Finance Director’s report

Financial overview

	2013 £m	2012 (Restated) £m
Revenue	**619.6**	587.8
Headline operating profit	**107.4**	97.5
Amortisation of acquired intangible fixed assets	**(4.5)**	(2.0)
Operating profit prior to exceptional items	**102.9**	95.5
Profit on disposal of investments	**–**	2.4
Acquisition costs	**–**	(2.5)
Reorganisation costs	**(0.8)**	(2.4)
Operating profit	**102.1**	93.0
Net finance charge	**(3.7)**	(3.0)
Profit before taxation	**98.4**	90.0
Taxation	**(25.3)**	(22.8)
Profit for the year	**73.1**	67.2

Group revenue was £619.6m, an increase of 5.4%, of which acquisitions accounted for 5.5%, with organic revenues down 2.5% and foreign exchange rate movements having a positive impact of 2.4%.

Headline operating profit for the year increased by 10.2% from £97.5m to £107.4m and headline operating margin was 17.3% (2012: 16.6%). Acquisitions in the prior year increased headline operating profit by £6.7m. The impact of foreign currency movements in the year was to increase headline operating profit by £3.6m. Despite a £14.8m decline in organic revenue, organic headline operating profit decreased by only £0.4m.

The amortisation of acquired intangible assets arises from acquisitions in prior years and the level of the charge has increased to £4.5m (2012: £2.0m) due to the full year impact of the acquisitions completed during 2012.

Operating profit was £102.1m (2012: £93.0m) after charging £4.5m (2012: £2.0m) in respect of the amortisation of acquired intangible assets and £0.8m (2012: £2.4m) of reorganisation costs. During 2012 a profit on disposal of the Group’s investment in Ionbond of £2.4m and acquisition costs of £2.5m were also recognised.

Headline operating cash flow[1] for the Group was £108.9m (2012: £110.8m). This was 101.4% of headline operating profit (2012: 113.6%). Net capital expenditure was 1.0 times depreciation (2012: 0.9 times) as the Group continued to focus on increasing the utilisation of existing equipment. There was a working capital outflow in the year mainly due to a decrease in the level of payables and an increase in the level of inventories offset by a small decrease in the level of receivables.

After deducting interest and tax, the Group recorded positive free cash flow[2] of £78.8m (2012: £81.2m).

Exceptional costs

Total exceptional costs charged to the income statement amounted to £0.8m (2012: £2.5m). Redundancy and reorganisation costs of £0.8m (2012: £2.4m) have been incurred in relation to the transfer of accounting services for our Sweden, Finland and Denmark operations to our Shared Service Centre in Prague. There was no profit on disposal of investments (2012: £2.4m) and no acquisition costs were expensed in the year (2012: £2.5m).

Restructuring provisions outstanding at 31 December 2013 totalled £8.6m. Of the remaining costs, £4.1m is expected to be spent in 2014 and £4.5m in 2015 and later. All expenditure after the end of 2014 relates to ongoing environmental remediation, primarily in the USA.

Profit before tax

Headline profit before tax was £103.7m (2012: £94.5m). Profit before tax was £98.4m (2012: £90.0m). These amounts are reconciled as follows:

	2013 £m	2012 (Restated) £m
Headline operating profit	**107.4**	97.5
Net finance charge	**(3.7)**	(3.0)
Headline profit before tax	**103.7**	94.5
Amortisation of acquired intangible fixed assets	**(4.5)**	(2.0)
Profit before tax prior to exceptional items	**99.2**	92.5
Profit on disposal of investments	**–**	2.4
Acquisition costs	**–**	(2.5)
Reorganisation costs	**(0.8)**	(2.4)
Profit before tax	**98.4**	90.0

1 Headline operating cash flow is reconciled on page 15.

2 Free cash flow is reconciled on page 15.

3 2012 restated for the adoption of IAS 19 (revised) ‘Employee Benefits’, which has the effect of reducing headline operating profit and operating profit by £0.4m, reducing finance charge by £0.6m and increasing profit before taxation by £0.2m.

4 Headline EBITDA is reconciled on page 15.

Finance charge

The net finance charge was £3.7m compared to £3.0m in 2012[3]. The increase results primarily from higher average net debt during the year due to the cost of acquisitions completed during 2012 and a refinancing of the €125m revolving credit facility in 2013 (£0.2m due to higher commitment fees and £0.2m from the amortisation of upfront fees).

	2013 **£m**	2012 (Restated) £m
Net interest payable	**0.6**	0.5
Financing costs	**1.5**	1.1
Bank and other charges	**1.0**	0.8
Pension finance charge	**0.6**	0.6
Net finance charge	**3.7**	3.0

Taxation

The tax charge was £25.3m for the year (2012: £22.8m).

The effective tax rate of 25.7% (2012: 25.3%) resulted from the blending of differing tax rates in each of the countries in which the Group operates.

The headline tax rate for 2013 was 24.7% (2012: 25.6%), being stated before accounting for exceptional items, including amortisation of goodwill and acquired intangibles, which are generally not allowable for tax purposes.

Subject to any future tax legislation changes, and with the Group making most of its profits in countries other than the UK, the headline tax rate is expected to remain around current levels, being higher than the current UK statutory tax rate of 23%, which is due to fall to 20% from 2015.

Earnings per share

Basic headline earnings per share (as defined in note 9) increased to 41.2p from 37.5p. Basic earnings per share for the year increased to 38.5p from 35.9p.

Dividend

The Board has recommended a final ordinary dividend of 9.1p (2012: 8.3p) bringing the total ordinary dividend to 13.5p per share (2012: 12.3p). The Board has also recommended a supplemental distribution, by way of a special dividend, amounting to 10.0p per share. If approved by shareholders, the final ordinary dividend of 9.1p per share for 2013 and the supplemental distribution of 10.0p per share for 2013 will be paid on 2 May 2014 to all shareholders on the register at the close of business on 11 April 2014.

Capital structure

The Group's balance sheet at 31 December 2013 is summarised below:

	Assets £m	Liabilities £m	Net Assets £m
Property, plant and equipment	444.6	–	444.6
Goodwill and intangible assets	167.9	–	167.9
Current assets and liabilities	146.4	(166.1)	(19.7)
Other non-current assets and liabilities	3.4	(13.1)	(9.7)
Retirement benefit obligations	–	(18.5)	(18.5)
Deferred tax	29.4	(61.6)	(32.2)
Total before net cash	791.7	(259.3)	532.4
Net cash	16.9	(1.9)	15.0
Net assets as at 31 December 2013	**808.6**	**(261.2)**	**547.4**
Net assets as at 31 December 2012 (restated)	792.8	(288.7)	504.1

Net assets increased by £43.3m (8.6%) to £547.4m (2012[3]: £504.1m). At constant exchange rates, net assets increased by £42.5m (8.4%). The major movements compared to 31 December 2012 were a reduction in net debt of £49.2m, together with an increase in net deferred tax liabilities[3] of £9.3m and a decrease in property, plant and equipment of £4.1m.

The decrease in property, plant and equipment was due to additions of £57.3m offset by depreciation of £51.9m, asset impairments of £5.1m and foreign exchange variances.

Net deferred tax liabilities[3] increased by £9.3m due to the inclusion of deferred tax liabilities attributed to the 2012 acquisitions, timing differences on depreciation and local provisions and a reduction in deferred tax assets following the utilisation of tax losses. Restructuring provisions were reduced by £2.9m, as Group restructuring activities proceeded as planned.

Retirement benefit obligations[3] decreased by £0.5m during the year, largely as a result of benefit payments made from the scheme offsetting the increase in liabilities generated from accrued interest, in addition to the effect of the change in RPI to 3.4% (2012: 3.1%).

Net cash/(debt)

Group net cash at 31 December 2013 was £15.0m (2012: net debt £34.2m). During the year, loans of £33.9m drawn under committed facilities were repaid. The Group continues to have access to committed facilities at competitive rates and therefore currently deems this to be the most effective means of funding.

Cash flow

The net increase in cash and cash equivalents was £13.7m (2012: decrease of £7.6m), made up of net cash from operating activities of £139.4m (2012: £131.2m), less investing activities of £58.2m (2012: £130.6m) and less cash used in financing activities of £67.5m (2012: £8.2m).

The increase in net cash flow from operating activities from £131.2m to £139.4m was driven primarily by the increase in headline EBITDA[4] from £152.7m to £168.9m. Working capital increased in line with levels of activity. Net current tax liabilities decreased by £2.5m, mainly due to the timing of tax payments made compared to the previous year. The continuing utilisation of environmental and restructuring provisions resulted in a cash outflow of £2.4m.

Net cash outflows from investing activities decreased from £130.6m to £58.2m, primarily as a result of no acquisitions being completed in 2013 compared to the prior year. The level of net capital expenditure in 2013 was £57.3m (2012: £47.7m), consistent with plans to maintain and improve the capacity and capability of the Group, whilst keeping expenditure levels close to depreciation.

Net cash outflows used in financing activities increased from £8.2m to £67.5m. 2013 saw the repayment of loans of £36.6m (2012: £2.3m) and new bank loans raised of £nil (2012: £28.8m), together with payment of dividends totalling £24.0m (2012: £21.3m).

There has been a continued focus on cash collection, although receivable days at 31 December 2013 increased by one to 59 days (2012: 58 days).

Net interest payments for the year were £3.3m (2012: £2.5m). Tax payments were £22.5m (2012: £19.3m) reflecting the increase in Group profits.

Capital expenditure

Net capital expenditure (capital expenditure less proceeds from asset disposals) for the year was £57.3m (2012: £47.7m). The multiple of net capital expenditure to depreciation was 1.0 times (2012: 0.9 times), which reflects the Group's continued careful management of its capital expenditure programme. Major capital projects that were in progress during 2013 included installation of new Giga HIP capacity in Camas, Washington, expansion of our production facilities in Silao, Mexico, completion of the Jinan facility in China, and expansion of our vacuum furnace capacity in Holland, Michigan and Derby, UK. The Group also continued to invest in the implementation of a new ERP system.

Borrowing facilities

Total funding available to the Group under its committed facilities at 31 December 2013 was £229.0m (2012: £226.4m), expiring between August 2016 and March 2018, as well as access to a US$10m committed letter of credit facility maturing in August 2016.

The €125m revolving credit facility was refinanced for a further five years in February 2013 at a higher margin than the 2006 arranged facility it replaced.

At 31 December 2013, the Group had the following committed facilities:

Facility	Expiry Date	Facility £m	Loan and Letter of Credit Utilisation £m	**Facility Headroom £m**
£125m Revolving Credit	31 August 2016	125.0	–	**125.0**
€125m Revolving Credit	1 March 2018	104.0	–	**104.0**
		229.0	–	**229.0**
$10m Letter of Credit	31 August 2016	6.1	4.8	**1.3**
		235.1	4.8	**230.3**

Capital management

The Group manages its capital to ensure that entities in the Group will be able to continue as going concerns, while maximising the return to shareholders. The capital structure of the Group consists of debt, which includes borrowings, cash and cash equivalents, and equity attributable to equity holders of the parent, comprising capital, reserves and retained earnings.

The capital structure is reviewed regularly by the Board. The Group's policy is to maintain gearing, determined as the proportion of net debt to total capital, within defined parameters, allowing movement in the capital structure appropriate to the business cycle and corporate activity. Due to the net cash position at 31 December 2013 the gearing ratio has fallen to 0% (2012: 7%).

Defined benefit pension arrangements

The Group has defined benefit pension obligations in the UK, Germany, Switzerland, Liechtenstein and USA and cash lump sum obligations in France, Italy and Turkey, the liabilities for which are reflected in the Group balance sheet.

The net deficits in these arrangements are as follows:

	2013 £m	2012 (Restated) £m
Funded		
UK	**4.8**	4.2
Other Western Europe	**1.2**	0.5
North America	**0.2**	0.9
	6.2	5.6
Unfunded		
Western Europe	**12.1**	13.1
Emerging markets	**0.2**	0.3
	12.3	13.4
Total deficit	**18.5**	19.0

The UK plan is closed to new entrants but the 87 active members continue to accrue benefits. The arrangements in France, Italy and Turkey are open to new members. All other arrangements are closed to new entrants.

UK Scheme liabilities remained broadly unchanged over the year (2012: £85.6m, 2013: £85.7m). The actuarial assumptions used to assess the present value of the liabilities are unchanged from 2012, with the exception of the RPI inflation assumption which has increased from 3.1% in 2012 to 3.4% in 2013. Although this and the interest accrued over the year marginally increased the value of the liabilities, this increase was largely offset by benefit payments made from the scheme.

Assets have decreased over the period from £81.4m to £80.9m, leading to a deficit of £4.8m as at 31 December 2013.

The liability for unfunded Western European schemes reduced by £1.0m, primarily in Germany. The key reason for the decrease in the deficit in the Western European schemes is an increase in corporate bonds yields and the impact of the settlement of certain liabilities.

For the year ended 31 December 2013 the Group is required to adopt IAS 19 (revised) 'Employee Benefits'.

IAS 19 (revised) 'Employee Benefits' and the related consequential amendments have impacted the accounting for the Group's defined benefit scheme by:

- reclassifying pension scheme administration costs from finance costs to operating costs in the income statement;
- replacing the interest cost and expected return on plan assets with a net interest charge on the net defined benefit liability; and
- charging past service costs immediately to the income statement as incurred.

As a result of this change in accounting policy the comparative amounts have been restated as follows:

Consolidated balance sheet	2012 £m
Retained earnings (as previously reported)	152.0
Increase in deferred tax asset	0.2
Increase in pension deficit	(0.5)
Retained earnings (as restated)	151.7

Consolidated statement of comprehensive income	
Profit for the year (as previously reported)	67.0
Increase in operating costs	(0.4)
Reduction in finance costs	0.6
Profit for the year (as restated)	67.2
Other comprehensive expense (as previously reported)	(18.1)
Increase in actuarial losses on defined benefit pension schemes	(0.2)
Other comprehensive expense (as restated)	(18.3)

	2012		
	As previously reported £m	As restated £m	Variance £m
Operating costs	1.1	1.5	0.4
Net finance charge	1.2	0.6	(0.6)
Total IAS 19 (revised) charge	2.3	2.1	(0.2)
Headline operating profit	97.9	97.5	(0.4)

For the current year, the profit is £0.2m higher and other comprehensive expense is £0.2m higher than it would have been prior to the adoption of IAS 19 (revised).

Post balance sheet events

There are no post balance sheet events.

Going concern

In determining the basis of preparation for the Annual Report, the directors have considered the Group's business activities, together with the factors likely to affect its future development, performance and position. This includes an overview of the Group's financial position, cash flows, liquidity position and borrowing facilities.

The Group meets its working capital requirements through a combination of cash resources, committed and uncommitted facilities and overdrafts. The overdrafts and uncommitted facilities are repayable on demand but the committed facilities are due for renewal as set out below. There is sufficient headroom in the committed facility covenants to assume that these facilities can be operated as contracted for the foreseeable future.

Committed facilities as at 31 December 2013 were as follows:

- £125m Revolving Credit Facility maturing 31 August 2016
- €125m Revolving Credit Facility maturing 1 March 2018
- $10m Letter of Credit Facility maturing 31 August 2016

On 18 February 2013, the €125m Revolving Credit Facility was refinanced for the same amount, extending the maturity to 1 March 2018. The December 2013 weighted average life of the committed facilities was 3.3 years.

The Group's forecasts and projections, taking account of reasonable potential changes in trading performance, show that the Group should be able to operate within the level of its current committed facilities.

The directors have reviewed forecasts and projections for the Group's markets and services, assessing the committed facility and financial covenant headroom, central liquidity and the Group's ability to access further funding. The directors also reviewed downside sensitivity analysis over the forecast period, thereby taking into account the uncertainties arising from the current economic environment. Following this review, the directors have formed a judgement, at the time of approving the financial statements, that there is a reasonable expectation that the Group has adequate resources to continue in operational existence for the foreseeable future. For this reason the directors continue to adopt the going concern basis in preparing the financial statements.

D.F. Landless
Group Finance Director
27 February 2014