

Strategic review

We operate in relatively non-cyclical markets with resilient growth drivers. This enables us to increase shareholder value via organic growth and acquisitions.

RETURN ON SALES*

18.4%

REVENUE GROWTH TO ASIA

21%

MACRO-ECONOMIC, REGULATORY AND COMPETITIVE ENVIRONMENT

Our expectation for 2008/09 is that the macro-economic environment will be generally favourable to our growth strategy. We expect a higher risk of instability in the global economy but anticipate that for us any demand reduction in specific markets will be more than offset by: rising demand in developing regions; extending sales channels and gaining market share in developed regions; and more value-enhancing acquisitions.

Increasing environmental and safety legislation in our markets is favourable to us since it creates demand for our products. Global, national and regional product approvals and technical validations are an increasing cost and technical challenge, but also form an increasing barrier to market entrants.

While a slowdown in the more mature economies may moderate our rate of organic growth, we have a resilient business mix. Many Halma products sell into highly regulated markets characterised by low sales cyclicalities. Demand resilience due to many of our products being driven by 'non-discretionary' customer spend, together with the diversity of our product portfolio, geographic market spread and a significant contribution from service income, upgrading and replacement products provide protection from unfavourable macro-economic trends.

While our markets are competitive, sales are spread across a wide range of industries; our largest single market is fire detection (approximately 15% of revenue) and our largest individual customer constitutes less than 3% of Halma revenue. This wide spread of activity means that competition issues are analysed at subsidiary company or operating sector level and our competitive environment is considered in the Sector reviews on pages 16-27.

GROUP STRATEGY AND FORWARD VISION

We have a clear vision of how the world is changing. Increased regulation and legislation, long-term demographic trends and generally higher safety, health and environmental expectations are relevant examples. As the world changes, our customers and their needs change too.

Within our operating businesses growth strategies tend to have a three to five-year horizon. However, at Group level, our strategy for acquiring businesses, developing positions in markets and investing in manufacturing resources has a horizon of 10 years or more.

We position our businesses in markets which we identify as relatively non-cyclical. We select markets with good prospects of long-term, sustained growth whatever the prevailing macro-economic conditions. Our criteria for choosing markets is that they are underpinned by resilient growth drivers.

OUR PRIMARY GROWTH DRIVERS

Demand for energy and water resources

Worldwide growth in energy and water consumption is relentless. The total world consumption of marketed energy is projected to increase by 57% from 2004 to 2030¹. Despite the predicted economic slowdown in the USA, Asian economies are forecast to grow by 7.6% in 2008, with the PRC economy expanding by 10%². As an indicator of rising energy demand, Asian electricity generation is predicted to rise annually by more than 4% from 2004 to 2030¹. These trends favour our Industrial Safety businesses as investment in oil exploration and power generation continues to rise.

Growth in population, ageing and urbanisation

While population growth, ageing and urbanisation are sales drivers with a global dimension, their impact on our businesses is different regionally. For example, population growth and urbanisation drives demand for our Infrastructure Sensor products in Asia while the ageing population in the Western World drives demand for health products.

By the end of 2008 more than half of the world's population, 3.3 billion people, will be living in urban areas, rising to almost 5 billion by 2030³. The next few decades will see unprecedented urban growth, particularly in the developing world. Urbanisation drives investment in non-residential buildings like shops, offices, schools and hospitals, the primary market for our infrastructure sensors.

¹ International Energy Outlook 2007, Energy Information Administration (US Government)

² Asian Development Outlook 2007, Asian Development Bank

³ State of World Population 2007, UNFPA (United Nations)

* See Financial highlights

Strategic review (continued)

Poor water quality and the urgent need to conserve water resource stimulate demand for our water leak location equipment, water quality testing kits and UV water treatment systems.

Increasing demand for healthcare

Many factors are fuelling the growing worldwide demand for healthcare and our health related products. The USA, the world's largest healthcare market, is expected to grow at an annual rate of 6.7% from 2007 to 2017. US healthcare spending will rise from 16.3% of GDP in 2007 to 19.5% in 2017⁴.

In the developed world population ageing creates rising demand, whereas in the developing world economic development is making healthcare affordable to an increasing number of people. Throughout the world, advances in medical technology enable new medical procedures, stimulating demand for new instruments and equipment.

Increasing regulation and rising expectations of health and safety

Each year as many as 270 million people suffer occupational accidents and 160 million contract occupational diseases. Approximately two million people die from work-related accidents and diseases annually⁵. To combat this, governments worldwide introduce increasingly rigorous safety and environmental legislation to provide improved safety and quality of life. Failure to address these risks carries a huge potential cost to our customers.

Globalisation also drives demand for safety equipment. Western multinational businesses see the development of transnational safety and health standards as good business practice, effectively exporting high safety standards to the countries they operate in. In time, these practices become integrated into the regulatory frameworks of the 'host' countries. This is a process we see evolving in Asia currently.

New technology

During the past year, Halma companies spent 4.7% of revenue (£18.6m) on R&D and introduced around 90 new products into their market niches. Although we develop leading edge technology in some businesses, for example our Photonics business, most of our R&D is spent on taking proven technology and applying it in new ways using our market leading understanding of the application challenges. Our R&D resources are placed in each of the subsidiary companies to ensure market needs are understood and met efficiently. This agility results in products with superior performance and value for customers delivering strong product margins and sustained revenue growth.

OUR STRATEGIC PRIORITIES

Organic growth

Our strategic priorities for 2008/09 are to continue to deliver organic growth and maintain a balance between investment and profitability. The ability to grow and to make additional investments is an important element of our progress over the past three years.

Acquisitions

We want to accelerate our rate of growth by acquisition. We have invested more resources in our search for acquisitions and to ensure newly acquired businesses are integrated effectively. The characteristics of target businesses and their markets are most important. They have to be a good fit with our operating culture and strategy in addition to being value-enhancing financially.

Asian business expansion

We are seeing continued progress and opportunities in Asia – where revenue grew by 21% this year and represents around 11% of the Group total. The Halma China hubs created in 2006 resulted in 16 Group companies with a presence in the country, up from three originally. Since then we have made small investments in Fire and Gas Detection and are creating a manufacturing hub in Shanghai which will be operational in mid-2008. We are establishing a new Halma India hub in Mumbai which will be operational by the end of 2008.

Management development

We will continue to strengthen our management. Our increased investment in training has improved the quality and flexibility of our senior management and resulted in greater movement of managers across Group companies. Active management of our people resources is a key factor in our ability to sustain long-term growth.

Executive Board responsibilities are adjusted regularly to match our strategic priorities.

High rate of innovation

Innovation is continually improving from an already high standard. Our emphasis is on both product and process innovation since the latter often results in significant competitive advantage for niche businesses. The quality of entries in our monthly and annual innovation awards, together with the high number of new products launched each year, underline this success.

⁴ Outlook – Healthcare Properties 2008, Grubb & Ellis Company (US)

⁵ Decent Work, Safe Work, International Labour Office

Strategic principles

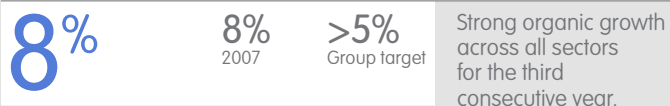
We apply five strategic principles to create shareholder value.

1. Operate in specialised global markets offering long-term growth underpinned by robust growth drivers achieving organic growth rates above the blended long-term growth rate of our markets of around 5%.
2. Build businesses which lead specialised global markets through innovative products differentiated on performance and quality rather than price alone.
3. Recruit and develop top quality boards to lead our businesses and nurture an entrepreneurial culture within a framework of rigorous financial discipline.
4. 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.
5. Achieve a high Return on capital employed to generate cash efficiently to fund organic growth, closely targeted acquisitions and sustained dividend growth.

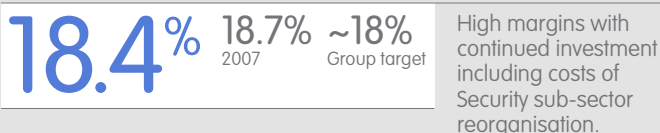
KPIs

We use financial Key Performance Indicators (KPIs) to monitor progress.

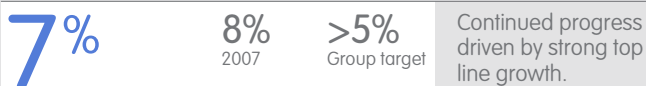
ORGANIC REVENUE GROWTH¹



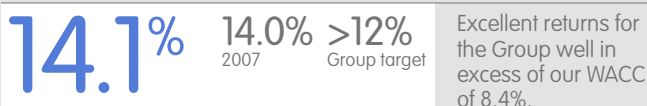
RETURN ON SALES²



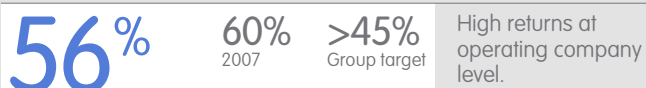
ORGANIC PROFIT GROWTH¹



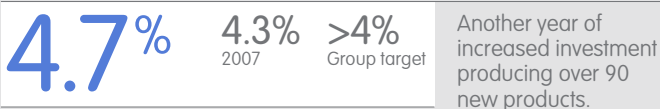
ROTIC (RETURN ON TOTAL INVESTED CAPITAL)³



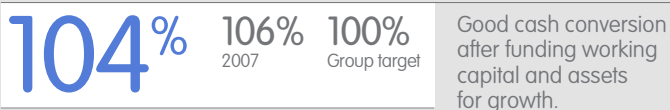
ROCE (RETURN ON CAPITAL EMPLOYED)³



R&D AS A PERCENTAGE OF REVENUE⁴



OPERATING CASH TO PROFIT⁵



See pages 32 to 35 for non-financial KPIs

1. Organic growth measures the change in the revenue and profit 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 profit at the date of acquisition.
 2. Return on sales is defined as adjusted⁶ profit before taxation from continuing operations expressed as a percentage of revenue from continuing operations.
 3. ROTIC and ROCE 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 operations expressed as a percentage of adjusted⁶ profit from continuing operations.
 6. Adjusted to remove the amortisation of acquired intangible assets.

Risks and resources

These are the major risks and uncertainties facing us and what we are doing to identify, manage and mitigate them.

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 the inherent risks that are an integral component of business activities must be identified, managed and mitigated. 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 employees. Accordingly we invest heavily in identifying, recruiting and training talented people who are able to manage these risks while delivering the excellent results we require. 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.

ORGANIC GROWTH AND COMPETITION

The Group faces competition in the form of pricing, service, reliability and substitution. 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 maintain management information systems that provide local management with valuable product and market data. By empowering and resourcing local operations to respond to changing market needs, we have shown that any 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, as is ensuring the new businesses are rapidly integrated into the Group. We aim to pay sensible multiples for businesses whose technology and markets we typically know well. In the past year, we have increased the resource allocated to these activities, focusing on sectors where we see the greatest opportunity. These new resources are targeted to increase the pipeline of opportunities and ensure post-acquisition integration is successfully implemented.

R&D

New products are critical to our organic growth and underpin our 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, we spread the risk and ensure 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 our continued success. Whilst no single product or process is critical to the Group as a whole, all appropriate actions are taken to protect our 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 risk increases as we pursue our strategy of geographic expansion often into regions with different accounting bases and cultures. Therefore the Group ensures that there is adequate local management and financial resource in each operational location and regularly reiterates to the subsidiary 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 Group's pension plans is essential to funding our pension obligations effectively. 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.

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 and transactions are hedged but future currency profits are not hedged. 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, including the need to report any major legal or contractual risks. 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. Each operating company has a health and safety manager responsible for compliance and our performance in this area is excellent.

INTANGIBLE RESOURCES ADDRESSING RISK

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.



470 million people live in regions with severe **water shortages**, predicted to increase to 3 billion by 2025*

* International Water Association

Alabama, USA



“Our water distribution system consists of almost 4,000 miles of transmission lines. Leaks waste resources and raise costs for the city. The Permalog sensors do a great job at finding leaks and have become an integral part of our water system.”

[Geoff Goodwin](#)

Director of Water Recovery, Birmingham Water Works Board



Over 3,000 Permalog leak detectors monitor the underground water pipe network in the city of Birmingham, Alabama, USA to help conserve water in this drought-stricken region. Permalog is a state-of-the-art, battery-powered acoustic sensor and data recording device which fits on mains water pipes via magnetic force and periodically sends a 'no leak' radio signal or an alarm if a leak is detected.



City water supply

Halma's making a difference