PRINCIPAL RISKS AND UNCERTAINTIES

Risk description	Potential impact	Mitigation	Change*
Operational Risk We seek to continuously grow our profits, generating and sustaining a high return for shareholders within a clear strategic framework. We view risk within the context of this objective as well as in absolute terms. In any business the inherent risks that are an integral component of business activities must be identified, managed and mitigated. We perceive our primary operational risks to emanate from remoteness of operations and the actions and quality of our employees.	• Reduced financial performance • Inability to deliver growth strategy • Unexpected variation in Group results	Our key means of risk control is the choice of the markets in which we operate and the people and methods we use to exploit those market opportunities. Our choice is to operate in the safety and health-related technology markets which we consider to be robust over the long term. Our products are predominantly critical components or instruments which are warranted as fit for the purpose rather than systems or intangible products where satisfactory performance is contingent upon third parties. Our quality systems and close management mitigate the risk of product failure/recall and the risk of an accident or fatality. We invest heavily in identifying, recruiting and training talented people who are able to manage the risks we face while delivering the excellent results we require. We always seek to spread our risks. We have processes in place to ensure any major transactions are reviewed at the appropriate level.	→
Organic Growth, Customer and Supplier Risk and Competition The Group faces competition in the form of pricing, service, reliability and substitution. Individual operating companies are at some risk of over-reliance on larger customers. We rely on high quality service from our supply partners. These constitute an ongoing potential threat to our growth.	• Loss of market share • Disruption of service to customers • Reduced financial performance	Our focus on investing in management development, innovation and international growth is a direct result of assessing these risks. We do not place undue reliance on any one Group company nor does the Group rely heavily on one customer, supplier or transaction. We address customer concentration at Company level through active diversification of the customer base. No customer represents more than 2% of Group revenue. We aim to manage the risk of timing and quality of component supply by dual sourcing and long-standing working relationships. By empowering and resourcing local operations to respond to changing market needs, the potential adverse impact of downward price pressure and competition can be mitigated and growth maintained. We recognise the competitive threat coming from emerging economies and by operating within these economies, typically using local staff, we are better placed to make fast progress ourselves.	→
Research and Development New products are critical to our organic growth and underpin our ability to earn high margins and high returns over the long term.	• Reduced financial performance • Loss of market share • Failure to obtain adequate return on investment	By devolving control of product development into the autonomous operating businesses, we spread the risk and ensure that the resource is as close to the customer as possible. New product development 'best practice' is shared between Group companies and return on investment of past and future innovation projects is tracked monthly. Large R&D projects, especially those which are capitalised, require Head Office approval.	→
Intangible Resources Our businesses build competitive advantage and strengthen barriers to entry in many ways including patents, product approvals, technical innovation, product quality, customer service levels and branding. We look for these qualities in the businesses we seek to acquire. Protection of our intellectual property is important to our continued success.	• Loss of market share	The main intangible resources which deliver competitive advantage and which support our strategic objectives are: the patents and trademarks which protect our products; our employees, whose understanding of our technology, customers' needs and the dynamics of the markets we operate in, enable us to maintain leadership in many markets; and the enviable reputation enjoyed by our brands for superior product quality and market leading customer support. Whilst no single product or process is critical to the Group as a whole, all appropriate actions are taken to protect our intellectual property rights. With our development activity increasing in emerging economies we will often segregate the elements of a project to protect the know how.	→

*The arrows indicate the direction of change in particular risks during the year.

PRINCIPAL RISKS AND UNCERTAINTIES CONTINUED

Risk description	Potential impact	Mitigation	Change*
Laws and Regulations Group operations are subject to wide-ranging laws and regulations including business conduct, employment, environmental and health and safety legislation. There is also exposure to product litigation and contractual risk. The laws and regulations we are exposed to as our businesses expand around the world increase each year.	• Reduced financial performance • Reputational damage • Diversion of management resources • Financial penalties	All Group companies have an employee handbook detailing employment practices, including the need to report any major legal or contractual risks. The Group's emphasis on excellent financial control, the deployment of high quality management resource and the strong focus on quality control over products and processes in each operating business helps to protect us from product failure, litigation and contractual issues. Each operating company has a health and safety manager responsible for compliance and our performance in this area is good. Updated Health and Safety policies and guidance were issued recently, with enhanced monthly reporting. We carry comprehensive insurance against all standard categories of insurable risk. Contract review and approval processes mitigate exposure to contractual liability. Our well established policies on bribery and corruption have been updated during the year to ensure continued compliance with best practice with a Group Code of Conduct issued and by appropriate clauses included in third party agreements.	↑
Acquisitions The identification and purchase of businesses which meet our demanding financial and growth criteria is an important part of our strategy for developing the Group, as is ensuring the new businesses are rapidly integrated into the Group.	• Reduced financial performance • Unforeseen liabilities • Failure to deliver expected returns	We acquire businesses whose technology and markets we know well. Divisional Chief Executives are responsible for finding and completing acquisitions in their business sectors subject to Board approval supported by central resources to search for opportunities. We use detailed post-acquisition integration plans. Incentives are aligned to encourage acquisitions which are value-enhancing from day one and to adversely impact executives for buying businesses which fail to deliver a return above a cost of capital.	→
Information Technology/ Business Interruption Group and operational management depend on timely and reliable information from our software systems. We seek to ensure continuous availability, security and operation of those systems.	• Delay or impact on decision making • Reduced service to customers • Loss of Intellectual Property	There is substantial redundancy and back up built into Group-wide systems. The spread of business offers good protection from individual events. We have a small central resource, Halma IT Services, to assist Group companies with any major IT needs and to ensure adequate IT security policies are used across the Group. We carry out regular IT audits. We utilise external penetration testing and have nearly completed the roll-out of a centralised IT disaster recovery solution to supplement local processes. Business Continuity plans are well advanced in each business unit.	→
Financial Irregularities and International Expansion Our objective is to grow our business across the world and to increase revenue and profit outside of developed markets and particularly in Asia. This presents both operating and cultural risks across the world. We recognise that the size and remoteness of some operations may not permit full segregation of duties and that Internal and External Audit procedures may not always identify a financial irregularity.	• Reduced financial performance • Reputational damage • Missed opportunity • Inability to deliver on growth strategy	The Group ensures that there is adequate local management and financial resource in each operational location ensuring they are adequately trained in financial matters whilst maintaining a culture of openness to promote disclosure. Responsibility for remote operations rests with operational management in the sponsoring company who supervises closely and visits frequently. We continue to seek, attract and develop senior talent in developing markets. Group companies operate a common set of reporting procedures and accounting policies, disseminated via the Group intranet. Internal Audit regularly reviews operations and we appointed a new Internal Auditor in China last year.	→

*The arrows indicate the direction of change in particular risks during the year.

Risk description	Potential impact	Mitigation	Change*
Cash A key risk is that the Group will run out of cash or have inadequate access to cash. In addition, cash deposits need to be held in a secure form or location.	• Constraints on, or inability to, trade • Inability to deliver on growth strategies • Permanent loss of shareholder funds	The strong cash flow generated by the Group provides financial flexibility. Cash needs are monitored regularly. In addition to short-term overdraft facilities the Group renewed and increased to £260m its five-year revolving credit facility during the year providing security of funding and sufficient headroom for its needs. Cash deposits are monitored centrally and spread amongst a number of highly rated banks. Subsidiaries report their cash status to Head Office every week.	→
Treasury Risks Foreign currency risk is the most significant treasury related risk for the Group. In times of increased volatility this can have a significant impact on performance. The Sterling value of overseas profit earned during the year is sensitive to the strength of Sterling, particularly against the US Dollar and the Euro. The Group is exposed to a lesser extent to other treasury risks such as interest rate risk and liquidity risk.	• Reduced financial performance • Reputational damage • Financial penalties	The Group does not use complex derivative financial instruments and no speculative treasury transactions are undertaken. Currency profits are not hedged. Currency hedging must fit with the commercial needs of the business and we have in place a hedging strategy to manage Group exposures. This requires the hedging of a substantial proportion of expected future transactions up to 12 months (and in exceptional cases 24 months) ahead. Longer term currency trends can only be covered through a wide geographic spread of operations. We closely monitor performance against the financial covenants on our revolving credit facility and are operating well within these covenants. The risk has increased because more of the Group's profits are derived from non-Sterling currencies.	↑
Economic Conditions In times of uncertain economic conditions businesses face additional or elevated levels of risk. These include market and customer risk, customer default, fraud, supply chain risk and liquidity risk. Uncertainty in the Eurozone in particular adds to current uncertainty.	• Reduced financial performance • Loss of market share • Unforeseen liabilities • Disruption of service to customers	We manage such risks primarily at local company level where they are best understood and where we are closest to the markets and our customers. Operating companies consider contingency plans as part of the annual budget process. The financial strength, availability of finance and diversity of the Group provides mitigation to much of this risk as does the demand for many of our products which is driven by legislation. We operate robust credit management at each operating company. The Halma Executive Board identifies any wider trends which require action. The Group has reviewed its potential exposure to the current macro-economic uncertainty relating to the Eurozone economies. The Group operates in a broad spread of markets, which substantially limits the risk associated with instability in any given territory. Whilst the Group has sales into Mainland Europe of £154m in 2011/12 (27% of total Group sales), sales into Greece, Ireland, Italy, Portugal and Spain represented just £26m (4% of total Group sales). The Group does not have any significant operations within these countries. The Group holds no significant cash deposits in, and none of the Group's funding is provided by an institution primarily located in, any of these countries.	↑
Pension Deficit Monitoring the funding needs of the Group's pension plans is essential to funding our pension obligations effectively. Our UK defined benefit pension plans are closed to new members.	• Excessive consumption of cash limiting investment • Unexpected variability in company results	There is regular dialogue with pension fund trustees and pension strategy is a regular Halma Board agenda item. The Group's strong cash flows and access to adequate borrowing facilities mean that the pensions risk can be adequately managed. The Group has increased pension contributions with the overall objective of paying off the deficit in line with the Actuary's recommendations. We monitor and consider alternative means of reducing our pension risk in light of the best long-term interest for shareholders.	→

*The arrows indicate the direction of change in particular risks during the year.