

Finance Director's Review



Financial Performance

The Group fully implemented Financial Reporting Standard 17 "Retirement Benefits" and Urgent Issues Task Force 38 "Accounting for ESOP Trusts" in the period. The comparative figures for 2003 have been restated with underlying earnings per share for 2003 being restated to 3.13p from the previously reported 3.52p.

The Chairman has commented on the Group's headline results in his statement. For a second consecutive year, the reported results were significantly impacted by adverse currency movements with the average rate of the US dollar weakening by 10.4% (US\$1.83:£ in 2004 compared to US\$1.64:£ in 2003). Overall, on translation, currency movements reduced turnover of continuing operations by £19.8m (6.1%) and operating profit from continuing operations before goodwill amortisation by £1.5m (8.6%) when compared to 2003.

Hence, when stated on a constant currency basis, Group turnover from continuing activities increased by 1.2% to £306.8m (2003 – £303.1m using 2004 average exchange rates) and the Group's operating profit from continuing operations before goodwill amortisation increased by 3.1% to £16.4m (2003 – £15.9m). The operating profit of the Aerospace Division improved by 32.9% to £9.3m (2003 – £7.0m), the Automotive Division declined by 7.0% to £6.6m (2003 – £7.1m) and the Industrial Division, heavily impacted by the restructurings at Pathway and Hargreaves, declined to £0.5m (2003 – £1.8m).

The Group's operating profit is reported after £1.7m (2003 – £1.3m) of reorganisation and restructuring costs. The main reasons for the 2004 charge were: the consolidation of Pathway's manufacturing onto a single site (£0.4m); the outsourcing of component manufacture at Senior Aerospace Bosman (£0.4m) and the business restructurings at Senior Automotive Blois and Senior Hargreaves (each £0.3m).

Interest Charge

The net interest charge fell by 41% to £2.9m (2003 – £4.9m) due to a £0.8m interest receipt, received in connection with the recovery of the US tax overpaid in prior periods, as well as the combination of lower interest rates, reduced borrowings and the weaker US dollar. Interest cover, calculated on operating profit before goodwill amortisation less the net finance cost in respect of retirement benefits, was 5.4 times (2003 – 3.3 times).

Net Finance Cost – Retirement Benefits

The net finance cost in respect of retirement benefits fell to £1.2m (2003 – £2.2m). This cost, which was reported for the first time in 2004 following the full implementation of FRS 17, arises from the difference between the expected return on pension assets and the interest on pension scheme liabilities.

Taxation

The overall tax charge for 2004 was £1.7m (2003 – £1.8m) with £0.2m (2003 – £nil) relating to the profit on sale of fixed assets. The Group's effective tax rate for 2004, measured on profit before goodwill amortisation and the effect of the disposal of operations and fixed assets, was 11.8% (2003 – 15.8%). The low 2004 effective tax rate benefited from £0.9m of adjustments in respect of prior years. During the year, cash refunds of £4.0m were received in respect of US tax overpaid in prior periods such that, overall, the Group recovered a net £2.7m in respect of taxes in 2004 compared to the £0.8m paid during 2003.

Disposals

The Group disposed of its five industrial hose businesses (located in the UK, France, Holland, Sweden and the USA) in August. The consideration was discharged by way of £5.8m of cash at completion and the issue of a £2.5m convertible loan note and £2.5m in convertible preference shares. In calculating the total anticipated consideration of £8.3m, on a debt-free/cash-free basis, full provision was made against the carrying value of the convertible preference shares. A loss on disposal of £13.3m was recorded after taking account of the £0.6m of disposal costs, £1.3m of goodwill held on the Group's balance sheet and £8.7m of goodwill previously written-off directly to reserves.

Earnings and Dividends per Share

As a result of the loss on disposal of the industrial hose businesses, the Group reported a basic loss per share of 2.25p (2003 – earnings per share of 1.50p). Underlying earnings per share, before goodwill amortisation and the effect of the disposal of operations and fixed assets, was 3.65p (2003 – 3.13p).

An unchanged final dividend of 1.35p per share is proposed to be paid on 27 May 2005 to shareholders on the register on 29 April 2005. This will bring the total dividends paid in respect of 2004 to 2.00p (2003 – 2.00p).

Cash Flow

Free cash flow was £10.5m (2003 – £20.2m). The year-on-year reduction was largely due to £4.0m (2003 – £1.3m) of pension payments in excess of service cost and an adverse working capital movement of £5.7m (2003 – £0.4m). This was primarily due to changes in customer mix, year-end development inventory for the Joint Strike Fighter, which was due for shipment in early 2005, and a higher level of contract debtors at Senior Hargreaves, a significant portion of which has already been recovered in 2005. Net capital expenditure increased to 73% of depreciation (2003 – 43%).

Funding and Liquidity

Net borrowings for the Group fell by £13.6m in the year to end at £50.6m, with exchange rate movements, principally the weakening US dollar (from \$1.79:£ to \$1.92:£), accounting for £4.7m of the reduction. Gross debt at the year-end was £57.3m (2003 – £79.1m) of which 92% was in US dollar as a policy hedge against the Group's US dollar assets. Gearing at the year-end, was 67% (2003 – 81%) measured on total shareholders' funds and 43% (2003 – 52%) measured on net assets before retirement benefit liabilities.

The Group primarily finances its borrowings through the US private placement market and two revolving credit facilities. During the year, the term of the smaller, US\$25m, revolving credit facility was extended by 12 months to May 2007. At the end of 2004 the Group had total facilities of £130.4m, of which £73.1m was unused. £111.1m of the total facilities were committed for more than one year.

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 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 Treasury Committee once a year. All activities are focused on the management and hedging of risk and it is Group policy not to engage in speculative financial transactions.

Cash Flow	2004	2003
	£m	£m
Operating profit	11.7	13.1
Goodwill amortisation	5.1	5.4
Depreciation	13.3	16.1
Net capital expenditure ^{o)}	(9.7)	(6.9)
Pension payments above service cost	(4.0)	(1.3)
Working capital movement	(5.7)	(0.4)
Net interest paid	(2.9)	(5.0)
Tax recovered/(paid)	2.7	(0.8)
Free cash flow	10.5	20.2
Net disposals and acquisitions	4.5	0.4
Dividends paid	(6.1)	(6.1)
Effect of exchange rates	4.7	8.7
Reduction in net borrowings	13.6	23.2
Net borrowings	50.6	64.2

^{o)}Includes finance leased capital expenditure of £0.4m (2003 – £nil)

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. Transaction 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 66% (2003 – 62%) of gross borrowings were subject to fixed rates.

Pensions

The Group operates a number of defined benefit pension plans, with the largest being the UK scheme, as well as a number of geographically based defined contribution and government sponsored arrangements. The Group fully implemented FRS 17 "Retirement Benefits" during the year.

At the end of 2004, total FRS 17 pension and post-retirement liabilities were £41.2m (2003 – £44.0m) with £33.5m (2003 – £35.5m) being in respect of the UK scheme. The triennial actuarial valuation of the UK scheme was carried out during 2004 with the past service deficit being confirmed as £18.5m. This is to be funded by additional Company contributions of £2.6m per annum. During 2004 an additional contribution of £1.4m was made in respect of the UK scheme in anticipation of the outcome of the actuarial valuation and a supplementary payment of £2.4m made in respect of the three US defined benefit schemes to improve their funding position. The actuarial deficit for the UK scheme is lower than the FRS 17 deficit primarily due to the different discount rates used to value the liabilities.

In total, £2.0m (2003 – £2.0m) was charged to the profit and loss account during 2004 for defined benefit schemes, in addition to the net finance costs described earlier. The total charge for defined contribution schemes was £2.2m (2003 – £2.7m).

International Accounting Standards

Senior will be reporting its financial results in accordance with International Financial Reporting Standards (IFRS) from 1 January 2005. The conversion project is ongoing and the Auditors are due to report to the Audit Committee in May 2005. It is considered that the standards potentially having the most significant effect on the Group are:

IFRS 2 Share-based Payments – IFRS 2 requires all options granted since 7 November 2002 to be valued at the date of the grant and the value amortised through the profit and loss account over the likely life of the option. The Group only granted such options on 12 March 2003. Under IFRS 2 the expense, calculated on the basis of the fair value at the date of the award using the Black-Scholes pricing model, is estimated at less than £0.1m for each of 2004 and 2005.

IFRS 3 Business Combinations – Under IFRS, goodwill is no longer amortised but is instead held at its carrying value on the balance sheet and tested annually for impairment. The transitional arrangements contained in IFRS do not require this standard to be applied to acquisitions made prior to 1 January 2004 and the Group intends to take this option. Under UK GAAP, the goodwill amortisation charge for 2004 was £5.1m and hence Group profit before tax would be expected to have been a similar amount higher if 2004 results had been reported under IFRS.

IAS 19 Employee Benefits – IAS 19 is similar to FRS 17, which was adopted by the Group during 2004. The Group intends to follow the "FRS 17" option under IAS 19 of immediately recognising all actuarial gains and losses through reserves. Accordingly, the introduction of IAS 19 is not expected to result in any material differences to either

the Group's consolidated balance sheet or profit and loss account for 2004.

IAS 38 Research and Development – Under UK GAAP, research costs must be written-off immediately as incurred whereas development costs may either be capitalised and amortised or written-off as incurred. Historically, Senior has written-off development costs as incurred. IAS 38 requires development expenditure meeting certain criteria to be capitalised, amortised and subjected to an annual impairment review. Much of the Group's development expenditure results in incremental, rather than significant, improvements to existing products and processes and capitalisation under such circumstances is unlikely. Where development expenditure does result in new or significantly improved products or processes, it will only be capitalised where its carrying value can be validated with reasonable certainty. Overall, the adoption of IAS 38 is not anticipated to have a significant effect on the Group's results.

IAS 32 and 39 Financial Instruments – IFRS requires most financial assets and liabilities and all financial instruments to be recognised at fair value at the balance sheet date with changes in their value taken through the profit and loss account. Unless hedge accounting is used, this could introduce significant volatility to a company's profit. Senior intends to apply the hedge accounting provisions of IAS 39, to minimise future volatility, to the extent practically and economically appropriate to do so. Comparative figures for 2004 are not required and, whilst unlikely to have a material effect on the Group's net assets or profit before tax, it is not possible to exactly predict the impact of IAS 32 and 39 on future results.

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 profit before tax and underlying earnings per share – these indicate the overall performance of the Group before the effect of goodwill amortisation and the disposal of businesses and fixed assets. Note 9 reconciles these to the reported results.
- 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 review explains its derivation.

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