Chief Executive's review

"2012 has been another year of good progress. Improving business mix and the part-year benefit of acquisitions have enabled further improvements in performance and enhanced the Group's geographic balance."

Stephen Harris | Group Chief Executive

Trading overview

Bodycote delivered another strong performance in what was a difficult economic environment. Sales growth of £17.1m included a contribution of £22.4m from acquisitions but was impacted by £19.6m of foreign exchange translation headwind. Notwithstanding the difficult trading environment Bodycote continued to demonstrate its pricing power and ability to improve the mix of business, resulting in headline margins[1] increasing to 16.6%.

The Aerospace, Defence and Energy business took full advantage of the strong markets and delivered sales growth of 11.5%, of which 4.2% came from acquisitions, with margins expanding to 26.7% (2011: 21.9%). Progress was particularly pleasing in the Automotive and General Industrial segments. Even though revenues declined by 2.9%, notwithstanding adding 3.8% from acquisitions, margins remained constant at 13.3%, providing continued evidence of the improved resilience of Bodycote's profitability.

Return on capital employed increased to 19.5% (2011: 16.9%) on the back of the higher level of profits and carefully managed net capital expenditure of £47.7m, which was 0.9 times depreciation (2011: 0.9 times). Capital expenditure was lower than expected due primarily to longer than anticipated approval and regulatory processes. Capital expenditure was targeted at expansion of aerospace capacity and greenfield sites in emerging economies together with a focus on specific technologies such as Specialty Stainless Steel Processes (S^3P), HIP Product Fabrication, Corr-i-Dur® and Low Pressure Carburising.

Headline operating cash conversion was once again very strong at 113% demonstrating the Group's commitment to cash generation as a primary focus. Net debt finished the year at £34.2m after spending £84.7m on acquisitions during the year. On 18 February 2013, the Group's €125m revolving credit facility was refinanced to 1 March 2018.

Strategic Progress

2012 marked a year of excellent strategic progress for Bodycote. Our initiatives aimed at improving market focus and increasing efficiencies through deployment of enhanced business processes all worked together to help drive profitable growth. Indeed the expansion of Group margins and growth in ROCE underscores the quality of earnings and resilience of the business.

While there are many examples of the successful deployment of Bodycote's strategy, activities in Brazil and in Eastern Europe disappointed in 2012. In Brazil the currency rose strongly, disrupting Brazil's position in the global supply chain. In Eastern Europe sales dropped, mainly due to manufacturers choosing to sustain their facilities in France and Germany, bearing the brunt of cutbacks in parallel plants in Eastern Europe.

In contrast, the growth in S^3P was very pleasing, overcoming many of the capacity constraints that had hampered this business following its strong growth in 2011. Late in the year capacity was increased in the HIP Product Fabrication business and the benefits should be seen in 2013.

A number of businesses were acquired in 2012. North America has been under-represented in Bodycote, with the business heavily weighted towards Western Europe. Acquisitions in North America were high on the priority list as a result.

In April the heat treatment division of Curtiss-Wright was acquired, adding eight sites to the Group's footprint in North America. One major attraction of this business is its high degree of aerospace and energy work. Three of the acquired sites are located in the Wichita, Kansas aerospace hub, an important centre that previously did not have a Bodycote presence. The remaining sites dovetail very well into the pre-existing North American network.

[1] Headline margin is defined as headline operating profit as a proportion of revenue. Headline operating profit is reconciled on page 15.

In October seven sites were acquired from Bluewater Thermal Processing LLC. Six of these sites constituted the business formerly known as Carolina Commercial Heat Treating, which has a strong competitive position in the so called 'right to work' states of the South Eastern USA. This region, spanning from North Carolina down to Georgia and across to Tennessee, has enjoyed higher than average growth in the USA having been the target for significant inward investment for some time. It is not only benefiting from the arrival of many new foreign companies, but also from businesses that are relocating away from the union dominated north. The fledgling aerospace supply chain that is being established in the region provides a further attraction for Bodycote.

Other acquisitions included a small business comprising three sites in Michigan and Indiana, which was acquired from a private owner on 31 December 2012. They bring to the Group some of the best practitioners of Low Pressure Carburising and sophisticated vacuum heat treating technology in the world and are a welcome addition to the Group.

As we enter 2013 all of the businesses acquired are performing in line with expectations.

Summary and outlook

2012 has been another year of good progress. Growth in our global Aerospace and Energy business outweighed the decline in Automotive and General Industrial markets in Europe. Improving business mix and the part-year benefit of acquisitions have enabled further improvements in performance and enhanced the Group's geographic balance.

2013 has started slowly and we are mindful of the near term macroeconomic environment. Nevertheless, at this early stage in the year the Board expects modest progress in 2013.

Looking further ahead, the improvements made to the business in recent years give the Board confidence that Bodycote will continue to deliver good profits and cash through the business cycle.

S.C. Harris
Group Chief Executive
27 February 2013