Interim management report

Overview

Bodycote revenues grew 18.8% to £345.7m in the first half (2016: £291.0m) corresponding to a growth of 8.3% at constant exchange rates. The five sites acquired in 2016 provided 3.5% of the constant currency growth such that organic constant currency growth was 4.8%. The contribution of recent greenfield investments made up 2.0% of the growth at constant exchange rates. The remaining 2.8% of the constant currency growth stems primarily from the macro-economic tailwind the Group has seen since the second half of 2016.

Of particular note was the performance of the general industrial business, which returned to healthy growth in the first half after three years of declines. The recovery has been broad based, although North American growth rates did not start to strengthen until the final months of the first half.

Oil & gas remains a drag on growth although now much less pronounced than in previous periods. The onshore business in North America did register strong growth in the second quarter but subsea continued to decline.

Excluding the oil & gas sector, Specialist Technologies revenues increased 10.2% at constant exchange rates. HIP Product Fabrication (HIP PF) and Surface Technology have large portions of their business exposed to the oil & gas sector, and in particular to subsea. Revenues from these technologies were, therefore, down.

The recent acquisitions are performing well and are achieving average Group margins although, as expected, the greenfield start-ups are still somewhat below this level. However, the Group's strong operational gearing and the AGI margin expansion programme helped push the Group's headline operating margin[1] up to 17.8% (2016: 16.9%). The Group's headline operating profit grew 25.2% to £61.7m (2016: £49.3m). The Group's headline tax rate was reduced to 25.5% (2016: 27.5%) and is now expected to increase gradually from this reduced base. The net impact of these movements has been to drive first half headline earnings per share up 29% to 23.6p (2016: 18.3p).

The Group continues to maintain tight control over capital expenditure as well as costs. Net capital expenditure in the first half was £29.7m (2016: £31.0m), which equates to 1.0 times depreciation (2016: 1.2 times). The Group has a number of areas of increasing prospects for superior return on investments, particularly in the Specialist Technology arena. Engineering and project management resources are being increased to take advantage of this and a higher level of capital investment is expected to be achieved going forward. In keeping with these prospects, growth projects involving capital investment of £36m were approved in the first half.

The improved profitability, as well as tight control of working capital, resulted in free cash flow increasing to £42.1m in the first half (2016: £20.9m). Net cash at the half year was £17.7m (2016: net debt £5.5m).

The main strands of the Group's strategy are the drive for operational efficiency and margin expansion in the more mature parts of the business; expansion of the Group's footprint in the rapid growth countries; bolt-on acquisitions in classical heat treatment where the Group's target investment returns can be achieved more quickly than greenfield investment alone; and the focus on growth in the higher value-added businesses, particularly the Specialist Technologies. The validity of this consistent strategy is clear with significant progress now apparent across all aspects.

1 Headline operating margin is defined as headline operating profit as a percentage of revenue.