Chemring Group

Delivering global protection

Chemring Group PLC

Results for the six months to 30 April 2016

Key points

Revenue	£180.1m, up 11.4% with growth in all three segments
Operating profit*	£3.8m, down £1.7m due to revenue mix weighted towards low margin contracts and a reduced production rate
Safety	Lost time incident rate lowest on record
Progress	Rights issue successfully completed 40mm contract fully effective, significant H2 delivery expectations US Programs of Record progressing as expected Wallop Defence Systems countermeasures asset purchase Site rationalisation and restructuring projects continuing
Order book	£591.3m, up 18% Anticipated H2 revenue c.90% covered by orders in hand
FY16 outlook	Significant H2 weighting Full year outlook slightly below market expectations**

* *References to operating profit are to underlying measures*
** *As of 20 June 2016, Chemring's compiled consensus of analysts' forecasts was for FY16 underlying operating profit of £48.7m*

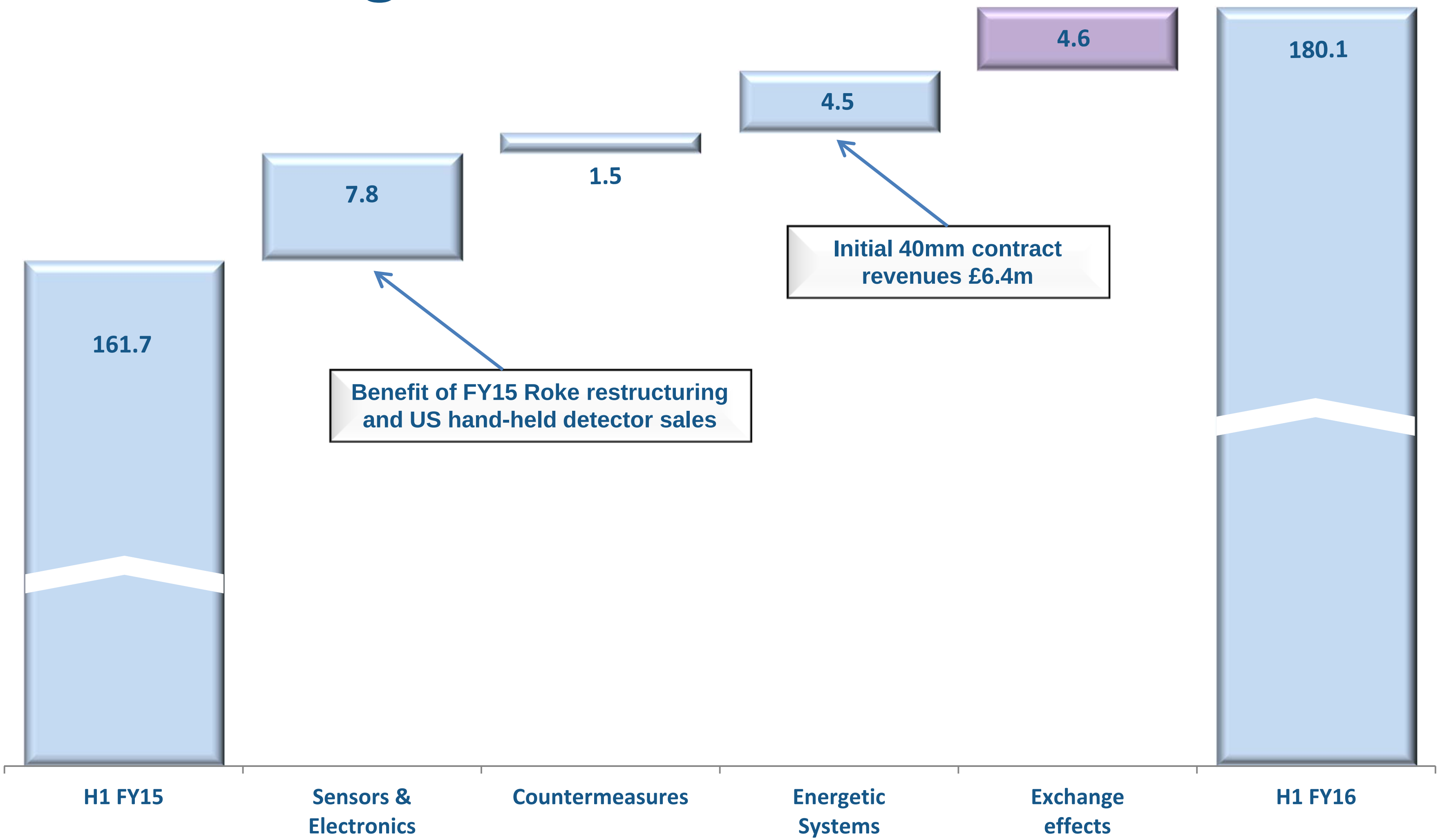
Safety

- Lost time incident rate lowest on record, reflecting enhanced culture and investment in safety
- Zero energetic related injuries during period
- Systems and processes in place across Group to minimise exposure of employees to high hazard conditions
- Continued emphasis on reduction of risk in high hazard activities
- Safety culture programs remain key, every employee responsible for ensuring their peers are safe

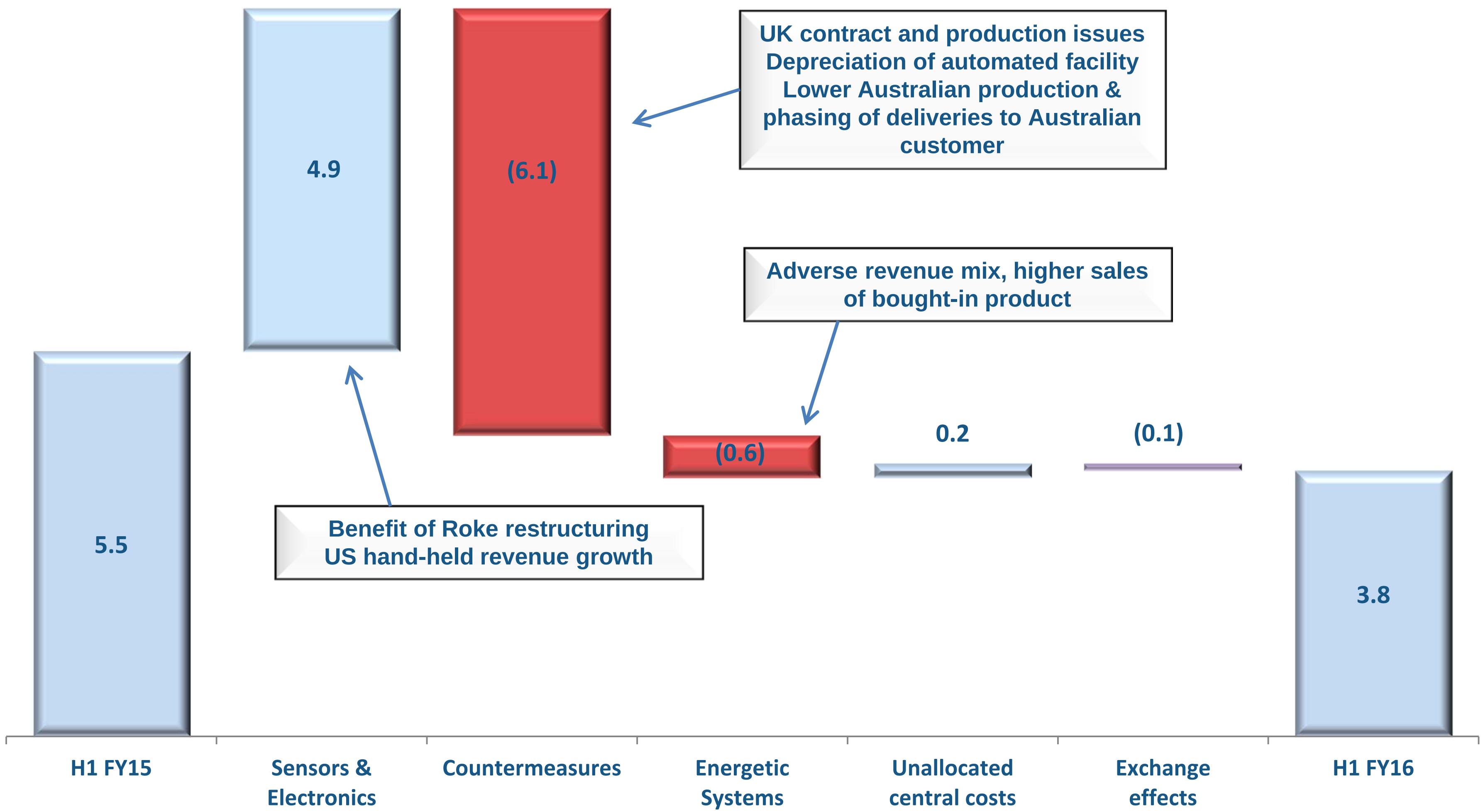
Financial Review

Steve Bowers – Group Finance Director

Revenue bridge



Operating profit bridge



References to operating profit are to underlying measures

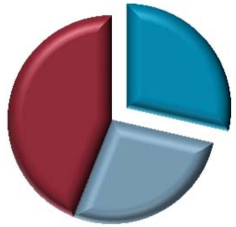
Chemring Group

Segmental results

Countermeasures

H1	FY16	Change	FY15
Revenue	**£52.2m**	+ £2.7m	£49.5m
Operating (loss)/profit	**£(1.4)m**	- £6.1m	£4.7m
Operating margin	**(2.7)%**		9.5%
Order book	**£171.5m**	- £27.8m	£199.3m

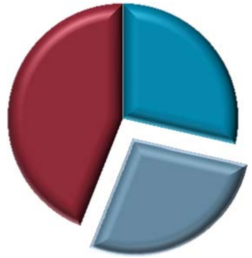
29% revenue



Sensors & Electronics

H1	FY16	Change	FY15
Revenue	**£50.2m**	+ £8.8m	£41.4m
Operating profit	**£5.7m**	+ £4.8m	£0.9m
Operating margin	**11.4%**		2.2%
Order book	**£91.5m**	+ £2.7m	£88.8m

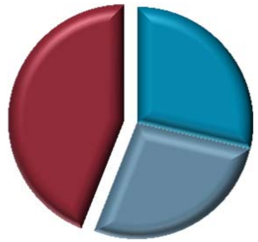
28% revenue



Energetic Systems

H1	FY16	Change	FY15
Revenue	**£77.7m**	+ £6.9m	£70.8m
Operating profit	**£3.0m**	- £0.6m	£3.6m
Operating margin	**3.9%**		5.1%
Order book	**£328.3m**	+ £113.6m	£214.7m

43% revenue



Income statement

Interest

Higher interest cost due to adverse US dollar rate effect on loan note interest and higher average debt pre rights issue

Tax

Consistent effective tax rate

Loss per share

H1 shares in issue 241.9m

Dividend

No FY16 interim dividend

£m	H1 FY16	H1 FY15
Operating profit	**7.3**	9.2
Corporate costs	**(3.5)**	(3.7)
Operating profit	**3.8**	5.5
Interest	**(7.8)**	(6.8)
Loss before tax	**(4.0)**	(1.3)
Tax rate	**21.5%**	20.3%
Loss per share	**(1.3)p**	(0.5)p
Dividend per share	**nil**	2.4p

References to operating profit, (loss)/profit before tax and loss per share are to underlying measures

Non-underlying items

Business restructuring and incident costs

Countermeasures incident costs and US headcount reduction

Cash outflow reflects Roke FY15 restructuring

Acquisition and disposal costs

Release of provisions relating to prior year disposals

Claim-related costs

Cash paid in relation to historic claims, fully accrued for in FY15

Debt repayment and accelerated interest costs

Interest due on early repayment of loan notes and associated covenant amendment fees

H1 FY16 £m	P&L cost	Cash paid
Business restructuring and incident costs	0.6	2.2
Acquisition and disposal costs	(1.8)	0.2
Claim-related costs	(0.2)	4.8
Acquired intangibles amortisation	6.7	-
Debt repayment costs	1.5	0.8
Accelerated interest costs	3.7	3.7
Other items	0.3	-
	10.8	11.7

Balance sheet

Capitalised R&D

Includes investment relating to long-term US chemical & biological detection programmes

Working capital

See next slide

Net debt

£39.9m decrease in H1, reflecting rights issue proceeds

Other

Includes £9.7m provisions relating to disposed businesses

£m	**H1 FY16**	H1 FY15	FY15
Goodwill & intangibles	**194.6**	202.9	195.4
Property, plant & equipment	**168.7**	174.1	168.0
Capitalised R&D	**36.5**	35.2	36.1
Working capital	**103.2**	75.5	81.8
Tax	**-**	(7.4)	(5.5)
Pension deficit	**(17.4)**	(18.6)	(17.7)
Gross debt	***(124.9)***	*(161.9)*	*(161.9)*
Cash	***10.5***	*13.4*	*7.6*
Net debt	**(114.4)**	(148.5)	(154.3)
Other	**(11.0)**	(17.7)	(13.2)
Net assets	**360.2**	295.5	290.6

Chemring Group

Working capital

H1 increase £21.4m, £4.7m FX related

Inventories

Increase driven by Energetic Systems – lengthening customer acceptance timescales, lower customer funding of inventory at Chemring Ordnance

Trade receivables

Strong collections in period. Some Middle East settlement delays now apparent

Other items

Reduction reflects advance payment to 40mm supply chain and settlement of claim-related items during H1

£m	**H1 FY16**	H1 FY15	FY15
Inventories	**111.8**	96.3	96.2
Trade receivables	**49.1**	49.4	66.1
Contract receivables	**12.6**	22.7	15.2
Trade payables	**(40.5)**	(43.6)	(46.7)
Advance payments	**(10.9)**	(11.6)	(11.5)
Other items	**(18.9)**	(37.7)	(37.5)
	103.2	75.5	81.8

Working capital actions

Inventories	H1 increase in inventory driven by lengthening customer acceptance timescales and contract specific issues Procurement processes robust, with high level of scrutiny of purchase commitments where no confirmed customer order in place – majority of inventory relates to orders on hand Line-item level review with business unit management teams Investment in procurement and production systems, especially within Energetic Systems – completion in 2016
Trade receivables	Greater focus on reducing debtors – significant H1 success in reducing overdues, some Middle East issues remain to be resolved Ongoing review of bids and contract terms to maximise advance payments from customers and ensuring multiple payment milestones
Trade payables	Continue to manage tightly

Operating cash flow

Depreciation

Increased depreciation from Countermeasures UK automated facility

Amortisation

Increased following completion of projects – amortisation now exceeds capitalisation

Working capital

Net outflow reflects inventory increase – driven by phasing of revenue, and expected to reverse in H2

£m	**H1 FY16**	H1 FY15	FY15
Operating profit	**3.8**	5.5	34.4
Depreciation	**8.9**	7.5	16.3
Loss on fixed asset disposals	**0.1**	-	0.3
Amortisation	**3.6**	3.1	6.4
Pension contributions	**(2.5)**	(2.5)	(5.0)
Other	**1.2**	0.6	1.2
	15.1	14.2	53.6
Inventory	**(10.7)**	(16.8)	(19.1)
Debtors	**6.6**	6.0	(3.1)
Creditors & provisions	**(6.1)**	9.5	4.0
Working capital change	**(10.2)**	(1.3)	(18.2)
Operating cash flow	**4.9**	12.9	35.4

Movement in net debt

Rights Issue

Net H1 cash inflow £76.0m

Change in net debt

Excluding rights issue, H1 net debt up £36.1m, driven by:

- £11.1m exchange rate effects – translation of USD debt at $1.46 (Oct 15: £1.54)
- £10.2m working capital outflow
- £4.5m non-underlying accelerated interest costs and fees

Capex

Spend continues to be focused on modernising production facilities

Capitalised R&D

Investment centred on Sensors & Electronics

£m	**H1 FY16**	H1 FY15	FY15
Operating cash flow	**4.9**	12.9	35.4
Non-underlying items	**(8.0)**	(3.8)	(8.4)
Capex	**(4.5)**	(3.1)	(8.2)
Capitalised R&D	**(2.8)**	(4.5)	(8.9)
Interest	**(10.7)**	(6.2)	(11.8)
Tax	**(2.5)**	(2.8)	(1.3)
Dividends	**-**	-	(7.9)
Share issue (net of costs)	**76.0**	-	-
Other	**(1.4)**	0.6	(2.1)
Exchange rate effects	**(11.1)**	(6.0)	(5.5)
Movement in net debt	**39.9**	(12.9)	(18.7)
Net debt b/f	**(154.3)**	(135.6)	(135.6)
Net debt c/f	**(114.4)**	(148.5)	(154.3)

Debt funding and covenants

Revolving Credit Facility

£70.0m, committed to July 2018

Loan notes

£48.8m of loan notes repaid from rights issue proceeds

£128.7m principal outstanding following repayment from share issue proceeds

First repayment £24.6m, due Nov 2016

Covenant position considerably more robust following share issue

April 2016	Actual	Covenant
Revolving Credit Facility		
Leverage - net debt to EBITDA	2.00x	<3.00x
Interest cover	4.77x	>4.00x
Loan notes		
Leverage		
- gross debt to EBITDA	2.10x	<3.75x
- adjusted debt to EBITDA	2.02x	<3.00x
Interest cover	4.60x	>3.50x

Chief Executive's Review

Michael Flowers

Our strategy

Position for growth through innovation, manufacturing excellence and international expansion

Countermeasures

- Strengthen position on key programs: Typhoon and F-35
- Acquisition of Wallop assets enhances portfolio
- Continue focused R&D effort
- Investment in operational processes

Sensors & Electronics

- Focus on areas of technological lead in counter-IED, Electronic Warfare, and chemical and biological detection
- Increase technology lead through customer funded and internally funded R&D
- Win key NATO programmes to exploit globally
- Roke to grow, particularly in cyber and security applications

Energetic Systems

- Maintain current business base and product range whilst seeking new markets
- Broaden into adjacent commercial markets
- Growth focus on Middle East and North Africa

Strategy – implementation, monitoring and performance improvement

- Further safety performance improvement – use of new maturity model
- Primary focus on operational improvement – 3 site closures, major overhead reduction in 3 businesses, Wallop integration
- Countermeasures manufacturing improvement – process engineering tools delivering predictability
- Working capital improvement program – inventory reduction key controllable element
- Waste reduction – improving margins, working capital and safety
- Improved sales effectiveness – CRM implemented to coordinate global sales and marketing
- Improved risk management – single Group wide framework

- **A Group philosophy rather than a series of independent business activities**

Transformation and diversification

Transforming customer relationships

- Growing installed base of products gives opportunity for maintenance and upgrade sales
- Transformation in customer interaction from transactional to relationship-based
- Success achieved in hand-held detection and Electronic Warfare

Sector diversification

- Current revenue mix: c.80% defence, c.20% non-defence
- Growing base of dual use technologies – eg components for civil as well as military and space; ground penetrating radar for road monitoring; Metron actuators for fire suppression and civil aerospace applications

Geographic diversification

- Current mix: c.75% NATO, c.25% non-NATO
- Continuing focus on Middle East – UAE branch office opened

Countermeasures

Air countermeasures

Naval launcher

Advanced countermeasures

Naval decoys

Special material decoys

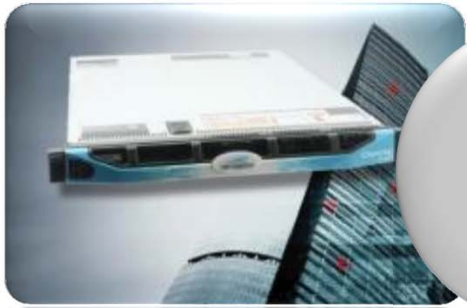
Countermeasures

2016 Priorities	2016 H1 Performance
F-35 programme	Delivering in support of initial US operational capability, second source development progressing
Kilgore operational improvement	Kilgore safety, waste reduction and margin improvement continues
Alloy Surfaces consolidation	Alloy plant consolidation progressing, all approvals in place, physical consolidation commencing. Completion 2017
Naval countermeasures	New naval round launched with significant orders from UK market, significant export interest. Major new customer in Middle East won, initial work in US market progressing
Collaboration within Chemring and with international partners	Greater alignment in operations, safety, strategy, product development and marketing
Progress Centurion launcher	Commercial interaction with three potential Centurion launch customers ongoing

Sensors & Electronics

Counter IED & Explosive Ordnance Disposal

Security



Chemical & biological detection

Electronic warfare

Sensors & Electronics

2016 Priorities	2016 H1 Performance
HMDS A2 counter-IED R&D programme	Funded development ongoing, DoD critical design review planned for February 2017
Next Generation Chemical Detection ("NGCD") R&D programme	Progression to prototype phase of NGCD in two development streams, awaiting contract award for third
Joint Biological Tactical Detection System ("JBTDS") R&D programme	Funded development ongoing, sole source position maintained
Hand-held counter-IED systems	c.$10m orders received for hand-held IED detectors
Progress global sales of route clearance systems (HMDS and 3d-Radar)	Opportunities continue to be progressed
Increase market footprint for land Electronic Warfare systems	New customers secured, upgrades and repeat orders for existing customers
Enhance collaboration through sensors businesses globally	Greater focus on joint technical development and solution cross-selling

Roke

- Recognised as a worldwide centre of research and development excellence
- Separation of Roke from Chemring Technology Solutions has transformed and simplified the business
- Recent performance significantly above expectations
- Now focused clearly on development of complex, enabling solutions for high-end UK defence and national security customers
- Rapid growth in exploitation of communications and data, and cyber security research and operations
- Satellite office in Gloucester being established to build closer links with key customers

Energetic Systems

Space and missile components

Military pyrotechnics

Demolition stores

Mine & obstacle breaching systems

Aircrew egress / safety

Energetic Systems

2016 Priorities	2016 H1 Performance
40mm production at Chemring Ordnance	First deliveries in April, routine deliveries ongoing. Risk still remains in meeting ramp up and production forecasts for full year, these factored into revised outlook
Win DoD non-standard ammunition 5 year IDIQ	Won, with initial $18m order received in half, further $30m order in June 2016. Maximum potential lifetime order value $750m, each award to be competed
Progress closure of Chemring Energetic Devices' California site	80% of new Torrance orders now transitioned to Downers Grove facility, Illinois. Capability uplift at Downers Grove and transition out of Torrance continues to plan
Remove capacity bottlenecks and improve first time right performance at Chemring Nobel	Capacity investment leading to growing order book and revenues, set against decline of core oil and gas market
Implement systems to facilitate better production and working capital management	New system fully operational at Chemring Defence Chemring Energetics implementation to complete in 2016

H2 Outlook

- Delayed start to and ramp up of 40mm contract has impacted phasing
- Significant H2 weighting adds greater risk to full year delivery
- Order book solid, c.90% of expected H2 revenue in order book
- Board’s current assessment is that the FY16 out-turn is likely to be slightly below market expectations

Summary

- Safety remains an imperative
- Successful completion of rights issue
- Strategic programme focused on working capital and cash conversion
- Site consolidations continuing to plan
- FY16 outlook slightly below expectations, c.90% of required H2 revenue in order book
- Major programmes continue to progress – HMDS A2, JBTDS, NGCD, F-35
- Growing sense of momentum across the business

Q&A

Appendices

Appendix 1. Our vision

Customers

Operational Excellence

Innovation

A leading, growing and innovative developer and manufacturer of detection, countermeasure and energetic technologies for the global defence and security markets

Deliver enhanced capabilities and solutions to our customers, provide a safe and secure work environment for our people, deliver enhanced returns for our investors

Safety

Financial Performance

People

Appendix 2. Organisation chart

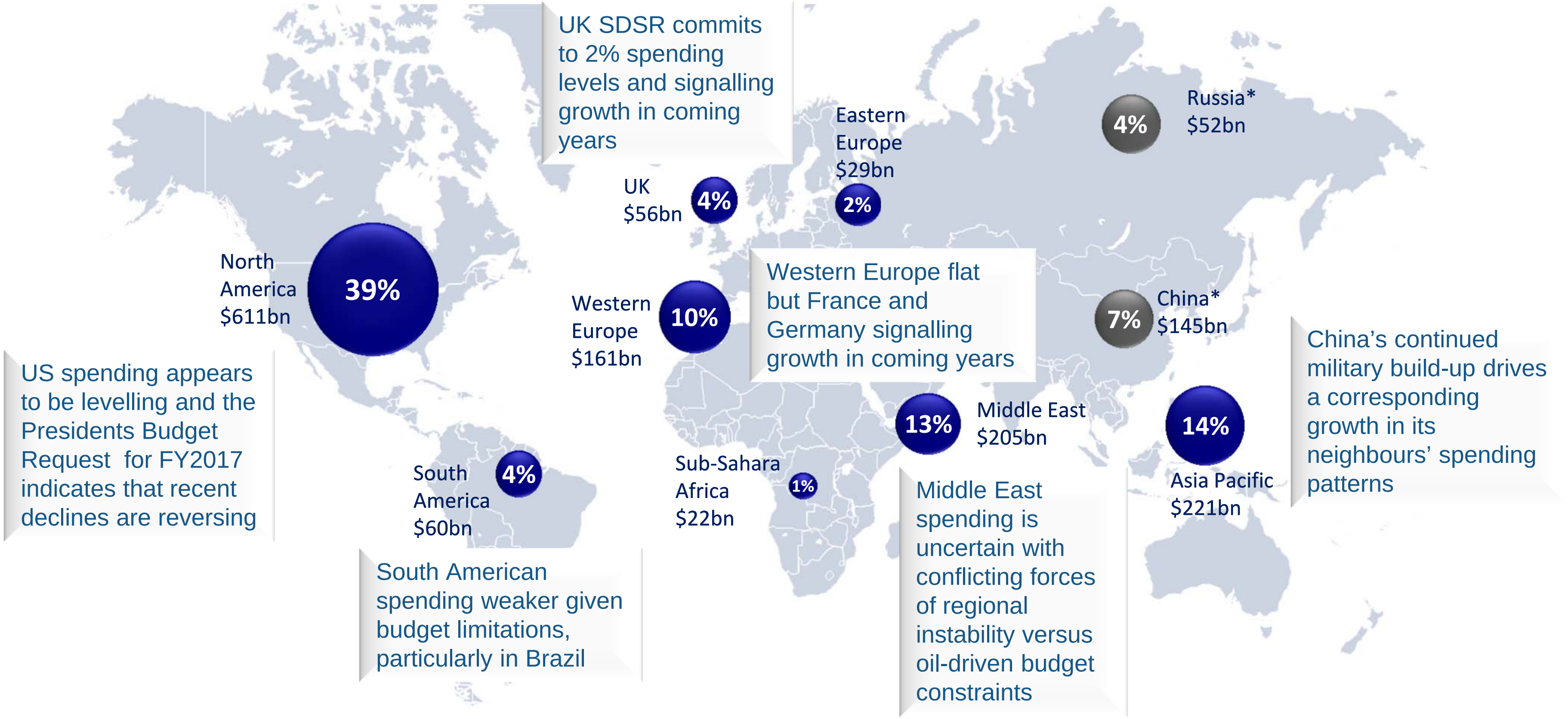
Chemring Group PLC

Operating Business Units

- **Countermeasures**
  - Chemring Countermeasures UK
  - Chemring Countermeasures USA (Kilgore Flares)
  - Chemring Countermeasures USA (Alloy Surfaces)
  - Chemring Australia
- **Sensors & Electronics**
  - Chemring Technology Solutions (UK)
  - Roke (UK)
  - Chemring Sensors & Electronic Systems (USA) – NIITEK & Chemring Detection Systems
  - 3d-Radar (Norway)
- **Energetic Systems**
  - Chemring Defence (UK)
  - Chemring Ordnance (USA)
  - Chemring Prime Contracts (UK)
  - *Military Pyrotechnics*
  - Chemring Energetic Devices (USA)
  - Chemring Energetics (UK)
  - Chemring Nobel (Norway)
  - *Energetic Sub-systems*

Appendix 3. Market update

Global defence spending has stabilised globally, at long-term ‘peace time’ rate



*Total inaccessible market (Russia, China, Iran, Syria and North Korea) represents about $200bn (13%) of global defence spend

Growth opportunities in niche market segments such as cyber defence, tactical Electronic Warfare, counter-IED and broader detection market

Appendix 4. Modelling considerations

Income statement

- 40mm contract anticipated to provide a significant contribution during H2 – major driver of the H2 weighting in FY16
- USD rate effect minor - 1¢ stronger USD gives £0.2m increase in PBT
- FY16 underlying interest expected to be c.£14m, plus non-underlying interest of £3.7m
- Tax rate stable at c.21%
- No interim dividend in FY16

Balance sheet

- USD rate effect - 1¢ stronger USD gives c.£1m more debt
- Strong cash generation in H2 expected as delivery levels step up, particularly 40mm contract
- Capex to run at c.75% of depreciation
- Capitalised R&D to run at c.75% of amortisation in FY16, reducing thereafter as US Sensors & Electronics projects complete

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