

Full Year Results to 31 October 2012



Counter-IED



Countermeasures



Munitions



Pyrotechnics

Peter Hickson – Chairman



Counter-IED



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Munitions



Pyrotechnics

Introduction

- A disappointing year
 - *Poor operational performance*
 - *Specific problem issues*
 - *Unhelpful market background*
- New executive management team
- Recovery programme
- Difficult defence market background

Financial Review

Nigel Young – Interim Chief Financial Officer



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Final Results 2012

| £m | 2012 | 2011 | Change |
|--------------------|--------------|-------|---------|
| Revenue | 740.3 | 724.1 | 2% |
| Operating profit | 88.3 | 135.8 | (35%) |
| Margin | 12% | 19% | (7 pts) |
| Underlying PBT | 70.1 | 120.2 | (42%) |
| Underlying EPS (p) | 28.5p | 50.0p | (43%) |
| Dividend (pps) | 9.5p | 14.8p | (36%) |

Note: excludes Marine interests

- Revenue growth of 2%
 - £37m growth from full year impact of 2011 CDS acquisition
 - 2% organic decline (pre fx)
- Reduced margin
- Interest costs 17% higher than 2011
- Tax rate 22% from 23%
- Dividend 3 x covered

Non-underlying Charges & Order Book

| £m | 2012 | 2011 |
|--|--------|-------|
| Acquisition and disposal related costs | 8.2 | 5.7 |
| Restructuring & incident costs | 11.9 | 7.2 |
| Profit on disposal of business | (10.3) | - |
| Impairment of Goodwill | 22.5 | - |
| Intangible amortisation arising from business combinations | 20.9 | 24.3 |
| Gain on fair value movements of derivatives | (1.9) | (2.4) |
| Total | 51.3 | 34.8 |

- Order book
 - Cover for 2013 delivery

Key issues impacting the year

- FY12 financial performance was impacted by:
 - A softening defence market, particularly in the US
 - Several operational and supply chain problems, principally:
 - ERP System at Florida subsidiary
 - APOBS production delay
 - Vehicle based mortar system export licences
 - Middle East Countermeasure order delay
 - Technical problems with the development of a countermeasure
- Modest forward cash implication

Segmental analysis

C-IED

| | 2012 | 2011 | ▲ |
|------------------|-------|-------|--------|
| Revenue | 205.3 | 167.6 | ↑22% |
| Operating Profit | 43.9 | 31.9 | ↑38% |
| Operating Margin | 21% | 19% | ↑ 2pts |
| Order Book | 172.8 | 127.1 | ↑36% |

COUNTERMEASURES

| | 2012 | 2011 | ▲ |
|------------------|-------|-------|---------|
| Revenue | 184.1 | 200.8 | ↓(8%) |
| Operating Profit | 18.3 | 46.7 | ↓(61%) |
| Operating Margin | 10% | 23% | ↓ 13pts |
| Order Book | 182.3 | 234.0 | ↓(22%) |

PYROTECHNICS

| | 2012 | 2011 | ▲ |
|------------------|-------|-------|---------|
| Revenue | 123.0 | 118.7 | ↑4% |
| Operating Profit | 12.3 | 26.4 | ↓(53%) |
| Operating Margin | 10% | 22% | ↓ 12pts |
| Order Book | 178.2 | 143.9 | ↑24% |

MUNITIONS

| | 2012 | 2011 | ▲ |
|------------------|-------|-------|--------|
| Revenue | 227.9 | 237.0 | ↓(4%) |
| Operating Profit | 24.3 | 40.8 | ↓(40%) |
| Operating Margin | 11% | 17% | ↓ 6pts |
| Order Book | 227.6 | 371.7 | ↓(39%) |

Counter-IED

Revenue

↑ 22% **£205.3m**

Operating Profit

↑ 38% **£43.9m**

Operating Margin

↑ 2pts **21%**

Closing Order Book

↑ 36% **£172.8m**

- Revenue growth of 22%
 - Full year contribution of CDS
 - Other parts of this segment broadly in line
- Operating profit up by 38%
 - Full year contribution from CDS
 - Niitek operating profit slightly reduced
- Operating profit margins
 - Up by 2 percentage points due to CDS
- Order book up 36%
 - More healthy order books versus prior year
 - APOBS order book at COR \$114m

Countermeasures

Revenue

↓ 8% £184.1m

Operating Profit

↓ 61% £18.3m

Operating Margin

↓ 13pts 10%

Closing Order Book

↓ 22% £182.3m

- Decline in revenues
 - Continued reduction in NATO demand
 - Order delays on flare and chaff for Middle East
- Major reduction in profit
 - Alloy volume reduction
 - Middle East order delay – product manufactured in anticipation could not be contract accounted for in 2012
 - Provisioning re countermeasure development LAT failure previously contract accounted
- Operating margin more than halved to 10%
 - Provision for countermeasure development LAT failure was a one-off
- Order book decline reflects reduced NATO demand

Pyrotechnics

Revenue

↑ 4% £123.0m

Operating Profit

↓ 53% £12.3m

Operating Margin

↓ 12pts 10%

Closing Order Book

↑ 24% £178.2m

- Modest revenue growth
- Significant reduction in operating margin and profits
- Order book up
 - UK orders for Simmel IR Illum
 - Middle-East demand for pyrotechnic rounds
 - Hi-Shear orders for space and missile components

Munitions

Revenue

↓ 4% **£227.9m**

Operating Profit

↓ 40% **£24.3m**

Operating Margin

↓ 6pts **11%**

Closing Order Book

↓ 39% **£227.6m**

- Revenue flat
 - Mecar revenue from munitions deliveries off-sets mortar systems contract delay
 - Simmel growth in munitions from Italy and NATO
- Profit reduction from Mortar systems contract delays
- Order book decline
 - Significant Middle East munitions orders delayed by export licence approval constraints
 - Delays to order placement with Simmel both from Europe and non-NATO countries

Balance Sheet

| <u>£m</u> | <u>Final 2012</u> | <u>Final 2011</u> |
|----------------------|-----------------------|-----------------------|
| Goodwill | 214.8 | 243.7 |
| Acquired Intangibles | 166.1 | 190.8 |
| Tangible Assets | 240.0 | 231.1 |
| Other Net Assets | 20.1 | 15.4 |
| Working capital | 105.3 | 125.2 |
| Tax | (41.0) | (42.9) |
| Pension Deficit | (27.0) | (25.2) |
| Gross Debt | (340.8) | (354.6) |
| Cash | 96.0 | 91.9 |
| Net Debt | (244.8) | (262.7) |
| Shareholders' Funds | 433.5 | 475.4 |

- Impairment of goodwill £23m
 - *Chemring Ordnance* £7m
 - *Chemring Energetic Devices* £16m
- £21m amortisation of acquired intangibles
- Development of new products £12m
 - *Roke* £2m
 - *CCM* £3m
 - *Simmel* £2m
- Capex guidance for 2013 of c. £30m

Working Capital

| Working Capital | 2012 £m | 2012 Days | 2011 £m | 2011 Days | Change £m | Change Days |
|------------------------------|--------------|--------------|--------------|--------------|---------------|----------------|
| Inventory | 113.8 | 56 | 146.8 | 74 | (33.0) | (18) |
| Trade receivables | 90.9 | 45 | 109.0 | 55 | (18.1) | (10) |
| Contract receivables | 87.6 | 43 | 55.1 | 28 | 32.5 | 15 |
| Trade payables | (100.2) | (49) | (105.3) | (53) | 5.1 | 4 |
| Advance Payments | (11.7) | (6) | (48.7) | (25) | 37.0 | 19 |
| Accruals and deferred income | (45.6) | (23) | (20.9) | (11) | (24.7) | (12) |
| Other working capital items | (29.5) | (15) | (10.8) | (5) | (18.7) | (9) |
| Working Capital | 105.3 | 52 | 125.2 | 63 | (19.9) | (11) |
| Revenue | 740.3 | | 724.1 | | 16.2 | |

- Utilisation of advance payments within Munitions
- Reduction in net trade receivables and payables
- Inventory reduction offset by increase in contract receivables
- £10 million of the reduction in working capital relates to the removal of the Marine business

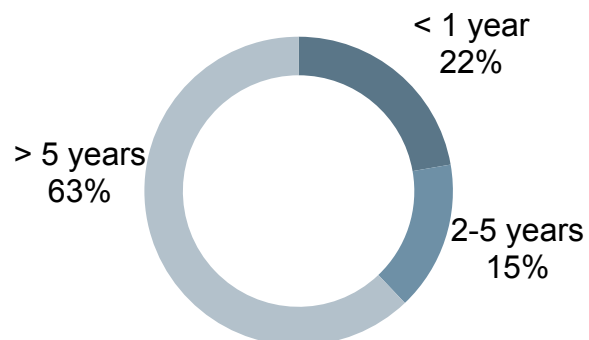
Cash & Debt

| RCF | Covenant | Actual |
|--------------------------|------------|--------|
| Interest cover to EBITDA | Minimum 4x | 6.8x |
| Net debt / EBITDA | Maximum 3x | 2.1x |

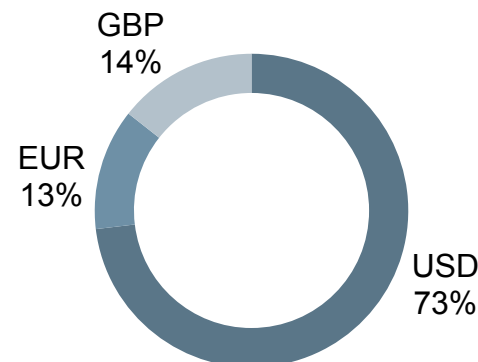
| Private Placement | Covenant | Actual |
|--------------------------|--------------|--------|
| Interest cover to EBITDA | Minimum 3.5x | 6.8x |
| Gross debt / EBITDA | Maximum 3x | 2.8x |

- £230m RCF established in Jan 2011, maturing April 2015
- 63% of debt is repayable after five years
- Average cost of debt 5% (2011: 5%)
- Gearing 56% (2011: 55%)

Gross Debt Profile £341m



Analysis of Debt in Local Currency



Cash Flow

| <u>£m</u> | <u>Final 2012</u> | <u>Final 2011</u> |
|--|-----------------------|-----------------------|
| EBIT | 88.3 | 135.8 |
| Depreciation/Amortisation | 23.7 | 19.6 |
| EBITDA | 112.0 | 155.4 |
| Other working capital movements | 19.9 | (15.6) |
| Other movements (including FX and removal of Marine) | (17.0) | (21.2) |
| Operating Cash Flow | 114.9 | 118.6 |
| Operating Cash conversion from EBITDA | 103% | 76% |
| Tax | (6.1) | (17.2) |
| Capital spend | (41.1) | (56.6) |
| Interest | (23.8) | (22.5) |
| Free cashflow | 43.9 | 22.3 |

- Operating cash flow at 103%
 - *Good cash conversion, but Q4 loaded*
- Free cashflow
 - *Tax lower*
 - *Payment timing and lower profits*
 - *Capex*
 - *Beta facility completed, Alpha nearing completion*
 - *£30m spent on capex and £11m on development of new products*
 - *Interest*

Movement in Net Debt

| <u>£m</u> | <u>Final 2012</u> | <u>Final 2011</u> |
|------------------------------|-----------------------|-----------------------|
| Net Debt b/f | (262.7) | (308.0) |
| Free Cash Flow | 43.9 | 22.3 |
| Equity dividends paid | (31.1) | (22.7) |
| Equity issue/treasury shares | (4.8) | 108.9 |
| Acquisitions/Disposals | 21.8 | (58.0) |
| Other movements | (11.9) | (5.2) |
| Net Debt c/f | (244.8) | (262.7) |

- Strengthening position due to improved free cash flow and disposal of Marine business
- Other movements include FX, acquisition related costs and restructuring costs
- £21.8m net proceeds on disposal of Marine business
 - *After fees and contribution to pension scheme*

Operational Review

Mark Papworth – Chief Executive



Counter-IED



Countermeasures



Munitions



Pyrotechnics

Agenda

- Chemring's markets
- Principal challenges that face Chemring today
- Chemring's strengths
- Priorities for performance recovery
 - Strengthen and simplify the management structure
 - Integration of operating units
 - Operational performance improvement
 - Focussed business development
 - Prioritisation of cash and cost management
- Priorities for 2013

Chemring's markets

Geographies

- **US** – remains under significant pressure regardless of US fiscal cliff compromise
- **UK and European** market are flat – planned reductions in Germany offset by limited growth in new NATO countries
- **Middle East** – will grow steadily but export licence issues remain
- **Asia Pacific** – growth driven by India and growing economies, but procurement processes and budget underspends are a challenge

Business Segments

- **C-IED** – continued interest in state-of-the-art equipment for Force Protection around the world
- **Countermeasures** – reducing NATO demand
- **Pyrotechnics** – military pyrotechnics under pressure but long-term programmes sustain Space and Safety Systems
- **Munitions** – Chemring's business predominantly naval and growing Middle and Far East markets

Challenging market backdrop likely to continue throughout 2013

Principal challenges that face Chemring today

- Complex organisational structure
 - Overcomplicated for our size
 - Excess management information, policy and procedure
 - Accountability and ownership
 - Duplication and waste
- Incomplete integration of acquisitions
 - Management style and culture
 - Silo mentality
 - Inadequate integration
- Continual operational issues
 - Slow to respond
 - Failure to leverage Group knowledge
- Costs too high
- Cash management

Significant opportunity to improve performance

Chemring's strengths

- Market leading positions in a number of core businesses
- Excellent technology and attractive products
- Knowledgeable and experienced talent base
- Significant new market opportunities

Proactively leverage key strengths

Priorities for performance recovery

1. Strengthen and simplify the management structure
2. Integration of operating units
3. Operational performance improvement
4. Focussed business development
5. Prioritisation of cash and cost management

Create a strong foundation for the future

1. Strengthen and simplify the management structure

- Appointment of Steve Bowers and Jim Devine
- Announcement to streamline Head Office and Divisions

Further work:

- Integration, consolidation, simplification of policies and procedures
- Implementation of standardized business KPI's and financial reporting
- Standardization of business performance reviews
- Management performance and behaviours
 - Ownership and accountability
 - Aligned incentivisation
 - Performance measurement and upgrade

Improve focus, accountability and responsiveness

2. Integration of operating units

- Alloy Surfaces and Kilgore Flares
- Chemring Detection Systems and NIITEK
- Others being evaluated

Integration process includes:

- Consolidation of management team
- Functional integration
- Organisational structure and re-design (layers and span)
- Operational synergies
- Standardized process and business systems

Exploit operating synergies and reduce costs

3. Operational performance improvements

- Upgrade operational leadership
- Drive performance
 - Ownership and accountability
 - Performance measurement
 - Communication
- Chemring tiger teams
- Operational centres of excellence

Create high performance operations

4. Focussed business development

- New products to existing customers
 - Leverage existing client relationships
- New products to new customers
 - Co-ordinated “Chemring” approach to new clients
- Current product portfolio leverage to new markets
 - HMDS exports to Europe
 - Internationalisation of Resolve
 - International markets for Cyber services
- Technology applied to non-defence markets
 - Pyro valves for civil aircraft safety systems
 - New initiators for Space-X commercial launch
 - Sabrex and Metron actuators for Oil & Gas industry
 - Smart Switch application on cellular networks

Leverage who and what we know

5. Prioritisation of cash and cost management

- Implementation of Group wide Delegated Level of Authority
 - Recruitment
 - Pay and rations
 - Travel and expenses
 - Capital and R&D expenditure
 - Bids and contracts
- Closure of Pall Mall, with other divisional offices being considered
- Focus on Working Capital
- Improve cash generation

Cash is King

Priorities for 2013

- Streamlined operations and management structure
- Identify centres of excellence within the Group
- Focus on core competencies and review of non-core operations
- Deleveraging through tighter cash management
- Implementation of Chemring values

Peter Hickson – Chairman



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Countermeasures



Munitions



Pyrotechnics

Outlook

- The new management team is taking firm action to improve operational efficiency
- However 2013 is expected to be a challenging year for defence companies
- Overall therefore, the Board's expectations for performance in the year remain unchanged

Appendix



Counter-IED



Countermeasures



Munitions



Pyrotechnics

Glossary of Terminology

| | |
|-----------|--|
| • APOBS | Anti Personnel Obstacle Breaching System |
| • CDS | Chemring Detection Systems |
| • C- IED | Counter Improvised Explosive Device |
| • CM | Countermeasure |
| • FMS | Foreign Military Sales |
| • GPR | Ground Penetrating Radar |
| • HMDS | Husky Mounted Detection System |
| • IAWS | Individual Airburst Weapon System |
| • IDIQ | Indefinite Delivery Indefinite Quantity |
| • JBPDS | Joint Biological Point Detection System |
| • JCAST | Joint Combined Air Systems Tester |
| • JSLSCAD | Joint Services Lightweight Stand-Off Chemical Agent Detector |
| • LAV | Light Armoured Vehicle |
| • MJU | Multi-Jetison Unit |
| • OCO | Overseas Contingency Operations |
| • PAC-3 | Patriot Advanced Capability 3 |
| • RF | Radio Frequency |

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