EUROPEAN VALUATIONS

MARKET SECTOR INSIGHTS - JULY 2020

Pipings & Fittings Industry

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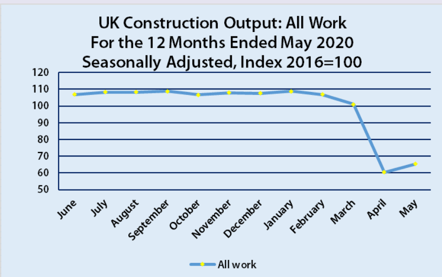

Fig 1: UK construction output

Overview

Pipes and fittings are used globally and have a wide range of applications as they are used in various areas from household to industrial applications. At the domestic level, pipes and fittings can be used in sewers, drainage systems and plumbing, while in the industrial sector pipes and fittings can be used for carrying hazardous waste, chemicals or liquified natural gas.

With the continuously growing population, construction materials are in high demand, and pipes and fittings are vital prerequisites for housing. Urbanisation has led to an increase in drainage requirements with a wide network of connections. In order to cope with advanced piping connection, there is an increased demand for pipes and fittings, which in turn, is driving market growth and is expected to continue doing so in the foreseeable future.

Global Outlook

According to a report by Industry ARC, the global pipes and fittings market is projected to grow at a CAGR of 4.7% during the forecast period of 2020 to 2025. The pipes and fittings market is driven primarily by the factors such as increasing urbanization leading to infrastructure growth, and growing demand towards plastic pipes. Moreover, rising use of pipes and fittings in mining industries and chemical industries can help the market to grow further. Adoption of steel pipes and fittings by various industries is also helping the market to rise significantly during the forecast period.

North America is currently the dominant region with a major share of the piping and fittings industry. As for Europe, various technological developments have taken place in this region, pushing the piping and fittings industry even further, while the APAC region is fast becoming the dominant region due to growing demand in countries such as China and India.

Increased Infrastructure Investments Fuelling Market Growth

Government investments for construction projects due to rapid urbanization is anticipated to mark a major rise towards the global pipes and fittings market in the coming years. Governments around the world are investing huge amounts towards infrastructure growth, thereby fueling the growth for pipes and fittings due to their demand in applications such as water distribution systems.

Moreover, with the rising growth towards pipeline projects, oil and gas industry is increasingly contributing more towards the growth of pipes and fittings market. Major oil-based companies today are continuously focusing towards pipeline projects, thereby further driving the global market growth

Steel is the Dominant Material in Europe

Around half of all pipes used in Europe are made from steel. Heavy steel pipes are mainly used in the oil and gas segment, but are also found in the industrial sector, for example in plant and machine construction. In the future, however, plastic pipes, being much lighter and cheaper in production, will gain the largest amount of market share. In regard to distance covered, plastic pipes already account for a significant share of the market for pipes. Compared to concrete pipes, which are usually substituted for other materials, plastic pipes can be replaced much more quickly when damaged or worn out. Furthermore, these can also be customised to specialty applications.

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UK Construction Industry

According to figures from the Office for National Statistics (“ONS”), construction output grew by a record 8.2% in the month-on-month all work series in May 2020 following the record decline of 40.2% in April 2020; the level of construction output is now down 38.8% on February 2020 before the impact of the coronavirus (COVID-19) pandemic.

Construction output fell by a record 29.8% in the three months to May 2020, compared with the previous three-month period; this was driven by record falls of 30.3% in new work and 28.9% in repair and maintenance.

The decrease in new work (30.3%) in the three months to May 2020 was because of record falls in most of the new work sectors; private new housing and private commercial were the largest contributors, falling by 42.5% and 29.5% respectively.

The decrease in repair and maintenance (28.9%) in the three months to May 2020 was because of record falls in all repair and maintenance sectors; the largest contributor was private housing repair and maintenance, which fell by 39.8%.

Recent Trends

Touchless Fittings

A recent trend in the piping and fittings industry is the popularity of touchless fixtures. These are more often found in commercial buildings, but they are slowly seeing increased demand in many residential constructions as well. These fixtures rely on motion sensor technology to know when water should be turned on or off.

3D Printing Technology

3D printing technology is increasingly being used in plastics manufacturing, including pipes and shapes, for high designing flexibility, reduced production time and cost. 3D technology (also known as additive manufacturing) allows manufacturers to create a complete self-supporting object, usually by laying down many thin layers of a material in succession. This technology enables manufacturers to produce complex objects that are light and reliable. Greater flexibility in terms of product designing and customization are some of the other major advantages of 3D printing technology. With more technological advancements, this trend is expected to become even more prominent in the coming years.

Economic Impact of Coronavirus

Undoubtedly, coronavirus is a black swan event – something that happens once in a century. Its spread has left businesses around the world counting costs, with many investors fearing the spread of coronavirus will pose an insurmountable challenge to the economic growth of all major countries across the globe. Almost every industry has been affected, with governments scrambling to somehow arrest the economic decline. Central banks in more than 50 countries, including the US Federal Reserve and the Bank of England

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> *… It is clear now that the spread of coronavirus has led to a decline in global consumer spending…*

have cut interest rates to try to strengthen their economies. Furthermore, most countries have announced unprecedented stimulus packages in the hopes of reviving their economy.

Manufacturing and Services Have Been Massivley Hit

In China, where the coronavirus first appeared, industrial production, sales and investment all fell in the first two months of the year, compared with the same period in 2019. China makes up a third of manufacturing globally and is the world's largest exporter of goods. Like China, factories in many other economic powerhouses like the US, UK and Germany were shut, resulting in a decline in manufacturing output at perhaps unprecedented levels.

Likewise, services sectors around the world including IT, IT enabled Services ("ITeS") and banking have also taken a hit, and perhaps the biggest hit has been the travel sector, with many companies in this sector now facing an existential crisis.

Effect on Global Demand

Restaurants, cinemas and shops around the world have emptied, while flights, road traffic and energy use have fallen steeply. Oil prices have plummeted leading to oil producers slashing outputs.

The retail industry has been hit hard. Lockdowns in many major economies have been in place until the middle of May 2020, with only essential shops being allowed to open which has meant huge losses for retailers, leading to many retailers shutting up shop.

It is clear now that the spread of coronavirus has led to a decline in global consumer spending, the heart of global economic activity. Moreover, employee layoffs in various industries are becoming increasingly common, in many cases on a large scale. This will lead to further pullback in consumer spending, at least in the near future, exacerbating the economic impact of coronavirus.

Cautious but Increasing Optimism

However, more than four months into this pandemic, as major economies gradually emerge out of lockdown, not all is doom and gloom. The most recent McKinsey Global Survey on the economy suggests increasing optimism. Executives report ever-more-positive expectations for company demand and profitability—two months after reporting record pessimism on both fronts—and for their countries' economic prospects.

While executives' views on company profits remain more negative than positive, the share expecting increased profitability has grown. Respondents are more likely to expect customer demand will increase than decrease; two months ago, the opposite was true.

By industry, more than half of respondents in retail and in high tech and telecom expect demand to rise. Retail executives also report a much more optimistic view on demand since the April 2020 survey, as do those in capital projects and infrastructure.

When asked about the economy's future, respondents were cautiously but increasingly optimistic. Fifty-one percent said the world economy will be better six months from now, a share that has grown throughout 2020. Similarly, one-half of respondents expect conditions in their home economies to improve; in May, 43 percent said so, up from 36 percent in April and 26 percent in March.

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"The IMF estimated…that the global economy could decline by 4.9% in 2020, down from its April 2020 projection of a negative 3%, before growing by 5.4% in 2021..."

Impact on UK

According to a report released by KPMG titled UK Economic Outlook June 2020, the UK economy is in the midst of the most severe economic downturn in modern times. Lockdown and social distancing restrictions have curtailed the ability of businesses to operate. Uncertainty around the future outlook is putting some spending on hold. A full resumption of activity is unlikely until a vaccine or effective treatments are available for COVID-19. The timing for such a breakthrough is a major uncertainty, with far-reaching implications for the speed of the recovery and the extent of any permanent damage to the UK economy.

The report goes on to add that consumer spending could fall by 9.5% in 2020 and recover modestly by 1.3% next year, as a vaccine or effective treatments would come too late in the year to boost spending significantly.

The combination of significant uncertainty and the need of many businesses to conserve cash while revenues are low could see investment falling by 12.6% during 2020.

The West Midlands could be the most heavily impacted region this year, with a 9.1% drop in output compared to 7.2% for the UK as a whole. This is due to the relatively high concentration of automotive and other transport manufacturing industries in the region, which are expected to be hit hard by the pandemic.

Despite heavy government support, the current crisis is having a material impact on the labour market. Lockdown restrictions imposed to combat the pandemic created a weaker economic environment which could see the unemployment rate averaging 8.6% this year and 11% in 2021.

Global Economic Forecast

Labeling the projected decline in global economic activity as the "Great Lockdown," the International Monetary Fund ("IMF") released an updated forecast recently. The IMF concluded that the global economy would experience its "worst recession since the Great Depression, surpassing that seen during the global financial crisis a decade ago.".

In addition, the IMF estimated in its baseline projection that the global economy could decline by 4.9% in 2020, down from its April 2020 projection of a negative 3%, before growing by 5.4% in 2021; global trade was projected to fall in 2020 by 11.9% and oil prices were projected to fall by 41%.The Organization for Economic Cooperation and Development (OECD) on March 2, 2020, lowered its forecast of global economic growth by 0.5% for 2020 from 2.9% to 2.4%, based on the assumption that the economic effects of the virus would peak in the first quarter of 2020. However, the OECD estimated that if the economic effects of the virus did not peak in the first quarter, which is now apparent that it did not, global economic growth would increase by 1.5% in 2020. That forecast now seems to have been highly optimistic.

In contrast, the OECD's single-wave scenario projects a global economic contraction of 7.6% in 2020 and a growth rate of 2.8% in 2021, delaying a return to full recovery until 2022.

Furthermore, the IMF forecast reflects an estimated larger decline in consumption than previously assumed as consumers curtail spending to increase their savings and the effects on economic activity of social distancing. The IMF also stated that many countries were facing a multi-layered crisis that included a health crisis, a domestic economic crisis, falling external demand, capital outflows, and a collapse in commodity prices.

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Advanced economies as a group were forecast to experience an economic contraction in 2020 of 8% of GDP, with the US economy also projected by the IMF to decline by 8%, about four times the rate of decline experienced in 2009 during the financial crisis.

The rate of economic growth in the Euro area was projected to decline by 10.2% of GDP. While most developing and emerging economies were projected to experience a decline in the rate of economic growth of 3%, reflecting tightening global financial conditions and falling global trade and commodity prices.

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