

# Financial review

## A strong financial position



**Kevin Thompson**  
Finance Director

### Another year of good progress

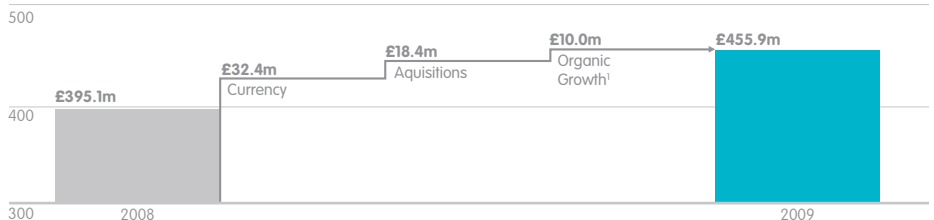
For the sixth consecutive year we are reporting record results. Results from continuing operations were as follows:

|                              | 2009<br>£m | 2008<br>£m | Percentage change |                             |  |
|------------------------------|------------|------------|-------------------|-----------------------------|--|
|                              |            |            | Total             | Organic growth <sup>1</sup> | Organic growth <sup>1</sup> at constant currency |
| Revenue                      | 455.9      | 395.1      | 15.4%             | 10.7%                       | 2.5%   |
| Adjusted profit <sup>1</sup> | 79.1       | 72.8       | 8.7%              | 5.1%                        | (3.3%)   |

Organic growth<sup>1</sup> is calculated before the inclusion of acquisitions and our target is 5% year on year improvement. We benefited from favourable currency movements in the translation of our results to Sterling.

### REVENUE FROM CONTINUING OPERATIONS

£million



### Revenue from continuing operations

These results include the cost of reorganisation activities undertaken in the second half of the year to reduce the base level of overhead cost. This charge against profits amounted to £1.2m and we expect that approximately a further £2.5m will be expensed in 2009/10 for the cost of further actions. It is anticipated that these combined actions will reduce overheads by at least £15m compared with the run rate in the second half of the year, being approximately 7% of 2008/09 total overheads.

The financial KPIs we use to monitor our progress are shown on pages 18 and 19. Whilst in this year one profit-related measure fell slightly below the demanding targets we set for ourselves, the KPIs collectively show the high returns and good performance delivered by Halma, even in a tougher environment. Our balance sheet remains strong.

In the second half of the year revenues increased by 12% but profits increased by only 2%. There was an approximately 12% benefit to revenue and profit from currency translation in the second half compared with approximately 5% in the first half. The profit performance in the second half of the year was heavily influenced by the increased overhead costs in the Health and Analysis sector discussed in the Chief Executive's and Sector reviews.

### Strong sector revenue growth

All three sectors increased revenues once again. Infrastructure Sensors, our largest sector at 41% of total revenue, grew by 11%, all organic growth. Health and Analysis increased revenue by 23% and Industrial Safety by 12% and both of these sectors also delivered double-digit organic revenue growth, at a similar level to Infrastructure Sensors.

Infrastructure Sensors and Industrial Safety profit growth was strong, at 16% and 14% respectively. As indicated above, Health and Analysis produced profit only marginally above last year including the benefit of acquisitions resulting in us undertaking reorganisation activity.

### Expanding business outside the UK

Outside the UK there was very strong revenue growth. Revenue from continuing operations by destination was as follows:

| £million                     | Revenue | % growth | % of total |
|------------------------------|---------|----------|------------|
| Mainland Europe              | 132.5   | 22.9%    | 29.0%      |
| United States of America     | 120.7   | 17.2%    | 26.5%      |
| United Kingdom               | 104.4   | (4.4%)   | 22.9%      |
| Asia Pacific and Australasia | 54.1    | 26.2%    | 11.9%      |
| Other Countries              | 44.2    | 37.9%    | 9.7%       |
|                              | 455.9   | 15.4%    | 100%       |

### ADJUSTED PROFIT BEFORE TAXATION<sup>1</sup>

£million

**£79m** **+9%**

|      |    |
|------|----|
| 2009 | 79 |
| 2008 | 73 |
| 2007 | 66 |
| 2006 | 60 |
| 2005 | 50 |

For the first time Mainland Europe was the biggest sales destination with the United Kingdom third largest behind the USA. Growth in Mainland Europe was widespread with our Door Sensors business performing very well and boosted by the full year contribution of Riester, a manufacturer of handheld medical and ophthalmic devices, acquired in the second half of 2007/08. Health and Analysis was a good contributor to revenue growth in the USA, typically a strong market for its products and a region which may show signs of economic recovery earliest. The decline in the UK was primarily due to lower sales by our water leak detection businesses to the UK water utilities, by our subsea asset monitoring business to its customer base in the North Sea and continued softness in the demand for our Security Sensor products.

Revenue to the rest of the world (outside Mainland Europe, USA and UK) increased by 31.2% from 19.0% of total revenue to 21.6%. We are targeting growth in these territories and it is pleasing to see this trend. The growth in Asia Pacific and Australasia included 25% growth in China and 20% growth in India. These are still small markets for us in absolute terms but we believe they offer good long-term potential and therefore they continue to receive a lot of investment. Rest of World revenues benefited from the addition of Riester, with a geographic footprint complementary to Halma's traditional areas of strength, and a number of other businesses grew well here including our Infrastructure Sensors businesses and those selling into the energy-related markets.

#### Favourable currency impact

The international nature of our business makes currency movement an important factor in our performance, especially in times of volatile currency markets. This year there was a significant favourable currency impact on our results with an 8% increase in revenue and profit due to currency translation.

Other than Sterling, the main currencies for Halma are the US Dollar and Euro. Approximately 30% of Group revenue is denominated in US Dollars and 20% in Euros. We do not hedge foreign currency profits but do hedge actual (rather than forecast future) sales and purchase transactions into the functional currency of the relevant operating company. Currency loans are used to hedge a proportion of the net currency assets on our balance sheet. As noted below, because we have borrowings denominated in currency, movements in exchange rates impact on our headroom in our borrowing facilities.

Around half of our revenue originates in the UK and of that approximately 50% is exported, mostly to Europe and the Rest of World territories. There is some natural hedging and as discussed in the review of risks on pages 20 to 21, we are reviewing our currency hedging strategy in the context of the current environment to ensure individual businesses remain competitive in export markets without significant future exposure due to rapid movement in currency exchange rates.

|           | Weighted average rates used in income statement |      | Year end exchange rates used to translate balance sheet |      |
|-----------|---|------|---|------|
|           | 2009  | 2008 | 2009  | 2008 |
| US Dollar | 1.72  | 2.01 | 1.43  | 1.99 |
| Euro      | 1.20  | 1.42 | 1.08  | 1.26 |

As a guide to the sensitivity of translated results to currency movements, a 1% movement in the US Dollar relative to Sterling is expected to change revenue by £1.3m and profit by £0.2m in a full year. A 1% change in the Euro would change revenue and profit by £0.8m and £0.2m respectively.

#### Margins remain strong

Return on sales<sup>1</sup> was at the high rate of 17.3% (2008: 18.4%). This metric reflects our rate of profitability and the high value our customers place on our products. This year the Return on sales is just below our KPI target of around 18%. The Group typically operates in the range of 16-20% Return on sales and the figure has been above 16% for the past 24 years. Maintaining the rate of profitability within our target range is an important focus for 2009/10.

One element of the year on year decrease in Return on sales is the reorganisation costs noted above. Infrastructure Sensors and Industrial Safety increased their Return on sales compared with the prior year. Health and Analysis Return on sales fell from 20.7% to 17.4% due to lower rates of profitability in the Water and Photonics sub-sectors. Gross margins, being revenue less the cost of materials and direct labour, have remained very steady indicating that the decline in Return on sales is mostly related to overheads.

#### Lower effective tax rate

The effective tax rate on profit before amortisation of acquired intangible assets was 27.7% (2008: 29%). As indicated last year the reduction primarily arises from the reduction in the UK rate of corporation tax from April 2008.

## Financial review (continued)

### ADJUSTED EARNINGS PER SHARE<sup>1</sup>

pence

15.30p +10%

|      |       |
|------|-------|
| 2009 | 15.30 |
| 2008 | 13.86 |
| 2007 | 12.42 |
| 2006 | 11.27 |
| 2005 | 9.45  |

There has been a broad trend in recent years towards a reduction in corporation tax rates around the world and this benefits us. The effective tax rate in any particular year will depend on the geographic mix of profit made by the Group. We expect the Group's effective tax rate to remain at close to its current level in the near future.

#### Finance costs increase

The net finance expense in the Consolidated income statement increased to £3.4m (2008: £2.1m). This resulted from a net pension finance charge £0.5m higher than the prior year combined with the increased cost of financing a higher level of debt throughout the year, due in particular to the Riester acquisition made at the end of the third quarter of 2007/08, offset somewhat by our good cash generation and reduced interest rates.

In 2009/10 we anticipate that the net pension finance charge will increase by a further £1.2m due to the deterioration in pension plan asset values that occurred in 2008/09. Subject to any further acquisition expenditure, this should be offset partly by a lower cost of financing external debt assuming that interest rates remain at their current relatively low levels. Of course this also means we would earn lower amounts of interest on any cash deposits held.

#### Further growth in earnings per share and dividends

Adjusted earnings per share<sup>1</sup> increased 10% to 15.30p (2008: 13.86p). This increase is above the rate of increase in profit before amortisation of acquired intangible assets due primarily to the lower effective tax rate this year. Statutory earnings per share were 8% higher at 14.07p (2008: 12.97p) a slightly lower rate of increase due to the extra amortisation of intangible assets on recent acquisitions.

In line with our policy of progressive and sustainable dividends, the Board has recommended a further increase of 5% in the final dividend, subject to shareholder approval. Together with the increase of 5% in the interim dividend this gives a total dividend of 7.93p per share (2008: 7.55p), the 30th consecutive year of 5% or more dividend increases as shown on page 9. The cumulative dividend paid out over this 30-year period will be £293m.

Dividend cover (calculated on earnings before amortisation of acquired intangible assets) increased to 1.93 times, moving closer to our target of 2 times earnings cover.

#### ROTIC<sup>1</sup> of 13.1% and ROCE<sup>1</sup> of 47.7%

Return on total invested capital (ROTIC), the post tax return on the Group's assets including all historic goodwill, was 13.1% (2008: 14.1%) comparing very favourably with the Weighted average cost of capital (WACC) calculated as currently being 9% (2008: 8.4%). This is a key measure for us of shareholder value creation.

Also typical of our high returns, Return on capital employed (ROCE) was once again strong at 47.7% (2008: 55.8%). Efficient use of operating assets within our business is an integral part of our business model and this shows through in our consistently high returns. Both ROTIC and ROCE have been reduced because of the higher Sterling value of currency denominated assets given the weakening of Sterling. See note 3 to the accounts for the definitions of ROTIC and ROCE.

#### Capital structure remains strong

Our strategy is to use our balance sheet to sustain and accelerate business development. We continue to have access to borrowings at competitive rates and view a modest level of debt as an effective way to fund the Group's progress. Our treasury policies aim to ensure there is significant liquidity and that funds are held in highly rated banks with risks spread. No speculative treasury transactions are undertaken.

We put in place a £165m five-year syndicated revolving credit facility on attractive terms with a core group of banks in February 2008. The Group continues to operate well within its banking covenants and with ample headroom on its facilities.

We ended the year with net debt of £51.2m (2008: £44.3m). As well as financing the growth of our business we funded two acquisitions in the year. We hold most of our debt in US Dollars and Euros having financed past acquisitions in those currencies which brought with them currency assets. The Sterling equivalent of bank loans increased by £17m in the year due to exchange rate movements, reducing headroom on our available borrowing facilities but not to a significant extent.

### Good cash flow generation and strong balance sheet

Cash generated from operations, excluding taxation paid, was £86.4m (2008: £76.0m) representing 109% (2008: 104%) of adjusted profit<sup>1</sup>. A summary of the Group's cash flow is as follows:

| Change in net debt<br>£million            | 2009   | 2008   |
|---|--------|--------|
| Cash generated from operations            | 86.4   | 76.0   |
| Acquisition of businesses                 | (12.4) | (46.5) |
| Disposal of businesses                    | 2.9    | 2.4    |
| Development costs capitalised             | (3.8)  | (3.8)  |
| Net capital expenditure                   | (15.2) | (14.9) |
| Dividends paid                            | (28.8) | (27.3) |
| Taxation paid                             | (20.5) | (17.6) |
| Issue of shares/treasury shares purchased | (0.2)  | 0.2    |
| Net interest paid                         | (2.7)  | (1.8)  |
| Exchange adjustments                      | (12.6) | (3.3)  |
|   | (6.9)  | (36.6) |
| Net debt brought forward                  | (44.3) | (7.7)  |
| Net debt carried forward                  | (51.2) | (44.3) |

Because of the weakness in Sterling relative to the US Dollar and Euro when compared to the March 2008 year end, many balance sheet headings are reported at increased levels. A clearer picture of movements is given in the Consolidated cash flow statement where currency movements are adjusted out within the various headings.

Our balance sheet remains strong. Across the Group there is always considerable emphasis on the management of working capital including inventory. At a time when there is reduced availability of export insurance cover we have tightened further our processes to secure debtor balances. Our risk is reduced because no customer represents more than 3% of Group revenues and debts are spread across many customers. Responsibility for credit control and debt collection continues to be down at the operating company level, closest to the customer.

### Acquisition and disposal activity

Acquisition expenditure in the year was £12.4m (2008: £46.5m). This comprised Fiberguide Industries acquired in September 2008 and the Colorado operation of Oerlikon Optics USA in November 2008.

Fiberguide, based in New Jersey, designs and manufactures complex optical fibre cables and assemblies and was acquired for \$14m. Its most recent annual accounts prior to acquisition show operating profit of \$1.8m on revenues of \$10.7m. Deferred purchase consideration of up to \$10m is potentially payable to the vendors based on achieving earnings growth objectives. Oerlikon is a much smaller business acquired for \$6m and specialising in optical coatings. This was substantially the acquisition of complementary assets enabling the expansion of our existing optical coating business within the Ocean Optics business. Both join our Photonics sub-sector within the Health and Analysis sector.

Two small disposals were made in the year. In January 2009, the assets of the South African operation of Texecom, our Security Sensor business, were sold to local management at asset value (approximately £1.5m). In February 2009, the high-power resistor business of Fortress Systems Pty was sold for £1.2m. These disposals are not treated as discontinued operations because of their size and since there is no substantial change in the Group's operations.

### Sustaining capital expenditure

The expenditure on property, plant and computer software in the year was £16.8m (2008: £15.7m). This year's figure represents 151% of depreciation.

Proposed capital expenditure receives close scrutiny, although we expect to continue to invest at current levels in the foreseeable future, enabling our businesses to take opportunities as they arise. With the Group's very high Return on capital employed there is a good payback for the projects undertaken.

## Financial review (continued)

### Continued high pension contributions

At year end the pension deficit for our defined benefit plans, on an IAS 19 basis, was £42.6m (2008: £36.0m) before the related deferred tax asset. There has been a fall in the value of plan assets to £89.8m (2008: £110.0m) with scheme liabilities valued at £132.4m (2008: £146.0m). Pension plan assets are 64% invested in equities whose value has fallen in 2008/09. As noted in the finance cost section of this review, the lower value of plan assets will increase Group finance costs in 2009/10. The reduction in pension plan liabilities is mainly the result of the increase in the discount rate used to value those liabilities.

The Group's defined benefit pension plans were closed to new members in 2003. We are currently making extra contributions at the rate of £6m per annum into the plans as we work toward our objective of eliminating the deficit, as measured on an IAS 19 basis, over a 10-year period. The valuation of the main pension plan is currently under review based on figures as at 1 December 2008. We expect the funding position as at that date will have deteriorated and is likely to result in additional cash contributions starting later in 2009. Such extra contributions are a notable use of our cash but are not expected to impact significantly on our ability to make progress across the Group.

The Board reviews pension strategy at the time of each pension fund valuation and significant changes are monitored in between. When reviewing the latest actuarial valuation all assumptions will be reviewed, including those related to mortality, to ensure an appropriate level of pension plan funding to meet our obligations.

### Growing investment in R&D

Investment in Research and Development (R&D) is a critical part of the development of the Group and is integral to our core value of Innovation. Expenditure on R&D grew this year by 23% to £22.9m (2008: £18.6m) and now represents 5% of Group revenues (2008: 4.7%). R&D expenditure as a percentage of revenue is one of the KPIs we report on. Industrial Safety maintained the same rate of expenditure this year as last but Infrastructure Sensors and Health and Analysis both increased their rates, well clear of our benchmark level of 4% of revenue.

We are required under International Financing Reporting Standards (IFRS) to capitalise certain development expenditure and amortise the resultant asset over an appropriate period. We have chosen an amortisation period of three years. In 2009 we capitalised £3.8m (2008: £3.8m) and amortised £2.9m (2008: £2.0m) noting that the carried forward figures include a substantial uplift due to currency movements. This results in an asset carried on the Consolidated balance sheet of £10.2m (2008: £8.2m). R&D is by its nature an activity carrying with it some risk, therefore projects, and in particular those giving rise to capitalisation, are subject to close scrutiny and a rigorous approval and review process.

### Risk diversification in the current environment

The key operating risks are discussed above in the Strategic and Sector reviews. In addition risks facing the Group, and our response to these, are reviewed on pages 20 and 21.

We spread risk across our business via a number of independent operating units, each with its own high quality local team, including a senior finance executive. There is a significant level of review both locally and at divisional level and through the independent review of our Internal Audit function. We have strengthened the resources of Internal Audit this year, resulting in an even greater level of focused scrutiny.

We recognise the additional financial risks facing the Group in the current economic environment, for example from fraud or bad debts, and also understand the risk to our business of not having a structure and cost base appropriate to the circumstances. Each of these areas receives close and continued scrutiny so that we can actively manage risk whilst allowing opportunities to be taken. The Board has taken these factors into account in its Going concern review as set out on page 50. Our model of autonomy and accountability is an integral part of Halma and key to us continuing to deliver value for our shareholders in the long term.

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### Kevin Thompson

Finance Director

<sup>1</sup> See Financial highlights

WE ADD VALUE THROUGH

# Encouraging COLLABORATION



## In this section:

- > **Sharing best practice** – Cross sector communication helps to resolve business challenges
- > **Meeting the demand** – creating Halma hubs to benefit and service new clients

# Halma Innovation & Technology Exposition

The first ever Exposition was held in London in 2009 with the goal of building on Innovation and Collaboration between Halma companies.



02



01

- 01 Tan Eng Aun, Divisional Finance Director, Elevator Safety, and Dinesh Musalekar, General Manager, TL Jones India, met during HITE to discuss how the Indian business can be expanded and how the division can assist
- 02 Steve Cech, VP Technology, Volk and Frederic Duchesne, Technical Director, SERV, explored the potential use of optical components in safety interlocks
- 03 Patricia Seniw, VP Finance, Perma Pure, talked to Rob Randelman, President, Ocean Optics about their distributor network in South America
- 04 Adrian Beasley, Technical Director, Keeler, explained the technology used in their eye testing system
- 05 Chong Siew Tan, General Manager, E-Motive showed Martin Zhang, Director Halma China, a world-leading interactive LCD display technology which can be used either in an elevator or as interior building signage



## Encouraging global and cross sector collaboration

Halma's value creation strategy 'in action'

### Global collaboration

This exciting event gave Halma companies from across the world the opportunity to share knowledge of their markets and home regions. Relationships already established by programmes such as HEDP were reinforced and new ones created to support future growth opportunities.

### Cross sector problem solving

Seminars were held covering core technologies and applications common to many Group companies. For example they emphasised the potential to share photonics technologies more widely across the Group.



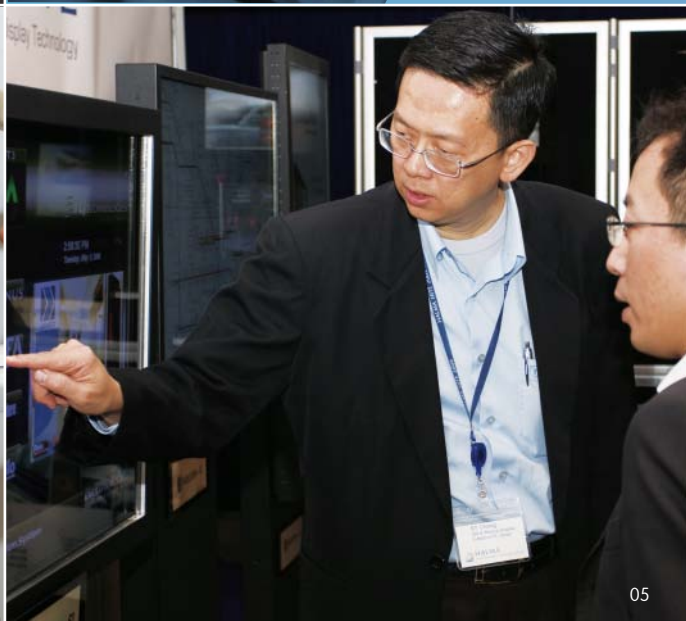
03



BEA's Laser Scanner's initial market is for industrial automatic doors, but its performance exceeds existing laser sensors at a fraction of the cost and it will potentially open up many other markets for the company.



04



05

**Showcasing award winners**

The Halma Innovation Awards recognise individuals and teams who convert their ideas into commercial success.

This year the first prize of £20,000 was won by a team from BEA for their new Laser Scanner automatic door sensor.

**Encouraging R&D**

New product innovation is a key element of Halma's growth strategy. A number of additional new product ideas came from the event building on recent successes arising from existing collaboration.

**Halma hubs**

The Halma China hubs in Shanghai and Beijing have been instrumental in growing revenues in the region. The new manufacturing hub in Shanghai will enable further Group companies to start manufacturing in the region for the first time. The presence of personnel from the new Halma India hub at the Exposition highlights the opportunity to repeat these successes in India.