Chairman's Statement

"...no shortage of ideas, determination or actions..."

Geoff Unwin, Chairman

In my first year as Chairman of Halma, I am delighted to announce record profit before tax* of £50.3 million.

Observations from a new Chairman

However, before turning to more of the headline numbers, I thought it might be useful, as a new boy to the Group, to share some of my initial observations, and to glimpse behind the scenes at some of the issues we have been tackling.

Firstly let me say that I was attracted to Halma by its extraordinary track record (one of the top performing stocks on the London Stock Exchange over 20 years), its management style and the robustness of demand for its products even under difficult market conditions. I was intrigued. My induction into the Group, guided by David Barber, was exemplary. He left me alone to go where I wanted, ask whatever I wished, yet was always available to discuss, debate and question what I had observed.

Over the first few months I visited operations accounting for about half our profits. I saw companies both large and small; some fighting in tough markets, many successful – the picture became clearer. The strengths were evident:

- demand related to health and safety provided a driver or (at least) support to demand.
- high market shares gave some protection to pricing.
- autonomously run companies gave clarity of responsibility and ownership of performance.
- high returns on sales and capital.
- financial control was tight.
- a track record of which to be proud.
- many truly excellent and dedicated people.

*see Financial Highlights

However, over the last few years, performance as measured by our high historic standards had not moved ahead as we would have wished. This was undoubtedly due, to a certain extent, to the tough economic conditions we have seen recently, but had other factors crept in that were holding us back?

Our Response

This was the question that was posed to the Board and senior management. Extremely thoughtful answers came in followed by very lively debates – no factor remained unexamined, no cow, sacred or otherwise, undisturbed. The outcome? Work was accelerated on a number of potential bottlenecks:

- **management:** much strengthening (from both within and outside) and training programmes increased.
- **incentives:** new bonus schemes to explicitly align performance to shareholder value.
- **knowledge transfer:** "wiring up" the Group to facilitate transfer of knowledge without destroying the foundations of autonomy.
- **reduced span of control:** remarkably, senior management felt they could be more effective if they had fewer companies to manage and could therefore implement necessary change faster. Done.
- **sales:** renewed emphasis on all aspects of selling and sharing of the best ideas for tackling new markets across the Group.
- **innovation:** more funds allocated to innovation and new techniques introduced to get improved or new products to market, faster.
- **resource allocation:** the beginnings (more to come) of a more rigorous allocation of resources (capital and management) to higher growth areas. This year we have made three non-core disposals.

Have the actions on these issues had some effect on performance? Impossible to quantify but no one is in any doubt we are the better for focusing on these priorities. However, what is undeniable is that the results from these actions are due to the hard work and single-mindedness of the management team together with the dedication from all our employees towards our customers.

The Results

Profit before tax* was a record £50.3 million and earnings per share*, also a record, increased by 10% to 9.44p. Return on capital* was 52.4% and net cash at the year end was £22 million.

Turnover grew by 9% to a record £292.6 million. During the year we disposed of three businesses deemed to be non-core, and shortly after the year end acquired Diba Industries, Inc., strengthening our position in the life sciences market, and Ocean Optics, Inc., extending our optical technology.

The Board recommend a final dividend of 3.75 pence per share, giving an increase of 7% for the year.

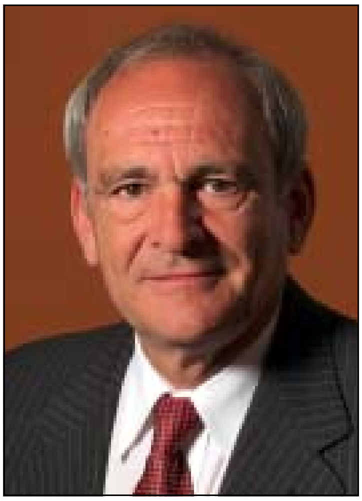
*see Financial Highlights

Prospects

There is no shortage of ideas, determination or actions and these should show through next year, as they have this year, in our results. We continue to focus on those areas that are clearly under our control or influence, notwithstanding that there is still little evidence of any significant uplift in our markets.

Geoff Unwin

Chief Executive's Review



"strong and active management delivers record profits"

Stephen O'Shea, Chief Executive

Strong and active management delivers record profits

The Group performance has been strong despite market conditions remaining difficult. We achieved record profits* of £50.3 million on a lower level of operating assets, despite a net £1 million profit hit from currency movements. Widespread improvement in sales performance across the Group's businesses and regions produced 9% sales growth. These results reflect our active management approach through which we achieve growth through focused acquisitions, efficiency improvements and the organic development of our existing businesses. I am pleased that excellent efforts from our management teams produced a return on capital employed* of 52%, outstanding for any engineering and manufacturing company.

In the year we sold three non-core businesses from our Optics and Specialist sector that were not compatible with our targets for growth and financial returns. Since the year end we have made two important acquisitions for a total initial sum of £22 million, significantly strengthening this sector. Looking forward we expect to gain useful benefits from our acquisition and disposal activities. Two further businesses were also consolidated to achieve the benefits of greater integration. We remain strongly cash generative, creating net cash of £22 million during the year. We funded our acquisitions from profits and also paid a record sum in dividends to our shareholders.

Well positioned for growth

Our growth has come primarily from new products, the new customers they attract and new applications for long-term repeat ordering customers. We spent a record amount on research and development which now accounts for 4% of sales and launched many new products. Our cost base has been well managed so that we maintained our 17% return on sales* for yet another year. The Group is in a strong position to benefit from improvements in our end markets although we saw no upturn in the 2003/04 financial year and are not reliant on a market recovery for our future growth.

*see Financial Highlights

Management team strengthened

There has been a seamless transition with our Chairman, Geoff Unwin, stepping up from his previous role as Deputy Chairman in July 2003 and with the appointment of a new non-executive Director, Stephen Pettit, in September 2003. The management team has been further strengthened with the recruitment of two additional senior managers, Nigel Trodd and Andy Richardson, whom we welcome into the Group. We said goodbye to David Barber, the founder and architect of the Halma culture who served the Group over an outstanding tenure of 31 years. We owe much to him and all of us wish him well in his retirement.

Widespread sales and profit growth

I am encouraged by the number of countries where we have built up stronger positions. Territorial sales were grown to the UK, Europe, USA, Middle and Far East and Other Countries. The US Dollar weakened considerably during the year so that although sales in the USA grew by 12% in local currency, this translated to a 2% increase in Sterling terms. We make over a quarter of our profits from our US based companies. They increased US Dollar profits although in Sterling terms this converts to a small decline of 5%, £0.7 million. We were helped in the early part of the year by the strength of the Euro.

Sales from our European companies grew by 42% to £43.7 million. We owned BEA, the world market leading supplier of automatic door sensors, for the whole of the year (compared to a 6 month contribution last year). This very successful acquisition continues to deliver impressive results by producing excellent products and growing its customer base across the world. We have rolled out one of BEA's innovation techniques across the whole of the Group, demonstrating our commitment to transferring best practice.

Just over half our sales and profits are made by the UK companies. Continuing operations earned profits of £26.6 million, reflecting organic growth of £1.9 million, and increased sales by £10.6 million. Profits from our companies outside of the UK and USA, helped by £2.7 million from BEA, rose by £3.2 million.

New Elevator safety products

Our Elevator and Door Safety sector performed particularly well demonstrating both organic and acquisition growth. Its profits are now £12.1 million, 24% of the Group's total. The Far East and Asia are increasingly important territories and we extended our premises in Beijing and our manufacturing facilities in Shanghai and Beijing, as well as growing in Singapore. Important product innovations include new emergency communication equipment, demand for which is likely to grow following new European legislation in this area.

Repositioning in Optics and Specialist sector

We are increasing the focus on higher technology products and more technically advanced customers. Evidence of this can be seen in both the disposals made this year and in the acquisitions of Diba and Ocean Optics since the year end, both of which significantly broaden our capabilities in our Optics and Specialist sector. Diba products extend our product range offered to instrument makers in the growing field of life sciences. Ocean Optics make spectrometers that help analyse substances via their reaction to light. They are closely related to our water purity measuring photometers and other optical diagnostic equipment. Our trading in this sector produced increased profits. However within the sector we report our Head Office companies and the improved trading was more than offset by the costs of increasing senior management and lower income from subsidiaries who reduced their capital employed whilst growing profits. The net effect was a reduction in profits of £0.4 million to £7.1 million.

Organic growth in Fire and Gas sector

The Fire and Gas sector increased both sales and profits with new fire detectors and personal gas warning monitors. They earned £1.6 million of organic profit growth. This sector increased its already effective use of assets, producing a return on capital employed of 85%, exceeding even the Group's strong ratios.

Resistors sector as predicted

As expected, our Resistors sector continued to suffer a depressed market, particularly in US heavy industry. There are some indications of improvement in one of our customer areas, mass transit systems. The sector has been managed vigorously in terms of both cost and working capital reductions though we have yet to reverse the decline in profits.

Investment in new products

Our Process Safety sector did not quite match last year's sales and profits. The UK market proved difficult although there are now improving conditions in the petrochemical sector, which look likely to continue. New applications and specially developed products are particularly important in this sector. New products introduced late in the year that improve safety at delivery bays and provide enhanced emergency pressure relief, are examples of increasing innovation in this otherwise stable sector.

Product leadership helps Water sector to increased profits

Our Water sector increased both sales and profits this year. We believe we are now offering customers the best UV sterilisation systems for drinking water on the market. Sales of water leak detection and control equipment are growing in the USA and there are prospects of capital spending by UK water utilities beginning to rise. We see this as a long-term growth sector.

Sustained growth based on sustained innovation

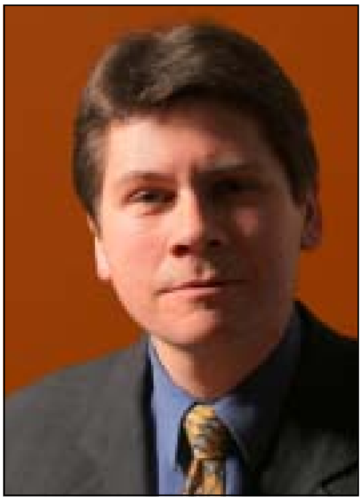
Our focus on innovation and investment in research and development is bringing forward increasing numbers of new products and accelerating the acquisition of new customers. The free cash generated by our businesses and through disposals has been invested in maintaining this momentum and building our range of products through judicious acquisitions. We will benefit significantly once our markets improve but we are not dependant on this. We have the talent and the resources we need to build on our progress through our own efforts. The evidence for this is the record sales and profits earned this year and the confidence we have in continuing our rapid rate of dividend increase. I look forward to the coming year.

Stephen R O'Shea

Financial Review

"...a resilient group in excellent shape..."

Kevin Thompson,
Finance Director



Record profit with organic growth despite adverse currency movements

I am pleased to report that turnover for the year was 9% higher than last year at £293 million (2002/03: £267 million). Turnover on continuing operations was increased by 10%. Profit before tax* set a new record at £50.3 million (2002/03: £46.5 million). Return on sales* exceeded 17%, as it has now done every year for more than a decade.

Currency translation, with about one-third of our profits linked to the currently weak US Dollar, offset slightly by profits earned in stronger Euros, reduced 2003/04 reported sales and profits by around 2%. Looking ahead, if the US Dollar and Euro were to stay at their level so far in this new financial year and with the current mix of results we might expect a further 3% adverse translation impact on our 2004/05 profits.

The extra £1.7 million of UK National Insurance, pension and general insurance costs which I anticipated in my review last year have arisen and have been funded within this year's profits. These extra costs are ongoing. However, their effects are mitigated by our success in producing consistently high net and gross margins through continuous improvements in procurement and processes.

6% of the turnover increase over last year came from acquisitions. Stripping out the currency effect and the incremental impact of acquisitions and disposals, I am very pleased to report that these figures show 6% organic growth in turnover, and profits show the same trend.

Consistently high returns generate strong cash flow

Each year I comment on our key metric, return on capital employed (profit before tax* expressed as a percentage of net tangible assets). This key indicator guides our operations, combining both return on sales and asset turns. We have generated £22 million of cash in the year and despite its inclusion in the Group's return on capital employed calculation we still produced a figure of 52% – remarkable by any measure.

*see Financial Highlights

On my regular visits to our businesses I see the benefits we obtain from a deep understanding of the importance of producing high returns from the minimum possible level of assets. This efficient use of assets benefits our customers and shows through in our return on capital* which has exceeded 40% for well over 20 years. We grew this year and used less operating assets to do it. The result of these outstanding returns is a strong flow of cash available to us for further investment in our businesses, to pay dividends and to make acquisitions.

Investing for the future

New products and innovation in our processes underpin our future growth. This year we invested a record amount of £11.2 million, about 4% of turnover, in research and development. We have maintained the investment in the capital assets used across our businesses with capital expenditure once again at a typical level of around 125% of depreciation. We have used the tougher market conditions which we have experienced in the recent years to strengthen our businesses with this type of investment, to gain market share and put ourselves in the best shape for the future.

A progressive dividend policy with dividend cover edging up

The Board recommends a final dividend of 3.75p per share, giving a full year dividend of 6.19p per share, 7% up on last year's record level. This dividend represents a continuation of Halma's progressive dividend policy and also makes a small contribution toward increasing the dividend cover which is our intention over the medium term.

If approved, this final dividend will be paid on 23 August 2004 to shareholders on the register at the close of business on 23 July 2004. Together with the interim dividend this will give a total of £23 million paid to shareholders in relation to the 2003/04 year financed by our strong cash flow, with a total of £88 million distributed as dividends in the past five years.

Prudent approach to treasury, tax and pensions

With three-quarters of the Group's sales made overseas and half the profits made by companies based outside the UK, the Group's results are sensitive to movements in exchange rates, particularly the US Dollar and Euro. Currency movements in the year affect our results through the translation into Sterling of profits earned in local currencies as well as affecting the underlying transactions. We have an element of natural hedging, in particular through the purchase of components in US Dollars. Our operating companies hedge their trading transactions back into their local reporting currency. We do hedge the majority of our US Dollar and Euro net assets using currency loans. The objective of our treasury activities is risk management and control, no speculative transactions are undertaken.

The effective tax rate on profits* was 31.3% compared with 32.9% in 2002/03. We benefited from higher profits earned in lower tax jurisdictions, including China.

We have continued to adopt the transitional provisions of FRS 17 (Retirement Benefits) pending the introduction of International Accounting Standards. The value of the pension plans' assets have increased since the last balance sheet date as can be seen from the FRS 17 disclosures, however revised inflation assumptions have increased the calculated liabilities. The net deficit on an FRS 17 basis has reduced by 7% to £29 million after the related deferred tax.

*see Financial Highlights

As noted last year, we have closed our defined benefit schemes to new members and established a defined contribution scheme. Contributions into the defined benefit schemes are in line with the actuaries' recommendations, following the triennial actuarial valuations last year and are fully reflected in the Consolidated Profit and Loss Account, with no further increases necessary at this time.

I note that the funding of pension obligations is a long-term issue, even though scheme assets are subject to short-term fluctuations. Our long-term funding basis is solid and the currently reported deficit, by any set of rules, is small relative to the Group's market capitalisation.

Compliance and control continue at a high level

I remain committed to maintaining strong internal control across the Group. For many years we have successfully used our senior finance staff to carry out reviews of our operating companies at half year and year end, making rotational visits at other times to assess internal controls. During the year we have enhanced these procedures and in particular those relating to internal control visits by the introduction of independent reporting lines. In 2004/05 we intend to confirm that our procedures amount to a formal internal audit function.

Through close monitoring of our businesses, the use of simple relevant systems and involvement of high quality finance executives based at each operating company, we continue to have a strong control environment whilst providing value to our entrepreneurial operations.

Active management of our operations

We have taken a number of actions to improve our businesses and make good use of our cash. Shortly before the end of the year we sold three non-core businesses for £5 million. They accounted for turnover of £13 million and in aggregate were operating around breakeven. If these discontinued operations are excluded the Group's return on sales is 18%. After deducting the costs of sale and pension and property obligations retained within the Group, the net result was an exceptional charge of £9.1 million including goodwill of £5.8 million. The goodwill adjustment is a non-cash item and includes £5.6 million previously written off to reserves and now recycled. The net effect of the disposals will be a net cash inflow to the Group having met all necessary costs.

Combining the proceeds from the above transactions with our existing self-generated cash, we spent £22 million just after the year end on two high-quality acquisitions, Diba Industries, Inc., and Ocean Optics, Inc. This active management produces an even stronger base for future growth.

International Accounting Standards on the horizon

International Accounting Standards will be in full effect for the first time in our 2005/06 accounts, although preparations are in progress now to collect data for use in the comparative figures. Other than the additional disclosures which will be required, we anticipate that these new Standards will have most impact in the following areas: accounting for share options, pensions and accounting for research and development.

Continuously creating value

Our returns and cash flow performance this year have been up to the high standards we have established over many years. The business has been strengthened by investment in new product innovation, prudent acquisitions, the disposal of non-core assets and by further process improvement. The objective remains unchanged, to maintain a resilient group in excellent shape to create even more value for our shareholders.

Kevin J Thompson