Change in the pipeline

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PLUMBING AND BUILDING MATERIALS IS BIG BUSINESS FOR FTSE100 STALWART WOLSELEY GROUP, WHICH HAS GROWN MORE BY STEALTH THAN THROUGH MEGA-DEALS. GROUP TREASURER MIKE VERRIER EXPLAINS THE STRATEGY TO **GRAHAM BUCK**.

It's a stalwart of the FTSE 100, but Wolseley is possibly one of its least-known constituents. The group has nonetheless established itself as the world's biggest distributor of heating and plumbing products to the professional market and is also a major supplier of building materials and services.

The group was briefly supplanted from the top 100 blue chips in early 2000, when the dotcom boom was at its height and a clutch of tech stocks ejected companies representing the "old economy". The absence was short-lived; Wolseley had rejoined the FTSE 100 within 18 months and a steady stream of mostly minor acquisitions has seen its ranking move upwards into the top 50.

Overseeing this development has been Group Treasurer Mike Verrier, who is based at the group's head office near Reading. He joined Wolseley in May 2000 and in the subsequent seven years has significantly transformed the treasury department. The group, which was financed solely by overdraft when he joined, now employs a variety of different instruments.

A new treasury management system was introduced in 2005 and the same year saw the arrangement of a $1.2bn private placement which was the largest international issue ever at that time. In 2006, Wolseley followed with a €2.8bn syndicated loan facility in which a group of 27 banks participated.

Over the seven years, the group has expanded its operations from seven countries then to 28 countries currently, but has so far restricted itself to North America and Europe. As Verrier envisages the group doubling in size every five to seven years – and Wolseley has avoided moving heavily into the retail sector – its own pipeline will undoubtedly involve many more acquisitions.

Verrier graduated from Cambridge in the late 1970s with a degree in Natural Sciences and says "as a very average chemist, I thought my future lay in industry rather than as a professional scientist". As a graduate trainee with Dunlop, he spent three years as a work study engineer and planned to move to Imperial Tobacco in a similar role, when a chance meeting resulted in him being offered the position of foreign currency manager for the Dunlop group. These were exciting times as exchange controls had only recently been removed by the new Thatcher government.

A four-year period at Dunlop, during which he acquired his MBA degree, ended in 1985 when the group was acquired by BTR (now Invensys). Two years in Brussels followed at Chemical Bank's foreign advisory service, then a return to the UK and a brief stint at First National Bank of Chicago, advising large international clients such as General Motors and Ericsson.

"Four years at a boutique bank came next and during this time I completed my MCT exams and in 1992 I joined Touche Ross, working for the inimitable Derek Ross," recalls Verrier.

"Derek was a one-man industry with an encyclopedic knowledge of aspects of treasury and inexhaustible energy. I learned a huge amount about treasury, but even more about handling clients and developing pragmatic value adding solutions rather than over-engineering theoretically possible, but practically risky, solutions for many large corporations throughout Europe and North America."

In the 1996, he was approached by Ken Lever, the Finance Director of Albright & Wilson, to manage the treasury and tax functions of this chemical company, which had been floated on the UK market in 1995. The chemicals industry "isn't for the faint-hearted" he observes and the job "was technically demanding, with huge foreign exchange flows and lots of different currencies involved. The commercial environment is tough, with strong competitors, and even stronger customers. Ken's exceptional understanding of shareholder value and clear strategic thinking taught me a great deal."

However, four years after its flotation, the company was acquired by French rival Rhodia in 2000. Meantime, Steve Webster, the Finance Director of Wolseley, then based at Droitwich, was seeking a treasurer and Verrier joined the group in May 2000. At that time Wolseley's head office consisted of only five managers and less than 15 staff in total; now based in Theale, head office has over 150 staff. "Steve is an inspirational Finance Director, he has a tremendous grasp of detail and has remarkable ability to get people to reach agreement on the way forward. In our time working together, we have had four deals nominated for the ACT's deal of the year, which I think demonstrates just how well we work together as a team."

Over the past decade, Wolseley has focused on small 'bolt-on' acquisitions with a large strategic acquisition every couple of years.

The big buys were the C$550m acquisition of North American group Westburne in 2001, which coincided with the group listing on the New York Stock Exchange, France's Pinault Bois & Matriaux (PBM) in 2003, which cost €550m and Denmark's DT Group in September 2006 for which it paid £1,350m.

"Last year the group spent a total of £917m on 53 acquisitions," says Verrier. "However, strip out the biggest three and it works out that we paid approximately £500m for the remaining 50 acquisitions, or an average of £10m per acquisition." He adds that the large acquisitions have considerable appeal, but also demand significantly more effort and resources. In the year ending in July 2007, Wolseley has continued its focus on bolt-on acquisitions with another 43 bolt-on acquisitions costing £383m. This strategy is set to continue for many years to come."

It also expects to continue its policy of entering into a new territory through acquiring an established market leader, rather

Plumbing the bank relationship

Over the past seven years, the group's relationship banks have grown in number to over 30 – partly as a result of its geographic expansion and partly due to organic growth.

Verrier says that Wolseley likes to have at least two banks for each country in which it operates to "maintain competitive tension". In larger territories the number may be three and in its most important markets, four.

"We want to have banks that have demonstrated a commitment to us," he adds. "Those that come out on top have consistently been ready to lend us money and to provide a strong product range.

"All of these banks also took time to get to know us. They showed they were keen to find out what made us tick and wanted to know our plans for developing the business."

Of the 30-plus relationship banks, Wolseley has a core group of nine; three in the UK, three in the US and three in continental Europe. In addition, there are two or three more "that are very close to us in particular areas, rather than across the whole range."

Is he concerned by the bank consolidation trend?

"The down side of consolidation is that if two of our bank group merge then we lose some credit capacity. Generally 1 plus 1 ends up something considerably less than 2! For example, we have a relationship with ABN-AMRO and all of its potential suitors, so there will no doubt be some small impact on our credit capability no matter what the outcome. However, we don't immediately seek to replace a lost bank," he responds.

"Otherwise, consolidation is generally a good thing. The resulting players have greater strength and capability, while there are still plenty of good quality banks remaining, so the trend is still positive rather than negative."

than attempting to set up a 'greenfield' operation from scratch. "The group's focus will remain on North America and Europe, the group recently expanded in Central Europe. Expansion into the Far East is something that will only happen in the very long term; however the Far East does offer great opportunities for sourcing products."

And what of the increasingly fragile US housing market? Wolseley's exposure has not been welcomed by all investors and the share price has suffered as a result. Choosing the Nordic Region for its most recent major acquisition suggests the group also intends to lessen its reliance on North America. But Verrier suggests that the current difficult markets should be viewed in context. "US housing growth has been strong over the past few years," he says. "It's obviously having a torrid time at the moment, but we don't see it as a long-term structural issue. The underlying demographics mean that the market will recover and the long run trend will be to our advantage."

And a downturn in the housing sector has been offset by the success of the group's Ferguson Enterprises unit in North America, which supplies industrial pipes and valves, heating and cooling equipment, in addition to plumbing and building products. "Wolseley's markets are much broader than domestic housing and the wide geographic spread of the 5,000 plus branches gives the group a solid foundation which can weather most economic cycles which tend to be localised to regions or sectors."

Had Wolseley considered joining British Airways, ICI and other UK companies that have recently discontinued their US listing and deregistered with the Securities and Exchange Commission to escape the strictures of the Sarbanes-Oxley Act?

"I don't think there is any corporate who is a fan of Sarbox. Sarbox compliance is expensive and time-consuming so given a preference we would rather not have to deal with it. However, at the same time compliance does involve good housekeeping and has helped to make us more disciplined.

"Has it added real value? Probably not and overall the effect has been mildly negative, but that's not to say it doesn't have a number of good points." He adds that delisting would also be contrary to the interests of Wolseley's many US associates and employees who are in its share savings arrangements. "So while we've got a strong US presence, it makes sense for us to keep it."

Wolseley has declared its central aim as being the sector's premier plumbing and heating materials supplier. Chief Executive Chip Hornsby is championing an initiative known as "Earn, Turn, Grow".

As Verrier terms it: "This means bringing shareholder value concepts throughout the whole organisation, down to every counter in every branch. Earn is all about improving efficiency and increasing our operating margin. Turn focuses on 'making the bricks sweat', by making working capital more efficient, the assets more effective, and importantly generating cash. Grow is about increasing like-for-like sales."

A bold initiative like Earn, Turn, Grow would have been difficult to implement in a period of rapid growth, such as that experienced over recent years. "We take advantage of the cyclical down turns by focusing on improving our operational capabilities so when the cycle picks up we will be able to motor on ahead of our competition."

As Verrier believes the group can further increase its size significantly he wants to be prepared for this development.

"Once the business stops growing, it generates a lot of cash. Approximately 85% of the group's net debt finances its working capital. Debt financing large acquisitions is repaid within approximately five to seven years. So the group does not require long-term debt, this is a relatively unusual feature of the group's capital structure that needs careful explanation to our lenders and investors."

One thing has not changed under the treasurer's stewardship. Wolseley remains unusual for a blue chip in continuing not to have a credit rating – a situation that has arisen historically.

Seven years ago, the group was still financed solely by overdraft. The move away from this situation include its foray into the unrated private placement market in 2005, which "was a great experience", attracting 31 investors and a good spread of funding, ranging from three to 15 years in eight tranches.

"If and when Wolseley does approach the bond markets, it will apply for a rating," says Verrier. "In the meantime, the group can effectively achieve this by making it quite clear to the markets its policy on capital structure, enabling investors to have a good idea of what its balance sheet will look like over time.

"We want our average long-term gearing (net debt to shareholders funds) to be 50%-75%, but in the short term we would allow the gearing to rise to near 100% provided that it would return to the long run average within a couple of years or so.

"Our gearing is closely correlated to the ratio of net debt to EBITDA, which is also the basis of our principal financial covenant in our borrowing facilities. Our target for this ratio is 1.5 to 2.3."

So the policy is one of moderate, but not of excessive gearing. This hasn't stopped the department being regularly approached "by investment bankers trying to persuade the group to gear up". And while their number has dropped off in the past few months with the onset of the credit crunch, they haven't gone away completely. "This is a group that historically has believed in having a strong balance sheet and it is highly unlikely that it will move away from this philosophy in the foreseeable future."