Plastic Pipe Industry Faces Headwinds for Private Equity-Backed Companies

By PPN Editor

Introduction

The plastic piping sector which has been a pillar of growth in the infrastructure, energy and water/wastewater industries is currently facing some challenges. Some major players such as Infra Pipe Solutions, Merfish Pipe Holdings, Pipeline Plastics, Tigre and United Poly Systems (UPS) are backed by substantial private equity (PE) investments and this can be a double-edged sword.

There has been a maturing of the plastic pipe industry as larger companies pass from family-owned business to more sophisticated structures like PE ownership. Being publicly owned (i.e. listed) or PE owned is about access to capital to fund growth.

Boston-based private equity firm Advent International invested $262M to acquire a 25% stake in Tigre to manufacture plastic pipes in Brazil and USA.

Industrial Opportunity Partners (IOP) private equity acquired United Poly Systems (UPS), a manufacturer of HDPE pipes.

SCF Partners, a private equity firm focused on oil and gas equipment and services, acquired Pipeline Plastics, LLC, a manufacturer of high-performance polyethylene pipe for various applications including water, gas, and oil.

Wynnchurch Capital paid CAN$62.5 million Infra Pipe Solutions Ltd. (IPS) a leading manufacturer of large-diameter, HDPE pipe in Canada.

One Equity Partners (OEP) own Merfish Pipe Holdings, which includes Merfish Pipe & Supply and United Pipe & Supply which distribute plastic pipes.

Where private equity gets tough is when cash generation is weaker (generally due to lower sales or margins) and the debt is about to mature. Remembering that corporate debt is not 30-years like a mortgage, rather it is more like 5-7 years and then you need to refinance by going to market again. At this point the interest rate you pay changes back to market rate and the

Moody's & S&P ratings matter. Companies which were bought by PE in say 2019-2022 are now seeing their debt mature and they are not in the best of shape, so debt refinancing at unpalatable interest rates will be a challenge.

Credit Rating Downgrades

Recent reports indicate that credit rating agencies Moody's and Standard & Poor's have downgraded several key players in the plastic pipe market. This comes as a result of weakening financial performance and concerns over the companies' ability to service their debt obligations.

In good times, when the plastic pipe manufacturing business is buoyant, companies may cope perfectly well with the cost of servicing their debt, including that carried in the preference shares. But in tougher trading environments – like now – many businesses may struggle to generate free cash flow given profits are siphoned off by onerous debt obligations.

Impact on Interest Rates

The credit rating downgrades have led to increased interest rates on the substantial debt loads carried by these private equity-backed firms. This creates a vicious cycle, as higher interest payments further strain already tight cash flows, potentially compromising the companies' ability to invest in research and development or expand their market presence.

Even when the interest rate on the majority of the debt is locked in for the debt period, the problem comes when you refinance at end of debt term – this is when your credit rating score matters as this will determine the premium you pay above market interest rate.

Market Challenges

Several factors contribute to the current struggles faced by plastic pipe companies:

1. Slowing infrastructure spending: Many governments (not the US) have scaled back infrastructure projects due to budget constraints, directly impacting demand for plastic pipe products.

2. Raw material costs: Fluctuations in polymer prices, a key component in polymer pipe manufacturing and volatile ocean freight costs have squeezed profit margins. Global shipping rates and supply uncertainty reached a peak during the period of COVID-19 but has remained highly volatile since this period and significantly impacts efficient supply-chain costs.

3. Increased competition: New entrants, particularly from emerging markets, have intensified price competition in the sector.

4. The pool of deep plastic pipe technical expertise is shrinking, and staff retention is an ongoing challenge. Plastic pipe expertise and the ability to differentiate products as an engineered solution can be undervalued by private equity models and has been a key driver of company margins historically.

Why Private Equity can be a Disadvantage

Why private equity tends to be bad for companies is the amount of debt
these companies become saddled with and the astronomical management fees these PE firms pay themselves. There's also the risk of increased debt and financial restructuring, impacting the company's financial flexibility.

The private equity focus on revenue growth can threaten manufacturers who have traditionally relied on differentiating their polymer piping products as an “engineered solution”, being replaced by a desire for high-volume commodity sales.

Private equity firms’ reputation for dramatically increasing the value of their investments has helped fuel this growth. Their ability to achieve high returns is typically attributed to a number of factors: high-powered incentives both for private equity portfolio managers and for the operating managers of businesses in the portfolio; the aggressive use of debt, which provides financing and tax advantages; a determined focus on cash flow and margin improvement; and freedom from restrictive public company regulations.

But the fundamental reason behind private equity’s growth and high rates of return is something that has received little attention, perhaps because it’s so obvious: the firms’ standard practice of buying businesses and then, after steering them through a transition of rapid performance improvement, selling them. That strategy, which embodies a combination of business and investment-portfolio management, is at the core of private equity’s success.

Industry Outlook

Despite current challenges, the long-term outlook for the plastic pipe manufacturing market remains optimistic. Global concerns over waste management, water conservation, mining, renewable energy and sustainable infrastructure development continue to drive demand for plastic pipe solutions.

However, companies in this sector will need to navigate the immediate financial pressures while positioning themselves for future growth. This may involve:

- Restructuring debt to more manageable levels
- Focusing on high-margin, specialized products
- Investing in innovative solutions to address emerging environmental challenges
- Exploring strategic partnerships or consolidation within the industry

As the plastic pipe manufacturing sector weathers this storm, it remains to be seen which companies will emerge stronger and how the landscape of this critical industry will evolve in the coming years.