



David Gawler

Whilst the group's underlying operating profit, before exceptional items and amortisation of goodwill, for the year ended 31 December 2001 of £37.2 million was down on last year, second half underlying operating profit was £23.1 million, 64% up on the first half. The Air and Gas Handling ("Howden") and Specialised Engineering divisions, both of which reported operating losses in the first half, successfully generated profits sufficient in the second half for both divisions to record an underlying operating profit for the full year. The Welding and Cutting business ("Esab"), which generated operating profits of £35.7 million, improved its performance in Europe and Asia but experienced difficult trading conditions, particularly in the second half, in its key markets in North America where already fragile business confidence was dented further by the terrorist attacks in September.

Following the group wide strategic and operational reviews initiated in 2001 to improve future profitability and cash flow, it was decided to close a number of plants in both Esab and Howden to remove excess manufacturing capacity. The headquarters of Esab at Atlanta in the USA has been closed and the management of Esab has commenced rationalising parts of the supply chain and reorganising its European sales companies. The functions at Charter's head office in London have been subjected to a comprehensive reassessment to improve both efficiency and cost effectiveness. Financial controls are being further strengthened across the group.

Inevitably these initiatives to streamline the group have resulted in significant exceptional costs in 2001. Although far more modest in scale, further limited exceptional costs are anticipated in 2002 which will include the completion of the reorganisation of Esab's European sales companies. These restructuring initiatives will increasingly benefit profits in 2002 and future years.

Group results

In the year ended 31 December 2001 turnover from continuing businesses increased by 3.0% to £961.8 million. The underlying operating profit, before exceptional items and amortisation of goodwill, for the year was £37.2 million (2000: £47.8 million). After amortisation of goodwill of £1.1 million (2000: £1.0 million) and an ordinary interest charge of £18.3 million (2000: £16.4 million), profit before tax before

exceptional items was £17.8 million (2000: £30.4 million).

After charging £42.5 million of exceptional costs (2000: exceptional profit of £3.8 million) and an exceptional gain of £4.4 million (2000: nil) on the termination of certain interest rate swap agreements, the group's loss on ordinary activities before tax amounted to £20.3 million (2000: profit of £34.2 million).

The group's ordinary tax charge was £5.0 million (2000: £7.9 million). The exceptional tax charge of £6.1 million (2000: nil) includes an amount in respect of prior year transactions, currently under discussion with local tax authorities. The loss for the financial year, after charging minority interests of £1.4 million (2000: £5.7 million), was £32.8 million (2000: profit of £20.6 million).

Underlying earnings per share amounted to 12.3 pence (2000: 18.9 pence) of which 9.2 pence was earned in the second half.

Cash flow and borrowings

The cash inflow from operating activities in the second half of the year was £37.3 million whereas there had been an outflow of £5.7 million in the first half making a total cash inflow for the ended 31 December 2001 of £31.6 million (2000: £44.5 million). Capital expenditure fell to £17.2 million from £21.8 million in 2000.

Over the year net debt rose slightly by £4.3 million to £214.1 million at 31 December 2001. However, net debt has been reduced by £24.8 million since 30 June 2001 and borrowings are targeted to be reduced further in 2002. Subsequent to the year end the group's multi-currency syndicated bank facilities of £150 million (2000: £175 million) were renewed.

Retirement benefits

At 31 December 2001, the group's balance sheet reflected a provision of £33.7 million in respect of unfunded pension liabilities. Under FRS 17 the group would have been required to make provision for the lesser net pension liability of £22.5 million. If the provision required by FRS17 had been incorporated in the consolidated balance sheet at 31 December 2001, net assets would have increased by £11.2 million.

In addition the group's estimated future overseas medical costs of £32.9 million are provided for in full in the group's balance sheet.

Dividends

In view of the policy adopted in March 2001 to set dividends in the light of earnings and

cash flow, the Board has decided not to declare a dividend for the year ended 31 December 2001.

Operating review

Underlying operating profit for the year was £37.2 million of which £14.1 million was earned in the first half and £23.1 million in the second half.

Welding and cutting products

For the year ended 31 December 2001, Esab's turnover was £621.5 million (2000: £632.4 million) and underlying operating profits were £35.7 million (2000: £43.9 million).

During 2001 Esab experienced significant regional variations in its markets and from differing fortunes in the industry sectors it serves. The European welding businesses, which account for just over half of Esab's turnover, produced an excellent performance with sales and underlying operating profits up 5% and 15% respectively. The European businesses benefited from strong demand, particularly in sectors such as shipyards and wind turbines, offset in part by sectors with lower demand.

Esab's Asian region doubled its operating profits over the prior year as a result of an excellent performance by Esab SeAH, the group's 50% associate, which is an important supplier to the shipbuilding industry and other key sectors in South Korea.

By contrast, the results of both the North and South American regions, which together generate some 40% of Esab's sales of welding products, suffered from the deteriorating economic environment in these markets. In North America, the recessionary trading conditions, which prevailed for much of the year, were exacerbated by the 11 September terrorist attacks. The South American businesses endured the near collapse of the Argentinean economy and the resultant repercussions in Brazil and other neighbouring countries. In the Americas, several key customers postponed major capital projects or sought significant price reductions. As a result of these circumstances, in the North and South American regions, sales overall declined by 8% and operating profits were half of those achieved in 2000.

In Esab's relatively small cutting systems business, overall sales declined by some 10% and operating profits fell to a quarter of that achieved in 2000. Demand for cutting equipment from shipyards and certain other

sectors held up well in Europe, but was lower in North America.

The group structure of Esab and its management have been reorganised to enhance operational efficiencies and customer focus. The challenge for the year ahead is to generate profitable sales growth and, in this regard, the nature and timing of a recovery in the markets in the Americas will be significant.

Air and gas handling

At Howden, turnover for the year increased by 10.6% to £283.8 million. Underlying operating profits for the second half of 2001 were £9.1 million, which reflects a substantial improvement, over the first half loss of £1.9 million. The total underlying operating profit for the year was £7.2 million (2000: £13.1 million).

Approximately half of Howden's global sales are to the power generation industry. In North America, where environmental control legislation requires power stations to reduce nitrogen oxide emissions, the use of a selective catalytic reduction ("SCR") process to reduce emissions results in a requirement for upgraded fans and air pre-heaters. Accordingly, during the year, this sector continued to show significant growth in terms of sales of custom engineered equipment. However, profits were affected by a cost overrun on a major project in the United States. Operating procedures have now been strengthened to reduce the risk of similar cost overruns arising in the future. The results for the year also suffered from the deferment of profitable planned repairs and maintenance work in the United States power industry. The medium to long term outlook for the power sector is also encouraging given that a number of new coal-fired power stations are being planned in the United States as the gas supply infrastructure reaches capacity. This should benefit Howden given an increase in the requirement for fans, air pre-heaters and gas to gas heat exchangers.

The general industrial market has been affected by the slow down in the world economy and Howden's markets in Europe, South Africa and North America remain weak and flat. The commercial HVAC (heating, ventilation and air-conditioning) market in the United States declined following general lay offs as the economy faltered. The outturn for the year also recognised the losses incurred at the new commercial fan facility in South Carolina, that was commissioned towards the end of 1999.

VSH Systems, which served the tunnel and metro ventilation markets outside France, and Howden's commercial HVAC business in Australia incurred operating losses for the year totalling £2.7 million. The closure of these businesses was announced in August 2001 and largely accomplished by the year end.

In the North American power sector, the repair and maintenance market was showing signs of recovery in the second half and the prospects in the new build markets in the

medium term are encouraging. Howden's order book at 31 December 2001 increased to £124 million (2000: £116 million), 7% ahead of last year. It is envisaged that profit generation in 2002 is expected to be weighted more heavily towards the second half.

Specialised engineering

Turnover for the year increased by 25.8% to £56.5 million and the division successfully returned to profitability with full year underlying operating profits for 2001 of £2.9 million (2000: loss of £1.6 million) of which £3.1 million were earned in the second half compared with a loss in the first half of £0.2 million.

As envisaged at the time of the interim report, the North American aerospace and defence businesses, which account for 60% of this division's turnover, returned to overall profitability following the successful resolution of contractual problems which had beset certain design and build programmes at Western Design in recent years.

Market conditions were depressed for much of the year for the two food equipment manufacturing businesses, both of which are based in the United States, but improved in the last quarter. One of these companies, Solbern, was sold to its management on 21 February 2002.

HD Engineering in Hong Kong improved its operating profits despite weakening market conditions.

Specialised engineering's order book totalled £35 million at the year end, reflecting an increase of 30% over the previous year.

Central costs

Central costs amounted to £8.6 million in 2001 compared with £7.6 million in 2000. However the costs in 2000 were after offsetting some £1.4 million of one-off credits in respect of investment income and the release of a provision. In 2001, expenditure was incurred on a major upgrade of the worldwide management information system, which will be completed in 2002.

Central costs are expected to fall by £2 million in 2002 following the restructuring of the group's head office in London.

Exceptional costs

Exceptional costs totalled £42.5 million of which £32.1 million arose from restructuring costs, £2.6 million from litigation and warranty costs and the balance of £7.8 million from discontinued and discontinuing operations.

Welding and cutting products

During the year the exceptional costs of restructuring Esab totalled £24.8 million. Specific restructuring steps taken include:

- The global headquarters of Esab at Atlanta in the United States was closed in August 2001 and management responsibility transferred to Europe.
- An ongoing reorganisation of sales companies has been initiated together with a rationalisation of the supply chain and the introduction of an integrated planning process across Europe. This entails the

merger of sales offices, the consolidation in Central Europe of six local warehouses into one regional distribution centre and the implementation of a daily pan-European transport network. The completion of this reorganisation will result in further limited exceptional costs in 2002.

- Esab's European capacity for the manufacture of flux cored wire is being rationalised and phased closures were announced last year at Utrecht in Holland and at Waltham Cross in the United Kingdom. Production of flux cored wire is being transferred from these two plants to Vamberk in the Czech Republic to achieve greater cost efficiencies and to locate production nearer to the growing markets in Eastern Europe. This will be implemented over a two to three year period.

- The plant at Chascamou in Argentina and part of the facility at Mesero in Italy have been closed. Plant closures have been announced at Niagara Falls in North America and at the equipment manufacturing factory in Thailand and these closures will be accomplished during the first half of 2002.

- Other initiatives include the relocation of the manufacture of certain types of welding equipment from Sweden and North America to Poland, Brazil and Mexico in order to benefit from proximity to markets and lower costs.

These measures resulted in a head count reduction at Esab of some 300 in the year, with a further reduction of just over 100 to follow in 2002. These restructuring initiatives will increasingly benefit profits in 2002 and future years.

Air and gas handling

During the year the exceptional costs of restructuring Howden totalled £4.7 million. Specific restructuring steps taken include:

- The plant at Cambridge, Ontario in Canada was closed in September 2001 after a six-week strike and production was transferred, without interruption, to other plants in North America.

- Two businesses which had incurred losses for a number of years, VSH tunnel and metro systems in Holland and the Australian commercial HVAC business in Sydney, were closed. Future business in the tunnel systems sector will be undertaken by the Voith Howden operation in Germany.

These measures and other restructuring initiatives involved a head count reduction at Howden of 250 in the year and are expected to result in improved profits in 2002.

The full year's exceptional charge of £2.6 million for litigation and warranty costs has been reduced from £4.2 million as reported at the half year following the settlement of a claim.

Central operations

During the year, the group's corporate head office in London has been reorganised resulting in restructuring costs of £2.6 million. As explained in the interim report, this exceptional item principally related to the departure of former executive directors.

Discontinued operations

Losses on discontinued and discontinuing operations totalled £7.8 million, the principal item of which is a provision of £4.1 million arising on the disposal of Solbern. The balance relates to costs incurred in respect of businesses closed or sold in prior years.

The provision of £4.1 million on the disposal of Solbern is in respect of the diminution in the value of goodwill on its acquisition, previously written off to reserves. This charge to the profit and loss account has no overall effect on shareholders' funds.

Board

David Eilbeck, who joined the group in 1992 as chief accountant, was appointed Finance Director on 30 June 2001 in succession to Nigel Robson who resigned as a director.

Neil Johnson and Martin Taylor are retiring as non-executive directors at the conclusion of the forthcoming annual general meeting to be held on 24 April 2002 and I should like to thank them for their contribution over many years.

James Bruce, Michael Foster and Homi Mullan joined the board as non-executive directors on 14 December 2001. It is proposed that, following the annual general meeting Homi Mullan will succeed Martin Taylor as Deputy Chairman and senior independent non-executive director.

The new non-executive directors, together with John Neill, will individually and collectively bring a broad range of international, financial and commercial expertise to Charter and I am sure that their counsel and experience will prove invaluable.

Prospects

Progress has been made in rebuilding the necessary confidence in our businesses and securing the trust of our customers. I am confident that the initiatives taken in restructuring the group's activities, closing loss-making businesses and reducing the ongoing cost base will provide a more stable platform for profitable growth and enhanced cash flow in the future. The prospects for 2002 will, to an extent, be dependent on the prevailing economic climate, particularly in the Americas, but on balance further steady progress should be made in the year ahead.

David Gawler

Chairman & Chief Executive
4 March 2002