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Deep dive on Wienerberger's pipes business

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In April we showed[1] that Wienerberger underperforms peers in its wall and pipes businesses. Given that the capital markets community appears to be bewildered as to how to assess Wienerberger's pipes business, we are now following up with an analysis focussed on the pipes business.

Wienerberger's pipes business has consistently lagged peers with respect to EBITDA margins, and has invested more to achieve lower top-line growth. As a matter of fact, revenue has been flat and EBITDA has declined by almost 10% p.a. since 2013. Such underperformance is staggering.

Pipes: EBITDA margin v peers

EBITDA margin	2013	2014	2015	2016	2017	Mid-term target
Uponor	9.2%	9.7%	10.5%	10.2%	11.5%	>13%
Aliaxis	12.1%	11.8%	12.9%	12.0%	13.3%	na
Georg Fischer	13.3%	12.9%	13.6%	14.3%	14.6%	14.4%
Tessenderlo	4.6%	9.7%	9.4%	9.5%	8.0%	na
Peer average	**9.8%**	**11.0%**	**11.6%**	**11.5%**	**11.9%**	**13.7%**
Wienerberger - Pipes	**9.9%**	**9.4%**	**10.0%**	**9.5%**	**6.6%**	**12.0%**

Pipes: cash conversion v peers

Cash conversion	2013	2014	2015	2016	2017	Sales CAGR, '13-17
Uponor	59.3%	64.1%	54.7%	55.0%	53.1%	6.6%
Aliaxis	54.8%	54.9%	62.6%	70.0%	73.1%	5.4%
Georg Fischer	na	na	na	na	na	4.6%
Tessenderlo	(78.6%)	41.2%	78.0%	48.6%	(12.1%)	5.7%
Peer average	**11.8%**	**53.4%**	**65.1%**	**57.9%**	**38.0%**	***5.6%***
Wienerberger - Pipes	**68.4%**	**61.4%**	**60.0%**	**39.8%**	**17.7%**	**0.1%**

Note. Figures for Georg Fischer and Tessenderlo are based on the reported figures for the piping systems division and the industrial solutions segment respectively. Mid-term target EBITDA margins for Uponor and Georg Fischer are based on the announced mid-points of their target EBIT margin ranges, to which the average D&A/revenue has been added to have comparable figures to Wienerberger's mid-term target EBITDA margin.
Cash conversion defined as (adj. EBITDA-capex)/adj. EBITDA. Given that the definition of maintenance capex differs across the peer group considered, total reported capex was taken into account to calculate the cash conversion.

Based on our research, discussions with industry experts, and channel checks, we have identified five reasons for Wienerberger's relative underperformance:

1) Silo mentality
Wienerberger's pipes business has historically been run with a country/product silo approach with limited revenue and/or cost synergies created across its end-markets.

2) Commoditised product mix
While peers such as Georg Fischer, Tessenderlo and Aliaxis have systematically addressed the low-profitability nature of commoditised products by moving into value-add products (i.e. fittings and accessories) and solutions, Wienerberger has been too slow to do so. Management has confirmed this point with us. We believe this has been a mistake by a long-standing management team and not simply a structural reason for low profitability that could not have been addressed.

3) Reliance on large distributors
Similarly to its wall business, Wienerberger has been exceptionally slow to address the issue

[1] Please see http://www.petrusadvisers.com/media/en_20180419_unlocking_value_at_wienerberger.pdf for details.

of over-reliance on large distributors with strong negotiation power. This has to do with the geographic focus of the company's growth plans and Wienerberger's distribution strategy. This is an area where increased management focus could have prevented the current operational issues. This issue has come up repeatedly during our due diligence and it is one of the reasons we proposed Mr Buck-Emden for the supervisory board as he has extensive experience in distribution, marketing and branding strategies.

4) **Dependency on high-margin oil & gas pipes business**
Unlike most peers, Wienerberger has historically benefitted from the contribution of its high-margin oil & gas and project pipes business. With the downturn of the oil & gas industry beginning in 2014, these high-margin sales fell away and displayed the weak underlying nature of Wienerberger's core business.

5) **Lack of proactive cost measures**
Unfortunately, the pipes business is characterised by relatively low barriers to entry. This means a management team needs to focus on cost reduction on a "daily" basis. However, all the cost measures undertaken by Wienerberger are exclusively reactive. For instance, the closure of part of the French operation came in reaction to not having acted early enough to address the difficulties in the market.

Although we are aware that businesses are never fully comparable and there are differences in terms of products and geographies, all companies in our peer group are by-and-large addressing the same end-markets, hence representing a decent basis for benchmarking.
The management team has always claimed that Wienerberger is structurally exposed to the wrong markets and products and therefore its EBITDA margin is naturally inferior to peers'.
As a matter of fact, Wienerberger management told us they had been slow at developing an accessories business and that they were now planning to build such a business by means of a greenfield investment.

This is hard to accept given that Wienerberger has been in the plastic pipes business since 1989, firstly as a joint-owner and then as a sole owner of Pipelife[2]. Arguably, 29 years is a long time to shift the product portfolio towards a more favourable mix and become a best-in-class player. Indeed, as early as in 1995, the EU commission wrote in its merger case for Pipelife that "*[…] fittings […] constitute a separate market as […] they are less voluminous, have a higher added value and are intended to be adapted to various types of pipes*"[3]. The high profitability of fittings is hardly a recent trend.

Furthermore, in our meetings management refused to accept that Wienerberger be benchmarked against peers except Uponor, which underwent a period of subdued profitability and therefore represents an easy comp.

We reject the notion that Uponor is Wienerberger's only comparable competitor. In fact, Wienerberger competes in the same end-markets as Aliaxis, Georg Fischer and Tessenderlo and we deemed it appropriate to run a comprehensive benchmarking analysis. Back in in 2011, Wienerberger itself mentioned Aliaxis, Georg Fischer and Tessenderlo as competitors in plastic pipes at its capital markets day.

Nonetheless, to prove that Wienerberger's underperformance is not entirely explicable by the different geography mix, we have compared the EBITDA margin and cash generation of Wienerberger's pipes business to Uponor's building solutions – Europe division. It's worth noting that a few structural differences give Wienerberger advantages over Uponor in this side-by-side comparison. These include: 1) the oil & gas-related segment (reported by Uponor under a

[2] Pipelife was established in 1989 as a 50/50 joint-venture between Solvay and Wienerberger. In 2014 Wienerberger bought Solvay's stake in Pipelife.
[3] Source: http://ec.europa.eu/competition/mergers/cases/decisions/m565_en.pdf

different division) which Wienerberger management told us was significantly margin-accretive prior to 2015, 2) the ceramic pipes business, which historically generated a higher EBITDA margin than the plastic pipes business[4], and 3) Wienerberger's much larger scale[5].

Although both companies had similar profitability levels in 2013, Uponor fixed its loss of competitiveness by undertaking a cost savings programme aimed at reducing its 2015 cost base by almost 3%. In contrast, Wienerberger passively watched the profitability of its pipes business drop over time.

Furthermore, Wienerberger invested more capital into the business notwithstanding a top-line growth that lagged Uponor's by about 200 basis points p.a.

Wienerberger's pipes v Uponor's building solutions - Europe

	2013	2014	2015	2016	2017	
EBITDA margin						**EBITDA CAGR, '13-17**
Uponor - Building solutions Europe	9.2%	9.5%	8.2%	10.2%	10.9%	6.6%
Wienerberger - Pipes	9.9%	9.4%	10.0%	9.5%	6.6%	(9.6%)
Cash conversion						**Sales CAGR, '13-17**
Uponor - Building solutions Europe	81.8%	70.0%	59.7%	72.3%	76.2%	2.1%
Wienerberger - Pipes	68.4%	61.4%	60.0%	39.8%	17.7%	0.1%

Note: EBITDA for Uponor calculated based on reported comparable operating profit to which divisional D&A was added.

Wienerberger has been performing much worse than all players in its space in terms of margins and especially growth. This despite having invested more than peers. We believe this is the result of both strategic mistakes and a lack of cost discipline.

This is why it is of the utmost importance that Wienerberger review the business with external consultants, and set out and implement a strategy to revive its pipes operation.

[4] In 2010, last year when Wienerberger provided key financials for both the ceramic pipes and the plastic pipes businesses, the former reported an EBITDA margin of 11.4% whereas the latter reported an EBITDA margin of 7.7%.
[5] In 2017, Uponor's building solutions – Europe division generated a revenue of €522m, compared to a revenue of €975m generated by Wienerberger's pipes business.