Financial review

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Results for the year

In the year ended 31 December 2005, revenue increased by 22.4 per cent to £1,065.7 million (2004: £870.4 million). Operating profit (before exceptional items) was £97.5 million (2004: £54.9 million). In 2005, there was exceptional income of £4.2 million (2004: pre-tax exceptional losses of £3.0 million).

The profit for the year attributable to equity shareholders was £74.0 million (2004: £29.8 million).

Headline earnings per share were 46.9 pence (2004: 20.9 pence), an increase of 124.4 per cent.

Exceptional items

In order to provide shareholders with a better indication of Charter's underlying business performance, items that are both material and non-recurring have been highlighted and described as exceptional items within the relevant income or expenditure categories.

Exceptional items are set out below.

	2005 £m	2004 £m
Restructuring costs	–	(12.8)
Recovery of unauthorised payments	**4.2**	0.5
Legal and environmental costs	–	(1.9)
Disposal of assets and business	–	11.2
Total exceptional items before tax	**4.2**	(3.0)
Tax credit on exceptional items	–	0.5
Exceptional tax credit	–	6.6
Total exceptional items after tax	**4.2**	4.1

In the year ended 31 December 2005, there was exceptional income of £4.2 million, arising from the settlement of an action brought against City Index in respect of losses incurred as a consequence of certain unauthorised payments having been made by a former employee. The proceeds of the settlement, earlier recoveries from the Company's insurers and realisation of the former employee's assets have resulted in a full recovery except for the £200,000 insurance deductible.

Tax

In 2005, the total tax charge was £20.0 million (2004: £11.5 million, excluding exceptional tax items), reflecting higher taxable profits but a lower effective tax rate.

Within the 2005 tax charge, there was an amount of £0.5 million (2004: £0.4 million tax credit) in relation to gains and losses on retranslation of intercompany loans.

The adjusted effective tax rate for the year on profit before exceptional items, gains or losses on retranslation of intercompany loans and share of post tax profits of associates was 21.4 per cent (2004: 27.4 per cent).

The reduction in the tax rate in the year was a consequence of increasing profits being generated in low tax jurisdictions such as China and Eastern Europe and the utilisation of brought forward tax losses not previously recognised.

Minority interests

The profit for the year attributable to minority interests was £9.5 million (2004: £6.8 million), made up as set out below.

	2005 £m	2004 £m
Minority share of profit for the year	**8.3**	6.8
Minority share of foreign exchange on intercompany loans	**1.4**	–
Tax thereon	**(0.2)**	–
	1.2	–
	9.5	6.8

As at 31 December 2005, the total equity attributable to minority interests reduced to £13.5 million (2004: £22.2 million).

Following the acquisition of the outstanding minority interest in the South American welding and cutting businesses in September 2005, the only remaining minority interests that are significant are the 30 per cent interest in Howden Hua Engineering Co Limited and the 45 per cent interest in Howden Africa Holdings Limited.

During 2005, the Company's share price increased from 232p to 560p. On this basis, shareholders who held their Charter shares throughout the year received a gross return of 141 per cent.

Balance sheet

During the year, total equity shareholders' funds increased to £135.1 million (2004: £11.5 million), an increase of £123.6 million. The principal components of this increase were the profit for the financial period attributable to Charter shareholders of £74.0 million, the net proceeds from the placing of new ordinary shares in April 2005 of £19.1 million and the shares issued to the vendors of the South American welding and cutting businesses with a value at the time of their issue of £21.2 million.

The following table shows a summary of the balance sheet.

	2005 £m	2004 £m
Non current assets (excluding retirement benefits assets)	**204.3**	167.7
Net current assets (excluding net debt and provisions)	**137.4**	125.0
Net retirement benefit obligations	**(127.1)**	(134.8)
Provisions	**(40.7)**	(40.2)
Other long-term liabilities (excluding net debt)	**(18.8)**	(17.7)
	155.1	100.0
Shareholders' funds	**135.1**	11.5
Minority interests	**13.5**	22.2
Net debt	**6.5**	66.3
	155.1	100.0

Retirement benefit obligations

The table below shows a summary of retirement benefit obligations.

	2005 £m	2004 £m
Total assets	**538.9**	486.1
Defined benefit liabilities	**(690.5)**	(636.2)
Net deficit	**(151.6)**	(150.1)
Amount not recognised	**26.3**	17.6
Amount not recoverable	**(1.8)**	(2.3)
Net retirement benefit obligation recognised	**(127.1)**	(134.8)

The following amounts are included in operating profit in the income statement:

	2005 £m	2004 £m
Defined benefit pension schemes and overseas medical schemes	**(7.6)**	(4.2)
Defined contribution pension schemes	**(2.6)**	(2.1)
	(10.2)	(6.3)

Net retirement benefit obligations, as provided for in the consolidated balance sheet, amounted to £127.1 million (2004: £134.8 million), a reduction of £7.7 million.

As permitted under IAS 19, the cumulative actuarial gains and losses arising subsequent to 1 January 2004 which fall within a 'corridor', calculated by reference to the greater of 10 per cent of plan assets or liabilities, are not recognised on the balance sheet. At 31 December 2005 the amount of the actuarial losses not so recognised was £26.3 million (2004: £17.6 million).

In respect of 2005, an amount of £7.6 million (2004: £4.2 million) was charged against operating profit in respect of defined benefit schemes and overseas medical costs. The cash contribution into the schemes during the year was £18.4 million (2004: £16.6 million).

As the great majority of liabilities are in respect of past employees, future changes in the net liabilities in respect of retirement benefits will depend primarily upon movements in long-term interest rates and stock markets, and changes in life expectancy. Future cash contributions will also depend on other factors, such as the outcome of negotiations with the pension trustees and changes in legislation.

Provisions
At 31 December 2005, provisions were £40.7 million (2004: £40.2 million). Of this amount, £21.7 million (2004: £16.8 million) was in respect of legal and environmental claims and disputes. Of the remainder, £4.6 million (2004: £11.0 million) was in respect of disposals and restructurings, £10.4 million (2004: £8.7 million) was in respect of warranty and product liability, and £4.0 million (2004: £3.7 million) was in respect of other items.

Cash flow and net debt

		2005 £m	2004 £m
Operating profit		**101.7**	51.9
Depreciation and amortisation		**15.5**	15.7
Charge for share based incentives		**0.8**	0.4
(Profit)/loss on sale of fixed assets		**(0.8)**	0.2
Movement in working capital		**(21.9)**	8.4
Movement in provisions		**(4.9)**	(12.3)
Exceptional items	– amount recognised in period	**(4.2)**	3.0
	– amount paid in period	**(1.7)**	(19.6)
Cash flow from operations		**84.5**	47.7
Capital expenditure		**(20.0)**	(10.0)
Capitalised development costs		**(2.2)**	(0.2)
Acquisitions		**(1.9)**	(3.5)
		(24.1)	(13.7)
Disposals		**0.4**	13.1
Sale of fixed assets		**3.3**	2.9
		(20.4)	2.3
Dividends from associates		**3.0**	1.3
Interest paid (net)		**(6.0)**	(13.3)
Dividends paid to minority interests		**(2.8)**	(2.8)
Tax paid		**(14.9)**	(11.7)
Share issues		**20.2**	44.6
Net cash flow		**63.6**	68.1
New finance leases		**(0.2)**	(0.6)
Movement in interest payable accrual		**0.3**	–
Foreign exchange adjustments		**(2.3)**	2.7
Movement in net debt		**61.4**	70.2
Opening net debt		**(66.3)**	(136.5)
Opening interest payable accrual		**(1.6)**	–
Closing net debt		**(6.5)**	(66.3)

During the year, net debt was virtually eliminated, reducing from £66.3 million to £6.5 million. Cash flow from operations generated £84.5 million (2004: £47.7 million), an increase of 77 per cent. Capital expenditure was £20.0 million (2004: £10.0 million), an increase of 100 per cent, whereas the depreciation charge amounted to only £14.7 million (2004: £15.3 million).

Funding
The Company finances its operations through a mix of equity and borrowings. The Company's capital structure is kept under review to ensure that it is consistent with current and anticipated future funding needs.

During the year, the Company issued a total of 14,617,132 new ordinary shares. Of these:

7,531,800 new ordinary shares were placed on 3 May 2005 and raised £19.1 million, net of expenses. The placing represented approximately 5 per cent of the then current issued ordinary share capital. The Company is utilising the proceeds from the placing for general corporate purposes.

6,424,914 new ordinary shares were issued as consideration to the vendors of the minority interest in the South American welding and cutting businesses with a value at the time of their issue of £21.2 million.

660,418 new ordinary shares were issued for cash of £1.1 million on the exercise of options under various employee share option schemes.

Charter's central treasury department is responsible for ensuring the availability of suitable and sufficient borrowing and other financing facilities. In addition, it is responsible for managing the interest rate risks, liquidity risks and balance sheet foreign exchange translation risks. Foreign exchange transaction exposures are generally managed by operating subsidiaries within strict guidelines and controls established by the management of their parent companies and overseen by the central treasury department. It is the Company's policy not to hedge profit and loss account translation exposures.

In the year to 31 December 2005, net interest payable of £6.3 million was covered 16.2 times (2004: 4.5 times) by profit before interest and exceptional items.

Borrowings
During the year, the reduction in net debt was £59.8 million (2004: £70.2 million), resulting in net borrowings as at 31 December 2005 of £6.5 million (2004: £66.3 million). As at 31 December 2005, gross borrowings were £82.2 million (2004: £111.4 million).

The Company has significant investments in overseas operations; as a result, movements in exchange rates can significantly affect the consolidated balance sheet. Where practicable, borrowings are denominated in the currencies of the Company's net investments overseas with a view to hedging currency fluctuations. Forward foreign exchange contracts are also used to hedge currency flows within the operating units. Gains and losses arising from borrowings used to hedge foreign currencies are recognised as required under IFRS in the consolidated statement of changes in equity until the items being hedged have impacted on the income statement.

In March 2005, the Company cancelled its onerous syndicated banking facility and replaced it with a two year £50 million credit facility provided by HSBC on conventional terms and due to expire on 31 March 2007. This facility was still in place, although unutilised, at the year end, and in March 2006 was cancelled and replaced by a new five year committed £50 million revolving credit facility with HSBC expiring on 31 March 2011.

The Company's outstanding borrowings principally comprise US loan notes of $120 million (£69.7 million), of which $85 million (£49.4 million) fall to be repaid in October 2007 and $35 million (£20.3 million) in October 2009.

Cash

As at 31 December 2005, cash balances were £75.7 million (2004: £45.1 million) of which £37.6 million (2004: £2.9 million) was held in the UK, with the balance being held overseas for local working capital purposes or pending dividend payments. Of the £38.1 million (2004: £42.2 million) held overseas, £7.5 million (2004: £5.7 million) is retained as cash collateral in connection with certain local trading practices or banking facilities. The credit status of institutions where cash is held is kept under review with credit limits being set and monitored accordingly.

Commercial pricing and credit risk

Product pricing is kept under regular review. Most products contain steel or other metals whose prices can fluctuate significantly. In general, product prices respond to changes in underlying costs within a reasonable period. The credit status of customers is assessed prior to entering into a contract. For large contracts, advance and progress payments are negotiated, as appropriate.

Acquisitions

On 13 September, following approval by shareholders at an extraordinary general meeting, the Company completed the acquisition of the 49 per cent minority interest in the South American welding and cutting businesses from the Acevedo family. Full details of the acquisition were set out in the circular to shareholders dated 26 August 2005.

The total cost of the acquisition was £26.4 million. Of the purchase consideration, £21.2 million was satisfied on 13 September 2005 by the issue of 6,424,914 new ordinary shares in the Company, being 3.9 per cent of the enlarged share capital. In addition, in January 2006, the vendors received US$7.8 million (£4.4 million) in cash in lieu of dividends that they will not now be paid in respect of the period from 1 January 2004 to 13 September 2005. Other costs of the acquisition were £0.8 million.

Under the terms of the acquisition, the Company has acquired certain holding companies, through which the Acevedo family held its 49 per cent interest in the South American welding businesses. The amount paid to the vendors in January reflected the net assets of the holding companies at completion. Goodwill of £13.9 million arose on the acquisition, which appears as an asset in the consolidated accounts of the Company as at 31 December 2005.

During the year, the Board reviewed a number of acquisition opportunities. Acquisitions will only be pursued where the Directors believe that such acquisitions would increase the market share, geographic coverage or product range of ESAB or Howden, and would enhance the Company's earnings per share.

Contingent liabilities

Details of contingent liabilities are set out in note 26 to the consolidated financial statements.

Long-term incentive plan ('LTIP')

Mr Gawler has an LTIP which is due to vest on 30 June 2006. The maximum gross amount payable under this award is £8,987,040 provided that the average share price for the 20 dealing days following the announcement of the annual results for the year ended 31 December 2005, which took place on 16 March 2006, remains at or above 395 pence. Under the terms of the LTIP, he is entitled to receive an amount calculated in accordance with a formula which may be settled by cash or securities. The Board has resolved that this amount will be settled by the issue of shares in the Company.

International Financial Reporting Standards ('IFRS')

The Company has adopted IFRS in the preparation of its consolidated financial statements with effect from 1 January 2005. Therefore the results for the year ended 31 December 2005 are presented in accordance with IFRS and the comparative figures have been restated.

The standards that have had the most impact on the Company are:

- IAS 19 ('Employee Benefits') requires the recognition of additional pension and other post retirement liabilities initially on a basis similar, but not identical, to those previously disclosed under FRS 17;
- IAS 21 ('The Effects of Changes in Foreign Exchange Rates') has led to certain gains and losses on foreign exchange previously recognised in reserves affecting the income statement and will mean greater profit volatility in the future;
- IAS 38 ('Intangible Assets') requires the recognition on the balance sheet of internal development costs that meet the recognition criteria of the standard; and
- IFRS 3 ('Business Combinations') no longer allows an annual charge for the amortisation of goodwill; instead capitalised goodwill is subject to annual impairment tests.

In addition, under IFRS 1 ('First-time Adoption of International Financial Reporting Standards') the Company has chosen to revalue certain properties on transition to IFRS, with such revaluations treated as deemed cost in the future.

Summaries of the reconciliations between profit before tax for the year ended 31 December 2004 and net assets at that date as presented under UK GAAP and IFRS are set out below.

	Profit before tax Year ended 31.12.04 £m	Net assets 31.12.04 £m
UK GAAP	28.1	97.9
Post-retirement benefits	5.4	(81.3)
Property revaluations on transition	(0.2)	15.6
Capitalised development costs	0.2	1.6
Amortisation of goodwill	1.2	1.8
Reclassification of associates' tax	(1.7)	–
Deferred tax (net)	–	(2.1)
Other	–	0.2
	4.9	(64.2)
	33.0	33.7
Items not related to underlying business performance		
Losses on retranslation of intercompany loan balances	(3.0)	–
Exceptional items:		
Goodwill on business disposal	6.0	–
Unauthorised payments arising in prior years	5.0	–
	8.0	–
IFRS	41.0	33.7

Full details of the IFRS translation reconciliations are set out in notes 30 and 31 to the consolidated financial statements.

Robert Careless
Finance Director
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