HALMA

Halma plc

Capital Markets Day

14 February, 2013

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The Capital Markets event focussed on two major topics.

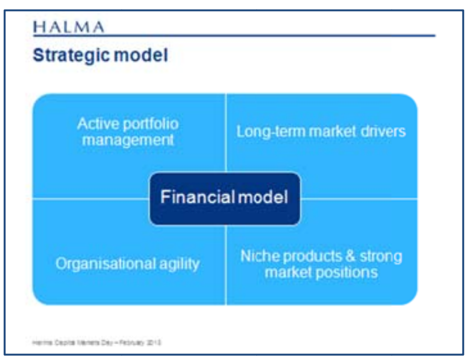
- An update on strategy and new reporting sectors
- Halma's M&A model and track record

An Interim Management Statement was published on the morning of 14 February. No further trading information was disclosed or discussed during the Capital Markets event.

Andrew Williams, Halma's Chief Executive, began by outlining Halma's strategy and new reporting sectors.

We choose to operate in markets where there are long-term market drivers which are unlikely to be reversed when taking a 15 – 20 year view. These are:-

- Increasing health and safety regulations
- Increasing demand for healthcare
- Increasing need for life critical resources (e.g. Energy and Water)



We choose niches within these markets which offer sustainable growth and high returns, including high Return on sales and Return on capital. We aim to build a strong market position within these niches either nationally, regionally or globally, both organically and through acquisition.

Our strategy is to have an agile organisation which enables us to move resources to growth opportunities easily.

We have a very flat management structure with only one management layer (Divisional Chief Executives) between the Group Chief Executive and the subsidiary Managing Directors. This gives clear responsibility and accountability for performance. Significant autonomy is given to local management who have the resources they need to succeed. This fosters a culture of entrepreneurship which is why people sell their companies to us, and want to work for us.

For Halma to sustain success over the longer term, we need to manage our portfolio actively.

When I became CEO in 2005, although Halma was still able to deliver high returns, it was not growing. This was because we owned businesses in markets with weak growth drivers or with products that had weakening market positions or which were unable to grow internationally.

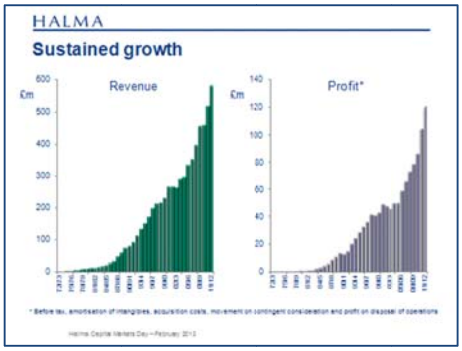
In addition to increasing investment in innovation, management development and international expansion to accelerate organic growth[1], it was important to reshape our portfolio so that it could deliver both growth and high returns on a sustainable basis.

At the centre of Halma's strategic model is a well-defined financial model which has been developed and refined over the past 40 years.

The model is based around cash generation. We build highly cash generative businesses and reinvest this cash in our existing companies and in new acquisitions. This cycle sustains growth over the longer term.

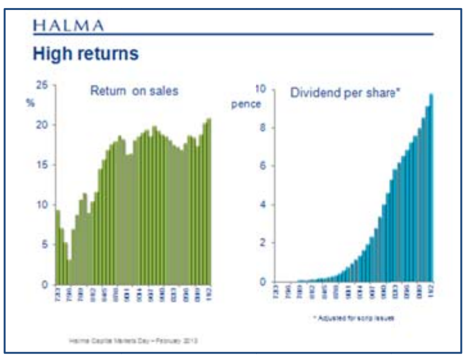
The overall objective of Halma's financial model is to double profit[2] every 5 years and deliver high returns (for example, Return on sales[3] above 16%, Return on capital employed[4] of operating companies above 45% and a Return on total invested capital[5] of greater than

12%). We also aim to increase our dividend by 5% or more every year.



Over the past 40 years, our revenue has increased every year except two. On both occasions revenue declined by less than 1%. Profit has reduced on just six occasions, with the biggest decline being less than £2m, in 2003.

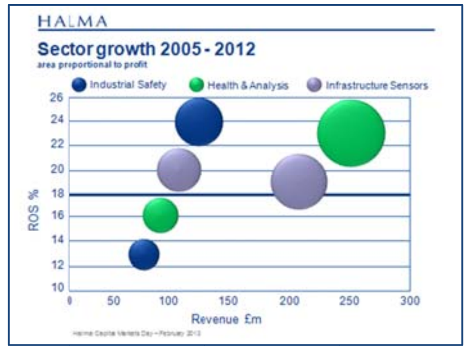
Over the last 5 years we have achieved 13% compound profit growth rate, which although a little under our 15% per year target, is an excellent performance.



Return on sales has been 16% or more every year for the past 27 years. We have increased our dividend by 5% or more every year for the past 33 years.

Growth plateaued in the early 2000s. The impact of more investment in organic growth and M&A can be seen in the rapid recovery and sustained growth since then. This was achieved by:

- selling lower growth or declining returns businesses (e.g. Resistors division in 2006)
- buying higher growth businesses (especially in Health & Analysis)
- improving the growth and returns for our existing businesses (especially Industrial Safety)



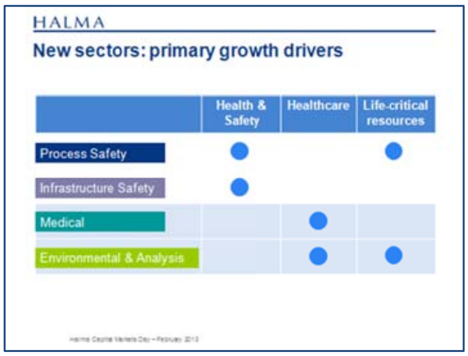
In 2005, Infrastructure Sensors was our largest sector and had the highest Return on sales. By 2012, all three sectors had increased revenue and profit and all three had maintained or increased Return on sales. Health & Analysis is now our largest sector, representing almost half the Group profit.

Today we have announced a change to our reporting sectors. These changes will:

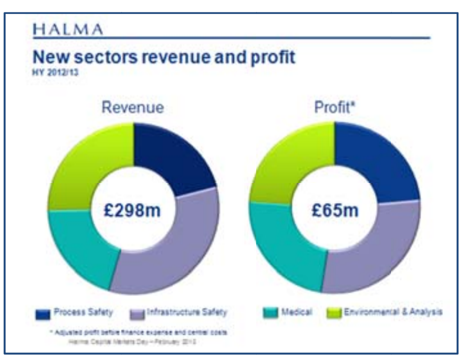
- clearly align with our strategic theme of "protecting life" and "improving the quality of life"
- clearly align with our market growth drivers
- simplify and eliminate the previous sub-sector complexity
- broaden our opportunities for growth

Our two Safety related sectors, Industrial Safety and Infrastructure Sensors, have been renamed Process Safety and Infrastructure Safety respectively.

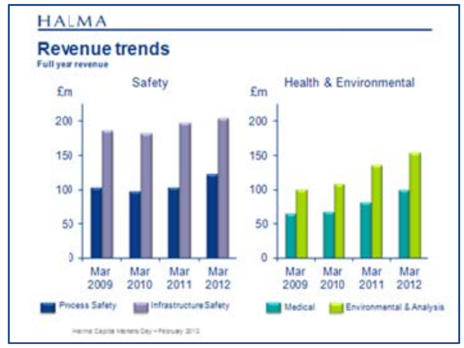
Health & Analysis will divide into two new sectors. Our previous Health Optics sub-sector will become our Medical sector, whilst the Photonics and Water sub-sectors will combine to become Environmental & Analysis. Our Fluid Technology sub-sector will be divided between Medical and Environmental & Analysis based on the individual company end-markets.



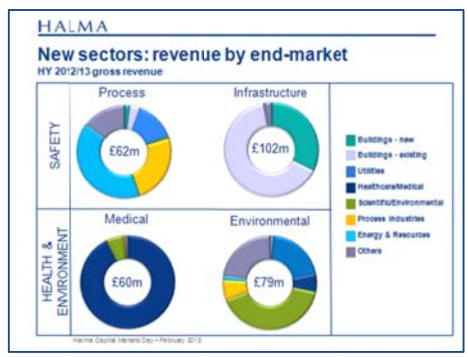
Each of our new four sectors has a clear alignment with one or more of the Halma growth drivers. The two Safety-related sectors growth is driven by increasing health and safety regulations together with increasing demand for life critical resources (in particular Energy). Our Medical sector growth is driven by the increasing demand for healthcare whilst our Environmental & Analysis sector is supported by increasing demand for life critical resources (such as Water) together with increasing demand for healthcare (especially in life sciences).



The sectors are broadly equivalent in terms of revenue and profit. However, the recent acquisitions of Microsurgical Technology and Longer Pump, together with the disposal of Tritech, will increase the relative size of the Medical sector. All four sectors have a Return on sales within, or above, our current target range of 18% - 22%.

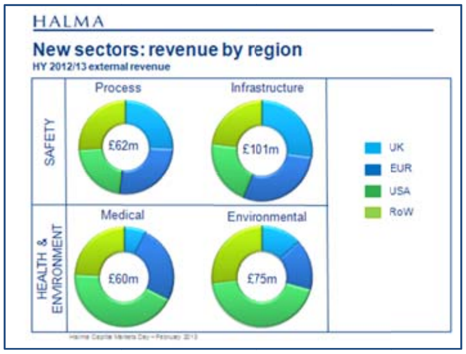


All sectors have grown in recent years and all were resilient during the downturn in 2009/10. Here, we benefitted from the 'counter-cyclicality' of the four sectors which ensured Halma continued to grow each year. Higher growth in Medical and Environmental & Analysis sectors has been supported by acquisitions.

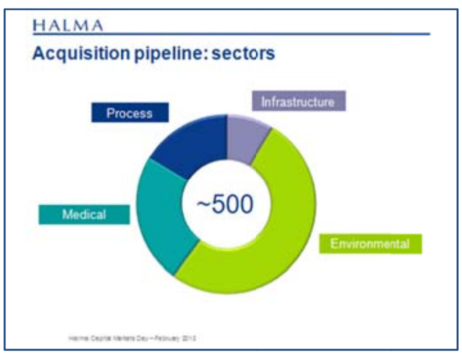


Each sector has different dominant end-markets which makes it easier for investors to understand the macro-economic and structural growth drivers in each case. These are:-

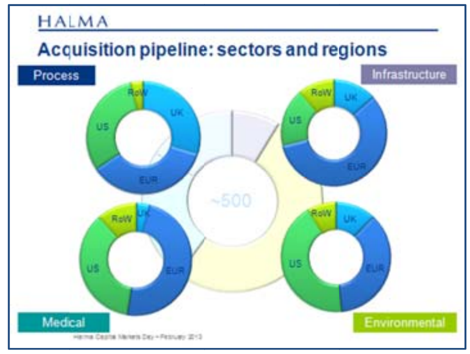
Process Safety: (Process Industry / Energy resources)
Infrastructure Safety: (Existing buildings and new construction)
Medical: (Healthcare)
Environmental & Analysis: (Science, Environmental and Utilities)



All sectors have a similar proportion of sales coming from outside developed markets. We aim to have 30% of Group revenue coming from outside UK/Europe/USA by 2015. Medical and Environmental & Analysis are growing faster in emerging markets than our Safety sectors. In developed markets our Safety sectors are growing more strongly in the UK and Europe, reflecting stronger Health and Safety regulation. The Medical and Environmental & Analysis sectors are growing much faster in the USA.



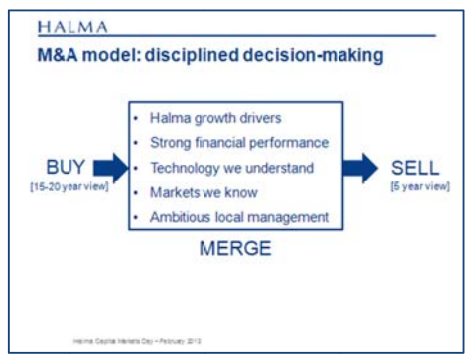
The overall trend towards Medical and Environmental & Analysis markets is also reflected in our acquisition pipeline. Of the 500 targets currently on the database, approximately 75% are in these two sectors. Although we are trying to increase the number of acquisition opportunities in the Safety sectors, we are not seeing as many. Over the past year we have rejected over 600 opportunities across all sectors.



The geographic locations of our acquisitions and our opportunities are still predominantly in developed markets. However, we are starting to see an increased number of opportunities in emerging markets. This was reflected in the recent acquisition of Longer Pump in China.

Andrew Williams then continued by giving an 'in-depth' view of Halma's M&A model and recent track record.

Our M&A model has not changed much over the past 30 years. A big factor in our success has been our consistent application of a simple strategy in a disciplined way, constantly trying to improve our execution of it each year.

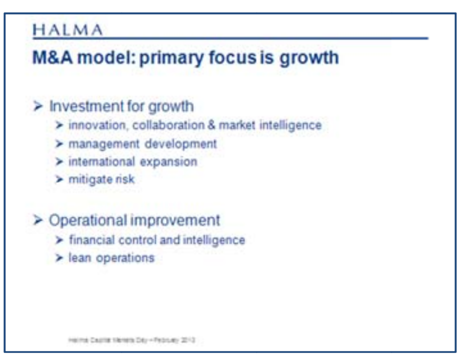


We search for businesses which operate in markets with the Halma growth drivers. We look for a strong financial track record and therefore do not acquire turnaround situations. We buy businesses with technology we understand and which customers value, operating in markets we know. We want businesses which have ambitious local management whose goals we can help to achieve.

When buying a business we take a 15-20 year view of its end-market. We want growth drivers which will not be reversed easily and which give us the confidence to invest. Every year we review all businesses in our portfolio, taking a 5-year view of likely trading performances and growth prospects. If we start to see a dilution of the characteristics we seek in an acquisition, for example, a particular area of competitive advantage is weakening or cash generation is declining, we will decide whether there is a better owner for the business.

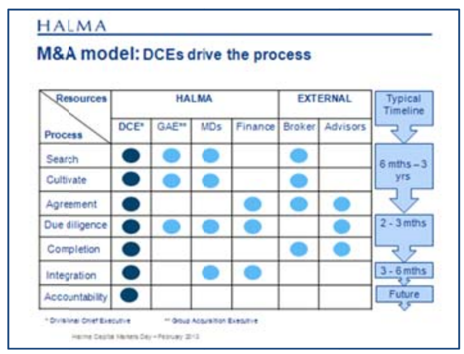
We merge businesses together if we see that this will give us significant customer or market advantage. Over the last 10 years, we have completed over 20 internal mergers, including those completed at the time of acquisition. A benefit of this is that it enables us to keep the number of companies within the Group at a manageable level which protects management's span of control.

Our primary focus when making an acquisition is growth. We buy companies which already have good returns. We value each business based on its growth potential on a standalone basis, rather than by including any synergies (even if they are present). This often means that we increase investment following acquisition, rather than seek cost savings to justify the price we have paid. It also means that sometimes we lose out on a deal if we compete against a buyer who is including significant cost-savings in their valuation model.



We bring to new acquisitions the benefits of innovation, collaboration and market intelligence through the direct involvement of our Divisional Chief Executives (DCEs). Each DCE becomes the Chairman of the Board of any company they acquire. They help develop the management team through the Halma training programmes and by attracting high quality management. Senior Management is often a key constraint for the privately-owned companies that we typically buy. Halma has expertise and an infrastructure which helps companies grow internationally. Being part of a larger group mitigates the risk of significant investment by individual businesses. For example, a large R&D investment which might previously have been considered too risky for a small company is possible since the risk is manageable at a Group level.

We also aim to improve the operational performance of the companies we acquire. We have a rigorous system of financial control which helps managers understand their business and make better decisions.



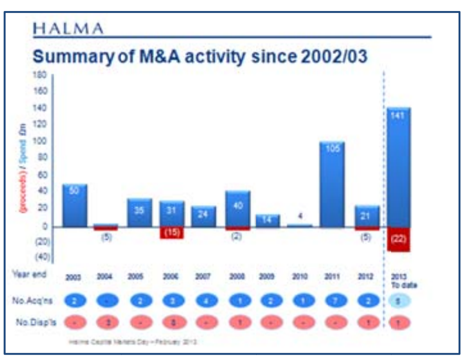
Our DCEs drive our acquisition process. Each is responsible for both the organic growth and acquisitions within their division and are incentivised accordingly with an EVA-based (Economic Value Added) bonus plan.

We use a database which monitors every acquisition opportunity through the key stages in the acquisition process. The Group Chief Executive and Finance Director provide approval at key stages to ensure discipline is maintained, with final sign-off by the Halma Board.

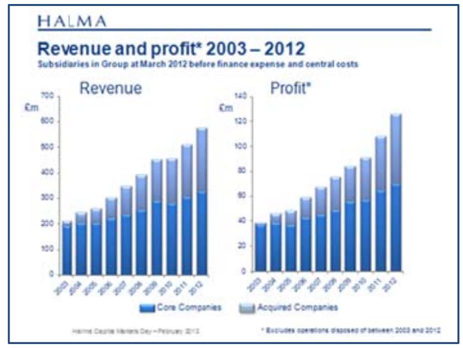
DCEs assemble and co-ordinate a team for each opportunity. The balance is heavily towards using internal resources with people who know the specific technology and markets directly. We have two Group Acquisition Executives, who were previously Halma subsidiary Managing Directors, to help us search and qualify new opportunities.

The timeline for each stage in the M&A process can vary, with the process sometimes taking many years to complete from first contact.
A DCE is accountable for, and rewarded on, delivering growth. Incentives from the Group Chief Executive down to Managing Director level in Halma are based on EVA growth which ensures that rewards are only earned if the return on investment from acquisitions is well above the cost of capital.

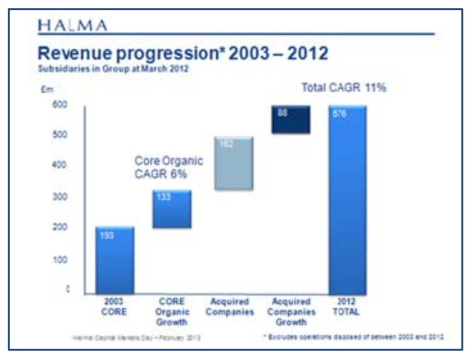
Including the current year, since 2003 we have spent over £400m on acquisitions and received proceeds of around £50m from disposals. During the same period, the average multiple paid for acquisitions was approximately 8x EBIT. Recent disposals were sold for a similar multiple. Prior to that, the Resistors division was sold in 2006 for approximately 6-7x EBIT.



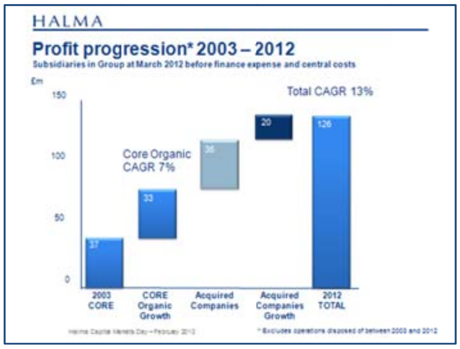
During the period, we have not suffered any impairment on acquisitions, with our least successful deals still delivering a post-tax return on investment close to our WACC of approximately 8%. We have made an average of just under 3 acquisitions (including bolt-on mergers) and one disposal per year. This level of activity enables us to keep the mix of our businesses towards higher growth markets without having to resort to making a single transformational deal.



Growth was sustained throughout the recent recession with a strong contribution from both core organic growth and acquisitions. Profit of these businesses has almost tripled during the past decade and all Halma sectors have contributed both organically and through acquisition.



The revenue waterfall chart from 2003 to 2012 (for those companies in Halma at the end of March 2012), shows that core companies (those in the Group throughout the period) achieved a compound growth rate for revenue of 6% over the decade. Acquisitions added £162m of revenue at acquisition and £88m of growth since acquisition.



The profit waterfall chart, which excludes Head Office costs, and finance expense, shows that core businesses achieved 7% p.a. compound growth. Acquisitions added £36m profit at acquisition and £20m of profit since, giving a total profit compound growth rate of 13% p.a.

If you compare the revenue and profit charts together, you can see that the core business has increased margins significantly (especially in Industrial Safety). During the period, acquisitions were accretive to growth but broadly neutral for margins when compared to our core businesses. However acquisitions were accretive to both growth and margins compared to disposals.

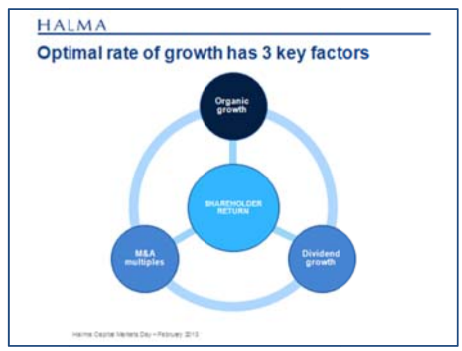
Although this data shows that our M&A activity has been successful over many years some may not go to plan. This can be due to poor management execution or more structural challenges.

For example, success of Halma businesses is dependent on local management quality and sometimes we have not made the correct initial assessment, subsequently being forced to make changes. On other occasions, customer concentration was identified as a risk during due diligence, but we struggled to diversify the business fast enough. These two factors are examples of execution risks which can be resolved, but result in delaying the company achieving its growth forecast – as we saw in Fluid Technology last year.

In some cases, international expansion can prove to be more difficult than we predicted or we have moved into an adjacent market and found that the Halma market growth drivers are significantly diluted. These are structural issues which we believe are very tough to fix and can result in us choosing to sell a business. Both these factors were present in the Asset Monitoring business we sold back in August 2012.

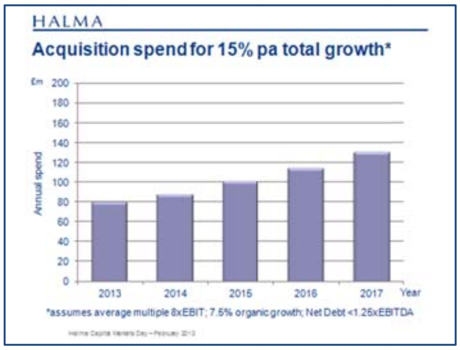
Halma's financial model has a number of important factors which determine success, but the critical one is cash generation. A number of cash related metrics are relatively stable for Halma including operating company cash generation, tax rate (less than 25%) and our balance sheet policy (less than 1.25x EBITDA). Consequently, there are three metrics which determine our optimal and sustainable growth rate. These are:

- Organic growth rate
- M&A multiples
- Dividend growth rate



We regularly monitor the trade-offs between each of these, whilst recognising that organic growth is critical. For example, if organic growth was zero, we would only be able to generate 4% growth through acquisitions from cash flow, whereas 7% organic growth could support an additional 7% of growth via acquisitions (both assuming multiples of 8x EBIT), without taking on significant debt.

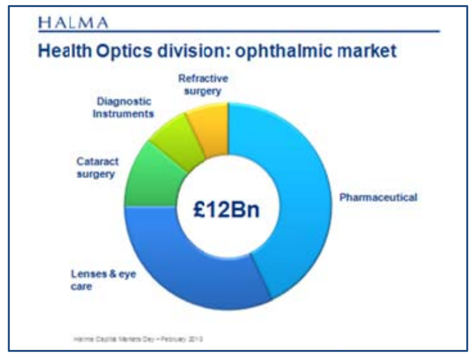
If we maintain a good rate of organic growth and continue to pay sensible multiples for acquisitions, we could achieve 15% total profit growth per year without having to make a transformational acquisition.



The chart above shows how much we would have to spend on acquisitions every year over the next 5 years to maintain an overall 15% rate of profit growth, if roughly balanced between organic and acquisitions. We have already shown that we typically complete three acquisitions per year but even if we made just one acquisition each year, that one deal in 2017 would be less than £140m. With an EBIT multiple of 8x, the acquired company's profit would be less than the largest Halma company today. This demonstrates that the Halma model does not require us to make a transformational acquisition to double profit in 5 years, provided organic growth is good.

The sustainability of Halma's growth model requires us to maintain an effective span of control. Our decentralised approach is effective because we have a flat management structure with clear accountability, resource allocation and incentives for success. An extra layer in this management structure would potentially threaten this dynamic. Over the past ten years, whilst profit has almost tripled, the number of companies has remained around 40 due to our active portfolio management. We regularly plan 3-5 years ahead to ensure we can maintain a manageable number of companies.

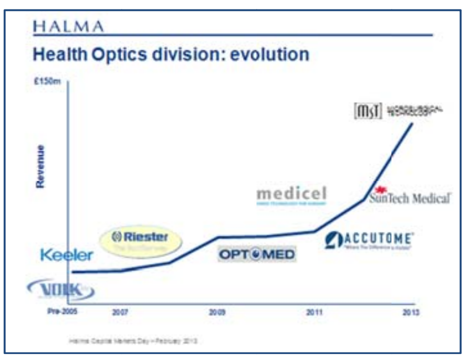
Adam Meyers, a Halma main Board Director and Divisional Chief Executive of the Health Optics Division, gave a summary of how he has built the division through organic growth and M&A.



Initially, Halma's Health Optics division had a singular focus on the ophthalmic market. Today, this is a £12bn market dominated by pharmaceuticals, lenses and eye care products. Within this market, our focus is on niches within the three segments of cataract surgery, diagnostic instruments and refractive surgery which together represent around 25% of the total ophthalmic market.

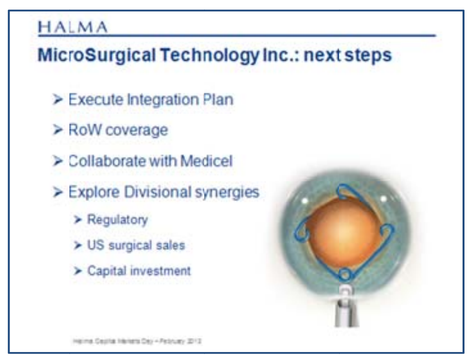
Ophthalmology has excellent market characteristics with long-term growth driven by increasing demand for healthcare. It benefits from ageing global demographics, improving worldwide access (particularly in developing countries) and increasingly difficult global regulations which improve barriers to entry. There are well established competitors and the devices we manufacture are chosen by individual physicians rather than being bought in bulk by health authorities. We manufacture a range of products which cover ophthalmology diagnostics and ophthalmology surgical products. More recently, have entered the adjacent primary care diagnostics market.

In ophthalmology diagnostics, we make a range of products including those that measure the interoccular pressure (used to diagnose glaucoma) and hand held devices which can take an image of the retina. In ophthalmology surgical, we make devices such as disposable injectors which insert a new artificial lens into the eye during cataract surgery. In primary care diagnostics, we have expertise in blood pressure monitoring together with other vital signs monitoring.

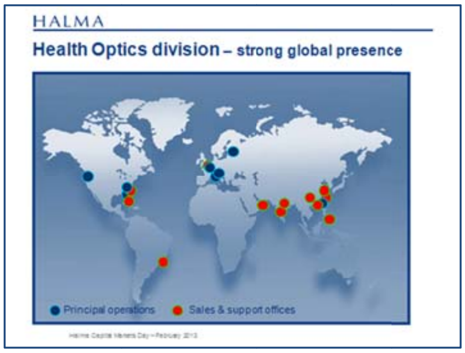


The Health Optics division has evolved significantly in the past 10 years. In the mid-1990s Halma acquired two ophthalmic businesses, Keeler and Volk, based in the UK and US respectively. In 2007, we acquired a German business Riester, which sold ophthalmic devices to the primary care market and also manufactured a range of vital signs monitoring products including blood pressure measurement. In 2010, we identified a business based in Finland, called Optomed which had developed a new hand held retinal imaging device which, we believe, has significant growth potential. We made a minority investment and continued to help them grow. In 2011, we acquired Medicel, which manufactures lens injection devices and accessories used in cataract surgery. Accutome, acquired in April 2012, manufacture products for ophthalmic surgery which are complimentary to those made by Medicel, Volk and Keeler. In May 2012 we acquired SunTech Medical. SunTech has expertise in digital blood pressure monitoring which fits closely with Riester. Most recently, in December 2012, we bought MircoSurgical Technology (MST) which, like Medicel, make disposable devices which are used in cataract surgery.

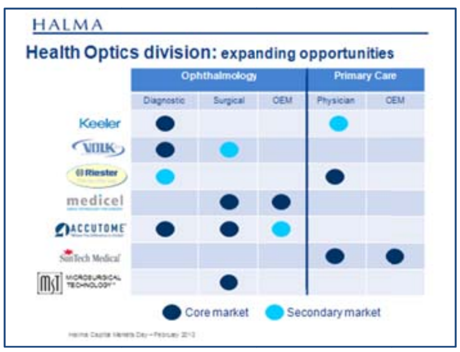
MST's main product which is used to dilate the pupil during complex cataract surgery procedures. We originally made contact with MST's management 2 or 3 years ago. When they decided to sell the company, they conducted a limited auction process and ultimately decided that Halma would be the best home for their business. Importantly, management wanted to stay with the business and we are now supporting them to help achieve their ambitions for growth.



When we buy a business, we have a standard integration template, which we tailor to the particular situation. This includes the introduction of a rigorous system of financial control but also investment for growth. In MST's case, we aim to help them grow internationally and also to collaborate with Medicel, which sells into the same market. In the medium-term we are exploring synergies with other divisional companies, which include regulatory approval, USA surgical sales and capital investment.



Our Health Optics division has a strong global presence with principal operations in the East and West coast USA, UK, mainland Europe and Asia. We have a growing network of sales and support offices.



The Health Optics division has grown substantially by adding businesses which build on existing technical expertise and market knowledge. As each new business is added, we open up new opportunities in ophthalmology and primary care and today have significant scope for further progression.

Andrew Williams concluded the presentation.

This presentation has shown how Halma's M&A strategy has continued to deliver success. Over the past decade the Group has increased growth and already high returns. Halma has great opportunities for further investment and growth - both organically and through M&A due to the structural market and geographic growth drivers. This gives us confidence that our success will continue in the future.

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[1] *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 is equalised by adjusting for their contribution based on their revenue and profit at the date of acquisition or disposal.*

[2] *Before amortisation of acquired intangible assets, acquisition costs, movement on contingent consideration and profit on disposal of operations.*

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

[4] *Return on Capital Employed (ROCE) is defined as operating profit[2] before taxation from continuing operations expressed as a percentage of capital employed. **

[5] *Return on Total Invested Capital (ROTIC) is defined as profit[2] 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.*