

## Directors' report

The Directors present their report, together with the audited financial statements for the year ended 31 December 2006.

### Activities and review of operations

A review of the activities and operations of the Company and its subsidiaries is given in the Chairman's statement on pages 4 and 5, the Chief Executive's statement on pages 6 and 7 and the Business and Financial review on pages 8 to 30. These are incorporated into and form part of this report.

### Business and Financial review

The Business and Financial review, which forms part of this report, can be found on pages 8 to 30. This is a review of the development and performance of the business, including the financial performance during the year ended 31 December 2006 and a description of the principal risks and uncertainties facing the business.

### Dividends

The Directors have decided not to recommend a final dividend for the year ended 31 December 2006 (2005: nil). No interim dividend was paid for the six months ended 30 June 2006 (2005: nil). As mentioned in the Chairman's statement on pages 4 and 5, the Directors intend to review dividend policy later in the year and envisage that the Company will declare a final dividend in respect of the financial year ending 31 December 2007 provided that the general economic environment and the Company's trading and financial condition are at least broadly in line with the Board's current expectations.

### Directors

A list of the current Directors, including brief biographical details, appears on pages 34 and 35. All Directors with the exception of James Deeley, Legal Director and Company Secretary, served throughout the year. Details of the Directors' interests in the share capital of the Company, their remuneration and service contracts can be found in the Remuneration Report on pages 44 to 49.

Grey Denham and Andrew Osborne are retiring by rotation under the Company's articles of association and, each being eligible, offers himself for re-election at the forthcoming Annual General Meeting ('AGM'). In addition, John Neill also offers himself for re-election as he has served as a Non-Executive Director of the Company for more than nine years and James Deeley will stand for election having been appointed since the last AGM.

During the year, ESAB Holdings Limited, a subsidiary of the Company, entered into an arms length consultancy agreement with Unipart Logistics Limited ('Unipart Logistics') for the provision of Lean-manufacturing and logistics consultancy services to ESAB Global. John Neill, a Non-Executive Director of the Company, is currently Group Chief Executive of the Unipart Group of Companies. The total charges paid to Unipart Logistics during the year were £682,155.

In addition, Hoeganaes Corporation ('Hoeganaes Corp'), a wholly owned subsidiary of GKN plc, supplied powdered metal to two subsidiaries of the Company, being ESAB Group Inc and ESAB Mexico SA de CV, during the year under review with a total sales value of \$1.8 million. There was a further trading transaction between Hoeganaes Corporation Europe SA ('Hoeganaes Europe'), a wholly owned subsidiary of GKN plc and ESAB Kft, a subsidiary of the Company, for a value of approximately €12,000. The relationship between both GKN subsidiaries and the Company's subsidiaries is ongoing, on an arms length basis and in the ordinary course of trade. Grey Denham, a Non-Executive Director of the Company, is Company Secretary of GKN plc but has no day to day involvement in the management of Hoeganaes Corp or Hoeganaes Europe.

No other Directors had any interest in contracts with the Company or its subsidiaries at any time during the period other than service contracts and indemnity agreements.

### Settlement with City Index

On 7 February 2006, the Company announced that it had settled its legal proceedings against City Index in respect of losses incurred as a consequence of certain unauthorised payments having been made by a former employee. The Board is aware that, following the settlement with the Company, City Index sought to continue to pursue claims for contribution against certain current and former Directors of the Company and against the Company's Auditors. Those Directors and the Company's

Auditors successfully applied to the High Court for an order that the claims be struck out. City Index has appealed to the Court of Appeal against that order.

### Corporate governance

A review of the Company's application of the principles and provisions of the Financial Reporting Council's Combined Code on Corporate Governance can be found on pages 39 to 42.

### Directors' indemnities

Each of the Directors has been granted an indemnity by the Company to the extent permitted by law in respect of certain liabilities incurred as a result of their office. In accordance with the Company's articles of association each Director is indemnified against liability to third parties, excluding criminal liability and regulatory penalties and certain other liabilities. In addition, the Company may pay the Directors' legal costs as they are incurred, subject to reimbursement if the Director is convicted, or if judgement is given against the Director in an action brought by the Company.

### Financial instruments

The financial risk management objectives and policies of the Company including interest rate, currency and credit risk are outlined in Note 21 of the Company's consolidated financial statements.

### Annual General Meeting

The Company's AGM will take place at 12 noon on Tuesday 26 June 2007 at the offices of ABN AMRO, 250 Bishopsgate, London, EC2M 4AA. The Notice of Meeting (the 'Notice') can be found on pages 92 to 94. The special business to be considered at the meeting is as follows:

#### **Authority to allot shares and disapplication of pre-emption rights**

The Directors wish to renew for a further year the general authority granted to them on 27 June 2006 under section 80 of the Companies Act 1985 to allot ordinary shares. Approval of shareholders will be sought at the AGM by the passing of an ordinary resolution whereby the Directors will be authorised to allot authorised but unissued ordinary shares representing one third of the issued share capital of the Company. The wording of the proposed resolution is set out in Resolution 9 of the Notice and the total number of shares in respect of which this authority is sought is set out in the note to such resolution. This new authority will expire at the 2008 AGM of the Company.

The Directors are also proposing a special resolution under section 95 of the Companies Act 1985 to renew the disapplication of statutory pre-emption rights in respect of ordinary shares having an aggregate nominal value of £166,688 representing 5 per cent of the ordinary shares in issue. The wording of the proposed resolution is set out in Resolution 10 of the Notice. This authority will expire at the 2008 AGM of the Company.

The Directors have no present intention of exercising these authorities, except for allotments of shares pursuant to the Company's long term incentive schemes, and would not seek to issue more than 7.5 per cent of the Company's ordinary share capital for cash, other than to existing shareholders, in any rolling three-year period without prior consultation with the investment committees of the Association of British Insurers and the National Association of Pension Funds.

#### **Authority to purchase own shares**

The Directors wish to renew for a further year the authority to allow the Company to purchase its own ordinary shares on a recognised investment exchange. The authority is restricted to 16,668,885 ordinary shares, representing 10 per cent of the current issued share capital and will expire at the 2008 AGM of the Company or, if earlier 26 September 2008. The resolution also sets out the maximum and minimum prices at which the shares may be purchased. Purchases will only be made if the Directors expect this to result in an increase in the Company's earnings per share and consider this to be in the best interests of shareholders generally.

Any shares purchased in this way not held in treasury will be cancelled and the number of shares in issue will be reduced accordingly. Other than in relation to shares bought back and held in treasury as described above, it is not the Directors' current intention to offer to purchase shares in the market for any particular period. The wording of the proposed resolution is set out in Resolution 11 of the Notice.

The Directors intend to seek renewal of this power at subsequent AGMs.

### **Charitable and political donations**

The Company intends to seek authority to make donations to EU Political Organisations not exceeding £25,000 in total and to incur EU Political Expenditure not exceeding £25,000 in total. The Company does make a number of charitable donations as described below, but it does not currently make any political donations. Whilst there is no current intention to change this policy, the meaning and implications of the Political Parties, Elections and Referendums Act 2000 remain unclear, and could extend to routine activities undertaken by the Company in the ordinary course of business that are not 'political' or 'party political' in any usual meaning of those terms. The wording of the proposed resolution is set out in Resolution 12 of the Notice and further information regarding the background to this resolution is contained in note viii to the Notice.

### **Electronic communications**

The Directors intend to take advantage of the new provisions in the Companies Act 2006 and the Financial Service Authority's ('FSA') Disclosure and Transparency Rules concerning electronic communications and will propose a resolution to allow the Company to send or supply documents or information to shareholders by making such documents available on the Company's website.

Full details of all resolutions can be found in the notes to the Notice on pages 93 and 94. The Directors believe that the adoption of all the resolutions set out in the Notice is in the best interests of the Company and its shareholders as a whole. Accordingly, the Directors unanimously recommend that shareholders vote in favour of the resolutions, as they intend to do in respect of their beneficial holdings.

### **Employees**

The Company's policy is to encourage effective communication and consultation between employees and management. Subsidiary undertakings develop their own consultation and communication procedures as part of their employment practices. Full details can be found in the Corporate social responsibility report on pages 31 to 33.

The Company and its subsidiary undertakings give full and fair consideration to applications for employment made by disabled people, having regard to their aptitudes and abilities. Should employees become disabled during employment, they would be considered for any necessary retraining and available work within their capabilities. For the purposes of training, career development and promotion, disabled employees are treated in the same way as other employees.

### **Creditor payment policy**

The creditor payment policy of the Company and its subsidiaries provides that local practice must be observed in the countries in which they operate – standard payment terms in each country may also be varied by negotiation with individual suppliers. The policy is to settle amounts due to creditors in accordance with agreed terms.

The Company had no trade creditors at the year end.

### **Charitable and political contributions**

During the year the Company and its subsidiaries donated £58,000 (2005: £84,000) to charities of which £8,000 (2005: £6,000) was to charities in the United Kingdom. Within the United Kingdom, donations were made in the year to support charities working in education (£1,000), medical research/support (£4,000) and community support (£3,000). There were no political donations made during the year (2005: £nil).

### **Research and development**

The Company and its subsidiaries continue to place strong emphasis on research and development to meet the changing needs of the markets they serve. Research and development expenditure, which excludes engineering and production support costs, totalled £9.1 million (2005: £7.5 million) for the year of which £6.7 million (2005: £5.3 million) has been charged to the income statement for the year and £2.4 million (2005: £2.2 million) has been capitalised as intangible assets.

### **Substantial shareholdings**

Prior to 20 January 2007, the Company maintained a register of substantial shareholdings pursuant to section 211 of the Companies Act 1985.

At 19 January 2007 the Company had been notified of the following holdings exceeding 3 per cent of the issued ordinary share capital of the Company: Barclays PLC – 7.08 per cent, Lazard Asset Management LLC – 4.09 per cent and Legal & General Group PLC – 3.13 per cent.

On 20 January 2007, the FSA's Disclosure and Transparency Rules came into force and replaced the provisions of the Companies Act 1985. As at 14 March 2007, the Company had been notified of the following holdings exceeding 3 per cent in the total voting rights attached to the issued share capital of the Company: Barclays PLC – 3.46 per cent, Standard Life Investments Limited – 4.75 per cent, Schroder plc – 5.49 per cent and JP Morgan Chase & Co – 7.68 per cent. An update will be given in the Notice.

### **Corporate social responsibility ('CSR')**

The Company's report on CSR, including its approach to environmental issues, can be found on pages 31 to 33.

### **Statement of disclosure of information to Auditors**

So far as the Directors are aware, there is no relevant audit information (that is, information needed by the Company's Auditors in connection with preparing their report) of which the Company's Auditors are unaware, and each Director has taken all reasonable steps that he ought to have taken as a Director in order to make himself aware of any relevant audit information and to establish that the Company's Auditors are aware of that information.

### **Auditors**

A resolution (Resolution 7) to reappoint PricewaterhouseCoopers LLP as Auditors to the Company and a further resolution (Resolution 8) to authorise the Board to fix the Auditors' remuneration will be proposed at the AGM.

By order of the Board

### **James R Deeley**

Company Secretary  
14 March 2007

Registered office:-  
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Registered in England Number 2794949