Chief Executive's review

"Our outlook is positive and we remain optimistic that we are well placed to take advantage of an upturn in our markets."

S.C. Harris | Group Chief Executive

Overview

Reported revenues for the Group were up 6% in 2016. However, the significant weakness in the oil & gas market and the knock-on effect on general industrial demand continued to exert considerable downward pressure on Group results. Group revenue on a like-for-like basis[1] was down 3.5%. Like-for-like sales to the energy markets were down 27%. Excluding the impact of these falling energy revenues, the Group had flat sales year on year. It should be noted that like-for-like revenues at the half year were down 6%. The improved performance for the full year was due to a notable pickup in activity in the fourth quarter.

Civil aerospace in Western Europe was strong, particularly in the second half, while the North American business was more mixed as the supply chains for this sector continue to go through adjustment associated with the changeover of aircraft and engine platforms.

In automotive, car and light trucks built on the strong start to 2016, accelerating through the year such that the second half growth rate was 6% on a like-for-like basis. While the background market demand in the car and light truck market has moderated over recent months, Group revenues continue to grow on the back of new programme wins.

Specialist Technologies performed well overall, increasing their contribution to Group headline operating profit to 42%. While two of these technologies, Surface Technology and HIP Product Fabrication, continue to be hard hit by low levels of activity in the oil & gas sector, the remaining technologies once again showed good growth. Margins continued to exceed 30% in Specialist Technologies.

The Group's headline operating margin[2] was resilient at 16.6%. Headline operating profit declined 2% from £102.1m to £99.6m (13% at constant exchange rates). The robust margin performance was partly helped by favourable currency translation. However, the Bodycote Margin Model is helping to drive improvements and this, together with the improved flexibility the Group now has in its cost base and the favourable impact on mix coming from Specialist Technologies, combined to deliver margin resilience that would not have been possible in past downturns.

We completed the acquisition of five plants in 2016, in line with our bolt-on strategy in Classical Heat Treatment. In some cases these acquisitions brought new capability into the Group, but in all cases they strengthened our network and enhanced our local cluster strength. They were all completed in the second half of the year with the majority in the final quarter and, correspondingly, had an immaterial impact on our Group result. They will, on the other hand, provide us with a small impetus as we enter 2017. Annualised sales from the acquisitions will be around £20m, with average Group margins expected to be achieved in 2017. We have a good acquisition pipeline and fully intend to continue to execute these acquisition opportunities provided we are confident that they will create further shareholder value.

Basic headline earnings per share were 37.0p, a decline of 6%, principally reflecting a higher tax rate in 2016. Cash generation has remained strong, with 92% of headline operating profit turned into cash[3] (2015: 80%). Indeed, even after spending £30m on acquisitions, capital investment of £63m (corresponding to 1.1 times depreciation), restructuring costs and £48m of dividends, the Group's year end net cash position only reduced by £11.2m to £1.1m (2015: £12.3m). The Group continues to be in a strong financial position, with plenty of available financial headroom.

Strategic progress

We continued our strategy of investing in areas where we see high-growth potential but are always mindful of the Group's minimum 20% hurdle rate for return on capital employed. Expenditure in the year included new facilities in the USA, Mexico, Poland and France, as well as continued expansion of our Specialist Technologies' capacities and capabilities, and further deployment of the Group's ERP programme. The strategy of preferential investment in Specialist Technologies continues to benefit the Group.

The Group's strategy remains relevant and unaltered. The drive for operational efficiency in the more mature parts of the business, expansion of the Group's footprint in rapid-growth countries and the focus on growth in the higher value-added businesses, particularly Specialist Technologies, are all designed to increase the quality of the Group's earnings and create significant value. We have made further progress during this challenging year and remain readier than ever to respond to developments in our markets.

Summary and outlook

The Group delivered a robust performance in 2016 despite significant headwinds in some key business sectors. The speed and effectiveness of management's actions, in addition to the continued focus on improved mix, resulted in resilient margins.

While our business, by its nature, has limited forward visibility, we continue to demonstrate that we are capable of adapting with great agility to changes in market conditions. Our outlook is positive and we remain optimistic that we are well placed to take advantage of an upturn in our markets.

The Board is confident that management's continued focus on business improvements and execution of the Group strategy will generate good returns through the cycle.

S.C. Harris
Group Chief Executive
28 February 2017

1. Like-for-like year-on-year revenue growth rates are at constant exchange rates and exclude acquisitions, closed sites and the impact of the disposal of businesses.
2. Headline operating margin is defined as headline operating profit as a percentage of revenue.
3. Cash conversion is defined as headline operating cash as a percentage of headline operating profit.