Group overview

Halma protects lives and improves quality of life for people worldwide through innovation in market leading products which make our customers safer, more competitive and more profitable.

Business overview

Halma is made up of three sectors each comprising autonomous operating companies which mainly manufacture innovative electronic and electrical products for niche markets with global dimensions. We are an international group with businesses in over 20 countries and major operations in Europe, the US, Asia and Africa. You will find a description of our products, the industries in which we operate and trends in our markets in the sector reviews on pages 22 to 27. These sectors are:

→ Infrastructure Sensors	detecting hazards, and protecting people and property in buildings
→ Health and Analysis	improving public and personal health; protecting the environment
→ Industrial Safety	protecting property and people at work

KPI	Group target	2007	2006
Organic revenue growth[1]	>5%	8%	11%
Organic profit growth[1]	>5%	8%	15%
Return on sales[2]	~18%	18.6%	18.7%
ROCE[3] (Return on capital employed)	>45%	60.1%	56.9%
ROTIC[3] (Return on total invested capital)	>12%	14.0%	12.8%
R&D as a % of revenue[4]	~4%	4.3%	4.3%
Operating cash to operating profit[5]	100%	106%	117%

1. Organic growth measures the change in the revenue and profits from continuing Group operations. The effect of acquisitions made during the current or prior financial period has been equalised by subtracting from the current year results a pro-rated contribution based on their revenue and profits at the date of acquisition.
2. Return on sales is defined as adjusted[6] profit before taxation from continuing operations expressed as a percentage of revenue from continuing operations.
3. ROCE and ROTIC are non-GAAP measures used by management in measuring the returns achieved from the Group's asset base. See note 3 to the accounts for details of the calculation basis.
4. Research and development expenditure as a percentage of revenue from continuing operations.
5. Cash generated from continuing operations expressed as a percentage of adjusted[6] operating profit from continuing operations.
6. Adjusted to remove the amortisation of acquired intangible assets.

Key performance indicators

Financial key performance indicators (KPIs) used by the Board to monitor progress are listed in the table on the left. Similar indicators are used to review performance in our three sectors. KPIs are calculated on results from continuing operations.

We have delivered an impressive performance against our KPI targets. The prior year comparatives for 2006/07 were demanding as, unlike that year, there were no "recovery" situations in the current year to benefit from. Underlying organic profit growth remained healthy and was again driven by top line growth rather than cost reduction.

Strong Return on sales, ROCE and ROTIC metrics confirm Halma's ability to deliver growth without diluting the quality of its returns. Indeed, the increase in ROTIC indicates enhanced value creation for shareholders.

R&D investment remained high relative to many of our peers reflecting both increased innovation activity and an overall uplift in the technology level of Group companies due to M&A actions in the past two years. Further discussion of the Group's financial performance is given in the Financial review later in this Annual report.

This Business and financial review is based on the guidelines for Operating and Financial Reviews published by the Accounting Standards Board. To help shareholders get a clear insight into our business we look at issues affecting the Group as a whole on pages 20 and 21, followed by an analysis of our three principal operating sectors in more detail on pages 22 to 27, and then we summarise the Operating environment, risks and uncertainties, review corporate responsibility and conclude with a Financial review.

Strategy and business objectives

Our strategy for driving growth and creating shareholder value centres on five key principles:

- → Operate in specialised global markets offering long-term growth underpinned by robust growth drivers;
- → Build businesses which lead specialised global markets through innovative products differentiated on performance and quality rather than price alone;
- → Recruit and develop top quality boards to lead our businesses and nurture an entrepreneurial culture within a framework of rigorous financial discipline;
- → Acquire companies and intellectual assets that extend our existing activities, enhance our entrepreneurial culture, fit into our decentralised operating structure and meet our demanding financial performance expectations;
- → Achieve a high Return on capital employed to generate cash efficiently and to fund organic growth, closely targeted acquisitions and sustained dividend growth.

Organic growth is the key to our value creation strategy. The "blended" long-term growth rate of our markets is around 5% per year and our aim is to grow faster than our markets. Following a strong year in 2005/06, achieving 8% organic growth in 2006/07 was an excellent result and represents a second year of good progress following low organic growth in the preceding years 2000 to 2005.

R&D and innovation play an important role. Strategically, we aim to provide technical resources within each business as close as possible to the customer. Whilst respecting the autonomy of subsidiary companies, we encourage collaboration between Halma companies and see this as a potential competitive advantage that has been under-utilised in the past. During 2006/07, the increased collaboration started to bear fruit with new products launched incorporating technology and know-how from two or more Halma companies. These included fire products, which combined visual and audible alarm modules together with our market leading smoke detectors.

Our businesses build competitive advantage and strengthen barriers to entry in many ways including patents, product approvals, technical innovation, product quality, customer service levels and branding. We look for these qualities in the businesses we seek to acquire. We like regulated markets which require suppliers to achieve compliance with demanding product standards but also look for other robust long-term growth drivers such as demographic change.

Growth drivers

- → Safety regulations and legislation
- → Risk and cost of accidents
- → Commercial construction (new build and refurbishment)
- → Population growth, ageing and urbanisation
- → Rising expectations of health and safety
- → Capital investment in industrial facilities
- → Industrialisation of developing world
- → Energy and water resources markets growth
- → New technology

How we operate

We cultivate a highly decentralised operating culture which encourages our businesses to focus on establishing market leadership in their selected niche within a global market. Each subsidiary is led by a management team who enjoy genuine autonomy and the freedom to grow in an entrepreneurial environment.

These management teams are chaired by Halma's Divisional Chief Executives (DCEs) who understand the market needs and can contribute broadly to the individual company's strategy in technical, operational and commercial areas. These DCEs meet with the Group Chief Executive regularly to review progress against their operating division's strategic objectives.

Through the regular interaction between the Group's Executive Board members, common challenges and opportunities for Group businesses are identified which sometimes leads to a central initiative. Examples of initiatives underway are sales process improvement, innovation, people development and increasing activity in China via our Halma hubs in Shanghai and Beijing.

DCEs are responsible for finding, negotiating, completing and managing acquisitions in their own business sectors. Acquisition costs, including goodwill, are incorporated in the incentive plans of all Executive Board members.

When new acquisitions join Halma they invariably retain their name and identity, and vendors often continue to work with us. Elsewhere entrepreneurs who typically find working in a large international organisation too constraining welcome our autonomous culture and decentralised structure which allows them to develop further.

Outlook

2006/07 marked another year of good progress for the Group with record revenues and profits. Significant investment continues in R&D, capital expenditure and strengthening channels to market. This combination of delivering strong results whilst increasing investment provides a solid platform from which it is possible for the Group to sustain organic growth above market rates.

Good quality prospects for further acquisitions in our target markets exist and acquisitions will continue to play an important role in the Group's long-term growth.

We have clear growth strategies for our markets and we continue to work hard to improve the quality of our execution through active resource allocation and people development. We are well placed to deliver sustained growth and enter the new year in good shape.

Infrastructure Sensors sector review

We make products which detect hazards to protect people and property in public and commercial buildings.

KPI	Group target	2007	2006
Revenue growth[1]	>5%	17%	12%
Profit growth[2]	>5%	16%	2%
Return on sales[3]	~18%	18.1%	18.3%
ROCE[4] (Return on capital employed)	>45%	64%	60%
R&D as a % of revenue[5]	~4%	4.2%	4.4%

KPIs are calculated on results from continuing operations.

1. Sector revenue compared with the prior year.
2. Adjusted[6] sector profit before finance expense compared with the prior year.
3. Return on sales is defined as adjusted[6] sector profit before finance expense and taxation expressed as a percentage of sector revenue.
4. Adjusted[6] sector profit before finance expense expressed as a percentage of sector operating net assets.
5. Sector research and development expenditure expressed as a percentage of sector revenue.
6. Adjusted to remove the amortisation of acquired intangible assets.

Sector overview
Infrastructure Sensors, our largest business, contributes 44% of Group revenue (£155 million) and 41% (£28 million) of Group profit†. Our principal products are sensors for fire, security, automatic doors and elevator controls. There are four sub-sectors:

Fire detection We make fire and smoke detectors and audible/visual warning devices. We are the second largest manufacturer of point smoke detectors in the world. We make fire products in the UK and US, with sales offices in the US, Europe, Africa, the Middle East and Asia.

Security sensors We have a strong presence in this strategically important and fast growing market. We are the market leaders in the UK and South Africa for security sensors used in public and commercial property*. These products are made in the UK.

Automatic door sensors We are one of the world's largest manufacturers of sensors used on automatic doors in public and commercial buildings*. These products are made in China, Belgium and the US.

Elevator safety We are the world's largest manufacturer of elevator/lift door safety sensors*. We also make emergency communication devices, display modules and control panels for elevators. These products are made in the UK, the Czech Republic, New Zealand, the US, China and Singapore.

Sector strategy
Our strategy in this sector is to become the leading supplier of safety-critical sensor components used in non-residential building monitoring and control systems. We focus on specialist components, not complete installed systems. The global manufacturers of complete building infrastructure systems see us as a strategic partner or specialist supplier of advanced technology components rather than a direct competitor.

To support our Elevator safety sales growth, during the past year we organised our companies into three regional businesses covering Asia, Europe and North America. Our strategy is to boost competitiveness by presenting customers with a single, seamless source for our complete range of elevator safety products in each region. As part of a strategy of getting closer to elevator customers than our competitors, we opened new regional sales offices in Delhi, Houston and Toronto adding to the new offices opened in Asia and the Middle East last year.

Continuous manufacturing cost reduction remains a key strategic activity within this sector balanced by the need to remain close to our customers. Consequently, we will continue to invest significantly in our Czech and Chinese factories.

† See note 1 to the accounts

Strategic achievements

→ Return to organic profit growth
→ New global strategy for Elevator Safety
→ Further new sales offices opened in North America and Asia
→ Launch of first Chinese designed and manufactured automatic door sensor product

Strategic directions

→ Organic profit growth driven by revenue growth
→ Increase direct presence further in China and Asia regions
→ Develop internal technical/commercial collaboration opportunities
→ Complete implementation of new global strategy for Elevator Safety businesses
→ Add new products and technology organically and via acquisition

Market trends

A significant trend in the Infrastructure Sensors market sector is rising demand for integrated fire, security, evacuation and access systems. To accommodate this need, we have developed a new technology platform which will be licensed to our fire alarm system partners so that our fire detectors can be specified in buildings with integrated fire and security monitoring.

Worldwide demand for fire detectors remains strong. With an estimated growth rate of 18%, China continues to offer the highest revenue growth potential. Europe, where our fire product revenues grew by over 15%, reversed the downward trend of last year due to recovery in the German market.

Downward pricing pressure continues in the fire detector market, particularly in the Middle East and Asia. Further investment in our sales channels, coupled with increased spending on R&D and the supply chain, delivered continued growth in these markets and gross margins remained solid.

Our ability to innovate and respond rapidly to frequent regulatory changes maintains competitive advantage. In addition to new technical standards, during the past year we accommodated new regulations covering: safe disposal and recycling of waste electrical products (WEEE Directive); restrictions on the use of hazardous substances in electrical products (RoHs Directive); and enhanced electromagnetic compatibility standards (CPD Directive).

Our Security sensors sell into a global market worth over £2 billion annually, which continues to grow at 6% per year. Following our acquisition of Texecom in November 2005, we established a strong presence in the UK and South African markets and are making good progress towards gaining the necessary product approvals to sell our products into China and the US. These markets offer us significant growth potential and we will be using expertise in our other Infrastructure Sensors businesses to develop our presence more rapidly.

Our internal estimate is a 3% to 4% global growth rate for the automatic door safety market. We have high market shares in Europe and the US where many of our competitors have chosen low prices as their main competitive strategy. Our strategy to maintain our margins and market share by reducing production costs and introducing new market leading products tailored for each region, continued to be successful.

We believe that the global market growth rate for new elevators (and elevator services) is in the region of 5% to 6%.** We calculate the annual value of the elevator markets that we serve at £180 million. The Middle East, India and China offer the highest growth rates for elevator safety sensors. Price competition is prevalent; severe in China, but moderate in Europe and the US.

New European legislation called "Safety Norm EN-81", designed to improve elevator safety and accessibility for people with disabilities, boosted European demand for our products in the building modernisation market.

Sector performance

Our Fire detector businesses produced record revenues and profits. In 2006/07, organic revenue and profit growth was more than double market growth rates thereby increasing market share while improving profitability. More than 10 significant new fire products were introduced and we obtained 450 new product approvals for global markets.

Despite strong revenue growth, profit growth from security sensor products suffered from currency volatility as well as high investment in new markets and product development.

Even with strong price competition in the automatic door sensor market, both revenues and profits grew significantly. We maintained our high market shares in Europe and the US and defended our good profit margins partly by cutting production costs through increased investment in our Chinese manufacturing capacity. However, we also benefited from launching innovative, market leading products, such as the 4Safe sensor which prevents people from being trapped or injured in automatic, revolving or swing doors. New legislation boosted sales of 4Safe in Germany.

Last year we began to increase our direct presence in key developing elevator markets and this year both revenue and profit moved ahead. We countered a slight dip in margins in the past year with new, lower cost products and by cutting production costs. Revenues from offices set up in Dubai and Mumbai have grown very successfully, whilst progress in new regional offices in China has been more varied.

ROCE for the sector as a whole continues to be excellent.

Sector outlook

With our Fire detector and Automatic door sensor businesses achieving solid organic profit growth on increased revenues, a flow of new products aimed at diversification and market expansion is planned to drive growth. Continued strengthening of senior management and IT investment in our Security sensor and Elevator safety businesses is well underway to improve the potential for profit growth in these businesses in the future.

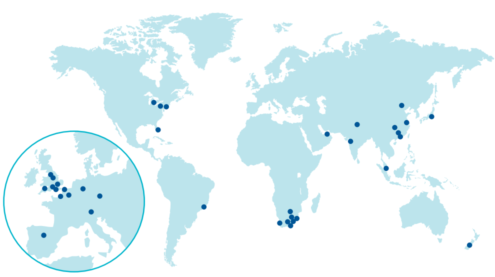
Sources of information:

* Internal market analysis including confidential market sources

** Freedonia "Industry Study 2016 – World Elevators" and elevator manufacturers' websites

Geographic regions

Belgium
Brazil
China
Czech Republic
France
Germany
Italy
Hong Kong
India
Japan
New Zealand
Singapore
South Africa
Spain
United Arab Emirates
UK
USA



Main growth drivers

→ Safety regulations and legislation
→ Risk and cost of accidents
→ Commercial construction (new build and refurbishment)
→ Population growth, ageing and urbanisation
→ Rising expectations of health and safety
→ Capital investment in industrial facilities
→ Industrialisation of developing world
→ Energy and water resources markets growth
→ New technology

Health and Analysis sector review

We make components and products used to improve personal and public health. We also develop technologies and products which are used for analysis in safety, environmental and leisure related markets, including Water.

KPI	Group target	2007	2006 (restated)*
Revenue growth[1]	>5%	9%	18%
Profit growth[2]	>5%	7%	52%
Return on sales[3]	~18%	20.4%	20.7%
ROCE[4] (Return on capital employed)	>45%	75%	79%
R&D as a % of revenue[5]	~4%	5.3%	4.9%

* restated to reflect the reclassification of Radio-Tech Limited to the Industrial Safety sector.

KPIs are calculated on results from continuing operations.

1. Sector revenue compared with the prior year.
2. Adjusted[6] sector profit before finance expense compared with the prior year.
3. Return on sales is defined as adjusted[6] sector profit before finance expense and taxation expressed as a percentage of sector revenue.
4. Adjusted[6] sector profit before finance expense expressed as a percentage of sector operating net assets.
5. Sector research and development expenditure expressed as a percentage of sector revenue.
6. Adjusted to remove the amortisation of acquired intangible assets.

Sector overview

Health and Analysis contributed 34% (£120 million) of Group revenue and 36% (£24 million) of Group profit†. There are four principal sub-sectors:

Water We estimate that we are the world leaders in monitoring and finding leaks in underground water pipelines and among the world leaders in UV technology for disinfecting and treating water. We manufacture our water products in the UK, The Netherlands, France and the US.

Fluid technology We make critical components such as pumps, probes, valves, connectors and tubing used by scientific, environmental and medical diagnostic instrument manufacturers for demanding fluid handling applications. These products are made in the US and UK.

Photonics We have market leading technologies and products which generate, measure and condition light and analyse the interaction of light with substances. We have manufacturing sites in the US, Germany and The Netherlands.

Health optics We make handheld devices used to assess eye health, diagnose disease and assist with eye surgery. Our ophthalmic products are made in the UK and the US.

Sector strategy

In Water management we aim to be the technology leaders and offer water utilities worldwide new solutions to their water supply problems. Our Water UV treatment growth strategy is to unlock new regulated markets via further product validations, and to adapt existing product lines for new applications.

We aim to grow our Fluid technology business by broadening our product range and our presence outside of our traditional US stronghold both via organic growth and acquisitions.

Geographic expansion and innovative product development are our twin organic growth strategies for Photonics. The Mikropack and Labsphere acquisitions completed this year added complementary light generation and measurement technologies. We will seek further photonics acquisitions which we can grow rapidly using our well-established sales channels.

In Health optics, higher R&D investment is resulting in an increased rate of new product introduction. This will enable us to grow market share in developed countries whilst we build sales channels in the developing world for the longer term.

† See note 1 to the accounts

Strategic achievements

→ Organic revenue and profit growth despite strong adverse currency movement
→ Mikropack, Baldwin Environmental and Labsphere acquisitions
→ Five companies establish new presence in China via Halma hubs
→ Increased rate of R&D to 5.3% of revenue
→ Over 40 new products launched

Strategic directions

→ Organic revenue and profit growth
→ Develop business in China and Asia region
→ Establish local manufacturing in major export territories
→ Increase technical collaboration
→ Target further acquisitions

Market trends
Confidential market research values the US market for UV water treatment plant at £120 million annually which our internal estimates suggest equates to the rest of the world's combined markets. Market growth is estimated to be over 15%, driven by increasing health regulation and an expanding industrial customer base including semiconductors, aquaculture and leisure pools.

Regulation plays an increasingly important role in developing regional water markets. The US Environmental Protection Agency recently issued guidance* that will accelerate adoption of UV treatment for controlling water-borne diseases in drinking water. EU expansion is driving demand; new member states must adopt EU health and safety regulations.

Using internal data, we estimate that the global market for water pipework monitoring and leak location equipment is worth over £45 million annually. We estimate the market has grown by 7% per year for the past four years and we anticipate similar growth as a minimum for the next five years.

In Fluid technology, there has been greater consolidation within the clinical diagnostic instrumentation market than in previous years due to M&A activity. We are broadening our product offering into the medical and environmental instrumentation segments which are also growing fast. For example, China plans to invest £87 billion between 2006 and 2010 on environmental protection projects**.

Photonics continues to offer us exciting organic and acquisition growth prospects. We are global leaders in the miniature spectrometer market niche which we estimate to be worth £70 million annually and growing at 15% per year.

The use of photonic methods is increasing rapidly in a vast range of end markets. The advantages of optical sensors over traditional methods can include lower cost, greater sensitivity, in-situ measurement capability (particularly in hazardous environments), immunity from electromagnetic interference, repeatability and stability. Over 60% of Halma companies use optical technologies.

Growth drivers for our Health optics products include rising demand for eye care due to demographic changes in the developed world plus increasing access to health services in developing countries. We estimate*** that the health optics market is growing in developing countries by 5% annually and 2% to 3% worldwide.

New ophthalmic products undergo lengthy clinical trials and rigorous medical product regulation which is a disincentive to market entrants. Digital and video imaging technology for examining the eye continues to evolve and a disruptive technology could emerge to change the market dynamics in the medium term. We continue to monitor this closely and have established relationships with some of the leading digital imaging companies where our products can be complementary to their technology.

Sector performance
In our Water businesses we consolidated the strong recovery achieved in 2005/06. Although progress in the US market remained patchy, revenues in European markets rose sharply.

Fluid technology revenues increased although profits were flat due to increased investment in new products as well as in sales and distribution.

Revenues and profits from Photonics products grew to record levels. A new photonics sales and technical support office was opened in Shanghai and European activities were strengthened by the Mikropack acquisition.

In Health optics our strong brand positioning and a healthy stream of new and enhanced products delivered record revenues and profit.

The increased rate of investment in R&D (now 5.3% of revenue) is an important element in maintaining the excellent operating returns in this sector.

Sector outlook
New product innovation and technical collaboration are increasingly important organic growth drivers.

Geographic expansion into developed and developing regions offers further organic growth opportunities and we hope to benefit from the higher investment in 2006/07 in the coming year.

Increased acquisition search resources are identifying opportunities which can strengthen our technology and market presence.

This combination of organic and acquisitive growth prospects should lead to further progress during 2007/08.

Sources of information:

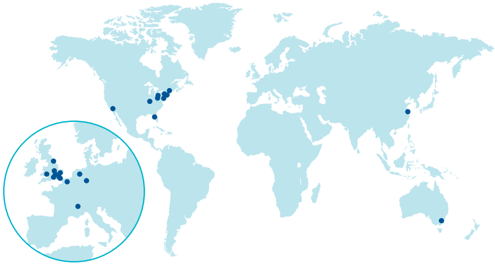
* EPA – Long-Term 2 Enhanced Surface Water Treatment Rule

** Chinese official Xinhua News Agency

*** Discussions with competitors, company country visits, confidential market reports

Geographic regions

Australia
China
France
Germany
The Netherlands
UK
USA



Main growth drivers

→ Safety regulations and legislation
→ Risk and cost of accidents
→ Commercial construction (new build and refurbishment)
→ Population growth, ageing and urbanisation
→ Rising expectations of health and safety
→ Capital investment in industrial facilities
→ Industrialisation of developing world
→ Energy and water resources markets growth
→ New technology

Industrial Safety sector review

We make products which protect property and people at work

KPI	Group target	2007	2006 (restated)*
Revenue growth[1]	>5%	15%	20%
Profit growth[2]	>5%	19%	34%
Return on sales[3]	~18%	20.0%	19.4%
ROCE[4] (Return on capital employed)	>45%	75%	76%
R&D as a % of revenue[5]	~4%	2.9%	3.2%

* restated to reflect the reclassification of Radio-Tech Limited from the Health and Analysis sector.

KPIs are calculated on results from continuing operations.

1. Sector revenue compared with the prior year.
2. Adjusted[6] sector profit before finance expense compared with the prior year.
3. Return on sales is defined as adjusted[6] sector profit before finance expense and taxation expressed as a percentage of sector revenue.
4. Adjusted[6] sector profit before finance expense expressed as a percentage of sector operating net assets.
5. Sector research and development expenditure expressed as a percentage of sector revenue.
6. Adjusted to remove the amortisation of acquired intangible assets.

Sector overview

Industrial Safety contributed 22% of Group revenue (£80 million) and 23% of Group profit† (£16 million). Following recent acquisitions, we created a new Asset monitoring sub-sector.

Gas detection We make portable instruments and fixed systems which detect flammable and hazardous gases. We make our gas detectors in the UK where we have a market leading position.

Bursting discs We make “one time use” pressure relief devices to protect large vessels and pipework in process industries. We are UK market leaders and, based on our own estimates, number four in the world market. Our bursting discs are made in the UK and the US.

Safety interlocks We make specialised mechanical, electrical and electromechanical locks which ensure that critical processes operate safely and prevent accidents. We have significant market strength in petrochemicals, oil and gas, and significant geographic market share in Western Europe and Australasia. We manufacture interlocks in the UK, The Netherlands, France, Tunisia and Australia.

Asset monitoring We make products which monitor the condition of physical assets above ground, below ground and underwater using innovative sensor and communications technologies. This sub-sector was created following the acquisitions of Radio-Tech in 2005 and, most recently Tritech/System Technologies in November 2006. Underwater applications include monitoring of oil pipelines and telecommunications cables as well as vessel and harbour security. Applications on dry land include systems for monitoring railway tracks and structures such as bridges. Our asset monitoring products are made in the UK.

Sector strategy

We choose to operate in global industrial safety market niches which demand innovative, robust technologies to protect against critical safety hazards where the cost of the protecting product is relatively small compared with the cost of an accident. Competitive advantage can be gained through technical innovation and superior customer service and technical support.

Strong global competition in gas detectors means that we must have a dual strategy of constant cost reduction and a regular stream of new products. In the next year we plan to start manufacturing in China and are already using R&D resources in India to accelerate the rate of product development.

† See note 1 to the accounts

Strategic achievements

→ Strong organic revenue and profit growth
→ New Asset monitoring sub-sector created through Tritech acquisition
→ Strengthened Gas detection presence in China and India
→ Introduced new wireless communication technology for use by our Water businesses in the Health and Analysis sector

Strategic directions

→ Organic profit growth driven by revenue growth
→ Expand gas detector R&D and manufacture in India and China
→ Develop more new products for the oil and gas industry
→ Accelerate new product development cycles
→ Introduce wireless communication technologies into other Halma businesses

Our Bursting disc companies continue to develop their distribution network to improve market share. Capital investment in plant, improved processes, product rationalisation and outsourcing of component supplies have cut production costs and increased competitiveness by reducing lead times.

Our strong position in the global market for Safety interlocks dictates that we not only have to protect our position through new products and market leading customer service but also find ways to broaden our market opportunity. For example we are adding safety interlock capability to adjacent product categories like the new eGard product which marries safety interlocking with machine control.

In Asset monitoring we see a significant opportunity in satisfying the growing worldwide demand for remote monitoring of expensive or safety critical physical assets – particularly those in hazardous or remote locations.

Market trends

Our internal assessment of the global market for gas detection products is £500 million; we forecast an average annual growth rate of 3% to 4%. The demand for gas detection products remains robust in the developed industrial countries. The gradual adoption of Western safety standards in the fast-growing Asian economies will drive additional demand in these markets.

Our internal data suggest that the market for bursting discs is growing at 3% to 4%. Substantial continued investment by our customers in lower cost labour markets, and the transfer of US and European safety standards is leading us to allocate more of our resources into developing regions such as Eastern Europe and Asia.

In addition to increasing safety awareness and regulation, the safety interlock market continues to benefit from the trend of increasing capital spending in the oil and gas sector driven by relatively high oil prices and global demand. High-profile accidents at petrochemical processing plants during the past 18 months have impacted on customer behaviour with some oil companies now specifying safety interlocks earlier in the plant design phase.

Customer feedback suggests that Chinese authorities are now encouraging Western companies with manufacturing plants in China to adopt the same safety standards as in their home territory. Over the medium term, this will help to improve industrial safety expectations throughout China and drive demand for our products.

Rising global demand for closer monitoring of energy usage and for capturing data relating to high value infrastructure assets, offers excellent growth prospects for our Asset monitoring businesses. Our recent acquisition, Tritech, serves an exciting niche in subsea sensors and communication products which help service companies install, inspect and monitor underwater assets. The trend towards deeper water activities in the oil and gas sector will support demand for our underwater acoustic surveillance sensors. Online research indicates that between 2001 and 2005 global deepwater capital investment was £16.5 billion and it is estimated to more than double to £44 billion during 2006 to 2010.

Sector performance

2006/07 was a very successful year with organic revenue and profit growth significantly above the market growth rates and a major acquisition completed.

Geographically, revenue growth was particularly good in the Middle East where we benefited from major oil and gas projects. Regions such as the UK were also strong where our new Sprint V flue analyser product was adopted by BG Group with a £1.4 million supply contract.

We succeeded in integrating our wireless communications technology used in asset monitoring with other sectors in the Group and can see other opportunities for technical collaboration in the future.

Relative to our other sectors we invest a slightly lower percentage of revenue in R&D. However, good growth opportunities continue to exist and the Return on sales and ROCE remain at a high level.

Sector outlook

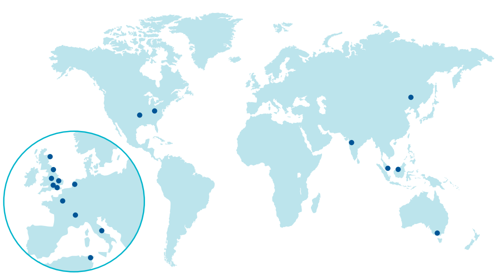
In the long term, increasing safety regulation, greater concern over the consequences of accidents from company boards and higher safety expectations by workers will continue to drive demand for our Industrial Safety products.

We will continue to seek bolt-on acquisitions which will enhance our products and distribution strength in higher growth markets.

We have solid positions in each of our chosen markets and by continuing to invest in new products, additional sales offices and our activities in lower cost territories such as Eastern Europe and Asia, we are well placed to continue our track record of healthy organic growth.

Geographic regions

Australia
China
France
India
Italy
Malaysia
The Netherlands
Singapore
Tunisia
UK
USA



Main growth drivers

→ Safety regulations and legislation
→ Risk and cost of accidents
→ Commercial construction (new build and refurbishment)
→ Population growth, ageing and urbanisation
→ Rising expectations of health and safety
→ Capital investment in industrial facilities
→ Industrialisation of developing world
→ Energy and water resources markets growth
→ New technology

Operating environment, risks and uncertainties

Macro-economic, regulatory and competitive environment
We anticipate that the 2007/08 macro-economic environment will be broadly favourable to our growth strategy. In global terms, we see the US, Europe and Asian economies offering good opportunities with Asia having higher growth rates from a lower base. Growth in the more mature economies is important to our overall growth prospects albeit that our products are often used in regulated markets and this affords some protection from the extremes of economic cycles.

Safety and environmental legislation is constantly evolving, worldwide, towards increased safeguards and protection. This favours us because it relentlessly drives demand growth in our core markets. Legislative change challenges us to continually refresh our product portfolio whilst regulatory compliance is also a powerful barrier to entry for competitors. Our well developed capacity to innovate, coupled with strong R&D resources, positions our companies for leadership of markets dominated by regulatory control.

The markets we operate in are generally highly competitive. Our diversified product portfolio and wide geographic coverage means that competitive product manufacturers are analysed at subsidiary company or operating sector level. We have commented on the competitive environment in the sector reviews.

Employee, health and safety and environmental issues
Our core values are Innovation, Empowerment, Achievement and Customer Satisfaction. The core values have been selected following extensive surveying of employees across the Group. Our culture is one of openness, integrity and accountability. We encourage our employees to act fairly in their dealings with fellow employees, customers, suppliers and business partners. We recognise that our employees determine our success and therefore have invested in and encouraged their development more this year than ever before, not only with our intranet training facilities and Halma Executive Development Programme, but also through clearer leadership and decisive action. By ensuring that our team has the approach and skills required to succeed we are better placed to meet the challenges of the future.

We recognise the necessity of safeguarding the health and safety of our own employees whilst at work and operate so as to provide a safe and comfortable working environment for employees, visitors and the public. Our policy is to manage our activities to avoid causing any unnecessary or unacceptable risks to health and safety and the environment. We have an excellent long-term record for addressing environmental issues that affect our businesses and for developing products that protect the environment and improve safety at work and in public places.

Many of our innovative products play a very positive role in monitoring and improving the environment. Our brands lead the world in a number of technologies which help to minimise environmental damage.

We support the concept of sustainability and recognise that, in common with all businesses, our activities have an environmental impact. Our strategy is not to have capital-intensive manufacturing processes, so the environmental impact of our operations is relatively low compared to manufacturers in other sectors. We also recognise that we can improve our own environmental performance and so resources are now being deployed to actively reduce our own carbon footprint. More information on these activities is given in the Corporate responsibility section of this review.

Halma was designated a member of the FTSE4Good UK index on its establishment in July 2001.

Resources, risks and uncertainties
The main intangible resources which deliver competitive advantage and which support our strategic objectives are: the patents and trade marks which protect our products; our employees, whose understanding of our technology, customers' needs and the dynamics of the markets we operate in, enable us to maintain leadership in many markets; and the enviable reputation enjoyed by our brands for superior product quality and market leading customer support. Our businesses build competitive advantage and strengthen barriers to entry in many ways including patents, product approvals, technical innovation, product quality, customer service levels and branding. We look for these qualities in the businesses we seek to acquire.

We like regulated markets which require suppliers to achieve compliance with demanding product standards but also look for other long-term growth drivers such as demographic change.

We seek to continuously grow our profits, generating a high return for shareholders over the long term. We view risk within the context of this objective as well as in absolute terms.

In any business there are inherent risks that are an integral component of its business activities. Our strategy is to operate a continuous process to identify the risks faced by our companies and the Group, to assess each risk's likelihood of occurring and impact were it to occur, and to ensure that a system of controls is in place to manage or mitigate those risks assessed as significant. Appropriate actions are taken to address any weaknesses. Comprehensive insurance cover is maintained where warranted and cost effective.

Our key means of risk control is the choice of the markets in which we operate and the people and methods we use to exploit those market opportunities. We perceive our primary operational risks to emanate from remoteness of operation and the actions and quality of our people.

Our choice to operate in the safety products and health-related technology markets, and the depth of market knowledge we have built up within the Group, allows us to adequately evaluate and assess the risks we encounter throughout our operations.

We do not place undue reliance on any one Group company nor does any one Group company rely heavily on one customer or transaction. In managing the portfolio of companies within the Group and in managing the transactions in any one company, we seek to spread our risks. We have processes in place to ensure any major transactions are reviewed at the appropriate level, including at Board level if necessary.

Another factor limiting risk is that our products are predominantly critical components or instruments which are warranted as fit for the purpose rather than systems or intangible products where satisfactory performance is contingent upon third parties.

Our procedures to identify, manage and mitigate the risks within the Group address the following major risk factors:

Organic growth and competition The Group is affected by competition in the form of pricing, service, reliability and substitution. There is an ever present risk of losing market share or failing to adapt to market changes. High quality alternative products at low cost will always be a threat. Our focus on improving our rate of innovation is a direct result of assessing these risks and determining how best to concentrate our efforts. Maintaining the high quality of our products is critical. In addition, all businesses analyse revenue and margin by product line on a monthly basis. Through continual innovation and by ensuring that local management are well resourced and free to respond to changing market needs, we feel that the adverse impact of downward price pressure and competition can be mitigated.

Acquisitions The identification and purchase of businesses which meet our demanding financial and growth criteria is an important part of our strategy for developing the Group. Therefore we have been increasing the resource allocated to this activity, focusing on sectors where we see the greatest opportunity. There is always a significant potential integration risk, particularly in the purchase of private businesses, and this is an area which is being continually improved.

R&D New products have always been critical to the growth of the Group and have underpinned its ability to earn high margins and high returns over the long term. R&D is of necessity a risky activity but by devolving control of product development into the autonomous operating businesses, the Group spreads the risk and ensures that the resource is as close to the customer as possible, giving the maximum chance of success. Protection of our intellectual property is important to the Group's continued success. Whilst no single product or process is critical to the Group as a whole, all appropriate actions are taken to protect the Group's intellectual property rights.

Financial irregularities and increasing span of control We recognise that the size and remoteness of some operations may not permit full segregation of duties and that Internal and External Audit procedures may not always identify a financial irregularity. This is increasingly the case as we pursue our strategy of geographic expansion often into regions with different accounting bases and cultures. Therefore the Group seeks to ensure there is adequate local management and financial resource and regularly reiterates to the operating company officers their fiduciary responsibilities, ensuring they are adequately trained in financial matters whilst maintaining a culture of openness to promote disclosure. Group companies operate a common set of reporting procedures and accounting policies, disseminated via the Group intranet.

Pension deficit Monitoring the funding needs of the pension obligations is essential to controlling the cash the pension plan requires from Halma. Our UK defined benefit pension plans are closed to new members. There is regular dialogue with pension fund trustees and pension strategy is a regular Halma Board agenda item. The Group's strong cash flows and access to adequate borrowing facilities mean that the pensions risk can be adequately managed. The Group is currently increasing contributions with the overall objective of paying off the deficit in line with the Actuary's recommendations.

Financial and treasury risks The Group does not use complex derivative financial instruments and no speculative treasury transactions are undertaken. Foreign currency risk is the most significant treasury related risk for the Group. Significant currency denominated net assets are hedged but future currency profits are not hedged. Therefore, the Sterling value of overseas profit earned during the year is sensitive to the strength of Sterling, particularly against the US Dollar and the Euro. The Group is exposed to a lesser extent to other treasury risks such as interest rate risk and liquidity risk. These financial risks are discussed more fully in note 26 to the accounts.

Laws and regulations Group operations are subject to wide-ranging laws and regulations including employment, environmental and health and safety legislation. There is also exposure to litigation and contractual risk. All Group companies have an employee handbook detailing employment practices and we consider our relations with our employees to be good. Each operating company has a health and safety manager responsible for compliance and our performance in this area is excellent. The Group's emphasis on excellent financial control, the deployment of high quality management resource and strong focus on quality control over products and processes in each operating business helps to protect us from adverse litigation and contractual issues.

Corporate responsibility

A summary of our progress and performance for all areas of corporate responsibility follows. Halma is developing meaningful key performance indicators (KPIs) that reflect the importance the Group places on corporate responsibility and will enable the Board to monitor the Group's progress in meeting its objectives and responsibilities in these areas. Halma will report against these KPIs next year.

The biggest area of emphasis over the past year has been the transformation of the Group's environmental policy into a Carbon Policy stating actual targeted reductions for the Group to achieve over a set timescale. Halma has an excellent health and safety record and a culture of safety is deeply embedded within the Group. We want to recognise the effort behind this exemplary record and will promote our safety culture more visibly over the coming year. Finally, the increased investment in management training continues to be valuable and we are exploring a number of key metrics to better communicate this to stakeholders.

Socially responsible investment

Investing in Halma shares meets the criteria of many professional and private investors who base their decisions on environmental, ethical and social considerations. The Group is a world leader in several key environmental technologies and has a reputation for honesty and integrity in its relationships with employees, customers, business partners and shareholders.

Social conditions can be improved for all through the creation of wealth. Halma creates wealth responsibly allowing our employees, customers, business partners and shareholders to determine where this wealth is best distributed.

Halma's policies reflect the core requirements of the Universal Declaration of Human Rights and the ILO Declaration on Fundamental Principles and Rights at Work. We do not tolerate practices which contravene these international standards.

Regulatory demands upon us vary considerably around the world, so in each of the following areas Halma establishes the core structure to ensure that Group companies fully comply with regulatory requirements while permitting them to tailor the solutions to their particular needs.

The environment

Within Halma, we have an excellent long-term record and a clear strategy for addressing environmental issues that affect our businesses and for developing products that protect the environment and improve safety at work and in public places.

Our products

Many of our innovative products play a very positive role in monitoring and improving the environment. Halma brands lead the world in a number of technologies which help to minimise environmental damage.

Our principal environmental technologies are water leakage detection, gas emissions monitoring, water and effluent analysis, UV water treatment and optical sensing. We tirelessly promote the use of UV water sterilisation which eliminates the need to use dangerous chemicals, as well as products that minimise the waste of clean water.

Our commitment to the development of equipment for measuring environmental changes and controlling the damaging impact of industrial activities is long term.

We make safety equipment for use at work, in public places and in transportation systems that contribute to increased personal safety by ensuring safe practice at work, protecting people from fire and making elevators and automatic doors safe and effective. We are the major world supplier in several of these areas.

Carbon policy

The Group's policy on carbon is published on our website and has been distributed and explained to all Halma business units.

A senior executive in each of our higher-impact business units is responsible for implementing the carbon policy at local level. The Group Finance Director, Kevin Thompson, has principal responsibility for coordinating and monitoring the policy.

Keeler scholarship

Dr Srilakshmi Sharma from Bristol Eye Hospital is this year's winner of the highly prestigious Keeler Scholarship for research into ocular inflammatory disease. Worth £20,000, the scholarship is funded by Keeler, Halma's world leader in high precision optical instruments. It allows the winner to spend up to two years undertaking research into ophthalmology.

"I'm very pleased to have won this Scholarship," she said. "It will be a fantastic experience which will allow me to conduct research at an internationally acclaimed medical ophthalmology clinic."

The Keeler Scholarship is awarded every two years and is designed to advance the science and practice of ophthalmology by enabling the winner to study, research or acquire special skills, knowledge or experience for a minimum period of six months. The award is administered through the Royal College of Ophthalmologists.

UV and wastewater

The development of new UV technologies is a perfect example of an industry investing to meet market demand for an effective, low cost, and environmentally friendly way to disinfect wastewater for reuse.

Potential applications for wastewater reuse are extremely wide-ranging and include any instance where water is needed for non-potable use. The most popular and widespread use is for agricultural irrigation, with California and Florida leading the way in the US and a number of Australian states also making significant progress. Other irrigation uses include landscape and recreational applications such as golf courses, parks, and lawns.

Founded less than ten years ago Anthem, a town just north of Phoenix, Arizona, now has a population of over 40,000. As part of its rapid expansion the town recently installed three closed chamber medium pressure UV systems from Berson UV-techniek to disinfect its wastewater. This allows the town to not only meet increased demands in its water and wastewater treatment capacity, but also to exceed the output quality standards.

Environmental management system

We are committed to developing and implementing an environmental management system (EMS) throughout the Group to measure, control and, where practical, reduce our environmental impacts. We are developing performance indicators that will assist local management in implementing the policy and developing an EMS. The requirement for an EMS and the related reporting has been rolled out to all UK business units, which represent over 50% of Group production facilities in terms of external turnover. All Group companies are encouraged to undertake ISO 14001, the international environmental standard, accreditation where warranted, and during the year, Radcom (Technologies) Limited and Palmer Environmental Limited both obtained ISO 14001 approval. The requirement to implement an EMS will be extended to the rest of the Group in the medium term.

Our impacts

We support the concept of sustainability and recognise that, in common with all businesses, our activities have an environmental impact. Our strategy is not to have capital-intensive manufacturing processes, so the environmental effect of our operations is relatively low compared to manufacturers in other sectors. FTSE4Good has assessed Halma as having a low impact on the environment.

Nevertheless, Group companies are encouraged to improve energy efficiency, reduce waste and emissions and reduce the use of materials in order to reduce their environmental impact. The Group established baseline data in 2004/05 on emissions to air and water, water and energy consumption, and waste production, the results of which are updated on the website each year. The data collected for the past three years has enabled the Group to set comprehensive and quantifiable objectives for reducing its environmental impacts in those areas and to set targets for reduction in key areas.

The collected data confirms that the main areas of impact on the environment are energy consumption and solid waste disposal. The Group does not operate a fleet of distribution vehicles although we do own a number of company cars. From May 2007, we are implementing a cap on permissible CO_2 emissions of all UK company vehicles and will extend this requirement to the rest of the world in the short term. This limit will be reduced annually so as to consistently reduce our vehicles' environmental impact.

Having identified the main areas of impact, we are now committed to their reduction and minimisation. Using the baseline data the total Group carbon emissions for 2006/07 was calculated as being approximately 15,000 tonnes, an average of less than 50 tonnes per £million of revenues. We plan to reduce the Group's total carbon emissions relative to revenues by 10% by 2010.

We are working with AEA, an international environment and energy consultancy, to facilitate this reduction by providing each subsidiary with the means to identify tailored initiatives for energy efficiency. This will be complemented by internal programmes, including the use of our own wireless communications technology to monitor energy usage and use of the Group intranet to allow for inter-company communication, reporting of data and feedback. We expect that this initiative will lead to cost savings for the Group as well as preparing us for compliance with anticipated climate change legislation.

The new Carbon Policy can be found on the Halma website. The Group's environmental performance will continue to be reported in both the Annual report and on our website.

The Group is committed to examining the establishment of "green" procurement policies and increasing our use of recycled materials.

Green innovation

Fortress Interlocks has won the prestigious "Green" Innovation Award at this year's innovation & Design Excellence Awards (iDEA) against strong competition. The award was for Fortress' eGard, a unique new product which combines both machine safety and control modules in one flexible unit.

The iDEAs, organised by Eureka, New Electronics and Cranfield School of Management, recognised that the innovation behind eGard opens up a new, large market sector for Fortress. The award also recognised that Fortress designed and manufactured eGard along environmental principles taking into account the whole life-cycle of the product.

Fortress decided to make the housing from polymer using the same material throughout to make recycling more efficient. Other parts are made of stainless steel. In addition, the housing has no fixings or adhesive; parts are clipped together or ultrasonically welded. This reduces component count and also makes recycling much easier.

Corporate responsibility continued

The workplace

Halma operates an employment policy with the objective of ensuring equal opportunities and preventing harassment in the workplace. This gives us access to the widest labour market and enables us to secure the best employees for our needs.

Halma demonstrated that it is one of the UK's most admired businesses again this year by another high ranking in Management Today magazine's annual survey of corporate reputation. The awards are a peer review, distilling the opinions of directors who run many of the UK's largest companies. This is a revealing survey based on the key elements that make companies succeed. Companies are, in effect, judged by their competitors, and the survey is unique in the UK.

Halma was ranked the 55th most admired company out of a list of 239 businesses. The awards are based on a survey by Nottingham Business School of the ten largest UK-based companies in each of 24 different sectors. Respondents rate companies in categories such as quality of management, financial soundness, quality of products, ability to attract, develop and retain talented managers, value as a long-term investment and capacity to innovate.

Training

2006/07 was another successful year for the Halma Executive Development Programme (HEDP) which is based on our recognition of the fundamental part our people play in the success of the Group. HEDP is an integrated development plan for our senior people – including the next generation of Managing Directors and Divisional Chief Executives. Our objective is to provide these individuals with the tools and training to achieve more in their existing role and potentially to advance through the organisation if their achievements merit it.

HEDP is aimed squarely at employees already serving on subsidiary boards but we also encourage applications from senior managers who can demonstrate they already have equivalent responsibilities and will benefit from the programme.

The programme has been developed from a proven course structure and is specifically and continuously tailored to suit Halma's needs, aligning the content to the Group's four core values of Innovation, Achievement, Empowerment and Customer Satisfaction. It focuses strongly on strategic and leadership capabilities and developing personal attributes – commitment, determination and resilience. There is an emphasis on performance management and team development. It includes skill-based elements such as sales and marketing, management, project leadership, corporate governance, finance and innovation, but all are presented in a strategic context.

The first four programmes have now been completed and the success of the programme can be measured by the enthusiasm of the participants upon their return to their businesses, the achievements and promotion of a number of participants and their eagerness to coordinate further sessions to explore topics of particular interest to their programme group. The final week of the programme immerses the participants in an environment related to an emerging market or a market of significant opportunity. Participants have been to China, India, Argentina and Japan and had access to many local businesses and officials as well as local community programmes aimed at improving the quality of life of local children and young adults.

Eureka!

In April 2007, Halma held a prize draw for its monthly innovation award, Eureka! The lucky winner, Steve Jansen of Texecom was randomly picked from over 150 names who had submitted innovation ideas during the year and won a car to the value of £9,000. Steve is Procurement Manager and entered two innovation ideas over the year that he has put into practice at the company, one for a small circuit board which reduced assembly times of the company's bell boxes by around 50% and another for the company's packaging which has also significantly increased the production rate. Eureka! is simply looking for the actual birth of the idea, the creative spark that heralds the start of an original thought process which will bring new benefit to a Group business. A prize is also awarded for the most creative innovation idea submitted during any one month.

Health and safety

The Group recognises the necessity of safeguarding the health and safety of our own employees whilst at work and operates so as to provide a safe and comfortable working environment for employees, visitors and the public. The Group's health and safety policy, which is set out on our website, is to manage our activities to avoid causing any unnecessary or unacceptable risks to health and safety. The policy is understood by all Group companies, and given the autonomous structure of the Group, operational responsibility for compliance with relevant local health and safety regulations is delegated to the board of directors of each Group company. We believe health and safety training is important and it is carried out within companies as appropriate. Adequate internal reporting exists in order that the Group Finance Director may monitor each company's compliance with this policy.

The Group has collected details of its worldwide reported health and safety incidents which are available on our website at www.halma.com. We are pleased to report that there were no fatalities during 2006/07 or 2005/06, and we achieved a considerable decrease in both serious and minor injuries in comparison with low levels in 2005/06.

Ethics

The Group culture is one of openness, integrity and accountability. Halma encourages its employees to act fairly in their dealings with fellow employees, customers, suppliers and business partners. We aim to have suppliers of high quality and operate to acceptable international standards. Halma operates a confidential "whistleblowing" policy, which enables all Group employees to raise any concerns they may have.

Halma has a zero-tolerance policy on bribery and corruption which extends to all business dealings and transactions in which we are directly involved. This includes a prohibition on making political donations, offering or receiving inappropriate gifts or making undue payments to influence the outcome of business dealings.

Queen's Award

In April 2007, following the year end, Fortress Interlocks, one of our UK-based Industrial Safety businesses was awarded a prestigious Queen's Award for Enterprise: Innovation in recognition of their mGard safety interlock product. This is the 10th Queen's Award received by one of our companies since the inception of the Queen's Award scheme.

Innovation

Innovation is a critical ingredient for Halma's growth. Continually refreshing our intellectual property leads to new products and processes and helps us to maintain the strong market positions held by many of our companies. Innovation is not just the responsibility of the R&D department but is integral to all commercial activities within the business. Innovative ideas can range from a novel way to enter a new or remote market to administration process improvements speeding the delivery of products to customers. All employees within the Group have the opportunity to deliver innovative ideas to help their company and the Group achieve the growth objectives.

The Group continued the successful Halma Annual Innovation Awards, launched in 2004/05, which recognise the major product and process innovations during the past year. The 2006/07 Gold Award of £20,000 was presented at the annual CEO Conference by Geoff Unwin to Brian Back and Inder Panesar of Radio-Tech for their Rail Temperature Monitor system, a radio telemetry system that enables rail temperatures to be monitored constantly, anywhere on the network, providing early warning of the risk of track buckling. The Silver Award of £10,000 was awarded to Jim Lane, Phil Buchsbaum, Cliff Batchelder, Greg Williamson and Steve Mattessich of Ocean Optics Thin Films Division for the SeaChanger xG Color Engine, a revolutionary colour filter system for spotlights. It can be used to produce dramatic lighting effects in theatres and large venues such as museums and churches. The Bronze Award of £5,000 was awarded to Emmanuel Eubelen, Thierry Jongen, Marc Meyers and Jean-Michel Bechet of BEA for the 4Safe, a new type of safety sensor, specifically designed to prevent anyone from being trapped or injured in automatic revolving or swing doors.

Financial review

Kevin Thompson
Finance Director

A strong performance with widespread growth

Record revenue and profit

We achieved our highest ever revenue from continuing operations at £354.6 million (2006: £310.8 million), an increase of 14% over the prior year. Profit before tax and amortisation of acquired intangibles at £66.1 million (2006: £58.1 million) on our continuing operations, excluding the disposals made in the prior year, was 14% higher and was also a record.

Adjusting for the extra profit which came with acquisitions gives organic growth* of 8.1% in revenue and 7.6% in terms of profit. There was a notable currency headwind through the year and without that organic revenue and profit growth would have been 2.3% and 2.5% higher respectively. See below for more detail on currency impacts. Earnings per share were up 11% on a statutory basis and up 14% on our adjusted* basis. A year of good further progress.

As noted above there were disposals last year but none this year and so the comparative figures are for continuing operations only. We have made a minor reclassification within our sector figures, moving our Asset monitoring business into the Industrial Safety sector and details of the change are given in note 1 to the accounts.

All sectors grew strongly

Infrastructure Sensors and Industrial Safety sectors both grew revenue and profit by more than 15%. The strong performance of Infrastructure Sensors, our largest sector, was underpinned by the higher investment made last year. The Health and Analysis sector grew revenue by 9% and 7% in terms of profit*, well above our target of 5% growth and following on from very strong growth in the previous year. Return on sales* for each sector remained firmly in the 18% to 21% range. Sector performances are discussed further on pages 22 to 27.

Revenue to all destinations grew

There was widespread geographic growth in revenue. The following table gives revenue from continuing operations by destination.

£ million	Revenue	% change
United States of America	98.9	5.1%
United Kingdom	96.5	16.4%
Mainland Europe	91.4	18.4%
Asia Pacific and Australasia	35.5	6.6%
Africa, Near and Middle East	22.3	51.5%
Other	10.0	16.5%
	354.6	14.1%

In the US our Health and Analysis and Industrial Safety businesses showed solid growth with Infrastructure Sensors not yet making as strong progress. In the UK, Africa, Near and Middle East, Infrastructure Sensors performed very well, as it did in Mainland Europe, with the majority of the European increase coming organically. Industrial Safety grew strongly in the UK assisted by the addition of the Tritech business. Growth in the Asia Pacific region was more modest although sales to China grew by 26% from a low base. We are putting far greater resources into this region to capture the opportunity there. Importantly, revenue outside of the US/UK/Mainland Europe grew by a further 20% as we expand our geographic coverage.

*See Financial highlights.

A continued trend of strong margins and returns

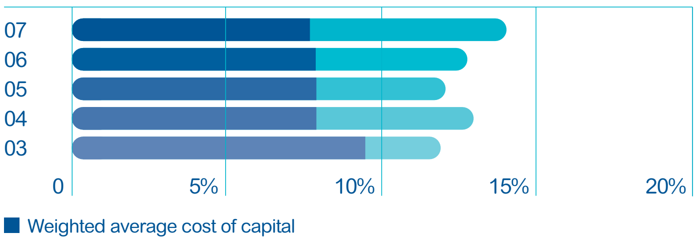
Resumption of strong growth

In the year we again achieved very good organic growth and at the same time maintained high returns. An important part of our strategy, reflected in our KPIs (see page 20) is the delivery of excellent returns and the strong cash flow which comes from them. These high returns have been a feature of the Group over many years, but significantly this has once again been coupled with good organic growth in these past two years.

ROCE* of 60.1% and ROTIC* of 14.0%

Our returns are strong and stable. Return on capital employed (ROCE) was 60.1% (2006: 56.9%) showing the high value we generate from our tangible asset base. Return on total invested capital (ROTIC) increased to 14.0% (2006: 12.8%), this is a post-tax return on the total asset base including all historic goodwill but excluding the pension deficit. See note 3 to the accounts for the full calculation of ROCE and ROTIC. The pattern of ROTIC over the past five years is as follows:

ROTIC %



ROTIC has grown recently because we have grown earnings at a faster rate than the underlying capital base. In each year ROTIC has been well in excess of our Weighted average cost of capital (WACC) which has been calculated as currently being 7.7%. A sustained high ROTIC well above our WACC is a central element of our value creation strategy.

High Return on sales* at 18.6%

Once again we delivered a high Return on sales* figure at 18.6% (2006: 18.7%). We disposed of some businesses last year which generated a slightly lower margin. The Group has operated with a Return on sales* range of 16.2% to 19.8% for more than 20 years. These sustained high margins demonstrate the significant value placed on our products by our customers throughout the economic cycle.

Maintaining a strong financial position

Good cash flow

The Group generated strong cash flow once again with cash generated from operations of £70.3 million. The following table sets out the main components of our cash flows and these are discussed in the sections below.

Change in net cash/(debt)

£ million	2007	2006
Cash generated from operations	70.3	70.2
Acquisition of businesses	(27.5)	(36.2)
Disposal of businesses	–	14.6
Development costs capitalised	(3.9)	(2.5)
Net capital expenditure	(7.3)	(11.6)
Dividends paid	(25.9)	(24.5)
Taxation paid	(19.5)	(16.8)
Issue of shares/purchase of treasury shares	3.6	0.6
Net finance expense	(0.8)	(0.4)
Exchange adjustments	(0.2)	(1.9)
	(11.2)	(8.5)
Net cash brought forward	3.5	12.0
Net (debt)/cash carried forward	(7.7)	3.5

The Group finances its operations from retained earnings and has access to third party borrowings when needed. There are no material funds outside the UK where repatriation is restricted. Our treasury policies seek to minimise financial risks and ensure sufficient liquidity. No speculative transactions are undertaken. Foreign currency profits are not hedged but purchase and sale transactions are hedged into the functional currency of the relevant operating company and balance sheet net currency assets are substantially hedged.

More earnings enhancing acquisitions

We continued to implement our strategy of acquiring successful businesses and helping them grow. In particular, we offer businesses an autonomous environment within which to continue their record of success. We spent £27.5 million on acquisitions in the year of which £8.2 million related to the payment of deferred consideration on acquisitions made in previous years. Acquisitions made in the year have met or exceeded our expectations.

Financial review continued

The largest acquisitions in the year were of Tritech/System Technologies and Labsphere. We acquired Tritech/System Technologies, who design and manufacture underwater asset monitoring equipment, in November 2006. Their 2005 audited accounts showed annual revenue of £5.4 million and profit of £1.1 million on a combined basis, with further encouraging growth since that time. We paid an initial consideration of £10 million, with a further potential payment of up to £4.5 million conditional on substantial future growth.

Labsphere, a world leader in light testing and measurement products, was acquired in February 2007 for a cash consideration of US$14.3 million (£7.2 million). There are no additional payments to make for this acquisition. Labsphere's unaudited accounts for 2006 show revenues of US$12.5 million (£6.3 million) and operating profit of US$2.4 million (£1.2 million).

In the year we also acquired Mikropack, which makes light sources and photonic accessories, for €2.3 million (£1.5 million) and Baldwin Environmental for US$1.1 million (£0.6 million) with a potential further total of £1.9 million payable on the two acquisitions if performance targets are met.

All of these acquisitions were immediately earnings enhancing and were generating a rate of return in excess of our WACC at the time of acquisition. We continue to invest considerable resources into identifying further acquisitions in our chosen markets.

Capital expenditure at typical levels

We spent £10.9 million on property, plant and computer software in the year, a lower figure than the high expenditure last year representing 134% of depreciation/amortisation – a more typical level for the Group. Two surplus properties sold during the year increased disposal proceeds. In 2007/08 we expect to undertake two specific property developments at separate subsidiaries which should add to the underlying rate of capital investment and also produce a small gain on a property disposal.

Further 5% dividend increase with cover raised

The Board has recommended a further 5% increase in the final dividend up to 4.33p which together with the interim dividend (also 5% higher) will give a total dividend of 7.18p for the year, assuming the final dividend is approved. This will mean a total payout to the shareholders in dividends of £26.7 million in relation to the year ended 31 March 2007. This continues our progressive dividend policy stretching back many years. It also furthers our objective of increasing dividend cover (based on profit from continuing operations before amortisation of acquired intangible assets) towards a figure of around 2.0 over time, by lifting the cover from 1.61 to 1.74 times.

Tax rate

The effective tax rate on profit from continuing operations (before amortisation of acquired intangible assets) is very similar to last year at 29.8% (2006: 30.1%). Future effective tax rates are more likely to be higher although not significantly so.

Pension contributions increased, deficit reduced

As indicated last year we have increased the rate of contributions into our defined benefit pension plans which were closed to new entrants in 2003. An additional £3 million was paid into the plans in the year and over the next couple of years we expect the annual cash contributions to continue to increase by a further £2 million so that we can meet our objective of paying off the deficit, as measured on an IAS 19 basis, over a ten-year period. These extra contributions are not insignificant but are not expected to impair our growth opportunities. The pension deficit on an IAS 19 basis reported in the accounts has reduced from £46 million last year to £37 million at year end, before the related deferred tax asset. This decrease arises from an increase in the value of plan assets, helped by the additional contributions, offset by proportionately less of an increase in the present value of plan liabilities due to a higher discount rate being applied.

Modest net debt of £7.7 million

We finished the year with a modest level of gearing at £7.7 million (2006: £3.5 million net cash). This begins to utilise the £60 million five-year debt facility put in place last year with our well-established banking partners. The Board would be willing to utilise more of this facility if good acquisition and investment opportunities are identified. The Group continues to be able to borrow at competitive rates and therefore currently deems this to be the most effective method of funding our increasing investment.

A currency headwind continues

There was a currency headwind through the year, particularly in the second half. Approximately one-third of Group revenue is denominated in US Dollars and 15% in Euros with the US Dollar recently showing significant adverse movement relative to Sterling. We translated our US Dollar revenue and profit to Sterling at an average rate of 1.78 in 2005/06 but in 2006/07 this average was 1.89. As a guide, a 1% weakening of the US Dollar relative to Sterling is expected to reduce revenue by approximately £1 million and profit by £0.2 million in a full year. The adverse movement in the South African Rand relative to Sterling in the year also reduced profitability in our Infrastructure Sensors business which has a sizable operation in South Africa. As previously indicated there has been an adverse impact in translating our results into Sterling which we estimate as reducing revenue by 2.3% and profit by 2.5% and most of this impact has fallen in the second half of the year. If current exchange rates prevail, our results will continue to be adversely impacted, particularly in the first half of the current financial year.

The impact of currency movements on the Group's net tangible assets is largely offset by the currency hedging loans we have in place.

Amongst the operating sectors it is the Health and Analysis sector which has the biggest trading exposure to the US Dollar both in terms of origin and destination of its business. The Health and Analysis businesses generate 45% of their revenue from the US compared with 21% for Infrastructure Sensors and 16% for Industrial Safety. This gives an indication of the relative impact of US Dollar movement and it is the profitability of the Health and Analysis sector which was hardest hit by the fall in the US Dollar relative to Sterling in 2006/07.

Active investment for the future

Growing R&D and extending innovation

We continue to invest heavily in Research & Development (R&D) and are active in promoting an innovative culture across the Group. Expenditure on R&D in the year was 4.3% of revenue (2006: 4.3% of revenue) and amounted to £15.3 million, 14% up on last year for continuing operations. We do not specifically capture the expenditure on all innovation as it permeates every aspect of our activities but this is an increasing use of existing and new resources. The Sector reviews on pages 22 to 27 show the percentage of revenue spent in each sector on R&D as one of our KPIs. They show that relative to our growing revenue our spend this year is consistent with last year and that the Health and Analysis sector continues to invest the highest percentage at 5.3%.

Under International Financial Reporting Standards (IFRS) we are required to capitalise certain development expenditure on the Consolidated balance sheet and also to amortise that asset over an appropriate period. In the year we capitalised £3.9 million of such development expenditure and amortised £1.5 million, giving rise to an asset of £6.1 million in the March 2007 balance sheet. The nature of R&D is that it involves risk and therefore we carefully monitor all costs carried on the balance sheet. The Consolidated income statement was charged with a cost 4% higher than last year. This increasing rate of investment in new, innovative products underpins our future growth.

Developing in China

We have taken a big step forward in China this year in terms of getting more high quality resource on the ground. The Asia Pacific region contributes only 10% of our total revenue, with China as a small part of this. We see substantial opportunity for many of our products in this region and so the extra investment in China, around £0.5 million more in 2006/07, is an important part of the growth process. Our task in 2007/08 and beyond is accelerating the payback on this investment.

Developing our strong control culture and our people

We spread our risks in part by operating through a number of closely managed individual businesses. The main risks and uncertainties facing Halma are discussed above in this Business and financial review. We have high quality local teams guiding each business within our overall reporting and control framework. There is significant external review of these operations and one element of that review process, our Internal Audit, has been further enhanced this year by more in-depth visits. Each business has a senior finance executive on site who plays an important part in the control and growth of the business. We continue to actively develop our people and we have now had 13 of our senior finance staff graduate from the Halma Executive Development Programme (HEDP) and are finding them able to make an even broader contribution to the progress of the business.

Taking our environmental responsibilities seriously

Our impact on the environment is low and we produce many products which themselves have a positive impact. Carbon emissions reduction seems to be important for the future and we are putting in place a variety of actions to both monitor and actively manage our carbon footprint. We are at the early stages of formulating reliable measures and KPIs, but are making good progress and this is discussed more fully on pages 30 and 31. We take a broader view that our impact on the environment is not just in relation to carbon emissions but also water usage, packaging and waste generally, all areas where we have a good record.

Not only should we be able to comply with regulations as they develop but also we are focussing our efforts in this area on increasing profitability and genuinely improving our business. Improving further in these areas should deliver greater value for customers and shareholders.

Cautionary note

The Business and financial review has been prepared solely to assist shareholders to assess the Board's strategies and their potential to succeed. It should not be relied on by any other party, for other purposes. Forward-looking statements have been made by the Directors in good faith using information available up until the date that they approved the Report. Forward-looking statements should be regarded with caution because of the inherent uncertainties in economic trends and business risks.

In preparing this Business and financial review, the Directors have aimed to comply with the Accounting Standards Board's 2006 Reporting Statement guidance on Operating and Financial Reviews. However, we are only at the early stages of developing non-financial Key Performance Indicators and so these have not been included in this Annual report.