FINANCIAL REVIEW

"Another year of record revenue, profit and dividend payments."
Kevin Thompson, Finance Director

Delivering on our strategy

This was another strong year for Halma, continuing to deliver financial results in keeping with our strategic objectives. We continued to deliver organic growth while maintaining high returns and good cash flow. Once again we acquired high quality businesses and we disposed of one business. Our geographic reach expanded further, building on established success in many countries. These record results were delivered with a growing dividend for shareholders while maintaining a strong financial position.

Revenue and profit growth

Revenue grew by 11.9% to £579.9m (2011: £518.4m). Acquisitions made in 2011/12 and the prior year, at the run rate when acquired, added an incremental £34m to this year's revenue and so organic revenue growth was 5.4%. Currency translation had a minimal impact and therefore organic revenue growth at constant currency was 5.5%.

1 In addition to those figures reported under IFRS Halma uses adjusted figures as key performance indicators as the Directors believe the adjusted figures give a more representative view of underlying performance. Adjusted profit figures exclude the amortisation of acquired intangible assets, acquisition transaction costs, movement on contingent consideration and profit on disposal of operations, all of which are included in statutory figures. More details are given in note 1 to the Accounts.

2 See Group highlights.

Revenue and profit growth				Percentage change		
	2012 £m	2011 £m	Increase £m	Total	Organic growth*	Organic growth* at constant currency
Revenue	**579.9**	518.4	61.5	11.9%	5.4%	5.5%
Adjusted[1] profit	**120.5**	104.6	15.9	15.2%	5.1%	4.9%

* Organic growth[2] is calculated excluding the results of acquisitions.

Adjusted[1] profit before tax increased by 15.2% to the record level of £120.5m (2011: £104.6m) with organic profit growth of 5.1% and 4.9% at constant currency. This is the ninth consecutive year of record results, part of Halma's long history of achieving growth.

We believe that the adjusted profit figure we use gives a helpful view of underlying performance trends. Statutory profit before tax increased by 13.9% to £112.0m (2011: £98.3m). Statutory profit before tax is after charging the following items: amortisation of acquired intangibles of £10.4m (2011: £4.8m) much higher this year due to the addition of intangible assets relating to acquisitions in 2010/11 and 2011/12; acquisition transaction costs £0.7m (2011: £1.3m); and movement on contingent consideration relating to acquisitions including foreign exchange movements of £0.9m (2011: £0.2m). It is also after crediting the £3.5m profit on disposal of Volumatic.

Health and Analysis continues to be the largest of our three sectors and now represents 44% (2011: 42%) of Group revenue and 46% (2011: 42%) of Group profit. Industrial Safety delivered the highest organic growth this year extending its record of recent strong growth.

from acquisitions. Mainland Europe is the next largest destination and grew by 12%, with Health and Analysis growing fastest. The UK saw significant growth of 18% in the year with a very strong performance by our Water business within Health and Analysis. Asia Pacific and Australasia grew by 15%, slower than the 29% reported last year but including 25% growth in China, now 5% of Group revenue. Economic and political uncertainty, particularly in the Middle East, also meant that the other countries grew by only 7%.

more, of Group revenue compared with 2006/07.

We are targeting to have 30% of our revenue outside the USA/Mainland Europe/UK by 2015. In 2011/12 the figure is 24%, the same as the prior year. In part this was due to the strong growth we have seen in developed markets but also because recent acquisitions have the majority of their sales in the USA and Europe although they have good opportunities for growth in developing regions of the world.

High Return on Sales

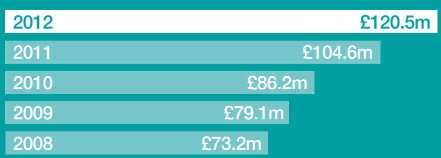
Our target is for the Group to operate in the 18% to 22% Return on Sales[2] range. It has been above 16% for every one of the past 27 years and is an important performance measure for the Group.

In 2011/12 we achieved 20.8% (2011: 20.2%) Return on Sales[2] with this year's increase coming from the high rate of profitability of recent acquisitions.

Geographic revenue growth	2012		2011			
	£m	**% of total**	£m	% of total	Change £m	% growth
United States of America	**162.0**	**28%**	150.3	29%	11.7	8%
Mainland Europe	**154.4**	**27%**	138.3	27%	16.1	12%
United Kingdom	**125.6**	**21%**	106.1	20%	19.5	18%
Asia Pacific and Australasia	**87.3**	**15%**	76.2	15%	11.1	15%
Other Countries	**50.6**	**9%**	47.5	9%	3.1	7%
	579.9	**100%**	518.4	100%	61.5	12%

Adjusted[1] profit before tax £m

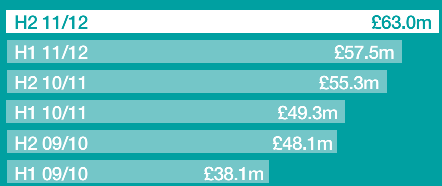
£120.5m



Half yearly adjusted[1] profit £m

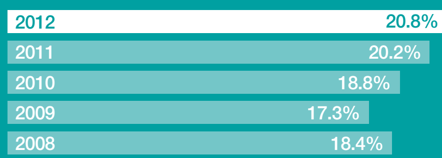
£63.0m

H2: 2011/12



Return on sales[2] %

20.8%



The first half/second half revenue and profit split was typical for Halma at 48%/52% building on a record first half performance. This continued the trend of half year over previous half year improvements we have seen in the past three years.

Geographic revenue growth

The USA continues to be our largest sales destination and its 8% growth benefited

The geographic revenue pattern in the second half of the year was similar to the first but with Mainland Europe growing less quickly and the USA increasing its rate of growth.

In the past five years there has been substantial change in our geographic profile with the UK now representing 6 percentage points less, and territories outside USA/Mainland Europe/UK 5 percentage points

High Return on Sales[2] is based on the good management of many factors including the mix of which products we sell, the cost of those products and close management of expenses. Gross margins (revenue less direct material and direct labour costs) exceeded 60% and remain a stable element of our profitability in the face of inevitable cost and price pressures.

Currency movement

The Group has both translational and transactional currency exposure. Translational exposures arise on the consolidation of overseas company results into Sterling. Transactional exposures arise where the currency of sale or purchase transactions differs from the functional currency in which each company prepares its local accounts. Whilst we do not attempt to forecast future movement in currencies, we understand their impact on our business and try to mitigate the risk of volatility with a transactional hedging strategy.

Halma reports its results in Sterling. The most important other trading currencies are the US Dollar, Euro, and to a lesser extent the Swiss Franc. Approximately 30% of Group revenue is denominated in US Dollars and 20% in Euros.

In 2011/12 there was a limited net currency translational impact on the results as, on average, the US Dollar weakened by 3% but the Euro strengthened by 2% and the Swiss Franc strengthened relative to 2010/11 – although the Swiss Franc movement had limited year on year impact as our Swiss business only joined the Group in late 2010/11. The net currency translation impact was therefore only 0.1% adverse on revenue and 0.2% favourable on profit.

Based on the current mix of currency denominated revenue and profit, a 1% movement in the US Dollar relative to Sterling changes revenue by £1.9m and profit by £0.35m. Similarly, a 1% movement in the Euro changes revenue by £0.9m and profit by £0.2m.

Within the Group there is a good degree of natural hedging (similar amounts of purchase and sale transactions) in US Dollars. We typically buy less products in Euros than we sell and so have a net exposure of approximately Euro 30m in any year. Our transactional hedging strategy is to fix currency rates up to 12 months, and in certain specific circumstances 24 months, forward. We hedge between 30-75% of each operating company's net exposure giving approximately 50% hedging of our trading transactions. This gives our businesses greater certainty in their overseas trading.

	Weighted average rates used in Income Statement		Year end exchange rates used to translate Balance Sheet	
	2012	2011	**2012**	2011
US Dollar	**1.60**	1.56	**1.60**	1.60
Euro	**1.16**	1.18	**1.20**	1.13

Increased finance cost

The net finance cost in the Income Statement increased to £1.4m (2011: £1.1m). The main elements are bank interest and funding costs and the pension financing charge. The net bank interest and funding costs increased because of higher average levels of debt, increased interest rates payable and the higher costs of funding our new bank facility.

The net pension financing charge reduced from £0.4m to £0.2m and this is dependent on the level of pension scheme assets and liabilities at the start of each year as well as the rates of return/discount rate applied to those assets/liabilities. This year the return on increased assets exceeded the cost of higher liabilities. In 2013/14 the pension accounting rules under IAS 19 will change and this will affect the Group Income Statement. The expected return on pension assets will be calculated using the same discount rate, effectively, as applied to the pension liabilities. This will cause a one-off increase in the net pension finance charge, which, based on current estimates, will reduce Group profit by approximately £1m for 2013/14 onwards. Comparative figures will be restated for this change at that time.

For 2012/13 we expect the net pension cost to be higher than 2011/12. In addition we expect a rise in bank interest and funding costs arising from a full year of the cost of the new bank facility.

Lower tax rates

Our approach to taxation is to minimise the tax burden in a responsible manner, managing good relationships with tax authorities based on legal compliance, transparency and cooperation.

The Group has its primary operating subsidiaries in 13 countries so the Group's effective tax rate is a blend of these different national rates applied to locally generated profits. As expected the effective tax rate on adjusted[1] profit reduced to 23.5% (2011: 26.2%) primarily due to the reduction in UK Corporation tax rates by 2%, the benefit of the low tax rates in Switzerland enjoyed by Medicel and the mix of profit earned in various jurisdictions.

We anticipate that the effective tax rate in 2012/13 will be similar to that in 2011/12.

> "We aim to deliver value to shareholders through consistent growth in earnings per share and increasing dividends."

Earnings per share and dividend increases

We aim to deliver value to shareholders through consistent growth in earnings per share and increasing dividends. Adjusted[2] earnings per share increased by 19.4% to 24.46p (2011: 20.49p). The increase was higher than the growth in adjusted[2] profit due to the reduction in the effective tax rate. Statutory earnings per share also increased by 19.7% with acquisition related expense being higher than last year but this increase being offset by the gain on disposal. Halma has a long record of growing its dividend. An increase of 7% is recommended in the final dividend to 5.95p (2011: 5.56p) and together with the 7.1% increase in the interim dividend gives a total dividend of 9.74p (2011: 9.10p). At the year end share price this represents a dividend yield of 2.6%. With this dividend increase Halma will have continued with its progressive dividend policy and increased the annual dividend by 5% or more for every one of the last 33 years, paying out £270m to shareholders in the past decade.

Dividend cover (the ratio of profit after taxation to dividends paid and proposed) calculated using adjusted[2] profit is 2.51 times (2011: 2.25 times).

Further increased returns
Return on Total Invested Capital (ROTIC), the post-tax return on the Group's assets including all historical goodwill, increased to a record of 16.8% (2011: 15.5%). Once again we were able to increase profits at a greater rate than growth in the asset base. Halma's ROTIC exceeds our long-term Weighted Average Cost of Capital (WACC) calculated as being approximately 8% (2011: 8.5%), indicating the creation of value for shareholders by the Group.

Return on Capital Employed (ROCE), measures this operating efficiency of our businesses and was also a record at 74.7% (2011: 71.9%). Both the ROTIC and ROCE figures (see note 3 to the Accounts for the detailed calculations) exceeded our KPI targets.

Good cash generation
Cash generated from operations, excluding taxation paid, was £125.5m (2011: £113.2m) and represented 104% (2011: 108%) of adjusted[1] profit. A summary of the year's cash flow is shown in the table above.

The working capital increase in the year reflected the growth in our business, with the second half of the year seeing targeted working capital improvements.

Expenditure on property, plant and computer software this year was £16m (2011: £15m). This year's figure represents 122% of depreciation once again falling within the 100% to 125% range we would expect. Our businesses generate significant return from investment as evidenced by our ROCE and we therefore continue to encourage them to actively invest.

Taxation paid was £28m (2011: £18m) much higher than last year due to the tax paid on higher profits and a tax credit in the prior year. We expect a slightly lower ratio of tax paid to profit in the coming year as UK Corporation tax rates in particular fall.

Cash flow	2012 £m	2011 £m
Operating cash flow before movement in working capital	133.1	116.8
Increase in working capital	(7.6)	(3.6)
Cash generated from operations	125.5	113.2
Acquisition of businesses and cash/debt acquired	(19.8)	(82.1)
Investment in associates	–	(1.7)
Disposal of businesses	3.6	–
Development costs capitalised	(4.7)	(4.7)
Net capital expenditure	(15.3)	(14.8)
Dividends paid	(35.2)	(32.9)
Taxation paid	(27.8)	(18.1)
Issue of shares/treasury shares purchased	(3.5)	(4.5)
Net interest paid/loan arrangement fees	(3.2)	(0.5)
Exchange adjustments	(1.2)	(0.1)
	18.4	(46.2)
Net (debt)/cash brought forward	(37.1)	9.1
Net debt carried forward	(18.7)	(37.1)

Strong financial position and refinancing
Halma is highly cash generative and has substantial bank facilities. We have access to competitively priced finance at short notice and spread our risks to provide good liquidity for the Group. Group treasury policy is conservative and no speculative transactions are allowed.

In October 2011 we refinanced our revolving credit facility. We now have in place a £260m facility (previously £165m) for five years to 2016 with five high quality international banks. Covenants remain unchanged and limits were improved in the new facility which is on attractive terms. We have continued security over a major source of funding, providing significant firepower for value adding acquisitions. The Group continues to operate well within its banking covenants. We use debt to accelerate the Group's development and review our funding needs regularly to ensure we have ample headroom.

Year end net debt was £18.7m (2011: £37.1m). The net debt figure is a combination of £64.0m of debt and £45.3m of cash (boosted by the receipt of cash from the disposal late in the year) held around the world to finance local operations. We have an active repatriation programme and are building on our existing cash pooling arrangements to ensure that our cash/debt position is managed efficiently.

Further acquisitions and a disposal
Acquisitions and disposals are an important part of our growth model. Halma buys successful businesses in safety, health and environmental markets and helps them grow further through investment in increasing innovation, management development and international expansion. In the past ten years we have spent nearly £350m acquiring more than 25 businesses with deal sizes ranging from £70m down to below £1m.

In 2011/12 we spent £15m on two acquisitions plus £5m in payment of deferred consideration on acquisitions made in previous years. Details are given in the Chief Executive's Strategic Review.

Goodwill of £11m and intangible assets of £10m were recognised on the two acquisitions made in the year. As expected the amortisation of acquired intangible assets increased substantially to £10.4m (2011: £4.8m).

In March 2012 we disposed of Volumatic for a cash consideration of £4.4m with a further £1.5m retained in escrow for release to Halma on achievement of an agreed performance target. Up to a further £2.4m is receivable if future sales targets are met. Over the past five years Volumatic's average annual profit has been £0.6m and average revenue £4.6m.

At the beginning of 2012/13 we spent a further £65m on three more acquisitions.

The two businesses acquired in 2011/12, together with the disposal in 2011/12 and the three acquisitions in 2012/13, are expected to add a net amount of £29.5m to revenue and £5.7m (after financing costs) to profit in 2012/13 based on their run rates at acquisition/disposal.

In April 2012 Halma made a further investment of Euro 3.9m in Optomed Oy, the Finnish ophthalmic equipment manufacturer. This is included as an Associate in the Group accounts.

Pension commitments

The Group primarily provides either defined benefit (DB) or defined contribution pension arrangements for its employees. The DB sections of the Group's pension plans were closed to new entrants in January 2003. There are now fewer than 450 employees (11% of all employees) retaining access to future accrual under the DB plans so our key focus is in mitigating the impact of the past service deficit.

On an IAS 19 basis the deficit on the DB plans at March 2012 was £33m (2011: £36m) before the related deferred tax asset. Plan assets increased to £153.0m (2011: £140.8m) with some further recovery in equity values and additional cash contributions. In total, 59% of plan assets are invested in return seeking assets: 39% in equities and 20% in diversified growth funds providing a higher expected level of return over the longer term. No derivative financial instruments are currently used in investment. Plan liabilities increased to £186.0m (2011: £177.1m) mainly due to the reduction in the discount rate used to value these liabilities.

Triennial funding valuations of the DB plans are currently being performed. We continue to make extra contributions to the plans at a rate agreed with the actuary and expect this to be at the rate of £7m per year with the objective of eliminating the deficit over the next seven years. We will continue to develop and implement our plans for reducing the risk in the future cost of our DB plans over the coming year.

R&D investment

Expenditure on R&D increased to £27.4m (2011: £25.7m) an increase of 6.8% and representing 4.7% (2011: 5.0%) of revenue. All three sectors increased their absolute spend on R&D although the overall percentage of revenue fell due to a lower rate of R&D expenditure in some recent acquisitions.

We are required under IFRS to capitalise certain development expenditure and amortise it over an appropriate period, for us three years. R&D by its nature carries risk and all R&D projects, particularly those requiring capitalisation, are subject to close scrutiny and a rigorous approval and review process. In 2012 we capitalised £4.7m (2011: £4.7m) and amortised £3.7m (2011: £4.2m). This results in an asset carried on the Consolidated Balance Sheet, after £0.2m foreign exchange movements, of £10.5m (2011: £9.7m).

“In October 2011 we refinanced our revolving credit facility. This new five-year £260m facility gives security over funding and provides significant firepower for value adding acquisitions.”

Managing risks and going concern considerations

The main risks facing the Group and how we address them are reviewed on pages 59 to 63. The key operating risks are covered in the Chief Executive's Strategic Review and Sector Reviews.

We spread risk across the Group via well-resourced independent operating units. There is extensive and regular review of operations at a local and divisional level. This review is supplemented by Internal Audit. In the year we continued to build on the strength of our local finance functions with a number of strong recruitments, particularly in the USA, giving us very good oversight at a local level across the Group.

We are in the process of refining our risk appetite analysis to enable an even greater focus on areas for future growth. We have nearly completed the rollout of a centralised IT disaster recovery solution to complement existing local processes within subsidiaries. During the year we substantially revised our policies and processes on the mitigation of Bribery and Corruption in line with best practice and have issued a new Code of Conduct to all staff. This supported our long-standing ethical approach to business.

The Board considers all of the above factors in its review of ‘Going Concern’ as described on page 75 and has been able to conclude its review satisfactorily. It takes discipline and hard work to manage risks well and maintain high returns consistently over time. Our commitment to this will ensure that our long-term delivery of value to shareholders continues.

Kevin Thompson
Finance Director

RISK MANAGEMENT AND INTERNAL CONTROL

Internal control

The Board meets regularly throughout the year and has adopted a schedule of matters which are required to be brought to it for decision. This procedure is intended to ensure that the Directors maintain full and effective control over all significant strategic, financial and organisational issues.

During the year, actions to strengthen the control environment continue to be taken centrally by Group management, particularly in the area of health and safety and bribery and corruption. The duties and responsibilities of subsidiary management are continually refreshed as well as documented in a manual circulated to all subsidiary managing directors. A comprehensive induction programme for subsidiary finance directors was launched in the year. We also strengthened the resources dedicated to identifying and investigating potential acquisitions and the policies to ensure a rapid and successful integration following acquisition. The scope of the Group's policies and the programme of compliance audits are regularly reviewed to ensure they are sufficient to address current risks. The Group placed additional emphasis on updating our business continuity plans over the past year.

The internal audit function has operated independently since 2004, reporting to the Audit Committee. In 2008/09, a dedicated Internal Audit manager was added to support the function and during 2010/11 an internal auditor based in China was recruited. Each year we implement further improvements to our Internal Audit procedures to enhance effectiveness.

The processes which the Board has applied in reviewing the effectiveness of the Group's system of internal control are summarised below:

- operating companies carry out a detailed risk assessment each year and identify mitigating actions in place or proposed for each significant risk. A risk register is compiled from this information, against which action is monitored through to resolution. Group management also compiles a summary of significant Group risks, documenting existing or planned actions to mitigate, manage or avoid risks;
- each month the board of every operating company meets, discusses and reports on its operating performance, its opportunities, the risks facing it and the resultant actions. The relevant Divisional Chief Executive chairs this meeting.

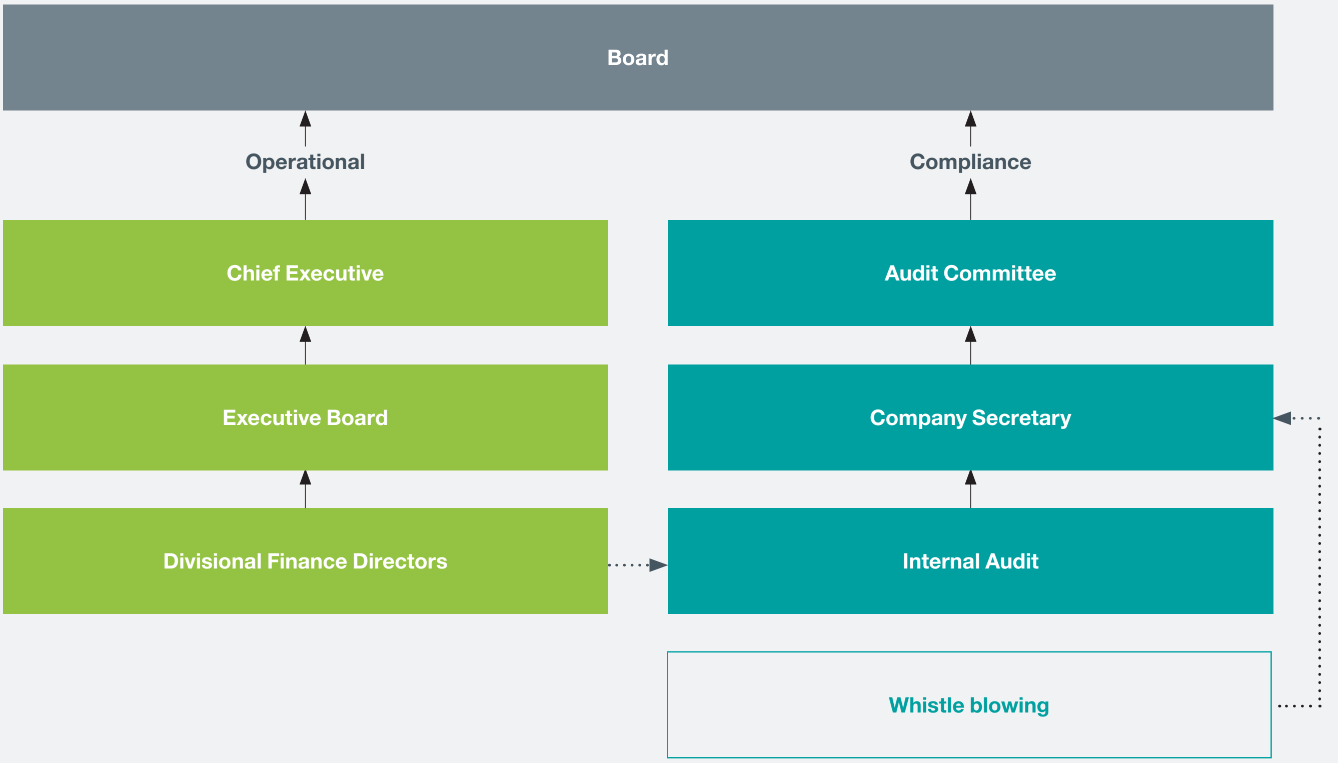
During the year, actions to further strengthen the control environment continued, particularly in the area of health & safety and bribery & corruption.

The Group's treasury and hedging policy was also updated to ensure that appropriate accounting and banking arrangements were in line with the Group's growth and to ensure continued compliance with accounting requirements.

Divisional Chief Executives meet regularly with the Chief Executive and Finance Director and report on divisional progress to the Executive Board;

- financial and trading 'warning signs' are reported to Group and divisional management. Weekly data on cash management and sales orders are also reported direct to the Chief Executive, the Finance Director and the Group finance team. This framework is designed to provide an early warning of potential risks and to direct appropriate action where necessary;
- the Chief Executive submits a report to each Halma plc Board meeting which includes financial information, the main features of Group operations and an analysis of the significant risks and opportunities facing the Group. The report also covers progress against strategic objectives and shareholder related issues;
- regular Director visits to Group companies are scheduled and open access to the subsidiary company boards is encouraged;
- cyclical and risk-based internal control visits are carried out by internal audit or senior finance staff resulting in actions being fed back to each company and followed up by Divisional Finance Directors and Divisional Chief Executives. Reviews are coded in terms of risk and a summary of all such reviews is given to the Audit Committee, with any significant control failings being reported directly to the Audit Committee; senior finance staff also conduct financial reviews at each operating company before publication of half-year and year-end figures. We have a Groupwide IT policy supported by a programme of IT audits; and
- the Chief Executive, Finance Director and Internal Audit report to the Audit Committee on all aspects of internal control. The Board receives regular reports from the Audit Committee chairman and the papers and minutes of the Audit Committee meetings are used as a basis for its annual review of internal control.

Group risk management



Group risk is mitigated by means of an operating structure which spreads the Group's activities across a number of autonomous subsidiary companies. Each of these companies is led by a high-quality board of directors including a finance executive.

Group companies operate under a system of controls which includes but is not limited to:

- a defined organisational structure with an appropriate delegation of authority to operational management which ensures appropriate segregation of key duties;
- the identification and appraisal of risks both formally, through the annual process of preparing business plans and budgets, through an annual detailed risk assessment carried out at local level and informally through close monitoring of operations;
- a comprehensive financial reporting system, recently enhanced, within which actual and forecast results are compared with approved budgets and the previous year's figures on a monthly basis. Weekly cash/sales/orders reporting including details of financial institutions are also maintained within the financial reporting system, all of which is reviewed at both local and Group level;
- an investment evaluation procedure to ensure an appropriate level of approval for all capital expenditure and other capitalised costs;
- self-certification by operating company management of compliance and control issues;
- a robust structure for electronic communication and conducting e-commerce to ensure that the Group is not negatively impacted by threats to its information technology infrastructure and to minimise potential for business disruptions. The Group has a wide range of measures, policies and framework in place which includes a virtual private network covering over 80 sites worldwide, secure firewalls, information management audits, disaster recovery and a mobile devices management system; and
- an acquisitions and disposals framework which governs the due diligence and negotiation and approval processes to ensure that value enhancing, quality investments are made in order to meet our strategic objectives.