DIPLOMA PLC

Annual Report & Accounts 2017

Diploma PLC is an international group of businesses supplying specialised technical products and services. We operate globally in three distinct Sectors

Life Sciences

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

For more information
See pages 16–19

Seals

Suppliers of seals, gaskets, filters, cylinders, components and kits for heavy mobile machinery and industrial equipment.

For more information
See pages 20–23

Controls

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

For more information
See pages 24–27

Contents

www.diplomaplc.com
For current information on Diploma PLC, including the Annual Report & Accounts 2017, please visit our website.

Financial Highlights

For the year ended 30 September 2017

Strong results with double-digit growth in revenue and earnings

Revenue
£451.9m
2016: £382.6m
+18%

Adjusted operating profit[1]
£78.2m
2016: £65.7m
+19%

Adjusted operating margin[1]
17.3%
2016: 17.2%
+10bps

Adjusted profit before tax[1,2]
£77.5m
2016: £64.9m
+19%

Profit before tax
£66.8m
2016: £54.0m
+24%

Free cash flow[3]
£55.7m
2016: £59.0m
–6%

	2017 pence		2016 pence
Adjusted earnings per share[1,2]	**49.8**	+19%	41.9
Basic earnings per share	**42.0**	+24%	33.9
Total dividend per share	**23.0**	+15%	20.0
Free cash flow per share[3]	**49.3**	–6%	52.2

1 Before acquisition related charges.
2 Before fair value remeasurements and gain on disposal of assets.
3 Before cash payments on acquisitions and dividends.

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, free cash flow, trading capital employed and return on adjusted trading capital employed ("ROATCE"). All references in this Annual Report & Accounts to "underlying" revenues or operating profits refer to reported results on a constant currency basis and before any contributions from acquired or disposed businesses. The narrative in the Annual Report & Accounts is based on these alternative measures and an explanation is set out in note 2 to the consolidated financial statements included in the Annual Report & Accounts.

Chairman’s Statement

Strong performance in 2017

John Nicholas, Chairman

The Group reported another strong performance in 2017 and delivered robust underlying growth in more confident global economies. The Board remains focused on executing the Group’s established strategy which is designed to deliver strong growth in earnings and shareholder value over the economic cycle.

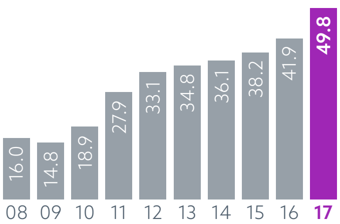
The Group has a long track record of consistent delivery against its key performance metrics by compounding stable “GDP plus” underlying growth with carefully selected, value enhancing acquisitions, funded by the Group’s free cash flow. This strategy has been successfully designed and executed under the outstanding leadership of Bruce Thompson since he became CEO of Diploma PLC in 1996. Over the last 15 years, since emerging from a major restructuring of the Group led by Bruce, the Group has delivered strong double-digit growth in earnings, dividends and share price and has grown market capitalisation from ca. £60m to ca. £1.2bn today, without any new equity having been issued.

In September of this year, the Board received notice from Bruce of his intention to retire as CEO before the end of 30 September 2018. This notice period ensures sufficient time to complete a thorough search process and a smooth transition of responsibilities. Bruce will be leaving the Group with a clearly defined and sustainable strategy, with a substantial runway for future growth and an experienced senior

The Group has a long track record of consistent delivery against its key performance metrics.

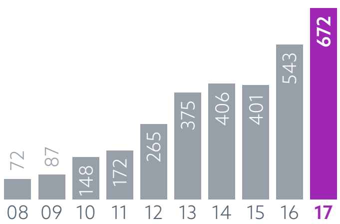
Adjusted EPS growth (pence)

+14%p.a.[1]



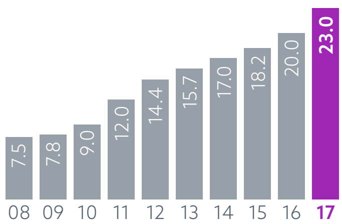
TSR growth (TSR index 2007 = 100)

+21%p.a.[1]



Dividend growth (pence)

+16%p.a.[1]



1 Ten-year compound.

management team. We all wish him a long, healthy and well-earned retirement.

Results

Group revenues increased in 2017 by 18% to £451.9m (2016: £382.6m), with the Group's results again boosted by currency effects from translating the results of the overseas businesses, following the substantial depreciation in UK sterling. After adjusting for the contribution from acquisitions completed both this year and last year, net of a small disposal and for these currency effects on translation, Group revenues increased by 7% on an underlying basis. The Controls businesses delivered robust underlying revenue growth of 14% and both the Life Sciences and Seals businesses reported a 4% growth in underlying revenues.

Adjusted operating profit increased by 19% to £78.2m (2016: £65.7m) reflecting the strong growth in revenues and a small increase of 10bps in adjusted operating margins to 17.3% (2016: 17.2%). Adjusted profit before tax increased by 19% to £77.5m (2016: £64.9m) and adjusted earnings per share ("EPS") also increased by 19% to 49.8p (2016: 41.9p).

The Group's free cash flow remained robust at £55.7m (2016: £59.0m) as working capital increased by £4.0m to support the stronger trading environment across the Group. Last year's free cash flow included an inflow of £6.3m from reduced working capital and £4.6m of cash realised on the sale of assets. Capital expenditure of £3.3m (2016: £3.7m) remained at a similar level to last year.

The Group has invested ca. £90m over three years in acquiring value enhancing businesses. However, expenditure on acquisitions slowed this year to £20.1m (2016: £32.7m) as some vendors postponed their exit plans in the face of a more favourable macroeconomic environment. There are still a number of good quality businesses in our acquisition pipeline which we are confident of completing when the vendors are ready to move forward.

The Group's balance sheet remains robust with cash funds at 30 September 2017 of £22.3m (2016: £10.6m), after investing £20.1m in acquisitions and making distributions to shareholders of £23.5m (2016: £21.0m). The Group also has renewed committed bank facilities of £30m with an accordion option to extend these facilities up to £60m.

Dividends

The combination of strong results and free cash flow, supported by a robust balance sheet has led the Board to recommend an increase in the final dividend of 16% to 16.0p per share (2016: 13.8p). Subject to shareholder approval at the Annual General Meeting ("AGM"), this dividend will be paid on 24 January 2018 to shareholders on the register at 1 December 2017.

The total dividend per share for the year will be 23.0p (2016: 20.0p) which represents a 15% increase on 2016. With underlying adjusted earnings increasing by 19%, the level of dividend cover increases slightly to 2.2 times on an adjusted EPS basis, from 2.1 times in recent years.

Governance

The Board's Committees, led by the non-Executive Directors, have had a productive year. Anne Thorburn led the Audit Committee through an audit tender process which in September resulted in a proposal to appoint PricewaterhouseCoopers LLP as Company and Group auditor from next year. Andy Smith has also led the Remuneration Committee through a thorough review of the Company's Remuneration Policy, in advance of the triennial vote by shareholders at the AGM on 17 January 2018. I have worked closely with Charles Packshaw as Senior Independent Director and with the Nomination Committee to commence a search for a new CEO to lead the Group, following the intended retirement of Bruce Thompson later in 2018.

Employees

Our employees remain our most important asset and their hard work continues to be a driving force behind our consistent and strong performance. Diploma is very much a people business and success is always a team effort. I wish to thank all of our employees for their support and contribution to the success of the Group this year.

Outlook

Diploma reported another strong performance in 2017, delivering strong double-digit growth in revenue and earnings. All of the Group's Sectors contributed to this growth with a particularly strong performance from Controls.

The Group's performance in 2017 provides confidence in the Group's prospects for solid underlying growth in the year ahead, which we aim to enhance by unlocking value enhancing acquisition opportunities. With a proven business model, broad geographic spread of businesses, robust balance sheet and consistently strong free cash flow, the Board is confident that further progress will be made in the next financial year.

Principal corporate objectives

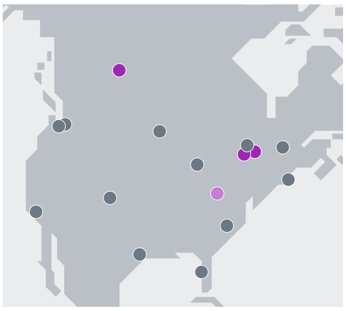
Achieve double-digit growth in adjusted EPS over the business cycle

Generate TSR growth in the upper quartile of the FTSE 250

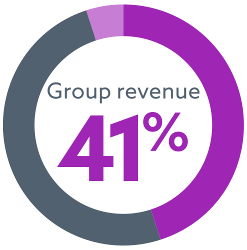
Deliver progressive dividend growth with two times dividend cover

Group at a Glance

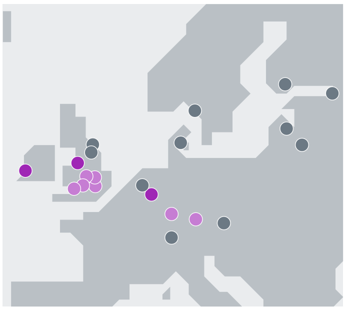
Well diversified by geography and business area



North American revenues
(by destination) by Sector

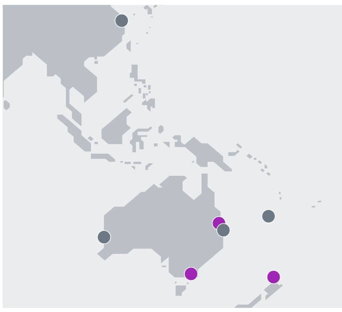


23% US 18% Canada

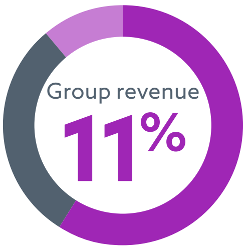


European revenues
(by destination) by Sector

22% UK 26% Continental Europe



Rest of World revenues
(by destination) by Sector



● Life Sciences ● Seals ● Controls

Life Sciences

Healthcare (84% of revenues)
Clinical diagnostic instrumentation, consumables and services supplied to hospital pathology and life sciences laboratories for the testing of blood, tissue and other samples.

Surgical medical devices and related consumables and services supplied to hospital operating rooms, GI/Endoscopy suites and clinics.

Environmental (16% of revenues)
Environmental analysers, containment enclosures and emissions monitoring systems.

Group revenue	Employees
28%	**412**

Primary growth drivers
- Public and private healthcare spending
- Population ageing and increasing life expectancy
- Health & Safety and Environmental regulation

For more information
See pages 16–19

Seals

North America – Aftermarket (32% of revenues)
Next day delivery of seals, sealing products and cylinder components for the repair of heavy mobile machinery.

North America – Industrial OEM (29% of revenues)
Sealing products, custom moulded and machined parts supplied to manufacturers of specialised industrial equipment.

International (39% of revenues)
Sealing products and filters supplied outside North America to Aftermarket and Industrial OEM customers as well as to Maintenance, Repair and Overhaul ("MRO") operations.

Group revenue
43%

Employees
862

Primary growth drivers
- General economic growth
- Activity and spending levels in Heavy Construction and Infrastructure
- Growth in industrial production
- MRO expenditure in Mining and process industries

For more information
See pages 20–23

Controls

Interconnect (59% of revenues)
Wiring, cable harness components and cable accessories used in specialised technical applications in Aerospace, Defence, Motorsport, Energy, Medical, Rail and Industrial.

Specialty Fasteners (18% of revenues)
Specialty aerospace-quality fasteners supplied to Civil Aerospace, Motorsport, Industrial and Defence markets.

Fluid Controls (23% of revenues)
Temperature, pressure and fluid control products used in Food, Beverage and Catering industries.

Group revenue
29%

Employees
437

Primary growth drivers
- General growth in the industrial economy
- Activity and spending levels in Aerospace, Defence, Motorsport, Energy, Medical and Rail
- Equipment installation and maintenance in Food, Beverage and Catering

For more information
See pages 24–27

Chief Executive's Review

Building larger, broader-based businesses

Bruce Thompson, Chief Executive Officer

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

Group strategy

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

The businesses target stable "GDP plus" underlying revenue growth over the business cycle with sustainable attractive margins and then convert the profit into strong free cash flow by tightly managing working capital and focused capital investments. The free cash flow generated then funds healthy growing dividends and selective value enhancing acquisitions which accelerate growth in revenues and profit to double-digit levels. The strategy consistently delivers a return in excess of 20% pre-tax on total capital invested and steadily increasing shareholder value.

Business model and KPIs

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

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

This year, underlying revenue growth, after adjusting for currency movements and acquisitions, has been a robust 7% with the growth rate strengthening in the second half of the year. Over five years, the average underlying revenue growth has been 5% p.a. which meets the Group's target of "GDP plus" growth.

Adjusted operating margins improved this year by 10bps to 17.3% of revenue, as transactional currency pressures eased during the year in the Healthcare businesses and improved operating leverage with tight control of operating costs has offset other pressures on gross margins. Over five years the average adjusted operating margin has been ca. 18% against the Group's medium term target of 18–19%.

The agility and responsiveness of the organisation is more difficult to measure directly, but non-financial KPIs can give an indication of the organisational health. The number of working days lost to sickness has consistently been only ca. 1% a year and over the last five years, the average length of service for all employees has been ca. 6.5 years (ca. 11 years for the senior management cadre).

Our Year in Review

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

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

Again we measure the success of the growth strategy with KPIs, the first of which is acquisition spend. To achieve the Group's objective of strong double-digit growth, acquisition spend of at least £30m p.a. is targeted, though year on year spend will vary with the acquisition environment. This year, the Group invested ca. £20m in acquisitions, bringing the total over three years to ca. £90m. The acquisitions completed over the last three years have contributed ca. 16% of 2017 revenues.

Strong cash flow funds our growth strategy (and supports healthy, growing dividends) and tight management of working capital maximises the conversion of profit to cash flow. This year, working capital has been managed down to a record low of 15.0% of revenue, generating free cash flow of £55.7m and representing a conversion rate of 99% of adjusted post tax earnings. Over five years, the average working capital to revenue ratio has been 16–17% and average free cash flow has been £45m p.a. with an average conversion ratio of 98%.

The Group's return on total investment measure is the pre-tax return on adjusted trading capital employed, excluding net cash, but including all goodwill and acquired intangible assets ("ROATCE"). This is used to measure the overall performance of the Group and very importantly, our success in creating value for shareholders through our acquisition programme. Over the last five years, ROATCE has comfortably exceeded the 20% target and this year was 24.0%.

Financial performance
In 2017, the Group delivered strong double-digit growth in revenue and earnings with robust underlying growth, a modest net contribution from acquisitions and further benefiting from the strong tailwind from the depreciation in UK sterling.

The Group's reported revenues increased by 18%, with currency movements increasing revenues by 9% and acquisitions contributing a further 2% to the revenue growth, net of a small prior year disposal. On an underlying basis, after adjusting for acquisitions and for currency effects on translation, Group revenues increased by 7%.

Group adjusted operating margins improved by 10bps to 17.3%, compared with 17.2% in the prior full year and the first half of the current year. Management gross margins have reduced overall by 60bps with margin pressures in several businesses from a combination of the impact on product costs from currency movements and increases in other margin support costs. These pressures have been partly mitigated by the stronger gross margins in recent acquisitions and transactional currency pressures in the Healthcare businesses have eased during the year. Operating costs as a percentage of revenue have reduced by 70bps with improved operating leverage from the increase in revenues and generally tight control of operating costs.

Working capital as a percentage of revenue was managed down through the year to 15.0%, although the Group's free cash flow reduced by 6% to £55.7m, reflecting the absence of prior year proceeds from one-off property sales and the divestment of the Medivators business.

Sector performance
In **Life Sciences**, underlying revenues increased by 4% after adjusting for currency movements, the acquisition of Abacus and the prior year disposal of the Medivators business. The Healthcare businesses benefited from stronger capital revenues as new technology was introduced and delayed projects were reactivated in the laboratory diagnostic sector. The Environmental businesses delivered steady growth in instrumentation sales and increasing service contract revenues.

In **Seals**, underlying revenues increased by 4% after adjusting for currency movements and the acquisitions of PSP and Edco. In North America, the improving trend in industrial activity seen in the second quarter, following the US election, strengthened further as the year progressed. In the International Seals businesses, strong growth in the UK and Scandinavia was offset by more challenging market conditions in Switzerland, Russia and Australia.

In **Controls**, underlying revenues increased by 14% after adjusting for currency movements and the prior year acquisitions of Cablecraft and Ascome. The Specialty Fasteners business increased revenues strongly, driven principally by a ramp-up in demand from customers in the Civil Aerospace sector. The Interconnect and Fluid Controls businesses also delivered good growth benefiting from increased project work and targeted investment in sales resources.

Acquisitions and disposals
Over the last three years, a total of ca. £90m has been invested in acquisitions which contributed ca. 16% of 2017 Group revenues.

During 2017, total acquisition spend was ca. £20m, of which ca. £15m was invested in the acquisition of Abacus, a long established supplier of diagnostics instrumentation and consumables to the Pathology and Life Sciences sectors in Australia and New Zealand. Abacus adds critical mass to our existing Healthcare businesses in the region and opens up new growth opportunities.

In addition, two smaller bolt-on acquisitions were completed in the Seals Sector during the year – PSP in the US and Edco in the UK. After the year end, a small acquisition was completed in the Controls Sector of Coast Fabrication Inc. ("Coast"), a US specialty fastener distributor.

Chief Executive's Review
continued

Building management strength

Essential values and culture
We encourage an entrepreneurial culture across our businesses, through a decentralised management structure.

In specialised distribution businesses it is essential that decisions are made close to the customer and that the businesses are agile and responsive to changes in the market and competitive environment. The success of the Group is therefore built upon strong, self-standing management teams in the operating businesses who are committed to and rewarded according to the success of their businesses.

This culture is very attractive to managers who join the Group in acquired businesses and who are used to a similar culture in their privately owned businesses.

Managing business clusters
We also recognise that there are significant synergy benefits which can be achieved through managing clusters of similar businesses. Typically these synergies come in the form of cross-selling and joint purchasing between the businesses and shared back office functions. There are also best practices which can be shared within the clusters in areas such as IT and digital capabilities.

We have therefore introduced small senior teams to manage the business clusters in each Sector, while being careful not to allow the build-up of heavy divisional structures with their associated costs and bureaucracy. This ensures that we gain the benefits of scale while retaining agility in the operating businesses.

These senior management teams are responsible for maximising the potential of their business clusters and also for identifying and progressing acquisition opportunities.

Executive Management Group
As the Group grows larger and becomes more broadly spread both geographically and operationally, it is important that we have in place a strong and broad based executive management team to drive the next stage of the Group's growth strategy.

The Executive Management Group ("EMG") was established in 2016, comprising the Executive Directors along with the executive managers who are responsible for the major business clusters and key Group functions. The EMG members are a combination of internally developed managers and experienced senior managers who have been recruited externally.

The EMG provides the opportunity for its members to broaden their perspective of the Group's activities in order to reinforce the key elements of the Group's culture and to identify best practices which are transferable across the Group. The EMG meets quarterly through a combination of full group meetings in London and sub-group meetings held in the major business locations.

The EMG provides the senior management bench strength to manage a growing and broadly spread Group while laying the groundwork for succession in key executive positions.

Capital Markets Day
In February 2017, the Group hosted a Capital Markets Day ("CMD") in London, exactly five years to the day after the previous CMD held in February 2012.

There were four key objectives for the day:

1. **Five-year track record** – to show the Group's progress over the last five years in executing its strategy and delivering strong growth in earnings and shareholder value.

2. **Resilience and sustainable margins** – to demonstrate the resilience of the Group's businesses and the high barriers to entry which protect the Group's stable and attractive margins.

3. **Runway for growth** – to give confidence in the substantial further "runway for growth" over the next five years, through a combination of stable underlying growth and value enhancing acquisitions.

4. **Senior management bench strength** – to introduce the strong and experienced senior management team which is in place to drive the next phase of the Group's development.

The first objective was achieved in an introductory presentation and animation video which summarised the development of the Group over the five years, with strong double-digit growth in adjusted EPS, TSR and dividends and an increase in market capitalisation from ca. £400m to ca. £1.2bn.

The other three objectives were achieved in break-out sessions for each of the three Sectors, where the EMG members presented the key features and resilient characteristics of their businesses and demonstrated key products. They also described the key elements of competitive advantage and barriers to entry which support the attractive margins. Finally, they detailed the substantial runway for growth in each business in terms of new product and market opportunities, geographic expansion and acquisitions.

The various presentations and video material delivered at the CMD are on the Diploma PLC website in the Investors section under the heading "Diploma PLC Investor Day 2017".

Our Business Model

Making us essential to our customers

Our Business Model is built on the three "Essentials" – essential Products, Solutions and Values.

What we put in

Essential Products

Our businesses focus on supplying essential products and services funded by customers' operating rather than capital budgets and supplied across a range of specialised industry segments.

The majority of the Group's revenues are generated from consumable products. In many cases, the products will be used in repair and maintenance applications and refurbishment and upgrade programmes, rather than supplied to original equipment manufacturers.

Essential Solutions

Our businesses design their individual business models to provide solutions which closely meet the requirements of their customers:

- Highly responsive customer service, such as the next day delivery from stock of essential, but low value items.
- Deep technical support, where we work closely with our customers in designing our products into their specific applications.
- Added value services which, if we did not provide these services, customers would have to pay others to provide them or would require them to invest in additional resources of their own.

Essential Values

We encourage an entrepreneurial culture across our businesses, through a decentralised management structure.

We want the managers to feel that they have the freedom to run their own businesses, while being able to draw upon the support and resources of a larger group where this is beneficial.

Within our businesses we have strong, self-standing management teams who are committed to and rewarded according to the success of their businesses.

What we get out

How we have made progress

Recurring income and stable revenue growth
Our focus on essential products and services contributes to the Group's record of stable revenue growth over the business cycle.

Our businesses target GDP plus levels of underlying revenue growth, over the economic cycle, with higher growth rates achieved at the Group level through carefully selected value enhancing acquisitions.

Performance is measured by the underlying growth in revenue, after adjusting for currency and acquisitions:

- This year, the underlying growth has been +7%.
- Over five years, the average has been +5% p.a..

For more information
See page 15

Sustainable and attractive margins
By supplying solutions, not just products, we build strong long term relationships with our customers and suppliers, supporting sustainable and attractive margins.

Our businesses achieve sustainable and attractive gross margins by offering strongly differentiated products and customer focused solutions within specialised market segments. By running efficient operations, these gross margins are converted into healthy operating margins.

Performance is measured by the level and stability over time of gross and operating margins:

- Gross margins have remained broadly stable over many years, excluding shorter term currency effects.
- This year, adjusted operating margin improved 10bps to 17.3%.
- Over five years, the average adjusted operating margin has been 18%.

For more information
See page 15

Agility and responsiveness
Our decentralised organisational model ensures that decisions are made close to the customer and that the businesses are agile and responsive to changes in the market and the competitive environment.

Agility and responsiveness in the businesses ensure close management of operating costs and working capital and deliver strong free cash flow.

Performance is more difficult to measure directly, but non-financial KPIs can give an indication of organisational stability and health. Over the last five years:

- Average length of service for all employees has been ca. 6.5 years (ca. 11 years for the senior management cadre).
- Number of working days lost to sickness has consistently been only ca. 1% a year.

For more information
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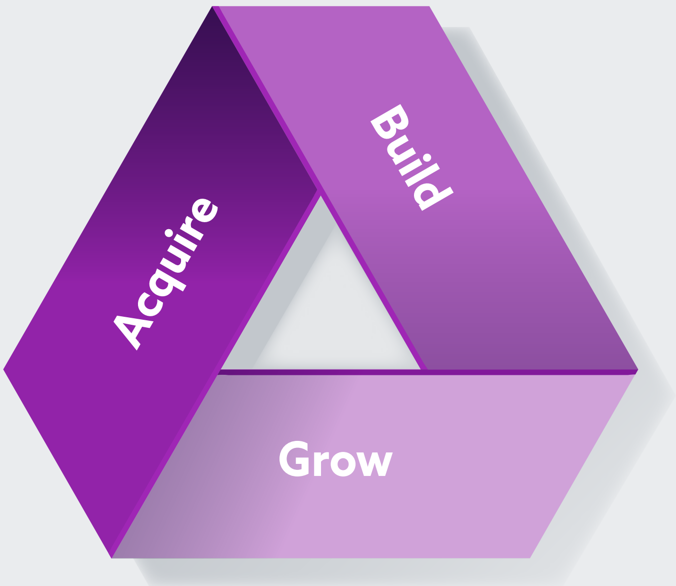
Growth Strategy

Compounding growth through acquisitions



Growth is accelerated by investing in value enhancing acquisitions

What we put in

Acquire

Clear business criteria have been established to guide the Group's acquisition programme:

- fit with the Group's business model;
- marketing led with strong customer relationships;
- secure supply of high quality, differentiated products; and
- capable management.

The principal financial criteria are:

- Track record of stable, profitable growth and cash generation.
- Exceed post-tax IRR threshold of 13% to ensure 20%+ pre-tax return on investment.

Build

The acquisitions we make are of businesses which are already successful and with a good track record. However, these businesses have typically reached the point where additional resources are needed to take them to the next level of growth.

Working with the management, we provide the investment required to build a solid foundation to allow the business to move to a new level of growth. The investment we make in new acquisitions will normally be in new facilities and IT systems, increased but better managed working capital and additional management resource.

Grow

Once the acquisition is integrated into the Group, with a solid platform established, the focus is on delivering stable, profitable growth.

The results of the Acquire, Build, Grow strategy can be seen in the improving revenue growth and operating margins post acquisition.

What we get out

How we have made progress

Acquisitions give entry into new but related markets and thereby extend the reach of the existing businesses and bring new growth opportunities.

The Group applies a consistent level of effort and resources to identifying and developing acquisition opportunities. However, the output in terms of acquisitions completed, ebbs and flows depending on the acquisition environment.

To achieve the Group's objective of strong double-digit growth, acquisition spend of at least £30m p.a. is targeted.

Abacus

In April 2017, the DHG group acquired Abacus, a long established supplier of specialised diagnostic instrumentation and consumables in Australia and New Zealand. Abacus has a good fit with our existing DS business, adds attractive product lines, critical mass and economies of scale in Clinical Diagnostics and gives entry to new segments within the broader Healthcare and Life Sciences sectors.

For more information
See pages 18–19

Except in the case of smaller bolt-on acquisitions, the acquired companies maintain their distinct sales and marketing identity and strong independent management teams.

Where there are opportunities for synergies with other Group businesses, these are managed in larger business clusters. Synergies typically include:

- Cross-selling between the businesses
- Joint purchasing between the businesses
- Shared operational infrastructure and shared back-office functions

US Industrial OEM Seals

In the second half of this year, a senior leadership team was established to manage the cluster of Industrial OEM Seals businesses in the US. While maintaining the distinct identities of the businesses and close local contact with the customers, key functions including Sales, Supply chain, Technical and Finance will be managed centrally by this team. Investment will also be made in implementing a new ERP system to replace the disparate legacy IT systems.

For more information
See pages 22–23

By the third year post-acquisition, underlying revenue growth for the acquired businesses is typically higher than the Group average and operating margins have improved by 200–300bps on average.

These improvements in financial performance ensure that the Group creates value through its acquisition programme and maintains ROATCE above the 20% threshold.

Cablecraft

Cablecraft, in only its second year as part of the Group, is already showing the benefits of investments made post-acquisition in increasing management and sales resources, expanding e-commerce capabilities and refurbishing facilities.

Under the continued strong leadership of one of the former owners, Cablecraft has increased revenues in 2017 by 7% on a like-for-like basis and has improved operating margins by ca. 300bps.

For more information
See pages 26–27

Strategic Priorities and KPIs

Strategic Priority

GDP+ underlying revenue growth

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

Attractive margins

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

Agile and responsive organisation

We encourage an entrepreneurial culture in our businesses through our decentralised organisation.

Acquisitions to accelerate growth

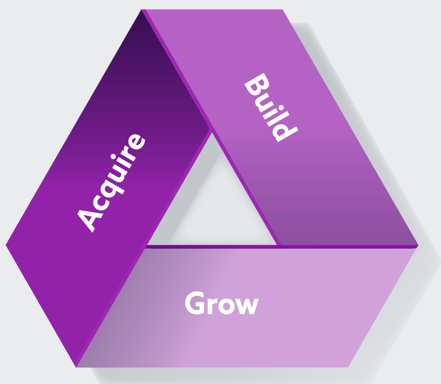
Carefully selected, value enhancing acquisitions accelerate the underlying growth and take us into related strategic markets.

Strong cash flow

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

Value creation

We aim to create value by consistently exceeding 20% ROATCE.



Key Performance Indicators

Total revenue growth (£m)

17	451.9
16	382.6
15	333.8
14	305.8
13	285.5

+12% p.a.
Five-year compound

Underlying revenue growth (%)

17	+7
16	+3
15	+1
14	+8
13	+4

+5% p.a.
Five-year average

Adjusted operating margins (%)

17	17.3
16	17.2
15	18.1
14	18.5
13	19.0

18%
Five-year average

Adjusted operating margin (Δbps)

Improvement in adjusted operating margin of acquired businesses three years after acquisition

+200–300bps

Length of service (years)

17	6.7
16	6.7
15	6.6
14	6.3
13	6.2

6.5 years
Five-year average

Average working days lost to sickness (%)

17	1.3
16	1.2
15	1.2
14	1.2
13	0.9

1.2%
Five-year average

Acquisition spend (£m)

17	20.1
16	32.7
15	37.8
14	16.5
13	2.2

£22m p.a.
Five-year average

Revenue from acquisitions[1] (% of total)

17	16
16	20
15	14
14	11
13	15

15%
Five-year average

1 Completed over the last (rolling) three years.

Free cash flow (£m)

17	55.7
16	59.0
15	40.3
14	37.8
13	31.6

£45m p.a.
Five-year average

Working capital (% of revenue)

17	15.0
16	16.6
15	17.0
14	17.2
13	16.7

16–17%
Five-year average

ROATCE (%)

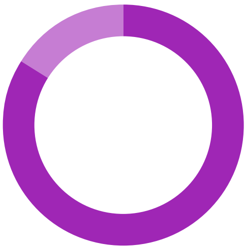
17	24.0
16	21.1
15	23.9
14	25.8
13	25.8

24%
Five-year average

Life Sciences

The Life Sciences Sector businesses supply a range of consumables, instrumentation and related services to the Healthcare and Environmental industries.

Principal segments



84% Healthcare
16% Environmental

Geography

52% Canada
28% Europe
20% Australasia

Customers

84% Clinical
9% Utilities
4% Chemical & Pharmaceutical
2% Life Sciences Research
1% Other Life Sciences

Products

74% Consumables
17% Instrumentation
9% Service

Healthcare

The Diploma Healthcare Group ("DHG") operates in three principal geographies – Canada, Australasia and Europe. In Canada, DHG supplies to the ca. 600 public hospitals across the country as well as to private clinics and pathology laboratories. Somagen Diagnostics ("Somagen") supplies a range of consumables and instruments used in the diagnostic testing of blood, tissue and other samples. It is also a leading supplier to the growing cancer screening and the assisted reproductive technology ("ART") markets. AMT surgical ("AMT") supplies specialised electrosurgery equipment and consumables for use in hospital operating rooms and is also building a portfolio of specialised surgical instruments and devices used in minimally invasive ("MI") surgery. Vantage Endoscopy ("Vantage"), now managed as a separate division within AMT, supplies endoscopes and related consumables, therapeutic devices and services to GI Endoscopy suites in hospitals and private clinics. Vantage is also expanding its portfolio into the Urology and Gynaecology surgical segments with rigid and flexible scopes and specialised instrument sets.

In Australia and New Zealand, DHG expanded its operations with the acquisition in April 2017 of Abacus ALS, a long established supplier of instrumentation and consumables to the Pathology and Life Sciences sectors. Abacus ALS is in the process of being combined with Diagnostic Solutions ("DS") to form abacus dx, a larger, broader based clinical diagnostics business supplying to both public and private laboratories. Big Green Surgical ("BGS") supplies a range of products to the Surgical Products sector and shares several common suppliers with AMT in Canada.

In Europe, DHG operates through Technopath Distribution ("TPD"), an established supplier of products to the Biotechnology, Clinical Laboratory and Medical Device markets in Ireland and the UK. Similar to the other DHG businesses, TPD focuses on specialised laboratory diagnostics and specialty medical device segments, again leveraging a number of common suppliers.

Environmental

The a1-group is a supplier to Environmental testing laboratories and to Health & Safety engineers. The a1-envirosciences business, based in Germany, supplies a range of specialised environmental analysers and a range of containment enclosures for potent powder handling. The a1-CBISS business, based 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 DHG businesses in Canada supply into areas of **Healthcare** which are predominantly public sector funded. Private sector funding, representing ca. 30% of Healthcare expenditure in Canada, is largely focused on areas where DHG do not participate, specifically dental, cosmetic and eye surgery and pharmaceuticals. The principal demand driver for DHG in Canada is therefore the sustainable level of Healthcare spending funded by the Canadian Government.

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. A growing, ageing and well educated population demands high standards of service delivery, helping to ensure ongoing growing demand.

The Provinces are responsible for the delivery of the Healthcare services, but the Federal Government partially 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 and current expenditure of

Principal operations

Healthcare

Somagen Diagnostics	Edmonton, AB, Canada
AMT Surgical	Kitchener, ON, Canada
Vantage Endoscopy	Kitchener, ON, Canada
abacus dx	Brisbane, QLD & Melbourne, VIC, Australia
Big Green Surgical	Melbourne, VIC, Australia
Technopath Distribution	Ballina, Co. Tipperary, Ireland

Environmental

a1-CBISS	Tranmere, UK
a1-envirosciences	Düsseldorf, Germany

10.3% of GDP (11.1% including capital expenditure) places Canada in the top 20% of OECD countries.

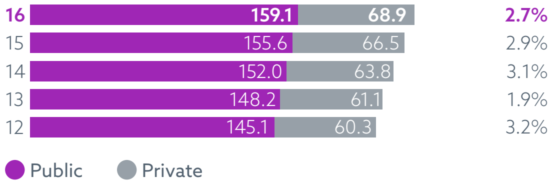
Over many years, Healthcare expenditure has grown steadily with annual variations mostly dependent on the periodic additional tranches of funding provided by individual Provinces. In periods when the economy has been slower, Healthcare funding has still shown positive growth, albeit at reduced levels. In 2016, public Healthcare spending in Canada was ca. C$160bn, with the largest category of expenditure (C$65bn) being in the hospital sector.

The Healthcare market in Australia shares with Canada many of the same attractive characteristics for specialised distribution. While privately funded Healthcare is more prevalent in areas such as surgery and laboratory testing, public sector Healthcare funding is still large and supported by a stable, resource based economy. As with Canada, Australia has 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 local distribution model a very attractive mechanism for manufacturers to serve the local markets.

Since 2013, the Canadian and Australian economies have come under significant pressure from the falling oil price and reduced demand for the countries' natural resources. This tougher economic environment has resulted in greater pressure on budgets throughout the Healthcare systems in both countries. In such periods, Healthcare funding is tightly constrained through targeted controls imposed on the number of laboratory tests and operating procedures as well as more rigorous tendering and Group procurement processes for expenditure on capital equipment. Even with such pressures, however, Healthcare funding has shown positive growth in total Healthcare expenditure of 2–3% and 4–5% respectively in Canada and Australia.

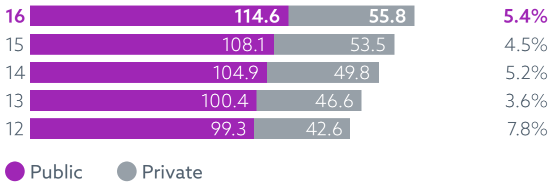
The principal market driver for the TPD business is Healthcare funding in the UK and Ireland, which totals ca. £200bn, representing ca. 10% of combined GDP. The UK accounts for ca. 90% of the total funding and ca. 80% is provided by public funding and 20% by private funding. Following the 2009 recession, annual growth in UK Healthcare expenditure has slowed to low single-digit levels, compared with average growth of 8% p.a. over the previous decade. In Ireland, Healthcare

Canadian Healthcare expenditure[1] (C$bn) % growth



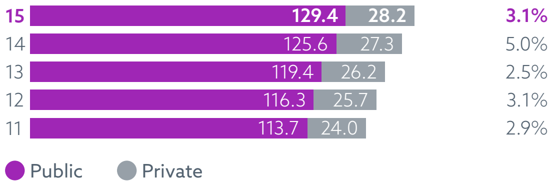
Source: Canadian Institute for Health Information.
1 Includes capital expenditure.

Australian Healthcare expenditure[1] (A$bn) % growth



Source: Australian Institute of Health & Welfare.
1 Includes capital expenditure.

UK Healthcare expenditure[1] (£bn) % growth



Source: UK Health Accounts (2016 data not yet available).
1 Excluding capital expenditure.

Total current Healthcare expenditure[1] **as a percentage of GDP**

	2012	2013	2014	2015	2016
Canada	10.2%	10.1%	10.0%	10.3%	**10.3%**
Australia	8.7%	8.8%	9.1%	9.4%	**9.6%**
UK	8.5%	9.9%	9.8%	9.9%	**9.7%**

Source: OECD.
1 Excluding capital expenditure.

expenditure saw reductions year-on-year in 2010 and 2011, since when growth has resumed again at low single digit levels.

The a1-group supplies to customers in the **Environmental** industry in the UK, Germany and France. The market demand is largely driven by Environmental and Health & Safety regulations and growth in recent years has been driven by the need to be compliant with a range of EU regulations. Since market demand is driven by regulation, this ensures reasonably steady demand for essential consumable products and services, though customers may defer capital expenditure during significant downturns in the economy.

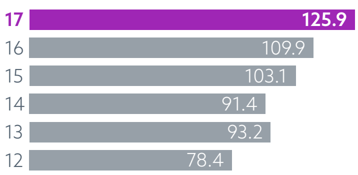
Life Sciences

Highlights from the year

- Sector revenue growth of 15%; underlying growth of 4% after adjusting for currency, an acquisition and a disposal
- In Canada, DHG underlying revenues increased by 6% with strong capital revenues as projects were reactivated; AMT and Vantage combined into single Surgical Products business
- In Australia, underlying revenues increased by 4%; Abacus acquired in April 2017 and being integrated with DS to form a larger broader-based business
- TPD revenues broadly flat in Ireland and the UK with new suppliers and products replacing suppliers moving to direct supply model
- Environmental businesses increased underlying revenues by 3%, finishing the year with strong order books

Revenue (£m)
(compound growth over five years)

+10%p.a.



Revenue

£125.9m

	2017	2016	
Revenue	**£125.9m**	£109.9m	+15%
Adjusted operating profit	**£23.3m**	£19.6m	+19%
Adjusted operating margin	**18.5%**	17.8%	+70bps
Free cash flow	**£17.0m**	£19.0m	–11%
ROATCE	**19.7%**	18.0%	+170bps

Sector performance

Reported revenues of the Life Sciences businesses increased by 15% to £125.9m (2016: £109.9m). The acquisition of Abacus ALS ("Abacus"), acquired in April 2017, added £7.6m or 7% to Sector revenues, but this was offset by the prior year disposal of the Medivators business. Currency movements, on translation of the results from overseas businesses to UK sterling, contributed a further 11% to Sector revenues. After adjusting for currency, the acquisition and the disposal, underlying revenues increased by 4%.

Sector adjusted operating margins improved by 70bps benefiting from a combination of stronger gross margins in Abacus and from reduced operating costs following the consolidation of the AMT and Vantage business operations into one facility at the beginning of the year. Transactional currency pressures on the Healthcare businesses also eased towards the end of the year, following a number of years when gross margins were significantly impacted by the progressive depreciation of the Canadian and Australian dollars relative to the US dollar and Euro. Operating margins also strengthened in the Environmental businesses, with an increase in gross margins and with improved leverage from the increased revenues. Sector adjusted operating profits increased by 19% to £23.3m (2016: £19.6m).

The Life Sciences businesses invested £2.0m in new capital during the year (2016: £1.9m) of which £1.6m (2016: £0.9m) was spent on acquiring field equipment for both new placements in hospitals and laboratories and for loan equipment and demonstration models to support existing placements. The increase in spend on field equipment was largely driven by the launch of a new series of flexible endoscopes, together with the addition of a range of rigid endoscopes under a new supplier agreement. A further £0.3m was invested, in part on the AMT/Vantage facility consolidation and in part on the general IT infrastructure of the Life Sciences businesses. Free cash flow reduced to £17.0m (2016: £19.0m), reflecting the slightly higher working capital in the Healthcare businesses; although last year's free cash flow also included £2.2m received on the disposal of the Medivators business.

Healthcare

The DHG group of Healthcare businesses, which account for 84% of Life Sciences revenues, increased underlying revenues by 4% after adjusting for currency, the acquisition of Abacus and the disposal of the Medivators business.

In Canada, underlying revenues increased by 6% against the background of continuing budget pressures throughout the Provincial healthcare systems, but with strong capital revenues as new technology was introduced and delayed projects were reactivated in the diagnostic laboratory sector.

Somagen's core Clinical Diagnostics business in Canada delivered an increase of 10% in revenues, with steady growth in consumable and service revenues boosted by strong growth in capital revenues. Demand for diagnostic testing remained robust, particularly with the growth of cancer screening tests and related diagnostics and capital revenues increased strongly with new technology introduced in the areas of Allergy, Autoimmunity and Histology. Capital revenues also benefited from some relaxation in the policy of regional consolidation of diagnostic laboratories in Quebec despite the continued drive for cost savings and efficiencies within many public medical laboratories.

AMT and Vantage were combined into a single, more efficient Surgical and GI specialty medical device business in Canada following the disposal of the Medivators business in September last year. Warehousing, logistics and back office functions have been integrated within AMT's facility in Kitchener, which has provided good opportunities for operational leverage from the increased scale of the combined business. In its core electrosurgery business, AMT continued to face pricing pressures from the tender and evaluation processes introduced by shared service organisations and national group purchasing organisations ("GPOs"). These pricing pressures will continue to be a factor as the GPOs continue to consolidate in Canada. However, AMT was able to maintain revenues by increasing sales of specialised surgical instruments and devices used in laparoscopic and other MI surgical procedures.

Vantage, operating now as a division of AMT, increased revenues in its core GI/endoscopy product lines and successfully launched a new series of flexible endoscopes with significantly improved light imaging performance and higher reliability. Vantage also secured the exclusive distribution rights for a premium range of rigid and flexible endoscopes and surgical instrument sets, which give entry into the Urology and Gynaecology segments and provide further opportunities for growth in the Surgical products sector.

In Australia, the Healthcare sector in recent years has experienced similar healthcare budget pressures to Canada, but has the added capacity of private Healthcare spending to offset some of the economic constraints. Against this background, the BGS and DS businesses have increased revenues by 4% in local currency terms. BGS increased revenues by 8%, with smoke evacuation programmes in existing and new accounts continuing to be the principal driver to growth. DS also delivered modest revenue growth, with strong sales of Protein Electrophoresis consumables following a number of capital placements during the prior year.

In April 2017, DHG completed the acquisition of Abacus, a long established supplier of diagnostics instrumentation and consumables to the Pathology and Life Sciences sectors in Australia and New Zealand. Abacus supplies to the large private laboratories that dominate the Clinical Diagnostic services industry in the region as well as supplying direct to certain hospitals and to the regional laboratory service groups that support hospital testing in the various States. Abacus has particular strengths in Immunology and Biochemistry testing and also is developing a niche specialty Patient Simulation business in the Australian market.

Abacus has very complementary clinical diagnostics products to the DS business and these two businesses are now in the process of being integrated to form abacus dx, a larger broader-based Clinical Diagnostics, Life Science and Patient Simulation business, supplying to both the public and private pathology laboratories, and to research and educational institutions across Australasia.

The TPD business in Ireland and the UK reported revenues broadly flat in Euro terms, with business transacted in UK sterling (ca. 40% of revenues) impacted by the weaker currency. TPD continued to achieve steady growth in supplying clinical chemistry and serology products used to control quality in Clinical Diagnostics laboratories. TPD also delivered revenue growth in specialty medical devices used in digestive health and rapid microbial testing products used in industrial laboratories. However, revenues reduced in the water testing and interventional cardiology segments as certain suppliers moved from specialised distribution to a direct supply model. TPD is introducing a number of new suppliers and products to replace these revenues and it is broadening its service capability beyond diagnostic instrumentation to extend into the blood services sector. TPD has also established a new Surgical Products division to bring to market the electrosurgical and smoke evacuation products similarly supplied by AMT and BGS in Canada and Australia.

Environmental

The a1-group of Environmental businesses in Europe, which account for 16% of Life Sciences revenues, saw revenues increase by 9% in UK sterling terms and 3% growth in constant currency terms.

The a1-envirosciences business based in Germany increased revenues by 3% in Euro terms against a strong prior year comparative, which had benefited from a large mercury detector order. Revenue from high-end trace and elemental analysers used in the Environmental and Petrochemical industries delivered good growth, with the second half of the year being particularly strong in the UK and the Benelux region. Service revenue continued to grow with the larger installed base and with increasing demand from the larger customers for faster response times. Demand for containment enclosures for the safe weighing of hazardous materials remains robust.

The a1-CBISS business based in the UK increased revenues by 2% with continued growth in the installation of continuous emissions monitoring systems ("CEMS") and increased service contract revenues from CEMS projects delivered in the last 18 months. The sector remains buoyant with new Energy from Waste ("EFW") plants playing an important role in reducing landfill waste. The gas detection sector has started to see increased demand from Oil & Gas customers for single-use gas detection tubes after a number of years of lower activity levels.

Potential for growth

Increase share of specialised segments of **Healthcare** markets in Canada, Australia and UK/Ireland

Leverage product portfolio across existing businesses and extend into other medical disciplines

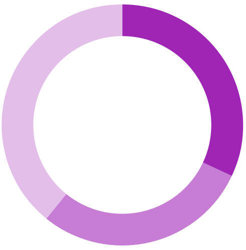
Pursue further acquisition opportunities in Europe and Asia-Pacific

Continue to develop product and geographic spread of **Environmental** businesses

Seals

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

Principal segments



- 32% North America Aftermarket
- 29% North America Industrial OEM
- 39% International

Geography

57% North America
33% Europe
10% Rest of World

Customers

45% Industrial OEMs
32% Heavy Construction
18% MRO & Other Industrial
3% Dump & Refuse Trucks
2% Logging and Agriculture

Products

38% Seals & Seal Kits
17% O-rings
17% Cylinder & Other
11% Filters
11% Gaskets
6% Attachment Kits

North America

The **Aftermarket** businesses in North America supply sealing and associated products to support a broad range of mobile machinery in applications which include Heavy Construction, Mining, Logging, Agriculture, Material Handling (lift trucks, fork lifts and dump trucks) and Refuse Collection. The products are generally supplied on a next day delivery basis and are used in the repair and maintenance of equipment after it has completed its initial warranty period or lease term, or has been sold on the pre-used market. The main customers are machinery and cylinder repair shops, engine and transmission rebuilders and other heavy equipment parts distributors.

The **Industrial OEM** businesses in North America supply seals, gaskets, O-rings and custom moulded and machined parts to a range of Industrial OEM customers. The businesses work closely with customers to select the most appropriate seal design, material and manufacturer for the application, provide technical support and guidance during the product development process and deliver the logistics capabilities to supply from inventory to support small to medium sized production runs.

International

The International Seals businesses outside North America supply a range of seals, gaskets, filters, custom moulded and machined parts and hydraulic cylinder components to both Aftermarket and Industrial OEM customers. The businesses also supply products to end users operating process plants within the Mining, Oil & Gas, Pharmaceutical, Chemical, Food and Energy sectors, where products are required to support Maintenance, Repair and Overhaul ("MRO") operations.

Market drivers – North America

In the **Aftermarket** businesses in North America, the principal drivers are the general GDP growth and in particular, activity and spending levels in the Heavy Construction and Infrastructure sectors. In 2017, the US economy is forecast to show annual GDP growth of 2.2% (2016: 1.6%) driven primarily by strong consumer spending and growth in business investments. Total US Construction spend (including non-residential and infrastructure spend, as well as residential housing activity) has continued to rise through 2017.

Unit sales in the US of Construction Equipment (defined as heavy mobile equipment including excavators above 14 tonnes, crawler dozers and wheeled loaders) is important as a medium term indicator for Hercules' replacement hydraulic seals activities, as the new equipment will move out of the dealer warranty period in the following years. It is also a good short term indicator for the HKX attachment kit business. During 2016 and the first half of 2017, the demand for new equipment declined as the general mobile machinery population is relatively new and contractors continue to opt for the rental model for their equipment needs; rental fleet utilisation rates have increased by ca. 10% year over year.

In Canada, 2017 GDP growth is forecast to increase to 3% (2016: 1.5%) as a stronger economy and stable oil prices are expected to lead to expanding exports and stable domestic demand.

In general, the economic conditions in the South and Central American economies served by the North American Aftermarket businesses continue to be challenging.

Principal operations

North America (HFPG)	
Aftermarket	
Hercules US	Clearwater, FL, US
Hercules Canada	Barrie, ON & Montreal, QC, Canada
Bulldog	Tampa, FL, US
HKX	Monroe, WA, US
Industrial OEM	
J Royal	Winston-Salem, NC & Tallassee, AL, US; Shanghai, China
RT Dygert	Minneapolis, MN, Chicago, IL & Seattle, WA, US
All Seals	Lake Forest, CA, Denver, CO & Houston, TX, US
International	
FPE Seals	Darlington & Aberdeen, UK; Breda, The Netherlands
Kentek	Helsinki, Finland; St. Petersburg, Russia; Riga, Latvia
M Seals	Espergaerde, Denmark; Halmstad, Sweden; Beijing, China; Gateshead & Leicester, UK
Kubo	Effretikon, Switzerland; Linz, Austria
WCIS	Perth & Brisbane, Australia; Noumea, New Caledonia

For the **Industrial OEM** Seals businesses in North America, the principal market driver is the growth rate in the general industrial economy. US industrial production reached a peak at the end of calendar year 2014 and then declined through 2015 and 2016. In 2017, the industrial economy returned to steady growth as a general rise in manufacturing was supported by stabilised activity within the Mining and Oil & Gas segments.

Market drivers – International

The International Seals businesses operate in a range of countries and diverse market sectors and each has its own specific market drivers. The most relevant market drivers and indicators are therefore the general GDP growth and Industrial sector performance for the major geographies in which the businesses operate.

In the UK, economic growth is forecast to remain broadly flat in 2017 at ca. 1.7% (2016: 1.8%). The weakened UK sterling is providing short term benefits to exporters, but this is offset by uncertainty over the terms of any future EU trade deal, which has led to investment decisions being postponed or deferred. The UK Construction sector, which drives the Aftermarket business, has been steadily growing since mid-2012, driven mostly by new housing work, but began to show signs of a slow-down in the second half of FY2017.

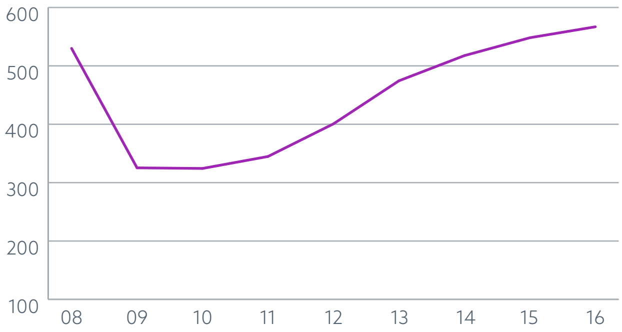
In the Nordic region, all countries are forecast to show positive GDP growth in 2017. Average growth across the region is forecast to be ca. 2.5% (2016: 2.0%) with Sweden forecast to show the strongest growth and Finland showing good recovery in 2016 and 2017 after several years of weakness.

In Switzerland, the economy continued to be affected by the strength of the Swiss Franc following its decoupling from the Euro in 2015, making exports of Swiss Industrial products less attractive. However, during 2017, the Swiss Franc has weakened against the Euro, resulting in an increase in Industrial activity.

In Russia, the impact of low oil prices and EU and US sanctions continues to hinder economic growth. However, the economy is benefiting from a stabilisation of oil prices and foreign exchange rates and lower levels of inflation and, after having contracted by 2.8% in 2015 and 0.2% in 2016, GDP is forecast to grow by 1.8% in 2017.

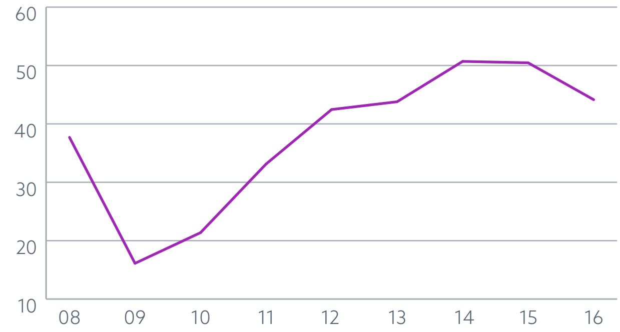
In Australia, industrial activity has been adversely affected by the downturn in the Mining sector, but the broader economy continues to be driven by increased public and consumer spending. GDP growth is forecast to slow to ca. 2.2% in 2017 (2016: 2.5%), but is forecast to increase in 2018 supported by the recovery in the Mining and Oil & Gas sectors.

US construction spend (US$bn)



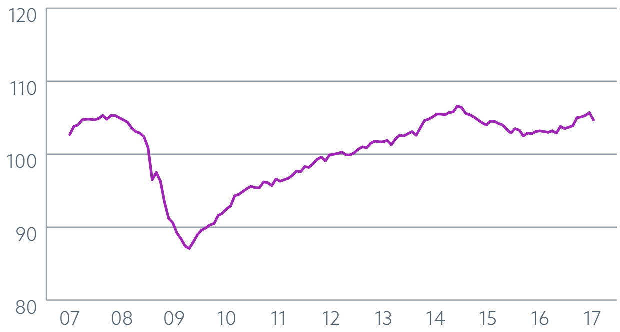
Source: Cyclast Intercast.

US construction equipment units ('000)



Source: Cyclast Intercast.

US industrial production index



Source: US Federal Reserve (seasonally adjusted).

GDP growth in principal International Seals territories

Real GDP growth	2012	2013	2014	2015	**2016**
UK	+1.3%	+1.9%	+3.1%	+2.2%	**+1.8%**
Nordic region	+0.5%	+0.8%	+1.7%	+2.2%	**+2.0%**
Switzerland	+1.0%	+1.9%	+2.5%	+1.2%	**+1.4%**
Russia	+3.7%	+1.8%	+0.7%	–2.8%	**–0.2%**
Australia	+3.6%	+2.1%	+2.8%	+2.4%	**+2.5%**

Source: IMF and Nordic Cooperation.

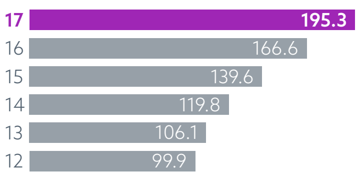
Seals

Highlights from the year

- Sector revenue growth of 17%; underlying growth of 4% after adjusting for currency and acquisitions
- In North America, Aftermarket underlying revenues increased by 5% with a good performance in the core Hercules business and a strong recovery in the HKX business
- Industrial OEM underlying revenues in North America increased by 7% with an improving trend through the year following the US election
- Senior leadership team established to manage cluster of Industrial OEM businesses in the US
- International Seals businesses increased underlying revenues by 1% with performances of the businesses very dependent on local market conditions

Revenue (£m)
(compound growth over five years)

+14%p.a.



Revenue

£195.3m

	2017	2016	
Revenue	**£195.3m**	£166.6m	+17%
Adjusted operating profit	**£31.9m**	£28.2m	+13%
Adjusted operating margin	**16.3%**	16.9%	–60bps
Free cash flow	**£24.9m**	£24.9m	–
ROATCE	**22.8%**	20.1%	+270bps

Sector performance

Reported revenues of the Seals businesses increased by 17% to £195.3m (2016: £166.6m), with the acquisitions of PSP and Edco completed during the year contributing £2.1m or 1% to Sector revenues. Currency movements, on translation of the results from overseas businesses to UK sterling, contributed a further 12% to Sector revenues. After adjusting for the acquisitions and for currency effects, underlying revenues increased by 4%.

Adjusted operating margins for the Sector reduced by 60bps to 16.3% (2016: 16.9%). Across the businesses, gross margins reduced with product margins under pressure from supplier cost increases, but also reflecting an increase in other margin support costs, such as freight, discounts and stock adjustments. This reduction in gross margins was significantly mitigated by a combination of tight control over operating costs and improved operating leverage through increased revenues. Adjusted operating profits increased by 13% to £31.9m (2016: £28.2m).

During the year, £1.1m (2016: £1.4m) of capital expenditure was invested in the Seals businesses which included £0.6m to fit out new and expanded facilities in J Royal, Hercules Canada and Kentek. A further £0.2m was spent on new warehouse equipment in the Industrial OEM businesses, both in the US and in Europe and £0.3m was spent in connection with a major upgrade to the IT facilities in the Hercules businesses. The free cash flow generated in this Sector was £24.9m, which remained unchanged from last year with the additional after tax operating cash flow offsetting an increase in working capital as trading strengthened in the second half of the year.

North American Seals

The North American Seals businesses, which account for 61% of Seals revenues, reported revenues up 21% on the prior year, benefiting from the weakening of UK sterling against the US and Canadian dollars and from the small bolt-on acquisition of PSP. After excluding contributions from the acquired businesses and currency effects, underlying revenues increased by 6%.

The HFPG **Aftermarket** businesses increased revenues by 5% on a constant currency basis, driven by a good performance in the core Hercules Aftermarket Seals business in the US and Canada and a strong recovery in the HKX attachment kit business.

In the domestic US market, Hercules revenues increased by 5% as utilisation of heavy mobile machinery increased substantially compared with the previous year and expenditure levels in the Construction sector showed steady growth. The additional investment last year in sales and marketing resources also had a positive impact on revenues and specific growth initiatives continued to gain traction, including the focus on national accounts and specialty distributors. E-commerce continues to deliver strong year on year growth of ca. 20% p.a. in terms of both revenues and invoices processed and now accounts for 23% of Hercules US revenues. Hercules continues to add new products and to expand the breadth of equipment supported, with the new focus on Bobcat cylinders and Aerial Lifts gaining good momentum.

In Canada, revenues increased by 5% in local currency terms, with the strengthening Construction sector driving growth in the repair market and good growth in the Manufacturing sector, particularly in Ontario and Quebec. The modest recovery in the Oil & Gas and Mining sectors has had a positive impact and sales to hydraulic component and attachment manufacturers have also seen good growth. In markets outside of North America, Hercules and Bulldog revenues were broadly flat with limited growth in Mexico and the Middle East and reduced revenues in South and Central America.

The HKX attachment kit business returned to growth after two years of significant revenue reductions, which had reflected the severely depressed market for new excavators. Revenues increased by 11% with growth particularly strong in sales to Canadian customers, driven by recovery in the Oil & Gas sector, increased pipeline construction and strong sales of excavators ahead of new emissions regulations. New attachment kits have been developed to drive further growth as well as quick coupler kits with added safety features. The HKX product line has also been extended into higher tonnage equipment which has seen good momentum supporting large scale demolition projects.

The HFPG **Industrial OEM** businesses in North America (J Royal, RT Dygert and All Seals) increased revenues by 9% in US dollar terms, as the improving trend in industrial activity seen in the second quarter, following the US election, strengthened further as the year progressed. All three businesses delivered double-digit revenue increases in the second half of the year with strong demand from key accounts across a range of specialised industrial applications in industries including Water, Medical, Oil & Gas, Appliances and Food Equipment. The businesses continue to provide high levels of customer service and technical support to service existing projects while looking for opportunities to deploy higher specification, regulatory-compliant compounds to target new projects with higher levels of added-value.

In April 2017, J Royal relocated its operations to a newly constructed, purpose built facility in Winston-Salem, North Carolina, which was then sold and leased back to the business. At the same time, the Group acquired PSP, a small bolt-on acquisition to All Seals based in Denver, Colorado which supplies O-rings and custom rubber moulded products and has strong customer relationships in the semi-conductor and pneumatics industries. PSP adds complementary new products and strengthens the position of the Industrial OEM Seals business in the Mountain Region of the US.

The Industrial OEM Seal businesses continue to pursue opportunities to create synergies through joint purchasing and through leveraging the different product, material and application skill-sets of the individual businesses. In the second half of the year, this was developed further by establishing a senior leadership team to manage this cluster of businesses in North America. While maintaining the distinct identity of the businesses and close local contact with customers, key functions including Sales, Supply Chain, Technical and Finance will be managed centrally by this team. The team has also initiated a project to implement a new ERP system across the Industrial OEM Seals businesses in the US, to replace the disparate legacy IT systems in the businesses. The new ERP system will be designed to increase operational efficiency, improve business intelligence and deliver broader marketing capabilities.

International Seals

The International Seals businesses, which account for 39% of Seals revenues, reported a 12% increase in UK sterling terms. After adjusting for currency and the acquisition of Edco, underlying revenues increased by 1%, but with performances in the individual businesses very dependent on local market conditions.

The FPE Seals and M Seals businesses, with their principal operations in the UK, Scandinavia and the Netherlands, together delivered underlying growth of 11% in revenues on a constant currency basis. FPE Seals experienced good growth in its core UK market for Aftermarket hydraulic seals and metal cylinder parts and benefited from a recovery in demand from the Oil & Gas sector for sealing products used in Maintenance, Repair and Overhaul ("MRO") operations. FPE Seals also benefited from strong growth in several export markets.

M Seals delivered good growth in revenues in its core markets, with particularly strong growth in Sweden, building on its strong customer relationships to develop a number of major new projects. M Seals has also extended its activities into the Finnish market for seals, by investing in a sales resource based in Kentek's facility and making use of its operational infrastructure. As with FPE Seals, M Seals has also seen a recovery in demand from the Oil & Gas sector in the UK and is targeting specialised Industrial OEMs in other sectors of the market.

In June 2017, the Group completed the acquisition of Edco, a specialised distributor of O-rings, seals and gaskets based in Leicester and supplying to UK OEMs and MRO companies operating within the Oil & Gas and other process industries. Edco's success has been built on deep technical knowledge, high levels of customer service and the ability to supply a wide range of products from stock. Edco is being managed as part of the M Seals group with good opportunities for cross-selling and improved purchasing power.

The Kentek business, with principal operations in Finland and Russia, increased revenues by 4% in Euro terms. The revenues generated in Russia, which account for ca. 65% of Kentek revenues, slowed in the second half of the year after strong revenue growth in Euro terms in the first half. As selling prices for US and European sourced filters are linked to the Euro in this territory, the weakening of the Russian Rouble against the Euro as well as increasing competitive pressures in this market contributed to the slow down in revenue growth. However, Kentek significantly increased sales of its own-brand filters in Russia and the Baltics and achieved good growth in Finland, benefiting from a recovery in both the Aftermarket and Industrial OEM sectors.

Kubo and WCIS saw combined underlying revenues for the year reduce by 3%, with a return to modest revenue growth in the second half of the year after a 9% reduction in the first half. Kubo has been facing significant challenges in its core industrial market in Switzerland, where the strong currency has made Swiss industrial manufacturers less competitive. However, the strengthening of the Euro through the year has contributed to an increase in industrial activity in Switzerland. In Austria, Kubo's improved sales focus has introduced new customer revenues in Pharmaceutical and Industrial OEMs to replace a large prior year order which was not repeated this year.

WCIS has core capabilities in gaskets and mechanical seals used in MRO operations in complex and arduous conditions and has been significantly impacted by cutbacks in the Mining sector in recent years. In New Caledonia, WCIS has come under substantial pricing pressure from cost reduction initiatives in the nickel mining and processing operations of its major customer and in Australia, it has also experienced reduced revenues from its core Mining customer base. WCIS has responded by investing in additional sales resources to broaden coverage across a wider range of market sectors and territories and this initiative is starting to gain some traction, though as yet the revenues are not sufficient to offset fully the reductions in the Mining customer base.

Potential for growth

Continue to gain share in Aftermarket Seals in North America through superior marketing, "Webstore" E-commerce and new products

Build and expand the group of Industrial OEM Seals businesses in North America

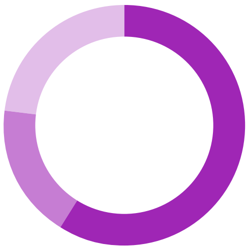
Explore opportunities more broadly in Industrial Distribution in North America

Build larger, broader-based International Seals business in the EMEA and Asia-Pacific regions

Controls

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

Principal segments



- 59% Interconnect
- 18% Specialty Fasteners
- 23% Fluid Controls

Geography

58% UK
33% Continental Europe
9% Rest of World

Customers

30% Aerospace & Defence
29% Industrial
15% Food & Beverage
14% Motorsport
5% Energy & Utilities
5% Medical & Scientific
2% Rail

Products

41% Wire & Cable
20% Fasteners
13% Connectors
12% Equipment & Components
10% Control Devices
4% Other Controls

Interconnect

The IS-Group, Filcon and Cablecraft businesses supply high performance electrical interconnect products used in technically demanding applications in a range of industries including Aerospace & Defence, Motorsport, Energy, Medical, Rail and Industrial. A high proportion of the products supplied are used in refurbishment, upgrade and maintenance programmes for equipment in service. Products include electrical wiring, protective sleeving, connectors and harnessing products and customised assemblies. A range of value adding activities enhances the customer offering, including marking of protective sleeves, customised labelling solutions, cut-to-length tubing, kitting, connector assembly and prototype quantities of customised multi-core cables. There is also a range of internally manufactured products, including flexible braided products for screening, earthing and lightning protection, power shunt connectors, multi-core cables, cable markers, sleeving and trunking.

Specialty Fasteners

The Clarendon business supplies specialty aerospace-quality fasteners to Civil Aerospace (focus on aircraft seating and cabin interiors), Motorsport and Industrial & Defence markets. Clarendon supports its key customers with its automated inventory replenishment solution ("Clarendon AIR") utilising bespoke dispensing racks located within the customers' production cells.

Fluid Controls

The Hawco Group businesses supply a range of fluid control products used broadly in the Food & Beverage sectors, in applications including food retailing and transportation, catering equipment, vending machines, coffee brewing, pure water and water cooling systems. Products include fluid controllers, compressors, valves, temperature and pressure measurement devices and specialised vending and liquid dispensing components. The customer offering is enhanced by value adding services including kitting for production line flow and the repair and refurbishment of soft drinks dispensing equipment.

Market drivers

Industrial economic background

The Controls businesses focus on specialised, technical applications in a range of industries, with over 90% of Sector revenues generated in the UK and Continental Europe (principally Germany). The background market drivers are therefore the growth of the industrial economies in the UK and Germany.

A good indicator of the health of the UK industrial economy is the UK Index of Production. Following the 2009 recession, gains in 2010 were reversed in 2011 and 2012 and since then there has been slow, steady growth. However, the index is still some 8% below pre-recession levels and economic growth is now more driven by the Services and Retail sectors.

In Germany, the Production Sector Output index tracks a strong period of recovery through 2010 and 2011, since when it has slowly increased and is now ca. 5% above pre-recession levels.

Specific industry drivers – Interconnect and Specialty Fasteners

Although influenced by the general industrial economic cycles, there are also more specific drivers within the main market segments served by the Interconnect and Specialty Fasteners businesses.

The Civil Aerospace market continues to grow steadily with growth in world passenger traffic averaging over 6% p.a. over the last five years and with continuing strong order books at Boeing and Airbus. The demand for new aircraft is being driven by the need to replace ageing fleets with more fuel efficient aircraft and the

Principal operations

Interconnect

IS-Group	
IS-Rayfast	Swindon, UK
IS-Cabletec	Weston-super-Mare, UK
IS-Sommer	Stuttgart, Germany
IS-Connect	Indianapolis, IN, US
Filcon	Munich, Germany & Le Mans, France
Cablecraft	Houghton Regis, Tewkesbury & Plymouth, UK

Specialty Fasteners

Clarendon	Leicester, Swindon & Totnes, UK

Fluid Controls

Hawco Group	Godalming, Bolton & Faringdon, UK

demand from airlines in the Asia-Pacific region. There is increased activity in the cabin interiors market where the wide range of complex seating and entertainment systems is driving growth.

In the Defence sector, the UK remains committed to maintaining the NATO spend target of 2% of GDP through to 2020. Despite this, the Ministry of Defence's budget is under pressure from the weakness of sterling and rising costs for ongoing new build projects. In Germany, the government has committed to increased defence spending in response to the emergence of new perceived threats and pressure to meet NATO's spending target.

In Motorsport, the major drivers of demand in Formula 1 are the number of races and teams (both of which reduced in the 2017 season) and the level of development work related to technology and rule changes. These changes were significant in the 2017 season and related principally to bodywork design; the 2018 rule changes are not expected to be as significant. The businesses do supply to other motor racing series and the Formula E series in particular continues to gain momentum; however the spend on Interconnect products is relatively low in these series compared to Formula 1.

In the UK, investment in Rail infrastructure continues with electrification projects, station upgrades, the Thameslink upgrade and the final stages of the Crossrail project. In addition, the first stages of the High Speed Two ("HS2") project have received approval, with work expected to run through to 2033. More generally, UK infrastructure investment is expected to continue with particular focus on energy and utilities. In Germany, electricity generation and distribution remains a positive sector due to the fragmented nature of the local supply of electricity, where it is the responsibility of the towns and cities.

Specific industry drivers – Fluid Controls
The Fluid Controls businesses generate over 60% of their revenues from the Food & Beverage sector in the UK. In Food Retailing, the trend away from major out-of-town stores to convenience stores and home delivery continues. There is also a drive in the Retail industry to reduce energy consumption and to introduce low Global Warming Potential ("GWP") refrigerants, in preparation for tighter EU regulations over the next five years. These trends are driving demand for smaller, more energy efficient components as supplied by Hawco.

UK index of production (value)

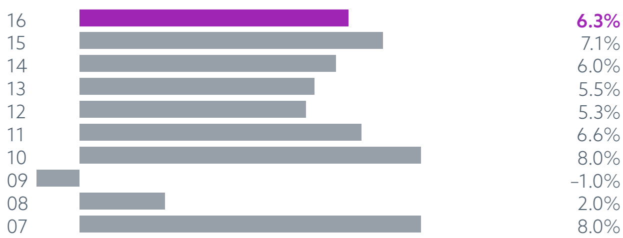
Source: UK Office for National Statistics.
Calendar and seasonally adjusted, reference year 2010 = 100.

German production sector output (including construction)

Source: Deutsche Bundesbank.
Calendar and seasonally adjusted, reference year 2010 = 100.

World passenger traffic (annual growth rate)

Revenue passenger km growth rate



Source: International Civil Aviation Organisation.

The Coffee market sector continues to grow at above 10% p.a., with Abbeychart supplying both the coffee machine manufacturers and the Aftermarket sector, predominately in the UK but also in Europe. The Vending market sector continues to see modest growth, driven by the sale of premium products, particularly in the hot drinks segment.

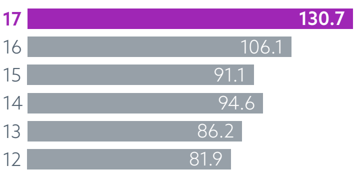
Controls

Highlights from the year

- Sector revenue increased by 23%; underlying increase of 14% after adjusting for currency and acquisitions
- The Interconnect businesses benefited from increased project work and delivered strong underlying growth of 8%; Cablecraft has expanded the range of products supplied and markets served
- Clarendon increased revenues by over 30%, with growth driven by increased customer demand in Civil Aerospace and Motorsport
- Fluid Controls increased revenues by 14% with upturn in refrigeration equipment sales and increased export sales in Europe and the US

Revenue (£m)
(compound growth over five years)

+10% p.a.



Revenue
£130.7m

	2017	2016	
Revenue	**£130.7m**	£106.1m	+23%
Adjusted operating profit	**£23.0m**	£17.9m	+28%
Adjusted operating margin	**17.6%**	16.9%	+70bps
Free cash flow	**£18.6m**	£16.4m	+13%
ROATCE	**32.2%**	27.0%	+520bps

Sector performance

Reported revenues of the Controls businesses increased by 23% to £130.7m (2016: £106.1m). Full year contributions from Cablecraft and Ascome, acquired in the first half of last year, added £6.4m or 6% to Sector revenues and currency movements contributed a further 3% to Sector revenues on translation to UK sterling. On an underlying basis, after adjusting for these acquisitions and currency effects, revenues increased by 14%, with growth moderating in the second half (though still double-digit) against stronger prior year comparatives.

Adjusted operating margins increased by 70bps to 17.6% (2016: 16.9%). Gross margins were broadly stable overall, with stronger margins in the Cablecraft business broadly offsetting the impact of weaker UK sterling on products purchased by the other Controls businesses. Operating costs remained tightly controlled across the businesses and improved leverage from the increased revenue more than offset increased investment in sales resources. Adjusted operating profits increased by 28% to £23.0m (2016: £17.9m).

Capital expenditure in this Sector remained very modest at £0.2m (2016: £0.4m), with £0.1m invested in the Clarendon business to upgrade its Totnes facility to improve operational efficiency. A further £0.1m was invested on general IT infrastructure across the Controls businesses. Free cash flow increased strongly to £18.6m (2016: £16.4m) reflecting stronger trading, including the additional contribution from Cablecraft and despite an increase in working capital to support the growth in trading.

Interconnect

The Interconnect businesses (IS-Group, Filcon and Cablecraft) account for 59% of Controls revenues and reported a revenue increase of 25% in UK sterling terms. After adjusting for the Cablecraft and Ascome acquisitions and for currency effects, underlying revenues increased by 8%.

The IS-Group continued to implement the business development programmes initiated last year, designed to position the business as the European supplier of choice for the full range of specialised cable harnessing components. Field sales resources have been realigned to focus on sectors and customer accounts with the highest growth potential and internal sales processes have been refocused to more efficiently manage the baseline business. Further investment has also been made in broadening the product range and further developing E-commerce capabilities.

The IS-Group UK businesses saw revenues increase by 7% in UK sterling terms. In Defence and Aerospace, the IS-Group reported a small increase in revenues, with the stronger growth seen in the first half of the year offset by slower trading in the second half. The lower level of activity at UK electrical harness customers towards the end of the year is partly from a tightening in Defence spending and partly from certain key customers being in between projects. In Motorsport, IS-Group increased revenues strongly, benefiting from regulation changes and the increased level of competition in races this year in the Formula 1 ("F1") series, development of new cars in the World Rally Championship ("WRC") Series and upgrades to the GT500 cars in Japan. The IS-Group also benefited from good double-digit growth in revenues from the Industrial sector in the UK and more broadly in Europe, as the business improved its competitive position under new sales leadership, following the appointment of a sales director focused on the EMEA region.

In Germany, IS-Sommer and Filcon reported a 14% increase in revenues in Euro terms, with modest growth in IS-Sommer boosted by major project activity in Filcon. In the Aerospace sector, IS-Sommer delivered good growth with a particularly strong performance in the Space market, supplying connectors and backshells to the Meteosat Third Generation ("MTG") and Sentinel satellites. Solid growth in the Industrial market was driven by the stronger global economy, which benefited German exporters. Revenues were held back in the important Energy market where lower utility company budgets delayed repair and maintenance of the electricity network and Motorsport revenues were impacted by the withdrawal of VW from the WRC Rally Series and Audi from the World Endurance Championship ("WEC") Series, which includes the Le Mans race. Revenues in the Medical sector performed strongly with key medical device manufacturers managing a solid pipeline of projects on the back of new regulations.

Filcon delivered a very strong performance, increasing revenues by ca. 30% in Euro terms. There was a full year contribution from the small Ascome acquisition, but the primary driver of growth came from major orders secured in the final quarter of the prior year from key Military Aerospace and Space customers. These sectors have generally seen increased activity, with projects delivered for the Tornado aircraft, the RAM missile programme and the Orion Mars capsule. In the Motorsport sector, the increased activity levels and demand in the F1 series has offset the reduced demand from the withdrawal by Audi from Le Mans. The Industrial market for connectors remains competitive and generally more challenging.

Cablecraft is a leading supplier of cable accessory products used to identify, connect, secure and protect electrical cables and has made a strong contribution to the Group since its acquisition in March 2016. Cablecraft has extended the markets served by the Interconnect businesses and has added attractive ranges of own branded and manufactured products. During the year the business continued to focus on its areas of specialism, including the development of new own branded identification products, the promotion of its upgraded Identification Solutions offering and the specialist sales resources added to support sales growth. Revenues have increased by 7% on a like-for-like basis, with good growth generated from the continued focus on end user customers, especially electrical panel builders and contractors upgrading the UK rail network. Cablecraft continues to benefit from the move by customers towards E-commerce, with online sales growing by ca. 30% in the year.

Specialty Fasteners
The Clarendon Specialty Fasteners business accounts for 18% of Controls revenues and increased revenues by over 30% compared with the prior year, with growth driven principally by increased demand from customers in the Civil Aerospace sector. Revenues increased strongly with the ramp up of the major business class seating programme at a key aircraft seating customer which Clarendon supplies through its automatic inventory replenishment system ("Clarendon AIR"). Clarendon also had success in increasing sales to a range of other aircraft seating and cabin interiors manufacturers and their subcontractors across Europe and introduced Clarendon AIR to a number of new customer locations.

Good growth was also achieved in Clarendon's other major market of Motorsport, where Clarendon supplies aerospace-quality fasteners to the F1 race teams, engine builders and subcontractors and also supplies the Aerocatch own-brand range of aerodynamic bonnet latches for high performance sports cars and offshore powerboat racing. More modest growth has been achieved in the supply of pre-assembled and captive fasteners and bespoke engineered solutions to the Defence and general Industrial sectors.

After the year end, in October 2017, Clarendon completed the acquisition of Coast Fabrication Inc. ("Coast"), a small US specialty fastener distributor based in Huntington Beach, California. Coast has a strong reputation in the US Motorsport industry and also provides a base in the US for supporting Clarendon's current Aerospace customers as well as expanding its aircraft interiors business in this large market. A US presence is also a strategic purchasing priority for Clarendon, giving access to major fastener suppliers that principally sell to US entities.

Fluid Controls
The Hawco Group of Fluid Controls businesses (comprising Hawco and Abbeychart) accounts for 23% of Controls revenues and increased revenues by 14% against the prior year, in a market that remains highly competitive and price sensitive.

Hawco reported a good upturn in activity in the UK Refrigeration Equipment market, as store refurbishment activity in the UK increased and as the cabinet display manufacturers targeted opportunities outside the UK. Hawco benefited in particular from supplying scroll compressors into a significant project with a major US retailer and demand in the commercial Catering and Home Delivery market remained robust. In the Contractor market, strong growth was achieved, as Hawco targeted the independent trade counters and medium sized contractors who value Hawco's stock holding, next-day delivery and exclusive supplier relationships. Revenues from the Industrial OEM market reduced in the second half of the year, as demand from UK manufacturers softened, but this was partly offset by an increase in export revenues.

Potential for growth

In Interconnect, create a broader-based European cable harnessing business and extend product range with own-branded products

In Specialty Fasteners, build on strong positions in Civil Aerospace and Motorsport and expand in niche industrial markets

Continue to reposition Fluid Controls business towards growth segments of the Food & Beverage industry

Explore opportunities outside the UK and Northern Continental Europe

Abbeychart has continued to strengthen its relationship with the large vending machine operators in Europe and during the year supplied products to a large project to refresh a range of vending machines for a major customer in Switzerland. Abbeychart revenues also benefited from a full year of sales activity for a range of spare parts for Wurlitzer vending machines and from the introduction of a catalogue of essential spare parts for the specialist coffee market, which has offset reduced revenues from one of its larger coffee OEM customers. Abbeychart has continued to take market share in the soft drinks market by targeting both the major and the independent soft drink suppliers, with its bar gun and pump refurbishment offering.

Finance Review

Maintaining focus on financial strength

Nigel Lingwood, Group Finance Director

Adjusted operating margin
17.3%

Free cash flow
£55.7m

ROATCE
24.0%

The businesses returned to robust underlying revenue growth delivering 7% on a Group basis.

Results in 2017

Diploma delivered another strong performance this year, increasing revenues by 18% to £451.9m and increasing adjusted operating profit by 19% to £78.2m. The Group's reported financial results benefited from strong underlying growth, particularly in the Controls businesses, following two years of weaker end markets. The significant depreciation in UK sterling of ca. 11%, following the UK's Brexit vote on Europe led to increases in revenues and adjusted operating profits of £34.9m and £6.3m respectively on the translation of the results of the overseas businesses, when compared with last year's average exchange rates.

The environment for completing acquisitions has been more challenging over the past 12 months and the contribution from acquisitions completed both this year and last year, net of a small disposal last year, was £8.5m (2016: £26.6m) to revenue and £2.3m (2016: £4.2m) to adjusted operating profit.

The stronger growth in underlying revenues of 7% this year helped compensate for this smaller contribution from acquired businesses. Underlying revenues are after adjusting for the contribution from businesses acquired during the year (and from the incremental impact from those acquired last year) and for the impact on the translation of the results of the overseas businesses from the significant weakening in the UK sterling exchange rate, against the currencies of the Group's overseas businesses.

Adjusted operating margin

The Group's adjusted operating margin improved by 10bps this year to 17.3% (2016: 17.2%) as transactional currency pressures finally eased in the Group's Healthcare businesses. These businesses represent 23% of Group revenue and since late in 2013, their gross margins have been significantly impacted on a transactional basis by the continuing depreciation of the Canadian and Australian dollars, against the US dollar in particular which is the currency in which most of their products are purchased.

The Canadian and Australian exchange rates have remained more stable since the early part of this year and after a short period of weakness during the early Summer, both currencies strengthened sharply against the US dollar towards the end of the financial year.

The transactional impact on the Group's adjusted operating margin from the substantial depreciation in UK sterling has been limited. The UK businesses (26% of Group revenues) have faced higher product costs from the depreciation in UK sterling, but they have generally managed to mitigate these increases by a combination of selling price increases, support from suppliers and by switching some key customer accounts into Euro or US dollar invoicing.

The operating margins in those businesses acquired in recent years have, as anticipated, also made a slightly stronger contribution to the Group this year reflecting the benefits from initiatives taken shortly after acquisition.

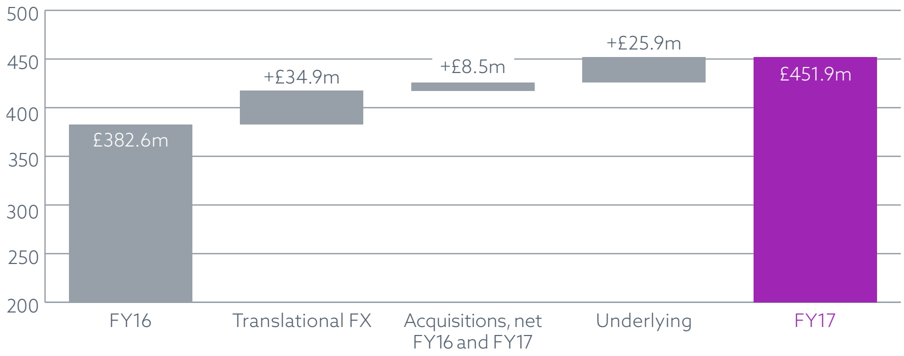
Adjusted profit before tax, earnings per share and dividends

Adjusted profit before tax increased by 19% to £77.5m (2016: £64.9m). The interest expense this year was £0.7m (2016: £0.8m) which included a £0.2m (2016: £Nil) arrangement fee paid on renewal of the bank facility during the year. However interest costs on borrowings decreased by £0.3m to £0.1m this year reflecting a lower level of acquisition activity in 2017, compared with last year. The notional interest expense on the Group's defined pension liabilities increased to £0.3m (2016: £0.2m) reflecting the larger deficit in the fund this year, following the actuarial valuation completed as at 30 September 2016.

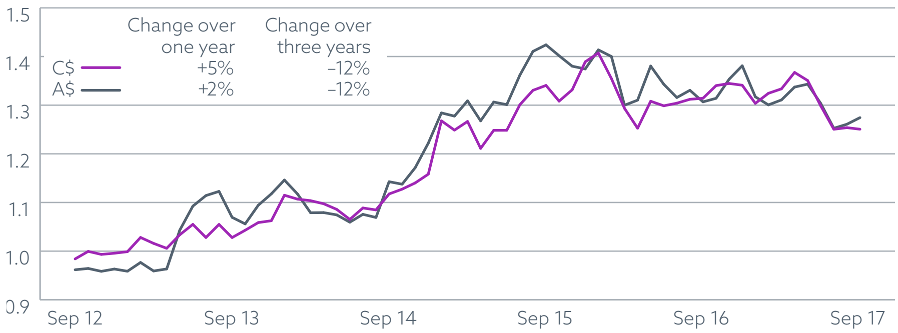
Statutory profit before tax was £66.8m (2016: £54.0m), after acquisition related charges of £9.7m (2016: £10.3m), which largely comprises the amortisation of acquisition related intangible assets and fair value remeasurements. These remeasurements of £1.0m (2016: £1.3m) relate to the put options held over minority interests and the charge this year reflects a small increase in the liability to acquire these minority interests and an unwinding of the discount on the liability. Last year's statutory profit also included a one-off gain of £0.7m from the disposal of the Medivators business in Canada and three small legacy properties in the UK.

The Group's effective tax charge in 2017 was 80bps above the previous year at 26.5% (2016: 25.7%) of adjusted profit before tax. The increase this year is despite a further reduction in the effective UK corporation tax rate to 19.5% (2016: 20.0%) which was insufficient to offset the impact from higher tax rates applied to the businesses acquired in Australia and the US this year.

Revenue bridge – FY17 (£m)



Transactional impact-base currency (US$)



GBP vs G10 currency basket securities

Adjusted earnings per share ("EPS") increased by 19% to 49.8p, compared with 41.9p last year and statutory basic EPS increased to 42.0p (2016: 33.9p).

The Board continues to pursue a progressive dividend policy which aims to increase the dividend each year broadly in line with the growth in adjusted EPS. In determining the dividend in any one year in accordance with this policy, the Board also considers a number of factors which include the strength of the free cash flow generated by the Group, the future cash commitments and investment needed to sustain the Group's long term growth strategy and the target level of dividend cover. The Board continues to target towards two times dividend cover (defined as the ratio of adjusted EPS to total dividends paid and proposed for the year) which provides a prudent buffer.

The ability of the Board to maintain future dividend policy will be influenced by the principal risks identified on pages 33 to 35 that could adversely impact the performance of the Group.

Finance Review continued

For 2017, the Board has recommended a final dividend of 16.0p per share (2016: 13.8p) making the proposed full year dividend 23.0p (2016: 20.0p). This represents a 15% increase in the proposed full year dividend with dividend cover increasing slightly to 2.2 times (2016: 2.1 times).

Free cash flow

The Group again generated strong free cash flow this year of £55.7m (2016: £59.0m). Last year's free cash flow included exceptional proceeds of £4.6m from the sale of the Medivators business in Canada and legacy properties and from an unusually large cash inflow of £6.3m from reduced working capital. Free cash flow represents cash available to invest in acquisitions or return to shareholders. Free cash flow conversion was 99% (2016: 124%) of adjusted earnings.

The Group's operating cash flow increased by £2.7m to £79.3m (2016: £76.6m) this year, despite a £4.0m outflow of cash into working capital. The generally stronger trading environment this year, together with some earlier seasonal stock builds in the Healthcare businesses contributed to a £5.1m increase in stock levels at the year end (2016: £1.3m) while the inflow from net payables reduced to £1.1m from £7.6m last year.

The Group's KPI metric of working capital to revenue at 30 September 2017 reduced to a record low of 15.0% (2016: 16.6%) reflecting much stronger revenues in the previous rolling 12 months, compared with last year.

Group tax payments increased by £1.7m to £19.3m (2016: £17.6m). On an underlying basis cash tax payments represented ca. 24% (2016: 23%) of adjusted profit before tax which was broadly unchanged from last year. Underlying tax payments are before currency effects of translation and exclude payments for pre-acquisition tax liabilities in acquired businesses.

The Group's tax strategy is to comply with tax laws in all of the countries in which it operates and to balance its responsibilities for controlling the tax costs with its responsibilities to pay tax where it does business. The Group's tax strategy has been approved by the Board and tax risks are regularly reviewed by the Audit Committee.

The Group's capital expenditure this year was £3.3m, compared with £3.7m last year. This expenditure excludes £1.9m (2016: £0.5m) which the Group paid for the construction of a new expanded facility for J Royal, a Seals business based in the US. On completion in April 2017, the facility was immediately sold and leased back to the business. A similar transaction was undertaken in 2015 in connection with the new FPE Seals facility.

The Life Sciences businesses invested £2.0m in new capital this year (2016: £2.2m) most of which was invested in field equipment in the Healthcare businesses to support placements in hospitals and diagnostic laboratories. This investment was £1.6m (2016: £0.9m) and included demonstration and loan equipment in connection with new capital equipment released in 2017 and a new supply agreement for a range of rigid endoscopes in Vantage. A further £0.3m was spent on upgrading the IT infrastructure in both the Healthcare businesses and the a1-group and £0.1m was spent on refurbishing a new facility in Markham, Canada which is used to service flexible endoscopes.

The Seals businesses invested £1.1m during the year in its operations with £0.5m being spent in the North American Seals businesses and £0.6m in the International Seals businesses. Across these businesses, £0.6m was invested to fit out new and expanded facilities in J Royal, Hercules Canada and Kentek. A further £0.2m was invested in new warehouse equipment in M Seals and Kubo and £0.3m was spent on upgrading the IT infrastructure across the Seals Sector. Capital expenditure in the Controls businesses remained modest at £0.2m (2016: £0.4m).

The Company paid the PAYE income tax liability of £0.7m (2016: £0.3m) on the exercise of LTIP share awards, in exchange for reduced share awards to participants.

The Group spent £20.1m of the free cash flow on acquisitions, including payment of deferred consideration, as described below and £23.7m (2016: £21.4m) on paying dividends to both Company and minority shareholders.

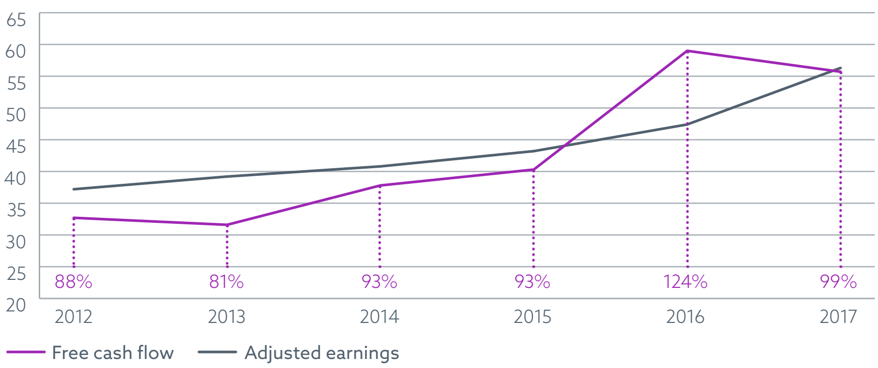
Acquisitions completed during the year

The Group invested £19.5m in acquiring new businesses this year and paid a further £0.6m of deferred consideration on a business acquired in the prior year. This compares with an aggregate of £32.7m invested last year in acquisitions, minority shareholdings and deferred consideration. The stronger economies in the US and Continental Europe contributed to a tougher environment to make acquisitions as business owners generally remained confident of increasing profitability in the year ahead.

In April 2017, the Group was successful in completing the acquisition of Abacus for cash consideration of £15.0m, including debt acquired and expenses. Abacus is a long-established supplier of clinical diagnostics instrumentation to the Pathology and Life Sciences sectors in Australia and New Zealand and provides critical mass to the Group's existing Healthcare businesses in this region. A further £4.5m in aggregate was invested in June 2017 to acquire Edco, a small hydraulic seal distributor in the UK and in April 2017 to acquire PSP, a small supplier of specialist seals based in the US.

These acquisitions added £10.1m to the Group's acquired intangible assets, which represents the valuation of customer and supplier relationships which will be amortised over periods ranging from five to ten years. At 30 September 2017, the carrying value of the Group's acquired intangible assets was £54.0m. Goodwill at 30 September 2017 was £122.7m and included £7.5m relating to those businesses acquired during the year (including fair value

Free cash flow conversion (£m)



adjustments to the assets acquired). Goodwill is not amortised but is assessed each year at a Sector level to determine whether there has been any impairment in the carrying value of goodwill acquired. The exercise to assess whether goodwill has been impaired is described in note 10 to the consolidated financial statements and concluded that there was significant headroom on the valuation of this goodwill, compared with the carrying value of goodwill at the year end.

Liabilities to minority shareholders
The Group's liability to purchase outstanding minority shareholdings at 30 September 2017 increased to £6.1m (2016: £5.1m) which comprise put options the Group holds over the outstanding minority interests held in M Seals, Kentek and TPD.

The liabilities for these put options are valued based on the Directors' latest estimate of the earnings before interest and tax ("EBIT") of these businesses when these options crystallise. The increase in this liability of £1.0m reflects in part a slightly higher value attributed to these businesses and in part an unwinding of the discount on the liability. Shortly after the year end the Group agreed to pay cash of £1.0m to acquire a further 5% shareholding in TPD from the minority shareholder.

In addition to the liability to minority shareholders, the Group also has a small liability at 30 September 2017 for deferred consideration of up to £0.5m (2016: £1.7m) which comprises the amount likely to be paid to the vendors of businesses purchased during the year, based on the Group's best estimate of the performance of these businesses next year. During the year, £0.6m was paid as deferred consideration relating to the acquisition of WCIS completed early in 2016 and a provision of £1.0m relating to the acquisition of Cablecraft was not required and was released to the Consolidated Income Statement as part of acquisition related charges.

Return on adjusted trading capital employed and capital management
A key metric that the Group uses to measure the overall profitability of the Group and its success in creating value for shareholders is the return on adjusted trading capital employed ("ROATCE"). At a Group level, this is a pre-tax measure which is applied against the fixed and working capital of the Group, together with all gross intangible assets and goodwill, including goodwill previously written off against retained earnings. At 30 September 2017, the Group ROATCE improved to 24.0% (2016: 21.1%) which reflects the strong increase in adjusted operating profits this year. Adjusted trading capital employed is defined in note 3 to the consolidated financial statements.

The Group continues to maintain a strong balance sheet with cash funds of £22.3m at 30 September 2017, compared with net cash funds of £10.6m last year. Surplus cash funds are generally repatriated to the UK, unless they are required locally to meet certain commitments, including acquisitions.

On 1 June 2017 the Group renewed its bank facility with a similar revolving multi-currency credit facility for a further three years and with an option to extend the facility from three years up to five years. The facility initially comprises a £30m committed facility, but with an accordion option which allows the Group to increase the commitment up to a maximum of £60m of borrowings. These new facilities were provided at a cost of 50bps and with a ratchet margin ranging from 70bps to 115bps over LIBOR depending on the ratio of EBITDA to net debt. These bank facilities are primarily used to meet any shortfall in cash to fund acquisitions.

Employee pension obligations
Pension benefits to existing employees, both in the UK and overseas, are provided through defined contribution schemes at an aggregate cost in 2017 of £2.8m (2016: £2.5m).

The Group maintains a legacy small closed defined benefit pension scheme in the UK. During the year a formal triennial funding valuation of this scheme as at 30 September 2016 was completed. This valuation reported an increase in the funding deficit of £6.5m to £9.2m with a 75% funding level which reflected the impact of bond yields falling to a record low of 1.5% at the valuation date from 3.6% in the previous funding valuation. However, bond yields have increased slightly since the valuation date and investment returns have been strong again this year.

This recent improvement in market conditions, together with the strength of the employer covenant, helped limit the increase in cash contributions paid by the Company to £0.5m from 1 October 2017, from £0.4m of cash contributions paid this year. This contribution rate will increase annually by 2% with the objective of eliminating the deficit within ten years.

In Switzerland, local law requires Kubo to provide a contribution based pension for all employees, which are funded by employer and employee contributions. This pension plan is managed for Kubo through a separate multi-employer plan of non-associated Swiss companies which pools the funding risk between participating companies. In Switzerland, Kubo's annual cash contribution to the pension scheme was £0.2m (2016: £0.3m).

Both the UK defined benefit scheme and the Kubo contribution scheme are accounted for in accordance with IAS19 (Revised). At 30 September 2017 the aggregate accounting pension deficit in these two schemes decreased by £7.3m to £9.9m reflecting a small increase in bond yields in both schemes, combined with a strong increase in the growth assets of the UK scheme compared with last year. The gross aggregate pension liability in respect of these two schemes at 30 September 2017 decreased by £6.6m to £49.5m which is funded by £39.6m of assets.

Potential impact of Brexit
The impact at an operational level on the Group's businesses from the current uncertainty regarding the process and timing of the UK's exit from the European Union is likely to be limited as only 26% of the Group's overall revenues are based in the UK. In addition, these businesses, as well as those based in Continental Europe, are substantially "in country" industrial suppliers of goods with limited sales activity being carried out across country borders.

At a macroeconomic level however, the Group's financial results have been impacted this year by the substantial depreciation in UK sterling that followed the Brexit vote. This has resulted in an increase to the Group's reported revenues, operating profits and net assets from translating the results of the Group's overseas businesses into UK sterling. It has also led to stronger inflation in supplier costs for the Group's UK based businesses which they have had to manage robustly to maintain gross margins.

The Group's UK businesses closely monitor developments in the Brexit plans of HM Government and their future investment plans include contingencies to mitigate the impact on their activities from a significant disruption in cross border trade between the UK and Continental Europe.

Internal Control and Risk Management

The Board is committed to protecting and enhancing Diploma's reputation and assets, while safeguarding the interests of shareholders. It has overall responsibility for the Group's system of risk management and internal control.

Diploma's businesses are affected by a number of risks and uncertainties. These may be impacted by internal and external factors, some of which we cannot control. Many of the risks are similar to those found by comparable companies in terms of scale and operations.

Our approach

Risk management and maintenance of appropriate systems of control to manage risk is the responsibility of the Board and is integral to the ability of the Group to deliver on its strategic priorities. The Board has developed a framework of risk management which is used to establish the culture of effective risk management throughout the businesses by identifying and monitoring the material risks, setting risk appetite and determining the overall risk tolerance of the Group. This framework of risk management has been further enhanced this year and additional processes have been developed which will assist the Board to monitor and assess the principal risks throughout the year.

The Group's risk management systems are monitored by the Audit Committee, under delegation from the Board. The Audit Committee is responsible for overseeing the effectiveness of the internal control environment of the Group. An internal audit function has been established for many years to provide independent assurance that the Group's risk management, governance and internal control processes are operating effectively.

Identifying and monitoring material risks

Material risks are identified through a detailed analysis of individual processes and procedures (bottom up approach) and a consideration of the strategy and operating environment of the Group (top down approach).

The detailed risk evaluation process begins in the operating businesses with an annual exercise undertaken by management to identify and document the significant strategic, operational, financial and accounting risks facing the businesses. This process is both robust and challenging and ensures risks are identified and monitored and management controls are embedded in the business' operations.

The Group uses a quantitative method to determine a Risk Score for each risk which is based on both the likelihood of each identified risk occurring and the consequence of an adverse outcome and its impact on the business. Each business will then identify processes established to control each risk and minimise its potential impact.

The risk assessments from each of the operating businesses are then considered by the Board who evaluate the principal risks of the Group with reference to the Group's strategy and operating environment.

Our principal risks and uncertainties

Set out in this section of the Strategic Report are the principal risks and uncertainties affecting the Group which have been determined by the Board, based on a robust risk evaluation process described above, to have the potential to have the greatest impact on the Group's future viability. These risks are similar to those reported last year, although with some movement on the relative ranking of these risks. In addition, following the risk evaluation process carried out this year as described above, a new principal risk has been added that relates to 'Cybersecurity/Information Technology/Business Interruption.'

The risks are each classified as either strategic, operational, financial or accounting. The Group's decentralised operations with different Sectors and geographical spread reduces the impact of these principal risks.

The Board has also considered the risks associated with the UK's Brexit vote to leave the European Union and this is explained further on page 31 in the Finance Review.

Viability Statement – Diploma PLC

The Directors confirm that they have a reasonable expectation that the Group will continue to operate and meet its liabilities, as they fall due, for the next three years to September 2020. The Directors' assessment has been made with reference to the resilience of the Group and its strong financial position, the Group's current strategy, the Board's risk appetite and the Group's principal risks and how these are managed, as described in the Strategic Report.

The Group has a broad spread of customers and suppliers across different geographic areas and independent market sectors, often secured with longer term agreements. The Group is supported by a robust balance sheet and strong operational cash flows.

The assessment period of three years has been chosen as it is consistent with the Board's triennial review of the Group's strategy at which the prospects of each business are discussed; assumptions are made regarding entering into new markets and geographies, about future growth rates of the existing businesses and about the acceptable performance of existing businesses. A robust financial model of the Group is built on a business-by-business basis and the metrics for the Group's KPIs are reviewed for the assessment period. These metrics are also subject to sensitivity analysis which includes flexing a number of the main assumptions, namely, future revenue growth, gross margins, operating costs and working capital management. The results of flexing these assumptions, both individually and in aggregate, are used to determine whether additional bank facilities will be required during this period.

The Directors confirm that this robust assessment also considers the principal risks facing the Group, as described on pages 33 to 35 and the potential impacts these risks would have on the Group's business model, future performance, solvency or liquidity over the assessment period. The Board considers that the diverse nature of the Sectors and geographies in which the Group operates acts significantly to mitigate the impact any of these risks might have on the Group.

Strategic risk – Downturn/instability in major markets

Risk description and assessment

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

A number of characteristics of the Group's businesses moderate the impact of economic and business cycles on the Group as a whole:

- The Group's businesses operate in three differing Sectors with different cyclical characteristics and across a number of geographic markets.
- The businesses offer specialised products and services, which are often specific to their application; this offers a degree of protection against customers quickly switching business to achieve a better price.
- A high proportion of the Group's revenues comprises consumable products which are purchased as part of the customer's operating expenditure, rather than through capital budgets.
- In many cases the products are used in repair, maintenance and refurbishment applications, rather than original equipment manufacturer.

Mitigation

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.

Significant global events are closely monitored to determine any potential impact on key markets.

Change

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Strategic risk – Supplier concentration/loss of key suppliers

Risk description and assessment

For manufacturer-branded products, there are risks to the business if a major supplier decides to cancel a 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 appointing another distributor.

Currently no single supplier represents more than 10% of Group revenue and only six single 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 interdependence has been established. The average length of the principal supplier relationships in each of the Sectors is over ten years.

The strength of the relationship with each supplier and the volume of activity generally ensures continuity of supply, when there is shortage of product.

The success of the businesses depends significantly on representing suppliers whose products are recognised in the marketplace as the leading competitive brand. If suppliers fail to support these products with new development and technologies, then our businesses will suffer from reduced demand for their products and services.

Mitigation

Long term, multi-year exclusive contracts signed with suppliers with change of control clauses, where possible, 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, together with regular review meetings and adherence to contractual terms.

Regular review of inventory levels.

Bundling and kitting of products and provision of added value services.

Periodic research of alternative suppliers as part of contingency planning.

The businesses work very closely with each of their suppliers and regularly attend industry exhibitions to keep abreast of the latest technology and market requirements/trends. The businesses also meet with key customers on a regular basis to gain insight into their product requirements and market developments.

Change

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Internal Control and Risk Management continued

Strategic risk – Customer concentration/loss of key customer(s)

Risk description and assessment	Mitigation	Change
The loss of one or more major customers can be a material risk. The nature of the Group's businesses is such that there is not a high level of dependence on any individual customer and no single customer represents more than 4% of Sector revenue or more than 2% of Group revenue.	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 and value added activities, close integration is established where possible with customers' systems and processes.	→

Operational risk – Cybersecurity/information technology/business interruption

Risk description and assessment	Mitigation	Change
Group and operating business management depend critically on timely and reliable information from their IT systems to run their businesses. The Group seeks to ensure continuous availability, security and operation of those information systems. Cyber threats to the businesses information systems have continued to show an increasing trend this year. Any disruption or denial of service may delay or impact decision making through lack of availability of reliable data. Poor information handling or interruption of business may also lead to reduced service to customers. Unintended actions of employees caused by a cyber-attack may also lead to disruption, including fraud. In North American Seals, HFPG's Aftermarket business is operated from a single warehouse based in Tampa, Florida which continues to be exposed to hurricanes during the season from August to November.	There is good redundancy and back-up built into local IT systems and the spread of businesses with their own stand alone IT systems also offers good protection from individual events. A member of the Executive Management Group maintains responsibility for ensuring each business in the Group has a robust cybersecurity programme and reports twice a year to the main Board on the status of cybersecurity across the Group. In addition, education/awareness of cyber threats continues to ensure Group employees protect themselves and Group assets. Business continuity plans exist for each business with ongoing testing. During September 2017, HFPG successfully deployed their business continuity plans to mitigate the impact of Hurricane Irma.	↗

Operational risk – Loss of key personnel

Risk description and assessment	Mitigation	Change
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 an impact on performance, for a limited time period. The average length of service of the ca. 90 senior managers in the Group is 11 years and for all personnel in the Group is consistently ca. seven years.	Contractual terms such as notice periods and non-compete clauses can mitigate the risk in the short term. However, 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 for key managers in the operating businesses including: • 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 cash 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 risk – Product liability

Risk description and assessment	Mitigation	Change
There is a risk that products supplied by a Group business may fail in service, which could lead to a claim under product liability. The businesses, in their terms and conditions of sale with customers, will typically mirror the terms and conditions of purchase from the suppliers. In this way the liability can be limited and subrogated to the supplier. 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 potential damages if the claim succeeds and the supplier fails to meet its liabilities for whatever reason. Product liability insurance can be limited in terms of its scope of insurable events, such as product recall.	Technically qualified personnel and control systems are in place to ensure products meet quality requirements. The Group's businesses are required to undertake Product Risk assessments and comprehensive Supplier Quality Assurance assessments. The Group has also established Group-wide product liability insurance which provides worldwide umbrella insurance cover of £30m across all Sectors. The Group's businesses have undergone product liability training and are continually reviewed to demonstrate compliance with Group policies and procedures relating to product liability.	→

Financial risk – Foreign currency

Risk description and assessment	Mitigation	Change
Foreign currency risk is the risk that currency rates will affect the Group's results. The Group is exposed to two types of financial risk caused by currency volatility: **translational** exposure, being the effect that currency movements have on the Group's financial statements on translating the results of overseas subsidiaries into UK sterling; and **transactional** exposure, being the effect that currency movements have on the results of operating businesses because their revenues or product costs are denominated in a currency other than their local currency. The Group operates internationally and is exposed to translational foreign exchange risk arising from various currency exposures, primarily with respect to the US dollar, the Canadian dollar, the Australian dollar and the Euro. The results and net assets of the Group's operations outside the UK are also exposed to foreign currency translation risk. A strengthening of UK sterling by 10% against all the currencies in which the Group does business, would reduce adjusted operating profit before tax by approximately £6.2m (8%), due to currency translation. Similarly, a strengthening of UK sterling by 10% against all the non-UK sterling capital employed would reduce shareholders' funds by £19.1m. The Group's UK businesses are exposed to transactional foreign exchange risk on those purchases that are denominated in a currency other than their local currency, principally US dollars and Euros. 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 and Euros. The Group's US businesses do not have any material foreign currency transactional risk.	The Group operates across a number of diverse geographies but does not hedge translational exposure of operating profit and net assets. The Group's businesses may hedge up to 80% of forecast (being a maximum of 18 months) foreign currency transactional exposures using forward foreign exchange contracts. The Group finance department monitors rolling monthly forecasts of currency exposures. 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 28 to the consolidated financial statements.	→

Accounting risk – Inventory obsolescence

Risk description and assessment	Mitigation	Change
Working capital management is critical to success in specialised industrial businesses as this has a major impact on cash flow. The principal risk to working capital is in inventory obsolescence and write-off. The charge against operating profit in respect of old or surplus inventory in the year was £1.3m but inventories are generally not subject to technological obsolescence.	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 both excess inventory and potential obsolescence.	→

Corporate Responsibility

Employees

Building and developing the skills, competencies, motivation and teamwork of employees is recognised by the Board as being essential to achieving the Group's business objectives. The loss of key personnel is also identified by the Board as a Principal Risk as set out on page 34. The stability and commitment of the employees is demonstrated by the average length of service which is consistently high at ca. seven years. In addition, the number of working days lost to sickness is ca. 1% a year. These measures remain consistent across each of the Group's Sectors.

Key employee statistics

	2017	2016	2015
Average number of employees in year	**1,658**	1,602	1,449
Females as percentage of total	**35%**	36%	34%
Length of service (years)	**6.7**	6.7	6.6
Average staff turnover	**20.6%**	24.9%	23.0%
Sick days lost per person	**3.3**	3.1	3.0

The Group encourages healthy lifestyles and the level of sick days lost per person is heavily influenced by a small number of employees who are on long term sick leave.

Set out below is an analysis of the number of employees by gender at the year end:

	2017			2016		
	Male	Female	Total	Male	Female	Total
Directors	**5**	**1**	**6**	5	1	6
Senior managers	**73**	**19**	**92**	72	21	93
Employees	**1,044**	**586**	**1,630**	950	549	1,499
Total	**1,122**	**606**	**1,728**	1,027	571	1,598

The Board recognises the importance of gender diversity in the Group and 35% of the Group's employees are female. Some of the Group's operating companies have structured apprenticeship schemes and of the five UK based apprenticeships started in 2017, three of these were for females.

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 the 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 Review and Annual Report & Accounts 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 2017, the Group employed seven disabled employees.

Employment policies throughout the Group have been established to comply with relevant local legislation and codes of practice relating to employment, Health & 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.

The Group provides sponsorship for high potential employees for higher education courses where appropriate. Vocational training is also provided and some staff are enrolled on National Vocational Qualification ("NVQ") or similar level courses. Employees are actively encouraged to undertake Continuing Professional Development ("CPD") to maintain any relevant professional accreditations.

In accordance with the Market Abuse Regulation of the Financial Conduct Authority, employees are required to seek approval of the Group Company Secretary before dealing in its shares.

Health & Safety

The Group is fully committed to ensuring clean, safe and healthy working conditions. The Group actively promotes a strong safety culture and ensures a collective responsibility for ensuring Health & Safety standards are continually improved.

The Chief Executive Officer has overall responsibility for Health & Safety policies and procedures across the Group. However, in line with the Group's decentralised management approach, accountability for Health & Safety is with local management to ensure compliance with local regulatory requirements, culture and specific business needs. The Group requires that each operating business conducts Health & Safety reviews against its specific operational risk profile and local regulatory requirements.

Health & Safety forms part of the induction process for new employees and where relevant, more specialist training is provided for specific functions. The Group has good coverage of employees who have formal Health & Safety training and/or qualifications and this has continued to increase during 2017.

Following the implementation of near miss reporting in 2016, the Group has now used its first full year of the system to assist in ensuring that Health & Safety hazards are proactively identified and appropriate mitigation put in place to ensure that they do not result in Health & Safety incidents.

	2017	2016	2015
Minor injuries	**56**	87	54
Reportable lost time incidents[1]	**5**	11	4
Minor injuries per 1,000 employees	**33.8**	54.3	37.3
Reportable lost time incidents[1] per 1,000 employees	**3.0**	6.9	2.8

1 Three or more days' absence from workplace.

The absolute level of minor injuries has significantly reduced this year and also reduced when normalised to a rate per 1,000 employees. The near miss reporting system has placed new emphasis on the need to identify and implement corrective actions prior to incidents occurring and this methodology indirectly assists with reducing health and safety risk. The vast majority of the minor injuries resulted in no lost time and were considered low level. The number of reportable lost time incidents has also reduced significantly.

All incidents are fully investigated and corrective actions and preventative measures put in place to ensure that the incident does not reoccur and future risks are mitigated.

Human rights

The Group's activities are substantially carried out in developed countries that have strong legislation governing human rights. The Group complies fully with appropriate legislation in the countries in which it operates to ensure the rights of every employee are respected and to treat all stakeholders with dignity and respect. The Group promotes employment practices to ensure fair regard to diversity and equal opportunities. Staff are provided with a safe, secure and healthy environment in which to work. Employees have access to an independent hotline to report any issues relating to Human Rights violations.

Modern slavery

The Group adopted a zero tolerance approach to slavery in all its forms, including human trafficking, forced labour and child labour. In 2017, each business assessed the risk of slavery taking place either within the business itself or among its principal suppliers. Group businesses carry out due diligence of suppliers through questionnaires, audits and visits. Based on these assessments and the initiatives implemented by the businesses to counter slavery, the Board was assured that slavery is not taking place within the Group and has published a Modern Slavery statement on the steps taken to prevent slavery, which is available on the Company's website.

Environmental

The Group comprises sales and marketing focused businesses which essentially receive products from suppliers and despatch them to customers. The Group's businesses do not operate delivery fleets; they use third-party carriers to deliver their products to customers and to provide much of their packaging requirements. The Group's ability to control the environmental impact of its logistics partners is therefore limited. The primary impact on the environment, which is entirely in the Group's control, is consumption of the normal business energy sources such as heating and power, which the Group aims to minimise through compliance with relevant environmental legislation.

The Group is committed to identifying and assessing environmental risks, such as packaging waste, arising from its operations. Waste management initiatives are encouraged and supported by the Group and materials are recycled where practical. The Group's usage of water is minimal and relates to cleaning, bathrooms and staff refreshments.

Local management are committed to good environmental management practices throughout our operations. The Managing Directors have responsibility for environmental performance of their operating businesses and each subsidiary is required to implement initiatives to meet their responsibilities.

Each facility participates in recycling paper, plastic, cardboard and wood from pallets and continues to focus on minimising energy consumption through the efficient use of heating and lighting. In addition, a number of the businesses now use fully recycled and biodegradable filler materials for packaging.

Greenhouse gas emissions

UK listed companies are required to report their global levels of Greenhouse Gas ("GHG") emissions in their Annual Report & Accounts. This requirement is for disclosure of Scope 1 and 2 only (direct emissions e.g. heating, cooling, transport fuel; and indirect emissions, e.g. from purchased electricity) and only to the extent that such emissions are the responsibility of the Company.

The Group has considered the six main GHGs and report emissions in tonnes of CO_2 equivalent ("CO_2e") for Scope 1 (direct) and Scope 2 (indirect) emissions. These emissions are calculated following the GHG Protocol and UK Government Environmental Reporting Guidelines. The Group has used Defra UK GHG Conversion Factors, US Environmental Protection Agency Emission Factors and International Energy Agency Factors.

As a distributor with no owned logistics or freight, the Group's primary direct energy usage and related CO_2 emissions arise from the Group's facilities. Where possible the Group has reported billed data which represents ca. 80% of the Group's global emissions. For the remaining entities the Group has used an estimation using sales data and local conversion factors.

An intensity ratio of CO_2e per £1m revenue has been selected, which will allow a comparison of performance over time and with other similar types of business.

		Tonnes of CO_2e	
	Source of emissions	**2017**	2016
Direct emissions (Scope 1)	Natural gas	**657**	714
	Owned transport	**68**	100
Indirect emissions (Scope 2)	Electricity	**2,955**	2,732
Gross emissions		**3,680**	3,547
Tonnes CO_2e per £1m revenue		**8.1**	9.3

Business ethics

The Group recognises its obligations towards the parties with whom the Group has business dealings including customers, shareholders, employers, suppliers and advisors.

In general, the interactions with these parties are managed at a local level by senior management and the Group expects a high standard of expertise and business principles to be maintained in such dealings.

The Group's policy towards suppliers is that each operating business is responsible for negotiating the terms and conditions under which they trade with their suppliers. The Group does not operate 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 or 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.

Community

The Group believes that good community relations are important to the long term development and sustainability of the operating businesses.

The Group's businesses participate within their local communities on a number of charitable and fundraising activities primarily in support of health and children's charities.

The Group also contributes to local worthwhile causes and charities and in 2017 the Group made donations to charitable organisations of £54,418 (2016: £44,958). No political donations were made.

Board of Directors

John Nicholas[1,3]
Chairman

Appointed:
Joined the Board on 1 June 2013 and appointed Chairman on 21 January 2015.

Skills and experience:
A Chartered Certified Accountant with a Masters degree in Business Administration from Kingston University, London. John has a wealth of business and commercial experience and spent much of his early career in technology-focused international manufacturing and service companies involved in analytical instruments, fire protection and food processing.

He has been Group Finance Director of Kidde plc (on its demerger from Williams Holdings) and of Tate & Lyle PLC.

External appointments:
John is currently non-Executive Director and Chairman designate of Porvair plc and non-Executive Director and Chairman of the Audit Committee of Hunting PLC (until April 2018). John is Senior Independent Director of Mondi plc.

Bruce Thompson
Chief Executive Officer

Appointed:
Joined the Board in 1994 as a Group Director and appointed Chief Executive Officer in 1996.

Will retire from the Board before 30 September 2018.

Skills and experience:
Bruce started his career in the automotive industry, first as a design engineer and then in product marketing. He then spent three years in international marketing with a construction materials company, developing new markets in Europe, the Middle East and North Africa. Prior to joining Diploma, he was a Director with Arthur D Little Inc., the technology and management consulting firm, initially in the UK and then as Director of the firm's Technology Management Practice based in Cambridge, Massachusetts.

External appointments:
None.

Charles Packshaw[1,2,3]
Senior Independent Non-Executive Director

Appointed:
Joined the Board on 1 June 2013 and appointed Senior Independent Director on 27 February 2015.

Skills and experience:
Charles has over 30 years of City experience, including 15 years at HSBC where he was Head of UK Advisory and Managing Director in HSBC's global banking business. Prior to that, he was Head of Corporate Finance at Lazard in London. Charles has been a non-Executive Director of two listed companies and he is also a Chartered Engineer.

External appointments:
Charles is a non-Executive Director of BMT Group Limited.

Executive Management Group

Bruce Thompson
Chief Executive Officer

Nigel Lingwood
Group Finance Director

Dan Brown

Joined the Group in October 2015 to take responsibility for the Group's Healthcare businesses across all international markets.

Darin Clause

Joined the Group in November 2015 to take responsibility for the Seals businesses in North America and more broadly to develop new opportunities in US Industrial Distribution.

Nigel Lingwood
Group Finance Director

Appointed:
Joined the Company in June 2001 and appointed Group Finance Director in July 2001.

Skills and experience:
Prior to joining the Company, Nigel was the Group Financial Controller at Unigate PLC where he gained experience of working in a large multinational environment and on a number of large corporate transactions. Nigel qualified as a Chartered Accountant with Price Waterhouse, London.

External appointments:
None.

Anne Thorburn[1,2,3]
Non-Executive Director

Appointed:
Joined the Board on 7 September 2015 and appointed Chairman of the Audit Committee on 17 November 2015.

Skills and experience:
Anne was Chief Financial Officer of Exova Group plc until 30 November 2015 and has many years of experience at Board level in listed international groups. Anne was previously Group Finance Director at British Polythene Industries PLC. Anne is a member of the Institute of Chartered Accountants in Scotland.

External appointments:
None.

Andy Smith[1,2,3]
Non-Executive Director

Appointed:
Joined the Board and appointed Chairman of the Remuneration Committee on 9 February 2015.

Skills and experience:
Andy is Managing Director, Severn Trent Business Services with responsibility for the company's non-regulated businesses. He has many years of plc Board level experience having previously served on the Boards of The Boots Company PLC as Group HR Director and Severn Trent PLC as Water Services Director. Andy is a Mechanical Engineering graduate and has significant operational and HR experience. He has worked in the UK and overseas previously with global businesses including BP, Mars and Pepsi.

External appointments:
None.

Committee membership: 1 Remuneration Committee 2 Audit Committee 3 Nomination Committee

Gustav Röber

Joined the Group in September 2004 initially as Finance Controller and then as Corporate Development Director. Now responsible for the Group's Controls and Environmental businesses.

James Routh

Joined the Group in September 2012 initially as Business Development Director and now responsible for the Group's International Seals businesses outside North America.

Stuart Bell

Joined the Group in May 2013 in the Group Finance department and appointed as Group Financial Controller in June 2015.

Corporate Governance

John Nicholas, Chairman

"With a proven strategy and the support of an experienced group of managers on the EMG, the Board is confident that it remains in a strong position to meet the likely challenges during this transition year."

Members of Board	Attendance
Chairman	
John Nicholas	7/7
Independent non-Executive Directors	
Andy Smith	7/7
Charles Packshaw	7/7
Anne Thorburn	7/7
Executive Directors	
Nigel Lingwood	7/7
Bruce Thompson	7/7

Dear Shareholder

The Board and its Committees have enjoyed a productive year in 2017 guiding the Company through some important Governance tasks set out in the Code, namely a formal review of the Company's Remuneration Policy and undertaking a tender for the Company's audit engagement. As these two exercises drew to a close in September, the Board also embarked on a process to recruit a new CEO, after Bruce Thompson had notified the Board of his decision to retire from his role by 30 September 2018. Bruce has been an outstanding leader of the Group for over 20 years and has been instrumental in developing and executing the existing strategy that has underpinned the tremendous success of the Group.

The Board, led by the Nomination Committee, has commenced a formal process with a search agency to recruit a new CEO. I look forward to updating shareholders on this process as soon as we have identified a successor.

The Board recognises that the period of transition to the new CEO is likely to be challenging, but it is confident that with a proven strategy and the support of an experienced group of managers on the EMG, it remains in a strong position to meet the likely challenges during this transition year.

The Audit Committee completed a formal competitive tender for the external audit engagement during this year. This process is described in more detail in the Audit Committee Report. After a thorough process, the Board has resolved, on the recommendation of the Committee, to propose to shareholders that PricewaterhouseCoopers be appointed as auditor to the Company from 1 October 2017. On behalf of the Board, I wish to thank Deloitte, the retiring auditor, for their excellent service over the past ten years.

The Remuneration Committee completed its review of the Remuneration Policy for Directors during the year. Their review was supported by Aon Hewitt and included consultation with the Company's largest shareholders who in aggregate represent over 50% of the Company's ordinary shares. The review resulted in a tightening of some elements of the Policy to ensure the Company remains up to date with current best practice, as described further in the Remuneration Report. However the Board was pleased that this review also confirmed that the core principles of the existing Policy continued to provide a strong basis for linking Diploma's strategy to Director remuneration.

The Company's Capital Markets Day held in February this year provided an opportunity for shareholders and potential investors to meet with senior management in the Group who comprise the EMG. I thought it was an excellent morning which demonstrated very well the breadth and depth of the Group's businesses and the growth opportunities that remain available to each of the Group's Sectors. I would recommend that shareholders have a look at the videos and presentations that were used at this event and which are available on the Company's website.

I hope that as shareholders in the Company you will be able to find time to attend our AGM on Wednesday, 17 January 2018. It provides an excellent opportunity to meet the Board of Directors and challenge them on any matters you feel are important to the development of the Company.

John Nicholas
20 November 2017

Compliance with the Code

Diploma PLC is required to state whether it has complied with the Main Principles of the UK Corporate Governance Code ("the Code"), issued by the Financial Reporting Council in April 2016. Set out on pages 41 to 63 is an explanation of how the Company has complied with the Main Principles of the 2016 Code.

The Board confirms that throughout the financial year, the Company applied all of the Principles set out in sections A to E of the Code for the period under review. The Board also confirms that it complies with all of the Provisions of the Code as at the date of this Report.

The Company's auditor Deloitte LLP, is required to review whether the statement reflects the Company's compliance with the Provisions of the Code specified for their review by the Listing Rules of the UK Listing Authority and to report if it does not reflect such compliance.

Framework of Corporate Governance

The Board

The Diploma PLC Board is accountable to the Company's shareholders for standards of Governance across the Group's businesses. Certain strategic decision-making powers and authorities of the Company are reserved as matters for the Board. The principal matters reserved for the Board are set out below. Day-to-day operational decisions are managed by the Chief Executive Officer.

- Setting the overall strategic direction and oversight of the management of Diploma PLC.
- Recommending or declaring dividends.
- Approval of the Group and Company financial statements.
- All new bank facilities, or significant changes to existing facilities.
- Assessment and approval of the principal risks facing the Group and how they are being managed.
- Approval of the Viability Statement.
- Maintaining sound internal control and risk management systems.
- Approval of major corporate transactions and commitments.
- Succession planning and appointments to the Board.
- Review of the Group's overall corporate governance arrangements and reviewing the performance of the Board and its Committees annually.
- Approval of the delegation of authority between the Chairman and the Chief Executive Officer and the terms of reference of all Committees of the Board.

Where appropriate, matters are delegated to a Committee which will consider them in accordance with its terms of reference. Details of each Committee's terms of reference are available on the Diploma PLC website at www.diplomaplc.com.

Audit Committee

Chaired by Anne Thorburn

Number of meetings in the year: Eight

Role of the Committee

The Audit Committee has responsibility for overseeing and monitoring the Company's financial statements, accounting processes, audit (internal and external), internal control systems and risk management procedures and also monitors issues relating to fraud, anti-bribery and corruption, sanctions and whistleblowing.

Nomination Committee

Chaired by John Nicholas

Number of meetings in the year: Three

Role of the Committee

The Nomination Committee regularly reviews the structure, size and composition of the Board and its Committees. It identifies and nominates suitable candidates to be appointed to the Board (subject to Board approval) and considers succession generally.

Remuneration Committee

Chaired by Andy Smith

Number of meetings in the year: Seven

Role of the Committee

The Committee reviews and recommends to the Board, the framework and policy for the remuneration of the Chairman and the Executive Directors. The remuneration of the non-Executive Directors is determined by the Chairman and the Executive Directors. The Committee takes into account the business strategy of the Group and how remuneration policy should reflect and support that strategy.

Leadership

Board composition

The Board currently comprises a Chairman, two Executive Directors and three independent non-Executive Directors. The non-Executive Directors are appointed for specified terms and the details of their respective appointments are set out in the Remuneration Committee Report on page 57. The biographical details of the Board members are set out on pages 38 and 39.

John Nicholas is Chairman of the Board and the Nomination Committee. Each of the three independent non-Executive Directors performs additional roles: Charles Packshaw serves as Senior Independent Director, Andy Smith is Chairman of the Remuneration Committee and Anne Thorburn is Chairman of the Audit Committee.

Activities of the Board

The Company's governance framework is set out above together with a summary of the formal terms of reference. The core activities of the Board and its Committees are planned on an annual basis and this framework forms the basic structure within which the Board operates.

The Board's terms of reference also set out the separate and distinct roles of the Chairman and the Chief Executive Officer.

Corporate Governance
continued

The Chairman is responsible for the overall leadership and governance of the Board and ensures that the Directors have an understanding of the views of the Company's major shareholders. The Chairman sets the Board's agenda and ensures that there is a healthy culture of challenge and debate at Board and Committee meetings.

The Board appoints the Chief Executive Officer and monitors his performance in leading the Company and providing operational and performance management in delivering the agreed strategy. The Chief Executive Officer is responsible for developing, for the Board's approval, appropriate values, culture and standards to guide all activities undertaken by the Company and for maintaining good relationships and communications with investors.

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.

Other matters reserved to the Board include treasury policies, internal control and risk management.

To ensure that non-Executive Directors can constructively challenge and support proposals on strategy, the Board has adopted a process of reviewing and approving the agreed strategy for the Company on a three-yearly basis. The Board met for a formal review of the Company's strategy at the end of June 2015 in Zurich, Switzerland. The Board received a number of presentations and had thorough and challenging reviews with Executive management. In 2017 (as in 2016), the Board reviewed progress against the objectives set at the Group strategy session in June 2015.

In normal circumstances, the Board would expect to hold the next formal review of the Company's strategy in 2018. However in light of the impending retirement of the Chief Executive Officer, this review is likely to be postponed until a new Chief Executive Officer has been appointed.

Meetings of the Board

The Board has seven scheduled meetings during the financial year but will meet more frequently if required.

Each Director is expected to attend all meetings of the Board or Committees of which they are a member. In addition, senior management from across the Group and advisors attend certain meetings for the discussion of specific items in greater depth.

The Board ensures that at least one of the scheduled meetings is held on site at one of the Group's facilities, where the Board has an opportunity to both receive presentations from local management and meet employees of that business. In March 2017, the Board's scheduled meeting was held at Kentek's new facility in Helsinki. At this meeting the Board received presentations from senior management in Kentek and had an opportunity to view the new facility and meet with employees to gain a better understanding of the products and operation managed from this facility.

In September 2017 the Board's scheduled meeting reviewed the Group's strategic objectives identified at the strategy session held in 2015 and the Chief Executive Officer provided an update on the progress achieved in implementing these objectives.

This exposure to the members of senior management from across the businesses helps enhance the Board's understanding of the businesses, the implementation of strategy and the changing dynamics of the markets in which the businesses operate.

Effectiveness

Independent non-Executive Directors

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. The Chairman, John Nicholas was considered independent by the Board both at the time of his appointment as Director on 1 June 2013 and as Chairman on 21 January 2015. In accordance with the Code, the ongoing test of independence for the Chairman is not relevant.

All non-Executive Directors are advised of the likely time commitments at appointment. The ability of individual Directors to allocate sufficient time to the discharge of their responsibilities is considered as part of the Directors' annual evaluation process, overseen by the Chairman. Any issues concerning the Chairman's time commitment are dealt with by the Nomination Committee, chaired for this purpose by the Senior Independent Director.

Each non-Executive Director is required to inform the Board of any changes to their other appointments.

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

The appointments of non-Executive Directors are subject to formal, rigorous and transparent procedures which are described more fully in the Nomination Committee Report which is set out on page 50.

Diversity

The Board is committed to a culture of equal opportunity and diversity to attract and retain talented people to deliver outstanding performance and further enhance the success of the Group.

In that culture, diversity across a wide range of criteria is valued, including skills, knowledge and experience as well as gender, ethnicity, religion and sexual orientation. People are appointed on merit, in an equal opportunities environment and without any form of positive or negative discrimination. External consultants, when used, are made aware of this policy.

The Nomination Committee reviews the structure, size, diversity, balance and composition of the Board and makes recommendations to the Board concerning the reappointment of any non-Executive Director at the conclusion of their specified term of office and in the identification and nomination of new Directors. The principal objective of the Nomination Committee is to ensure that all candidates have appropriate knowledge, ability and experience for the role.

The Board supports the recommendations of the Davies review on gender diversity but believes that other types of diversity are equally important. The Board is currently diverse across a range of criteria but it is committed to strengthen that diversity, including gender and ethnic diversity, when appropriate opportunities arise. The Board will also take account of its objective to meet the Davies review targets before the end of the next Board rotation of non-Executive Directors.

Information and professional development

An induction programme is agreed for all new Directors aimed at ensuring that they are able to develop an understanding and awareness of the Group's core processes, its people and businesses. The non-Executive Directors' awareness of the businesses is further developed through periodic visits to the principal business locations and presentations to the Board by senior management of the businesses. In 2017, the Board received presentations from senior management of the Kentek business.

Following the new appointments to the Board in 2015, a managed induction programme was set up which included a visit by each of the new non-Executive Directors to the major business units in each of the Group's Sectors where they have an opportunity to meet with senior management in these businesses. Meetings were also held individually between each of the non-Executive Directors and the Executive Directors and with some of the principal advisors to the Company.

The Chairman, with the assistance of the Chief Executive Officer and the Group Company Secretary, is responsible for ensuring that Directors are supplied with information in a timely manner that is in a form and of a quality appropriate to enable them to discharge their duties. In the normal course of business, the Chief Executive Officer gives an oral report to the Board at each meeting and information is provided and reported through formal Board reports that include information on operational matters and strategic developments. There are also reports on the performance of the Group's businesses, financial performance relative to the budget, risk management, business development and investor relations.

The training needs of the Directors are periodically discussed at Board meetings and where appropriate, briefings as necessary are provided on various elements of corporate governance and other regulatory issues.

The Chairman has reviewed and agreed the training and development needs of individuals Directors and encourages them to continually update their skills, together with knowledge and familiarity with the Company to fulfil their role on the Board and Board Committees.

The Group Company Secretary acts as an advisor to the Board on matters concerning governance and regulatory issues and ensures compliance with Board procedures. All Directors have access to his advice. The appointment and removal of the Group Company Secretary and his remuneration are matters for the Board as a whole.

Board evaluation

The Board undertakes an externally led evaluation of the effectiveness of the Board every three years, in accordance with the Code. This exercise encompasses an evaluation of the Board as a whole, the Board Committee and of individual Directors. The last externally led evaluation was carried out in July 2015 and the external facilitator concluded that the Board's effectiveness at that time was very strong. A similar external evaluation exercise is scheduled to be carried out again in 2018.

In those years when an external evaluation is not performed, the Board undertakes an internal evaluation of the Board's effectiveness using specially designed evaluation forms and under the direction of the Chairman. This exercise encompasses an evaluation of the performance of the Board as a whole, as well as of each of the Committees and individuals. Feedback on Board performances is presented by the Chairman to the Board and actions and objectives are agreed for the following year.

The internal Board evaluation was carried out in August 2017 and results of this review were again satisfactory.

The issues identified in this evaluation were more broadly focused on matters that the Board believed should be further developed for later discussion at meetings of the Board or in the next review of Company strategy. There were no significant issues identified that required immediate attention. There were also no negative performance issues identified from the evaluation that related to individual Directors or the performance of the Board Committees.

The Board also received an update on progress made with implementing those recommendations arising from the internal evaluations carried out in 2016. These primarily related to the non-Executive Directors wishing to receive more information on the competitive factors facing the principal businesses in each Sector, on a review of the potential impact of innovative and/or disruptive technologies on the Group's businesses and further discussions on strategies to manage the Group in a post Brexit and particularly lower growth environment.

The Board agenda during 2017 has included discussions to address these recommendations more generally. However a comprehensive review of each of these topics will be included in the next Board meeting on Company strategy.

The Senior Independent Director, together with the non-Executive Directors also carries out each year and has done so in 2017, a performance evaluation of the Chairman, having taken account of the views of all of the Directors.

Re-election

All Directors of the Board are subject to election by the shareholders at the first AGM following their appointment by the Board and in accordance with the Code, all Directors will also stand for re-election annually at the AGM.

Liability insurance

In line with market practice, each Director is covered by appropriate directors' and officers' liability insurance ("D&O"), at the Company's expense. The D&O insurance covers the 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 provides cover where the Director or Officer has acted fraudulently or dishonestly.

Professional advice

A policy is in place pursuant to which each Director may obtain independent professional advice at the Company's expense. In furtherance of their duties as a Director of Diploma PLC. No formal requests were made during the year, but post-year end, advice was sought in relation to Board succession. In addition, each of the Committees are authorised, through their Terms of Reference, to seek advice at the Company's expense. During the year, advice was sought by the Remuneration Committee in relation to the development of the Directors' Remuneration Policy.

Conflicts of interest

Directors are subject to a statutory duty under the Companies Act 2006 ("the Act") to avoid a situation where they have, or could have, a direct or indirect interest that conflicts, or possibly could conflict, with the Company's interests. The Act allows directors of public companies to authorise conflicts and potential conflicts where appropriate, where the Articles of Association ("the Articles") contain a provision to this effect. The Act also allows the Articles to contain other provisions for dealing with Directors' conflicts of interest to avoid a breach of duty.

Corporate Governance
continued

Procedures adopted to deal with conflicts of interest continue to operate effectively and the Board's authorisation powers are being exercised properly in accordance with the Company's Articles.

Accountability

The Board is responsible for ensuring that the Annual Report & Accounts taken as a whole present a fair, balanced and understandable assessment of the Group and provides the information necessary to shareholders to assess the Group's position and performance, business model and strategy. This is achieved through this Annual Report & Accounts, the Annual Review and through other periodic financial statements and announcements.

The Board is responsible for determining the nature and extent of the principal risks it is willing to take in achieving its strategic objectives and for maintaining sound risk management and internal control systems. The Board is also responsible for monitoring the Group's risk management and internal control systems and it reviews the effectiveness of these systems through the work of the Audit Committee.

The principal risks which the Board has identified this year are set out in the section on Internal Control and Risk Management on pages 32 to 35 of the Strategic Report.

Relations with shareholders

The Company has a well-developed investor relations programme managed by the Chief Executive Officer and Group Finance Director. Through this programme, the Company maintains regular contact with major shareholders to communicate clearly the Group's objectives and monitors movements in significant shareholdings.

During the past several years, these communications have been enhanced by the introduction of Investor Days, both in the UK and in Canada which were well attended. In addition, Investor Roadshows are now held each year in the US and Canada as well as in the UK and formal investor presentations are made twice a year to groups of private client fund managers.

The Company also engages with existing and potential new investors through a formal Capital Markets Day at which attendees have an opportunity to meet with senior management in the Group to gain a better understanding of the businesses' product portfolios.

In February 2017, a Capital Markets Day was held in London which was attended by over 50 members of the investment community. This proved to be a very successful event for the Company and further details are set out on page 9 in the Chief Executive's Review.

Most shareholder contact is with the Chief Executive Officer and Group Finance Director through presentations made twice a year on the operating and financial performance of the Group and its longer term strategy. The Chief Executive Officer and Group Finance Director generally deal with questions from individual shareholders.

The Group's website contains up-to-date information for shareholders which includes the Annual Report & Accounts of the past eight years, current and historic share price information, news releases and presentations to analysts and key shareholders. The website also contains factual data on the Group's businesses, products and services.

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, focused on both investors and analysts.

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

Electronic communications to shareholders include the Notice of the AGM which is sent at least 20 working days prior to the meeting. The Company proposes a separate resolution on each separate issue and for each resolution, proxy appointment forms provide shareholders with the option to vote in advance of the AGM.

All shareholders have the opportunity to put questions at the Company's AGM, 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 are available to answer questions at the meeting.

The Board has resolved, in line with best practice, to conduct a poll on each resolution proposed at the AGM. The results of the AGM resolutions, including details of votes cast, are published on the Company's website.

With regard to shareholder meetings, other than AGMs, the Board will continue, in ordinary circumstances, to provide as much notice as possible and certainly no less than 14 working days. However, the Board considers that it should still retain the flexibility to reduce the timescale to 14 clear days in the case of non-routine business and where it is merited by the business of the meeting. For this reason, the Board has again proposed a resolution at the AGM to reduce the notice period for General Meetings from 21 to no less than 14 clear days.

Audit Committee Report

Anne Thorburn, Chairman of the Audit Committee

"I wish to thank Deloitte, the retiring audit firm, for their excellent service and wise counsel to the Committee over many years."

Members of Committee:	Attendance
Anne Thorburn (Chairman)	8/8
Charles Packshaw	8/8
Andy Smith	8/8

Dear Shareholder
The Committee's work this year has been largely focused on carrying out a tender process for the Company and Group audit engagement, as Deloitte will have completed ten years as auditor at the end of the 2017 financial year.

The process was very thorough, beginning in January this year and concluding in early September and is explained further on page 47. The Committee was pleased with the strong quality of presentations received from each of the participating audit firms, but unfortunately there could only be one successful firm. After a close contest, the Committee unanimously agreed to recommend that the Board appoint PricewaterhouseCoopers as auditor with effect from 2018. This appointment remains subject to the approval of shareholders at the AGM in January 2018.

On behalf of the Committee, I wish to thank Ed Hanson and his team at Deloitte, the retiring audit firm, for their excellent service and wise counsel to the Committee over many years.

The breadth of the Group's operations has expanded substantially through acquisition in recent years. The Committee was therefore pleased that the Group's Internal Audit function was strengthened during the year with the recruitment of an experienced and multi-lingual auditor from one of the "Big 4" firms. The Committee places strong reliance on Internal Audit's ability to visit each of the Group's operating businesses during the course of a year, particularly given the Group's decentralised operating model. As Chairman of the Committee, I find it very helpful to meet regularly with members of the team to discuss their reports. This provides me with greater insight of the overall culture of the internal control environment in the Group.

I am pleased to report that there were no significant control deficiencies or accounting irregularities reported to the Committee during the year. The Group continues to maintain a strong culture of robust and effective systems of internal control, overseen by strong and experienced finance departments.

I look forward to meeting shareholders at the AGM on 17 January 2018 and will be happy to respond to any questions relating to the activities of the Audit Committee.

Anne Thorburn
20 November 2017

Audit Committee Report
continued

Key Duties

(Full terms of reference are available on the Company's website.)

- Monitors the integrity of the financial statements of the Group and assists the Board in fulfilling its responsibilities relating to external financial reporting and similar announcements, including Half Year and Annual financial statements and quarterly trading updates.
- Reviews key accounting, auditing and tax issues.
- Reviews effectiveness of the Group's risk management and internal control systems.
- Recommends appointment and/or reappointment of the external auditor and approves their terms of engagement.
- Reviews and monitors independence of the external auditor and the effectiveness of the audit process.
- Monitors policy on external auditor supplying non-audit services.
- Monitors operation of the Company's Whistleblowing and anti-bribery/corruption policies and investigates any reports of fraud within the Group.
- Reviews effectiveness of the Internal Audit function and approves the Internal Audit work programme and reviews the results of the work undertaken.
- Reviews the basis on which the Company and its principal subsidiaries continue to prepare their financial statements on a going concern basis.
- Reports to the Board on how it has discharged its responsibilities.

Audit Committee

The Committee is chaired by Anne Thorburn and comprises three independent non-Executive Directors. The Chair of the Committee is a qualified accountant, who has recent and relevant financial experience.

The Audit Committee is satisfied that as a whole, the Committee has sufficient knowledge and competence in the business sectors in which the Group operates in order to provide appropriate challenge to management.

The Group Company Secretary acts as Secretary to the Committee. The Executive Directors also attend Committee meetings and the Internal Audit Manager also attended two Committee meetings. The Committee met with the external auditor during the year, without the Executive Directors being present.

Engagement of the external auditor

The external auditor is engaged to express an opinion on the financial statements of the Group and of the Company. The audit includes the review and testing of the systems of internal financial control and the data contained in the financial statements, to the extent necessary for expressing an audit opinion on the truth and fairness of the financial statements.

Deloitte LLP has been the Company's auditor since its appointment in 2008. Deloitte LLP provides the Committee with relevant reports, reviews and advice throughout the year, as set out in their terms of engagement.

In accordance with UK regulations, the Company's auditor adheres to a rotation policy based on best practice and a new Group lead engagement partner was appointed in 2013 in place of the previous lead engagement partner who had completed a term of five years in that role.

During the year, the Committee carried out an assessment of the effectiveness of the external audit process. The assessment was led by the Chair of the Committee, assisted by the Group Finance Director and focused on certain criteria which the Committee considered to be important factors in demonstrating an effective audit process. These factors included the quality of audit staff, the planning and execution of the audit and the role of management in the audit process. Following this assessment, the Committee concluded that the external audit process remained effective and that it provides an appropriate independent challenge of the Group's senior management.

The Committee was satisfied that Deloitte provided a robust and effective audit and supports the work of the Committee through clear and objective communication on developments in financial reporting and governance.

Audit tender

During the year, with Deloitte approaching the end of their ten-year term as the Group's auditor at 30 September 2017, the Company carried out a formal competitive tender for the external audit engagement. The tender process began early in 2017 and was overseen by the Chair of the Committee, together with the assistance of the Group Financial Controller. The tender process was carried out in accordance with best practice guidelines provided by the FRC and the Investment Association.

The Committee reviewed a potential list of audit firms to be invited to tender for the audit and concluded that, in light of the size and geographic spread of the Group's businesses, an audit firm from the "Big 4" would be most appropriate for the Group audit engagement. In March 2017, formal invitations to tender were sent to each of the audit firms, including the incumbent firm, Deloitte. These letters set out a schedule of matters to be addressed in the tender presentations, the proposed timetable and a set of confidential documents relating to the Group's reporting processes and the key criteria that the Committee would use to evaluate the tender process. Each audit firm was also invited to visit the senior management teams in the principal businesses, as part of the tender process.

The Committee received written proposals from each of the four audit firms in May, which was followed in June by a formal presentation by each firm to a meeting of the Committee, which included the Chairman, the Executive Directors and the Group Financial Controller. The Committee scored each audit firm against criteria of capability, cultural fit, audit quality, resource and proposed fees. These scores were used to reduce the tender process to a shortlist of two audit firms.

At the end of August, following further soundings and the taking up of references, the Audit Committee recommended to the Board the appointment of PricewaterhouseCoopers LLP ("PwC") as auditors for the year ending 30 September 2018 for a period of up to ten years. The final decision was judged against the principal selection criteria of capability, audit quality and cultural fit. The Board accepted and endorsed this recommendation, which is now subject to shareholder approval at the AGM to be held on 17 January 2018.

Following the announcement to shareholders on 5 September 2017 of the Board's proposal to appoint PwC, a transition plan was agreed with PwC which highlights key milestones, beginning with PwC shadowing Deloitte at the 2017 Group audit close meeting with management and attendance at the Audit Committee meeting held on 14 November 2017. PwC do not provide any non-audit services to the Company or its subsidiaries and have confirmed their independence as at 1 October to the Audit Committee.

The Audit Committee confirms that the Company has complied with the provisions of the Competition & Markets Authority Order throughout its financial year ended 30 September 2017 and up to the date of this report.

Audit Committee Agenda – 2017

- Reviewed and agreed the scope of audit work to be undertaken by the external auditor and agreed the terms of engagement and fees to be paid for the external audit.
- Reviewed the Annual Report & Accounts and received reports from the Group Finance Director and the external auditor on the key accounting issues and areas of significant judgement.
- Reviewed the processes necessary to ensure that the Board was able to confirm that the Annual Report & Accounts are "fair, balanced and understandable".
- Reviewed the report from the Group Finance Director on the controls in place to mitigate fraud risk.
- Reviewed the Half Year Announcement and received reports from the Group Finance Director and the external auditor on the key accounting issues and areas of significant judgement.
- Reviewed the Trading Updates at meetings held in January, March and August.
- Reviewed the effectiveness of the Group's internal control and risk management procedures and, where appropriate, made recommendations to the Board on areas for improvement.
- Invited the Internal Audit Manager to attend meetings in September and January to review the results of the Internal Audit work for the current year and to agree the scope and focus of Internal Audit work to be carried out in the following year.
- Reviewed the effectiveness of the external audit process and following a competitive tender process, recommended the appointment of the Group's external auditor.
- Reviewed terms and implications of the Competition & Markets Authority Order and the EU Audit Directive and Audit Regulation.
- Reviewed the Group's policy on anti-bribery/corruption and the procedures in place to ensure compliance across the Group.
- Reviewed the scope of sanctions issued by the European Union and the US and the procedures being followed by the Group's businesses to monitor compliance.
- Reviewed the whistleblowing arrangements and the use made by employees of a dedicated external independent and confidential telephone hotline service for all employees to raise concerns.

Audit Committee Report
continued

Financial reporting and significant judgements

As part of its monitoring of the integrity of the financial statements, the Committee reviews whether suitable accounting policies have been adopted and whether management has made appropriate estimates and judgements and seeks support from the external auditor to assess them.

The main areas of focus reviewed in the year ended 30 September 2017 are set out below:

Impairment of goodwill

The Committee considered the carrying value of goodwill and the assumptions underlying the impairment review. The judgements in relation to goodwill impairment largely relate to the assumptions underlying the calculations of the value in use of the Sector being tested for impairment. These judgements are primarily the calculation of the discount rate, the achievability of strategic business plans and macroeconomic assumptions underlying the valuation process. This area is a prime source of audit focus and accordingly the external auditor provided detailed reporting to the Committee.

Accounting for acquisitions

The Committee reviewed the accounting for acquisitions completed during the year and the assumptions underlying the valuation of intangible assets. They discussed the nature of the intangible assets with the Group Finance Director and the period over which these assets are to be amortised. The Committee also discussed the fair value adjustments and the value attributed to deferred consideration. The Committee also discussed with the external auditor the work they had carried out to satisfy themselves that the valuation assumptions were appropriate.

Valuation of inventory

The Committee reviewed the Report of the Group Finance Director that set out the gross balances by business, together with any related provision against the carrying value. The Committee reviewed the bases used to value and confirm existence of inventory held across the Group; they also considered the appropriateness of provisions held against the carrying value of inventory, having regard to the age and volumes of inventory, relative to expected usage. This matter was also discussed with the external auditor.

The Committee was satisfied that each of the matters set out above had been fully and adequately addressed by the Executive Directors, appropriately tested and reviewed by the external auditor and that the disclosures made in the Annual Report & Accounts were appropriate.

In addition to the main areas reviewed above, the Committee also seeks confirmation from the auditor that the Group's businesses follow appropriate policies to recognise material streams of revenue and that the audit work carried out more generally has assessed any instances where management may be able to override key internal controls designed to guard against fraud or material misstatement. The auditor also reports to the Committee on other less material matters in relation to accounting for the Group's two pension scheme arrangements, (accounted for in accordance with IAS19 (Revised)) and the Group's taxation position.

Non-audit services

The Committee has reviewed its internal guidelines covering the type of non-audit work that can be carried out by the external auditor of the Company, in light of the new regulation set out in the EU Audit Directive and Audit Regulation 2014 ("the Regulations"). These Regulations came into force on 17 June 2016 and applied to the Company from 1 October 2017.

The Regulations substantially curtail those non-audit services which can be provided by the auditor to the Company and in particular, prohibits all tax related services, including compliance services as well as general advice and all consultancy and advisory services. The Regulations require that Board approval is required if eligible non-audit services, such as due diligence and similar assurance services exceed 30% of the prior year Group audit fee and the Company may not allow eligible non-audit services to exceed 70% of the Group audit fee, calculated on a rolling three-year basis.

In Diploma PLC, taxation services are not provided by the Group's current or proposed audit firm; a separate firm is retained to provide tax advice and any assistance with tax compliance matters generally. In addition, due diligence exercises on acquisitions and similar transactions are not provided by the auditor, but are placed with other firms.

The Group auditor is retained to carry out assurance services to the Committee in connection with carrying out "agreed upon procedures" on the Group's Half Year consolidated financial statements.

The Group Finance Director does not have delegated authority to engage the auditor to carry out any non-audit work, but must seek approval from the Chairman of the Audit Committee.

The Committee assures itself of the auditor's independence by receiving regular reports from the external auditor which provide details of any assignments and related fees carried out by the auditor in addition to their normal audit work and these are reviewed against the above guidelines.

Details of the external auditor's total fees, including non-audit fees of £13,000 paid to Deloitte LLP during the year are set out in note 27 to the consolidated financial statements.

Risk management and internal control

The principal risks and uncertainties which are currently judged to have the most significant impact on the Group's long term performance are set out in a separate section of the Strategic Report on Internal Control and Risk Management on pages 32 to 35.

The Committee is responsible for reviewing the effectiveness of the Group's system of internal control. The system of internal control 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.

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 relating to revenues, cash and receivables are reported on a weekly basis. Detailed management accounts and KPIs are prepared monthly using a robust proprietary reporting system to collect and analyse financial data in a consistent format. Monthly results are measured against both budget and half year reforecasts which have been approved and reviewed by the Board. All capital expenditure above predefined amounts must be supported by a paper prepared by business management.

All financial data is taken directly from the trial balances of each business held in their local ERP systems and reanalysed and formatted in a separate Group management reporting system, operated by the Group finance department. There is no rekeying of financial data and very limited use is made of spreadsheets by the Group businesses to report monthly financial results. The Group finance department continues to develop the functionality of this management reporting system to provide greater insights into the activities of the Group's businesses, both financial and operational. The Group's internal auditor regularly audits the base data at each business to ensure it is properly reported through to the Group management reporting system.

As part of the year end close process each business is required to complete a self-assessment which evaluates their financial control environment in the business designed to identify weaknesses in controls. These assessments are critically reviewed by the Group's Internal Audit manager and a summary for each business is prepared for the Audit Committee. In addition, senior management of each business are required to confirm their adherence with Group accounting policies, processes and systems of internal control by means of a representation letter addressed to the Audit Committee.

The Committee has reviewed the effectiveness of the Group's risk management and internal control systems for the period from 1 October 2016 to the date of this Report. Taking into account the matters set out on pages 32 to 35 relating to principal risks and uncertainties and the reports from the Internal Audit manager, the Board, with the advice of the Committee, is satisfied that the Group has in place effective risk management and internal control systems.

Internal Audit

The Group maintains a small Internal Audit department which reports directly to both the Group Finance Director and Chair of the Audit Committee. The department comprises an Internal Audit manager, based in one of the Group's businesses in Minneapolis, US and an experienced Senior Internal auditor based in the Group's offices in London.

A full programme of Internal Audit visits has been completed during the year. The scope of work carried out by Internal Audit generally focuses on the internal financial controls and risk management procedures operating within each business. In January the Internal Audit manager presents his Audit Plan for the year to the Committee for their approval. Formal written reports are prepared on the results of each Internal Audit visit which set out weaknesses identified during their work, together with recommendations to improve the control environment. These reports are discussed with management of the business visited and are reviewed by the appropriate member of the Executive Management Group.

At the end of the financial year, the Internal Audit manager formally reports to the Committee on the results of the Internal Audit work carried out by his department during the year. The Committee reviews management's responses to matters raised, including the time taken to resolve such matters. The Audit Chair also meets separately with the Internal Audit manager at least twice a year to review some of the department's reports and discuss their findings.

There were no significant or high risk matters identified in the internal audits undertaken during the current financial year. Several recommendations were made to the businesses with regard to formalising and improving their inventory cycle count procedures and improving the regularity and depth of credit control assessments of customers with large credit balances. The Internal Audit manager also reported that good progress have been made with addressing those recommendations made in 2016 in connection with inadequate inventory reconciliations and more detailed employee expense reporting. It was also identified that further work is still required in some businesses to tighten up access controls in their ERP systems.

The work of the Internal Audit department was also extended this year to review and report on progress made by Group businesses in ensuring that their control environment was sufficiently robust to resist cyber-attacks. This work identified a number of instances where systems need to be upgraded and strengthened and these results were reported to the member of the EMG who has been given responsibility for managing and reporting to the Board on the Group's cybersecurity status.

The Internal Audit department also continues to monitor the businesses compliance with Group policies on anti-bribery/corruption and sanctions.

The Committee is satisfied that the Internal Audit department is sufficiently independent of Executive management and has sufficient resources and scope that is appropriate for the size and nature of Diploma PLC.

Sanctions

The Audit Committee continued to work with senior management of the Company, in conjunction with local management of Kentek's Russian operations, to ensure ongoing compliance with EU and US led sanctions. The Committee has received reports on compliance with these sanctions and will continue to monitor developments until the sanctions are suspended or revoked.

Anti-bribery and whistleblowing

Diploma maintains a Group-wide policy on anti-bribery/corruption which addresses the requirements of the Bribery Act 2010. The Committee periodically reviews this policy and the procedures to ensure continued and effective compliance in its businesses around the world. During the year, the Group rolled out a refresher using an e-learning training programme to all its business. This training has been undertaken by all senior management and employees in customer or supplier facing roles and in particular by management and employees from companies that have recently joined the Diploma Group. The e-learning training programme is being extended to encompass other regulatory and compliance based topics, including a Code of Conduct.

The Committee also monitors the Group's Whistleblowing policy, which provides the framework to encourage and give employees confidence to "blow the whistle" and report irregularities. The policy, together with Hotline posters are placed on site noticeboards across the Group. Employees are encouraged to raise concerns via the confidential Hotline which is managed by an independent external company. Reports to the hotline are investigated and reported to the Committee, together with details of corrective action taken. The Group received three Whistleblowing reports during the year. On further review and investigation, the Committee concluded that all three reports essentially related to grievance issues in the workplace and the concerns reported to the Committee were satisfactorily resolved under the business grievance policy and procedures.

Nomination Committee Report

Members of Committee	Attendance
John Nicholas (Chairman)	3/3
Charles Packshaw	3/3
Andy Smith	3/3
Anne Thorburn	3/3

The Nomination Committee is chaired by John Nicholas, the Chairman of the Company. The Committee is chaired by the Senior Independent Director on any matter concerning the chairmanship of the Company. The Committee comprises the non-Executive Directors and meets as necessary to discharge its responsibilities.

The Group Company Secretary acts as Secretary to the Committee.

Appointment of Directors

The Committee will always appoint an external search consultancy, which does not have any connection with the Company, to assess potential candidates to be considered as prospective non-Executive Directors and where appropriate, Executive Directors. As part of any appointment process, the Committee determines the selection criteria for each Director which takes account of diversity, including gender and sets out a detailed description of the requirements for the role. The Committee works closely with the external search consultancy who draw up a long list of candidates from a range of industries and backgrounds for initial appraisal by the Committee. From this, a shortlist is prepared of suitable candidates that most closely meet the selection criteria and these candidates are interviewed by members of the Committee and Executive Directors. Following these interviews, the Committee recommends to the Board the appointment of a Director.

Retirement of the Chief Executive Officer ("CEO")

On 26 September 2017, Bruce Thompson informed the Board of his intention to retire as CEO of Diploma PLC before the end of September 2018 and to terminate his employment with the Company with effect from 30 September 2018. In compliance with the Committee's procedures on appointment of Directors, the Committee, after appropriate consideration and review, retained Ridgeway Partners ("Ridgeway") a search consultancy to lead a process to recruit a new CEO. Ridgeway does not provide any other services to, or have any connection with the Company.

The Committee is keen to find a successful senior business executive with broad management experience of an international industrial focused business. The Committee has considered the challenges and opportunities facing the Group currently and in the future. With this background, the Committee prepared and agreed a detailed specification for the role with Ridgeway, which identified the background, skills, knowledge and experience that will be required of the Company's CEO in the future. A list of potential candidates has been prepared and provided to the Committee and the search for a new CEO is progressing well. Further details of the process will be set out in the 2018 Annual Report & Accounts.

Succession planning

The Committee reviews succession planning, taking into account the challenges and opportunities facing the Group and the background skills and expertise that will be required by the Board in the future. As part of this exercise development plans are agreed to target potential successor senior management in the Group over the next five years.

In January each year the Committee also reviews management succession planning processes in relation to the Company's senior executives, which comprise a cadre of ca. 90 senior managers across the Group's businesses.

The Committee has reviewed succession planning for the non-Executive Directors. While the Board has been recently refreshed, the Chairman's intention is to stagger retirement among the non-Executive Directors in order to maintain continuity and to preserve Board balance.

As part of the review of the composition of the Board and the succession planning process set out above, both the Board and the Committee recognise the importance of both gender and ethnic diversity throughout the Group.

Committee evaluation

During the year, an evaluation of the performance of the Committee and its members was undertaken in line with the Committee's Terms of Reference. The evaluation of the performance of the Committee concluded that the Committee operates effectively.

Key Duties

(Full terms of reference are available on the Company's website.)

- Reviews the size, composition and structure of the Board and the Board Committees.
- Ensures the right balance of skills, knowledge, experience and diversity on the Board.
- Identifies, evaluates and nominates candidates to fill Board and Committee vacancies.
- Reviews succession planning for the Board and senior executives, taking account of experience, knowledge, skills and diversity.
- Reviews the Group policy on conflicts of interest and ensures there are no material conflicts of interest.
- Reviews, as part of the annual evaluation exercise, the time commitment of non-Executive Directors to the role and externally.

Agenda 2017

- Evaluated the balance of skills, knowledge and experience on the Board and its diversity, including gender.
- Considered succession planning in relation to the Executive Directors and senior management.
- Carried out a management mapping exercise.
- Commenced process to recruit a CEO to succeed Bruce Thompson on his retirement by 30 September 2018.
- Reviewed and updated the Board diversity policy.
- Reviewed Board members' register of conflicts of interest.
- Carried out a review of the Committee's performance, using an evaluation questionnaire.

Remuneration Committee Report

Andy Smith, Chairman of the Remuneration Committee

"Our new Remuneration Policy aligns with best practice and provides a strong basis for linking Diploma's strategy and performance to Executive remuneration."

Members of Committee:	Attendance
Andy Smith (Chairman)	7/7
Anne Thorburn	7/7
John Nicholas	6/7
Charles Packshaw	7/7

Dear Shareholder

The work of the Committee this year has been focused on the review of the Remuneration Policy for Directors, which is required by law to be resubmitted to shareholders for approval at the Company's AGM every three years.

The Committee's view is that the existing Policy has served the Company well and the fundamental design continues to provide a strong basis for linking Diploma's strategy and performance to Executive remuneration. This was confirmed in a detailed consultation exercise carried out by Aon Hewitt, who were re-appointed by the Committee this year (see page 52) to advise on the latest developments in best practice for Executive remuneration. There were however, some areas identified where changes could be made to adopt present best practice and improve the Policy. The principal proposed changes are as follows:

- **Annual performance bonus deferral** – to ensure shareholder alignment, a requirement has been introduced to defer 50% of any bonus awarded (net of tax) into shares until minimum shareholding guideline levels have been achieved.
- **Long term incentive awards** – to reflect developments in best practice and the Board's continued focus on long term shareholder alignment, a post-vesting holding period of two years will now apply to new awards granted after the adoption of the new Policy.
- **Shareholder guidelines** – an increase has been made to the current guidelines so that all Executive Directors will be required to hold 200% of base salary in shares (currently 200% for the CEO and 100% for other Executive Directors).
- **Clarification of the treatment of long term incentive awards in a good leaver situation** – the policy around vesting timeframes has been clarified to ensure alignment with best practice for new awards granted after the adoption of the new Policy.

No other significant changes to the Policy are proposed and the maximum incentive opportunity remains unchanged as described on page 54. I wrote to the 12 largest shareholders in October and to three proxy advisors to explain the proposed changes and to ask for their feedback. The feedback I have received has been supportive of the proposed changes. Subject to shareholder approval at the AGM on 17 January 2018, it is intended that the new Policy will apply until the next triennial review due at the AGM in 2021.

This year's Annual Report on Remuneration is set out on pages 58 to 63 of the Annual Report & Accounts. The current Remuneration Policy, approved by shareholders in 2015, has been applied and no discretion has been applied by the Committee.

Base salaries for Executive Directors for the new financial year (that is, from 1 October 2017) will increase by 3.0% (2016: 2.5%) taking into account the salary increases applying across the senior management cadre and generally across the Group. The financial element of the annual performance bonus paid to the Executive Directors this year was at the maximum (2016: ca. 95%) as determined by the targets set for the increase in adjusted earnings per share. The Group delivered an increase of 19% in adjusted earning per share ("EPS") which the Committee considers to be an exceptional performance in the current environment and which has helped underpin the strength of the Company's share price this year. In the year ending 30 September 2018, adjusted operating profit on a constant currency basis will replace adjusted EPS as the primary measure of financial performance in the annual performance bonus.

The LTIP awards for the three years ended 30 September 2017 vested at 89% of the maximum (2016: 45%), supported by an upper quartile FTSE 250 performance in terms of total return to shareholders (average 20% p.a. each year over three years) and average compound growth of 11% p.a. in adjusted EPS. As much of this period was during a global environment of sluggish growth, the Committee considers the level of LTIP awards to be appropriate.

I look forward to meeting shareholders at this year's AGM on 17 January 2018 and will be pleased to answer any questions or concerns they have on the Company's remuneration policies.

Andy Smith
20 November 2017

Remuneration Committee Report
continued

Remuneration Committee

The Remuneration Committee ("the Committee") is chaired by Andy Smith and comprises independent non-Executive Directors.

Bruce Thompson, Chief Executive Officer, attends meetings at the invitation of the Committee to provide advice to the Committee to help it make informed decisions. The Group Company Secretary attends meetings as Secretary to the Committee.

The Remuneration Committee Report

The Report has again been presented this year in two sections. The first section sets out the Director's Remuneration Policy ("the Policy"), which will be subject to a binding triennial vote by shareholders at the AGM on 17 January 2018.

In preparation for the triennial approval by shareholders of the Policy at the AGM on 17 January 2018, the Committee undertook a review of its Policy for Directors to ensure that it remained appropriate with the Company strategy and reflected the latest developments in remuneration best practice.

Work began in January 2017 when meetings were held with four remuneration consultancy firms to discuss their assessment of the Group's present Policy and to hear their proposals for becoming remuneration advisors to the Committee. Aon Hewitt was judged to offer the best service and value and consequently was reappointed.

Following a detailed consultation exercise with Aon Hewitt, the Committee concluded that the existing Policy continues to provide a strong basis for linking Diploma's strategy and performance to Executive Remuneration. However, the Committee also identified some areas where changes should be made to apply current best practice and improve the Policy. These changes are summarised in the letter from the Chairman of the Committee on page 51 and are reflected in the new revised Remuneration Policy Table set out on pages 53 and 54.

This revised new Policy, will, subject to shareholder approval at the AGM on 17 January 2018, continue for a period of three years until 16 January 2021, unless replaced or amended by a new Policy.

The second section of this Report sets out the annual remuneration paid to the Directors in the year ended 30 September 2017 in accordance with the existing Remuneration Policy approved on 21 January 2015. This section of the Report will continue to be subject to an advisory vote by shareholders at the AGM.

Remuneration principles and structure

The Committee has adopted remuneration principles which are designed to ensure that senior executive remuneration:

- is aligned to the business strategy and promotes the long term success of the Company;
- supports the creation of sustainable long-term shareholder value;
- provides an appropriate balance between remuneration elements and includes performance related elements which are transparent, stretching and rigorously applied;
- provides an appropriate balance between immediate and deferred remuneration; and
- encourages a high-performance culture by ensuring performance-related remuneration constitutes a substantial proportion of the remuneration package and by linking maximum payout opportunity to outstanding results.

Key Duties

(Full terms of reference are available on the Company's website.)

- Sets, reviews and recommends to the Board for approval the Group's overall Remuneration Policy and strategy.
- Sets, reviews and approves individual remuneration arrangements for the Executive Directors, including terms and conditions of employment and any Policy changes.
- Reviews and monitors remuneration arrangements for the senior managers of the operating businesses, including terms and conditions of employment and any Policy changes.
- Approves the rules and design of any Group share-based incentive plans and the granting of awards under any such plans.
- Sets, reviews and approves the fees of the Chairman.

Agenda 2017

- Reviewed policy on remuneration for Executive Directors; receiving reports and advice from Aon Hewitt and Stephenson Harwood LLP.
- Carried out a consultation with the Company's major shareholders on the proposed changes to the Remuneration Policy for Executive Directors.
- Reviewed Executive Directors' salaries, pensions and benefits.
- Approved Annual Performance Bonus targets and the subsequent bonus awards for 2017.
- Approved new PSP awards to Executive Directors and confirmed the performance conditions for such awards.
- Confirmed the vesting percentages for the PSP awards made in February 2015 which crystallised in 2017.
- Approved the exercise of nil cost options.
- Approved the 2017 Remuneration Committee Report.
- Reviewed the AGM 2017 votes on the 2016 Remuneration Committee Report.
- Maintained watching brief on external reports on Directors' remuneration.

The Remuneration Policy Table

The Remuneration Policy Table set out below summarises the components of reward for the Executive Directors of Diploma PLC that will govern the Company's intentions as regards future payments of remuneration.

This Policy, if approved by shareholders at the AGM on 17 January 2018, will apply from 17 January 2018 for a term of three years. Any commitment made by the Company prior to the approval and implementation of the Policy set out in this Report which were consistent with the Policy in force at the time, can be honoured, even if they would not be consistent with the Policy prevailing when the commitment is fulfilled.

Executive Directors

Component	Purpose and link to strategy	Operation	Maximum opportunity	Performance metrics
Base salary	To attract and retain people of the calibre and experience needed to develop and execute the Company's strategy.	Salaries are reviewed annually, with changes normally effective from 1 October.	There is no maximum limit set. Salaries are targeted at a mid-market range for equivalent roles in similar companies. Salary increases will generally be no higher than those awarded to other employees, although the Committee retains discretion to award larger increases if it considers it appropriate.	Salary levels and increases are determined based on a number of factors, including individual and business performance, level of experience, scope of responsibility, salary increases both for UK employees and for the senior management cadre more generally and the competitiveness of total remuneration against companies of a similar size and complexity.
Pensions	Designed to be competitive within the market to reward sustained contribution by Executive Directors.	Pension contributions up to 20% of base salary, which are either paid into personal pension savings schemes or paid as a separate cash allowance.	No maximum limit set.	No performance metric.
Benefits	To provide a competitive package of benefits	Includes various cash/non-cash benefits such as: payment in lieu of a company car, life assurance, income protection, annual leave, medical insurance.	No maximum limit is prescribed, but the Committee monitors annually the overall cost of the benefit provision.	No performance metric.
Annual Performance Bonus Plan	To incentivise and reward Executive Directors on the achievement of the annual budget and other business priorities for the financial year.	Provides an opportunity for additional reward based on annual performance against targets set and assessed by the Committee. Where shareholding guidelines have not been met, half of any annual bonus awarded (net of tax) will be deferred in shares for up to three years, but will remain eligible for dividends. The remaining bonus shall be paid in cash following the relevant year end. Malus and clawback provisions apply to bonus awards.	Maximum of 125% of base salary for the Chief Executive Officer and 100% for other Executive Directors. Performance below threshold results in zero payment. On-target bonus is 50% of maximum bonus and threshold performance is 5% of base salary.	Performance metrics are selected annually based on the current business objectives. The majority of the bonus will be linked to financial performance. For FY18, bonuses will be based on adjusted operating profit on a constant currency basis. Discretion to reduce awards if satisfactory threshold levels are not achieved for adjusted operating margin, free cash flow or ROATCE. Different performance measures, including personal objectives, may be used for future cycles to take into account changes in the business strategy. Personal objectives, if used, will account for no more than 20% of the bonus.

Remuneration Committee Report continued

Directors' Remuneration Policy continued

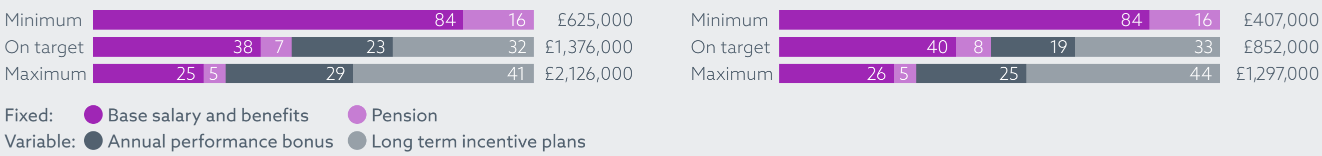
Component	Purpose and link to strategy	Operation	Maximum opportunity	Performance metrics
Long Term Incentive Plan – PSP Awards	Incentivise Executive Directors to achieve superior returns and long term value growth.	Performance assessed over rolling three-year performance periods. Awards are discretionary and do not vest until the date on which the performance conditions are determined. If employment ceases during a three-year performance period, other than in the case of a "good leaver", awards will normally lapse. For awards granted after the adoption of this new Policy on 17 January 2018, Executive Directors will be required to retain shares vesting under the LTIP (net of tax) until the fifth anniversary of grant. Awards may include dividend equivalents which are cash bonuses or shares in lieu of dividends forgone on vested shares, from the time of award up to the time of vesting. Malus and clawback provisions apply.	The maximum opportunity as a percentage of salary is 175% for each award made to the Executive Directors under the 2011 Performance Share Plan ("PSP"). The Committee has discretion to increase awards under the PSP to 250% of salary in exceptional circumstances. No more than 25% of the award will be payable at threshold performance.	Awards will be granted subject to a combination of financial measures (including, for example, adjusted EPS, ROATCE and TSR), tested over a period of at least three years. The Committee may change the weighting of the performance measures or introduce new performance measures for future awards, so that they are aligned with the Company's strategic objectives.

Chairman and non-Executive Directors

Component	Purpose and link to strategy	Operation	Maximum opportunity	Performance metrics
Chairman and non-Executive Directors' fees	To attract and retain a Chairman and independent non-Executive Directors of the required calibre and experience.	Paid quarterly in arrears and reviewed each year. Any reasonable business related expenses (including tax thereon) can be reimbursed if determined to be a taxable benefit.	The Chairman's and non-Executive Directors' fees are determined by reference to the time commitment and relevant benchmark market data.	Annual Board evaluation.

Pay-for-performance: Executive Director's potential value of 2018 remuneration package

Bruce Thompson (%) **Nigel Lingwood** (%)



1 Base salary is as at 1 October 2017; benefits are as set out on page 58.

On target remuneration assumes an Annual Performance Bonus of 50% of the maximum for the Executive Directors. It has been assumed that a face value limit of 175% of base salary applies to each PSP award. On target vesting of PSP awards assumes an adjusted EPS growth of 8% p.a. and TSR performance which is equivalent to 50% of the maximum vesting under the PSP. Maximum remuneration assumes maximum annual performance bonus and maximum vesting of PSP awards. In all cases, for simplicity, no share price growth or dividend equivalents are assumed.

Executive Directors

Base salary

In determining the annual base salary increases which apply from 1 October, the Committee considers comparative salaries in companies of a similar size and complexity and the range of remuneration increases applying across the Group.

The Committee also takes into account the salary increases applying across the senior management cadre. This comparator group comprises ca. 90 senior managers across the Group's businesses. This senior management cadre has been chosen as a representative group, as it provides a meaningful comparison considering the global and diverse nature of the Group's business.

Annual performance bonus

The Diploma PLC Annual Performance Bonus Plan is substantially a cash based scheme designed to reward Executive Directors for meeting stretching annual performance targets.

Under the new Policy proposed for adoption by shareholders at the AGM on 17 January 2018, the financial performance target of "adjusted EPS" will be replaced by "Group adjusted operating profit" and this will be calculated on a basis that excludes the impact of currency effects on the translation of Group adjusted operating profit. If approved by shareholders, this amendment will apply to the financial year ending 30 September 2018.

At the start of the financial year (1 October), the Board sets a financial performance target principally focused on achievement of a target Group adjusted operating profit (or for financial year ending 30 September 2017 only, adjusted EPS). Adjusted operating profit will be calculated on a constant currency basis and full disclosure of the targets will continue to be published on a retrospective basis. The level of bonus payable for achieving the minimum target is 5% of base salary. No bonus is payable if performance does not meet the minimum target.

The definition of adjusted operating profit (or for 2017 only, adjusted EPS) is consistent with the Group's financial statements. However, the Committee has discretion to modify the definition in the event of changes in accounting policy and/or material operational, market, exchange rate or environmental factors in order to more appropriately reflect management performance. The Committee has discretion to reduce awards if minimum thresholds are not achieved for adjusted operating margins, free cash flow and return on adjusted trading capital employed ("ROATCE"). Where used, the rationale for the exercise of this discretion will be disclosed in the next Remuneration Committee Report.

Different performance measures may be used for future cycles of the Annual Performance Bonus Plan to those set out in the Policy Table to take into account changes in the business strategy.

Individual objectives have also been set for the Group Finance Director in the financial year ended 30 September 2017 relating to factors including operating performance, business and management development activities. While retaining that flexibility under the new Policy, the bonus payable to the Group Finance Director for the financial year ending 30 September 2018 will be based solely on adjusted operating profits.

At the end of the financial year, the Committee meets to assess the performance of each Executive Director against the financial and individual objectives. Bonuses are normally paid in cash in December.

There will be a new requirement after the adoption of the new Policy proposed at the AGM on 17 January 2018, to defer 50% of any bonus awarded for the financial year ending 30 September 2018 or thereafter, on a net of tax basis into shares until minimum shareholding guideline levels, set at 200% of base salary for Executive Directors under this new Policy, have been met.

Long term incentive award

The Company operates a long term incentive award plan for Executive Directors, being the Diploma PLC 2011 Performance Share Plan ("PSP"). The PSP is designed to promote the long term success of the Company, while also aligning the Directors' interests with those of Diploma PLC shareholders.

The PSP provides for a grant of conditional awards of a specified number of ordinary shares in the Company, or an option to acquire a specified number of shares at an exercise price determined by the Committee (which may be nil or a nominal amount). No payment is required for the grant of an award.

Awards, which are normally granted annually, must generally be made within 42 days after the announcement of the Company's annual results. When making the decision on the level of award, the Committee takes into consideration a number of factors, including the face value of the award and plan dilution limits.

The face value of an award is equal to the number of shares, or shares under option, multiplied by the relevant share price. The relevant share price will be the mid-market closing share price on the dealing day before the award. A face value limit of 175% of base salary applies to each PSP award to Executive Directors, although the Committee, at its discretion, may increase the face value of an award to a maximum of 250% in exceptional circumstances.

All awards will normally vest on the date on which the performance conditions are determined and confirmed by the Committee, following the end of the performance period. The vesting of awards is conditional on:

- continued employment;
- the Company's growth in adjusted EPS over a three-year performance period; and
- the Company's TSR performance over a three-year performance period.

The latter two performance conditions apply to each award so that the vesting of 50% of the award is based on growth in adjusted EPS and 50% of the award is based on the relative TSR performance. These measures align with our long-term goal of value creation for shareholders through underlying financial growth and above-market shareholder returns.

Each performance condition is measured over a three-year period commencing on the first day of the financial year in which the award is made. There is no retesting of the performance metrics. At the minimum performance threshold, 25% of the PSP awards will vest.

The Committee will regularly monitor the continuing suitability of the performance conditions and may impose different performance conditions or targets for awards granted in subsequent years, to align with the Company's strategic objectives and having regard to prevailing market practice.

The Committee may decide, on or before the grant of a share incentive award, that on exercise of the award, the participants may receive, in addition to the shares in which they then become entitled, a dividend equivalent in respect of the dividends (excluding any tax credit) which would have been paid to the participant in respect of shares vesting between the date of the award and the time of vesting. These dividend equivalent payments may be made in cash or in an equivalent number of shares.

For awards granted after the adoption of this new Policy proposed at the AGM on 17 January 2018, Executive Directors will be required to retain shares vesting under the LTIP (net of tax) until the fifth anniversary of grant ("the Holding Period"), to reflect developments in best practice and the Committee's continued

Remuneration Committee Report continued

Directors' Remuneration Policy continued

focus on long term shareholder alignment. The Holding Period shall expire on the earliest of:

- the fifth anniversary of the date of grant of an award;
- the date of a change of control event;
- the death of the participant; or
- such other date as determined by the Committee in its discretion.

Service contracts

The Executive Directors' service contracts, including arrangements for early termination, are carefully considered by the Committee and are designed to recruit, retain and motivate directors of the calibre required to manage the Company and successfully deliver its strategic objectives.

The Committee considers that a rolling contract with a notice period of one year is appropriate for existing and newly appointed Directors.

The Executive Directors' service contracts, copies of which are held at the Company's registered office, were updated in March 2014 to recognise developments in law and best practice relating to such contracts. These service contracts contain provisions for compensation in the event of early termination or change of control, equal to the value of salary and contractual benefits for the Director's notice period. The Company may make a payment in lieu of notice in the event of early termination and the Company may make any such payment in instalments with the Director being obliged in appropriate circumstances to mitigate loss (for example by gaining new employment).

The Committee considers that these provisions assist with recruitment and retention and that their inclusion is therefore in the best interests of shareholders.

Details of the service contracts of the Executive Directors who served during the year are set out below:

	Contract date	Unexpired term	Notice period	Compensation payable upon early termination
Bruce Thompson	20 Mar 2014	Rolling	1 year	1 year
Nigel Lingwood	20 Mar 2014	Rolling	1 year	1 year

Other remuneration policies

Payment for loss of office

The Committee has considered the Company's policy on remuneration for Executive Directors leaving the Company and is committed to applying a consistent approach to ensure that the Company pays no more than is fair and reasonable in the circumstances.

The loss of office payment policy is in line with market practice and will depend on whether the departing Executive Director is, or is deemed to be treated as, a "good leaver" or a "bad leaver". In the case of a good leaver the Policy includes:

- Notice period of 12 months' base salary, pension and contractual benefits or payment in lieu of notice.
- Bonus payable for the period worked, subject to achievement of the relevant performance condition. Different performance measures (to the other Executive Directors) may be set for a departing Director as appropriate, to reflect any change in responsibility.
- Vesting of award shares under the Company's long term incentive plan is not automatic and the Committee would retain discretion to allow partial vesting depending on the extent to which performance conditions had been met and the length of time the awards have been held. Time prorating may be disapplied if the Committee considers it appropriate, given the circumstances. For awards granted under the current Policy (i.e. prior to the adoption of the new Policy on 17 January 2018) performance will be measured to the date of cessation of employment and, to the extent applicable, vest shortly thereafter. For awards granted after the adoption of the new Policy on 17 January 2018, performance will be measured to the end of the normal performance period and, to the extent applicable, vest on the normal vesting date, save in exceptional circumstances when the Committee may determine that early vesting should still apply.
- The Committee will provide for the leaver to be reimbursed for a reasonable level of legal fees in connection with a settlement agreement.

When calculating termination payments, the Committee will take into account a variety of factors, including individual and Company performance, the obligation for the Executive Director in appropriate circumstances to mitigate loss (for example, by gaining new employment) and the Executive Director's length of service.

The Committee reserves the right to make additional exit payments where such payments are made in good faith in discharge of an existing legal obligation (or by way of damages for breach of such an obligation) or by way of settlement or compromise of any claim arising in connection with the termination of a Director's office or employment.

Change of control

Change of control provisions provide for compensation equal to the value of salary and contractual benefits for the notice period. In the event of a change in control, vesting of an award of shares under the Company's PSP depends on the extent to which performance conditions had been met at that time. Time prorating may be disapplied if the Committee considers it appropriate, given the circumstances of the change of control.

Malus and clawback

Malus provisions apply to awards made under the Company's long term incentive and annual bonus plans which give the Committee the right to cancel or reduce unvested share awards (or in the case of the Annual Performance Bonus Plan, cash payments) in the event of material misstatement of the Company's financial results, miscalculation of a participant's entitlement or individual gross misconduct.

Clawback provisions apply to PSP and Annual Bonus Performance Plan awards granted to Executive Directors after 1 October 2015. The clawback arrangements permit the Committee to recover amounts paid to Executive Directors in specified circumstances and further safeguard shareholders' interests.

Remuneration for new appointments

The Committee has determined that new Executive Directors will receive a compensation package in accordance with the terms of the Group's approved Policy in force at the time of appointment.

The Committee has agreed the following principles that will apply when arranging a remuneration package to recruit new Executive Directors:

- The remuneration structure will be kept simple where practicable, hence the use of base salary, benefits, pension (or cash allowance in lieu), annual performance bonus and long term incentives.
- The emphasis on linking pay with performance shall continue; hence the use of variable pay in the form of an annual performance bonus and a long term incentive award, which will continue to be a significant component of the Executive Directors' total remuneration package.
- Initial base salary will take into account the experience and calibre of the individual and their existing remuneration package. Where it is appropriate to offer a lower salary initially, a series of increases to the desired salary positioning may be given over subsequent years subject to individual performance.
- The structure of variable pay will be in accordance with Diploma's approved Policy detailed above with an exceptional maximum aggregate variable pay opportunity of 375% of salary. Different performance measures may be set in the first

year for the annual bonus, taking account of the responsibilities of the individual and the point in the financial year that the executive joined the Company.
- Benefits will generally be provided in accordance with the approved Policy, with relocation expenses/an expatriate allowance paid if appropriate.
- In the case of an external recruitment, the Committee may also offer additional cash and/or share-based elements when it considers these to be in the best interests of Diploma and shareholders, to replace variable remuneration awards or arrangements that an individual has foregone in order to join the Group. This includes the use of awards made under section 9.4.2 of the UK Listing Rules. Any such payments would take account of the details of the remuneration foregone including the nature, vesting dates and any performance requirements attached to that remuneration and any payments would not exceed the expected value being forfeited.
- In the case of an internal appointment, any outstanding variable pay awarded in relation to the previous role will be allowed to pay out according to the terms of grant.
- For all new Executive Director appointments, the mandated shareholding guidelines, deferral of annual performance bonus and the Holding Period for LTIP awards will apply in accordance with the Policy and the relevant Plan rules.
- Fees for a new Chairman or non-Executive Director will be set in line with the approved Policy.

Committee discretion
The Committee operates the Annual Performance Bonus Plan and the LTIP in accordance with the relevant plan rules and where appropriate, the Listing Rules and HMRC legislation. The Committee also retains discretion over a number of areas relating to the operation and administration of the plans. These include, the timing of awards and of setting performance criteria each year, dealing with leavers, discretion to waive or shorten the Holding Period for shares acquired under the LTIP, the discretion to retrospectively amend performance targets in exceptional circumstances and in respect of share awards, to adjust the number of shares subject to an award in the event of a variation in the share capital of the Company. The Committee will exercise its powers in accordance with the terms of the relevant plan rules. The Committee also has discretions to set components of remuneration within a range from time to time as set out in the maximum opportunity sections of the Policy Table.

Dilution
In any ten-year period, the number of shares which are or may be issued under option or other share awards under any discretionary 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 aggregate number of shares which are or may be issued under option, or other share awards under all share plans established by the Company, may not exceed 10% of the issued ordinary share capital of the Company, from time to time.

Consultation with shareholders and employees
The Committee will consult with its major shareholders in advance of any significant changes to the approved Policy or exercise of discretion, as appropriate, to explain their approach and rationale fully and to understand shareholders' views. Additionally, the Committee considers shareholder feedback received in relation to each AGM alongside any views expressed during the year. The Committee also reviews the executive remuneration framework in the context of published Investor Guidelines.

The Committee does not consult directly with employees when formulating the Policy for Executive Directors.

Policy in respect of external board appointments for Executive Directors
The Committee recognises that external non-executive directorships may be beneficial for both the Company and Executive Director. At the discretion of the Board, Executive Directors are permitted to retain fees received in respect of any such non-executive directorship.

Shareholding guidelines
The Committee has adopted guidelines for Executive Directors, to encourage substantial long-term share ownership. These specify that, over a period of five years from the date of appointment, each Executive Director should build up and then retain a holding of shares with a value equivalent to 200% of base salary. The guidelines also require that, in relation to long term incentive awards, vested shares (net of tax) must be retained by the individual until the required shareholding level is reached. As at 20 November 2017, both Executive Directors exceeded the applicable shareholding guidelines.

Chairman and non-Executive Directors
Recruitment and term
The Board aims to recruit non-Executive Directors of a high calibre, with broad and diverse commercial, international or other relevant experience. Non-Executive Directors are appointed by the Board on the recommendation of the Nomination Committee. Appointments of the non-Executive Directors are for an initial term of three years, subject to election by shareholders at the first AGM following their appointment and subject to annual re-election thereafter. The terms of engagement are set out in letters of appointment which can be terminated by either party serving three months' notice.

Chairman
John Nicholas was appointed Chairman on 21 January 2015, having previously been the Senior Independent Director. His appointment is subject to annual re-election by shareholders at the AGM.

Chairman and non-Executive Directors' letters of appointment:

	Date of original appointment	Date of election/ re-election	Expiry of term
John Nicholas	1 Jun 13	18 Jan 17	20 Jan 18
Charles Packshaw	1 Jun 13	18 Jan 17	1 Jun 19
Andy Smith	9 Feb 15	18 Jan 17	9 Feb 18
Anne Thorburn	7 Sep 15	18 Jan 17	7 Sep 18

Fees
The non-Executive Directors are paid a competitive basic annual fee which is approved by the Board on the recommendation of the Chairman and the Executive Directors. The Chairman's fee is approved by the Committee, excluding the Chairman. Additional fees may also be payable for chairing a Committee of the Board or for acting as Senior Independent Director. The fees are reviewed each year and take account of the fees paid in other companies of a similar size and complexity, the responsibilities and the required time commitment. If there is a temporary yet material increase in the time commitments for non-Executive Directors, the Board may pay extra fees on a pro rata basis to recognise the additional workload.

The non-Executive Directors are not eligible to participate in any of the Company's share plans, incentive plans or pension schemes and there is no provision for payment in the event of early termination.

Remuneration Committee Report
continued

Annual Report on Remuneration

The following section of this Report provides details of the implementation of the existing Remuneration Policy for both Executive Directors for the years ended 30 September 2017 and 2016. All of the information set out in this section of the Report has been audited, unless indicated otherwise.

Executive Directors
Total remuneration in 2017 and 2016

	Bruce Thompson		Nigel Lingwood	
	2017 £000	2016 £000	2017 £000	2016 £000
Salary	486	474	314	306
Benefits	24	24	18	19
Pension	97	95	63	61
Annual performance bonus	607	565	310	288
Short term remuneration (cash)	1,214	1,158	705	674
Long term incentive plans – dividend equivalent (cash)	43	6	28	4
Long term incentive plans – performance element	714	374	461	242
Long term incentive plans – share appreciation element	287	96	186	62
Long term share price based remuneration (non-cash)	1,001	470	647	304
Total	2,258	1,634	1,380	982

The aggregate short term remuneration paid to the Executive Directors in the year ended 30 September 2017 was £1.9m (2016: £2.1m).

Nigel Lingwood was Senior Independent Director and Chairman of the Audit Committee at Creston plc until his resignation on 22 December 2016 and received £20,000 as fees during the year ended 30 September 2017.

Base salary
The average base salary increase for Executive Directors which applied from 1 October 2016 was 2.5%, compared with 4% for the Group's senior management cadre. On 14 November 2017, the Committee approved an increase of 3.0% in base salaries for the Executive Directors which will apply in respect of the year beginning 1 October 2017.

Benefits

	2017				2016			
	Cash allowance in lieu of a car £000	Life assurance and income protection £000	Medical insurance £000	Total benefit £000	Cash allowance in lieu of a car £000	Life assurance and income protection £000	Medical insurance £000	Total benefit £000
Bruce Thompson	13	7	4	24	13	10	1	24
Nigel Lingwood	11	6	1	18	11	7	1	19

Pension
The Executive Directors receive pension contributions from the Company which they may pay into personal savings vehicles or may take as a separate cash allowance, subject to income tax.

Pension contributions, which are equivalent to 20% (2016: 20%) of base salary were applied as follows:

	2017			2016		
	Paid as cash allowance £000	Paid as pension contribution £000	Total cash paid £000	Paid as cash allowance £000	Paid as pension contribution £000	Total cash paid £000
Bruce Thompson	97	–	97	95	–	95
Nigel Lingwood	63	–	63	61	–	61

Annual performance bonus

The following table summarises the performance assessment by the Committee in respect of 2017 with regard to the following performance measures:

(1) Group financial objectives – Bruce Thompson: 100% of bonus; Nigel Lingwood: 75% of bonus

Performance measure	Performance in 2017	Overall assessment against targets
Adjusted EPS	The minimum performance target was 100% of 2016 adjusted EPS of 41.9p, the on-target performance was 45.9p (which was equivalent to 10% above 2016 adjusted EPS) and the maximum target was at least 15% growth above 2016 adjusted EPS at 48.2p. Adjusted EPS grew by 19% to 49.8p. Minimum thresholds were exceeded for adjusted operating margins, free cash flow and ROATCE.	100% of maximum

(2) Individual objectives – Nigel Lingwood: 25% of bonus

The performance of Nigel Lingwood was assessed against a range of specific individual objectives under the following headings:

Performance measure	Performance in 2017	Overall assessment against targets
Nigel Lingwood	Strong level of achievement across a range of specific individual objectives, including re-negotiating bank facilities on significantly improved terms; strengthening and extending scope of internal audit and improving general control environment; developing and executing successful Capital Markets Day; establishing a robust cybersecurity programme across the Group; managing several facility relocations and related investments.	95% of maximum

Based on the performance set out above, the resulting bonus for each Executive Director relating to 2017 is as follows:

	2017 actual bonus – as a percentage of 2017 base salary						2017 bonus delivered as cash
	Minimum	On-target	Maximum	Financial objectives	Individual performance objectives	Total bonus	£000
Bruce Thompson	5%	63%	125%	125.0%		125.0%	607
Nigel Lingwood	5%	50%	100%	75.0%	23.8%	98.8%	310

The Annual Performance Bonus for the financial year beginning 1 October 2017 will be in accordance with the new revised Policy set out on page 53. The financial performance targets set for the Annual Performance Bonus will be disclosed in next year's Annual Report & Accounts.

Long term incentive awards

Performance conditions

Set out below is a summary of the performance conditions that apply to both the long-term incentive awards which vest in 2017 and the outstanding PSP awards, including those granted in December 2015 and December 2016. PSP awards since 1 October 2014 have been granted at 175% of base salary. The performance conditions applying to these awards made under the PSP are set out below. The Committee has confirmed that the same performance conditions will be applied to PSP awards made in December 2017.

The first performance condition for the PSP awards is that the average annual compound growth in the Company's adjusted EPS, over the three consecutive financial years following the financial year immediately prior to the grant, must exceed the specified absolute figures. The performance conditions are as follows:

Adjusted EPS growth (over three years)	% of awards vesting PSP
14% p.a.	100
5% p.a.	25
Below 5% p.a.	Nil

Where the Company's adjusted EPS performance is between these percentage bands, vesting of the award is on a straight-line basis. For the purposes of this condition, EPS is adjusted EPS as defined in note 2 to the consolidated financial statements and this definition remains consistent with the definition of adjusted EPS approved by the Committee in previous years.

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 250 Index (excluding Investment Trusts). The performance conditions are as follows:

	% of awards vesting PSP
Upper quartile	100
Median	25
Below median	Nil

Remuneration Committee Report continued

Annual Report on Remuneration continued

Where the Company's TSR performance is between these percentage bands, vesting of the award is on a straight-line basis. The FTSE 250 Index was chosen because this is a recognised broad equity market index of which the Company is a member.

Awards vesting in 2017

The PSP awards made to the Executive Directors on 5 February 2015, were subject to operating performance conditions as set out in the table above, independently assessed over a three-year period ended 30 September 2017. The outcome of each award is shown in the table below:

Adjusted earnings per share:	Base EPS	EPS at 30 Sep 2017	CAGR in EPS	Maximum target	Maximum award	Vested award
PSP (5 February 2015)	36.1p	**49.8p**	11.3%	14.0%	50%	**38.8%**

TSR growth against FTSE 250 (excluding Investment Trusts):	TSR at 30 Sep 2017	Median	Maximum target	Maximum award	Vested award
PSP (5 February 2015)[1]	**20.1% p.a.**	7.3% p.a.	19.4% p.a.	50%	**50.0%**

As a result of the above performance conditions, 88.8% of the shares awarded as nil cost options vested to each Director under the PSP award made on 5 February 2015. Set out below are the shares which vested to each Executive Director at 30 September 2017 in respect of these awards.

	Share price at date of grant pence	Share price at 30 Sep 2017 pence	Proportion of award vesting	Shares vested Number	Performance element[1] £000	Share appreciation element[2] £000	Total £000
Bruce Thompson – PSP	755.5p	**1059.0p**	**88.8%**	**94,565**	**714**	**287**	**1,001**
Nigel Lingwood – PSP	755.5p	**1059.0p**	**88.8%**	**61,056**	**461**	**186**	**647**

1 The performance element represents the face value of awards that vested, having met the performance conditions set out above.
2 The share appreciation element represents the additional value generated through appreciation of the share price from the date the awards were granted to the end of the three -year performance period on 30 September 2017.

Dividend equivalent payments

There were no dividend equivalent payments paid in respect of outstanding nil cost options which vested in the prior year on 30 September 2016. Dividend equivalent payments of £42,743 and £27,597 will be payable to Bruce Thompson and Nigel Lingwood respectively, in respect of awards which vested on 30 September 2017 and these are accounted for in this year's Annual Report on Remuneration.

Long term incentive plan – awards granted in the year

The CEO and Group Finance Director received grants of PSP awards on 22 December 2016, in the form of nil-cost options. These awards were based on a share price of 997.5p, being the mid-market price of an ordinary share in the Company at close of business on the day immediately preceding the award.

Under normal circumstances, the options will not become exercisable until the performance conditions are determined after the end of the three-year measurement period which begins on the first day of the financial year in which the award is made and provided the Director remains in employment. The level of vesting is dependent on the achievement of specified performance criteria at the end of the three-year measurement period. The performance conditions for these awards are set out on page 59.

Outstanding share-based performance awards

Set out below is a summary of the share-based awards outstanding at 30 September 2017, including both share awards which have vested during the year based on performance and share awards which have been granted during the year. The awards set out below were granted based on a face value limit of 175% of base salary at December 2016. No awards will vest unless the performance conditions set out on page 59 are achieved over a three-year measurement period.

Diploma PLC 2011 Performance Share Plan

	Market price at date of award	Face value of the award at date of grant £000	End of performance period	Maturity date	Shares over which awards held at 1 Oct 2016	Shares over which awards granted during the year	Vested during the period	Lapsed during the period	Shares over which awards held at 30 Sep 2017
Bruce Thompson									
5 February 2015	755.5p	805	30 Sep 2017	30 Sep 2017	106,552	–	**94,565**	**11,987**	–
17 December 2015	730.0p	829	30 Sep 2018	30 Sep 2018	113,630	–	–	–	**113,630**
22 December 2016	997.5p	850	30 Sep 2019	30 Sep 2019	–	**85,263**	–	–	**85,263**
Nigel Lingwood									
5 February 2015	755.5p	520	30 Sep 2017	30 Sep 2017	68,795	–	**61,056**	**7,739**	–
17 December 2015	730.0p	535	30 Sep 2018	30 Sep 2018	73,356	–	–	–	**73,356**
22 December 2016	997.5p	549	30 Sep 2019	30 Sep 2019	–	**55,035**	–	–	**55,035**

The PSP awards vest on the date on which the performance conditions are determined and confirmed by the Committee, following the end of the performance period.

The PSP awards are granted in the form of nil-cost options (there is a notional exercise price of £1 per award). To the extent that the awards vest, the options are then exercisable until the tenth anniversary of the award date. Details of options exercised during the year and outstanding at 30 September 2017 are set out on page 62.

Services from external advisors (unaudited)
Stephenson Harwood LLP provide legal advice to the Remuneration Committee on remuneration matters and Ashurst LLP provide advice on employment matters. During the year Stephenson Harwood LLP provided advice to the Remuneration Committee on matters relating to the Directors' Remuneration Policy.

The Committee also received advice and assistance from Aon Hewitt in connection with the Committee's review of the Company's Remuneration Policy this year. The Committee engages MEIS to provide certain data analyses to the Committee.

The Committee has considered and is satisfied that the advice received from the external advisors it has appointed is objective and independent.

Advisor	Appointed by	Services provided to the Committee	Other services provided to the Company	Fees
Stephenson Harwood LLP	Committee	Legal advice	None	£8,000
Aon Hewitt	Committee	Remuneration advice	None	£15,000
MEIS	Committee	Data analysis	None	£7,000

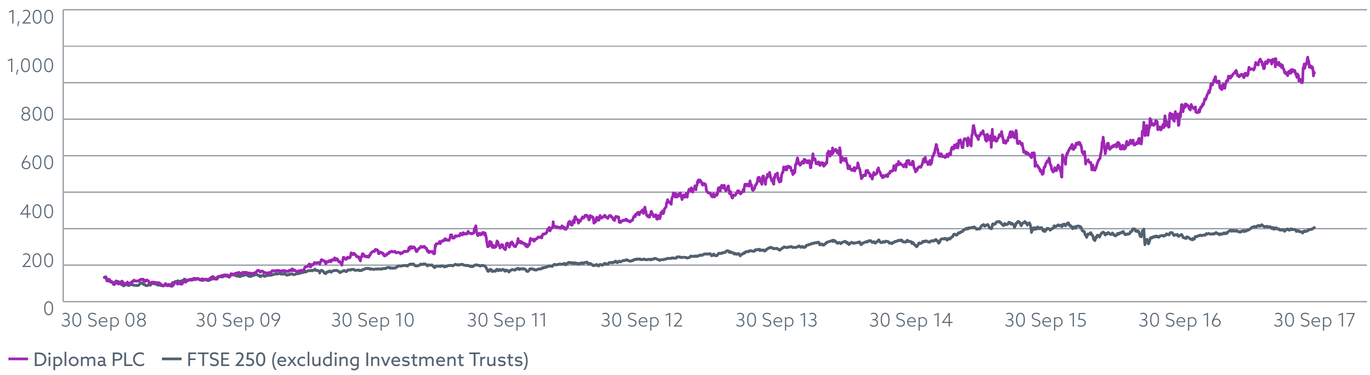
Shareholder voting at previous Annual General Meeting (unaudited)
The Remuneration Committee's Annual Report ("Report") for the year ended 30 September 2016 was approved by shareholders at the AGM held on 18 January 2017, with the following votes being cast:

Votes for	88,141,059	96.63%
Votes against	3,077,684	3.37%
Withheld	1,642,882	

There was no requirement to propose a resolution on the Policy at the AGM held in 2017 and shareholders will be asked to vote on the revised proposed Remuneration Policy at the AGM on 17 January 2018, as set out in the Policy Table on pages 53 and 54. The votes in favour of the Policy at the AGM held on 21 January 2015 was 94.6%.

Aligning pay with performance (unaudited)
The graph below shows the Total Shareholder Return ("TSR") performance of Diploma PLC for the nine-year period ended 30 September 2017 against the FTSE 250 Index as the Company is a member of this Index.

Growth in the value of a hypothetical £100 holding over nine years



TSR is defined as the return on investment obtained from holding a company's shares over a period. It includes dividends paid, the change in the capital value of the shares and other payments to or by shareholders within the period.

Remuneration Committee Report continued

Annual Report on Remuneration continued

Chief Executive Officer remuneration compared with annual growth in TSR

	2017	2016	2015	2014	2013	2012	2011	2010	2009
Annual growth in TSR	**+24%**	+36%	–1%	+8%	+42%	+54%	+16%	+71%	+21%
	£000	£000	£000	£000	£000	£000	£000	£000	£000
Salary, pensions and benefits	**607**	593	575	523	504	484	454	435	429
Annual performance bonus	**607**	565	294	339	164	367	360	345	102
Short term remuneration	**1,214**	1,158	869	862	668	851	814	780	531
Long term incentive plans (including dividend equivalent)	**1,044**	476	270	984	1,733	979	887	507	303
CEO total remuneration	**2,258**	1,634	1,139	1,846	2,401	1,830	1,701	1,287	834
Actual bonus as a percentage of the maximum	**100%**	95%	51%	65%	33%	95%	100%	100%	30%
Actual share award vesting as a percentage of the maximum	**89%**	45%	25%	61%	100%	100%	100%	100%	91%

Set out below is the change over the prior year in base salary, benefits, pension, annual performance bonus and short term remuneration of the Chief Executive Officer and the Group's senior management cadre.

	Change in base salary %	Change in pension %	Change in benefits %	Change in annual performance bonus %
Chief Executive Officer	+3	+3	–	+7
Senior management cadre	+4	+2	–	+15

The Committee chose the senior management cadre for pay comparisons with the Chief Executive Officer as it provided the most closely aligned comparator group, considering the global and diverse nature of the Group's business.

Relative importance of Executive Director remuneration (unaudited)

	2017 £m	2016 £m	Change £m
Total employee remuneration	**86.4**	75.8	10.6
Total dividends paid	**23.5**	21.0	2.5

Executive Directors' interest in options over shares

In respect of nil cost options granted under the PSP, the remuneration receivable by an Executive Director is calculated on the date that the options first vest. The remuneration of the Executive Director is the difference between the amount the Executive Director is required to pay to exercise the options to acquire the shares and the total value of the shares on the vesting date.

If the Executive Director chooses not to exercise the nil cost options on the vesting date (he may exercise the options at any time up to the day preceding the tenth anniversary of the date of grant), any subsequent increase or decrease in the amount realised will be due to movements in the underlying share price between the initial vesting date and the date of exercise of the option. This increase or decrease in value reflects an investment decision by the Executive Director and, as such, is not recorded as remuneration.

The nil cost options outstanding at 30 September 2017 and the movements during the year are as follows:

	Year of vesting	Options as at 1 Oct 2016	Exercised in year	Vested during the year	Options unexercised as at 30 Sep 2017[4]	Exercise price	Earliest normal exercise date	Expiry date
Bruce Thompson	2016	53,436	53,436	–	**–**	£1	Nov 2016	Dec 2023
	2017	–	–	94,565	**94,565**	£1	Nov 2017	Feb 2025
Nigel Lingwood	2016	34,599	34,599	–	**–**	£1	Nov 2016	Dec 2023
	2017	–	–	61,056	**61,056**	£1	Nov 2017	Feb 2025

1 Bruce Thompson exercised 53,436 options on 30 November 2016, at a market price of 924.0p per share and the total proceeds before tax were £493,748.
2 Nigel Lingwood exercised 34,599 options on 30 November 2016, at a market price of 924.0p per share and the total proceeds before tax were £319,694.
3 On 30 November 2016, the aggregate number of shares received by the participants was reduced by 41,376 shares as part of arrangements under which the Company settled the PAYE liability that arose as a result of the exercise in full by the Executive Directors of options held over shares. The market price at that time was 924.0p.
4 The closing price of an ordinary share on 30 September 2017 was 1059.0p (2016: 879.0p).

Executive Directors' interests in ordinary shares

The Executive Directors' interests in ordinary shares of the Company were as follows:

	As at 30 Sep 2017			As at 30 Sep 2016		
	Ordinary shares	Options vested but unexercised	Interest in shares with performance measures	Ordinary shares	Options vested but unexercised	Interest in shares with performance measures
Bruce Thompson	**570,000**	**94,565**	**198,893**	850,000	53,436	220,182
Nigel Lingwood	**200,000**	**61,056**	**128,391**	275,000	34,599	142,151

Interests in ordinary shares include shares held through personal saving vehicles. As of 20 November 2017, there have been no changes to these interests in ordinary shares of the Company.

At 30 September 2017 the ordinary shares held by Bruce Thompson and Nigel Lingwood represented 1,242% and 675% of their base salaries respectively. As set out on page 57, the Committee has set a minimum shareholding guideline of 200% for the Executive Directors.

Chairman and non-Executive Directors' remuneration

Individual remuneration for the year ended 30 September was as follows:

	Total fees	
	2017 £000	2016 £000
John Nicholas	**140**	137
Charles Packshaw	**54**	52
Andy Smith	**54**	52
Anne Thorburn	**54**	52

The non-Executive Directors received a basic annual fee of £48,600 during the year and there were additional fees paid in 2017 of £5,000 (2016: £5,000) for chairing a Committee of the Board or for acting as Senior Independent Director. The fees for non-Executive Directors are reviewed every year by the Board, taking into account their responsibilities and required time commitment. Following a review undertaken on 14 November 2017, the Board approved an increase of 3% in the Chairman's fee to £144,600 p.a. and in the total annual fee paid to non-Executive Directors to £55,000, both to take effect from 1 October 2017.

Chairman and non-Executive Directors' interests in ordinary shares

The non-Executive Directors' interests in ordinary shares of the Company at the start and at the end of the financial year were as follows:

	Interest in ordinary shares	
	As at 30 Sep 2017	As at 30 Sep 2016
John Nicholas	**5,000**	5,000
Charles Packshaw	**1,500**	1,500
Andy Smith	**5,500**	5,500
Anne Thorburn	**3,000**	3,000

Senior executives below the Board

The policies and practices with regard to the remuneration of senior executives below the Executive Directors are generally treated consistently with the Executive Directors. These senior executives all have a significant portion of their reward package linked to performance. Annual bonuses are linked to short term financial targets which use similar performance metrics to the targets for the Executive Directors. Members of the Executive Management Group ("EMG") participate in the Diploma PLC 2011 Performance Share Plan described further on page 55. Senior management outside the EMG participate in cash based long term incentive plans which are focused on the operating profit growth of their businesses over rolling three-year periods.

Set out below is a summary of the share-based awards outstanding at 30 September 2017 which have been granted to members of the EMG, including share awards which have vested during the year based on performance and share awards which have been granted both last year and during this year. The awards set out below were granted based on a face value limit that varied between 30% and 60% of base salary. No awards will vest unless the performance conditions set out on page 59 are achieved over a three-year measurement period.

Diploma PLC 2011 Performance Share Plan

	Market price at date of award	Face value of the award at date of grant £000	End of performance period	Maturity date	Shares over which awards held at 1 Oct 2016	Shares over which awards granted during the year	Vested during the period	Lapsed during the period	Shares over which awards held at 30 Sep 2017
5 February 2015	755.5p	161	30 Sep 2017	30 Sep 2017	21,364	**–**	**18,961**	**2,403**	**–**
17 December 2015	730.0p	159	30 Sep 2018	30 Sep 2018	21,781	**–**	**–**	**–**	**21,781**
22 December 2016	997.5p	390	30 Sep 2019	30 Sep 2019	–	**39,126**	**–**	**–**	**39,126**

Directors' Report

This section contains information which the Directors are required by law and regulation to include within the Annual Report & Accounts.

Shareholders

Incorporation and principal activity

Diploma PLC is domiciled in England and registered in England and Wales under Company Number 3899848. At the date of this Report there were 113,239,555 ordinary shares of 5p each in issue, all of which are fully paid up and quoted on the London Stock Exchange.

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 on pages 4 to 37; the Strategic Report on pages 1 to 37 incorporates the requirements of the Companies Act 2006 ("the Act").

Annual General Meeting

The Annual General Meeting ("AGM") will be held at midday on Wednesday, 17 January 2018 in the Brewers Hall, Aldermanbury Square, London EC2V 7HR. The Notice of the AGM, which is a separate document, will be sent to all shareholders and will be published on the Diploma PLC website.

Substantial shareholdings

At 17 November 2017, the Company had been notified of the following interests amounting to 3% or more of the voting rights in its ordinary share capital:

	Percentage of ordinary share capital
Fidelity Management & Research Co.	9.26
Mondrian Investment Partners Limited	7.26
Mawer Investment Management Limited	6.49
Standard Life Aberdeen plc	6.41
Royal London Asset Management Limited	4.95
BlackRock, Inc.	3.30
Norges Bank Investment Management	3.03

As far as the Directors are aware,- there were no other interests above 3% of the issued ordinary share capital.

Share capital

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 Group Company Secretary and are available on the Company's website.

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.

Restrictions on transfer of shares

The Directors may refuse to register a transfer of a certificated share that is not fully paid, provided that the refusal does not prevent dealings in shares in the Company from taking place on an open and proper basis, or where the Company has lien over that share. The Directors may also refuse to register a transfer of a certificated share, unless the instrument of transfer is: (i) lodged, duly stamped (if necessary), at the registered office of the Company or any other place as the Board may decide accompanied by the certificate for the share(s) to be transferred and/or such other evidence as the Directors may reasonably require to show the right of the transferor to make the transfer; (ii) in respect of only one class of shares; (iii) in favour of a person who is not a minor, infant, bankrupt or a person of unsound mind; or (iv) in favour of not more than four persons jointly.

Transfers of uncertificated shares must be carried out using CREST and the Directors can refuse to register a transfer of an uncertified share in accordance with the regulations governing the operation of CREST.

Participants in the Company's Performance Share Plan ("the PSP"), who have yet to meet shareholding guidelines, have vested PSP shares held in trust until the earlier occurrence of them meeting their required shareholder guideline or for a period of two years, during which period these shares cannot be transferred to them. There are no other restrictions on the transfer of ordinary shares in the Company except certain restrictions which may from time to time be imposed by laws and regulations (for example insider trading laws); or where a shareholder with at least a 0.25% interest in the Company's certified shares has been served with a disclosure notice and has failed to provide the Company with information concerning interests in those shares.

Shares held by the Diploma PLC Employee Benefit Trust

While ordinary shares are held within the Diploma PLC Employee Benefit Trust, the voting rights in respect of those shares are exercisable by the Trustees in accordance with their fiduciary duties. The Trustees of the Diploma PLC Employee Benefit Trust also waive dividends on all shares held for the purposes of the Company's long term incentive arrangements.

Share allotment

A general allotment power and a limited power to allot shares in specific circumstances for cash, otherwise than pro rata to existing shareholders, were given to the Directors by resolutions approved at the AGM of the Company held on 18 January 2017. In the year ended 30 September 2017, the Company has not allotted any shares. These powers will expire at the conclusion of the 2018 AGM and resolutions to renew the Directors' powers are therefore included within the Notice of the AGM in 2018.

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 AGM of the Company held on 18 January 2017. In the year to 30 September 2017 the Company has not acquired any of its own shares. This authority will expire at the conclusion of the 2018 AGM and a resolution to renew the authority is therefore included within the Notice of the AGM in 2018.

Financial

Results and dividends

The profit for the financial year attributable to shareholders was £47.5m (2016: £38.3m). The Directors recommend a final dividend of 16.0p per ordinary share (2016: 13.8p), to be paid, if approved, on 24 January 2018. This, together with the interim dividend of 7.0p (2016: 6.2p) per ordinary share paid on 14 June 2017 amounts to 23.0p for the year (2016: 20.0p).

The results are shown more fully in the consolidated financial statements on pages 66 to 94 and summarised in the Finance Review on pages 28 to 31.

Independent auditor

The Company held a competitive tender process during 2017 for its statutory audit contract, which was overseen by the Audit Committee. On completion of this process the Board, on the recommendation of the Audit Committee, proposed that PricewaterhouseCoopers LLP ("PwC") shall be appointed auditor. The appointment of PwC is subject to approval of shareholders at the Annual General Meeting on 17 January 2018. Deloitte LLP ("Deloitte"), the current external auditor, have undertaken the audit of the Group and Company for the financial year ended 30 September 2017.

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 Strategic Report on pages 1 to 37. The financial position of the Group, its cash flows, liquidity position and borrowing facilities are described in the Finance Review on pages 28 to 31. In addition, pages 79 to 81 of the Annual Report & Accounts include 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 as described further on pages 32 to 35.

The Group also has a committed multi-currency revolving bank facility of £30.0m with an accordion option to increase the committed facility by a further £30.0m up to a maximum of £60.0m. This facility expires on 31 May 2020, with an option to extend the facility to 31 May 2022. At 30 September 2017, the Group had cash funds of £22.3m and had no borrowings.

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 & Accounts.

Statement of disclosure
Each of the Directors has reviewed this Annual Report & Accounts and confirmed that so far as he is aware, there is no relevant audit information of which the Company's auditor is unaware and that he has taken all the 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 auditor is aware of that information. This confirmation is given and should be interpreted in accordance with the provisions of the Companies Act 2006.

Statement of Directors' responsibilities for preparing the financial statements
The Directors are responsible for preparing the Annual Report & Accounts, 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 IFRS 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) including FRS101 ("Reduced Disclosures Framework").

The Group financial statements are required by law and IFRS as adopted by the EU, to present fairly the financial position and the performance of the Group; the Act 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 Parent 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 IFRS, 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; and
- 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 adequate accounting records that are sufficient to show and explain the Parent Company's transactions and disclose with reasonable accuracy at any time the financial position of the Parent Company and enable them to ensure that the financial statements comply with the Act. They are also responsible for safeguarding the assets of the Parent Company and hence for taking reasonable steps for the prevention and detection of 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.

Directors' Responsibility Statement
The Directors confirm that to the best of their knowledge:

- the Group's consolidated financial statements, prepared in accordance with IFRS 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;
- the Annual Report & Accounts 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; and
- the Annual Report & Accounts, taken as a whole, are fair, balanced and understandable and provides the information necessary for shareholders to assess the Company's performance, business model and strategy.

This responsibility statement was approved by the Board of Directors on 20 November 2017 and is signed on its behalf by:

BM Thompson
Chief Executive Officer

NP Lingwood
Group Finance Director

Registered office:
12 Charterhouse Square
London
EC1M 6AX

Consolidated Income Statement

For the year ended 30 September 2017

	Note	2017 £m	2016 £m
Revenue	3,4	**451.9**	382.6
Cost of sales		**(290.8)**	(245.4)
Gross profit		**161.1**	137.2
Distribution costs		**(10.6)**	(8.4)
Administration costs		**(82.0)**	(73.4)
Operating profit	3	**68.5**	55.4
Gain on disposal of assets		**–**	0.7
Financial expense	6	**(1.7)**	(2.1)
Profit before tax		**66.8**	54.0
Tax expense	7	**(18.6)**	(14.9)
Profit for the year		**48.2**	39.1
Attributable to:			
Shareholders of the Company		**47.5**	38.3
Minority interests	21	**0.7**	0.8
		48.2	39.1
Earnings per share			
Basic and diluted earnings	9	**42.0p**	33.9p

Alternative Performance Measures (Note 2)

	Note	2017 £m	2016 £m
Operating profit		**68.5**	55.4
Add: Acquisition related charges	11	**9.7**	10.3
Adjusted operating profit	3,4	**78.2**	65.7
Deduct: Interest expense	6	**(0.7)**	(0.8)
Adjusted profit before tax		**77.5**	64.9
Adjusted earnings per share	9	**49.8p**	41.9p

The notes on pages 70 to 92 form part of these consolidated financial statements.

Consolidated Statement of Income and Other Comprehensive Income

For the year ended 30 September 2017

	Note	2017 £m	2016 £m
Profit for the year		**48.2**	39.1
Items that will not be reclassified to the Consolidated Income Statement			
Actuarial gains/(losses) in the defined benefit pension schemes	25c	**7.1**	(6.6)
Deferred tax on items that will not be reclassified	7	**(1.3)**	1.0
		5.8	(5.6)
Items that may be reclassified to Consolidated Income Statement			
Exchange rate (losses)/gains on foreign currency net investments		**(0.8)**	31.7
(Losses)/gains on fair value of cash flow hedges	19	**(1.0)**	0.2
Net changes to fair value of cash flow hedges transferred to the Consolidated Income Statement	19	**(0.2)**	(1.5)
Deferred tax on items that may be reclassified	7	**0.3**	0.3
		(1.7)	30.7
Total Comprehensive Income for the year		**52.3**	64.2
Attributable to:			
Shareholders of the Company		**51.6**	62.7
Minority interests		**0.7**	1.5
		52.3	64.2

Consolidated Statement of Changes in Equity

For the year ended 30 September 2017

	Note	Share capital £m	Translation reserve £m	Hedging reserve £m	Retained earnings £m	Shareholders' equity £m	Minority interests £m	Total equity £m
At 1 October 2015		5.7	(0.5)	1.2	183.2	**189.6**	5.2	**194.8**
Total Comprehensive Income		–	31.0	(1.0)	32.7	**62.7**	1.5	**64.2**
Share-based payments	5	–	–	–	0.4	**0.4**	–	**0.4**
Minority interests acquired	21	–	–	–	2.0	**2.0**	(2.0)	**–**
Tax on items recognised directly in equity	7	–	–	–	0.1	**0.1**	–	**0.1**
Notional purchase of own shares		–	–	–	(0.3)	**(0.3)**	–	**(0.3)**
Dividends	8,21	–	–	–	(21.0)	**(21.0)**	(0.4)	**(21.4)**
At 30 September 2016		5.7	30.5	0.2	197.1	**233.5**	4.3	**237.8**
Total Comprehensive Income		–	(0.8)	(0.9)	53.3	**51.6**	0.7	**52.3**
Share-based payments	5	–	–	–	0.8	**0.8**	–	**0.8**
Minority interests acquired		–	–	–	–	**–**	–	**–**
Tax on items recognised directly in equity	7	–	–	–	0.3	**0.3**	–	**0.3**
Notional purchase of own shares		–	–	–	(0.7)	**(0.7)**	–	**(0.7)**
Dividends	8,21	–	–	–	(23.5)	**(23.5)**	(0.2)	**(23.7)**
At 30 September 2017		**5.7**	**29.7**	**(0.7)**	**227.3**	**262.0**	**4.8**	**266.8**

The notes on pages 70 to 92 form part of these consolidated financial statements.

Consolidated Statement of Financial Position

As at 30 September 2017

	Note	2017 £m	2016 £m
Non-current assets			
Goodwill	10	**122.8**	115.2
Acquisition intangible assets	11	**54.0**	54.6
Other intangible assets	11	**0.7**	1.0
Investment	12	**0.7**	0.7
Property, plant and equipment	13	**22.6**	23.7
Deferred tax assets	14	**0.2**	0.2
		201.0	195.4
Current assets			
Inventories	15	**73.2**	66.8
Trade and other receivables	16	**68.9**	59.9
Cash and cash equivalents	18	**22.3**	20.6
		164.4	147.3
Current liabilities			
Trade and other payables	17	**(69.7)**	(60.6)
Current tax liabilities	7	**(4.0)**	(2.7)
Other liabilities	20	**(2.5)**	(1.7)
Borrowings	24	**–**	(10.0)
		(76.2)	(75.0)
Net current assets		**88.2**	72.3
Total assets less current liabilities		**289.2**	267.7
Non-current liabilities			
Retirement benefit obligations	25	**(9.9)**	(17.2)
Other liabilities	20	**(4.1)**	(5.1)
Deferred tax liabilities	14	**(8.4)**	(7.6)
Net assets		**266.8**	237.8
Equity			
Share capital		**5.7**	5.7
Translation reserve		**29.7**	30.5
Hedging reserve		**(0.7)**	0.2
Retained earnings		**227.3**	197.1
Total shareholders' equity		**262.0**	233.5
Minority interests	21	**4.8**	4.3
Total equity		**266.8**	237.8

The consolidated financial statements were approved by the Board of Directors on 20 November 2017 and signed on its behalf by:

BM Thompson
Chief Executive Officer

NP Lingwood
Group Finance Director

The notes on pages 70 to 92 form part of these consolidated financial statements.

Consolidated Cash Flow Statement

For the year ended 30 September 2017

	Note	2017 £m	2016 £m
Operating profit		**68.5**	55.4
Acquisition related charges	23	**9.7**	10.3
Non-cash items	23	**5.1**	4.6
(Increase)/decrease in working capital	23	**(4.0)**	6.3
Cash flow from operating activities	23	**79.3**	76.6
Interest paid		**(0.4)**	(0.6)
Tax paid		**(19.3)**	(17.6)
Net cash from operating activities		**59.6**	58.4
Cash flow from investing activities			
Acquisition of businesses (including expenses)	22	**(19.5)**	(30.1)
Deferred consideration paid	20	**(0.6)**	(0.7)
Proceeds from sale of business (net of expenses)		**–**	2.2
Purchase of property, plant and equipment	13	**(3.1)**	(3.5)
Purchase of other intangible assets	11	**(0.2)**	(0.2)
Proceeds from sale of property, plant and equipment		**0.1**	2.4
Net cash used in investing activities		**(23.3)**	(29.9)
Cash flow from financing activities			
Acquisition of minority interests	20	**–**	(1.9)
Dividends paid to shareholders	8	**(23.5)**	(21.0)
Dividends paid to minority interests	21	**(0.2)**	(0.4)
Notional purchase of own shares on exercise of share options		**(0.7)**	(0.3)
Repayment of borrowings, net	24	**(10.0)**	(10.0)
Net cash used in financing activities		**(34.4)**	(33.6)
Net increase/(decrease) in cash and cash equivalents		**1.9**	(5.1)
Cash and cash equivalents at beginning of year		**20.6**	23.0
Effect of exchange rates on cash and cash equivalents		**(0.2)**	2.7
Cash and cash equivalents at end of year	18	**22.3**	20.6

Alternative Performance Measures (Note 2)

	Note	2017 £m	2016 £m
Net increase/(decrease) in cash and cash equivalents		**1.9**	(5.1)
Add: Dividends paid to shareholders	8	**23.5**	21.0
Dividends paid to minority interests	21	**0.2**	0.4
Acquisition of businesses (including expenses)	22	**19.5**	30.1
Acquisition of minority interests	20	**–**	1.9
Deferred consideration paid	20	**0.6**	0.7
Repayment of borrowings, net	24	**10.0**	10.0
Free cash flow		**55.7**	59.0
Cash and cash equivalents	18	**22.3**	20.6
Borrowings	24	**–**	(10.0)
Net cash	24	**22.3**	10.6

The notes on pages 70 to 92 form part of these consolidated financial statements.

Notes to the Consolidated Financial Statements

For the year ended 30 September 2017

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 20 November 2017. These statements are presented in UK sterling, with all values rounded to the nearest 100,000, except where otherwise indicated.

The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRSs"), as adopted by the European Union ("EU") 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 FRS101 "Reduced Disclosure Framework" and are set out in a separate section of the Annual Report & Accounts on pages 93 and 94.

2. Alternative performance measures

The Group uses a number of alternative (non-Generally Accepted Accounting Practice ("non-GAAP")) performance measures which are not defined within IFRS. The Directors use these measures for internal management reporting in order to assess the operational performance of the Group on a comparable basis 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 & Accounts:

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 expenses, adjustments to deferred consideration (collectively, "acquisition related charges"), the costs of a material restructuring or rationalisation of operations and the profit or loss relating to the sale of businesses or property. The Directors believe that adjusted operating profit is an important measure of the 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 adjusted operating profit, after finance expenses (but before fair value remeasurements under IAS39 in respect of future purchases of minority interests) and before tax. The Directors believe that adjusted profit before tax is an important measure of the operational performance of the Group.

2.3 Adjusted earnings per share

"Adjusted earnings per share" ("EPS") is calculated as the total of adjusted profit before tax, less income tax costs, but including the tax impact on the items included in the calculation of adjusted profit, 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 EPS provides an important measure of the 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/investments 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 or distribution to shareholders.

2.5 Trading capital employed and ROATCE

In the Sector analysis in note 3, "trading capital employed" is reported, being defined as net assets less cash and cash equivalents and after adding back: borrowings; retirement benefit obligations; deferred tax; and acquisition liabilities in respect of future purchases of minority interests and deferred consideration. Adjusted trading capital employed is reported as being trading capital employed plus goodwill and acquisition related charges previously written off (net of deferred tax on acquisition intangible assets). Return on adjusted trading capital employed ("ROATCE") at the Group and Sector level is defined as the adjusted operating profit, divided by adjusted trading capital employed and adjusted for the timing effect of major acquisitions and disposals. The Directors believe that ROATCE is an important measure of the profitability of the Group.

3. Business Sector analysis

The Chief Operating Decision Maker ("CODM") for the purposes of IFRS8 is the Chief Executive Officer. The financial performance of the Sectors are reported to the CODM on a monthly basis and this information is used to allocate resources on an appropriate basis.

For management reporting purposes, the Group is organised into three main reportable business Sectors: Life Sciences, Seals and Controls. These Sectors form the basis of the primary reporting format disclosures below. The principal activities of each of these Sectors is described in the Strategic Report on pages 1 to 37. Sector revenue represents revenue from external customers; there is no inter-Sector revenue. Sector results, assets and liabilities include items directly attributable to a Sector, as well as those that can be allocated on a reasonable basis.

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

3. Business Sector analysis continued

	Life Sciences		Seals		Controls		Group	
	2017 £m	2016 £m	**2017 £m**	2016 £m	**2017 £m**	2016 £m	**2017 £m**	2016 £m
Revenue – existing	**118.3**	109.9	**193.2**	166.6	**130.7**	106.1	**442.2**	382.6
Revenue – acquisitions	**7.6**	–	**2.1**	–	**–**	–	**9.7**	–
Revenue	**125.9**	109.9	**195.3**	166.6	**130.7**	106.1	**451.9**	382.6
Adjusted operating profit – existing	**22.1**	19.6	**31.5**	28.2	**23.0**	17.9	**76.6**	65.7
Adjusted operating profit – acquisitions	**1.2**	–	**0.4**	–	**–**	–	**1.6**	–
Adjusted operating profit	**23.3**	19.6	**31.9**	28.2	**23.0**	17.9	**78.2**	65.7
Acquisition related charges	**(3.2)**	(2.9)	**(5.5)**	(5.0)	**(1.0)**	(2.4)	**(9.7)**	(10.3)
Operating profit	**20.1**	16.7	**26.4**	23.2	**22.0**	15.5	**68.5**	55.4

	Life Sciences		Seals		Controls		Group	
	2017 £m	2016 £m	**2017 £m**	2016 £m	**2017 £m**	2016 £m	**2017 £m**	2016 £m
Operating assets	**42.2**	35.1	**74.6**	70.3	**48.1**	44.4	**164.9**	149.8
Investment	**–**	–	**0.7**	0.7	**–**	–	**0.7**	0.7
Goodwill	**59.5**	52.8	**39.9**	39.1	**23.4**	23.3	**122.8**	115.2
Acquisition intangible assets	**15.4**	10.6	**27.0**	30.4	**11.6**	13.6	**54.0**	54.6
	117.1	98.5	**142.2**	140.5	**83.1**	81.3	**342.4**	320.3
Unallocated assets:								
– Deferred tax assets							**0.2**	0.2
– Cash and cash equivalents							**22.3**	20.6
– Corporate assets							**0.5**	1.6
Total assets	**117.1**	98.5	**142.2**	140.5	**83.1**	81.3	**365.4**	342.7
Operating liabilities	**(21.3)**	(17.9)	**(26.6)**	(22.9)	**(21.1)**	(18.8)	**(69.0)**	(59.6)
Unallocated liabilities:								
– Deferred tax liabilities							**(8.4)**	(7.6)
– Retirement benefit obligations							**(9.9)**	(17.2)
– Acquisition liabilities							**(6.6)**	(6.8)
– Corporate liabilities							**(4.7)**	(3.7)
– Borrowings							**–**	(10.0)
Total liabilities	**(21.3)**	(17.9)	**(26.6)**	(22.9)	**(21.1)**	(18.8)	**(98.6)**	(104.9)
Net assets	**95.8**	80.6	**115.6**	117.6	**62.0**	62.5	**266.8**	237.8

Alternative Performance Measures (Note 2)

	Life Sciences		Seals		Controls		Group	
	2017 £m	2016 £m	**2017 £m**	2016 £m	**2017 £m**	2016 £m	**2017 £m**	2016 £m
Net assets	**95.8**	80.6	**115.6**	117.6	**62.0**	62.5	**266.8**	237.8
Add/(less):								
– Deferred tax, net							**8.2**	7.4
– Retirement benefit obligations							**9.9**	17.2
– Acquisition liabilities							**6.6**	6.8
– Net cash funds							**(22.3)**	(10.6)
Reported trading capital employed							**269.2**	258.6
– Historic goodwill and acquisition related charges, net of deferred tax	**28.8**	28.0	**28.1**	22.7	**9.4**	8.5	**66.3**	59.2
Adjusted trading capital employed	**124.6**	108.6	**143.7**	140.3	**71.4**	71.0	**335.5**	317.8
Pro-forma adjusted operating profit[1]	**24.6**	19.6	**32.8**	28.2	**23.0**	19.2	**80.4**	67.0
ROATCE	**19.7%**	18.0%	**22.8%**	20.1%	**32.2%**	27.0%	**24.0%**	21.1%

1 After annualisation of adjusted operating profit of acquisitions and disposals.

Notes to the Consolidated Financial Statements continued

For the year ended 30 September 2017

3. Business Sector analysis continued

Other Sector information

	Life Sciences		Seals		Controls		Group	
	2017 £m	2016 £m	**2017 £m**	2016 £m	**2017 £m**	2016 £m	**2017 £m**	2016 £m
Capital expenditure	**2.0**	1.9	**1.1**	1.4	**0.2**	0.4	**3.3**	3.7
Depreciation and amortisation	**2.2**	2.0	**1.9**	1.9	**0.6**	0.6	**4.7**	4.5

4. Geographic segment analysis by origin

	Revenue		Adjusted operating profit		Non-current assets[1]		Trading capital employed		Capital expenditure	
	2017 £m	2016 £m	**2017 £m**	2016 £m	**2017 £m**	2016 £m	**2017 £m**	2016 £m	**2017 £m**	2016 £m
United Kingdom	**118.4**	97.4	**20.6**	16.1	**42.3**	42.3	**60.1**	59.6	**0.3**	0.5
Rest of Europe	**112.8**	98.3	**17.2**	15.0	**58.6**	62.7	**76.9**	79.2	**0.6**	1.0
North America	**188.3**	165.2	**36.3**	32.3	**70.9**	74.0	**99.9**	101.3	**1.9**	1.8
Rest of World	**32.4**	21.7	**4.1**	2.3	**28.3**	15.5	**32.3**	18.5	**0.5**	0.4
	451.9	382.6	**78.2**	65.7	**200.1**	194.5	**269.2**	258.6	**3.3**	3.7

1 Non-current assets exclude the investment and deferred tax assets.

5. Group employee costs

Average number of employees

	2017	2016
Life Sciences	**382**	387
Seals	**830**	813
Controls	**430**	388
Corporate	**16**	14
Number of employees – average	**1,658**	1,602
Number of employees – year end	**1,728**	1,598

Group employee costs, including key management

	2017 £m	2016 £m
Wages and salaries	**75.7**	66.5
Social security costs	**7.1**	6.4
Pension costs	**2.8**	2.5
Share-based payments	**0.8**	0.4
	86.4	75.8

Key management short term remuneration, including Directors

	2017 £m	2016 £m
Salaries and short term employee benefits	**3.2**	3.2
Pension costs	**0.3**	0.2
Share-based payments	**0.8**	0.4
	4.3	3.8

The Group considers key management personnel as defined in IAS24 "Related Party Disclosures" to be the Directors of the Company and the members of the Executive Management Group ("EMG") as set out on pages 38 and 39.

The Directors' remuneration and their interests in shares of the Company are given in the Remuneration Committee Report on pages 51 to 63. The EMG's interests in the Group's LTIP is set out on page 63. The charge for share-based payments of £0.8m (2016: £0.4m) relates to the Group's LTIP, described in the Remuneration Committee Report.

Directors' short term remuneration

	2017 £m	2016 £m
Non-executive Directors:	**0.3**	0.3
Executive Directors:	**1.9**	2.1
	2.2	2.4

6. Financial expense

	2017 £m	2016 £m
Interest expense and similar charges		
– bank facility and commitment fees	**(0.3)**	(0.2)
– interest payable on bank and other borrowings	**(0.1)**	(0.4)
– notional interest expense on the defined benefit pension scheme (note 25b)	**(0.3)**	(0.2)
Interest expense and similar charges	**(0.7)**	(0.8)
– fair value remeasurement of put options (note 20)	**(1.0)**	(1.3)
Financial expense	**(1.7)**	(2.1)

The fair value remeasurement of £1.0m (2016: £1.3m) comprises £0.5m (2016: £0.5m) which relates to the unwinding of the discount on the liability for future purchases of minority interests and a movement in the fair value of the put options of £0.5m debit (2016: £0.8m debit).

7. Tax expense

	2017 £m	2016 £m
Current tax		
The tax charge is based on the profit for the year and comprises:		
UK corporation tax	**3.7**	2.9
Overseas tax	**17.2**	13.7
	20.9	16.6
Adjustments in respect of prior year:		
UK corporation tax	**(0.5)**	(0.2)
Overseas tax	**0.2**	(0.2)
Total current tax	**20.6**	16.2
Deferred tax		
The net deferred tax credit based on the origination and reversal of timing differences comprises:		
United Kingdom	**(1.9)**	(1.6)
Overseas	**(0.1)**	0.3
Total deferred tax	**(2.0)**	(1.3)
Total tax on profit for the year	**18.6**	14.9

In addition to the above credit for deferred tax included in the Consolidated Income Statement, a net deferred tax debit relating to the retirement benefit scheme and cash flow hedges of £1.0m was debited (2016: £1.3m credit) directly to the Consolidated Statement of Income and Other Comprehensive Income. A further £0.3m of current tax (2016: £0.1m) was credited to the Consolidated Statement of Changes in Equity which relates to share-based payments made during the year.

Factors affecting the tax charge for the year
The difference between the total tax charge calculated by applying the effective rate of UK corporation tax of 19.5% to the profit before tax of £66.8m and the amount set out above is as follows:

	2017 £m	2016 £m
Profit before tax	**66.8**	54.0
Tax on profit at UK effective corporation tax rate of 19.5% (2016: 20.0%)	**13.0**	10.8
Effects of:		
– change in UK tax rates	**–**	(0.1)
– higher tax rates on overseas earnings	**5.3**	4.1
– adjustments to current tax charge in respect of previous years	**(0.3)**	(0.4)
– other permanent differences	**0.6**	0.5
Total tax on profit for the year	**18.6**	14.9

The Group earns its profits in the UK and overseas. The UK corporation tax rate was reduced from 20.0% to 19.0% on 1 April 2017. As the Group prepares its consolidated financial statements for the year to 30 September, the effective tax rate for UK corporation tax in respect of the year ended 30 September 2017 was 19.5% (2016: 20.0%) and this rate has been used for tax on profit in the above reconciliation. The Group's net overseas tax rate is higher than that in the UK, primarily because profits earned in the US, Canada and Australia are taxed at significantly higher rates than the UK.

The UK deferred tax assets and liabilities at 30 September 2017 have been calculated based on the future UK corporation tax rate of 17.0%, substantively enacted at 30 September 2017.

At 30 September 2017, the Group had outstanding tax liabilities of £4.0m (2016: £2.7m) of which £1.6m related to UK tax liabilities and £2.4m related to overseas tax liabilities. These amounts are expected to be paid within the next financial years.

Notes to the Consolidated Financial Statements continued

For the year ended 30 September 2017

8. Dividends

	2017 pence per share	2016 pence per share	2017 £m	2016 £m
Interim dividend, paid in June	**7.0**	6.2	**7.9**	7.0
Final dividend of the prior year, paid in January	**13.8**	12.4	**15.6**	14.0
	20.8	18.6	**23.5**	21.0

The Directors have proposed a final dividend in respect of the current year of 16.0p per share (2016: 13.8p) which will be paid on 24 January 2018, subject to approval of shareholders at the Annual General Meeting on 17 January 2018. The total dividend for the current year, subject to approval of the final dividend, will be 23.0p per share (2016: 20.0p).

The Diploma PLC Employee Benefit Trust holds 92,898 (2016: 172,577) shares, which are ineligible 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 113,133,341 (2016: 113,058,835) and the profit for the year attributable to shareholders of £47.5m (2016: £38.3m). There are no potentially dilutive shares.

Adjusted earnings per share

Adjusted EPS, which is defined in note 2, is calculated as follows:

	2017 pence per share	2016 pence per share	2017 £m	2016 £m
Profit before tax			**66.8**	54.0
Tax expense			**(18.6)**	(14.9)
Minority interests			**(0.7)**	(0.8)
Earnings for the year attributable to shareholders of the Company	**42.0**	33.9	**47.5**	38.3
Acquisition related charges	**8.6**	9.1	**9.7**	10.3
Fair value remeasurement of put options	**0.9**	1.1	**1.0**	1.3
Gain on disposal of assets	**–**	(0.6)	**–**	(0.7)
Tax effects on acquisition related charges and fair value remeasurements	**(1.7)**	(1.6)	**(1.9)**	(1.8)
Adjusted earnings	**49.8**	41.9	**56.3**	47.4

10. Goodwill

	Life Sciences £m	Seals £m	Controls £m	Total £m
At 1 October 2015	44.9	29.6	14.8	89.3
Acquisitions	–	4.0	7.8	11.8
Exchange adjustments	7.9	5.5	0.7	14.1
At 30 September 2016	52.8	39.1	23.3	115.2
Acquisitions (note 22)	6.1	1.4	–	7.5
Exchange adjustments	0.6	(0.6)	0.1	0.1
At 30 September 2017	**59.5**	**39.9**	**23.4**	**122.8**

The Group tests goodwill for impairment at least once a year. For the purposes of impairment testing, goodwill is allocated to each of the Group's three operating Sectors. This reflects the lowest level within the Group at which goodwill is monitored by management and reflects the Group's strategy of acquiring businesses to drive synergies across a Sector, rather than within an individual business. The impairment test requires a "value in use" valuation to be prepared for each Sector using discounted cash flow forecasts. The cash flow forecasts are based on a combination of annual budgets prepared by each business and the Group's strategic plan. Beyond five years, cash flow projections utilise a perpetuity growth rate of 2%.

The key assumptions used to prepare the cash flow forecasts relate to gross margins, revenue growth rates and the discount rate. The gross margins are assumed to remain sustainable, which is supported by historical experience; revenue growth rates generally approximate to the average rates for the markets in which the business operates, unless there are particular factors relevant to a business, such as start-ups. The annual revenue growth rates used in the cash flow forecasts for the next five years represent the budgeted rates for 2018 and thereafter, average growth rates for each Sector; these annual growth rates then reduce to 2% over the longer term.

The cash flow forecasts are discounted to determine a current valuation using a single market derived pre-tax discount rate of ca. 12% (2016: 11%). This single rate is based on the characteristics of lower risk, non-technically driven, distribution businesses operating generally in well developed markets and geographies and with robust capital structures. As these features are consistent between each of the Group's Sectors, the Board considers that it is more appropriate to use a single discount rate applied to each Sector's cash flow forecasts.

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

10. Goodwill continued

The Directors have also carried out sensitivity analysis on the key assumptions noted above to determine whether a "reasonably possible adverse change" in any of these assumptions would result in an impairment of goodwill. The analysis indicates that a "reasonably possible adverse change" would not give rise to an impairment charge to goodwill in any of the three Sectors.

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**
Cost					
At 1 October 2015	52.3	22.1	2.6	77.0	3.8
Additions	–	–	–	–	0.2
Acquisitions	18.4	–	–	18.4	–
Disposals	(0.9)	(3.6)	–	(4.5)	(0.2)
Exchange adjustments	8.8	3.3	0.3	12.4	1.8
At 30 September 2016	78.6	21.8	2.9	103.3	5.6
Additions	–	–	–	–	0.2
Acquisitions (note 22)	2.3	7.8	–	10.1	–
Disposals	–	–	–	–	(0.1)
Exchange adjustments	(0.7)	–	(0.1)	(0.8)	(0.1)
At 30 September 2017	**80.2**	**29.6**	**2.8**	**112.6**	**5.6**
Amortisation					
At 1 October 2015	23.1	11.6	2.1	36.8	2.6
Charge for the year	6.9	2.2	0.2	9.3	0.5
Disposals	(0.5)	(2.6)	–	(3.1)	–
Exchange adjustments	3.8	1.7	0.2	5.7	1.5
At 30 September 2016	33.3	12.9	2.5	48.7	4.6
Charge for the year	7.8	2.3	0.2	10.3	0.4
Disposals	–	–	–	–	(0.1)
Exchange adjustments	(0.4)	0.1	(0.1)	(0.4)	–
At 30 September 2017	**40.7**	**15.3**	**2.6**	**58.6**	**4.9**
Net book value					
At 30 September 2017	**39.5**	**14.3**	**0.2**	**54.0**	**0.7**
At 30 September 2016	45.3	8.9	0.4	54.6	1.0

Acquisition related charges are £9.7m (2016: £10.3m) and comprise £10.3m (2016: £9.3m) of amortisation of acquisition intangible assets, £0.4m of acquisition expenses (2016: £1.2m) and a credit of £1.0m relating to adjustments to deferred consideration (2016: £0.2m credit).

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

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

Notes to the Consolidated Financial Statements continued

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12. Investment

	2017 £m	2016 £m
Investment	**0.7**	0.7

The Group holds a 10% interest in the share capital of Kunshan J Royal Precision Products Inc. ("JRPP"), a supplier to J Royal. The Group has no involvement in the day-to-day operations or management of JRPP. At 30 September 2017, there was no material difference between the book value of this investment and its fair value.

13. Property, plant and equipment

	Freehold properties £m	Leasehold properties £m	Plant and equipment £m	Hospital field equipment £m	Total £m
Cost					
At 1 October 2015	15.8	2.8	12.8	7.4	38.8
Additions	0.5	0.9	1.2	0.9	3.5
Acquisitions of businesses	–	0.2	0.7	–	0.9
Disposals	(2.2)	(0.9)	(1.5)	(0.8)	(5.4)
Transfers	(1.5)	–	1.5	–	–
Exchange adjustments	2.4	0.6	4.6	1.9	9.5
At 30 September 2016	15.0	3.6	19.3	9.4	47.3
Additions[1]	0.2	0.1	1.2	1.6	3.1
Acquisitions of businesses (note 22)	–	–	0.2	0.8	1.0
Disposals	(0.5)	–	(0.8)	(0.5)	(1.8)
Exchange adjustments	(0.2)	0.1	1.2	0.2	1.3
At 30 September 2017	**14.5**	**3.8**	**21.1**	**11.5**	**50.9**
Depreciation					
At 1 October 2015	2.8	1.2	8.3	3.7	16.0
Charge for the year	0.5	0.4	1.7	1.4	4.0
Disposals	(0.2)	(0.9)	(1.4)	(0.4)	(2.9)
Exchange adjustments	0.8	0.8	4.1	0.8	6.5
At 30 September 2016	3.9	1.5	12.7	5.5	23.6
Charge for the year	0.5	0.4	1.8	1.6	4.3
Disposals	–	–	(0.8)	(0.4)	(1.2)
Exchange adjustments	–	0.1	1.3	0.2	1.6
At 30 September 2017	**4.4**	**2.0**	**15.0**	**6.9**	**28.3**
Net book value					
At 30 September 2017	**10.1**	**1.8**	**6.1**	**4.6**	**22.6**
At 30 September 2016	11.1	2.1	6.6	3.9	23.7

1 The Group spent £1.9m during the financial year on completing the construction of a new facility for J Royal in Winston-Salem, US. On completion in April 2017, the facility was immediately sold to a third party and leased back to J Royal on a 15 year full repairing list. No profit or loss was recorded on the sale of the facility. This expenditure has not been included as an addition and disposal in the above analysis.

Land included within freehold properties above, but which is not depreciated, is £3.4m (2016: £3.4m). Capital commitments contracted, but not provided, were £1.1m (2016: £1.9m) relating to the planned extension of the facility at IS-Sommer.

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 at 30 September 2017 is £1.0m (2016: £1.0m), with a book value of £Nil.

14. Deferred tax

The movement on deferred tax is as follows:

	2017 £m	2016 £m
At 1 October	**(7.4)**	(5.9)
Credit for the year (note 7)	**2.0**	1.3
Acquisitions (note 22)	**(2.0)**	(3.7)
Disposals	**–**	0.5
Accounted for in Other Comprehensive Income	**(1.0)**	1.3
Exchange adjustments	**0.2**	(0.9)
At 30 September	**(8.2)**	(7.4)

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 on a net basis.

	Assets		Liabilities		Net	
	2017 £m	2016 £m	2017 £m	2016 £m	2017 £m	2016 £m
Property, plant and equipment	**0.5**	0.4	**(1.7)**	(1.8)	**(1.2)**	(1.4)
Goodwill and intangible assets	**–**	–	**(12.3)**	(11.4)	**(12.3)**	(11.4)
Retirement benefit obligations	**1.8**	3.1	**–**	–	**1.8**	3.1
Inventories	**1.8**	1.4	**(0.1)**	–	**1.7**	1.4
Share-based payments	**0.2**	0.2	**–**	–	**0.2**	0.2
Trading losses	**0.1**	0.2	**–**	–	**0.1**	0.2
Other temporary differences	**1.6**	0.8	**(0.1)**	(0.3)	**1.5**	0.5
	6.0	6.1	**(14.2)**	(13.5)	**(8.2)**	(7.4)
Deferred tax offset	**(5.8)**	(5.9)	**5.8**	5.9	**–**	–
	0.2	0.2	**(8.4)**	(7.6)	**(8.2)**	(7.4)

No deferred tax has been provided on unremitted earnings of overseas Group companies as the Group controls the dividend policies of its subsidiaries. Unremitted earnings may be liable to overseas withholding tax (after allowing for double taxation relief) if they were to be distributed as dividends. The aggregate amount for which deferred tax has not been recognised in respect of unremitted earnings was £5.5m (2016: £4.5m).

15. Inventories

	2017 £m	2016 £m
Finished goods	**73.2**	66.8

Inventories are stated net of impairment provisions of £8.3m (2016: £7.8m). During the year £1.3m (2016: £1.1m) was recognised as a charge against operating profit, comprising the write-down of inventories to net realisable value.

16. Trade and other receivables

	2017 £m	2016 £m
Trade receivables	**64.2**	55.5
Less: impairment provision	**(0.8)**	(0.7)
	63.4	54.8
Other receivables	**2.3**	2.4
Prepayments and accrued income	**3.2**	2.7
	68.9	59.9

The maximum exposure to credit risk for trade receivables at 30 September, by currency, was:

	2017 £m	2016 £m
UK sterling	**20.4**	18.2
US dollars	**13.9**	11.7
Canadian dollars	**10.2**	8.5
Euro	**10.3**	9.8
Other	**9.4**	7.3
	64.2	55.5

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16. Trade and other receivables continued

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

	2017 £m	2016 £m
Not past due	52.3	45.6
Past due, but not impaired	11.1	9.2
Past due, but impaired	0.8	0.7
	64.2	55.5

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

	2017 £m	2016 £m
Up to one month past due	9.2	7.6
Between one and two months past due	1.4	1.2
Between two and four months past due	0.5	0.3
Over four months past due	–	0.1
	11.1	9.2

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

	2017 £m	2016 £m
At 1 October	0.7	0.6
Charged against profit, net	0.1	0.1
Set up on acquisition	–	–
Utilised by write-off	–	–
At 30 September	0.8	0.7

17. Trade and other payables

	2017 £m	2016 £m
Trade payables	42.5	35.8
Other payables	3.3	2.7
Other taxes and social security	4.6	4.3
Accruals and deferred income	19.3	17.8
	69.7	60.6

The maximum exposure to foreign currency risk for trade payables at 30 September, by currency, was:

	2017 £m	2016 £m
UK sterling	10.7	9.2
US dollars	18.0	14.8
Canadian dollars	0.6	0.9
Euro	10.8	8.7
Other	2.4	2.2
	42.5	35.8

18. Cash and cash equivalents

	UK £m	US$ £m	C$ £m	Euro £m	Other £m	2017 Total £m	UK £m	US$ £m	C$ £m	Euro £m	Other £m	2016 Total £m
Cash at bank	6.0	4.1	2.3	3.2	2.7	18.3	6.9	3.5	1.8	2.6	2.1	16.9
Short term deposits	3.0	0.2	0.5	–	0.3	4.0	3.0	0.2	0.2	–	0.3	3.7
	9.0	4.3	2.8	3.2	3.0	22.3	9.9	3.7	2.0	2.6	2.4	20.6

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

19. Financial instruments

The Group's overall management of the financial risks is carried out by a central treasury team under policies and procedures which are reviewed and approved by the Board. The treasury team identifies, evaluates and where appropriate, hedges financial risks in close cooperation with the Group's operating businesses. The treasury team does not undertake speculative foreign exchange dealings for which there is no underlying exposure.

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

The financial risks to which the Group is exposed are those of credit, liquidity, foreign currency, interest rate and capital management. An explanation of each of these risks, how the Group manages these risks and an analysis of sensitivities is set out below and on page 35 within Internal Control and Risk Management, all of which have been audited.

a) 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.

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. Trade receivable exposures are managed locally in the operating units where they arise and credit limits are set as deemed appropriate for each customer.

The Group establishes a provision for impairment that represents its estimate of potential 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 provision is written off against the underlying receivable. During the year, the Group had no significant unrecoverable trade receivables; there have been no other significant trade receivables written off in the past five years other than £0.2m written off in 2015.

Exposure to counterparty credit risk with financial institutions is controlled by the Group treasury team which establishes and monitors counterparty limits. Centrally managed funds are invested entirely with counterparties whose credit rating is "AA" or better.

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

	Carrying amount	
	2017 £m	2016 £m
Trade receivables	**63.4**	54.8
Other receivables	**2.3**	2.4
Cash and cash equivalents	**22.3**	20.6
	88.0	77.8

There is no material difference between the book value 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 16. An analysis of cash and cash equivalents is set out in note 18.

b) 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 continually monitors net cash and forecasts cash flows to ensure that sufficient resources are available to meet the Group's requirements in the short, medium and long term. Additionally, compliance with debt covenants are monitored regularly and during 2017 all covenants were complied with fully.

The Group is highly cash generative and uses monthly cash flow forecasts to monitor cash requirements and to optimise its return on shorter term deposits. Typically the Group ensures that it has sufficient cash on hand to meet foreseeable operational expenses, but the Group also maintains a committed revolving bank facility. On 1 June 2017, the Group replaced its existing facility that was due to expire on 23 June 2017 with a similar committed three year facility for £30.0m with an accordion option to increase the committed facility by a further £30.0m up to a maximum of £60.0m and to extend the term up to five years. Interest on this facility is payable at between 70 and 115bps over LIBOR, depending on the ratio of net debt to EBITDA. None of the facility had been drawn down (2016: £10.0m) at 30 September 2017.

The undrawn committed facilities available at 30 September are as follows:

	2017 £m	2016 £m
Expiring within one year	**–**	40.0
Expiring after two years	**30.0**	–

Notes to the Consolidated Financial Statements continued

For the year ended 30 September 2017

19. Financial instruments continued

The Group's financial liabilities are as follows:

	Carrying amount 2017 £m	2016 £m
Trade payables	42.5	35.8
Other payables	3.3	2.7
Other liabilities (note 20)	6.6	6.8
	52.4	45.3
The maturities of the undiscounted financial liabilities are as follows:		
Less than one year	48.3	40.2
One to two years	4.5	2.0
Two to five years	–	3.9
	52.8	46.1
Less: discount	(0.4)	(0.8)
	52.4	45.3

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

c) Currency risk

The Group's principal currency risk comprises translational and transactional risk from its exposure to movements in US dollars, Canadian dollars and Euros. The transactional exposure arises on trade receivables, trade payables and cash and cash equivalents and these balances are analysed by currency in notes 16, 17 and 18, respectively. Net foreign exchange gains of £0.5m (2016: £0.8m) were recognised in operating profit for the year.

The Group holds forward foreign exchange contracts in certain of the Group's businesses to hedge forecast transactional exposure to movements primarily in the US dollar and Euro. These forward foreign exchange contracts are classified as cash flow hedges and are stated at fair value. The notional value of forward contracts as at 30 September 2017 was £33.0m (2016: £25.9m). The net fair value of forward foreign exchange contracts used as hedges at 30 September 2017 was £0.7m liability (2016: £0.2m asset). The amount removed from Other Comprehensive Income and taken to the Consolidated Income Statement in cost of sales during the year was £0.2m (2016: £1.5m). The change in the fair value of cash flow hedges taken to Other Comprehensive Income during the year was £1.0m debit (2016: £0.2m credit).

Management considers that the most significant foreign exchange risk relates to the US dollar, Canadian dollar and Euro. The Group's sensitivity to a 10% strengthening in UK sterling against each of these currencies (with all other variables held constant) is as follows:

	2017 £m
Decrease in adjusted operating profit (at average rates)	
US dollar: UK sterling	2.1
Canadian dollar: UK sterling	1.7
Euro: UK sterling	1.1
Decrease in total equity (at spot rates)	
US dollar: UK sterling	4.1
Canadian dollar: UK sterling	5.0
Euro: UK sterling	2.8

d) 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 and borrowings. 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. Surplus funds are deposited with commercial banks that meet the credit criteria approved by the Board, for periods of between one and six months at rates that are generally fixed by reference to the relevant UK base rate, or equivalent rate. An increase of 1% in interest rates would not have a significant impact on the Group's adjusted profit before tax. An analysis of cash and cash equivalents at the reporting dates is set out in note 18.

19. Financial instruments continued

e) Fair values

There are no material differences between the book 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 forward rates, adjusted for the forward points to the contract's value date with gains and losses taken to equity. No contract's value date is greater than 18 months from the year end.

Trade and other receivables/payables

As the majority of receivables/payables have a remaining life of less than one year, the book value 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.

f) Capital management risk

The Group's objectives when managing capital are to safeguard its ability to continue as a going concern and to maintain robust capital ratios to support the development of the business and provide strong returns to shareholders. The Group's capital structure comprises cash funds and medium term bank borrowing facilities.

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

20. Other liabilities

	2017 £m	2016 £m
Future purchases of minority interests	6.1	5.1
Deferred consideration	0.5	1.7
	6.6	6.8
Analysed as:		
Due within one year	2.5	1.7
Due after one year	4.1	5.1

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

	2017 £m	2016 £m
At 1 October	5.1	5.7
Acquisition of minority interest on exercise of option	–	(1.9)
Unwinding of discount	0.5	0.5
Fair value remeasurements	0.5	0.8
At 30 September	6.1	5.1

At 30 September 2017, the Group retained put options to acquire minority interests in TPD, Kentek and M Seals.

The estimate of the financial liability at 30 September 2017 to acquire the outstanding minority shareholdings was reassessed by the Directors, based on their current estimate of the future performance of these businesses and to reflect foreign exchange rates at 30 September 2017. This led to a remeasurement of the fair value of these put options and the liability was increased by £0.5m (2016: £0.8m) reflecting a revised estimate of the future performance of the businesses and by a further £0.5m (2016: £0.5m) charge which arises from unwinding the discount on the liability. In aggregate £1.0m (2016: £1.3m) has been charged to the Consolidated Income Statement.

The put options to acquire the remaining minority interest of 10% held in both M Seals and in Kentek are exercisable from November 2018. Subsequent to the year end, the option to acquire an outstanding 5% minority interest in TPD has been exercised for cash consideration of £1.0m. The remaining 5% is exercisable within the next 12 months.

Deferred consideration comprises the following:

	2017 £m	2016 £m
WCIS	–	0.6
Cablecraft	–	1.0
Ascome	0.1	0.1
Edco	0.4	–
At 30 September	0.5	1.7

Notes to the Consolidated Financial Statements continued

For the year ended 30 September 2017

20. Other liabilities continued

The amounts outstanding at 30 September 2017 are expected to be paid within the next 12 months and will largely be based on the performance of these businesses in the period following their acquisition by the Group.

During the year, outstanding deferred consideration of £0.6m (A$1.0m) was paid to the vendors of WCIS in respect of the performance of the business in the year ended 30 September 2016. The deferred consideration of £1.0m relating to Cablecraft was not required and has been released to the Consolidated Income Statement as part of acquisition related charges in note 11.

21. Minority interests

	£m
At 30 September 2015	5.2
Share of minority net assets acquired of TPD	(2.0)
Share of profit	0.8
Dividends paid	(0.4)
Exchange adjustments	0.7
At 30 September 2016	4.3
Share of profit	0.7
Dividends paid	(0.2)
Exchange adjustments	–
At 30 September 2017	**4.8**

External shareholders, represented by management in each business hold a 10% minority interest in M Seals, TPD and Kentek.

22. Acquisition of businesses

On 19 April 2017 the Group acquired 100% of Abacus ALS Pty Ltd based in Brisbane, Australia and its wholly owned subsidiary Abacus ALS Limited based in Auckland, New Zealand (together "Abacus") for total cash consideration of £14.1m (A$23.3m). This comprised initial consideration of £12.4m (A$20.4m), together with £1.7m (A$2.9m) of deferred consideration based on the performance of the business for the year ended 30 June 2017. The initial consideration of £13.6m (A$22.5m) was before adjustments relating to working capital and net debt on completion of £1.2m (A$2.1m), but before acquisition expenses of £0.3m (A$0.5m).

On 19 April 2017, the Group acquired 100% of Problem Solving Products, Inc ("PSP"), based in Colorado US, for total cash consideration of £1.4m (US$1.9m).

On 16 June 2017, the Group acquired 100% of Edco Seal & Supply Limited ("Edco") based in Leicester, England, for initial cash consideration of £3.2m, which included £0.2m of surplus cash and was before acquisition expenses of £0.1m. Maximum deferred consideration of up to £0.7m is payable based on the performance of Edco for the 12 months ended 30 April 2018, of which £0.4m has been provided at 30 September 2017.

Set out below is an analysis of the net book values and fair values relating to these acquisitions:

	Abacus		PSP		Edco		Total	
	Book value £m	Fair value £m	Book value £m	Fair value £m	Book value £m	Fair value £m	Book value £m	Fair value £m
Acquisition intangible assets	–	7.8	–	0.8	–	1.5	–	10.1
Deferred tax	0.2	(1.7)	–	–	–	(0.3)	0.2	(2.0)
Property, plant and equipment	1.0	0.9	–	–	0.1	0.1	1.1	1.0
Inventories	1.6	1.0	0.2	0.1	0.5	0.4	2.3	1.5
Trade and other receivables	2.4	2.4	0.3	0.3	1.4	1.4	4.1	4.1
Trade and other payables	(1.8)	(1.8)	(0.2)	(0.2)	(0.7)	(0.7)	(2.7)	(2.7)
Net assets acquired	3.4	8.6	0.3	1.0	1.3	2.4	5.0	12.0
Goodwill	–	6.1	–	0.4	–	1.0	–	7.5
	3.4	**14.7**	**0.3**	**1.4**	**1.3**	**3.4**	**5.0**	**19.5**
Cash paid		14.1		1.4		3.2		18.7
Net debt acquired		0.6		–		–		0.6
Cash acquired		–		–		(0.2)		(0.2)
Expenses of acquisition		0.3		–		0.1		0.4
Net cash paid, after acquisition expenses		**15.0**		**1.4**		**3.1**		**19.5**
Deferred consideration payable		–		–		0.4		0.4
Less: expenses of acquisition		(0.3)		–		(0.1)		(0.4)
Total consideration		**14.7**		**1.4**		**3.4**		**19.5**

Goodwill of £7.5m recognised on these acquisitions represents the amount paid for future sales growth from both new customers and new products, for operating cost synergies and for employee know-how.

22. Acquisition of businesses continued

From the date of acquisition to 30 September 2017, the newly acquired Abacus business contributed £7.6m to revenue and £1.2m to adjusted operating profit, the newly acquired PSP business contributed £1.0m to revenue and £0.2m to adjusted operating profit and the newly acquired Edco business contributed £1.1m to revenue and £0.2m to adjusted operating profit. If these businesses had been acquired at the beginning of the financial year, they would in aggregate have contributed on a pro rata basis £21.6m to revenue and £3.8m to adjusted operating profit. However these amounts 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.

23. Reconciliation of operating profit to cash flow from operating activities

	2017 £m	2017 £m	2016 £m	2016 £m
Operating profit		68.5		55.4
Acquisition related charges (note 11)		9.7		10.3
Adjusted operating profit		78.2		65.7
Depreciation or amortisation of tangible and other intangible assets	4.7		4.5	
Share-based payments expense (note 5)	0.8		0.4	
Cash paid into defined benefit schemes (note 25)	(0.4)		(0.3)	
Non-cash items		5.1		4.6
Operating cash flow before changes in working capital		83.3		70.3
Increase in inventories	(5.1)		(1.3)	
Increase in trade and other receivables	(6.6)		(0.3)	
Increase in trade and other payables	7.7		7.9	
(Increase)/decrease in working capital		(4.0)		6.3
Cash flow from operating activities, before acquisition expenses		79.3		76.6

24. Net cash

The movement in net cash during the year is as follows:

	2017 £m	2016 £m
Net increase/(decrease) in cash and cash equivalents	1.9	(5.1)
Decrease in borrowings	10.0	10.0
	11.9	4.9
Effect of exchange rates	(0.2)	2.7
Movement in net cash	11.7	7.6
Net cash at beginning of year	10.6	3.0
Net cash at end of year	22.3	10.6
Comprising:		
Cash and cash equivalents	22.3	20.6
Borrowings	–	(10.0)
Net cash at 30 September	22.3	10.6

On 1 June 2017, the Group replaced its existing facility that was due to expire on 23 June 2017 with a similar committed three year facility for £30.0m with an accordion option to increase the committed facility by a further £30.0m up to a maximum of £60.0m and an option to extend the facility up to five years. At 30 September 2017, none of the facility had been drawn down (2016: £10.0m). Interest on this facility is payable at between 70 and 115bps over LIBOR, depending on the ratio of net debt to EBITDA.

25. Retirement benefit obligations

The Group maintains two pension arrangements which are accounted for under IAS19 (Revised) "Employee Benefits". The principal arrangement is the defined benefit pension scheme in the UK, maintained by Diploma Holdings PLC and called the Diploma Holdings PLC UK Pension Scheme ("the Scheme"). This Scheme provides benefits based on final salary and length of service on retirement, leaving service or death and has been closed to further accrual since 5 April 2000.

The second and smaller pension arrangement is operated by Kubo in Switzerland and provides benefits on retirement, leaving service or death for the employees of Kubo in accordance with Swiss law. Kubo was acquired by the Group on 13 March 2015. The Kubo pension scheme is a defined contribution based scheme, which for technical reasons, is required under IFRS to be accounted for in accordance with IAS19 (Revised).

The amount of pension deficit included in the Consolidated Statement of Financial Position in respect of these two pension arrangements is:

	2017 £m	2016 £m
Diploma Holdings PLC UK Pension Scheme	5.4	10.0
Kubo Pension Scheme	4.5	7.2
Pension scheme net deficit	9.9	17.2

Notes to the Consolidated Financial Statements continued

For the year ended 30 September 2017

25. Retirement benefit obligations continued

The amounts included in the Consolidated Income Statement in respect of these two pension arrangements are:

	2017 £m	2016 £m
Diploma Holdings PLC UK Pension Scheme	**(0.3)**	(0.2)
Kubo Pension Scheme	**(0.2)**	(0.3)
Amounts charged to the Consolidated Income Statement	**(0.5)**	(0.5)

Defined contribution schemes operated by the Group's businesses are not included in these disclosures.

Diploma Holdings PLC UK Pension Scheme

The Scheme is subject to a Statutory Funding Objective under the Pensions Act 2004 which requires that a valuation of the Scheme is carried out at least once every three years to determine whether the Statutory Funding Objective is met. As part of the process the Company must agree with the Trustees of the Scheme the contributions to be paid to address any shortfall against the Statutory Funding Objective. The most recent triennial actuarial valuation carried out as at 30 September 2016 reported that the Scheme had a funding deficit of £9.2m and held assets which covered 75% of its liabilities at that date. The next triennial actuarial valuation of the Scheme will be carried out as at 30 September 2019. There were no Scheme amendments, curtailments or settlements during the year.

The Scheme is managed by a set of Trustees appointed in part by the Company and in part from elections by members of the Scheme. The Trustees have responsibility for obtaining valuations of the fund, administering benefit payments and investing the Scheme's assets. The Trustees delegate some of these functions to their professional advisors where appropriate.

The Scheme exposes the Company and therefore the Group, to a number of risks:

- **Investment risk.** The Scheme holds investments in asset classes, such as equities, which have volatile market values and while these assets are expected to provide real returns over the long term, volatility over the short term can cause additional funding to be required if a deficit emerges.
- **Interest rate risk.** The Scheme's liabilities are assessed using market yields on high quality corporate bonds to discount the liabilities. As the Scheme's assets include equities, the value of the assets and liabilities may not move in the same way.
- **Inflation risk.** A significant proportion of the benefits under the Scheme are linked to inflation. The Scheme's assets are expected to provide a good hedge against inflation over the long term, however movements over the short term could lead to funding deficits emerging.
- **Mortality risk.** In the event that members live longer than assumed, a larger funding deficit may emerge in the Scheme.

a) Pension deficit included in the Consolidated Statement of Financial Position

	2017 £m	2016 £m
Market value of Scheme assets:		
Equities	**24.8**	22.0
Bonds	**6.0**	6.1
Cash	**0.1**	–
	30.9	28.1
Present value of Scheme liabilities	**(36.3)**	(38.1)
Pension scheme net deficit	**(5.4)**	(10.0)

b) Amounts charged to the Consolidated Income Statement

	2017 £m	2016 £m
Charged to operating profit	**–**	–
Interest cost on liabilities	**(0.9)**	(1.1)
Interest on assets	**0.6**	0.9
Charged to financial expense, net (note 6)	**(0.3)**	(0.2)
Amounts charged to the Consolidated Income Statement	**(0.3)**	(0.2)

c) Amounts recognised in the Consolidated Statement of Income and Other Comprehensive Income

	2017 £m	2016 £m
Investment gain on Scheme assets in excess of interest	**2.7**	5.0
Effect of changes in financial assumptions on Scheme liabilities	**3.2**	(9.3)
Effect of changes in demographic assumptions on Scheme liabilities	**(1.3)**	0.3
Experience adjustments on Scheme liabilities	**(0.1)**	–
Actuarial gains/(losses) charged in the Consolidated Statement of Income and Other Comprehensive Income	**4.5**	(4.0)

The cumulative amount of actuarial losses recognised in the Consolidated Statement of Income and Other Comprehensive Income, since the transition to IFRS, is £5.8m (2016: £10.3m).

25. Retirement benefit obligations continued

d) Analysis of movement in the pension deficit

	2017 £m	2016 £m
At 1 October	**10.0**	6.1
Amounts charged to the Consolidated Income Statement	**0.3**	0.2
Contributions paid by employer	**(0.4)**	(0.3)
Net effect of remeasurements of Scheme assets and liabilities	**(4.5)**	4.0
At 30 September	**5.4**	10.0

e) Analysis of movements in the present value of the Scheme liabilities

	2017 £m	2016 £m
At 1 October	**38.1**	30.5
Interest cost on liabilities	**0.9**	1.1
Impact from changes in actuarial assumptions	**(1.8)**	9.0
Benefits paid	**(0.9)**	(2.5)
At 30 September	**36.3**	38.1

f) Analysis of movements in the present value of the Scheme assets

	2017 £m	2016 £m
At 1 October	**28.1**	24.4
Interest on assets	**0.6**	0.9
Return on Scheme assets	**2.7**	5.0
Contributions paid by employer	**0.4**	0.3
Benefits paid	**(0.9)**	(2.5)
At 30 September	**30.9**	28.1

The actual return on the Scheme assets during the year was a £3.3m gain (2016: £5.9m gain).

Assets

The Scheme's assets are held in passive unit funds managed by Legal & General Investment Management and at 30 September 2017, the major categories of assets were as follows:

	2017 %	2016 %
North America equities	**20**	20
UK equities	**20**	19
European equities (non-UK)	**20**	19
Asia-Pacific and Emerging Markets equities	**20**	20
Corporate bonds	**12**	13
Index-linked gilts	**8**	9
Cash	**0**	0

Principal actuarial assumptions for the Scheme at balance sheet dates

		2017 %	2016 %	2015 %
Inflation rate	– RPI	**3.4**	3.2	3.1
	– CPI	**2.4**	2.4	2.3
Expected rate of pension increases	– CPI	**2.4**	2.4	2.3
Discount rate		**2.8**	2.3	2.3

Demographic assumptions

Mortality table used:	S1NxA
Year the mortality table was published:	CMI 2016
Allowance for future improvements in longevity:	Year of birth projections, with a long term improvement rate of 1.0%
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)

The weighted average duration of the defined benefit obligation is around 18 years.

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For the year ended 30 September 2017

25. Retirement benefit obligations continued

Sensitivities

The sensitivities of the 2017 pension liabilities to changes in assumptions are as follows:

		Impact on pension liabilities	
Factor	Assumption	Estimated increase %	Estimated increase £m
Discount rate	Decrease by 0.5%	9.3	3.4
Inflation	Increase by 0.5%	3.8	1.4
Life expectancy	Increase by one year	2.6	0.9

Risk mitigation strategies

When setting the investment strategy for the Scheme, the Trustees, in conjunction with the employer, take into account the liability profile of the Scheme. The current strategy is designed to broadly match assets and liabilities in respect of pensioner members, but to invest in growth assets in respect of deferred pensioners. Annuity policies have been taken out in respect of some historic pensioners, but the Scheme has not purchased annuities for retirements since 2005.

Effect of the Scheme on the Group's future cash flows

The Company is required to agree a schedule of contributions with the Trustees of the Scheme following each triennial actuarial valuation. Following the triennial actuarial valuation carried out as at 30 September 2016, the Company agreed to increase the annual cash contribution to the scheme to £0.5m (from £0.4m). The next valuation of the Scheme will be carried out as at 30 September 2019.

The Kubo Pension Scheme ("the Kubo Scheme")

In accordance with Swiss law, Kubo's pension benefits are contribution based with the level of benefits varying according to category of employment. Swiss law requires certain guarantees to be provided on such pension benefits. Kubo finances its Swiss pension benefits through the ASGA Pensionskasse, a multi-employer plan of non-associated companies which pools risks between participating companies. As at 30 September 2017 the ASGA Pensionskasse had a local coverage ratio of 110.7%.

Set out below is a summary of the key features of the Kubo Scheme.

a) Pension deficit included in the Consolidated Statement of Financial Position

	2017 £m	2016 £m
Assets of the Kubo Scheme[1]	**8.7**	10.8
Actuarial liabilities of the Kubo Scheme	**(13.2)**	(18.0)
Pension scheme net deficit	**(4.5)**	(7.2)

1 The assets of the Kubo Scheme are held as part of the funds managed by ASGA Pensionskasse.

b) Amounts charged to the Consolidated Income Statement

	2017 £m	2016 £m
Service cost	**(0.2)**	(0.3)
Amount charged to operating profit in the Consolidated Income Statement	**(0.2)**	(0.3)

c) Analysis of movement in the pension deficit

	2017 £m	2016 £m
At 1 October	**7.2**	3.7
Amounts charged to the Consolidated Income Statement	**0.2**	0.3
Contributions paid by employer	**(0.2)**	(0.3)
Net effect of remeasurements of Kubo Scheme assets and liabilities	**(2.6)**	2.6
Exchange adjustments	**(0.1)**	0.9
At 30 September	**4.5**	7.2

25. Retirement benefit obligations continued

Principal actuarial assumptions for the Kubo Scheme at balance sheet dates

	2017	2016
Expected rate of pension increase	**0%**	0%
Expected rate of salary increase	**1.0%**	1.0%
Discount rate	**0.7%**	0.15%
Interest credit rate	**1.0%**	0.50%
Mortality	**BVG2015**	BVG2015

Sensitivities

The sensitivities of the 2017 pension liabilities to changes in assumptions are as follows:

		Impact on pension liabilities	
Factor	Assumption	Estimated increase %	Estimated increase £m
Discount rate	Decrease by 0.5%	10.6%	1.4
Life expectancy	Increase by one year	7.0%	0.9

Effect of the Kubo Scheme on the Group's future cash flows

	£m
Best estimate of employer's contribution in 2018	0.4
Best estimate of employees' contribution in 2018	0.3

The weighted average duration of the defined benefit obligation is approximately 20 years.

26. Commitments

At 30 September 2017 the Group had outstanding aggregate commitments for future lease payments (under non-cancellable operating leases) in respect of the following years:

	Land and buildings		Other		Total	
	2017 £m	2016 £m	2017 £m	2016 £m	2017 £m	2016 £m
Within one year	**4.1**	3.4	**1.3**	1.0	**5.4**	4.4
For years two to five	**9.7**	7.4	**1.6**	1.3	**11.3**	8.7
After five years	**4.2**	3.2	**–**	–	**4.2**	3.2
	18.0	14.0	**2.9**	2.3	**20.9**	16.3

Other commitments comprise plant and machinery, motor vehicles and office equipment. Operating lease payments made during the year in respect of land and buildings and other commitments were £4.2m (2016: £4.2m) and £1.5m (2016: £1.1m), respectively.

27. Auditor's remuneration

During the year the Group paid fees for the following services from the auditor:

	2017 £m	2016 £m
Fees payable to the auditor for the audit of:		
– the Group's Annual Report & Accounts	**0.1**	0.1
– the Company's subsidiaries	**0.5**	0.4
Audit fees	**0.6**	0.5

Non-audit fees of £13,000 (2016: £13,000) were paid to the Group's auditor for carrying out "agreed upon procedures" on the Half Year Announcement, which is unaudited.

28. Exchange rates

The exchange rates used to translate the results of the overseas businesses are as follows:

	Average		Closing	
	2017	2016	2017	2016
US dollar (US$)	**1.27**	1.41	**1.34**	1.30
Canadian dollar (C$)	**1.67**	1.87	**1.68**	1.71
Euro (€)	**1.15**	1.28	**1.13**	1.16
Swiss franc (CHF)	**1.26**	1.40	**1.30**	1.26
Australian dollar (A$)	**1.67**	1.92	**1.71**	1.70

29. Subsequent events

On 16 October 2017, the Group completed the acquisition of 100% of Coast Fabrication, Inc. ("Coast"), a supplier of specialist fasteners based in California, US, for initial cash consideration of £1.0m (US$1.3m) and maximum deferred consideration of £0.3m (US$0.4m). A review to determine fair values of the net assets acquired will be completed during the next financial year.

Group Accounting Policies

For the year ended 30 September 2017

The consolidated financial statements have been prepared in accordance with IFRS as endorsed by the EU 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 2017 and the comparative year.

There were no new Standards, amendments or interpretations to existing Standards which have been published and endorsed by the EU and which have a significant impact on the results, financial position or presentation of the consolidated financial statements for the year ended 30 September 2017.

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 on page 65.

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 assets, liabilities and 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 Acquisitions

Acquisitions are accounted for using the acquisition method as at the acquisition date, which is the date on which control is transferred to the Group. Goodwill at the acquisition date represents the cost of the business combination (excluding acquisition related costs, which are expensed as incurred) plus the amount of any non-controlling interest in the acquiree in excess of the fair value of the identifiable tangible and intangible assets, liabilities and contingent liabilities acquired.

Minority interests may be initially measured at fair value or, alternatively, at the minority interest's proportionate share of the recognised amounts of the acquiree's identifiable net assets. The choice of measurement basis is made for each business combination separately.

1.4 Divestments

The results and cash flows of major lines of businesses that have been divested have been classified as discontinued businesses. There were no discontinued operations in either 2017 or 2016.

1.5 Revenue recognition

Revenue is measured as the fair value of the consideration received or receivable for goods and services supplied to customers, after deducting sales allowances and value added taxes; revenue receivable for services supplied to customers, as opposed to goods, is less than ca. 3% of Group revenue. 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 on a pro rata basis over the period of the contract.

1.6 Employee benefits

The Group operates a number of pension plans, both of the defined contribution and defined benefit type. The defined benefit plan is operated by Diploma Holdings PLC and is closed to the accrual of further 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 plan: The deficit recognised in the balance sheet for the Group's defined benefit pension plan 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 plan is recognised as follows:
   i) Within the Consolidated Income Statement:
      - 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 net deficit in the plan – calculated by applying the discount rate to the net defined benefit liability at the start of the annual reporting period.
   ii) Within the Consolidated Statement of Income and Other Comprehensive Income ("Other Comprehensive Income"):
      - Actuarial gains and losses arising on the assets and liabilities of the plan 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 its defined benefit plan in the period in which they occur, outside the Consolidated Income Statement, but in Other Comprehensive Income.

c) Share-based payments: Equity-settled transactions (which are where the Executive Directors and certain senior employees receive a part of their remuneration in the form of shares in the Company, or rights over shares) 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 Consolidated Income Statement 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.

1.7 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 Consolidated Income Statement.
   ii) Non-monetary items measured at historical cost in a foreign currency are not retranslated.
   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 Consolidated Income Statement, any exchange component of that gain or loss is also recognised in the Consolidated 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.
   iii) All resulting exchange differences are recognised in Other Comprehensive Income; these cumulative exchange differences are recognised in the Consolidated 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 Consolidated Income Statement in the separate financial statements of the reporting entity or the foreign operation as appropriate. In the consolidated financial statements such exchange differences are initially recognised in Other Comprehensive Income as a separate component of equity and subsequently recognised in the Consolidated Income Statement on disposal of the net investment.

1.8 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 Consolidated 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 scheme, the difference between accelerated capital allowances and depreciation and for short term timing differences where a provision held against receivables or inventory 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 Consolidated Income Statement, except when the item on which the tax or charge 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.

1.9 Property, plant and equipment
Property, plant and equipment are stated 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 repairs and maintenance expenditure is charged to the Consolidated Income Statement in the period in which it is incurred.

Group Accounting Policies continued

For the year ended 30 September 2017

1.9 Property, plant and equipment continued
Freehold land is not depreciated. Depreciation on other items of property, plant and equipment begins when the asset is available for use and is charged to the Consolidated Income Statement on a straight-line basis 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
Leasehold property	– term of the lease
Plant and equipment	– plant and machinery between 3 and 7 years – IT hardware between 3 and 5 years – fixtures and fittings between 5 and 15 years
Hospital field equipment	– 5 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 Consolidated Income Statement.

1.10 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 unless forecast revenues for a particular project exceed attributable forecast development costs in which case they are capitalised 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.

c) Acquired intangible assets – business combinations
Intangible assets that may be acquired as a result of a business combination, include, but are not limited to, customer lists, supplier lists, databases, technology and software and patents 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 Consolidated Income Statement over the expected useful economic lives.

Fair values of customer and supplier relationships on larger acquisitions are valued using a discounted cash flow model; databases are valued using a replacement cost model. For smaller acquisitions, intangible assets are assessed using historical experience of similar transactions.

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, tangible and current 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. Transaction costs are expensed and are not included in the cost of acquisition.

1.11 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 ("CGU") exceeds its recoverable amount.

The recoverable amount of an asset or CGU 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 CGU, 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 Consolidated Income Statement.

a) Impairment of goodwill
Goodwill acquired in a business combination is allocated to a CGU; CGUs for this purpose are the Group's three Sectors 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. CGUs 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 CGU is less than the carrying amount of the unit, the impairment loss is allocated first to reduce the goodwill attributable to the CGU. Impairment losses cannot be subsequently reversed.

b) Impairment of other tangible and intangible assets
Other tangible and intangible assets are reviewed for impairment when events or changes in circumstances indicate the carrying value may not be recoverable. Impairment losses and any subsequent reversals are recognised in the Consolidated Income Statement.

1.12 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.

1.13 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 Consolidated Income Statement.

b) Trade payables

Trade payables are non-interest bearing and are initially measured at their nominal 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 can form an integral part of the Group's cash management.

d) Put options held by minority interests

The purchase price of shares to be acquired under options held by minority shareholders in the Group's subsidiaries are calculated by reference to the estimated 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 Consolidated 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 Consolidated Income Statement.

e) Derivative financial instruments and hedge accounting

The Group holds derivative financial instruments in the form of forward foreign exchange contracts to hedge its foreign currency exposure. These derivatives are designated as cash flow hedges.

Derivatives are initially recognised at fair value on the date a derivative contract is entered into and subsequent changes in the fair value of foreign currency derivatives which are designated and effective as hedges of future cash flows are recognised in equity in the hedging reserve and in Other Comprehensive Income and are reclassified to profit or loss on maturity of the derivative. Changes in the fair value of foreign currency derivatives which are ineffective or do not meet the criteria for hedge accounting in accordance with IAS39 are recognised immediately in the Consolidated Income Statement.

The Group documents, at the inception of the transaction, the relationship between hedging instruments and hedged items, as well as its risk management objectives and strategy for undertaking various hedging transactions. The Group also documents its assessment, both at hedge inception and on an ongoing basis, of whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in cash flows of hedged items.

No derivative contracts have been designated as fair value hedges or net investment hedges.

f) Borrowings

Borrowings are initially recognised at the fair value of the consideration received. They are subsequently measured at amortised cost. Borrowings are classified as non-current when the repayment date is more than 12 months from the period-end date or where they are drawn on a facility with more than 12 months to expiry.

1.14 Investments (available for sale financial assets)

The investment held by the Group comprises equity shares which are not held for the purposes of equity trading and in accordance with IAS39 is classified as available for sale. They are initially recognised at fair value. Subsequent to initial recognition, they are measured at fair value and changes therein are recognised in Other Comprehensive Income.

1.15 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. Rentals payable under operating leases are charged to the Consolidated 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.

1.16 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 Directors' best estimate of the expenditure required to settle the obligation at the balance sheet date.

1.17 Dividends

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

1.18 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.

c) Retained earnings reserve – The retained earnings reserve comprises total cumulative recognised income and expense attributable to shareholders. Bonus issues of share capital and dividends to shareholders are also charged directly to this 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.

Group Accounting Policies
continued

For the year ended 30 September 2017

1.18 Share capital and reserves continued

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.

1.19 Related parties

There are no related party transactions (other than with the key management) that are required to be disclosed in accordance with IAS24. Details of their remuneration are given in note 5 to the consolidated financial statements.

1.20 Accounting Standards, interpretations and amendments to published standards not yet effective

The IASB has published a number of new Standards, amendments and interpretations to existing Standards which are not yet effective, but will be mandatory for the Group's accounting periods beginning on or after 1 October 2017. Set out below are those which are considered most relevant to the Group:

- IFRS15 "Revenue from Contracts with Customers": IFRS15 is effective for the Group for the year ended 30 September 2019. The Group reviewed its revenue recognition policies and concluded that for substantially all of its sales to customers the performance obligation is the delivery of goods and it is therefore appropriate to recognise revenue at a single point of time, on delivery of goods, which is consistent with the current accounting policies. The review has identified specific contracts within Life Sciences where goods and services are sold together which in aggregate account for less than 5% of Group consolidated revenues. The impact of the application of IFRS15 to these contracts is unlikely to have a material impact on Group revenues or adjusted operating profit.
- IFRS16 "Leases": IFRS16 is effective for the Group for the year ended 30 September 2020 and the Group has begun an impact assessment on the consolidated financial statements in 2018.

The following new or amended standards are not expected to have a significant impact on the Group's consolidated financial statements:

- IAS12 "Recognition of Deferred Tax Assets for Unrealised Losses"; and
- IFRS9 "Financial Instruments".

1.21 Accounting estimates and judgements

The preparation of the Group's consolidated financial statements does not require management to make any critical accounting judgements, assumptions or estimates with regard to assets or liabilities that could potentially have a material adjustment to the carrying amount of assets or liabilities in the next 12 months.

Management however are required to make judgements, assumptions and estimates relating to certain assets and liabilities that could potentially have a material impact over the longer term. These relate to:

1.21.1 Acquisition accounting and goodwill impairment

When the Group makes an acquisition it recognises the identifiable assets and liabilities, including intangible assets, at fair value with the difference between the fair value of net assets acquired and the fair value of consideration paid comprising goodwill. Acquisitions are accounted for using the acquisition method as described in note 1.3 and 1.10 of Group Accounting Policies the key assumptions and estimates used to determine the valuation of intangible assets acquired are the forecast cash flows, the discount rate and customer/supplier attrition. Customer and supplier relationships are valued using a discounted cash flow model. Acquisitions often comprise an element of deferred consideration and may include a minority interest, which are subject to put options. These put options are valued at fair value at the date of acquisition. Deferred consideration is fair valued based on the Directors' estimate of future performance of the acquired entity.

The Group's growth strategy is to grow through acquisitions. This results in material amounts of goodwill and intangible assets (principally customer and supplier relationships) being recognised in the Consolidated Statement of Financial Position. As set out in note 1.11 of Group Accounting Policies, goodwill is tested annually to determine if there is any indication of impairment. Assumptions are then used to determine the recoverable amount of each CGU, principally based on the present value of estimated future cash flows to derive the "value in use" to the Group of the capitalised goodwill. The key estimates made and assumptions used in performing impairment testing this year are set out in note 10 to the consolidated financial statements.

1.21.2 Inventory provisions

Inventories are stated at the lower of cost and net realisable value as set out in note 1.12 of Group Accounting Policies. In the course of normal trading activities, judgement is used to establish the net realisable value of inventory and impairment charges are made for obsolete or slow-moving inventories and against excess inventories.

The decision to make an impairment charge is based on a number of factors including management's assessment of the current trading environment, aged profiles and historical usage and other matters which are relevant at the time the consolidated financial statements are approved.

1.21.3 Defined benefit pension

Defined benefit pensions are accounted for as set out in note 1.6 of Group Accounting Policies. Determining the value of the future defined benefit obligation requires estimates in respect of the assumptions used to calculate present values. These include discount rate, future mortality and inflation. Management makes these estimates in consultation with an independent actuary. Details of the estimates and key sensitivities made in calculating the defined benefit obligation at 30 September 2017 are set out in note 25 to the consolidated financial statements.

Parent Company Statement of Financial Position

As at 30 September 2017

	Note	2017 £m	2016 £m
Fixed assets			
Investments	c	**72.0**	72.0
Creditors: amounts falling due within one year			
Amounts owed to subsidiary undertakings		**(17.1)**	(20.5)
Total assets less current liabilities		**54.9**	51.5
Capital and reserves			
Called up equity share capital	d	**5.7**	5.7
Profit and loss account		**49.2**	45.8
		54.9	51.5

The financial statements of Diploma PLC, company number 3899848, were approved by the Board of Directors on 20 November 2017 and signed on its behalf by:

BM Thompson
Chief Executive Officer

NP Lingwood
Group Finance Director

Parent Company Statement of Changes in Equity

For the year ended 30 September 2017

	Note	Share capital £m	Shareholders' equity £m	Total equity £m
At 1 October 2015		5.7	37.1	42.8
Total Comprehensive Income	a	–	29.3	29.3
Dividends paid		–	(21.0)	(21.0)
Settlement of LTIP awards	d	–	0.4	0.4
At 30 September 2016		5.7	45.8	51.5
Total Comprehensive Income	a	–	26.2	26.2
Dividends paid		–	(23.5)	(23.5)
Settlement of LTIP awards	d	–	0.7	0.7
At 30 September 2017		**5.7**	**49.2**	**54.9**

Notes to the Parent Company Financial Statements

For the year ended 30 September 2017

a) Accounting policies

a.1) Basis of accounting

The Parent Company financial statements ("Financial Statements") have been prepared in accordance with the Companies Act 2006 and FRS101 "Reduced Disclosures Framework". The Directors confirm they have a reasonable expectation that the Company has adequate resources to continue in operational existence for the foreseeable future and accordingly, they continue to adopt the going concern basis in preparing the Financial Statements. The Financial Statements are presented in UK sterling and all values are rounded to the nearest million pounds (£m) except when otherwise indicated.

As permitted by section 408 of the Companies Act 2006, no separate profit and loss account is presented for the Company. There were no gains or losses either in the current or preceding years recognised in other comprehensive income.

The following disclosures have not been provided as permitted by FRS101:

- a cash flow statement and related notes;
- a comparative period reconciliation for share capital;
- disclosures in respect of transactions with wholly owned subsidiaries;
- disclosures in respect of capital management;
- the effects of new but not yet effective IFRS;
- disclosures in respect of the compensation of key management personnel as required.

The Company has also taken the exemption under FRS101 available in respect of the requirements of paragraphs 45(b) and 46 to 52 of IFRS2 "Share-based Payment" in respect of group settled share-based payments as the consolidated financial statements of the Company include the equivalent disclosures.

a.2) Total Comprehensive Income

Total Comprehensive Income comprises dividends received from subsidiaries, interest payable on inter-company balances, net of tax. Total Comprehensive Income is distributable to shareholders.

a.3) Dividends

Dividend income is recognised when received. Final 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.

The capacity of the Company to make dividend payments is primarily determined by the availability of retained distributable reserves and cash resources. As at 30 September 2017 the Company had distributable reserves of £49.2m (2016: £45.8m) and the total external dividends declared in 2017 amounted to £26.0m. When required the Company can receive dividends from its subsidiaries to further increase distributable reserves.

a.4) Diploma PLC Employment Benefit Trust and employee share schemes

Shares held by the Diploma PLC 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 and options have been exercised by the participants.

a.5) Auditor's remuneration

Fees payable to the auditor for the audit of the Company's accounts of £3,500 (2016: £3,500) were borne by a fellow Group undertaking.

b) Directors' and employees' remuneration

No remuneration is paid directly by the Company; information on the Directors' remuneration (which is paid by an immediate holding company) and their interests in the share capital of the Company are set out in the Remuneration Committee Report on pages 51 to 63. The Company had no employees (2016: none).

c) Investments

	£m
Shares in Group undertakings	
At 30 September 2017 and 1 October 2016	**72.0**

A full list of subsidiary and other related undertakings are set out on page 102.

d) Share capital

	2017 Number	2016 Number	**2017 £m**	2016 £m
Allotted, issued and fully paid ordinary shares of 5p each				
At 30 September	**113,239,555**	113,239,555	**5.7**	5.7

During the year 79,679 ordinary shares in the Company (2016: 48,861) were transferred from the Trust to participants in connection with the exercise of options in respect of awards which had vested under the 2011 Long Term Incentive Plan, as set out on pages 60 and 63 in the Remuneration Committee Report. At 30 September 2017, the Trust held 92,898 (2016: 172,577) ordinary shares in the Company representing 0.1% of the called up share capital. The market value of the shares at 30 September 2017 was £1.0m (2016: £1.5m).

Independent Auditor's Report to the Members of Diploma PLC

Report on the audit of the financial statements

Opinion

In our opinion:

- the financial statements give a true and fair view of the state of the Group's and of the Parent Company's affairs as at 30 September 2017 and of the Group's profit for the year then ended;
- the Group financial statements have been properly prepared in accordance with International Financial Reporting Standards ("IFRSs") as adopted by the European Union;
- the Parent Company financial statements have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice including Financial Reporting Standard 101 "Reduced Disclosure Framework"; and
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006 and, as regards the Group financial statements, Article 4 of the IAS Regulation.

We have audited the financial statements of Diploma plc ("the Parent Company") and its subsidiaries ("the Group") which comprise:

- the Consolidated Income Statement;
- the Consolidated Statement of Income and Other Comprehensive Income;
- the Consolidated and Parent Company Statement of Financial Position;
- the Consolidated and Parent Company Statements of Changes In Equity;
- the Consolidated Cash Flow Statement;
- the Group Accounting Policies; and
- the related notes 1 to 29 and notes (a) to (d) to the Parent Company Financial Statements.

The financial reporting framework that has been applied in the preparation of the Group financial statements is applicable law and IFRSs as adopted by the European Union. The financial reporting framework that has been applied in the preparation of the parent company financial statements is applicable law and United Kingdom Accounting Standards, including FRS101 "Reduced Disclosure Framework" (United Kingdom Generally Accepted Accounting Practice).

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) (ISAs (UK)) and applicable law. Our responsibilities under those standards are further described in the auditor's responsibilities for the audit of the financial statements section of our report.

We are independent of the Group and the Parent Company in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, including the FRC's Ethical Standard as applied to listed public interest entities and we have fulfilled our other ethical responsibilities in accordance with these requirements. We confirm that the non-audit services prohibited by the FRC's Ethical Standard were not provided to the Group or the Parent Company.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Summary of our audit approach

Key audit matters	The key audit matters that we identified in the current year were: • recoverability of goodwill and assessment for impairment; • accounting for acquisitions; and • appropriateness of inventory obsolescence provisioning. Within this report, any new key audit matters are identified with and any key audit matters which are the same as the prior year identified with
Materiality	The materiality that we used in the current year was £3.2m which was determined on the basis of approximately 5% of profit before tax.
Scoping	We have performed full scope audits at 13 locations, with an additional nine locations subject to specified audit procedures which address each of the significant balances and key audit risks within these entities. Together, the work at these locations represents the principal business units of the Group and accounts for 81% of the Group's revenues and 83% of the Group's operating profit.
Significant changes in our approach	There have been no other significant changes in our approach in the year.

Independent Auditor's Report to the Members of Diploma PLC continued

Report on the audit of the financial statements continued

Conclusions relating to principal risks, going concern and viability statement

We have reviewed the Directors' statement regarding the appropriateness of the going concern basis of accounting contained within page 65 to the financial statements and the Directors' statement on the longer-term viability of the Group contained within the Strategic Report on page 32.

We are required to state whether we have anything material to add or draw attention to in relation to:

- the disclosures on pages 32 to 35 that describe the principal risks and explain how they are being managed or mitigated;
- the Directors' confirmation on page 32 that they have carried out a robust assessment of the principal risks facing the Group, including those that would threaten its business model, future performance, solvency or liquidity;
- the Directors' statement on page 65 to the financial statements about whether they considered it appropriate to adopt the going concern basis of accounting in preparing them and their identification of any material uncertainties to the Group and the Parent Company's ability to continue to do so over a period of at least 12 months from the date of approval of the financial statements;
- the Directors' explanation on page 32 as to how they have assessed the prospects of the Group, over what period they have done so and why they consider that period to be appropriate and their statement as to whether they have a reasonable expectation that the Group will be able to continue in operation and meet its liabilities as they fall due over the period of their assessment, including any related disclosures drawing attention to any necessary qualifications or assumptions; or
- whether the Directors' statements relating to going concern and the prospects of the company required in accordance with Listing Rule 9.8.6R(3) are materially inconsistent with our knowledge obtained in the audit.

We confirm that we have nothing material to add or draw attention to in respect of these matters.

We agreed with the Directors' adoption of the going concern basis of accounting and we did not identify any such material uncertainties. However, because not all future events or conditions can be predicted, this statement is not a guarantee as to the Group's ability to continue as a going concern.

Key audit matters

Key audit matters are those matters that, in our professional judgement, were of most significance in our audit of the financial statements of the current period and include the most significant assessed risks of material misstatement (whether or not due to fraud) that we identified. These matters included those which had the greatest effect on: the overall audit strategy, the allocation of resources in the audit; and directing the efforts of the engagement team.

These matters were addressed in the context of our audit of the financial statements as a whole and in forming our opinion thereon and we do not provide a separate opinion on these matters.

Recoverability of goodwill and assessment for impairment

Key audit matter description	As at the year end, the Group held an aggregate of £122.8m of goodwill (2016: £115.2m) on the Statement of Financial Position and, as such, it is the most significant asset class. This goodwill has been recognised in respect of acquisitions that the Group has undertaken in the current and previous years. We consider that the carrying value of goodwill is a key area due to the judgemental inputs involved in the assessment for impairment. There are a number of such inputs used when assessing for impairment, including the determination of the discount rate, the determination of projected cash flows which includes assumptions relating to medium and long term growth rates and gross margins and the sensitivities applied. Refer also to page 45 (Audit Committee Report), page 88 for the Group Accounting Policies and note 10 of the consolidated financial statements (page 74).
How the scope of our audit responded to the key audit matter	We have obtained management's goodwill impairment review calculations and assessed the mechanical accuracy of the model. Furthermore, we challenged the assumptions and inputs used in the impairment model including the revenue growth rates and margins, discount rates, long term growth rates and the sensitivities applied and disclosed. Our procedures included reviewing forecast cash flows with reference to historical trading performance and the Board-approved budgets and consulting with our valuation specialists who benchmarked assumptions such as the discount rate to external macroeconomic and market data. The long term growth rate used in the cash flow projections was assessed to check that it did not materially differ to the average long term growth rate in any territories in which the Group operates. We have also performed sensitivity analysis on the impairment model to determine if a reasonable possible adverse change in the key assumptions, results in the carrying amount exceeding the recoverable amount for any cash generating unit.

Key observations	We concluded that the assumptions and judgements set out in management's model are reasonable and we concur with the Directors' assessment that there is no impairment. We also considered the disclosures within the consolidated financial statements to be appropriate.

Accounting for acquisitions

Key audit matter description	The Group has made one material acquisition in the year, being Abacus. The total combined consideration for this acquisition was £14.1m and an additional £6.1m of goodwill and £7.8m of intangible assets were recognised. The judgements used in determining the value of the goodwill and intangible assets and the allocation between these asset classes could, if performed inaccurately, lead to a material misstatement. There is significant judgement and complexity involved in the allocation of excess consideration over net assets of the acquiree between the fair value of intangible assets and remaining goodwill. For the fair value of intangible assets, this includes estimates for growth rates, discount rates and retention rates for supplier relationships. Management must exercise judgement to accurately measure the fair value of the acquired assets and liabilities as at the acquisition date. This includes, for example, assessing the amounts required for any additional inventory or receivables provisions. Refer also to page 45 (Audit Committee Report), page 88 for the Group Accounting Policies and note 22 of the consolidated financial statements (page 82).
How the scope of our audit responded to the key audit matter	We have obtained management's calculations for the accounting for the acquisition and we checked the mathematical accuracy of each acquisition model. We also assessed the adjustments to assets and liabilities in order to bring them to fair value and have held discussions with management in order to challenge the completeness of these adjustments. In order to assess the accuracy of the acquired intangible assets valuation, we have reviewed the methodology applied in management's calculation and challenged the assumptions behind the calculation including the growth rates, discount rates and supplier retention rates. We have involved our own internal specialists to assist in our assessment. We have reviewed the disclosures included within note 11 of the consolidated financial statements (page 75).
Key observations	We are satisfied that the assumptions and judgements used to determine the value of intangible assets acquired and the fair value adjustments made to the assets and liabilities of the acquired entity are reasonable. We have not identified any material misstatements in the accounting for acquisitions and consider the disclosures in the consolidated financial statements to be appropriate.

Independent Auditor's Report to the Members of Diploma PLC continued

Report on the audit of the financial statements continued

Appropriateness of inventory obsolescence provisioning

Key audit matter description	The valuation of inventory as at 30 September 2017 is £76.1m (2016: £66.8m), recorded net of a provision of £8.3m (2016: £7.8m). High levels of inventory are held across the Group, which gives rise to a greater risk of there being slow moving or obsolete lines of inventory. Therefore, we have determined that there is a key risk that inventory is recorded below its net realisable value due to insufficient obsolescence provisions. Management judgement is required in determining the completeness of inventory provisions and making an assessment of their adequacy, considering the age and volumes of inventory relative to expected usage. We have identified a risk of fraud in relation to this judgement. Changes to these assumptions could result in a material change in the carrying value of inventory and the associated movement recorded in the income statement. Refer also to page 45 (Audit Committee Report), page 88 for the Group Accounting Policies and note 15 of the consolidated financial statements (page 77).
How the scope of our audit responded to the key audit matter	We evaluated the recorded inventory obsolescence provision by obtaining management's workings and independently recalculating the provision in line with their stated policy. We challenged the underlying assumptions and completeness of the provision by considering the age and volumes of inventory relative to expected usage. Any aged inventory lines which were excluded from management's calculation were also challenged in order to further verify completeness of the provision. Management's historical ability to estimate the required inventory obsolescence provision was assessed by comparing write-offs during the period to the prior period provision. Furthermore, we compared the actual sales value of a sample of inventory items to their book value to ascertain that the carrying value of inventories does not exceed their net realisable value.
Key observations	We are satisfied that the provision for inventory obsolescence is not materially misstated.

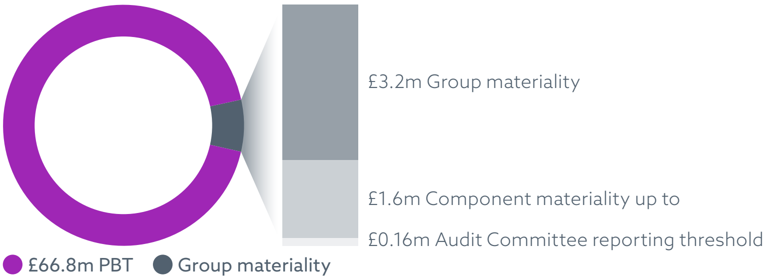
Our application of materiality

We define materiality as the magnitude of misstatement in the financial statements that makes it probable that the economic decisions of a reasonably knowledgeable person would be changed or influenced. We use materiality both in planning the scope of our audit work and in evaluating the results of our work.

Based on our professional judgement, we determined materiality for the financial statements as a whole as follows:

Group materiality	We determined materiality for the Group to be £3.2m (2016: £2.7m).
Basis for determining materiality	Materiality is based on a calculation of approximately 5% (2016: 5%) of profit before tax ("PBT").
Rationale for the benchmark applied	PBT has been chosen as the basis for materiality as this is the measure by which stakeholders and the market assess the wider performance of the entity and is the key metric that current and potential investors monitor when making their financial decisions.

Audit of components are performed at a materiality level not exceeding 50% (2016: 50%) of Group materiality (£1.6m, 2016: £1.35m).



We agreed with the Audit Committee that we would report to the Committee all audit differences in excess of £160,000 (2016: £130,000), as well as differences below that threshold that, in our view, warranted reporting on qualitative grounds. Having assessed the facts and circumstances of the Group and the prior history of misstatements, we determined that an increase in this threshold from prior year was appropriate. We also report to the Audit Committee on disclosure matters that we identified when assessing the overall presentation of the financial statements.

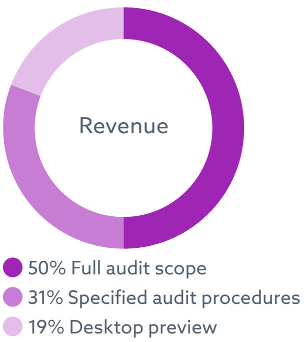
An overview of the scope of our audit

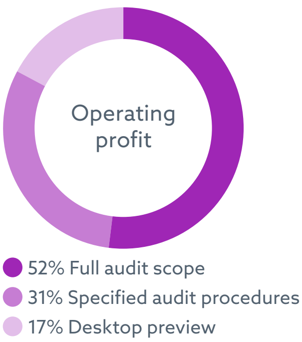
Our Group audit was scoped by obtaining an understanding of the Group and it environment, including Group-wide controls and assessing the risks of material misstatement at the Group level and where these are most likely to occur in the business. Based on this assessment, we focused our Group audit scope primarily on the audit work at 13 (2016: 12) locations, with the increase from the prior year due to the inclusion of DHG Australia as a full scope audit following the acquisition of Abacus by the Group during the period. Each of these 13 locations was subject to a full scope audit. An additional nine (2016: eight) locations were subject to specified audit procedures which address each of the significant balances and key audit risks within these entities. Together the work at these locations represents the principal business units of the Group and accounts for 81% (2016: 75%) of the Group's revenue and 83% (2016: 80%) of the Group's operating profit.

The Group audit team has designed and implemented a country visit programme so that the Senior Statutory Auditor or another senior member of the Group audit team visits the component locations to hold discussions with the lead partner, review their working papers, conclude on any findings an attend close out meetings with local management. Each year this programme of visits includes the three most significant territories (being the US, Canada and UK).

Where no visits are carried out the Senior Statutory Auditor or another senior member of the team has held discussions with the lead partner and attended close out meetings by phone.

At the parent entity level we also tested the consolidation process and carried out analytical procedures to confirm our conclusion that there were no significant risks of material misstatement in the aggregated financial information of the remaining components not subject to audit or specified audit procedures.





Independent Auditor's Report to the Members of Diploma PLC continued

Report on the audit of the financial statements continued

Other information

We have nothing to report in respect of these matters.

The Directors are responsible for the other information. The other information comprises the information included in the Annual Report other than the financial statements and our auditor's report thereon.

Our opinion on the financial statements does not cover the other information and, except to the extent otherwise explicitly stated in our report, we do not express any form of assurance conclusion thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated.

If we identify such material inconsistencies or apparent material misstatements, we are required to determine whether there is a material misstatement in the financial statements or a material misstatement of the other information. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact.

In this context, matters that we are specifically required to report to you as uncorrected material misstatements of the other information include where we conclude that:

- **Fair, balanced and understandable** – the statement given by the Directors that they consider the Annual Report and Financial Statements taken as a whole is fair, balanced and understandable and provides the information necessary for shareholders to assess the Group's performance, business model and strategy, is materially inconsistent with our knowledge obtained in the audit; or
- **Audit Committee reporting** – the section describing the work of the Audit Committee does not appropriately address matters communicated by us to the Audit Committee; or
- **Directors' statement of compliance with the UK Corporate Governance Code** – the parts of the Directors' statement required under the Listing Rules relating to the Company's compliance with the UK Corporate Governance Code containing provisions specified for review by the auditor in accordance with Listing Rule 9.8.10R(2) do not properly disclose a departure from a relevant provision of the UK Corporate Governance Code.

Responsibilities of Directors

As explained more fully in the Directors' Responsibilities Statement, the Directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view and for such internal control as the Directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the Directors are responsible for assessing the Group's and the Parent Company's ability to continue as a going concern, disclosing as applicable, matters related to going concern and using the going concern basis of accounting unless the Directors either intend to liquidate the Group or the Parent Company or to cease operations, or have no realistic alternative but to do so.

Auditor's responsibilities for the audit of the financial statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error and to issue an Auditor's Report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

A further description of our responsibilities for the audit of the financial statements is located on the Financial Reporting Council's website at: www.frc.org.uk/auditorsresponsibilities. This description forms part of our Auditor's Report.

Use of our report

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 Auditor's 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.

Report on other legal and regulatory requirements

Opinions on other matters prescribed by the Companies Act 2006
In our opinion the part of the Remuneration Committee Report to be audited has been properly prepared in accordance with the Companies Act 2006.

In our opinion, based on the work undertaken in the course of the audit:

- the information given in the Strategic Report and the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements; and
- the Strategic Report and the Directors' Report have been prepared in accordance with applicable legal requirements.

In the light of the knowledge and understanding of the Group and the Parent Company and their environment obtained in the course of the audit, we have not identified any material misstatements in the Strategic Report or the Directors' Report.

Matters on which we are required to report by exception

Adequacy of explanations received and accounting records Under the Companies Act 2006 we are required to report to you if, in our opinion: • we have not received all the information and explanations we require for our audit; or • 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 are not in agreement with the accounting records and returns.	**We have nothing to report in respect of these matters.**
Directors' remuneration Under the Companies Act 2006 we are also required to report if in our opinion certain disclosures of Directors' remuneration have not been made or the part of the Directors' Remuneration Report to be audited is not in agreement with the accounting records and returns.	**We have nothing to report in respect of these matters.**

Other matters
Auditor tenure
Following the recommendation of the Audit Committee, we were appointed by the Board to audit the financial statements for the year ending 30 September 2008 and subsequent financial periods. The period of total uninterrupted engagement including previous renewals and reappointing of the firm is ten years, covering the years ended 2008 to 2017. Following a full tender process the Board intends to appoint PricewaterhouseCoopers LLP as its auditor for the financial year ending 30 September 2018, subject to shareholder approval at the 2018 AGM.

Consistency of the Audit Report with the additional report to the Audit Committee
Our audit opinion is consistent with the additional report to the Audit Committee we are required to provide in accordance with ISAs (UK).

Edward Hanson (Senior Statutory Auditor)
For and on behalf of Deloitte LLP
Statutory Auditor
London, United Kingdom
20 November 2017

Subsidiaries of Diploma PLC

	Registered Office Address*
Life Sciences	
Somagen Diagnostics Inc.	F
AMT Electrosurgery Inc.	V
Vantage Endoscopy Inc.	V
Big Green Surgical Company Pty Limited	X
Diagnostic Solutions Pty Limited	X
Diploma Healthcare Group NZ Limited	Z
Techno-Path (Distribution) Limited[3]	J
Abacus ALS Pty Limited	X
Abacus ALS Limited	Z
A1-CBISS Limited	A
a1-envirosciences GmbH	G
a1-Envirosciences Limited[1]	A
Hitek Limited[1]	A
Hitek Group Limited[1]	A
Seals	
HB Sealing Products Inc.	D
J Royal US, Inc.	C
HKX Inc.	E
All Seals Inc.	B
RTD Seals Corp.	C
HB Sealing Products Limited	W
M Seals A/S[3]	S
M Seals AB[3]	T
M Seals NCL Limited[2]	A
EDCO Seal and Supply Limited[2]	A
Diploma (Tianjin) Trading Co. Limited	AB
FPE Seals Limited	A
A.B. Seals Limited[1]	A
Swan Seals (Aberdeen) Limited[1]	A
FPE Seals BV	P
Kentek Oy[3]	K
ZAO Kentek[3]	O
Kentek Eesti Ou[3]	L
SIA Kentek Latvija[3]	M
UAB Kentek Lietuva[3]	N
Kubo Tech AG	Q
Kubo Form AG	Q
Kubo Tech GmbH	R
West Coast Industrial Supplies Pty Limited	Y
West Coast Industrial Supplies New Caledonia SAS	AA
Controls	
IS Rayfast Limited	A
IS Motorsport Inc.	C
Amfast Limited[1]	A
Clarendon Specialty Fasteners Limited	A
Clarendon Specialty Fasteners, Inc.	B
Clarendon Engineering Supplies Limited[1]	A
Cabletec Interconnect Component Systems Limited[1]	A
Sommer GmbH	H
Filcon Electronic GmbH	I
Ascome SARL	U
Cablecraft Limited	A
Birch Valley Plastics Limited[2]	A
Krempfast Limited[2]	A
Betaduct Limited[1]	A
Hawco Limited	A
Abbeychart Limited[1]	A
HA Wainwright Limited[1]	A
Microtherm Limited[1]	A
Hawco Refrigeration Limited[1]	A
Microtherm UK Limited[1]	A
IS Group (Europe) Limited[1]	A
Specialty Fasteners Limited[1]	A
Specialty Fasteners & Components Limited[1]	A
Interconnect Components Services Group Limited[1]	A
Cabletec Flexibles Limited[1]	A
Intermediate holding companies	
Diploma Holdings PLC	A
Diploma Holdings Inc.	C
Pride Limited	A
Diploma Australia Holdings Limited	A
Diploma Canada Holdings Limited	A
Diploma Overseas Limited	A
Napier Group Limited	A
Williamson Cliff Limited	A
Newlandglebe Limited	A
Diploma Germany Holding GmbH	H
Diploma Canada Healthcare Inc	F
Diploma Australia Healthcare Pty Limited	X
Diploma Australia Seals Pty Limited	X

1 Dormant company.
2 These subsidiaries, both of which are incorporated in England, are exempt from the requirements of the UK Companies Act 2006 relating to the audit of individual accounts by virtue of section 479A of the Act.
3 These subsidiaries are 90% owned, all other subsidiaries are wholly owned.

All subsidiaries are owned through ordinary shares.

* Registered Office address
A 12 Charterhouse Square, London, EC1M 6AX, UK.
B 5716 Corsa Avenue, Ste 110, Westlake Village, CA 91362-7354, USA.
C 1201 Orange Street, Ste 600 One Commerce Center, Wilmington, DE 19899, USA.
D 17888 67th Court North, Loxahatchee, FL 33470-2525, USA.
E 4505 Pacific Highway East, Ste C2, Fife, WA 98424-2638, USA.
F 3400 First Canadian Centre, 350-7th Avenue SW, Calgary, Alberta T2P 3N9, Canada.
G Eichsfelder Strasse 1, 40595, Düsseldorf, Germany.
H Kraichgaustrasse 5, D-73765 Neuhausen, Germany.
I Rotwandweg 5, D-82024, Taufkirchen/Munchen, Germany.
J Fort Henry Business Park, Ballina, Co. Tipperary, Ireland.
K Nuolikuja 8, FI-01740, Vantaa, Finland.
L Laki tn 16, Kristiine linnaosa, Tallinn, Harju maakond, 10621, Estonia.
M Maskavas iela 459, Riga, LV-1063, Latvija.
N Vilniaus r. sav., Bukiškio k., Bičiulių g. 29, Lithuania.
O Dom 2, Liter B, Proezd Mebeljyj, 197374 , St. Petersburg, Russia.
P Industrieterrein Dombosch 1, Effweg 38, 4941 VP Ramsdonksveer, the Netherlands.
Q Im Langhag 5, 8307 Illnau-Effretikon, Switzerland.
R Lederergasse 67, AT-4020 Linz, Austria.
S Bybjergvej 13, DK 3060, Espergaerde, Denmark.
T Industrivagen 17, SE-302, 41 Halmstad, Sweden.
U 10, allee du Vivier, 72700 Allonnes, France.
V 333 Bay St., Suite 2400, Toronto, Ontario M5H 2T6, Canada.
W 226 Lockhart Road, Barrie, Ontario, L4N 9G8, Canada.
X 46 Albert Street, Preston, Victoria, 3072, Australia.
Y 72 Platinum Street, Crestmead, Queensland, 4132, Australia.
Z Office of Bendall & Cant Ltd, Southern Cross Building, 61 High Street, Auckland, New Zealand.
AA 22 Avenue des Géomètres Pionniers, ZAC PANDA – 98835, Dumbéa, New Caledonia.
AB 18 Fuyuandao Road, Wuqing Development Area, Tianjin, China.

Financial Calendar and Shareholder Information

Announcements (provisional dates)

First Quarter Statement released	17 January 2018
Annual General Meeting (2017)	17 January 2018
Half Year Results announced	14 May 2018
Third Quarter Statement released	29 August 2018
Preliminary Results announced	19 November 2018
Annual Report posted to shareholders	7 December 2018
Annual General Meeting (2018)	16 January 2019

Dividends (provisional dates)

Interim announced	14 May 2018
Paid	13 June 2018
Final announced	19 November 2018
Paid (if approved)	23 January 2019

Annual Report & Accounts
Copies can be obtained from the Group Company Secretary at the address shown below.

Share Registrar – Computershare Investor Services PLC
The Company's Registrar is Computershare Investor Services PLC, The Pavilions, Bridgwater Road, Bristol BS99 6ZZ. Telephone: 0870 7020010. Its website for shareholder enquiries is 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 Group Company Secretary at the address shown below.

Group Company Secretary and Registered Office
AJ Gallagher FCIS, Solicitor, 12 Charterhouse Square, London EC1M 6AX. Telephone: 020 7549 5700. Fax: 020 7549 5715. Registered in England and Wales, number 3899848.

Website
Diploma's website is www.diplomaplc.com.

Advisors

Investment Bankers
Lazard
50 Stratton Street
London W1J 8LL

Corporate Stockbrokers
Numis Securities
10 Paternoster Square
London EC4M 7LT

Solicitors
Ashurst LLP
Broadwalk House
5 Appold Street
London EC2A 2HA

Auditor
Deloitte LLP
2 New Street Square
London EC4A 3BZ

Bankers
Barclays Bank PLC
1 Churchill Place
London E14 5HP

HSBC Bank plc
City Corporate Banking Centre
60 Queen Victoria Street
London EC4N 4TR

Five Year Record

Year ended 30 September	2017 £m	2016 £m	2015 £m	2014 £m	2013 £m
Revenue	**451.9**	382.6	333.8	305.8	285.5
Adjusted operating profit	**78.2**	65.7	60.3	56.7	54.3
Finance expense	**(0.7)**	(0.8)	(0.7)	(0.5)	–
Adjusted profit before tax	**77.5**	64.9	59.6	56.2	54.3
Acquisition related charges	**(9.7)**	(10.3)	(7.4)	(6.4)	(5.6)
Gain on disposal of assets	**–**	0.7	–	–	–
Fair value remeasurements	**(1.0)**	(1.3)	(0.4)	–	(0.2)
Profit before tax	**66.8**	54.0	51.8	49.8	48.5
Tax expense	**(18.6)**	(14.9)	(14.4)	(13.7)	(13.7)
Profit for the year	**48.2**	39.1	37.4	36.1	34.8
Capital structure					
Equity shareholders' funds	**262.0**	233.5	189.6	184.4	176.9
Minority interest	**4.8**	4.3	5.2	2.9	1.4
Add/(deduct): cash and cash equivalents	**(22.3)**	(20.6)	(23.0)	(21.3)	(19.3)
borrowings	**–**	10.0	20.0	–	–
retirement benefit obligations	**9.9**	17.2	9.8	4.3	4.7
acquisition liabilities	**6.6**	6.8	6.6	4.0	3.0
deferred tax, net	**8.2**	7.4	5.9	3.3	1.7
Reported trading capital employed	**269.2**	258.6	214.1	177.6	168.4
Add: historic goodwill and acquisition related charges, net of deferred tax	**66.3**	59.2	53.6	49.6	43.1
Adjusted trading capital employed	**335.5**	317.8	267.7	227.2	211.5
Net increase/(decrease) in net funds	**11.9**	4.9	(17.4)	2.9	11.8
Add: dividends paid	**23.7**	21.4	19.9	18.4	17.6
acquisition of businesses	**20.1**	32.7	37.8	16.5	2.2
Free cash flow	**55.7**	59.0	40.3	37.8	31.6
Per ordinary share (pence)					
Basic earnings	**42.0**	33.9	32.5	31.4	30.7
Adjusted earnings	**49.8**	41.9	38.2	36.1	34.8
Dividends	**23.0**	20.0	18.2	17.0	15.7
Total shareholders' equity	**232**	206	167	163	156
Dividend cover	**2.2**	2.1	2.1	2.1	2.2
Ratios	**%**	%	%	%	%
Return on adjusted trading capital employed ("ROATCE")	**24.0**	21.1	23.9	25.8	25.8
Working capital: revenue	**15.0**	16.6	17.0	17.2	16.7
Operating margin	**17.3**	17.2	18.1	18.5	19.0

1 Acquisition related charges comprise the amortisation and impairment of acquisition intangible assets, acquisitions expenses and adjustments to deferred consideration.
2 Acquisition liabilities comprise amounts payable for the future purchases of minority interests and deferred consideration.
3 ROATCE represents adjusted operating profit, before acquisition related charges, as a percentage of adjusted trading capital employed (adjusted for the effect of the timing of major acquisitions and disposals). Trading capital employed and adjusted trading capital employed are calculated as defined in note 2 to the consolidated financial statements.
4 Adjusted earnings per share is calculated in accordance with note 9 to the consolidated financial statements.
5 Total shareholders' equity per share has been calculated by dividing equity shareholders' funds by the number of ordinary shares in issue at the year end.
6 Dividend cover is calculated on adjusted earnings as defined in note 2 to the consolidated financial statements.

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