

## Financial review

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### Operating performance

£ million	2004	2003
Turnover	614.2	568.0
Operating profit	65.2	59.8
Operating margin	10.6%	10.5%

(Unless otherwise stated, all profit and earnings figures are before exceptional items and goodwill amortisation.)

Sales increased by 8% overall, with organic growth in sales at constant currencies being 11%, driven largely by increasing demand from Asia.

Operating profit rose by 9% overall with organic growth at constant currencies being 25%. Underlying operating margins improved as a result of the actions taken in the businesses but this was largely absorbed by adverse currency movements.

Operating profits, after including goodwill amortisation of £13.0 million (2003: £12.4 million), increased by 10% from £47.4 million to £52.2 million. Profit before tax, after including goodwill amortisation and exceptional losses on sale or termination of businesses of £1.2 million (2003: £0.4 million), increased by 2% from £36.1 million to £36.9 million.

### Acquisitions

During the year, a number of small, bolt-on acquisitions were made for which the total consideration, including acquisition expenses, was £10.4 million. These acquisitions contributed £20.5 million of sales during the year.

### Earnings per share

pence	2004	2003
Basic earnings per share	20.4	21.6
Adjustment for exceptional items and goodwill amortisation (after tax)	11.7	10.5
Earnings per share before exceptional items and goodwill amortisation	32.1	32.1

Earnings per share before exceptional items and goodwill amortisation remained constant compared with 2003. The growth in operating profits was offset by higher interest and tax charges as described further below.

## Cash flow

Operating cash flow (€ million)	2004	2003
Operating profit (before goodwill amortisation)	65.2	59.8
Add back: depreciation	13.4	13.0
Working capital movement	(14.3)	(8.0)
Net cash flow from operating activities before capex	64.3	64.8
Capex	(15.6)	(14.1)
Operating cash flow	48.7	50.7
Cash conversion	75%	85%
<b>Non-operating cash flow</b>		
Tax paid	(7.7)	(2.5)
Interest paid	(13.8)	(8.9)
Dividends paid	(16.3)	(15.5)
Acquisitions	(10.5)	(8.2)
Shares issued	0.7	0.8
Exchange/other	3.4	(2.3)
Total non-operating cash flow	(44.2)	(36.6)
Operating cash flow	48.7	50.7
Movement in net debt	4.5	14.1

Cash conversion of operating profit to operating cash was 75% (2003: 85%). The reduction was chiefly due to a working capital outflow of £14.3 million (2003: £8.0 million). Debtor days outstanding rose from 55 at December 2003 to 59 at the end of 2004. Inventory increased due to a one-off safety stock build although inventory turns improved from 2.5 to 2.9 over the same period and trade working capital expressed as a percentage of sales remained constant at 16%.

Capital expenditure equates to 2.5% of sales (2003: 2.5%) and, at £15.6 million, was 116% of depreciation (2003: 108%). Capital investments in HBM, BTG, PANalytical and Brüel & Kjær Sound and Vibration accounted for 58% of total capital expenditure. Other significant investments included the cost of Loma's transfer of production to the Czech Republic.

The level of tax paid in 2003 was lower than 2004 due in part to a £3.2 million US tax rebate in 2003.

Overall, net debt fell by £4.5 million (2003: £14.1 million), despite net investment in bolt-on acquisitions of £10.5 million (2003: £8.2 million).

Interest cost, excluding the financing charge arising from FRS 17, was covered by operating profits 4.7 times (2003: 5.6 times), providing reasonable headroom over and above banking covenants which require a minimum of 3 times cover.

## Taxation

The effective tax rate on profits was 24.1% (2003: 21.1%) which continues to be substantially below the weighted average statutory tax rate of 31.6% (2003: 30.4%) as a consequence of the utilisation of unrecognised tax losses in Germany, extra-territorial income relief in the US and prior year tax credits.

The increase in the tax rate in 2004 was due to increased profits made in high tax jurisdictions such as the US and the recognition this year of a deferred tax asset in Denmark.

The underlying tax charge is expected to increase further towards the weighted average statutory tax rate over the next three years.

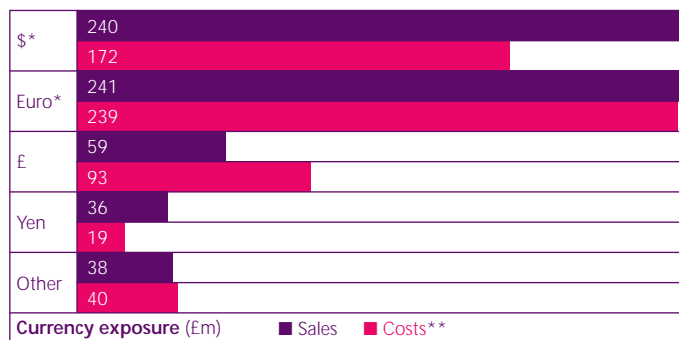
## Financing and treasury

The group finances its operations from both retained earnings and third party borrowings, the majority of which are currently at fixed rates of interest.

The increase in interest costs was primarily attributable to the following factors. In 2003, interest rate swap contracts were in place for \$50 million and €40 million of borrowings which generated interest savings of £1.5 million during that year, however both arrangements lapsed in July and September 2003 respectively. Additionally, in October 2003, fixed rate private placement loan notes were issued, replacing shorter-term floating rate debt. Where appropriate, interest rate swap arrangements will be used to optimise the group's interest rate profile. No interest rate swaps were in place in 2004.

During 2004, no significant new loan borrowings were taken out and the majority of third party borrowings continue to be comprised of US private placement loans which have been partly swapped into euros to provide a hedge against euro denominated net assets in the group's balance sheet.

At the year end, 99% of group borrowings were at fixed interest rates (2003: 99%). Additionally, the ageing profile at the year end showed that 27% of debt was due to mature in two to five years (2003: 29%) and the remaining 73% in more than five years (2003: 71%).



\*Dollar/euro categories include tracking currencies  
 \*\*Costs include interest

## Currency

The group has both translational and transactional currency exposures. Translational exposures arise on the consolidation of overseas company results into sterling. Transactional exposures arise where the currency of sale or purchase invoices differs from the functional currency in which each company prepares its local accounts. The transactional exposures include situations where foreign currency denominated trade debtor, trade creditor and cash balances are held.

To demonstrate the currency exposures faced by the group, the chart opposite shows the differences between the group's consolidated revenues and costs for each of the major currencies.

The largest exposure relates to the US dollar and the continued weakening of the dollar during 2004 had a significant impact on the operating results in the year. In total, at constant 2003 exchange rates, it is estimated that 2004 operating profits would have been higher by £7.8 million, of which the change in US dollar rates is the most significant factor.

Key exchange rates were as follows:

	2003 (average)	2004 (average)	2004 (year-end rate)
US\$	1.64	1.83	1.92
Euro	1.44	1.47	1.41
Yen	189	197	197

The group's US dollar, euro and yen net translation exposures were hedged in 2004 through zero cost average rate options which, in aggregate, generated net gains of £3.2 million (2003: £1.6 million). In 2005, the group has zero cost average rate options in place to provide a hedge against \$145 million, at average rates (compared to sterling) of between \$1.75 and \$1.90. For planning purposes in 2005 the group has assumed a dollar to sterling exchange rate of \$1.90.

**FRS 17**

The reporting standard on retirement benefits, FRS 17, was adopted early by the group in 2001.

Operating profit includes a defined benefit scheme pension charge of £0.8 million (2003: £0.7 million). The net pension liability in the balance sheet has increased to £14.0 million (2003: £12.0 million) as a consequence of a reduced discount rate and increased inflationary expectations, mitigated in part by an increase in underlying asset values.

**IFRS**

IFRS Summary Financial Statements will be published on 15 June. The differences between the UK GAAP and IFRS Financial Statements are expected to be modest with the following exceptions.

**Goodwill** Historically under UK GAAP no distinction has been made between the various components of any intangible asset arising on acquisitions where the price paid exceeds the fair market value of the tangible assets and liabilities acquired. Currently, all such intangibles are disclosed as goodwill and amortised over an appropriate economic life. IFRS requires separate identification of these intangibles, and amortisation where appropriate, with any residue being classified as goodwill.

**IAS 39 (Hedge Accounting)** Under IAS 39 derivative instruments are marked to market at the balance sheet date. On subsequent revaluation at each period end, the ineffective element of the hedge is taken to the income statement. Spectris currently has three categories of financial instrument that are accounted for under IAS 39, however only two are expected to result in amounts being charged or credited to the income statement.

- 1) Average rate option – a nil cost option for \$145 million with a spread of 1.75–1.90 has been put in place. This instrument was taken out to protect the group's US dollar exposure.
- 2) Cross currency interest rate swaps – these were taken out to fix the floating rate private placement US dollar debt into fixed interest euro debt.
- 3) Forward currency contracts – a number of contracts exist hedging US dollar exposure on sales. These effective hedges should not result in amounts being charged to the income statement.

The effect of holding the first two instruments above is to introduce volatility into the income statement which, in the case of 1) will be driven by US dollar to sterling exchange rate movements, and in the case of 2) euro interest rate movements.

**Share options** A charge to the profit and loss account is recognised under IFRS where previously no such charge existed under UK GAAP. The charge applies to options issued after November 2002.

**Deferred tax** IAS 12 will require a deferred tax impact to be recognised in the group balance sheet relating to goodwill held in the local accounts of certain US subsidiaries. IAS 12 also requires deferred tax balances arising on inter-company stock profit eliminations to be calculated using the buying company's tax rate rather than that of the selling company. It will also be necessary to apply deferred tax to the adjustments required by other IFRS accounting standards, as appropriate.

**Presentational matters** IFRS has different presentation and disclosure requirements to UK GAAP and will involve changes to the presentation and content of the primary statements and notes to the accounts, including the segmental analysis.



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