Chemring Group PLC

Half year results for six months to 30 April 2013

Mark Papworth – Chief Executive

Agenda

Headlines Market commentary Performance Recovery Programme	Mark Papworth
Financial & operational review H2 guidance	Steve Bowers
Summary	Mark Papworth
Q & A	

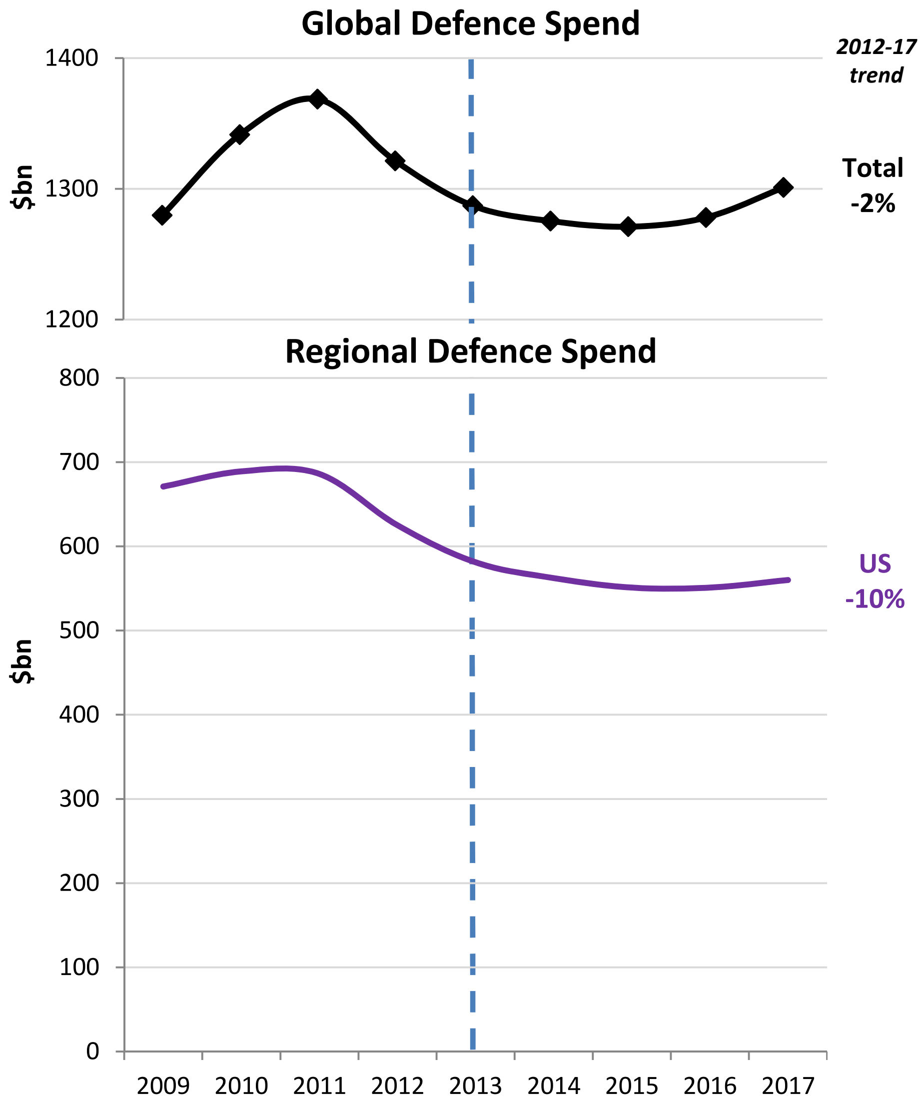
Chemring Group

Today's headlines

	H1 FY13	H1 FY12
	£m	£m
Revenue	**297.4**	333.3
Underlying operating profit	**35.1**	48.5
Underlying profit before tax	**25.6**	39.2
	Pence	Pence
Underlying earnings per share	**10.3**	16.0
Dividend per share	**3.4**	5.3

- Important progress in Performance Recovery Programme
- Restructuring costs of £15m to deliver annual savings of £10m from 2014, underpinning FY14 profitability and providing greater medium term resilience
- Closing order book of £701.1m (October 2012: £760.9m), of which £287.6m deliverable in FY13
- Challenging market environment is persisting

Global defence market is dominated by US decline….



- **Global defence spend will be lower in 2014 than 2013**
- **In the US, sequestration continues to have a dramatic effect on the budget**
  - Current FY14 President's base Budget Request of $527bn does not include sequestration
  - Sequestration and a Continuing Resolution for FY14 is likely
  - Overall expect a c.10% decline in the US defence budget between 2012 and 2017

Source: Company data

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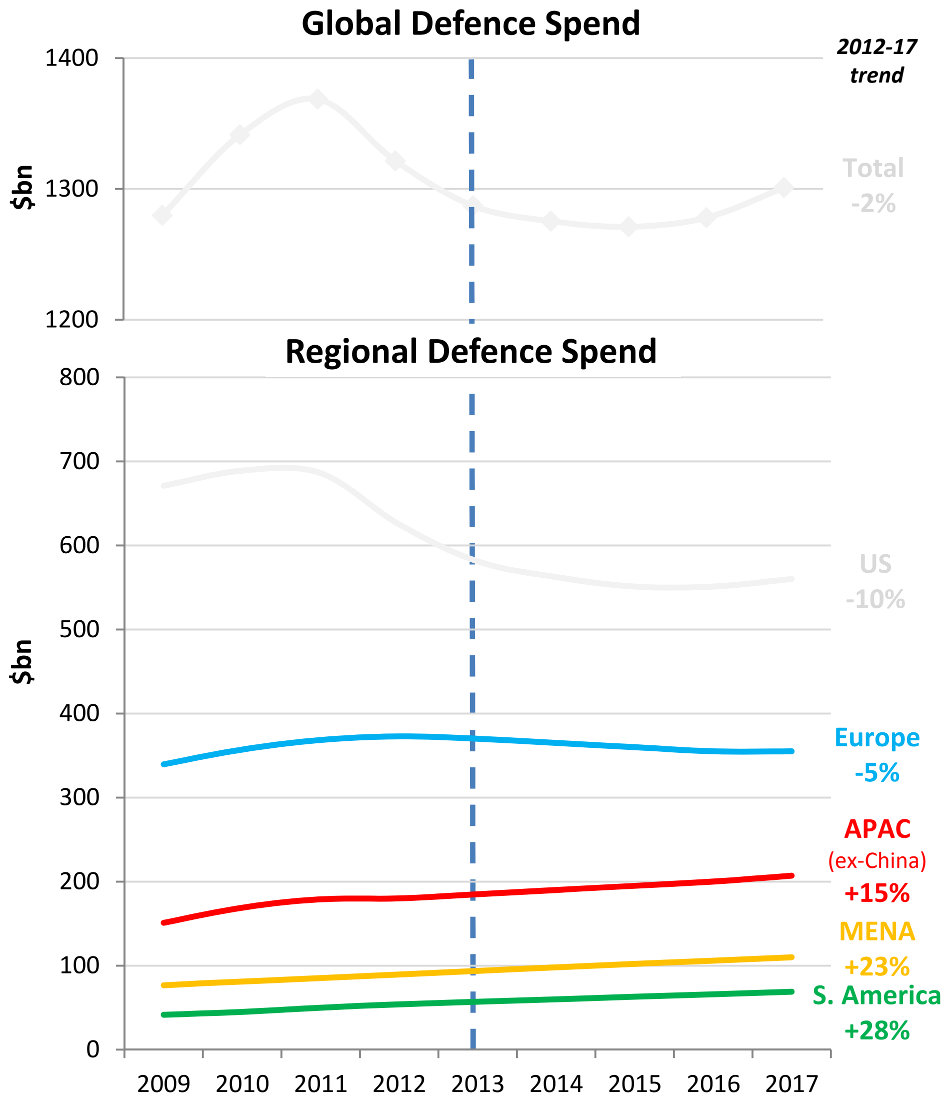
….which off-sets growth from elsewhere in the world.



- Moderate decline in UK and European spend continues
- Asia Pacific driven by India's growth
- Middle East and Maghreb expected to grow at about 4% per year
- South America dominated by Brazil

Source: Company data

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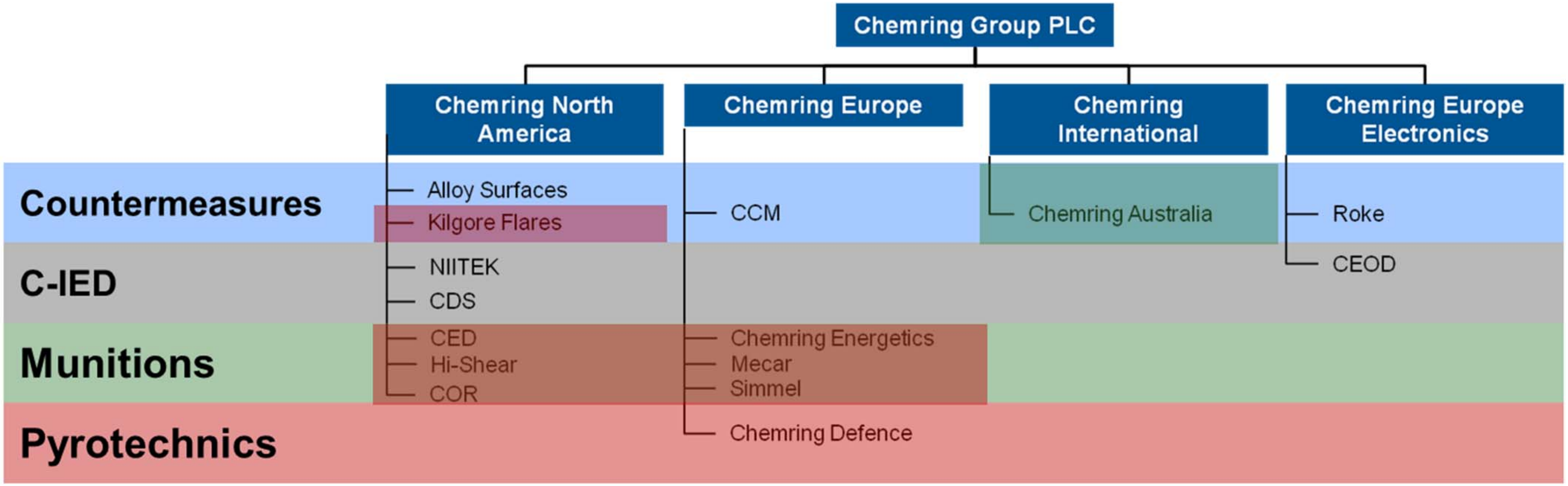
Market commentary – Chemring specific

Countermeasures	Troop drawdown and inventory levels continue to suppress countermeasure procurement at minimum sustainable rates Lead customers continue to invest in next generation countermeasures, albeit at low volumes
Sensors & Electronics	International demand for HMDS remains strong US HMDS Urgent Operational Requirement transitions to base budget line item Positioning for significant hand-held detection programmes
Pyrotechnics & Munitions	Reduced NATO demand for Pyrotechnics & Munitions affecting near-term growth opportunities Only 10% of revenue dependent on Afghanistan Strong position with non-NATO customers
Energetic Sub-Systems	Secure positions on long term missile and space programmes supports a steady base in Energetic Sub-Systems Internal demand and commercial opportunities underpin growth

Five Priorities for Performance Recovery

1. Strengthen and simplify the organisational structure
2. Integrate business units and exploit the untapped synergies that exist
3. Implement a systematic programme of operational performance improvement
4. Refocus business development activity
5. Prioritise cash and cost management

Incoherent previous structure



The "segmental" analysis mixes fundamentally different markets, with different customers, drivers and trends, and obscures any relevant external analysis

Confusing for our customers, staff and investors

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1. Strengthen and simplify management structure

New structure to drive efficiency, focus and performance:

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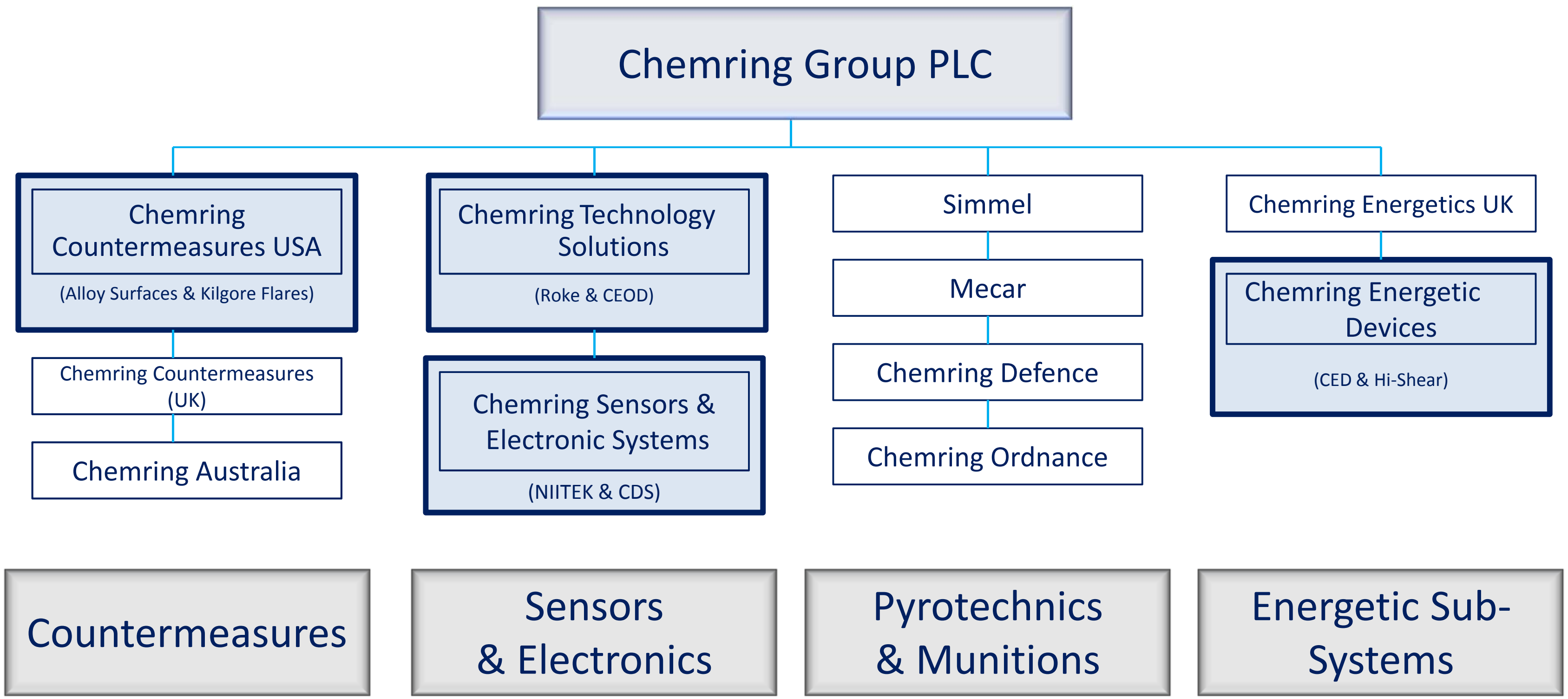
Countermeasures	Sensors & Electronics	Pyrotechnics & Munitions	Energetic Sub-Systems
Alloy Surfaces	Roke	Simmel	Chemring Energetics UK
Kilgore Flares	CEOD	Mecar	Chemring Energetic Devices
Chemring Countermeasures(UK)	NIITEK	Chemring Defence	Hi-Shear
Chemring Australia	CDS	Chemring Ordnance	

2. Integration of operating units

Further opportunities through integration of individual businesses:



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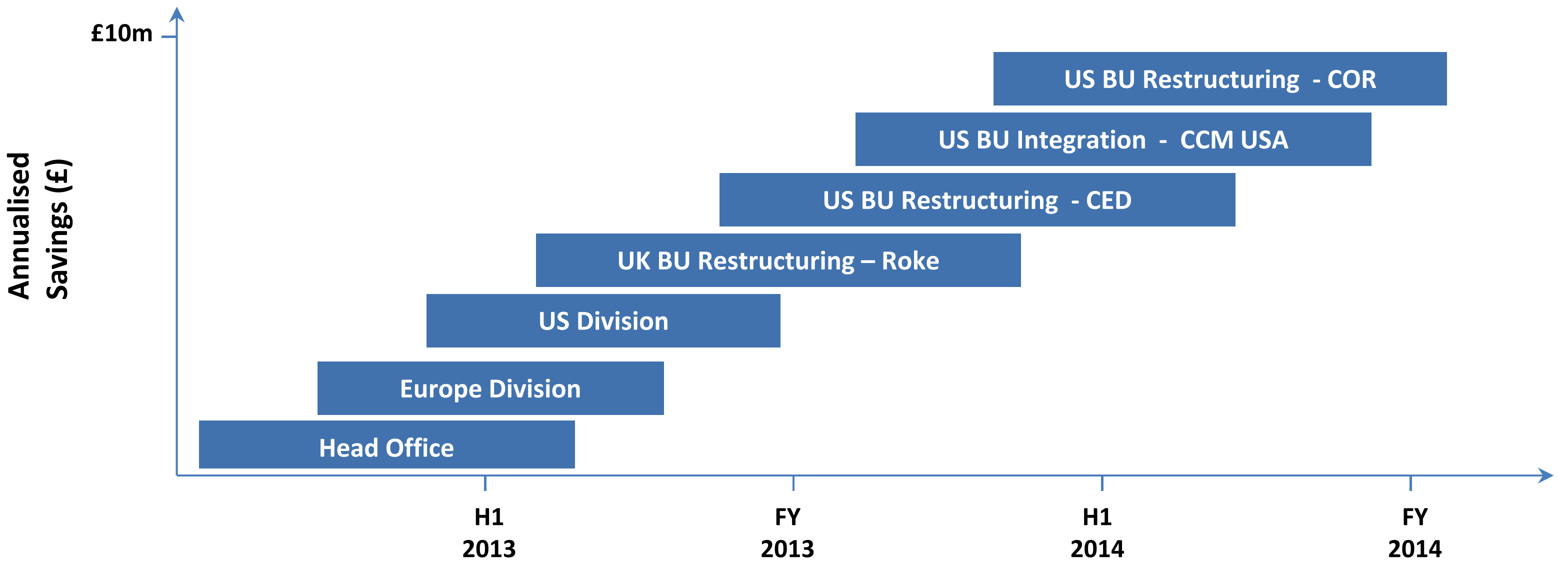
Benefits of new simplified structure & integrated businesses

- Clarity, ownership and accountability
- Improved communication and team working
- Elimination of duplication and waste
- Reduction in management overhead and infrastructure
- New structure enables greater market-facing effectiveness
- The cost of this restructuring will be £15m in 2013, and will deliver a £10m recurring benefit going forward

Further incremental benefits to be achieved from a deeper integration of similar operating companies



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3. Operational performance improvement

- Upgrade of operational leadership
- Tight control of R&D portfolio
- Active management of capacity utilisation across the Group – eg Simmel & Mecar
- Rationalisation of product ranges
- The elimination of waste, together with reduced down time and increased cycle times = reduced re-work and reduced inventory

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4. Focused business development

New SBUs created around common attributes and natural 'route to market' synergies:

SBU	Attributes	Group Sales and International Development
Countermeasures	➢ Sophisticated home customers used to drive technical requirements ➢ Complementary international sales force to address world market ➢ Manufacturing/R&D optimised across global factory base	➢ Promote full US and UK product range to international customers
Sensors & Electronics	➢ High R&D tempo needed to maintain competitive edge ➢ Integrated technology strategy and centres of excellence to reduce costs ➢ System sell requires sustained campaign by technical specialists	➢ Bundle capabilities and sub-systems to offer system solutions
Pyrotechnics & Munitions	➢ Selling to explosive ordnance branches of MoD customers ➢ 'Catalogue' of standard products enables agent-based international sales network ➢ Slow adoption of new technologies - focus on cost engineering and production optimisation	➢ Optimise routes to market to maximise geographic coverage ➢ Assemble coherent product "catalogue"
Energetic Sub-Systems	➢ Selling to ammunition and missile primes and end-users ➢ Diverse manufacturing operations for 'repeaters' & 'strangers' ➢ Qualification barriers to entry constrain organic growth rate but support high margins	➢ Build position with prime contractors to win next generation programmes

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5. Cash and cost management

A stringent cost management culture is now in place across the Group….

- *Capex – Focus on Health & Safety, and product quality - H1 FY13 £7.6m vs H1 FY12 £21.8m*
- *Headcount in H1 FY13 reduced by 203, including senior executives associated with streamlining Head Office and Divisional structures*
- *Recruitment spend across the Group has reduced by 58% in the period*
- *Closure of Pall Mall, Derby, Philadelphia and Washington offices to be completed in FY13. Annual savings of £0.6m (UK - £0.4m, US - £0.2m)*

….and this is coupled with an embedded focus on maximising cashflow

- *Improved quality of forecasting*
- *Strict management of receivables and payables*
- *Better payment terms being negotiated with clients*

Performance Recovery – summary of progress

- Management and reporting structure now in place to drive change
- Substantial restructuring programme now underway
- Operational improvement on the way but much to do
- Further opportunities for rationalisation being identified
- Focused business development starting to deliver results
- Management of costs and cash delivering to the bottom line

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Priorities for the next six months

1. Complete the integration of the four Strategic Business Units
2. Complete operational performance assessment at CCM UK, CE UK, Simmel & Mecar
3. Commence benefit delivery of operational improvements:
    - Improved on time delivery
    - Improved delivered quality
    - Reduced cost of poor quality
    - Sustained improvement in margins
4. Delivery of order book from focussed business development activity in the areas of:
    - Non-US sales of existing sensors and electronics portfolio
    - Further development of non-defence products
    - Build on our recent success in India with further sales
5. Completion of a comprehensive planning process that will detail the business strategy for the next three years

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Steve Bowers – Group Finance Director

Financial & Operational Review

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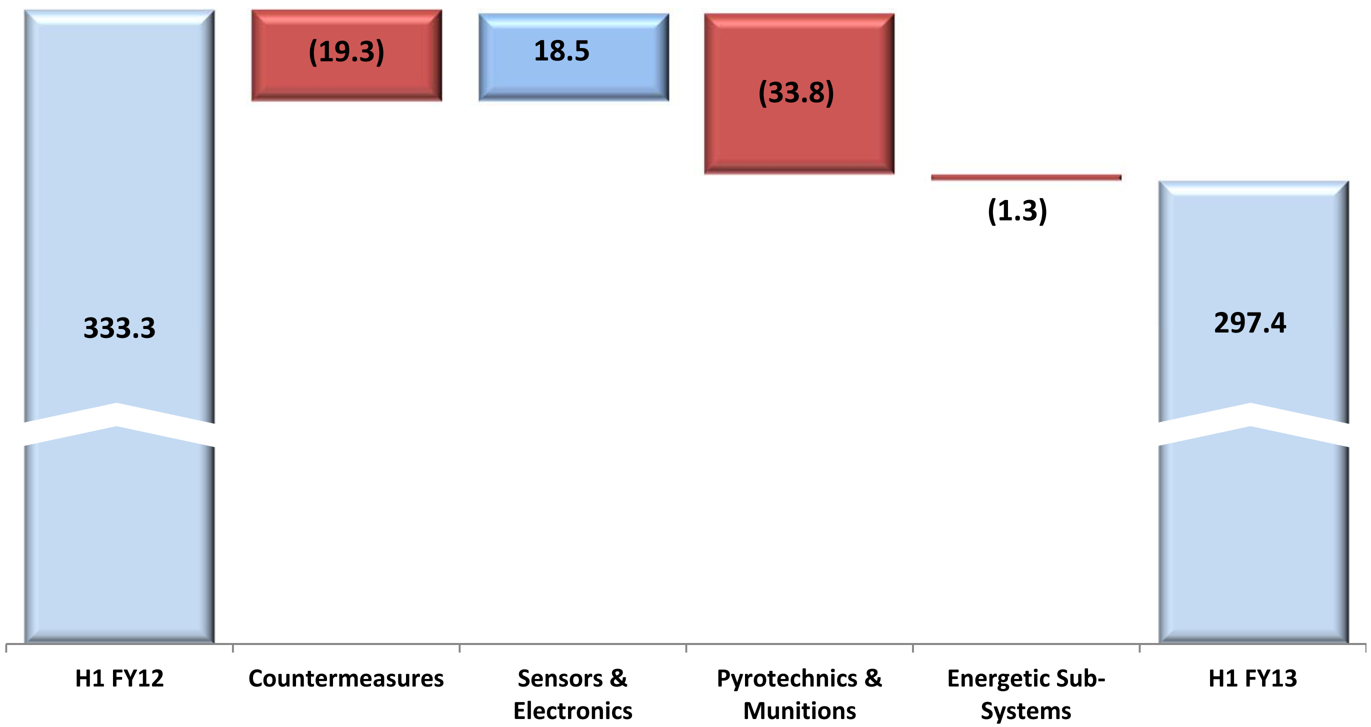
Headline results

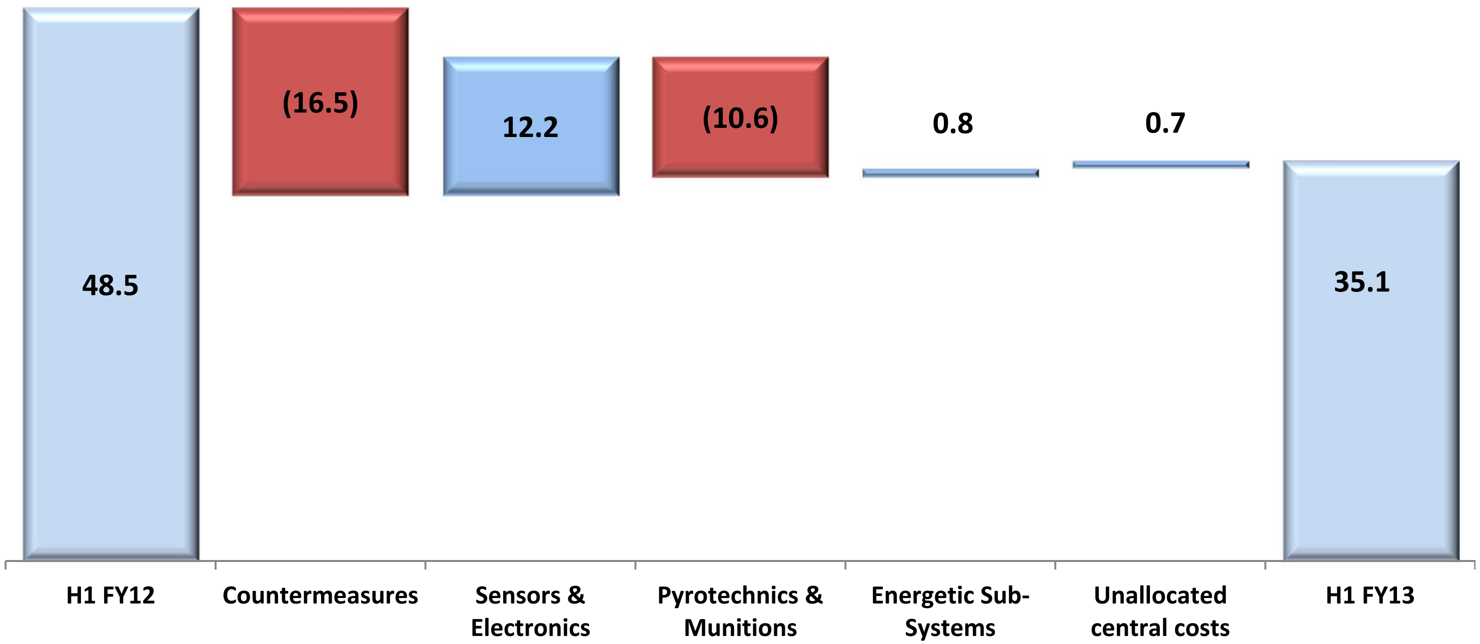
	H1 FY13	H1 FY12	Change
Revenue	**£297.4m**	£333.3m	- 10.8%
Operating profit	**£35.1m**	£48.5m	- 27.6%
Operating margin	**11.8%**	14.6%	
Profit before tax	**£25.6m**	£39.2m	- 34.7%
Earnings per share	**10.3p**	16.0p	- 35.6%
Dividend per share	**3.4p**	5.3p	-35.8%

- Revenue decline results from lower activity levels in most areas
- Margin impact reflects relatively high fixed operating cost base
- Closing order book £701.1m, 7.9% reduction in H1

Revenue bridge



Operating profit bridge

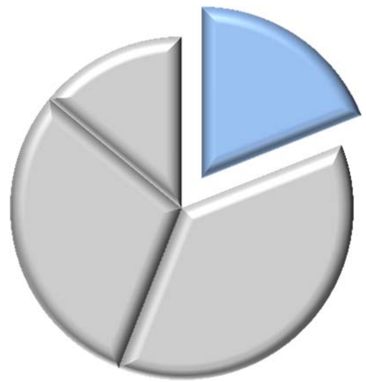


Countermeasures

Countermeasures USA, Countermeasures UK, Chemring Australia

	H1 FY13	H1 FY12	Change
Revenue	**£57.0m**	£76.3m	-25.3%
Operating profit	**£4.9m**	£21.4m	-77.1%
Operating margin	**8.6%**	28.0%	
Order book	**£199.0m**	£260.1m	- 23.5%

19% of revenue



H1 drivers

Reduced US volumes due to drawdown and on-going production delays

Strong result in H1 FY12 due to flare demand

Profit impact as result of operating cost base

Order book reduced at all business units

H2 guidance

Progress on USA product quality issues

Middle East countermeasure order anticipated – for delivery in H2

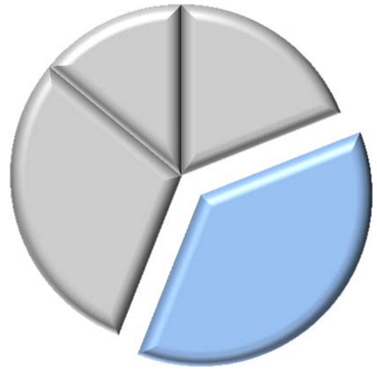
Countermeasure development project on-going

Sensors & Electronics

Chemring Sensors & Electronic Systems, Chemring Technology Solutions

	H1 FY13	H1 FY12	Change
Revenue	**£108.3m**	£89.8m	+ 20.6%
Operating profit	**£25.2m**	£13.0m	+ 93.8%
Operating margin	**23.3%**	14.5%	
Order book	**£99.8m**	£192.8m	- 48.2%

37% of revenue



H1 drivers

Strong growth, driven by HMDS – first IDIQ delivery order completed in April

Margins benefitted from favourable mix

Order book impacted by change in procurement patterns

H2 guidance

$76m HMDS order announced 3 June - underpins FY13 & H1 FY14

Continued market leading position

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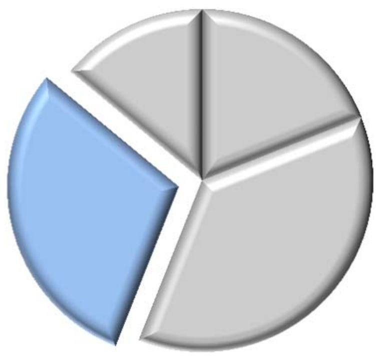
Pyrotechnics & Munitions

Mecar, Simmel, Chemring Defence, Chemring Ordnance

	H1 FY13	H1 FY12	Change
Revenue	**£89.2m**	£123.0m	-27.5%
Operating profit	**£5.0m**	£15.6m	-67.9%
Operating margin	**5.6%**	12.7%	
Order book	**£316.7m**	£444.4m	- 28.7%

30% of revenue



H1 drivers

Impact of defence spending cuts – especially in shorter cycle Pyrotechnics segment

Lower activity on mortar systems contract vs H1 FY12. Export licence issues now resolved

Weak order intake within Munitions businesses

H2 guidance

APOBS production resumed early in H2

H2 margins should benefit from APOBS and greater activity under mortar systems contract

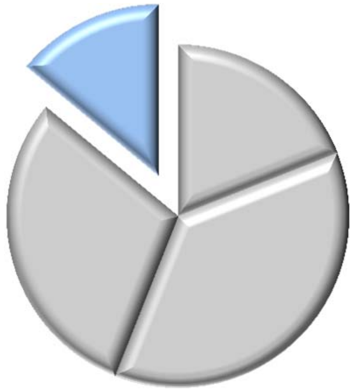
Order placement timescales difficult to predict

Energetic Sub-Systems

Chemring Energetics UK, Chemring Nobel, Chemring Energetic Devices

	H1 FY13	H1 FY12	Change
Revenue	**£42.9m**	£44.2m	-2.9%
Operating profit	**£5.2m**	£4.4m	+ 18.2%
Operating margin	**12.1%**	10.0%	
Order book	**£85.6m**	£103.3m	- 17.1%

14% of revenue



H1 drivers

Volumes relatively stable overall

Increased margin – production quality

Improvements at Hi-Shear, low margin contracts addressed at CED

H2 guidance

Outlook poor for Chemring Energetic Devices' build-to-print products and cartridges

Work continuing to resolve Hi-Shear production issues

Order book pressures expected to continue

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Income statement

Unallocated corporate costs

Initial savings from cost control regime

Comparative period unusually high

Interest

Charge broadly unchanged, reflecting stable average debt levels

Tax

No material change in tax rate

Earnings per share

Reduction in line with reduction in PBT

Dividend per share

Maintained policy of 3.0x cover

£m	**H1 FY13**	H1 FY12	Change
Product segment profit	**40.3**	54.4	
Unallocated corporate costs	**(5.2)**	(5.9)	
Operating profit	**35.1**	48.5	- 27.6%
Interest	**(9.5)**	(9.3)	
Profit before tax	**25.6**	39.2	- 34.7%
Tax rate	**22.2%**	21.5%	
Earnings per share	**10.3p**	16.0p	- 35.6%
Dividend per share	**3.4p**	5.3p	- 35.8%
Dividend cover	**3.0x**	3.0x	

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Non-underlying items

Management structure simplification

Headcount reduction in corporate and senior divisional teams

Retention incentive – £0.2m cost in H1 (no main Board participation)

Business unit integration & redundancy

H1 costs principally CCM USA

Onerous lease provision

Costs regarding vacant property, rental guaranteed by Chemring

Property & leasing arrangements

Write down of Pall Mall assets & related costs

Carlyle bid fees

Fees paid H1 FY13

Incident & bid costs

Costs of incident at CCM USA in prior period

£m	**H1 FY13 P&L**	H1 FY13 Cash
Management structure simplification	**3.1**	1.8
SBU integration & redundancy	**1.3**	0.9
Onerous lease provision	**1.8**	-
Property & leasing	**0.8**	0.3
Carlyle bid fees	**0.2**	2.9
Incident & bid costs	**0.5**	0.6
Other items	**0.2**	0.1
	7.9	6.6

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Balance sheet

Goodwill & acquired intangibles

£76.8m Hi-Shear, £60.5m Simmel

Plant & equipment

£34.5m Salisbury manufacturing plant

£25.8m Chemring Australia

£9.6m Italian demilitarisation facility

Capitalised R&D

£5.4m Roke projects, eg Resolve

£4.2m Centurion launcher

Working capital

£51.4m rise in H1 – see next slide

Pension deficit

Deficit reflects current actuarial assumptions

Net debt

H1 increase includes £10.1m FX

£m	**H1 FY13**	H1 FY12	FY12
Goodwill & intangibles	**367.3**	415.5	382.2
Property, plant & equip	**242.2**	235.2	240.0
Capitalised R&D	**31.7**	27.6	31.0
Working capital	**144.7**	148.7	93.3
Tax	**(36.5)**	(42.9)	(41.0)
Pension deficit	**(31.7)**	(27.2)	(27.0)
Gross debt	***(301.0)***	*(351.1)*	*(340.8)*
Cash	***25.9***	*39.6*	*96.0*
Net debt	**(275.1)**	(311.5)	(244.8)
Other	**(0.8)**	9.8	(0.2)
Net assets	**441.8**	455.2	433.5

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Working capital

Inventory

Risen due to investment in preparation for increased H2 activity and impact of production delays

Trade receivables

Continued strong debtor control

Contract receivables

Growth in Munitions contract balances

Trade payables

Reduced from FY12 – more sustainable creditor management adopted

Advance payments

Improved funding profile on a number of contracts

£m	**H1 FY13**	H1 FY12	FY12
Inventory	**139.3**	113.4	113.8
Trade receivables	**65.2**	90.6	90.9
Contract receivables	**108.6**	95.8	87.6
Trade payables	**(69.6)**	(73.2)	(100.2)
Advance payments	**(18.3)**	(30.9)	(11.7)
Other creditors, accruals etc	**(80.5)**	(47.0)	(87.1)
Net working capital	**144.7**	148.7	93.3

Operating cash flow

Depreciation

Consistent with FY12

Amortisation

Rise in amortisation reflects completion of development projects

Working capital

Increase in inventory to support H2 trading and as result of production issues

£m	**H1 FY13**	H1 FY12	FY12
Operating profit	**35.1**	48.5	88.3
Depreciation	**9.8**	9.5	15.9
Loss on fixed asset disposals	**0.6**	-	3.4
Amortisation	**2.4**	2.1	4.6
Other	**(0.2)**	5.3	3.6
	47.7	65.4	115.8
Inventory	**(25.5)**	27.9	28.0
Debtors	**(4.1)**	(34.8)	(8.2)
Creditors & provisions	**(13.1)**	(40.5)	(17.4)
Working capital change	**(42.7)**	(47.4)	2.4
Operating cash flow	**5.0**	18.0	118.2

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Movement in net debt

Non-underlying items
Cash impact of restructuring & fees

Capex
Significantly below depreciation

Capitalised R&D
Much reduced spend compared to FY12

Interest
Consistent with income statement, £1.8m interest capitalised in H1

Tax
UK corporation tax refund received

Dividends
No H1 cash outflow – FY12 final dividend of £8.1m paid May 2013

Exchange rate effects
Translation of US denominated debt

£m	**H1 FY13**	H1 FY12	FY12
Operating cash flow	**5.0**	18.0	118.2
Non-underlying items	**(6.6)**	(7.5)	(15.6)
Capex	**(5.7)**	(16.7)	(30.1)
Capitalised R&D	**(1.9)**	(5.1)	(11.0)
Interest	**(11.4)**	(9.0)	(23.8)
Tax	**1.3**	(4.0)	(6.1)
Dividends	**-**	(20.8)	(31.1)
Disposal of Marine	**-**	-	21.8
Other	**(0.9)**	(5.9)	(6.3)
Exchange rate effects	**(10.1)**	2.2	1.9
Net debt b/f	**(244.8)**	(262.7)	(262.7)
Net debt c/f	**(275.1)**	(311.5)	(244.8)

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Debt funding & covenants

Revised financial covenants agreed

Additional near term headroom secured

Revolving Credit Facility

£230m, expiry April 2015

Leverage covenant raised: 3.50x (Apr & Jul 2013), 3.25x (Oct 2013 & Jan 2014)

Debt translated at average rates

Additional interest payable if leverage >3.00x

Private Placement Loan Notes

$405m + £12.5m, expiry 2016-2019

Leverage covenant raised to 3.50x (Apr 2013 to Jan 2014)

Leverage test remains on gross debt basis

Debt translated at average rates

Additional interest payable based upon leverage / credit rating

April 2013 tests	**Actual**	Covenant
Revolving Credit Facility		
Leverage – net debt to EBITDA	**2.79x**	3.50x
Interest cover	**4.95x**	4.00x
Private Placement Loan Notes		
Leverage – gross debt to EBITDA	**2.83x**	3.50x
Interest cover	**6.23x**	3.50x

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Modelling considerations

Income statement

- Further restructuring in H2 FY13, including headcount reductions within Countermeasures and Sensors & Electronics – total c.60 employees
- Stable tax rate
- Dividend covered 3x by underlying EPS

Balance sheet

- $ exchange rate effect – 1¢ weakening in sterling gives £2m more debt
- Capex < depreciation
  - depreciation of Salisbury facility will result in £2m higher charge – FY14 onwards
- Capitalised R&D in line with amortisation
- Pension scheme
  - £20m cash funding commitment due June 2014 – under discussion with trustees
  - IAS19: £0.9m additional non-cash interest per annum – effective FY14

Mark Papworth – Chief Executive

Summary

Q&A

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Summary

- Solid progress in the first six months of the 24 month Performance Recovery Programme
- Markets are likely to remain challenging into 2014 with little visibility, particularly in the US
- The Board's outlook is towards the lower end of expectations
- Performance Recovery Programme announced is expected to underpin 2014 profitability, provide greater resilience in the medium term and increase market-facing effectiveness.

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Half year results for six months to 30 April 2013

Appendices

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Segmental analysis – FY12 result

New segmental basis

Revenue - £m	H1 FY12	FY12
Countermeasures	76.3	163.2
Sensors & Electronics	89.8	228.9
Pyrotechnics & Munitions	123.0	249.5
Electronic Sub-Systems	44.2	98.7
	333.3	740.3

Operating profit - £m	H1 FY12	FY12
Countermeasures	21.4	20.4
Sensors & Electronics	13.0	44.9
Pyrotechnics & Munitions	15.6	21.2
Electronic Sub-Systems	4.4	12.3
Unallocated central costs	(5.9)	(10.5)
	48.5	88.3

Previous basis

Revenue - £m	H1 FY12	FY12
Countermeasures	93.6	184.1
Counter-IED	69.9	205.3
Pyrotechnics	40.7	123.0
Munitions	129.1	227.9
	333.3	740.3

Operating profit - £m	H1 FY12	FY12
Countermeasures	21.0	18.3
Counter-IED	11.2	43.9
Pyrotechnics	5.1	12.3
Munitions	17.1	24.3
Unallocated central costs	(5.9)	(10.5)
	48.5	88.3

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Segmental analysis – FY11 result

New segmental basis			Previous basis		
	H1			H1	
Revenue - £m	FY11	FY11	Revenue - £m	FY11	FY11
Countermeasures	86.2	183.5	Countermeasures	89.6	200.8
Sensors & Electronics	101.9	194.8	Counter-IED	95.7	167.6
Pyrotechnics & Munitions	91.4	249.5	Pyrotechnics	48.6	118.7
Electronic Sub-Systems	39.8	96.3	Munitions	85.4	237.0
	319.3	724.1		319.3	724.1
Operating profit - £m			Operating profit - £m		
Countermeasures	21.9	46.3	Countermeasures	20.8	46.7
Sensors & Electronics	19.7	32.7	Counter-IED	20.0	31.9
Pyrotechnics & Munitions	17.8	47.8	Pyrotechnics	8.8	26.4
Electronic Sub-Systems	3.7	19.0	Munitions	13.5	40.8
Unallocated central costs	(5.5)	(10.0)	Unallocated central costs	(5.5)	(10.0)
	57.6	135.8		57.6	135.8