Australian Shareholders' Association

Australian Shareholders' Association Limited
ABN 40 000 625 669
Suite 11, Level 22
227 Elizabeth Street, Sydney NSW 2000
PO Box A398, Sydney South NSW 1235
t (02) 9252 4244 | f (02) 9071 9877
e share@asa.asn.au

Reece thinks it was a good year for their overpaid CEO but we're not that sure

Company/ASX Code	Reece/REH
AGM date	Wednesday 30 October 2019
Time and location	2pm, Grand Hyatt Melbourne, 123 Collins Street Melbourne
Registry	Computershare
Webcast	No
Poll or show of hands	Poll on all items (for the first time)
Monitor	John Whittington assisted by Michael Muntisov
Pre AGM Meeting?	Yes, with Executive Chair Alan Wilson, Chair of Remuneration Committee Tim Poole, and Company Secretary Gavin Street

Item 1	**Consideration of accounts and reports**
ASA Vote	No vote required

Summary of ASA Position

Governance and culture

The Wilson family own approximately 73% of Reece and the Executive Chair, CEO, and four of seven members of the board are members of the extended family. So, any other shareholder is basically coming along for the ride that the Wilson family directs. That's not necessarily a bad thing – most Reece shareholders have probably done very well over the past forty years – but shareholders need to be aware of this issue.

Financial performance

In FY19, Reece's total revenue increased by 103% to $5,464m. This was largely driven by the acquisition of US plumbing distributor MORSCO during the year, a company of similar size to Reece. More than half (52%) of revenue came from Australia and New Zealand (up 7% to $2,866m) and 48% of revenue from the US (AU$2,598m).

Reported net profit after tax (NPAT) was down 10% to $202.1m, although adding back $28.5m in acquisition costs would suggest that underlying NPAT (something Reece don't quote) was up 3% to $230.6m. Out of the total underlying profit, 88% came from Australia and New Zealand (down 9% to $202.7m although this included interest payments on debt required to fund the US acquisition) and only 12% from US operations (AU$27.9m). Earnings per share was down 20% to 36 cents.

Cash flow from operations was up 41% (to $254m) with free cash flow (dominated by the MORSCO acquisition of $2,001m) down to -$1,841m (from $44m).

Dividends for the year were unchanged at 20.25 cents and total shareholder return for the year was -21.2% (-22.8% from the decrease in share price and 1.6% from dividends).

Key events

On 2 July 2018 the company acquired MORSCO, a distributor of plumbing, waterworks, and HVAC (heating, ventilation, and air conditioning) products operating in 16 states in the North America and of similar size to Reece.

Key Board or senior management changes

Mr Bruce W C Wilson retired from the board on 31 August 2018 after 48 years on the board and was replaced by his son Mr Andrew Wilson. Mr Ron Pitcher AM retired from the board on 31 October 2018 after 15 years on the board.

ASA focus issues

The company does not have an independent Chair or majority of independent directors for the reasons mentioned above. Given the company now has almost half its operations in the US we see the board has poor geographic diversity. Gender diversity is borderline, and the information provided on Directors up for re-election is barely adequate.

Remuneration disclosure has improved somewhat but is still poor in key areas. The Wilson family have excellent "skin in the game" and alignment with shareholders but that of the independent directors is poor with two of the three independent directors not having any Reece shares at all.

Shareholder participation is generally poor – as mentioned above you are going along for the ride – and the last capital raising (in 2018) diluted retail shareholders who didn't have the ability to take it up.

Summary

(As at FYE)	**2019**	**2018**	**2017**	**2016**	**2015**
NPAT ($m)	202.1	224.6	211.8	203.1	165.6
UPAT ($m)	230.6	224.6	211.8	203.1	165.6
Share price ($)	9.76	12.65	8.40*	7.40*	6.94*
Dividend (cents)	20.25	20.25	20.0*	18.4*	15.2*
TSR (%)	-21.2	52.4	16.1*	8.9	17.0
EPS (cents)	36	45	43*	39*	33*
CEO total remuneration, statutory ($m)	4.701	5.135	4.194	3.986	3.700

* Adjusted to account for a 5 for 1 share split in December 2017

For FY19, the CEO's total actual remuneration was **53 times** the Australian Full time Adult Average Weekly Total Earnings (based on May 2019 data from the Australian Bureau of Statistics).

Item 2	To Adopt the Remuneration Report
ASA Vote	Against

Summary of ASA Position

FY2018	Target $m	% of Total	Max. Opportunity $m	% of Total
Fixed Remuneration	2.257	50%	2.257	40%
STI - Cash	2.257	50%	3.386	60%
STI - Equity	-	0%	-	0%
LTI	-	0%	-	0%
Total	4.514	100%	5.643	100%

With the acquisition of MORSCO the remuneration report structure has been significantly updated and (perhaps due to more shareholder focus) the detail and clarity of the report itself is much improved.

Executive remuneration is structured into three components – fixed remuneration, short-term incentives (STI) and long-term incentives (LTI).

The fixed remuneration is supposedly set following benchmarking but we're not sure what they are using as the benchmark for the CEO who received $2.257m fixed remuneration in FY19. We have done our own benchmarking and found that:

- It is 26% higher than the median fixed pay for all companies in the ASX100, a group which includes BHP and the big banks and where Reece would fit in near the bottom (source ACSI CEO Pay in the Top 200 – 2019); and
- It is 52% higher than the median (28% higher than the 75th percentile) of all companies with a market capitalisation between $3.5-7.5b where Reece's market capitalisation is about $5.5b (source Godfrey Remuneration Group All Industries KMP Remuneration Guide 2019)

We believe this is excessive. Reece is not that big or complex a company.

The STI provides a cash payment for achieving targets of 100% of fixed remuneration if performance is on target and up to 150% of fixed remuneration for above target performance. The targets are 80% financial (normalised EBITDA performance, normalised EBITDA to sale, net debt to normalised EBITDA, and earnings per share) and 20% individual (not identified). The weighting of the financial targets and the performance achieved have not been disclosed which we find difficult to accept. The end result is that the CEO got paid 108% of target (and 108% of fixed remuneration) this year where statutory profit was down and TSR was -21%.

Further to the benchmarking above, we have done our own benchmarking and found:

- This incentive is 54% higher than the median bonus for CEOs in the ASX100 (source ACSI CEO Pay in the Top 200 – 2019); and
- The combination of fixed remuneration and STI ($4,701m) is 75% higher than the median (56% higher than the 75th percentile) of base remuneration plus STI, and 41% higher than the

median (8% higher than the 75th percentile) of total remuneration package of all companies with a market capitalisation between $3.5-7.5b (source Godfrey Remuneration Group All Industries KMP Remuneration Guide 2019)

We believe this is also excessive. Reece's size and results do not warrant this level of incentive payment.

Reece have introduced an LTI for the first time this year. To prevent duplication please refer to item 5 below for our commentary on the LTI plan. We also note that many essential aspects of the LTI plan (eg use of "fair value") were not disclosed in the Remuneration Report.

Whilst we really like the improved layout of the report and that the new LTIs are at risk for seven years, the quantum of the current CEO's remuneration, the seeming lack of alignment with actual performance, no disclosure of the number of LTI options to be issued nor their strike price, and the poor disclosure of target achievement and other details of the LTI plan means we cannot support this resolution.

Item 3	**To Re-elect Mr Timothy M Poole as Director**
ASA Vote	**Undecided**

Summary of ASA Position

Mr Poole, who previously worked at Price Waterhouse and Hastings Funds Management, (where he reached the position of Managing Director) was appointed to the board in July 2016. He has a shareholding equivalent to only 44% of his total remuneration.

Mr Poole is Chairman of two ASX listed companies (Aurizon Holdings and McMillan Shakespeare) and director of one other (Reece) so we consider that he is fully loaded but his workload is not excessive.

We believe that Mr Poole is very well qualified to contribute to the board however we are disappointed by his lack of "skin in the game" (ie shareholding). If, prior to or at the AGM, he makes a commitment to increase his stake in the company we will support his election, otherwise we will vote against.

Item 4	**To Re-elect Mr Bruce C Wilson as Director**
ASA Vote	**For**

Summary of ASA Position

Mr Wilson manages Wilson Sheet Metals, a manufacturer of roof guttering, downpipes, flashing, and accessories as appointed to the board (replacing his father Mr John Wilson) in September 2016. He has related interests in Reece of over 180,000% of his annual fees so has plenty of "skin in the game".

Mr Wilson is not a director of any other listed company and considering his executive role we consider that he is fully loaded but his workload is not excessive.

We believe that Mr Wilson is probably suitably qualified to contribute to the board and, whilst Reece does not have a majority of independent directors, we find it difficult to object to this given all the non-independent directors are from the Wilson family which owns approx. 62% of the company and has considerable "skin in the game". As a result, we will support his election.

Item 5	**Approval of the Company's Long Term Incentive Plan ("LTI Plan")**
ASA Vote	**Against**

Summary of ASA Position

This item is the first of two which seeks support for the implementation of an LTI plan – Reece having introduced an LTI for the first time this year.

This for the issue of an indeterminant number of options nominally worth $1.278m but likely to be far more due to not disclosing either the number of options issued or the strike price – we can't even guess roughly what it would be.

All of this will be based on the compound average growth rate (CAGR) of the earnings per share (EPS) over a five-year period. If the company's EPS CAGR is below 5% then no shares will vest. If the EPS CAGR is between 5-10% then a linear scale will apply from 50% vesting at 5% to 100% vesting at 10%. If the EPS CAGR exceeds 10% then all shares will vest.

This plan allows incentives to be paid even if the share price declines significantly, like this year. We believe that there should be at least a gateway of positive total shareholder return (TSR) before any incentives can be paid.

We note that Reece's EPS CAGR over the period FY14 to FY18 was 16.2% so we see these targets as rather soft. One thing we do like however about the scheme is that there is further two-year disposal restriction that prohibits the Executive from exercising and selling the resultant shares meaning that the shares are at risk for seven years.

Whilst we like that the LTIs are at risk for seven years, the totally unknown number of LTI options to be issued, the undisclosed strike price, the soft CAGR targets, and the lack of a TSR gateway, means that we cannot support this item.

Item 6	**Grant of Equity to Managing Director and Chief Executive Officer**
ASA Vote	**Against**

Summary of ASA Position

This item is the second of two items seeking support for the new LTI plan and which, like for item 5, we will not support. To avoid duplicating our comments please refer to item 5.

The individuals (or their associates) involved in the preparation of this voting intention have no shareholdings in this company.