WELDING AND CUTTING PRODUCTS

Welding of stainless steel bus frames at Van Hool bus and trailer plant in Belgium

One of two ESAB TXB fully automatic cutting machines for steel panels up to 30 mm thick ordered by Spain's largest shipyard in September

Market overview

During the year Esab generated solid operating profits, improved cash flow and maintained gross margins despite experiencing challenging trading conditions in certain of its major markets during the first half of 2003. Performance in the second half showed a marked improvement over the corresponding period last year and over the first half of 2003.

Demand in North America and Europe was weak during the first half of the year, as industrial production fell and customers postponed capital goods orders. However, demand for welding equipment, cutting equipment and welding supplies did begin to strengthen in North America towards the end of the year and there were also encouraging signs in Europe. Customers in these two important markets are beginning to place orders for substantial steel scarfing machines, heavy-duty cutting equipment and other capital goods items

Steel prices began to increase significantly towards the end of the year with heavy demand driven by the needs of Chinese industry. This trend is continuing and clearly has implications for the welding industry, and its customer base. Notwithstanding this, demand for Esab products has continued to strengthen in North America, South America and parts of Asia.

The transfer of Esab's manufacturing centres closer to customers in developing markets is on schedule to be completed by the end of the year. During the year, headcount was reduced by 340, partly offset by the acquisition of the remaining 50 per cent of a cutting joint venture in Shanghai, which added some 100 workers.

In 2003, Esab saw the largest number of new product introductions for some years. New, modular based standard equipment was introduced that is now widely perceived as a class leader. New consumables product introductions included copper free wire and upgraded stainless steel wire incorporating improvements in surface technologies. New consumables for mechanised plasma applications have also been launched.

Further product introductions included new automated welding and cutting solutions, laser-hybrid technologies and SuperPulse™ technology. This enables the precision welding of ultra thin plate without distortion and has particular application to the automotive industry. Esab continues to work closely with its customers on the development and application of technologies.

Results overview

Despite the challenging conditions, and a particularly poor first half, sales for the full year were almost in line with prior year levels at £577.1 million (2002: £581.9 million). Adjusted operating profit was £35.3 million (2002: £36.0 million). Profit margins were maintained at above 6.1 per cent. The performance in the second half of 2003 showed a marked improvement over the corresponding period last year and the first half of 2003.

In Europe, Esab's largest market that represents just over half of its turnover, sales were ahead of, and operating profit was maintained at, last year's levels. The UK and Southern regions continued to hold up well, although demand in the Nordic and Western European regions was more subdued. Good growth was achieved in Poland and the Czech Republic, as the economies began to recover and the transfer of production to these countries continued.

Esab's businesses in Asia, the Middle East and Russia continued to grow in significance and more resources are being targeted on these markets. Business confidence in Asia suffered from the impact of the SARS crisis and the war in Iraq during the first half of the year, but the beginning of a recovery in demand and the continuing growth of the Chinese economy led to a stronger performance in the second half. The Russian and Chinese markets continued to expand, whilst demand in the Middle East proved to be resilient in spite of the Iraq war. The rest of Asia saw some recovery, although operating profits from Esab's South Korean associate, ESAB SeAH, were lower than the previous year as a consequence of the weaker South Korean domestic economy. For the Asian region as a whole, turnover, operating profits and operating margins improved.

The welding and cutting businesses in North America, which generate some 30 per cent. of Esab's sales, suffered from weaker demand in the first half of the year. However, increased industrial production, several large capital goods orders and a renewed focus on customers produced significantly better results towards the end of the year. Alcotec, Esab's specialised aluminium consumables business, continued to perform well and maintained its market leadership position. Esab's overall North American turnover declined year on year, although operating profit significantly improved.

Esab operates through partly owned subsidiaries in South America, principally in Brazil and Argentina, where sales and profits for the year were higher in both local currency and US dollar terms than in the previous year.

Restructuring

The restructuring of the Esab business has continued during 2003. Exceptional charges for restructuring the business during the year amounted to £5.9 million (2002: £12.2 million). Actions taken during the period included:

- The continued restructuring and reorganisation of the European business. Progress has been made in consolidating warehouse facilities. Further restructuring is now in process, which should lead to improved operational efficiency, more efficient manufacturing and the reallocation of resources to growing markets.
- The North American business was restructured during the year. The business has been streamlined and reorganised into smaller units with tighter market focus.
- The ongoing transfer of flux-cored wire production from Waltham Cross in the United Kingdom and Utrecht in Holland to Katowice in Poland and Vamberk in the Czech Republic. This project is on schedule for completion by the end of 2004.
- The transfer of certain standard equipment lines from Laxå in Sweden to Opole in Poland was completed during the year.

Outlook

Esab should emerge at the end of this year from a period of radical restructuring over several years. The benefits of these initiatives and a renewed focus on customers, the Esab brand name and Esab's positioning as a truly global supplier, should provide a strong foundation for the future and its management view the prospects for the business with confidence.

ESAB laser-hybrid welding head for robot applications. This technology is finding growing potential within the automotive sector.

Howden

AIR AND GAS HANDLING

Axial flow fan hubs in Howden Power's Belfast machine shop.

Market overview

In the Power Division, Howden's largest business, both sales and order intake increased largely due to growth in the businesses supplying the Chinese and Australian markets which more than offset reduced activity in North America and the effects of the weakening US dollar. The North American power market remained depressed for much of the year but there were some signs of improving confidence and activity towards the year-end. In Europe, where markets have been relatively flat for several years, there are indications that projects to replace obsolete generating capacity are beginning to move ahead, particularly in countries such as Italy, Germany and Spain.

In China, the Power Division continued to experience dramatic growth and Howden Hua, where the group has a 70 per cent. interest, almost doubled its order intake year on year and increased sales by some 30 per cent. Howden's European-based businesses also benefited from demand from the Chinese market.

The Industrial Division experienced flat booking rates, however there were signs towards the end of the year of increased bidding activity and a recovery in the petrochemical market. The petrochemical segment is Howden's second most important market.

Following the closure of the Camden manufacturing facility and the exit from the commercial heating ventilating and air-conditioning (HVAC) market, Howden's North American activities are now focused primarily on industrial sectors such as steel, petrochemical, mining and tunnels.

Howden's South African subsidiary benefited from strong local markets and increased sales and profitability in 2003.

Howden finished the year with an overall order book of £119 million, an increase of £11 million over last year.

Results overview

Howden's 2003 turnover was £256.9 million (2002: £267.4 million) and adjusted operating profits improved substantially to £6.3 million (2002: £1.5 million).

The profit improvement was due to a significant reduction in the losses in the North American operations, and from growth and enhanced profitability in Howden's operations in China and South Africa. During the year operational cash flow benefited from tighter working capital management.

In general, markets were subdued except in China, where Howden is well-positioned with its Howden Hua joint venture, and in South Africa. Towards the end of the year, there were signs of recovery in Howden's US markets and in the petrochemical market worldwide.

The restructuring initiatives and other cost control measures have resulted in a headcount reduction in Howden of just over 450 employees in 2003, offset in part by recruitment of some 70 employees, mainly in China and Mexico.

In the Power Division, profits were marginally lower in part due to reduced activity in North America. Projects to replace obsolete generating capacity in Europe are beginning to move ahead and latterly there has been some upturn in the US markets. There has been dramatic growth in China in 2003, where Howden Hua's sales and orders increased by around 30 per cent. and 95 per cent. respectively. In addition, Howden's European Power operating companies increased sales into this market. Howden Hua is planning to increase its capacity in 2004 in order to be able to meet the market opportunities. Howden's Australian company has also seen significant sales growth in new project business.

AIR AND GAS HANDLING - continued

For the Industrial Division, overall sales were 20 per cent. lower than in 2002 primarily due to the completion of the Mont Blanc tunnel project and a weakening in the German domestic market in 2003, but overall profitability was maintained. However the general economic and business outlook appears to be improving, with some recovery in most markets in which this division operates. During the year the French compressor operation was downsized and integrated into the Industrial Division, primarily to exploit synergies in the recovering petrochemical market segment.

Induced draught fan for Tuoketuo power station on test in Howden Hua's factory in China.

Howden Buffalo centrifugal ventilation fans supplied to the Boston Central Artery Tunnel.

Given the decline in profitability in North America, a major strategic and operational review was carried out of all Howden's operations in North America. As a result the manufacturing plant in Springfield, Illinois, together with two smaller facilities in Canada were closed. Following these closures together with the closure of the factory at Camden, South Carolina, announced last year, Howden's only remaining facility in the United States is at New Philadelphia, Ohio. Howden also continues to have a manufacturing facility in Mexico.

Compared to 2002, sales in North America were lower due to the exit from the commercial HVAC market, completion of the Boston Artery tunnel project and market contractions. The North American business, excluding Power, substantially improved its peformance in 2003 recording a small loss. Following the closures in 2003 and the subsequent reorganisation, the North American business is positioned to improve in 2004. Howden has now, except for South Africa, exited the low-margin commercial HVAC market segment worldwide.

There was a strong performance from Howden's South African subsidiaries, which benefited from buoyant local markets and this group of subsidiaries reported increased sales and profitability in 2003. However in the second half of the year the strong rand slowed expenditure and orders particularly from those customers who are resource-based and export market dependent. During the year the loss-making electric motor company, Hertz Technologies, was sold for a nominal consideration, a number of other loss making entities were closed and Howden's pump manufacturing subsidiary was merged with a major South African competitor.

Restructuring

In 2003 the exceptional costs of restructuring Howden totalled £4.1 million (2002: £7.7million). During the year the following restructuring initiatives were completed:

- The closure of Howden's manufacturing plant located in Camden, South Carolina, completed on schedule in the first quarter of 2003.
- The closure of the industrial fan manufacturing plant in Springfield, Illinois, together with two smaller facilities in Canada.
- The downsizing of Burton Corblin, the compressors business in France.
- The closure of Calidair a non-core dampers business, in Gloucestershire in the United Kingdom.

Outlook

The recovery in profits in Howden in 2003, together with the lower cost base arising from the restructuring programme, should place the business in a good position to benefit from growth in the market sectors in which it operates, particularly in China.

SPECIALISED ENGINEERING

Market overview

The sale of the group's US Defence businesses was completed in December 2003 and consequently their turnover for 2003 of £28.8 million (2002: £32.9 million) and adjusted operating profits of £6.6 million (2002: £6.2 million) are shown as discontinued operations.

In 2003 the continuing operations comprised two small businesses, HD Engineering Limited, the Hong Kong drilling equipment business and Howden Food Equipment Inc., a US manufacturer of industrial food processing equipment based in Florida, trading as Demaco.

HD Engineering continues to face weak local market conditions with many governmental and private sector capital projects being delayed or cancelled. In the light of this HD Engineering has reduced its cost base in line with demand and managed to generate a small operating profit in the year.

In 2003 Demaco recorded a decline in turnover and made an operating loss. The company's long-standing contingent pension liability was resolved at the year-end and as a result, the closure of the company's costly New York operation was announced. The site will be vacated by the end of March 2004 and this, plus ongoing diversification into complementary product lines, means that Demaco is targeted to break even in 2004.

Results overview

The continuing businesses had turnover in 2003 of £8.4 million (2002: £18.3 million), and recorded adjusted operating losses of £1.3 million (2002: £0.8 million). The comparative figures include turnover of £2.8 million and an adjusted operating loss of £0.6 million in respect of Bauer, the aviation test stand business sold in 2002.