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# Financial Review

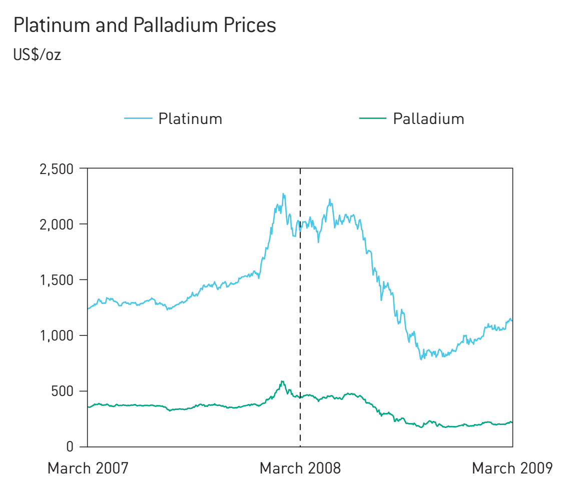
### Introduction

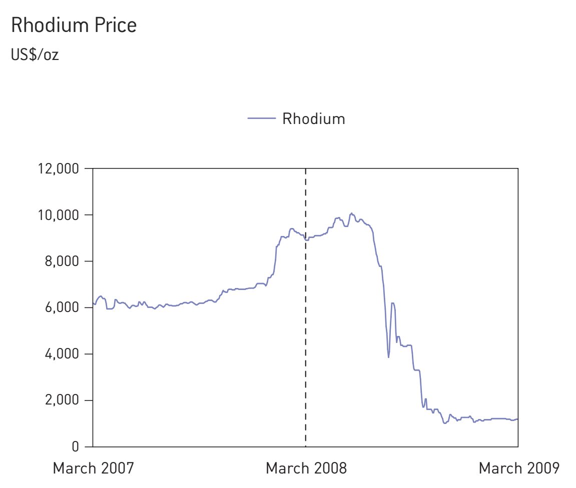
In the financial year to 31st March 2009, Johnson Matthey's revenue rose by 5% to £7.8 billion and sales excluding the value of precious metals increased by 3% to £1.8 billion. Underlying profit before tax (before amortisation of acquired intangibles and restructuring charges) was up 1% at £267.9 million. Underlying earnings per share increased by 0.1 pence to 89.6 pence.

Market conditions changed significantly during the year. In the first six months revenue increased by 24% and underlying profit before tax rose by 20%. Environmental Technologies Division and Precious Metal Products Division both achieved double digit growth in sales and operating profit. Although the recession had already started in North America, global car production for the first six months was unchanged from the same period in 2007/08. Emission Control Technologies, which supplies catalysts to the automotive market, performed well with growth in new products and a good contribution from Argillon, which was acquired in February 2008. Prices for platinum group metals were also very strong in the early part of the year, with platinum averaging $1,795/oz for the six months to 30th September 2008.

In the late summer and early autumn of 2008 car sales in many of the world's major economies fell dramatically and have remained low since then. Global car production in the second half of Johnson Matthey's financial year was 26% down on the same period in 2007/08. With car producers taking action to reduce stocks, sales of autocatalysts fell by more than 30%. Platinum group metal prices were also significantly lower with platinum averaging $952/oz for the six months to 31st March 2009.

Not all of Johnson Matthey's businesses experienced lower demand in the second half. Process Technologies in particular achieved good growth. Although the oil price has fallen substantially from its peak, concerns over energy security and environmental issues continued to drive demand for syngas catalysts and purification products. The group's reported results have also benefited from sterling's weakness, particularly against the US dollar which averaged $1.50/£ in the second half compared with $1.93/£ in the first half.






In response to deteriorating conditions in the automotive market, our Emission Control Technologies business took early action to reduce costs. Total headcount for the business was reduced by 13% compared with 31st March 2008. Long term savings of £10 million p.a. were secured by increased production efficiency and reduced distribution costs. We have increased our focus on cash, with the group generating £96.8 million of net cash flow in the year and net debt reduced by £76.0 million, despite the effect of exchange translation on foreign currency borrowings. The group's balance sheet is strong with gearing (net debt / equity) falling to 45% at 31st March 2009.

### Sales

Revenue for the year ended 31st March 2009 increased by 5% to £7.8 billion, with 24% growth in the first half of the year followed by a 12% decline in the second half. Platinum group metal prices, which had reached record levels in the first quarter of the year, fell sharply in the summer of 2008 which reduced revenue in the second half of the year. Sales excluding the value of precious metals rose by 3% to £1,797 million. Once again, all the growth came in the first half of the year when sales were 10% ahead, followed by a 4% drop in the second half. The fall reflected substantially lower autocatalyst demand from October 2008 onwards, partly offset by good sales of non-automotive products. Translated at constant exchange rates, revenue for the year fell by 2% and sales excluding precious metals were 5% lower.

Environmental Technologies Division's revenue fell by 3% to £2.2 billion and sales excluding precious metals were £4.4 million down at £1,135 million. Translated at constant exchange rates, sales excluding precious metals fell by 7%. Emission Control Technologies' (ECT's) sales excluding precious metals were 26% down at constant exchange rates in the second half, having been 8% up on the same basis in the first six months, as a result of the sharp fall in automotive demand in the second half of the year. By contrast, Process Technologies achieved good growth throughout the year with sales 8% up on a constant currency basis. The Ammonia, Methanol, Oil and Gas (AMOG) business was well ahead of last year with continued strong demand for catalysts and purification materials for industries where hydrogen or synthesis gas are key intermediates.

Precious Metal Products Division's revenue increased by 7% to £5.0 billion, boosted by higher prices for platinum group metals (pgms) in the first half of the year. Sales excluding the value of precious metals were 2% up at £314 million benefiting from favourable exchange translation. At constant currency rates sales excluding precious metals fell by 8% with demand for products sold to the automotive industry declining in the second half. Fine Chemicals & Catalysts Division achieved good growth in reported sales, largely as a result of favourable exchange translation. Many of the division's businesses are located outside the UK, particularly in the USA, and sales reported in sterling benefited from currency movements. Revenue increased by 16% to £606 million and sales excluding precious metals rose by 15% to £347 million. Translated at constant exchange rates, revenue grew by 2% and sales excluding precious metals increased by 3%.

### Operating Profit

Underlying operating profit (before amortisation of acquired intangibles and restructuring charges) was 1% higher than last year at £298.5 million. Exchange translation was favourable with sterling falling significantly against most major currencies. Translated at constant rates underlying operating profit would have been 7% down on last year. Amortisation of acquired intangibles increased from £3.1 million in 2007/08 to £9.1 million in 2008/09 of which £7.8 million related to Argillon. In March 2009 we announced the closure of our fine chemical facility in Ireland to consolidate manufacturing of prostaglandin products at our facility in the USA. The closure gave rise to a restructuring charge of £9.4 million in this year's accounts.

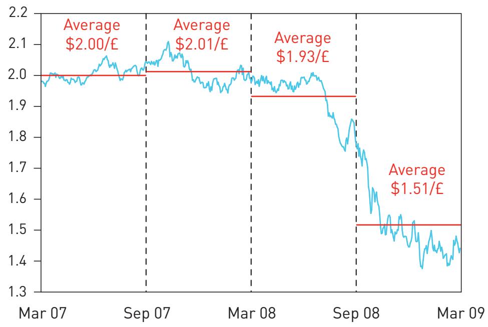
### Underlying Operating Profit

(before amortisation of acquired intangibles and restructuring charges)

| | Year to 31st March | | | 2008 at 2009 exchange rates | |
|---|---|---|---|---|---|
| | **2009 £ million** | 2008 £ million | change % | £ million | change % |
| Environmental Technologies | **124.3** | 147.3 | -16 | 158.7 | -22 |
| Precious Metal Products | **119.7** | 102.1 | +17 | 109.7 | +9 |
| Fine Chemicals & Catalysts | **72.8** | 67.1 | +8 | 73.6 | -1 |
| Corporate | **(18.3)** | (19.7) | | (20.0) | |
| **Operating profit** | **298.5** | 296.8 | +1 | 322.0 | -7 |

### US Dollar Exchange Rates

$/£




Environmental Technologies Division's underlying operating profit was 16% down at £124.3 million. On a constant currency basis the division was 22% below prior year. Emission Control Technologies' operating profit fell sharply in the second half of the year as car manufacturers reduced their purchases of autocatalysts in response to the global fall in car sales. The division took action to reduce costs which benefited operating profit. Process Technologies achieved good growth in operating profit with increased sales of catalysts and purification materials.

Precious Metal Products Division's operating profit rose by 17% to £119.7 million. At constant exchange rates the operating profit was 9% up with all the growth achieved in the first half of the year. The platinum price averaged over $2,000/oz in the first quarter and then fell back in the second quarter in volatile trading conditions. Our Platinum Marketing and Distribution business achieved strong growth in the first half of the year in these favourable conditions.

Fine Chemicals & Catalysts' underlying operating profit increased by 8% to £72.8 million as a result of favourable exchange translation. On a constant currency basis underlying operating profit was 1% down on 2007/08. The Fine Chemicals businesses achieved good growth in the year but Catalysts and Chemicals was down on a constant currency basis. More details of the performance of the individual divisions are set out on pages 17 to 23.

### Exchange Rates

The main impact of exchange rate movements on the group's results comes from the translation of foreign subsidiaries' profits into sterling. Sterling weakened significantly against most major currencies in 2008/09, with much of the decline occurring in the third quarter of the year.

Around a quarter of the group's profits are made in North America, mainly in the USA. The average rate for the US dollar for the year was $1.719/£ compared with $2.007/£ for 2007/08. Each one cent change in the average rate for the dollar has approximately a £0.4 million effect on underlying operating profit in a full year. The fall of 29 cents in the average exchange rate for the dollar in 2008/09 increased reported group underlying operating profit for the year by £12.0 million. Sterling also fell against the euro averaging €1.205/£ compared with €1.417/£ in 2007/08, which increased reported underlying operating profit by £6.4 million. Sterling strengthened against the South African rand, from R14.3/£ to R15.0/£. However, the catalysts manufactured by our South African business are ultimately for export and the benefit of a weaker rand on margins more than offsets the translational effect.

Overall, excluding the rand, exchange translation increased the group's underlying operating profit by £25.2 million compared with 2007/08. Most of the group's long term borrowings are denominated in US dollars or euros. Sterling's fall increased reported borrowings by over £100 million and increased interest by around £5 million.

### Return on Sales

We measure return on sales as underlying operating profit divided by sales excluding precious metals. Return on sales for the group fell by 0.4% to 16.6% with the ratio improving in Precious Metal Products Division but declining in the other two divisions. The rise in return on sales in Precious Metal Products Division was the result of the very strong performance by our Platinum Marketing and Distribution business in the first half.

Environmental Technologies Division's return on sales for the year fell by 2.0% to 10.9%. All of the decline occurred in the second half of the year when the return fell to 8.6%. ECT remained profitable in both the third and fourth quarters thanks to early action to reduce costs, but return on sales fell. Process Technologies' return on sales in the second half was higher than the first with continued growth in sales.

The fall in the return for Fine Chemicals & Catalysts Division reflected the more difficult market conditions for the Catalysts and Chemicals business in the second half of the year. The Fine Chemicals businesses performed well with a return on sales of 23.0%.

Return on Sales excluding Precious Metals

| | Sales excluding precious metals 2009 £ million | Sales excluding precious metals 2008 £ million | Return on sales excluding precious metals[1] 2009 % | Return on sales excluding precious metals[1] 2008 % |
|---|---|---|---|---|
| Environmental Technologies | **1,135** | 1,140 | **10.9** | 12.9 |
| Precious Metal Products | **314** | 307 | **38.1** | 33.2 |
| Fine Chemicals & Catalysts | **347** | 303 | **21.0** | 22.1 |
| **Continuing businesses** | **1,797** | 1,750 | **16.6** | 17.0 |

[1] Underlying operating profit divided by sales excluding precious metals.

Return on Invested Capital

| | Average invested capital[1] 2009 £ million | Average invested capital[1] 2008 £ million | Return on invested capital[2] 2009 % | Return on invested capital[2] 2008 % |
|---|---|---|---|---|
| Environmental Technologies | **1,186** | 970 | **10.5** | 15.2 |
| Precious Metal Products | **146** | 188 | **81.8** | 54.3 |
| Fine Chemicals & Catalysts | **516** | 483 | **14.1** | 13.9 |
| Corporate / other | **(107)** | (34) | **n/a** | n/a |
| **Total group** | **1,741** | 1,607 | **17.1** | 18.5 |

[1] Average of opening and closing segment assets less segment liabilities as shown in note 1 on the accounts on pages 65 and 66. For the group, the average of opening and closing equity plus net debt.

[2] Underlying operating profit divided by average invested capital.



### Return on Invested Capital

The group's return on invested capital (ROIC) fell by 1.4% to 17.1%. Underlying operating profit was £1.7 million ahead of last year at £298.5 million and average assets £134 million higher at £1,741 million as a result of exchange translation and the acquisition of Argillon in February 2008. The group's ROIC of 17.1% was still well ahead of our pre-tax cost of capital, which we estimate to be 11.5%.

Our long term group target for ROIC is 20% on a pre-tax basis. We had been making good progress towards that target with steady improvements over the last five years to reach 18.5% last year (page 106). The global recession has significantly reduced demand in a number of our businesses, particularly those which sell into the automotive market, and we now have spare capacity. The medium term outlook for the group remains encouraging with growth in catalyst demand underpinned by new emissions legislation which is already in place. Once global activity starts to recover the group's ROIC should improve again as capacity utilisation increases.

Precious Metal Products Division and Fine Chemicals & Catalysts Division both improved their ROICs and were above the group's pre-tax cost of capital of 11.5% in 2008/09. Environmental Technologies Division's ROIC fell to 10.5%, 1% below the group's cost of capital, as a result of the impact of the global recession in the second half of the year.

### Interest

The group's net finance costs rose by £2.3 million to £32.6 million as a result of higher average borrowings for the year as a whole, partly offset by the benefit of lower interest rates in the second half of the year. A revised accounting standard, IAS 23, was adopted in January 2009 which requires interest on major projects to be capitalised. The effect of this new standard was to reduce the group's finance charge for the year by £1.6 million and increase capital expenditure by the same amount.

Average borrowings for the year as a whole increased compared with 2007/08 as a result of the acquisition of Argillon in February 2008. With strong cash generation and lower interest rates on floating rate borrowings, the finance charge for the second six months of 2008/09 fell to £14.3 million (excluding the benefit of capitalised interest on major projects) compared with £19.9 million in the first half.

### Profit before Tax

Underlying profit before tax rose by 1% to £267.9 million. After amortisation of acquired intangibles and restructuring charges, profit before tax was 5% down at £249.4 million. Profit before tax included a £2.0 million profit from associates, compared with a £1.1 million loss in 2007/08. This relates to AGR Matthey, the Australian gold refining business in which the group has a 20% stake, which performed well in the year with good demand for gold refining. In 2007/08 AGR Matthey's results were adversely affected by additional costs to reorganise the business.

### Taxation

The group's total tax charge for the year was £76.7 million, 1% lower than in 2007/08. Excluding tax relief on amortisation of acquired intangibles, the average tax rate for the continuing businesses was 29.6%, which was 0.2% higher than last year.

Tax paid was £85.3 million, which was £8.6 million higher than tax payable as a result of the timing of tax payments. In 2009/10 tax paid should be correspondingly lower. In addition we expect to benefit from a repayment of tax in the UK which partly arises from tax relief on exchange losses on the group's long term currency borrowings.

### Earnings per Share

Underlying earnings per share increased by 0.1 pence to 89.6 pence. Total earnings per share were 82.6 pence, 7% below 2007/08, as a result of increased amortisation charges and the cost of closure of the facility in Ireland.

In November 2008 we announced the sale of the Insulators and Alumina businesses, acquired as part of the Argillon Group, for €21 million in cash plus a €2 million vendor loan note. The businesses had been classified as "assets held for sale" in last year's accounts. The sale resulted in a profit of £0.9 million in discontinued businesses, which is excluded from underlying earnings per share.

#### Dividend

The board is recommending to shareholders a final dividend of 26.0 pence (unchanged from 2008) making a total dividend for the year of 37.1 pence, an increase of 1%. Cover for 2008/09 would be 2.4 times. The overall percentage increase in the dividend for the full year is slightly greater than the growth in underlying earnings per share as a result of the 5% increase in the interim dividend.

#### Pensions

At 31st March 2009 the group's main UK pension scheme was in deficit by £45.2 million (94% funded) on an IFRS basis compared with a surplus of £65.1 million at 31st March 2008. The change mainly reflected the fall in asset values at 31st March 2009 compared with a year earlier, with equity investments in particular adversely affected by the global recession. The valuation was also adjusted for the latest information on mortality for the members of the scheme with expected longevity rates increasing.

Worldwide, including provisions for the group's post-retirement healthcare schemes, the group had a net deficit of £151.6 million on employee benefit obligations at 31st March 2009 compared with a surplus of £16.4 million at 31st March 2008. In 2009/10 we plan to make an additional payment of US $30 million into our US schemes to bring the funds closer to balance. The triennial revaluation of our main UK scheme is currently underway and it is likely that the company will need to increase its rate of contributions from 2010. In 2008/09 the company's contribution to the UK scheme was £22.1 million.

#### Cash Flow

The group achieved strong cash generation in 2008/09 with a net cash inflow of £96.8 million. After taking into account the impact of exchange translation on foreign currency borrowings the group's net debt fell by £76.0 million to £534.4 million. Included in cash flow under IFRS is the impact of swap transactions used to manage currency borrowings. If these are added to exchange translation the total translational effect of exchange rate movements on borrowings denominated in foreign currencies was over £110 million and cash generation more than £190 million.

Net cash flow from operating activities increased by £271.8 million to £501.4 million. In response to the fall in demand from the automotive sector and lower precious metal prices we were able to generate £204.2 million from reduced working capital. We invested £209.3 million in capital expenditure and other investments, which was 2.0 times depreciation. Major projects included the construction of the two new ECT facilities in Macedonia and western Pennsylvania, USA, and new production capacity at Clitheroe, UK to manufacture methanol synthesis catalysts. In November 2008 we completed the planned disposal of Argillon's Insulators and Alumina businesses for €21 million in cash plus a €2 million vendor loan note.

We plan to reduce capital expenditure to 1.2 times depreciation in 2009/10. Major projects will include completion of ECT's new facilities in Macedonia and western Pennsylvania and investment in China on manufacturing capacity for plate catalysts used for reducing harmful NOx emissions from power stations.

#### Capital Structure

In 2008/09 net debt fell by £76.0 million to £534.4 million and equity rose by £15.8 million to £1,176.1 million. Gearing (net debt / equity) fell by 7.2% to 45.4%. The group's target range for gearing is 50% to 60%. Given the current level of economic uncertainty and more difficult conditions in the credit markets the board is happy to keep gearing below the target range for the time being. Net debt / EBITDA for the year was 1.3 times and interest cover (underlying operating profit / net finance costs) was 9.2 times.

On 31st July 2008 we drew down a five year fixed rate loan of €125 million from the European Investment Bank (EIB) under a facility arranged earlier in the year. The facility is provided to support the group's investment in research and development. At 31st March 2009 the group had £609.1 million of debt in the form of long term bonds issued in the USA and loans from the EIB. Gross debt (net of related swaps) amounted to £649.6 million offset by £115.2 million of cash and deposits. The group also had £315.0 million of committed bank facilities which are individually negotiated and over half have expiry dates after 31st March 2011 (see note 29b on page 90). There were no drawings under these bank facilities at 31st March 2009.

## Treasury Policies

#### Financial Risk Management and Treasury Policies

The group uses financial instruments, in particular forward currency contracts and currency swaps, to manage the financial risks associated with its 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 2009 the group had net borrowings of £534.4 million. Some 63% of this debt was at fixed rates with an average interest rate of 5.1%. The remaining 37% of the group's net borrowings was funded on a floating rate basis. A 1% change in all interest rates would have a 0.7% impact on underlying profit before tax. This is within the range the board regards as acceptable.