |
| | (\$'000s) | (\$'000s) | (\$'000s) | (\$'000s) | (\$'000s) | (\$'000s) |
| Cost | | | | | | |
| At 1 July 2017 | 155,369 | 49,800 | - | - | - | 205,169 |
| Additions through business combinations | 9,318 | - | 6,087 | 4,224 | 943 | 20,572 |
| Net book value at 30 June 2018 | 164,687 | 49,800 | 6,087 | 4,224 | 943 | 225,741 |
| Additions through MORSCO business combination | 1,124,508 | - | 334,056 | 39,420 | 8,673 | 1,506,657 |
| Additions through other business combinations | 3,873 | - | 1,456 | - | - | 5,329 |
| Net foreign currency exchange movement | 57,513 | - | 17,552 | 2,025 | 559 | 77,649 |
| At 30 June 2019 | 1,350,581 | 49,800 | 359,151 | 45,669 | 10,175 | 1,815,376 |
| Amortisation and impairment | | | | | | |
| At 1 July 2018 | - | - | - | - | - | - |
| Amortisation | - | - | 25,435 | 8,500 | 9,275 | 43,210 |
| At 30 June 2019 | - | - | 25,435 | 8,500 | 9,275 | 43,210 |
| Net book value at 30 June 2019 | 1,350,581 | 49,800 | 333,716 | 37,169 | 900 | 1,772,166 |

For impairment testing, goodwill acquired through business combinations and brand names with indefinite useful lives are allocated according to the Group's cash generating units (CGUs) according to the businesses acquired.

The carrying amount of goodwill and brand names allocated to each of the CGUs are:

| | Goodwill | Brand Names |
|-------------------------------------|-----------|-------------|
| | (\$'000s) | (\$'000s) |
| MORSCO Inc ("MORSCO") | 1,185,743 | - |
| Actrol Parts Pty Ltd ('Actrol') | 119,326 | 29,100 |
| AC Components Pty Ltd ('Metalflex') | 28,949 | 20,200 |
| Viadux Pty Ltd ('Viadux') | 3,919 | - |
| Other | 12,644 | 500 |
| | 1,350,581 | 49,800 |

The Group performed its annual impairment test in June 2019.

To the financial statements for the year ended 30 June 2019

Notes

MORSCO

The recoverable amount of the MORSCO, as at 30 June 2019, has been determined based on a value in use calculation using cash flow projections from financial budgets approved by senior management covering a five-year period. The projected cash flows have been updated to reflect current economic forecasts and business growth opportunities. A terminal growth rate of 2.5% and a pre-tax discount rate of 9.6% has been used to determine value in use.

Actrol

The recoverable amount of Actrol, as at 30 June 2019, has been determined based on a value in use calculation using cash flow projections from financial budgets approved by senior management covering a five-year period. The projected cash flows have been updated to reflect current economic forecasts and business growth opportunities. A terminal growth rate of 2.5% (2018: 3.5%) and a pre-tax discount rate of 15.3% (2018: 15.3%) has been used to determine value in use.

Metalflex

The recoverable amount of Metalflex, as at 30 June 2019, has been determined based on a value in use calculation using cash flow projections from financial budgets approved by senior management covering a five-year period. The projected cash flows have been updated to reflect current economic forecasts and business growth opportunities. A terminal growth rate of 2.5% (2018: 3.5%) and a pre-tax discount rate of 14.9% (2018: 14.9%) has been used to determine value in use. As a result of this analysis, there is headroom of \$3m and management did not identify an impairment for the Metalflex CGU.

Viadux

The recoverable amount of Viadux, as at 30 June 2019, has been determined based on a value in use calculation using cash flow projections from financial budgets approved by senior management covering a five-year period. The projected cash flows have been updated to reflect current economic forecasts and business growth opportunities. A terminal growth rate of 2.5% (2018: 2.0%) and a pre-tax discount rate of 15.4% (2018: 17.1%) has been used to determine value in use. As a result of this analysis, there is headroom of \$2m and management did not identify an impairment for the Viadux CGU.

Key assumptions used in value in use calculations and sensitivity to changes in assumptions:

- The calculation of value in use for all CGUs is most sensitive to the following assumptions:
 - Gross margins
 - Discount rates
 - Terminal growth rate

Gross margins – Gross margins are based on average values achieved in the three years preceding the beginning of the budget period. Decreased demand could lead to a decline in the gross margin.

Discount rates – Discount rates represent the current market assessment of the risks specific to each CGU, taking into consideration the time value of money, individual risks of the underlying assets that have not been incorporated in the cash

flow estimates, and the comparable companies that operate broadly in the distribution of manufacturing of plumbing materials or water systems. The discount rate calculation is based on the specific circumstance of the Group and is derived from its weighted average cost of capital ('WACC'). The WACC takes into account both debt and equity. The cost of equity is derived from the expected return on investment by the Group's investors. The cost of debt is based on the interest-bearing borrowings the Group is obliged to service. Adjustments to the discount rate are made to factor in the specific amount and timing of the future tax flows in order to reflect a pre-tax discount rate.

Terminal growth rates – Terminal growth rates are based on published industry research.

The estimated recoverable amounts for each of the CGUs exceeded their carrying amounts. Management has identified that a reasonably possible adverse change in key assumptions (gross margins, discount rates and terminal growth rate) could cause the carrying amount to exceed the recoverable amount for Metalflex and Viadux. The discount rate would need to change by 30bps before the recoverable amount of Metalflex would be equal to the carrying amount. The discount rate would need to change by 30bps before the recoverable amount of Viadux would be equal to the carrying amount. Management has identified that if Metalflex and Viadux do not substantially meet its forecast earnings, this could cause the carrying amount to exceed the recoverable amount.

13. Trade and other payables

| | Consolidated Entity | |
|-----------------------------|---------------------|-------------------|
| | 2019 (\$000's) | 2018 (\$000's) |
| Current | | |
| Trade payables | 526,056 | 286,742 |
| Other payables and accruals | 173,837 | 82,815 |
| | 699,893 | 369,557 |
| Non Current | | |
| Other | 29,335 | 2,212 |

14. Finance income and finance costs

| | Consolidated Entity | |
|---|---------------------|-------------------|
| | 2019 (\$000's) | 2018 (\$000's) |
| a) Finance income | | |
| Realised foreign currency gain on forward exchange contract | 5,753 | - |
| Unrealised foreign currency gain/(loss) on derivative instruments | 18,195 | - |
| Total finance income | 23,948 | - |
| b) Finance costs | | |
| Interest on debt and borrowings | (83,304) | (5,035) |
| Total finance cost | (83,304) | (5,035) |

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15. Provisions

| | Consolidated Entity | | | |
|-------------------------|---------------------|----------|----------|----------|
| | Employee benefits | Warranty | Other | Total |
| | (\$'000) | (\$'000) | (\$'000) | (\$'000) |
| At 1 July 2018 | 62,489 | 1,528 | - | 64,017 |
| Arising during the year | - | - | 4,092 | 4,092 |
| Utilised | 3,789 | (82) | - | 3,707 |
| At 30 June 2019 | 66,278 | 1,446 | 4,092 | 71,816 |
| Current | 61,270 | 1,446 | 4,092 | 66,808 |
| Non-current | 5,008 | - | - | 5,008 |

16. Financial risk management

The Group is exposed to a variety of financial risks comprising:

- Foreign currency risk
- Interest rate risk
- Credit risk
- Liquidity risk
- Fair values

The Group is exposed to certain risks relating to its ongoing business operations. The primary risks managed using derivative instruments are foreign currency risk and interest rate risk. The Board has overall responsibility for identifying and managing operational and financial risks. The consolidated entity seeks to minimise the effects of these risks by using derivative financial instruments to hedge these risk exposures, and does not enter into or trade financial instruments, including derivative financial instruments, for speculative purposes.

(a) Foreign currency risk

Foreign currency risk is the risk that the fair value or future cash flows of an exposure will fluctuate because of changes in foreign exchange rates. The Group's foreign currency risk arises from interest bearing liabilities, net investments and other transactions denominated in currencies other than Australian Dollars; consequently, exposures to exchange rate fluctuations arise. Exchange rate exposures are 100% hedged and managed in accordance with the hedge policy detailed in this note, utilising forward foreign exchange contracts and cross-currency interest rate swaps.

Foreign forward exchange contracts (FECs)

The Group enters into forward exchange contracts to manage the foreign currency risk associated with anticipated sales and purchases transactions. The Group reviews its currency risk on a regular basis, taking into account refinancing, renewal of existing positions and alternative financing. Budgeted foreign currency requirements are determined over a rolling 12 month period and forward exchange positions are taken in consideration of those requirements in accordance with the Group's Foreign Exchange Management Policy. The Group utilised a mixture of forward exchange contracts and direct purchase of foreign currency to manage its foreign currency exposure. The accounting policy in regard to financial instruments is detailed in Note 1(m).

The full amount of the foreign currency the Group will be required to pay or purchase when settling the brought forward exchange contracts should the counterparty not pay the currency it is committed to deliver at balance date was \$109,835,975 (2018: \$115,395,935).

At balance date, the details of outstanding forward exchange contracts are:

| Settlement | Sell Australian dollars | | Average exchange rate | |
|-------------------------|-------------------------|----------------|-----------------------|------------|
| | 2019 \$'000 | 2018 \$'000 | 2019 \$ | 2018 \$ |
| Buy US Dollars | | | | |
| Less than 6 months | 79,698 | 72,038 | 0.72 | 0.79 |
| 6 months to 1 year | 13,838 | - | 0.72 | - |
| 1 to 2 years | - | - | - | - |
| Buy Euros | | | | |
| Less than 6 months | 16,300 | 36,662 | 0.62 | 0.62 |
| 6 months to 1 year | - | 4,727 | - | 0.63 |
| 1 to 2 years | - | - | - | - |
| Buy Japanese Yen | | | | |
| Less than 6 months | - | 1,969 | - | 81.76 |
| 6 months to 1 year | - | - | - | - |

If the exchange rate was to increase by 10% from the rates used to determine the fair values as at the reporting date, then the impact for the year would be an additional loss of \$7.1m after tax (2018: \$7.6m). If the exchange rate was to decrease by 10% from the rates used to determine the fair values as at the reporting date, then the impact for the year would be an additional profit of \$8.7m after tax (2018: \$9.3m).

Cross currency interest rate swaps (CCIRs)

The consolidated entity is exposed to foreign currency risk from interest bearing liabilities denominated in United States Dollars (USD). At 30 June 2019, these interest bearing liabilities were hedged through cross currency swaps and interest rate swaps until maturity of the bonds. As a result, a strengthening or weakening of the AUD will have no impact on profit or loss or equity. A cross currency swap has embedded option features on interest rate risk which has no designated hedged item and fair value movements on this feature is recognised directly in profit and loss.

Notes

The following table details the cross currency interest rate swaps outstanding at the end of the reporting period.

| | Consolidated Entity | | | | | |
|---|--|--------|---------------------------------|-------------|------------------|-------------|
| | Average contracted fixed interest rate | | Notional principal amount (USD) | | Fair value (AUD) | |
| | 2019 % | 2018 % | 2019 \$'000 | 2018 \$'000 | 2019 \$'000 | 2018 \$'000 |
| Receive floating USD pay fixed AUD | | | | | | |
| Less than 1 year | 5.02 | - | 650,000 | - | (4,091) | - |
| 1 to 2 years | 5.02 | - | 650,000 | - | (9,939) | - |
| 2-5 years | 5.15 | - | 650,000 | - | 47,660 | - |
| 5 years or more | - | - | - | - | - | - |
| | | | | | 33,630 | - |

Net investment hedges

The consolidated entity seeks to mitigate the effect of its foreign currency operations exposure by borrowing in USD. The entity which undertakes the majority of the consolidated entity's borrowing activities has an Australian Dollar functional currency. Where considered appropriate the USD denominated debt is designated as a hedge of a net investment in foreign operations.

Exchange gains or losses upon subsequent revaluation of USD denominated borrowings are recognised through OCI and deferred in equity in the Foreign Currency Translation Reserve and will be released to the profit and loss if the foreign operation is sold. As at 30 June 2019, USD borrowings of US\$40 million were designated as a net investment in foreign operations (2018: nil).

If the exchange rate was to increase by 1 cent from the rates used to determine the fair values as at the reporting date, then the impact (net of hedging) for the year would be an increase in equity of \$0.4m after tax (2018: nil).

If the exchange rate was to decrease by 1 cent from the rates used to determine the fair values as at the reporting date, then the impact (net of hedging) for the year would be a decrease in equity of \$0.9m after tax (2018: nil).

Hedge accounting

The amounts relating to items designated as hedging instruments and hedge ineffectiveness were as follows.

| 30 June 2019 | Cash flow hedges | | | | Net investment hedge | |
|---|------------------|-----------------|-----------------|------------------|----------------------|-----------------|
| | USD FECs \$'000 | EUR FECs \$'000 | JPY FECs \$'000 | USD CCIRS \$'000 | USD IRS \$'000 | USD Debt \$'000 |
| Notional amount | 93,536 | 16,300 | - | 866,089 | 477,600 | 40,781 |
| Carrying amount of the hedging instrument | | | | | | |
| - Assets | 1,717 | 269 | - | 37,721 | - | - |
| - Liabilities | - | - | - | (4,091) | (21,936) | (40,781) |
| Total carrying amount of the hedging instrument | 1,717 | 269 | - | 33,630 | (21,936) | (40,781) |
| Change in value of hedging instrument | (3,043) | 558 | (8) | 25,009 | (21,936) | (2,659) |
| Change in value of hedged item | 3,043 | (558) | 8 | (13,360) | 22,088 | 2,659 |
| Change in value of the hedging instrument recognised in reserve | (3,043) | 558 | (8) | (34,043) | (21,936) | (2,659) |
| Hedge ineffectiveness recognised in profit or loss (i) | - | - | - | 12,688 | - | - |
| Amount reclassified from hedge reserve to profit or loss | - | - | - | 46,363 | - | - |

(i) The effective portion of changes in the fair value of derivatives that are designated and qualify as cash flow hedges is recognised in OCI and accumulated under the heading of cash flow hedging reserve. The gain or loss relating to the ineffective portion is recognised immediately in profit or loss and is included in the 'finance income' or finance cost' line items.

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Gains or losses on any portion of the hedge instrument determined to be ineffective is immediately recognised in profit or loss. Ineffectiveness can potentially arise from timing differences, for example, differences in the timing of settlement between the hedging instrument and hedged item. There was no material ineffectiveness related to financial instruments in designated cash flow hedge relationships during the year.

b) Interest Rate Risk

Interest rate risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates. The Group's interest rate risk arises from interest bearing liabilities with variable interest rates where interest rate movements can impact the consolidated entity's cash flow exposures. The risk is managed by the use of interest rate swaps (IRS) and cross currency interest rate swap contracts. The consolidated entity's long-term borrowings are for a period of 5 years at both floating and fixed interest rates.

Interest rate risk also arises from short-term cash deposits. During 2019 and 2018, the consolidated entity held both fixed and variable rate deposits. The consolidated entity reviews its interest rate exposure from cash deposits on a monthly basis, taking into account both short-term and long-term deposit rates.

The Group reviews its interest rate exposure on a monthly basis, taking into account both short-term and long-term deposit rates. At 30 June 2019, if interest rates had changed +/-1% from the year-end rates, with all other variables held constant, the effect on post-tax profit for the year would have been immaterial.

The Group's exposure to interest rate risks and the effective interest rates of financial assets and financial liabilities, both recognised and unrecognised at the balance date, are as follows:

| Consolidated Entity | | | | | | | |
|-----------------------------------|----------------------------------|----------------|-------------------|-------------------|----------------------|--|--|
| Financial Instruments | Fixed interest rate maturing in: | | | | Non-interest bearing | Total carrying amount as per Statement of financial position | Weighted average effective interest rate |
| | Floating interest rate | 1 year or less | Over 1 to 5 years | More than 5 years | | | |
| | 2019 2018 | 2019 2018 | 2019 2018 | 2019 2018 | 2019 2018 | 2019 2018 | 2019 2018 |
| | \$'000 | \$'000 | \$'000 | \$'000 | \$'000 | \$'000 | % |
| (i) Financial assets | | | | | | | |
| Cash | 126,890 | - | - | - | 817 | 127,707 | 1.41 |
| | 539,660 | - | - | - | 231 | 539,891 | 1.85 |
| Trade and other receivables | - | - | - | - | 875,324 | 875,324 | - |
| | - | - | - | - | 405,733 | 405,733 | - |
| Total financial assets | 126,890 | - | - | - | 876,141 | 1,003,031 | - |
| | 539,660 | - | - | - | 405,964 | 945,624 | - |
| (ii) Financial liabilities | | | | | | | |
| Borrowings | 40,781 | - | 1,568,516 | - | - | 1,609,297 | 5.29 |
| | - | - | - | - | - | - | - |
| Trade payables | - | - | - | - | 699,893 | 699,893 | - |
| | - | - | - | - | 369,557 | 369,557 | - |
| Long-term payables | - | - | - | - | 29,335 | 29,335 | - |
| | - | - | - | - | 2,212 | 2,212 | - |
| Total financial liabilities | 40,781 | - | 1,568,516 | - | 729,228 | 2,338,525 | -- |
| | - | - | - | - | 371,769 | 371,769 | - |

Interest rate swaps

The following table details the notional principal amounts and remaining terms of interest rate swap contracts outstanding at the end of the reporting period:

| | Consolidated Entity | | | | | |
|-----------------------------------|--|--------|---------------------------------|-------------|------------------|-------------|
| | Average contracted fixed interest rate | | Notional principal amount (USD) | | Fair value (AUD) | |
| | 2019 % | 2018 % | 2019 \$000s | 2018 \$000s | 2019 \$000s | 2018 \$000s |
| Receive floating pay fixed | | | | | | |
| Less than 1 year | 5.01 | - | 421,750 | - | (3,759) | - |
| 1 to 2 years | 5.01 | - | 335,750 | - | (6,324) | - |
| 2 to 5 years | 5.01 | - | 296,000 | - | (11,853) | - |
| 5 years or more | - | - | - | - | - | - |
| | | | | | (21,936) | - |

The table below shows the impact of 100bps movement (net of hedging) in the interest rate curve on the consolidated entity's profit and equity before tax for both derivatives and non-derivative financial instruments at 30 June 2019, with all other variables held constant.

| Interest rate sensitivity | 2019 \$'000s | 2018 \$'000 |
|--|--------------|-------------|
| Increase in interest rate +100bps | | |
| (Loss) after tax | (4,462) | - |
| Equity | 31,898 | - |
| Decrease in interest rate +100bps | | |
| Gain after tax | 7,354 | - |
| Equity | (34,192) | - |

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(c) Credit risk exposures

Credit risk refers to the risk that a counterparty will default on its contractual obligations resulting in financial loss to the consolidated entity. At balance date, the maximum exposure to credit risk, excluding the value of any collateral or other security, to recognised financial assets is the carrying amount of those assets, net of any impairment as disclosed in the Consolidated Statement of Financial Position and Notes to the financial statements.

Credit risk for cash deposits is managed by holding all cash deposits with a selection of major Australian banks.

Credit risk for derivative financial instruments arises from the potential failure by counterparties to the contract to meet their obligations. The credit risk exposure to forward exchange contracts and cross currency interest rate swaps is the net fair value of these contracts. All derivative financial instruments are with our major international banking partner.

With the exception of its bankers, the Group does not have any material credit risk exposure to any single debtor or group of debtors under financial instruments entered into by the Group.

The Group minimises concentrations of credit risk in relation to trade receivables by undertaking transactions with a large number of customers.

The Group has established systems and controls in relation to the approval of credit terms for each customer, monitoring of any overdue amounts and removal of credit terms where appropriate. In addition the Group holds an insurance policy against certain larger customers whereby the Group is compensated in the event of a customer default.

The Group applies a simplified approach in calculating expected credit loss (ECL) which requires lifetime expected credit losses to be recognised from initial recognition of the receivables. As such, the Group does not track changes in credit risk, but instead recognises a loss allowance based on lifetime ECLs at each reporting date. The Group has established an impairment provision matrix that is based on its historical credit loss experience, adjusted for forward-looking factors specific to the debtors and the economic environment.

(d) Liquidity Risk

Liquidity risk refers to the risk that the Group has insufficient liquidity to meet its financial obligations when they fall due. The Group's risk management includes maintaining sufficient cash and the availability of funding via an adequate amount of credit facilities as disclosed in Note 21.

Cash flow Information

The table below details the consolidated entity's remaining undiscounted principal and interest cash flows and their contractual maturity based on the earliest date on which the consolidated entity is required to pay.

| | Consolidated Entity | | | | | |
|---------------------------------|---------------------|------------------------|----------------|--------------|--------------|-----------------|
| | Carrying value | Contractual cash flows | 1 year or less | 1 to 2 years | 2 to 5 years | 5 years or more |
| | \$000 | \$000 | \$000 | \$000 | \$000 | \$000 |
| 30 June 2019 | | | | | | |
| Derivatives related to net debt | 21,936 | (22,474) | (4,298) | (6,324) | (11,852) | - |
| 30 June 2018 | | | | | | |
| Derivatives related to net debt | - | - | - | - | - | - |

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Notes

17. Financial assets and financial liabilities

17.1 Derivatives

The consolidated entity enters into a variety of derivative financial instruments to manage its exposure to interest rate and foreign exchange rate risks, including foreign exchange forward contracts, cross currency interest rate swaps (vanilla and structured with options) and interest rate swaps. Refer to Note 1 (m) for detailed accounting policies.

| | Consolidated Entity | | | |
|--|----------------------------|--------------------|------------------|--------------------|
| | 2019 | | 2018 | |
| | (\$000's) | | (\$000's) | |
| | Current | Non-current | Current | Non-current |
| Derivatives designated as hedging instruments | | | | |
| Assets | | | | |
| Interest rate swaps | - | - | - | - |
| Forward exchange contracts | 1,986 | - | 4,479 | - |
| Cross-currency interest rate swaps | - | 37,721 | - | - |
| Interest receivable | 223 | - | - | - |
| Total financial instruments assets at fair value | 2,209 | 37,721 | 4,479 | - |
| Liabilities | | | | |
| Interest rate swaps | 3,759 | 18,177 | - | - |
| Forward exchange contracts | - | - | - | - |
| Cross-currency interest rate swaps | 4,091 | - | - | - |
| Interest payable | 830 | - | - | - |
| Total financial instruments liabilities at fair value | 8,680 | 18,177 | - | - |

17.2 Interest bearing liabilities

| | Consolidated Entity | |
|---------------------------------------|----------------------------|--------------------|
| | 2019 | 2018 |
| | (\$000's) | |
| | Current | Non-current |
| Current interest-bearing loans | | |
| Term loan | 16,256 | - |
| Total current | 16,256 | - |
| Non-current | | |
| Term loan (maturing July 2025) | 1,593,041 | - |
| Total non-current | 1,593,041 | - |

The Term Loan is a Senior Secured Term Loan B USD facility with the carrying value of the borrowings translated at the spot rate at period end date. The Term loan is secured by the Group. It is subject to both foreign currency and interest rate hedging instruments (refer to Note 16).

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Changes in liabilities arising from financing activities

| | Consolidated Entity | | | | | |
|------------------------------|---------------------|------------|------------|---------------------------|------------------------|--------------|
| | 1 July 2018 | Cash flows | | Foreign exchange movement | Changes in fair values | 30 June 2019 |
| | | Proceeds | Repayments | | | |
| | \$'000 | \$'000 | \$'000 | \$'000 | \$'000 | \$'000 |
| Interest bearing liabilities | - | 1,556,567 | (15,937) | 68,667 | - | 1,609,297 |

18. Fair value measurements

This note provides information about how the Group determines the fair value of various financial assets and financial liabilities.

The following table provides an analysis of financial instruments that are measured subsequent to initial recognition at fair value, grouped into Level 1 to 3 based on the degree to which the fair value is observable.

- Level 1 – fair value measurements are those derived from quoted prices (unadjusted) in active markets for identical assets and liabilities.
- Level 2 – fair value measurements are those derived from inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (as prices) or indirectly (derived from prices).
- Level 3 – fair value measurements are those derived from valuation techniques that include inputs for the asset or liability that are not based on observable market data (unobservable inputs).
- The Group's derivative financial assets and liabilities, which are measured at fair value on a recurring basis, are categorised as Level 2 measurements using Discounted Cash Flows and standard option models.

The carrying amount of financial assets and liabilities recognised at amortised cost in the financial statements approximate their fair value.

| | Consolidated Entity | | | |
|---|---------------------|---------------|---------|-----------------------|
| | Level 1 | Level 2 | Level 3 | Total carrying amount |
| | \$'000 | \$'000 | \$'000 | \$'000 |
| 30 June 2019 | | | | |
| Financial assets | | | | |
| <i>Derivative financial instruments</i> | | | | |
| Cross currency swap contracts | - | 37,721 | - | 37,721 |
| Interest rate swap contracts | - | 223 | - | 223 |
| Forward foreign exchange contracts | - | 1,986 | - | 1,986 |
| | - | 39,930 | - | 39,930 |
| Financial liabilities | | | | |
| <i>Derivative financial instruments</i> | | | | |
| Cross currency swap contracts | - | 4,091 | - | 4,091 |
| Interest rate swap contracts | - | 22,766 | - | 22,766 |
| Forward foreign exchange contracts | - | - | - | - |
| | - | 26,857 | - | 26,857 |

Notes

| 30 June 2018 | Consolidated Entity | | | |
|---|---------------------|--------------|---------|-----------------------|
| | Level 1 | Level 2 | Level 3 | Total carrying amount |
| | \$'000 | \$'000 | \$'000 | \$'000 |
| Financial assets | | | | |
| <i>Derivative financial instruments</i> | | | | |
| Cross currency swap contracts | - | - | - | - |
| Interest rate swap contracts | - | - | - | - |
| Forward foreign exchange contracts | - | 4,479 | - | 4,479 |
| | - | 4,479 | - | 4,479 |
| Financial liabilities | | | | |
| <i>Derivative financial instruments</i> | | | | |
| Cross currency swap contracts | - | - | - | - |
| Interest rate swap contracts | - | - | - | - |
| Forward foreign exchange contracts | - | - | - | - |
| | - | - | - | - |

- (1) As the carrying amounts of cash and cash equivalents, trade and other receivables, borrowings and trade and other payables approximate their fair values, they have not been included in the above table.
- (2) For financial instruments that is carried at fair value on a recurring basis, the Group determines whether transfers have occurred between levels in the valuation hierarchy categorisation. There were no transfers between levels during the period.
- (3) The fair value estimation of foreign currency exchange contracts, interest rate swaps and cross currency swaps are considered to be Level 2 valuations and measured using Discounted Cash Flows. The present value of future cash flows is based on forward exchange rates and forward interest rates (from observable market rates) and discounted based on the applicable yield curves derived from quoted interest rates and the credit risk of various counterpart risk volatilities and forward market rate curves and discounted based on applicable yield curves derived from quoted interest rates and the credit risk of various counterparties, at the reporting date.

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19. Contributed equity

| | 2019 (\$000's) | 2018 (\$000's) |
|---|-------------------|-------------------|
| Issued and paid up capital | | |
| Ordinary shares fully paid: 560,822,855 (2018: 560,822,855) | 604,849 | 604,349 |

Ordinary shares participate in dividends and the proceeds on winding up of the parent entity in proportion to the number of shares held.

At shareholder's meetings each ordinary share is entitled to one vote when a poll is called, otherwise each shareholder has one vote on a show of hands.

Capital Management

When managing capital, management's objective is to ensure the Group continues as a going concern as well as to maintain returns to shareholders and benefits for other stakeholders. This is achieved through the monitoring of historical and forecast performance and cash flows.

During 2019, the Group paid /declared dividends of \$113.6m (2018: \$109.8m).

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20. Reserves

| | Consolidated Entity | |
|--|---------------------|--------------------|
| | 2019 (\$'000's) | 2018 (\$'000's) |
| Asset revaluation reserve (historic revaluation of properties) | 461 | 461 |
| General reserve | 51 | 51 |
| Capital profits reserve (historic profits from sale of property) | 2,491 | 2,491 |
| Foreign currency translation reserve (translation of foreign entities) | 83,229 | 390 |
| Cash flow hedge reserve | (56,652) | 4,479 |
| | 29,580 | 7,872 |

21. Cash flow information

(a) Reconciliation of the net profit after tax to the net cash flows from operations:

| | | |
|--|----------|---------|
| Net profit | 202,100 | 224,620 |
| Plus business acquisition costs | 28,516 | - |
| Add/(less) non cash items: | | |
| Profit or loss on sale or disposal of non-current assets | (5,580) | 31 |
| Depreciation and amortisation | 128,072 | 53,847 |
| Foreign exchange translation | 1,372 | 4,124 |
| Amounts set aside to provisions | 7,683 | 2,780 |
| Finance income | (23,948) | - |
| Net cash flows from operations before change in assets and liabilities | 338,215 | 285,402 |

Change in assets and liabilities

| | | |
|---|----------------|----------------|
| (Increase)/decrease in receivables | (17,041) | (29,160) |
| (Increase)/decrease in inventory | (59,829) | (53,436) |
| Increase/(decrease) in payables | (10,591) | (8,144) |
| Increase/(decrease) in income taxes payable | (1,614) | (8,765) |
| (Increase)/decrease in deferred tax assets | (202) | (4,972) |
| Increase/(decrease) in deferred taxes liabilities | 5,528 | - |
| Net cash flow from operating activities | 254,466 | 180,925 |

Change in assets and liabilities excludes the acquired assets and liabilities from acquisitions during the year but includes the subsequent movement from settlement dates.

(b) Financing facilities

Bank Loans and Overdraft

This revolver facility covenant requires that the net leverage ratio must not exceed 3.75x until 30 June 2021, after which it must not exceed 3.50x. Furthermore, the net leverage ratio is to be tested if the revolver usage is greater than 30% at the end of any half-year reporting period.

Bank facilities are secured by Deed of Negative Pledge.

The Group has access to the following lines of credit:

Total facilities available and unused at 30 June 2019

| | | 2019 (\$'000's) | 2018 (\$'000's) |
|--|--------------------|------------------------------------|----------------------------------|
| Senior secured term loan B | facility unused | 1,609,297 - | - - |
| Bank overdraft | facility unused | 956 956 | 917 917 |
| Syndicated revolver | facility unused | 213,888 213,888 | - - |
| Term loan | facility unused | - - | 100,000 100,000 |
| Uncommitted placement line | facility unused | - - | 15,000 15,000 |
| Multi-currency cash advance | facility unused | - - | 5,000 5,000 |
| Cash advance | facility unused | - - | 60,000 60,000 |
| Bank guarantees | facility unused | 25,598 5,010 | 20,598 914 |
| Trade refinance & documentary letters of credit/surrenders | facility unused | 10,209 8,024 | 10,196 9,427 |
| Credit cards | facility unused | 7,717 5,925 | 3,429 1,953 |
| Total | facility unused | 1,867,665 233,803 | 215,140 193,211 |

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22. Commitments

Operating lease commitments – Group as a lessee

The Group has entered into operating leases on certain buildings and motor vehicles, with lease terms between 1 and 20 years.

The Group has an option, under some of its leases, to lease the assets for additional terms of 1 to 10 years.

Future minimum rentals payable under non-cancellable operating leases as at 30 June 2019 are as follows:

| | Consolidated Entity | |
|---|---------------------|-------------------|
| | 2019 (\$000's) | 2018 (\$000's) |
| Future operating lease rentals not provided for and payable in respect of: | | |
| Buildings | 422,500 | 256,890 |
| Motor vehicles | 1,709 | 791 |
| Other | 165 | - |
| | 424,374 | 257,681 |
| Due not later than one year | 95,085 | 51,744 |
| Due later than one year but not later than five years | 254,510 | 139,045 |
| Due later than five years | 74,779 | 66,892 |
| | 424,374 | 257,681 |

23. Earnings per share

| | | |
|---|---------|---------|
| Earnings used in calculating basic and diluted earnings per share | 202,100 | 224,620 |
|---|---------|---------|

| | Thousands | Thousands |
|--|-----------|-----------|
| Weighted average number of ordinary shares outstanding during the year used in the calculation of basic and diluted earnings per share | 560,823 | 503,336 |
| The earnings per share has been calculated on the weighted average of share capital during the year | 36 cents | 45 cents |

24. Auditor's remuneration

| | Consolidated Entity | |
|-------------------|---------------------|--------------|
| | 2019 (\$) | 2018 (\$) |
| Audit/Review fees | 1,352,548 | 690,000 |

Amounts paid and payable to KPMG (2018: Pitcher Partners) for non-audit services:

| | | |
|--------------------------|---------|-----------|
| Taxation services | 293,110 | 787,565 |
| Other assurance services | - | 339,458 |
| | 293,110 | 1,127,023 |

To the financial statements for the year ended 30 June 2019

Notes

25. Related party disclosures

(a) Directors and key management personnel

The names of each person holding the position of Director of Reece Limited during the financial year were

L.A. Wilson, B.W.C. Wilson (retired August 2018), P.J. Wilson, R.G. Pitcher AM (retired 25 October 2018), T.M. Poole, B.C. Wilson, M.L. Quinn, G. Williams and A.W. Wilson. Key Management Personnel were to include G.W. Street, S. Nikolic and C.A.S. Hornsby.

Employee benefits of \$10,101,694 (2018: \$9,915,902) and superannuation benefits of \$171,079 (2018: \$213,689) were made to the Directors' and other Key Management Personnel.

(b) Ownership Interests in Related Parties

Details of interests in controlled entities are set out in Note 27.

(c) Transactions with Directors

Director of Reece, Mr B.C. Wilson has a beneficial interest in an entity that sold plumbing and building supplies to the Group. All dealings are in the ordinary course of business and on normal terms and conditions. Goods purchased from this entity during the year total \$4,640,240 (2018: \$4,780,263) of which \$355,922 (2018: \$431,937) was owing at year end.

Director of Reece, L.A. Wilson has a beneficial interest in entities that lease premises to the Group. All dealings with these entities are in the ordinary course of business and on normal terms and conditions no more favourable than those which would have been expected if dealing at arm's length in the same circumstances. Lease rentals paid to these entities during the year were \$1,250,164 (2018: \$1,235,029).

26. Deed of cross guarantee

All entities listed in Note 27 with the exception of Reece New Zealand Limited and MORSCO are parties to a deed of cross guarantee under which each company guarantees the debts of the others. Pursuant to ASIC Corporations (Wholly-owned Companies) Instrument 2016/785, the wholly owned subsidiaries listed in Note 27 with the exception of Reece New Zealand Limited and MORSCO are relieved from the Corporations Act requirement to prepare a financial report and Director's report.

A consolidated Statement of Comprehensive Income and Statement of Financial Position, comprising the Company and controlled entities subject to the deed, after eliminating all transactions between parties to the Deed of Cross Guarantee is set out as follows:

| | 2019 (\$000's) | 2018 (\$000's) |
|--------------------------------|-------------------|-------------------|
| Revenue | | |
| Sales revenue | 2,754,829 | 2,645,317 |
| Other income | 14,952 | 3,570 |
| | 2,769,781 | 2,648,887 |
| Less: Expenses | | |
| Cost of sales | 1,862,365 | 1,768,316 |
| Employee benefits expense | 311,601 | 295,475 |
| Depreciation and amortisation | 57,173 | 52,460 |
| Business acquisition costs | 25,973 | - |
| Other expenses | 222,593 | 208,897 |
| | 2,479,705 | 2,325,148 |
| Operating profit | 290,076 | 323,739 |
| Finance income | 23,387 | - |
| Finance cost | (48,372) | (5,035) |
| Profit before income tax | 265,091 | 318,704 |
| Income tax expense | 85,074 | 96,646 |
| Net profit for the year | 180,017 | 222,058 |

To the financial statements for the year ended 30 June 2019

Notes

26. Deed of cross guarantee (cont'd)

| | 2019 (\$000's) | 2018 (\$000's) |
|---|-------------------|-------------------|
| Other comprehensive income | | |
| Items that may be reclassified subsequently to profit and loss: | | |
| Exchange differences on translation of foreign operations, net of tax | (3,022) | - |
| Change in fair value of effective cash flows, net of tax | (39,196) | 5,328 |
| Total comprehensive income | 137,799 | 227,386 |
| Basic earnings per share | 32 cents | 45 cents |
| Diluted earnings per share | 32 cents | 45 cents |
| Movements in retained earnings | | |
| Retained earnings at the beginning of the financial year | 1,280,414 | 1,158,952 |
| Profit for the year | 180,017 | 222,058 |
| Dividends paid | (113,566) | (100,596) |
| Retained earnings at end of financial year | 1,346,865 | 1,280,414 |
| Current assets | | |
| Cash and cash equivalents | 38,812 | 533,827 |
| Receivables | 398,937 | 396,331 |
| Inventories | 555,023 | 525,541 |
| Derivative financial instruments | 2,209 | 4,479 |
| Total current assets | 994,981 | 1,460,178 |
| Non-current assets | | |
| Investments and receivables | 1,457,046 | 60,912 |
| Property, plant and equipment | 563,996 | 548,476 |
| Intangible assets | 221,316 | 222,179 |
| Deferred tax assets | 38,817 | 37,548 |
| Derivative financial instruments | 37,721 | - |
| Total non-current assets | 2,318,896 | 869,115 |
| Total assets | 3,313,877 | 2,329,293 |
| Current liabilities | | |
| Payables | 351,768 | 363,854 |
| Current tax payable | - | 7,580 |
| Interest bearing liabilities | 16,256 | - |
| Provisions | 61,094 | 59,409 |
| Derivative financial instruments | 4,382 | - |
| Total current liabilities | 433,500 | 430,843 |
| Non-current liabilities | | |
| Long-term payable | 1,559 | 2,212 |
| Long-term borrowings Interest bearing liabilities | 951,376 | - |
| Deferred tax liabilities | 5,462 | - |
| Provisions | 5,002 | 3,993 |
| Total non-current liabilities | 963,399 | 6,205 |
| Total liabilities | 1,396,899 | 437,048 |
| Net assets | 1,916,978 | 1,892,245 |
| Equity | | |
| Contributed equity | 604,849 | 604,349 |
| Reserves | (34,736) | 7,482 |
| Retained earnings | 1,346,865 | 1,280,414 |
| Total equity | 1,916,978 | 1,892,245 |

To the financial statements for the year ended 30 June 2019

Notes

27. Particulars in relation to corporations in the Group

| Name of entity | Country of Incorporation | Ownership Percentage 2019 | Ownership Percentage 2018 |
|---|--------------------------|---------------------------|---------------------------|
| Parent entity Reece Limited | | | |
| Controlled entities of Reece Limited | | | |
| 1. Reece Australia Pty Ltd | Australia | 100% | 100% |
| 2. Plumbing World Pty Ltd | Australia | 100% | 100% |
| 3. Reece Project Supply Pty Ltd | Australia | 100% | 100% |
| 4. Reece International Pty Ltd | Australia | 100% | 100% |
| 5. Reece New Zealand Limited | New Zealand | 100% | 100% |
| 6. Actrol Parts Holdings Pty Ltd | Australia | 100% | 100% |
| 7. Actrol Parts Finance Pty Ltd | Australia | 100% | 100% |
| 8. Actrol Parts Pty Ltd | Australia | 100% | 100% |
| 9. A.C. Components Pty Ltd | Australia | 100% | 100% |
| 10. Metalflex Pty Ltd | Australia | 100% | 100% |
| 11. Metalflex Regional Pty Ltd | Australia | 100% | 100% |
| 12. Metalflex (S.A.) Pty Ltd | Australia | 100% | 100% |
| 13. Metalflex (W.A.) Pty Ltd | Australia | 100% | 100% |
| 14. Air Plus Pty Ltd | Australia | 100% | 100% |
| 15. The Creative Plane Pty Ltd | Australia | 100% | 100% |
| 16. Viadux Holdco Pty Ltd | Australia | 100% | 100% |
| 17. Viadux Bidco Pty Ltd | Australia | 100% | 100% |
| 18. Viadux Pty Ltd | Australia | 100% | 100% |
| 19. Hamilton HoldCo, LLC | Delaware (US) | 100% | 100% |
| 20. Hamilton BidCo, Inc | Delaware (US) | - | 100% |
| 21. Patriot Supply Holdings LLC | Delaware (US) | 100% | - |
| 22. Patriot Supply Intermediate, Inc | Delaware (US) | 100% | - |
| 23. MORSCO Inc | Delaware (US) | 100% | - |
| 24. MORSCO Supply LLC | Delaware (US) | 100% | - |
| 25. Fortiline LLC | Delaware (US) | 100% | - |
| 26. Fortiline Inc | Delaware (US) | 100% | - |

All shareholdings are of ordinary shares
All corporations financial years end on 30 June

28. Subsequent events

There has been no other matter or circumstance, which has arisen since 30 June 2019, that has significantly affected or may significantly affect:

- the operations, in financial years subsequent to 30 June 2019, of the Group; or
- the results of those operations; or
- the state of affairs, in financial years subsequent to 30 June 2019, of the Group.

29. Parent entity details

| | Parent Entity | |
|---|-------------------|-------------------|
| | 2019 (\$000's) | 2018 (\$000's) |
| (a) Summarised statement of financial position | | |
| Assets | | |
| Current assets | 5,467 | 507,020 |
| Non-current assets | 907,242 | 374,651 |
| Total Assets | 912,709 | 881,671 |
| Liabilities | | |
| Current liabilities | 300,326 | 275,250 |
| Non-current liabilities | 5,462 | - |
| Total Liabilities | 305,788 | 275,250 |
| Net Assets | 606,921 | 606,421 |
| Equity | | |
| Contributed equity | 604,849 | 604,349 |
| Retained earnings | 2,035 | 2,035 |
| Reserves | 37 | 37 |
| Total Equity | 606,921 | 606,421 |
| (b) Summarised statement of comprehensive income | | |
| Profit for the year | 113,566 | 101,105 |
| Total comprehensive income for the year | 113,566 | 101,105 |
| (c) Parent entity guarantees | | |
| Bank overdraft | 956 | 917 |
| Cash advance facility | - | 65,000 |
| Term loan facility | - | 100,000 |
| Secured term loan B | 1,609,297 | - |
| Syndicated revolver | 213,888 | - |

(d) The final dividend declared to be paid on 30 October 2019 as per note 6 shall be funded by way of a dividend to be received from a wholly owned subsidiary.

Directors' Declaration

The Directors declare that the financial statements and notes set out on pages 56 to 85 in accordance with the Corporations Act 2001:

- (a) Comply with Accounting Standards and the Corporations Regulations 2001, and other mandatory professional reporting requirements;
- (b) As stated in Note 1(a) the consolidated financial statements also comply with International Financial Reporting Standards; and
- (c) Give a true and fair view of the financial position of the consolidated entity as at 30 June 2019 and of its performance for the year ended on that date.

In the Directors' opinion there are reasonable grounds to believe that Reece Limited will be able to pay its debts as and when they become due and payable.

The Company and the group entities identified in Note 27 will be able to meet any obligations or liabilities to which they are or may become subject to by virtue of the Deed of Cross Guarantee between the Company and those group entities pursuant to ASIC Class Order 2016/785.

This declaration has been made after receiving the declarations required to be made by the Chief Executive Officer and Chief Financial Officer to the Directors in accordance with sections 295A of the Corporations Act 2001 for the financial year ending 30 June 2019.

This declaration is made in accordance with a resolution of the Directors.

Dated at Melbourne on 28 August 2019.



L. A. Wilson
Executive Chairman



P.J. Wilson
Group Chief Executive Officer

Independent Auditors' Report



Independent Auditor's Report

To the shareholders of Reece Limited

Report on the audit of the Financial Report

Opinion

We have audited the **Financial Report** of Reece Limited (the Company).

In our opinion, the accompanying Financial Report of the Company is in accordance with the *Corporations Act 2001*, including:

- giving a true and fair view of the **Group's** financial position as at 30 June 2019 and of its financial performance for the year ended on that date; and
- complying with *Australian Accounting Standards* and the *Corporations Regulations 2001*.

The **Financial Report** comprises:

- Consolidated statement of financial position as at 30 June 2019
- Consolidated statement of profit or loss, Consolidated statement of comprehensive income, Consolidated statement of changes in equity, and Consolidated statement of cash flows for the year then ended 30 June 2019
- Notes including a summary of significant accounting policies
- Directors' Declaration.

The **Group** consists of the Company and the entities it controlled at the year end or from time to time during the financial year.

Basis for opinion

We conducted our audit in accordance with *Australian Auditing Standards*. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Our responsibilities under those standards are further described in the *Auditor's responsibilities for the audit of the Financial Report* section of our report.

We are independent of the Group in accordance with *the Corporations Act 2001* and the ethical requirements of the *Accounting Professional and Ethical Standards Board's APES 110 Code of Ethics for Professional Accountants* (the Code) that are relevant to our audit of the Financial Report in Australia. We have fulfilled our other ethical responsibilities in accordance with the Code.

Key Audit Matters

The **Key Audit Matters** we identified are:

- Acquisition of MORSCO Inc.
- Valuation of goodwill and intangible assets
- Valuation of inventory
- Valuation and accounting for derivatives

Key Audit Matters are those matters that, in our professional judgement, were of most significance in our audit of the Financial Report of the current period.

These matters were addressed in the context of our audit of the Financial Report as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

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Independent Auditors' Report

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| Acquisition of MORSCO Inc. (\$2.0b) | |
|--|---|
| Refer to Note 7 to the Financial Report - Business Combinations | |
| The key audit matter | How the matter was addressed in our audits |
| <p>In July 2018, the Group acquired a 100% equity interest in Patriot Supply Holdings, Inc. and its controlled entities (MORSCO) for consideration of \$2.0b, resulting in \$1.12b of goodwill acquired.</p> <p>This is a key audit matter due to the:</p> <ul style="list-style-type: none"> • Size of the acquisition and its pervasive impact on the financial statements. The acquisition resulted in an increase in total assets of \$2.35b; • Group's judgement involved in establishing the fair value of assets and liabilities acquired, in particular the identifiable intangible assets, such as customer relationships and trade names. <p>The Group engaged an external expert to advise on the identification and measurement of intangible assets in connection with the acquisition. Our assessment of the assumptions into the valuations of intangible assets, including forecast revenue growth rates, useful lives and discount rates, was complex. This, together with the introduction of new geographies and markets for the Group, increases the risk of inaccurate forecasts. This drives additional audit effort specifically on the feasibility of these assumptions and consistency of application to the Group's strategy.</p> <p>We involved our valuation specialists to supplement our senior team members in assessing this key audit matter.</p> | <p>Working with our valuation specialists, our procedures included:</p> <ul style="list-style-type: none"> • Assessing the scope, competency, and objectivity of the external expert engaged by the Group; • Reading the transaction documents to understand the key terms and conditions of the acquisition; • Evaluating the valuation methodology used by the Group to determine the fair value of assets and liabilities acquired, considering accounting standard requirements and observed industry practices; • Comparing the relevant historical financial information, primarily revenue, used by the Group as the starting point in determining the fair value of intangible assets acquired, to past performance of MORSCO available to us via their incumbent auditor; • Challenging the key assumptions used by the Group and their external expert in determining the fair value of intangible assets acquired by: <ul style="list-style-type: none"> • Assessing the percentage of cash flows attributable to customer relationships and trade names to understand the extent of each business unit's reliance on customer relationships and trade names to generate future cash flows. We used our knowledge of MORSCO, its business and customers, via the incumbent auditors as part of our Group audit approach; • Assessing the useful life allocated to customer relationships and trade names, using our knowledge of MORSCO, its business and customers, and our industry experience; • Comparing forecast revenue growth rates over the useful lives to published studies of industry trends and expectations, while considering differences for MORSCO's operations based on our knowledge of MORSCO, its business and customers; • Analysing the discount rates applied against our knowledge of the Group, its industry and publicly available data of comparable entities; • Assessing the adequacy of the Group's disclosures in respect of the acquisition using our understanding obtained from our testing and against the accounting standard requirements. |

Independent Auditors' Report



Valuation of goodwill and intangible assets (\$1.8b)

Refer to Note 12 to the Financial Report – Intangibles

The key audit matter

A key audit matter for us was the Group's annual testing of goodwill and intangible assets given the size of the balance (being 40% of total assets). The Group has a number of different operating businesses which have significant goodwill recorded, including the MORSCO business acquired during the year. The Group assesses the valuation of goodwill and intangible assets via detailed value in use modelling, which contains a number of assumptions.

We focussed on the significant forward-looking assumptions the Group applied in these value in use models, including:

- Forecast operating cash flows - the acquisition of MORSCO during the year increased the possibility of inaccurate forecasts or a wider range of possible outcomes for us to consider, due to this being the first year the Group has forecasted operating cash flows relating to MORSCO;
- Growth rates and terminal growth rates - the Group's models are highly sensitive to small changes in these assumptions, reducing available headroom. This drives additional audit effort specific to their feasibility and consistency of application to the Group's strategy;
- Discount rate - these are complex in nature and vary according to the specific risks of each business and the primary regions they operate in. The Group's modelling is also sensitive to small changes in the discount rate.

We involved valuation specialists to supplement our senior audit team members in assessing this key audit matter.

How the matter was addressed in our audit

Working with our valuation specialists, our procedures included:

- Assessing the value in use methodology applied by the Group to perform the annual test of goodwill and intangible assets for impairment against the requirements of the accounting standards;
- Assessing the integrity of the value in use models used, including the accuracy of the underlying calculation formulas;
- Considering the sensitivity of the models by varying key assumptions, such as forecast growth rates and discount rates. We did this to identify those CGUs at higher risk of impairment and to focus our further procedures;
- Assessing the accuracy of previous Group forecasts to inform our evaluation of forecasts incorporated in the models;
- Challenging the Group's forecast cash flows and growth rates, considering the acquisition of MORSCO during the year. We compared forecast growth rates and terminal growth rates to published studies of industry trends and expectations, and considered differences to the Group's operations. We used our knowledge of the Group, their past performance, business and customers, and our industry experience;
- Checking the consistency of forecast cash flows and the growth rates to the Group's stated plan and strategy, past performance of the Group, and our experience regarding the feasibility of these in the economic environment in which they operate;
- Independently developing a discount rate range using publicly available data for comparable entities, adjusted by risk factors specific to the Group and the industry it operates in;
- Assessing the disclosures in the financial report using our understanding obtained from our testing and against the requirements of the accounting standards.

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| Valuation of inventory (\$1.0b) | |
|---|---|
| Refer to Note 10 to the Financial Report – Inventories | |
| The key audit matter | How the matter was addressed in our audit |
| <p>The valuation of inventory is a key audit matter due to the:</p> <ul style="list-style-type: none"> • Size of the inventory balance, which is significant to the balance sheet (21% of total assets); • Importance of inventory valuation to the business operations and financial performance of the Group; • Group's inventory values being assessed across multiple product categories; • Group's judgement involved in estimating the level of inventory allowance. Estimating the allowance for obsolete inventory, and therefore the value of inventories, by the Group requires consideration of the ageing of products on hand, level of inventory on hand, inventory turnover and anticipated future sales. Such judgements may have a significant impact on the Group's allowance, and therefore the overall carrying value of inventories, necessitating additional audit effort. | <p>Our procedures included:</p> <ul style="list-style-type: none"> • Assessing the Group's policies for the valuation of inventory against the requirements of the accounting standards; • Applying our understanding of the Group's business model in critically evaluating the Group's methodology to identify slow moving and obsolete inventory; • Testing the Group's slow moving and obsolete inventory assessment at year-end, by: <ul style="list-style-type: none"> • Assessing its integrity by performing computation checks; • Identifying key data, such as the number of items on hand and recent selling prices, and comparing a sample to recent sales invoices before year-end; • Considering its sensitivity by varying key assumptions, such as the allowance percentages by product category and number of items on hand; • Challenging the Group's assumptions, such as the allowance percentages by product category and number of items on hand, with reference to shelf life, using our understanding of the Group's business and the markets for the products; • Comparing a sample of inventory product values recorded by the Group at year-end to the Group's post year-end recommended retail selling prices, to identify products at risk of selling below their recorded values. We compared the results to the Group's assessment; • Assessing the integrity of the inventory allowance, including the accuracy of the underlying calculations. |

Independent Auditors' Report



Valuation and accounting for derivatives (\$39.9m assets; \$26.9m liabilities)

Refer to Note 17.1 of the Financial Report – Financial assets and liabilities

| The key audit matter | How the matter was addressed in our audit |
|--|--|
| <p>The valuation and accounting for derivatives is a key audit matter due to the:</p> <ul style="list-style-type: none"> • size of the Group's derivatives entered into to hedge the Group's exposure to foreign currency and interest rate risk arising on debt used to fund the acquisition of MORSCO, in particular cross currency and interest rate swaps hedging Australian dollar and US dollar denominated floating rate debt; • inherent complexity in the Group's estimation of the fair value of derivatives and the Group's application of hedge accounting. This includes ongoing monitoring of hedge effectiveness for compliance with the specific requirements of AASB 9 <i>Financial Instruments</i>. <p>In assessing this key audit matter, we involved our valuation specialists, who have industry-specific experience and detailed knowledge of the complex accounting standard requirements, to supplement our senior audit team members.</p> | <p>With the assistance of our valuation specialists, our procedures included:</p> <ul style="list-style-type: none"> • evaluating the valuation methodologies and hedge accounting, including hedge effectiveness, to observed industry practices and accounting standard requirements; • evaluating the adequacy of the Group's hedge designation documentation for a sample of hedges against accounting standard requirements; • assessing the Group's market data and assumptions underlying the valuation of derivatives at hedge designation date and the year-end date. We compared market data and assumptions to independently sourced market and credit data sets, including spot foreign exchange rates, currency interest rate curves, currency basis spreads and credit pricing curves; • performing our own valuation of a sample of derivatives using independently sourced market and credit data and assumptions, and industry accepted valuation techniques. We compared these valuations to the Group's recorded valuations; • obtaining independent confirmation from counterparties with which the Group has derivative financial instruments and comparing the key terms of these to the Group's accounting records; • evaluating the appropriateness of the classification and presentation of derivative financial instruments and related financial risk management disclosures against accounting standard requirements. |

Independent Auditors' Report



Other Information

Other Information is financial and non-financial information in Reece Limited's annual reporting which is provided in addition to the Financial Report and the Auditor's Report. The Directors are responsible for the Other Information.

Our opinion on the Financial Report does not cover the Other Information and, accordingly, we do not express an audit opinion or any form of assurance conclusion thereon, with the exception of the Remuneration Report and our related assurance opinion.

In connection with our audit of the Financial Report, our responsibility is to read the Other Information. In doing so, we consider whether the Other Information is materially inconsistent with the Financial Report or our knowledge obtained in the audit, or otherwise appears to be materially misstated.

We are required to report if we conclude that there is a material misstatement of this Other Information, and based on the work we have performed on the Other Information that we obtained prior to the date of this Auditor's Report we have nothing to report.

Responsibilities of the Directors for the Financial Report

The Directors are responsible for:

- preparing the Financial Report that gives a true and fair view in accordance with *Australian Accounting Standards* and the *Corporations Act 2001*
- implementing necessary internal control to enable the preparation of a Financial Report that gives a true and fair view and is free from material misstatement, whether due to fraud or error
- assessing the Group and Company's ability to continue as a going concern and whether the use of the going concern basis of accounting is appropriate. This includes disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless they either intend to liquidate the Group and Company or to cease operations, or have no realistic alternative but to do so.

Auditor's responsibilities for the audit of the Financial Report

Our objective is:

- to obtain reasonable assurance about whether the Financial Report as a whole is free from material misstatement, whether due to fraud or error; and
- to issue an Auditor's Report that includes our opinion.

Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with *Australian Auditing Standards* will always detect a material misstatement when it exists.

Misstatements can arise from fraud or error. They are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of the Financial Report.

A further description of our responsibilities for the audit of the Financial Report is located at the *Auditing and Assurance Standards Board* website at: http://www.auasb.gov.au/auditors_responsibilities/ar1.pdf. This description forms part of our Auditor's Report.

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Report on the Remuneration Report

Opinion

In our opinion, the Remuneration Report of Reece Limited for the year ended 30 June 2019, complies with *Section 300A* of the *Corporations Act 2001*.

Directors' responsibilities

The Directors of the Company are responsible for the preparation and presentation of the Remuneration Report in accordance with *Section 300A* of the *Corporations Act 2001*.

Our responsibilities

We have audited the Remuneration Report included on pages 42 to 50 of the Directors' report for the year ended 30 June 2019.

Our responsibility is to express an opinion on the Remuneration Report, based on our audit conducted in accordance with *Australian Auditing Standards*.

KPMG

KPMG

BW Szentirmay

Partner

Melbourne

28 August 2019

Shareholders Information

In accordance with Section 4.10 of the Australian Stock Exchange Limited Listing Rules, the Directors provide the following information.

Shareholding analysis

(a) Distribution of shareholders

At 9 August 2019, the distribution of shareholdings was as follows:

| Size of Shareholding | Number of Shareholders |
|---|------------------------|
| 1 – 1,000 | 1,887 |
| 1,001 – 5,000 | 1,956 |
| 5,001 – 10,000 | 481 |
| 10,001 – 100,000 | 467 |
| Over 100,000 | 103 |
| Holdings of less than a marketable parcel | - |
| | 4,894 |

(b) Substantial shareholdings

The number of shares held by the substantial shareholders listed in the Company's register of substantial shareholders as at 9 August 2019 were:

| Shareholder | Number of Shares |
|------------------------------|------------------|
| John Gay Wilson | 352,145,364 |
| Leslie Alan Wilson | 348,182,864 |
| Bruce Walter Campbell Wilson | 334,692,138 |
| Wilaust Holdings Pty Ltd | 313,050,000 |
| Two Hills Holding Pty Ltd | 97,800,366 |

Note: Many of these substantial shareholdings relate to the same shares.

(c) Class of shares and voting rights

At 9 August 2019, there were 4,894 holders of ordinary shares of the Company. All of the issued shares in the capital of the parent entity are ordinary shares and each shareholder is entitled to one vote per share.

(d) Twenty largest shareholders, as at 9 August 2019:

| Shareholder | Number of Shares | % Held |
|---|------------------|--------|
| L.T. Wilson Pty Ltd | 157,200,000 | 28.0% |
| L.T.W. Holdings Pty Ltd | 60,000,000 | 10.7% |
| Warramunda Investments Pty Ltd | 48,645,000 | 8.7% |
| HSBC Custody Nominees (Australia) Limited | 38,487,635 | 6.9% |
| J P Morgan Nominees Australia Limited | 26,993,464 | 4.8% |
| Florizel Investments Pty Ltd | 16,801,600 | 3.0% |
| W.A.L. Investments Pty Ltd | 16,801,600 | 3.0% |
| J.G.W. Investments Pty Ltd | 16,801,600 | 3.0% |
| Geronimo Custodian Pty Ltd | 15,053,764 | 2.7% |
| Glentemp Custodian Pty Ltd | 14,951,945 | 2.7% |
| Austral Hardware Pty Ltd | 14,925,000 | 2.7% |
| Austral Hardware (Healesville) Pty Ltd | 12,000,000 | 2.1% |
| Addawarra Nominees Pty Ltd | 11,550,000 | 2.1% |
| BNP Paribas Nominees Pty Ltd (Agency Lending DRP A/C) | 9,001,557 | 1.6% |
| Wilaust Holdings Pty Ltd | 8,730,000 | 1.6% |
| National Nominees Limited | 7,411,314 | 1.3% |
| Citicorp Nominees Pty Limited | 7,098,139 | 1.3% |
| Australian Foundation Investment Company Limited | 6,219,996 | 1.1% |
| Argo Investments Ltd | 5,180,177 | 0.9% |
| John G. Wilson | 4,671,819 | 0.8% |

The twenty members holding the largest number of shares together held a total of 88.9% of the issued capital.

A.B.N. 49 004 313 133

Reece Limited

Controlled Entities

Reece Australia Pty Ltd
A.B.N. 84 004 097 090

Plumbing World Pty Ltd
A.B.N. 99 004 910 829

Reece Project Supply Pty Ltd
A.B.N. 54 100 065 307

Reece International Pty Ltd
A.B.N. 11 100 278 171

Reece New Zealand Limited
Company No. 1530569

Actrol Parts Holdings Pty Ltd
A.B.N. 98 142 644 488

Actrol Parts Finance Pty Ltd
A.B.N. 21 142 653 889

Actrol Parts Pty Ltd
A.B.N. 93 142 654 564

A.C. Components Pty Ltd
A.B.N. 69 134 588 935

Metalflex Pty Ltd
A.B.N. 18 007 133 057

Metalflex Regional Pty Ltd
A.B.N. 50 142 651 509

Metalflex (S.A.) Pty Ltd
A.B.N. 88 084 260 837

Metalflex (W.A.) Pty Ltd
A.B.N. 98 105 291 263

Air Plus Pty Ltd
A.B.N. 33 135 270 718

The Creative Plane Pty Ltd
A.B.N. 50 092 585 058

Viadux Holdco Pty Ltd
A.B.N. 51 603 303 368

Viadux Bidco Pty Ltd
A.B.N. 42 603 305 326

Viadux Pty Ltd
A.B.N. 75 087 415 745

Hamilton HoldCo, LLC
Company Number 6843365

Patriot Supply Holdings Inc
Company Number 45-4808005

Patriot Supply Intermediate Inc
Company Number 45-3852987

MORSCO Inc
Company Number 75-0450550

MORSCO Supply, LLC
Company Number 75-2588495

Fortiline, LLC
Company Number 56-2136499

Fortiline, Inc
Company Number 57-0819190

Directors

L.A. Wilson (Executive Chairman)
P.J. Wilson (Chief Executive Officer /
Managing Director)
B.W.C. Wilson (retired August 2018)
T.M. Poole
B.C. Wilson
R.G. Pitcher, AM (retired October 2018)
M.L. Quinn
G. Williams
A.W. Wilson (appointed September 2018)

Company Secretary

G.W. Street

Bankers

National Australia Bank
Commonwealth Bank of Australia
Bank of New Zealand
Bank of America
JP Morgan Chase

Solicitors

Lander & Rogers
Mills Oakley Lawyers
DLA Piper

Auditors

KPMG

Registered Office

118 Burwood Highway
Burwood, Victoria, 3125
Telephone (03) 9274 0000
Facsimile (03) 9274 0197

Share Registry

Computershare Investor Services Pty Limited
Yarra Falls
452 Johnston Street
Abbotsford, Victoria, 3067
Telephone (03) 9415 5000
Facsimile (03) 9473 2500

Stock Exchange Listing

Reece Limited shares are listed
on the Australian Securities Exchange
ASX Code: REH

NOTICE OF MEETING

Notice is hereby given that the Annual General Meeting of Reece Limited will be held at 2pm on Wednesday, 30 October, 2019 at the Mayfair Ballroom, Grand Hyatt Melbourne, 123 Collins Street, Melbourne, Victoria, Australia.

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