

An interview with Mark Vernon Chief Executive Officer



Sharpening our edge

What makes Spirax Sarco different?

We are a niche industrial engineering group that supplies a very broad base of customers around the world in a wide range of industries. We concentrate on assisting our customers achieve process efficiency, increased production output, energy savings and regulatory compliance. We go to market through an extensive network of outstanding local sales and service engineers that are highly trained and singularly focused on providing the knowledge and expertise to understand the challenges facing steam and pump users. Our application and systems knowledge, breadth of products and services, experience and global presence all enable us to offer the most extensive range of engineered solutions to our customers. The position of Spirax Sarco and Watson-Marlow as world leaders is founded on our long-held strategy of investing for growth both organically and by complementary acquisitions.

The Group is very international. We have 49 operating companies in 34 countries around the world. Our headquarters are based in the UK and we have sizeable manufacturing and selling operations on nearly every continent. Our manufacturing operations are strategically located in all key market regions with major facilities in the UK, France, Italy, USA, Brazil, Argentina, and China. We also manufacture in South Africa, Mexico, Netherlands, India, Germany, Sweden, Korea and Denmark. Amongst our competitors, we have generally been first to build a direct selling and trading organisation in new markets and, within the past year, we acquired our Turkish distributor, giving us a direct presence in this important country that boasts the world's 16th largest economy.

The resilience of our business was readily visible in the past year, as our total sales at constant currency declined less than 7%, as compared to falls of typically 15% to 20% or more for many other international industrial engineering businesses. This resilience stems from a large portion of our revenues being derived from product replacements and spares, the diverse range of industries served, the breadth

of product solutions we bring to our customers and good geographic distribution of sales, well spread between developing and developed markets.

We serve a very broad range of industries including: foods, brewing & distilling, dairies, oil refining & petrochemicals, chemicals, pharmaceuticals, textiles, fine chemicals, mining, printing, water & wastewater treatment and many other general process industries. We also work with hospitals and commercial buildings by supplying solutions for sterilisation, space heating, hot water generation and laundering. It is important to note that no single industry represents more than 10% of sales and no single customer accounts for more than 1% of sales – in short, our sales are very well spread.

We have remained focused on our niche businesses and their development through geographic expansion, new product developments, acquisitions and expanding our range of products and service solutions. This has enabled us to increase market share and to generate steady, profitable growth for a long period of time, evidenced by our excellent 42 year dividend record. Although we are the market leader in both our businesses, there remain considerable opportunities available to us in our fragmented markets.

How does Spirax Sarco create value?

The Spirax Sarco and Watson-Marlow businesses are anchored on the philosophy of understanding the detail of the customers' processes and the ability to apply the properly engineered solutions. To do this we go to market using mostly direct sales people – about 70% of our sales are generated through our direct selling approach. In doing so we form strong, long-term customer relationships. The Group employs nearly 1,200 direct sales and service people working in 56 countries in the world.

Our sales people are highly skilled in both product applications and, perhaps even more importantly, in system understanding and troubleshooting for unique customer applications and industrial processes. We train our sales engineers in our 38 training centres located around the world,

Sharpening our edge through research and development

We are increasing our investment in research and development.

Our new R&D Centre being created in Cheltenham, will enhance our capability to offer customers innovative solutions for controlling and conditioning steam.



An interview with **Mark Vernon** continued Chief Executive Officer

**Sharpening our edge
through being the best in
our field**

Spirax Sarco beat international competition to win the 2009 IChemE Innovation and Excellence Award in Energy, with a Flash Recovery Energy Management Equipment (FREME) system that enables customers to recover waste heat.



“It is not our products alone that provide the value to our customers; it is the application of our extensive knowledge.”

most of which are equipped with live steam that facilitates hands-on training. These centres are also used to train our customers' technical staff.

This product and systems application knowledge, combined with local availability of products, engineered packages and on-site services, enables our customers to achieve meaningful energy savings, comply with increasingly stringent health, safety and environmental regulations, reduce emissions and achieve more efficient processes.

It is not our products alone that provide the value to our customers; it is the application of our extensive knowledge.

How is Spirax Sarco managing the business through this difficult economic period?

Like other industrial businesses, we took early action and made the appropriate decisions to reduce our operating costs. Whilst needing to address the abrupt decline in economic activity, we largely protected our global network of highly skilled and trained sales engineers.

As a result, we reduced our workforce by 7% through the year, most of which came as part of an announced 5% headcount reduction in early 2009, with the balance coming from natural attrition throughout the year. Most of the headcount reductions were in back-office support functions and manufacturing. Additionally, our local operating company management teams were vigilant in controlling other operating costs. The announced general headcount reduction was the first ever for Spirax Sarco – indicative of the unprecedented global economic downturn – but it was managed effectively by our management teams around the world.

We took steps to size our manufacturing operation in Cheltenham, not only for the decline in volume resulting from the global economic recession but also in anticipation of the volume transfer to our new manufacturing plant in China. Additionally, we recently announced a reduction in our manufacturing footprint at Châtellerault, France, also in line with our global manufacturing strategy.

We continued to invest in key growth programmes for the future. In China, we selectively added sales people for the steam business. We also invested in our Watson-Marlow business to continue developing new markets, adding sales people in Russia and Mexico. We believe that our sales teams are well positioned to handle the eventual rebound in our end markets. Also, we increased the amount of direct R&D investment, virtually the only area of the business that was allowed increased expenditure. New product development is a key activity that will drive longer-term growth and therefore we have continued to invest through the downturn. We have also sustained capital expenditure at a high level in the year as we invest in delivering our manufacturing strategy.

What are the key business drivers and trends?

Our business is well spread geographically, across the product range and over a diverse range of industries. The following key factors have the primary influence on the underlying demand in our markets:

- Global economic growth.
- Industrial production and investment.
- Capacity utilisation.
- Energy costs.
- Increasing customer outsourcing of design and maintenance.
- Regulatory legislation (eg, emissions, hygienic standards, plant safety).

Looking ahead how do you plan to take the business forward?

Our business strategy remains focused on achieving long-term, steady and profitable sales growth. The industrial and commercial steam-using market is highly fragmented and although Spirax Sarco is the market leader, we still have significant growth opportunities.

An interview with **Mark Vernon** continued Chief Executive Officer

“Increasing Watson-Marlow’s capability in offering high purity... particularly in the biopharm sector.”

Sharpening our edge by investing in our manufacturing processes

We completed the construction of a completely sterile £6.3 million silicone tubing extrusion plant in Falmouth, enabling Watson-Marlow to offer high purity pumping solutions to its customers in the biopharm sector.



We believe the underlying industry drivers are favourable for long-term growth. For the steam business, energy prices are at historic highs and the emphasis on reducing emissions is becoming increasingly important; these factors provide a nice tailwind. We are reaping the benefits of our solutions approach to problem solving as customers increase the outsourcing of design and maintenance; customers are looking for simple, single-source transactions to solve their local maintenance, operations, product quality and capacity expansion issues. Our ability to effectively bundle a wide range of products and pre-fabricated engineered packages backed up by our installation and commissioning services, is simply the best and is unmatched by any competitor. We increasingly expand on a simple troubleshooting sales call, to audit an entire steam system and provide a range of engineered solutions in a single transaction that customers value.

We are widening our range of products and site services to expand our market reach. Our technically expert direct sales force allows us to leverage our brands into new products and applications. This increases the amount of plant spend that we can capture in small-scale capital projects and maintenance activities that are at the heart of our business. There remains good growth potential, whether in the developing economies of Asia and South America or in the large and more mature markets of western Europe and North America, as we apply tailored market development strategies.

One of our major tasks at our Watson-Marlow business is to educate customers about the intrinsic advantages of peristaltic pumps so that they will increasingly be used to solve difficult pumping problems. The product range is being progressively widened and developed, making use of improved electronics and materials to broaden the addressable market by taking business from other pump types. All these factors make peristaltics one of the fastest growing sectors of the global positive displacement pump market. As we widen the possible applications for our pumps, we see increasing opportunities, including hygienic applications in pharmaceuticals, biotechnology and the food industries.

We continue to make complementary bolt-on acquisitions to build our product portfolio, introduce new technologies and speed access to geographic markets. During 2009 we acquired MasoSine, a supplier of unique sinusoidal pumps that extends the application range of our existing line of Watson-Marlow hygienic pumps. We also acquired the business of our Turkish distributor, Inter Valf Sanaya ve Ticaret, to build a direct presence in this important and developing market.

How is Spirax Sarco sharpening its edge?

The Group is making a significant investment in modernising its manufacturing processes and facilities to improve efficiency and reduce operating costs. We

are midway through a four-year £50 million capital investment programme, having recently completed the new tube extrusion facility in Falmouth, England. The new manufacturing plant in China will begin production late Q2 2010. The consolidation of the three manufacturing facilities onto one site at our major manufacturing location in Cheltenham, England will be mostly completed by year-end 2010. Some production has already been transferred into the first refurbished buildings and we should see the cost reduction, efficiency and stock reduction benefits from this site consolidation starting in 2011.

Despite the challenging market environment in 2009, we increased our investment in R&D by over 20% and have begun to generate a stronger flow of new products whilst shortening the time to market. There are a number of exciting new product development programmes underway in both the steam business and Watson-Marlow, and we expect new products to make an increasing contribution to sales growth. We were particularly pleased to win the UK's IChemE 2009 'Innovation and Excellence Award in Energy' with a packaged Flash Recovery Energy Management Equipment system. The Board has approved the creation of a new R&D development and test centre at our Cheltenham manufacturing site that will increase our testing capability to much higher live steam temperatures, pressures and flow rates – we believe this new test centre will be the world's largest and most advanced facility of its type.

We are taking advantage of our global purchasing power to consolidate purchasing volumes with fewer key suppliers of our cast, wrought and forged metals. This has resulted in material cost benefits in the past several years, and we expect further benefit in 2010 to our materials and freight costs.

We have developed online based tools to improve the technical training of our sales engineers around the world and speed up their development process. Additionally, we are implementing information collection and sharing software to improve our ability to utilise application knowledge and provide a forum to accommodate greater knowledge sharing amongst work groups across our global sales network.

People lie at the core of every business and we have high expectations of performance from our people. We have taken steps to upgrade the quality of professional human resource leadership in guiding our progression to a more performance-based culture throughout the organisation. We have articulated a concise set of core values and leadership competencies that are being implemented worldwide.



Mark Vernon Chief Executive Officer