Financial Review

We have delivered improved profitability, strong cash flow, a robust balance sheet and a more focused Group

Chris O'Shea
Chief Financial Office

Since the demerger we have been busy on a number of fronts: streamlining and focusing the asset portfolio; improving operating margins; increasing cash flow; and strengthening the balance sheet. We have made significant progress in each of these key areas during the year, all of which underpin our ability to provide superior returns to our shareholders.

In line with our strategy of focusing the portfolio, in 2013 we completed the disposal of the Precious Metals Processing division and other lower margin businesses.

In 2013 we improved our performance with underlying operating margins improving by 1 percentage point from 8.3% in 2012 to 9.3% in 2013 despite the reduced activity levels experienced in the second half of 2012 continuing throughout 2013. We remain confident in our ability to deliver further margin improvement in the coming years by continuing to focus on improving our financial and operational flexibility. As indicated in our principal risks section (see pages 18 and 19), we consider end-market cyclicality to be a significant concern. This financial and operational flexibility will ensure that we are able to react appropriately, and quickly, to changes in end-market conditions.

As set out in our KPIs on page 17, we consider cash flow as a primary measure of success. Our continued efforts to focus the business in this area are bearing fruit, with a cash conversion ratio of 107% in 2013, meaning that for each £100 of trading profit, we generated operating cash flow after capital expenditure of £107. This contributed to a 13% reduction in our net debt to £256 million.

This reduction in net debt, together with a further improvement in the funding position of our defined benefit pension plans, has contributed to a strengthening of our balance sheet. This enabled us to raise new long-term debt on attractive terms in the second half of the year, increasing the maturity profile of our debt and thus, in line with mitigations noted in our principal risks section (see pages 18 and 19), reducing refinancing risks in future years.

During the year we returned £70 million to shareholders through dividends and a share repurchase programme, thereby returning the majority of the net proceeds of the disposal of the Precious Metals Processing division to shareholders.

With net debt of £256 million and committed debt facilities of £637 million with maturities out to 2028, we have a strong balance sheet. At the end of the year net debt represented 1.4 times 2013 EBITDA (Earnings before Interest, Taxes, Depreciation and Amortisation), well within our debt covenants. Our business is strongly cash generative with relatively low capital intensity. In short, we are well positioned to invest in organic projects, fund attractive acquisition opportunities as they arise, and provide superior returns to shareholders.

The following review considers our financial KPIs, our financial risks, and sets out other relevant financial information.

Basis of preparation

Please see Note 2.6 of the Financial Statements on page 97. All references in this review are to Headline Performance unless otherwise noted. All comparatives have been restated as noted in Note 2.7 of the Financial Statements on page 97.

Dividend

In line with the dividend policy outlined by the Chairman on page 6, the Board has recommended a final dividend of 10.25 pence per share. Together with the interim dividend paid during 2013, this will bring the full year dividend to 15 pence per share, an increase of 5.3% on Vesuvius' share of the 2012 Cookson Group plc dividend.

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Financial KPIs

Underlying revenue growth

We look at underlying (or organic) movements in our results to establish meaningful period-on-period comparisons. Underlying movements are calculated by:

- restating the previous period's results at the same foreign exchange rates used in the current period
- removing the results of disposed businesses in both the current and prior years
- removing the results of businesses acquired in the current year
- assuming acquisitions made in the prior year were made on the first day of that period.

Group revenue of £1,511 million was 2.4% lower than 2012 (£1,548 million); underlying revenues fell by 0.8% reflecting the fact that the strong market conditions experienced in the first half of 2012 were not repeated in 2013, with reductions in the Foundry division more than offsetting underlying growth in the Steel division.

Trading profit and return on sales

The underlying trading performance of the Group is measured by both the trading profit in absolute terms, and as a percentage of sales (return on sales). Trading profit of £140 million was 6.6% ahead of 2012 (£131 million); on an underlying basis, trading profit increased by 10.9%.

In the Steel division, trading profit increased from £83 million in 2012 to £89 million in 2013; on an underlying basis, trading profit increased by 9.9% with return on sales increasing from 8.1% to 8.7%. These results reflect a substantial improvement in underlying profits in the Advanced Refractories product line and the impact of a lower bad debt charge.

In the Foundry division, trading profit increased from £48 million in 2012 to £51 million in 2013; on an underlying basis, trading profit increased by 12.6% with return on sales increasing from 8.7% to 10.4%. These results reflect the elimination of the losses in the Solar Crucibles product line, which was partially offset by an underlying reduction in other Foundry activity which fed through into profitability.

Free Cash Flow	**2013 £m**	2012 £m
Recurring free cash flow	**108**	78
Demerger & restructuring expenses	**(13)**	(24)
Discontinued operations	**(10)**	3
Net free cash flow	**85**	57

Headline PBT and EPS

Headline profit before tax ("PBT") and earnings per share ("EPS") are used to assess the underlying financial performance and earnings capacity of the Group. The principal difference between trading profit and PBT is net finance costs.

Net finance costs of £17 million comprised £16 million of net interest payable on borrowings (2012: £22 million), £2 million on retirement benefit plans (2012: nil), and £1 million relating to the unwinding of discounts on provisions (2012: £2 million); this was partially offset by £2 million (2012: £2 million) of finance income which principally comprised interest income.

The net interest payable on borrowings in 2012 includes substantially all interest costs relating to the former Cookson Group as all such costs were incurred by companies which remained with Vesuvius following the demerger. We estimate that net interest payable on borrowings in 2012 would have been £16 million had Vesuvius been a stand-alone entity throughout 2012.

Headline PBT, including our share of the profits of joint ventures of £2.5 million (2012: £0.1million) has increased by 14% to £125 million (2012: £110 million).

Headline EPS has grown from 27.0 pence per share to 31.9 pence per share, reflecting the increased profitability of the Group, the lower effective tax rate (26.5%; 2012: 27%) and the impact of the share repurchase programme which reduced the number of shares.

Free cash flow and working capital

Free cash flow is used to assess the underlying cash generation of the Group, which is impacted by the working capital employed in the business. In order to drive sustained performance in working capital management we measure performance on a 12 month moving average basis at constant exchange rates.

On this basis, trade working capital as a percentage of sales was 24.7% in 2013, a reduction of 1.9 percentage points on 2012 (26.6%). Inventory days reduced from 85 days of cost of sales at the end of 2012 to 77 days at the end of 2013, with debtor days reducing from 74 days of sales at the end of 2012 to 73 days at the end of 2013.

Operating cash flow was £150 million in 2013 (2012: £133 million), which represents a cash conversion rate of 107% (2012: 101%) in relation to trading profit from continuing operations. Our focus on working capital has led to a net cash inflow from trade and other working capital of £16 million in the year relating to continuing operations, repeating the strong performance in 2012, where the net inflow was £13 million. Free cash flow from continuing operations, before restructuring and demerger costs, of £108 million was generated in the year (2012: £78 million).

Return on net assets

Return on net assets ("RONA") is used to assess the underlying financial performance of the Group. RONA is affected both by the assets employed by the business, and the returns earned by the business. In 2013, a combination of the reduction in working capital and the improvement in profitability led to an increase in Group pre-tax RONA to 24.4% (2012: 19.5%).

Net debt and interest cover

The Group's debt facilities have financial covenants with specific limits on the ratios of Net Debt to EBITDA (maximum 3 times limit) and EBITDA to Interest (minimum 4 times limit). These ratios are monitored regularly to ensure the Group has sufficient financing available to run the business and fund future growth. At the end of 2013, the Net Debt to EBITDA ratio was 1.4, with EBITDA covering net interest paid 13.0 times; accordingly, the Group was well within its covenants.

Net Debt	2013 £m	2012 £m
Drawings — Committed Facilities	**308**	421
Drawings — Uncommitted Facilities	**19**	9
	327	430
Cash & short-term deposits	**(68)**	(130)
Capitalised borrowing costs	**(3)**	(5)
Net debt	**256**	295

At the end of the year we had £637 million of gross committed debt facilities (2012:£579 million), of which £329 million was unutilised (2012: £158 million). Our net debt stood at 256 million at the end of 2013, a reduction of £39 million in the year. As part of a process to increase the efficiency of the utilisation of our facilities, we have reduced the cash and short-term deposits held to £68 million at the end of 2013 (2012: £130 million).

We keep our capital structure under regular review, and we took advantage of favourable market conditions and strong demand for our credit to raise new long-term fixed rate debt on the US Private Placement market on attractive terms as follows:

- €15 million at 3.46% maturing in December 2021
- US$30 million at 4.61% maturing in December 2023
- €15 million at 3.93% maturing in December 2025
- US$30 million at 4.96% maturing in December 2028.

As a result, at the end of 2013 one-third of our committed debt facilities comprised long-term fixed rate facilities, with the remainder being the £425 million multi-currency revolving credit facility which runs until April 2016.

Gross borrowings at the end of 2013 amounted to £327 million. Of this, approximately two-thirds is long-term fixed rate debt, with the remainder floating rate. The currency split of the borrowings is approximately one-third in each of euros, US dollars, and sterling.

Financial risk factors

There are two main financial risk factors. End-market cyclicality is discussed in the introduction to this section on page 13. In addition, the Group faces risks relating to foreign exchange, capital market, interest rate and inflation uncertainties. Despite the mitigations described on page 19, we operate in many countries and, as such, our reported results vary with foreign exchange rates. When sterling strengthens against a currency, our revenues and profits as reported in sterling are reduced; however, the underlying revenues and profits in the local currency are unaffected.

The second half of 2013 saw a strengthening of sterling against a number of our important trading currencies, most notably the Indian rupee and the Brazilian real. This, coupled with the weakness experienced throughout the year in the Japanese yen and the South African rand, more than offset the effects of a stronger US dollar, euro, and renminbi. The combined effects of these foreign exchange movements served to constrain our growth in profits. We continue to monitor this closely, and where possible seek to balance our cost and revenue base in similar currencies to minimise exposure. As with all international companies, and particularly ones like ours focused on growth in emerging markets, this continues to be an area of attention.

Other relevant financial information

Trading Results – Discontinued Operations

The results of the Precious Metals Processing division up to the date of disposal (31 May 2013) are reported as discontinued operations in 2013. In 2012 the consolidated results of the Alent plc group of businesses up to 18 December 2012, plus the results of the Precious Metals Processing division were reported as discontinued operations.

Revenue in the Precious Metals Processing division for 2013 was £65 million, down from £190 million in 2012, reflecting the disposals of the European business on 31 May 2013 and the US business on 1 May 2012. Trading profit for the year of £14 million (2012: £17 million) reflected weaker end-market conditions in 2013 together with the effect of the business disposals. Included within trading profit is £10 million relating to the release of a provision following the successful conclusion of a UK VAT dispute.

Total revenue of Alent plc for the period up to the 18 December 2012 was £698 million, with trading profit of £100 million.

Restructuring

The restructuring charge in 2013 of £4 million principally comprises costs relating to the relocation of a Steel division production facility in Australia, the closure and relocation costs relating to two Foundry production sites in China, and some trailing costs relating to prior restructuring programmes. Around one-third of this charge is non-cash.

The restructuring charge in 2012 of £57 million principally related to the restructuring of the Solar Crucibles business, with around 80% representing non-cash asset write-offs.

Taxation

The headline effective income tax rate for the year reduced to 26.5% (2012: 27.0%).

The income tax credit on separately reported items principally consists of non-cash deferred tax movements relating to the amortisation of a deferred liability arising from the acquisition of Foseco plc in 2008 (£7 million; 2012: £7 million), and the recognition of a deferred tax asset due to the forecast utilisation of US tax losses incurred in prior years (£29 million). Due to the uncertain nature of future profitability we have recognised an asset equivalent to the estimated profitability in the three coming years.

During the year the major part of a dispute with the UK tax authorities over VAT on metal purchases relating to the Precious Metals Processing division was resolved in our favour, resulting in the release of a provision of £10 million held in relation to this matter. This has been included in the results from discontinued operations. Further details are set out in Notes 25 and 37 to the Financial Statements.

Capital expenditure

Capital expenditure in 2013 of £48 million (2012: £57 million) comprised £29 million (2012: £38 million) in the Steel division and £19 million (2012: £19 million) in the Foundry division. This represented 3.2% of revenue (2012: 3.7%).

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Pensions

The net pension deficit in our post-retirement employee benefits plans reduced during the year from £69 million to £48 million, with the reduction coming primarily from employer contributions (£15 million) and gains on plan assets (£9 million), partially offset by service charges, administration costs and finance costs.

The triennial valuation of the UK plan as at 31 December 2012 was agreed during 2013. This showed the plan had a funding surplus of £11 million. As a result of this valuation, we ceased obligatory contributions to the plan in July 2013 and agreed with the Trustee, on a non-binding basis, to make payments of £2 million per annum from 1 January 2014 to build further the strength of the plan.

The funding surplus of £11 million is equivalent to the accounting surplus of £23.3 million at the end of 2012. The difference reflects the use of more conservative assumptions for the funding basis than is allowed for the accounting basis.

Our activities to reduce Vesuvius' exposure to defined benefit pension risks continue and in early 2014 we are transferring the liabilities for members who have retired since July 2012 to Pension Insurance Corporation ("PIC"), under the terms of an extension to the original buy-in agreement signed with PIC in 2012.

This extension provides that UK plan members who retire up to the end of 2015 will have their pensions insured on agreed terms. This agreement covers up to £30 million of liabilities, with the future premium payments to be met from the existing assets of the UK plan. As a result, we expect around 65% of the total UK plan liabilities will be covered by these agreements with PIC.

Corporate activity

On 31 May 2013 we completed the disposal of the Precious Metals Processing division for a cash consideration of €56.8 million. The results of this business prior to disposal have been reported as discontinued operations.

Our non-core German brick manufacturing business, VGT-Dyko, was disposed of in February 2013. In August 2013 we announced the disposal of our construction and installation business in Canada which follows the disposal of a similar business in Australia in 2012.

During 2013, no businesses were acquired as we focused on putting in motion the actions required to improve the profitability of the base business. Metallurgica was acquired in 2012 for £28 million. It is one of the world's leading suppliers of fluxes - a range of powders used together with refractory products in the enclosed continuous casting process. Profit margins in Metallurgica improved in 2013 following the integration of the business into Vesuvius. With improvements in margins also achieved in 2012, this highlights the synergies achievable from acquiring such complementary businesses.

Share buy-back

During the year we committed to returning the majority of the net disposal proceeds of the Precious Metals Processing division to shareholders by way of an on-market repurchase of shares. The net proceeds from the disposal amounted to £37 million, comprising the cash-free debt-free gross proceeds of £47 million less the cash consumed by the business operations in the period prior to disposal, which amounted to £10 million. Of this, £30 million was used to repurchase 7,271,174 shares currently held in treasury at an average price, including transaction costs, of 412.59 pence per share between 5 June 2013 and 17 September 2013.

Additionally, during the year the Employee Share Ownership Trust ("ESOT") purchased 851,736 shares at an average price, including transaction costs, of 479.77 pence per share. These shares were purchased by the ESOT partially to cover the anticipated vesting of current share-based incentive awards. Subsequent to the year-end, the EBT purchased a further 82,152 shares at an average price, including transaction costs, of 503.52 pence per share.

Chris O'Shea
Chief Financial Officer
4 March 2014

Pension and other post retirement schemes	2013 £m	2012 £m
Pension Deficits		
US	**23.3**	35.2
Germany	**32.6**	33.0
Rest of World	**11.3**	15.4
UK ex gratia	**1.3**	1.2
	68.5	84.8
Pension Surplus		
UK	**(28.7)**	(23.3)
Net deficit on pension schemes	**39.8**	61.5
Net deficit on other post retirement benefit plans	**8.1**	7.3
Net deficit on pension and other post retirement schemes	**47.9**	68.8