Interim management report continued

Financial overview

Revenue and headline operating profit

	Half year to 30 June					
	Revenue		Headline operating profit		Headline operating margin	
	2014	2013	**2014**	2013	**2014**	2013
	£m	£m	**£m**	£m	**%**	%
ADE	**133.5**	132.6	**36.0**	34.2	**27.0**	25.8
AGI	**178.8**	183.9	**25.3**	25.4	**14.1**	13.8
	312.3	316.5	**61.3**	59.6	**19.6**	18.8
Central costs	**–**	–	**(5.2)**	(7.2)	**–**	–
Total	**312.3**	316.5	**56.1**	52.4	**18.0**	16.6

Revenue for the half year was £312.3m (2013: £316.5m), a decrease of 1.3% compared to the same period last year, but an increase at constant exchange rates of 4.6% (£14.5m).

Headline operating profit increased to £56.1m (2013: £52.4m) and headline operating margin improved to 18.0% (2013: 16.6%). The increase in headline operating profit of £3.7m was achieved despite a negative exchange rate effect of £3.2m.

Operating profit increased to £54.2m (2013: £50.3m) and operating margin was 17.4% (2013: 15.9%).

Headline operating margins for the first six months improved in both ADE and AGI. ADE reported a headline operating margin of 27.0% (2013: 25.8%) and AGI reported a headline operating margin of 14.1% (2013: 13.8%).

Profit before taxation

	Half year to 30 June	
	2014	2013
	£m	£m
Headline operating profit	**56.1**	52.4
Net finance charge	**(1.6)**	(1.8)
Headline profit before taxation	**54.5**	50.6
Amortisation of acquired intangible fixed assets	**(1.9)**	(2.1)
Profit before taxation	**52.6**	48.5

Finance charge

The net finance charge for the Group was £1.6m compared to £1.8m in 2013 with £0.3m of the movement relating to lower average net debt, offset by higher undrawn committed facility costs of £0.1m.

	Half year to 30 June	
	2014	2013
	£m	£m
Net interest payable	**0.1**	0.4
Financing costs	**0.8**	0.7
Other charges	**0.4**	0.4
Pension finance charge	**0.3**	0.3
Net finance charge	**1.6**	1.8

Cash flow

	Half year to 30 June	
	2014	2013
	£m	£m
Headline operating profit	**56.1**	52.4
Add back non-cash items:		
Depreciation and amortisation	**26.4**	28.2
Share-based payments	**1.9**	3.0
Headline EBITDA[1]	**84.4**	83.6
Net capital expenditure	**(31.5)**	(28.6)
Net working capital movement	**(8.9)**	(8.5)
Headline operating cash flow	**44.0**	46.5
Cash cost of restructuring	**(1.2)**	(3.0)
Operating cash flow	**42.8**	43.5
Interest	**(1.3)**	(1.7)
Taxation	**(9.4)**	(14.3)
Free cash flow	**32.1**	27.5

Free cash flow for the period was £32.1m compared to £27.5m in the first six months of 2013. The increase is mainly as a result of increased profits and lower tax payments.

The net working capital outflow for the six month period amounted to £8.9m (2013: £8.5m). Receivables increased by £8.7m (2013: £12.8m) as a result of the normal seasonally higher revenues in May and June in comparison to November and December. The increase in 2013 was higher than usual, as 30 June 2013 fell on a weekend, which resulted in some cash receipts being delayed into July. Debtor days outstanding at 30 June 2014 showed a modest improvement compared to 30 June 2013 at 58 days (30 June 2013 and 31 December 2013: 59 days). Payables decreased by £2.5m (2013: £4.4m increase). Inventory was unchanged in the six months to 30 June 2014 (2013: increase of £0.3m).

The continuing utilisation of environmental and restructuring provisions resulted in a cash outflow of £1.2m (2013: £3.0m). Expenditure has reduced as the Group's restructuring programme nears completion.

The Group has continued to manage carefully its capital expenditure programme and is focused on growing the Group's new technology offerings and expanding capacity in emerging markets. Net capital expenditure for the first half was £31.5m (2013: £28.6m) and the ratio to depreciation was 1.2 times (2013: 1.0 times). Major capital projects that were in progress during the first half of 2014 included ongoing work to establish two greenfield facilities in China as well as new Eastern European facilities in Poland and Turkey. Additional aerospace heat treatment capacity has been added in the USA as well as further expansion of S³P capacity in Germany.

Income taxes paid during the first six months at £9.4m were £4.9m lower than in 2013, reflecting a refund of tax overpaid in the prior year.

Taxation

The tax charge in the first half of 2014 was £12.4m, compared to a charge of £12.5m for the same period of 2013. The effective tax rate of 23.5% (2013: 25.7%) results from the impact of differing tax rates in each of the numerous jurisdictions in which the Group operates. The interim tax rate is lower primarily due to agreements reached with tax authorities in respect of previously open tax positions. Provisions against these matters have therefore been released and are included in the adjustments in respect of prior

1 Earnings before interest, tax, depreciation, amortisation, impairment, profit or loss on disposal of property, plant and equipment and share-based payments.

periods. The rate represents the weighted average of corporation tax charges expected for the full financial year.

Earnings per share

Basic headline earnings per share from operations for the half year were 22.1p (2013: 20.0p). Basic earnings per share from operations for the half year were 21.1p (2013: 18.9p). Diluted earnings per share were 21.1p (2013: 18.9p).

Dividend

The Board has declared an interim dividend of 4.6p (2013: 4.4p) which represents an increase of 4.5% over the prior year. The interim dividend will be paid on 7 November 2014 to all shareholders on the register at the close of business on 3 October 2014.

Net cash/(debt)

Group net cash at 30 June 2014 was £5.5m (31 December 2013 net cash: £15.0m and 30 June 2013 net debt: £27.1m). Loans and letters of credit drawn under the committed facilities at 30 June 2014 totalled £4.6m, compared to £4.8m at 31 December 2013 and £22.6m at 30 June 2013. The Group continues to be able to borrow at competitive rates and therefore currently deems this to be the most effective means of funding.

Liquidity and investments

The Group is financed by a mix of cash flows from operations, short-term borrowings, longer-term loans and finance leases. The Group's funding policy aims to ensure continuity of finance at reasonable cost, based on committed facilities from several sources over a spread of maturities. At 30 June 2014, 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	100.1	–	**100.1**
		225.1	–	**225.1**
$10m Letter of Credit	31 August 2016	5.8	4.6	**1.2**
		230.9	4.6	**226.3**

On 3 July 2014, the £125m and €125m revolving credit facilities were replaced by a single committed revolving credit facility for £230m, maturing on 3 July 2019. This amendment and maturity profile extension gives rise to a reduction in both the drawn margin and undrawn commitment fees.

Defined benefit pension schemes

The Group's principal defined benefit pension obligations have been reviewed as at 30 June 2014. The deficit in the UK scheme decreased to £4.6m (31 December 2013: £4.8m). In France, for its primarily unfunded cash lump sum obligation, the deficit is £8.1m (31 December 2013: £8.2m). The sum of the deficits for all other Group schemes is £5.3m (31 December 2013: £5.5m). These amounts are fully provided at 30 June 2014. The principal actuarial assumptions are unchanged from those used as at 31 December 2013.

Principal risks and uncertainties

The directors do not consider that the principal risks and uncertainties of the Group have changed since the publication of the annual report for the year ended 31 December 2013. The risks and associated risk management processes can be found on pages 24, 25, 95 and 96 of the 2013 Annual Report, which is available at www.bodycote.com. The risks referred to and which could have a material impact on the Group's performance for the remainder of the current financial year relate to:

- Markets;
- Loss of key customers;
- Human resources;
- Safety and health;
- Environment;
- Service quality;
- Major disruption at a facility;
- Information technology systems;
- Regulatory and legislative compliance;
- Liquidity;
- Interest rate fluctuation; and
- Currency exchange rate fluctuation.

Going concern

As stated in note 1 to the condensed financial statements, the directors have formed a judgement, at the time of approving the condensed 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 condensed financial statements.

Summary and outlook

The Group delivered a strong first half performance. Organic growth and margin improvement were affected by currency headwinds, which at current exchange rates will have a greater impact in the second half.

Noting that the Group has limited forward visibility, the Board continues to expect further progress in 2014 on a constant currency basis.

S.C. Harris
Group Chief Executive
31 July 2014

D.F. Landless
Group Finance Director
31 July 2014