Case Study 2

2.1.1 Kingspan plc Background Information

Unit:	Study Unit 3 – Strategic Treasury Solutions
Case:	Case 2 – Treasury evolution
Date:	1 September 2016
Summary:	Background information on Kingspan Plc, the subject company for Study Unit 3, Case Study 2.
Key words:	treasury, funding, hedging

Contents

1 Company background 1
2 Peer group 2
3 Evolution of the business 2
4 Share price history 5
5 Evolution of treasury 7
6 Funding 8
7 Hedging 9
8 Other 10
9 Financial information on Kingspan plc website 10

1 Company background

Kingspan plc manufactures innovative building materials and systems which feature variously energy, cost and construction efficiencies.

Summary financials for years ended 31st December 2010 to 2016 are:

€m	2016	2015	2014	2013	2012	2011	2010
Revenue	3,109	2,774	1,891	1,777	1,629	1,547	1,193
Operating profit	328	247	142	116	105	91	67
PBT	314	232	128	102	90	78	56
PAT	256	191	107	89	75	63	49
Total assets	3,005	2,549	1,837	1,589	1,583	1,434	1,213
Net debt (inc. derivatives 2011 onwards)	427	326	126	108	165	170	124
Net worth	1,472	1,294	1,009	860	813	735	667
Market capitalisation	4,645	4,350	2,534	2,275	1,443	1,093	1,286

The shares reached a low of €2.04 on 24th February 2009 when the market capitalisation was about €345 million. In the detailed financial information, records go back to 2001. Those records include the year 2009 and it is useful to review the performance of Kingspan in that recessionary period following the financial crisis.

Kingspan is headquartered in Ireland and had average employees in 2016 of 10,396 - up nearly 2,000 on the year before, mainly through acquisition, of which several were completed in 2016. The business is spread over more than 70 countries, has nearly 150 subsidiaries or joint venture presence in over 40 countries, with over 60 manufacturing locations. The company is a regular on the acquisition trail:

Year	Spend (euro millions)
2011	107
2012	73
2013	negligible
2014	105
2015	439 Vicwest in Canada (for C$155m) and Joris Ide group in The Netherlands (for €315 million).
2016	262

There are four business segments:

Insulated Panels	Insulated cladding panels for roofs and walls for predominantly office, industrial and commercial use. This includes solar panel technology. Includes building units manufactured off-site
Insulation Boards	Insulated boards for roofs, walls and floors for predominantly residential use
Environmental	Solar systems, wind power, fuel and water storage, rain-water collection, oil containment, factory built sewage treatment plant, recycling systems
Access Floors	Floor systems which are installed raised to provide access e.g. cabling in dealing rooms

A new division is to be established from 2017 – Light & Air, previously part of Insulated Panels.

There are four pillars to their strategy, with a financial target:

Product Innovation	**Penetration**	**Geography**	**Net Zero Energy**
Differentiated and proprietary	Structural growth of high performance buildings	Globalisation of primary product set	Initiatives across the business globally targeting the adoption of renewable power

The financial target is to achieve an average annual return on capital employed of circa 20%[1]

2 Peer group

Brokers compare Kingspan with insulation companies, UK building materials companies and "rest of world" building companies. In fact, it is difficult to find a tightly fitting peer group. The company itself would consider insulation companies Rockwool (Denmark), Recticel (Belgium) and Paroc (Finland) as reasonable matches.

3 Evolution of the business

It is important to understand how the business was established and this comment, by UBS Investment Research in August 2007, on Kingspan[2] records the evolution of the business:

> "The group was formed in 1972 by Eugene and Brendan Murtagh, starting in structural steel building components. By the late 1970s the company had developed a composite panel for roofs and external walls for commercial and industrial buildings, enclosing insulation between sheets of steel, the insulated panel.

[1] The target of 20% is seen on p6 of the presentation but appears as 15% in Note 19 of the accounts
[2] UBS Investment Research (2007), *Kingspan Stay Cool*, 30.08.07, pp 10-11.

> In the late 1970s Kingspan started to address the market for thermal insulation boards and started manufacturing boards, using technology licensed from the US, in 1980. This technology was also used to improve the composition of its insulation panels. It started in environmental containers by acquiring a manufacturer of steel oil storage tanks in 1976.
>
> The company floated on the Irish Stock Exchange in 1989, at a comparable price of €0.20 per share, valuing the business at €25 million. In 1998, it had sales of €37 million, of which 62% came from the UK. Of the original board of six, four are still with Kingspan, of which two have executive roles on the board, including Dermot Mulvihill, the group finance director.
>
> Since its float, it has widened its product range to include raised access flooring, a wider range of environmental containers and off-site manufacturing activities, including timber-framed housing. It has also increased its geographical scope with manufacturing activities or a sales presence in 30 (at end 2007 now standing at 33) countries.
>
> The group has achieved 19% compound growth in turnover and operating profit over the past ten years (to Aug 2007). The growth has been driven by expansion of its markets, acquisitions to broaden the product spread and continuous capital expenditure."

One remaining founder retains a seat on the board, as Chairman, and also has the largest shareholding, at nearly 17%. His son is the Chief Executive, thus emphasising the close-knit family nature of the business.

In the relatively short space of around 50 years the company has transformed itself from a small family business into a large family business and then in the last decade into a fully quoted international plc. During this most recent ten years there have been more than 30 acquisitions totalling in the region of € 1.1 billion. In 2007 €50 million was spent on acquisitions and €140 million on capital expenditure. In 2008, €93 million was spent on acquisitions and €98 million on capital expenditure. Until 2015, the major acquisition was Metecno in the US, in the Insulated Panels and Boards division, for USD 115 million, bringing in revenues of about USD 135 million. Even in 2009 when, arguably, uncertainty about the business environment was sufficient to force the suspension of dividends, the group made a small acquisition in Australia.

The largest single acquisition (perhaps sharing the honours with Metecno) during this early period was Tate, the US market leader in access floors with 60% of the market. Kingspan paid €138 million for the company in 2001 but after a disappointing first year performance it was discovered that the vendor had misled Kingspan and after arbitration €25 million was recovered in 2004.

While growth by acquisition remains a necessary core objective, Kingspan sharpened the focus on organic growth following the Tate experience, culminating in the high capital expenditure of 2007 and 2008. However, Kingspan returned to acquisitions in August 2008 with the purchase of Metecno, itself a similar size to Tate. However, the downturn of 2008

has led to a reining back of capex and the group fulfilled its promise to spend only €50 million in 2009 (Outturn €48 million).

Capex spending in recent years has been:

- 2010 €16.0 million
- 2011 €23.6 million
- 2012 €31.8 million
- 2013 €36.7 million
- 2014 €40.6 million
- 2015 €69.5 million
- 2016 €103.1 million

Performance in 2009 was of course substantially worse than 2008 and the immediately preceding years as the recession hit the building industry much harder than any other, the property world being heavily dependant on finance for its lifeblood. Revenues fell by around 33% (28% at constant exchange rates) and operating profits by about 60%. EBITDA halved. Nevertheless, Kingspan remained profitable with the swift actions taken to reduce cost in 2008 with both fixed costs and capex reduced. Net debt fell in the period with capex at these very low levels, combined with swift reductions in working capital.

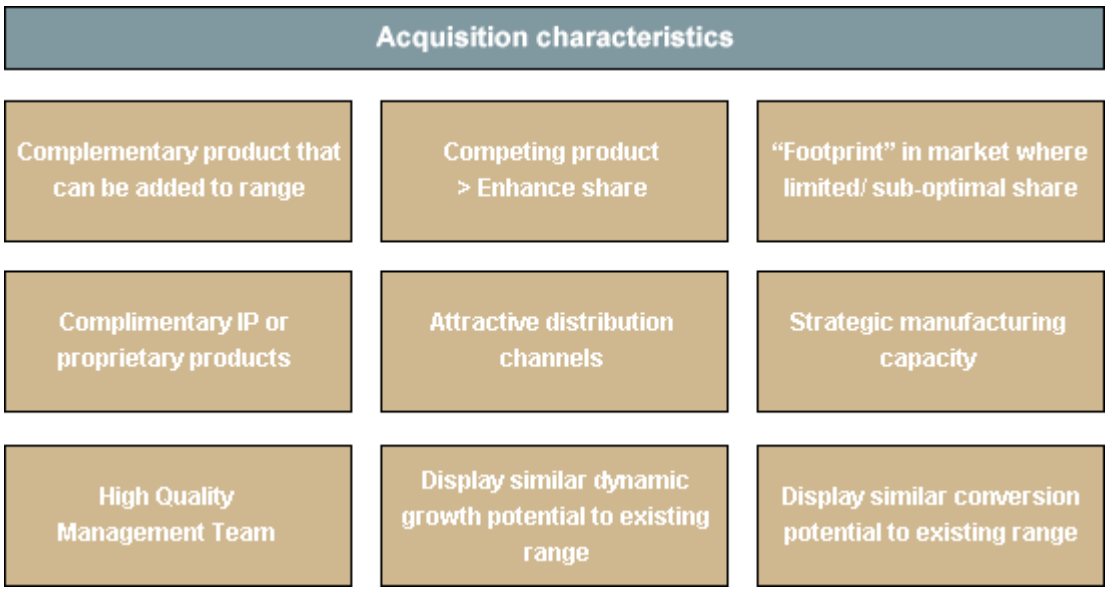
In the past Kingspan has been quite specific about earnings forecasts although this confidence dwindled when there was less visibility in its markets. Following a fairly equivocal approach to the future in the 2010 interims, the publication of the results for the full year 2010 brought more confidence for the future, with a return to stability in their markets. However, the interim results for 2010 are most notable for the re-introduction of the dividend, signalling some confidence in the future. This confidence was reinforced with the acquisition in January 2011 of a further €240 million of sales and continued presence in the acquisition markets, culminating in the largest acquisition yet, of the Joris Ide Group, for €315 million, bringing in turnover of €465 million.

Management statements say more than the few words they comprise. From the bullish statement of May 2011 to the more balanced comments in November 2012, the rather non-committal comment in February 2014 and bullish remarks in 2016, the fortunes of the group can be read reasonably easily. The continuing uncertainty over the fortunes of the sector are often mentioned but the diversity of the group is also highlighted. In the latest update, dated 27th April 2017, the message is rather muted: despite strong sales growth, there is obvious concern over the ability to pass on increased input prices.

Through all this, lenders have been very supportive and recent financings include a (weighted) 9 year private placement of €250 million in November 2016, extensions of and new (bilateral) bank facilities in 2014. They are great fans of private placements.

Kingspan remains committed to its strategy and with highlighted strong credit measures, believes that acquisition opportunities will arise which it can take advantage of. Acquisition strategy seeks to create value by expanding product range or market share. The board has

established an Acquisition Committee to consider and appraise all proposals made by the Group. Acquisition targets typically possess one or more of the following characteristics[3]:



IP = Intellectual Property

One of the founding directors retains around 17% of the equity and in aggregate all directors own 18.0% of the share capital.

4 Share price history

The following graph[4] shows the share price history for the 2 years to 5th April 2017 together with a graph of the sector performance in which Kingspan is placed (re-based to earliest available data).

[3] Source: Kingspan plc
[4] Source: Reuters, through Kingspan website

The following graph[5] shows Kingspan's share price alone over a longer period starting in 1996.

[5] Source: Interactive Investor

Data as of 6th April 2017.

The share price fell from a high of nearly €23 in May 2007 to a low of just over €2 in February 2009 and a recent price of around €30. It suffered particularly following the financial sector crisis of October 2008, and underperformed its sector until around February 2009. It is clear that the market took the view that the growth priced in to the shares in the optimistic times in 2007 was no longer possible, due mainly to the fall in the construction sectors in its main markets following the credit crunch and continuing lack of confidence in the construction sector in the western world which Kingspan predominantly serves. It has taken nearly 10 years to recover its poise.

5 Evolution of treasury

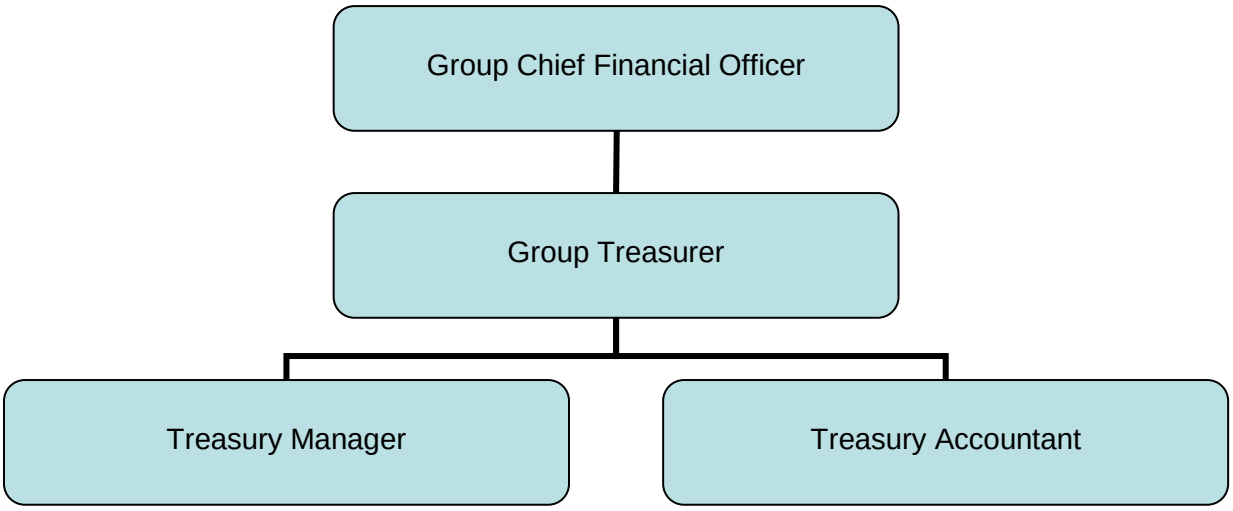
Up until 2001 there was no formal treasury role. Treasury issues such as currency transaction hedging were brought to the Board by the Group Finance Director (GFD) on an

ad-hoc basis for discussion and sanction, with decisions very much influenced by the founders' business-driven instincts, arguably a sensible approach.

The Group Financial Controller (GFC) was in effect the group treasurer. The function was fully centralised at Group level and supported by a Dublin-based international treasury consultancy firm. This appointment of treasury consultants came about because the increasing scale and scope of the business overall prompted the directors to seek help to devise a framework for managing treasury issues. The objective was to determine formal policies and procedures so that operational treasury issues could be managed routinely without having to come to the Board, taking up directors' time which could be spent more profitably on the strategic development of the business. The nature of the outsourcing was that the treasury consultancy firm predominantly allowed subsidiaries to maintain contact with local banks. The Board, of course, retained responsibility for the policy.

In the early 2010s, a Group Treasurer was appointed for the first time. He slowly took back in those functions which had been outsourced and now operates a centralised treasury function although the modus operandi remains broadly unchanged. This approach continues the strong presumption in favour of a centralised treasury, reflecting the culture at Group level of close involvement on the ground with individual subsidiaries. There is also strong pressure from Group level on subsidiaries to focus on winning contracts and growing sales, coupled with a desire to protect them from technical financial distractions, especially those which can be managed more effectively at Group level but with a broad level of local responsibility for operating results.

The current treasury function structure is:



6 Funding

Post flotation, the first major funding was in 1995 which was refinanced in 2001. Since then a whole series of refinancing has taken place with private placement markets, syndicated loan markets and bilateral bank finance used. In the early days the structure of the financing

was driven by the founders with documentation which was not wholly satisfactory for the company but this has changed with the improvement in the fortunes of the company and the appointment of professional treasury staff.

The current facilities comprise:
Private placements:

- USD 200 m private placement (repayable 2021)
- USD 42 m private placing (repayable 2017)
- €250 m private placing (€220 drawn at end 2016)
- €127.5 m private placement (repayable 2020 / 2022 / 2024)
- €110 m private placement notes

Bank facilities

- €300 m committed syndicated facility (repayable March 2019)
- €160 m committed bilateral facilities
- €44 m uncommitted bilateral facilities

The variety of debt sources is interesting, from both US and € sources and both syndicated and bilateral bank facilities. The facilities have covenants for Net debt / EBITDA, EBITDA / Net interest and minimum net assets.

8 banks are listed on p131 on the annual report and accounts 2016.

With generally strong cash flows, funding is mostly required for acquisitions. Funding also allows the group to sustain short term outflows of cash in economic downturns while conditions stabilise. There is, however, plenty of cash on the balance sheet although none is held in the name of the parent and there is no indication of where this cash might be. There are, incidentally, a very large number of subsidiaries, both finance and operating. While preferring a centralised approach to treasury, this will be a challenge.

Public comment on this aspect has shifted from:

Kingspan is “underpinned by a strong balance sheet” “to capitalise on corporate opportunities”

To:

Kingspan “remains exceptionally well positioned, both in product and geography, to deal with the opportunities and challenges which it is likely to encounter” and “with low debt levels and strong cash generation we retain the flexibility…”

Investment in subsidiaries is predominantly by equity, but with a small portfolio of intercompany loans.

7 Hedging

There is no hedging of the translation of earnings, i.e. the translation of non-Euro earnings.

Hedging focuses on protecting profit and smoothing volatility. Non-vanilla hedges are avoided, partly to pre-empt the need to explain them to the Board and partly to retain treasury as an uncomplicated function which supports business needs in as direct a way as possible.

The majority of trade sits within the currency of the region of that trade so there is little transaction exposure.

In Poland, for example, prices can be adjusted in line with exchange rate movements, making the economic risk low and in that case two month rolling hedges are used.

By contrast, in the UK, some purchases are made in currencies other than GBP and the UK subsidiaries cannot pass on exchange rate changes as they occur to customers. Kingspan has identified that this occurs mostly in € and USD. Hedging is executed each quarter on a twelve-month rolling basis up to a maximum 75% of forecast exposure, affording Kingspan the opportunity to adjust prices at appropriate frequencies. Estimates of this exposure for the UK for 2017 amount to GBP 92 million to be converted into €. In addition, GBP is to be sold to the equivalent of USD 28 million.

So each business has its own dynamic which treasury takes into account.

All currency transactions, including spot, are managed centrally.

Steel, which costs around 25% of sales, is sourced centrally. It is bought in painted so the price does not necessarily move in line with the underlying commodity. Some hedging is achieved by negotiating price contracts with individual steel mills. Increased prices have been noted in the most recent interim management statement.

The group has a policy of ensuring that at least 40% of its debt is at a fixed rate. The detail is explained fully in note 19 to the accounts for the year ended 31 December 2016. It is worthy to note the comparison with earlier years when there was very little GBP debt.

8 Other

Wherever possible, cash is swept into concentration accounts so it is visible and controllable at the centre.

The defined benefit pension schemes have been closed and the deficits are being made good by agreed levels of annual payments.

Energy costs are not considered significant enough to hedge.

9 Financial information on Kingspan plc website

You will also need to access the following information available from Kingspan plc –

https://www.kingspan.com/group/investors/financial-reports-and-presentations

- Kingspan Annual Report and Financial Statements 2016
- Kingspan Full Year Results 2016 Presentation
- Kingspan Full year Results 2016 press release
- Kingspan interim management statement dated 27th April 2017