Chief Executive's Review

Building larger, broader based businesses

"The Group's strategy, consistently applied, delivers strong growth in earnings and shareholder value."

Group strategy and corporate objectives

The Group's strategy is designed to generate strong growth in earnings and shareholder value over the business cycle, by building larger, broader-based businesses in the three Group Sectors of Life Sciences, Seals and Controls.

The Group's principal corporate objectives are to achieve double-digit growth in adjusted earnings per share ("EPS") over the business cycle, to generate total shareholder return ("TSR") growth in the upper quartile of the FTSE 250 and to deliver progressive dividend growth with two times dividend cover.

This year the Group delivered 10% growth in adjusted EPS, with modest underlying organic growth boosted by a good contribution from acquisitions completed over the last 18 months and from translational currency benefits. TSR growth this year has been 36%, which compares with a 4% increase in the median and a 23% increase in the upper quartile TSR performance of the FTSE 250 index (excluding Investment Trusts). Dividends have increased progressively in each of the last 17 years and this year the dividend has increased by 10%, covered 2.1 times by adjusted EPS.

Business model

Our businesses target GDP plus levels of organic revenue growth over the business cycle. Stable and resilient revenue growth is achieved through our focus on **essential products** and services funded by customers' operating rather than capital budgets and supplied across a range of specialised industry segments. By supplying **essential solutions**, not just products, we build strong long term relationships with our customers and suppliers, which support sustainable and attractive margins. Finally, we encourage an entrepreneurial culture in our businesses through our decentralised management structure and these **essential values** ensure that decisions are made close to the customer and that the businesses are agile and responsive to changes in the market and the competitive environment.

The key performance indicators ("KPIs") we use to measure the success of the business model relate to recurring income and stable revenue growth, sustainable and attractive margins and strong cash flow.

This year, underlying organic revenue growth has again been hard won against a background of challenging market conditions across all three Sectors and across all geographies served. Total revenue grew by 15%, of which 3% was underlying organic growth, with the balance coming from acquisitions and translational currency benefits. This continues a trend over five years of 11% compound annual revenue growth, with an average of 4% p.a. underlying organic revenue growth.

Adjusted operating margins this year were 17.2% of revenue, compared with a five-year average of 18.6% and as always there were a number of factors impacting the Group's margin. Margins were negatively impacted again this year by transactional currency effects in the Healthcare businesses, initial dilution from acquired businesses and reduced operating leverage in a lower growth environment. The Group's medium term target for operating margin, in an improved economic environment, remains 18–19%.

Agility and responsiveness in the businesses ensure close management of operating costs and working capital and deliver strong free cash flow. This year, free cash flow was very strong at £59.0m, which represented 124% of adjusted earnings, compared with an average of 96% over the last five years. The principal driver of the strong cash flow this year, was the close management of working capital which was managed back down to 16.6% of revenues by the year end, compared with a five-year average of 16–17%. In addition, free cash flow benefited this year from the sale of the Medivators product line and the sale of certain legacy properties.

Growth strategy

Overall growth is accelerated from the underlying GDP plus levels to the corporate target of strong, double-digit growth, through carefully selected, value enhancing acquisitions which fit the business model and offer entry into new strategic markets.

Acquisitions are not made just to add revenue and profit, but rather to bring into the Group successful businesses which have growth potential, capable management and a good track record of profitable growth and cash generation. As part of our **Acquire, Build, Grow** strategy, we invest in the businesses post-acquisition to build a firm foundation to allow them to move to a new level of growth. These acquisitions form a critical part of our Sector growth strategies and are designed to generate a pre-tax return on investment of at least 20% and hence support our Group objectives for return on total investment.

Again we measure the success of the growth strategy with KPIs, the first of which is acquisition spend. To achieve the Group's objective of strong double-digit growth, acquisition spend at the level of ca.£30m p.a. is targeted. This year, the Group continued to benefit from a positive acquisition environment and invested ca.£33m in acquisitions, bringing the average over three years to ca.£30m p.a. The acquisitions completed over the last three years contributed 20% of 2016 revenues.

The Group's return on total investment measure is the pre-tax return on adjusted trading capital employed, excluding net cash, but including all goodwill and acquired intangible assets ("ROATCE"). This is used to measure the overall performance of the Group and very importantly, our success in creating value for shareholders through our acquisition programme. Over the last five years, ROATCE has comfortably exceeded the 20% target and this year was 21.1%.

Management strength

The success of the Group is built upon strong, self-standing management teams in the operating businesses, making decisions close to the customer and agile and responsive to changes in the market and competitive environment. The Group places very high importance on planning the development, motivation and reward structures for the ca.90 senior managers which make up the senior management cadre. This group has an average age of 47 and an average length of service of 11 years.

Although we place high importance on our decentralised organisation and the entrepreneurial culture this encourages, we also recognise that there are significant synergy benefits which can be achieved through managing clusters of similar businesses. Typically these synergies come in the form of cross-selling and joint purchasing between the businesses and shared back-office functions in finance and administration. There are also best practices which can be shared within the clusters in areas such as IT and digital capabilities.

At the beginning of this year, a formal Executive Management Group ("EMG") was established to ensure that we have a strong and broad-based senior management team in place to support the next stage of the Group's growth strategy. The members of the EMG are the senior managers responsible for the major business clusters and for certain key Group functions. The EMG combines individuals who have developed internally as well as selective external recruits. The EMG gives the senior management bench strength to manage a growing and broadly spread Group, while laying the groundwork for succession in key executive positions.

Strategic objectives

- Generate stable GDP plus organic revenue growth over the business cycle
- Maintain stable attractive margins
- Accelerate growth through carefully selected, value enhancing acquisitions
- Generate consistently strong cash flow to fund growth strategy and dividends
- Create value by consistently exceeding 20% ROATCE

Strategic Report
Governance
Financial Statements

For more information, please visit:
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