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ASX Announcement

13 May 2019

Trading Update: Revised FY2019 EBITDA guidance[1]

Reliance Worldwide Corporation Limited (ASX: RWC) provides the following trading update for FY2019, including the anticipated impact of changed trading conditions on EBITDA for FY2019.[1]

As the second half of FY2019 is progressing, each of RWC's operating segments is being affected by market-specific factors which are negatively impacting performance and results, as described below.

RWC now expects FY2019 EBITDA to be in the range of $260 million to $270 million. The previous FY2019 EBITDA range advised by RWC was $280 million to $290 million, subject to, among other things, an assumption that a modest freeze event would be experienced in the USA.[2]

Americas Segment

The Americas business continues to achieve good underlying growth, particularly at point of sale. However, two issues are restraining net sales in the second half of FY2019.

The first is the almost complete absence of what we have previously described as a modest freeze event. A modest freeze event is considered to be the average level occurrence of winter storms over a sustained period across the USA causing cracked or broken pipes. RWC's business will usually benefit more from freeze events occurring in the southern parts of the USA than in the north-east or mid-west. This is because water pipes are generally not as well insulated in the south meaning a freeze event can cause these pipes to break. RWC estimates the lack of a modest freeze event has reduced net sales by the order of $12 million to $15 million in FY2019. The Company has previously advised that the absence of a modest freeze event could impact FY2019 EBITDA by 1.5% to 3.0%.[3] The estimated impact is within this range.

Second, while the business continues to see strong sales of products by channel partners at point of sale, a number of channel partners have pursued strategies in the second half of the financial year to actively reduce inventory on hand. As a result, net sales in this half are lower than expected, particularly in the Retail channel. While this is ultimately a timing issue due to these inventory strategies rather than a fundamental demand issue, we are not assuming any meaningful change in customer inventory levels during the remainder of FY2019.

From a cost perspective, the Americas Segment is performing to expectations in the second half, with lower copper costs, in the form of brass bar, flowing through production and the absence of any further challenges from the supplier related issues that impacted the first half of FY2019.

The John Guest business in the Americas continues to perform to expectations from both a sales perspective and in terms of synergy realisation.

EMEA Segment

The EMEA business continues to deliver strong growth led by the first full year inclusion of John Guest. The John Guest business remains on target to achieve annual net sales growth in FY2019 in line with our expectations at the time of the acquisition. However, sales in the core RWC businesses in the UK and Spain have not met expectations in the second half. There are two principal drivers of this underperformance which together are negatively impacting sales.

The first and most significant driver of lower net sales in the second half relates to a decision by RWC to exit certain product lines previously sold by the core RWC business in the UK, in particular Thermal Interface Units. While RWC previously saw these products as an opportunity in the context of its smaller UK business, it was determined that the growth opportunities presented by the combined RWC / John Guest product portfolio are more attractive and should be prioritised. Accordingly, given the amount of time and resources which would be required to grow these RWC UK products to establish market leading positions and our preference to focus resources on the most attractive growth opportunities, a decision was taken in the second half to exit those product categories. Following the announcement to customers regarding the decision to exit certain product lines, demand for those products has been dropping significantly more quickly than anticipated. Together these product lines are expected to generate net sales $6 million to $7 million lower for FY2019 than previously expected.

The RWC Spain business, which supplies PEXa pipe and related plastic fittings, has not grown as anticipated and net sales for FY2019 are now expected to be $4 million to $5 million lower than previously expected. This reflects lower than expected levels of demand across continental Europe as well as intense competition from larger competitors.

John Guest integration activities in EMEA continue to progress as planned with synergies realisation on or ahead of schedule.

APAC Segment

The APAC segment has under-performed second half expectations principally as a result of a sharper than forecast decline in new home construction in Australia. APAC is the smallest RWC operating segment from an external sales perspective, accounting for about 13% of external net sales. However, approximately half of these external net sales are made in the more cyclical new residential construction market. Moreover, the majority of those sales are to the multi-family segment of the market. Recent data suggests that, on a rolling twelve-month basis to the end of March, the overall new housing market has declined by 7%, while the multi-family sector in particular has declined 11%.[4] We believe this decline has accelerated as the year has progressed. As a result of this decline, APAC net sales for FY2019 are now expected to be $10 million to $15 million lower than previously expected.

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As noted at the time of release of the FY2019 half year results, the full year results for APAC would include the impact of delays in the release of two new product ranges which had been scheduled to be launched into the Australian market in the first half of FY2019. The issues related to the release of those new products have been resolved and they are now in the process of being rolled out to key customers. Revenue in the second half of FY2019 is estimated to be $4 million to $6 million lower as a result of the delays, which is in addition to the $5 million impact on FY2019 first half revenue. From an operations perspective, the business is performing as expected in the second half, with the ERP rollout having been completed in March and operating and materials costs coming through largely as expected.

John Guest synergies

Overall, John Guest integration activities continue to progress on or ahead of schedule. Realised synergies for FY2019 remain on track to meet or exceed the target of $10 million with expected run rate synergies of $20 million per annum by the end of FY2019.

Potential impacts of US tariff changes and Brexit

The recent increase in US tariffs on imports from China from 10% to 25% is not expected to have a material impact on FY2019 EBITDA but could potentially have a negative impact on the Americas segment in FY2020. The tariffs increase will prima facie increase the cost of materials and manufactured components that are imported from China to the US. RWC will seek to mitigate the effects of the increased tariffs through customer price increases and/or negotiated supplier price reductions. Longer-term options to seek to reduce the impact will include considering domestic US sourcing or moving production of manufactured components to alternative sources of supply. It is too early to estimate the impact of the tariff increases on FY2020 performance at this time.

Economic uncertainty also continues in the UK and the EU as a result of the agreement to postpone the Brexit deadline. RWC's assessment of the potential impact of Brexit on the business remains as set out in the half year results announcement dated 25 February 2019.

Outlook

Despite these near-term challenges, RWC continues to be pleased with how the business is positioned, its current trajectory and the underlying performance across our core products and geographies. RWC remains a global leader in both brass and plastic push to connect (PTC) fittings technology. Given the current relatively low penetration levels of PTC, particularly in the USA and the UK, there remains sizeable runway to grow product sales.

We remain very pleased with the progress of integrating the John Guest and core RWC businesses. Cost synergies are being realised as expected and we are starting to see revenue synergies coming through. We have made significant progress integrating the people and cultures of the two businesses and aligning our combined resources to pursue the most attractive growth opportunities.

RWC retains market leading positions across multiple product categories in key geographic segments and has unrivalled distribution networks in the Americas, Australia and the UK which can be leveraged to extend the reach of future products we develop or acquire. In support of that goal, RWC continues to invest in developing and commercialising new products which we believe are both an attractive and necessary source of future growth, particularly as we approach the limits of new distribution and product extension opportunities.

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1 EBITDA referred to in this announcement represents earnings before interest, tax, depreciation and amortisation excluding the following items: one-time integration costs incurred; a $2.4 million expense related to finalising the unwinding of a fair value adjustment made at acquisition date to John Guest inventory; and the estimated impact on EBITDA in connection with the timing of revenue recognition following adoption of new accounting standard AASB 15. EBITDA includes John Guest related synergies achieved during the period.

2 Assumptions as set out in RWC's previous announcements, including 1 February 2019 and 25 February 2019. Those assumptions still apply, where relevant.

3 Measured against the previously announced FY2019 EBITDA guidance range of $280 million to $290 million.

4 Source: Australian Bureau of Statistics.