

Financial Review



John Sheldrick
Group Finance Director

“Johnson Matthey’s balance sheet remains strong with shareholders’ funds rising by £74.9 million to £862.2 million and gearing of 45%.”

Review of Results Total sales for the financial year ending 31st March 2004 rose by 4% to £4.5 billion. Sales excluding the value of precious metals rose by 6% to £1.2 billion.

Operating profit before exceptional items and goodwill amortisation increased by 9% to £206.0 million, despite the effects of adverse exchange translation. The group has adopted FRS 17, the new accounting standard for pensions, and last year’s results have been restated accordingly. Divisional results are discussed in the Chief Executive’s Statement on pages 4 to 7, and in the individual divisional reports on pages 16 to 23.

Interest also rose, partly reflecting higher average borrowings following the acquisition of Syntex, but also as a consequence of the change to FRS 17 and the reduction in pension fund surplus at 31st March 2003. Profit before tax, exceptional items and goodwill amortisation rose by 3% to £195.7 million.

Earnings per share before exceptional items and goodwill amortisation increased by 4% to 64.0 pence.

Exceptional items gave rise to a net credit of £2.1 million before tax, compared with a £2.7 million charge last year. Goodwill amortisation increased by £6.1 million to £19.8 million reflecting the full year’s ownership of Syntex which was acquired in November 2002. After exceptional items and goodwill amortisation, profit before tax rose by 3% to £178.0 million. Earnings per share on the same basis increased by 1% to 56.0 pence.

The board is recommending to shareholders a final dividend of 18.2 pence, making a total dividend for the year of 26.4 pence, an increase of 4%. The proposed dividend would be covered 2.4 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.

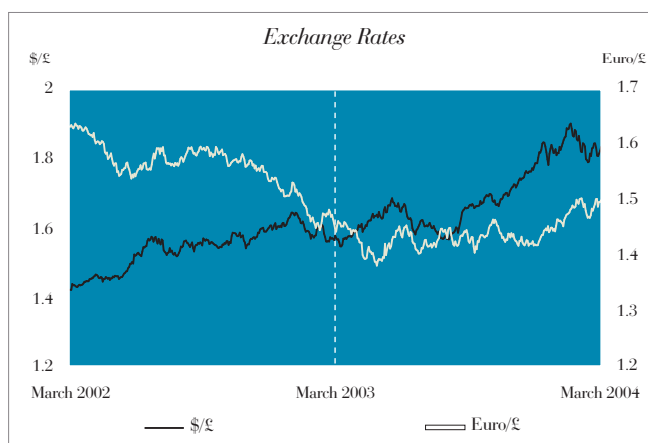
To provide a more useful measure of return on sales, the adjacent table shows sales by division excluding the value of precious metals. Total sales excluding precious metals were £1,224 million which was 6% up on last year and return on these sales averaged 16.8% which was 0.5% up on 2002/03 (restated for FRS 17). 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 2003/04.

Catalysts achieved 10% growth in sales excluding precious metals benefiting from a full year’s ownership of former Syntex businesses. A significant proportion of the division’s operations are located in the USA, and both sales and profits were adversely affected by exchange translation as a result of the decline in value of the US dollar. Margins improved, benefiting from sales of new, technologically advanced products.

PMD’s sales excluding precious metals were down 9% reflecting subdued trading conditions for palladium and rhodium for most of the year and the impact of the renewed contracts with Anglo Platinum in the final quarter.

Colours & Coatings’ sales were very similar to last year but margins improved as a result of good growth in our glass coatings business, which has higher margins than other parts of the division.

Pharmaceutical Materials achieved 8% growth in sales excluding precious metals, despite adverse exchange translation, with good growth in sales of platinum anticancer compounds and opiates. Margins improved at our Edinburgh based business, Macfarlan Smith, as a result of increased sales of high margin specialist opiates.



	Sales excluding precious metals		Return on sales excluding precious metals	
	2004	2003	2004	2003 restated
	£ million	£ million	%	%
Catalysts	720	652	15.2	14.6
Precious Metals	121	132	36.7	36.4
Colours & Coatings	252	253	10.6	10.0
Pharmaceutical Materials	131	122	32.2	30.1
	1,224	1,159	16.8	16.3

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 16.2% (see pages 70 and 71) compared with 16.8% in 2002/03. The decline in the overall return reflects the impact of the acquisition of Syntex which is expected to take a few years to meet the group's target.

On a post tax basis the return on invested capital was 11.4% which was 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 3.4%, which was below last year's restated figure of 3.8% but still satisfactory.

Exceptional Items and Goodwill Amortisation

Exceptional items included in operating profit gave rise to a net credit of £2.1 million.

The group benefited by £14.8 million from the settlement of litigation with Research Corporation and Research Corporation Technologies, Inc. relating to royalties earned under a licence agreement with Bristol-Myers Squibb Company in respect of carboplatin.

This exceptional credit was partly offset by a charge of £12.7 million for the rationalisation of Catalysts Division. The rationalisation costs relate to the reorganisation of PCT's pgm refining business and the phasing out of ECT's older autocatalyst process technology now that precision coating technology has been fully installed across the group. This rationalisation is expected to improve the division's profits by £8 million in 2005/06.

Goodwill amortisation increased by £6.1 million to £19.8 million, reflecting the full year's ownership of the former Syntex businesses, which were acquired in November 2002.

Interest The group's net interest charge rose by £3.1 million to £16.3 million as a result of the increase in average net borrowings following the acquisition of Syntex. The average interest rate was lower than last year benefiting from lower US dollar interest rates and reduced rates on gold leases.

The group has adopted FRS 17, the new accounting standard for pensions. Under FRS 17 the net return on retirement benefits assets and liabilities fell by £7.9 million to £6.0 million. The drop reflected the fall in the value of the pension fund surplus in 2002/03 as measured on 31st March 2003, when the world equity markets were particularly depressed. Equity markets recovered somewhat in 2003/04 and the group's UK pension fund surplus has increased. The net return on retirement benefits assets and liabilities is likely to be roughly £3 million higher in 2004/05.

Exchange Rates Over a third of the group's profits were made in North America, mainly in the USA. The average rate for the US dollar weakened significantly, from \$1.55/£ in 2002/03 to \$1.69/£ in 2003/04, which reduced reported group profit before tax by £6.7 million.

The group has significant operations in several euro-zone countries and in South Africa whose currencies have strengthened against sterling. The group benefited by £2.4 million from the translation of profits made in euros, of which £1.7 million related to Colours & Coatings, but the euro's strength also had a negative impact on demand for that division's products. The overall impact of the appreciation of the South African rand was negative. The products the group manufactures in South Africa are generally for export with pricing mainly related to euros and US dollars, whereas costs are in rands, and margins were adversely affected by currency movements.

Financial Review *(continued)*

Taxation The group's tax charge increased by £4.2 million to £57.9 million. The increase largely reflected higher profits. The group's average tax rate on profit before tax, exceptional items and goodwill amortisation rose slightly from 29.7% to 29.8%.

Cash Flow Johnson Matthey's net cash flow from operations increased by 13% to £259.7 million. Capital expenditure was £13.4 million lower than prior year at £113.1 million and represented 1.8 times depreciation. We are planning to spend at a lower rate in 2004/05 although still maintaining investment to support future growth opportunities. Free cash flow for the group (after dividends, but before acquisitions and share purchases) was strong at £29.9 million.

The group spent £18.4 million on acquisitions (mainly AMC) and made a net purchase of shares (for the employee share ownership trusts) which cost £8.5 million, leaving a net cash inflow of £3.0 million.

After taking into account favourable exchange translation of £6.1 million on the group's foreign currency borrowings (mainly US dollars), and £1.1 million of loan notes issued to acquire subsidiaries, net borrowings fell by £8.0 million to £394.5 million. Johnson Matthey's balance sheet remains strong with shareholders' funds rising by £74.9 million to £862.2 million and gearing (net borrowings / shareholders' funds and minority interests) of 45%. The comparative figures for last year have been restated for FRS 17 and UITF 38, under which shares held in employee share ownership trusts are accounted for in the same way as treasury shares. Restated for these new accounting standards, last year's gearing was 50%.

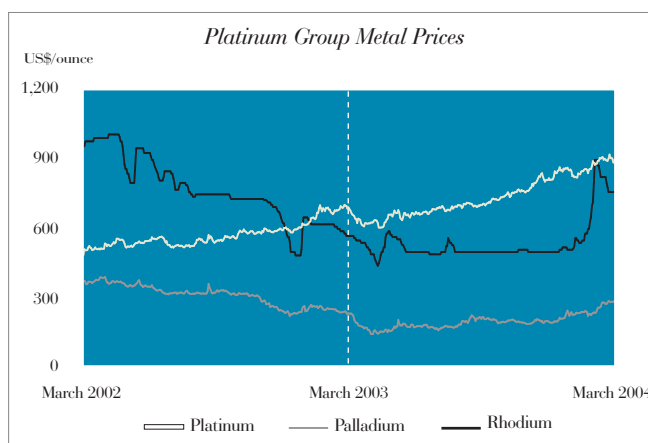
Pensions For the financial year 2003/04 the group has adopted FRS 17, and the figures for 2002/03 have been restated accordingly. The value of the assets in the group's pension funds increased significantly in 2003/04, partly reflecting the recovery in equity prices from their depressed levels at 31st March 2003. The surplus on the group's UK schemes increased by £42.6 million to £43.3 million at 31st March 2004 after taking into account the results of the triennial actuarial revaluation (see page 51).

Worldwide, including provisions for the group's post-retirement healthcare schemes and pension related deferred tax assets and liabilities, the group had a net surplus of £3.5 million on retirement benefits net assets compared with a net deficit of £25.4 million at 31st March 2003.

Financing The group financed the acquisition of Syntex 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.

At 31st March 2004 the maturity profile of the group's debt was as follows:

Borrowings and Finance Leases	31st March 2004		31st March 2003	
	£ million	%	£ million	%
Over ten years	111.3	22	126.6	25
Five to ten years	66.6	13	67.5	14
Two to five years	210.9	42	151.1	30
One to two years	65.7	13	111.2	22
Within one year	46.5	10	46.5	9
Gross borrowings	501.0	100	502.9	100
Less: cash and deposits	106.5		100.4	
Net borrowings	394.5		402.5	



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 2004 the group had net borrowings of £394.5 million. Some 35% of this debt is at fixed rates with an average interest rate of 5.6%. The remaining 65% of the group's net borrowings are 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. The group has committed bank facilities of £280 million. Borrowings drawn under these facilities at 31st March 2004 amounted to £219.8 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 59).

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 2004 are shown on page 61.

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
Group Finance Director