

Chemring Group PLC

Full year results for the year to 31 October 2013

Mark Papworth – Chief Executive

Introduction

Agenda

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Performance Recovery Programme

Mark Papworth

Financial & Operational Review
FY14 Guidance

Steve Bowers

Strategic Planning Process
Performance Recovery Programme - H1 FY14 Priorities
Summary

Mark Papworth

Q & A

Summary

- **Good progress with Performance Recovery Programme**
 - underpins FY14 profitability
 - creates a more resilient business
- **Strategic Planning Process now complete**
 - core businesses identified
 - priorities & segmental strategies agreed
 - strategic direction determined for next three years, reflecting market realities
- **Results in line with recent guidance**
 - budgetary pressures in core defence markets
 - impact from internal operational issues
- **Market backdrop creating drag on performance**
 - continued delays in US and Non-NATO order placement
 - UK and European markets remain flat
 - Middle East, Asia Pacific and South American markets still growing
- **Board's expectations for the current year remain unchanged**

Performance Recovery Programme

H1 FY13 Priorities

H2 FY13 Priorities

Management

Right size and upgrade senior leadership team



Focus management on operational performance improvement

Cash & Costs

Focus organisation on costs and cash



Deliver cash performance and covenant renegotiation

Integration

Identify operations for consolidation into centres of excellence



Complete integration of eight strategic business units to create four centres of excellence

Business Development

Understand application of current product portfolio to new markets and applicability of technology to non-defence opportunities



Focus business development in key countries and commercial evaluation of non-defence opportunities

Strategy

Gain thorough understanding of the organisation and start to build a common Chemring identity



Complete Strategic Planning Process and implement key actions to deliver growth

Benefits from Performance Recovery Programme

Costs

- 46% reduction in Head Office & Divisional headcount
- Closure of three offices
- Elimination of “excess” throughout the Group



- Delivering £10 million per annum in savings

Operational integration / performance improvement

- Eight operating units consolidated into four
- Capacity adjustments at all operating units
- ‘Problem’ businesses recovering



- Group margins broadly maintained despite revenue reduction

Management / management process

- Improved management capability
- Removed senior poor performers
- 75% reduction in management reporting burden
- Eliminated two organisational levels
- New forecasting and budget process implemented



- Co-ordinated and cohesive management team
- Forecast accuracy improved and variation reduced, but market itself remains volatile
- Clarity and responsiveness improved
- Aligned incentivisation and accountability

Benefits from Performance Recovery Programme (cont'd)

Cash/ debt position

- Better focus on managing cash and debt
- Managed cash performance to deliver below original quarterly net / gross debt to EBITDA position



- Successfully negotiated covenant alleviation in June 2013
- Successfully spread FY14 £20m pension bullet payment over three years

Business development

- Secured significant export sales for Sensors & Electronics products
- Evaluating four co-production agreements
- Secured strategic partners in Brazil, India, Saudi Arabia and UAE



- New export sales into seven countries
- Co-production Agreements signed for Countermeasures into Middle East
- Munitions co-production opportunities now being considered in Brazil

Non-defence markets

- Evaluating commercial opportunities for four core Chemring Technology Capabilities
 - Ground Penetrating Radar
 - GPS anti-jam
 - Data protection – commercial cyber security
 - Secure cellular communications



- Higher profile given to non-defence opportunities
- Focused management attention

Steve Bowers – Group Finance Director

Financial & Operational Review

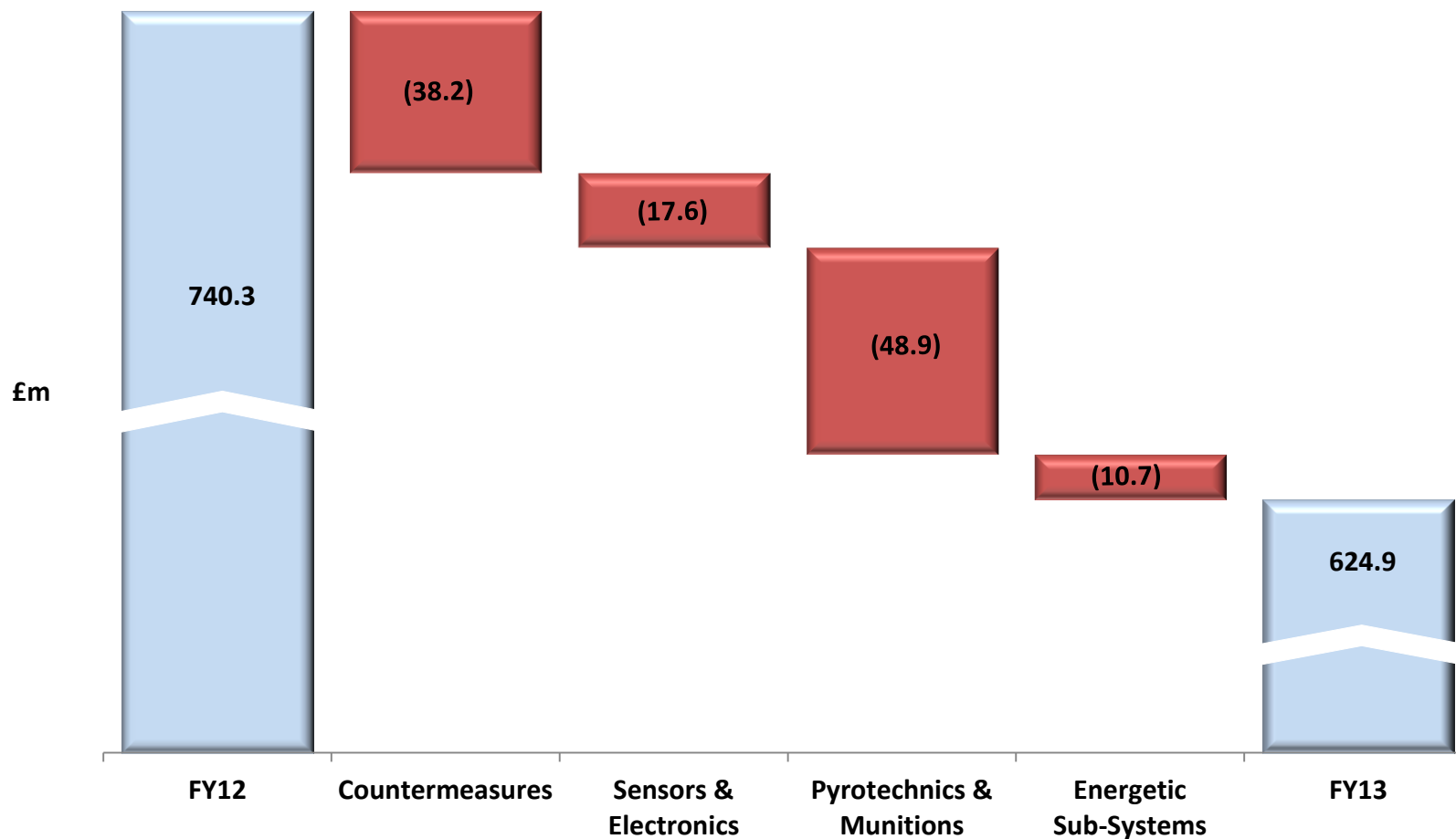
Headline results

	FY13	FY12	Change
Revenue	£624.9m	£740.3m	- 15.6%
Operating profit	£72.1m	£88.3m	- 18.3%
Operating margin	11.5%	11.9%	
Profit before tax	£52.4m	£70.1m	- 25.2%
Earnings per share	21.6p	28.5p	- 24.2%
Dividend per share	7.2p	9.5p	- 24.2%
Net debt	£248.7m	£244.8m	+ 1.6%

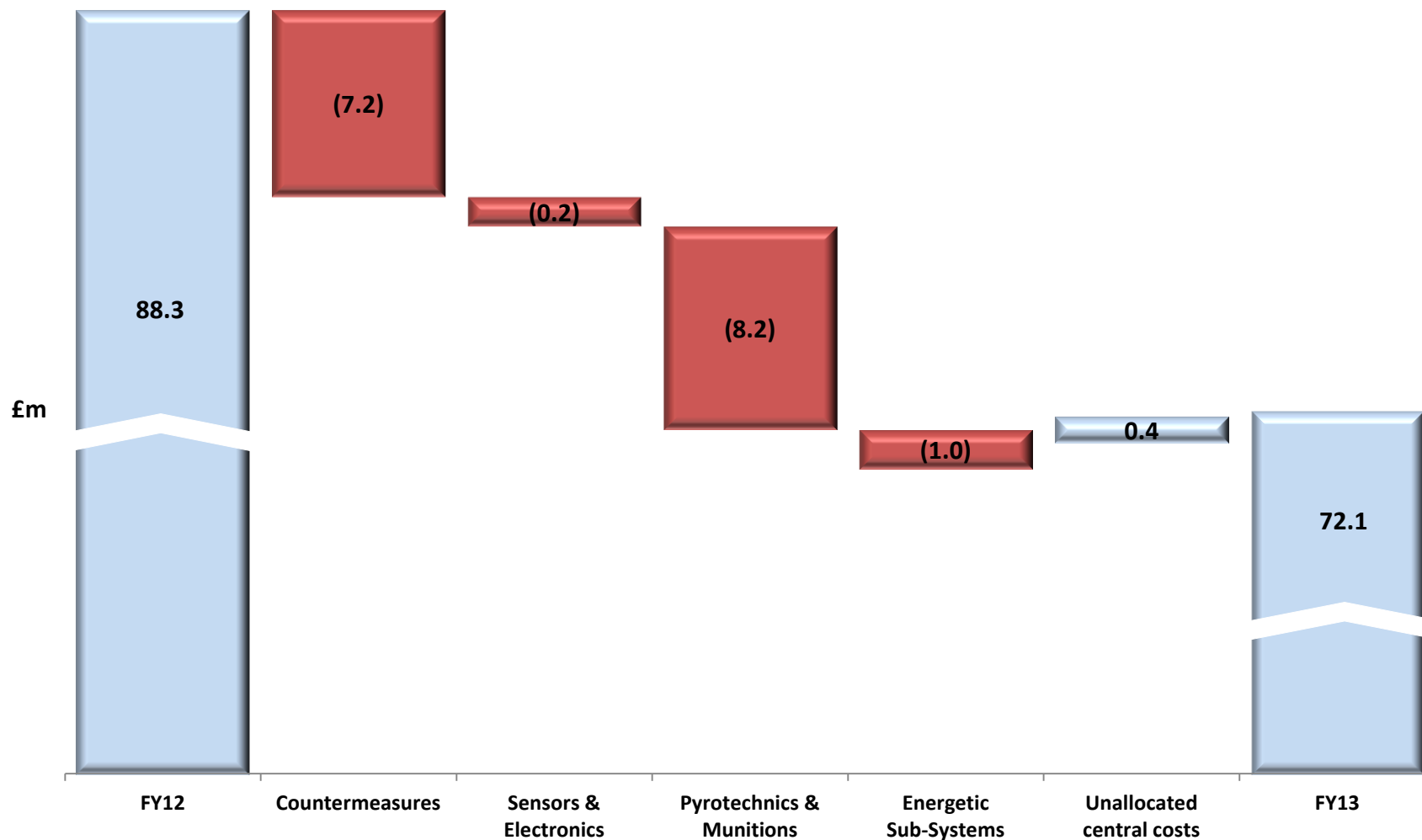
References to operating profit, profit before tax and earnings per share are to underlying measures

- Revenue decline results from lower activity levels in all areas
- Operating margins broadly constant through cost savings and efficiency actions
- Order book £675.5m, of which over £450m deliverable in FY14

Revenue bridge



Operating profit bridge

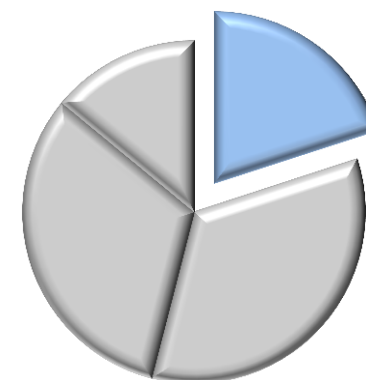


Countermeasures

Countermeasures USA, Countermeasures UK, Chemring Australia

	FY13	FY12	Change
Revenue	£125.0m	£163.2m	-23.4%
Operating profit	£13.2m	£20.4m	-35.3%
Operating margin	10.6%	12.5%	
Order book	£160.8m	£213.3m	- 24.6%

20% of Group revenue



FY13 review

Reduced US volumes due to Afghanistan drawdown and ongoing delays to orders

October 2013 closure of Defence Contract Management Agency impacted deliveries, exacerbating production issues at Kilgore

Headcount and overheads resized to reflect current demand levels

FY14 guidance

Business close to minimum sustaining order volumes

Sole source qualified positions on Typhoon and Joint Strike Fighter but order timing remains uncertain

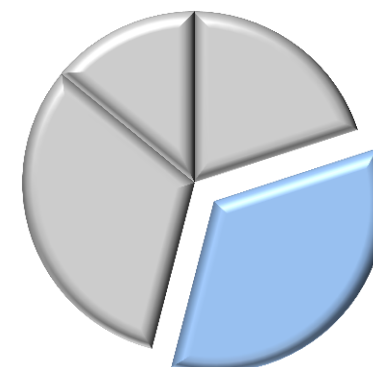
Progress continues to be made on Kilgore product quality issues

Sensors & Electronics

Chemring Sensors & Electronic Systems, Chemring Technology Solutions

34% of Group revenue

	FY13	FY12	Change
Revenue	£211.3m	£228.9m	-7.7%
Operating profit	£44.7m	£44.9m	-0.4%
Operating margin	21.2%	19.6%	
Order book	£106.2m	£100.7m	+5.5%



FY13 review

Performance driven by HMDS – further US orders of \$141m under IDIQ contract

Widespread demand outside US for Ground Penetrating Radar systems

Improved margins result from sales mix biased toward product sales

FY14 guidance

Final HMDS IDIQ order expected in H2 FY14; chem/bio programme completes in FY14

Sustained global interest in detection, jamming and defeat products

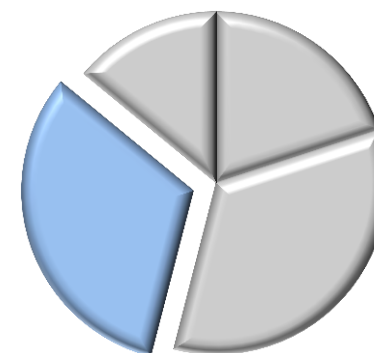
HMDS and other programmes transitioning from urgent operation requirement to base budget – entering R&D phase for several key products

Pyrotechnics & Munitions

Mecar, Simmel, Chemring Defence, Chemring Ordnance

	FY13	FY12	Change
Revenue	£200.6m	£249.5m	-19.6%
Operating profit	£13.0m	£21.2m	-38.7%
Operating margin	6.5%	8.5%	
Order book	£315.5m	£350.1m	-9.9%

32% of Group revenue



FY13 review

Delays in order placement, particularly in non-NATO markets

Impact of reduced volume and adverse mix offsets benefit of operational improvements

Mortar systems deliveries resumed in Q4 FY13 as export licence issues resolved

FY14 guidance

Outlook mixed due to lower demand from NATO markets

Significant non-NATO order pipeline evidences leading positions in naval and land ammunition

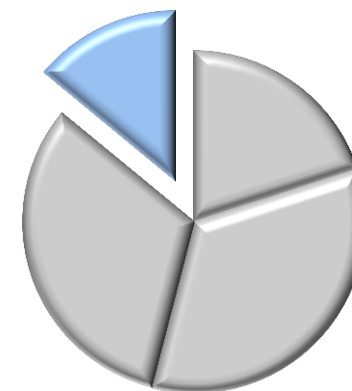
\$42.1m non-standard ammunition order to be fulfilled, albeit at lower margins

Energetic Sub-Systems

Chemring Energetics UK, Chemring Nobel, Chemring Energetic Devices

	FY13	FY12	Change
Revenue	£88.0m	£98.7m	-10.8%
Operating profit	£11.3m	£12.3m	-8.1%
Operating margin	12.8%	12.5%	
Order book	£93.0m	£96.8m	-3.9%

14% of Group revenue



FY13 review

Revenue impacted by reduction in US and UK defence spending

Early production synergies realised from integration of Hi-Shear into Chemring Energetic Devices

FY14 guidance

Outlook is flat – continued reduction in NATO requirements mitigated by emerging markets

Emphasis on resolution of production issues, integration of manufacturing sites

Sale of US build-to-print business for \$10.0m signed December 2013, completion imminent

Income statement

Unallocated corporate costs

Initial savings from restructuring

Interest

Cost reflects average debt levels

Tax

Slightly lower tax rate due to profit mix

Earnings per share

Reduction in line with reduction in PBT

Dividend per share

Maintained policy of 3.0x cover

£m	FY13	FY12	Change
Product segment profit	82.2	98.8	
Unallocated corporate costs	(10.1)	(10.5)	
Operating profit	72.1	88.3	-18.3%
Interest	(19.7)	(18.2)	
Profit before tax	52.4	70.1	-25.2%
Tax rate	20.2%	21.5%	
Earnings per share	21.6p	28.5p	-24.2%
Dividend per share	7.2p	9.5p	- 24.2%
Dividend cover	3.0x	3.0x	

Non-underlying items

	£m	FY13 P&L	FY13 Cash
Management structure simplification			
Headcount reduction in corporate and divisional teams		4.4	2.9
Retention incentive – no Board participation		5.5	5.1
Business unit integration & redundancy			
Costs include Countermeasures £1.9m and Sensors & Electronics £2.3m		2.1	0.3
Onerous lease provision			
Costs regarding vacant property for which rentals were guaranteed by Chemring		1.1	0.4
Carlyle bid fees			
Fees paid FY13 in relation to FY12 approach		0.2	3.0
Disposal costs			
Professional costs relating to divestment processes		0.6	0.1
		1.0	0.9
		14.9	12.7

Balance sheet

Goodwill & intangibles

FY13 impairments at Hi-Shear (£50.9m) and Chemring Energetic Devices (£15.7m)

Capitalised R&D

Chemring Technology Solutions projects and Centurion launcher

Working capital

Reduction during H2 FY13 despite delayed shipments to Middle East – see next slide

Net debt

Reduced in H2 FY13

Held for sale

Net assets of Clear Lake build-to-print business

£m	FY13	H1 FY13	FY12
Goodwill & intangibles	303.8	367.3	382.2
Property, plant & equipment	222.3	242.2	240.0
Capitalised R&D	32.7	31.7	31.0
Working capital	125.6	144.7	93.3
Tax	(32.5)	(36.5)	(41.0)
Pension deficit	(25.1)	(31.7)	(27.0)
<i>Gross debt</i>	(262.9)	(301.0)	(340.8)
<i>Cash</i>	14.2	25.9	96.0
Net debt	(248.7)	(275.1)	(244.8)
Held for sale	5.6	-	-
Other	0.1	(0.8)	(0.2)
Net assets	383.8	441.8	433.5

Working capital

Inventories

Decline in H2 reflecting higher shipments and initial benefits of improved inventory management

Trade receivables

Continued strong debtor control, rise since H1 reflects phasing of revenue

Contract receivables

Munitions contract receivables began to reduce during H2 FY13

Trade payables

Reduction reflects more sustainable creditor management

Advance payments

Improved contract funding profile

£m	FY13	H1 FY13	FY12
Inventories	113.7	139.3	113.8
Trade receivables	76.2	65.2	90.9
Contract receivables	104.8	108.6	87.6
Trade payables	(62.8)	(69.6)	(100.2)
Advance payments	(17.4)	(18.3)	(11.7)
Other creditors, accruals etc	(88.9)	(80.5)	(87.1)
Net working capital	125.6	144.7	93.3

Operating cash flow

		H2	H1		
	£m	FY13	FY13	FY13	FY12
Depreciation					
Increase from FY12 reflects capital investments coming on-stream, eg Australia production facility	Operating profit	72.1	37.0	35.1	88.3
	Depreciation	20.1	10.3	9.8	15.9
Amortisation	Loss on fixed asset disposals	2.2	1.6	0.6	3.4
Increase due to completion of development projects	Amortisation	5.9	3.5	2.4	4.6
	Retirement benefit obligation	(1.0)	(1.0)	-	-
Retirement benefit obligation	Other	0.6	0.8	(0.2)	0.3
Initial contributions paid under new funding structure during H2 FY13		99.9	52.2	47.7	112.5
Operating cash flow	Inventory	0.1	25.6	(25.5)	28.0
Significant operating cash generation during H2 FY13	Debtors	(15.9)	(11.8)	(4.1)	(8.2)
	Creditors & provisions	(15.5)	(2.4)	(13.1)	(17.4)
	Working capital change	(31.3)	11.4	(42.7)	2.4
	Operating cash flow	68.6	63.6	5.0	114.9

Movement in net debt

	£m	FY13	H2 FY13	H1 FY13	FY12
Non-underlying items					
Cash impact of restructuring	Operating cash flow	68.6	63.6	5.0	114.9
Capex	Non-underlying items	(12.7)	(6.1)	(6.6)	(15.6)
Significantly below depreciation & FY12	Capex	(12.3)	(6.6)	(5.7)	(30.1)
Capitalised R&D	Capitalised R&D	(7.4)	(5.5)	(1.9)	(11.0)
Growth in Sensors & Electronics	Interest	(20.4)	(9.0)	(11.4)	(23.8)
spend during H2 FY13	Tax	(0.5)	(1.8)	1.3	(6.1)
Interest	Dividends	(14.7)	(14.7)	-	(31.1)
Reflects lower gross debt in FY13	Disposal of Marine	-	-	-	21.8
Tax	Other items	(2.0)	(1.1)	(0.9)	(3.0)
UK & US corporation tax refunds in FY13	Exchange rate effects	(2.5)	7.6	(10.1)	1.9
Dividends	Net debt b/f	(244.8)	(275.1)	(244.8)	(262.7)
All paid in H2	Net debt c/f	(248.7)	(248.7)	(275.1)	(244.8)
Exchange rate effects					
Translation of US denominated debt					

Debt funding & covenants

Revolving Credit Facility

£230m, expiry April 2015

Leverage covenant 3.25x Oct 2013 & Jan 2014,
3.00x thereafter

Debt translated at average

Facility to be refinanced during 2014

October 2013 tests	Actual	Covenant
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Revolving Credit Facility

Leverage – net debt to EBITDA	2.65x	3.25x
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Interest cover	4.98x	4.00x
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Private Placement Loan Notes

\$405m + £12.5m, expiry 2016-2019

Leverage covenant 3.50x Oct 2013 & Jan 2014,
3.00x thereafter

Leverage calculated on gross debt

Debt translated at average rates

Additional interest payable based on leverage
and credit rating

Private Placement Loan Notes

Leverage – gross debt to EBITDA	2.78x	3.50x
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Interest cover	5.61x	3.50x
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Investing for future growth

	FY14 forecast £m	Capex	Capitalised R&D
Countermeasures			
Completion of Salisbury facility	Countermeasures	7.0	4.0
Development of Australian capability	Sensors & Electronics	2.0	10.0
Sensors & Electronics			
Next generation detection and electronic warfare technology	Pyrotechnics & Munitions	9.0	3.0
R&D supports transition of key capabilities to Programmes of Record	Energetic Sub-Systems	6.0	1.0
		24.0	18.0
Pyrotechnics & Munitions			
Facility upgrades for safety and production capacity			
Energetic Sub-Systems			
Safety and systems investment			

Modelling considerations

Income statement

- \$ exchange rate effect – 1¢ weakening in sterling gives £0.2m increased PBT
- Completion of restructuring projects in FY14
- Interest charge – c. £20-21m
- Stable tax rate – c. 22%
- Dividend covered 3.0x by underlying EPS

Balance sheet

- \$ exchange rate effect – 1¢ weakening in sterling gives £2m more debt
- Organic cash generation to reduce net debt
- Capex in-line with depreciation
 - £2m per annum depreciation on new Salisbury facility from FY14
- Pension scheme
 - revised funding commitment – £8m in FY14, £5m per annum thereafter
 - IAS19: £0.9m additional non-cash interest per annum – effective FY14

Mark Papworth – Chief Executive

Strategic Planning Process

Strategic Planning Process

1. Market assumptions – the new “normal”
2. Key outcomes
3. Segmental strategies

Market assumptions – the new “normal”

- Previous strategy & structure was designed for different market conditions
 - Independent, autonomous and internally competitive
 - Conflict driven requirement and replenishment order cycle
 - Technology developed in response to Urgent Operational Requirements (UORs)
 - Acquisitive model for growth
- The new “normal” – NATO
 - Drawdown from Afghanistan and minimisation of continuing operations globally
 - Minimum sustaining stock levels of ‘active’ operational capability only
 - Redirected focus on counter threat and cyber security applied to Homeland Security and critical national infrastructure
- The new “normal” – non-NATO
 - Drive to secure regional positions of influence
 - Focus on latest available technology from Western suppliers
 - Priority given to the set up of independent and indigenous defence capabilities
 - Bureaucratic and time consuming process but funding is not the principal constraint
- Implications for Chemring
 - Manage capacity down to minimum sustaining levels whilst maintaining technology capability
 - Migrate current product from UOR to baseline capability
 - Assess regional partners and co-production opportunities to gain international market share
 - Transform core defence technologies into commercial applications

Strategic objectives – our longer term ambitions (3-5 years)

Financial Performance	Each SBU to be capable of achieving minimum 15% operating margin with improving ROCE
Growth	Each core SBU capable of year-on-year growth in revenue
Market Positioning	Each core SBU will hold or plan to hold no. 1 or no. 2 position in its chosen market segments
Technology Leadership	Technology leadership to be established and maintained
Balanced Portfolio	Business development focused on providing geographically balanced portfolio of Defence Prime, Defence Service and Non-Defence revenues

Strategic Planning Process – Key Outcomes

1. Clear view of market environment, competitive dynamics and future prospects for each SBU
2. Market leading positions and technology strength confirmed in a number of areas
3. New defence and adjacent non-defence opportunities identified but yet to be exploited
4. Clear understanding of where to prioritise investment for future growth
5. Further operational initiatives identified to provide greater resilience and improve margins
6. A number of businesses identified as not forming part of longer term strategy



Focus on core competencies, directing investment into lines of business with technologies, products and market positioning that provide opportunities to achieve sustainable high margins and revenue growth

Segmental strategies: Countermeasures

Strengths	Opportunities	Strategic Priorities
<ol style="list-style-type: none"> 1. Clear market leader in expendable countermeasures 2. Strong home customer relationships in US, UK and Australia 3. World's largest R&D capability for infra-red countermeasures 4. Leading technologies in flares, special material decoys and Radio Frequency decoys 	<ol style="list-style-type: none"> 1. Further improvements at Chemring Countermeasures USA 2. Prime positions on Typhoon and Joint Strike Fighter programmes 3. Easing of export restrictions to non-NATO customers increases sales opportunities for latest technology 4. Increasing need to meet gap in naval countermeasure inventories 	<ol style="list-style-type: none"> 1. Fix operational issues at Kilgore and complete US integration 2. Maintain technological lead in home markets - promote customer funded development 3. Exploit co-production opportunities to gain market share and stimulate local consumption 4. Support development of Centurion launcher through customer trials
Maintain world lead in Countermeasures market		

Countermeasures strategic highlights

1. Gained US/UK approval for advanced technology export sales resulting in \$100m of unsolicited bids pending to the Middle East
2. Signed and executing co-production agreement for Middle East partner which will enable us to grow our regional market share
3. Successful trial of Centurion launcher in both decoy and missile configurations. Renewed interest from a number of potential customers to take product development forward
4. Development of special materials technology for defence training applications and catalytic converters

Segmental strategies: Sensors & Electronics

Strengths	Opportunities	Strategic Priorities
<ol style="list-style-type: none"> 1. World leading technologies in chemical, biological and IED threat detection 2. Proven capability in electronic warfare and cyber protection 3. Technological leadership well recognised in home markets 4. Established positions on IDIQ programmes 5. World-class technology development capabilities in data and telecoms 	<ol style="list-style-type: none"> 1. Widespread NATO interest in HMDS outside US orders 2. HMDS transitioning to Program of Record 3. Significant IED threat detection capability gap in many countries 4. Large number of Sensor & Electronic technologies are attractive to non-defence markets 5. Continued interest in electronic warfare and cyber security solutions 	<ol style="list-style-type: none"> 1. Ensure critical programme wins in US market 2. Build world leading technology base across trans-Atlantic footprint 3. Leverage capability and reputation to build cyber protection business 4. Incubate technologies for non-defence markets 5. Grow technology base through small selected business and technology acquisitions

Build world-leading technology base in Sensors & Electronics

Sensors & Electronics strategic highlights

1. \$10.6m order received from US Army to migrate HMDS from Urgent Operational Requirement to Program of Record, securing HMDS as an enduring capability over the next 10-15 years
2. Order received from US DoD to develop latest advanced technology hand-held IED detector
3. Chemring Technology Solutions support for Chemring Australia in the development of Electronic Warfare capabilities in Australia
4. New commercial cyber security product undergoing beta testing with commercial launch scheduled in 2014

Segmental strategies: Pyrotechnics & Munitions

Issues/Strengths	Opportunities	Strategic Priorities
<ol style="list-style-type: none"> 1. Mature markets, long cycles disproportionately hit by decline in NATO operations 2. Mixed operational performance 3. Volatility of some export markets 4. World leading position in naval ammunition 5. Leading position in large calibre tank & armoured vehicle ammunition 	<ol style="list-style-type: none"> 1. Further scope for operational improvement 2. Growing relationship for naval ammunition supply to NATO Support Agency 3. Strategic agreements for local assembly of munitions products in Middle East 4. Non-NATO customers renewing armoured vehicle fleets 	<ol style="list-style-type: none"> 1. Address operational issues in pyrotechnics 2. Maintain position in large calibre ammunition niches 3. Complete current medium calibre programmes & partner for funded development 4. Maximise utilisation of international capacity
<p>Optimise performance from current position</p>		

Pyrotechnics & Munitions strategic highlights

1. Signed and executing co-production agreement with Brazilian partner which will enable us to penetrate South American munition market
2. Successful execution on mortar systems contract creates strong foundation for subsequent munitions and follow on mortar system orders
3. Development of modern, high-performance, Insensitive Munitions 40mm grenade completed
4. Collaboration with Chemring Countermeasures on development of special material defence training product
5. Recent Non-Standard Ammunition successes establishes credibility to develop significant annual revenue stream

Segmental strategies: Energetic Sub-Systems

Issues/Strengths	Opportunities	Strategic Priorities
<ol style="list-style-type: none"> 1. Poor operational performance at Hi-Shear 2. Market characterised by high qualification costs and barriers to entry 3. Chemring Energetics UK has leading position in military demolition products 4. Sole source position with Martin-Baker 	<ol style="list-style-type: none"> 1. Combined customer portfolio of Hi-Shear and Chemring Energetic Devices offers organic growth potential 2. Chemring Energetic Devices contract wins beginning to generate recurring revenues 3. Potential to further improve operational performance 4. Opportunities to diversify into bespoke non-defence products 	<ol style="list-style-type: none"> 1. Complete integration of Hi-Shear into Chemring Energetic Devices 2. Improve operational performance across the segment 3. Exploit Hi-Shear's strong market position on key programmes – PAC3, NASA 4. Explore non defence markets – civil aerospace, automotive, space, and oil & gas
Focus on performance improvement and near-term market opportunities		

Energetic Sub-Systems strategic highlights

1. Signed agreement to sell Clear Lake built-to-print energetics operation for \$10.0m consideration
2. Successfully addressing manufacturing bottlenecks at Hi-Shear by transferring workload to Chemring Energetic Devices, to increase capacity and reduce overdue backlog
3. Final commissioning of primary explosives facility at Chemring Energetics UK provides world class capability
4. Chemring Energetics UK won its largest ever contract to develop and deliver demolition explosives to the UK MoD leads to follow on export opportunities
5. Secured first sales of “Metron” actuators into Brazil for trials on ATM security system

Performance Recovery Programme

2014 - Priorities

- Continue the divestment of non-core businesses and reposition Group finances
- Continue to deliver operational efficiencies
 - Cost reduction and cash generation
 - Improve margins through further restructuring and 'self help' programmes
- Invest for future growth
 - Investing in targeted R&D to launch new products and services
 - Growing our technology base and reach through small selected business and technology acquisitions
 - Expansion into emerging and adjacent markets
- Continue to drive the programme of cultural change

Summary

- Significant progress made in addressing fundamental business issues despite challenging markets
- Benefits of substantial change being felt internally - Performance Recovery Programme is at least a 24 month process
- Strategic Planning Process has identified platforms for future growth, and clear strategic priorities for each segment
- Market backdrop clouding visibility and creating drag on performance
- Board's expectations for the current year remain unchanged



Chemring is a more resilient business today, with a clear strategic direction

Q&A