

WATPAC LIMITED
INTERIM FINANCIAL REPORT
31 DECEMBER 2017



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The Directors present their report, together with the consolidated interim financial statements of Watpac Limited (**Watpac** or **Company**) and its controlled entities (**Group**) for the half year ended 31 December 2017 (**1H FY18** or **Reporting Period**) and the Auditor's review report thereon.

Directors

The Directors of the Company (**Board**) at any time during or since the end of the half year are:

Name	Period of directorship
Non-executive	
Mr Peter L Watson (Chair)	Director since 7 July 2017 Chair since 25 August 2017
Mr Garret J Dixon	Director since 12 February 2014
Ms Linda C Evans	Director since 25 August 2015
Ms Bronwyn K Morris	Director since 3 February 2015
Mr Carlo J Schreurs	Director since 10 October 2014
Mr Rik Vandenberghe	Director since 23 August 2017
Mr Johan C M C Beerlandt	Retired 23 August 2017
Mr Richard B McGruther	Retired 25 August 2017
Executive	
Mr Martin G Monro	Director since 10 October 2014

Review of operations

The Group's operations for the Reporting Period principally comprised its core businesses of Construction and Civil & Mining.

Financial

The Group recorded a statutory loss after tax of \$1.4M for the Reporting Period. This compares to the statutory profit after tax of \$0.6M recorded for the half year ended 31 December 2016 (**1H FY17** or **Comparative Period**).

Included in the table and graph below is an overview of the Statutory Result for the Group and its reportable segments for 1H FY18 compared to 1H FY17.

In thousands of AUD	Revenue				Statutory Profit/(Loss)			
	1H FY18	1H FY17	\$ Variance	% Variance	1H FY18	1H FY17	\$ Variance	% Variance
Construction	524,664	511,547	13,117	2.56%	9,208	10,102	(894)	(8.85%)
Civil & Mining	47,465	67,671	(20,206)	(29.86%)	(3,026)	2,808	(5,834)	(207.76%)
Operating Total	572,129	579,218	(7,089)	(1.22%)	6,182	12,910	(6,728)	(52.11%)
Property	-	4,660	(4,660)	(100.00%)	(131)	(254)	123	48.43%
Unallocated	-	-	-	N/A	(7,865)	(11,957)	4,092	34.22%
Inter-segment/Elimination	(652)	(68)	(584)	(858.82%)	-	-	-	N/A
Total	571,477	583,810	(12,333)	(2.11%)	(1,814)	699	(2,513)	(359.51%)
Tax benefit/(expense)					397	(129)	526	407.75%
Net profit/(loss) after tax					(1,417)	570	(1,987)	(348.60%)

Key metrics in respect of the Statutory Result for 1H FY18 compared to 1H FY17 are summarised in the following table:

In thousands of AUD	1H FY18	1H FY17	\$ Change	% Change
Statutory result				
Total revenue	571,477	583,810	(12,333)	(2.11%)
Profit/(loss) before tax	(1,814)	699	(2,513)	(359.51%)
Income tax benefit/(expense)	397	(129)	526	407.75%
Profit/(loss) after tax	(1,417)	570	(1,987)	(348.60%)
Profit/(loss) after tax attributable to members	(1,417)	570	(1,987)	(348.60%)
Basic earnings per share attributable to members (cents)	(0.77)	0.31	(1.08)	(348.39%)
NTA per share (cents)	97	115	(18)	(15.65%)
Return on shareholders' funds (percentage)	(1.44%)	0.49%	(1.93%)	(393.88%)

The table below summarises the Group's result at both a statutory reporting level and an underlying trading result level.

In thousands of AUD	1H FY18	1H FY17	\$ Change	% Change
Underlying result				
Statutory net profit/(loss) after tax attributable to members	(1,417)	570	(1,987)	(348.60%)
Adjust for:				
Pre-tax new business expenditure	-	3,297	(3,297)	(100.00%)
Tax on adjustments	-	(763)	763	(100.00%)
Underlying profit/(loss) after tax attributable to members	(1,417)	3,104	(4,521)	(145.65%)
Underlying earnings per share attributable to members (cents)	(0.77)	1.67	(2.44)	(146.11%)

As illustrated in the table above, the Comparative Period result included \$3.3M (pre-tax) in new business costs that were considered outside the scope of normal operations, being the pursuit of strategic growth and to utilise surplus capital in income producing activities. While the Group continues to investigate new opportunities, no significant new business expenditure costs considered outside normal operations were incurred in the Reporting Period.

Construction

Financial Overview

The Construction segment provides building, refurbishment, project management, and construction management services across all Eastern states in Australia, and South Australia.

The Construction segment reported a pre-tax profit for 1H FY18 of \$9.2M (1H FY17: \$10.1M). After allocation of Corporate overheads, this translates to a pre-tax profit for the Reporting Period of \$2.0M (1H FY17: \$2.5M), and represents an annualised pre-tax return on allocated equity capital of 4.56%.

As previously reported, the Construction segment's profitability has been adversely affected in recent reporting periods by the prolonged cost escalation pressures emanating from the intense residential construction activity. Several projects that were adversely impacted by these market conditions continued into the Reporting Period and will continue into the second half of the 30 June 2018 financial year (**FY18**).

While the balance of the projects are performing in accordance with expectations, reflecting the execution of strategies and the improvement in underlying market conditions, this has not yet translated into enhanced financial performance, as a consequence of the early stage of completion of a number of projects awarded over the past 12 months.

Work in hand remained at approximately \$1.3B at Balance Date, with Watpac maintaining its previously disclosed approach of:

- adopting more selective tendering practices, in accordance with the Group's targeted sector strategy; and
- applying margin and risk/cost escalation discipline to all new potential projects.

Importantly over the last 12 months, the Group has seen a marked improvement in the quality of the Construction workbook, which now features more projects in targeted sectors that exhibit improved earnings prospects, are more specialised, and are less price sensitive.

Management and the Board believe that the enhanced focus on project selection has delivered on the objective of significantly enhancing the quality of the workbook when compared to the Comparative Period.

Key Risks

As has been disclosed in previous reports, the selection and conversion of appropriate work opportunities to maintain sufficient forward work volumes in targeted sectors represents a key risk when assessing the Construction business' outlook. The immediate pipeline of opportunities across all operating regions, however, includes projects meeting Watpac's selection criteria and providing an appropriate risk/return outcome for the Group.

In the prior period the financial performance of Watpac's Construction business was adversely impacted by heightened levels of construction activity and corresponding high input costs from enhanced demand for subcontractor trades. While subcontractor pricing levels have started to return to levels more aligned to longer term averages, Watpac will continue to apply additional scrutiny and management of project time and cost elements. This represents a critical investment assisting in risk minimisation, with the additional costs anticipated to be more than offset through the enhanced financial performance of projects.

Notwithstanding the additional measures, some residual risks remain in completing the carry forward work affected by the prolonged cost escalation pressures within the Queensland residential market.

Strategies and Future Performance

Watpac is currently tendering on a number of project opportunities in targeted sectors where the Group has strong credentials. These projects generally require application of specialised experience and know-how, and provide greater scope for Watpac to secure new work on factors beyond simply price.

Other near-term strategies applicable to the Group's Construction business, all of which are currently in the process of execution, include:

- enhancement of business development capabilities and further revision of go/no go processes and sector and client management plans;
- improvements to the bid strategy plans, including the implementation of rating matrices and project capture plans;
- the substantial improvement in internal program and cost management competencies, with an emphasis on efficiency and consistency by expanding resources and encouraging the adoption and sharing of best practices nationally; and

- the continuing development of in-house design management capabilities that will result in greater overall project value capture for all stakeholders, allowing Watpac more influence over a broader range of activities within the project value chain.

The establishment of national operational centres of excellence, focussing on both demonstrated and innovative building methods, highlights Watpac's commitment to delivering the best possible outcomes for all project stakeholders.

Management and the Board remain confident that through the management of current and emerging risks and the execution of these business enhancing strategies, Watpac can deliver substantially improved value in the future.

Strategic initiatives are overlaid with a robust enterprise risk management system, which is designed to not stifle innovation, but foster an innovative culture driven to deliver excellence for both shareholders and other key stakeholders.

Civil & Mining

Performance Review

The Group's Civil & Mining business provides contract mining services and civil infrastructure activities throughout Australia.

The Civil & Mining segment reported a pre-tax loss for the Reporting Period of \$3.0M (1H FY17 \$2.8M pre-tax profit). After allocation of Corporate overheads, this translates to a pre-tax loss for the Reporting Period of \$3.7M (1H FY17: \$1.8M pre-tax profit), and represents an annualised pre-tax return on equity capital of -9.0%.

This reduction in the financial contribution of the Civil & Mining business reflects the lower levels of work completed during the Reporting Period, with several large projects having reached or nearing completion. While disappointing, given the low work in hand position existing at 30 June 2017, this result was not unexpected. Importantly the resources sector is showing signs of improvement, correlating into an enhancement in new work opportunities with potential for improved margins.

Despite work in hand levels reducing over the Reporting Period to \$22M at Balance Date, a number of significant projects were tendered in 1H FY18. No new mining projects were converted, however, as competitive pressures for new work opportunities persisted, and projects were awarded at pricing levels that Management do not believe are sustainable or represent appropriate returns on investment. Additionally, the long-term nature of these project opportunities means input cost escalation risk is significant.

Despite there being no new mining contract wins, Watpac was successful in being awarded a number of civil infrastructure projects during the Reporting Period.

At the date of this report, the Group is participating in a significant number of mining services and civil infrastructure tenders, and remains confident of several project awards in the second half of the financial year.

Key Risks

Similar to the Construction segment, the maintenance of appropriate forward work volumes reflects the most significant risk when assessing the Civil & Mining business' outlook.

While tendering levels have enhanced significantly in recent months, and economic data indicates the resources sector may now be entering an expansionary part of the cycle, a disciplined approach must be maintained when pricing new opportunities. As such, notwithstanding the enhanced opportunity levels, there is a continued risk that Watpac's Civil & Mining business' workbook will not achieve targeted growth forecasts, which would negatively impact future profitability and could ultimately affect the carrying value of the business' assets.

Strategies and Future Performance

Watpac Civil & Mining's focus is to grow work volumes steadily through existing client relationships in targeted product sectors.

Within the context of the adopted risk and return pricing disciplines, the Group expects an increase to mining project work volumes in future periods, at more acceptable margins and across a more diversified range of commodities. It is also anticipated that this will provide greater opportunities for Watpac's presently small but successful Civil operations, where increased investment in estimating and conversion resources has occurred in FY18.

At \$8.5M at Balance Date, equipment funding levels have resulted in modest debt servicing obligations. Meaningful cash returns can therefore be generated in the future should more appropriate work volumes return.

The Board and Management remain conscious of the levels of capital required to support the Civil & Mining business, and will continue to explore ways to limit investment levels while maximising plant fleet expansion and utilisation capacity.

Property

Performance Review

The Property segment recorded a \$0.1M loss before tax for the Reporting Period (1H FY17: \$0.3M pre-tax loss).

Key Risks, Strategies and Future Performance

The carrying value of the Group's property inventory assets at 31 December 2017 totalled \$13.2M (31 December 2016: \$12.7M).

While there remains some risk that current book values will not be achieved upon sale, the Board and Management consider this only a low risk at this time.

The Board remains committed to divesting all remaining property development assets as appropriate in a timely manner.

Capital Management and Liquidity

Performance Review

Gross cash and deposits totalled \$256.7M at Balance Date (30 June 2017: \$229M), with net cash (calculated after adjusting for gross debt) being \$248.2M (30 June 2017: \$217.6M). Despite the \$1.8M pre-tax loss recorded in 1H FY18, gross and net cash balances increased markedly, mainly reflective of normal working capital movements associated with the Group's core operating businesses.

In addition to a strong cash position, the Group also maintains (amongst other facilities):

- \$170M committed syndicated banking facility for the provision of bank guarantees (drawn to \$76.5M at Balance Date); and
- \$245M in bi-lateral facilities for the provision of insurance bonds (drawn to \$134.6M at Balance Date).

Watpac therefore has extensive capacity to provide required performance bonding on new projects, with the scope of the Group's bank guarantee and insurance bonding facilities being a positive demonstration for current and future clients of Watpac's financial strength.

Key Risks, Strategies and Future Performance

Maintaining a strong balance sheet and funding facilities is a key strategic priority for the Group.

The substantial level of cash and liquidity is, however, under constant review by the Board and Management, and opportunities for capital management are regularly assessed in the context of the Group's other strategies and capital requirements.

In addition to continuing to investigate new opportunities in adjacent markets, the Group is currently actively investigating opportunities to deploy surplus working capital and/or liquidity into adjacent markets within the property lifecycle, providing a more diversified income stream and enhancing overall returns on capital.

Rounding

In accordance with the ASIC Corporations (Rounding in Financial/Directors' Report) Instrument 2016/191, amounts in the consolidated interim financial statements and Directors' Report have been rounded off to the nearest thousand dollars, unless otherwise stated.

Lead auditor's independence declaration

The lead auditor's independence declaration is set out on page 7 and forms part of the Directors' Report for the half year ended 31 December 2017.

Dated at Brisbane this 25th day of February 2018.

Signed in accordance with a resolution of the Directors.



P L Watson – Chair

Lead Auditor's Independence Declaration



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

To the Directors of Watpac Limited

I declare that, to the best of my knowledge and belief, in relation to the review of Watpac Limited for the half-year ended 31 December 2017 there have been:

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

A handwritten signature of the KPMG representative, written in black ink.

KPMG

A handwritten signature of Scott Guse, written in black ink.

Scott Guse
Partner

Brisbane
25 February 2018

Consolidated statement of profit or loss and other comprehensive income

For the six months ended 31 December 2017

<i>In thousands of AUD</i>	Note	2017	2016
Revenue		571,477	583,810
Cost of sales		(547,274)	(552,887)
Gross profit		24,203	30,923
Other income		14	304
Property development holding costs expensed		(128)	(239)
Administration expenses		(27,495)	(27,960)
Net finance income	9	1,592	968
Results from operating activities		(1,814)	3,996
New business expenditure	10	-	(3,297)
Profit/(loss) before tax		(1,814)	699
Income tax benefit/(expense)	7	397	(129)
Profit/(loss) after tax		(1,417)	570
Other comprehensive income for the period, net of tax		-	-
Total comprehensive income/(loss) for the period		(1,417)	570
Earnings per share			
Basic earnings/(loss) per share		(0.77)c	0.31c
Diluted earnings/(loss) per share		(0.77)c	0.30c

Consolidated statement of financial position

As at 31 December 2017

<i>In thousands of AUD</i>	Note	31 Dec 17	30 Jun 17
ASSETS			
Current assets			
Cash and cash equivalents		96,885	94,916
Cash deposits		159,786	134,127
Trade and other receivables	11	107,257	157,352
Inventories - stock on hand		10,367	10,352
Inventories - property development assets		1,333	1,321
Total current assets		375,628	398,068
Non-current assets			
Inventories - property development assets		11,858	11,188
Property, plant and equipment		84,010	84,154
Intangibles	12	17,676	17,676
Deferred tax assets		24,114	23,717
Total non-current assets		137,658	136,735
Total assets		513,286	534,803
LIABILITIES			
Current liabilities			
Trade and other payables	13	280,183	293,548
Borrowings	14	6,279	6,089
Employee benefits		13,866	14,004
Provisions		37	49
Total current liabilities		300,365	313,690
Non-current liabilities			
Trade and other payables	13	10,231	11,756
Borrowings	14	2,192	5,380
Employee benefits		3,422	3,739
Provisions		873	875
Total non-current liabilities		16,718	21,750
Total liabilities		317,083	335,440
Net assets		196,203	199,363
EQUITY			
Issued capital		233,727	235,563
Reserves		7,764	7,671
Retained earnings		(45,288)	(43,871)
Total equity		196,203	199,363

Consolidated statement of changes in equity

For the six months ended 31 December 2017

<i>In thousands of AUD</i>	31 Dec 2017				
	Share capital	Equity benefits reserve	Fair value reserve	Retained earnings	Total
Balance at 1 July 2017	235,563	9,771	(2,100)	(43,871)	199,363
Total comprehensive income/(loss) for the period					
Profit/(loss)	-	-	-	(1,417)	(1,417)
Total comprehensive income/(loss) for the period	235,563	9,771	(2,100)	(45,288)	197,946
Purchase of Treasury shares	(1,836)	(302)	-	-	(2,138)
Share settled performance rights awarded	-	395	-	-	395
Total contributions by and distributions to owners	(1,836)	93	-	-	(1,743)
Total transactions with owners	(1,836)	93	-	-	(1,743)
Balance at 31 December 2017	233,727	9,864	(2,100)	(45,288)	196,203

<i>In thousands of AUD</i>	31 Dec 2016				
	Share capital	Equity benefits reserve	Fair value reserve	Retained earnings	Total
Balance at 1 July 2016	235,563	9,844	(2,100)	(12,458)	230,849
Total comprehensive income/(loss) for the period					
Profit/(loss)	-	-	-	570	570
Total comprehensive income/(loss) for the period	-	-	-	570	570
Purchase of Treasury shares	-	(539)	-	-	(539)
Share settled performance rights awarded	-	221	-	-	221
Total contributions by and distributions to owners	-	(318)	-	-	(318)
Total transactions with owners	-	(318)	-	-	(318)
Balance at 31 December 2016	235,563	9,526	(2,100)	(11,888)	231,101

Consolidated statement of cash flows

For the six months ended 31 December 2017

<i>In thousands of AUD</i>	2017	2016
Cash flows from operating activities		
Cash receipts from customers	681,058	643,555
Cash paid to suppliers and employees	(644,650)	(649,189)
Cash generated from operations	36,408	(5,634)
Interest received	2,457	2,258
Interest paid	(988)	(1,220)
Net cash (used in)/provided by operating activities	37,877	(4,596)
Cash flows from investing activities		
Draw down/(investment in) cash deposits	(25,659)	19,192
Acquisition of assets	(5,886)	(5,625)
Proceeds from sale of assets	471	330
Net cash provided by/(used in) investing activities	(31,074)	13,897
Cash flows from financing activities		
Repayment of borrowings	(2,998)	(3,631)
Purchase of treasury shares	(1,836)	(539)
Net cash used in financing activities	(4,834)	(4,170)
Net increase in cash and cash equivalents	1,969	5,131
Cash and cash equivalents at 1 July	94,916	129,351
Cash and cash equivalents at 31 December	96,885	134,482

Condensed notes to the consolidated interim financial statements

For the six months ended 31 December 2017

1. Reporting entity

Watpac Limited (**Watpac** or **Company**) is a company domiciled in Australia. The consolidated interim financial statements of the Company as at and for the six months ended 31 December 2017 comprises the Company and its subsidiaries (**Group**).

2. Statement of compliance

These consolidated interim financial statements are general purpose financial statements prepared in accordance with AASB 134 Interim Financial Reporting, IAS 34 Interim Financial Reporting and the *Corporations Act 2001*. Selected explanatory notes are included to explain events and transactions that are significant to an understanding of the changes in financial position and performance of the Group since the last annual consolidated financial statements as at and for the year ended 30 June 2017. These consolidated interim financial statements do not include all of the information required for the full annual financial statements, and should be read in conjunction with the Group's 30 June 2017 consolidated financial statements.

These consolidated interim financial statements were approved by the Board of Directors on 25 February 2018.

3. Functional and presentation currency

These consolidated interim financial statements are presented in Australian dollars, which is the functional currency of the Company. In accordance with the ASIC Corporations (Rounding in Financial/Directors' Reports) Instrument 2016/191, amounts in the consolidated interim financial statements and Directors' Report have been rounded off to the nearest thousand dollars, unless otherwise stated.

4. Significant accounting policies

The accounting policies applied by the Group in the consolidated interim financial statements are the same as those applied in the Group's 30 June 2017 consolidated financial statements.

5. Judgements and estimates

The preparation of the consolidated interim financial statements requires Management to make judgements, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets and liabilities, income and expenses. The estimates and underlying assumptions are reviewed on an ongoing basis and actual results may differ from these estimates. Revisions to accounting estimates are recognised prospectively.

In preparing these consolidated interim financial statements, the significant judgements made by Management in applying the Group's accounting policies and the key sources of estimation uncertainty were the same as those that applied to the consolidated financial statements of the Group as at and for the year ended 30 June 2017.

6. Comparatives

Where necessary, comparatives have been reclassified and repositioned for consistency with current reporting period disclosures.

7. Income tax expense

The Group's effective tax rate for the six months ended 31 December 2017 is 21.89% (for the six months ended 31 December 2016: 18.45%). This tax rate is consistent with Management's estimate of the effective tax rate that will be applicable for the year ending 30 June 2018, and reflects taxation benefits expected to arise to the Group in the current year as a consequence of participating in the Research and Development tax incentive regime.

8. Operating segments

An operating segment is a component of the Group that engages in business activities from which it may earn revenues and incur expenses.

The Group has identified its operating segments by assessing the internal reports where discrete financial information is reported on a regular basis to the Managing Director, Watpac's chief operating decision maker, to effectively allocate Group resources and assess performance.

Reportable segments are based on aggregated operating segments determined by the similarity of products sold and/or services provided.

For the half-year ended 31 December 2017 (**Reporting Period**), the Group has identified three reportable segments, being:

- *Construction*: Construction, refurbishment, project and design management.
- *Civil & Mining*: Contract mining services and civil infrastructure works.
- *Property*: Development, investment in and trading of property assets.

The following items are not allocated to operating segments as they are not considered part of the core operations of any segment:

- corporate assets
- unallocated/corporate expenses
- costs associated with new business

Information regarding the results of each reportable segment is included in the following tables.

	2017					
<i>In thousands of AUD</i>	Construction	Civil & Mining	Property	Unallocated	Elimination	Total
External Revenue	524,012	47,465	-	-	(652)	570,825
Inter-segment revenue	652	-	-	-	-	652
Total segment revenue	524,664	47,465	-	-	(652)	571,477
Other material non-cash items:						
- Depreciation	(326)	(4,295)	-	(946)	-	(5,567)
New business expenditure	-	-	-	-	-	-
Finance income	-	-	-	2,642	-	2,642
Finance expense	(734)	(316)	-	-	-	(1,050)
Total segment profit before tax	9,208	(3,026)	(131)	(7,865)	-	(1,814)
Total capital expenditure	255	5,947	-	2,315	(190)	8,327

Condensed notes to the consolidated interim financial statements

For the six months ended 31 December 2017

	2016					
<i>In thousands of AUD</i>	Construction	Civil & Mining	Property	Unallocated	Elimination	Total
External Revenue	511,479	67,671	4,660	-	(68)	583,742
Inter-segment revenue	68	-	-	-	-	68
Total segment revenue	511,547	67,671	4,660	-	(68)	583,810
Other material non-cash items:						
- Depreciation	(349)	(8,659)	-	(1,002)	-	(10,010)
New business expenditure	-	-	-	(3,297)	-	(3,297)
Finance income	-	-	-	2,335	-	2,335
Finance expense	(841)	(526)	-	-	-	(1,367)
Total segment profit before tax	10,102	2,808	(254)	(11,957)	-	699
Total capital expenditure	236	4,410	-	979	-	5,625

9. Net finance income and expense

<i>In thousands of AUD</i>	2017	2016
Interest income	2,642	2,335
Finance income	2,642	2,335
Interest expense	(1,050)	(1,367)
Finance expense	(1,050)	(1,367)
Net finance income	1,592	968

10. New business expenditure

In the six months to 31 December 2016, the Group incurred \$3.3M in pre-tax costs relating to the pursuit of strategic growth and to utilise surplus capital in income producing activities.

While the Group continues to investigate new opportunities, no significant new business expenditure costs were incurred in the Reporting Period that are considered outside the scope of normal business operations.

11. Trade and other receivables

<i>In thousands of AUD</i>	31 Dec 17	30 Jun 17
Current		
Trade receivables	41,663	26,617
Allowance for expected losses	(138)	(109)
	41,525	26,508
Other debtors and prepayments	6,353	13,785
	47,878	40,293
Construction work in progress – amounts due from customers	59,379	117,059
	107,257	157,352

Condensed notes to the consolidated interim financial statements

For the six months ended 31 December 2017

Recognition and measurement

Trade and other receivables

Trade and other receivables are recognised initially at fair value plus any directly attributable transaction costs where they do not contain a significant financing component. This typically results in the initial measurement of trade and other receivables at their transaction price.

Subsequent to initial recognition, receivables are measured at amortised cost using the effective interest method, less any allowance for expected credit losses.

The following is used to assess the allowance for expected losses:

- historical collectability data;
- an individual account assessment of past credit history; and
- any current facts and circumstance that indicate an increase or decrease in credit risk or likelihood of debtor insolvency.

Watpac has a strong receivables collection history across all its operations. Consequently, only a modest allowance for impairment of \$138,000 has been recognised against trade and other receivable assets at 31 December 2017 (30 June 2017 \$109,000).

Construction work in progress

Construction work in progress is carried at cost plus profit recognised to date, based on the value of work completed, less progress billings and provision for foreseeable losses, allocated between amounts due from customers and any amounts due to customers.

Cost includes both variable and fixed costs directly related to specific contracts, being those costs which directly relate to contract activity, those which can be allocated to specific contracts on a reasonable basis, and other costs specifically chargeable under the contract.

Where the outcome of a contract cannot be reliably estimated, contract costs are expensed as incurred. Revenue is recognised to the extent of costs incurred where it is probable that the costs will be recovered. Provision for the total estimated loss on a contract is made as soon as a loss is estimated.

12. Intangibles and CGU impairment testing

Recognition and measurement

Goodwill

<i>In thousands of AUD</i>	31 Dec 17	30 Jun 17
Construction	17,676	17,676
Civil and Mining	-	-
	17,676	17,676

Goodwill acquired in a business combination is initially measured at cost and subsequently measured at cost less any impairment losses. Cost represents the excess of the cost of the business combination over the net fair value of the identifiable assets, liabilities and contingent liabilities acquired.

As at the acquisition date, any goodwill acquired is allocated to each of the cash-generating units (**CGU**) expected to benefit from the combination's synergies. Goodwill is not amortised.

Allocation of goodwill to cash-generating units (CGUs)

Goodwill has been allocated for impairment testing purposes to CGU's that are significant either individually or in aggregate, taking into consideration the nature of the service, resource allocation, how operations are monitored and where independent cashflows are identifiable.

Two independent CGU's have been identified by the Group against which asset impairment testing is conducted.

CGU Impairment Testing

Goodwill is reviewed for impairment annually, or more frequently if events or changes in circumstances indicate that the carrying value may be impaired. Impairment is determined by assessing the recoverable amount of the cash-generating unit to which the goodwill relates, and involves a number of key judgements and estimates. Where the recoverable amount of a CGU, determined on a value in use basis, is less than the carrying amount, an impairment loss is recognised.

Impairment testing is also relevant to the assessment of the carrying value of each CGU's assets, including Plant & Equipment assets allocated to the Civil and Mining CGU.

No impairment to Construction or Civil & Mining CGU assets was identified as at Balance Date. The next impairment test will be performed at 30 June 2018.

13. Trade and other payables

<i>In thousands of AUD</i>	31 Dec 17	30 Jun 17
Current		
Trade payables and accrued expenses	9,542	17,554
Subcontractor payable	51,206	39,226
Subcontractor accrual	190,989	214,194
Retentions payable	28,446	22,574
	280,183	293,548
Non-current		
Retentions payable	10,231	11,756

Recognition and measurement

Trade and other payables are recognised when the Group becomes obliged to make future payments resulting from the purchase of goods or services or an assessment is made that costs have been incurred. Due to the typically short-term nature of these financial obligations, their carrying amounts are estimated to represent their fair values.

A provision for the total estimated loss on a construction project is made as soon as the loss is identified, with any resulting cost adjustments recognised as an increase to the subcontractor accrual balance.

14. Financing Facilities

At 31 December 2017 and 30 June 2017, the Group had the following facilities.

<i>In thousands of AUD</i>	31 Dec 17		
	Utilised	Unutilised	Facility limit available for utilisation
Bank guarantees	80,068	87,653	167,721
Insurance company bonding	134,560	110,440	245,000
Total bonding	214,628	198,093	412,721
Equipment finance	8,471	2,000	10,471

<i>In thousands of AUD</i>	30 Jun 17		
	Utilised	Unutilised	Facility limit available for utilisation
Bank guarantees	70,977	96,744	167,721
Insurance company bonding	128,049	116,951	245,000
Total bonding	199,026	213,695	412,721
Equipment finance	11,469	10,000	21,469

Bonding

At 31 December 2017, the Group had \$412.7M of bank guarantee and insurance company bond facilities to support its activities. \$167.7M of these facilities are provided to the Group on a committed basis and \$245M on an uncommitted basis. All facilities are subject to the specific terms and conditions contained in the relevant funding agreements.

A syndicate of lenders provides the Group's committed bank guarantee facilities on a secured basis. This syndicated bank facility is due to mature in November 2020. The total facility limit of \$170M is currently reduced by an agreed percentage of the value of outstanding bank guarantees issued by the fronting bank of the previous syndicate, a process that is expected to be completed in full by 30 June 2018.

The Group's uncommitted insurance bond facilities are provided by four insurance companies on an unsecured basis, and are subject to certain unsecured Group guarantees. The insurance bond facilities have varying maturity dates and are subject to annual reviews. Some of these facilities currently have the ability to be bank-fronted.

The Group believes that the total \$198.1M headroom under the bank guarantee and insurance bond facilities is more than sufficient to meet the requirements of all presently identified new project opportunities and to support future growth strategies.

Equipment finance facilities

At 31 December 2017, the Group had \$10.5M (30 June 2017: \$21M) of equipment finance facilities provided by a number of financial institutions. These facilities were used for the acquisition and general financing of plant & equipment assets utilised in the Civil & Mining business. The Group's equipment finance facilities are due to mature by no later than May 2019.

15. New accounting policies

The accounting standards that have not been adopted early for the half-year ended 31 December 2017 but will be applicable to the Group in future reporting periods are detailed below:

- AASB 15 *Revenue from Contracts with Customers* (**AASB 15**) provides a new five step model for recognising revenue earned from a contract with a customer and will replace the existing AASB 118 *Revenue*, AASB 111 *Construction Contracts*, and various related interpretations. The core principal of AASB 15 is that an entity recognises revenue in accordance with the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The standard becomes mandatory for the Group for the 30 June 2019 financial year.

During the financial year ended 30 June 2017, the Group established a project team to assess the impacts of the new standard. This project team has since performed a high level diagnostic for construction project revenue streams, as these are assessed as likely being the most impacted by implementation of the new standard.

Areas potentially resulting in a change to current revenue recognition treatment (the financial impact of which requires further analysis) include:

- *Determination of performance obligations*

The Group has to determine the performance obligations that exist under each contract. For example, contracts may contain multiple performance obligations in the form of staged deliveries or separate services of design and construct. The identification of performance obligations is necessary as the transaction price is subsequently allocated to it and revenue recognised as it is satisfied.

- *Measuring progress of an over-time performance obligation*

AASB 15 requires an entity to measure progress, and thus recognise revenue, of an over-time performance obligation based on either an input or output method. The input method is determined based on an entity's efforts in satisfying a performance obligation, relative to total expected inputs to satisfy a performance obligation. Costs incurred is an example of measuring progress under the input method. The output method is determined based on direct measurements of value transferred to a customer at a point in time, relative to the remaining value of work to be completed, with an example being surveys of work performed. The Group presently recognises construction contract revenue on a surveys of work performed basis (being an output based methodology under AASB 15). An assessment is presently being made on whether the input or output method will be used for measuring progress of construction contracts under AASB 15.

- *Identification and determination of variable consideration*

AASB 15 requires an entity to identify variable consideration and apply either a probability weighting, or most likely value, for revenue recognition based on any uncertainties which have not been resolved. Most construction contracts contain a form of variable consideration in the form of liquidated damages or other penalties.

- *Treatment of contract modifications*

It is not uncommon in the construction industry for contracts to be modified during their life. AASB 15 contains specific rules regarding the treatment of contract modifications.

- *Treatment of costs*

Under AASB 15 costs are expensed when a performance obligation is satisfied and control of the underlying asset is transferred to the customer. This may result in changes to the timing of cost (and therefore margin) recognition compared to treatment under the current accounting standards, with costs recognised based on the value of work completed. The timing of margin recognition may also be impacted if the Group elects to adopt an input based method for recognising revenue for some or all contracts. Recognition and measurement of contract losses may also be affected.

A decision on transition has not yet been determined because the outcome of assessment activities and the resultant impact on revenue (if any) will invariably impact the transition method adopted. Watpac will provide further information in its 30 June 2018 financial report.

- AASB 16 *Leases* will eliminate the distinction between on-balance sheet finance leases and off-balance sheet operating leases by mandating a single, on-balance sheet accounting model that is similar to current finance lease accounting. The new standard will become mandatory for the Group for the 30 June 2020 financial year.

16. Subsequent events

There has not arisen, in the interval between the end of the financial period and the date of this report, any item, transaction or event of a material and unusual nature likely, in the opinion of the Directors, to affect the operations or state of affairs of the Group in future financial periods.

In the opinion of the Directors of Watpac Limited (the "Company"):

1. the consolidated interim financial statements and notes set out on pages 8 to 19 are in accordance with the *Corporations Act 2001*, including:
 - (a) giving a true and fair view of the financial position of the Group as at 31 December 2017 and of its performance for the half-year ended on that date; and
 - (b) complying with Australian Accounting Standard AASB 134 *Interim Financial Reporting* and the Corporations Regulations 2001; and
2. there are reasonable grounds to believe that the Company will be able to pay its debts as and when they become due and payable.

Dated at Brisbane this 25th day of February 2018.

Signed in accordance with a resolution of the Directors.

A handwritten signature in black ink, appearing to be 'P L Watson', written over a horizontal line.

P L Watson – Chair



Independent Auditor's Review Report

To the shareholders of Watpac Limited

Conclusion

We have reviewed the accompanying **Interim Financial Report** of Watpac Limited.

Based on our review, which is not an audit, we have not become aware of any matter that makes us believe that the Interim Financial Report of Watpac Limited is not in accordance with the *Corporations Act 2001*, including:

- giving a true and fair view of the **Group's** financial position as at 31 December 2017 and of its performance for the Half-year ended on that date; and
- complying with *Australian Accounting Standard AASB 134 Interim Financial Reporting* and the *Corporations Regulations 2001*.

The **Interim Financial Report** comprises:

- Consolidated statement of financial position as at 31 December 2017
- Consolidated statement of profit or loss and other comprehensive income, Consolidated statement of changes in equity and Consolidated statement of cash flows for the Half-year ended on that date
- Notes 1 to 16 comprising a summary of significant accounting policies and other explanatory information
- The Directors' Declaration.

The **Group** comprises Watpac Limited (the Company) and the entities it controlled at the Interim Period's end or from time to time during the Interim Period.

The **Interim Period** is the six months ended on 31 December 2017.

Responsibilities of the Directors for the Interim Financial Report

The Directors of the Company are responsible for:

- the preparation of the Interim Financial Report that gives a true and fair view in accordance with *Australian Accounting Standards* and the *Corporations Act 2001*
- for such internal control as the Directors determine is necessary to enable the preparation of the Interim Financial Report that is free from material misstatement, whether due to fraud or error.



Auditor's responsibility for the review of the Interim Financial Report

Our responsibility is to express a conclusion on the Interim Financial Report based on our review. We conducted our review in accordance with *Auditing Standard on Review Engagements ASRE 2410 Review of a Financial Report Performed by the Independent Auditor of the Entity*, in order to state whether, on the basis of the procedures described, we have become aware of any matter that makes us believe that the Interim Financial Report is not in accordance with the *Corporations Act 2001* including: giving a true and fair view of the Group's financial position as at 31 December 2017 and its performance for the half-year ended on that date; and complying with *Australian Accounting Standard AASB 134 Interim Financial Reporting* and the *Corporations Regulations 2001*. As auditor of Watpac Limited, *ASRE 2410* requires that we comply with the ethical requirements relevant to the audit of the annual financial report.

A review of an Interim Period Financial Report consists of making enquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. A review is substantially less in scope than an audit conducted in accordance with *Australian Auditing Standards* and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

In conducting our review, we have complied with the independence requirements of the *Corporations Act 2001*.

The KPMG logo, consisting of the letters 'KPMG' in a bold, blue, sans-serif font, with a stylized graphic of four vertical bars of increasing height to the left of the letters.

KPMG

A handwritten signature in black ink, reading 'Scott Guse'.

Scott Guse
Partner

Brisbane
25 February 2018

