

Strategic review

Organic growth is central to our value creation strategy, and we continue to identify good quality prospects for further acquisitions

MACRO-ECONOMIC, REGULATORY AND COMPETITIVE ENVIRONMENT

Our expectation for 2009/10 is that the macro-economic environment will continue to be challenging but that there will be opportunities to offset this with market share growth in developed regions, rising demand in developing regions and value-enhancing acquisitions.

Increasing environmental and safety legislation in our markets creates demand for our products. Global, national and regional product approvals or technical validations are an increasing cost and technical challenge, but also provide a hurdle to new market entrants.

While the slowdown in our markets has reduced our rate of organic growth, we have a resilient business mix. Many Halma businesses have products which are driven by 'non-discretionary' customer spend, are sold into diverse geographic regions and end-markets and benefit from strong market positions providing upgrading and replacement sales opportunities. We aim to not be over-reliant on any single region, market or customer. For example, our largest customer constitutes less than 3% of Halma revenue.

Our wide spread of activity means that competition issues are managed at Group company or sub-sector level. Details are given in the Sector reviews on pages 22 to 32.

ADDING VALUE THROUGH OUR STRATEGY

OUR STRATEGY

Create sustained shareholder value by operating in markets offering consistent high-returns and long-term growth

STRATEGIC DIRECTIONS

Organic growth Acquisitions

DELIVERING THE STRATEGY

- | | |
|---|---|
| <ul style="list-style-type: none"> • Niche market focus • Entrepreneurial culture • Decentralised decision making • High quality management • Intercompany collaboration | <ul style="list-style-type: none"> • Strong financial resources • Investment in innovation • International operations expertise • Acquisition/disposal expertise • Progressive dividend policy |
|---|---|

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 are that they are underpinned by resilient growth drivers.

Strategic actions to mitigate the impact of adverse market conditions, and in the short-term to exploit the new economic landscape to our advantage, vary across our businesses. In some markets we have anticipated falling demands by cutting costs so that overheads are aligned with revenue. Our strong balance sheet and committed debt facilities will enable us to take advantage of opportunities requiring capital expenditure in existing businesses or investment in acquisitions.

Throughout our businesses we will continue to invest in customer-facing resources and maintain R&D spend to extend technology leadership. Our aim is to emerge from the current downturn with larger market shares, improved competitive positions, and strong margins.

OUR PRIMARY GROWTH DRIVERS

Demand for energy and water resources

Demand for energy and water continues to rise fuelled by population growth and increasing affluence. According to the US Government's energy statistics office¹, total world consumption of marketed energy is projected to increase by 44% between 2006 and 2030 despite sustained high oil prices projected over the long term. Some of our Health and Analysis businesses are positioned to benefit from the rising demand for energy and water, notably our companies making water treatment, water testing and water distribution management products. Continued investment in oil and gas exploration and extraction drives demand for our Industrial Safety products.

Growth in population, ageing and urbanisation

About half of the world's population, 3.3 billion people, now live in urban areas, expected to rise to almost 5 billion by 2030. Unprecedented urban growth is predicted in the developing world where the urban population is expected to double between 2000 and 2030². Urbanisation drives investment in non-residential buildings like shops, offices, schools and hospitals, the primary market for our infrastructure sensors. Population growth and urbanisation are strongest in Asia, while the ageing population in the West drives demand for health products.

¹ International Energy Outlook 2009. Energy statistics published by the US Government

² United Nations, Department of Economic and Social Affairs, Population Division and Population Fund

RETURN ON SALES**17.3%****REVENUE GROWTH TO ASIA PACIFIC AND AUSTRALASIA****26%****Increasing demand for healthcare**

Worldwide demand for healthcare and health-related products continues to grow. During 2008 US healthcare spending rose to \$2.4 trillion (17% of GDP), and is projected to reach \$4.3 trillion by 2016 (20% of GDP)³. Growing populations drive demand in the developing world and healthcare spending in China is predicted to grow at 11% per year between 2007 and 2012⁴. Population ageing creates rising healthcare demands and health services are becoming available to an increasing number of people in the developing world as incomes rise. Continuous advances in medical technology create new medical procedures, stimulating demand for new instruments and equipment.

Increasing regulation and rising expectations of health and safety

Every year over 2 million people die from occupational accidents or work-related diseases. According to the ILO⁵, workers suffer 270 million occupational accidents and 160 million cases of occupational disease annually. Governments worldwide continue to introduce safety and environmental legislation to protect workers from injury, sickness or death at work. Failure to address these risks carries a huge potential cost to our customers.

Globalisation accelerates the spread of health and safety regulation. Multinational businesses based in developed economies effectively export their home market safety standards to the developing countries they operate in. These practices gradually become integrated into the regulatory frameworks of the 'host' countries increasing the market for our safety products.

New technology

During 2008/09 our businesses invested 5% of revenue (£22.9m) on R&D. In some businesses we develop novel products using state-of-the-art technology, but most of the R&D spend is used to adapt proven technology to new applications and extend our customer base. R&D resources are located in each subsidiary to ensure market needs are understood and met efficiently. This agility results in products with superior value for customers delivering strong product margins and sustained revenue growth.

OUR STRATEGIC DIRECTIONS**Organic growth**

Our strategic priorities for 2009/10 are to continue to deliver organic growth where markets support it and maintain a balance between investment and profitability. Whilst we must continue to achieve high returns, it is important for us to ensure we continue to invest to protect our success in the medium term too.

Acquisitions

We have the financial headroom to support further acquisitions within our existing sectors. 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

Continued revenue growth in Asia remains a priority. Asian markets offer significant and consistent growth potential for our businesses. Asian revenue grew by 26% during 2008/09 and now comprises around 12% of total revenue. The Halma China hubs, established three years ago, now support 19 Halma companies with local sales and manufacturing. Our new manufacturing hub in Shanghai is operational. A new Halma hub was set up in Mumbai, India in mid-2008.

Management development

We will continue to strengthen our management. Increased investment in training has improved the quality and flexibility of our senior management and the opportunity for movement of managers between Group companies. Active management of our people resources is a key factor in our ability to sustain long-term growth. For example, 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 annual innovation awards, together with the high number of new products launched each year, underline this success.

³ The National Coalition on Health Care, USA and Keehan, S. et al. "Health and Spending Projections Through 2017", Health Affairs Web Exclusive W146: 21 February 2008

⁴ China Healthcare Sector Analysis

⁵ International Labour Organisation

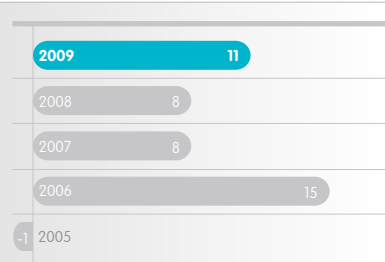
Strategic review (continued)

We have a clear focus on achieving organic growth, maintaining high returns, investing in new products and generating cash

KPIs

ORGANIC REVENUE GROWTH¹

%

2009: **11%**Target **>5%**

Definition

Organic revenue growth measures the change in revenue achieved in the current year compared with the prior year from continuing Group operations. The effect of acquisitions made during the current or prior financial period has been equalised.

Performance

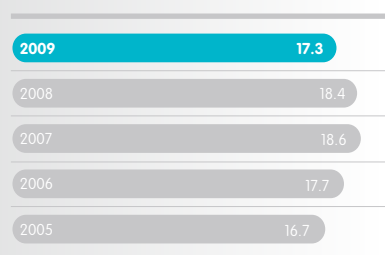
Strong organic growth across all sectors for the fourth consecutive year.

Target

The Board established a minimum organic growth target of 5% representing the blended long-term growth rate of our markets.

RETURN ON SALES¹

%

2009: **17.3%**Target **~18%**

Definition

Return on sales is defined as adjusted profit before taxation¹ from continuing operations expressed as a percentage of revenue from continuing operations.

Performance

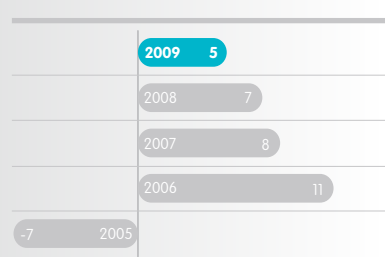
High returns achieved representing a marginal drop in performance against this target. This reflected a reduction in profitability within the Health and Analysis sector.

Target

The Return on sales target reflects the expectation that high returns are sustained and will vary within a narrow range of 16 – 20% giving the average 18% target.

ORGANIC PROFIT GROWTH¹

%

2009: **5%**Target **>5%**

Definition

Organic profit growth measures the change in profit achieved in the current year compared with the prior year from continuing Group operations. The effect of acquisitions made during the current or prior financial period has been equalised.

Performance

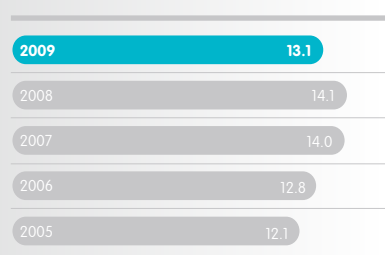
Organic profit growth met the target assisted by positive currency impacts.

Target

The Board established a minimum organic growth target of 5% representing the blended long-term growth rate of our markets.

ROTC (RETURN ON TOTAL INVESTED CAPITAL)¹

%

2009: **13.1%**Target **>12%**

Definition

Return on total invested capital is defined as the post-tax return from continuing operations before amortisation of acquired intangibles as a percentage of adjusted shareholders' funds as detailed in note 3 to the accounts.

Performance

Strong returns maintained in excess of our current WACC of 9% (2008: 8.4%).

Target

The target of 12% was set in 2005 when the Group's ROTC was 12.1%; a range of 12 – 14% is considered representative of the Board's expectations over the long term.

ROCE (RETURN ON CAPITAL EMPLOYED) ¹ %	2009: 47.7%	Target >45%											
<table border="1"> <tr><td>2009</td><td>47.7</td></tr> <tr><td>2008</td><td>55.8</td></tr> <tr><td>2007</td><td>60.1</td></tr> <tr><td>2006</td><td>56.9</td></tr> <tr><td>2005</td><td>48.8</td></tr> </table>	2009	47.7	2008	55.8	2007	60.1	2006	56.9	2005	48.8	<p>Definition Return on capital employed is defined as the operating profit from continuing operations before amortisation of acquired intangibles as a percentage of capital employed as detailed in note 3 to the accounts.</p>	<p>Performance Continued high returns above the target level achieved. The reduction against the prior year was due to slightly lower profitability and an increase in the capital base due to currency impacts.</p>	<p>Target The target is set in order to ensure the efficient generation of cash at all levels to fund organic growth, closely targeted acquisitions and sustained dividend growth.</p>
2009	47.7												
2008	55.8												
2007	60.1												
2006	56.9												
2005	48.8												
R&D AS A PERCENTAGE OF REVENUE %	2009: 5.0%	Target >4%											
<table border="1"> <tr><td>2009</td><td>5.0</td></tr> <tr><td>2008</td><td>4.7</td></tr> <tr><td>2007</td><td>4.3</td></tr> <tr><td>2006</td><td>4.0</td></tr> <tr><td>2005</td><td>3.7</td></tr> </table>	2009	5.0	2008	4.7	2007	4.3	2006	4.0	2005	3.7	<p>Definition Total research and development expenditure in the financial year (regardless of whether or not it was capitalised) as a percentage of revenue from continuing operations.</p>	<p>Performance Total spend in the year increased by over £4 million increasing the proportion spent to 5% of revenue.</p>	<p>Target New products contribute strongly to achieving organic growth, maintaining high returns and building strong market positions. The 4% minimum investment target is appropriate to the mix of product life cycles and technologies within Halma.</p>
2009	5.0												
2008	4.7												
2007	4.3												
2006	4.0												
2005	3.7												
OPERATING CASH TO PROFIT %	2009: 109%	Target 100%											
<table border="1"> <tr><td>2009</td><td>109</td></tr> <tr><td>2008</td><td>104</td></tr> <tr><td>2007</td><td>106</td></tr> <tr><td>2006</td><td>121</td></tr> <tr><td>2005</td><td>127</td></tr> </table>	2009	109	2008	104	2007	106	2006	121	2005	127	<p>Definition Cash generated from operations expressed as a percentage of adjusted profit before taxation from continuing operations¹.</p>	<p>Performance Cash conversion of 109% was above target. Cash generation continues to receive close attention at subsidiary company and Group levels.</p>	<p>Target The goal of cash inflow exceeding 100% is a metric that has relevance at all levels of the organisation and aligns management action with the strategic goals of organic growth, acquisitions and progressive dividends.</p>
2009	109												
2008	104												
2007	106												
2006	121												
2005	127												

See page 42 for non-financial KPIs

¹ See Financial highlights

Strategic review (continued)

We recognise major risks and uncertainties facing us and take action to identify, manage and mitigate them

Risk factors

DESCRIPTION	MITIGATION
OPERATIONAL RISK	
<p>We seek to continuously grow our profits, generating a high return for shareholders over the long term within a clear strategic framework. 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. We perceive our primary operational risks to emanate from remoteness of operation and the actions and quality of our employees.</p>	<p>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. Our choice is to operate in the safety products and health-related technology markets which we consider to be robust over the long term. We invest heavily in identifying, recruiting and training talented people who are able to manage the risks we face while delivering the excellent results we require. 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, customer, supplier or transaction. We have processes in place to ensure any major transactions are reviewed at the appropriate level, including at Board level if necessary. 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.</p>
ORGANIC GROWTH AND COMPETITION	
<p>The Group faces competition in the form of pricing, service, product performance and substitution. These constitute an ongoing threat to our growth.</p>	<p>Our focus on increasing our investment in, and rate of, innovation is a direct result of responding to these risks. 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, the potential adverse impact of downward price pressure and competition can be mitigated and growth maintained.</p>
RESEARCH AND DEVELOPMENT	
<p>New products are critical to our organic growth and underpin our ability to earn high margins and high returns over the long term. Protection of our intellectual property is important to our continued success.</p>	<p>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. New product development 'best practice' is shared between Group companies and return on investment of past and future innovation projects is tracked monthly.</p>
INTANGIBLE RESOURCES	
<p>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.</p>	<p>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. 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.</p>
LAWS AND REGULATIONS	
<p>Group operations are subject to wide-ranging laws and regulations including employment, environmental and health and safety legislation. There is also exposure to product litigation and contractual risk.</p>	<p>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 product failure, litigation and contractual issues. Each operating company has a health and safety manager responsible for compliance. We carry comprehensive insurance against all standard categories of insurable risk. Contract review and approval processes mitigate exposure to contractual liability.</p>

DESCRIPTION	MITIGATION
INFORMATION TECHNOLOGY/BUSINESS INTERRUPTION	
Group and operational management depend on timely and reliable information from our software systems. We seek to ensure continuous availability and operation of those systems but disruption could delay or impact on decision making and service to our customers.	There is substantial redundancy and back up built into any Group-wide systems. The spread of our businesses offers good protection from individual events and disaster recovery plans are widespread. We have a small central resource available, Halma IT Services, to assist Group companies with any major IT needs and to ensure adequate IT security policies are set across the Group.
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 know well. Divisional Chief Executives are responsible for finding and completing acquisitions in their business sectors subject to Board approval. We support them with central resources to search for opportunities and assist with implementation of a post-acquisition plan. Incentives are aligned to encourage acquisitions which are value-enhancing from day one.
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.	The Group ensures that there is adequate local management and financial resource in each operational location and regularly reiterates to the Group 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. This year we have further strengthened our Internal Audit function, increasing its independence and enabling greater depth and scope of audit.
CASH	
For any business a key risk is that it will run out of cash or have inadequate access to cash. In addition, cash deposits need to be held in a secure form or location.	The strong cash flow generated by the Group provides financial flexibility. Cash needs are monitored regularly. In addition to short-term overdraft facilities, the Group holds a 5-year revolving credit facility, renewable in February 2013, which provides sufficient headroom for its needs. Cash deposits are monitored centrally and spread amongst a number of highly rated banks.
TREASURY RISKS	
Foreign currency risk is the most significant treasury related risk for the Group. In times of increased volatility this can have a significant impact on performance. 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.	The Group does not use complex derivative financial instruments and no speculative treasury transactions are undertaken. Significant currency denominated net assets and transactions are hedged but future currency profits are not hedged. Currency hedging must fit with the commercial needs of the business and we are currently reviewing hedging strategy and developing tools to further monitor and manage foreign currency exposures. Longer-term trends can only be covered through a wide geographic spread of operations. We closely monitor performance against the financial covenants on our revolving credit facility and are operating well within these covenants.
CURRENT ECONOMIC CONDITIONS	
In current economic conditions businesses face additional or elevated levels of risk. These include market and customer risk, customer default, fraud, supply chain risk and liquidity risk.	We manage such risks primarily at local company level where they are best understood and where we are closest to the markets and our customers. The financial strength, availability of finance and diversity of the Group provides mitigation to much of this risk. We utilise export credit insurance where this is available and operate robust credit management at each operating company. Each business has undertaken a close examination of its cost structure to determine that it is appropriate to the current economic circumstances it faces and contingency plans are in place for potential future changes. High quality subsidiary boards provide close monitoring of operations whilst the Halma Executive Board identifies any wider trends which require action on a broader basis across the Group.
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 increasing contributions with the overall objective of paying off the deficit in line with the Actuary's recommendations.