

The Group's net borrowings fell by £23.2m to £64.2m (2002 – £87.4m) during 2003. Gearing, on shareholders' funds, at the year-end was 53% (2002 – 72%).



Mark Rollins Finance Director



Financial Performance

The Group's headline results have already been commented on by the Chairman in his statement. With the Group's operations being largely based in the USA, these results have been adversely impacted by the effects of currency movements. The US\$ weakened significantly in 2003 such that the average rate of US\$1.64:£ was 8.5% worse than 2002 (US\$1.50:£). Overall, on translation, currency movements reduced Group turnover by £13.1m (3.3%) and operating profits before goodwill amortisation by £1.6m (6.8%) when compared to 2002.

On a constant currency basis, Group operating profit before goodwill amortisation fell by £4.2m to £17.6m (2002 – £21.8m using 2003 exchange rates, e.g. \$1.64) with the Aerospace Division up £0.3m to £7.3m, the Automotive Division down £4.1m to £7.4m and the Specialised Industrial Division down £0.4m to £2.9m.

The end of February exchange rate of US\$1.86:£ represents a further decline of 11.8% over the 2003 average rate. Whilst such a weakening is likely to help bolster the North American economy, with a consequent benefit to the Group, it will nevertheless have a further adverse effect on the translation of local results into sterling. It is estimated that, if February 2004 month end exchange rates had been in effect throughout 2003 then, on translation, the reported 2003 Group turnover would have been adversely impacted by around £26m and Group operating profit before interest, tax and goodwill amortisation by around £1.8m. Conversely, the 2003 interest charge would have benefited by around £0.5m.

Operating profit is reported after £1.3m (2002 – £1.3m) of reorganisation and restructuring costs. Note 2 provides the segmental split of these costs. In both years, the charges arose from the implementation of cost reduction measures necessary for the Group to remain competitive. Total employee numbers for continuing business reduced by 380 (7%) during 2003.

The goodwill amortisation charge reduced to £5.4m (2002 – £5.8m) as a result of the prior year's disposals and the effect of exchange rate movements.

Interest Charge

The net interest charge fell by 26% to £4.9m (2002 – £6.6m) due to the combination of lower interest rates, reduced borrowings and generally beneficial exchange rate movements, particularly the weakening US\$ in which the majority of the Group's borrowings are denominated. Interest cover, calculated on operating profits before goodwill amortisation, was 3.6 times (2002 – 3.5 times).

Taxation

The Group's effective tax rate for 2003, measured on profit before goodwill amortisation and the effect of the disposal of operations and fixed assets, was 14.9% (2002 – 18.5%). A reconciliation between the effective tax rate and the UK corporate tax rate of 30% is included in Note 7. The overall charge of £1.9m comprised £2.4m relating to ordinary activities, a net benefit of £0.4m relating to prior years and a net reduction in deferred tax liabilities of £0.1m. The net cash paid in respect of taxes during 2003 was £0.8m (2002 – £0.3m recovery).

Earnings and Dividends per Share

Basic earnings per share was 1.89p (2002 – 1.29p). Underlying earnings per share (before goodwill amortisation and the effect of the disposal of operations and fixed assets) was 3.52p (2002 – 4.47p). An unchanged final dividend of 1.35p per share is proposed to be paid on 27 May 2004 to shareholders on the register on 30 April 2004. Total dividends paid in respect of 2003 are therefore 2.00p (2002 – 2.00p).

Free cash flow was £20.2m (2002 – £25.2m). Net capital expenditure was only 43% of depreciation. The free cash flow was principally used to fund dividends to shareholders of £6.1m and to further reduce the Group's borrowings. 2004 is anticipated to see a number of new programmes moving from the engineering and design stage to prototyping and testing such that capital expenditure spend is expected to be much closer to the level of depreciation.

Funding and Liquidity

The Group's net borrowings fell by £23.2m to £64.2m (2002 – £87.4m) during 2003. Gross debt at the year-end, being net borrowings of £64.2m adjusted for cash of £11.6m and foreign exchange forward contract gains of £3.3m as set out in Note 10 (c), was £79.1m (2002 – £101.1m) of which 74% was in US\$, as a policy hedge against the Group's US\$ assets. The weakening US\$ (from \$1.61:£ to \$1.79:£) together with other exchange rate movements accounted for £8.7m (2002 – £10.4m) of the year's reduction in net borrowings. Gearing, on shareholders' funds, at the year-end was 53% (2002 – 72%).

The Group finances its borrowings at Group level through the US private placement market and revolving credit facilities. In addition it has a number of other local banking facilities. Group policy is to ensure that all projected borrowing requirements are covered by committed facilities. The Group repaid its £70m multi-bank revolving credit facility in October, nine months early, and replaced it with two revolving credit facilities: a US\$25m (£14.0m) single bank three year facility to May 2006 and a £46.0m multi-bank three year facility to October 2006. At the end of 2003 the Group had total facilities

Cash flow	2003 £m	2002 £m
Operating profit	12.2	17.6
Goodwill amortisation	5.4	5.8
Depreciation	16.1	17.8
Net capital expenditure	(6.9)	(11.7)
Working capital movement	(0.8)	2.7
Net interest paid	(5.0)	(7.3)
Tax (paid)/recovered	(0.8)	0.3
Free cash flow	20.2	25.2
Disposals and acquisitions	0.4	2.2
Dividends paid	(6.1)	(2.5)
Effect of exchange rates	8.7	10.4
Reduction in net borrowings	23.2	35.3
Net borrowings	64.2	87.4

of £137.9m (including £115.9m committed for more than one year) of which £58.8m was unused. The maturity profile of the gross borrowings and committed facilities at the end of 2003 was:

£m	2004	2005	2006	2007	2008+	Total
Group borrowings	6.2	0.3	14.9	14.1	43.6	79.1
Committed facilities	–	–	60.0	14.0	41.9	115.9

Financial Risk Management

The main financial risks faced by the Group continue to be movements in interest rates and foreign currency exchange rates as well as funding and liquidity risks. All such risks are managed by a centralised treasury department which reports to the Group Finance Director. It operates under the guidance of the Group Treasury Committee, which meets quarterly and acts according to the laid-down objectives, policies and authority levels approved by the Board. The Group's external auditors attend the Group Treasury Committee meeting once a year. All treasury activities are focused on the management and hedging of risk and it is Group policy not to engage in speculative financial transactions.

The Group is exposed to movements in exchange rates for both foreign currency transactions and the translation of net assets and profit and loss accounts of overseas operations. The Group has a policy of hedging its net investment in overseas operations through currency denominated loans and forward contracts but it does not hedge the effects of currency movements on the translation of its overseas earnings into sterling. Transactions exposures are, however, normally hedged through forward exchange contracts on a rolling 12 month basis.

It is Group policy to have the majority of its gross borrowings subject to fixed rates of interest. This is achieved through having a mixture of fixed and variable rate borrowings and by entering into interest rate swaps. At the year-end 62% (2002 – 78%) of gross borrowings were subject to fixed rates.

Pensions

The Group has continued to account for retirement benefits in accordance with SSAP24 with full details being disclosed in Note 24 (a). In 2003 the Group charged £3.0m (2002 – £2.7m) in respect of its defined benefit schemes and £2.7m (2002 – £3.3m) in respect of its defined contribution schemes. The total cash funding of £3.2m (2002 – £1.8m) made to defined benefit schemes included a discretionary £0.9m payment in respect of the UK scheme. Whilst the valuation on 6 April 2001 showed the UK defined benefit scheme to be fully funded, it is anticipated that the next valuation (effective 6 April 2004) will show a significant deficit. Accordingly,

the Group is planning to further increase the discretionary funding of this scheme, as well as making increased payments to the three small US schemes, such that total cash contributions in respect of all defined benefit schemes are anticipated to rise to around £7.5m in 2004. Following a recent review, employee contributions for the UK defined benefit scheme are to increase from 5.0% to 7.5% of pensionable salary from April 2004.

Although the full implementation of FRS17 (Retirement Benefits) has been deferred pending the introduction of International Accounting Standards in 2005, certain disclosures are still required. These disclosures are provided in Note 24 (c) and show that, at 31 December 2003, there were total pension deficits, net of deferred tax, of £28.0m (2002 – £27.6m). Had the Group adopted FRS17 in 2003 then the charge to the profit and loss account would have been £4.1m (2002 – £2.2m).

International Accounting Standards

Work is ongoing to ensure that the Group is in a position to make the transition to International Accounting Standards with effect from 1 January 2005. Whilst detailed modifications and disclosures will be required in a number of areas, the principal impact to the Group is expected to be the incorporation of the net pension deficit onto the balance sheet.

Non-Statutory Information

In the commentary to the year's results reference is made to non-statutory financial information. Such information includes:

- Operating profit before goodwill amortisation – this is used to illustrate the underlying trading performance of the Group. The Group Profit and Loss Account provides the information to reconcile this to operating profit with segmental detail provided in Note 2.
- Underlying earnings per share – this indicates the overall performance of the Group before the effect of goodwill amortisation and the disposal of assets and discontinued operations. Note 9 reconciles this to basic earnings per share.
- Free cash flow – this highlights the total net cash generated by the Group prior to corporate activity such as acquisitions, disposals and dividend payments. A table earlier in this report explains its derivation.

Going Concern

After undertaking a review of the future prospects and funding of the Group, the Directors are of the opinion that the Group has adequate financial resources to continue to operate for the foreseeable future. Consequently the accounts were prepared on a going concern basis.