Interim management report

Overview

Bodycote made encouraging progress in the first half of 2014. Revenues increased by 4.6% at constant exchange rates although adverse foreign exchange movements led reported revenues to decline by 1.3%. Headline operating profit grew by 7.1% to £56.1m and operating profit grew by 7.8% to £54.2m, despite a £3.2m impact due to the effect of adverse exchange movements.

The new technologies of S³P (Specialty Stainless Steel Processes) and HIP PF (Hot Isostatic Pressing Product Fabrication) both performed strongly. Together with mix improvements particularly in emerging markets these factors led to a further headline operating margin[1] expansion of 140 basis points to 18.0% (2013: 16.6%). There were no acquisitions completed in the period, but the Group continues to seek to acquire value-adding business to add to its portfolio.

In oil & gas, and in particular subsea, market changes are moving in our favour and our investment programmes over the past few years are enabling the Group to realise significant growth, with HIP PF in particular benefiting from these changes. In the aerospace market, a combination of OEM supply chain structural changes, inventory adjustments ahead of platform changeovers, and reduced defence spending are offsetting the underlying secular growth of this segment. Work to expand the Group's footprint in the aerospace OEMs' supply chains has been stepped up in order to secure more of the latent growth available though this will take some time to come through.

Growth in the automotive segment continues its upward trajectory. Bodycote is increasingly becoming the preferred supplier of thermal processing services for many customers, particularly for car and light truck production. The Group's emphasis on very high service levels and technical proficiency is driving considerable differentiation and value accretion in what in most other respects is a difficult environment to thrive. Success in this business will be enhanced by further network development as our customers expand in the lower cost economies.

Net capital expenditure of £31.5m represents an expenditure to depreciation ratio of 1.2 times (2013: 1.0 times), as the Group increased the pace of investment over that seen in the last few years. Much of this capital expenditure is being invested in the new high growth technologies and the greenfield expansion plan for the emerging markets, with four new plants in progress during the first half. Headline operating cash flow conversion was 78%[2] (2013: 89%) yielding a headline operating cash flow of £44.0m. The Group finished the half with a net cash position of £5.5m after the payment of the 2013 final and special dividends.

The Group's strategy of focusing on services that are highly valued by our customers; targeted customer engagement; increasing our emerging market footprint; growth in selected new technologies; and the drive for operational excellence continues to deliver good results, notwithstanding the mixed macroeconomic backdrop.

1 Headline operating profit as a percentage of sales.
2 Headline operating cash flow divided by headline operating profit.