

Business Review

Financial Review

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19%

Increase in sales from continuing businesses

13%

Increase in adjusted operating profit from continuing businesses

86%

Cash conversion

Introduction

Spectris uses adjusted figures as key performance measures in addition to those reported under IFRS. Adjusted figures exclude certain non-operational items which management has defined as amortisation of acquisition-related intangible assets, goodwill impairment charges, profits or losses on the termination or disposal of businesses or major fixed assets, unrealised changes in the fair value of financial instruments, net gains or losses on retranslation of short-term inter-company loan balances, related tax effects and other tax items which do not form part of the underlying tax rate. Unless otherwise stated, all profit and earnings figures referred to below are adjusted measures – for explanation of adjusted figures and reconciliation to the statutory reported figures see Note 3.

Operating performance

	2008	2007	Increase/ decrease
Continuing businesses			
Sales (£m)	787.1	659.8	19%
Operating profit (£m)	118.3	104.3	13%
Operating margin	15.0%	15.8%	(0.8)pp
Statutory basis			
Sales (£m)	787.1	668.4	18%
Operating profit (£m)	113.7	102.9	10%
Operating margin	14.4%	15.4%	(1.0)pp

Reported sales in continuing businesses increased by 19% to £787.1 million. Favourable movements in foreign currency exchange rates had an impact of approximately £81.7 million or 12% on sales, meaning that sales in continuing businesses increased by approximately 7% on a constant currency basis. The year-on-year impact on sales from acquisitions was approximately £28.1 million or 4% of sales in continuing businesses.

Adjusted operating profit rose by 13% in continuing businesses to £118.3 million, with operating margins declining from 15.8% to 15.0%. The decrease in margins can largely be explained by an increase in research and development expenditure (0.4pp) and the dilutive effect of foreign exchange (0.1pp) and acquisitions (0.2pp). Favourable movements in foreign currency exchange rates had an impact of approximately £12.1 million or 12% on operating profits, and profits in continuing businesses increased by approximately 2% on a constant currency basis. The year-on-year impact on profits from acquisitions was approximately £3.4 million or 3% of profits in continuing businesses.

The year-on-year increase in interest costs is £1.4 million (from £6.8 million to £8.2 million). This includes £1.0 million relating to foreign exchange and the balance is due to the extra cost of additional borrowing in the year. Adjusted profit before tax increased by 12% from £98.0 million to £110.1 million.

Statutory operating profit, after including acquisition-related intangible asset amortisation of £4.6 million (2007: £1.9 million), increased by 10% from £102.9 million to £113.7 million.

Statutory profit before tax decreased by 10% from £118.1 million to £106.1 million.

The differences between statutory and adjusted profit before tax are shown in the table below.

	2008 £m	2007 £m
Statutory profit before tax	106.1	118.1
Profit on disposal of businesses	(0.3)	(19.0)
Goodwill charges and acquisition-related intangible asset amortisation	4.6	1.9
Unrealised changes in fair value of financial instruments	(0.9)	(3.0)
Net losses on retranslation of short-term inter-company loan balances	0.6	–
Adjusted profit before tax	110.1	98.0

Acquisitions

The total cost of acquisitions made in the year was £88.8 million, including acquisition expenses as well as a small amount of deferred and contingent consideration expected to be paid in future years, and excluding cash acquired. The largest of these acquisitions took place close to the end of 2008. These acquisitions contributed £28.1 million of sales and £3.4 million of profits during the year.

Taxation

The effective tax rate on profits was 23.7% (2007: 28.0%), a decrease of 4.3pp. The effective tax rate continues to be below the weighted average statutory tax rate of 29.7% (2007: 32.3%), primarily as a consequence of the tax effects of a tax efficient inter-company financing structure and the recognition of tax assets from tax losses arising in prior years in the UK.

The underlying tax charge is expected to remain approximately 3pp below the weighted average statutory tax rate for the foreseeable future.

Earnings per share

Adjusted earnings per share increased by 25% from 58.1 pence to 72.8 pence, reflecting the net impact of a 12% increase in profit before tax, a reduction in the average number of shares in issue, and the reducing tax charge.

Basic earnings per share decreased by 1% from 70.9 pence to 70.3 pence. The differences between the two measures are shown in the table below.

	2008 Pence	2007 Pence
Basic earnings per share	70.3	70.9
Goodwill charges and acquisition-related intangible asset amortisation	4.0	1.6
Profit on disposal of businesses	(0.3)	(15.6)
Unrealised changes in fair value of financial instruments	(0.8)	(2.4)
Net losses on retranslation of short-term inter-company loan balances	0.5	–
Tax effect of the above and other tax items that do not form part of the underlying tax rate	(0.9)	3.6
Adjusted earnings per share	72.8	58.1

The weighted average number of shares outstanding during the year decreased from 121.6 million to 115.4 million. This decrease arose as a result of the share buy-back programme that was completed in February 2008, partially offset by the exercise of share options in the year.

Cash flow

	2008 £m	2007 £m
Operating cash flow		
Adjusted operating profit	118.3	104.8
Add back: depreciation and software amortisation	13.5	13.1
Working capital movement/other	(7.8)	(1.5)
Net cash flow from operating activities before capital expenditure	124.0	116.4
Capital expenditure	(21.9)	(12.7)
Operating cash flow	102.1	103.7
Cash conversion	86%	99%
Non-operating cash flow		
Tax paid	(24.0)	(23.8)
Interest paid	(8.5)	(6.3)
Dividends paid	(25.0)	(22.2)
Acquisitions	(87.8)	(6.0)
Disposals	1.5	29.8
Share buy-back	(9.3)	(79.2)
Exercise of share options	0.3	4.1
Purchase/sale of own shares by Employee Benefit Trust	(0.2)	(1.6)
Exchange	(33.9)	(4.1)
Total non-operating cash flow	(186.9)	(109.3)
Operating cash flow	102.1	103.7
Movement in net debt	(84.8)	(5.6)

Cash conversion of operating profit to operating cash was 86% (2007: 99%). The lower cash conversion was a result of a combination of capital expenditure (£21.9 million), net of disposals (£0.9 million), being £7.5 million higher than depreciation, and a build in working capital towards the second half of the year.

Average working capital expressed as a percentage of sales reduced to 13.4% whereas year-end working capital expressed as a percentage of sales increased from 14.4% to 18.4%. 2.9pp of this increase is attributable to the year-end on year-end foreign exchange rate movement with the US dollar strengthening by 28% against sterling and the euro appreciating by 24%. At constant exchange rates, the year-end working capital ratio would have been 15.5%, still 1.1pp higher than the prior year, reflecting the build up of working capital towards the end of the year.

Capital expenditure during the year equated to 2.7% of sales (2007: 1.9%) and, at £21.9 million (2007: £12.7 million), was 162% of depreciation (2007: 97%).

Business Review

Financial Review continued

Overall, net debt increased by £84.8 million (2007: increase of £5.6 million) from £77.3 million to £162.1 million. Interest cost, excluding the financing charge arising from IAS 19, was covered by adjusted operating profit 14.4 times (2007: 15.6 times), providing significant headroom over and above banking covenants which require a minimum of 3.75 times cover.

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.

As at 31 December 2008, the group had £257 million of committed facilities, which consists of £164 million of private placements maturing between September 2010 and October 2013, £90 million of revolving credit facilities, of which £50 million matures on 31 December 2009, and £3 million of bank loans secured on property of three of our businesses. £40 million of revolving credit facilities were undrawn at the year end. In addition, the group had a cash balance of £64.4 million and has £40.5 million of uncommitted facilities, mainly in the form of overdraft facilities for our local operations. £9.6 million of these facilities were drawn at the year end.

At the year end, 73% of group borrowings were at fixed interest rates (2007: 96%). The ageing profile at the year end showed that 15% of debt is due to mature within one year (2007: 3%) and 85% of debt is due to mature in between one and five years (2007: 31%).

Since the year end, an additional £50 million, five-year term facility was secured in January 2009 under covenant conditions in line with existing facilities.

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.

The largest transactional exposures are to the US dollar and, to a lesser extent, the euro and the Japanese yen. The largest translational exposures are to the US dollar, euro and Danish krone. The table below shows the key average exchange rates during 2008 and 2007.

	2008 average	2007 average
US\$	1.85	2.00
Euro	1.26	1.46
Yen	192	236

Translational currency exposures are not hedged.

Forward exchange contracts are used to hedge forecast sale transactions where there is reasonable certainty of an exposure. At 31 December 2008, approximately 65% of the estimated

US dollar and Japanese yen exposures for 2009 were hedged using forward exchange contracts.

To demonstrate the currency exposure faced by the group, the table below shows the differences between the group's consolidated revenues and costs for each of the major currencies in 2008 before reflecting the effect of transactional hedges taken out in the year.

	\$*	€*	£	Yen	Other	Total
Total sales (£m)	273	322	63	56	73	787
% of sales	35%	41%	8%	7%	9%	
Total costs (£m)**	(195)	(295)	(70)	(26)	(91)	(677)
PBT by currency (£m)	78	27	(7)	30	(18)	110
% of PBT	71%	24%	-6%	27%	-16%	

* Dollar/euro categories include tracking currencies

** Costs include interest of £3.3 million in \$, £5.2 million in € and income of £(0.3) million in GBP

In 2009, the currency exposure is expected to change significantly following the decision to change the currency of invoicing in certain countries in Asia from US dollars to euros in order to better balance our euro cost base. If this decision had been fully effective at the beginning of 2008, the US dollar sales revenues would have been reduced by approximately £30 million and the euro sales revenues increased by a corresponding amount.

Defined benefit pension schemes

Operating profit includes a defined benefit pension scheme current service charge of £1.7 million (2007: £0.9 million). The net pension liability in the balance sheet (before taking account of the related deferred tax asset) has reduced to £8.5 million (2007: £11.1 million), largely as a consequence of the buy-out of the liability on the Brüel & Kjør pension scheme in full in the USA during the year and actuarial gains on the scheme liabilities.

During 2008, the group made cash contributions into the defined benefit pension scheme amounting to £5.4 million (2007: £3.1 million).

Principal risks and uncertainties

The group has identified the key potential strategic, operational and financial risks and uncertainties which could have a material impact on the group's long-term performance. These potential risks, and the actions to manage and mitigate them, are described in detail on the following pages. The directors do not foresee any further specific risks in 2009.



Clive Watson
Group finance director