HALMA

Halma plc
Final results
2013/14

Summary of analysts' presentation by:

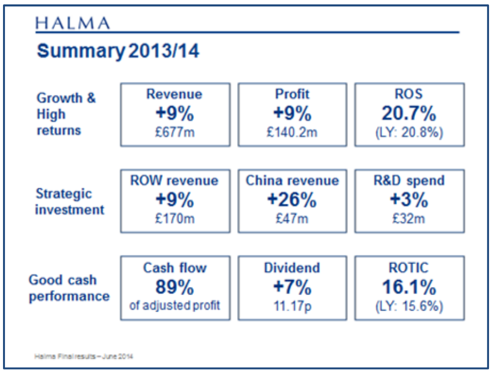
Andrew Williams, Chief Executive
Kevin Thompson, Finance Director

12 June 2014

Halma plc, Misbourne Court, Rectory Way, Amersham, Bucks HP7 0DE, UK. Registered in England number 40932.
Tel: +44 (0)1494 721111 Fax: +44(0)1494 728032 Email: investor.relations@halma.com Web: www.halma.com

Record results and continued dividend growth

Andrew Williams, Group Chief Executive, introduced the final results stating that it had been a strong year for Halma. Changes made recently to its Executive Board structure position the business to sustain growth in the future whilst maintaining Halma's unique operating culture. The simplified management structure is clearly aligned with Halma's four market sectors, providing each sector with the opportunity to grow to be the size of the whole of Halma today.



Once again we have delivered a strong performance, achieving record results for the 11th consecutive year.

Revenue increased by 9% to £677m and adjusted[1] profit was up 9% to £140.2m. Return on Sales[2] of 20.7% was very much in line with last year. We achieved widespread organic[3] growth across all sectors and all regions.

We continued to increase strategic investment in international expansion, innovation and people development. Revenue from outside the UK/Europe/USA grew by 9% and constitutes 25% of the group total. In China, revenue growth remained strong, up 26% to £47m and representing 7% of the group total. We increased our investment in R&D with expenditure rising 3% to £32m. This investment helps to sustain growth in market conditions which have continued to vary across different industries and regions.

Our operational management remains strong and resulted in good cash generation. Cash flow was 89% of adjusted[1] profit, well above our 85% KPI.

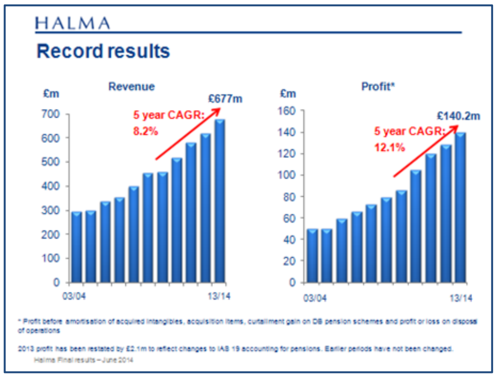
The Halma Board is recommending an increase of 7% in the final dividend which together with the 7% Interim increase represents the 35th consecutive year of dividend increases of 5% or more.

Our post-tax Return on Total Invested Capital[4] increased to 16.1%, comparing favourably with our Weighted Average Cost of Capital of 7.5%.

Overall this has been a very good year. I am pleased with the progress that the group has made in balancing growth with investment and high returns.

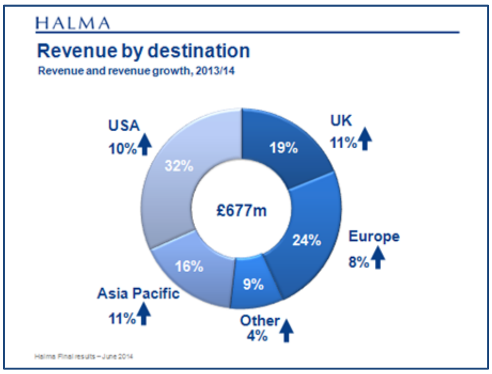
Kevin Thompson, Finance Director, presented the financial performance in more detail.

This is another set of record results with widespread growth in all sectors and all regions. High returns were maintained and good cash generation supported the continuation of our long-term record of dividend increases. Halma's financial position remains strong.



Halma has achieved strong and consistent growth. In the past five years we have delivered a Compound Annual Growth Rate (CAGR) of 8.2% for revenue and 12.1% for adjusted[1] profit. This is part of our long-term record of growth having increased revenue in 38 of the past 40 years.

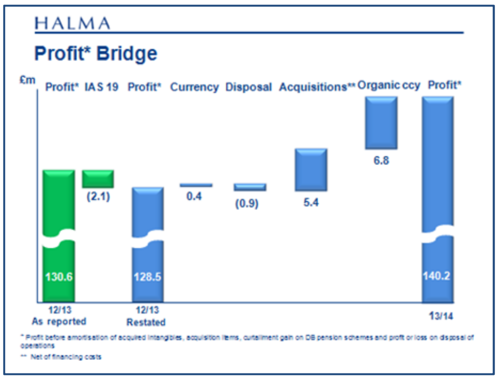
We achieved widespread growth across the four sectors and our main geographies. There was 9% full year revenue growth with a higher first half increase due to the benefit of prior year acquisitions. Organic[3] revenue growth at constant currency (excluding the impact of acquisitions, disposals and currency translation) was 6% in each half year.



We achieved strong revenue growth in developed markets with the USA, still our largest sales destination, increasing by 10%. All sectors grew in the USA with growth in the Medical sector boosted by prior year acquisitions. Revenue in the UK was 11% up on the prior year with Environmental & Analysis the standout performer, in particular the Water businesses. After a small decline in revenue in 2012/13 Mainland Europe grew well, up 8%.

Asia Pacific continued to grow, this year by 11%, with a strong performance from the Medical sector but a weaker performance in Environmental & Analysis.

Underlying growth (organic constant currency) was 5-7% in all the main geographies.

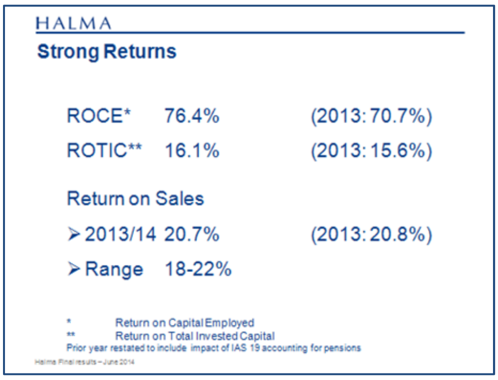


The Profit bridge above shows the restatement of the 2012/13 adjusted[1] profit due to IAS 19[5] - a revision to the accounting for pensions (see the Annual Report and Accounts for more details). The rest of the bridge shows the movements through to the full year 2013/14 adjusted[1] profit of £140.2m.

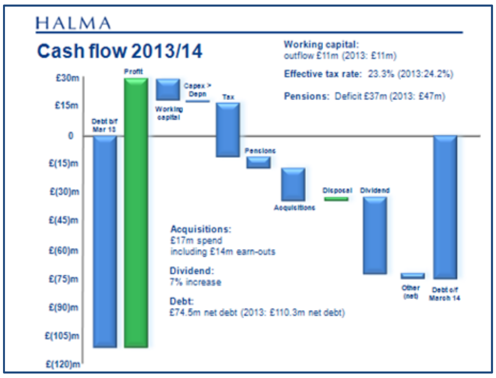
Currency impact was minimal in the year as a whole, with the currency translation benefit experienced in the first half year eroded in the second half as Sterling strengthened against the US Dollar and Euro in particular. Assuming a similar mix of sector performances, at current rates of exchange we would expect an adverse impact on 2014/15 results, compared with 2013/14, of around 3%.

There was a small impact from the disposal in 2012/13 of Tritech. One acquisition was made in 2013/14, Talentum, purchased for £3m, but most of the acquisition benefit this year was from acquisitions made in the prior year.

Adjusted[1] profit grew by 9% in 2013/14 and at that rate in both halves. Organic[3] constant currency profit growth was stronger in the second half with a strong finish to the year. In the first half we incurred the costs of a supplier quality problem – now resolved – and costs related to reorganisation in our Photonics businesses, now close to completion at less than the forecast cost. We are starting to see the benefits of that reorganisation in the improved second half performance of the Environmental & Analysis sector.



We maintained high returns, in particular a high Return on Capital Employed[6] which underpins strong cash generation. Return on Sales[2] at 20.7% (2012/2013: 20.8%) was in line with last year and well positioned in our 18-22% range.



Cash flow was strong, achieving an 89% cash conversion compared with our KPI target of 85%. We reduced net debt in the year from £110m to £74m having financed acquisition spend, tax payments of £28m and a record dividend payment of £40m as well as continued investment in our businesses.

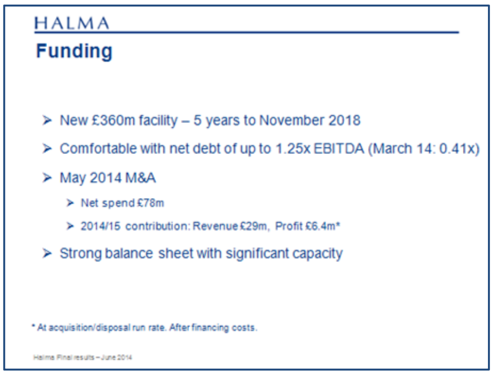
Working capital requirements increased as our business grew. £17.4m (2012/13: £15.5m) was invested in fixed assets in the year.

The effective tax rate was 23.3% (2012/13: 24.2%), lower than last year due in particular to the reducing UK Corporation tax rate and the benefit of the UK "Patent Box" tax regime.

We have announced the closure to future benefit accrual of our UK defined benefit pension schemes, effective December 2014. That will reduce our future pension risk. We continue to make extra contributions to fund the UK pension schemes in line with the recommendations of the scheme actuary.

Cash expenditure on acquisitions in the year was mainly the payment of contingent consideration on prior year acquisitions for achievement against performance targets.

The Halma Board is recommending an increase of 7% in the final dividend which together with the 7% Interim increase represents the 35th consecutive year of dividend increases of 5% or more.



In November 2013 we increased (from £260m to £360m) and extended (from October 2016 to November 2018) our syndicated bank facility.

We remain comfortable with net debt levels up to 1.25x EBITDA and at March 2014 gearing was 0.4x EBITDA. After the year end, in May 2014, we made three acquisitions and one disposal for a net cost of £78m. Our increased bank facility means that we have a strong balance sheet and financial capacity for the medium term to continue to invest in our businesses, make acquisitions and pay increasing dividends to shareholders.

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Financial KPI Summary 2013/14

	Target	Achieved
Organic revenue growth	> 5%	6%
Organic profit growth	> 5%	6%
Revenue outside UK/Europe/USA	30% by 2015	25%
Return on Sales	> 18%	20.7%
R&D investment (% of revenue)	> 4%	4.7%
Cash conversion	> 85%	89%

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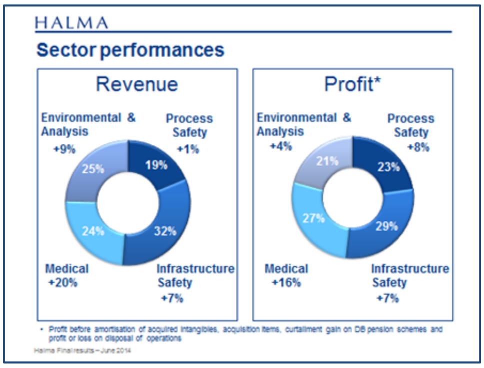
We once again performed well against our financial KPI targets. Organic revenue and profit growth, both at 6%, were ahead of our 5% target. Revenue from outside UK/Europe/USA was 25% of total revenue, less than our target of 30% but achievement has been made more difficult by our success in finding acquisitions, and growing our business, in developed markets.

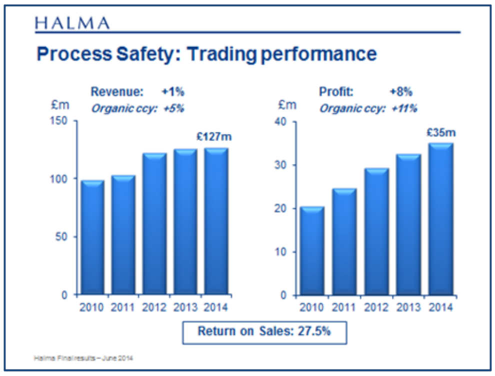
We continued to both invest in our businesses and generate strong cash flow to support continued growth in the future.

Andrew Williams then commented on the performance of each sector. He emphasised how increasing collaboration, in product development and international expansion, is contributing to growth. This will become increasingly valuable under the new Executive Board structure as more focused sector growth strategies are established.

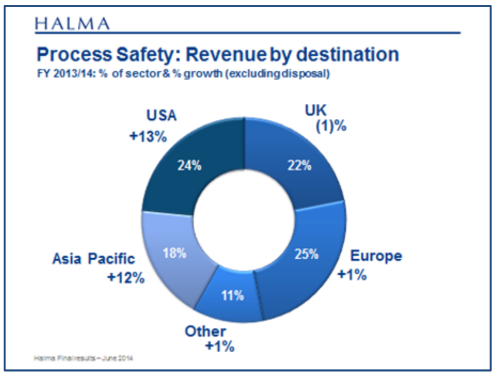


We have a good balance to our portfolio with our two safety sectors representing around half of our revenue and profit. Demand for these products is driven by increasing global health and safety regulation. Demand for our Medical and Environmental & Analysis products is driven by increasing demand for healthcare and increasing demand for life critical resources (including water) worldwide.

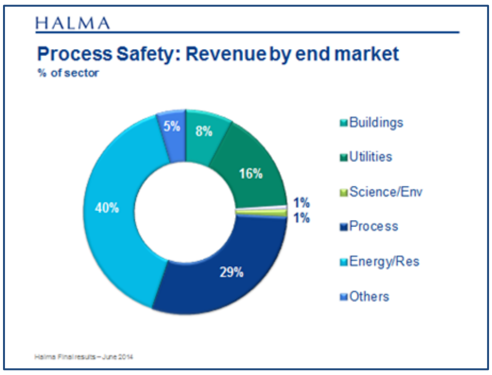
All four sectors increased revenue and profit during the year. In addition, all delivered organic[3] revenue and profit growth with organic[3] revenue growth between 5% - 7% in all sectors.



Our Process Safety sector had a good year with revenue up 1% to £127m, including 5% organic growth. Profit improved by 8% to £35m, including 11% organic growth. Return on Sales improved from 25.7% to 27.5%. There was negligible currency impact during the year. Since 2010, profit has grown at a compound annual growth rate of 15%.

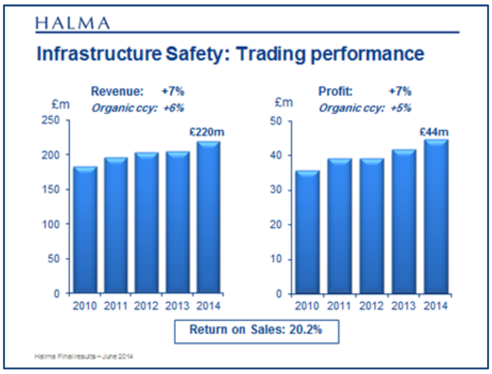


Regionally, the strongest growth was in the USA where new applications in the oil and gas industry opened up new market niches. In Asia Pacific, strong performances from China and South Korea more than compensated for some weakness in Australia. Our UK and European revenue was flat with last year, seeing a satisfactory progress in oil and gas markets combined with more of a mixed picture in general process industries.



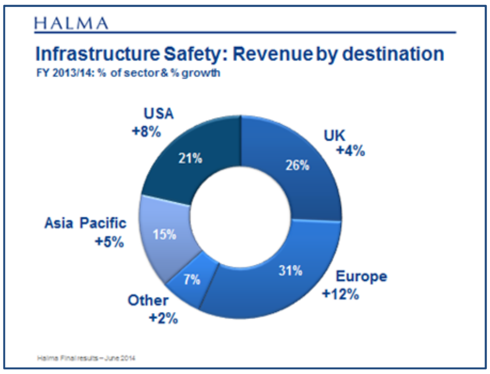
40% of our revenue in this sector comes from energy and resources markets. We have more exposure to oil and gas industries than to mining, while most of our products are sold as part of our customers' OPEX spend rather than CAPEX. We achieved growth in all major market segments with the biggest growth in Energy/Resources and Process industries.

Overall this was another good year for Process Safety. I expect investment in new product launches and international expansion to continue to drive growth in the future, supplemented by the recent acquisition of Rohrback Cosasco Systems.

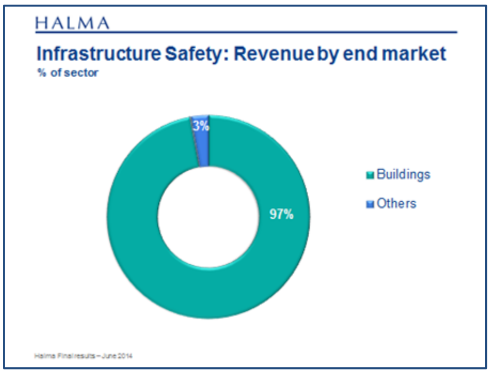


I was very pleased with the performance from our Infrastructure Safety sector this year. Revenue improved by 7% to £220m including 6% organic growth. Profit was up 7% to £44m, including 5% organic growth. There was little currency translation impact and the expected contribution from the acquisition of the small flame detection company, Talentum. Since 2010, this sector's profit has grown at a compound annual growth rate of 6%. Almost all of this growth has been organic.

Return on Sales was maintained at a healthy level of 20.2% - in line with last year.



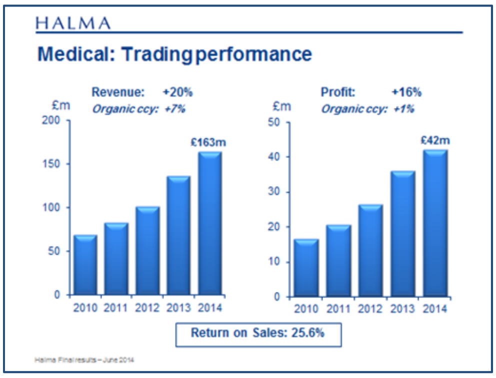
It was pleasing to see widespread regional growth, with the highest growth in developed markets. USA and Europe grew most strongly boosted by increasing sales of new products launched by our Fire Detection and Door Sensor businesses. There was encouraging growth from Northern Europe, especially France. In Asia Pacific, China continued to grow well as we benefitted from newly launched, locally developed products. This compensated for some weakness in demand from Australia.



Almost everything we sell in this sector goes into buildings to comply with health and safety regulation. Two-thirds of what we sell goes into existing infrastructure, and one-third into new construction. A small proportion of revenue goes to 'other' markets, including transportation. It was pleasing to see renewed demand for our Automatic Door Sensors following the resumption of the China High Speed Train project.

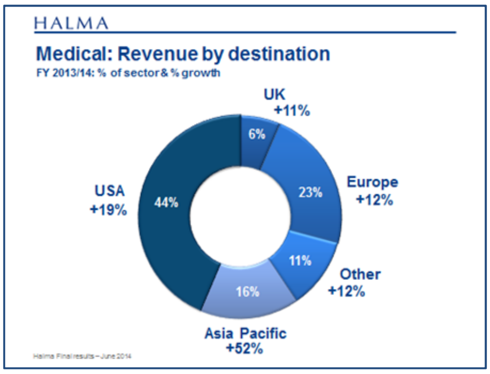
Overall, this was a good year for Infrastructure Safety, which continues to make a valuable contribution to the group. It was encouraging to see two acquisitions completed in the past year or so (Talentum in April 2013 and Advanced Electronics Ltd in May 2014) to further boost solid organic growth.

It was another record year for our Medical sector which reported the highest rate of growth of all Halma's sectors, helped by a significant contribution from prior year acquisitions.



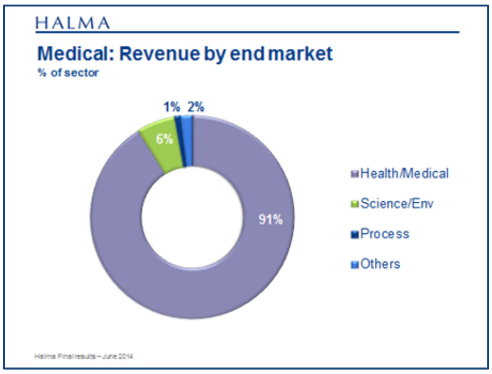
Revenue improved by 20% to £163m, including organic growth of 7%. Profit was up by 16% to £42m, including 1% organic constant currency profit growth. The lower profitability resulted from absorbing the full year impact of the USA Medical Device tax (introduced in 2013) and our increasing investment in recent acquisitions to support longer-term growth. Typically, in the first couple of years after acquisition we increase investment in areas such as international expansion and strengthening the management team. We expect to see the positive benefit of this investment through improved organic growth and returns in the future.

Return on Sales was 25.6%, below last year's record 26.4%. Over the past five years, our Medical sector has established a very strong track record of success, achieving a profit compound annual growth rate of over 25%.



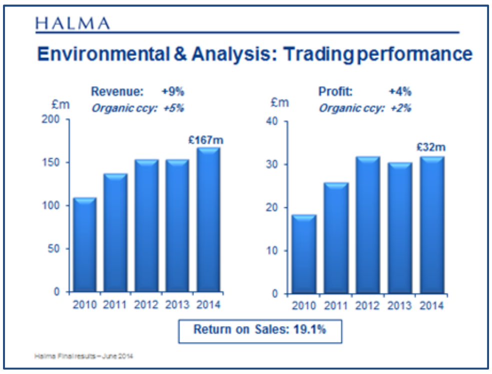
Our Medical sector grew strongly in all regions with USA revenue up 19%. USA contributes 44% of total sector revenue, which reflects the fact that an estimated 35% of global healthcare spend is in that region. UK and Europe contributed double-digit growth, although revenue from Germany was weaker this year. In combination, organic revenue growth from these three major developed regions was 5%.

We saw even stronger growth in Asia Pacific, with revenue up 52% including the first full year's contribution from our recent China based acquisition, Longer Pump. Organic revenue growth in Asia Pacific of 22%, reflected strong underlying growth in China where we are starting to see the benefit of investing in new product registrations and approvals. This has been a key focus for this sector in recent years.



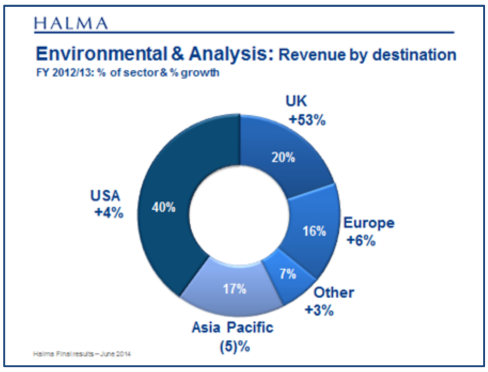
Demand for our Medical products is driven by increased worldwide demand for healthcare. We also sell some of our medical pumps, valves and fluidic components into science and environmental markets which are also growing well.

Overall this was another year of strong progress for our Medical sector and I was pleased to see the way in which recent acquisitions have been successfully integrated into the group.



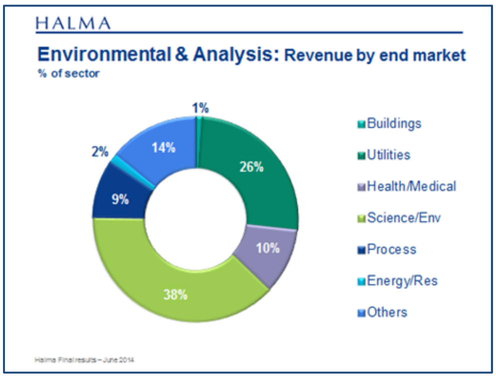
I am pleased to report revenue and profit growth in our Environmental & Analysis sector after a disappointing prior year. Revenue improved by 9% to £167m, with organic growth of 5%. Profit improved by 4% to £32m, including 2% organic growth. Reorganisation costs had an impact on Return on Sales. However, at 19.1% this was still well within our 18% - 22% target and only slightly down from 19.9% last year.

Despite a little more variability in performance relative to our other three sectors, since 2010 our Environmental & Analysis sector has achieved a profit compound annual growth rate above 15%.



Regionally, the trends we saw at the half year broadly continued. In the UK, revenue was up by 53%, including 24% organic growth. This was driven by strong demand for flow and pressure monitoring instruments from UK water utilities, in preparation for the deregulation of their commercial market in 2017. We expect demand for these products to slow somewhat during the year ahead.

There were solid performances from both the USA and Europe. Asia Pacific revenue was down by 5%, albeit an improvement from 9% decline reported at the half year results. Major contracts for our Photonics and Water businesses in China in the prior year came to an end. There continues to be excellent growth opportunities for this sector in Asia Pacific supported by a greater emphasis on local new product development and stronger local management teams.



Environmental & Analysis is our most diverse sector. There was strong growth in Utilities driven by the UK water companies, while revenue from Process industries grew as we continued to find new industrial applications for our technology. For example, systems previously sold to support customers' LCD display product development are now being used by those same customers, in greater quantities, for shop-floor manufacturing quality control.

Overall, this was a year of satisfactory progress for Environmental & Analysis after a tough first half. Prospects are steadily improving and we expect a better contribution from developing markets in the future.

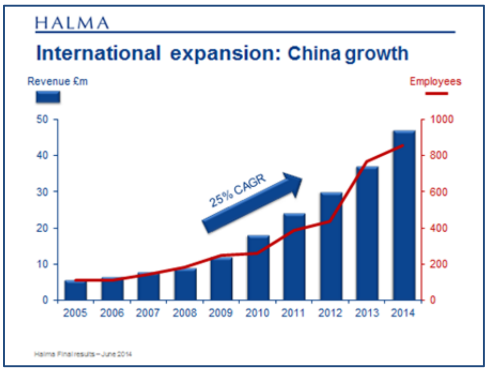
Halma has four key areas for strategic investment. They also define how companies benefit from being part of Halma rather than continuing independently.

It was a quiet year for M&A. However, since the year end we have completed three acquisitions and one disposal. These included our most recent acquisition, Rohrback Cosasco Systems (RCS) which was acquired in May 2014.

RCS is based in Los Angeles close to another Halma company, Sensorex. When we acquired Sensorex in 2012, they suggested we take a look at a local company called RCS which was involved in pipeline safety monitoring. This is not unusual for Halma as we source 80% of our acquisitions internally, giving us the chance to get the deal done without going through an open auction process.

RCS makes devices and systems used for monitoring corrosion in pipelines – both invasively and non-invasively. It sells into markets we know well, (such as oil and gas) using technologies that we understand (including ultra-sonic sensing and wireless communication). RCS also brings a wealth of new application knowledge in corrosion monitoring, built up over many decades of trading.

This acquisition is a good example of how creating a more open, collaborative culture in Halma is helping us to identify new opportunities, including acquisition prospects. It also demonstrates the benefit of having a more rigorous acquisition search process, which we put in place two years ago. I expect both of these factors to become increasingly valuable to us as we seek to focus our M&A search efforts under our new sector management structure.



In international expansion, China continues to deliver strong growth and is another example of how working together as a group has accelerated growth. This chart shows revenue and employees growth over the past ten years.

In 2005, we had around 100 employees (2% - 3% of group total) and revenue of £6m (2% - 3% of group total). By 2014, our China employees had increased to 860 (17% of group total) and, even more impressively, revenue has grown at a compound annual growth rate of 25% to £47m (7% of group total). It is worth noting that we are achieving similar rates of profitability in China to our other major regions.

A key driver of this substantial growth has been the Halma corporate hubs which were established in Shanghai and Beijing in 2006, followed by expansion into three regional hubs in Chengdu, Guangzhou and Shenyang in later years. There are good growth opportunities for Halma in China as demand for our products is driven by the continued social development. We have also built a strong corporate structure over the past eight years and we are building a healthy acquisition pipeline.

All Halma companies are challenged constantly by their customers to be more innovative and to offer even better solutions to their needs. One of my priorities has been to build a more innovative and collaborative culture across Halma so that the solutions we offer also have real competitive advantage. As a result, we are seeing more collaboration across the group – exemplified by our biennial Halma Innovation and Technology Expositions, the most recent of which was held in Orlando in May 2013.

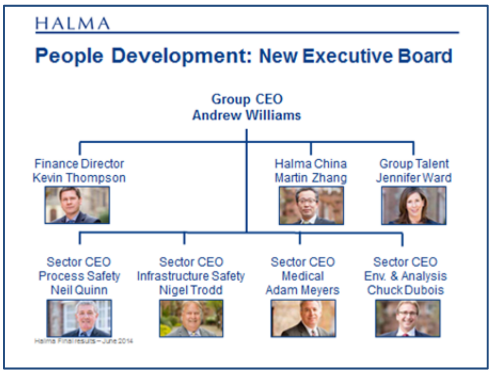
One of the ways innovation excellence is recognised in Halma is through our Annual Innovation Award. This year it was pleasing to see the award go to a collaboration between Avo Photonics (who design and manufacture specialised photonics assemblies) and Aquionics (who have expertise in UV water treatment). Together, they developed a new product, called PearlSense, which uses new UV LED technology to monitor UV water disinfection systems. Compared to existing products PearlSense is smaller, safer, more accurate and more environmental friendly (as it doesn’t use mercury based lamp technology). It ensures a better and more efficient disinfection process and reduces energy costs by ensuring the appropriate dose of UV energy is always applied.

Finally, and most significantly, I have aligned the Halma Executive Board with our four sectors, giving Halma a scalable business model for the future.

As we continue to grow, we have had to consider how Halma should be structured in order to support our long-term growth ambitions whilst retaining our unique operating culture. In particular, should we keep a portfolio of 40-50 companies, or have an organisation which can handle more companies?

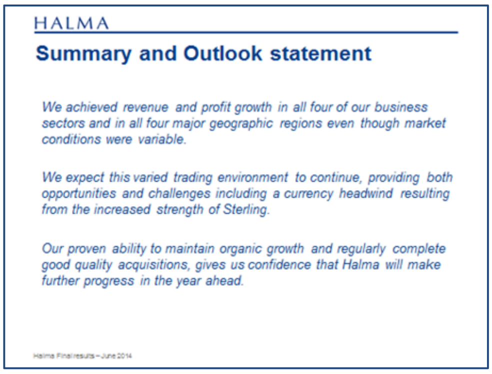
We know how to find and acquire high quality small to medium-sized manufacturing companies and help them to grow through innovation, management development and international expansion. Consequently, our new Executive Board structure leverages this proven capability yet gives each of our four sectors the potential to become as large as Halma is today. This is a significant and exciting change for Halma, giving us greater scalability built around our long standing core values and capabilities.

Each sector has a Sector CEO, all of whom has a proven track record within Halma of delivering both organic growth and successful acquisitions. Their challenge is to build their sectors in a more focused way, both organically and through acquisition, supported by the other Executive Board members.



These other executives include the Director of Halma China, Martin Zhang and Jennifer Ward in the newly created position of Group Talent Director. Before joining Halma in March 2014, Jennifer built a strong track record of success in senior talent development with businesses such as Bank of America and Ebay/Paypal. She will work closely with the Sector CEOs and me to identify, assess, attract and develop senior management talent globally.

As you have seen today, Halma has delivered a strong performance over the past year, with widespread growth in all regions and all sectors in varied market conditions. We have continued with our focused strategic investment and individual companies are increasingly benefitting from being part of a larger group. The new Executive Board management structure will drive more focused growth strategies within each sector and provide greater scalability to the Halma business model for the longer term.



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[1] Adjusted to remove the amortisation of acquired intangible assets, acquisition items, the effects of closure to future benefit accrual of the defined benefit pension schemes (net of associated costs) and profit or loss on disposal of operations totalling £1.6 million (2012/13: £8.4 million).

[2] Return on Sales is defined as adjusted profit[1] before taxation from continuing operations expressed as a percentage of revenue from continuing operations.

[3] Organic growth measures the change in the revenue and profit from continuing operations. The effect of acquisitions and disposals during the current or prior financial year has been equalised by adjusting for their contribution based on their revenue and profit at the date of acquisition or disposal.

*[4] Return on Total Invested Capital (ROTIC) is defined as profit for the year from continuing operations before amortisation of acquired intangible assets, acquisition items, the effects of closure to future benefit accrual of the defined benefit pension schemes (net of associated costs) and profit or loss on disposal of operations but after taxation; expressed as a percentage of total shareholders' funds, adding back net retirement benefit obligations, cumulative amortisation of acquired intangible assets and historic goodwill.**

[5] The Group adopted IAS 19 (revised) in 2013/14, which changed the accounting for defined benefit pension schemes. The prior year has been

*restated resulting in a £2.1m reduction in adjusted[1] profit. Results prior to 2012/13 have not been restated.**

*[6] Return on Capital Employed (ROCE) is defined as operating profit from continuing operations before amortisation of acquired intangible assets, acquisition items, the effects of closure to future benefit accrual of the defined benefit pension schemes (net of associated costs) and profit or loss on disposal of operations, as a percentage of capital employed.**

** see the Preliminary Statement published on 12 June 2014 for more details.*

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