Stocks & Shares

Moneybag$

Gene Murtagh's strange strategy at Kingspan

SHORTLY BEFORE the company's latest PR debacle at the hands of the EU, Kingspan CEO Gene Murtagh announced a strategy involving the commitment of €750m to enter the American roofing and waterproofing market. This could well prove another of the follies that have characterised some of the big moves by the Murtagh family-dominated insulation group. Of more immediate concern to investors, however, must be the imminent report of the Grenfell Tower Inquiry, which could further damage the already underwhelming share price. It looks like the impact of the London tragedy on Kingspan has already been around €10bn.

Gene Murtagh

If it is the Kingspan strategy to spend big bucks to push expansion in the roofing and warterproofing sector over the next five years, it is difficult to understand why the company would not continue to focus on the areas where it has the biggest sales presence – the UK and continental Europe. Kingspan's market penetration in North America is actually tiny.

Even if Murtagh is right to set about building a big new product base in the US, a country where it is not a leading supplier, why announce it?

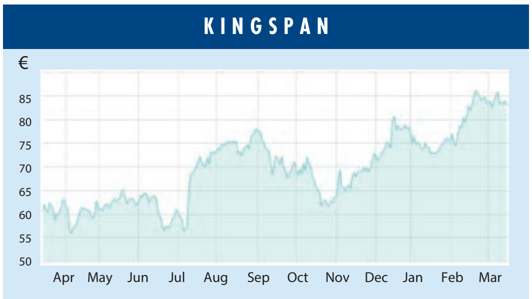
He says Kingspan is going to deliver on the strategy by building its own plant and courtesy of mergers and acquisitions. Clearly, it is not a good idea to go on record about a plan to shell out €¾bn in North America before approaching target companies.

Another curiosity concerning Kingspan is that Murtagh has moved in virtually the opposite direction to fellow Irish multinationals by abandoning its London listing, while Flutter and CRH have exited the Dublin market in favour of New York.

Being quoted solely on the Euronext market in Dublin at a time when the company is targeting US expansion makes the strategy all the more odd.

In the 2022 annual report, roofing and waterproofing accounted for just 2% of group sales and 1% of profits, so this area of its business is clearly limited and more suited to expansion on a staged basis. Geographically, Europe accounted for 73% of Kingspan's turnover, while the Americas (north and south) together accounted for 21%.

The more obvious path forward for Kingspan is not in buying conventional roofing and waterproofing businesses but rather developing roof products with built-in solar panels as part of an integrated structure and single installation offering.



Kingspan has only just developed an integrated option, incorporating solar panels into its QuadCore insulated panels, which it calls PowerPanel. It has arrived here rather late in the day but this PowerPanel engineering innovation forms part of the group's insulated panel division rather than its roofing and water proofing division.

Kingspan should be ahead of the curve here, with solar-embedded insulated roofing panels as a way to achieve the twin objectives of energy conservation and renewable energy generation. The company should clearly be planning to spend big bucks on developing its integrated solar insulated panels rather than acquiring conventional roofing companies.

It is worrying that, on a like-for-like basis, underlying sales last year actually fell 7%. Even after including significant sales from acquisitions, total sales were still down 3% to €8.1bn and of most concern is the fact that Kingspan's core insulated panels division saw sales drop by 9%.

On the trading profit front, despite the fall-off in sales, on a like-for-like basis the underlying figures showed a surprising 3% increase in 2023. Including contributions from acquisitions, total group trading profits were up a moderate 5% to €833m, which reflected an increase of 80 basis points in trading margin to 10.8%, compared with 10% in the previous year.

The biggest acquisition Kingspan made last year was that of a German roofing and waterproofing company, CaPlast, for a total cost of €87m.

Another €139m was spent on other, smaller acquisitions in Portugal, France, Uruguay and the Baltics on the insulation panel side, and on Hempflax in Germany and Thor in Australia on the insulation board side of the business.

The group increased its existing stake in Nordic Waterproofing to 6.8% at a cost of €22m, to bring its holding up to 30.9% and triggering a mandatory offer, one that has been rejected. It will be interesting to see how this partial acquisition works out.

Kingspan's significant cashflow was well in excess of its acquisition costs, such that it was able to reduce its previous year's €1.5bn net debt to just under €1bn net debt in December 2023. The group, however, is still carrying huge firepower for acquisitions thanks to the private placings of loan notes for €1.6bn and a revolving credit facility of €800m. This means Kingspan could spend €1.4bn in cash if the right acquisition came up.

PERFORMANCE

An interesting move last year was Murtagh's "informal" approach to a similar-sized American insulation company, Carisle, which is capitalised at €16bn. Presumably, the thinking was that – just as Smurfit Kappa Group is proceeding with its mainly paper acquisition of the larger American WestRock operation – this would be a way of backing Kingspan into a main quotation on the New York Stock Exchange. The deal, however, did not get very far.

Kingspan's performance last year was disappointing when compared to recent outturns. Sales in 2021, admittedly driven by significant acquisitions, were up a whopping 42% to €6.5bn and trading profits an even larger 50% to €755m, to return trading margins of 11.6%.

In 2022, sales bounded ahead (again helped by acquisitions) by a chunky 28% to €8.3bn, although

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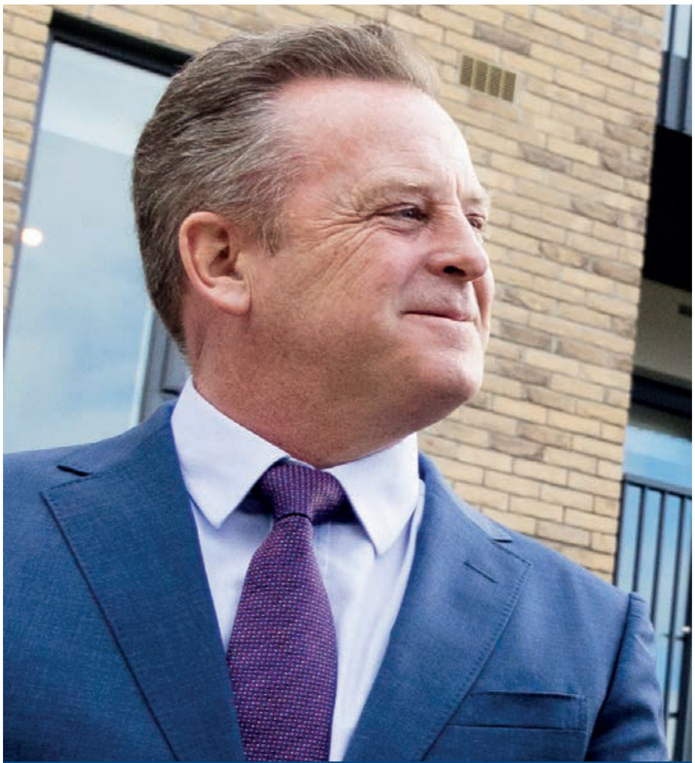
Rising Cairn Homes shares still undervalued



Michael Stanley

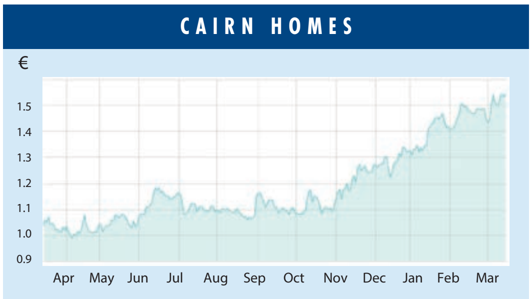
THE HOUSING crisis continues to dominate politics but, were it not for the raising of almost €1bn in equity between Cairn Homes and Glenveagh, the current state of affairs would be an awful lot worse. In particular, Michael Stanley's Cairn Homes delivered 1,741 new homes last year, up from 1,526 in 2022, bringing the total units it has built since the company was set up in 2015 to 7,500, while the target for this year is 2,200. The market has been reacting well to Cairn's performance but the share price still does not reflect the company's potential.

Cairn acquired large plots of development land around Dublin, which contained sites for 17,000 dwelling units that Stanley appears to have been trying to deliver as fast as he can, despite the not insignificant challenges associated with the Irish planning system, legal challenges, road engineering, water connections etc.

When releasing the latest Cairn results earlier this month, Stanley let fly, highlighting the huge impact on the economy of the shortage of housing.

He commented: "We are an affluent society but this feels like the mid-80s" – a period that was blighted by mass immigration.

He also noted that home-ownership rates among the key 25-39-year-old age group have fallen dramatically to 7% compared with 22% in 2011.



Stanley is well aware that last year's completion rate of 32,695 housing units is totally inadequate and way off the Housing Commission's estimate of a required 42,000-62,000 new homes completed per annum.

This is not just an Irish problem, however. In the UK only 210,000 houses were built last year, well short of the target of 300,000, although the difference is levels of affordability.

Across the Irish Sea, the ratio of average house price to average income has risen from 5.92 in 2003 to the current 8.28. Here, the multiple is worse, at just on 10 times, which puts houses out of reach for most buyers.

SOLUTIONS

Although the crisis is very evident, realistic solutions are notably thin on the ground, as is imagination.

The Government should be procuring 10,000 houses a year but not by direct build, where the costs get out of control. Supply could also be boosted by the importation of completed housing pods from Eastern Europe, where completed two-bed units can be bought for €100,000.

Another option would be to loosen planning regulations to allow for greater intensification in city centres – as is the case in Houston, Texas, for example, where all the back-up facilities such as water and power are delivered easily and promptly, with average house prices in that city at $300,000.

Cairn lashed out €1.5bn to build up the company's 17,000-site landbank after raising €720m in the 2015 IPO, topping this up to €900m over the following few years.

Stanley, however, has often been frustrated in his plans, such as sitting on the €107m high-profile 9-acre site he bought at Montrose in Donnybrook for five years.

Planning permission was finally granted last summer for a development of 808 apartments, although a hotel and 80 additional units were excluded under appeal, despite the appeals board inspector recommending that permission be granted for the full scheme. But Cairn has yet to lay one block on this big development.

Nevertheless, Stanley was able to deliver 1,741 completed dwellings last year, generating sales of €667m, a rise 8% on 2022. On the back of this, Cairn generated a 10% increase in operating profits to €113m and pushed trading margins up by 40 basis points to 22.1%. This increased earnings per share by 12% to €12.7c.

Stanley has managed to achieve this outturn on the back of controlling total assets of just over €1bn, financed mainly by equity of €757m and debt of €148m. After paying interest, last year Cairn was left with pre-tax profits of €99m, up only 6% on the €93m turned in for 2022. This means that on a capital employed of €900m, the return generated was an underwhelming 11%.

This is pretty underwhelming considering all the work involved in delivering finished housing. Stanley could simply opt to sell off fully serviced sites with planning permission rather than building out the units but he can forge ahead with the extensive building programme because of Cairns's huge equity base of €757m.

Other house builders, apart from the listed Glenveagh, have to rely on the risk-averse pillar banks to buy and develop sites.

This leaves most builders reliant on secondary funders that charge around 12% – a level that would leave Cairn unable to even cover the costs.

Stanley is planning to increase Cairn's housing output by a hefty 26% to 2,200 dwellings in the current year. On the back of this higher level of activity, he hopes to achieve significant efficiency benefits across the group, targeting an operating profit of €145m. If achieved, that would boost the return on capital employed to over 15%.

SOCIAL HOUSING

Cairn is currently working with the Land Development Agency, approved housing bodies and local authorities to provide

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'The product is fair trade, but I'm on zero hours.'

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trading margins fell off by 160 basis points to 10%. This still left operating profits up 10% at €833m.

In comparison, last year's results underwhelmed, with the group's core insulation panels division recording a 9% downturn in sales to €4.7bn. Surprisingly, the division delivered an increase in its trading profit contribution of 5% to €574m, while trading margins actually increased 160 basis points to 12.2% boosted by lower energy costs.

MARGINS

On the insulation board side, turnover was likewise down 8% to €1.5bn. In this case Murtagh, couldn't maintain margins, with trading profits here falling 12% to €145m and trading margins dropping 50 basis points to 9.5%. These were impacted by Murtagh having to reduce prices.

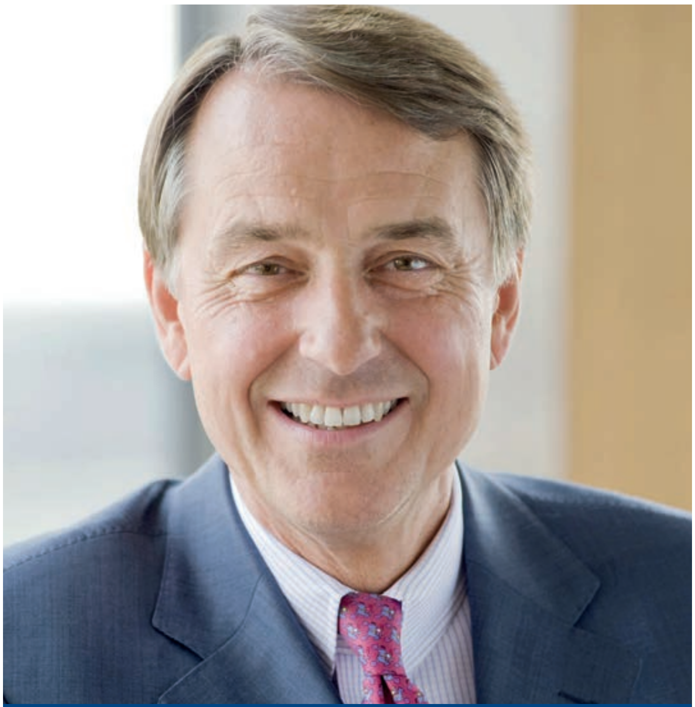
Despite acquisitions in its so-called Light, Air + Water division, which includes Kingspan's attempt to get into areas such as natural daylighting, sales actually fell 2% to just under €1bn. This division returned trading profits up 16% to €79m, while trading margins were up 120 basis points from 8.1%, still significantly under the group's average.

On the roofing and waterproofing side, the acquisitions of Ondura and Derbigum in 2022 were followed by the €87m acquisition in April last year of the German CaPlast operation. Sales in the division more than doubled to €493m and trading profits jumped to €28m. Trading margins, however, hit just 5.7%, again well under the group average.

In Kingspan's raised flooring division – which mainly is dominated by Tate in the US and Hewetson in the UK – sales were only up 5% to €380m but trading profits increased by 19% to €51m, returning trading margins of 13.4%, the highest in the group.

Kingspan's €250,000 pa chairman, Jost Massenberg – who has been *in situ* for two years and had joined the board in February 2018 – has not overly impressed the market and he should surely have seen to it that heads rolled after damaging evidence emerged from the Grenfell Tower Inquiry.

He also should have intervened before Murtagh's embarrassing €5m Formula One sponsorship with Mercedes, which was "mutually" ended a week after the deal was announced.



Jost Massenberg

Presumably Massenberg is onside with Murtagh's current plan to build a big plant in Lviv in Ukraine, where the company has acquired 120 acres and intends to spend €250m on a so-called "Building Technology Campus".

No doubt Murtagh got a good deal on the land but, with the war with Russia looking to be far from over, this commitment seems premature.

The Kingspan share price has never really recovered from the Grenfell Tower disaster and, despite its progress over the last couple of years, the shares are still significantly off the €105 at the beginning of 2021. While they have recovered from €47 in October 2022, today the shares are still trading at only €83, which is just on 20% off the 2021 level.

At this price, Kingspan stock is on a respectable trailing price/earnings multiple of 24.

At €83, the company is capitalised at a little over €15bn. Without the Grenfell factor, it is likely that Kingspan would have maintained its 40 times pre-disaster p/e multiple, which would mean that, on the current higher earnings base, the company would be capitalised at just on €27bn. In other words, it looks like the impact of the Grenfell Tower fire on Kingspan has been of the order of €10bn-plus. And now there is a potential €800m fine hanging over the company courtesy of Margaret Vestager.

The headaches are mounting for Gene Murtagh and his hapless shareholders.

Cairn Homes continued from page 23

social and affordable homes. These schemes include the likes of Seven Mills in Clonburris in west Co Dublin, where Cairn is building 318 homes; Parkside, which is in Dublin 13 (368 homes); and Piper's Square in Dublin 11 (598 new homes).

PLANNING

Elsewhere, the John Reynolds-chaired Cairn is working on 17 sites, including a new one at Sorrell Wood in Blessington, Co Wicklow, and Bayly in Douglas, Cork. The company is also opening new phases in existing developments such as Nyne Park in Kilkenny, Castletroy in Limerick, Mercer Vale in Cherrywood, Swanbrook in Navan, and Citywest in Dublin 24.

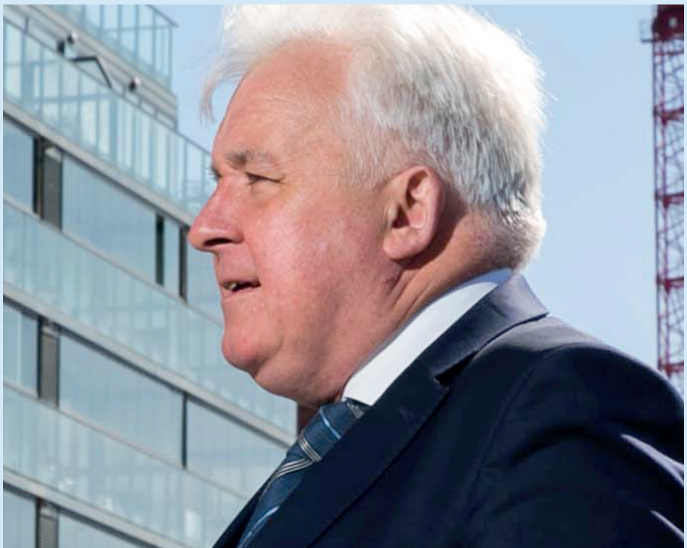
Significantly, Cairn obtained planning permission last year for a total of only 2,350 new homes. Stanley cannot keep increasing housing output at pace if the company in unable to secure significantly more planning permissions than house completions.

At the same time, the CEO has to keep an eye on his shareholders and is finally paying out 50% of earnings via dividends of €42m – which is giving shareholders a return on equity of only 5.5%. This is an awful lot better than in the past but is certainly nothing to shout about.

Despite the progress Cairn has made since it was established in 2015, it is hard for those shareholders who bought at the peak of €2 a share in December 2017 to celebrate.

The shares sank to a dreadful low of 50c in April 2020, having almost halved on foot of the Covid-19 pandemic. They have since recovered well, however, more than doubling from the price at the beginning of last year. Moreover, in the last four months, Cairn shares have jumped by 30% to the current €1.56.

This leaves the shares on a trailing price/earnings multiple of 12 and, on the basis of the CEO's guidance for 2024, a prospective



John Reynolds

p/e of 10. This is why the share price has performed so well over the last number of months.

If it turns out that Cairn can continue to grow while increasing trading margins at the same time, the shares will look like great value to investors.

One concern that investors will have relates to the general election that is now in the offing and whether Sinn Féin gets into government, at least partly on the back of a promise to try to drive house prices down to an average €300,000.

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