

Absolutely positively polybutylene

Fletcher Building may be optimistic about a piping problem in Australia but the market has good reason to be wary.



Investors have an opportunity to make a call - will the outcome be positive or negative for Fletcher?

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Some say there is a staff assembly at Fletcher Building headquarters first thing each morning for tai chi followed by announcements and a chorus of the company song – ‘Always Look on the Bright Side of Life’.

Do-do, do-do-do-do, do-do.

If so, it would be only natural.

The company has suffered enough calamities to put a dent in the sunniest outlook, what with all those provisions for major construction project losses, fire, lawsuits and so on.

But perhaps the power of positive thinking can go too far.

Fletcher shares dropped 8.4% when the company reported its full year results on August 16 and have fallen further since to trade around \$4.85 this week.

In terms of market capitalisation that’s a loss of about \$500 million in value.

What gives?

Analyst Grant Swanepoel of Jarden was quick to pin the blame on Fletcher’s Australian subsidiary Iplex, whose problematic plumbing products had “spooked” the market.

While Fletcher chief executive Ross Taylor stressed the company’s view any problems were limited to Western Australia and the product was unlikely to be at fault, the context carries greater baggage.

For one thing, Fletcher has had to make repeated provisions for losses on major construction projects, the NZ International Convention Centre in particular, while repeatedly expressing a belief all the downside had been accounted for.

As one analyst put it: “The recent history of having the right number in the provision line is, how would you put this politely?...”

It can be reported the analyst was unable to think of a polite way to put it.

The other thing is Iplex's pipe problem looks uncannily similar to others with more serious implications.

February disclosure

To briefly reprise the Iplex situation, Fletcher's half year report in February noted Iplex had received some complaints relating to a hot and cold water polybutylene pipe product it had manufactured under the brand name Pro-fit.



The complaints related to leaks in homes built by group home builders in Western Australia, some of which caused damage.

In April Fletcher gave further information to the NZX, saying about 1200 of 15,000 houses built with the product in WA between mid-2017 and mid-2022 had experienced leaks.

The company said it was helping two group home builders remediate customer properties and had established a fund to do the same for other plumbers and builders. The provision for costs was A\$15m.

Last week Fletcher said the number of homes affected was now 1500 and the WA Department of Mines, Industry Regulation and Safety had referred the matter to the Australian Competition & Consumer Commission, after its investigation had established installation practices had not caused the leaks – ie, it was probably a product fault.

On a conference call with analysts, Taylor was asked several times about the Iplex situation and was careful to downplay the potential liability.

Leak rates

“Roughly the product went into 30,000 homes, half of them in Western Australia and half on the east coast. There are no abnormal leak rates anywhere other than the Western Australia homes,” he said.

Iplex's own investigations had found no product defect so far and tests were ongoing to look at potential causes, including water chemistry, water pressure and installation practices.

“We've been to 200 repairs now so we're getting a good solid database, so we need to get all that together with the test results and get to causation,” he said.

“Once you know that, it does go to liability as well, but more importantly it goes to the fix...”

“At this stage it feels like it's just a Western Australia issue. It feels like it's something we'll get to the bottom of as we do the reviews in the houses.”



Ross Taylor

Pressed on the potential liability Taylor declined to go beyond the A\$15m estimate, saying to do so would be “pure speculation”.

Taylor’s comments are fair and accurate, as far as they go.

However, what some investors will be finding spooky is the history of other alleged polybutylene pipe failures.

Class action

The most notable case occurred in the US, where a class action lawsuit was filed in June 1995 on behalf of homeowners against Shell Oil Company and Hoechst Celanese Corporation.

The claim, one of several, alleged the companies had made faulty polybutylene piping which burst and damaged homes.

When the class action was settled for US\$950m in November 1995 the *Washington Post* reported the pipes “started failing when chlorine commonly found in drinking water caused them to corrode and leak or burst”.

Plumbers in the US had subsequently stopped using polybutylene in favour of polyvinyl chloride or copper.

Importantly, although the claim was settled Shell and Hoechst did not admit the product had failed.

Dux Industries

Here in New Zealand, similar problems have occurred with a polybutylene product called Dux Quest, made by Dux Industries and installed in tens of thousands of homes in the 1970s and 80s.

Dux withdrew it from sale when multiple failures emerged and the company was placed in liquidation in the mid-1990s, although the product is still causing failures today.

One building inspection company, Betta Inspect It, says Dux piping had increased risk of failure when exposed to sunlight.

“The ideal exposure time for Dux Quest piping is less than 30 days of direct sunlight. This time also includes the time it spent sitting in the back of a tradesman’s van.”

(A new company called Dux Industries was formed in 2006 and still sells polybutylene pipe for home plumbing under the name SecuraGold, this time with a 25-year guarantee. Its owner, French multinational Aliaxis, also owns Marley.)

The concern is obviously that Iplex's problem is not isolated to a percentage of installations in Western Australia.

While it appears the causes of pipe failures have not been proven, several factors could be influential including exposure to sunlight.

Listen to plumbers and Fletcher could have more to reckon with.

Master Plumbers NZ chief executive Greg Wallace says it looks like Iplex is dealing with a major issue.

"I'd estimate Fletcher is underestimating the liability they potentially have," he says.

While product failures do happen, "the level and volume of failures in Australia is quite astonishing."

Tip of the iceberg

In West Australia building group BGC, the largest builder in the state, has publicly said it believes the problem is not confined to the state.

"Having attended to more than 1,700 bursts, across nearly 1,000 homes, we understand the challenges and frustrations that homeowners have experienced due to these water pipe failures," said BGC chief executive Daniel Cooper.

He endorsed the findings of the DMIRS Building & Energy investigation.

"Their findings align with our own continuing investigation, which indicates the pipe failures are a result of manufacturing issues.

"Having understood the root cause, we believe this is an Australia-wide issue and that WA is simply the tip of the iceberg."

Pattern

Cooper said the reason problems have emerged in WA first is because the state has a small number of large builders, while other markets are more fragmented.

"BGC has used Iplex Pro-fit in almost every home, which is why it – like Delstrat (another large WA home builder) - has been able to identify the pattern on these bursts ahead of the rest of the market."

Even then, it took 18 months from the first Iplex burst in October 2020 to identify a pattern.

"BGC believes the problem is more widespread than Western Australia because the root cause is inherent in the product, and failures will manifest over time in all installations where the pipe is bent."

Cooper encouraged homeowners to make warranty claims against Iplex's 25-year guarantee.

Clearly, it will take some time before the extent of Fletcher's liability is known. Taylor told analysts it would be October or November before the company's own investigations were complete. Regulatory inquiries could take longer still.

In the meantime there's an opportunity for investors to make a call – is the market unnecessarily spooked or unrealistically optimistic about Iplex?

Taylor is looking on the bright side.

- *Disclosure: Interests associated with Tim Hunter own shares in Fletcher Building.*