

16 Financial review



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While profits reflect the downturn in the US, cash flow generated from operations and the disposal programme enabled us to maintain investment in the core business and to reduce debt.

Accounting standards

The Group's accounting policies reflect the applicable standards issued by the Accounting Standards Board.

FRS17 – Retirement Benefits has been adopted in preparing the accounts for 2001 and the comparative figures for 2000 have been restated. As indicated in last year's annual report, this new standard has a significant impact compared to the previous treatment under SSAP 24. Although full adoption of the new standard is not obligatory until 2003, the particular circumstances of Coats' UK Pension Scheme has led management to the view that early adoption is best practice.

FRS18 – Accounting Policies has also been adopted but has no impact on the figures reported.

Review of operating results

Turnover of continuing businesses was down 4% at £1,212.6 million. Operating profit before reorganisation and other exceptional items was £68.8 million compared to £95.2 million in 2000. The US downturn and de-stocking throughout the apparel supply chain had a negative impact on Thread profits. Jaeger, which had been showing signs of recovery in the first half, was impacted by the events of 11 September. Reduced turnover in India textiles reflected the exit from apparel fabrics and success with the voluntary retirement scheme prevented further deterioration in profit. Head office costs were reduced while benefiting from an exchange gain of £0.9 million.

Although the Group enjoys pension contribution holidays, under FRS17 notional employer pension contributions are included as a charge to operating profit. The notional contribution rates are higher in 2001 due to a reduction in the expected investment returns. The charge is £12.0 million in 2001, which is £1.4 million higher than in 2000. There is also a non-repeating FRS17 credit of £4.0 million in 2000 for adjustments to the conditions of the US post-retirement medical plan. Together, these adjustments account for a £5.4 million reduction in reported operating profit in 2001 compared to 2000.

Including discontinued businesses, operating profit was £68.4 million compared to £87.3 million in 2000.

Reorganisation costs (including impairments of fixed assets) at £31.5 million were slightly lower than in 2000 but with a higher spend in Thread (£25.7 million) driven by swift action to reduce costs in the US, in the light of significantly lower industrial thread demand.

Disposals

There has been significant activity in disposing of both businesses and surplus assets. The programme of disposal of Clothing and Home Furnishings businesses resulted in a net loss of £2.7 million. The other main items were the termination of the Indian apparel fabrics business (loss – £12.8 million) and the sale of Dimensions, the US Kits business, which due to a write-back of previously written-off goodwill, resulted in a net loss of £11.8 million. Gains on sales of property

Turnover



Operating profit before exceptional items



and other assets made surplus by the disposal and reorganisation programme totalled £13.6 million. The net loss on sales or terminations and asset sales was £13.2 million, compared to £81.2 million in 2000.

The disposal programme generated £33.1 million in cash on the sale of businesses and a further £24.0 million on the sale of property and other assets.

Net interest costs were £10.5 million compared to £20.1 million in the previous year. This included investment income, £0.6 million gain on the sale of certain fixed asset investments and the impact of exchange rates on US dollar interest income.

Operating profit after associates and net interest was £26.0 million (2000 – £30.9 million), a reduction of £4.9 million.

FRS17 has introduced a new line “other finance income” which represents the net return on pension assets and liabilities. This credit is lower in 2001 at £10.2 million compared to £19.2 million in 2000. The reduction is due to the lower expected rate of return in 2001. This is applied to the lower market value of the pension assets, which had fallen in line with equity markets between 1 January 2000 and 1 January 2001.

Profit before tax

The profit before tax was £23.0 million (2000 – loss £31.1 million). On the IIMR basis (before goodwill and FRS3 exceptionals) profit before tax was £38.0 million (2000 – £53.1 million).

The comparable figures under SSAP 24 for the IIMR basis profit before tax was £46.3 million (2000 – £53.3 million). The UK SSAP 24 pension credit for 2001 would have been £1.3 million, £3.9 million lower than 2000 (£5.2 million).

Taxation

The tax charge was reduced to £11.1 million (2000 – £16.8 million). This charge is made up of tax on profits of overseas subsidiaries, while the Group continued to experience losses in the UK. The reduction in the tax charge reflects lower profits in the US.

The principal exchange rates used in preparing the financial statements were:

£m		2001	2000
Average	US\$	1.44	1.51
	Euro	1.61	1.64
Year end	US\$	1.46	1.49
	Euro	1.63	1.59

The translation of 2000 overseas turnover and profits at 2001 average rates increased sales by £27.6 million and operating profit by £2.5 million.

EPS is impacted by the new standard and the comparative figures are shown below:

EPS (p)		2001	2000
FRS17	Headline EPS	2.8	3.9
	Basic EPS	1.4	(9.0)
SSAP 24	Headline EPS	3.6	3.8
	Basic EPS	2.4	(8.9)

Pension arrangements

The Company operates a defined benefits plan in the UK. This plan has a healthy surplus at 31 December and remains open to new members. There are similar arrangements in the US where again the plan is in surplus. Continued suspension of employer contributions has been recommended by the actuaries in both cases.

Pre-tax profit/(loss) before FRS3 exceptional items

Net interest cover (operating profit)



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There are various pension and leaving indemnity arrangements in other countries where the Group operates, which are in general not funded.

Pension assets and liabilities

FRS17 requires greater disclosure of the pension assets and liabilities. Under FRS17 where a plan is in surplus, the balance sheet pension assets are restricted to the surplus recoverable through contribution holidays plus any agreed refunds of surplus to the Company net of deferred tax. On this basis, the pension asset at 31 December 2001 is £50.7 million, of which £24.4 million refers to the UK plan and the remainder to plans in North America. The amount recoverable through contribution holidays has fallen during the Group's restructuring due to the significant reduction in active members in the UK pension plan. There are currently no refundable surpluses and there have been no refunds.

Pension liabilities are shown in respect of obligations in other countries, mainly in Europe. These are mainly unfunded and amount to £52.9 million net of deferred tax at 31 December 2001.

Cash flow

Net cash inflow from operating activities was £86.9 million, up £13.6 million on 2000. The disposal of businesses and surplus assets generated £57.1 million (2000 – £55.5 million).

Capital expenditure was £54.7 million (2000 –

£51.7 million). The cost of acquisitions, including a share buy-back scheme in India, was £24.9 million of which £22.4 million was in cash and £2.5 million in loan notes.

Year end debt decreased to £128.1 million (2000 – £148.2 million).

The Group's borrowing facilities were renegotiated following completion of the main disposals. The Group has facilities of £418 million at the year-end of which £243 million are committed. The Group was not in breach of any of its borrowing covenants.

The Group policy on interest rates is to minimise exposure by ensuring an appropriate balance of fixed and floating rates. This exposure is managed through the use of interest rate swaps and forward rate agreements, the nominal principal of which does not exceed the underlying debt and cash positions covered.

Following the restructuring of the UK businesses the majority of the Group's profits, cash flows and assets relate to its overseas Thread operations and are denominated in a range of currencies. The Group's translation exposure in the profit and loss account is not hedged. Borrowings are taken or swapped into US\$ to hedge the impact of changes in the sterling/US dollar exchange rate on the translation of US dollar denominated assets. Further details are contained in note 19 of the Report and Accounts.

Net cash flow from operating activities



Gearing

