

DIPLOMA<sup>PLC</sup>

Annual Report  
& Accounts 2010

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# Financial Highlights

## Strong revenue and profit growth, excellent cash flow

### Year ended 30 September

	2010 £m	2009 £m	
Revenue	<b>183.5</b>	160.0	+15%
Adjusted operating profit*	<b>32.1</b>	25.6	+25%
Adjusted operating margin*	<b>17.5%</b>	16.0%	
Adjusted profit before tax**	<b>32.2</b>	25.5	+26%
Profit before tax	<b>26.7</b>	20.5	+30%
Profit for the year†	<b>23.0</b>	14.3	+61%
Free cash flow	<b>29.8</b>	23.5	+27%

	Pence	Pence	
Adjusted earnings per share**	<b>18.9</b>	14.8	+28%
Basic earnings per share	<b>14.6</b>	10.8	+35%
Total dividends per share	<b>9.0</b>	7.8	+15%
Free cash flow per share	<b>26.3</b>	20.8	+27%

\* Before acquisition related charges

† Before fair value remeasurements

‡ Profit for the year is stated after tax and includes the profit on sale of the discontinued businesses. All other reported results relate to the continuing businesses.

Note: Diploma PLC uses alternative performance measures as key financial indicators to assess the underlying performance of the Group.

These include adjusted operating profit, adjusted profit before tax, adjusted earnings per share and free cash flow.

The narrative on pages 2 to 40 is based on these alternative measures and an explanation is set out in note 2 to the consolidated financial statements.



# Chairman's Statement

## Strong earnings, value and dividend growth over the business cycle

John Rennocks, Chairman

Diploma has delivered good revenue and profit growth in the 2010 financial year, with a strengthening trend into the second half of the year. In the face of the global recession in 2009, the Group quickly scaled back operating costs and working capital and reduced balance sheet exposure. These actions left the Group well placed to maintain performance during the downturn and then to capitalise on the opportunities presented by the recovery, which began to emerge in the second quarter of the 2010 financial year in most of the Group's key markets. Given continuing uncertainty in the major economies, management has continued to maintain close control over costs and working capital, which has resulted in a further strengthening of operating margins and continued strong cash flow.

### Results

Group revenue increased in 2010 by 15% to £183.5m (2009: £160.0m). The combination of increased revenue and cost reductions implemented in 2009, contributed to an increase in adjusted operating profit of 25% to £32.1m (2009: £25.6m) and operating margins improved to 17.5% (2009: 16.0%)

Adjusted profit before tax increased by 26% to £32.2m (2009: £25.5m) and adjusted earnings per share increased by 28% to 18.9p (2009: 14.8p).

The Group generated free cash flow in the year of £29.8m (2009: £23.5m), including net proceeds of £6.4m received from the sale of the two Anachem businesses. After spending £11.0m on acquiring new businesses and certain minority shareholdings during the year, the Group ended the year with cash balances of £30.1m (2009: £21.3m). The strong balance sheet, together with renewed medium term bank facilities, will provide the resources to continue to exploit the acquisition opportunities which are now emerging.

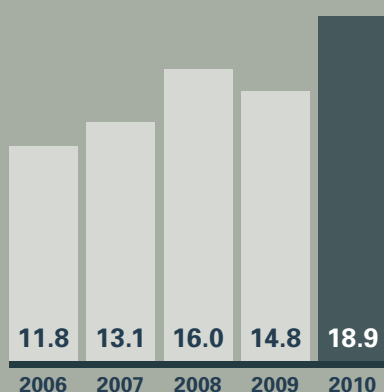
### Dividends

Diploma continues to generate attractive and growing dividends for its shareholders. The Board is recommending an increase in the final dividend of 17% to 6.2p per share (2009: 5.3p) which, subject to shareholder approval at the Annual General Meeting, will be paid on 19 January 2011, to shareholders on the register at 3 December 2010.

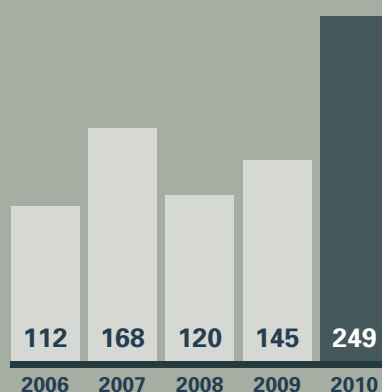
The total dividend per share for the year will be 9.0p which represents a 15% increase on 2009 and is consistent with the Board's policy to target dividends per share towards a cover ratio of 2.0 times based on adjusted earnings.

## Five Year Performance

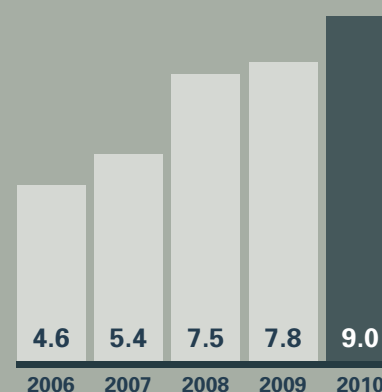
**EPS growth: +14% p.a.**  
(Based on adjusted EPS in pence)



**TSR growth: +20% p.a.**  
(compared with FTSE 250: +5% p.a.)



**Dividend growth: +18% p.a.**  
(dividends in pence)



### Five years of progress

The strength and resilience of the Group's business model is demonstrated by the consistent profitable growth of the Group over the past five years. Adjusted earnings per share has grown at 14% per annum through a combination of organic growth and carefully targeted acquisitions. This consistent growth in earnings, combined with a strong balance sheet and excellent cash flow has encouraged the Board to significantly increase the rate of dividends paid to shareholders from 4.0p in 2005 to 9.0p this year, an annual average increase of 18% per year. At the same time the Group's market capitalisation has increased from £161m in 2005 to over £300m. Taken together, the Group has therefore delivered an average total shareholder return of 20% per year, over the past five years.

### Governance

There were no changes to the Board during the year, but we continue to evaluate performance thoroughly on an annual basis, as well as reviewing appropriate succession plans.

### Employees

The requirement to reduce costs during the recession has largely had to be borne by our employees, through a combination of reduced headcount and constrained salary increases. The Board is very grateful for the way in which our employees have adapted to these difficult and challenging conditions and it again demonstrates that a key strength of Diploma is the proactive and responsive attitude of our employees. I wish to thank all of our employees for their exceptional efforts and dedication which are key to the success of the Group.

### Outlook

In recent years, the Group has demonstrated both the resilience of its business model and its ability to react swiftly to changes in market conditions.

Robust underlying organic growth together with strong cash generation and an active acquisition programme, provide the Board with confidence that the Group will achieve further progress in 2011.

### John Rennocks

Chairman  
22 November 2010

# Group at a Glance

Diploma PLC is an international group of businesses supplying specialised technical products and services

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## **Resilient Revenues**

We focus on essential products and services funded by customers' operating rather than capital budgets, giving stability to revenues

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## **Attractive Margins**

Our attractive margins are sustained through the quality of customer service, the depth of technical support and value adding activities

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## **Focused Management**

In the operating businesses, strong committed management teams execute well formulated development strategies

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## **Value Enhancing Acquisitions**

Carefully selected, value enhancing acquisitions accelerate the organic growth strategy and take us into new but related markets

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## **Strong Cash Flow**

An ungeared balance sheet and strong cash flow fund our growth strategy while providing healthy dividends

## Sectors

### Life Sciences

**30%**  
of revenues

**199 employees**

Suppliers of consumables, instrumentation and related services to the healthcare and environmental industries

### Seals

**33%**  
of revenues

**371 employees**

Suppliers of hydraulic seals, gaskets, cylinders, components and kits for heavy mobile and industrial machinery

### Controls

**37%**  
of revenues

**234 employees**

Suppliers of specialised wiring, connectors, fasteners and control devices for technically demanding applications

## Geography\*

### Europe

**48%**

UK & Eire 25%

Continental Europe 23%

### North America

**46%**

US 21%

Canada 25%

### Rest of World

**6%**

\* revenue by destination

# Chief Executive's Review

## Stable revenue growth, sustainable margins and an active acquisition programme

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### Strategy and performance

The Group comprises a number of high quality, specialised businesses supplying technical products and services to the Life Sciences, Seals and Controls industries. The businesses aim to achieve stable revenue growth and attractive margins by focusing on supplying essential products and services to customers who value high levels of customer service, technical support and value adding activities. The businesses target organic revenue growth over the economic cycle at a rate of "GDP plus" growth (5-6% p.a.), with higher growth rates achieved through carefully selected, value enhancing acquisitions.

This strategic model has been closely tested through the dramatic downturn in the global economy in 2009 and the subsequent recovery in the markets. During the recession, the businesses showed their resilience with revenues less impacted than competitors who were more dependent on capital equipment budgets or could offer less differentiated products and services. With the recovery taking hold in 2010, revenues have rebounded strongly, supporting our belief that the businesses have succeeded in further penetrating their markets by maintaining service levels through the downturn. Revenues increased by 15% in 2010 to £183.5m (2009: £160.0m) with underlying growth of 11% after adjusting for currency translation effects, acquisitions and certain one-off items.

Operating margins have also performed well under extreme market pressure, providing further evidence of the continuing value provided to customers and the success in achieving operational efficiency. During the recession, the businesses acted quickly and decisively to optimise performance and reduce costs to match the reduced revenue levels. As a result, operating margins were held at 16.0% of revenue. As revenues have rebounded, the businesses have been very controlled in adding back costs, given the uncertainty in the sustainability of the recovery. With the resulting benefits of operational leverage, operating margins have increased to 17.5% of revenue and adjusted operating profits have increased by 25% to £32.1m (2009: £25.6m); this increase is 19% after adjusting for currency translation effects, acquisitions and certain one-off items.

Performance against other key indicators has also been strong through the recession and into the subsequent recovery. In 2009, the businesses reduced working capital by £6.1m to match the reduced revenues and as revenues have recovered in 2010, the businesses have again been cautious about adding back inventory too quickly. Working capital as a percentage of revenue has decreased to 15.4% (2009: 17.6%), though it is likely to trend back to the target range of 16-17% if revenues continue to increase. Free cash flow, including proceeds from the disposal of the Anachem businesses, has been very strong at £29.8m (2009: £23.5m). Finally, return on trading capital employed ("ROTCE") has increased to 22.1% (2009: 19.0%) with the improved operating margins and working capital ratios.



"The businesses target "GDP plus" organic growth in revenues over the economic cycle, with growth accelerated through carefully selected, value-enhancing acquisitions."

**Bruce Thompson, Chief Executive Officer**



### Sector developments

The Group's strategic objective is to build more substantial, broader based businesses in each of its chosen sectors through a combination of organic growth and acquisition. Good progress was made in the year in executing this strategy in each of the three sectors. The key developments in the year are summarised below with a more detailed analysis of market drivers and business performance included in the Business Review.

#### Life Sciences

	2010 £m	2009 £m	
Revenue	<b>55.4</b>	49.9	+11%
Adjusted operating profit	<b>11.9</b>	10.6	+12%
Adjusted operating margin	<b>21.5%</b>	21.2%	

The DCHI group of **Healthcare** businesses in Canada now account for over 70% of the Life Sciences sector revenues. They operate in a market which is mostly public sector funded and where the demand from a growing, aging and well-educated population drives a steady growth in funding. Within this market, DCHI supplies specialised products which are used in the pathology laboratories, operating rooms and endoscopy suites of the hospitals across Canada. The worldwide recession had some impact on the market with limits imposed on the number and cost of specific medical procedures and diagnostic tests and extended tender processes for capital equipment. However, overall Healthcare expenditure in Canada has continued to grow steadily in real terms and recently there has been some evidence of an easing of capital approvals.

The business model is built on the supply, on an exclusive basis, of high quality, manufacturer branded products secured by long term distribution agreements. Strong customer relationships are forged through high levels of customer service, including experienced technical consultants advising on product applications and new product ideas and service engineers who ensure the instrumentation products are operating to the detailed specifications. A large proportion (over 60%) of DCHI's revenues are secured under multi-year customer contracts.

During the year, DCHI consolidated its position in the Canadian market, delivering solid growth in the core product lines through increased utilisation of the products in existing accounts and good success in penetrating new accounts. Good progress was also achieved in expanding newer product areas including allergy testing, assisted reproductive technology ("ART") and a new instrument to treat Barrett's oesophagus, an early stage of oesophageal cancer.

In July 2010, the acquisition was completed of 80% of BGS in Australia. The Healthcare market in Australia shares many of the same attractive characteristics as that of Canada, with steadily growing Healthcare funding and structural market challenges which make the specialised distribution model attractive to manufacturers. We believe there is a good opportunity to grow the business by investing in direct sales resource and leveraging from the experience of DCHI's electrosurgery business in Canada.

## Chief Executive's Review continued

The balance (25-30%) of the sector revenues are generated by the a1-group of **Environmental** businesses in Europe, which supply a range of products used in Environmental Testing and Health & Safety applications. The market demand is largely driven by regulation which ensures steady demand for the essential consumable products. However, in times of economic downturn, as experienced through the 2009 recession, customers have deferred capital expenditure on new equipment and instrumentation. Markets have shown some sign of recovery in 2010 and a1-group revenues have increased, boosted in particular by new sales of containment enclosures to protect technicians in pharmaceutical research laboratories as well as increased investment in emissions monitoring in power stations and gas detection. Actions taken during the year to consolidate operations will also establish a stronger base for profitable growth.

### Seals

	2010 £m	2009 £m	
Revenue	<b>60.1</b>	48.2	+25%
Adjusted operating profit	<b>8.9</b>	5.5	+62%
Adjusted operating margin	<b>14.8%</b>	11.4%	

Currently around 70% of Seals sector revenues are generated from the **Aftermarket** businesses of HFPG (Hercules, Bulldog and HKX) and FPE. Own brand sealing products are supplied to a broad range of mobile machinery applications in heavy construction, logging, mining, agriculture, material handling and refuse collection. The principal market drivers are therefore the growth in the general industrial economy and in particular heavy construction.

With the broad industrial economy in North America moving into recession in 2009, construction spending, housing starts and mobile hydraulic shipments all experienced substantial falls. The Aftermarket businesses were impacted, but to a lesser extent than businesses more dependent upon sales of capital equipment. A recovery in the general economy has resulted in Aftermarket revenues increasing by ca. 15%, but activity levels are still below 2008 peak levels and the construction market has remained somewhat muted despite the various stimulus packages.

In the core Hercules business, the key to success is the ability to provide a next day delivery service from inventory, for seals and seal kits used in a broad range of different manufacturers' machinery and different applications. Hercules has therefore continued to invest in warehouse automation at the main facility in Clearwater, Florida. This will improve further Hercules' service proposition and bring greater efficiency to warehouse operations. The benefits of operational leverage can be seen in the improved operating margin this year as revenues have recovered, but operating costs have not been added back at a similar level.

Outside North America, the main focus for development has been in Europe where good progress was made in both direct sales in the Benelux countries as well as the appointment of sub-distributors to distribute Hercules seal kits in other mainland European countries. Initiatives are also being developed to increase penetration in other developing markets in Asia Pacific and South America.

The major rebound in Seals sector revenues has come from the **Industrial OEM** businesses, RT Dygert and M Seals. On a like-for-like basis, these businesses have increased revenues by 30% in 2010 and are now experiencing demand levels approaching pre-recession levels. Order levels from core customers in North America began to recover at the end of calendar year 2009, as the OEM's regained confidence and moved back to full time working and carried out some re-stocking. Confidence was slower to return to M Seals' customers in Europe, with a return to growth only in the second half of the year. M Seals has continued to

be a key supplier of large bearing seals to the wind turbine manufacturers and has now established a small specialist team in China to service this rapidly expanding wind turbine market.

In September 2010, the Industrial OEM business was further expanded through the acquisition of All Seals, a long established supplier of O-rings and custom manufactured parts to Industrial OEM customers across a range of specialist applications. All Seals has a strong position in the important Californian market and the adjacent South Western States and is therefore complementary to RT Dygert. The company has enjoyed strong growth in 2010 and plans are being developed to expand its product range and to penetrate new accounts.

## Controls

	2010 £m	2009 £m	
Revenue	<b>68.0</b>	61.9	+10%
Adjusted operating profit	<b>11.3</b>	9.5	+19%
Adjusted operating margin	<b>16.6%</b>	15.3%	

The Controls sector businesses supply high performance wiring, connectors, fasteners and control devices used in a range technically demanding applications. The businesses offer high quality, manufacturer branded products sourced under the terms of long term exclusive distribution agreements. Strong customer relationships are based on ex-stock availability of product, responsiveness, technical advice on product applications and a range of value added services.

The largest end user sector is **Defence & Aerospace**. The businesses do not typically supply to major platform OEMs and Tier 1 suppliers, who are mostly served direct by the manufacturers. Rather, the businesses supply into repair, refurbishment and upgrade programmes, where ex-stock availability and responsiveness are critical. Operational funding has remained buoyant during the year, particularly in the ground vehicle and military marine segments, but sales into Military Aerospace have been softer, possibly reflecting the priority given to ground vehicles. Although the businesses are not too directly impacted in the short term by cutbacks and delays in major defence projects, it is clear that the defence spending reviews will have an impact longer term at the sub-contractor and component supply level. In Commercial Aerospace, the businesses supply products principally for the initial installation and subsequent upgrades of aircraft interiors. After falling back in 2009, demand has again picked up as passenger numbers have increased.

In **Motorsport**, activity has suffered in recent years from cost cutting measures and team withdrawals in the Formula 1 series. However, this series has returned to relative stability with a highly competitive grid and new team entrants. **Medical Equipment** is another specialised market where the businesses continue to have success and maintain a more stable demand profile than the background economies.

The businesses also supply to a range of specialised applications in the **General Industrial** sector in the major markets of the UK and Germany. Demand has recovered well and in particular, there has been strong growth in the Commercial Refrigeration market, with the major retailers investing in new and refurbished stores. In the broader **Energy** sector, there has been an increased demand for energy efficient components as customers implement energy reduction programmes and move to alternative coolant gases using natural refrigerants. In August 2010, the German Controls business acquired the customer list and trading stock of a distributor of Tyco Energy products. The sales and logistics activities have now been integrated and this small acquisition will boost our presence in this growing business area.

## Summary and outlook

The steady performance of the businesses through the dramatic economic downturn and subsequent period of uncertain recovery, have given added confidence in the resilience of the business model. Over the business cycle, we are looking for continued organic revenue growth at the "GDP plus" level, combined with sustained attractive operating margins.

The strategy remains to accelerate growth through carefully selected, value enhancing acquisitions. Over the last five years, we have invested ca. £70m in acquisitions which are delivering a pre-tax return of over 20%. Current cash balances of ca. £30m, combined with the renewed debt facility and strong continuing cash flow give the resources to continue to pursue this active acquisition strategy.

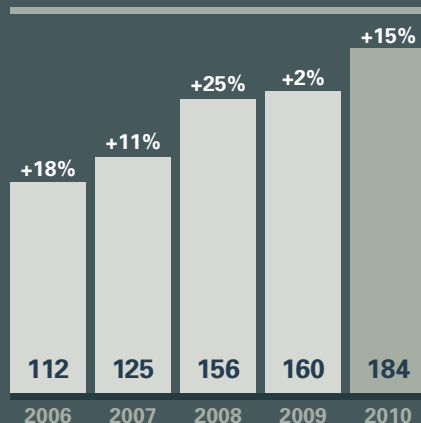
The environment for acquisitions has certainly improved and valuation gaps between Buyer and Seller are now closer. However, the general uncertainty in the economic environment means that transactions are taking longer to complete as Buyers and Sellers try to identify, quantify and limit any risk elements. Though more time consuming to bring to closure, three acquisitions were completed in the second half of the year and further opportunities are currently being pursued.

## Bruce Thompson

Chief Executive Officer  
22 November 2010

# Key Performance Indicators

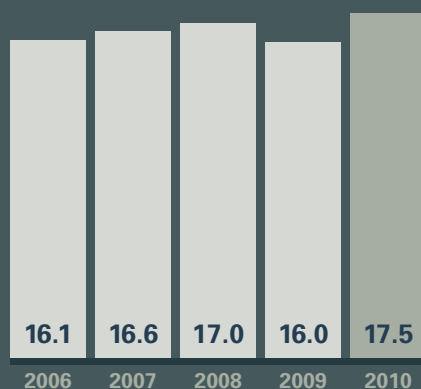
## Revenue Growth (£m)



**Revenue growth is a key measure of performance at both the sector and operating business levels. The businesses target organic revenue growth, over the economic cycle, at a rate of 5-6% p.a. ("GDP plus" growth), with higher growth rates achieved at the Group level through carefully selected acquisitions.**

Over the last five years, average revenue growth of 14% p.a. has been achieved in the continuing businesses, of which 6% p.a. has been organic growth with 8% p.a. contributed from acquisitions and currency gains. In 2010, the businesses recovered well from the 2009 recession and delivered 15% growth in revenues; 11% growth after adjusting for acquisitions and currency.

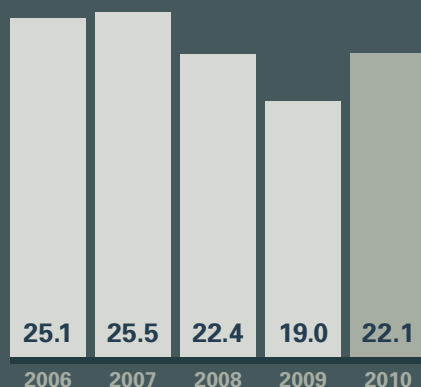
## Operating Margin (%)



**Operating margin represents operating profit, before acquisition related charges, divided by revenue. It is an important measure of the success of the businesses in achieving superior margins by offering strongly differentiated products and services, as well as by running efficient operations.**

Product margins are very stable in all sectors and businesses over the business cycle with short term variations driven mainly by product mix or currency effects. With tight management of operations, this translates into Group operating margins which have consistently been in the range of 16-17% of revenue, even during the 2009 recession. As revenues have recovered in 2010, operating margins have increased to 17.5%, mainly driven by operational leverage in the Seals sector businesses.

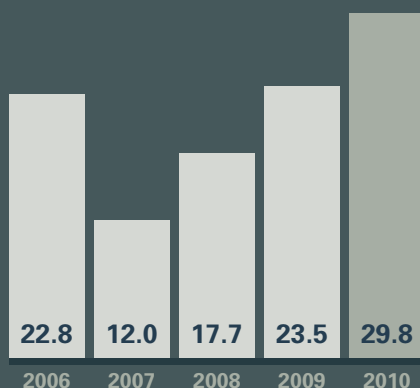
## ROTCE (%)



**Return on trading capital employed ("ROTCE") represents operating profit, before amortisation of acquisition related charges, as a percentage of trading capital employed ("TCE"), defined as net assets less net cash and non-operating assets and liabilities. TCE includes the total cash invested in acquisitions, including all goodwill and acquired gross intangible assets.**

The ROTCE target level of 20% on a pre-tax basis is consistent with the 13% post tax IRR threshold used for investments. Over the last five years, ROTCE has mostly been above the 20% target, although it slipped to 19.0% in the 2009 recession. In 2010, ROTCE has recovered to 22.1% with the improvement in operating margins and continued good management of working capital.

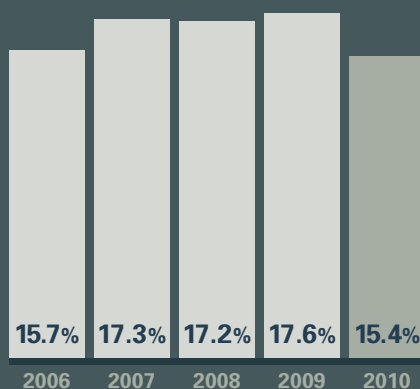
## Free Cash Flow (£m)



**Free cash flow is defined as the cash flow generated after tax, but before acquisitions and dividends. This measures the success of the operating businesses and the Group as a whole, in turning profit into cash through the careful management of working capital and capital investments in the business.**

Over the last five years, the Group has generated a robust free cash flow averaging £21.2m p.a., which excluding disposal proceeds represents 99% of average adjusted profit after tax. Free cash flow in 2009 was particularly strong due to tight management of working capital during the recession. In 2010, an additional £0.1m was released from working capital, contributing to strong free cash flow of £29.8m.

## Working Capital (% of revenue)



**This measure focuses on working capital as a percentage of revenue. This measure can vary significantly by business depending on the level of inventory required by the business model, as well as credit terms with suppliers and customers. However, experience shows that, for the Group overall, an average of 16-17% of revenue is a reasonable target.**

When revenues move quickly up or down, it takes time to move working capital to the appropriate level. Although creditor and debtor balances adjust reasonably quickly, inventories have to be managed through forward ordering levels and are slower to respond. Even so, during the 2009 recession, working capital was managed to an average of 17.6% of revenue and this has decreased in 2010 to 15.4% of revenue.

## Key Employee Statistics

	2008	2009	2010
Number of Employees	833	823	814
Males as % of total	65%	66%	66%
Length of Service (years)	5.2	6.4	6.4
Average staff turnover	20.2%	18.3%	15.0%
Sick days lost per person	3.4	3.6	2.8

**In the operating businesses, non-financial KPIs are used which are tailored to the particular requirements and characteristics of each business. At the Group level, the principal non-financial KPIs relate to the management of human resources.**

The average number of employees in the continuing businesses in 2010 has decreased by 1% to 814 (2009: 823). The proportion of males to females is unchanged with males accounting for 66% of the total (2009: 66%); average length of service remains unchanged at 6.4 years (2009: 6.4 years). Average staff turnover has decreased to 15.0% (2009: 18.3%) and sick days lost per person were 2.8 days (2009: 3.6 days).

## Directors and Advisors

Our experienced board focuses on strategy, financial control and risk management



**JL Rennocks FCA (65)\*†‡**

Non-Executive Chairman

Joined the Board in July 2002. He is Chairman of Nestor Healthcare plc and Intelligent Energy plc, Deputy Chairman of Inmarsat plc and a non-Executive Director of Babcock International Group PLC and of other companies. He has previously been Executive Director Finance at Corus Group Plc and Finance Director of PowerGen Plc and Smith & Nephew plc.



**BM Thompson (55)**

Chief Executive Officer

Joined the Board in 1994 and appointed Chief Executive Officer in 1996. He started his career in the automotive industry, first as a design engineer and then in marketing. Prior to joining Diploma, he was Director of Arthur D Little Inc's Technology Management Practice in the United States.



**NP Lingwood FCA (51)**

Group Finance Director  
and Company Secretary

Joined the Company in June 2001 and appointed Group Finance Director on 3 July 2001. Prior to joining Diploma, he was Group Financial Controller of Unigate PLC, having previously qualified with Price Waterhouse, London.



**Investment Bankers**

Lazard  
50 Stratton Street  
London W1J 8LL

**Auditors**

Deloitte LLP  
2 New Street Square  
London EC4A 3BZ

**Bankers**

Barclays Bank PLC  
1 Churchill Place  
London E14 5HP

**Corporate Stockbrokers**

Panmure Gordon & Co  
Moorgate Hall  
155 Moorgate  
London EC2N 6XB

**Solicitors**

Ashurst  
Broadwalk House  
5 Appold Street  
London EC2A 2HA

HSBC Bank plc  
City Corporate Banking Centre  
60 Queen Victoria Street  
London EC4 4TR

**JW Matthews FCA (66)\*†‡**

Non-Executive

Joined the Board in 2003. He is Senior Independent non-Executive Director of Minerva plc and SDL plc. He has previously been Chairman of Regus Group plc, Crest Nicholson plc and was a Managing Director of County NatWest and Deputy Chairman/Deputy Chief Executive of Beazer plc.

**IM Grice (57)\*†‡**

Non-Executive

Joined the Board in January 2007. He is a member of the Supervisory Board of Arcadis NV, a non-Executive Director of John Graham Holdings Limited, and Chairman of NM-UK Limited. He was until February 2008 Group CEO of Alfred McAlpine plc.

**I Henderson (54)**

Chief Operating Officer

Joined the Board as a Director in 1998. He was previously a Director of Glencrowton plc and ANC Holdings Limited.

Member of:

\* the Remuneration Committee

† the Audit Committee

‡ the Nomination Committee

# Strategy and Performance

## Group Strategy

The Group comprises a number of high quality, specialised businesses supplying technical products and services and operating in the three broad industry sectors of Life Sciences, Seals and Controls. The Group's strategic objective is to build more substantial, broader based businesses in the chosen sectors through a combination of organic growth and acquisition. The following are the core themes which underpin the strategies of the Group and its operating businesses:

### Focus on markets which can deliver stable revenue growth

The businesses aim to achieve stable revenue growth by focusing on markets where the demand is funded by operating budgets which are less impacted by economic cycles than capital budgets. A high proportion of the Group's revenues are generated from consumable products and service contracts and in many cases the products will be used in repair and maintenance applications and up-grade programmes, rather than supplied to original equipment manufacturers ("OEMs"). Where public sector funding or regulation is involved, year on year changes in funding may also be less dramatic.

In Life Sciences, the Canadian businesses supply into the publicly funded Healthcare sector which, over many years, has been growing steadily at the rate of 6-7% p.a. Annual variations are mostly dependant on the periodic additional tranches of funding provided by individual Provinces. Additional stability is provided in this sector by multi-year customer contracts for consumables and service which underpin at least 60% of sector revenues. The acquisition in July 2010 of BGS in Australia, extends the Healthcare activities into a new geographic market with similar characteristics to that of Canada. The European environmental businesses supply to utilities and other industrial customers where the demand is largely driven by Environmental and Health & Safety regulations.

In Seals, the core business is the next day delivery of seals and seal kits used in the repair and maintenance of heavy mobile machinery. This focus on the Aftermarket means that the businesses, though not immune from a market downturn, are relatively insulated from the extremes of the business and economic cycles. This has been demonstrated by the performance of the business during the 2009 recession. The Hercules Aftermarket business saw revenues reduce by ca. 20%, while many construction equipment OEMs experienced reductions of 40-60% in revenues. The risk profile of the business has also been improved by extending further into international markets and specialised industrial OEMs, through the acquisitions of M Seals, RT Dygert and All Seals and the investment in Hercules Europe. In 2010, 32% of sector revenues were generated in international markets outside North America while Industrial OEMs now account for ca. 30% of sector revenues.

In Controls, the businesses offer specialised products and services used in technically demanding applications. These specialised sectors have demonstrated a more resilient performance than the general industrial economies in which they operate, by focusing on more buoyant markets including Defence & Aerospace, Medical, Motorsport, Energy and General Industrial. Although total Defence expenditure is now likely to be constrained by budget cuts, the military operating budgets on which our businesses mostly depend, should prove more resilient than major capital programmes.

### Strong customer relationships underpinned by full service offering

A key priority for the businesses is to build strong customer relationships within selected product and market segments. Attractive margins are sustained over time by providing a range of services to customers which they value and are prepared to pay for. Such services fall broadly into three categories:

- Customer service – which can be, for example, the delivery of products held in inventory on a next day basis.
- Technical support – for example, helping customers design the product into their specific applications.
- Value adding activities – services such as kitting or assembly, which the customers would have to pay someone else to provide or would require investment in their own resources.

Ultimately, customers will always demand strong product performance, competitive pricing and responsive delivery. However, the broader service offering builds stronger links with the customers at many levels, making switching to competitive suppliers more difficult.

If real value is not provided to customers, product margins will erode over time. The evidence that value is being delivered to customers is provided by the stability over time of the Group's product margins in specific product and market segments. Shorter term movements in product margins principally arise due to changes in the mix of business or volatile currency markets. Over time however, the businesses work closely with suppliers and customers to ensure stable product margins which, with efficient operations, translate into consistent operating margins in the range 16-18%.

### Secure supply of quality differentiated products

Given the specialised nature of the businesses, it is critical that they have a secure supply of quality, differentiated products. There are a number of ways that this can be achieved and each business uses a blend to develop their product portfolios:

- Quality manufacturer-branded products supplied on an exclusive basis, typically secured with long term distribution agreements.
- Own brand products manufactured under contract to the businesses' detailed specifications.
- Selective in-house manufacturing and assembly.

The Life Sciences and Controls sector businesses mostly source high quality, manufacturer branded products under exclusive, longer term contracts. These contracts are typically 3-5 years in duration, but in some cases extend to ten years. In these two sectors, manufacturer branded products account for 87% of revenues. The balance is made up of own brand and manufactured products. For example, the a1-group has improved competitiveness by developing its own range of containment products for potent powder handling, which are now manufactured by reliable sub-contractors. Cabletec has also had success with its own range of manufactured products, including flexible braided products and multi-core cables.



In the Seals sector, the business model is a little different, with own brand and manufactured products accounting for over 90% of revenues. Aftermarket products are marketed under the businesses' own brand names including Hercules, Bulldog and HKX. Products are sourced globally from a range of manufacturers and security of supply is provided by supply contracts and by the cultivation of multiple alternative suppliers. In supplying Industrial OEM's, more emphasis is placed on the manufacturer brands by M Seals, RTD Seals and the recently acquired All Seals.

Securing quality differentiated products is seen as a continuous process rather than a one-off activity. Over time, products in the portfolio will become less competitive and it is important that the businesses have plans for selective new product development and for the introduction of new suppliers.

#### Motivated and committed management teams

The Diploma organisational philosophy is to develop strong, self-standing management teams in the operating businesses committed to, and rewarded according to, the short and long term success of their businesses. The small corporate team focuses on strategy and financial control.

The development of strong managers and management teams remains a priority for the Group and is key to the successful implementation of the business strategies. The Group needs to maintain and develop a group of managers with the potential to manage aggressive growth strategies. Importantly they must be able to motivate their staff and engender in them the same commitment.

To achieve this, the businesses concentrate on ensuring a challenging work environment and appropriate reward systems. Balanced compensation packages comprise a combination of competitive salaries, annual bonuses and long term incentive plans, targeted at the individual business level.

The cadre of ca. 60 senior managers in the operating businesses, demonstrate a good blend of energy, ambition and experience. The average age of these managers is 43 and they have an average length of service within their companies of 10 years.

#### Efficient and responsive operations and information systems

Continuing, substantial investments are made in infrastructure and systems to give high levels of customer service, responsiveness and operational efficiency. This is an important element of the value added by the Group when transforming owner-managed companies into more substantial broader based businesses. Ongoing investment programmes ensure that the principal businesses are operating from purpose built or newly expanded facilities designed for efficient operations and with the scale to support significant future growth.

Similarly in the area of information systems, regular investment ensures that the businesses are supported by integrated IT systems designed to give strong functionality and efficiency and capable of supporting growth. Over the past five years, an average of £0.6m p.a. has been invested in improving the Group's information systems and this investment is maintained over the business cycle. During the recent recession, the Hercules operation in Clearwater, Florida invested £1.2m in new warehouse management software and automated stock

picking carousels. This will position the operation well to manage increasing revenues as markets recover, without needing to take cost levels back to historic levels.

Once the businesses have achieved a certain critical mass and have invested in appropriate facilities and IT systems, they can generally increase revenues without a significant increase in working capital. A strong focus on operating costs (80-90% employee related) and tight management of working capital ensure resilient operating margins and strong cash flow.

#### Carefully selected acquisitions to accelerate growth

To complement the organic growth strategy, the Group makes selective acquisitions to accelerate growth and enter into new, but related markets. The Group's currently ungeared balance sheet, supported by strong and consistent operating cash flow and medium term bank facilities, provides the resources to support an active acquisition programme. Clear criteria have been established to guide the Group's pro-active acquisition programme and these criteria are derived from the strategic themes above. Prospective acquisitions should be sales and marketing led with strong customer relationships and a secure supply of quality, differentiated products. They should have capable management, and the potential for profitable growth and cash generation.

A competitive advantage in making acquisitions is the Group's flexibility in structuring transactions. In many of the medium sized acquisitions, such as AMT and Somagen, where the objective was to extend into new markets or geographies, less than 100% of the business has been acquired. In these cases, owner managers are left with a minority stake in the business (up to 25%), with put and call options exercisable over 3-5 year periods. This allows vendors to remain in the businesses with a large part of the value crystallised, but still with the potential for future gain. For the Group, this reduces risk and gives additional confidence in the quality of the acquisition.

Over the last five years, a total of ca. £70m has been invested in acquisitions across the sectors and geographies:

	Life Sciences	Seals	Controls
<b>Europe</b>	CBISS	M Seals (90%) Snijders	Cabletec Hitek Fischer
<b>North America</b>	AMT (75%) Meditech Somagen (20%)	RT Dygert HKX All Seals	
<b>Rest of World</b>	BGS (80%)		

In evaluating potential acquisitions, a discounted cash flow model is used with the normal threshold set at an internal rate of return ("IRR") of 13% on a post tax basis. This broadly translates to 20% on a pre-tax basis which corresponds to the Group target for ROTCE. The success of the acquisition programme in purely financial terms can be measured crudely by the current operating profit return on the total investment. In 2010, ca. £14m of adjusted operating profit was generated from the businesses acquired over the last five years. This represents a return of over 20% on the total of £70m invested, after adjusting for full year contributions from the acquisitions completed in 2010.

## Sector Review: Life Sciences

### Sector Definition and Scope

**The Life Sciences sector businesses supply a range of consumables, instrumentation and related services to the healthcare and environmental industries.**

The Healthcare businesses are managed through Diploma Canada Healthcare Inc ("**DCHI**"). The two principal operating businesses are Somagen, based in Edmonton, Alberta and AMT, based in Kitchener, Ontario. Somagen supplies a range of consumables and instruments used in the diagnostic testing of blood, tissue and other samples in the 500-600 hospital pathology laboratories across Canada. It is also a leading supplier of products and services to the growing assisted reproductive technology ("**ART**") market. AMT supplies specialty electrosurgery and endoscopy equipment and consumables for use in the operating rooms and endoscopy suites of the same Canadian hospitals. A large proportion of DCHI's revenues come from multi-year customer contracts with hospitals and buying groups.

In July 2010, Diploma completed the acquisition of 80% of Big Green Surgical ("**BGS**") located near Sydney, Australia. BGS is a smaller more narrowly focused version of AMT's existing electrosurgery business in Canada and shares a number of common suppliers.

The **a1-group** is a supplier to Environmental testing laboratories and to Health & Safety engineers. The a1-envirosciences business has locations in Dusseldorf in Germany and Basel in Switzerland and also has sales and service resources across Northern Europe. It supplies a range of specialised analysers for detecting and measuring specific elements in liquids, solids and gases and also supplies a range of containment enclosures for potent powder handling. The CBISS business, located in Tranmere in the UK, supplies equipment and services for the monitoring and control of environmental emissions, as well as a range of gas detection devices.

### Market Drivers

The DCHI businesses in Canada supply into the **Healthcare** sector which is mostly public sector funded. The principal demand driver is therefore the level of healthcare spending by the Canadian Government.

C\$bn	2006	2007	2008	2009	Growth % p.a
Public sector health expenditure in Canada	105.8	113.2	120.3	128.6	+6.7%
Total healthcare expenditure	151.3	161.6	171.9	183.1	+6.6%

Source: Canadian Institute for Health Information

The Canadian Healthcare industry is a proven, long term growth environment for medical device distribution. A growing, aging and well-educated population demands high standards of service delivery, helping to ensure on-going growing demand. The Canadian Health Act ("**the Act**") ensures universal coverage for all insured persons for all medically necessary services provided by hospitals, physicians and other healthcare providers. The Provinces are responsible for the delivery of the healthcare services, but the Federal Government controls delivery through Federal-Provincial transfer payments, which represent the largest source of revenues for the Provinces.

The relative stability and consistency in funding by each of the Provinces, guaranteed through the Act, ensures that the market remains well funded through the economic cycle. Over many years, healthcare expenditure has grown steadily in the range 6-7% p.a. with annual variations mostly dependant on the periodic additional tranches of funding provided by individual Provinces.

In 2009, the recession had some impact on the market with opportunities at times constrained by extended tender processes and limits set by individual Provinces on the number and cost of specific medical procedures in important jurisdictions such as British Columbia and Ontario. However, overall Healthcare expenditure continues to grow steadily in real terms and recently there has been some evidence of an easing in capital approvals.

The Healthcare market in Australia shares many of the same attractive characteristics as that of Canada. While privately funded healthcare is more prevalent, public sector healthcare funding is steady and growing and supported by a stable, resource based economy. As with Canada, there is a large geography to be covered, low population density and purchasing processes that vary by State. These characteristics necessarily demand a significant investment by manufacturers in technical sales and service resource which makes the specialised distribution model more attractive as an efficient way to serve the market.

The a1-group supplies to customers in the **Environmental** industry across Europe. The market demand is largely driven by Environmental and Health & Safety regulations. Growth in recent years has been driven by the need to be compliant with a range of EU regulations including:

- new legislation or regulatory obligations relating to the environment, pollutants or potentially hazardous contaminants;
- the growing importance to companies of protecting the workforce from contact with potentially hazardous materials; and
- greater use of new technologies in process control and integrated pollution control.

In the UK, the market demand for emissions monitoring, gas detection and gas leakage products has been positive; partly in response to legislative requirements but also driven by larger enterprises setting internal targets for reductions in pollutants and energy usage. In Germany, there were signs that capital budgets were beginning to be released in both the water quality monitoring and petrochemical analysis sectors.

### Sector Performance

The Life Sciences businesses increased revenues in 2010 by 11% to £55.4m (2009: £49.9m). Sector revenues benefited on translation from the stronger Canadian dollar relative to UK sterling and from the contribution from the newly acquired BGS business in Australia. On a comparable and constant currency basis, sector revenues increased by 1%. On a transaction basis, the stronger Canadian dollar, relative to both the US dollar and the euro, had a positive effect on gross margins in the Canadian businesses. Adjusted operating profits, which also benefited from the stronger Canadian dollar, increased by 12% to £11.9m (2009: £10.6m), with operating margins increasing to 21.5% (2009: 21.2%).

Capital expenditure in the sector was £0.7m, including £0.6m invested in field equipment for placement by the Canadian Healthcare businesses. The balance was invested in hire equipment to help service customers of the a1-group. Strong free cash flow of £10.1m was generated in the sector (2009: £7.6m) through higher profitability and lower tax payments.

Revenues from the **DCHI** businesses increased by 13% in UK sterling terms but were unchanged in Canadian dollars against a strong prior year comparative. In 2009, revenues were boosted by an exceptional sale of face shields to protect against swine flu and there was also a full year's contribution from the sale of test kits from a supplier which was discontinued after the first quarter of this year. After adjusting for these items, underlying revenues from the continuing product lines increased by 8% in Canadian dollars.

AMT, excluding the impact of the exceptional face shield sale in 2009, increased revenues by 13%. In its core electrosurgery business, AMT encouraged increased utilisation of its proprietary smoke evacuation products in existing accounts and also succeeded in penetrating key new installations. There were also strong sales of grounding pads and laparoscopic electrodes used in electrosurgery procedures and of other surgical instruments, such as disposable scissor tips and clips. AMT's endoscopy business saw good growth in its sales of consumable products, including argon probes and flexible endoscopic instruments. Growth was also achieved in the sales of capital equipment, including several installations for a new instrument to treat Barrett's oesophagus, an early stage of oesophageal cancer. A number of other new product lines have also been added later in the year to extend the product offering in the growing endoscopy market.

In July 2010, the acquisition was completed of 80% of BGS in Australia. BGS is a specialised distributor of electrosurgery consumables and equipment supplied to both public and private hospitals in Australia and New Zealand. It is a smaller version of AMT's electrosurgery business in Canada and we believe that there is a good opportunity to grow BGS revenues by investing in direct sales resources and broadening the product line and geographical coverage.

Somagen, excluding the impact of the discontinued product line, increased revenues by 2%. There was continued growth in sales from Somagen's core suppliers of consumable products, delivered to hospital pathology laboratories under longer term reagent rental contracts. Somagen also had good success in placing newly developed instruments into existing accounts, taking the opportunity to sign up longer term contract extensions. Good growth was also achieved with new products for allergy testing and other new products introduced to strengthen further Somagen's position in the market for assisted reproductive technology ("ART").

The **a1-group** increased revenues by 7%, with a1-envirosciences revenues growing by 5% and CBISS revenues growing by 15%. The growth in the a1-envirosciences business was driven principally by large new contracts in Switzerland for the supply of customised stainless steel containment enclosures for the personal protection of technicians in the research laboratories of major pharmaceutical companies.

## Life Science Statistics

	2010	2009
Revenue	<b>£55.4m</b>	£49.9m
Adjusted Operating Profit	<b>£11.9m</b>	£10.6m
Operating Margin	<b>21.5%</b>	21.2%
Free Cash Flow	<b>£10.1m</b>	£7.6m
Trading Capital Employed	<b>£49.7m</b>	£45.5m
ROTC	<b>24.0%</b>	23.3%

### Customers

Clinical	78%
Utilities	8%
Life Sciences Research	8%
Chemical & Petrochemical	4%
Industrial & Other	2%

### Geography

North America	74%
Europe	25%
Rest of World	1%

### Products

Consumables	66%
Instrumentation	25%
Service	9%

Germany and the Benelux countries also remain strong markets for a1-envirosciences in the supply of elemental analysers to the petrochemical and bulk chemistry industries. Although constraints in customers' capital budgets held back demand earlier in the year, both prospects and order levels improved in the second half. During the year, the decision was made to consolidate the UK operations of a1-envirosciences into Germany. The UK market will now be serviced by home based sales and service resources and all purchasing, administrative and logistical support will be provided by the main German operation. The costs of this reorganisation of £0.1m were charged against operating profit in 2010.

CBISS experienced strong growth across its product range. The core emissions monitoring ("CEMS") business returned to growth as new power stations came on line and operators replaced out-dated monitoring equipment in existing installations. The value of active prospects also increased sharply during the year as funding became more readily available for alternative power plants (waste, biofuels, syngas) and concerted efforts were made to remove bottlenecks in the planning process. CBISS also had success with gas detection products designed to reduce greenhouse gas emissions and improve energy usage in supermarkets and other specialised applications.

## Sector Review: Seals

### Sector Definition and Scope

**The Seals sector businesses supply a range of hydraulic seals, gaskets, cylinders, components and kits used in heavy mobile machinery and specialised industrial equipment.**

The **Hercules Fluid Power Group** ("HFPG") supplies to the Aftermarket through the Hercules, Bulldog and HKX businesses and to Industrial OEM's ("Original Equipment Manufacturers") and equipment dealers through the RT Dygert and All Seals businesses.

Hercules is the core Aftermarket business based in Clearwater, Florida and provides a next day delivery service throughout the US, for seals, seal kits and cylinders used in a range of heavy mobile machinery applications. Hercules in Canada offers the same range of products from its two branch operations located in the provinces of Ontario and Quebec. In Europe, Hercules has centred its operations in the Netherlands. Bulldog, based in Reno, supplies a range of gasket and seal kits for heavy duty diesel engines, transmissions and hydraulic cylinders used in off road and marine applications. HKX is based near Seattle and supplies hydraulic kits used in the installation of attachments on excavators.

The Industrial OEM businesses in North America comprise RT Dygert, acquired in January 2009, with operations in Minneapolis and Chicago and All Seals, acquired in September 2010, based in Santa Ana, California. Both companies supply seals, O-rings and custom moulded and machined parts to a range of Industrial OEM customers, cylinder manufacturers and sub-distributors. Applications range from spray painting guns to water filtration to medical devices.

**FPE** is based in the UK, with operations in Darlington and Doncaster, and supplies a range of seals, seal kits, cylinder parts and sealants to ram repairers, mobile and heavy plant operators, mechanical handling and process control companies. **M Seals** is a specialised distributor of O-rings, moulded parts, PTFE products and shaft seals, supplied to a range of specialised Industrial OEM customers. Products range from the finest precision seals for hearing aids to large heavy duty seals for wind power mills. M Seals has operations in Espergaerde in Denmark and Halmstad in Sweden.

### Market Drivers

The **Aftermarket** businesses supply sealing products to the mobile machinery Aftermarket to support a broad range of applications in heavy construction, logging, mining, agriculture, material handling (lift trucks, fork lifts and dump trucks) and refuse collection. Products are generally used in the repair and maintenance of equipment after it has completed its initial warranty period or lease term, or has been sold on in the pre-used market. The main customers are machinery and cylinder repair shops, engine and transmission re-builders and tractor parts distributors. The principal market drivers are the growth in the general industrial economy and in particular, heavy construction. The customers of the **Industrial OEM** businesses are manufacturers of a wide range of specialised industrial (and some retail) products. The principal market driver in the OEM sector is therefore general growth in the industrial economy.

	2006	2007	2008	2009	Growth % p.a.
US real GDP growth <sup>(1)</sup>	+2.7%	+1.9%	+0%	-2.6%	0.5%
Annual US construction spending \$billion <sup>(2)</sup>	1,168	1,151	1,072	908	-4.7%
US mobile hydraulic shipments \$million <sup>(3)</sup>	2,766	2,626	2,913	1,669	-11.5%

Sources:

(1) Bureau of Economic Analysis – US Department of Commerce

(2) US Census Bureau

(3) National Fluid Power Association

In the US, while the residential construction sector had been in decline since 2007, the broader industrial economy moved into recession in 2009 and construction spending, housing starts and mobile hydraulic shipments all registered substantial falls. The HFPG Aftermarket businesses were impacted, but to a lesser extent than the Industrial OEM businesses, where manufacturers moved quickly to shorter working weeks and generally destocked. In 2010, more favourable economic conditions began to restore confidence in the general industrial sector and the Industrial OEM business rebounded strongly. Construction spending however has remained muted, despite the stimulus packages.

Canada was not as severely impacted by the financial crisis, but by 2009 there was significantly lower economic activity in key industrial regions which are dependent on demand from the US market. The Canadian economy grew strongly in the first two quarters of 2010 as worldwide demand for natural resources returned and the manufacturing sector in Eastern Canada regained momentum after a period of severe destocking.

In Europe, the general downturn impacted in the UK from late 2008, followed by Continental Europe in early 2009. Activity levels in general picked up in the final quarter of 2009 and have been sustained throughout 2010, though still below peak 2008 levels.

### Sector Performance

The Seals businesses saw revenues increase in UK sterling terms by 25% to £60.1m (2009: £48.2m). The results benefited from a full twelve months trading from RT Dygert compared to nine months in 2009, and a first month's contribution from All Seals. After adjusting for these acquisitions and the impact of currency translation, underlying sector revenues increased by 20%. Adjusted operating profits increased by 62% to £8.9m (2009: £5.5m) and operating margins, through a combination of a strong increase in revenue and the impact of the prior year cost reduction programmes, increased to 14.8% (2009: 11.4%). Capital expenditure in the sector was £0.5m with the major elements being the continued investment by HFPG in the new warehouse automation system at Clearwater and a new custom seal making machine in FPE. Free cash flow of £7.9m was generated in the year compared with £8.6m in 2009 which benefited from a sharp reduction in working capital.

**HFPG** saw underlying revenues, adjusted for the acquisitions of RT Dygert and All Seals, increase by 21% in US dollar terms. The core Hercules business in North America, with its focus on the Aftermarket, achieved ca. 12% growth for the year, with the recovery strengthening during the second half, which has



traditionally been the seasonal peak period for construction activity, though not in 2009. Hercules continued to invest in the warehouse automation and picking carousel project, which will provide a further underpinning to the Hercules service proposition and add greater efficiency to the warehouse operations in Clearwater. Phase 1 was completed in 2010 and Phase 2 has now begun and is expected to be completed in 2011. The Seals-on-Demand business of custom machining of non-standard and out-of-production seals, delivered another year of substantial growth and investment in additional capacity is planned for 2011. Investment in e-commerce is also delivering results with ca. 7% of Hercules Clearwater revenues now processed through the new WebStore service.

Hercules Canada had an excellent year and delivered particularly strong growth in the second half of the year, with revenues improving across all regions and customer groups. Outside North America, the strategic development of the Aftermarket seal kit business in Europe continued to be a key focus for Hercules, with good progress being made in both direct sales in the Netherlands and Belgium and in the appointment of sub-distributors in other mainland European countries. Sales from the US to other international markets also grew with the key South American region recovering strongly.

Bulldog sells its products through a worldwide network of dealers that buy in relatively large quantities to take advantage of volume discounting and lower, consolidated, freight charges. Following destocking by the dealer network during the recession, confidence began to return in the final quarter of 2009 with demand being sustained throughout 2010, translating into 20% revenue growth for the year. Domestic US sales were strong across the board and the international business, which represents over 75% of Bulldog's sales, saw the return of large stocking orders from a range of countries.

In the Industrial OEM businesses, there was a strong rebound in demand from RT Dygert's core customers. Order levels began to recover at the end of 2009 as the OEM's regained confidence and moved back towards full working weeks and carried out some re-stocking. By March 2010, RT Dygert was experiencing demand comparable to pre-recession levels, with second half revenues up by ca. 50%, compared to the prior year. RT Dygert added new sales and product development resources during the year and qualified many new products and compounds for customer applications. In September 2010, HFPG acquired All Seals, a well established supplier of O-rings and custom manufactured parts to Industrial OEM customers across a range of specialist applications in aerospace, medical, filtration and general manufacturing industries. All Seals has a strong position in the important Californian market and the adjacent South Western States. The company has enjoyed strong growth in 2010 and plans are being developed to expand its product range and to penetrate new accounts.

HKX's traditional customers are the North American franchised dealers of the key excavator manufacturers. In 2009, sales of new excavators fell sharply (down by over 70% from the 2005 peak) and although the construction market stabilised in 2010, new excavator sales in North America remained subdued. In response, HKX has extended its business model to target the attachment retro-fit sector, as machine operators seek to make more flexible use of existing excavators. HKX also expanded internationally, finding new business in the South American and

## Seals Statistics

	2010	2009
Revenue	<b>£60.1m</b>	£48.2m
Adjusted Operating Profit	<b>£8.9m</b>	£5.5m
Operating Margin	<b>14.8%</b>	11.4%
Free Cash Flow	<b>£7.9m</b>	£8.6m
Trading Capital Employed	<b>£43.5m</b>	£38.2m
ROTC	<b>20.6%</b>	14.6%

### Customers

Heavy Construction	47%
Industrial OEMs	28%
Logging & Agriculture	4%
Dump & Refuse Trucks	3%
General Industrial	18%

### Geography

North America	68%
Europe	16%
Rest of World	16%

### Products

Seals & Seal Kits	66%
O-rings	13%
Attachment Kits	9%
Gaskets	6%
Cylinders & Other	6%

Middle Eastern markets and this contributed to overall revenue growth of 24% for HKX.

The **FPE** business in the UK recovered quickly from the worst effects of the downturn and delivered 18% revenue growth. In the domestic UK market, FPE expanded its range of cylinder components sold into its traditional seal customer base and also invested £0.2m in a third seal making machine to meet increasing demand from customers for low volume, non-standard seals. Exports to sub-distributors increased significantly as dealers began to restock their depleted inventories. For **M Seals**, confidence was slower to return among its core Industrial OEM customers, with a return to steady growth only in the second half. This resulted in an increase in revenues of 12% for the full year. M Seals continues to be a key supplier of large bearing seals to the established wind turbine manufacturers and achieved steady business throughout the year. In China, which is forecast to become the largest wind turbine market in the world, M Seals has established a small specialist team to service the rapidly expanding Chinese wind turbine industry.

# Sector Review: Controls

## Sector Definition and Scope

**The Controls sector businesses supply specialised wiring, connectors, fasteners and control devices used in a range of technically demanding applications.**

The **IS-Group** supplies high performance wiring, interconnect and fastener products for use in a range of technically demanding applications in industries including Defence & Aerospace, Motorsport, Energy and General Industrial. The IS-Group also supplies a range of its own manufactured products, including flexible braided products and multi-core cables.

The IS-Rayfast, Cabletec and Clarendon businesses are located in the UK in Swindon, Weston-Super-Mare and Leicester. The businesses serve the UK market, as well as supplying to other sub-distributors across Continental Europe. IS-Connect is located in Indianapolis to serve the Motorsport market in the US, as well as other specialised technical applications. A representative office has also been established in Beijing, China with an initial focus on Aftermarket requirements in the Commercial Aerospace and Industrial sectors.

**Hawco** supplies a range of control devices used in the sensing, measurement and control of temperature and pressure. Applications range from chilled cabinets for supermarkets, bars and restaurants to fire detection systems. Hawco has its operations in Guildford and Bolton, in the UK.

In Germany, **Sommer** and **Filcon** supply a range of high performance wiring, connectors and other interconnect products to customers in industries including Defence & Aerospace, Medical Equipment, Energy and General Industrial. A range of value adding activities enhances the customer offering, including connector assembly, marking of protective sleeves, cut-to-length tubing, kitting and prototype quantities of customised multi-core cables. Sommer and Filcon have operations in Stuttgart and Munich in Germany.

## Market Drivers

The Controls sector businesses focus on specialised, technical applications in a range of industries including Defence & Aerospace, Motorsport, Medical Equipment, Energy, Commercial Refrigeration and General Industrial. The most important sector is **Defence & Aerospace**.

	2006	2007	2008	2009	Growth % p.a.
Defence equipment budgets:					
UK £billion <sup>(1)</sup>	6.8	7.2	7.9	8.7	+7.6%
German € billion <sup>(2)</sup>	8.2	8.6	9.5	10.3	+6.2%
Commercial Aerospace market growth <sup>(3)</sup>	+5.2%	+7.2%	+1.6%	-2.0%	+3.0%

Sources:

(1) MOD UK Defence Statistics

(2) Federal Ministry of Finance – Germany

(3) Boeing and Airbus market outlook – revenue passenger kilometres

The Defence equipment budgets in the UK and Germany have grown strongly in recent years averaging 7.6% p.a. and 6.2% p.a. growth respectively.

The IS-Group and Sommer businesses focus primarily on repair, refurbishment and upgrade programmes, as well as supplying to Tier 2 electronics suppliers. As a result, they have benefited from Urgent Operational Requirements during

a period when the armed forces have been involved in two major conflicts. The businesses typically only supply to OEMs and the Tier 1 suppliers when ex-stock availability and responsiveness are important; they have therefore been less exposed to cutbacks and postponements in major defence programmes. Filcon has a greater involvement in the major capital projects through its supply of connectors. However, Filcon has its products designed-in to a broad range of air, sea and land applications and is not over-exposed to individual projects. Nevertheless, in both the UK and Germany, Defence spending reviews are underway and it is not yet clear how the likely cutbacks will impact at the sub-contractor and component supply level.

In the Commercial Aerospace sector, the businesses supply products principally for the initial fit-out of aircraft interiors and then their subsequent upgrade and refurbishment. The Commercial Aerospace market has shown strong growth in the five year period to 2008, before registering a 2% decline in 2009 as a result of the global economic downturn. Passenger numbers began to recover in 2010 with an average 6% annual growth rate projected for 2011 through 2014.

In **Motorsport**, activity has suffered in recent years from the range of cost cutting measures, including the testing restrictions implemented in Formula One and the withdrawal of the Toyota and BMW teams. The Formula One series, however, returned to relative stability in the 2009/10 season with a highly competitive grid and the introduction of three new teams. Certain markets, including **Medical Equipment** (particularly in Germany) and **Energy**, have remained resilient through the downturn and the products supplied to these markets have generally maintained a stable demand profile over the period.

The businesses also supply to a range of specialised technical applications in the **General Industrial** sector. There has been strong growth in the Commercial Refrigeration market in the UK, with the major retailers investing in new and refurbished stores. For other Industrial segments, the underlying market drivers are the growth of the industrial economies:

	2006	2007	2008	2009	Growth % p.a.
UK real GDP growth <sup>(1)</sup>	+2.9%	+2.6%	+0.5 %	-4.9%	+0.3%
UK Production index <sup>(2)</sup>	100.0	100.5	97.6	87.1	-2.9%
Germany real GDP growth <sup>(1)</sup>	+3.4%	+2.6%	+1.0%	-4.9%	+0.5%

Sources:

(1) Organisation for Economic Co-operation and Development (OECD)

(2) The Office of National Statistics – Index of Production for Manufacturing

The worldwide recession impacted the UK in late 2008 and Germany in early 2009. The economy in the UK returned to modest growth in the final quarter of 2009 and activity in Germany picked up in the first quarter of 2010 with a sharp recovery in demand from German industrial customers.

## Sector Performance

The Controls businesses saw revenues increase in 2010 by 10% to £68.0m (2009: £61.9m) on both a UK sterling and a constant currency basis. Adjusted operating profits increased by 19% to £11.3m (2009: £9.5m). As with other sectors, improved sales combined with the impact of the cost reduction measures implemented in 2009, moved operating margins up to 16.6% (2009: 15.3%).

A combination of higher profitability, tight control over working capital and modest capital investment of £0.1m, combined to generate strong free cash flow of £9.9m (2009: £8.9m).

The **UK Controls** businesses grew revenues by 13%, with good growth in IS-Group revenues and a very strong performance from Hawco.

The IS-Group's core Defence market benefited from on-going upgrade, refurbishment and maintenance programmes focused largely on ground equipment. Revenues were strong with components supplied into the Light Weight Mine Roller project and other military vehicle programmes. The marine sector benefited from work on gun systems and below-deck cabinet work on Type 45 destroyers and on radiation monitoring, periscope and sonar systems for Astute submarines. Sales into Military Aerospace have been softer, possibly reflecting the priority given to ground vehicles. In Civil Aerospace, demand picked up during the year as new aircraft deliveries began to gather momentum. In Motorsport, the relative stability in the Formula One series enabled the IS-Group to maintain its leading position as a supplier of wiring and components to specialist electrical harness builders. Significant gains were also made in the supply of aerospace quality fasteners to the Formula One teams and engine manufacturers in the UK and Continental Europe. There was a substantial increase in demand for IS-Group's products supplied to General Industrial customers. In addition, the Energy market benefited from the returning confidence, with strong demand for components supplied to manufacturers of Uninterrupted Power Supply (UPS) batteries and Fuel Cells. Undersea cables for oil and gas exploration also provided good opportunities for the IS-Group's wire products.

Hawco delivered strong revenue growth as its core Commercial Refrigeration customers responded to significantly increased demand from the large food retailing groups opening new stores or refurbishing existing outlets. Hawco has positioned itself as a specialist supplier of energy efficient components as many of the large food retailers implement energy reduction programmes and move to alternative coolant gases using natural refrigerants.

The **German Controls** businesses grew revenues by 4% in both UK sterling and constant currency terms. The market downturn came later to Germany than the UK and the US, but there was a strong rebound in demand in certain sectors in 2010. Sommer benefited from a sharp recovery in Germany's traditionally strong General Industrial sector where it achieved strong revenue increases. Sales to the specialist satellite market were also strong with both Astrium and NASA adopting the Sommer backshells for scientific satellites. However, Defence & Aerospace sales declined as projects came to an end and were not replaced by new programmes and in Motorsport, the withdrawal of the Toyota and BMW Formula One teams in late 2009 had a significant impact on Motorsport revenues in Germany.

The Medical market had another strong year supplying protective sleeves for stents, laparoscopic and cardiovascular instruments and catheters. In order to develop the market further, Sommer invested in a new cut and slit machine which will allow the business to add significant value to products sold in this market. In August 2010, Sommer purchased the customer list and trading stock of Fischer, a distributor of Tyco

## Controls Statistics

	2010	2009
Revenue	<b>£68.0</b>	£61.9
Adjusted Operating Profit	<b>£11.3m</b>	£9.5m
Operating Margin	<b>16.6%</b>	15.3%
Free Cash Flow	<b>£9.9m</b>	£8.9m
Trading Capital Employed	<b>£29.3m</b>	£30.0m
ROTCE	<b>38.6%</b>	31.7%

### Customers

Defence & Aerospace	34%
Commercial Refrigeration	19%
Motorsport	11%
Medical & Scientific	5%
Energy & Utilities	5%
General Industrial	26%

### Geography

United Kingdom & Eire	55%
Continental Europe	39%
Rest of World	6%

### Products

Wire & Cable	38%
Connectors	24%
Control Devices	12%
Fasteners	8%
Equipment & Components	18%

Energy products with sales in 2009 of ca. €0.4m. The sales and logistics activities have now been integrated and this small acquisition will boost Sommer's presence in this growing niche business.

The principal markets for Filcon's connector products are the Defence, Aerospace and Motorsport sectors. In common with many countries, Germany is reviewing its spending on Defence and there was a general slowdown in approvals for new projects during the year and delays in their commencement dates. Nevertheless Filcon delivered increased sales as existing programmes such as the Eurofighter and four separate helicopter projects, the NH90, Eurocopter 135, CH53 and Tiger, continued to generate demand. Sales to the ManPack radio project were also very strong. Order levels were marginally down reflecting delays to programmes, but Filcon has its products designed-in to a wide range of applications and is therefore not over-dependant on single projects.

# Finance Review

## Strong Increase in Operating Profits

Diploma achieved strong revenue and profit growth and excellent cash generation during 2010, as market conditions gradually improved during the year. Revenue increased by 15% to £183.5m (2009: £160.0m) and adjusted operating profit, which is before acquisition related charges, increased by 25% to £32.1m (2009: £25.6m). The adjusted operating margin increased to 17.5% from 16.0% in the 2009 financial year. The Group's principal markets began to show signs of recovery in the second quarter of the financial year and continued to strengthen throughout the year. Adjusted operating profits in the second half of the year of £17.5m were 28% ahead of the comparable period last year and represented 55% of the full year's operating profit.

These results demonstrate both the benefit of action taken in 2009 to reduce operating costs in the face of weak trading markets and the impact of operational leverage, particularly in the Seals businesses, as revenues increased.

## Underlying Operating Profits

Acquisitions completed during both 2009 and 2010 incrementally contributed £3.4m and £0.5m to revenues and operating profit, respectively. In addition, with over 70% of the Group's results denominated in US dollars, Canadian dollars or Euros, the Group's revenues and adjusted operating profits benefited on translation to UK sterling by £3.5m (2%) and £1.1m (3%), respectively. The gross margin of the Canadian Healthcare businesses also benefited from the strength of the Canadian dollar against the US dollar, in which the majority of its inventory is purchased. However this benefit in 2010 was matched by the benefit these businesses received in 2009 from the exceptional sale in AMT of face shields to protect against swine flu. After adjusting for these items, underlying revenues and adjusted operating profits increased by 11% and 19%, respectively.

## Adjusted Profit, Earnings per Share and Dividends

Adjusted profit before tax increased 26% to £32.2m (2009: £25.5m), after net interest income of £0.1m (2009: expense of £0.1m). IFRS profit before tax, which is after acquisition related charges of £3.5m (2009: £3.1m) and fair value remeasurements of £2.0m (2009: £1.9m), was £26.7m (2009: £20.5m).

The Group's adjusted effective tax charge represented 29.2% (2009: 29.8%) of adjusted profit before tax. This year's effective rate benefited from a reduction in the Canadian corporate tax rate following a change to the Provincial tax residence of Somagen. The Group's adjusted effective tax rate in any particular year also continues to depend on the geographic mix of profits made by the Group.

Adjusted earnings per share increased 28% to 18.9p compared with 14.8p last year, reflecting increased profits, a slightly lower effective tax rate and the buyout of certain minority interests this year. IFRS basic earnings per share were 14.6p (2009: 10.8p).

Diploma follows a progressive dividend policy and also targets a dividend cover of two times based on adjusted earnings per share; the recommended final dividend of 6.2p per share gives a total dividend per share for the year of 9.0p per share with represents a 15.4% increase on the prior year.

## Successful Disposal of Anachem Businesses

The Group completed the disposal of the MLH business of Anachem on 7 January 2010 and Anachem Instruments on 29 April 2010. Cash proceeds of £7.9m were received on completion of these disposals of which £0.8m will be held in escrow until July 2011. The results of these businesses are classified as discontinued and the contribution to profit after tax from these businesses was £5.1m, including a profit on disposal of the businesses of £5.5m.

## Excellent Free Cash Flow Generation

The Group generated excellent free cash flow in 2010 of £29.8m (2009: £23.5m), which is before expenditure on acquisitions or returns to shareholders, but includes £6.4m received from the sale of the Anachem businesses.

Operating cash flow remained broadly unchanged from last year at £34.3m (2009: £34.2m) as the businesses worked hard to constrain any increases in working capital, despite the underlying growth in trading. This led to a further improvement in the Group's key metric of working capital to sales to 15.4% from 17.6% reported in 2009. Group tax payments of £9.3m were also similar to last year's payments of £9.0m, although last year's payments were inflated by the impact of AMT moving to a monthly tax payment basis in 2009, as well as having to pay its 2008 annual tax liabilities. Capital expenditure was particularly modest in 2010 at £1.3m (2009: £1.8m), following completion during the year of a number of projects commenced in 2009. In Seals, HFPG spent £0.3m on completion of Phase 1 of the warehouse automation project at the Clearwater facility and FPE acquired a second custom seal machine for £0.2m; in Controls a new cut and slit machine was acquired for £0.1m to further enhance its product supplied to medical device companies. The Healthcare businesses continued to acquire field equipment in support of their customer contracts and spent £0.6m during the year.

The Group spent £11.0m (2009: £12.2m) of its cash resources on the acquisition of businesses during the year, including £2.5m on acquiring minority interests and £0.4m (2009: £1.1m) on deferred consideration.

## Minority Shareholdings Acquired

On 12 January 2010 the Group acquired the remaining 8.2% of the outstanding shares in Somagen from the minority shareholders for consideration of £2.5m. These shares were acquired through the exercise of put/call options, agreed at the time of acquisition in July 2004. Dividends of £1.1m were also paid to the minority shareholders of Somagen, AMT and M Seals during the year.

At 30 September 2010, the Group retains a liability to purchase the remaining minority shareholdings in AMT, M Seals and BGS. The liability for the outstanding 25% minority shareholding in AMT is estimated at £12.0m (2009: £10.1m) and it is now likely that the larger part of this will be paid in the first half of 2011. The remaining liability of £1.2m relates to M Seals and BGS and will be payable in the first half of 2013. These liabilities arise under put/call options entered into at the time of acquisition and are based on the Directors' estimate of the Earnings Before Interest and Tax of these businesses when the options crystallise.



Based on the expected performance of these businesses, the Directors have reassessed the potential liability at 30 September 2010 to acquire the remaining outstanding minority interests. The fair value remeasurement of these options results in a financial charge of £2.0m (2009: £1.9m) being made in the Consolidated Income Statement.

### Improved Environment for Acquisitions

The environment for acquisitions improved during 2010, following a year when uncertainties caused by the recession had severely limited opportunities to acquire businesses. In the final quarter of the year, the Group completed three small acquisitions for an initial cash cost of £8.1m; further deferred consideration payable of £1.0m has also been provided at 30 September 2010 in respect of these acquisitions. Each of these acquisitions extends the geographic coverage of the Group's existing businesses, while continuing to focus on the core products and competencies developed in each business sector.

Acquisition intangible assets of £4.5m were recognised in connection with these acquisitions, as well as goodwill of £3.8m, reflecting the amount paid for the acquisitions during the year, in excess of the value of the net assets. This goodwill largely comprises the value in each of these businesses relating to the product know-how held by the employees, prospects for sales growth in the future (from both new customers and new products) and operating cost synergies.

### Robust Balance Sheet and Strong Return on Trading Capital

The Group is highly cash generative and cash balances increased again in 2010 by £8.8m to £30.1m (2009: £21.3m). These funds are generally repatriated to the UK, unless they are required locally to meet certain commitments, including acquisitions. The Group also has substantial bank facilities available, having negotiated a new three year £20m revolving credit facility (with an option to extend to £40m) on competitive terms and shared between two banks.

The Group's trading capital employed ("TCE"), which is defined in note 2 to the consolidated financial statements, represents the amount of operational assets held by the businesses on which they are required to generate operating profits. At 30 September 2010 Group TCE increased by £6.2m to £122.3m (2009: £116.1m), most of which increase was accounted by goodwill which arose on acquisitions completed during the year. The Group's return on TCE, which is a pre-tax measure and includes all gross historic goodwill and intangible assets, represents an indication of the profitability of the Group and increased to 22.1% in 2010, from 19.0% last year. This increase arose from a combination of the growth in profits and from good management of working capital across the businesses.

### Merger of Pension Schemes Completed

The Group retains a small number of defined benefit pension schemes in the UK which are closed to future accruals. In a drive to reduce the costs of administering these legacy schemes, the Group completed a merger of all these schemes as at 30 September 2010. An actuarial funding valuation of the merged scheme will now be undertaken and the benefits of having a single defined benefit pension scheme will start to be realised.

During the year the Group increased its cash contribution to fund the deficit in these schemes to £0.4m pa (2009: £0.2m pa). In addition the Group made exceptional one-off contributions of £0.7m in connection with the Trustees' consents to both the scheme merger and to the transfer of the residual liabilities of the Anachem scheme to Diploma Holdings PLC, on sale of the Anachem businesses. Despite these higher cash contributions, the accounting deficit in the principal defined benefit schemes increased by £0.6m to £5.3m (2009: £4.7m) at 30 September 2010, largely because of the continuing reduction in bond yields.

Pension benefits to existing employees are provided through defined contribution schemes at an aggregate cost in 2010 of £0.7m (2009: £0.7m).

### Land at Stamford

The Group continues to retain approximately 150 acres of farm and former quarry land in Stamford which relates to a former legacy business. This land is included in the Consolidated Statement of Financial Position at £Nil and in the opinion of the Directors, is unlikely to be worth more than £0.5m in its present condition. The Directors anticipate that this land will continue to be leased to a local farmer and there is no intention to dispose of this land in the foreseeable future.

### Measuring Financial Performance

The implementation of a revised IFRS on Business Combinations this year has included the requirement for the Group to expense the costs of acquiring businesses against operating profit, rather than capitalise such costs as part of the investment. In order to allow the Board and Shareholders to continue to assess the underlying performance of the Group, this new IFRS has prompted the introduction of Adjusted Operating Profit, which adds back to operating profit the expenses of acquiring businesses, as well as the amortisation of acquisition intangible assets (collectively, "acquisition related charges"). This new measure is one of a number of specific measures used when assessing the performance of the Group and these are referred to throughout this Annual Report in the discussion of the performance of the businesses. These measures are not defined in IFRS, but are used by the Board to assess the underlying operational performance of the Group and its businesses. As such the Board believes these performance measures are important and should be considered alongside the IFRS measures. The alternative performance measures, which have been used in this Annual Report, are described in note 2 to the consolidated financial statements.

Reported performance takes into account all the factors (including those which the Group cannot influence, principally currency exchange rates) that have affected the results of the Group's business and which are reflected in the consolidated financial statements prepared in accordance with International Financial Reporting Standards ("IFRS"), as adopted by the European Union.

The Group has not been required to adopt any other new accounting standards during the year which have had a material impact on the consolidated financial statements.

# Risks and Uncertainties

## Risk Management Process

Risk assessment and evaluation is an integral part of the Group's annual planning cycle and market specific risks are evaluated as part of the budgetary process.

Each operating business is required each year to identify and document the significant strategic, operational and financial risks facing the business. For each significant risk, a number of scenarios are mapped out and an assessment is made of the likelihood and impact of each risk scenario. Finally, plans and processes are established, which are designed to control each risk and minimise its potential impact.

The risk assessments from each of the operating businesses are reviewed with the Executive Directors and a consolidated risk assessment is reviewed by the Board.

The risks and uncertainties which are currently judged to have the largest potential impact on the Group's long term performance are set out below. It should be recognised that additional risks not currently known to management, or risks that management currently regard as immaterial, could also have a material adverse effect on the Group's financial condition or the results of operations.

## Strategic Risks

### Downturn in major markets

Adverse changes in the major markets in which the businesses operate can have a significant impact on performance. The effects will either be seen in terms of slowing revenue growth, due to reduced or delayed demand for products and services, or pressure on margins due to increased competitive pressures.

To mitigate the effects of such adverse changes, the businesses identify key market drivers and monitor the trends and forecasts, as well as maintaining close relationships with key customers who may give an early warning of slowing demand. Changes to cost levels and inventories can then be made in a measured way to mitigate the effects.

In addition, there are a number of characteristics of the Group's businesses which moderate the impact of economic and business cycles on the Group as a whole:

- The Group's businesses operate in three different sectors with different cyclical characteristics and across a number of geographic markets.
- The businesses offer specialised products and services and this offers a degree of protection against customers quickly switching business to achieve better pricing.
- A high proportion of the Group's sales comprise consumable products and service contracts which are purchased as part of customers' operating expenditure, rather than through capital budgets.
- In many cases the products will be used in repair, maintenance and refurbishment applications, rather than original equipment manufacture.

## Loss of key supplier(s)

The Group's businesses ensure that they have secure long term access to high quality, differentiated product offerings by combining:

- Quality manufacturer-branded products, mostly sourced under long term distribution agreements.
- Own-brand products, manufactured under contract.
- Selective in-house manufacture and assembly.

For manufacturer-branded products, there are risks to the businesses if a major supplier decides to cancel the distribution agreement or if the supplier is acquired by a company which has its own distribution channels in the relevant market. There is also the risk of a supplier taking away exclusivity and either setting up direct operations or establishing another distributor.

The potential impact on an individual business may be high where a supplier represents a significant proportion of the revenues of the business. However, the potential impact on the Group is lower as no supplier represents more than 15% of Group revenue and only six suppliers represent more than 2% each of Group revenue.

Relationships with suppliers have normally been built up over many years and a strong degree of inter-dependence has been established. There are further actions planned and implemented by the operating businesses to control or to mitigate risks:

- Where dependence is high, long term, multi-year exclusive contracts signed with suppliers.
- Where possible, change of control clauses included in contracts for protection or compensation in the event of acquisition.
- Collaborative projects and relationships maintained with individuals at many levels of the supplier organisation.
- Regular review meetings and adherence to contractual terms.
- Regular reviews of inventory levels.
- Bundling and kitting of products and provision of added value services.
- Periodic research of alternative suppliers as part of contingency planning.

## Loss of major customer(s)

As with any business, the loss of one or more major customers can be a material risk.

Specific large customers are important to individual operating businesses and a high level of effort is invested in ensuring that these customers are retained and encouraged not to switch to another supplier. In addition, to providing high levels of customer service, close integration is established where possible with customers' systems and processes.

The nature of the Group's businesses, however, ensures that there is not a high level of dependence on any individual customers. No customer represents more than 6% of sector revenue or more than 2% of total Group revenue.

### Technological change

The Group's businesses operate in specialised markets offering products which are often technical in nature. As a result, there is always the risk that a technological change will make specific products less competitive or in the worst case, obsolete. In addition to the write-off of unsaleable inventory, this can impact the sales performance of the business if replacement products are not available.

The Group's exposure to this risk is reduced by the spread of businesses and technologies, as well as by the fact that the products, though technical, are typically not subject to very rapid technological change.

The operating businesses monitor the key technologies to ensure early warning of changes in product competitiveness, so that plans can be developed with suppliers for replacement products. Also, the businesses, with sufficient lead time, mostly have the opportunity to change suppliers in the event of a major technology shift.

### Product liability

There is always a risk that products supplied by a Group business may fail in service, which could lead to a claim under product liability.

To offset this risk, technically qualified personnel and control systems are in place to ensure products meet quality requirements. The businesses, in their Terms and Conditions of sale with customers, will typically mirror the Terms and Conditions of sale from their suppliers. In this way the liability can be limited and subrogated to the supplier.

However, if a legal claim is made it will typically draw in our business as a party to the claim and the business may be exposed to legal costs and potentially damages if the claim succeeds and the supplier fails to meet its liabilities for whatever reason. To mitigate this risk, the Group has established Group-wide product liability insurance which provides worldwide umbrella insurance cover of £10m in all sectors.

### Loss of key personnel

The success of the Group is built upon strong, self-standing management teams in the operating businesses, committed to the success of their respective businesses. As a result, the loss of key personnel can have a significant impact on performance, at least for a time.

Contractual terms such as notice periods and non-compete clauses can mitigate the risk in the short term. However, the more successful initiatives focus on ensuring a challenging work environment with appropriate reward systems. The Group places very high importance on planning the development, motivation and reward of key managers in the operating businesses to mitigate this risk:

- Ensuring a challenging working environment where managers feel they have control over and responsibility for their businesses.
- Establishing management development programmes to ensure a broad base of talented managers.
- Offering a balanced and competitive compensation package with a combination of salary, annual bonus and long term incentive plans targeted at the individual business level.
- Giving the freedom, encouragement, financial resources and strategic support for managers to pursue ambitious growth plans.

### Operational Risks

#### Major damage to premises

The Group businesses mostly operate from combined office/warehouse facilities which are dedicated to the business and not shared with other Group businesses. Major damage to the facility from fire, malicious damage or natural disaster would impact the business for a period until the damage is repaired or alternative facilities have been established.

The businesses have developed plans to prevent incidents, including fire and security alarms and regular fire drills. Insurance policies are also in place including property, contents and business interruption cover which would mitigate the financial impact.

However, the priority in such an event is to become operational as quickly as possible to minimise disruption to customers. Plans to ensure a quick and orderly recovery have been developed by the businesses and are periodically reviewed.

The business where the risk is greatest is Hercules in Clearwater, Florida which is most at risk from an environmental disaster caused by a hurricane or tornado. The building structure has been designed to withstand 150mph winds and a specific disaster plan has been drawn up and is regularly reviewed. This includes:

- Back-up power generator.
- Materials on hand to secure the facility.
- Communications re-route to other branches or interim location.

## Risks and Uncertainties continued

- IT recovery plan using back-up server in separate location.
- Regular building inspection and weather monitoring.
- Plans to drop-ship product from suppliers direct to customers.

### Loss of information technology ("IT") systems

Computer systems are critical to the businesses since their success is built on high levels of customer service and quick response. A complete failure of IT systems, with the loss of trading and other records, would be more damaging to the businesses than major physical damage to facilities. IT system failure could have a number of causes including power failure, fire and viruses.

Business interruption insurance cover is held across the Group and contingency plans have been drawn up in all businesses. The recovery plans differ by individual business, but will include some or all of the following elements:

- Full data back-ups as a matter of routine.
- Back-up tapes stored in fire proof safes.
- Back-up servers identified.
- Communication re-route options identified.
- Service contracts with IT providers with access to replacement servers.
- Uninterruptible power sources and back-up generators where required.
- Virus checkers and firewalls.

### Disruption by service providers

All the operating businesses use third party carriers to physically transport products. Disruption to this service is most critical in businesses such as Hercules where the business model requires rapid, often next day, delivery of products. Most businesses will have a principal carrier that is used, but they will monitor performance closely and maintain accounts with alternative carriers.

### Financial Risks

The Group's activities expose it to a variety of financial risks; foreign currency, liquidity, interest rate and credit. The Group's overall management of these risks is carried out by a central treasury team (Group treasury) under policies and procedures which are reviewed and approved by the Board. Group treasury identifies, evaluates and where appropriate, hedges financial risks in close co-operation with the Group's operating businesses. The Group treasury team does not undertake speculative foreign exchange dealings for which there is no underlying exposure. The policies for managing these financial risks are set out below and further analyses of these risks are set out in note 18 to the consolidated financial statements.

### Foreign currency risk

Foreign currency risk is the risk that changes in currency rates will affect the Group's results. The Group operates internationally and is exposed to foreign exchange risk arising from various currency exposures, primarily with respect to the US dollar, the euro and the Canadian dollar (translational exposure). During the year ended 30 September 2010, ca. 70% of the Group's revenue and operating profits were earned in currencies other than UK sterling. In comparison to the prior year, the net effect of currency translation was to increase revenue by £3.5m and to increase operating profit by £1.1m. It is estimated that a strengthening of UK sterling by 10% against all the currencies in which the Group does business, would reduce operating profit, before acquisition related charges and tax, by approximately £2.4m (7.5%) due to currency translation.

The Group has certain investments in foreign operations whose net assets are also exposed to foreign currency translation risk. Currency exposure arising from the net assets of the Group's foreign operations are not hedged. At 30 September 2010, the Group's non-UK sterling trading capital employed in overseas businesses was £103.1m (2009: £87.7m), which represented 84% of the Group's trading capital employed. It is estimated that a strengthening of UK sterling of 10% against all the non UK sterling capital employed would reduce shareholders' funds by £9.8m.

The Group's UK businesses are also exposed to foreign currency risk on purchases that are denominated in a currency other than their local currency, principally US dollars, euro and Japanese yen (transactional exposure). The Group's Canadian and Australian businesses are also exposed to a similar risk as the majority of their purchases are denominated in US dollars.

These businesses may hedge up to 80% of forecast US dollar and euro foreign currency exposures using forward foreign exchange contracts. The Group classifies its forward foreign exchange contracts, hedging forecasted transactions, as cash flow hedges and states them at fair value.

Details of average exchange rates used in the translation of overseas earnings and of year end exchange rates, used in the translation of overseas balance sheets, for the principal currencies used by the Group, are shown in note 27 to the consolidated financial statements.

### Liquidity risk

Liquidity risk is the risk that the Group will not be able to meet its financial obligations as they fall due. The Group's approach to managing liquidity is to ensure, as far as possible, that it will always have sufficient liquidity to meet its liabilities when due, under both normal and stressed conditions, without incurring unacceptable losses or risking damage to the Group's reputation.

The Group is highly cash generative and uses monthly cash flow forecasts to monitor cash requirements and to optimise its return on investments. Typically the Group ensures that it has sufficient cash on hand to meet foreseeable operational expenses, but the Group also has an undrawn committed £20m revolving bank facility which was renewed on 19 November 2010. Interest on this facility is payable at between 150 and 195 bps over LIBOR, depending on the ratio of net debt to EBITDA.

#### Interest rate risk

Interest rate risk is the risk that changes in interest rates will affect the Group's results. The Group's interest rate risk arises primarily from its cash funds. An analysis of the currency and interest rate profile of the Group's funds is shown in note 18 to the consolidated financial statements. The Group manages its interest-bearing funds in a manner designed to maximise interest income, while at the same time minimising any risk to these funds. Surplus funds are deposited with commercial banks that meet the credit criteria approved by the Board, for periods of between one to six months at rates that are generally fixed by reference to the relevant UK Base Rate, or equivalent rates. The Group does not undertake any hedging activity of interest rates.

It is estimated that an increase of 1% in interest rates would increase the Group's profit before tax by a maximum of £0.3m.

#### Credit risk

Credit risk is the risk of financial loss to the Group if a customer or counterparty to a financial instrument fails to meet its contractual obligations; this arises principally from the Group's trade and other receivables from customers and from cash balances (including deposits) held with financial institutions.

Trade receivable exposures are managed locally in the operating units where they arise and credit limits are set as deemed appropriate for the customer. The Group is exposed to customers ranging from government backed agencies and large public and private wholesalers, to small privately owned businesses and the underlying local economic risks vary throughout the world. An analysis of the Group's credit risk to trade receivables is set out in note 15 to the consolidated financial statements.

The Group establishes an allowance for impairment that represents its estimate of incurred losses in respect of specific trade and other receivables where it is deemed that a receivable may not be recoverable. When the receivable is deemed irrecoverable, the allowance account is written off against the underlying receivable.

Exposure to financial counterparty credit risk is controlled by the Group treasury team in establishing and monitoring counterparty limits. Centrally managed funds are invested entirely with counterparties whose credit rating is 'A' or better.

#### Capital risk management

The Group's objectives when managing capital are to safeguard the Group's ability to continue as a going concern in order to provide returns for shareholders and benefits for other stakeholders and to maintain an optimal capital structure.

In order to maintain or adjust the capital structure the Group may adjust the amount of dividends paid to shareholders, return capital to shareholders or issue new shares.

#### Accounting Risks

##### Inventory obsolescence

Working capital management is critical to success in specialised distribution businesses as this has a major impact on cash flow. The principal risk to working capital, other than credit risk to trade receivables is in inventory obsolescence and write-off. Inventory write-offs are controlled and minimised by active management of inventory levels based on sales forecasts and regular cycle counts. Where necessary, a provision is made to cover excess inventory and potential obsolescence.

##### Fraud and theft

The Group's operating businesses are relatively straightforward businesses where a significant incidence of fraud or theft should become apparent relatively quickly. The risks are also moderated by the fact that the products are relatively specialised industrial products and therefore not particularly valuable or attractive on the open market. Finally, tangible fixed assets are not significant across the Group and generally comprise IT and warehouse equipment, where any loss would be quickly apparent.

As additional security, processes are in place to further reduce the opportunity for fraud or theft:

- Specified signature levels and responsibilities.
- Segregation of responsibilities.
- Controls on shipping addresses.
- Weekly flash reports of cash balances and regular bank reconciliations.
- Regular review of supplier and creditor ledgers to identify fictitious suppliers.
- Group-wide policy and procedures for "whistle-blowing".

The Audit Committee carries out an annual assessment of the fraud risks in the businesses and discusses these risks with management.



# Corporate and Social Responsibility

The Board takes serious account of the social, environmental and ethical impacts of the Group's activities and monitors them as part of the annual risk assessment process. The risk assessments are led by the Managing Directors of each of the Group's operating companies and are then reviewed by the Board. The Managing Directors are responsible for complying with the relevant employment, social and environmental regulations in the geographical areas in which they operate.

## Employment

Building and developing the skills, competencies, motivation and teamwork of employees is recognised by the Board as being key to achieving the Group's business objectives. The stability and commitment of the employees is demonstrated by the average length of service being 6.4 years (2009: 6.4 years). In addition the number of working days lost to sickness is less than 1% a year (2009: 2%). These measures remain consistent across each of the Group's sectors.

The Group values the commitment of its employees and recognises the importance of communication to good working relationships. The Group keeps employees informed on matters relating to their employment, on business developments and on financial and economic factors affecting the Group. This is achieved through management briefings, internal announcements, the Group's website and by the distribution of Preliminary and Interim Announcements and press releases. Copies of the Annual Report are also made available in the operating businesses. This communication programme enables employees to gain a better understanding of the Group's business objectives and their roles in achieving them.

Both employment policy and practice in the Group are based on non-discrimination and equal opportunities. Ability and aptitude are the determining factors in the selection, training, career development and promotion of all employees. The Group remains supportive of the employment and advancement of disabled persons. Applications for employment by disabled persons are always fully considered, bearing in mind the respective aptitudes and abilities of the applicants concerned. If an employee is, or becomes disabled during their period of employment, the Group will, if necessary and to the extent possible, adapt the work environment to enable the employee to continue in their current position or retrain the employee for duties suited to their abilities following disablement. At 30 September 2010 the Group's employees included one who was disabled and one who was on long term sick leave.

Employment policies throughout the Group have been established to comply with relevant legislation and codes of practice relating to employment, health and safety and equal opportunities. The Group provides good quality working environments and facilities for employees, and training and development appropriate to each of their roles.

## Health and Safety

The Group places a great deal of importance on the provision of clean, healthy and safe working conditions. In addition to compliance with all local regulations, the Group promotes working practices which protect the health and safety of its employees. Health and Safety matters are kept under regular review by local management who report on such matters to the Chief Operating Officer. During 2010, 5 employees (2009: 36)

were reported as having suffered minor injuries at work; none of these injuries resulted in absence from work for more than three days. One employee (2009: none) suffered a serious injury during the year and was absent from work for four days.

Health and Safety training is part of the induction process for new employees. Specific training is given where relevant, for example regarding forklift truck operation and chemical handling, as well as general fire safety and first aid matters.

## Environmental

The Group regards compliance with relevant environmental laws as an important part of its responsible approach to the environment and is committed to good environmental management practices throughout its operations. The Managing Directors appointed by the Board have responsibility for the environmental performance of their operating businesses and each subsidiary is required to implement initiatives to meet their responsibilities.

## Relationships with Suppliers, Customers and Other Stakeholders

The Group recognises the obligation it has towards the parties with whom it has business dealings including customers, shareholders, employees, suppliers and advisors. Dealings with these groups depend upon the honesty and integrity of the Group's employees and every effort is made to ensure that a high standard of expertise and business principles is maintained in such dealings. Where appropriate, training is given to maintain and to raise standards.

The Group's policy towards suppliers is that each operating company is responsible for negotiating the terms and conditions under which they trade with their suppliers.

The Group does not have a formal code that it follows with regard to payments to suppliers. Group companies agree payment terms with their suppliers when they enter into binding purchasing contracts for the supply of goods and services.

Suppliers are, in that way, made aware of these terms. Group companies seek to abide by these payment terms when they are satisfied that the supplier has provided the goods or services in accordance with the agreed terms and conditions. At 30 September 2010 the amount of trade creditors shown in the Group balance sheet represents 51 days (2009: 46 days) of average purchases.

## Community Impact and Involvement

The Group contributes to local worthwhile causes and charities and ensures that the Group's operations cause minimal negative impact within the community.

In common with all companies, the Group has limited resources and the amount of money available for charitable purposes varies over time.

The Group made donations for charitable purposes during the year which amounted to £25,950 (2009: £14,852). No political donations were made.

# Directors' Report

For the year ended 30 September 2010

The Directors present their Report and the audited financial statements for the year ended 30 September 2010.

## Principal Activities

The principal activity of the Group is the supply of specialised technical products and services. A description and review of the activities of the Group during the financial year and an indication of future developments is set out in the Business Review on pages 14 to 28; the Business Review incorporates the requirements of the Companies Act.

## Results and Dividends

The profit for the financial year attributable to shareholders was £21.5m (2009: £13.0m). The Directors recommend a final dividend of 6.2p per ordinary share (2009: 5.3p), to be paid, if approved, on 19 January 2011. This, together with the interim dividend of 2.8p per ordinary share paid on 16 June 2010, amounts to 9.0p for the year (2009: 7.8p).

## Share Capital

At the date of this Report there were 113,239,555 ordinary shares of 5 pence each in issue, all of which are fully paid up and quoted on the London Stock Exchange. The rights attaching to the Company's ordinary shares, as well as the powers of the Company's Directors, are set out in the Company's Articles of Association, copies of which can be obtained from the Company Secretary.

There are no restrictions on the transfer of ordinary shares in the capital of the Company, other than those which may be imposed by law from time to time. In accordance with the Listing Rules of the Financial Services Authority, certain employees are required to seek approval of the Company to deal in its shares.

The Company is not aware of any agreements between shareholders that may result in restrictions on the transfers of securities and/or voting rights. No person holds securities in the Company carrying special rights with regard to control of the Company. The Company's Articles of Association may be amended by special resolution of the Company's shareholders.

## Share Allotment

A general allotment power and a limited power to allot in specific circumstances for cash, otherwise than pro-rata to existing shareholders, were given to the Directors by resolutions approved at the Annual General Meeting of the Company held on 13 January 2010. These powers will expire at the conclusion of the 2011 Annual General Meeting and resolutions to renew the Directors' powers are therefore included within the Notice of the 2011 Annual General Meeting.

## Authority to Make Market Purchases of Own Shares

An authority to make market purchases of shares was given to the Directors by a special resolution at the Annual General Meeting of the Company held on 13 January 2010. In the year to 30 September 2010 the Company has not acquired any of its own shares. This authority will expire at the conclusion of the 2011 Annual General Meeting and a resolution to renew the authority is therefore included within the Notice of the 2011 Annual General Meeting.

## Substantial Shareholdings

At 19 November 2010 the Company had been notified, pursuant to the Financial Service Authority's Disclosure and Transparency Rules, of the following notifiable voting rights in its ordinary share capital:

	Percentage of ordinary share capital
Fidelity International	9.77
F&C Asset Management plc	8.27
Mondrian Investment Partners Limited	6.02
Newton Investment Management Limited	4.31
Legal & General Investment Management Limited	3.93
IG International Management Limited	3.20

As far as the Directors are aware there were no other notifiable interests.

## Directors

The persons currently serving as Directors of the Company are shown on pages 12 and 13. I Henderson, NP Lingwood and IM Grice retire from the Board by rotation at the Annual General Meeting on 12 January 2011 and being eligible, offer themselves for re-election. The Directors' beneficial interests in the Company's ordinary share capital at 30 September 2010 are set out in the Remuneration Report on page 39.

## Directors' Assessment of Going Concern

The Group's business activities, together with the factors likely to affect its future development, performance and position are set out in the Business Review on pages 14 to 28. The financial position of the Group, its cash flows, liquidity position and borrowing facilities are described in the Finance Review on page 23. In addition pages 26 and 27 of the Annual Report includes the Group's objectives, policies and processes for managing its capital; its financial risk management objectives; details of its financial instruments and hedging activities; and its exposures to credit risk and liquidity risk.

The Group has considerable financial resources together with a broad spread of customers and suppliers across different geographic areas and sectors, often secured with longer term agreements. As a consequence, the Directors believe that the Group is well placed to manage its business risks successfully, despite the current uncertain economic outlook.

After making enquiries, the Directors have a reasonable expectation that the Company and the Group have adequate resources to continue in operational existence for the foreseeable future. Accordingly, they continue to adopt the going concern basis in preparing the Annual Report and Accounts.

# Directors' Report continued

For the year ended 30 September 2010

## **Directors' and Officers' Liability Insurance and Indemnity**

The Company has purchased insurance to cover its Directors and Officers against the costs of defending themselves in legal proceedings taken against them in that capacity and in respect of any damages resulting from those proceedings. The Company also indemnifies its Directors and Officers to the extent permitted by law. Neither the insurance nor the indemnity provide cover where the Director or Officer has acted fraudulently or dishonestly.

## **Other Statutory Information**

An explanation of the Company's policy on matters relating to Employment, Health and Safety, Environmental and its relationship with suppliers, customers and other stakeholders is set out within the Business Review on page 28 of the Annual Report. The Group's use of financial instruments is discussed on page 26. Corporate Governance disclosures are set out on pages 31 to 40.

## **Annual General Meeting**

The Annual General Meeting will be held at midday on 12 January 2011 in the Brewers Hall, Aldermanbury Square, London EC2V 7HR. The special business of the meeting

includes resolutions which seek Shareholders' approval for the replacement of the Company's Long Term Incentive Plan ("LTIP") with a new LTIP comprising a Performance Share Plan and a Share Matching Plan, as explained further on page 36 in the Remuneration Report. A Circular setting out in detail these proposals, together with the routine business of the meeting will be set out in the Notice of the Annual General Meeting which is a separate document which will be sent to all Shareholders.

## **Independent Auditors**

A resolution to re-appoint Deloitte LLP as auditors and to authorise the Directors to determine their remuneration will be proposed at the forthcoming Annual General Meeting.

## **By order of the Board**

**NP Lingwood**  
**Company Secretary**

22 November 2010



# Corporate Governance

## Compliance Statement

The Board recognises the importance of high standards of corporate governance throughout the Group. The Board is accountable to the Company's shareholders for good governance and this statement sets out how the principles set out in the Combined Code on Corporate Governance ("the Code"), issued in June 2003 and updated in June 2008 by the Financial Reporting Council, are applied by the Company. The Board confirms that the Company has complied with all of the Provisions set out in Section 1 of the Code, throughout the year.

The FRC published the UK Corporate Governance Code 2010 on 28 May 2010. This new Code is designed to replace the existing Code, although compliance with the new Code will not be mandatory for the Company until 2011.

## Directors

### The Board

The Board comprises three non-Executive Directors, including the Chairman, and three Executive Directors, providing a wide range of skills and experience. The biographical details of the Board members are set out on pages 12 and 13. The Board has six scheduled meetings each year and meets more frequently as required. It met on six occasions during the year under review.

The following table sets out the number of meetings of the Board and its Standing Committees during the year and individual attendance by Board members at these meetings:

	Board	Audit Committee	Remuneration Committee	Nomination Committee
Number of meetings during the year	6	6	7	1
<b>Non-Executive Directors:</b>				
JL Rennocks (Chairman)	6	6	7	1
JW Matthews	6	6	7	1
IM Grice	6	5	7	1
<b>Executive Directors*:</b>				
BM Thompson	6			
I Henderson	6			
NP Lingwood	6			

\*The Executive Directors attend all the meetings of the Audit Committee; BM Thompson attended the meetings of the Remuneration Committee during the year.

The September 2010 Board meeting was held in Edmonton, Canada and was extended to a two day meeting to include a bi-annual review and discussion of the Group's longer term strategy.

The duties of the Board and its Committees are set out clearly in formal terms of reference which are reviewed regularly and state the items specifically reserved for decision by the Board. The Board establishes overall Group strategy, including acquisitions and withdrawal from existing activities. It approves the Group's strategy and the operating budget and reviews performance through monthly reports and management accounts.

The approval of acquisitions, for the most part, is a matter reserved for the Board, save that it delegates to the Chief Executive Officer the responsibility for such activities to a specified level of authority. Similarly, there are authority levels covering capital expenditure which can be exercised by the Chief

Executive Officer. Beyond these levels of authority, projects are referred to the Board for approval.

The Board establishes the remuneration of non-Executive Directors and the Company's framework of executive remuneration and its cost in the light of recommendations made by the Remuneration Committee.

Other matters reserved to the Board include treasury policies, internal control, risk management and the appointment or removal of the Company Secretary. The Company maintains appropriate insurance cover in respect of legal action against its Directors.

### Chairman and Chief Executive

The roles of the Chairman, who is non-Executive, and the Chief Executive Officer are separate and clearly defined. The Chairman is also Chairman of Nestor Healthcare plc and Intelligent Energy plc and has a number of other Board appointments. The Board is satisfied that the Chairman's other Board appointments and commitments do not place constraints on his ability properly to fulfil his role as Chairman of Diploma PLC.

### Board Balance and Independence

The non-Executive Directors are appointed for specified terms, the details of their respective appointments being as set out in the Remuneration Report on page 35. Non-Executive Directors are required to inform the Board of any changes to their other appointments.

The non-Executive Directors are determined by the Board to be independent in character and judgement and there are no relationships or circumstances which could affect, or appear to affect, a Director's judgement. JW Matthews is the senior independent Director.

There are three standing Committees of the Board to which various matters are delegated. Membership of the Committees is set out on page 13 and terms of reference are available on request and are set out on the Company's website. Following publication of the UK Corporate Governance Code 2010, earlier this year, the terms of reference of each Committee are being updated to bring them into line with current guidance. The new terms of reference will be available on the Company's website in 2011. In order to ensure that undue reliance is not placed on particular individuals, the Board has decided that all its independent non-Executive Directors should serve on all Committees. The Board regularly reviews the chairmanship of its Committees.

During the year the Chairman has had meetings with the non-Executive Directors, without the Executive Directors present.

### Appointments to the Board

The Board has established a Nomination Committee which leads the process for Board appointments and makes recommendations to the Board. The members of the Nomination Committee are JL Rennocks, who is the Chairman, and the two non-Executive Directors.

The Committee would be chaired by the senior independent Director on any matter concerning the chairmanship of the Company. The Company Secretary is the Secretary to the Committee.

## Corporate Governance continued

The Nomination Committee has written terms of reference which were reviewed and updated during 2005, covering the authority delegated to it by the Board. These include the following duties:

- To be responsible for identifying and nominating, for the approval of the Board, candidates to fill Board vacancies as and when they arise.
- Before making an appointment, the Committee will evaluate the balance of skills, knowledge and experience on the Board and in the light of this evaluation, prepare a description of the role and capabilities required for a particular appointment.
- In identifying suitable candidates, the Committee shall consider candidates on merit and against objective criteria and will take care that appointees have enough time available to devote to the position.
- The Committee will consider candidates from a range of backgrounds, both internally and externally and may use the services of external advisors to facilitate the search.

On appointment, Directors undertake an informal induction process which is designed to develop knowledge and understanding of the Company's business, and includes visits to various Group operating sites.

The Nomination Committee met once during the year under review.

### Information and Professional Development

The main Board papers comprising an agenda and formal Board reports, together with briefing papers on specific matters, are sent to the Directors in advance of each Board meeting.

The training needs of the Directors are periodically discussed at meetings with briefings as necessary on various elements of corporate governance and regulatory issues.

The Company Secretary acts as an advisor to the Board on matters concerning governance and regulatory issues and he ensures Board procedures are complied with. All Directors have access to his advice and a procedure also exists for Directors to take independent professional advice at the Company's expense. No such advice was sought during the year. The appointment and removal of the Company Secretary and his remuneration are matters for the Board as a whole.

The Board has decided that because of the relatively small size of the Company and to limit its costs, the role of the Company Secretary should be combined with that of the Group Finance Director. This matter is regularly reviewed by the Board.

### Performance Evaluation

During the year the Board completed the process of evaluating its own performance, together with that of its Committees and individual Directors, including the Chairman. The results of the evaluation process are discussed by the Board and areas for improvement are identified and action taken where necessary.

### Re-election

All Directors must stand for election at the first Annual General Meeting after they are appointed. The Articles provide that all Directors will stand for re-election at least every three years.

### Remuneration

The Board has established a Remuneration Committee consisting exclusively of independent non-Executive Directors. The application of corporate governance principles in relation to the Directors' remuneration is described in the Remuneration Report on page 35.

### Accountability and Audit Financial Reporting

It is a requirement of the Code that the Board should present a balanced and understandable assessment of the Company's position and prospects. This requirement extends to interim and other price sensitive public reports and to reports to regulators, as well as to information required to be presented by statutory requirements.

In this context, reference should be made to the Statement of Directors' Responsibilities on page 41, the Directors' Report on pages 29 and 30 which includes a statement regarding the Group's status as a going concern, and to the Reports of the Auditors on pages 76 and 77, which includes a statement by the auditors about their reporting responsibilities.

### Internal Control

The Board acknowledges that it is responsible for the Group's system of internal control and for reviewing its effectiveness. Such a system is designed to manage rather than eliminate the risk of failure to achieve business objectives and can only provide reasonable and not absolute assurance against material misstatement or loss. Throughout the year, the Group has been in full compliance with the Code provisions on internal control.

The Board has established a clear organisational structure with defined authority levels. The day to day running of the Group's business is delegated to the Executive Directors of the Company. The Executive Directors visit each operating unit on a regular basis and meet with both operational and finance management and staff.

Key financial and operational measures are reported on a weekly and/or monthly basis and are measured against both budget and interim forecasts which have been approved and reviewed by the Board. Each operating unit is required to prepare an annual self assessment report on internal control and these are reviewed by the Board.

During the year the Board has carried out a review of the effectiveness of the Group's systems of internal control. This review included a risk assessment process on the key financial, operational and compliance risks to identify, evaluate and manage significant risks to the Group's business. The assessments have been effected at both Group and individual company level. They included common definitions of risk and ensure, as far as practicable, that the policies and procedures established by the Board are appropriate to manage the perceived risks to the Group. During the year, the risk assessment process revealed no significant risks of which the Board was not previously aware.

The risks and uncertainties which are currently judged to have the largest potential impact on the Group's long term performance are set out in the Business Review on pages 24 to 27.

The Group's finance department includes a full time internal auditor. During the year, a full programme of internal audit visits has been completed at all of the Group's businesses. The scope of work carried out by internal audit is focused on internal financial controls and processes operating within each business. While there were no significant weaknesses identified during these audits, a number of recommendations were made to improve internal review processes and procedures, particularly in businesses where the opportunity to segregate duties was limited.

The Audit Committee keeps under review the need for a fully independent internal audit function in the Group. The Audit Committee believes that the Group's system of internal control is appropriate for a group of the size and nature of Diploma PLC and the Audit Committee's current view is that a separate independent internal audit function is not necessary.

### Audit Committee and Auditors

The Board has established an Audit Committee comprising the three non-Executive Directors. The Committee is chaired by JW Matthews. The Company Secretary is the Secretary to the Committee.

The main roles and responsibilities of the Committee are set out in written terms of reference, which were reviewed and updated during 2005 and which generally encompass those set out in the Code, which are as follows:

- to monitor the integrity of the financial statements of the Group and any formal announcements relating to the Group's financial performance, reviewing significant financial judgements contained therein;
- to review the Group's internal financial controls and its internal controls and risk management systems;
- to make recommendations to the Board, for it to put to shareholders for approval in general meeting, in relation to the appointment, re-appointment and removal of the external auditors and to approve the terms of engagement of the external auditors;
- to review and monitor the external auditors' independence and objectivity and the effectiveness of the audit process taking into consideration relevant UK professional and regulatory requirements;
- to develop and implement policy on the engagement of the external auditor to supply non-audit services, taking into account relevant guidance regarding the provision of non-audit services by external auditors;
- to report to the Board, identifying any matters in respect of which it considers that action or improvement is needed and making recommendations as to the steps to be taken; and
- to annually consider whether there is a need for a formal internal audit function and make recommendation to the Board.

In addition, the Audit Committee has an important role to play through its responsibility for, and oversight of, the auditor relationship and auditor independence. The Committee recognises that auditor independence is an essential part of the audit framework and the assurance it provides.

The Committee reviewed the audit engagement in 2008 and following an audit tender process, recommended to the Board the appointment of Deloitte LLP as auditors to the Company and Group.

The Committee normally meets at least five times a year. The external auditors and the Executive Directors generally attend Audit Committee meetings. In addition, the Committee periodically meets the external auditors without the Executive Directors present.

The Audit Committee's responsibilities are discharged in the following manner:

- at its meetings in May and November, the focus falls on a review of the Interim Report and the Annual Report and Accounts respectively. On both occasions, the Committee receives reports from the Group Finance Director and from the external auditors identifying any accounting or judgemental issues requiring its attention;
- the external auditors present their audit plan at the September meeting; and
- the Committee meets to approve formal Interim Management Statements which are released to the market in January and August, in accordance with the Disclosure and Transparency Rules.

The Committee has also formally reviewed and approved the arrangements by which Company employees may, in confidence, raise concerns about possible irregularities in financial reporting or other matters (so called "whistleblowing" procedures).

On an annual basis, the Committee also assesses annually the effectiveness of the external audit process. This assessment covers all aspects of the audit service provided by the Company's external auditors. The Committee also reviews annually a report on the external auditors' own quality control procedures.

The Committee has also established a set of guidelines covering the type of non-audit work that can be assigned to auditors. These relate to further assurance services – where the auditors' detailed knowledge of the Group's affairs means that they may be best placed to carry out such work. This extends to, but is not restricted to, shareholder and other circulars, regulatory reports, and on occasions, work in connection with disposals. Work in connection with acquisitions, including due diligence reviews, is generally not provided by the auditors, but is placed with other firms.

Taxation services are generally not provided by the auditors; a separate firm is retained to provide tax advice, including any assistance with tax compliance matters generally, except in Canada, where the auditors provide some assistance on the tax computations.

In other circumstances, proposed assignments are put out to tender and decisions to award work taken on the basis of demonstrable competence and cost effectiveness.

The Committee receives an annual report which provides details of any assignments and related fees carried out by the auditors in addition to their normal audit work, and these are reviewed against the above guidelines.

## Corporate Governance continued

The Committee received reports from management on two incidences of fraud which occurred during the year. In April 2010, one of the Group's UK businesses was subject to a sophisticated bank related fraud, carried out by an overseas third party, pretending to be a potential customer.

In July 2010, management discovered fraud in one of its overseas businesses, carried out by an employee who incurred unauthorised transactions on a company credit card.

The Group lost £106,000 in aggregate as a consequence of these two matters; the Committee concluded that both frauds were one-off opportunistic frauds and were not an indication of inadequate internal controls. However existing internal controls, which may have prevented these occurrences, have been strengthened and reinforced in each of the businesses.

### Communications with Shareholders

The Company maintains regular contact with major shareholders to communicate clearly the Group's objectives and monitors movements in significant shareholdings. The Company recognises the importance of communicating with its shareholders and does this through its Annual and Interim Reports, Interim Management Statements and at the Annual General Meeting and through the processes described below.

Most shareholder contact is with the Chief Executive Officer and Group Finance Director and presentations are made on the operating and financial performance of the Group and its longer term strategy. The slide presentations made to representatives of the investment community following the announcement of the Preliminary and Interim results are made available on the Company's website at [www.diplomaplc.com](http://www.diplomaplc.com)

The non-Executive Directors are given regular updates as to the views of institutional shareholders and an independent insight is sought through research carried out twice a year by the Company's advisors.

Through these processes, the Board is kept abreast of key issues. The opportunity for shareholders to meet the Chairman or Senior Independent Director, separately from the Executive Directors, is available on request.

Notice of the Annual General Meeting is sent to shareholders at least twenty working days prior to the meeting and includes a separate resolution on each substantially separate issue. In the absence of a poll being called, proxy votes cast are declared after each resolution has been dealt with on a show of hands.

The Chief Executive Officer and Company Secretary generally deal with questions from individual shareholders. All shareholders have the opportunity to put questions at the Company's Annual General Meeting when the Chairman and Chief Executive Officer give a statement on the Group's performance during the year, together with a statement on current trading conditions. The Chairman of the Board and of the Remuneration and Audit Committees will normally be available to answer questions at the meeting.

# Remuneration Report

This Report is presented to shareholders by the Board and provides information on Directors' remuneration. This Report complies with the Directors' Remuneration Report Regulations 2002 and also sets out how the principles of the FRC Combined Code on Corporate Governance ("the Code") issued in June 2003 and updated in June 2008, relating to Directors' remuneration are applied.

A resolution will be put to shareholders at the Annual General Meeting on 12 January 2011, inviting them to consider and approve this Report.

## Performance

The Board recognises the importance of linking remuneration policies to the performance of the Group and shareholder return.

The graph below shows the total shareholder return for a holding of the Company's ordinary shares for the five financial years to 30 September 2010. This is compared to the total shareholder return for a hypothetical holding in the FTSE mid-250 index (excluding investment trusts). This was chosen as the Remuneration Committee ("the Committee") believes it is the most appropriate index to which the Company's performance can be compared and it is the index which is used for the purposes of the Long Term Incentive Plan.

Total shareholder return is the growth in value of a share plus the value of dividends re-invested in the Company's shares on the day on which they are paid.



The five year total shareholder return figures for Diploma PLC and the FTSE mid-250 index were as follows:

	Diploma	FTSE mid-250
September 2005	100	100
September 2010	249	125
	+149%	+25%



# Remuneration Report continued

## Remuneration Committee

The Committee is governed by formal terms of reference agreed by the Board and comprises two non-Executive Directors and the Chairman. The written terms of reference were reviewed and updated during 2005 and are published on the Company's website. The Committee comprises IM Grice who is the Chairman, JW Matthews and JL Rennocks. The Committee determines the specific remuneration packages, including share schemes, of the Executive Directors and also monitors the remuneration of other senior executives who report to the Executive Directors. The Chief Executive attends meetings at the invitation of the Committee to provide guidance as appropriate on the impact of remuneration policy and advice on the performance of Executive Directors. The Chief Executive does not attend meetings when his own position is discussed. Any matter affecting the Chairman is discussed by the Committee without the Chairman present.

As indicated in last year's report, in 2010 the Committee appointed Kepler Associates to conduct a review of the Company's long term incentive arrangements for Executive Directors. The Company's existing long-term incentive plan ("LTIP") has been in place since 2004 and will expire in 2011.

As part of this review, the Committee received a written report from Kepler Associates and met with their consultants to discuss their recommendations. As a result of this exercise, as well as other routine business, the Committee met seven times during the year.

Following advice from Kepler Associates, the Committee is proposing to seek shareholders' approval for the adoption of new long-term incentive plans comprising a Performance Share Plan ("PSP") and a Share Matching Plan ("SMP"). The PSP will have a structure similar to the LTIP. The new SMP will offer an additional reward opportunity in return for an investment in shares and will provide a mechanism to reward exceptional performance.

These proposals will be set out in detail in a Circular to Shareholders for review and if thought fit, for approval at the Company's Annual General Meeting on 12 January 2011. The Remuneration Committee believes that these proposals are important to the Company being able to continue to motivate and retain its Executive Directors and are in the interests of Shareholders. The targets for the PSP represent a significant strengthening of the EPS performance condition and the maintenance of a stretching TSR condition. Additional reward will result only from Executive Directors making a significant personal investment in Company shares (as part of the SMP) and in large part for delivering performance above the upper-quartile of the market. Accordingly, the proposals have the full support of both the Remuneration Committee and the entire Board.

## Remuneration Policy

This Remuneration Report sets out the Company's policy on Directors' remuneration for 2010 and, so far as practicable, for subsequent years. In framing this policy the Committee has given full consideration to the provisions of the Code.

The Company's policy for Executive Director remuneration is that total remuneration (basic remuneration plus short term and long term remuneration) should reward both short and long term results, delivering competitive rewards for target performance.

The Company's policy for basic Director remuneration is to pay competitive market salaries and associated benefits, having regard to the Directors' experience, the size and complexity of the job, relative remuneration levels throughout the Group and any other relevant factors, such as business sector expertise.

Share ownership is encouraged. Equity-based reward programmes align the interests of Executive Directors with those of shareholders and the long term success of the Group.

The Committee considers that a successful remuneration policy needs to be sufficiently flexible to take account of future changes in the Company's business environment and in remuneration practice. Any changes in policy for years after 2010 will be described in future Remuneration Reports. Any statements in this Report in relation to remuneration policy for years after 2010 should be considered in this context.

## Components of Remuneration

The current elements of remuneration for Executive Directors are as follows:

### Salary and Benefits

The Committee reviews salaries taking account of Group and personal performance. Account is also taken of the levels of pay awarded elsewhere in the sector and competitive market practice.

The value of non-salary benefits for Executive Directors is included in the table of remuneration on page 38 and comprises health insurance and cash payments in lieu of a car. The value of these benefits is not pensionable, but is assessable to tax.

### Short Term Incentives

The Company operates an annual performance related cash bonus scheme for Executive Directors. The maximum bonus payment under this scheme in 2010 is 100% of basic salary for the Chief Executive Officer and 80% for other Executive Directors. On target bonus is 60% for the Chief Executive Officer and 50% for other Executive Directors. The bonus for the Chief Executive Officer is wholly dependent on the financial performance of the Group; the bonus for the other Executive Directors is 75% based on the financial performance of the Group, with the remaining 25% subject to achievement of specified personal objectives.

### Long Term Incentive Plan

The Company's LTIP for Executive Directors provides for annual grants to Executive Directors. It is intended that this LTIP will be replaced by the new PSP in January 2011, as described above. It is intended that no further awards will be made under the LTIP.

Under the existing LTIP, Executive Directors are awarded rights to acquire ordinary shares. Each award made under the LTIP is subject to performance conditions which will determine how many, if any, of the shares under the award the participant is entitled to receive after the three year performance period. The value of awards made to a participant in any year have been equal to 100% of basic salary.

In any ten-year period, the number of shares which may be issued or placed under option under any executive share plan established by the Company, may not exceed 5% of the issued ordinary share capital of the Company from time to time. In any ten-year period the number of shares which may be issued

or placed under option, under any all-employee share plan established by the Company, may not exceed 10% of the issued ordinary share capital of the Company, from time to time.

Two performance conditions apply to the awards so that the vesting of 50% of the award will be linked to earnings per share ("EPS") growth and 50% will be linked to Total Shareholder Return (share price growth and reinvested dividends) ("TSR"), measured by comparison with the FTSE mid-250 index (excluding investment trusts).

The first performance condition is that the average annual compound growth in the Company's earnings per share ("EPS") over the three consecutive financial years, following the year prior to the grant, must exceed the annual compound growth rate in the UK Retail Price Index (RPI) plus 3% per annum, over the same period. At this level of performance, 30% of the award relating to EPS performance would vest. Full vesting of the award relating to EPS performance requires that the Company's average annual compound growth in EPS exceeds the compound growth in RPI plus 5% per annum over the period. Between these two points, an increasing proportion of vesting occurs at RPI plus 3.5%, RPI plus 4% and RPI plus 4.5%. For the purposes of this condition, EPS will comprise adjusted EPS as defined in note 2 to the consolidated financial statements. The definition of adjusted EPS remains consistent with the definition of EPS approved by the Remuneration Committee in previous years.

EPS was chosen as the appropriate measure of performance as it provides an absolute benchmark of the Company's performance and is therefore a suitable balance to the relative TSR performance measurement.

The second performance condition compares the growth of the Company's TSR over a three year period to that of the companies in the FTSE mid-250 index (excluding investment trusts). The Company's ranking amongst the comparator companies determines the percentage of shares which will vest to a participant. For the participant to receive the full number of shares awarded, the Company must rank in the top quartile of the comparator group. Where the Company's performance is at the median, 30% of any award is vested. Between these two points, vesting is on a straight-line basis. Where performance over the three year period does not reach the median ranking, no shares are vested, the relevant award lapses and there is no re-testing of performance.

The TSR performance condition was chosen as the Committee believes that TSR is an appropriate method of comparing the performance of the Company to that of its peers. The FTSE mid-250 index (excluding investment trusts) was chosen as the comparator group as there are a limited number of companies which are directly comparable to the Company and the index was therefore felt to be a suitable yardstick of relative performance.

Subsisting awards may vest before their vesting date in the event of a change of control of the Company, in accordance with the rules of the LTIP. Benefits under the LTIP are not pensionable.

The Company's Employee Benefit Trust waives dividends on all the shares held for the purposes of the Company's LTIP. In 2010, the Remuneration Committee agreed that participating executive directors in the LTIP may receive discretionary

payments equal to the net dividend paid (excluding any tax credit) on shares in their LTIP awards which have vested, but are unexercised. Such discretionary payments will be made in respect of awards granted under the LTIP in 2007 and subsequent years.

Awards under this LTIP have been made annually by the Remuneration Committee to BM Thompson, I Henderson and NP Lingwood. The final award under the LTIP was made on 18 November 2009. Following the end of the relevant performance period, the number of shares over which an award vests is determined and a participant may then exercise the award on payment of £1 at any time within ten years of the date of grant. The numbers of shares over which the 2007 awards have vested at 30 September 2010 are set out on page 39. The outstanding awards will vest on 30 September 2011 and 2012 respectively, subject to the performance conditions set out above, measured over three year performance periods ending on 30 September 2011 and 2012.

### Pension Arrangements

The Executive Directors receive pension contributions from the Company which are paid into money-purchase schemes. No Directors are members of the Group's defined benefit schemes. The pension contributions are 20.0% (2009: 20.0%) of base remuneration, excluding bonuses.

In September 2010, the Company established an unregistered retirement benefits scheme, known as the Diploma Holdings PLC Employer-Financed Retirement Benefits Scheme ("the Scheme"). The Scheme was established for Executive Directors and higher paid UK employees in the Group as an alternative to the employees' current pension arrangements and contains all the key features of a conventional registered pension plan. At 30 September 2010, no contributions had been paid into the Scheme. In light of the statement issued on 14 October 2010 by HM Treasury and HM Revenue and Customs, entitled "Restricting Pensions Relief", the Committee is likely to review further in 2011 the provision of pensions to Executive Directors and higher paid employees.

### Relative Performance of Remuneration Elements

The Committee's view is that the performance related elements of the remuneration package for Executive Directors should be a significant element of the total. This serves to align the interests of such Directors with shareholders. Assuming full payment of all elements, more than 60% of the total remuneration of each of the Executive Directors would be performance related.

### Service Contracts – Executive Directors

The service agreements of the Executive Directors include the following terms:

	Date of Contract	Notice Period
BM Thompson	13 July 2000	12 months
I Henderson	1 August 2000	12 months
NP Lingwood	3 July 2001	12 months

## Remuneration Report continued

The Executive Directors are subject to rolling contracts and offer themselves for re-election as Directors at least every three years in accordance with the Company's Articles of Association. Payments on termination for Executive Directors are restricted to the value of salary and contractual benefits for the notice period. There is no predetermined special provision for Executive Directors with regard to compensation in the event of loss of office. The Remuneration Committee would consider the circumstances of individual cases of early termination and determine compensation payments accordingly.

### Non-Executive Directors

The fees for the non-Executive Directors are determined by the Board as a whole, having regard to market practice. Business expenses are also reimbursed.

The non-Executive Directors do not have contracts of service, but are appointed pursuant to letters of appointment. Such appointments are for a one year term and the Company's policy is for re-appointment to be on an annual basis. Non-Executive Directors are not eligible to participate in any incentive plan

or Company pension arrangement and are not entitled to any payment in compensation for any early termination of their appointment. They are due for re-appointment to the Board on the following dates:

	Date of Re-appointment	Renewal
IM Grice	24 January 2011	Annual
JW Matthews	24 July 2011	Annual
JL Rennocks	11 July 2011	Annual

All Directors' appointments are subject to approval of the shareholders in General Meeting sought on a three yearly basis.

During the year ended 30 September 2010 the non-Executive Directors each received a fee of £35,000 per annum (2009: £35,000). The Chairman, who is a non-Executive Director, received a fee of £70,000 per annum (2009: £70,000) for his services during the year ended 30 September 2010.

### Total Remuneration of the Directors

The total remuneration of the Directors for the year ended 30 September 2010 is set out below.

	Fixed emoluments			2010 Total £000	2009 Total £000
	Salary & fees £000	Other benefits £000	Performance based bonus £000		
IM Grice	35	–	–	<b>35</b>	35
I Henderson	210	11	168	<b>389</b>	268
NP Lingwood	220	12	176	<b>408</b>	269
JW Matthews	35	–	–	<b>35</b>	35
JL Rennocks	70	–	–	<b>70</b>	70
BM Thompson	345	14	345	<b>704</b>	456
	<b>915</b>	<b>37</b>	<b>689</b>	<b>1,641</b>	1,133

The pension contributions paid on behalf of the Directors are as follows:

	2010 £000	2009 £000
BM Thompson	<b>69</b>	68
I Henderson	<b>42</b>	41
NP Lingwood	<b>44</b>	41
	<b>155</b>	150



### Long Term Incentive Plan

On 18 November 2009 the Executive Directors received a share award with a face value of one times salary as set out below. On 30 September 2010 the performance period relating to the award made on 17 December 2007 ended and the LTIP awards vested and became exercisable by each of the Directors, as set out below.

	LTIP shares held at 30 Sept 2009 Number	LTIP shares awarded during the year ended 30 Sept 2010 Number	LTIP shares vested on 30 Sept 2010 (note 1) Number	LTIP shares lapsed on 30 Sept 2010 Number	Share price on date of award	Vesting date	Total LTIP shares held at 30 Sept 2010 Number
BM Thompson							
17 December 2007	178,225	–	178,225	–	184.6p	30 Sept 2010	–
17 December 2008	276,423	–	–	–	123.0p	30 Sept 2011	276,423
18 November 2009	–	204,748	–	–	168.5p	30 Sept 2012	204,748
I Henderson							
17 December 2007	106,715	–	106,715	–	184.6p	30 Sept 2010	–
17 December 2008	168,293	–	–	–	123.0p	30 Sept 2011	168,293
18 November 2009	–	124,629	–	–	168.5p	30 Sept 2012	124,629
NP Lingwood							
17 December 2007	106,715	–	106,715	–	184.6p	30 Sept 2010	–
17 December 2008	168,293	–	–	–	123.0p	30 Sept 2011	168,293
18 November 2009	–	130,564	–	–	168.5p	30 Sept 2012	130,564

Note:

- The awards which vested on 30 September 2010 were calculated in accordance with the performance conditions described on pages 36 and 37. The awards may be exercised at any time before 17 December 2017 on payment of £1. In aggregate 100% of the total LTIP award granted on 17 December 2007 vested unconditionally and became exercisable.
  - Under the first performance condition, the average annual compound growth rate in the Company's adjusted EPS (as defined on page 46) over the three year period ended 30 September 2010 was 13.0% pa; this compares with an annual compound growth rate in RPI +5.0% over the same period of 7.6% pa. Accordingly 100% of the shares relating to this award (representing 50% of the total award) vested unconditionally.
  - Under the second performance condition, the Company's TSR grew 61.5% over the three year period ended 30 September 2010; this growth gave the Company a ranking of 26 in the comparator group and put the Company in the 87 percentile. The median TSR was -20.8% and the lower threshold of the upper quartile was 17.4%. Accordingly 100% of the shares relating to this part of the award (representing 50% of the total award) vested unconditionally.

### Directors' Shareholdings

	Ordinary shares of 5p each		
	At 22 November 2010 Number	At 30 September 2010 Number	At 1 October 2009 Number
IM Grice	20,000	20,000	20,000
I Henderson	416,604	416,604	534,604
NP Lingwood	150,000	150,000	100,000
JW Matthews	–	–	–
JL Rennocks	73,766	73,766	223,766
BM Thompson	1,125,000	1,125,000	1,215,039

Note:

- The above table excludes interests in the Company's Long Term Incentive Plan, disclosed above.

## Remuneration Report continued

As described above, following the vesting of the LTIP awards the Executive Directors are able to exercise their vested awards to acquire ordinary shares of 5p each in the Company for an aggregate consideration of £1. The underlying shares are held by the Diploma Employee Benefit Trust and are transferred to the participant on exercise. Whilst ordinary shares are held within the Diploma Employee Benefit Trust, the voting rights in respect of those shares are exercisable by the trustees in accordance with their fiduciary duties. At 30 September 2009 and 2010 the number of shares which are the subject of vested LTIP awards and are held by each Director were as follows:

	Vested LTIP awards			Share price		Amount		
	At 30 Sept 2009 Number	Exercised during 2010 Number	Vested during 2010 Number	At 30 Sept 2010 Number	At 30 Sept 2009	At 30 Sept 2010	At 30 Sept 2009 £	At 30 Sept 2010 £
BM Thompson	175,132	(175,132)	178,225	<b>178,225</b>	173.0p	<b>284.5p</b>	302,978	<b>507,050</b>
I Henderson	105,079	(105,079)	106,715	<b>106,715</b>	173.0p	<b>284.5p</b>	181,787	<b>303,604</b>
NP Lingwood	105,079	(105,079)	106,715	<b>106,715</b>	173.0p	<b>284.5p</b>	181,787	<b>303,604</b>

Note:

- On 16 November 2009, each participant exercised their option to acquire shares which had vested at 30 September 2009, for consideration of £1. The share price at the date of exercise was 165.0p.
- The share price during the year to 30 September 2010 ranged from 161.0p to 284.5p.

The information set out above under the headings Total Remuneration of the Directors, Long Term Incentive Plan and Directors' Shareholdings has been audited. All other information provided in the Remuneration Report is not subject to audit.

This Remuneration Report has been approved by the Board and signed on its behalf by:

**IM Grice**  
Chairman of the Remuneration Committee

22 November 2010

# Statement of Directors' Responsibilities for the Financial Statements

The Directors are responsible for preparing the Annual Report, including the Group and Parent Company financial statements, in accordance with applicable law and regulations.

Company law requires the Directors to prepare Group and Parent Company financial statements for each financial year. Under that law the Directors are required to prepare Group financial statements in accordance with IFRSs as adopted by the European Union ("EU") and Article 4 of the IAS Regulations and have elected to prepare the Parent Company financial statements in accordance with United Kingdom Generally Accepted Accounting Standards (UK Accounting Standards).

The Group financial statements are required by law and IFRSs as adopted by the EU, to present fairly the financial position and the performance of the Group; the Companies Act 2006 provides in relation to such financial statements, that references in the relevant part of that Act to financial statements giving a true and fair view, are references to their achieving a fair presentation.

In preparing each of the Group and Company financial statements, the Directors are required to:

- Select suitable accounting policies and then apply them consistently.
- Make judgements and estimates that are reasonable and prudent.
- For the Group financial statements, state whether they have been prepared in accordance with IFRSs, as adopted by the EU.
- For the Parent Company financial statements, state whether applicable UK Accounting Standards have been followed, subject to any material departures disclosed and explained in the Parent Company financial statements.
- Prepare the financial statements on the going concern basis, unless it is inappropriate to presume that the Group and the Parent Company will continue in business.

The Directors are responsible for keeping proper accounting records that disclose with reasonable accuracy at any time the financial position of the Parent Company and enable them to ensure that its financial statements comply with the Companies Act 2006. They have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Group and to prevent and detect fraud and other irregularities.

The Directors are responsible for the maintenance and integrity of the corporate and financial information included on the Company's website. Legislation in the UK governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Each of the Directors confirms that so far as he is aware, there is no relevant audit information of which the Company's auditors are unaware and that he has taken all 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.

## Directors' Responsibility Statement

The Directors confirm that to the best of their knowledge:

- the Group's consolidated financial statements, prepared in accordance with IFRSs as adopted by the EU, and the Parent Company financial statements, prepared in accordance with UK Accounting Standards, give a true and fair view of the assets, liabilities, financial position and profit of the Group and Parent Company and the undertakings included in the consolidation taken as a whole; and
- the Annual Report includes a fair review of the development and performance of the business and the position of the Group and the undertakings included in the consolidation taken as a whole, together with a description of the principal risks and uncertainties faced by the Group.

This responsibility statement was approved by the Board of Directors on 22 November 2010 and is signed on its behalf by:

**BM Thompson**  
Chief Executive Officer

**NP Lingwood**  
Group Finance Director

# Consolidated Income Statement

For the year ended 30 September 2010

Continuing businesses	Note	2010 £m	2009 £m
<b>Revenue</b>	3,4	<b>183.5</b>	160.0
Cost of sales		<b>(115.5)</b>	(101.7)
<b>Gross profit</b>		<b>68.0</b>	58.3
Distribution costs		<b>(4.4)</b>	(4.1)
Administration costs		<b>(35.0)</b>	(31.7)
<b>Operating profit</b>	3	<b>28.6</b>	22.5
Financial expense, net	6	<b>(1.9)</b>	(2.0)
<b>Profit before tax</b>		<b>26.7</b>	20.5
Tax expense	7	<b>(8.8)</b>	(7.1)
<b>Profit for the year from continuing businesses</b>		<b>17.9</b>	13.4
Profit from discontinued businesses	22	<b>5.1</b>	0.9
<b>Profit for the year</b>		<b>23.0</b>	14.3
Attributable to:			
Shareholders of the Company		<b>21.5</b>	13.0
Minority interests	20	<b>1.5</b>	1.3
		<b>23.0</b>	14.3
<b>Earnings per share</b>	9		
Basic and diluted earnings – continuing		<b>14.6p</b>	10.8p
Basic and diluted earnings – discontinued		<b>4.5p</b>	0.8p
Basic and diluted earnings – continuing and discontinued		<b>19.1p</b>	11.6p

## Alternative Performance Measures (note 2)

	Note	2010 £m	2009 £m
Operating profit		<b>28.6</b>	22.5
Add: Acquisition related charges	11	<b>3.5</b>	3.1
<b>Adjusted operating profit</b>	3,4	<b>32.1</b>	25.6
Add/(deduct): Net interest income/(expense)	6	<b>0.1</b>	(0.1)
<b>Adjusted profit before tax</b>		<b>32.2</b>	25.5
<b>Adjusted earnings per share</b>	9	<b>18.9p</b>	14.8p

The notes on pages 46 to 73 form part of these financial statements.

# Consolidated Statement of Comprehensive Income

For the year ended 30 September 2010

	Note	2010 £m	2009 £m
Profit for the year		<b>23.0</b>	14.3
Exchange rate adjustments on foreign currency net investments		<b>1.9</b>	10.7
Losses on fair value of cash flow hedges		<b>(0.4)</b>	(0.4)
Actuarial losses on defined benefit pension schemes	24	<b>(1.8)</b>	(3.1)
Deferred tax on items recognised in equity	13	<b>0.6</b>	1.0
Other comprehensive income for the year		<b>0.3</b>	8.2
<b>Total comprehensive income for the year</b>		<b>23.3</b>	22.5
Attributable to:			
Shareholders of the Company		<b>21.8</b>	21.2
Minority interests		<b>1.5</b>	1.3
		<b>23.3</b>	22.5

# Consolidated Statement of Changes in Shareholders' Equity

For the year ended 30 September 2010

	Note	Share capital £m	Translation reserve £m	Hedging reserve £m	Retained earnings £m	Total £m
<b>At 1 October 2008</b>		5.7	8.0	0.7	93.7	108.1
Total comprehensive income		–	10.7	(0.4)	10.9	21.2
Share-based payments	5	–	–	–	0.5	0.5
Dividends	8	–	–	–	(8.4)	(8.4)
<b>At 30 September 2009</b>		5.7	18.7	0.3	96.7	121.4
Total comprehensive income		–	1.9	(0.4)	20.3	21.8
Share-based payments	5	–	–	–	0.5	0.5
Purchase of minority interests	19	–	–	–	2.5	2.5
Future purchase of minority interests	19	–	–	–	(0.6)	(0.6)
Purchase of own shares		–	–	–	(0.4)	(0.4)
Dividends	8	–	–	–	(9.1)	(9.1)
<b>At 30 September 2010</b>		<b>5.7</b>	<b>20.6</b>	<b>(0.1)</b>	<b>109.9</b>	<b>136.1</b>

The notes on pages 46 to 73 form part of these financial statements.

# Consolidated Statement of Financial Position

As at 30 September 2010

	Note	2010 £m	2009 £m
<b>Non-current assets</b>			
Goodwill	10	67.3	59.6
Acquisition intangible assets	11	22.7	21.2
Other intangible assets	11	0.6	0.8
Property, plant and equipment	12	11.1	11.6
Deferred tax assets	13	2.4	2.1
		<b>104.1</b>	95.3
<b>Current assets</b>			
Inventories	14	32.0	28.0
Trade and other receivables	15	30.5	25.2
Assets held for sale		–	5.4
Cash and cash equivalents	17	30.1	21.3
		<b>92.6</b>	79.9
<b>Current liabilities</b>			
Trade and other payables	16	(32.3)	(23.3)
Current tax liabilities		(2.0)	(1.8)
Other liabilities	19	(13.0)	(3.1)
Liabilities associated with assets held for sale		–	(3.5)
		<b>(47.3)</b>	(31.7)
<b>Net current assets</b>		<b>45.3</b>	48.2
<b>Total assets less current liabilities</b>		<b>149.4</b>	143.5
<b>Non-current liabilities</b>			
Retirement benefit obligations	24	(5.3)	(4.7)
Other liabilities	19	(1.2)	(10.6)
Deferred tax liabilities	13	(3.7)	(4.1)
<b>Net assets</b>		<b>139.2</b>	124.1
<b>Equity</b>			
Share capital		5.7	5.7
Translation reserve		20.6	18.7
Hedging reserve		(0.1)	0.3
Retained earnings		109.9	96.7
<b>Total shareholders' equity</b>		<b>136.1</b>	121.4
Minority interests	20	3.1	2.7
<b>Total equity</b>		<b>139.2</b>	124.1

The consolidated financial statements were approved by the Board of Directors on 22 November 2010 and signed on its behalf by:

**BM Thompson**  
Chief Executive Officer

**NP Lingwood**  
Group Finance Director

The notes on pages 46 to 73 form part of these financial statements.



# Consolidated Cash Flow Statement

For the year ended 30 September 2010

Continuing businesses	Note	2010 £m	2009 £m
<b>Cash flow from operating activities</b>			
Cash flow from operations	23	<b>34.3</b>	34.2
Interest income received, net		<b>0.1</b>	–
Tax paid		<b>(9.3)</b>	(9.0)
<b>Net cash from operating activities</b>		<b>25.1</b>	25.2
<b>Cash flow from investing activities</b>			
Acquisition of subsidiaries (net of cash acquired)	21	<b>(8.1)</b>	(11.1)
Acquisition of minority interests	21	<b>(2.5)</b>	–
Disposal of subsidiaries (net of cash disposed)	22	<b>6.4</b>	–
Deferred consideration paid	19	<b>(0.4)</b>	(1.1)
Proceeds from the sale of property, plant and equipment		<b>–</b>	0.1
Purchase of property, plant and equipment	12	<b>(1.2)</b>	(1.5)
Purchase of other intangible assets	11	<b>(0.1)</b>	(0.3)
<b>Net cash used in investing activities</b>		<b>(5.9)</b>	(13.9)
<b>Cash flow from financing activities</b>			
Dividends paid to shareholders	8	<b>(9.1)</b>	(8.4)
Dividends paid to minority interests	20	<b>(1.1)</b>	(0.7)
Purchase of own shares		<b>(0.4)</b>	–
<b>Net cash used in financing activities</b>		<b>(10.6)</b>	(9.1)
<b>Net cash (used in)/from discontinued businesses</b>	22	<b>(0.5)</b>	1.7
<b>Net increase in cash and cash equivalents</b>		<b>8.1</b>	3.9
Cash and cash equivalents at beginning of year		<b>21.3</b>	15.7
Effect of exchange rates on cash and cash equivalents		<b>0.7</b>	1.7
<b>Cash and cash equivalents at end of year</b>	17	<b>30.1</b>	21.3

## Alternative Performance Measures (note 2)

	2010 £m	2009 £m
<b>Net increase in cash and cash equivalents</b>	<b>8.1</b>	3.9
Add: Dividends paid to shareholders	<b>9.1</b>	8.4
Dividends paid to minority interests	<b>1.1</b>	0.7
Acquisition of subsidiaries/minority interests	<b>10.6</b>	11.1
Deferred consideration paid	<b>0.4</b>	1.1
<b>Free cash flow – continuing and discontinued businesses</b>	<b>29.3</b>	25.2
Add/(deduct): Free cash flow – discontinued businesses	<b>0.5</b>	(1.7)
<b>Free cash flow – continuing businesses</b>	<b>29.8</b>	23.5

The notes on pages 46 to 73 form part of these financial statements.

# Notes to the Consolidated Financial Statements

For the year ended 30 September 2010

## 1. General Information

Diploma PLC is a public limited company registered and domiciled in England and Wales and listed on the London Stock Exchange. The address of the registered office is 12 Charterhouse Square, London, EC1M 6AX. The consolidated financial statements comprise the Company and its subsidiaries (together referred to as the "Group") and were authorised by the Directors for publication on 22 November 2010. These statements are presented in UK sterling, with all values rounded to the nearest one hundred thousand, except where otherwise indicated.

The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS"), as adopted by the European Union, and in accordance with the Companies Act 2006, as applicable to companies reporting under IFRS. The financial statements of the Parent company, Diploma PLC, have been prepared in accordance with "UK GAAP", and are set out in a separate section of the Annual Report on pages 74 to 75.

## 2. Alternative Performance Measures

The Group uses a number of alternative (non-Generally Accepted Accounting Practice ("non-GAAP")) financial measures which are not defined within IFRS. The Directors use these measures in order to assess the underlying operational performance of the Group and as such, these measures are important and should be considered alongside the IFRS measures. The following non-GAAP measures are referred to in this Annual Report.

### 2.1 Adjusted operating profit

At the foot of the consolidated income statement, "adjusted operating profit" is defined as operating profit before amortisation and impairment of acquisition intangible assets, acquisition costs and adjustments to deferred consideration (collectively, "acquisition related charges"). The Directors believe that adjusted operating profit is an important measure of the underlying operational performance of the Group.

### 2.2 Adjusted profit before tax

At the foot of the consolidated income statement, "adjusted profit before tax" is separately disclosed, being defined as profit before tax and before the costs of restructuring or rationalisation of operations, the profit or loss relating to the sale of property, fair value remeasurements under IAS 32 and IAS 39 in respect of future purchases of minority interests, and acquisition related charges. The Directors believe that adjusted profit before tax is an important measure of the underlying performance of the Group.

### 2.3 Adjusted earnings per share

"Adjusted earnings per share" is calculated as the total of adjusted profit, less income tax costs, but excluding the tax impact on the items included in the calculation of adjusted profit and the tax effects of goodwill in overseas jurisdictions, less profit attributable to minority interests, divided by the weighted average number of ordinary shares in issue during the year. The Directors believe that adjusted earnings per share provides an important measure of the underlying earning capacity of the Group.

### 2.4 Free cash flow

At the foot of the consolidated cash flow statement, "free cash flow" is reported, being defined as net cash flow from operating activities, after net capital expenditure on fixed assets and including proceeds received from business disposals, but before expenditure on business combinations and dividends paid to both minority shareholders and the Company's shareholders. The Directors believe that free cash flow gives an important measure of the cash flow of the Group, available for future investment.

### 2.5 Trading capital employed

In the segment analysis in note 3, "trading capital employed" is reported, being defined as net assets less cash and cash equivalents and after adding back retirement benefit obligations, deferred tax, amounts in respect of future purchases of minority interests and adjusting goodwill in respect of the recognition of deferred tax on acquisition intangible assets. Return on trading capital employed is defined as being adjusted operating profit, divided by trading capital employed plus all historic goodwill and as adjusted for the timing effect of major acquisitions and disposals. Return on trading capital employed at the sector level does not include historic goodwill. The Directors believe that return on trading capital employed is an important measure of the underlying performance of the Group.

## 3. Business Segment Analysis

For management reporting purposes, the Group is organised into three main business segments: Life Sciences, Seals and Controls. These segments form the basis of the primary reporting format disclosures below. The principal activities of each of these segments is described in the Business Review on pages 14 to 28. Segment revenue represents revenue from external customers; there is no inter-segment revenue. Segment results, assets and liabilities include items directly attributable to a segment, as well as those that can be allocated on a reasonable basis.

	Life Sciences		Seals		Controls		Total	
	2010 £m	2009 £m	2010 £m	2009 £m	2010 £m	2009 £m	2010 £m	2009 £m
Revenue – existing businesses	55.0	49.9	59.6	48.2	68.0	61.9	182.6	160.0
– acquisitions	0.4	–	0.5	–	–	–	0.9	–
<b>Revenue</b>	<b>55.4</b>	<b>49.9</b>	<b>60.1</b>	<b>48.2</b>	<b>68.0</b>	<b>61.9</b>	<b>183.5</b>	<b>160.0</b>
Adjusted operating profit – existing businesses	11.8	10.6	8.8	5.5	11.3	9.5	31.9	25.6
– acquisitions	0.1	–	0.1	–	–	–	0.2	–
<b>Adjusted operating profit</b>	<b>11.9</b>	<b>10.6</b>	<b>8.9</b>	<b>5.5</b>	<b>11.3</b>	<b>9.5</b>	<b>32.1</b>	<b>25.6</b>
Acquisition related charges (note 11)	(1.6)	(1.4)	(1.5)	(1.3)	(0.4)	(0.4)	(3.5)	(3.1)
<b>Operating profit</b>	<b>10.3</b>	<b>9.2</b>	<b>7.4</b>	<b>4.2</b>	<b>10.9</b>	<b>9.1</b>	<b>28.6</b>	<b>22.5</b>

### 3. Business Segment Analysis (continued)

Segment assets exclude cash and cash equivalents, deferred tax assets and corporate assets that cannot be allocated on a reasonable basis to a business segment. Segment liabilities exclude retirement benefit obligations, deferred tax liabilities and corporate liabilities that cannot be allocated on a reasonable basis to a business segment. These items are shown collectively in the following analysis as "unallocated assets" and "unallocated liabilities", respectively.

	Life Sciences		Seals		Controls		Total	
	2010 £m	2009 £m	2010 £m	2009 £m	2010 £m	2009 £m	2010 £m	2009 £m
Operating assets	17.6	15.6	27.1	23.6	25.9	23.3	70.6	62.5
Goodwill	38.2	32.5	14.2	12.0	14.9	15.1	67.3	59.6
Acquisition intangible assets	9.9	10.9	11.5	8.8	1.3	1.5	22.7	21.2
	65.7	59.0	52.8	44.4	42.1	39.9	160.6	143.3
Unallocated assets:								
– Deferred tax assets							2.4	2.1
– Cash and cash equivalents							30.1	21.3
– Assets held for sale							–	5.4
– Corporate assets							3.6	3.1
<b>Total assets</b>							196.7	175.2
Operating liabilities	(11.3)	(9.0)	(8.0)	(4.8)	(12.2)	(9.3)	(31.5)	(23.1)
Unallocated liabilities:								
– Deferred tax liabilities							(3.7)	(4.1)
– Retirement benefit obligations							(5.3)	(4.7)
– Future purchases of minority interests							(13.2)	(13.1)
– Liabilities associated with assets held for sale							–	(3.5)
– Corporate liabilities							(3.8)	(2.6)
<b>Total liabilities</b>							(57.5)	(51.1)
<b>Net assets</b>							139.2	124.1
<b>Other segment information</b>								
Capital expenditure	0.7	0.6	0.5	1.1	0.1	0.1	1.3	1.8
Depreciation (including software)	0.8	0.8	0.9	0.8	0.4	0.6	2.1	2.2

#### Alternative Performance Measures (note 2)

	Life Sciences		Seals		Controls		Total	
	2010 £m	2009 £m	2010 £m	2009 £m	2010 £m	2009 £m	2010 £m	2009 £m
<b>Net assets</b>							139.2	124.1
Add/(less):								
– Deferred tax, net							1.3	2.0
– Retirement benefit obligations							5.3	4.7
– Future purchases of minority interests							13.2	13.1
– Cash and cash equivalents							(30.1)	(21.3)
– Adjustment to goodwill	(4.7)	(4.5)	(1.3)	(1.4)	(0.6)	(0.6)	(6.6)	(6.5)
<b>Group trading capital employed</b>							122.3	116.1
Assets held for sale, net							–	(1.9)
Corporate liabilities/(assets), net							0.2	(0.5)
<b>Segment trading capital employed</b>	49.7	45.5	43.5	38.2	29.3	30.0	122.5	113.7

# Notes to the Consolidated Financial Statements

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## 4. Geographic Segment Analysis by Origin

	Revenue		Adjusted operating profit		Gross assets		Trading capital employed		Capital expenditure	
	2010 £m	2009 £m	2010 £m	2009 £m	2010 £m	2009 £m	2010 £m	2009 £m	2010 £m	2009 £m
United Kingdom	55.9	50.1	8.4	6.8	50.0	49.3	19.2	28.4	0.3	0.1
Rest of Europe	35.1	32.6	4.5	3.9	33.2	34.8	19.6	21.0	0.1	0.2
North America	92.5	77.3	19.2	14.9	113.5	91.1	83.5	66.7	0.9	1.5
	183.5	160.0	32.1	25.6	196.7	175.2	122.3	116.1	1.3	1.8

## 5. Group Employee Costs

The key management of the Group are the Executive Directors who have authority and responsibility for planning and controlling all significant activities of the Group. The Directors' emoluments and interests in shares of the Company are given in the Remuneration Report on pages 35 to 40. The charge for share-based payments of £0.5m relate to the Group's share schemes, described in the Remuneration Report. The fair value of services provided as consideration for part of the grant of the LTIP awards has been based on a predicted future value model and was £0.2m (2009: £0.2m).

Group staff costs, including Directors' emoluments, are as follows:

	2010 £m	2009 £m
Wages and salaries	32.1	29.3
Social security costs	2.9	2.8
Pension costs – defined contribution	0.7	0.7
Share-based payments	0.5	0.5
	36.2	33.3

The average number of employees, including Executive Directors, during the year were:

	2010 Number	2009 Number
Life Sciences	199	207
Seals	371	358
Controls	234	248
Corporate	10	10
<b>Number of employees – average</b>	<b>814</b>	<b>823</b>
<b>Number of employees – year end</b>	<b>847</b>	<b>809</b>

## 6. Financial Expense, net

	2010 £m	2009 £m
<b>Interest and similar income</b>		
– interest receivable on short term deposits	0.2	0.1
– net finance income from defined benefit pension scheme (note 24)	0.1	–
	0.3	0.1
<b>Interest expense and similar charges</b>		
– bank commitment fees	(0.1)	(0.1)
– unwinding of discount on provisions	(0.1)	–
– net finance expense from defined benefit pension scheme (note 24)	–	(0.1)
	(0.2)	(0.2)
<b>Net interest income/(expense)</b>	<b>0.1</b>	<b>(0.1)</b>
– fair value remeasurement of put options (note 19)	(2.0)	(1.9)
<b>Financial expense, net</b>	<b>(1.9)</b>	<b>(2.0)</b>

The fair value remeasurement of £2.0m (2009: £1.9m) includes £1.1m (2009: £1.1m) which relates to the unwinding of the discount on the liability for future purchases of minority interests.

## 7. Tax Expense

	2010 £m	2009 £m
<b>Current tax</b>		
The tax charge is based on the profit for the year of the continuing businesses and comprises:		
UK corporation tax	2.2	2.4
Overseas tax	7.0	5.2
	9.2	7.6
Adjustments in respect of prior year:		
Overseas tax	(0.1)	–
	(0.1)	–
<b>Total current tax</b>	9.1	7.6
<b>Deferred tax</b>		
The deferred tax credit based on the origination and reversal of timing differences comprises:		
United Kingdom	(0.1)	(0.2)
Overseas	(0.2)	(0.3)
<b>Total deferred tax</b>	(0.3)	(0.5)
<b>Total tax on profit for the year</b>	8.8	7.1

### Factors affecting the tax charge for the year:

The difference between the total tax charge shown above and the amount calculated by applying the standard rate of UK corporation tax to the profit before tax is as follows:

	2010 £m	2009 £m
<b>Profit before tax</b>	26.7	20.5
Tax on profit at UK effective corporation tax rate of 28% (2009: 28%)	7.5	5.7
Effects of:		
Higher tax rates on overseas earnings	1.0	0.7
Adjustments to tax charge in respect of previous periods	(0.1)	–
Fair value remeasurements	0.6	0.5
Other permanent differences	(0.2)	0.2
<b>Total tax on profit for the year</b>	8.8	7.1

The Group earns its profits in the UK and Overseas. The UK corporation tax rate is 28% (2009: 28%) and this rate has been used for tax on profit in the above reconciliation. The Group's overseas tax rate is higher than that in the UK, primarily because the profits earned in North America are taxed at rates varying from 28% to 40%. The tax relating to the discontinuing business is £0.2m credit (2009: £0.3m charge), as set out in note 22.

# Notes to the Consolidated Financial Statements

For the year ended 30 September 2010

## 8. Dividends

	2010 pence per share	2009 pence per share	2010 £m	2009 £m
Interim dividend, paid in June	2.8	2.5	3.1	2.8
Final dividend of the prior year, paid in January	5.3	5.0	6.0	5.6
	8.1	7.5	9.1	8.4

The Directors have proposed a final dividend in respect of the current year of 6.2p (2009: 5.3p) which will be paid on 19 January 2011, subject to approval of shareholders at the Annual General Meeting on 12 January 2011. The total dividend for the current year, subject to approval of the final dividend, will be 9.0p (2009: 7.8p).

The Diploma Employee Benefit Trust holds 732,973 (2009: 868,263) shares, which are not eligible for dividends.

## 9. Earnings Per Share

### Basic and diluted earnings per share

Basic and diluted earnings per ordinary 5p share are calculated on the basis of the weighted average number of ordinary shares in issue during the year of 112,577,283 (2009: 112,316,906) and the profit for the year attributable to shareholders of £21.5m (2009: £13.0m). There were no potentially dilutive shares.

### Adjusted earnings per share

Adjusted earnings per share, which is defined in note 2, is calculated as follows:

	2010 pence per share	2009 pence per share	2010 £m	2009 £m
<b>Profit before tax – continuing businesses</b>			<b>26.7</b>	20.5
Tax expense			<b>(8.8)</b>	(7.1)
Minority interests			<b>(1.5)</b>	(1.3)
	<b>14.6</b>	10.8	<b>16.4</b>	12.1
Profit from discontinued businesses	<b>4.5</b>	0.8	<b>5.1</b>	0.9
<b>Earnings for the year attributable to shareholders of the Company</b>	<b>19.1</b>	11.6	<b>21.5</b>	13.0
Acquisition related charges	<b>3.1</b>	2.7	<b>3.5</b>	3.1
Fair value remeasurements	<b>1.8</b>	1.7	<b>2.0</b>	1.9
Tax effects on goodwill, acquisition intangible assets and fair value remeasurements	<b>(0.6)</b>	(0.4)	<b>(0.6)</b>	(0.5)
Profit from discontinued businesses	<b>(4.5)</b>	(0.8)	<b>(5.1)</b>	(0.9)
<b>Adjusted earnings – continuing businesses</b>	<b>18.9</b>	14.8	<b>21.3</b>	16.6



## 10. Goodwill

	Life Sciences £m	Seals £m	Controls £m	Total £m
At 1 October 2008	30.6	8.9	12.1	51.6
Acquisitions	1.4	2.1	–	3.5
Reclassification	(2.4)	–	2.4	–
Exchange adjustments	2.9	1.0	0.6	4.5
At 30 September 2009	32.5	12.0	15.1	59.6
Acquisitions (note 21)	3.7	2.5	–	6.2
Adjustment to prior year goodwill	–	(0.2)	–	(0.2)
Exchange adjustments	2.0	(0.1)	(0.2)	1.7
<b>At 30 September 2010</b>	<b>38.2</b>	<b>14.2</b>	<b>14.9</b>	<b>67.3</b>

The Directors carry out an impairment test on all goodwill generally twice a year. Goodwill is ascribed to a business which, for the purpose of these impairment tests, is referred to as a cash generating unit.

The impairment test requires each cash generating unit to prepare “value in use” valuations from discounted cash flow forecasts. The cash flow forecasts are initially based on the annual budgets and five year strategic plans, prepared by each business.

The key assumptions used to prepare the cash flow forecasts relate to gross margin, growth rates and discount rates. The gross margins are assumed to remain sustainable, which is supported by historical experience; growth rates generally approximate to the long term average rates for the markets in which the business operate, unless there are particular factors relevant to a business, such as start-ups. The growth rates used in the cash flow forecasts vary between 2-5% across all sectors over the next five years and trend down towards 2.0% over the longer term.

The cash flow forecasts are discounted to determine a current valuation, using a pre-tax discount rate of ca. 13% (2009: 13%). This rate is based on the characteristics of lower risk non-technically driven, distribution businesses with robust capital structures, which is broadly consistent with each of the Group’s businesses.

Based on the criteria set out above, no impairment of the value of goodwill was identified.

The Directors have also carried out sensitivity analysis on the key assumptions to determine whether a “reasonably possible change” in any of these assumptions would result in an impairment of goodwill. This analysis indicates that a “reasonably possible change” in these key assumptions would be unlikely to give rise to an impairment charge to goodwill in any of the businesses in the Controls or Life Sciences segments. However, a reduction of 2% in revenue growth in the medium term in some of the businesses in the Seals sector would result in an impairment charge of up to £1.0m. The headroom in the cash flow forecasts before any sensitivities and based on the original assumptions, in respect of the businesses in the Seals sector is £2.0m.

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## 11. Acquisition and Other Intangible Assets

	Customer relationships £m	Supplier relationships £m	Trade names and databases £m	Total acquisition intangible assets £m	Other intangible assets £m	Total £m
<b>Cost</b>						
At 1 October 2008	12.5	9.2	1.1	22.8	2.3	25.1
Additions	–	–	–	–	0.3	0.3
Acquisitions	2.7	–	1.5	4.2	–	4.2
Disposals	–	–	–	–	(0.2)	(0.2)
Exchange adjustments	1.1	0.8	–	1.9	0.1	2.0
Reclassified as held for sale	–	–	–	–	(0.4)	(0.4)
At 30 September 2009	16.3	10.0	2.6	28.9	2.1	31.0
Additions	–	–	–	–	0.1	0.1
Acquisitions (note 21)	4.5	–	–	4.5	–	4.5
Exchange adjustments	0.1	0.3	–	0.4	–	0.4
<b>At 30 September 2010</b>	<b>20.9</b>	<b>10.3</b>	<b>2.6</b>	<b>33.8</b>	<b>2.2</b>	<b>36.0</b>
<b>Amortisation</b>						
At 1 October 2008	2.4	1.5	0.3	4.2	1.1	5.3
Charge for the year	1.8	1.1	0.2	3.1	0.4	3.5
Disposals	–	–	–	–	(0.2)	(0.2)
Exchange adjustments	0.2	0.1	0.1	0.4	0.1	0.5
On assets reclassified as held for sale	–	–	–	–	(0.1)	(0.1)
At 30 September 2009	4.4	2.7	0.6	7.7	1.3	9.0
Charge for the year	1.9	1.1	0.3	3.3	0.3	3.6
Exchange adjustments	–	0.1	–	0.1	–	0.1
<b>At 30 September 2010</b>	<b>6.3</b>	<b>3.9</b>	<b>0.9</b>	<b>11.1</b>	<b>1.6</b>	<b>12.7</b>
<b>Net book value</b>						
<b>At 30 September 2010</b>	<b>14.6</b>	<b>6.4</b>	<b>1.7</b>	<b>22.7</b>	<b>0.6</b>	<b>23.3</b>
At 30 September 2009	11.9	7.3	2.0	21.2	0.8	22.0

Acquisition related charges are £3.5m (2009: £3.1m) and comprise £3.3m (2009: £3.1m) of amortisation of acquisition intangible assets and £0.2m (2009: £Nil) of acquisition costs.

Acquisition intangible assets relate to items acquired through business combinations which are amortised over their useful economic life.

	Economic life
Customer relationships	5-15 years
Supplier relationships	7-10 years
Databases and trade names	5-10 years

The amount in respect of customer relationships was valued using a discounted cash flow model; the databases were valued using a replacement cost model; the amount in respect of supplier relationships and trade names were valued on a relief from royalty method.

Other intangible assets comprise computer software that is separately identifiable from plant and equipment and includes software licences.

## 12. Property, Plant and Equipment

	Freehold properties £m	Leasehold properties £m	Plant & equipment £m	Total £m
<b>Cost</b>				
At 1 October 2008	8.4	1.0	14.1	23.5
Additions	–	–	1.6	1.6
Acquisitions	–	–	0.2	0.2
Disposals	–	–	(1.5)	(1.5)
Exchange adjustments	0.4	0.1	1.5	2.0
Reclassified as held for sale	–	–	(1.4)	(1.4)
At 30 September 2009	8.8	1.1	14.5	24.4
Additions	–	–	1.2	1.2
Disposals	–	–	0.5	0.5
Exchange adjustments	–	–	0.4	0.4
<b>At 30 September 2010</b>	<b>8.8</b>	<b>1.1</b>	<b>16.6</b>	<b>26.5</b>
<b>Depreciation</b>				
At 1 October 2008	1.8	0.5	9.6	11.9
Charge for the year	0.1	0.1	1.9	2.1
Disposals	–	–	(1.3)	(1.3)
Exchange adjustments	0.1	–	1.0	1.1
On assets reclassified as held for sale	–	–	(1.0)	(1.0)
At 30 September 2009	2.0	0.6	10.2	12.8
Charge for the year	0.1	0.1	1.6	1.8
Disposals	–	–	0.5	0.5
Exchange adjustments	–	–	0.3	0.3
<b>At 30 September 2010</b>	<b>2.1</b>	<b>0.7</b>	<b>12.6</b>	<b>15.4</b>
<b>Net book value</b>				
<b>At 30 September 2010</b>	<b>6.7</b>	<b>0.4</b>	<b>4.0</b>	<b>11.1</b>
At 30 September 2009	6.8	0.5	4.3	11.6

Land included above, but not depreciated, is £2.0m (2009: £2.0m). Capital commitments contracted, but not provided, were £Nil (2009: £Nil).

Freehold properties includes ca.150 acres of land at Stamford ("the Stamford land") which comprises mostly farm land and former quarry land. In the Directors' opinion the current value of this land is £0.5m (net book value: £Nil) (2009: £0.5m and £Nil, respectively).

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## 13. Deferred Tax

The movement on deferred tax is as follows:

	2010 £m	2009 £m
At 1 October	(2.0)	(3.3)
Credit for the year (note 7)	0.3	0.5
Acquisitions	–	0.1
Accounted for in equity	0.6	1.0
Exchange adjustments	(0.2)	(0.3)
<b>At 30 September</b>	<b>(1.3)</b>	<b>(2.0)</b>

Deferred tax assets and liabilities are only offset where there is a legally enforceable right of offset and there is an intention to settle the balances net.

	Assets		Liabilities		Net	
	2010 £m	2009 £m	2010 £m	2009 £m	2010 £m	2009 £m
Property, plant and equipment	0.3	0.2	(0.5)	(0.5)	(0.2)	(0.3)
Goodwill and intangible assets	–	0.1	(4.6)	(4.9)	(4.6)	(4.8)
Retirement benefit obligations	1.4	1.3	–	–	1.4	1.3
Inventories	0.7	0.9	–	–	0.7	0.9
Share-based payments	0.1	0.1	–	–	0.1	0.1
Other temporary differences	1.3	0.8	–	–	1.3	0.8
	3.8	3.4	(5.1)	(5.4)	(1.3)	(2.0)
Set off of deferred tax	(1.4)	(1.3)	1.4	1.3	–	–
	2.4	2.1	(3.7)	(4.1)	(1.3)	(2.0)

No deferred tax has been provided for unremitted earnings of overseas Group companies as the Group controls the dividend policies of its subsidiaries. Unremitted earnings may be liable to overseas taxation (after allowing for double taxation relief) if they were to be distributed as dividends. The aggregate amount for which deferred tax liabilities have not been recognised in respect of unremitted earnings was £1.2m (2009: £0.7m).

## 14. Inventories

	2010 £m	2009 £m
Finished goods and goods held for resale	32.0	28.0

Inventories are stated net of impairment provisions of £3.6m (2009: £3.4m). During the year £1.0m (2009: £1.1m) was recognised as an expense relating to the write-down of inventory to net realisable value.

## 15. Trade and Other Receivables

	2010 £m	2009 £m
Trade receivables	28.5	23.7
Less: Impairment provision	(0.6)	(0.5)
	27.9	23.2
Other receivables	1.4	0.8
Prepayments and accrued income	1.2	1.2
	30.5	25.2

**15. Trade and Other Receivables (continued)**

The maximum exposure to credit risk for trade receivables at the reporting date, by currency was:

	2010 £m	2009 £m
Sterling	10.0	8.6
US Dollars	6.8	5.0
Canadian Dollars	7.0	4.6
Euro	2.8	3.5
Other	1.9	2.0
	<b>28.5</b>	<b>23.7</b>

Trade receivables, before impairment provisions, are analysed as follows:

	2010 £m	2009 £m
Not past due	23.1	19.7
Past due, but not impaired	4.6	3.4
Past due, but partially impaired	0.8	0.6
	<b>28.5</b>	<b>23.7</b>

The ageing of trade receivables classed as past due, but not impaired is as follows:

	2010 £m	2009 £m
Up to one month past due	3.5	2.4
Between one and two months past due	0.8	0.8
Between two and four months past due	0.2	0.2
Over four months past due	0.1	–
	<b>4.6</b>	<b>3.4</b>

The movement in the provision for impairment of trade receivables is as follows:

	2010 £m	2009 £m
At 1 October	0.5	0.6
Charged against profit, net	0.2	–
Utilised by write off	(0.1)	(0.1)
<b>At 30 September</b>	<b>0.6</b>	<b>0.5</b>

**16. Trade and Other Payables**

	2010 £m	2009 £m
Trade payables	16.5	11.5
Other payables	2.8	1.9
Other taxes and social security	1.2	1.7
Accruals and deferred income	11.8	8.2
	<b>32.3</b>	<b>23.3</b>

# Notes to the Consolidated Financial Statements

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## 16. Trade and Other Payables (continued)

The maximum exposure to foreign currency risk for trade payables at the reporting date, by currency was:

	2010 £m	2009 £m
Sterling	5.6	3.9
US Dollars	6.7	4.2
Canadian Dollars	0.4	0.7
Euro	3.1	2.5
Other	0.7	0.2
	16.5	11.5

## 17. Cash and Cash Equivalents

	Sterling £m	US\$ £m	Can\$ £m	Euro £m	2010 Total £m	Sterling £m	US\$ £m	Can\$ £m	Euro £m	2009 Total £m
Cash at bank	2.7	3.5	1.5	1.4	9.1	1.0	2.8	1.5	1.2	6.5
Short term deposits	7.7	–	12.2	1.1	21.0	5.8	–	6.9	2.1	14.8
	10.4	3.5	13.7	2.5	30.1	6.8	2.8	8.4	3.3	21.3

The short term deposits and cash at bank are both interest bearing at rates linked to the UK Base Rate, or equivalent rate.

## 18. Financial Instruments

The Group's principal financial instruments, other than a limited number of forward foreign contracts, comprise cash and short term deposits, trade and other receivables and trade and other payables and other liabilities. Trade and other receivables and trade and other payables arise directly from the Group's day to day operations.

The principal financial risks to which the Group is exposed are those of credit, liquidity, foreign currency and interest rate. An explanation of each of these risks, how the Group manages these risks and an analysis of sensitivities is set out on page 26 within Risks and Uncertainties, which has been audited.

Further analyses of these risks are set out below:

### a) Credit risk

The Group's maximum exposure to credit risk was as follows:

	Carrying amount 2010 £m	2009 £m
Trade receivables	27.9	23.2
Other receivables	1.4	0.8
Cash and cash equivalents	30.1	21.3
	59.4	45.3

There is no material difference between the carrying amount of the financial assets and their fair value at each reporting date. An analysis of the ageing and currency of trade receivables and the associated provision for impairment is set out in note 15. An analysis of cash and cash equivalents is set out in note 17.



**18. Financial Instruments (continued)****b) Liquidity risk**

The Group has no cash loans or overdrafts at each reporting date.

	<b>Carrying amount</b>	
	<b>2010</b>	<b>2009</b>
	<b>£m</b>	<b>£m</b>
Trade payables	<b>16.5</b>	11.5
Other payables	<b>2.8</b>	1.9
Other liabilities	<b>14.2</b>	13.7
	<b>33.5</b>	27.1
The maturities of the undiscounted financial liabilities are as follows:		
Less than one year	<b>32.3</b>	16.5
One-two years	<b>–</b>	8.5
Two-five years	<b>1.4</b>	3.7
	<b>33.7</b>	28.7
Less: Discount	<b>(0.2)</b>	(1.6)
	<b>33.5</b>	27.1

There is no material difference between the carrying amount of these financial liabilities and their fair value at each reporting date.

**c) Currency risk**

The Group's main currency risk is its exposure to movements in US dollars, Canadian dollars and euros on trade receivables, trade payables and cash and cash equivalents balances. These balances are analysed by currency in notes 15, 16 and 17, respectively.

The Group holds forward foreign exchange contracts to hedge forecast transactional exposure of certain of the Group's businesses to movements in the US dollar and euro. These forward foreign exchange contracts are classified as cash flow hedges and are stated at fair value. The net fair value of forward foreign exchange contracts used as hedges at 30 September 2010 was a £0.7m liability (2009: £0.3m liability). The amount removed from equity and taken to the consolidated income statement in cost of sales during the year was £0.1m (2009: £0.1m). The fair value of cash flow hedges taken to equity during the year was £0.3m (2009: £0.4m).

**d) Interest rate risk**

The Group does not undertake any hedging of interest rates. All cash deposits, held in the UK and overseas, are held on a short term basis at floating rates or overnight rates, based on the relevant UK Base Rate, or equivalent rate.

An analysis of cash and cash equivalents at the reporting dates is set out in note 17.

**e) Fair values**

There are no material differences between the carrying value of financial assets and liabilities and their fair value. The basis for determining fair values are as follows:

- **Derivatives**  
Forward exchange contracts are valued at year end spot rates adjusted for the forward points to the contract's value date, and gains and losses taken to equity. No contract's value date is greater than 24 months from the year end. (Level 1 as defined by IFRS 7 Financial Instrument: Disclosure).
- **Trade and other receivables/payables**  
As the majority of receivables/payables have a remaining life of less than one year, the notional amount is deemed to reflect the fair value.
- **Other liabilities**  
The carrying amount represents a discounted value of the expected liability which is deemed to reflect the fair value.

# Notes to the Consolidated Financial Statements

For the year ended 30 September 2010

## 19. Other Liabilities

	2010 £m	2009 £m
Future purchases of minority interests	13.2	13.1
Deferred consideration	1.0	0.6
	<b>14.2</b>	<b>13.7</b>
Analysed as:		
Due within one year	13.0	3.1
Due after one year	1.2	10.6

The movement in the liability for future purchases of minority interests is as follows:

	2010 £m	2009 £m
At 1 October	13.1	11.2
Released to retained earnings on acquisition (note 21)	(2.5)	–
Put options entered into during the year	0.6	–
Unwinding of discount	1.1	1.1
Fair value remeasurements	0.9	0.8
<b>At 30 September</b>	<b>13.2</b>	<b>13.1</b>

The Group retains put/call options to acquire the outstanding minority shareholdings in AMT, BGS and M Seals, which are exercisable between 1 October 2010 and 31 December 2013. The Group is engaged in discussions with the minority shareholders in AMT with a view to acquiring all of the outstanding 25% shareholding in AMT in 2011. This would be earlier than anticipated in the original put/call option agreements and therefore the liability to acquire these interests of £12.0m has been shown as falling due within one year.

At 30 September 2010, the estimate of the financial liability to acquire the outstanding minority shareholdings was reassessed by the Directors, based on their current estimate of the future performance of the businesses and to reflect foreign exchange rates at 30 September 2010. This led to a remeasurement of the fair value of these put options and the liability was increased by £0.9m (2009: £0.8m) by a charge to the consolidated Income Statement.

At 30 September 2010, deferred consideration of £1.0m comprised £0.8m payable to the vendors of All Seals, £0.1m payable to the vendors of the Fischer business and £0.1m payable to the vendors of BGS. Deferred consideration of £0.3m was paid on 17 December 2009 to the vendors of Meditech in final settlement of their performance payment and £0.1m was paid on 19 May 2010 to the vendors of the trade and assets of RT/Dygert International Inc, in final settlement of their performance payment. The balance of £0.2m was not required and was released to goodwill (note 10).

## 20. Minority Interests

	£m
At 1 October 2008	1.9
Share of profit for the year	1.3
Dividends paid	(0.7)
Exchange adjustments	0.2
At 30 September 2009	2.7
Purchase of minority interests	(0.1)
Share of profit for the year	1.5
Dividends paid	(1.1)
Exchange adjustments	0.1
<b>At 30 September 2010</b>	<b>3.1</b>

## 21. Acquisition of Subsidiaries and Minority Interests

On 12 January 2010, the Group acquired the outstanding 8.2% of the ordinary share capital in Somagen Diagnostics Inc ("Somagen") for £2.5m (C\$4.3m) from the minority shareholders of Somagen, pursuant to put/call option agreements entered into at the time of the original acquisition in July 2004. As a consequence, the future purchase of minority interest liability of £2.5m that was recognised in the consolidated financial statements at 30 September 2009 has been released to retained earnings.

On 30 July 2010, the Group acquired 80% of Big Green Surgical Company Pty Limited ("BGS") for maximum consideration of £1.5m (A\$2.5m), before expenses. The initial cash paid on acquisition was £1.4m (A\$2.4m) and the balance of £0.1m (A\$0.1m) was paid on 29 October 2010, based on the net assets at completion. The outstanding 20% of shares are subject to put/call options, exercisable in 2013, based on an agreed multiple of operating profit.

On 3 August 2010, Sommer GmbH purchased the stock and customer list of ET Fischer Elektrotechnik ("Fischer") for maximum consideration of £0.2m (€0.3m), before expenses. The initial cash paid on acquisition was £0.1m (€0.2m) and further amount up to £0.1m (€0.1m) is payable, based on the revenue generated from those customers in the eighteen month period from the date of acquisition.

On 8 September 2010, the Group acquired 100% of All Seals Inc ("All Seals") for maximum consideration of £7.8m (US\$11.9m), before expenses. The initial cash paid on acquisition was £6.8m (US\$10.5m); a further amount up to £1.0m (US\$1.4m) is payable in March 2011, based on a number of factors, including principally, the results of All Seals in the year ending 31 December 2010. At 30 September 2010, £0.8m (US\$1.3m) has been provided as deferred consideration.

The consideration for all of the acquisitions set out above was paid in cash and met from the Group's existing cash resources.

Set out below is an analysis of the net book value and fair value of the net assets acquired and the consideration payable in respect of the acquisitions completed during the year.

	Book value £m	Fair value £m
Acquisition intangible assets	–	4.5
Inventories	0.9	0.8
Trade and other receivables	1.0	1.0
Trade and other payables	(0.9)	(1.0)
	1.0	5.3
Minority's share of net assets		0.1
Net assets acquired by the Group		5.4
Goodwill arising on acquisitions completed during the year		6.2
		<b>11.6</b>
<b>Satisfied by:</b>		
Cash paid, before acquisition expenses		10.8
Cash acquired		(0.2)
<b>Net cash paid</b>		<b>10.6</b>
Provision for deferred consideration payable		1.0
<b>Total consideration</b>		<b>11.6</b>

Goodwill of £6.2m which arose on acquisitions completed during the year represents the product know-how held by employees, prospects for sales growth from new customers and operating cost synergies. Goodwill and acquisition intangible assets acquired during the year of £10.7m, includes £7.1m that will be allowable for a tax deduction in future years.

Acquisition costs incurred during the year of £0.2m were expensed to the Consolidated Income Statement.

From the date of acquisition to 30 September 2010, the newly acquired businesses contributed £0.9m to revenue and £0.2m to operating profit. If the acquisition of these businesses had been made at the beginning of the financial year, these businesses would have contributed £5.2m to revenue and £0.5m to profit after tax. Profit after tax should not be viewed as indicative of the results of these businesses that would have occurred, if these acquisitions had been completed at the beginning of the year.

# Notes to the Consolidated Financial Statements

For the year ended 30 September 2010

## 22. Discontinued Businesses

On 7 January 2010, the Group completed the disposal of the Manual Liquid Handling ("MLH") business of Anachem Limited for a maximum consideration of £8.5m, before disposal costs. Initial cash proceeds of £7.7m were received, of which £0.8m is held in escrow; a further £0.8m may be receivable, depending on the revenues generated in the 12 months to 31 December 2010.

The remainder of the business in Anachem Limited comprised the Instruments division which supplied laboratory automation products. This was transferred to a separate entity, Anachem Instruments Limited, prior to completion of the sale of the MLH business.

On 29 April 2010, the Group completed the disposal of Anachem Instruments Limited for a maximum consideration of £0.4m, before disposal costs. Initial proceeds of £0.2m were received in cash with a further £0.2m due to be received over the next two years.

There is no tax payable on the profit on disposal of these businesses of £5.5m.

Anachem Limited and Anachem Instruments Limited were both classified as discontinued businesses in 2009 and their net assets were classified as "held for sale" at 30 September 2009.

The results of the MLH business, until it was sold on 7 January 2010, and the results of Anachem Instruments, until it was sold on 29 April 2010, are set out below:

	2010 £m	2009 £m
<b>Revenue</b>	<b>5.3</b>	15.7
Cost of sales	(4.3)	(10.2)
<b>Gross profit</b>	<b>1.0</b>	5.5
Distribution costs	(0.2)	(0.6)
Administration costs	(1.4)	(3.7)
<b>(Loss)/profit before tax</b>	<b>(0.6)</b>	1.2
Tax credit/(expense)	0.2	(0.3)
<b>(Loss)/profit after tax</b>	<b>(0.4)</b>	0.9
Profit on disposal	5.5	–
<b>Profit attributable to discontinued businesses</b>	<b>5.1</b>	0.9

The assets and liabilities of Anachem Limited and Anachem Instruments Limited sold during the year ended 30 September 2010 were as follows:

	£m
Other intangible assets	0.3
Property, plant and equipment	0.3
Deferred tax	0.1
Inventories	1.6
Trade and other receivables	1.8
Trade and other payables	(2.7)
<b>Net assets disposed of</b>	<b>1.4</b>
Profit on disposal	5.5
<b>Consideration</b>	<b>6.9</b>
	£m
<b>Satisfied by:</b>	
Cash received on completion	7.1
Less: Expenses of sale	(0.2)
Related disposal costs	(0.4)
Cash disposed	(0.1)
<b>Net cash proceeds received at 30 September 2010</b>	<b>6.4</b>
Add: Cash held in escrow, net	0.5
<b>Consideration</b>	<b>6.9</b>

**22. Discontinued Businesses (continued)**

Cash flows from the discontinued businesses included in the consolidated Cash Flow Statement are as follows:

	2010 £m	2009 £m
<b>(Loss)/profit from discontinued businesses</b>	<b>(0.4)</b>	0.9
Depreciation/amortisation of tangible and other intangible assets	<b>0.1</b>	0.3
Tax (credit)/expense	<b>(0.2)</b>	0.3
<b>Operating cash flow before changes in working capital</b>	<b>(0.5)</b>	1.5
Decrease in working capital	<b>0.5</b>	0.5
Cash paid into defined benefit scheme (note 24)	<b>(0.6)</b>	–
<b>Cash flow from operating activities</b>	<b>(0.6)</b>	2.0
Tax recovered/(paid)	<b>0.1</b>	(0.2)
<b>Net cash (used in)/from operating activities</b>	<b>(0.5)</b>	1.8
<b>Net cash used in investing activities</b>	<b>–</b>	(0.1)
<b>Net cash (used in)/from discontinued businesses</b>	<b>(0.5)</b>	1.7

As part of the agreement to dispose of the MLH business of Anachem Ltd, the Trustees of the Anachem Limited Retirement Benefit Scheme ("Scheme") consented to the transfer of the residual liabilities in the Scheme to Diploma Holdings PLC ("DHPLC"). In return for their consent, a cash sum of £625,000 was paid directly into the Scheme and is included in the net cash outflow of £0.5m from the discontinued businesses in the year ended 30 September 2010.

Anachem Limited was previously reported within the Life Sciences business segment and within the United Kingdom geographic segment analysis.

	2010 £m	2009 £m
Capital expenditure	–	0.1
Depreciation (including software)	<b>0.1</b>	0.3

The aggregate payroll costs and average number of employees of the discontinued businesses were as follows:

	2010 £m	2009 £m
Wages and salaries	<b>1.1</b>	3.7
Social security costs	<b>0.1</b>	0.4
Pension costs – defined contribution	<b>0.1</b>	0.2
	<b>1.3</b>	4.3

	2010 Number	2009 Number
Number of employees – average	<b>110</b>	118

# Notes to the Consolidated Financial Statements

For the year ended 30 September 2010

## 23. Reconciliation of Cash Flow from Operating Activities

	2010 £m	2009 £m
<b>Profit for the year from continuing businesses</b>	<b>17.9</b>	13.4
Depreciation/amortisation of tangible and other intangible assets	2.1	2.2
Acquisition related charges	3.5	3.1
Share-based payments expense	0.5	0.5
Financial expense, net	1.9	2.0
Tax expense	8.8	7.1
<b>Operating cash flow before changes in working capital</b>	<b>34.7</b>	28.3
(Increase)/decrease in inventories	(3.2)	6.0
(Increase)/decrease in trade and other receivables	(4.0)	2.4
Increase/(decrease) in trade and other payables	7.3	(2.3)
Cash paid into defined benefit schemes (note 24)	(0.5)	(0.2)
<b>Cash flow from operating activities</b>	<b>34.3</b>	34.2

## 24. Retirement Benefit Obligations

The Group maintains several defined benefit schemes in the UK, all of which are closed to future accrual and the assets of the schemes are held in separate trustee administered funds. The schemes are funded in accordance with rates recommended by independent qualified actuaries on the basis of triennial or shorter period reviews using the projected unit method. At 30 September 2010, all of the Group's defined benefit schemes were merged into a single scheme which was renamed Diploma Holdings PLC UK Pension Scheme. In connection with this merger, the sponsoring employer, Diploma Holdings PLC made an additional cash contribution of £120,000 to the merged scheme on 30 September 2010. A full funding valuation of the merged schemes will be undertaken as at 30 September 2010.

Prior to the merger, the two principal defined benefit schemes ("the schemes") were the Diploma Holdings PLC Permanent Staff Pension and Assurance Scheme ("the PLC Scheme") and the Anachem Limited Retirement Benefits Scheme ("the Anachem Scheme").

### Pension deficit included in the Consolidated Statement of Financial Position:

	2010 £m	2009 £m
Market value of schemes' assets		
Equities	12.9	11.1
Bonds	3.4	3.0
Cash	–	–
	16.3	14.1
Present value of schemes' liabilities	(21.6)	(18.8)
	(5.3)	(4.7)

### Amounts credited/(charged) to the Consolidated Income Statement in respect of defined benefit schemes:

	2010 £m	2009 £m
Charged to operating profit	–	–
Interest cost	(1.0)	(1.0)
Expected return on schemes' assets	1.1	0.9
Credited/(charged) to financial income/(expense) (note 6)	0.1	(0.1)
	0.1	(0.1)



**24. Retirement Benefit Obligations (continued)****Amounts recognised in the Consolidated Statement of Comprehensive Income:**

	2010 £m	2009 £m
Experience adjustments on schemes' assets	0.3	0.7
Changes in assumptions on schemes' liabilities	(2.2)	(3.8)
Experience adjustments on schemes' liabilities	0.1	–
<b>Actuarial loss on schemes' liabilities</b>	<b>(1.8)</b>	<b>(3.1)</b>

The cumulative amount of actuarial losses recognised in the consolidated Statement of Comprehensive Income, since the transition to IFRS, is £3.9m (2009: £2.1m).

**Analysis of movement in the pension deficit:**

	2010 £m	2009 £m
At 1 October	4.7	1.7
Amounts (credited)/charged to income statement	(0.1)	0.1
Contributions paid by employer	(1.1)	(0.2)
Actuarial loss	1.8	3.1
<b>At 30 September</b>	<b>5.3</b>	<b>4.7</b>

**Analysis of the movements in the present value of the schemes' liabilities:**

	2010 £m	2009 £m
At 1 October	18.8	14.2
Interest cost	1.0	1.0
Actuarial gain	(0.1)	–
Loss on changes in assumptions	2.2	3.8
Benefits paid	(0.3)	(0.2)
<b>At 30 September</b>	<b>21.6</b>	<b>18.8</b>

**Analysis of the movements in the present value of the schemes' assets:**

	2010 £m	2009 £m
At 1 October	14.1	12.5
Expected return on assets	1.1	0.9
Actuarial gain	0.3	0.7
Contributions paid by employer	1.1	0.2
Benefits paid	(0.3)	(0.2)
<b>At 30 September</b>	<b>16.3</b>	<b>14.1</b>

The actual return on schemes' assets during the year was £1.4m (2009: £1.6m).

# Notes to the Consolidated Financial Statements

For the year ended 30 September 2010

## 24. Retirement Benefit Obligations (continued)

### Principal actuarial assumptions for the schemes at balance sheet dates:

	2010	2009	2008
Inflation rate	3.2%	3.4%	3.8%
Expected rate of pension increases	3.2%	3.4%	3.8%
Discount rate	5.0%	5.5%	7.0%
Number of years a current pensioner is expected to live beyond age 65			
• Men	22.1	22.1	21.9
• Women	25.0	25.0	24.8
Expected return on schemes' assets*			
Analysed as:			
Equities	8.0%	8.0%	8.0%
Bonds	5.0%	5.5%	5.5%
Cash	1.0%	2.0%	4.5%

### Demographic assumptions:

Basic mortality table used:	100% of PCMA00/PCFA00
Year the mortality table was published:	2003
Allowance for future improvements in longevity:	Year of birth projections, with medium cohort improvements with adjustments to reflect expected scheme experience
Allowance made for members to take a cash lump sum on retirement:	Members are assumed to take 100% of their maximum cash sum (based on current commutation factors)

### Sensitivities:

Sensitivity of 2010 pension liabilities to changes in assumptions are as follows:

Assumption	Assumption	Impact on pension liabilities	
		Estimated increase %	Estimated increase £m
Discount rate	Decrease by 0.5%	11.1	2.4
Expected rate of pension increase	Increase by 0.5%	4.2	0.9
Life expectancy	Increase by 1 year	1.9	0.4

\* The expected return for each class of scheme assets is based on a combination of historical performance, current market yields and advice from investment managers.

## 24. Retirement Benefit Obligations (continued)

### Cash funding:

Accounting costs do not impact on the incidence or amount of cash contributions for defined benefit plans. Future cash contributions are determined based upon triennial actuarial valuations.

	PLC	Anachem
Date of last formal funding valuation	30 September 2008	30 September 2009
Deficit	£1,508,000	£2,786,000
Funding level	84%	75%
Funding approach	Assumes that schemes' assets will outperform Government bonds by 2.84% pa pre-retirement and 0.24% pa post-retirement	Assumes that schemes' assets will outperform Government bonds by 2.15% pa pre-retirement and NIL% pa post-retirement
Lump sum contributions per annum to remove the deficit – on going	£96,000	£216,000
– exceptional in 2010	£120,000	£625,000
Period over which the deficit is expected to be removed	1 October 2009 – 30 September 2029	1 October 2009 – 30 June 2026
Expected contributions during FY2011	£96,000	£216,000
Current investment strategy	80% Equities/20% Bonds	85% Equities/15% Bonds
Number of deferred members at date of actuarial valuation	137	187

### History of experience gains and losses:

All experience adjustments are recognised directly in equity, net of related tax.

	2010	2009	2008	2007	2006
Experience adjustments arising on schemes' assets:					
Amount (£m)	<b>0.3</b>	0.7	(3.4)	0.3	0.6
% of schemes' assets	<b>2%</b>	5%	27%	2%	5%
Changes in assumptions arising on present value of schemes' liabilities:					
Amount (£m)	<b>(2.2)</b>	(3.8)	3.0	2.3	(0.6)
% of present value of schemes' liabilities	<b>10%</b>	20%	21%	14%	3%
Experience adjustments arising on present value of schemes' liabilities:					
Amount (£m)	<b>0.1</b>	–	(0.1)	0.1	(0.6)
% of present value of schemes' liabilities	<b>–</b>	–	1%	1%	3%
Present value of schemes' liabilities	<b>(21.6)</b>	(18.8)	(14.2)	(16.4)	(18.0)
Market value of schemes' assets	<b>16.3</b>	14.1	12.5	14.8	13.3
Deficit	<b>(5.3)</b>	(4.7)	(1.7)	(1.6)	(4.7)

# Notes to the Consolidated Financial Statements

For the year ended 30 September 2010

## 25. Commitments

At 30 September 2010 the Group has total lease payments under non-cancellable operating leases as follows:

	Land and Buildings	
	2010 £m	2009 £m
Lease payments due:		
Within one year	1.3	1.3
Within two to five years	2.3	2.0
After five years	–	0.3
<b>Total payable at 30 September</b>	<b>3.6</b>	<b>3.6</b>

Operating lease payments made in respect of land and buildings during the year were £1.3m (2009: £1.4m).

## 26. Audit Fees

During the year the Group received the following services from the auditors:

	2010 £'m	2009 £'m
Fees payable to the auditors for the audit of:		
– the Company's annual report	0.1	0.1
– the Company's subsidiaries, pursuant to legislation	0.1	0.1
<b>Total audit fees</b>	<b>0.2</b>	<b>0.2</b>

Non audit fees of £7,000 (2009: £4,000) for taxation advisory services provided in Canada and £10,000 (2009: £10,000) in connection with the Interim Report, were paid to the Group's auditors.

## 27. Exchange Rates

The following exchange rates have been used to translate the results of the overseas businesses:

	Average		Closing	
	2010	2009	2010	2009
US Dollar	1.56	1.54	1.58	1.60
Canadian Dollar	1.63	1.82	1.62	1.72
Euro	1.15	1.14	1.15	1.09

# Group Accounting Policies

For the year ended 30 September 2010

The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") as endorsed by the European Union, and in accordance with the Companies Act 2006, as applicable to companies reporting under IFRS. The accounting policies set out below have been consistently applied in 2010 and the comparative period. The following new standards, amendments and interpretations to existing standards have been published and have been endorsed by the EU; these are mandatory for the first time for the year ending 30 September 2010 and are relevant to the Group:

- IAS 1 (revised) 'Presentation of Financial Statements';
- IAS 23 (revised) 'Borrowing Costs';
- IAS 27 (revised) 'Consolidated and Separate Financial Statements';
- IFRS 2 (revised) 'Share-based Payment';
- IFRS 3 (revised) 'Business Combinations'; and
- IFRS 8 'Operating Segments'.

*IAS 1 (revised) 'Presentation of Financial Statements'* requires the presentation of a statement of comprehensive income and the presentation of the statement of changes in equity as a primary statement. The changes are merely presentational and have not impacted the Group's reported profit or net assets.

*IFRS 3 (revised) 'Business Combinations'* applies to business combinations arising after 1 October 2009. Amongst other changes, the revisions effected by the new standard require subsequent changes in the fair value of contingent consideration payable in respect of an acquisition to be recognised in the income statement rather than against goodwill, and require transaction costs attributable to an acquisition to be recognised immediately in the income statement. These changes have been applied for acquisitions acquired during the year.

*IFRS 8 'Operating Segments'* requires that operating segments should be determined on the basis of those segments whose operating results are regularly reviewed by the chief operating decision maker, which has been determined to be the Board. This has not impacted the Group's presentation of its results and the Group continues to report using the same three business segments as previously.

*IAS 23 (revised) 'Borrowing Costs', IAS 27 (revised) 'Consolidated and Separate Financial Statements' and IFRS 2 (revised) 'Share-based Payment'* have had no impact on the results or net assets of the Group.

## 1 Group Accounting Policies

### 1.1 Basis of preparation

The consolidated financial statements have been prepared under the historical cost convention, except for derivative financial instruments which are held at fair value. The consolidated financial statements have been prepared on a going concern basis, as discussed in the Directors' Report on page 29.

### 1.2 Basis of consolidation

The consolidated financial statements incorporate the financial statements of the Company and entities controlled by the Company (its subsidiaries). Control exists when the Company has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. The results of subsidiaries acquired or disposed of during the year are included in the consolidated income statement from the effective date of acquisition or up to the effective date of disposal, as appropriate.

Where necessary, adjustments are made to the financial statements of subsidiaries to bring their accounting policies into line with those detailed herein to ensure that the Group financial statements are prepared on a consistent basis. All intra-group transactions, balances, income and expenses are eliminated in preparing the consolidated financial statements.

Non-controlling interests, defined as minority interests, in the net assets of consolidated subsidiaries are identified separately from the Group's equity therein. Minority interests consist of the amount of those interests at the date of the original business combination and the minority's share of changes in equity since the date of the combination.

### 1.3 Divestments

The results and cash flows of major lines of businesses that have been divested have been classified as discontinued businesses.

### 1.4 Revenue recognition

Revenue is measured as the fair value of the consideration received or receivable for goods supplied and services rendered to customers, after deducting sales allowances and value added taxes. Revenue is recognised when the risk and rewards of ownership transfers to the customer, which depending on individual customer terms, is at the time of despatch, delivery or upon formal customer acceptance. Provision is made for returns where appropriate. Service revenue received in advance is deferred and recognised over the period of the contract.

# Group Accounting Policies continued

For the year ended 30 September 2010

## 1.5 Employee benefits

The Group operates a number of pension plans, both of the defined contribution and defined benefit type. The defined benefit schemes are closed to the accrual of future benefits.

(a) Defined contribution pension plans

Contributions to the Group's defined contribution schemes are recognised as an employee benefit expense when they fall due.

(b) Defined benefit pension plans

The deficit recognised in the balance sheet for the Group's defined benefit pension schemes is the present value of the defined benefit obligation at the balance sheet date less the fair value of the scheme assets. The defined benefit obligation is calculated by independent actuaries using the projected unit cost method and by discounting the estimated future cash flows using interest rates on high quality corporate bonds. The pension expense for the Group's defined benefit plans is recognised as follows:

(i) Within profit before tax:

- Gains and losses arising on settlements and curtailments – where the item that gave rise to the settlement or curtailment is recognised in operating profit;
- Interest cost on the liabilities of the schemes – calculated by reference to the scheme liabilities and major assumptions, including the discount rate, at the beginning of the year; and
- Expected return on the assets of the schemes – calculated by reference to the scheme assets and long-term expected rate of return at the beginning of the year.

(ii) Within the statement of recognised income and expense:

- Actuarial gains and losses arising on the assets and liabilities of the schemes arising from actual experience and any changes in assumptions at the end of the year.

The Group has adopted a policy of recognising all actuarial gains and losses for all of its defined benefit schemes in the period in which they occur, outside the income statement, in the Consolidated Statement of Comprehensive Income.

(c) Share-based payments

The Executive Directors of the Group receive part of their remuneration in the form of share-based payment transactions, whereby the Directors render services in exchange for shares in the Company, or rights over shares ("equity-settled" transactions).

Equity-settled transactions are measured at fair value at the date of grant. The fair value determined at the grant date takes account of the effect of market based measures, such as the Total Shareholder Return ("TSR") targets upon which vesting of part of the award is conditional, and is expensed to the profit and loss account on a straight line basis over the vesting period, with a corresponding credit to equity. The cumulative expense recognised is adjusted to take account of shares forfeited by Executives who leave during the performance or vesting period and, in the case of non-market related performance conditions, where it becomes unlikely that shares will vest. For the market based measure, the Directors have used a predicted future value model to determine fair value of the shares at the date of grant.

The Group operates an Employee Benefit Trust for the granting of shares to Executives. The cost of shares in the Company purchased by the Employee Benefit Trust are shown as a deduction from equity.

## 1.6 Foreign currencies

The individual financial statements of each Group entity are prepared in their functional currency, which is the currency of the primary economic environment in which that entity operates. For the purpose of the consolidated financial statements, the results and financial position of each entity are translated into UK sterling, which is the presentational currency of the Group.

(a) Reporting foreign currency transactions in functional currency:

Transactions in currencies other than the entity's functional currency (foreign currencies) are initially recorded at the rates of exchange prevailing on the dates of the transactions. At each subsequent balance sheet date:

- (i) Foreign currency monetary items are retranslated at the rates prevailing at the balance sheet date. Exchange differences arising on the settlement or retranslation of monetary items are recognised in the income statement;
- (ii) Non-monetary items measured at historical cost in a foreign currency are not retranslated; and
- (iii) Non-monetary items measured at fair value in a foreign currency are retranslated using the exchange rates at the date the fair value was determined. Where a gain or loss on non-monetary items is recognised directly in equity, any exchange component of that gain or loss is also recognised directly in equity and conversely, where a gain or loss on a non-monetary item is recognised in the income statement, any exchange component of that gain or loss is also recognised in the income statement.

(b) Translation from functional currency to presentational currency:

When the functional currency of a Group entity is different from the Group's presentational currency, its results and financial position are translated into the presentational currency as follows:

- (i) Assets and liabilities are translated using exchange rates prevailing at the balance sheet date;
- (ii) Income and expense items are translated at average exchange rates for the year, except where the use of such an average rate does not approximate the exchange rate at the date of the transaction, in which case the transaction rate is used; and
- (iii) All resulting exchange differences are recognised in translation reserves as a separate component of equity; these cumulative exchange differences are recognised in the income statement in the period in which the foreign operation is disposed of.

## (c) Net investment in foreign operations:

Exchange differences arising on a monetary item that forms part of a reporting entity's net investment in a foreign operation are recognised in the income statement in the separate financial statements of the reporting entity or the foreign operation as appropriate. In the consolidated Group accounts such exchange differences are initially recognised in translation reserves as a separate component of equity and subsequently recognised in the income statement on disposal of the net investment.

**1.7 Taxation**

The tax expense relates to the sum of current tax and deferred tax.

Current tax is based on taxable profit for the year, which differs from profit before taxation as reported in the income statement.

Taxable profit excludes items of income and expense that are taxable (or deductible) in other years and also excludes items that are never taxable or deductible. The Group's liability for current tax, including UK corporation tax and overseas tax, is calculated using rates that have been enacted or substantively enacted at the balance sheet date.

Deferred tax is accounted for using the balance sheet liability method. Deferred tax is recognised on differences between the carrying amounts of assets and liabilities in the financial statements and the corresponding tax bases used in the computation of taxable profit. Deferred tax liabilities are generally recognised for all taxable temporary differences and deferred tax assets are recognised to the extent that it is probable that taxable profits will be available against which deductible temporary differences can be utilised. Temporary differences arise primarily from the recognition of the deficit on the Group's defined benefit pension schemes, the difference between accelerated capital allowances and depreciation and for short term timing differences where a provision held against receivables or stock is not deductible for taxation purposes. However, deferred tax assets and liabilities are not recognised if the temporary difference arises from goodwill or from the initial recognition (other than in a business combination) of other assets and liabilities in a transaction that affects neither the tax profit, nor the accounting profit.

Deferred tax liabilities are also recognised for taxable temporary differences arising on investments in subsidiaries, except where the Group is able to control the reversal of the temporary difference and it is possible that the temporary difference will not reverse in the foreseeable future. No deferred tax is recognised on the unremitted earnings of overseas subsidiaries, as the Group controls the dividend policies of its subsidiaries.

Deferred tax is calculated at the tax rates that are expected to apply to the period when the asset is realised or the liability is settled. Deferred tax is charged or credited to the income statement, except when the item on which the tax or charged is credited or charged directly to equity, in which case the deferred tax is also dealt with in equity. The carrying amount of deferred tax assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow all or part of the assets to be recovered. Tax assets and liabilities are offset when there is a legally enforceable right to enforce current tax assets against current tax liabilities and when the deferred income tax relates to the same fiscal authority.

**1.8 Property, plant and equipment**

Freehold land is carried at cost less accumulated impairment losses. Other items of property, plant and equipment are carried at cost less accumulated depreciation and accumulated impairment losses. Cost comprises the purchase price plus costs directly incurred in bringing the asset into use, but excluding interest. All other repairs and maintenance expenditure is charged to the income statement in the period in which it is incurred.

Freehold land is not depreciated as it has an infinite life. Depreciation on other items of property, plant and equipment begins when the asset is available for use and is charged to the income statement on a straight-line basis so as to write off the cost, less residual value of the asset, over its estimated useful life as follows:

Freehold property	– between 20 and 50 years	Plant and equipment	– plant and machinery between 3 and 7 years
Leasehold property	– term of the lease		– IT hardware between 3 and 5 years
			– fixtures and fittings between 5 and 15 years

The depreciation method used, residual values and estimated useful lives are reviewed and changed, if appropriate, at least at each financial year end. Assets held under finance leases are depreciated over their expected useful lives on the same basis as owned assets or, where shorter, over the term of the relevant lease. An asset's carrying amount is written down immediately to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount. Gains and losses arising on disposals are determined by comparing sales proceeds with carrying amount and are recognised in the income statement.

**1.9 Intangible assets**

All intangible assets, excluding goodwill arising on a business combination, are stated at their amortised cost or fair value less any provision for impairment.

## (a) Research and development costs

Research expenditure is written off as incurred. Development costs are written off as incurred until it can be demonstrated that the conditions for capitalisation as described in IAS 38 (Intangible Assets) are met. At which point further costs are capitalised as intangible assets up until the intangible asset is readily available for production and amortised on a straight-line basis over the asset's estimated useful life.

Costs are capitalised as intangible assets unless physical assets, such as tooling, exist when they are classified as property, plant and equipment.

## (b) Computer software costs

Where computer software is not integral to an item of property, plant or equipment its costs are capitalised as other intangible assets. Amortisation is provided on a straight line basis over its useful economic life of between three and seven years.



# Group Accounting Policies continued

For the year ended 30 September 2010

(c) Acquired intangible assets – business combinations

Intangible assets that are acquired as a result of a business combination, including, but not limited to, customer lists, supplier lists, databases, technology and software and patents and that can be separately measured at fair value, on a reliable basis, are separately recognised on acquisition at the fair value, together with the associated deferred tax liability. Amortisation is charged on a straight line basis to the income statement over the expected useful economic lives.

(d) Goodwill – business combinations

Goodwill arising on the acquisition of a subsidiary represents the excess of the aggregate of the fair value of the consideration over the aggregate fair value of the identifiable intangible and tangible assets and net of the aggregate fair value of the liabilities (including contingent liabilities of businesses acquired at the date of acquisition). Goodwill is initially recognised as an asset at cost and is subsequently measured at cost less any accumulated impairment losses. Impairment testing is carried out annually or more frequently if events or changes in circumstances indicate that the carrying value may be impaired. Goodwill on acquisitions is not amortised.

## 1.10 Impairment of tangible and intangible assets

An impairment loss is recognised to the extent that the carrying amount of an asset or cash generating unit exceeds its recoverable amount.

The recoverable amount of an asset or cash-generating unit is the higher of (i) its fair value less costs to sell and (ii) its value in use; its value in use is the present value of the future cash flows expected to be derived from the asset or cash-generating unit, discounted using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset or cash-generating unit. Impairment losses are recognised immediately in the income statement.

(a) Impairment of goodwill

Goodwill acquired in a business combination is allocated to a cash-generating unit; cash-generating units for this purpose are the business entities which represent the lowest level within the Group at which the goodwill is monitored by the Group's Board of Directors for internal and management purposes. Cash-generating units to which goodwill has been allocated are tested for impairment annually, or more frequently when there is an indication that the unit may be impaired.

If the recoverable amount of the cash-generating unit is less than the carrying amount of the unit, the impairment loss is allocated first to reduce the goodwill attributable to the cash-generating unit.

An impairment loss recognised for goodwill is not reversed in a subsequent period.

(b) Impairment of other tangible and intangible assets

At each balance sheet date, the Group reviews the carrying amount of its tangible and intangible assets to determine whether there is any indication that those assets have suffered an impairment loss. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent, if any, of the impairment loss. For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash inflows. Where it is not possible to estimate the recoverable amount of an individual asset, the Group estimates the recoverable amount of the cash-generating unit to which the asset belongs.

Where an impairment loss subsequently reverses, the carrying amount of the asset or cash-generating unit is increased to the revised estimate of its recoverable amount, but so that the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognised for the asset or cash-generating unit in prior years. A reversal of an impairment loss for tangible and intangible assets other than goodwill is recognised immediately in the income statement.

## 1.11 Inventories

Inventories are stated at the lower of cost, (generally calculated on a weighted average cost basis) and net realisable value, after making due allowance for any obsolete or slow moving inventory. Cost comprises direct materials, duty and freight-in costs.

Net realisable value represents the estimated selling price less all estimated costs of completion and the estimated costs necessary to make the sale.

## 1.12 Financial instruments

Financial assets and liabilities are recognised in the Group balance sheet when the Group becomes a party to the contractual provisions of the instrument.

(a) Trade receivables

Trade receivables are initially measured at fair value, do not carry any interest and are reduced by a charge for impairment for estimated irrecoverable amounts. Such impairment charges are recognised in the income statement.

(b) Trade payables

Trade payables are non interest-bearing and are initially measured at their fair value.

(c) Cash and cash equivalents

Cash and cash equivalents comprise cash in hand, interest bearing deposits, bank overdrafts and short-term highly liquid investments with original maturities of three months or less that are readily convertible to a known amount of cash and are subject to an insignificant risk of changes in value. Bank overdrafts are repayable on demand and form an integral part of the Group's cash management system.

(d) Put options held by minority interests

On exercise of put options held by minority shareholders in the Group's subsidiaries, the purchase price of the shares is calculated by reference to the profitability of the relevant subsidiary at the time of exercise, using a multiple based formula. The net present value of the estimated future payments under these put options is shown as a financial liability. The corresponding entry is recognised in equity as a deduction against retained earnings. At the end of each year, the estimate of the financial liability is reassessed and any change in value is recognised in the income statement, as part of finance income or expense. Where the liability is in a foreign currency, any change in the value of the liability resulting from changes in exchange rates is recognised in the income statement.

(e) Derivative financial instruments and hedge accounting

The Group uses derivative financial instruments in the form of forward foreign exchange contracts to manage the effects of its exposures to fluctuations in foreign exchange arising from operational and financial activities. In accordance with its treasury policy, the Group does not hold or issue derivative financial instruments for trading purposes. The fair value of forward foreign exchange contracts is their quoted market price at the balance sheet date.

Under IAS39, hedging relationships are categorised by type and must meet strict criteria to qualify for hedge accounting. At the inception of the transaction the Group documents the relationship between the hedging instrument and the hedged item. The Group also documents its assessment, both at hedge inception and on an ongoing basis, of whether the financial instruments that are used in hedging transactions are highly effective in offsetting changes in fair values or cash flows of hedged items. The Group uses cash flow hedges (eg forward foreign exchange currency contracts) to hedge exposure to variability in cash flows of a highly probable forecast transaction.

In relation to cash flow hedges, to hedge firm commitments which meet the conditions for hedge accounting, the portion of the gain or loss on the hedging instrument that is determined to be an effective hedge is recognised directly to equity and the ineffective portion is recognised in net profit or loss. For cash flow hedges that do not result in the recognition of an asset or a liability, the gains or losses that are recognised in equity are transferred to the income statement in the same year in which the hedged firm commitment affects the net profit and loss, for example when the future sale actually occurs.

Hedge accounting is discontinued when the hedging instrument expires or is sold, terminated or exercised, or no longer qualifies for hedge accounting. At that point in time, any cumulative gain or loss on the hedging instrument recognised in equity is kept in equity until the hedged transaction occurs. If a hedged transaction is no longer expected to occur, the net cumulative gain or loss recognised in equity is transferred to net profit or loss for the year.

The Group does not use financial instruments to hedge the exposure to changes in the fair value of recognised assets or liabilities that are attributable to a particular risk and could affect profit or loss (fair value hedges). No financial instruments are used to hedge net investments in a foreign operation (net investment hedges).

### 1.13 Leases

Leases are classified as finance leases whenever the terms of the lease transfer substantially all the risk and rewards of ownership to the lessee. Leases include hire purchase contracts which have characteristics similar to finance or operating leases. All other leases are classified as operating leases.

(a) Finance leases

Assets held under finance leases are recognised as assets of the Group at their fair value at the inception of the lease or, if lower, at the present value of the minimum lease payments. The corresponding liability to the lessor is included in the balance sheet as a finance lease obligation. Lease payments are apportioned between finance charges and reduction of the lease obligation so as to achieve a constant rate of interest on the remaining balance of the liability. Finance charges are charged to the income statement.

(b) Operating leases

Rentals payable under operating leases are charged to the income statement on a straight-line basis over the term of the relevant lease. Benefits received and receivable as an incentive to enter into an operating lease are also spread on a straight-line basis over the expected lease term.

### 1.14 Other liabilities

Other liabilities are recognised when the Group has legal or constructive obligation as a result of a past event and it is possible that the Group will be required to settle that obligation. Other liabilities are measured at the Director's best estimate of the expenditure required to settle the obligation at the balance sheet date.

### 1.15 Dividends

The annual final dividend is not provided for until approved at the Annual General Meeting; interim dividends are charged in the period they are paid.

### 1.16 Share capital and reserves

Ordinary shares are classified as equity. Incremental costs directly attributable to the issue of new shares are shown in equity as a deduction, net of tax, from the proceeds. The Group also maintains the following reserves:

- (a) Translation reserve – The translation reserve comprises all foreign exchange differences arising from the translation of the financial statements of foreign businesses.
- (b) Hedging reserve – The hedging reserve comprises the effective portion of the cumulative net change in the fair value of cash flow hedging instruments that are determined to be an effective hedge.

# Group Accounting Policies continued

For the year ended 30 September 2010

- (c) Retained earnings reserve – The retained earnings reserve comprises total recognised income and expense for the year attributable to shareholders. Bonus issues of share capital and dividends to shareholders are also charged directly to this reserve. On acquisition of minority interests, the liability held in the consolidated financial statements for the future purchases of those minority interests is released to the retained earnings reserve. In addition the cost of acquiring shares in the Company and the liability to provide those shares to employees, is accounted for in this reserve.

Where any Group company purchases the Company's equity share capital and holds that share either directly as treasury shares or indirectly within an ESOP trust, the consideration paid, including any directly attributable incremental costs (net of income taxes), is deducted from equity attributable to the Company's equity holders until the shares are cancelled, reissued or disposed of. Where such shares are subsequently sold or reissued, any consideration received, net of any directly attributable incremental transaction costs and the related income tax effects, is included in equity attributable to the Company's equity holders. These shares are used to satisfy share awards granted to Directors under the Group's share schemes. The trustee purchases the Company's shares on the open market using loans made by the Company or a subsidiary of the Company.

## 1.17 Accounting standards, interpretations and amendments to published standards not yet effective

The following new standards, amendments and interpretations to existing standards have been published and have been endorsed by the EU, that are mandatory for the Group's accounting periods beginning on or after 1 October 2010:

- Amendment to IFRS 2 'Share-based Payments': cash-settled share-based payment transaction;
- IFRS 9 (revised) 'Financial Instruments – Classification and Measurement';
- Amendment to IAS 24 'Related Party Disclosures': revised definition of related parties;
- Amendment to IAS 32 'Financial Instruments: Presentation': classification of rights issues;
- Amendment to IAS 39 'Financial Instruments: Recognition and Measurement': eligible hedged items; and
- Annual Improvements to IFRSs issued April 2009 and May 2010.

The Group has considered the impact of these new standards and interpretations in future periods and no significant impact is expected on reported profit or net assets.

The Group has chosen not to early adopt any of these new standards and interpretations.

## 2 Critical Accounting Estimates and Judgements

In order to prepare these consolidated financial statements in accordance with the accounting policies set out in note 1 above, management has used estimates and judgements to establish the amounts at which certain items are recorded. Critical accounting estimates and judgements are those which have the greatest impact on the financial statements and require the most difficult and subjective judgements about matters that are inherently uncertain. Estimates are based on factors including historical experience and expectations of future events that management believe to be reasonable. However given the judgemental nature of such estimates, actual results could be different from the assumptions used. The critical accounting estimates and judgements are set out below:

### 2.1 Goodwill impairment

The Directors use their judgement to determine the extent to which goodwill has a value that will benefit the performance of the Group over future periods. To assist in making this judgement, the Directors undertake an assessment, at least annually, of the carrying value of the Group's capitalised goodwill, using discounted cash flow forecasts to derive the "value in use" to the Group of the capitalised goodwill. This calculation is usually based on projecting future cash flows over at least a five year period and using a terminal value to incorporate expectations of growth thereafter. A discount factor is applied to obtain a current value ("value in use"). The "fair value less costs to sell" of an asset is used if this results in an amount in excess of "value in use".

Estimated future cash flows for impairment calculations are based on management's expectations of future volumes and margins based on plans and best estimates of the productivity of the assets in their current condition. Future cash flows therefore exclude benefits from major expansion projects requiring future capital expenditure where that expenditure has not been approved at the balance sheet date.

Future cash flows are discounted using discount rates based on the Group's weighted average cost of capital, adjusted if appropriate for circumstances specific to the asset being tested. The weighted average cost of capital is impacted by estimates of interest rates, equity returns and market and country related risks. The Group's weighted average cost of capital is reviewed on an annual basis.

The projection period is, in the opinion of the Directors, an appropriate period over which to view the future results of the Group's businesses for this purpose. Changes to the assumptions and discount rates used in making these forecasts could significantly alter the Directors' assessment of the carrying value of goodwill.

### 2.2 Retirement benefits

The Group's financial statements include the costs and obligations associated with the provision of pension retirement benefits to current and former employees. It is the Directors' responsibility to set the assumptions used in determining the key elements of the costs of meeting such future obligations. These assumptions are set after consultation with the Group's actuaries and are consistent with those assumptions used to determine the financing elements related to the Schemes' assets and liabilities. Whilst the Directors believe that the assumptions used are appropriate, a change in the assumptions used would affect the Group profit and financial position. Details of these assumptions, which are based on advice from the Group's actuaries, are set out in note 24.

### 2.3 Taxation

The Group operates in a number of tax jurisdictions around the world. Tax regulations generally are complex and in some jurisdictions agreeing tax liabilities with local tax authorities can take several years. Consequently, at the balance sheet date tax liabilities and assets are based on management's best estimate of the future amounts that will be settled. While the Group aims to ensure that the estimates recorded are accurate, the actual amounts could be different from those expected.

Deferred tax assets mainly represent timing differences that the Group expects to recover at some time in the future and by their nature, the amounts recorded are therefore dependent on management's judgement about future events. Account has also been taken of future forecasts of taxable profit in arriving at the values at which these deferred tax assets are recognised. If these forecast profits do not materialise or change, or there are changes in tax rates or to the period over which the timing difference might be recognised, then the value of the deferred tax asset will need to be revised in a future period.

### 2.4 Current assets

In the course of normal trading activities, judgement is used to establish the net realisable value of various elements of working capital, principally inventory and trade receivables. Impairment charges are made against obsolete or slow-moving inventories, bad or doubtful debts.

The decision to make an impairment charge is based on the facts available at the time the financial statements are approved and are also determined by using profiles, based on past practice, applied to certain aged inventory and trade receivables categories. In estimating the collectability of trade receivables, judgement is required in assessing their likely realisation, including the current creditworthiness of each customer and related ageing of the past due balances. Specific accounts are assessed in situations where a customer may not be able to meet its financial obligations due to deterioration of its financial condition, credit ratings or bankruptcy.

### 2.5 Property, plant and equipment

It is Group policy to depreciate its property, plant and equipment assets, except freehold land, on a straight-line basis over their estimated useful lives. This applies an appropriate matching of the revenue earned with the delivery of goods and services. A key element of this policy is the estimate of the useful life applied to each category of property, plant and equipment which, in turn, determines the annual depreciation charge. Variations in asset lives could impact Group profit through an increase or decrease in the depreciation charge.

### 2.6 Future purchases of minority interests

The Group's financial statements include a financial liability for the net present value of the expected amount that it will pay in future years to acquire the outstanding shares held by minority shareholders in the Group's subsidiaries. This amount is based on the Directors' estimate of the future profitability of the relevant subsidiary and on an assumption of the exchange rates prevailing at the time the payment is made. Any changes to the estimated profitability of the relevant business and/or changes to the assumption of the relevant exchange rate, will change the estimate of this financial liability.

# Parent Company Balance Sheet

As at 30 September 2010

	Note	2010 £m	2009 £m
<b>Fixed assets</b>			
Investments	c	72.0	70.2
<b>Creditors: amounts falling due within one year</b>			
Amounts owed to subsidiary undertakings		(42.3)	(41.0)
<b>Total assets less current liabilities</b>		<b>29.7</b>	29.2
<b>Capital and reserves</b>			
Called up equity share capital	d	5.7	5.7
Profit and loss account		24.0	23.5
		<b>29.7</b>	29.2

The financial statements of Diploma PLC, company number 3899848, were approved by the Board of Directors on 22 November 2010 and signed on its behalf by:

**BM Thompson**  
Chief Executive Officer

**NP Lingwood**  
Group Finance Director

The notes on page 75 form part of these financial statements.

## Reconciliation of Movements in Shareholders' Funds

For the year ended 30 September 2010

	Share capital £m	Profit and loss account £m	Total £m
<b>At 1 October 2009</b>	5.7	23.5	29.2
Retained profit for the year	–	0.3	0.3
Transfer of own shares, net	–	0.2	0.2
<b>At 30 September 2010</b>	<b>5.7</b>	<b>24.0</b>	<b>29.7</b>

# Notes to the Parent Company Financial Statements

For the year ended 30 September 2010

## a) Accounting Policies

### a.1 Basis of accounting

These financial statements have been prepared under the historical cost convention in accordance with the Companies Act 2006 and applicable UK accounting standards. A summary of the accounting policies of the Parent company ("the Company") is set out below. As permitted by section 404 of the Companies Act 2006, no separate profit and loss account is presented for the Company.

### a.2 Investments and dividends

Investments are stated at cost less provision for impairment. Dividend income is recognised when received. Dividend distributions are recognised in the Company's financial statements in the year in which the dividends are approved by the Company's shareholders. Interim dividends are recognised when paid.

### a.3 Employment Benefit Trust and Employee Share Schemes

Shares held by the Diploma Employee Benefit Trust ("the Trust") are stated at cost and accounted for as a deduction from shareholders' funds in accordance with UITF 38. Shares that are held by the Trust are not eligible for dividends until such time as the awards have vested to the employees.

## b) Directors' Remuneration

No emoluments are paid directly by the Company; information on the Directors' remuneration and interests in the share capital of the Company are set out in the Remuneration Report on pages 35 to 40.

## c) Investments

	£m
<b>Shares in Group undertakings</b>	
At 1 October 2009	70.2
Additions	1.8
<b>At 30 September 2010</b>	<b>72.0</b>

Details of the principal subsidiaries are set out on page 78.

## d) Share Capital

	2010 Number	2009 Number	2010 £m	2009 £m
<b>Allotted, issued and fully paid ordinary shares of 5p each</b>				
At 30 September	<b>113,239,555</b>	113,239,555	<b>5.7</b>	5.7

During the year 385,290 shares were transferred from the Diploma Employee Benefit Trust to participants in connection with vesting of awards under the Long Term Incentive Plan. On 19 March 2010, the Trust purchased a further 250,000 of shares for £0.4m. In accordance with UITF 38, the purchase cost of own shares, net of shares which have vested, are shown as a movement in shareholders' funds.

At 30 September 2010 the Trust held 732,973 (2009: 868,263) ordinary shares in the Company representing 0.6% of the called up share capital. The market value of the shares at 30 September 2010 was £2.1m (2009: £1.5m).

# Independent Auditors' Reports

For the year ended 30 September 2010

## Independent Auditors' Report on the Group financial statements to the Members of Diploma PLC

We have audited the Group financial statements of Diploma PLC for the year ended 30 September 2010 which comprise the consolidated income statement, the consolidated statement of financial position, the consolidated cash flow statement, the consolidated statement of comprehensive income, the consolidated statement of changes in shareholders' equity, the Group accounting policies and the related notes 1 to 27. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union.

This report is made solely to the Company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditors' report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's members as a body, for our audit work, for this report, or for the opinions we have formed.

## Respective responsibilities of directors and auditors

As explained more fully in the Statement of Directors' Responsibilities for the Financial Statements, the directors are responsible for the preparation of the Group financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit the Group financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's (APB's) Ethical Standards for Auditors.

## Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the Group's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the directors; and the overall presentation of the financial statements.

## Opinion on financial statements

In our opinion the Group financial statements:

- give a true and fair view of the state of the Group's affairs as at 30 September 2010 and of its profit for the year then ended;
- have been properly prepared in accordance with IFRSs as adopted by the European Union; and
- have been prepared in accordance with the requirements of the Companies Act 2006 and Article 4 of the IAS Regulation.

## Opinion on other matter prescribed by the Companies Act 2006

In our opinion the information given in the Directors' Report for the financial year for which the financial statements are prepared is consistent with the Group financial statements.

## Matters on which we are required to report by exception

We have nothing to report in respect of the following:

Under the Companies Act 2006 we are required to report to you if, in our opinion:

- certain disclosures of directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.

Under the Listing Rules we are required to review:

- the directors' statement contained within the Directors' Report in relation to going concern; and
- the part of the Corporate Governance Statement relating to the Company's compliance with the nine provisions of the June 2008 Combined Code specified for our review.

## Other matter

We have reported separately on the Parent company financial statements of Diploma PLC for the year ended and on the information in the Directors' Remuneration Report that is described as having been audited.

**Ian Waller (Senior Statutory Auditor)**  
**for and on behalf of Deloitte LLP**  
**Chartered Accountants and Statutory Auditors**  
**London**  
**22 November 2010**



### **Independent Auditors' Report on the Parent Company financial statements to the Members of Diploma PLC**

We have audited the Parent company financial statements of Diploma PLC for the year ended 30 September 2010 which comprise the Parent company balance sheet, the reconciliation of movements in shareholders' funds and the related notes a) to d). The financial reporting framework that has been applied in their preparation is applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice).

This report is made solely to the Company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditors' report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's members as a body, for our audit work, for this report, or for the opinions we have formed.

### **Respective responsibilities of directors and auditors**

As explained more fully in the Statement of Directors' Responsibilities for the Financial Statements, the directors are responsible for the preparation of the Parent company financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit the Parent company financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's (APB's) Ethical Standards for Auditors.

### **Scope of the audit of the financial statements**

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the Parent company's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the directors; and the overall presentation of the financial statements.

### **Opinion on financial statements**

In our opinion the Parent company financial statements:

- give a true and fair view of the state of the Parent company's affairs as at 30 September 2010;
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

### **Opinion on other matters prescribed by the Companies Act 2006**

In our opinion:

- the part of the Directors' Remuneration Report to be audited has been properly prepared in accordance with the Companies Act 2006; and
- the information given in the Directors' Report for the financial year for which the financial statements are prepared is consistent with the Parent company financial statements.

### **Matters on which we are required to report by exception**

We have nothing to report in respect of the following matters where the Companies Act 2006 requires us to report to you if, in our opinion:

- adequate accounting records have not been kept by the Parent company, or returns adequate for our audit have not been received from branches not visited by us; or
- the Parent company financial statements and the part of the Directors' Remuneration Report to be audited are not in agreement with the accounting records and returns; or
- certain disclosures of directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.

### **Other matter**

We have reported separately on the Group financial statements of Diploma PLC for the year ended 30 September 2010.

**Ian Waller (Senior Statutory Auditor)**  
**for and on behalf of Deloitte LLP**  
**Chartered Accountants and Statutory Auditors**  
**London**  
**22 November 2010**

# Principal Subsidiaries

	Group percentage of equity capital	Country of incorporation or registration
<b>Life Sciences</b>		
a1-envirosciences Limited	100%	England
a1-envirosciences GmbH	100%	Germany
a1-safetech AG	100%	Switzerland
Somagen Diagnostics Inc	100%	Canada
AMT Vantage Holdings Inc	75%	Canada
Big Green Surgical Company Pty Limited	80%	Australia
<b>Seals</b>		
Hercules Sealing Products Inc	100%	USA
RTD Seals Corp	100%	USA
All Seals Inc	100%	USA
HKX Inc	100%	USA
Hercules Europe BV	100%	Netherlands
M Seals A/S	90%	Denmark
FPE Limited	100%	England
<b>Controls</b>		
IS Rayfast Limited	100%	England
IS Motorport Inc	100%	USA
Clarendon Engineering Supplies Limited	100%	England
Cabletec Interconnect Components Systems Limited	100%	England
Sommer GmbH	100%	Germany
Filcon GmbH	100%	Germany
HA Wainwright (Group) Limited	100%	England
Hitek Limited	100%	England
<b>Other Companies</b>		
Diploma Holdings PLC	100%	England
Diploma Holdings Inc	100%	USA

A full list of subsidiaries will be annexed to the next Annual Return of Diploma PLC filed with the Registrar of Companies.

# Financial Calendar and Shareholder Information

## Announcements (provisional dates):

Interim Management Statement released	12 January 2011
Interim Management Statement released	1 August 2011
Half Year Results announced	17 May 2011
Preliminary Results announced	21 November 2011
Annual Report posted to shareholders	5 December 2011
Annual General Meeting	11 January 2012
Dividends (provisional dates)	
Interim announced	17 May 2011
Paid	22 June 2011
Final announced	21 November 2011
Paid (if approved)	18 January 2012

**Annual Report:** Copies can be obtained from the Company Secretary at the address shown below.

**Share Registrar – Computershare Investor Services PLC:** The Company's Registrar is Computershare Investor Services PLC, PO Box 82, The Pavilions, Bridgwater Road, Bristol BS99 7NH. Telephone: 0870 7020010. Their website for shareholder enquiries is [www.computershare.co.uk](http://www.computershare.co.uk)

**Shareholders' enquiries:** If you have any enquiry about the Company's business or about something affecting you as a shareholder (other than questions dealt with by Computershare Investor Services PLC) you are invited to contact the Company Secretary at the address shown below.

## Secretary and Registered Office:

N P Lingwood FCA, 12 Charterhouse Square, London EC1M 6AX. Telephone: 020 7549 5700. Fax: 020 7549 5715.  
Registered in England and Wales, number 3899848.

**Web site:** Diploma's web site is [www.diplomaplc.com](http://www.diplomaplc.com)

# Five Year Record

For the year ended 30 September 2010

Continuing businesses	2010 £m	2009 £m	2008 £m	2007 £m	2006 £m
<b>Revenue</b>	<b>183.5</b>	160.0	156.2	124.5	112.1
<b>Adjusted operating profit</b>	<b>32.1</b>	25.6	26.6	20.7	18.1
Finance income/(expense)	<b>0.1</b>	(0.1)	0.2	1.2	1.0
<b>Adjusted profit before tax</b>	<b>32.2</b>	25.5	26.8	21.9	19.1
Acquisition related charges	<b>(3.5)</b>	(3.1)	(2.7)	(1.0)	(0.3)
Property profits	<b>–</b>	–	–	–	11.1
Fair value remeasurements	<b>(2.0)</b>	(1.9)	(3.0)	–	–
<b>Profit before tax</b>	<b>26.7</b>	20.5	21.1	20.9	29.9
Tax expense	<b>(8.8)</b>	(7.1)	(7.2)	(7.1)	(6.6)
Profit for the year from continuing businesses	<b>17.9</b>	13.4	13.9	13.8	23.3
Profit from discontinued businesses	<b>5.1</b>	0.9	0.5	1.0	0.9
Profit for the year	<b>23.0</b>	14.3	14.4	14.8	24.2
<b>Capital structure</b>					
Equity shareholders' funds	<b>136.1</b>	121.4	108.1	90.7	92.9
Minority interest	<b>3.1</b>	2.7	1.9	1.8	1.6
Add/(less): cash and cash equivalents	<b>(30.1)</b>	(21.3)	(15.7)	(12.4)	(36.7)
retirement benefit obligations	<b>5.3</b>	4.7	1.7	1.6	4.7
future purchases of minority interests	<b>13.2</b>	13.1	11.2	11.8	–
deferred tax, net	<b>1.3</b>	2.0	3.3	3.6	(3.4)
adjustment to goodwill in respect of deferred tax	<b>(6.6)</b>	(6.5)	(6.0)	(5.6)	–
<b>Trading capital employed</b>	<b>122.3</b>	116.1	104.5	91.5	59.1
Net increase/(decrease) in cash	<b>8.6</b>	2.2	2.0	(25.3)	9.8
Add: dividends paid	<b>10.2</b>	9.1	7.8	5.7	5.0
acquisition of businesses	<b>11.0</b>	12.2	7.9	31.6	8.0
<b>Free cash flow</b>	<b>29.8</b>	23.5	17.7	12.0	22.8
<b>Per ordinary share (pence)</b>					
Basic earnings	<b>14.6</b>	10.8	11.4	11.8	20.3
Adjusted earnings	<b>18.9</b>	14.8	16.0	13.1	11.8
Dividends	<b>9.0</b>	7.8	7.5	5.4	4.6
Total shareholders' equity	<b>120</b>	107	95	80	82
Dividend cover	<b>2.1</b>	1.9	2.1	2.4	2.6
<b>Ratios</b>	<b>%</b>	<b>%</b>	<b>%</b>	<b>%</b>	<b>%</b>
Return on trading capital employed	<b>22.1</b>	19.0	22.4	25.5	25.1
Operating margin	<b>17.5</b>	16.0	17.0	16.6	16.1
<b>Continuing and discontinued businesses</b>	<b>£m</b>	<b>£m</b>	<b>£m</b>	<b>£m</b>	<b>£m</b>
Revenue	<b>188.8</b>	175.7	172.3	140.7	128.2
Adjusted profit before tax	<b>31.6</b>	26.7	27.5	23.3	20.4
Adjusted earnings per ordinary share (pence)	<b>18.5</b>	15.6	16.4	14.0	12.6

## Notes

- 1 Return on trading capital employed represents operating profit, before acquisition related charges, as a percentage of trading capital employed (as adjusted for the effect of the timing of major acquisitions and disposals). Trading capital employed is calculated as defined in note 2 to the consolidated financial statements.
- 2 Adjusted earnings per share is calculated in accordance with note 9 to the consolidated financial statements.
- 3 Total shareholders' equity per share have been calculated by dividing equity shareholders' funds by the number of ordinary shares in issue at the year end.
- 4 Dividend cover is calculated on adjusted earnings as defined in note 2 to the consolidated financial statements.
- 5 On 21 January 2008 the Company undertook a bonus issue of four new ordinary shares of 5 pence each for each ordinary share held by shareholders of the Company. The comparative amounts have been restated to reflect this bonus issue.
- 6 Acquisition costs have been charged against profit from 1 October 2009; prior to 1 October 2009 acquisition costs were included as part of the cost of investment.

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**Design: Energy Design Studio T. +44 (0)20 7249 1881**

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**Production: Imprima Limited T. +44 (0)20 7105 0300**

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# Diploma PLC

12 Charterhouse Square  
London EC1M 6AX

T. +44 (0)20 7549 5700  
F. +44 (0)20 7549 5715

[www.diplomaplc.com](http://www.diplomaplc.com)