

# Business Risk Analysis

## Financial Risk Management

In the normal course of business Kingspan Group has exposures to foreign currency, interest rate and credit risks. The Group's focus is to understand these risks and to put in place policies that minimise the economic impact on the Group's performance. On a regular basis meetings are held to review the results of the risk assessment, approve recommended risk management strategies and monitor the effectiveness of such policies.

## Funding and Liquidity Risks

The Group operates a prudent approach to liquidity management using a mixture of long-term debt together with short-term debt, cash and cash equivalents, to meet its liabilities when due. This is in addition to the Group's high level of free-cashflow generation.

The Group's core funding is provided by a private placement of \$200mn, of which \$158mn matures in March 2015 and the remaining \$42mn in March 2017. In addition, the Group has syndicated facilities comprising a €50mn term loan with repayments of €25mn per annum to 16 December 2009 and a €225mn revolving credit facility which also matures at the same date. The Group also has in place a number of uncommitted bilateral working capital facilities to service its working capital requirements.

The Group's credit facilities are subject to covenants which are based on net debt to EBITDA and EBITDA interest cover multiples. These covenants are less restrictive than Group internal targets. For the 12-months to the end of

December 2007 the Group's net debt to EBITDA was 0.79 times and EBITDA interest cover was 22.8 times.

## Foreign Exchange Risk

The Group is exposed to foreign currency risks on sales, purchases and borrowings that are denominated in a currency other than the euro. The currencies giving rise to this risk are primarily Pounds Sterling and U.S. Dollars. Through the use of foreign exchange contracts, the group hedges an appropriate proportion of its estimated foreign currency exposure in respect of forecasted sales and purchases over the following six months.

Balance sheet exposure in relation to foreign currency is hedged as far as possible by borrowing in the same currency.

## Interest Rate Risk

The Group adopts a policy of ensuring that an appropriate proportion of its exposure to changes in interest rates on borrowings is covered using a fixed rate basis. Interest rate swaps are entered into to achieve an appropriate mix of fixed and floating exposure that is consistent with the Group's policy. To this end, at the balance sheet date just over 60% of the Group's interest bearing loans and borrowings were classified as being fixed at a weighted interest rate of 4.15% for a weighted average period of 7.7 years. The interest on the remaining financing facilities is subject to floating rates which are re-priced at intervals of less than one year.

**Credit Risk**

Credit risk encompasses all forms of counterparty exposure relating to potential counterparty default on their obligations to Kingspan in relation to lending, hedging, settlement and other financial activities.

Kingspan mitigates its exposure to counterparty credit risk through minimum counterparty credit guidelines, diversification of counterparties, working within agreed counterparty limits and restricting transactions with financial institutions which have a minimum designated rating, or better. Based on these factors, Kingspan considers the risk of counterparty default at 31 December 2007 to be minimal.

**Other Risks and Uncertainties**

There are a number of other risks and uncertainties that can impact the performance of the Group, many of which are beyond the control of Kingspan and its Board. The Group's businesses closely monitor market trends and risks on an ongoing basis and are the focus of monthly management meetings where the business unit's performance is assessed versus budget, forecast and prior year. Such meetings are rotated around the different locations of the business unit and at least one Executive Board Director is present. An assessment of trends and risks is also an integral part of the business unit's annual review of its strategic plan and budget which are then submitted to the Group Board for approval.

**Market Conditions**

Kingspan's products are targeted to both the residential and non-residential (including retail, commercial and high-rise offices) construction sectors. As a result demand is dependent on

activity levels in these respective segments, which varies by geographic market and are subject to the usual drivers of construction activity (i.e. general economic conditions, interest rates, business/consumer confidence levels, unemployment, population growth etc).

While construction markets are inherently cyclical, changing building and environmental regulations continue to act as a positive structural trend for demand for many of the Company's products. The exposure to the cyclicity of any one construction market is also mitigated by the Group's diversification, both geographically and by product.

**Input Prices and Availability**

The Group's operating performance is impacted by the pricing and availability of its key inputs, which include steel, chemicals (the key chemicals are MDI and polyols) and timber. Pricing of such goods can be quite volatile at times due to the respective industries limited ability to adjust supply immediately to changes in demand. The Group looks to minimise the adverse effect of such movements through strong long-term relationships with suppliers, economies of purchasing, multiple suppliers and inventory management.

**Competitive Pressures**

Kingspan continually faces competition in each of the markets in which it has a presence. The competitive environment in any one market is a function of a number of local factors including number of competitors, production capacity and the economic / demand characteristics of that market.

While such competitive forces can impact profitability in the short-term, each of Kingspan's operations looks to offset such adverse effects by the following:

- (i) Ensuring a low cost manufacturing base through economies of scale, investment in modern and efficient plant and a programme of continuous process improvement;
- (ii) A permanent emphasis on product development which allows the Group's companies to be leading edge providers of innovative building solutions and, therefore, helps to differentiate itself from competitors; and
- (iii) Provide a best in class service to customers by offering expert technical support, short delivery times and products that come with a guaranteed performance.

#### **Customer Credit Risk**

As part of the overall service package Kingspan provides credit to customers and as a result there is an associated risk that the customer may not be able to pay outstanding balances. Each of the business units has established procedures around managing its receivables and takes action where necessary. Trade receivables are also managed by having credit insurance policies and credit limits. All major outstanding and overdue balances are reviewed regularly and concerns are discussed at monthly meetings at which Group Executive Directors are present. At a Group level no one customer represents more than 5% of sales and the bad debt charge has averaged below 0.3% of sales over the last five years.

#### **Regulation**

Following the expansion of Kingspan over the last decade the Group has manufacturing and distribution operations in over 25 countries, each having its own statutes, taxes, regulations and laws. Each business unit closely monitors regulations across its markets to ensure any adverse impacts are minimised. However, certain changes are positive for the Group, in particular those pertaining to building and environment regulations which are becoming ever more stringent and harmonised across countries, especially in Europe, and as a result are increasing the demand for the Group's products.

#### **R&D and Quality Control**

There is an ongoing risk that through product innovation by competitors Kingspan loses market share as new improved solutions come to the market and as a result profitability comes under pressure. To counter this and ensure continued differentiation Kingspan places significant emphasis on R&D and is planning to spend over €40mn on such activities over the next five years. Given the importance of product development and bringing new products to the market, all such activities are co-ordinated through the Group R&D Centre, which reports on a quarterly basis with financial reports and progress reports against budgets.

A key risk to Kingspan's business and its reputation is the potential for functional failure of products when put to use, thereby leading to warranty costs. Quality control procedures in relation to both inputs and Kingspan's own manufactured products are, therefore, an essential part of the process before the product is

delivered to the customer. With the support of external audits, quality control systems are reviewed and improved on an ongoing basis to ensure each business unit is addressing the whole control environment around product and process development and the formal signing off from development to manufacturing. The majority of new products have also to go through a certification process which is undertaken by a recognised and reputable authority (for example, in the UK it is the Building Research Establishment, BRE) before it is brought to the market. Such increased rigour around quality control is manifesting itself in reduced warranty charges across the Group.

To ensure that Kingspan meets the highest standards, ISO accreditation is a tool that is used across the Group and this is summarised in the table contained in the Corporate Social Responsibility Statement. At any one time 100% accreditation is unlikely as several of the sites are small operations and could be rationalised in the short to medium term. In addition there will be sites that have just been acquired and therefore are still in the process of being integrated into the Kingspan model.

### **Expansion and Acquisition**

A key element of the Group's strategy is to grow the business through both broadening its product offering and geographic expansion. This requires management to identify suitable investment opportunities both in the form of capital investment projects and acquisitions. Such expansion has its associated risks in terms of valuation, timing, integration / set-up and management resources. All investment proposals

undergo a rigorous internal evaluation process incorporating a detailed market / competitive analysis, strategic rationale, external due diligence and pay-back valuation which targets double-digit pre-tax returns by year two, in accordance with set criteria for approving investments.

### **Information Technology / Business Continuity**

Kingspan uses a range of computer systems across its business units for efficient processing of orders, control procedures and financial management. These systems are constantly reviewed and updated accordingly to meet the growing needs of the Group. Business continuity planning is continually being assessed and tested across the Group and addresses issues like personnel, manufacturing and disaster management.

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