



*"We are having success but it is patchy, we need to do more – faster."*

The Group produced a profit before tax\* of £50.4 million, another record profit for Halma – just.

The year was characterised by significant change within the Group – some of it visible, some less so. The most visible change was the appointment of Andrew Williams as CEO at the end of February 2005, having been appointed Deputy CEO in December 2004. Andrew succeeded Stephen O'Shea who reaches the normal retirement age for Halma this year, and on behalf of the Board I should like to record our gratitude to Stephen for all that he has contributed to the Group during his career with us. The succession process has gone extremely smoothly and Andrew is bringing a fresh impetus to our operations – I encourage those of you that can, to meet him at our AGM.

Last year I referred to a number of factors that the Board and senior management felt could possibly be holding back our performance. Some of them were issues that could be quickly addressed e.g. incentives, span

\*see Financial Highlights

of control; others were more long-term, such as resource allocation and the efficiency of our balance sheet. We are continuing to upgrade the quality of our management right across the Group and particularly at subsidiary board level.

All aspects of selling have received particular attention and we are disappointed not to see better progress on the revenue line. However, in common with many sectors, we face continuing pressure from price transparency via the internet and deflationary trends through lower manufacturing costs. Our response is the continual re-design and improvement of our products, allowing more outsourcing and 'off-shore' production as we re-double our efforts on innovation. We are having success but it is patchy, we need to do more – faster.

In terms of our sectoral performance (more detail is given in the Chief Executive's Review): Resistors continued to have a difficult year and the problems there are being tackled

in new ways and with renewed vigour. Water too had a tough year. Other sectors held their own or better.

Our two new acquisitions Diba Industries, Inc. and Ocean Optics, Inc. performed extremely well, exceeding our expectations.

### The results

Profit before tax\* was a record £50.4 million (previous year £50.3 million) and earnings per share\* were slightly down at 9.42p (previous year 9.44p). On a statutory basis, profit before taxation and earnings per share were £44.9 million and 7.97p respectively. These results were produced despite adverse currency translation impacts and raw material movements of the order of £2.5 million. The return on the capital\* that our managers control was a clear all time record for a full year at 62% – a staggering achievement, and return on total invested capital\* (including all goodwill) was 13.1% – far exceeding our cost of capital. Net cash at the year end was £12 million. Turnover edged ahead by 2% to £299 million (previous year £293 million). Excluding discontinued operations, sales increased by 7%.

The Board recommend a final dividend of 3.92 pence per share giving an increase of 5% for the year.

On behalf of the Board, I should like to thank all our employees for their dedication in producing this record result, and also for their imagination in continually improving our products and service to our customers.

### Prospects

We have strong market positions and we are highly cash generative. We are accelerating our own rate of change – particularly on innovation.

Overall, despite little fundamental help from our markets, we remain cautiously optimistic for the year ahead.



Geoff Unwin

\*see Financial Highlights



## *"Actions to reposition the Group for higher growth will continue both operationally and structurally."*

### Record sales, profits and ROCE, but .....

The Group delivered record sales, record profits and a ROCE\* of 62% despite the headwind of currency and rising raw material prices – particularly stainless steel. It is always pleasing to report such achievements together with a record dividend payment for shareholders, but there is more to be done if we are to achieve the performance levels we really aspire to.

The Group did do well to compensate for some adverse factors, achieve excellent cash generation and make two high quality acquisitions. However, the underlying level of organic growth was inconsistent with parts of the business failing to make satisfactory progress, thereby eroding the growth delivered elsewhere.

We take encouragement from our achievements but do not shy away from the challenges. Setting high standards and expectations of our

performance has been a key element of Halma's continuing success in delivering outstanding returns.

### Strong cash generation and a record dividend

The Group's excellent cash generation and outstanding ROCE\* record is not achieved easily but by the disciplined management of our assets at all levels. During the year this enabled us to make £9 million of capital investment in our existing operations, pay a record dividend to shareholders for the twenty-sixth consecutive year, make two significant acquisitions and still have £12 million of net cash available at the year end.

### Flat sales performance in continuing operations

Sales from continuing operations, excluding acquisitions, increased to all territories except for the US where turnover fell by 10%. Clearly currency was a key factor, but again, is not the whole story. We must become more

\*see Financial Highlights

active in the way we build the distribution channels of our businesses, particularly in the US and other key markets. We have sometimes lacked clarity and speed of action in this area in the past and not allocated a significant proportion of our resources to make it happen.

#### Exciting value-adding acquisitions strengthen Optics and Specialist sector

During the year we acquired Ocean Optics, based in Florida, and Diba Industries, based in Connecticut, for a total of £22 million. They have significantly enhanced our capability in optical sensing and fluid technology and have performed well since joining the Group. We remain committed to making such high quality acquisitions as they become available in accordance with our strategy of focussing more closely on those markets offering the best growth opportunities.

Excluding these acquisitions and costs of holding companies, the Optics and Specialist sector achieved underlying profit growth of 12%. New product innovation, improved sales processes and increasing efficiencies in manufacturing contributed to an excellent result.

#### Elevator and Door safety maintains market leadership

At constant currency, the sector reported marginal increases in both profits and sales. In the US, our voice communications equipment sales fell significantly. Since the year end we have merged this business with our US elevator safety products company to benefit from its well-developed sales channels.

BEA, the door safety business, performed slightly better in the second half than flagged at the Interim stage. After rapid growth

since acquisition, this was encouraging and underpinned a reasonable sector performance overall.

#### Water sector repositioned for new market needs

We have taken actions to position the business for better growth in the future. There were significant changes to senior management and to the product range, which had short-term consequences for operating costs and margins. For example, it was necessary to rationalise our range of instruments which measure flow and pressure in water networks to meet more precisely the growing demand for these products worldwide. This resulted in additional costs associated with stock write downs, field service replacements, and adjustments to product design and selling resources. In addition, there was no repeat of a major US leak detection contract this year following last year's success in Las Vegas. However, we continue with our investment in the US for leak detection, UV treatment and water quality. Our water business is now in better shape to meet the opportunities presented by this long-term growth market.

#### Resistors struggle against impact of currency and raw material prices

As indicated at the half year, the margins on our Resistor business came under intense pressure from stainless steel price increases. In the second half, we had some success in mitigating these increases although in certain cases long-term contract terms proved difficult to renegotiate. We have recognised for some time that our Resistors business has been struggling against rising raw material prices, currency and tough market conditions. Since the year end, more vigorous action is being taken and already we have consolidated two of

our manufacturing operations based near Cincinnati, Ohio.

**Fire and Gas delivers solid result in changing market**

We responded positively to the major M&A activity in the global Fire and Gas market. New product developments and industry-leading customer service levels helped us to compete with US based rivals who benefited from a weaker dollar when selling into export markets. Whilst the market is undergoing a period of significant consolidation we continue to find, and exploit, new opportunities.

**Process Safety introduces new products for new applications**

A number of products were launched targeting new applications for our safety interlock products. The roll out was more gradual than expected in some cases, but the year ended with greater momentum than it started, particularly in the oil and petrochemical market. Overall, the sector continues to deliver a satisfactory return on sales and excellent ROCE.

**Talented people and excellent products**

During the year, I visited all of Halma's principal subsidiaries and saw how hard our people are working towards our goal of higher growth. Halma has a talented workforce that creates, builds and sells excellent products covering a huge range of applications. Improving the timing of new product introductions is an area we need to improve continually and, although great strides have been made recently, a further improvement will have a significant impact on our organic growth prospects.

It is encouraging to see the increasing commitment of our businesses towards exceeding the expectation of customers. Our innovation often makes

a big difference to our customers' success and quicker new product introduction is another way in which we can exceed their expectation for our mutual benefit.

**Stephen O'Shea's retirement**

I would also like to record my thanks to Stephen O'Shea for his generous help during the recent handover period and for his contribution to the Group's many successes since he joined us as MD of Apollo Fire Detectors 22 years ago. I am sure you will join me in wishing him a long and happy retirement.

**A robust strategy although striving for greater growth**

Our ability to maintain strong returns reflects well on our strategy of creating unique, high value products which protect lives, or improve the quality of life, for individuals and businesses worldwide. We will continue to invest in, and develop, high return technology businesses which operate in niche, 'demand driven' global markets with strong barriers to entry.

Actions to reposition the Group for higher growth will continue both operationally and structurally. I am looking for greater consistency of performance across the Group to deliver the sustained organic growth which provides valuable returns for shareholders. Whilst there is still much work to be done, there are good opportunities available to us and I am very much looking forward to leading the Group in the year ahead.



Andrew J Williams



*"We maintained healthy margins, strong returns and good cash flow, but we aim for greater improvement."*

**Some underlying organic sales growth with marginal profit growth to a new high**

Group turnover was 2% higher than last year at £299 million (2003/04: £293 million) and ongoing turnover grew by 5% on a constant currency basis, excluding the turnover of new businesses at the time of acquisition. Profit before tax\* at £50.4 million (2003/04: £50.3 million) was the highest ever made by the Group, by a small amount. On a statutory basis profit before taxation increased to £44.9 million (2003/04: £36.9 million). These results were achieved in 52 weeks rather than 53 weeks last year. We maintained healthy margins, strong returns and good cash flow, but we aim for greater improvement.

**The currency headwind played a notable part in the results this year**

Around one-third of Halma's turnover and profits are made in US Dollars and

\*see Financial Highlights

US Dollar-related currencies, with around 15% in Euros. The average rate at which we translate US Dollars has deteriorated by 9% in the year and even though the Euro translation rate was reasonably stable, the total currency impact reduced turnover by £10 million (3.7%) and profits by £1.6 million (3.2%). The commercial effects of currency movements on transactions, which show themselves for example in the advantage gained by US competitors, are difficult to quantify, but have a notable adverse impact on our business.

Measured at constant exchange rates, four of our sectors moved ahead in sales and profits, the exceptions being Resistors and Water – these are discussed in the Chief Executive's Review.

Whilst the adverse currency effect was not as bad as we feared at the Interim stage, it impeded our progress.

### Our acquisitions exceeded expectations and helped development of the Optics sector

In May 2004 we acquired Diba Industries, Inc. for £8 million and in June 2004 we paid an initial consideration of £14 million for Ocean Optics, Inc. In both cases the purchase price was approximately equal to their turnover at the time of acquisition, and pro-rata they would have added £17 million to our 2004/05 turnover. Up to a further £14 million is payable for Ocean Optics, with the maximum reached if it doubles its profit in the two years post acquisition. In the first year, it met its target.

Both are high-return businesses and have developed well since acquisition, contributing to the ongoing development of our Optics and Specialist sector which started with the disposal of three non-core businesses last year. Within the Optics and Specialist sector we also report holding company costs which increased this year, in part due to the cost of management changes.

### Healthy margins and high returns continue shareholder value creation

Return on sales\* at 16.8% was slightly below last year's figure of 17.2%. High and consistent margins are a feature of the Group and all sectors except Resistors and Water maintained their return on sales. The benefit to Group margins from the disposals mentioned above was eliminated this year by the impact of those two sector performances. One important factor which affected the Resistors sector in particular, was the increase in stainless steel prices this year taking £0.9 million from Group profit.

A key indicator used internally in managing our businesses is Return on Capital Employed (ROCE\*) and we have therefore published its progress

\*see Financial Highlights

over many years. It demonstrates the effectiveness of our managers in utilising the tangible assets under their direct control. At 62% for the Group this year, ROCE\* is high even for Halma reflecting the good management of resource at operating company level.

We recognise the value to shareholders in reporting Return on Total Invested Capital (ROTIC\*) and so this year we are also reporting that figure. We are reporting a post-tax ROTIC\* which includes goodwill going back over the years. ROTIC\* recognises that businesses must use both retained earnings and debt wisely to give shareholders good returns. As the graph on page three of this Annual Report shows, this year's ROTIC\* of 13.1% is far in excess of our weighted average cost of capital, continuing the trend established over many years.

### Our strong cash flow funded increased dividends with no year end net debt

Halma has a history of good cash generation and this year was no exception. Operating cash flow net of capital expenditure as a percentage of operating profit was 101%. We finished the year with net cash of £12 million. As noted below we do carry loans to hedge our currency assets but overall we are currently ungeared.

These strong cash flows will finance another record dividend. The Board recommends a final dividend of 3.92p per share, giving a dividend for the full year of 6.5p, 5% up on last year. We have continued our progressive dividend policy, dividends having increased every year for more than 25 years.

As the dividend increase is above the earnings increase, dividend cover has reduced a little. Our task is to deliver

the earnings growth in the coming years so that we can raise that cover again. If approved, this final dividend will be paid on 24 August 2005 to shareholders on the register at the close of business on 22 July 2005.

#### Treasury, tax and pensions continue on a prudent path

Our operating companies hedge their trading transactions back into their local reporting currency. Our policy is to hedge our US Dollar and Euro net investment in overseas operations through currency denominated loans, but not to hedge the effects of currency movements on the translation of overseas earnings into Sterling. The philosophy behind our treasury activities is one of risk management and control; no speculative transactions are undertaken.

As anticipated, the effective tax rate on profits\* was in line with last year at 31.2%. Depending on the precise mix of profits earned in various tax jurisdictions, we expect the effective rate going forward to be broadly similar but perhaps a little higher.

Pending the introduction of International Financial Reporting Standards (IFRS) next year, we have continued to adopt the transitional provisions of FRS 17 (Retirement Benefits) and these disclosures are given in Note 26. Under FRS 17, the net pension deficit has remained at £29 million net of the related deferred tax. The increase in the market value of scheme assets has been offset by higher calculated liabilities in part due to lower discount rates. New cash going into the main (defined benefit) pension scheme is being invested in fixed interest securities so that over time the profile of assets is more closely matched with the scheme's liabilities, the scheme having been closed to new members several

\*see Financial Highlights

years ago.

#### Internal audit builds on a history of sound Group controls

A critical feature of Halma is the entrepreneurial and autonomous nature of our operating companies. To underpin that approach we install high-quality finance executives in each business to monitor and assist development.

Responsibility and accountability of local management has always been paramount but this has been further emphasised over the past year with strengthened local accounts sign-off and by widespread use of relevant financial warning signs across the Group.

We have further enhanced our internal review procedures this year, continuing to use senior finance staff to review other operating businesses but adding more rigorous feedback and follow-up. Together with the independent reporting route to the Audit Committee introduced in 2003/04, I can now confirm that our internal audit function is fully established.

#### IFRS preparations are well advanced

For 2005/06 the Group is required to prepare its consolidated accounts in accordance with International Financial Reporting Standards (IFRS). Halma's Interim Report and Annual Report and Accounts for 2005/06 will therefore contain financial statements for 2005/06 and comparatives for 2004/05 prepared under IFRS. There will be some presentational differences, but in summary the impact on trading results is not expected to be material and net assets will be reduced mainly by the inclusion in the Balance Sheet of the pension deficit noted above. Cash flows and

the underlying economics of the business remain unchanged.

In a little more detail, the main effects of IFRS on Halma are as follows: since Research and Development is an important part of our business (we spend 4% of sales on R&D) we will recognise this asset by capitalising appropriate costs, although we anticipate expensing most of the cost as we go; share-based payments will add a new charge against our profits, starting off low but expected to increase as each new year falls under these rules and as we transition away from share options to our proposed performance share plan; goodwill on acquisitions will be frozen, goodwill amortisation no longer appearing in the Profit and Loss Account; pension costs are likely to be a little more volatile and as mentioned above, the pension deficit will come onto the Balance Sheet. The new rules on financial instruments will have a negligible effect on us.

In late summer, ahead of our half year end, we will publish a full quantification, reconciliation and explanation of the impacts on Halma of IFRS.

### We continue to focus on high returns for our shareholders

This year has seen a fair amount of change, with some repositioning and a lot of investment – there has been associated cost. Our pursuit of positive change and improvement will continue. Our key objective is to continue creating wealth for our shareholders through investment in high performance businesses and the generation of strong cash flows.



Kevin J Thompson