# FINANCIAL REVIEW

## Review of Results

Johnson Matthey's turnover fell by 10% to £4.3 billion in the year to 31st March 2003 reflecting significantly lower prices for palladium and rhodium and the lower level of trading activity in those metals. Sales excluding the value of precious metals rose by 6% to £1.2 billion. Operating profit before exceptional items and goodwill amortisation also rose by 6% to £205.7 million. With over 40% of the group's profits earned in North America, the weaker US dollar adversely affected exchange translation. At constant exchange rates group operating profit would have risen by 12%.

Divisional results are discussed in the Chief Executive's Statement on pages 4 to 7, and in the individual divisional reports on pages 12 to 21.

The group's interest charge increased by £7.1 million as a result of higher average borrowings, particularly following the acquisition of Synetix in the second half of the year. Profit before tax, exceptional items and goodwill amortisation increased by 3% to £192.5 million. Earnings per share before exceptional items and goodwill amortisation rose by 4% to 62.6 pence. After exceptional items and goodwill amortisation earnings per share rose by 15% to 56.2 pence.

The board is recommending to shareholders a final dividend of 17.7 pence, making a total dividend for the year of 25.5 pence, an increase of 4%. The dividend would be covered 2.5 times by earnings before exceptional items and goodwill amortisation.

### Sales and Margins

Johnson Matthey's turnover is heavily impacted by the high value of precious metals sold by the group particularly in the Precious Metals Division (PMD). The total value of sales each year varies according to the mix of metals sold and level of trading activity. The value of the precious metals included in sales is generally separately invoiced and payment made within a few days. Consequently, although return on sales (operating profit / total external sales) for the precious metals businesses is low, return on investment is high.

To provide a more useful measure of return on sales, the adjacent table shows sales by division excluding the value of precious metals. Total sales excluding precious metals were £1,159 million which was 6% up on last year and return on sales averaged 17.7% which was the same as 2001/02. The group's target for each of its divisions is to achieve a return on sales excluding precious metals in excess of 10%. All four divisions were ahead of that target in 2002/03.

Catalysts achieved 9% growth in sales excluding precious metals with Synetix contributing £60.9 million of the total. Adverse exchange translation reduced the division's sales by £33.8 million compared with 2001/02. At constant currency rates, and excluding Synetix, sales were 5% up. Margins were very slightly better than prior year at 16.0%.

PMD's sales excluding precious metals were down 8% reflecting the impact of lower metal prices on commission income and reduced trading volumes for palladium and rhodium. Margins were also down at 38.0%.

| | Sales excluding Precious Metals | | Return on sales | |
|---|---|---|---|---|
| | 2003 £ million | 2002 £ million | 2003 % | 2002 % |
| Catalysts | 652 | 597 | 16.0 | 15.9 |
| Precious Metals | 132 | 143 | 38.0 | 39.1 |
| Colours & Coatings | 253 | 251 | 11.3 | 10.2 |
| Pharmaceutical Materials | 122 | 101 | 30.3 | 30.9 |
| Discontinued | – | 1 | – | n/m |
| | 1,159 | 1,093 | 17.7 | 17.7 |

Colours & Coatings' sales grew by 1% and margins improved by 1.1% reflecting the benefits of the rationalisation programme undertaken in the year to reduce costs. Pharmaceutical Materials' sales grew by 20% with a full year's contribution from Macfarlan Smith and good growth in all parts of the division. Margins remained just over 30%.

### Return on Investment

We set a target of 20% for the pre-tax return on assets (ROA) for all our businesses. For the group as a whole ROA was 17.3% (see pages 74 and 75) compared with 22.2% in 2001/02. The decline in the overall return reflects the more difficult trading conditions experienced in the year and the impact of the acquisitions made which are expected to take a few years to meet the group's target.

On a post tax basis the return on invested capital was 12.2% which was well above the estimated weighted average cost of capital (WACC) for the group of 8%. The margin above the cost of capital for the year was 4.2%, which was below last year's figure of 6.6% but still satisfactory.

### Exceptional Items and Goodwill Amortisation

Exceptional items included in operating profit gave rise to a net charge of £7.6 million. The main item was a £6.5 million charge for integrating Synetix into Johnson Matthey following its acquisition from ICI on 1st November 2002. The integration costs include a provision to cover the costs of exiting from a site at Hunwick, IT integration costs and other restructuring charges.

The group made an exceptional gain of £5.1 million on the sale of its remaining unhedged palladium stock. This was offset by a charge of £4.8 million to reduce costs in the Catalysts Division for those parts of the business which are adversely affected by weak market demand. This rationalisation will reduce headcount by over 250, mainly in the US.

A restructuring charge of £1.4 million was incurred following the merger of Johnson Matthey's Australian gold refining business with AGR to form AGR Matthey in which the group has retained a 20% stake. The formation of AGR Matthey also gave rise to a loss on disposal of £6.0 million, of which £5.4 million is related to historic goodwill which had already been written off to reserves.

On 8th November 2002 Johnson Matthey announced that Anglo Platinum had taken a 17.5% stake in its fuel cell components subsidiary, Johnson Matthey Fuel Cells Limited. Anglo Platinum has contributed its share of the intellectual property rights and know-how jointly developed under the agreement announced in May 1993. In addition, Anglo Platinum paid £20 million, which has resulted in an exceptional gain of £10.9 million.

After including tax credits of £2.0 million, the total impact of exceptional items on earnings was a small net cost of £0.7 million.

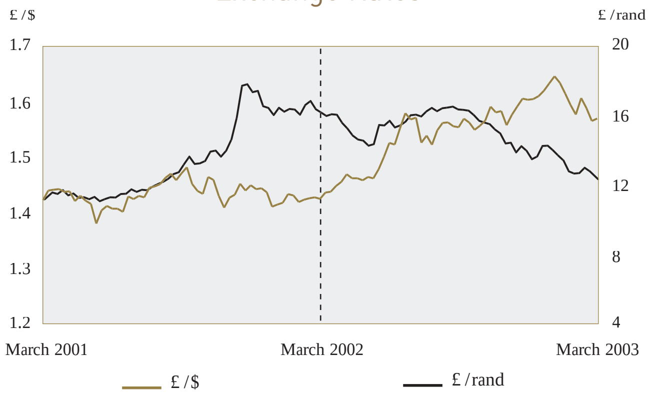
Goodwill amortisation rose by £6.9 million to £13.7 million. Goodwill on the acquisition of Synetix amounted to £191.4 million and the amortisation for Johnson Matthey's five months period of ownership was £4.0 million.

## Interest

The group's interest charge rose by £7.1 million to £13.2 million. The increase reflected higher average borrowings as a result of the acquisitions undertaken part way through 2001/02 and the acquisition of Synetix on 1st November 2002. Interest on gold and silver leases fell to £1.2 million from £3.5 million in 2001/02 when lease rates, particularly for silver, had been unusually high. Lease costs for platinum were high throughout 2002/03 reflecting strong levels of demand for the metal during the year.

Interest cover for the group was high at 15.6 times. On a pro-forma basis, including Synetix for a full year, interest cover would have been between 9 and 10 times, which would still be very comfortable.

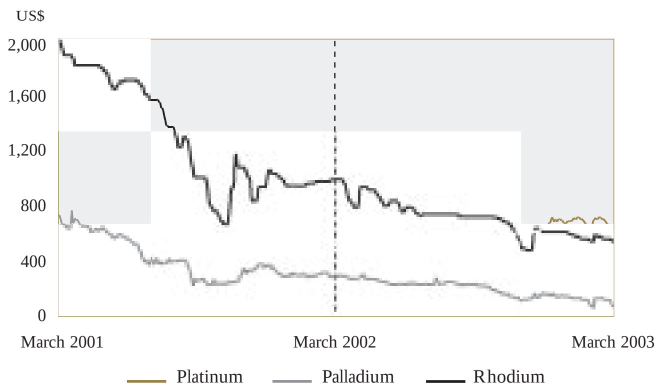
## Exchange Rates




Exchange translation reduced group profits by £10.0 million compared with last year. About £7.1 million of this fall related to the US dollar where the average rate against sterling fell by 8% from \$1.43/£ to \$1.55/£.

Another £2.5 million of the exchange impact related to the South African rand whose value against sterling showed significant variation over the year. The average rate for the rand was R14.96/£ compared with R13.70/£ in 2001/02. The products which the group manufactures in South Africa are generally for export and the group was able to achieve higher prices in rand, which largely compensated for this adverse translation effect.

## Platinum Group Metal Prices




## Taxation

The group's tax charge increased by £4.3 million to £54.5 million. Most of the increase related to lower tax credits on exceptional items. Before exceptional items and goodwill amortisation the group's average tax rate fell slightly from 29.9% to 29.7%.

## Cash Flow

Johnson Matthey's net cash inflow from operations was £229.9 million which was 3% up on last year. Capital expenditure was £7.3 million lower than last year at £126.5 million and represented 2.3 times depreciation. With the slowdown in some of the markets in which the group operates we are planning to spend at a lower rate in 2003/04 although still maintaining investment to support future growth opportunities. As a consequence of the continued high level of capital expenditure in 2002/03, free cash flow for the group (before acquisitions and divestments) was slightly negative at £4.5 million.

The group spent £267.0 million on the acquisition of Synetix (including costs) and £2.8 million on Cascade Biochem Limited. The group received £20.0 million from Anglo Platinum in part payment for its stake in Johnson Matthey Fuel Cells Limited. Including acquisitions, divestments and shares issued the group had a net cash outflow for the year of £250.5 million.

After taking into account favourable exchange translation on the group's US dollar borrowings, net borrowings increased by £243.5 million to £402.5 million. Johnson Matthey's balance sheet remains strong with shareholders' funds rising by £81.9 million to £895.6 million and gearing (net borrowings / shareholders' funds and minority interests) of 44%.

## Pensions

For the financial year ended 31st March 2003 the group has adopted the transitional arrangements for reporting under FRS 17 (the new accounting standard on retirement benefits). Under these arrangements the surplus or deficit arising on each of the group's main pension funds calculated in accordance with FRS 17 is shown as a note on the accounts.

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The group's UK defined benefit pension funds have a significant proportion of their assets invested in equities. In the year to 31st March 2003 the FTSE All Share index fell by 32% and the surplus on the group's funds was significantly reduced. Nevertheless the group's UK schemes still showed a small surplus at 31st March 2003 of £6.3 million. Worldwide, including provisions for the group's post-retirement healthcare schemes and pension related deferred tax assets and liabilities, the group had a net liability for retirement benefits of £19.2 million at 31st March 2003.

The effect that FRS 17 would have had on the profit and loss account for the financial year 2002/03 is shown in note 10c. The net effect would have been a reduction in profit before tax of £2.6 million. The board of Johnson Matthey has taken the decision to adopt FRS 17 in full for the financial year 2003/04.

### Financing

The group financed the acquisition of Synetix on 1st November 2002 out of additional borrowings. Initially this was done using bank facilities. Most of this additional debt was refinanced on 26th March 2003 with the proceeds of a long term private placement bond issue. The issue included a range of maturities, from 7 to 12 years, and comprised £40 million in sterling bonds and $230 million in US dollar bonds. Some $65 million of the dollar bonds were swapped into sterling to raise a total of £81.1 million of fixed rate sterling with an average maturity of just under 10 years at an average interest cost (including fees) of 5.15%. The remaining $165 million of bonds issued had a 12 year maturity and a fixed rate interest cost in dollars (including fees) of 4.98%. This part of the issue was swapped into floating rate dollars to provide attractively priced variable rate debt.

Following the bond issue, at 31st March 2003 the maturity profile of the group's debt was as follows:

| Borrowings and Finance Leases | 31st March 2003 £ million | % | 31st March 2002 £ million | % |
|---|---|---|---|---|
| Over 10 years | 126.6 | 25 | – | – |
| Five to ten years | 67.5 | 14 | 9.2 | 4 |
| Two to five years | 151.1 | 30 | 176.3 | 70 |
| One to two years | 111.2 | 22 | 0.3 | – |
| Within one year | 46.5 | 9 | 65.8 | 26 |
| Gross borrowings | 502.9 | 100 | 251.6 | 100 |
| Less: Cash and deposits | 100.4 | | 92.6 | |
| Net borrowings | 402.5 | | 159.0 | |

## Financial Risk Management

The group uses financial instruments, in particular forward currency contracts and currency swaps, to manage the financial risks associated with the group's underlying business activities and the financing of those activities. The group does not undertake any trading activity in financial instruments. Our Treasury department is run as a service centre rather than a profit centre.

### Interest Rate Risk

At 31st March 2003 the group had net borrowings of £402.5 million. Some 37% of this debt is at fixed rates with an average interest rate of 5.7%. The remaining 63% of the group's net borrowings is funded on a floating rate basis. A 1% change in all interest rates would have a 1.4% impact on group profit before tax. This is within the range the board regards as acceptable.

### Liquidity Policy

The group's policy on funding capacity is to ensure that we always have sufficient long term funding and committed bank facilities in place to meet foreseeable peak borrowing requirements. At 31st March 2003 the group had committed bank facilities of £405 million. Borrowings drawn under these facilities amounted to £195.5 million. The group also has a number of uncommitted facilities and overdraft lines.

### Foreign Currency Risk

Johnson Matthey's operations are global in nature with the majority of the group's operating profits earned outside the UK. The group has operations in 34 countries with the largest single investment being in the USA. In order to protect the group's sterling balance sheet and reduce cash flow risk, the group finances most of its US investment by US dollar borrowings. Although most of this funding is obtained by directly borrowing US dollars, some is achieved by using currency swaps to reduce costs and credit exposure. The group also uses local currency borrowings to fund its operations in other countries (see page 61).

The group uses forward exchange contracts to hedge foreign exchange exposures arising on forecast receipts and payments in foreign currencies. Currency options are occasionally used to hedge foreign exchange exposures, usually when the forecast receipt or payment amounts are uncertain. Details of the contracts outstanding on 31st March 2003 are shown on page 63.

### Precious Metal Prices

Fluctuations in precious metal prices can have a significant impact on Johnson Matthey's financial results. Our policy for all our manufacturing businesses is to limit this exposure by hedging against future price changes where such hedging can be done at acceptable cost. The group does not take material exposures on metal trading.

All the group's stocks of gold and silver are fully hedged by leasing or forward sales. Currently the majority of the group's platinum stocks are unhedged because of the lack of liquidity in the platinum market.

John Sheldrick

John Sheldrick
Group Finance Director