In May 2018, REH announced they had bought MORSCO. The rational for the purchase as stated in the press release[i]:

Provides Reece a strategic platform in the growing US Sun Belt region

- MORSCO footprint comprises a unique combination of coast-to-coast US scale
- MORSCO has a presence in 16 states in the US, with 171 branches and ~2,500 employees
- The Sun Belt states are forecast to generate higher rates of GDP and population growth compared to national forecasts

Allows access to a large, growing plumbing market in the US with strong demand drivers

- US plumbing is a US$32bn market, while the waterworks and HVAC markets are estimated at US$11bn and US$35bn respectively

MORSCO is a top 3 supplier in 85% of branch markets

- End markets are driven by building and construction demand which have a positive outlook, with US new housing starts still below the 40-year average

Delivers an experienced management team with a proven track record

- MORSCO CEO Chip Hornsby leads a strong team with distribution industry expertise (senior leadership brings a combined 130+ years in market)

Presents the ability to leverage operational expertise and relationships across both businesses

- Opportunity for the measured implementation of best-in-class operational capability, utilising Reece and MORSCO management's extensive industry expertise

A significant opportunity to drive future organic and acquisition led growth for Reece

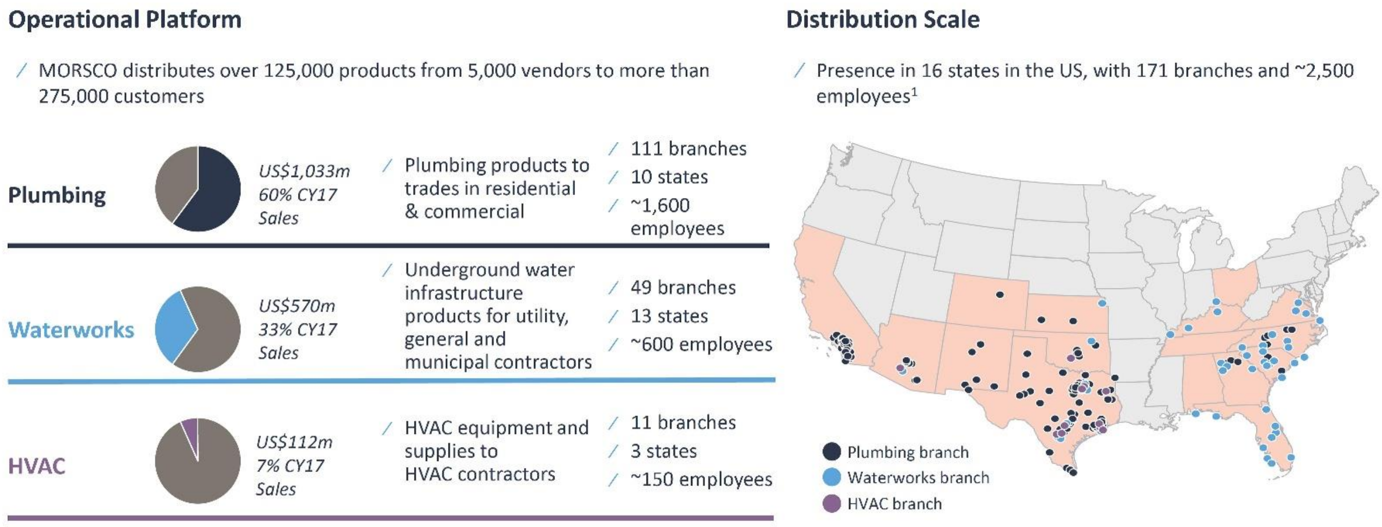
- Organic growth will be driven by both underlying market expansion and improvements in branch operating efficiency
- The US is a large, fragmented market with numerous potential consolidation opportunities across plumbing, HVAC and waterworks

Reece Chief Executive Officer, Peter Wilson said: "We're excited to be entering a long-term partnership with MORSCO to invest in the growth of their business in the US market. **It's a market that's forecast to grow at twice the rate of the Australian market and it is currently about eight times the size.*** By working with this experienced local team led by Chip Hornsby, we are writing the next chapter of Reece's growth for the benefit of our team, our customers, our suppliers and the long-term wealth generation of our shareholders."
* Bold text my edit

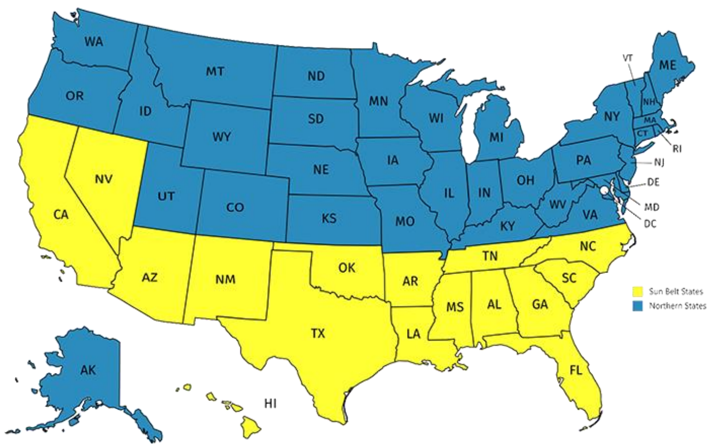
So Reece management believed the macro forecasts that the US Sunbelt region would continue to grow at twice the rate of the Australian market. In their MORSCO acquisition presentation document, they elaborate on this, highlighting the macro-economic forecasts under the heading "strong momentum in demand drivers for end markets" on page 17. The source of the forecasts on page 17 stated as FMI, which is an investment bank and advisory service[ii].

In essence, Reece's capital allocation strategy was derived from macro-economic forecasts provided by an investment bank. I find that really interesting. But what are the real underlying demand drivers of those macro-economic forecasts? More on that later.

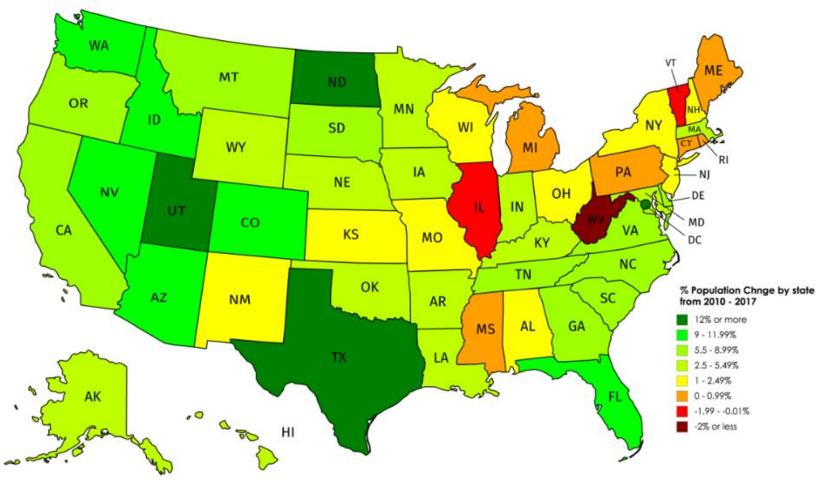
So what is MORSCO and what is the Sunbelt region? This is MORSCO. As you can see, 60% of sales is for the plumbing business which is heavily concentrated in and around the US state of Texas (more on the importance of that later), 33% of sales is for the waterworks business heavily screwed to the eastern states, and 7% for HVAC mainly in Texas.



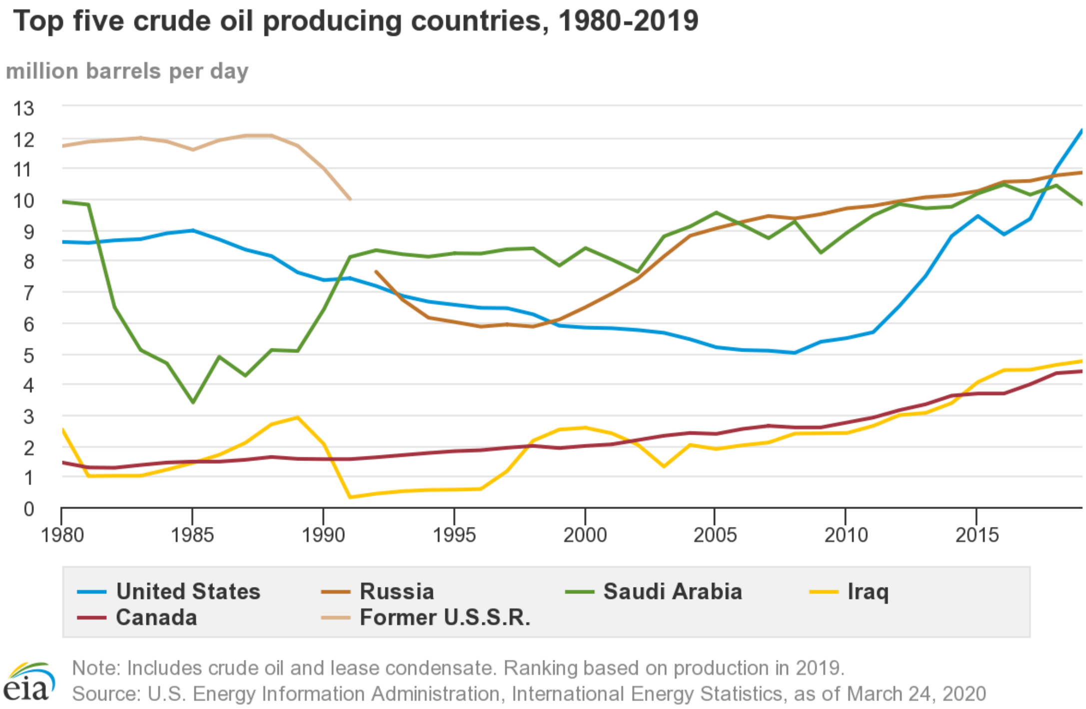
And the Sunbelt region....



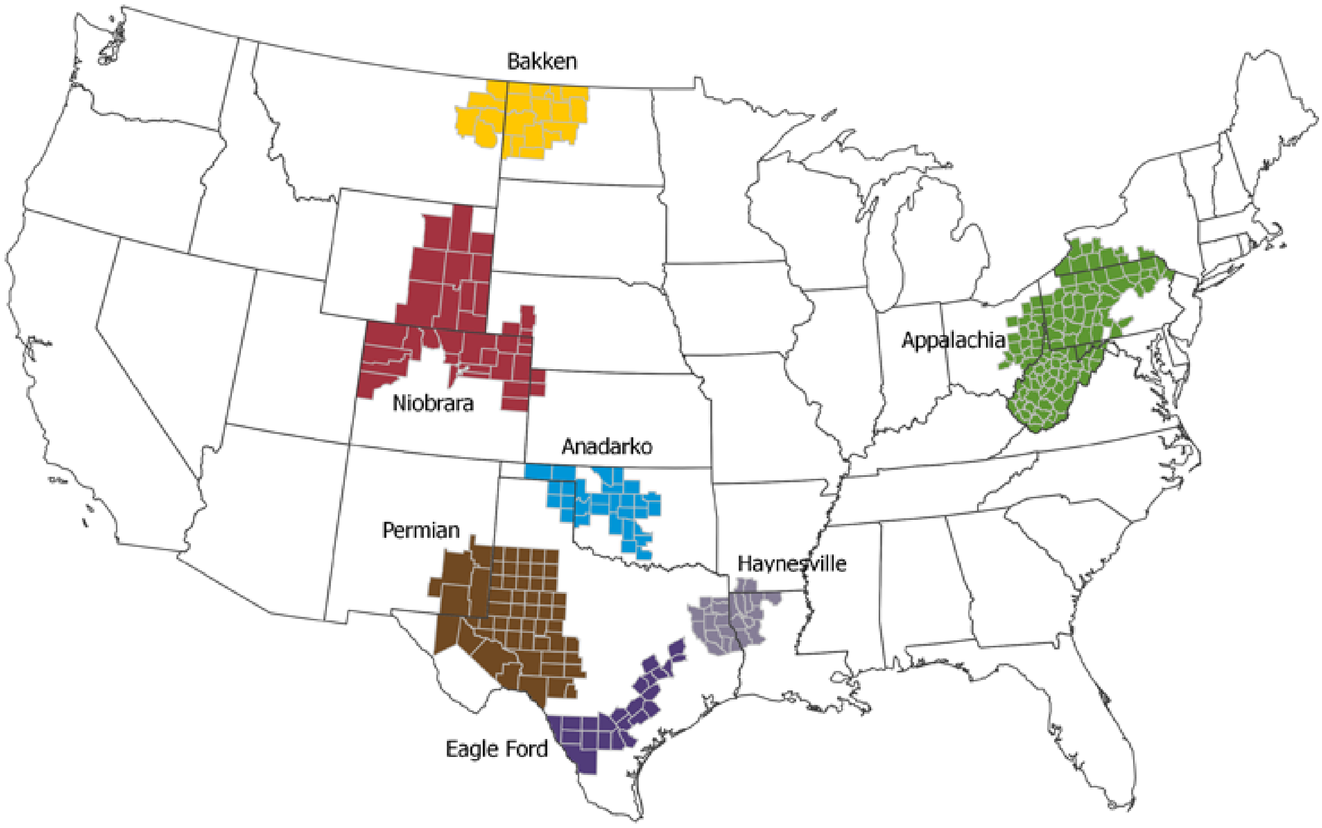
This is a heat map of population growth 2010-2017. I don't know how accurate it is, but it gives a sense of where human capital has been flowing to.



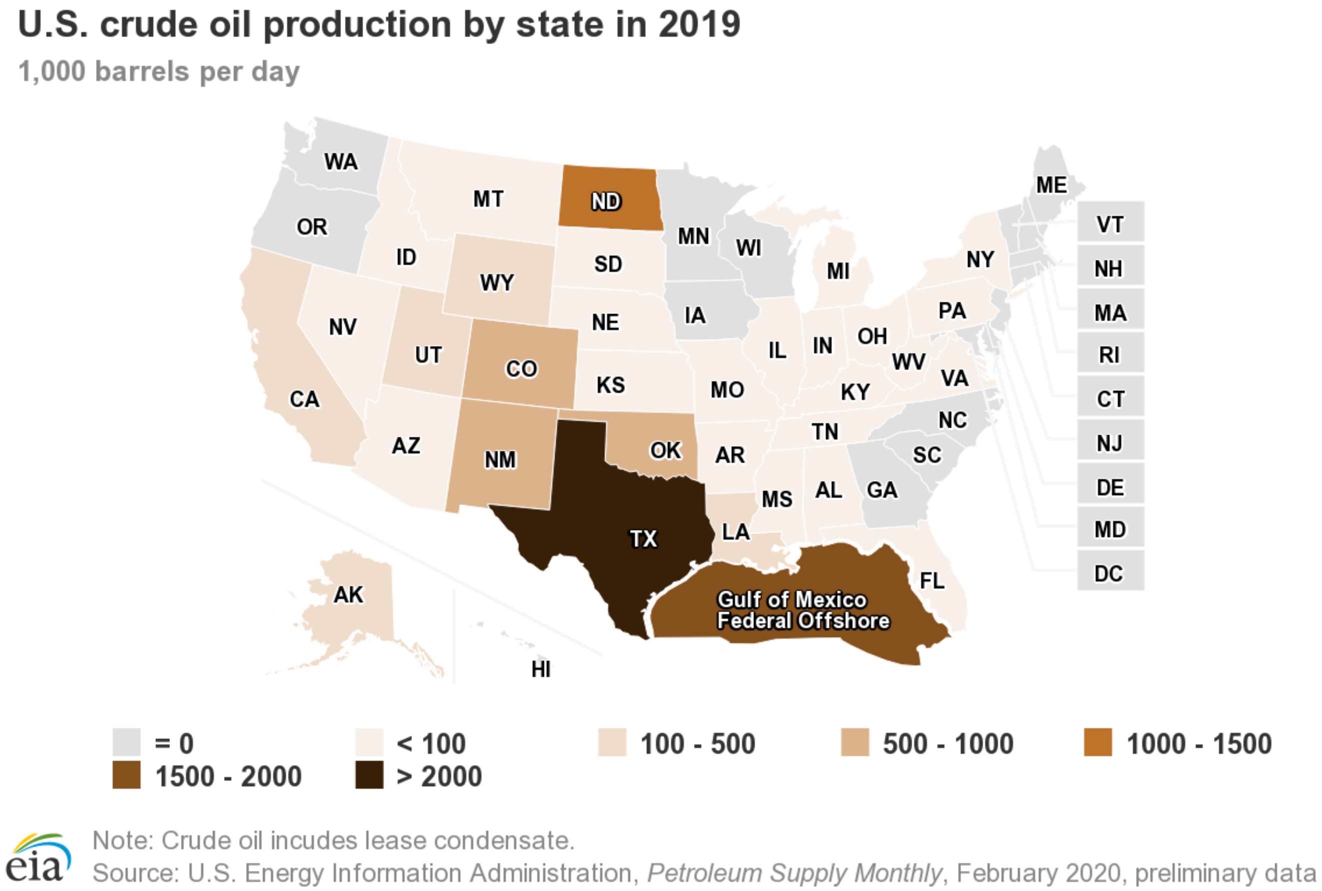
So what has been enticing people to Texas, Utah and North Dakota over the past decade? What is the underlying reasons for the rosy macro-economic forecasts that helped persuade Reece to purchase MORSCO? This is a graph showing the growth in the US shale oil industry. As you can see the growth in production over the past decade has been profound, propelling the US to the number 1 global producer of crude oil.



This map shows the oil and gas production regions



The regions in and around Texas make up approximately 74% of land based crude oil production and 51% of gas production.[iii] The top 5 crude oil producing states are: Texas 41%, North Dakota 11%, New Mexico 8%, Oklahoma 5%, Colorado 4% (and offshore Gulf of Mexico 15%). This is shown on the following map

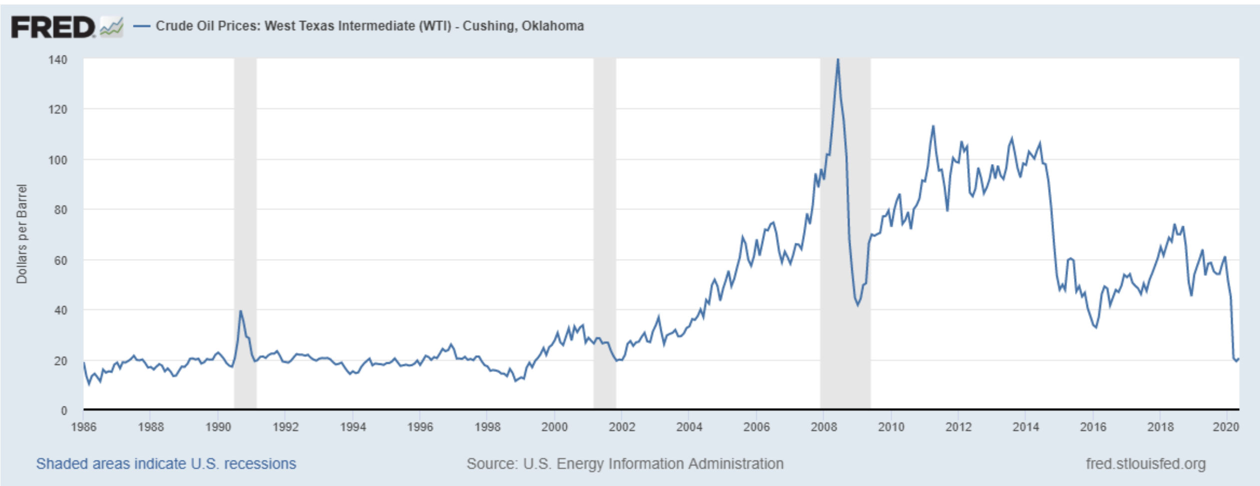


So clearly a large amount of capital has been poured into Texas and surrounding regions over the past decade. Population growth has followed that capital flow.

Private equity roll up strategies that produced the likes of MORSCO obviously thrived on that decade long growth. So companies such as Reece would naturally be enticed by that remarkable growth profile and forecasts for that growth to continue. As the CEO stated in the press release at the time **"**It's a market that's forecast to grow at twice the rate of the Australian market and it is currently about eight times the size".

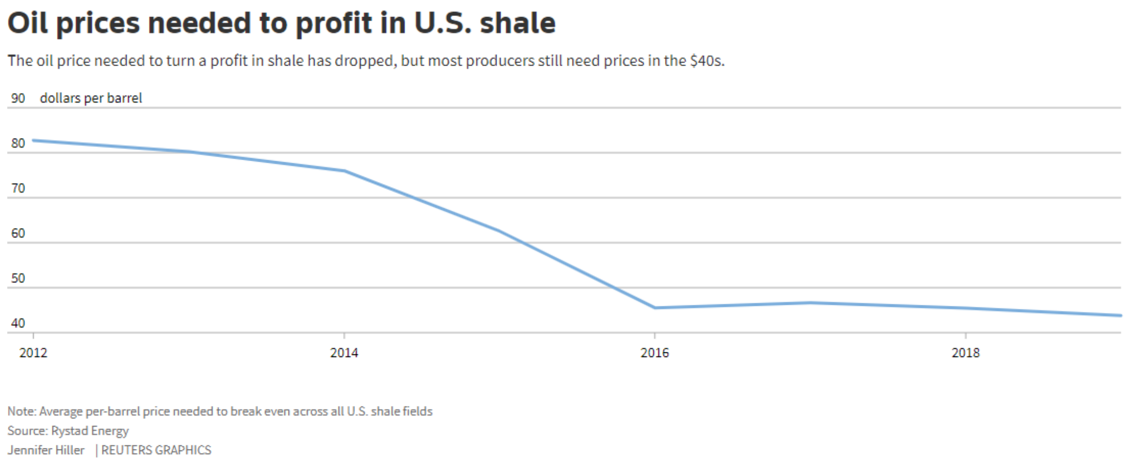
From the US Energy Information Administration (EIA) website… "In the United States, companies produce crude oil on private and public land and offshore waters. Most of these companies are independent producers, and they usually operate only in the United States. The other companies, often referred to as major oil companies, may have hundreds or thousands of employees and operate in many countries. Examples of major U.S. oil companies are Chevron and ExxonMobil."[iv]

As we know, oil price is at historical lows.



So how will a sustained low oil price effect shale oil producers in the sunbelt region? How will that effect population growth and all the associated demand drivers that Reece has pinned its big growth strategy too (A&NZ growth will be fairly subdued I guess as Reece has reached a fairly high saturation of the market here, with new store roll outs less of a growth driver into the future).

Well according to this reuters article[v].... "Shale producers, most of which budgeted for oil between $55 per barrel and $65 per barrel in 2020, have moved quickly to idle rigs, cut staff and generate cash for expenses. The industry is on the ropes for the second time since 2014, when de facto OPEC leader Saudi Arabia launched the last price war to drive shale producers out of the market. That effort pushed many shale producers into bankruptcy but ultimately failed because the industry made quick technological advance that drove costs down."



source of above graph: [vi]

Russia's and Saudi Arabia's "price war" was clever by Putin and the Saudi's to strike a blow to their main competitor when they are at their weakest. Will be interesting to see how Trump responds to all this, noting that Texas has the 2nd highest population and has 36 seats in the US house of reps.[vii]

But putting all that aside, one would think that REH will struggle to reach its aspirations in the US in the short to medium term if the Sunbelt region struggles for the next few years. At the very least, it is reason to be somewhat cautious in terms of portfolio weighting, for me anyway[viii].

Who would have thought that the world oil price would become a key factor in REH's growth strategy. How all this effects valuation estimates and appropriate forward multiples I have got no idea.

Other articles people may find of interest:

https://www.abc.net.au/news/2020-05-06/will-us-oil-industry-collapse-impact-trumps-election-chances/12201514?section=analysis

https://www.rystadenergy.com/newsevents/news/press-releases/us-fracking-set-for-the-biggest-monthly-decline-in-history-as-oil-prices-collapse-and-covid-19-persists/

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[i] https://www.reecegroup.com.au/asx-archive/#2018
[ii] https://www.fminet.com/
[iii] https://www.eia.gov/energyexplained/oil-and-petroleum-products/where-our-oil-comes-from.php
[iv] https://www.eia.gov/energyexplained/oil-and-petroleum-products/where-our-oil-comes-from.php
[v] https://www.reuters.com/article/us-global-oil-shale-costs-analysis-idUSKBN2130HL
[vi] https://fingfx.thomsonreuters.com/gfx/editorcharts/GLOBAL-OIL-SHALE-COSTS/0H001R8GDCBQ/index.html
[vii] https://simple.wikipedia.org/wiki/List_of_U.S._states_by_population
[viii] My weighting increased from 0.4% to 1.5% following the capital raise. I managed to get my price/unit down to ~$2.30 over the last five years, with the recent SPP helping a lot. So I am happy with my level of risk exposure to REH for the time being.