# Interim management report

## Overview

Bodycote made good progress in the first half of 2013. Reported revenues increased by 5.0% (2.6% in constant currencies). Acquisitions made in 2012 added 7.0% to Group revenues, whilst organic revenues (in constant currencies) were lower by 4.5% (£13.5m) compared to the first half of 2012. Headline operating profit[1] grew by 10.8% to £52.4m, operating profit[1] grew by 10.8% to £50.3m, and Group headline margin[2] at 16.6% increased by 90 basis points (2012: 15.7%).

Two achievements within the results are worthy of note. The first is the resilience of the profits in the face of organic revenue[3] declines in some sectors and the second is the further expansion of Group margins.

The profit resilience stems from the good cost management and efficiency gains in the parts of the Group that suffered revenue declines. In the Automotive & General Industrial (AGI) business the organic revenue declines of £10.9m were accompanied by a downside operational gearing of only 19%. This is far lower than seen in prior periods of sales decline and the resilience results directly from management actions and represents a validation of Group strategy. The lower organic sales in AGI were not unexpected given the global macroeconomic weakness. The heavy truck and tooling sectors were particularly weak, with sharp declines globally. The organic decline of £2.6m in the Aerospace, Defence & Energy (ADE) business revenues represented, we believe, a short-term slowdown in the inherent long-term growth of the aerospace and energy markets. The volatility of the oil & gas markets, with notable de-stocking in North America, combined with the weak general industrial elements of these divisions more than offset the growth segments. Notwithstanding this, organic profits increased by £1.2m in the ADE business.

The other key achievement in the half was the expansion of Group headline margin by 90 basis points over the same period in the prior year. Cost reductions played an important part in this with average headcount down a further 2.9% (excluding the impact of acquisitions). However, the contribution of some 70 basis points of the improvement in Group margins coming from the new technologies of S³P (Speciality Stainless Steel Processes) and HIP PF (Hot Isostatic Pressing Product Fabrication) was particularly pleasing. When the strategy of investing in these technologies was launched in 2010 it was clear that these nascent businesses would take some time before they had a meaningful impact on Group results. Growth in these technologies has been very good and margins have remained strong notwithstanding the investments in capital and operating expenses required. Now, some three years later, these growing businesses are thriving and are becoming a meaningful part of the Group.

The three acquisitions completed last year have been integrated into the Group and are performing well. The seamless integration of these businesses is not only due to the hard work of the North American management teams involved but is also testament to the attitude and skill sets of the employees who came with the acquisitions. To date, information flow and best practice transfer has been a two way street with the acquired businesses learning from the pre-existing businesses and vice versa. Overall the acquisitions added £21.2m in revenues and £4.6m in headline operating profit in the first six months of 2013, adding some 40 basis points to Group headline margin.

Headline operating cash flow conversion was 89%[4] (2012: 111%) yielding an operating cash flow of £43.5m. Net capital expenditure of £28.6m represents a capital expenditure to depreciation ratio of 1.0 times (2012: 1.1 times), in line with our stated intent to invest in capacity to service specific areas of long-term demand growth. Investment has been focussed on our new technologies, notably in HIP and S³P, expanded capacity to service the aerospace market and replenishment of assets in some of the acquired businesses which were under-invested.

As we move into the second half of 2013 we will continue to implement our successful strategy. The key elements of the Group's strategy are: a focus on services that are highly valued by our customers; targeted customer engagement; increasing our emerging market footprint; growth in selected new technologies; and the drive for operational excellence.

1 2012 restated for the adoption of IAS 19 (Revised) 'Employee Benefits', which has the effect of reducing headline operating profit and operating profit by £0.2m, reducing finance charge by £0.3m and increasing profit before taxation by £0.1m.
2 Headline operating profit as a percentage of sales.
3 Organic revenue growth or decline is defined as the change in revenue excluding the impact of foreign exchange rate movements and the impact of acquisitions.
4 Headline operating cash flow divided by headline operating profit.