

Financial Review: The Group has delivered a strong set of results which demonstrate yet again its underlying cash generation capability.



“The Group includes a strong portfolio of businesses in the oil & gas, power generation and mining markets where fundamentals point to sustained future progress.”

Operating Structure

The trading activities of The Weir Group PLC comprise the manufacture of pumps, valves and ancillary equipment for the mining, oil & gas, power generation and general industrial markets (the Group's Engineering Products Division); the provision of equipment maintenance, process support and asset management services (which constitutes the Engineering Services Division) and the specialist design of turnkey engineering projects, (the Group's Defence, Nuclear and Gas Division). The Group also has a number of joint ventures which are reported separately.

Results overview

The Group has delivered a strong set of results which demonstrate yet again its underlying cash generation capability. The results include the first contributions from the current year acquisitions of Weir SPM and Weir Multiflo and reflect the disposals of the Weir Pumps, Glasgow operations and our investment in Devonport Management Limited. The Group includes a strong portfolio of businesses in the oil & gas, power generation and mining markets where fundamentals point to sustained future progress.

Revenue¹ increased by 22% in 2007 from £870.4m to £1060.6m with all three divisions achieving growth over 2006. Continued buoyant conditions in the mining, oil & gas and power generation markets, together with first contributions from Weir SPM and Weir Multiflo, contributed to the year's results.

Over 75% (2006: 70%) of Group revenues are now generated from these three markets with original equipment sales representing 54% of revenues (2006: 50%). Strong growth was evident in North American revenues following the acquisition of Weir SPM and good growth was also experienced by our European and South American operations. Unfavourable exchange movements from the translation effects of overseas subsidiaries reduced revenue growth by £15.9m.

Operating profits² rose 57% to £122.1m (2006: £77.7m). Excluding attributable profits from our joint ventures, the operating margin² was 11.2% of revenues against 8.7% last year. Increased operational leverage and the impact of the higher margin Weir SPM acquisition benefited Engineering Products. Engineering Services performance improved following the restructuring of operations undertaken in 2007 and the Defence, Nuclear & Gas business benefited from the strength of its current order book. Attributable profits, reported on an after tax basis, from our joint ventures contributed £3.4m against £2.4m in 2006. The impact of unfavourable exchange movements reduced operating profits² in 2007 by £1.6m.

No exceptional profits from continuing operations were recognised in the year (2006: £15.7m). Intangibles amortisation, however, rose to £6.2m from £2.3m in the prior year primarily reflecting an incremental £3.7m charge in respect of intangible assets recognised on the Weir SPM acquisition. For 2008, this latter charge will rise to around £8m before falling to £5m in 2009.

Net interest costs of £5.1m were lower than 2006 (£5.5m) with the impact of positive operating cashflows and business disposal proceeds more than offsetting that of the purchase of Weir SPM and Weir Multiflo. The net interest costs were covered 24 times by operating profit². In addition, there was a £1.7m reduction in the net income earned from the Group's pension schemes reflecting a higher proportion of bonds within the pension fund investment portfolio.

Profit before tax² increased 56% on the previous year at £120.2m (2006: £77.1m). Reported profit before tax increased 26% to £114.0m (2006: £90.5m), reflecting the impact of additional amortisation in the current year and exceptional items in the prior year.

Details of the trading highlights of each of the Group's business segments are set out below.

Engineering Products

Input¹, on a constant currency basis, grew 30% to £760.7m with in excess of 80% being attributable to the oil & gas, mining and power generation markets. We achieved excellent results from Minerals (up 28%) and Clear Liquid (up 43%) which combined with 13% growth from Valves & Controls resulted in the Group achieving its highest ever level of order input.

Revenue¹ on a constant currency basis increased 35% to £711.6m in 2007 (2006: £525.5m), due to continued strong demand from our core mining, oil and power markets and a first revenue contribution of £78.7m from Weir SPM in the post acquisition period; ahead of our initial expectations.

Underlying revenue growth, excluding the part year impact of the Weir SPM acquisition, was 20% realised through a combination of increased output from existing facilities utilising the Weir Production System and selective capacity increases coming online. Over 83% (2006: 81%) of revenues were attributable to the oil & gas, mining and power markets with year on year revenue growth in these markets of around 20%, on a like for like basis. The impact of adverse foreign currency movements was to reduce current year revenues by £12.5m.

Operating margins² as a percentage of revenue increased to 13.9% against 11.1% in 2006, consistent with the Group's focus on higher technology, higher margin and speciality activities. Operating leverage from increased revenues across all operations and the inclusion of Weir SPM's higher margin product sales for a part year each contributed to this improved result. The Weir SPM operating margin² was in line with our expectations at 24.3%.

Operating profits², on a constant currency basis, increased 70% to £98.7m (2006: £58.1m) including a part year contribution of £19.1m from Weir SPM. Adverse foreign currency translation movements reduced current year operating profits by £1.8m.

Engineering Services

Input¹ from Engineering Services, on a constant currency basis, increased 8% to £250.6m (2006: £232.9m) with strong growth across the power and oil sectors. On a constant currency basis, revenue increased 4% to £231.4m (2006: £221.7m) reflecting a conscious focus on the most profitable activities and markets. Operating profits² on the same basis were £18.5m compared to £13.1m in 2006. This reflected an improvement in the underlying trading performance of the division and one-off costs of £4.4m in the prior year arising from restructuring activities in the UK, USA and Middle East.

Good progress was made across all operations during the year reflecting strong conditions in the oil & gas, mining and power markets with around 75% (2006: 63%) of revenues coming from these markets. In the UK and North America, the benefits of the 2006 restructuring were realised and the Middle East operations also delivered good growth following investment and restructuring in 2006.

Defence, Nuclear & Gas

This division comprises those businesses in the Group where revenue is derived from the specialist design of turnkey engineering projects for the defence, nuclear and gas markets. The division's revenue in 2007 increased 10% on a constant currency basis to £117.6m (2006: £107.3m), with gains in the marine market as revenue milestones were achieved on a number of major contracts. Operating profit² on the same basis grew 4% to £10.4m against £10.0m in 2006.

Joint ventures

The Group's share of profit from its joint ventures increased 42% to £3.4m with good growth from the Group's joint ventures in Saudi Arabia and Abu Dhabi.

Taxation

The tax charge for the year of £31.7m (2006: £18.9m), on attributable profits before exceptional items of £114.0m (2006: £74.8m), represents an underlying effective rate of 27.8% (2006: 25.3%). This differs from a theoretical expected rate of 31.3% (2006: 31%) principally as a consequence of the tax efficient use of capital, the recognition of historic losses and the release of provisions equivalent to 1.5% on the rate following closure of certain tax enquiries at no cost. The underlying tax rate is expected to rise further in 2008 given the full year impact of the Weir SPM acquisition which has an effective tax rate of around 35%.

In accordance with IFRS, earnings from joint ventures are reported on an after tax basis, with a tax charge of £0.6m reflected within these net earnings.

Discontinued operations

During the year, the Group disposed of the Weir Pumps Glasgow operations and its investment in Devonport Management Limited. As such, the post tax trading results of each of these businesses and disposal gains arising on Weir Pumps and Devonport Management Limited are classified within discontinued operations with prior year comparatives restated.

Profit after tax of £8.5m was recognised in the year in respect of these businesses for the periods prior to disposal. Profits of £3.3m have also been recognised in respect of prior period disposals following the settlement of outstanding legal matters and the expiry of warranty periods.

Disposal gains of £80.9m were recognised as exceptional items within discontinued operations in respect of Weir Pumps and Devonport Management Limited. No tax is payable on either disposal.

Earnings and Dividends

Earnings per share² was 41.4p, an increase of 49% compared to 2006. Reported earnings per share, taking account of exceptional items, intangible amortisation and discontinued operations, was 83.8p (2006: 39.4p). The weighted average number of ordinary shares in issue increased to 208.6m as a result of the issue of 1.1m shares during the year to fulfil option exercises and awards under the Long Term Incentive Plan.

Subject to shareholder approval, the total dividend for the year is 16.5p, an increase of 14% over last year's total of 14.5p. This represents dividend cover (being the ratio of earnings per share¹ before intangibles amortisation and exceptional items to dividend per share) of 2.5 times compared to 2.2 times in 2006. Going forward, the Group will look to sustain a progressive dividend policy and maintain cover of at least 2 times.

Acquisition of SPM Flow Control Inc.

On 19 July 2007, the Group completed the acquisition of SPM Flow Control Inc. and on 21 August 2007, the acquisition of Weir Multiflo for a total cash consideration, including expenses, of £331.2m. As required by IFRS, a review of the fair value of assets and liabilities at the date of acquisition has been undertaken and accounting policies aligned with those of the Group. This has given rise to fair value adjustments of £83.3m, resulting in net assets acquired of £153.1m. These principally reflect the valuation of separately identifiable intangible assets, including customer relationships and trade name, with the former amortised over their expected useful lives of up to 25 years. Other adjustments were made in relation to property, plant and equipment, inventory and provisions. Goodwill of £178.1m has been recorded in respect of these acquisitions.

Cashflows

The Group has delivered strong growth in cashflows, with cash generated from operations¹ of £151.8m substantially ahead of 2006 (£111.0m) as a consequence of increased profitability. A further £10.6m improvement in net working capital was realised, despite increased trading volumes. Operating cashflows of £23.5m were generated by Weir SPM in the period since acquisition reflecting a greater focus on working capital management. A £6.5m special contribution was made during the year to facilitate the purchase of an insurance policy from Legal & General Assurance Society to secure the current pensioners' liabilities of the main UK plan and this is outlined in more detail below.

Net capital expenditure¹ was £40.3m (2006: £23.9m) reflecting continued investment across the business and asset disposal proceeds of £3.2m (2006: £0.8m). This represents 2.2 times depreciation and we expect to continue to spend around 2.5 times in 2008 given projects now underway in Brazil, the USA and Australia to meet the medium term needs of the business.

Net cashflows¹ of £44.3m (2006: £35.6m) were generated from recurring activities. Cash proceeds from business disposals were £127.3m. Taken together with the net funding cost of new acquisitions of £317.8m and operating cashflows generated from discontinued operations of £0.9m, this resulted in an increase in net debt from cashflows of £145.7m. An £18.3m adverse movement arose on the translation of overseas borrowings, giving a year end net debt position of £171.3m, up £164.2m on 2006.

Liquidity and funding

Our general policy is to finance the Group through a mixture of debt and equity. The Group's capital structure is managed centrally with the objective of optimising the returns to shareholders over time, whilst safeguarding the Group's ability to continue as a going concern.

The Group has a £300m multi-currency revolving credit facility and Canadian dollar credit facilities of C\$180m maturing in 2009. These have standard covenant and variable rate interest structures and all covenants were met in 2007. Foreign currency denominated borrowings of £216.5m equivalent were outstanding under these facilities at 28 December 2007. In June 2007, the Group put in place a £550m revolving credit facility with a maximum maturity of two years, incorporating similar financial covenants, to support the acquisition of SPM Flow Control, Inc. This facility was subsequently reduced to £85m and has remained undrawn.

The maturity profile of committed borrowing facilities is regularly reviewed and facilities are extended or replaced as required in advance of their expiry.

The Group held cash balances of £46.1m at 28 December 2007, of which £9.3m was held in the UK and the remainder held as operating funds by Group companies worldwide.

The Group has a variety of committed and uncommitted bank facilities under which advance payment and performance guarantees are issued to support normal contract terms.

Treasury management & policies

The Group's treasury policies seek to reduce financial risk and to ensure adequate controls over treasury activities group-wide. Treasury activities in relation to transactional risk management are largely delegated to the Group's operating companies and are carried out within this policy framework. Under treasury policy, all material foreign exchange exposures are hedged, typically by means of forward contracts matching the underlying contract cashflows, to provide certainty of future revenues and costs. No speculative transactions are undertaken. Group Treasury monitors foreign exchange exposures group-wide and reports regularly to support Group financial risk management processes. Although all companies with risk exposures undertake hedging transactions, only two companies apply hedge accounting for such transactions for IFRS purposes.

In 2007, the extent of the Group's foreign currency denominated net investments in subsidiaries increased as a result of the purchase of Weir SPM. The Group has initiated a partial hedging programme to reduce its exposure to translation risk in respect of such net investments.

Further information on financial risk management objectives and policies can be found in note 30 on page 89.

Exchange rates

The Group operates in a number of foreign currencies. The results of overseas operations are translated into sterling at average exchange rates for the year with the impact of the weakening of the United States and Canadian dollar against sterling more than offsetting the marginal strengthening of the Australian dollar and Euro. Net assets are translated at year end rates. The weakening of sterling against the Euro, Canadian and Australian dollar at the year end contributed to a positive net asset translation effect of £3.1m.

Details of principal exchange rates used are contained in note 32 on page 95.

Retirement benefits

The Group has 16 pension plans around the world of which six are defined benefit plans, the most significant being the UK and Canadian plans. All defined benefit plans are closed to new members. The net retirement benefits obligation surplus reported at 28 December 2007 was £36.9m (2006: net deficit of £3.9m). During the year, the pension plans have benefited from rising equity markets and bond yields which, together with a further £6.5m special contribution made by the Company into the

UK plans, facilitated the purchase of an insurance policy from Legal & General Assurance Society to secure the current pensioners' liabilities of the main UK plan. This represents some 43% of the plan's total liabilities at 28 December 2007. This substantially reduces future investment and mortality risks borne by the Group. A similar process was also undertaken in Canada and it is planned to wind up that plan during 2008. The Group will also continue to explore ways of further reducing future volatility risk.

Net assets

Net assets at 28 December 2007 were £545.2m (2006: £371.9m), with the increase due to the improved profitability of the business, including business disposal profits and gains from pension fund performance.

Litigation

The Group has no material litigation. There are 112 (2006: 52) asbestos related actions outstanding against Group companies. All such actions are robustly defended.

Critical accounting policies

The financial statements have been prepared in accordance with IFRS and the material accounting policies are set out on pages 52 to 57 of this report. There have been no changes to the accounting policies adopted in 2006.

Applying accounting policies requires the use of certain judgements, assumptions and estimates. The most important of these are set out below. Further judgements, assumptions and estimates are set out in the financial statements.

Construction contracts

Approximately 10% of revenue was derived from construction contracts. The timing of revenue and profit recognition in these contractual arrangements is important and is usually measured by reference to the stage of completion of contract activity at the balance sheet date. This assessment necessarily requires a high degree of judgement. For other aspects of revenue recognition, our accounting policies allow revenue to be recognised only when the risks and rewards of ownership have passed to the customer.

Intangible assets

On the acquisition of a business it is necessary to attribute fair values to any intangible assets acquired (provided they meet the criteria to be recognised). The fair values of these intangible assets are dependent on estimates of attributable future revenues, margins and cashflows. In addition, the allocation of useful lives to acquired intangible assets requires the application of judgement based on available information and management's expectations at the time of recognition.

Impairment

IFRS requires companies to carry out impairment testing on any assets that show indications of impairment and annually on goodwill and intangibles that are not subject to amortisation. This testing involves exercising management judgement about future cashflows and other events which are, by their nature, uncertain.



Keith Cochrane
Finance Director
11 March 2008

¹ from continuing operations.
² from continuing operations, before intangibles amortisation and exceptional items.