Chemring Group PLC

Half year results for the six months to 30 April 2014

Peter Hickson – Chairman

Introduction

Agenda

Highlights and overview	Peter Hickson
Financial & Operational Review	Steve Bowers
Introduction and Strategy	Michael Flowers
Summary	Peter Hickson
Q & A	

Chemring Group

Highlights

- **Overall interim result in line, full year outlook remains broadly unchanged before the impact of further foreign exchange headwind**
  - significant reduction in net debt to £229.2 million before receipt of disposal proceeds
  - strong margins in Sensors & Electronics and good operational progress in Energetic Sub-Systems mitigates on-going issues in US Countermeasures business
- **Disposal of European Munitions business reshapes Chemring for future growth and enables greater focus on core competencies**
  - this disposal, together with the disposals of Clear Lake and Chemring Defence Germany, completes the strategic review process and creates a focused defence technology business
- **Successfully negotiated improvements in loan note funding arrangements**
  - disposal proceeds to be offset against gross debt in determining leverage covenant compliance
  - offer of proceeds to note holders at par to result in early repayment of $24.7 million of gross debt
- **Completed small but significant acquisition of 3d-Radar**
  - consolidates Chemring's leading international position in ground penetrating radar
  - ITAR-free technology means we are now able to offer product to a number of previously inaccessible non-NATO and commercial markets

Steve Bowers – Group Finance Director

Financial & Operational Review

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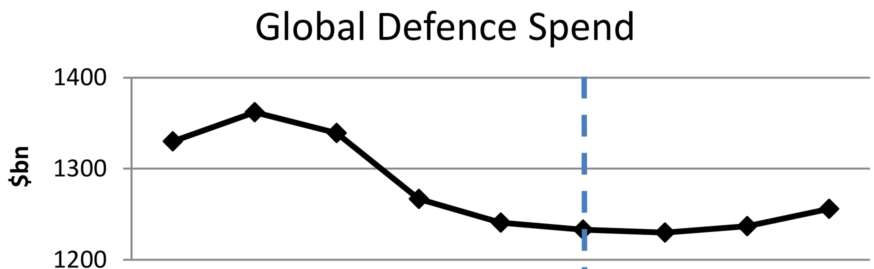
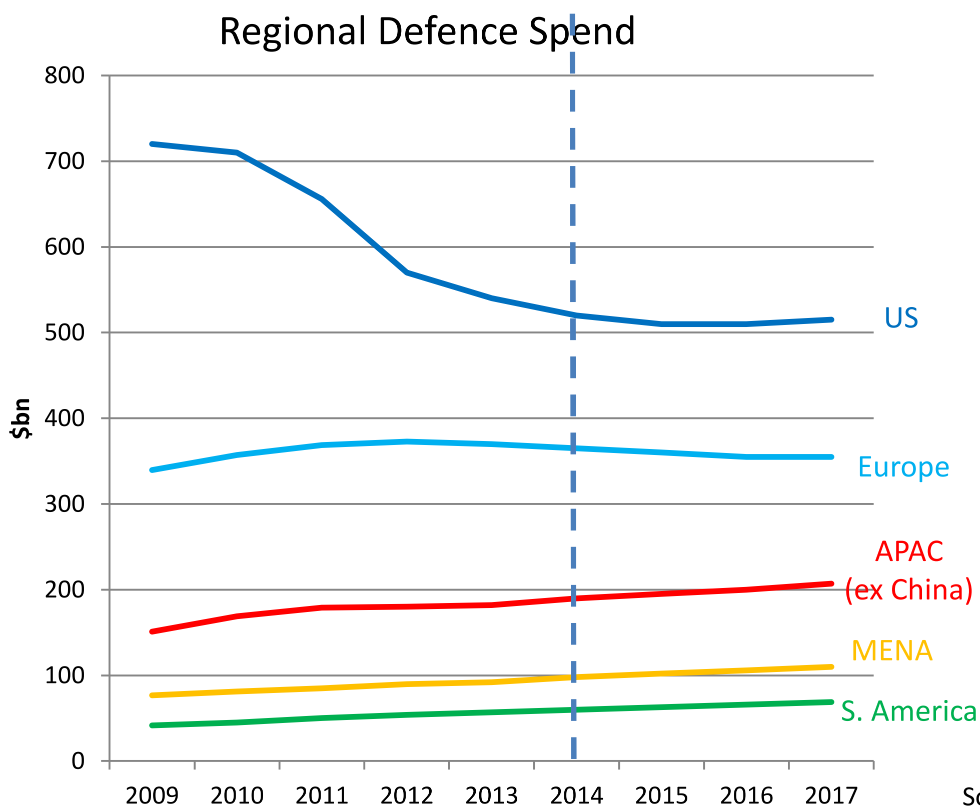
Market update





Decline in global defence spending will continue to decline until 2015

- US reduction in Overseas Contingency Operations funding will outweigh planned increases in baseline budget
- European spending remains constrained and generally below the NATO requirement for 2% of GDP
- Middle East spending continues to grow, but at a slower rate as Saudi Arabia completes major procurement programmes
- Asia Pacific is the fastest growing region and despite recent underspends India's growth is strong
- South American spending continues to grow, but Brazil's recent announcement of a 25% budget cut has a short term impact

Source: SIPRI, Global Military Balance, IHS Janes

Headline results

Including discontinued operations

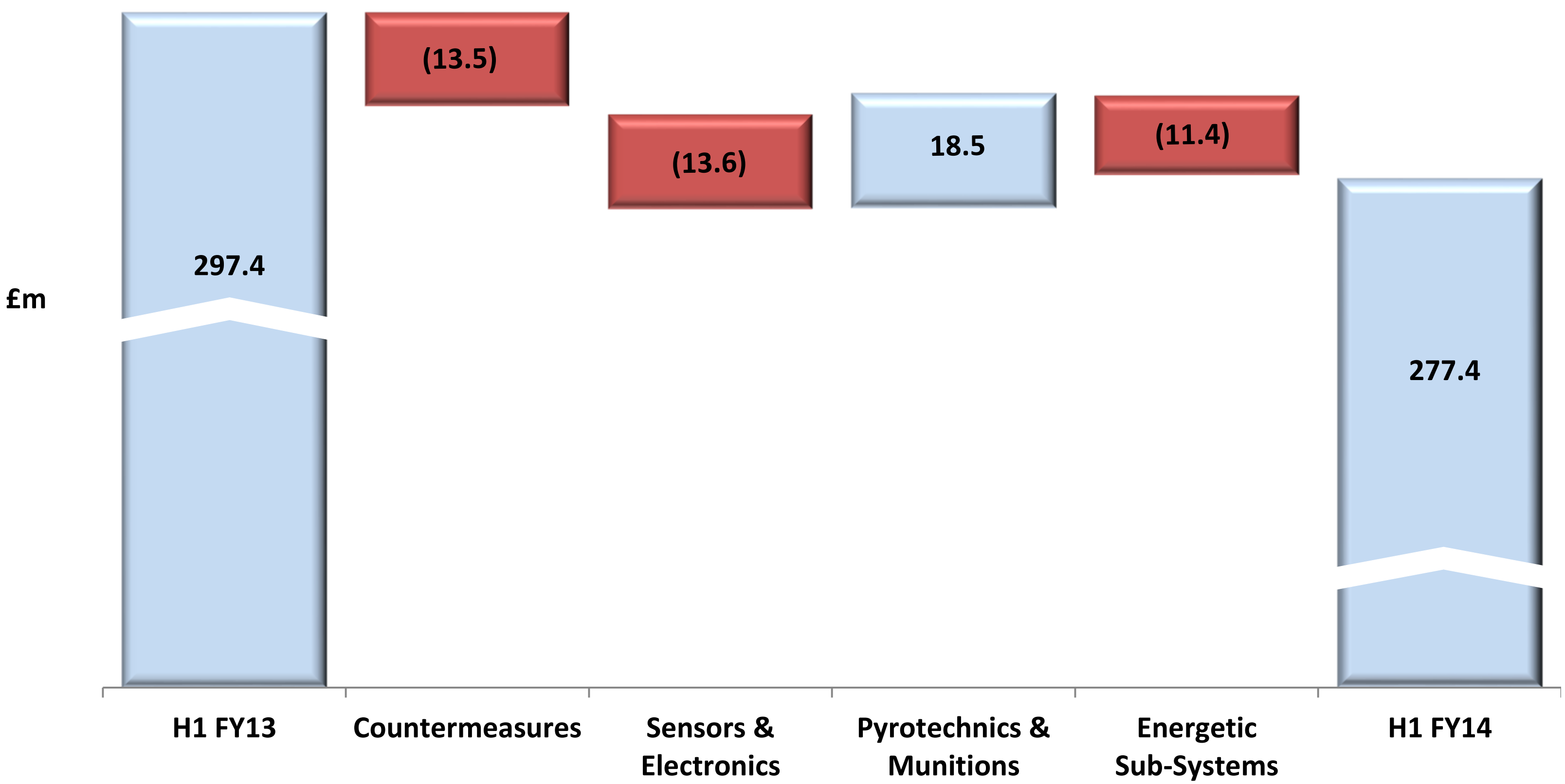
	H1 FY14	H1 FY13	Change
Revenue	**£277.4m**	£297.4m	- 6.7%
Operating profit	**£27.0m**	£35.1m	- 23.1%
Operating margin	**9.7%**	11.8%	
Profit before tax	**£18.0m**	£25.2m	- 28.6%
Earnings per share	**7.3p**	10.0p	- 27.0%
Dividend per share	**2.4p**	3.4p	- 29.4%
Net debt	**£229.2m**	£275.1m	

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

- Revenue decline reflects global defence market conditions
- Margins impacted by Kilgore incident and sales mix weighted towards Pyrotechnics & Munitions
- Continuing operations order book £401.8 million, of which £175.6 million deliverable in FY14
- Strong cash generation – net debt reduced to £229.2 million before receipt of disposal proceeds

Revenue bridge

Including discontinued operations



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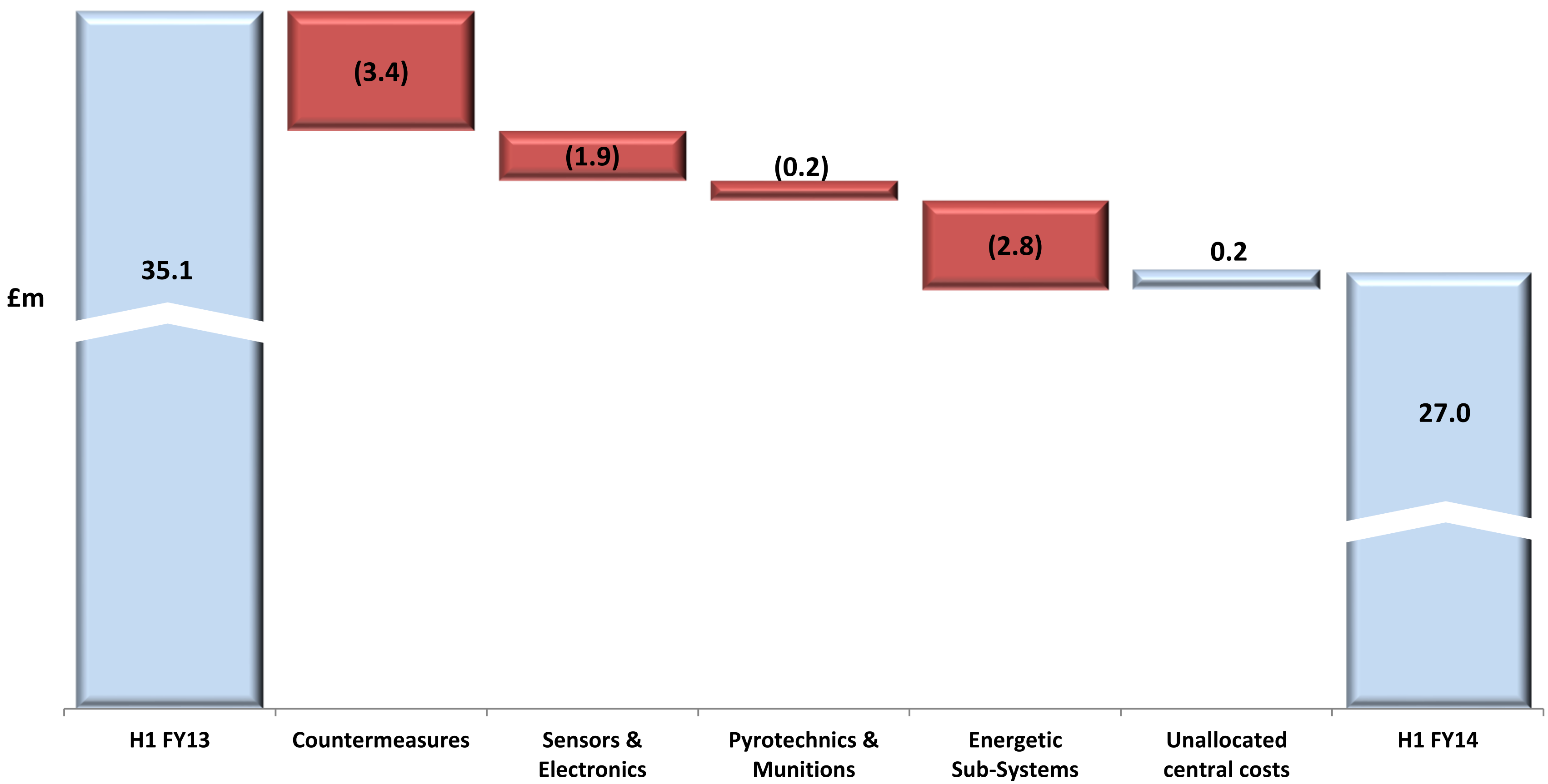
Operating profit bridge
Including discontinued operations



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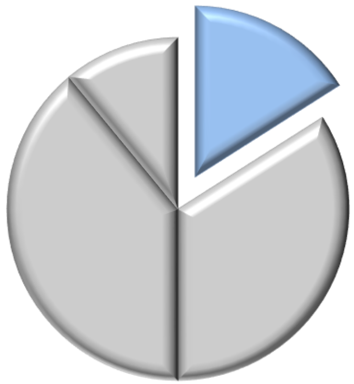
Countermeasures

16% of Group revenue



	H1 FY14	H1 FY13	Change
Revenue	**£43.5m**	£57.0m	- 23.7%
Operating profit	**£1.5m**	£4.9m	- 69.4%
Operating margin	**3.4%**	8.6%	
Order book	**£161.8m**	£199.0m	- 18.7%

H1 drivers

Demand levels remain subdued, activity reflects customers' minimum sustaining volumes

Countermeasures USA impacted by February 2014 Kilgore incident disrupting production – revenue £10.5m below H1 FY13

Order book stabilised in H1 - £52.5m order intake in the period

H2 guidance

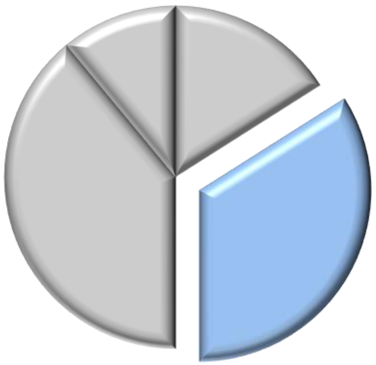
Kilgore production re-start expected to be completed in Q4 FY14, delay in shipments expected to be caught up by early FY15

No major shifts expected in near term volumes, robust H1 order intake supports expectations

Sole source positions on Typhoon and Joint Strike Fighter – initial production orders received but order timing remains uncertain

Sensors & Electronics

34% of Group revenue



	H1 FY14	H1 FY13	Change
Revenue	**£94.7m**	£108.3m	- 12.6%
Operating profit	**£23.3m**	£25.2m	-7.5%
Operating margin	**24.6%**	23.3%	
Order book	**£50.1m**	£99.8m	-49.8%

H1 drivers

Strong performance on US programs – existing HMDS orders closed out, benefiting margins

UK performance impacted by delays in order receipts

Order book decline reflects fulfilment of US product-based order book

H2 guidance

Final HMDS IDIQ order not expected to materialise, impact to be partially offset by R&D awards and international ground penetrating radar opportunities

Acquisition of 3d-Radar technology broadens product offering – accelerating international development and providing non-defence markets

Further R&D awards anticipated as US programs transition to base budget

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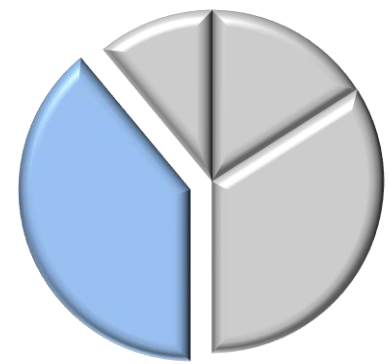
Pyrotechnics & Munitions

39% of Group revenue



Including discontinued operations	**H1 FY14**	H1 FY13	Change
Revenue	**£107.7m**	£89.2m	+ 20.7%
Operating profit	**£4.8m**	£5.0m	- 4.0%
Operating margin	**4.5%**	5.6%	
Continuing operations			
Revenue	**£39.1m**	£17.2m	+ 127.3%
Operating profit/(loss)	**£0.2m**	£(1.4)m	-
Operating margin	**0.5%**	(8.1)%	
Order book	**£108.3m**	£121.4m	- 10.8%

H1 drivers

Mecar, Simmel & Chemring Defence Germany disposed May 2014 – revenue lower, profit impacted by utilisation levels and sales mix

Continuing operations

Chemring Defence UK – order book reducing

Chemring Ordnance – much improved production quality and significant rise in volume

H2 guidance

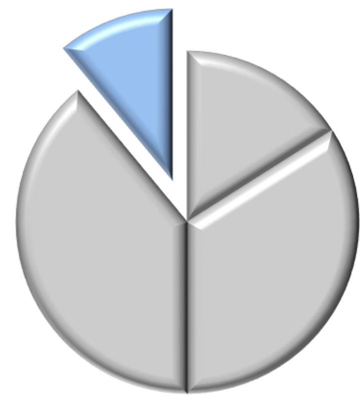
Chemring Defence UK awaiting Middle East orders

Continuing recovery at Chemring Ordnance

Businesses to be reported within Energetic Systems segment going forward

Energetic Sub-Systems

11% of Group revenue



	H1 FY14	H1 FY13	Change
Revenue	**£31.5m**	£42.9m	-26.6%
Operating profit	**£2.4m**	£5.2m	-53.8%
Operating margin	**7.6%**	12.1%	
Order book	**£81.6m**	£85.6m	-4.7%

H1 drivers

Reduction in revenue includes £4.1m effect of disposal of Clear Lake in January 2014

Revenues continue to be impacted by reductions in US and UK defence spending

Growing momentum of integration of Hi-Shear into Chemring Energetic Devices – improving build quality and customer relationships

H2 guidance

Outlook expected to remain flat – strong qualified positions on key programmes but substantial growth in volumes not considered likely

Emphasis remains on resolution of production issues, and level-loading of US sites

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Income statement

Including discontinued operations

Unallocated corporate costs

Reflects savings from FY13 restructuring – further savings to result from head office consolidation

Interest

Cost reflects lower average debt levels and £0.4m translation benefit on US dollar interest

Tax

Consistent underlying tax rate

Earnings per share

Reduction in line with reduction in PBT

Dividend per share

Maintained policy of 3.0x cover

£m	**H1 FY14**	H1 FY13	Change
Product segment profit	**32.0**	40.3	
Unallocated corporate costs	**(5.0)**	(5.2)	
Operating profit	**27.0**	35.1	-23.1%
Interest	**(9.0)**	(9.9)	
Profit before tax	**18.0**	25.2	-28.6%
Tax rate	**22.0%**	22.6%	
Earnings per share	**7.3p**	10.0p	-27.0%
Dividend per share	**2.4p**	3.4p	- 29.4%
Dividend cover	**3.0x**	3.0x	

Non-underlying items
Including discontinued operations

Management structure simplification
Further headcount reduction

Business unit integration & redundancy
Includes Countermeasures USA management restructuring and Head Office relocation

Kilgore incident costs
Includes anticipated claims and asset write-off

Profit on disposal
Profit on disposal of Clear Lake business

Impairments
Impairment of goodwill and other net assets – all relate to the divestments; no impairment of continuing operations

Acquisition and disposal costs
Professional fees, principally for European munitions disposal

£m	H1 FY14 P&L	H1 FY14 Cash
Management structure simplification	(0.5)	(0.5)
Business unit integration & redundancy	(1.6)	(1.0)
Kilgore incident costs	(0.9)	(0.1)
Profit on disposal	0.5	(0.2)
Impairments	(70.2)	-
Amortisation of intangibles	(9.2)	-
Acquisition and disposal costs	(9.1)	(2.1)
Other items	1.0	-
	(90.0)	(3.9)

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Balance sheet

Goodwill & intangibles

Impairments at Simmel (£63.9m) and Chemring Defence Germany (£6.3m) reducing assets to sale value

Capitalised R&D

Includes £13.6m relating to Sensors & Electronics

Working capital

Significant reduction due to exclusion of disposed entities in H1 FY14 – see next slide

Pension deficit

Reduction reflects benefits of new contribution structure – £4.0m paid in H1

Held for sale

Net assets of European Munitions business and Chemring Defence Germany

£m	**H1 FY14**	H1 FY13	FY13
Goodwill & intangibles	**204.9**	367.3	303.8
Property, plant & equipment	**175.5**	242.2	222.3
Capitalised R&D	**29.7**	31.7	32.7
Working capital	**65.4**	144.7	125.6
Tax	**(19.3)**	(36.5)	(32.5)
Pension deficit	**(20.8)**	(31.7)	(25.1)
Gross debt	**(249.8)**	(301.0)	(262.9)
Cash	**14.9**	25.9	14.2
Cash held for sale	**5.7**	-	-
Net debt	**(229.2)**	(275.1)	(248.7)
Held for sale	**94.6**	-	5.6
Other	**0.8**	(0.8)	0.1
Net assets	**301.6**	441.8	383.8

Working capital

Continuing operations

Inventories

Increase in H1 reflects continued ramp-up of production and timing of deliveries at Chemring Ordnance (£5.4m) and impact of Kilgore issues (£1.5m)

Contract receivables

Unwinding as existing product orders fulfilled in US Sensors & Electronics business

Trade payables

On-going tight creditor management

Discontinued operations

Decline in working capital due to unwind of delayed shipments at FY13

£m	**H1 FY14**	H1 FY13	FY13
Continuing operations			
Inventories	**83.4**	101.3	73.1
Trade receivables	**47.3**	49.8	39.9
Contract receivables	**31.0**	41.7	41.6
Trade payables	**(36.6)**	(37.5)	(31.1)
Advance payments	**(6.1)**	(9.3)	(5.8)
Other creditors & accruals	**(53.6)**	(40.9)	(59.8)
	65.4	105.1	57.9
Discontinued operations	**43.8**	39.6	67.7
Total net working capital	**109.2**	144.7	125.6

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Operating cash flow

Including discontinued operations

Depreciation

Consistent with H1 FY13

Amortisation

Increase due to completion of capitalised R&D projects

Retirement benefit obligation

Contributions paid under new funding structure

Operating cash flow

Total £27.2m, of which £11.7m from continuing operations

£m	**H1 FY14**	H1 FY13	FY13
Operating profit	**27.0**	35.1	72.1
Depreciation	**9.3**	9.8	20.1
Loss on fixed asset disposals	**0.1**	0.6	2.2
Amortisation	**3.2**	2.4	5.9
Retirement benefit obligation	**(4.0)**	-	(1.0)
Other	**0.7**	(0.2)	0.6
	36.3	47.7	99.9
Inventory	**(2.0)**	(25.5)	0.1
Debtors	**27.2**	(4.1)	(15.9)
Creditors & provisions	**(34.3)**	(13.1)	(15.5)
Working capital change	**(9.1)**	(42.7)	(31.3)
Operating cash flow	**27.2**	5.0	68.6

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Movement in net debt

Non-underlying items

Payment of restructuring and disposal costs

Disposal proceeds

£6.2m Clear Lake proceeds received January 2014

Capex

Significantly below depreciation

Capitalised R&D

Includes £3.9m Sensors & Electronics spend

Interest

Reflects benefit of lower average debt levels

Dividends

No H1 outflow, FY13 final dividend £7.3m paid May 2014

Exchange rate effects

Translation of US denominated debt

£m	**H1 FY14**	H1 FY13	FY13
Operating cash flow	**27.2**	5.0	68.6
Non-underlying items	**(3.9)**	(6.6)	(12.7)
Disposal proceeds	**6.2**	-	-
Capex	**(5.3)**	(5.7)	(12.3)
Capitalised R&D	**(5.5)**	(1.9)	(7.4)
Interest	**(9.5)**	(11.4)	(20.4)
Tax	**(0.5)**	1.3	(0.5)
Dividends	**-**	-	(14.7)
Amortisation of facility fees	**(1.0)**	(0.9)	(2.0)
Exchange rate effects	**11.8**	(10.1)	(2.5)
Movement in net debt	**19.5**	(30.3)	(3.9)
Net debt b/f	**(248.7)**	(244.8)	(244.8)
Net debt c/f	**(229.2)**	(275.1)	(248.7)

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Debt funding & covenants

Revolving Credit Facility

£230m, expiry April 2015

Leverage covenant 3.25x Apr 2014,

3.00x thereafter

Facility to be refinanced during FY14 – positive on-going discussions with banks

Private Placement Loan Notes

$405m + £12.5m, expiry 2016-2019

Disposal proceeds offered for repayment at par - $24.7m of notes to be repaid

Post disposal:

- ‘adjusted debt’ covenant 3.00x allows for netting of disposal proceeds
- gross debt tested against 3.75x covenant

Additional interest payable based on leverage and credit rating

April 2014 tests	**Actual**	Covenant
Revolving Credit Facility		
Leverage – net debt to EBITDA	**2.72x**	3.25x
Interest cover	**4.97x**	4.00x
Private Placement Loan Notes		
Leverage – gross debt to EBITDA	**2.98x**	3.50x
Interest cover	**5.24x**	3.50x

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Modelling considerations

Income statement

- H2 FY14 profits to be weighted towards final quarter
- $ exchange rate effect – 1¢ strengthening in sterling gives £0.3m reduction in PBT
- Interest benefit from loan note repayment of £0.7m in FY15
- Stable tax rate – c. 22%
- Dividend covered 3.0x by underlying EPS

Balance sheet

- Significant debt reduction in H2 FY14 from receipt of disposal proceeds
- $ exchange rate effect – 1¢ strengthening in sterling gives £1.5m less debt
- On-going organic cash generation of £10m+ per annum, assuming stable volumes
- Pension scheme funding commitment – £8m in FY14, £5m per annum thereafter

Michael Flowers – Chief Executive

Strategic Update

Chemring Group

A brief introduction

Member of the Chemring Executive Committee, responsible for the Munitions Business

- Managed disposal of European Munitions businesses

Managing Director Chemring Australia 2006-13

- Oversaw transformation from Marine Safety focussed company to a Defence manufacturer
- Managed major investment and capability development, successful implementation of new world leading countermeasures facility
- Five fold revenue growth and 20 fold earnings growth

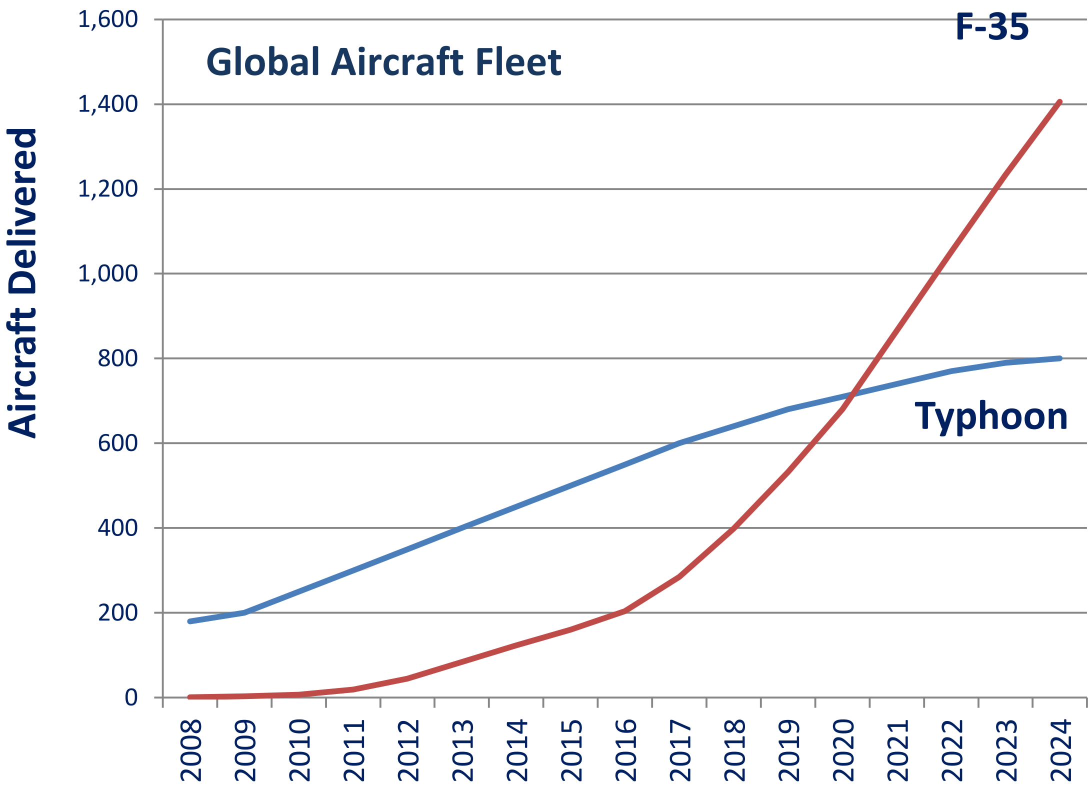
Program Manager BAE Systems 2001 – 2006

- Roles included management of the Nulka program, world's largest Naval countermeasures program, multinational program involving US, Australian and Canadian navies.

Australian Army 1979 – 2001

- Operational logistics and project management specialisation
- Six years working in Defence procurement and capability development

Countermeasures - Next generation aircraft drive market growth



Chemring sole supplier of all three flares:
- MJU-68 & 69 – unique to F-35
- MJU-64 Special Material Decoy

Chemring sole supplier of decoys:
- 55mm flare and spectral variant unique to Typhoon
- Additional opportunity for BOL chaff & IR

- Build-up of operational stockpiles of 500 – 1000 flares per aircraft delivered
- Training and test consumption of 10-50 flares per in-service aircraft per year
- New flares are higher value than the flares they replace
- Decoy user base expands as retiring platforms are sold on to new NATO and growing economies

Countermeasures strategic priorities

- Fix operational issues at Kilgore
- Optimise synergies between Countermeasures operating businesses
- Transfer product and process technologies between sites
- Secure launch customer for Centurion launcher
- Complete F-35 Low Rate Initial Production and secure contract for Chemring Australia to qualify as second source

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

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Sensors & Electronics strategic priorities

- Ensure critical programme wins in US market
- Build world leading technology across trans-Atlantic footprint
- Grow technology base through small selected business and technology acquisitions
- Leverage capability and reputation to build cyber protection business
- Incubate technologies for non-defence markets

Energetic Systems combines Pyrotechnics and Energetic Sub-systems

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Energetic Systems strategic priorities

- Complete integration of Hi-Shear into Chemring Energetic Devices
- Improve operational performance across the segment
- Exploit Hi-Shear’s strong market position on key programmes – PAC3, NASA
- Build trans-Atlantic capability to address US and European space, aircraft and missile prime contractors
- Closely manage pyrotechnics businesses, and scale to meet market requirements

H2 FY2014 - Priorities

- Maintain and extend operational improvement initiatives
- Complete recovery programme at Kilgore
- Finalise structural improvements to support delivery of internal synergies and improve routes to market
- Invest for future growth
- Continue to drive Safety Leadership Programme

Peter Hickson – Chairman

Summary

- Disposal process completed, strengthening the balance sheet and resulting in a more focused defence technology business
- Disposal proceeds significantly reduce net debt, providing relief on covenants and greater flexibility to invest
- Overall interim result in line, full year outlook remains broadly unchanged before the impact of further foreign exchange headwind
- Attention on future growth
- Market remains challenging but with some opportunities in new markets

Chemring is a more resilient business with a clear strategic direction

Questions?