MORGAN ADVANCED MATERIALS

INTERIM RESULTS 2013

MARK ROBERTSHAW, CEO

Results

Q: What were the key drivers of your first half results and how do you assess that performance?

A: In terms of the first half, we've delivered exactly what we said we would do. When we go back to February, we talked about revenues in the first half of this year being broadly in line with the second half of last year and that's exactly what we delivered. So the drivers of margin were really about the self-help actions which we took primarily on the cost base. And I would say that the single biggest impact of that was on our European business where our margins went from 8% to 11.2% in the first half of the year.

Q: And in terms of that margin improvement, how much of that was down to One Morgan and how much a result of earlier self-help initiatives?

A: From what we've seen in the first half, the vast majority of that was really on the back of actions that we initiated in the second half of last year. The One Morgan plan is being implemented very much in line with our expectations. The benefits of that are starting to come through in the first half, but we'll see much more of them from the second half onwards.

Q: And you've mentioned Europe already. What about the margin performance in the other geographic areas?

A: Of the two other areas, North America, a very solid performance in the first half of this year. The operating margins there have remained very much in the mid-teen range which is encouraging. On the Asian side of things, margins were just a little bit under 11%. I think there's been a lot of talk in the press about the relative slowness of China and India and I would have to say that's also our experience as well. We think that the consumer economies there could be relatively robust, but the industrial economies we think are still relatively flat.

Q: And how is that trading environment affecting your key end markets in terms of products and not just in Asia, but in the US and Europe as well?

A: From an end market perspective I would say, areas such as aerospace have remained pretty stable and pretty strong. The healthcare business, similarly. I would say the single biggest area I would point to would be large project business. That goes into areas such as petrochemical and what we've seen there is there's tended to be something of a push out in terms of large contracts being awarded there. And I would say we are seeing that particularly in places like China and India.

Q: And as you've just said people are making a lot of this slowdown in China. So what else can you tell us about what your businesses are seeing there?

A: In the first half of this year what we're seeing is China being broadly stable. Our book-to-bill ratio in the first six months of this year is around 1 times. We think that the credit availability is still something of an issue in China. We're certainly seeing that with some of the larger program orders that our customers are finding it more difficult than they would have done 12 or 18 months ago, to get the sort of credit to invest in some of those larger operations.

Q: And what about the longer term? How optimistic are you about China and other developing economies?

A: Oh, very much so. Strategically, if we look at all we've been doing over the last several months, we're continuing to invest for the longer time growth of those economies. We're building two brand new greenfield facilities at the moment. One of those in Northern China, the other one is in the Middle East.

The other thing that we're doing is we're investing heavily in research and development, technology and application engineering. In the last several months, we've put new resources into places like Singapore and the good news is we're beginning to see the early benefits of that coming through in terms of wins in markets like aerospace and healthcare. And over the next several years, we expect quite a lot of growth in those markets as places like China move up the value-added curve and we think we're very well placed for that.

Q: What's the rationale behind the dividend increase?

A: The way we think about the dividend is very much the Board taking a long-term view about prospects. You can see in the first half of this year that our profits and margins have picked up from where they were in the second half of last year. We would expect that pick-up to continue as we go through 2013 and therefore, the increase in the dividend is actually a reflection in the confidence of the Board about how we see our prospects, not just for this year, but beyond that.

One Morgan

Q: What else can you tell us about the progress that's been made in delivering the benefits of One Morgan and what challenges have you encountered?

A: I would have to say I'm very happy with how One Morgan is going. We're still in the relatively early days of this. It's about four or five months since we announced the new structure in February. We have the new regional management structures all in place now. We're beginning to deliver what I would describe as the first order benefits, so a de-layering of senior management and that's come through already. What we're now moving on to are the second order benefits so things like footprint rationalisation and back office consolidation.

And ultimately as I've said before, One Morgan is all about growth and we're beginning to see some good progress being made in building out the new business pipeline in an area that we're describing as synergy sales. We've made good progress on that. We're seeing some new opportunities in areas such as high temperature insulating materials. We're the world's number one provider of high temperature insulating fibres. We also make high temperature carbon graphite materials and we see good opportunities to leverage our existing channels to market with a broader portfolio of products.

Q: And are the restructuring charges in line with expectations so far?

A: Very much so. We are very much on track to deliver the benefits that we outlined when we announced this in February and the one-off costs associated with it are also in line with the previous guidance that we've given.

Q: And remind us of the cost benefits you're expecting.

A: From the One Morgan initiatives, we've talked about £6m to £8m of annualised benefits. Those will be coming through in full year impact from next year onwards. But we're beginning to see the benefits of those in 2013, particularly as we go into the second half of the year.

Q: And looking at sales and profit. Can you give us any idea of the benefits expected here?

A: From a sales perspective, it's always quite difficult to put a precise number on the revenue synergies as we see them. We would expect there to be a step-up in our levels of growth from 2014 onwards. It's quite difficult to put a number on that because it will also depend on the market environment that we're in at the time. It's quite straightforward to be able to pin down the precise cost numbers. Revenues, I would say it's more a medium to long term view but we are optimistic that there will be some further revenue growth on the back of what we've done with One Morgan.

M&A

Q: As One Morgan is rolled out, have you identified any non-core businesses in any areas? Can we expect any disposals?

A: I think it's worthwhile to put this in the context of where Morgan has come from over the last several years. We've really been on a journey of simplifying the portfolio and growing the business at the same time. So our revenues and profits have grown, but actually our footprint, in terms of the number of sites, has more than halved over that period and you should expect to see that trend continue.

We want to focus on secular growth markets where we have real differentiation, where we're doing thing that very few other people in the world can do, but also doing it from fewer, larger, more efficient sites.

Q: And given that focus on growth areas, are you planning any acquisitions in the coming months?

A: As with the direction that we've taken with simplifying the business, we're continuing to look at organic growth and growth through acquisitions. If we can find the right businesses with the right technologies in those growth markets that we're focusing on, then we are very open to the idea of acquisitions. It's always quite difficult to put a timeframe on those. It depends a little bit about finding a business that is a good fit, at the right price. We continue to look very proactively on that front.

Q: One of your competitors, Ceramtec was recently sold into private equity for a very high price and late last year, another competitor, Ceradyne was sold to 3M again for a very attractive multiple. What do you make of this market consolidation and are you concerned that Morgan Advanced Materials is a target, given the availability of cheap finance?

A: I actually see that as a very positive trend. If you see businesses like 3M and sensible private equity investors looking to the advanced material space and saying we want to make strategic investments there, that actually gives me comfort about the long-term attractiveness of the sort of businesses that we're in. So I feel good about that. It indicates that we are in a market that is attractive and that's where you want to be.

Outlook

Q: What update can you give us on research and development? Is there a new superwool in the pipeline?

A: We're an advanced materials business, so R&D is absolutely the beating heart of everything that we do. In the first half of this year, we've increased our investment again in R&D and specifically, we're looking to target it at some of those attractive end markets, so markets like healthcare and aerospace and also to make sure that we've got high quality technical application engineering resource in markets such as China, India, Singapore etc. And you should expect that trend of increasing spend to continue as we look out over the next several months and beyond.

Q: You're lowering your dependence on commoditised products, but at the same time, you're increasingly switching to lower cost locations. So are you confident that you can maintain the quality and sophistication of your bespoke solutions?

A: I think that's a really good question. At the heart of what we do is sophisticated material science and then putting that together with application engineering. The material science aspect of what we do, we keep the capability of that, the IP of that, in the Western world. When we're looking to use low cost manufacturing, it's typically for the downstream part of the process which is really about the assembly side of things. And we think if we get that right balance we'd protect our IP, but at the same time we'd get the benefits of lower cost manufacturing.

Q: And as we look to the rest of the year, what are your expectations for the second half?

A: Our expectations for the second half, they remain very much focused on what we can do to improve the businesses. It's about self-help again. We don't expect the market environment to be fundamentally different to that which we saw in the first half. We have had a positive book-to-bill in the first six months of this year and so we think that that gives us some potential for a modest increase in revenue in the second half.

But really it's about driving those cost improvements through on the back of the One Morgan program. We think that that should mean that the second half profits and the second half margins have the potential to be above those that we saw in the first half of this year.