



**Chemring Group PLC**

**Results for the year to  
31 October 2014**

# Agenda

**1. Highlights**

**Michael Flowers**

**2. Safety**

**Michael Flowers**

**3. Financial & operational review**

**Steve Bowers**

**4. CEO's review**

**Michael Flowers**

**5. Summary**

**Michael Flowers**

**6. Q & A**

## **Strategic highlights**

- Post divestments, Chemring is now a more focused business
- Core competencies in market sectors with leading positions
- Strengthened position on long-term Sensors & Electronics programmes
- Acquisition of 3d-Radar broadens market position in ground penetrating radar

## **Financial highlights**

- Improved operational performance in the second half
- Strategic divestments completed, strengthening the balance sheet
- Improved loan note funding terms and new revolving credit facility put in place
- Significant reduction in net debt and improved working capital management
- FY15 outlook unchanged, timing of Sensors & Electronics orders expected to result in H2 weighting

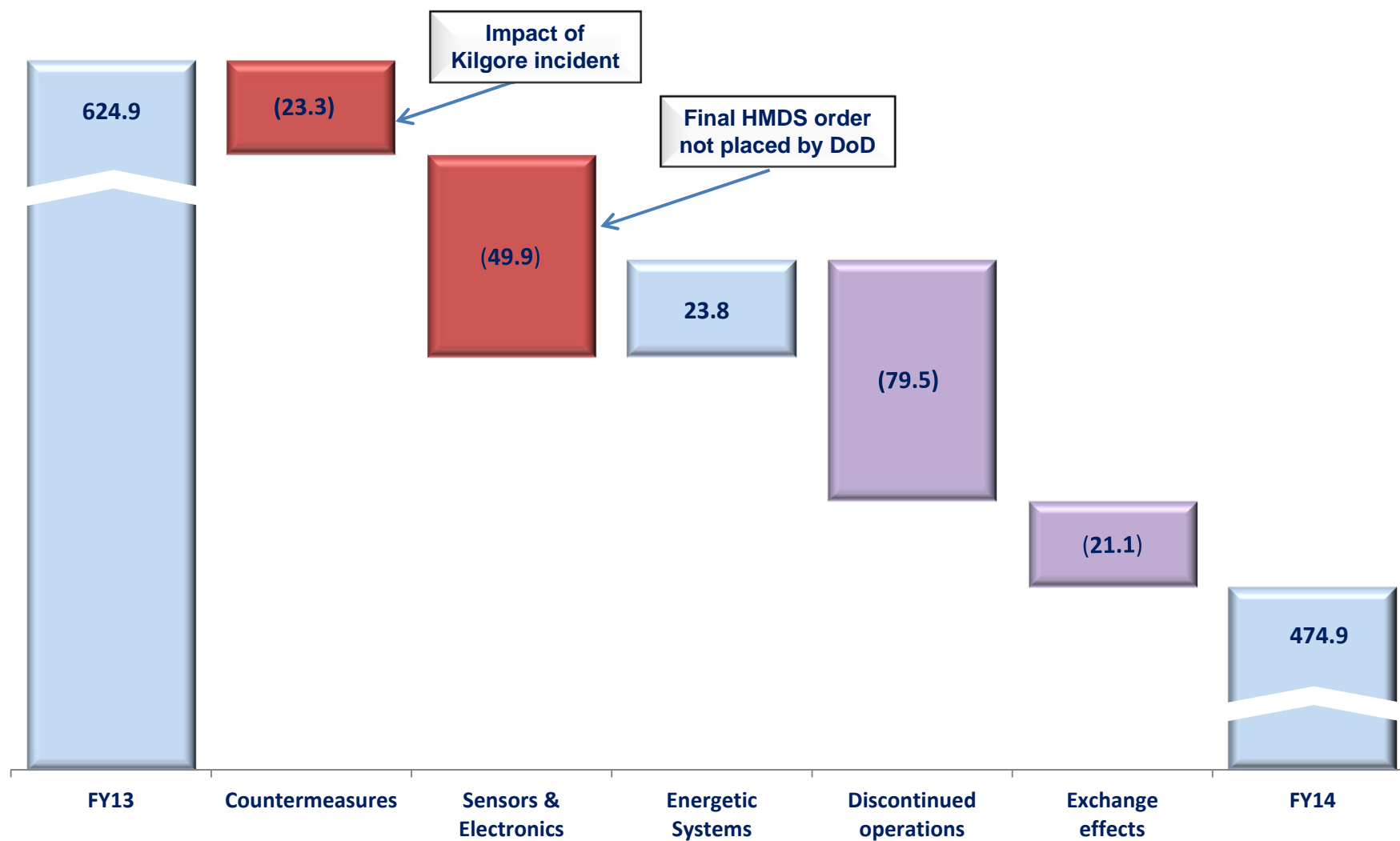
- **Kilgore incident – February 2014**
  - Investigation undertaken by Chemring and US authorities
  - Re-commissioning of facility completed in October 2014
  - Lessons learned and best practice rolled out – at Kilgore and throughout Chemring
- **Safety Leadership Program**
  - Developed to further improve safety culture
- **Key indicators**
  - Lost time incident rate lowest on record
  - Consistent “near miss” reporting
  - Environmental footprint reducing

# Headline results

		FY14	FY13	
<i>Total</i>	Revenue	<b>£474.9m</b>	£624.9m	
	Operating profit	<b>£49.0m</b>	£72.1m	
	Operating margin	<b>10.3%</b>	11.5%	
	Profit before tax	<b>£30.3m</b>	£51.6m	
	Earnings per share	<b>12.4p</b>	21.2p	
	Dividend per share	<b>4.1p</b>	7.2p	
	Net debt	<b>£135.6m</b>	£248.7m	
		FY14	FY13	Change
<i>Continuing</i>	Revenue	<b>£403.1m</b>	£472.3m	- 14.7%
	Operating profit	<b>£46.7m</b>	£56.3m	- 17.1%
	Operating margin	<b>11.6%</b>	11.9%	
	Order book	<b>£486.8m</b>	£494.9m	- 1.6%

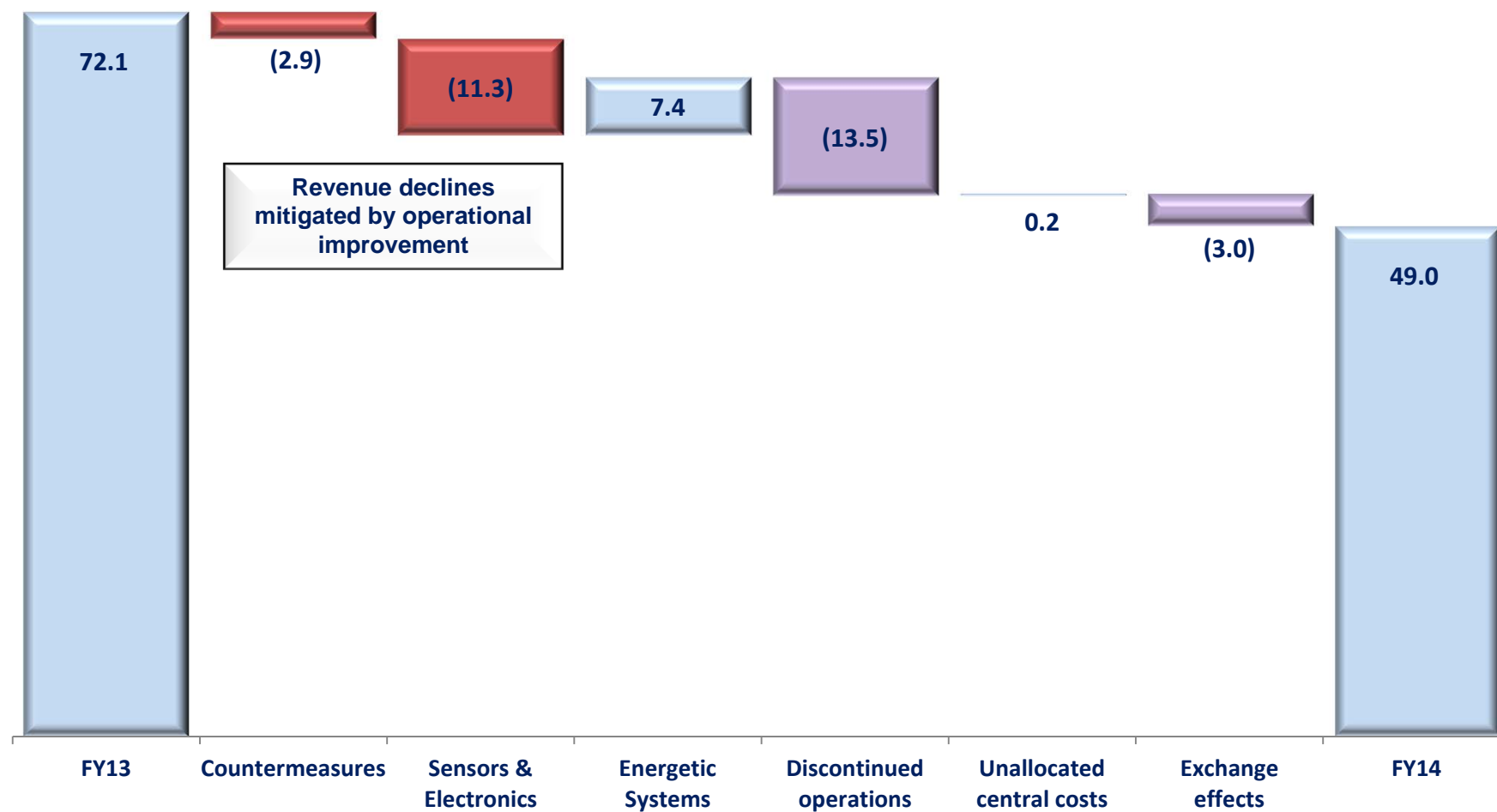
*References to operating profit, profit before tax and earnings per share are to underlying measures*

# Revenue bridge



All values £m

# Operating profit bridge

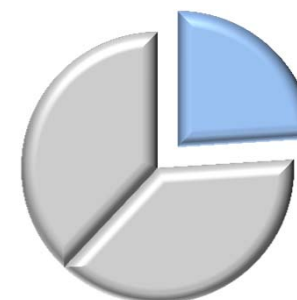


All values £m

# Countermeasures

	FY14	FY13	Change
Revenue	<b>£96.1m</b>	£125.0m	- 23.1%
Operating profit	<b>£9.7m</b>	£13.2m	- 26.5%
Operating margin	<b>10.1%</b>	10.6%	
Order book	<b>£193.3m</b>	£160.8m	+ 20.2%

24% revenue



## FY14 review

Production volumes affected by Kilgore incident

Re-commissioning of Kilgore facility completed October 2014

Growth in order book - lower US order intake offset by growth in other markets, including multi-year contracts

## FY15 guidance

Customer demand remains subdued, no material effect from Middle East tension

Incremental growth in Typhoon / F-35 orders

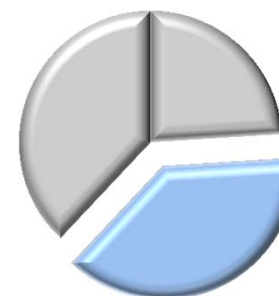
Further progress on US production and quality issues



# Sensors & Electronics

	FY14	FY13	Change
Revenue	<b>£154.4m</b>	£211.3m	- 26.9%
Operating profit	<b>£31.9m</b>	£44.7m	- 28.6%
Operating margin	<b>20.7%</b>	21.2%	
Order book	<b>£77.5m</b>	£106.2m	- 27.0%

38% revenue



## FY14 review

Conclusion of DoD production contracts for HMDS and chem/bio detection.

Anticipated final HMDS order not placed

Middle East HMDS production order secured in H2

UK business impacted by deferral of non-NATO production orders

## FY15 guidance

HMDS Program of Record R&D continuing, to be followed by transition to low rate initial production

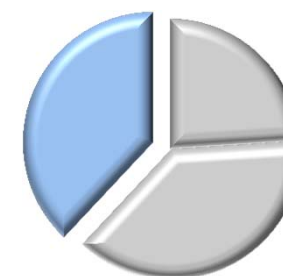
Non-US HMDS & 3d-Radar production orders key to near term

Growth in UK contract R&D services

# Energetic Systems

	FY14	FY13	Change
Revenue	<b>£152.6m</b>	£136.0m	+ 12.2%
Operating profit	<b>£15.0m</b>	£8.5m	+ 76.5%
Operating margin	<b>9.8%</b>	6.3%	
Order book	<b>£216.0m</b>	£227.9m	- 5.2%

38% revenue



## FY14 review

Growth in revenue and margins driven by operational improvement

Synergies from integration of Hi-Shear & Chemring Energetic Devices

Production throughput at Chemring Ordnance increased

## FY15 guidance

Market outlook remains flat - low NATO demand mitigated by emerging markets

Maintain margins and improve cash conversion

# Income statement

## Discontinued operations

European munitions and pyrotechnics businesses, sold May 2014

## Corporate costs

Further savings made, additional resource in FY14 to support divestment programme

## Interest

Reduced following paydown of loan notes in H2 FY14

## Dividend per share

Maintained policy of 3.0x cover

£m	FY14	FY13
Operating profit		
- continuing operations	<b>56.6</b>	66.4
- discontinued operations	<b>2.3</b>	15.8
Corporate costs	<b>(9.9)</b>	(10.1)
	<b>49.0</b>	72.1
Interest	<b>(18.7)</b>	(20.5)
Profit before tax	<b>30.3</b>	51.6
Tax rate	<b>21.1%</b>	20.5%
Earnings per share	<b>12.4p</b>	21.2p
Dividend per share	<b>4.1p</b>	7.2p
Dividend cover	<b>3.0x</b>	2.9x

# Non-underlying items

## Business restructuring and incident costs

- restructuring & redundancy £4.1m
- Kilgore incident £1.1m

## Loss on disposal

- write-down of disposed businesses (Simmel / Germany) £70.2m
- profit on Mear disposal £26.0m

## Accelerated interest

Triggered by loan note repayment in September 2014 - equal to 13.8% of principal repaid

£m	FY14 P&L	FY14 Cash
Acquisition and disposal costs	8.6	7.5
Business restructuring and incident costs	7.2	6.4
Loss on disposal	44.6	-
Accelerated interest	12.0	12.0
Acquired intangibles amortisation	16.1	-
Other items	0.7	-
	89.2	25.9

Chemring  
Group

## Capitalised R&D

Includes £18.0m Sensors & Electronics projects, £4.5m for Centurion launcher

## Working capital

See next slide

## Net debt

Benefit from receipt of disposal proceeds, majority applied to reduce loan note debt

## Other

## Disposal related provisions

# Working capital

			H1	
	£m	FY14	FY14	FY13
<b>Inventories</b>				
Reduced inventory during H2 at Energetic Systems as efficiency improves	<i>Continuing operations</i>			
	Inventories	<b>78.1</b>	83.4	73.1
	Trade receivables	<b>59.3</b>	47.3	39.9
	Contract receivables	<b>20.2</b>	31.0	41.5
<b>Trade receivables</b>	Trade payables	<b>(37.1)</b>	(36.6)	(31.1)
Increased due to phasing of FY14 revenue	Advance payments	<b>(4.5)</b>	(6.1)	(5.8)
	Other items	<b>(46.0)</b>	(53.6)	(56.4)
<b>Contract receivables</b>		<b>70.0</b>	65.4	61.2
Reduction reflects completion of Sensors & Electronics DoD production contracts	<i>Discontinued operations</i>	-	43.8	64.4
		<b>70.0</b>	109.2	125.6
<b>Other creditors</b>				
Reduced accruals and provisions				

# Operating cash flow

	£m	FY14	FY13
<b>Depreciation</b>			
Includes £1.8m relating to discontinued operations	Operating profit	<b>49.0</b>	72.1
	Depreciation	<b>17.0</b>	20.1
	Fixed asset disposals	<b>(0.2)</b>	2.2
<b>Amortisation</b>	Amortisation	<b>6.7</b>	5.9
Increased due to completion of development projects	Pension contributions	<b>(8.2)</b>	(1.0)
	Other	<b>1.2</b>	0.6
<b>Pension contributions</b>		<b>65.5</b>	99.9
Contributions paid under new funding plan	Inventory	<b>2.3</b>	0.1
	Debtors	<b>24.0</b>	(15.9)
	Creditors & provisions	<b>(28.3)</b>	(15.5)
	Working capital change	<b>(2.0)</b>	(31.3)
	Operating cash flow	<b>63.5</b>	68.6

# Movement in net debt

	£m	FY14	FY13
<b>Capex</b>			
Routine spend on health & safety upgrades and production optimisation	Operating cash flow	<b>63.5</b>	68.6
	Non-underlying items	<b>(25.9)</b>	(12.7)
	Capex	<b>(10.9)</b>	(12.3)
<b>Capitalised R&amp;D</b>			
Growth from Sensors & Electronics projects, including next generation programmes	Capitalised R&D	<b>(12.1)</b>	(7.4)
	Interest	<b>(20.6)</b>	(20.4)
	Tax	<b>(3.4)</b>	(0.5)
<b>Disposal proceeds</b>			
European munitions businesses and other divestments	Dividends	<b>(12.0)</b>	(14.7)
	Disposal proceeds	<b>137.1</b>	-
	Other	<b>(3.9)</b>	(2.0)
<b>Other</b>			
Includes £1.8m 3d-Radar acquisition	Exchange rate effects	<b>1.3</b>	(2.5)
	Movement in net debt	<b>113.1</b>	(3.9)
	Net debt b/f	<b>(248.7)</b>	(244.8)
<b>Exchange rate effects</b>			
Translation of US dollar debt	Net debt c/f	<b>(135.6)</b>	(248.7)



# Debt funding & covenants

## Revolving Credit Facility

- £70m facility established July 2014 with four-year term
- leverage covenant 3.00x
- interest cover covenant 4.00x

## Loan notes

FY14 repayments:

- June 2014 - £14.5m
- September 2014 - £87.2m

Remaining loan notes £161.0m; first maturity £30.6m in Nov 2016

Leverage covenant 3.00x adjusted debt to EBITDA; adjusted debt = gross debt less remaining disposal proceeds

Interest cover 3.50x

Additional interest payable based on leverage and credit rating

## October 2014

Actual Covenant

## Revolving Credit Facility

Leverage - net debt to EBITDA	<b>1.93x</b>	3.00x
Interest cover	<b>4.28x</b>	4.00x

## Loan notes

Leverage		
- gross debt to EBITDA	<b>2.31x</b>	3.75x
- adjusted debt to EBITDA	<b>2.25x</b>	3.00x
Interest cover	<b>4.39x</b>	3.50x

# Modelling considerations – FY15

## Income statement

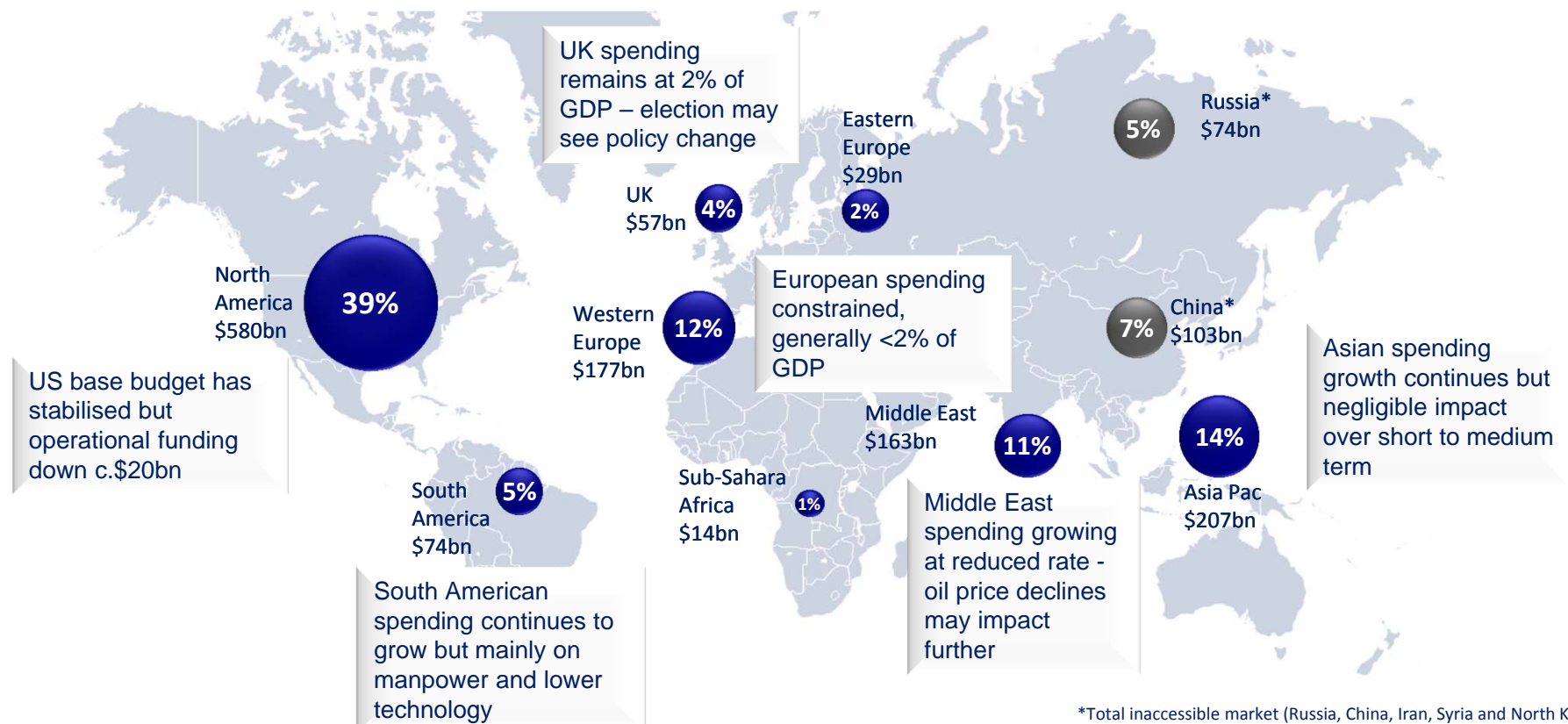
- Timing of Sensors & Electronics production orders will result in H2 weighting
- \$ exchange rate effect - 1¢ weakening gives £0.1m increase in PBT
- Further restructuring in FY15
- Interest charge - c.£15m, reflecting lower gross debt
- Stable tax rate - c.22%
- Unchanged dividend policy - 3.0x cover based on underlying EPS

## Balance sheet

- \$ exchange rate effect; 1¢ weakening gives £1m more debt
- Organic cash generation expected to reduce net debt
- Capex in line with depreciation at c.£18m – health and safety upgrades, IT systems
- Capitalised R&D c.£15m:
  - on-going investment in US Sensors & Electronics
  - UK investment in network assurance and communications

- 1. Market update**
- 2. Strategy**
- 3. Operational improvement**
- 4. Segmental analysis**
  - Countermeasures
  - Sensors & Electronics
  - Energetic Systems
- 5. Research and development**
- 6. 2015 Priorities**

## Global defence spending likely to stabilise over 2015



**Near-term growth in niche market segments such as cyber defence, tactical electronic warfare, and force protection**

## Portfolio and segmental strategies aligned to meet future demand



- **Countermeasures**

- *maintain world lead*
- *strengthen position on key programs; Typhoon and F-35*

- **Sensors & Electronics**

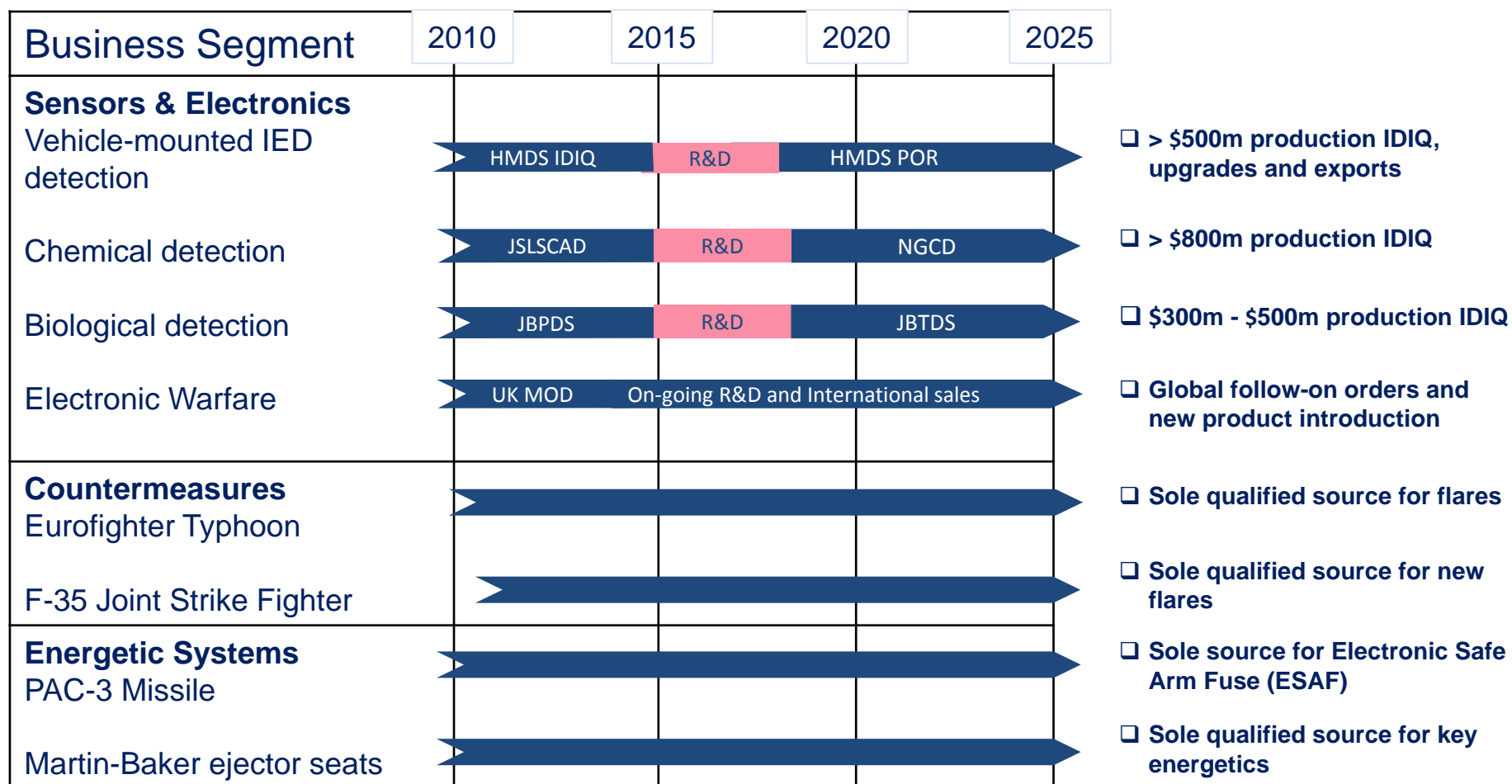
- *focus on areas of technological lead in detection, electronic warfare, and force protection*
- *build technology lead*
- *win key NATO programmes to exploit globally*

- **Energetic Systems**

- *maintain current business base and product currency whilst seeking new markets*

- **Target resources on growth opportunities**
- **Exploit capabilities and follow on products into adjacent markets**
- **Continue to improve operational performance at business unit level**

# Transitioning from short-cycle to long-term programmes



# Operational improvement

## Significant gains made...

### Chemring Energetic Devices

- Capacity utilisation
- Resource sharing
- Production scheduling
- CRM
- Significant improvement in gross margins
- Significant improvement in on-time delivery performance

### Chemring Ordnance

- Capacity utilisation
- Supply chain management
- Scrap rate improvement and process automation
- Broadening of business base
- Improved gross margin, particularly APOBS
- Operating profit margins at 8% compared to full-year losses over previous years

### Kilgore

- Safety systems and culture
- Increased manufacturing controls and automation
- Significant upskilling of staff
- Gross margin improved - further improvement in 2015
- Improvements not yet reflected in operating margins due plant closure from Feb - Oct

**...but more to go for**



# Countermeasures



Naval Launcher



Air  
Countermeasures



Advanced  
Countermeasures



Naval Decoys



Special Material  
Decoys





# Countermeasures achievements and future priorities

## 2014 Achievements

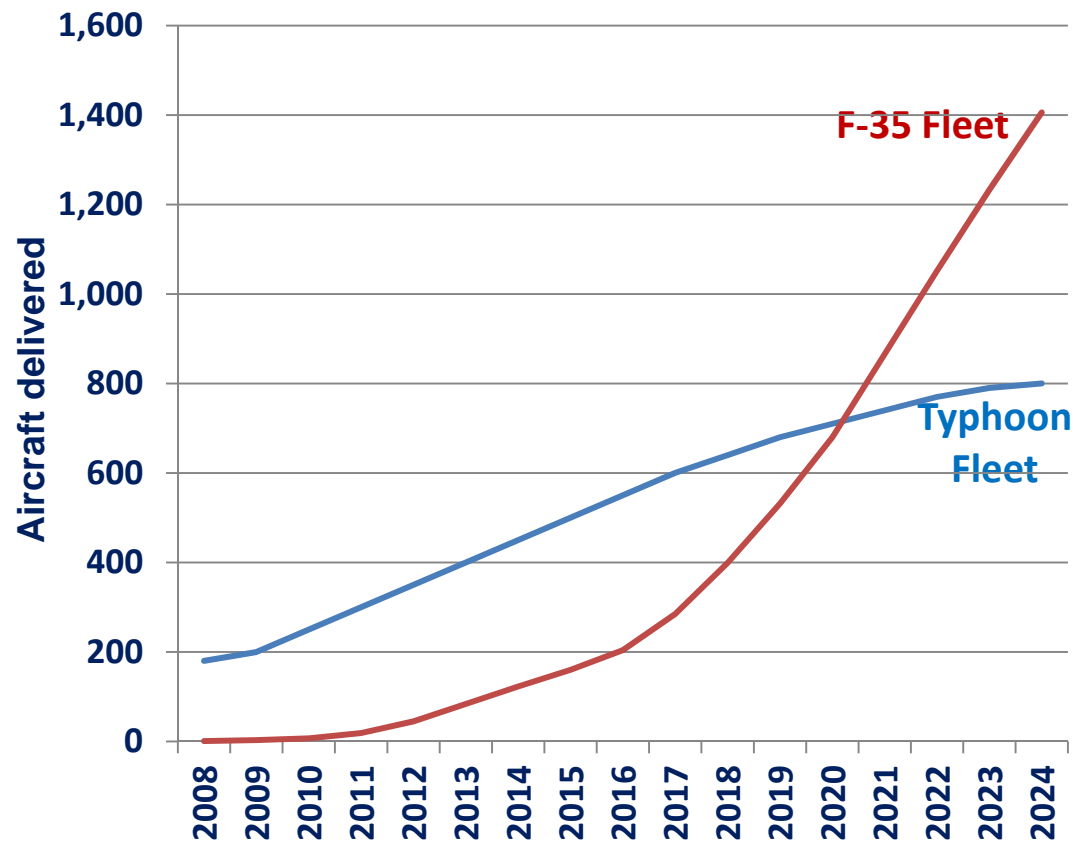
- Solid order intake across year, particularly at Chemring Countermeasures UK
- Strengthened operational and strategic leadership at Kilgore and, following re-opening, gross margins starting to improve
- Completed F-35 Low Rate Initial Production and secured contract for Chemring Australia to qualify as second source

## 2015 Priorities

- Consolidate gains made at Kilgore
- Maintain technology lead in home markets through customer-funded and self-funded R&D
- Deliver F-35 qualification contract in Australia
- Further segment collaboration, particularly across Atlantic
- Continue efforts to secure launch customer for Centurion launcher

# Growth drivers case study: next generation aircraft drive market growth

Global aircraft fleet



- Build-up of operational stockpiles of 3,000 flares per aircraft, but only for 50% of the actual fleet
- Training and test consumption of 150 flares per in-service aircraft per year (10% of war stock)
- New flares more expensive than the flares they replace
- Decoy user base expands as retiring platforms are sold on to new NATO and growing economies



F-35

Chemring sole supplier of F-35 unique flares:

- Ultimate global fleet of c.3,000 platforms



Typhoon

Chemring sole supplier of decoys:

- 55mm flare and spectral variant unique to Typhoon
- Additional opportunity for BOL chaff & IR
- Potential export opportunities remain in Bahrain, UAE, Kuwait, Denmark, Malaysia, and Qatar
- Global fleet of c.800 platforms

# Sensors & Electronics – five platforms for defence and non-defence growth

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# Sensors & Electronics achievements and future priorities

## 2014 Achievements

- Export order received for HMDS in Middle East
- Groundshark hand-held IED detector initial orders received
- Downselected for initial phase of all three streams of Next Generation Chemical Detector (“NGCD”) programme
- Success with Resolve Land Electronic Warfare (“EW”) in export markets

## 2015 Priorities

- Win export orders for HMDS
- Win non-NATO and civilian opportunities for 3d-Radar
- Exploit hand-held detector range and gain market share
- Successfully progress NGCD R&D programmes
- Enter commercial market for hand-held detection units
- Win development programme for Joint Biological Tactical Detection System (“JBTDS”)
- Enter Beta testing for Perception, conclude development and start product sales
- Optimise structure and R&D efforts

# Growth drivers case Study: HMDS counter-IED systems development and market penetration

## HMDS

- HMDS originally funded to as urgent operational requirement in Iraq and Afghanistan for US DoD
- Significant additional sales to 'coalition' forces – Canada, Australia, Spain, Italy, Turkey
- The system is transitioning to baseline capability through customer funded R&D. Potential solution includes Roke developed detection technologies. 300 – 600 US systems 2017 onwards, plus exports
- Significant international demand remains

## 3d-Radar

- 3d-Radar acquired to provide complementary non-ITAR solutions
- Opportunities in Middle East are progressing positively
- 3d-Radar solutions marketed in adjacent markets. Applications include infrastructure, tunnel detection and industrial survey

## Hand-held and Robot

- HMDS technologies utilised in Groundshark hand-held detector
- Initial orders received, substantial opportunities in pipeline
- Small remotely operated vehicle-based system also developed

**Originally a single solution for a single customer, GPR capability has now transitioned to a family of solutions**



The HMDS is a combat proven, high-performance ground penetrating radar (GPR) system providing rapid detection of landmines and other explosive devices (IEDs)



Groundshark employs HMDS technologies to provide latest generation hand-held solution for land mine and IED detection



# Energetic Systems



Military  
pyrotechnics

Space and  
missile  
components

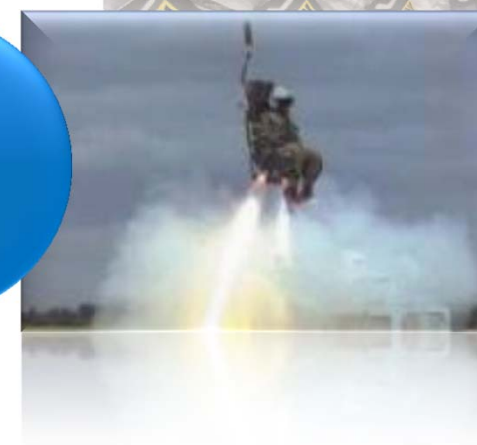


Demolition  
stores



Mine &  
obstacle  
breaching  
systems

Aircrew  
egress /  
safety



# Energetic Systems achievements and future priorities

## 2014 Achievements

- Hi-Shear integrated into Chemring Energetic Devices, delivering both on time delivery and operational margin improvements
- Chemring Ordnance returned to profit on back of significant operational improvements on APOBS programs, broadening of product base and effective cost controls
- Chemring Defence secured major export contracts to counter declining NATO market, underpinning ongoing profitability of business

## 2015 Priorities

- Consolidate gains made at Chemring Energetic Devices and Chemring Ordnance whilst exporting best practice to other sites
- Continue to seek new markets for existing products, particularly in the Middle East and Far East
- Focused and small-scale developments to ensure currency of product range
- Capital investment to support short payback programs that deliver margin improvement on current programs
- Continue to build trans-Atlantic capability to address US and European space, aircraft and missile prime contractors

# Research and Development

- Chemring's R&D is focused to support winning of known opportunities
- R&D more fully aligned to Group strategic focus and customer requirements
- Countermeasures spend reflects strategy of maintaining technology lead in home markets and winning customer funded research
- Sensors & Electronics R&D focused on critical wins, including HMDS, 3d-Radar exports, NGCD, JBTDS and land EW
- Energetics investment focuses on refreshing aging products and positioning for next generation programmes
- Spend across the Group, and within segments, is appropriate compared to industry benchmarks

	Group	Countermeasures	Sensors & Electronics	Energetic Systems
Revenue	403.1	96.1	154.4	152.6
Gross R&D spend	(50.3)	(6.6)	(39.2)	(4.5)
Less customer-funded	28.5	3.3	23.7	1.5
Net R&D spend	(21.8)	(3.3)	(15.5)	(3.0)
Net R&D % of sales	5.4%	3.4%	10.0%	2.0%
Benchmark R&D spend	4.5%	3%	6-8%	2.4%



- Chemring now a more focused defence technology business able to capitalise on organic and strategic growth opportunities
- Business structure and strategy has evolved, with greater focus on core capability areas, collaboration within segments, and individual accountabilities
- Attention on future growth, with R&D to support capture of major customer programmes
- Good 2014 order intake in Countermeasures and Energetic Systems segments positions positively for 2015
- FY15 outlook unchanged, timing of Sensors & Electronics orders results in H2 weighting
- Market remains challenging but with many opportunities in existing and new markets

# Questions?

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