



Market overview

Despite difficult trading conditions during the period, Esab generated a solid level of operating profit and cash flow, mainly attributable to the continuing success of the consumables and automation businesses and the impact of restructuring activities.

Demand in Esab's major markets in Europe and North America for welding equipment, cutting equipment and welding supplies has continued to be weak and these markets are showing little sign of recovery. In particular, in the North American market, industrial production fell in the last quarter of 2002. Overall, sales and orders were below the previous year's levels in North America and Europe but higher in emerging markets. Our activities in South America performed well despite the economic instability in Argentina and Brazil.

The start of 2003 has seen slightly lower demand for consumables and the threat of war in the Middle East has impacted adversely on capital goods demand. The economic situation in both Argentina and Brazil appears to have stabilised although the social and political unrest in Venezuela threatens to spread to its neighbours. China continues to enjoy rapid GDP growth, despite demand in other Asian markets remaining generally subdued.

Good progress has been made in continuing the transfer of Esab's manufacturing centres closer to the developing markets for metal fabrication, process engineering and shipbuilding in Eastern Europe, South America and Mexico. This shortens the supply chain to growing markets and also takes advantage of reduced manufacturing costs.

Progress has also been made in addressing some structural issues. Largely as a result of the restructuring initiatives, total head count across all Esab's global operations declined by some 500 during the period and now totals 6,711. A further reduction of just over 100 employees is planned in 2003.

Competitor activity continues to be intense in both North America and Europe with some competitors engaging in heavy discounting. Evidence of rationalisation amongst competitors to reduce manufacturing capacity continues but there is also new competition within the traditional electrode business coming from China in the Central American and the smaller South American markets.

Product development has continued with a large programme of new standard equipment products planned for launch in 2003. Many of

the new products demonstrate Esab's commitment to an increased use of modular design. Significant progress has been made in the area of modularisation both within standard equipment as well as within welding automation, resulting in substantially reduced production costs, increased flexibility and significantly shortened delivery times.

Results overview

Whilst sales for the full year were 6.4 per cent below 2001 at £581.9 million, adjusted operating profits, before exceptional items and amortisation of goodwill, were marginally higher at £36.0 million (2001: £35.7 million) representing an improved profit margin of 6.2% (2001: 5.7%).

This level of profit was a considerable achievement given the fall in sales revenues, and demonstrates progress in lowering the break-even point of the business by aggressive restructuring.

In Europe, which is Esab's largest market representing just over half of its turnover, sales were similar to the previous year but operating profits were slightly lower as a consequence of the economic environment. The UK and Southern European regions continued to hold up well, although demand in other Western European markets, including Germany and France, remained weak with sales for 2002 below the previous year's level. The results from the Nordic region were disappointing but there is some prospect of orders emerging from the Norwegian shipbuilding sector. There were some tentative signs of recovery in Central Europe, for example in Poland, where industrial production began to rise at the end of the year.

Esab's activities in emerging markets have also shown sound progress this year with strong gains in the final quarter leaving this sector significantly ahead of last year in both sales and operating profit.

In North America, Alcotec, the specialised aluminium consumables business, continued to perform well. However, trading margins have been disappointing in the consumables business. The South America region improved its operating profit despite the economic turbulence and currency volatility in the region.

In Asia, the Chinese economy continued to grow rapidly and demand in South Korea has been resilient. The South Korean associate, Esab SeAH, continued to produce solid operating profits and cash flow, whilst the operating profit in the rest of the operations in the region was ahead of last year. Outside of China, the general business climate continued

This page left to right

An ESAB A2 Multitrac machine welding circumferential joints in wind tower construction.

One of the new series of welding machines built using modular construction technology

Opposite page left to right

High quality welding electrode production at the ESAB plant in Katowice in Poland

Production of solid wires at the ESAB plant in Vamberk, Czech Republic



to be subdued, and the strengthening of the Euro and the Swedish Krona remains a challenge in relation to competition from imported products.

Restructuring

Exceptional charges arising from restructuring issues during the year totalled £12.2 million. Actions taken during the period included the closure of the Niagara Falls and Thailand plants during 2002 and the continuing transfer of flux cored wire production from Waltham Cross in the UK and Utrecht in the Netherlands to Katowice in Poland and Vamberk in the Czech Republic. This major project is on schedule for completion at the end of 2004. The ongoing transfer of production from the Waltham Cross facility in the UK also enabled the sale of this manufacturing site during the year.

During the year production of certain ranges of Standard equipment products were transferred from Laxå in Sweden to the facility at Opole in Poland. This transfer will be completed in 2003.

Esab's key global and European functions were relocated to a new London office in the third quarter of 2002. This office now provides the base to drive the changes, from both a market and internal operating perspective, required for improved performance.

Some further restructuring was initiated in the second half of the year in response to difficult trading conditions in the key European and North American markets.

Product divisions

Consumables

European sales finished the year ahead of forecast but marginally below last year. Gross margins were maintained, although operating profit was reduced by bad debt provisions in Poland and Italy relating primarily to difficulties in the shipbuilding sector. Headcount reductions continued in the consumables factories with further reductions committed for 2003. Progress is being made on improved integrated planning with greater analysis of demand patterns enabling reduced stock levels. Further improvements are expected through 2003.

A modern production line for stainless steel wires came on stream at the Vamberk plant during 2002. The stainless steel fabrication market offers the opportunity for high added value growth, especially within Europe. Additionally the company has developed new flux-cored wires for mechanised welding applications, including

robotics, within the automotive and automotive sub-supply sectors.

New fluxes and packaging systems for sub arc applications, a specialised fully automated welding process used in large scale metal fabrication industries, have already helped achieve increased market shares in some key segments and on a global basis. There have also been significant increases in sales of stick electrodes in key emerging markets.

The market in North America continues to be weak with a decline in industrial production for the fourth consecutive period and significant price pressure from competitors. Esab's North American distributors are also showing increasing resistance to building new stock levels during the current period of economic uncertainty. However orders for welding consumables from military shipyards, offshore fabricators and railcar manufacturers and an increasing number of quotes requested for Esab equipment indicate some positive movement.

The strong performance from Alcotec has helped to offset difficulties in the North American consumables business. Lower US dollar exchange rates relative to European currencies offer increased potential for exports.

The upgrade of the flux cored wire manufacturing process in our Hanover facility is virtually complete with all resulting headcount reductions achieved.

Standard equipment

Whilst sales by the Standard equipment division in 2002 were below the levels achieved last year, overall, the business traded close to break even in difficult market conditions. Modest improvements are expected in 2003 due to the introduction of certain new products together with ongoing cost reduction and restructuring activities.

The first group of a new family of high-end and portable welding equipment products based on new modular production platforms were developed as scheduled and have been successfully launched on the market.

In North America the transfer of the assembly of certain ranges of manual welding machines to Mexico is now complete. A further transfer of high-end arc equipment from North America to Laxå in Sweden has commenced with the first phase to be completed by April 2003. Additionally some standard equipment production has moved from Sweden to the facility in Poland.

Automation and cutting

Competitor activity for automation and cutting equipment is intense. Sales of automated welding equipment were well ahead of 2001 and operating profits were significantly increased mainly due to the modularisation concept and restructuring. By contrast, demand for cutting equipment was weak, particularly in North America. However gross margins were only slightly below the levels achieved in 2001 as a result of restructuring and other cost saving initiatives.

Further cost benefits will be realised in 2003 as automation and cutting are merged further and continuing progress is made with modularisation projects and globalisation of the business.

New product developments included a range of low cost standard automation equipment, new magnetic pulse welding and laser hybrid welding technologies and the first delivery of Esab laser welding equipment. On the cutting side, the division introduced a new dedicated precision cutting machine in the final quarter as well as competitively priced low and mid range machines.

Outlook

Esab is emerging from its restructuring process with a reduced manufacturing cost base and new product developments within all of its divisions. With its excellent global spread and high brand recognition in most major markets, Esab is well placed to benefit from the movement towards global procurement strategies for consumables by certain major international businesses. Further opportunities arise from initiatives such as the UK government's commitment to invest in renewable energy sources and the need to replace the world's aging tanker fleet in order to comply with new maritime regulations.

The trading conditions in the major markets in which Esab operates have remained challenging during 2002 and business confidence continues to be fragile partly due to continuing uncertainties in the Middle East. Demand in the major markets for welding supplies, cutting and welding equipment continues to be weak. However the restructuring initiatives presently being implemented will achieve a lower cost base and provide a sound platform for an improved performance by Esab in the future.



Market overview

The Power Division accounts for 40% of Howden's global turnover. However the continuing economic uncertainties in this Division's key markets in Europe continue to overshadow the performance of this business. Turnover increased by 5% in total, with declines in Europe being more than offset by sales growth of 25% by Howden Hua in China. Howden Hua, in which the group has a 70% interest, is well positioned to take advantage of the growth in the market in China where considerable investment is being undertaken in new generating capacity and a growing appreciation of the need to reduce pollution levels particularly in the light of the 2008 Olympic games in Beijing.

By contrast, Howden North America, which accounts for around 30% of Howden's global turnover in 2002, suffered a 15% decline in turnover from last year. The overwhelming market issue was the slump in demand in the power and industrial markets in North America. The major US corporate failures and consequent downgrading of credit ratings of many businesses has exacerbated the already uncertain economic climate following the terrorist attacks in 2001. In addition, uncertainties surrounding the Middle East and the US Federal Government policies regarding emissions controls have resulted in many customers postponing orders for capital goods.

The commercial heating, ventilating and air-conditioning (HVAC) markets have continued to experience serious decline particularly in North America. Howden has also suffered fierce competition from companies with high volume low cost manufacturing who have been much more focussed on this segment. In the light of the unacceptable level of margins being made, Howden took the strategic decision to close the manufacturing plant in Camden, South Carolina and withdraw from these markets in the US. With the exception of one small regional niche operation in South Africa, Howden no longer operates in these markets.

General industrial markets for fans and compressors were relatively depressed worldwide, with frequent delays in the commitment of capital projects due to widespread economic uncertainty.

One notable area of growth is South Africa where an upswing in the domestic economy started in the second half of the year, despite increases in interest rates and a

doubling of inflation during the year. Fixed capital investment continued at a faster rate than had been experienced for many years and order intake levels for Howden Africa were well ahead of last year particularly in the power, industrial and environmental control businesses.

Orders in hand at 31 December 2002 were £107 million compared with £124 million at 31 December 2001. This reduction was principally in respect of North America, the effect of exchange rate movements and businesses which have been closed.

Further action was taken during the year to close certain loss-making businesses and rationalise manufacturing capacity. The businesses which were closed in the year were the manufacturing and trading activities of James Howden Malaysia in Kuala Lumpur and the Camden, South Carolina, manufacturing plant, both of which served the commercial HVAC market, together with Burton Corblin Inc in Philadelphia which manufactured gas compressors. The employees of Howden Calidair, a specialist manufacturer of dampers based in Gloucestershire in the United Kingdom were informed that this business would close in the first half of 2003. The axial fan manufacturing plant in Næstved in Denmark was closed and production transferred to Belfast. In addition, announcements were made during the year which will result in substantial head count reductions in the Springfield Illinois heavy industrial fan plant and the Burton Corblin business in Nogent near Paris.

The total head count reduction from these and other previously reported restructuring initiatives is some 270 employees in the year with a further reduction of 190 forecast for 2003. Conversely, some 140 employees were hired in China, Mexico and South Africa where Howden is experiencing higher activity levels.

Results overview

Turnover for the year was £267.4 million compared with £283.8 million for 2001. The operating profits before exceptional items for the year of £1.5 million (2001: £7.2 million) fell short of earlier expectations. As announced on 27 January 2003, certain accounting irregularities were discovered in one of its business units in North America. Following an in depth investigation, an exceptional charge of £3.9 million has been

This page left to right
Beijing headquarters of Howden Hua
Engineering Company Limited, China
Ventilation fans for the Boston Central
Artery Tunnel, USA.

Opposite page left to right
New Howden TSL facility near Cartagena,
Spain, opened in mid-2002.
Element manufacture at Howden TSL,
Spain



incurred which reflects the overstatement of this unit's profits not arising in 2002. This investigation produced no evidence that these irregularities have led to any defalcation or that any cash or other assets have left the group.

Power

The Power Division serves the global power market. From 1 January 2003 the responsibility for centrifugal fan sales and major retrofit aftermarket projects in North America, including the Springfield Illinois manufacturing plant, has been transferred to the Power Division from Howden North America and the appropriate infrastructure was established in the last quarter of 2002 to achieve this. Headcount and shift levels at Springfield were reduced at the start of 2003 reflecting current market conditions. Howden Hua has a full order book well into 2003 and capacity is being increased by limited capital investment and increased use of subcontractors. Manufacturing had ceased at Næstved in Denmark by the year-end with axial fan production transferred to Belfast. The relocation and rationalisation of the production of air heater elements into one new purpose built factory near Cartagena in Spain was completed as planned. The financial performance in Australia has been turned round as a consequence of withdrawal from the commercial HVAC segment and instead focussing on the aftermarket power and industrial business.

Overall, the Power Division increased turnover and operating profits by 5% and 7% respectively.

North America

Howden North America showed a 15% decline in turnover and a fall in profitability. Measures have already been taken to address the lack of profitability in North America. The closure of the manufacturing plant located in Camden, South Carolina was announced to the workforce in November 2002 with closure planned by the end of the first quarter of 2003. This plant, which had been commissioned towards the end of 1999, manufactured fans for the commercial and general ventilation markets in the USA. These markets have been declining in recent

years and have proved fiercely competitive. In the light of the poor results achieved, Howden has withdrawn from these market sectors. In view of the generally disappointing results in North America, a strategic and operational review is being undertaken to determine what further actions need to be taken concerning the future.

Within Howden North America, the majority of the work associated with the Boston Central Artery project is complete. This contract, which has a total value of around £20 million, was to supply all the ventilation fans for what is one of the largest civil engineering projects undertaken in America to take the entire cross-city motorway underground.

South Africa

With a recovery of the South Africa domestic economy, and its currency, and increases in fixed capital investment, the reported results showed that this division increased sales by 12%. In local currency terms the sales growth was almost 40%. The business substantially increased profits from last year with its domestic power, industrial and environmental control businesses making a strong contribution. There was an unsatisfactory performance from certain small overseas subsidiaries and from its electric motor business and, as a result, a loss making sales office in Australia was sold to its minority shareholder during the year.

European industrial

Despite depressed market conditions this business showed steady progress in both sales and operating profits reflecting improved market coverage.

Compressors

Burton Corblin, the diaphragm and piston compressors business, suffered from a 30% decline in its markets due to customers cancelling or postponing capital investment projects. During the year the decision was made to close its small U.S. facility in Philadelphia and serve the market there from its main facility in Nogent near Paris using a US distributor. A headcount reduction plan is also being implemented at Nogent.



Market overview

The financial year 2002 saw growth in sales and profitability in the US Defence businesses. AirDynamics, the pump, fan and compressor business, continued to deliver components for the CH-47 programme, AH-64 Apache helicopter, V-22 aircraft, F-16 and F-18 fighters and DDG navy destroyer. Western Design, a developer of ammunition handling systems and military thermal control systems, continued production for the M1 Abrams Tank and the Apache helicopter, with new developments for anti-submarine warfare pods, 120mm mortar autoloaders, and ammunition/fuel hybrid magazines for the Apache.

Bauer, the loss making Connecticut based aviation test stand business, was sold to its management in December for a cash consideration of £0.4 million. It made an operating loss in the year up to the date of sale of £0.6 million.

Demaco, the Florida based pasta making machinery business, increased turnover substantially in the year but failed to achieve satisfactory margins and generated a small operating loss.

HD Engineering, the Hong Kong based drilling machine business, continues to face poor local market conditions with many governmental and private sector capital projects being delayed or cancelled. In the light of this, HD Engineering has taken cost reduction measures which enabled it to generate modest profits on significantly lower turnover.

Results overview

Turnover for the year in the Specialised engineering businesses was £51.2 million (2001: £56.5 million) with operating profits of £5.4 million (2001: £2.9 million).