

# Business Review

## Principal Risks and Uncertainties

The process for identifying, evaluating and managing any significant risks forms part of the group's system of internal controls.

### Internal controls

The Board is ultimately responsible for the group's system of internal controls and for reviewing its effectiveness. However, such a system is designed to manage rather than eliminate risk of failure to meet business objectives and can provide only reasonable and not absolute assurance against material misstatement or loss.

Consistent with the guidance provided for directors on internal control by the Financial Reporting Council ('Internal Control: Guidance for Directors on the Combined Code'), the Board confirms that there is an ongoing process for identifying, evaluating and managing assessed significant risks faced by the group, that this has been in place for the year under review and up to the date of approval of the annual report and accounts, that this process has been reviewed by the Board during the year and that the group accords with the guidance. The Board affirms the importance it attaches to the continuous review and application of the guidance, the regular and systematic assessment of the risks facing the group and the value of embedding risk management and internal control systems within its business processes. The group has an internal audit function which reviews the design and effectiveness of internal controls across the group's operations.

The processes which the Board and the audit committee have applied in reviewing the effectiveness of the group's system of internal controls are summarised below:

- an established process is in place whereby each business unit regularly assesses, evaluates and reports risks of group significance. Each business unit is required to document the management and mitigating actions in place and proposed;
- regular review of the status of risks and corresponding mitigating actions ensure that risk management is embedded in day-to-day management processes and decision-making as well as in the annual strategic planning cycle;
- the effectiveness of risk management and mitigating actions is reviewed regularly by the executive directors and twice yearly by the audit committee;
- additionally, the executive directors consider those risks to the group's strategic objectives which are not addressed within the business units and develop appropriate approaches to managing and mitigating these risks;
- annual financial plans for each business unit, significant capital investments or contractual commitments and major acquisitions or divestments are all subject to review and approval by the Board;
- a Group Accounting and Policies Manual sets out the minimum standards and procedures to be applied in relation to those risk areas which are regarded as significant in a group context;
- a process of self-assessment of compliance with the Manual and reporting thereon has been established, providing for a documented trail of accountability from business unit presidents and finance directors to the audit committee.

The necessary actions are taken by the audit committee to remedy any failings or weaknesses identified by its review of the internal control system; and

- the executive directors report to the Board on changes in the business and external environment which present significant risks. The group finance director provides the Board with monthly financial information which includes key performance indicators. Regular reports on significant legal issues and insurance matters are received from the company secretary.

The key potential risks and uncertainties which could have a material impact on the group's long-term performance are described below.

### Strategic risk

Spectris has a broad spread of markets, products and customers, as described previously in this review, and this limits, to a large extent, any specific risk to the ability to implement our strategy due to changes in the political and economic environments in the countries in which we operate. This broad spread of markets also provides a good averaging of individual sector investment cycles. Our products typically involve low capital outlay but provide significant and rapid payback. These benefits become even more attractive to customers as they seek to reduce their own costs of production.

A key element of Spectris' strategy is to grow the business portfolio through acquisition of stand-alone or bolt-on businesses which complement or extend the range of products and applications Spectris can provide. Potential risks exist in successfully integrating acquisitions. However, Spectris believes that its track record of carefully selecting businesses which fulfil its acquisition criteria and rigorous financial assessment of the potential acquisition's ability to contribute to growth will continue to ensure that any businesses acquired will be successfully integrated.

### Operational risk

In order to sustain competitive advantage, the group invests significantly in research and development. The development of all new technologies and products involves risk including the product being more expensive, or taking longer, to develop than originally planned; that the market for the product is smaller than originally envisaged; or that the product fails to reach the production stage. However, we endeavour to reduce this risk by ensuring that new product development is carried out in conjunction with customers to ensure that the products meet expectations of the market. All businesses are exposed to risk from competitive activity. However the diversity of Spectris' products and markets, and the high barriers to entry, limits the overall risk from any single competitor.

Although the majority of our business is to supply products only, there may be instances where Spectris companies enter into complex long-term or multi-site contracts with customers. Spectris has a strict approval process for such contracts in order to manage any risks they may present. Potential risk from loss of a key customer is limited as no single customer accounts for more than 1% of turnover, and credit control procedures limit the risk from non-payment by customers. Group operating companies also monitor customer satisfaction to ensure they are meeting

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## Principal Risks and Uncertainties continued

customers' product, delivery and service requirements. The company is also exposed to the risk that some of the components it sources, particularly for custom-built items or older components, are provided by a single supplier and are vulnerable to interruption of supply. The group seeks to address this risk by finding alternative sources to reduce dependency on single-source suppliers and building sufficient safety stock of critical components.

Spectris' operations are characterised by short lead times and seasonal fluctuations in sales, with some businesses exhibiting a greater trend towards sales in the second half of the year. This limited forward visibility and the potential for delays in the shipment of orders exposes the company to the potential risk that it may not meet its sales forecast for the year.

### Financial risk

The principal financial risks managed by the group are foreign currency, interest and liquidity. The group's exposure to commodity risk is perceived to be small by virtue of the nature of the businesses.

Foreign exchange transaction risk is managed principally through forward contracts covering up to 75% of forecast forward exposures for up to eighteen months ahead. Foreign exchange translation risk, which results from converting foreign currency to sterling, is not hedged but is actively managed through natural hedging by matching invoicing and purchasing currencies as far as is commercially practical. In addition, it is the aim where possible to hedge foreign currency investments with borrowings in the same currency. In order to minimise interest cost and maximise interest income, companies are required to pass surplus funds to Group Treasury through inter-company loans. Where possible zero balance pools are in place to centralise cash automatically.

The long-term aim with regard to interest rate risk is to have a balance between fixed and floating rate debt. Interest rate swaps are considered to achieve this balance.

The group manages its liquidity risk through the use of regularly updated cash flow forecasts and liquidity headroom analysis to determine its funding requirements. The group maintains sufficient lines of credit from high quality investment grade lenders to cover expected cash requirements and provide reasonable headroom. The facilities are described in detail in the Financial Review.

### Intellectual property risk

Spectris' business is focused on the design and manufacture of technologically advanced products and applications and the group makes significant investment in research and development. As a consequence, the group owns and protects patents, trademarks, trade secrets, copyright information and intellectual property licenses. Although these are important to growth as a whole, no single patent, trade secret or trademark is sufficiently important to present a material risk to the success of the company. Appropriate measures are taken to protect the company's intellectual property rights and to minimise the risk of infringement by third parties. Spectris is prepared to initiate legal action if necessary to safeguard

its interests. Inadvertent infringement of third-party rights also presents a risk and Spectris has procedures in place requiring its operating companies to maintain a watching brief on new applications and to undertake specific reviews prior to commencing new product development programmes, acquisitions or licenses.

### Information technology/business interruption risk

Spectris depends on timely and reliable information from key software applications to aid day-to-day operational management and to provide accurate financial information for its head office. Whilst the company endeavours to ensure the continuous availability and operation of these systems and software, any disruption could delay or otherwise impact day-to-day decision making. Disaster recovery plans to maintain business-critical processes and activities in the event of a significant interruption to the normal course of business are in place throughout the group and are regularly tested.

### Hazardous risk

Assessment of risk to the business is carried out on a continuous basis to determine any potential effects on the environment resulting both from product manufacture and operation of our products at the customer's site. Each operating company is required to produce a risk register which identifies possible hazardous risks to their business. For each risk the likelihood of the occurrence is documented, together with the possible consequences, the actions required to minimise the probability of the event occurring, and responsibility assigned to a member of the company's management team. The risk register is reviewed regularly by the group's internal audit function.

### Contractual arrangements

The company has no contractual or other arrangements which are essential to the business of the company, nor any key customers or major suppliers upon which it is dependent.