Financial review
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2009 was another good performance against the background of a world economic recession. We achieved record sales and adjusted pre-tax profit, and delivered an improved operating profit margin and good cash generation.

Spirax Sarco uses adjusted figures as key performance measures in addition to those reported under IFRS. Adjusted figures are used unless otherwise stated and they exclude the amortisation or impairment of acquisition-related intangible assets and exceptional headcount reduction costs, including the associated tax effects. We have adopted the new accounting standard IFRS 8 Segmental Reporting for 2009. The new segmental disclosure gives greater visibility and is more consistent with management reporting. The new segments comprise the Steam Specialties business, geographically split into Europe, Middle East and Africa (EMEA), Americas (North and South America) and Asia Pacific, and the Watson-Marlow Pumps business. Restated disclosures for the full year 2007, half-year 2008 and full year 2008 were published in August 2009.

Sales of £518.7 million were a record and up 3% compared with £502.3 million in the prior year. Currency movements were favourable and added over 10% to sales on translation. Average exchange rates for sterling were weaker against most currencies and in particular versus the US dollar, euro and Chinese renminbi which are important currencies for the Group. Acquisitions during the year added less than 1% to sales. Underlying sales, excluding currency and acquisition effects, were down 7% for the year but with improving year-on-year comparisons in the last few months of the year.

Adjusted operating profit of £89.9 million increased by 5% over the previous year profit of £85.7 million. We acted early in the year to reduce operating costs, including a reduction in our global workforce of 7% during the year, largely in back-office, support functions and manufacturing; a further reduction in our French manufacturing unit will take effect in 2010. These actions benefited the second half of 2009 and we expect further benefit in 2010. Favourable currency movements improved the profit on translation and also on transaction, where the Group gained from the weakness of sterling against most other currencies. At constant exchange rates, the operating profit was down 12%. The adjusted operating profit margin increased from 17.1% to 17.3%, despite the impact of lower sales volumes and some internal destocking by our sales companies that reduced the demand on our manufacturing plants.

Interest
Net finance expense of £2.5 million compares with net finance income of £1.7 million in the prior year. As expected and previously reported, the net finance income in respect of defined benefit pension schemes deteriorated, mainly due to a reduction in the expected return on pension fund assets in 2009 (under IAS 19) following the drop in pension asset values in 2008. Net bank interest deteriorated due to the fall in interest rates on cash deposits and the funding cost of acquisitions.

Associates
We have minority shareholdings in our operations in India and Mexico, which means that our share of the after tax profits is reported as Associates outside the operating profit. Associates' profit was overall unchanged at £2.8 million, comprising an increased contribution in India offset by slightly lower profit in Mexico.

Profit before tax
The adjusted pre-tax profit increased to £90.2 million (2008: £90.1 million). The actions to reduce our global workforce necessitated a one-off charge against the 2009 profit of £11.4 million, which includes the cost of the recently announced reduction in France. About £3.5 million of this charge will be a cash outflow in 2010. The pre-tax profit after charging these costs and including the amortisation of acquisition-related intangible assets was £76.4 million (2008: £85.2 million).

Unless otherwise stated, all profit measures exclude exceptional headcount reduction costs of £11.4 million (2008: £nil), the amortisation of acquisition-related intangible assets of £2.4 million (2008: £1.9 million), of which £0.4 million (2008: £0.3 million) relates to Associates, and the impairment of goodwill and intangible assets of £nil (2008: £3.1 million).

Capital employed	**2009 £'000**	**2008 £'000**
Property, plant and equipment	135,383	122,897
Inventories	86,479	102,382
Trade receivables	118,835	124,595
Prepayments and other current assets/(liabilities)	(72,861)	(78,050)
Capital employed	**267,836**	**271,824**
Intangibles and investments in associates	83,177	62,225
Post-retirement benefits	(73,763)	(73,717)
Deferred tax	23,522	19,466
Provisions	(1,441)	(1,182)
Net cash/(borrowings)	8,033	17,390
Net assets	**307,364**	**296,006**
Return on capital employed		
Operating profit	76,522	81,028
Acquisition intangibles amortisation and goodwill impairment	13,416	4,641
Adjusted operating profit	**89,938**	**85,669**
Average capital employed	**269,830**	**241,093**
Return on capital employed	**33.3%**	**35.5%**

Taxation

The tax charge, excluding Associates, was 31.4% compared with 30.0% in 2008. The increase reflects an unfavourable change in the mix of taxable profits, exchange rate movements and the introduction of withholding tax in relation to dividends from China. The tax rate in 2010 is expected to be broadly in line with 2009.

Earnings and dividends per share

The Group's prime financial objective is to provide enhanced value to shareholders through consistent growth in earnings per share and dividends per share. Adjusted earnings per share were 82.2p (2008: 83.4p). Earnings per share including exceptional headcount reduction costs and the amortisation of acquisition-related intangible assets were 69.6p (2008: 78.0p).

The proposed final dividend is increased by 10% to 25.6p per share which, together with the interim dividend of 10.5p per share paid in November 2009, makes a total dividend for the year of 36.1p per share. This represents an increase of 8% over the 33.3p per share last year and continues the Group's very long history of increasing dividends. The compound annual growth in dividends over the last 42 years has been 11%.

Acquisitions

As previously reported, in October 2009 the Group completed the acquisition of the Maso and Sine business from Maso Process-Pumpen GmbH ('MasoSine') based in Germany for £21.9 million. MasoSine extends the application range of our existing Watson-Marlow hygienic pumps and the integration into Watson-Marlow Pumps is progressing well. In October we also completed the acquisition of our Turkish distributor, Inter Valf based in Istanbul, for an initial consideration of £2.8 million. We are pleased with the performance of these businesses since acquisition and with their small positive contributions to our earnings per share for the year. Intangible assets amounting to £14.8 million were recognised in respect of acquisitions during the year, largely relating to MasoSine, which will be amortised over the respective useful lives of the individual assets. Goodwill amounting to £9.8 million was also recognised. Amortisation of total acquisition-related intangible assets was £2.4 million (2008: £1.9 million) of which £0.4 million (2008: £0.3 million) related to Associates. In the prior year there was also an impairment of goodwill and intangible assets of £3.1 million.

Research and development

Despite the economic downturn, we have continued to invest in the business and increased R&D spending by over 20% to £8.0 million for the year, including capitalised development costs under IFRS increasing to £2.1 million (2008: £1.5 million). We plan again to increase our investment in 2010 to take advantage of the development opportunities available and to accelerate the flow of new products to the market.

Capital employed

Capital employed at £267.8 million increased by only 2% during the year (at constant currency and excluding acquisitions), despite the substantial investments in capital expenditure. Currency movements, using year-end exchange rates, lowered capital employed on translation by £12.0 million. Working capital was brought down by £11.4 million at constant currency and excluding acquisitions, largely due to the reduction we achieved in stock levels, which were down by 13%. Acquisitions during the year added £1.7 million to capital employed.

Investment in fixed assets continued at a historically high level and net capital expenditure at £32.6 million was two times depreciation. Significant investment projects included the completion of our new premises in Korea and the new tubing extrusion plant at Watson-Marlow in Falmouth. The investment in new premises and manufacturing plant in China is progressing well, as is the project to consolidate onto one expanded manufacturing site in Cheltenham.

Finance review continued

Adjusted cash flow	2009 £'000	2008 £'000
Adjusted operating profit	89,938	85,669
Depreciation and amortisation	16,528	15,218
Equity settled share plans	1,929	1,519
Adjusted working capital changes	9,554	(11,353)
Adjusted cash from operations	117,949	91,053
Net interest paid	(736)	(189)
Income taxes paid	(29,877)	(22,087)
Net capital expenditure, including development	(34,654)	(26,543)
Net dividends paid	(24,265)	(23,189)
Underlying cash flow	28,417	19,045
Exceptional headcount reduction costs	(7,957)	–
Post-retirement deficit reduction payments, and provisions	(7,072)	(3,236)
Proceeds from issue of shares	1,966	(2,812)
Acquisitions	(27,192)	(13,939)
Cash flow for the year	(11,838)	(942)
Exchange movement	2,481	2,501
Opening net cash	17,390	15,831
Closing net cash at 31st December	**8,033**	**17,390**

Return on capital employed

The return on capital employed (ROCE), which is a key performance indicator, declined from 35.5% to 33.3%. Average capital employed (using the average of the opening and closing sterling balance sheets for the year) increased by 12% whereas adjusted operating profit was ahead 5%. Capital investment is planned to continue at a high level in 2010 and these investments will deliver good benefits in future years including scope for progressive reductions in stock levels.

Post-retirement benefits

The net post-retirement benefits liability shown on the balance sheet was broadly unchanged for the year at £73.8 million (£53.2 million net of deferred tax) but was lower than the £90.7 million net liability at the half-year. Pension fund asset value increased strongly reflecting the recovery in equity markets and also the payment of special deficit reduction payments of £7 million. However, liability values rose by a similar amount due to an increase in inflation expectations and a fall in corporate bond yields that pushed up the discounted present value of liabilities.

Most of the asset and liability values relate to the main UK defined benefit pension schemes. The triennial valuations of these schemes were carried out as at 31st December 2007 and resulted in agreed additional cash contributions of £3.7 million per annum for up to six years that commenced in the second half of 2008. The interim actuarial valuation as at 31st December 2008 resulted in further additional cash contributions of £4.2 million per annum for up to 12 years that commenced in the second half of 2009. The interim actuarial valuation as at 31st December 2009 is not yet complete but is expected to show a reduction in the deficit of the main UK schemes.

Cash flow

There was an excellent cash flow performance for the year. Adjusted operating cash flow increased to £117.9 million (2008: £91.1 million) reflecting an inflow from working capital with stocks reduced by 13% in the year. Taxation payments were higher at £29.9 million (2008 £22.1 million) reflecting currency movements and the settlement of higher 2008 tax liabilities following the profit increase that year. Capital expenditure, including capitalised development costs, increased to £34.7 million (2008: £26.5 million). Free cash flow was broadly unchanged at £37.7 million even after the cash outflow of nearly £8 million in respect of headcount reduction costs and £7 million of special pension contributions.

Dividend payments were up 7% in line with the increased dividends per share. Acquisitions absorbed £27.2 million of cash due largely to the purchase of MasoSine in August for £21.9 million. We also acquired our Turkish distributor, Inter Valf, in October for an initial consideration of £2.8 million.

Overall there was a net cash outflow of £11.8 million. Excluding acquisitions, shares issued, headcount reduction costs and special pension contributions, there was a strong underlying cash inflow of £28.4 million (2008: £19.0 million). Exchange gains on translation were £2.5 million, which means we finished the year with a net cash balance of £8.0 million (2008: net cash £17.4 million).

Capital structure

We continue to operate with a very strong balance sheet. In addition to the net cash balance, the Group had various undrawn, committed borrowing facilities at year-end of £28.6 million. Treasury and currency exchange exposures are handled by the Group Treasury function in the UK which manages the exposures from our worldwide geographic spread. This is not a profit centre and no speculative transactions are undertaken; typically, simple forward contracts are used when appropriate to match known cash flows. The Group has operations around the globe and therefore its balance sheet can be significantly affected by movements in exchange rates, particularly in relation to the euro, US dollar, Chinese renminbi and Korean won. Where appropriate, the Group uses local currency borrowings to mitigate this structural currency exposure, consistent with maintaining a low cost of debt. The Group keeps the structure of its balance sheet under regular review.

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Risks and uncertainties

The Group has well established risk management processes, including insurance cover, which are an integral part of the operation of our business and which are outlined in the Corporate Governance report on pages 35 to 38. Whilst risk can never be eliminated, our processes allow us to identify and appropriately manage and mitigate risks and uncertainties. These mainly arise from the inherent risks of operating a worldwide business largely using our own local sales companies to sell in local currency, direct to end-user customers, distributors, OEMs and contractors, a very wide range of products, mostly designed and manufactured in our own facilities in a number of different countries. The business is well spread geographically, across tens of thousands of customers and across most industrial and commercial sectors. This means that we do not rely excessively on any one customer, product application or industrial sector.

The principal risks and uncertainties are strategic, commercial, operational and financial. Ultimately these affect our ability to deliver our prime financial objective, which is to provide enhanced value to shareholders through consistent growth in earnings per share and dividends per share as a result of maintaining our world leading position and investing in our businesses for growth.

Strategic risks and uncertainties include customer relationships, the competitive environment, political and economic upheaval, technological changes, the regulatory and legal environment, and investment in acquisitions. These relate to maintaining our market and technological leadership including branding and reputation.

Commercial risks and uncertainties include issues such as product design and performance, product liability, competitor activity, relations with customers and suppliers, pricing and profit margins. Our employees are key to managing and mitigating risks and uncertainties and we therefore invest significant resources in the training and development of our people.

Operational risks and uncertainties include health and safety and environmental issues; employee relations; mitigation of, and recovery from, major disasters; product quality and customer service. We have for many years complied with recognised quality, health and safety and environmental standards and regulations and have applied project management disciplines in our business. The Group’s approach to the health and safety of employees is more fully described on page 28. Appropriate measures are implemented locally, particularly in the manufacturing companies, and there were further improvements in health and safety in our operations in the year. The environmental benefits from the use of Group products are more fully described on pages 23 and 24. General managers of operating companies are responsible for local compliance with the Group’s policy and with local legislation, and are required to report regularly.

The Group is committed to observing the highest standards of ethics in all its dealings with customers, suppliers, employees and all other stakeholders in the business. The Group Business Code sets out very clearly the standards expected of all employees and it is the responsibility of all managers within the Group’s businesses both to abide by those standards and to ensure that employees for whom they are responsible adhere to the standards. The Chief Executive writes annually to all general managers of Group businesses to remind them of the importance which the Group attaches to the Code and of their obligations to ensure compliance with the Code. Additionally, general managers are regularly required to certify compliance with the Code.

Financial risks and uncertainties include exchange rate exposures, interest rate movements, financial instruments, financial irregularities and protection of assets including pension fund assets. The Group has a comprehensive Treasury Policy covering many of these issues and defining our approach to minimise and mitigate such risks.