

# Chairman's Statement

Record profit and increased rate of dividend growth reflect Halma's resilience and adaptability



**Geoff Unwin** Chairman

Dividend per Share <b>+7%</b>	<b>8.50p</b> (paid and proposed)
Adjusted Earnings per Share <sup>1</sup> <b>+10%</b>	<b>16.89p</b>

## Halma: what we do and our strategy

Our business is to make products which protect lives and improve the quality of life for people worldwide. We do this through continuous innovation in market-leading products which meet the increasing demands for improvements to health, safety and the environment. We build strong positions in niche markets where the demand is global. Our businesses are autonomous and highly entrepreneurial.

Strategically we aim to grow profit and revenue in excess of 5% p.a. organically, to have Return on Sales of 18% or above and generate post-tax Return on Total Invested Capital of more than 12%. As a result, we are highly cash generative and reinvest in our businesses through people, product and market development, continue to acquire more companies with like characteristics and strive to give annual dividend growth of 5% or more to our shareholders; something we have achieved for more than 30 consecutive years.

## Results

Full year revenue increased by 1% to £459.1m (2009: £455.9m), organic revenue growth<sup>1</sup> was flat and at constant currency, showed a decline of 3%. Profit before tax and amortisation of acquired intangibles increased by 9% to £86.2m (2009: £79.1m), virtually all organic and we achieved 5% profit growth at constant currency. Statutory profit before tax increased by 12% to £81.4m. Return on Total Invested Capital was 13.6% (2009: 13.1%), Return on Capital Employed at the operating level increased to 61.3% from 47.7% in the previous year. Cash generation was excellent moving from net debt at the end of 2009 of £51.2m to net cash at the end of 2010 of £9.1m.

<sup>1</sup> See Financial Highlights.

The Board is recommending a final dividend of 5.19p per share, an increase of 8.6% giving a total dividend for the year up 7.2% to 8.50p. The final dividend is subject to approval by shareholders and will be paid on 25 August 2010 to shareholders on the register on 23 July 2010. Dividend cover is 1.98 times (2009: 1.92 times) meeting our objective of around 2 times cover.

These results show both the resilience and adaptability of Halma in difficult and uncertain times. Action to reduce costs was taken promptly (more detail in Andrew Williams' report) and this is also reflected in a significant improvement in Return on Sales from 17.3% in 2009 to 18.8%. However, this was not achieved by a major reduction in investment; expenditure on R&D was 4.7% of revenue compared to 5% the previous year. Investment in training and development was also maintained at the same level, vital for the future of Halma.

### **Geographic expansion**

It is pleasing to see our strategic investments in China and India bearing fruit. Sales to China increased by 59%, fuelled in part by the massive investments being made in this region's infrastructure. In 2010, we decided to increase our sales and support capability even further by investing in three additional regional centres (expanding on our existing bases in Shanghai and Beijing) which should benefit all our sub-sectors. Our manufacturing capability in China is also expanding. This year we will explore further the merits of additional investment into other high-growth territories.

Five years ago our sales outside the USA and Europe were £53m – this year they were £98m. As a result of our strategic actions to encourage expansion into high growth markets outside the USA and Europe, within two to three years, sales outside these territories should grow even further and begin to have a material effect on the growth rate of the Group overall.

### **Acquisitions**

Because of the general uncertainty in earnings outlook, we took a cautious view on acquisitions during the year and only invested £1.7m in acquiring SphereOptics, a good addition to our Photonics activities.

Meanwhile, we have plenty of financial capacity with net cash and longer term facilities in place to comfortably finance a further £100m of investment. However, our acquisition screening remains as rigorous as ever to make sure that both our strategic and financial criteria are met.

### **Governance**

There were no changes to the Board during the year but we continue to evaluate performance thoroughly, and as always, with an eye to appropriate succession on the Board.

### **People**

It has been a hard and uncertain market for many of our companies. It has been pleasing to see how well company boards have reacted to their own markets, taking the necessary actions as appropriate i.e. playing it as they see it. It is this proactive and adaptable attitude that is a key strength of Halma. To everyone in the Group, my sincere thanks for all your actions and dedication.

### **Outlook**

As we have seen, the Group can react swiftly to the market conditions as they unfold and will continue to invest in people, innovation and market development. This, together with strong cash generation which supports our efforts to grow organically and make acquisitions, gives us confidence for the future.

### **Geoff Unwin**

Chairman

# Chief Executive's Strategic Review 2010

We have greater momentum than a year ago and are well positioned to achieve growth



**Andrew Williams** Chief Executive

Revenue +1%	£459m
Adjusted profit before taxation <sup>1</sup> +9%	£86.2m
Operating cash to profit	131%

## A record year with momentum for the future

For the 53 weeks to 3 April 2010, adjusted profit<sup>1</sup> grew by 9% to £86.2m (2009: £79.1m) with underlying organic growth<sup>1</sup> of 9%, a 5% increase in constant currency. Revenue increased by 1% to £459.1m (2009: £455.9m) with underlying organic growth<sup>1</sup> of 0.5%, a 3% decline in constant currency.

These record results were accomplished during uncertain and challenging economic conditions and they reflect both the strength of Halma's fundamental strategy and the quality of our management. Cash generation was exceptionally strong which, together with continued investment and improving order intake levels, provides momentum for the future.

Cash generation is one of our key strengths and this year's performance was particularly impressive. We ended the year with net cash of £9m having started it with net debt of £51m. We maintained a healthy level of capital expenditure, paid a record dividend to shareholders and made a small acquisition. We are in a strong financial position and have core borrowing facilities of £165m in place until 2013. We can comfortably deploy up to £100m on acquisitions, should we find the right opportunities.

Order intake levels, which were very volatile a year ago, first stabilised and then improved as the year progressed. In the second half of 2009/10, order intake was 9% higher than the first half, giving a 4% increase for the year overall. We finished the year with an order book 14% higher than a year ago. Whilst our order book is typically equivalent to only six weeks of Group revenue, the improving trend left us well placed for the start of 2010/11.

## High returns increased further

We acted decisively to reduce costs. Each business did so according to their individual market needs with the overall impact on the Group being an 8% headcount reduction. Product margins increased by more than one percentage point due to improved efficiency in manufacturing. This enabled us to increase Return on Sales<sup>1</sup> to 18.8% (2009: 17.3%). We aim to achieve a Return on Sales of at least 18% with the potential to exceed 20% as rates of revenue growth increase.

Good management of our operating assets combined with earnings growth increased our Return on Total Invested Capital<sup>1</sup> (ROTIC) to 13.6% (2009: 13.1%) whilst, our Return on Capital Employed<sup>1</sup>, a better measure at the operating company level, rose to 61.3% (2009: 47.7%).

Our adjusted profit<sup>1</sup> of £86.2m includes £2.7m of restructuring costs (2009: £1.2m) predominantly related to the reduction in headcount. We achieved our overall objective of reducing our direct and indirect costs by at least £20m p.a. relative to our run-rate during the second half of 2008/09.

<sup>1</sup> See Financial Highlights.

A key objective for the future is to ensure that as order intake improves, we add an increasing proportion of our resources to growth generating activities like R&D and selling.

Our employees at all levels have achieved tremendous results during a period of uncertainty and, in many businesses, disruption caused by redundancies. I thank all of them for their commitment and determination in ensuring that we continued to meet the expectations of customers and, consequently, our shareholders.

### Macro-economic, regulatory and competitive environment

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

Whilst a slowdown in our markets did make organic growth more difficult to achieve, we proved that we have a resilient business mix. Many Halma businesses have products which are driven by non-discretionary customer spend and are sold into diverse geographic regions and end-markets. They benefit from strong market positions providing upgrading and replacement sales opportunities. We are not over-reliant on any single region, market or customer with our largest customer constituting less than 2% of revenue.

Increasing environmental and safety legislation in our markets creates relatively robust 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.

Our wide spread of activity in niche markets means that competition issues are best dealt with by management at company or sub-sector level. Details are given in the Sector reviews on pages 16 to 31.

### Our primary market growth drivers

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 developing positions in markets 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 due to the following resilient growth drivers:

### Increasing demand for energy and water

Demand for energy and water continues to rise driven by population growth and mobility, rising living standards, changes in food consumption and biofuels energy production.

Although global consumption of marketed energy contracted by 2.2% during 2009, the latest projection from the US Government's energy statistics office is for a 49% increase between 2007 and 2035. In non-OECD countries, energy demand is predicted to rise by 84% in the same period.<sup>2</sup> Water demand also rises relentlessly. Global population growth translates into an annual increase in fresh water demand of 64 billion cubic metres.<sup>3</sup>

Several of our Health and Analysis businesses are positioned to benefit from the rising demand for energy and water. Continued investment in oil and gas exploration and extraction drives demand for our Industrial Safety products.

### Increasing urbanisation and ageing of population

The world population, which stood at 6.8 billion in 2009, will reach 9 billion by 2050. Most of those additional 2.2 billion people will enlarge the population of developing countries, projected to rise from 5.6 billion in 2009 to 7.9 billion by 2050.<sup>4</sup>

The global population is ageing. The number of people over 60 is growing at 2.6% per year, faster than the 1.2% annual rise in the overall population.<sup>5</sup>

About half of the world's population (3.4 billion) now live in urban areas, predicted to increase to almost 5 billion by 2030. Rapid urban growth is predicted in the developing world where the urban population is expected to double between 2000 and 2030. By 2030, 81% of the world's urban population will live in the developing world.<sup>6</sup> Urbanisation drives investment in non-residential buildings like shops, offices, schools and hospitals, the primary market for our Infrastructure Sensors while a growing and ageing population drives demand for Health and Analysis products.

<sup>2</sup> International Energy Outlook 2010, <http://www.eia.doe.gov/oiaf/ieo/index.html>, US Energy Information Administration.

<sup>3</sup> World Water Assessment Programme. 2009. The United Nations World Water Development Report 3: Water in a Changing World. Paris: UNESCO, and London: Earthscan.

<sup>4</sup> World Population Prospects – The 2008 Revision, Population Division of the Department of Economic and Social Affairs of the United Nations Secretariat. June 2009.

<sup>5</sup> World Population Ageing 2009. Department of Economic and Social Affairs, Population Division, United Nations, 2009.

<sup>6</sup> State of the World Population 2007, United Nations Population Fund.

# Chief Executive's Strategic Review 2010

## continued

### Increasing demand for healthcare

Worldwide demand for healthcare and health-related products continues to increase, driving growth in our Health and Analysis markets. Healthcare spending is growing rapidly in the developed world, particularly in the USA where it rose from \$2.39tn in 2008 to \$2.50tn in 2009. Health spending accounted for about 17.6% of US GDP in 2009, but is expected to climb to over 20% by 2018.<sup>7</sup>

Population growth and rising incomes in the developing world also drive healthcare demand. Population ageing creates rising healthcare needs and as incomes rise health services are becoming available to an increasing number of people in the developing world. Healthcare spending in China is projected to rise to \$600bn by 2015, a threefold increase over expenditure in 2000.<sup>8</sup> Continuous advances in medical technology create new medical procedures, also stimulating demand for new instruments and equipment.

### Increasing health and safety regulation

Every day a million workers will suffer an accident at work, and about 5,500 workers will die due to a work-related accident or disease. This adds up to an estimated 2.3m people dying from work-related hazards every year.<sup>9</sup> The International Labor Organization suggests that there are 270 million occupational accidents and 160 million cases of occupational disease annually.<sup>10</sup> In addition to human tragedy, workplace accidents and sickness have a significant financial impact. A rough estimate suggests that direct and indirect costs of occupational accidents and diseases represent 4% of annual global GDP [US\$1.25tn].<sup>9</sup> In response, governments throughout the world enact increasingly strict laws and regulations to protect workers from workplace hazards. Continuing integration of regional economies through globalisation extends health and safety regulation to developing regions. The combination of increasing safety regulation and globalisation drives demand for our Industrial Safety and Infrastructure Sensors products.

### Sector performances

After a solid performance in the first half year, all of our three business sectors significantly improved profits in the second half.

#### Infrastructure Sensors resilient

Infrastructure Sensors had a resilient year with profit<sup>11</sup> increasing by 8% to £35.5m (2009: £33.0m) on revenue down 2% to £182.9m (2009: £186.0m). Organic profit growth was 9% (5% at constant currency) whilst organic revenue growth was 1% (a 3% decline at constant currency). Door Sensors had a very good year, gaining market share through a combination of new product launches and continuously improving service levels worldwide. Elevator Safety revenue was flat and profit slightly up whilst Fire Detection increased profit despite seeing some weakness in demand in the UK and US markets. Security Sensors generated revenue growth in its core markets, the UK and Mainland Europe, but overall profit was lower following the sale of our South African subsidiary in 2008/09.

#### Health and Analysis strong

Health and Analysis performed very strongly, increasing revenue by 7% to £176.0m (2009: £165.1m) and profit<sup>11</sup> by 23% to £35.3m (2009: £28.7m). Organic profit growth was 21% (15% at constant currency) whilst organic revenue growth was 3% (a 3% decline at constant currency). Water increased profits despite lower revenue. Health Optics, Fluid Technology and Photonics delivered strong profit increases with Photonics starting to gain traction in China and Asian markets.

### Industrial Safety improving

After a tough first half, Industrial Safety achieved revenue and profit growth in the second half of the year. Full year revenue was down by 4% at £100.5m (2009: £105.0m) compared to an 11% decline at the end of the first half. Full year profit<sup>11</sup> was down by 11% at £19.8m (2009: £22.2m), a significant improvement on the 29% decline reported for the first half year. In recent months, some larger prospects were finally converted into orders, most notably in South America and Asia.

Both Safety Interlocks and Gas Detection performed solidly whilst Bursting Disks benefited from improved order intake in the second half. Asset Monitoring had a disappointing year although a slight improvement in order intake in recent months and the benefits of significant restructuring during the past year provide optimism for an improved performance in 2010/11.

### Our strategic directions

We aim to operate in global specialised markets offering long-term growth with technology able to sustain high returns. We have clear strategic priorities based on five principal areas:

#### Organic growth

We aim to continue to deliver organic growth of at least 5% which we believe is the blended medium-term growth rates of our end markets, aiming to maintain a balance between investment and profitability. Over the last five years our average rate of organic growth has been 8% per annum.

#### International expansion with a focus on Asia

Asian markets offer significant and long-term growth potential for our businesses. We have increased investment to help our companies build a local presence in key regions.

The regional revenue trends were more mixed than in recent years. Revenue from the Far East and Australasia grew by 9% to £59m despite the adverse impact of the disposal of our Resistors business in Australia, in 2008/09. Encouragingly, revenue from China grew by 59% to £18m and has almost tripled since we established Halma hubs in Shanghai and Beijing in mid-2006. China now represents 4% of total revenue and we plan to significantly increase our investment there in 2010/11 by adding three new regional commercial hubs in Chengdu, Guangzhou and Shenyang.

Revenue in the UK fell by 6% to £98m (2009: £104m) with all three sectors down. Here, we saw some improvement in the latter part of the year, especially in Industrial Safety. In the USA, revenue increased by 5% to £127m (2009: £121m). Here, our Infrastructure Sensors businesses saw the most challenging market conditions, particularly Fire Detection. Mainland Europe's revenue increased by 2% to £136m (2009: £133m) and all three sectors showed modest improvements. The significant reduction in revenue from Africa, Near and Middle East of 14% was mainly due to last year's disposal of our Security Sensors business (based in South Africa).

#### High rate of innovation

We value both product and process innovation since the latter often results in significant competitive advantage and market share gain.

<sup>7</sup> Health Care Trends, Plunkett Research Ltd, 2009.

<sup>8</sup> Healthcare Market in China, Opportunities, Scientia Advisors, LLC, 2010.

<sup>9</sup> Facts on Health and Safety at Work, International Labor Organisation, 2009.

<sup>10</sup> Safety and health at work, ILO website.

<sup>11</sup> See note 1 to the Accounts.

In May 2009, we held our first Group-wide innovation and collaboration event, HITE (Halma Innovation and Technology Exposition). HITE not only increased the visibility and transfer of knowledge between Halma businesses, but also provided the opportunity for us to agree clear investment priorities for the year ahead. Despite the understandable increased focus on reducing costs, I am pleased that investment in growth for the medium term was maintained.

R&D expenditure during 2009/10 was £21m (2009: £23m) remaining close to 5% of revenue and above our minimum 4% target level. Importantly, we are seeing a steady improvement in the productivity of this investment. An example of this was the strength of entries for the internal Halma Innovation Awards 2010, which offered a first prize of £20,000.

This year's winners were Ocean Optics, one of our Photonics companies, who devised a new method of optical filtering enabling their low cost optical analyser to compete with much larger and complex systems for a fraction of the cost. Runners-up were Volumatic who developed an intelligent cash counting system for major retailers which not only securely collects bank notes at the counter but also detects forgeries within seconds of receiving payment from the customer. Fire Fighting Enterprises were in third place with a self-adjusting laser-based fire detector which is used in large building spaces such as museum halls.

These award winners highlight the shift towards higher technology we have seen across Halma over the past decade and the depth of application knowledge within our specialist niche market businesses. Both these factors help us generate and maintain high returns.

### Management development

Increased investment in training improves the quality and flexibility of our senior management, raises performance and creates opportunities for career progression. Our increased investment during the past five years really benefited us this year. Senior managers across the Group were well equipped to assess the impact of the global recession on their business, determine the appropriate strategy and take quick action to reduce costs appropriately. This localised decision making and resource allocation will continue to serve us well during any uncertain times ahead, particularly as we have such diverse end-markets.

The various Halma people development programmes offer training opportunities beyond subsidiary board level to all managers in the Group. During 2009/10, 130 managers attended Halma programmes and many more benefited from training organised within their subsidiary company. In 2010, we are introducing a new programme targeted at our technical engineers to equip them with a broader understanding of Halma's technology, improve their productivity and provide specific skills training in areas such as project management.

### Acquisitions

We look to buy companies with business and market characteristics like Halma. They have to be a good fit with our operating culture and strategy in addition to being value-enhancing financially.

2009/10 was a relatively quiet year for investment in both capital expenditure and acquisitions. This reflected a more cautious approach while we took care of our own operational challenges and understood how strong businesses like Halma would perform during the downturn. Capital investment was £11.0m compared to £16.8m in 2008/09.

We made one small acquisition during the year, adding SphereOptics to our existing Photonics business Labsphere, a market-leading light measurement company based in New Hampshire, USA. We paid \$2.5m at completion with up to \$3.5m to follow over the next two years should certain profit growth targets be achieved.

In recent months we have increased our acquisition search activity. Our experience has been that vendors of good quality businesses are now keener to talk but that many remain cautious about whether to sell now or to wait in the hope that markets will recover in the medium term. Our task is to convince them that they will achieve even greater success by being part of Halma now and to structure deals accordingly.

We continue to search for businesses in all of our existing market sectors and in all geographic regions.

### Delivering corporate responsibility and sustainability

The positive impact that our products have on customers, on society and on the environment is a significant source of satisfaction and motivation for all our employees. Halma's commitment to the environment, safety and improving the quality of life for individuals is shown not only in the solutions we create for our customers but also in the way we do business. Our Corporate Responsibility review on page 44 details our commitment in greater depth and includes the clear objectives we set ourselves in areas ranging from carbon policy to the safety of employees. These objectives make good business sense and are reviewed regularly by the Board so that, where necessary, action is taken to address issues as they arise.

Strategic actions to sustain success during the recent changing market conditions have varied between each Halma business. For example, in some markets we anticipated falling demand by cutting costs so that overheads were aligned with revenue. Our strong balance sheet and committed debt facilities have enabled 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 continues to be to emerge from the current downturn with larger market shares, improved competitive positions and strong margins.

### Outlook

In 2009/10, we achieved our stated objective of maintaining short-term returns through active cost control and protecting medium-term growth through continued investment. During the past year it has become clearer that our sustained increased investment in innovation, management and international expansion has made us a stronger business. Our aim for the coming year is to translate this into higher rates of growth and even higher rates of return.

Coming into 2010/11 we have greater momentum than a year ago, particularly in terms of order intake, and are well positioned to achieve growth. Therefore, we look forward to the year ahead with confidence.

### Andrew Williams

Chief Executive