

Chief Executive's review



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The sales growth in 2004 of 8%, or 11% organic growth at constant currencies, was a result of new products and applications, increased sales coverage in Asia and recovery in many of our markets. Gross margins were maintained at 57% as a result of the strong underlying operating performance. Operating profits grew by 9%, or 25% organic growth at constant currencies. However, with higher interest costs the resulting growth in profit before tax was 4%.

Earnings per share at 32.1p (2003: 32.1p) were affected by the increased tax rate of 24% in 2004 compared with 21% in 2003. The increase was the result of improved performance in the US and the recognition of a deferred tax asset of £12 million in Denmark. The underlying tax charge is expected to increase gradually towards the weighted average tax rate (currently 31.6%) over the next three years.

Asia continued to experience high growth in sales, up 16% compared with the prior year, or 23% at constant currencies, with another good year in China. Asia now represents 24% of total sales, compared with 12% in 1999. North America enjoyed a recovery with healthy growth of 12% at constant currencies although translated into sterling this resulted in an increase of only 1%. European sales grew by 9% compared with the prior year and by 11% at constant currencies.

The weakened US dollar has been a major feature for Spectris over the past three years. At 2002 average rates (£1 = \$1.5), operating margins in 2004 would have improved by approximately two percentage points compared with 2002. Good geographical sales coverage at European businesses such as PANalytical, Brüel & Kjær Sound & Vibration, BTG and Malvern gave rise to a greater exposure to the dollar in 2004.

1999	12%	42%	20%	26%
2004	11%	36%	21%	32%
Employee profile (% total headcount)				
■ Admin	■ Marketing/R&D			
■ Operations	■ Customer-facing			

The increased focus on sales and marketing, particularly in Asia, has resulted in a change in the staff mix over the past few years, with a higher proportion of customer-facing employees.

Operational improvements yielding results

On a day-to-day basis Spectris companies operate in a relatively autonomous way. Nevertheless, they have common strategic themes and share best practice across the group. 2004 was another productive year in this regard, with the following areas delivering further results:

Realignment of customer-facing personnel There has been a further increase in the proportion of customer-facing personnel from 31% of total employees in 2003 to 32% in 2004. This increase, compared with a figure of 26% in 1999, reflects a higher degree of outsourcing and the shift in staff mix to focus on sales and marketing, with the primary emphasis on continuing to extend coverage in Asia.

Continuous improvement in the quality of business In spite of currency pressures and some material cost inflation gross margins improved, reflecting management actions to improve the product mix.

Efficiency and effectiveness in sales, marketing and supply Strong organic sales growth for the second year running was achieved with only a marginal increase in headcount, excluding additions from bolt-on acquisitions. The result is sales growth and expanding underlying operating margins.

R&D and innovation leading to new business and increased competitiveness 2004 was a productive year in terms of new product introductions and penetration of new applications into high quality business areas. Examples include a proprietary small, flat microphone for acoustic measurement in automotive and aerospace applications; a hand-held scanner for reading 2D bar codes for parts tracking, particularly in the electronics industry; a portable gas analyser for measuring oxygen, targeted at the oil and gas and medical industries; and a remote wind turbine monitoring solution for the power industry. Expenditure on new product development in 2004 totalled £35 million.



Brüel & Kjær Sound & Vibration's new surface microphone is just 2.5mm high, enabling it to measure noise directly on flat surfaces, for example windows, in automotive and aerospace applications.



Brüel & Kjær Vibro's systems have found new applications in the power industry, in particular for the remote condition monitoring of wind turbines.

Sector performance

Electronic controls reported sales growth of 6% from £132.1 million to £139.7 million with operating profits up 9% from £15.8 million to £17.2 million. At constant currencies, sales grew by 12% and operating profit by 16%. Operating margins increased to 12.3% from 12.0% in 2003. All four companies increased sales and profits at constant currencies and performance improvements were particularly notable at Microscan and HBM. Microscan has steadily improved its market position and 2004 was no exception. HBM's progressive transfer of load cell production to China is expected to be completed in 2005. An impressive list of new products was introduced, including new human-machine interface controls from Red Lion and a range of force transducers from HBM.

In-line instrumentation achieved sales growth of 9% from £182.0 million to £198.4 million whilst operating profit declined by 7% from £22.3 million to £20.8 million. Operating margins were 10.5% compared with 12.3% in 2003. The decline in operating profit resulted from a significant adverse currency effect and the year-on-year impact of a bolt-on acquisition for Loma which added £10 million in sales but incurred restructuring and integration costs of £1.1 million. At constant currencies, sales grew by 15% and operating profit grew by 4%. BTG made good progress despite mixed conditions in the pulp and paper market, which accounts for nearly all of its business. Ircon, NDC and Servomex delivered solid performances. Beta LaserMike still suffers from weakness in the wire and cable markets, a reflection of the continuing low levels of investment in telecommunications infrastructure, but made progress in the year. New products were introduced by all the companies in this sector, and in particular at Brüel & Kjær Vibro, where the launch of new remote condition monitoring equipment opened up new opportunities in the power market.

00	26
01	30
02	30
03	34
04	35
Research & development (£m)	

Continued investment in R&D and innovation has resulted in new business and increased competitiveness for Spectris companies.

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Process technology reported sales growth of 9% from £253.9 million to £276.1 million. Operating profit grew by 25% from £21.7 million to £27.2 million and operating margins increased from 8.5% to 9.9%. All five companies grew sales, profits and margins. The impact of exchange rates was absorbed, with sales, at constant currencies, increasing by 15% and operating profit by 44%. The supplier issues experienced in the second quarter did not impede shipments in the second half. Bolt-on acquisitions for Particle Measuring Systems, Brüel & Kjær Sound & Vibration and Malvern contributed £10.5 million of sales. Innovation featured strongly, typified by a new environmental acoustics analyser from Brüel & Kjær Sound & Vibration and a new range of X-ray analysers from PANalytical making specific inroads in the minerals and materials market. The pharmaceuticals and materials research markets, such as nanomaterials, continue to be potential growth areas for PANalytical, Malvern and Particle Measuring Systems.

Organic growth and margin improvements

2005 will benefit from actions taken in 2004 to improve margins and operational gearing will continue to be a factor. Material cost increases are expected to have only a marginal effect. In addition, management has already taken further actions in the European operations to reduce operating costs and, as a consequence, to improve the level of natural hedging. HBM, for example, is moving standard load cell production to its facility in China and Servomex will start final assembly there. Further sales coverage in Asia is another major factor, as is the healthy pipeline of new products and applications. Management actions to improve the product mix will provide further margin support. A continued focus on cash generation and new treasury processes will help to improve return on net operating assets as well as reducing interest costs.

In summary, the key priorities going forward are to maintain organic sales growth momentum, deliver high levels of cash and build on existing margin improvement trends in 2005 and beyond.



Hans Nilsson Chief Executive



Microscan launched a hand-held scanner for reading 2D bar codes for parts tracking, particularly in the electronics industry.