FINANCE REVIEW

NIGEL LINGWOOD GROUP FINANCE DIRECTOR

MAINTAINING FINANCIAL DISCIPLINE

ADJUSTED OPERATING MARGIN

17.5%

FREE CASH FLOW

£60.5m

ROATCE

24.5%

REPORTED AND UNDERLYING RESULTS IN 2018

Reported revenues increased by 7% to £485.1m and adjusted operating profit increased by 9% to £84.9m, with each Sector benefiting from a favourable macroeconomic environment leading to robust customer demand in all geographies.

A recovery this year in UK sterling, particularly in the first half of the year, led to a currency headwind of 3% on the translation of the results of the overseas businesses, when compared with last year's average exchange rates. This currency headwind led to a reduction in revenues and adjusted operating profits of £13.1m and £2.4m, respectively. Acquisitions completed this year and last year, net of a small disposal this year, incrementally contributed £14.8m and £2.1m to revenue and adjusted operating profit, respectively.

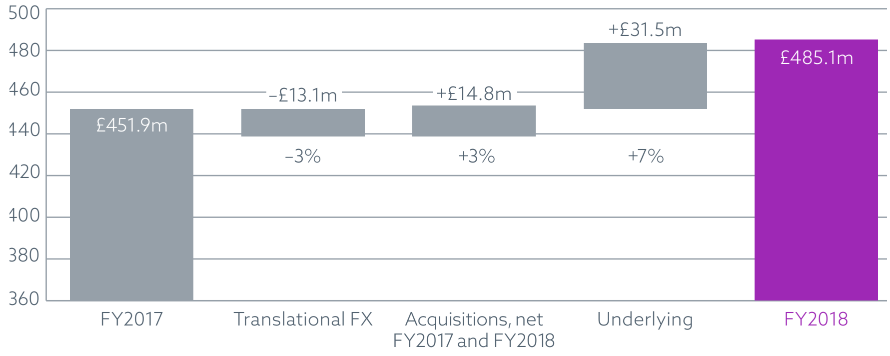
The underlying results present the performance of the Group on a like-for-like basis by adjusting for the contribution from businesses acquired during the year (and from the incremental impact from those acquired last year) and for the impact on the translation of the results of the overseas businesses from the strengthening in the UK sterling exchange rate, against most of the currencies of the Group's overseas businesses. With the currency headwind being broadly offset by the incremental contribution from acquisitions (net of a small disposal), underlying revenues and underlying adjusted operating profits also increased by 7% and 9%, respectively.

ADJUSTED OPERATING MARGIN

The Group's adjusted operating margin improved by 20bps this year to 17.5% (2017: 17.3%) reflecting the benefit of operational leverage, with Group gross margins remaining unchanged from last year.

In Life Sciences, gross margins strengthened slightly, reflecting a more favourable product mix and a small net currency transactional benefit from movements in exchange rates. The Canadian and Australian exchange rates have generally remained more stable this year and the benefit of favourable currency hedge contracts made a positive contribution. In Seals, gross margins slightly weakened as buoyant markets led to supplier price increases and longer product lead times. These price increases were generally not passed through to customers until the second quarter of the financial year. Freight costs also increased to mitigate longer lead times and maintain service levels to customers. In Controls, gross margins improved reflecting the benefit from a favourable product mix, proactive and targeted price increases and a decision to pull back from lower margin sales opportunities.

REVENUE BRIDGE – FY2018 (£m)



GBP VS G10 CURRENCY BASKET SECURITIES

ADJUSTED AND STATUTORY PROFIT BEFORE TAX

Adjusted profit before tax increased by 9% to £84.8m (2017: £77.5m). The interest expense this year was £0.1m (2017: £0.7m) and comprised the interest expense on the Group's net pension deficit, which had reduced from £0.3m last year, reflecting the smaller deficit in the fund at the beginning of this year.

There were no borrowing costs this year (2017: £0.1m) as the Group held cash funds for the majority of the year and interest earned on these cash funds of £0.1m offset bank facility commitment fees of £0.1m (2017: £0.3m). Last year's facility fees included a £0.2m arrangement fee on renewal of the bank facility.

Statutory profit before tax was £72.7m (2017: £66.8m) and is after charging acquisition related charges of £9.6m (2017: £9.7m) (which largely comprises the amortisation of acquisition related intangible assets) and fair value remeasurements of £0.4m (2017: £1.0m). In addition, one-off CEO transition costs of £2.1m were incurred relating to the change of the CEO in the current year.

The CEO transition costs comprise those charges directly attributable to the change, after 22 years, in the leadership of the Group this year. In particular, it includes the costs of recruitment, the costs of employment of the new CEO and the costs of the financial settlement relating to his departure from the Company on 28 August 2018, including advisors costs. These costs are set out in note 28 to the consolidated financial statements. The full year employment costs of Bruce Thompson, the retiring CEO, have been charged against adjusted operating profit and are not included in CEO transition costs.

The charge attributable to fair value remeasurements relate to the put options held over minority interests as described further below.

TAX CHARGE, EARNINGS PER SHARE AND DIVIDENDS

The Group's effective tax charge on adjusted profit reduced by 260bps in 2018 to 23.9%, compared with 26.5% last year. This lower rate reflected the impact from the reduction in the US Federal corporate income tax rate to 21% from 35%, effective 1 January 2018. The adjusted profit before tax earned in the US accounts for ca. 26% of Group adjusted profit before tax.

Adjusted earnings per share ("EPS") increased by 13% to 56.4p, compared with 49.8p last year and statutory EPS increased by 13% to 47.5p (2017: 42.0p).

The Board continues to pursue a progressive dividend policy that aims to increase the dividend each year broadly in line with the growth in adjusted EPS. In determining the dividend in any one year, 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 30 to 33 that could adversely impact the performance of the Group.

For 2018, the Board has recommended a final dividend of 17.8p per share (2017: 16.0p) making the proposed full year dividend 25.5p (2017: 23.0p). This represents an 11% increase in the proposed full year dividend with dividend cover remaining unchanged at 2.2 times.

FINANCE REVIEW CONTINUED

FREE CASH FLOW

Free cash flow represents cash available to invest in acquisitions or return to shareholders. The Group again generated strong free cash flow this year of £60.5m (2017: £55.7m), which benefited from £4.0m received on the sale of the small non-core US business. The free cash flow conversion was 95% (2017: 99%) of adjusted earnings.

The Group's operating cash flow increased by £5.0m to £84.3m (2017: £79.3m) this year, broadly reflecting the increase in operating profit. As anticipated in the Half Year Report, the outflow of cash into working capital reduced substantially in the second half of the year to £5.1m (2017: £4.0m) from £11.2m at 31 March 2018. Inventories increased by £8.3m (2017: £5.1m) to meet the stronger trading environment, particularly in the Seals businesses. This was partly offset by an inflow of £3.2m (2017: £1.1m) from an increase in net payables at the year end. The Group's KPI metric of working capital to revenue at 30 September 2018 remained broadly unchanged from last year at 15.1% (2017: 15.0%), again reflecting the robust revenues over the previous rolling 12 months.

Group tax payments decreased by £0.3m to £19.0m (2017: £19.3m). On an underlying basis cash tax payments represented ca. 23% (2017: 24%) of adjusted profit before tax reflecting the benefit from the lower US Federal corporate income tax rate. Underlying tax payments are before currency effects from 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 managing tax, with its responsibility to pay tax where it does business. The Group's tax strategy and policies have been approved by the Board this year and tax risks are regularly reviewed by the Audit Committee.

The Group's capital expenditure doubled this year to £6.6m (2017: £3.3m) reflecting in part the impact from new field equipment introduced in the Healthcare businesses and in part investment required in facility and IT infrastructure across the Group to support the increased trading activity seen over the past two years.

The Life Sciences businesses invested £3.5m in new capital this year (2017: £2.0m) of which £2.3m (2017: £1.6m) was invested in field equipment in the Healthcare businesses to support placements of new surgical equipment in hospitals and diagnostic machines in laboratories. A further £0.6m was invested in expanding and refurbishing facilities and offices in both the Healthcare and Environmental businesses and the remaining £0.6m on both warehouse equipment and on upgrading the IT infrastructure.

The Seals businesses invested £2.0m (2017: £1.1m), with £1.5m in the North American Seals businesses and £0.5m in the International Seals businesses. The new ERP systems being implemented in both the US Industrial OEM Seals business and in Kentek accounted for £1.1m and £0.8m was spent on refurbishing facilities and on warehouse equipment. The remaining £0.1m was spent on upgrading the IT infrastructure across the Seals Sector. In the Controls businesses £1.1m (2017: £0.2m) was invested primarily in expanding and refurbishing existing facilities. In particular the German business, IS-Sommer, invested £0.7m on expanding its existing warehouse and offices in Stuttgart, which is expected to be completed for a total cost of ca. £1.6m in March next year. The remaining £0.4m was spent on refurbishing the facilities in Cablecraft and Coast.

The Company paid the PAYE income tax liability of £1.0m (2017: £0.7m) on the exercise of LTIP share awards in November 2017, in exchange for reduced share awards to participants. In addition, £1.2m was paid to the Employee Benefit Trust to fund the acquisition of 100,000 ordinary shares in the Company to meet incentive awards.

The Group spent £20.4m (2017: £20.1m) of free cash flow on acquisitions, including £2.0m on acquiring outstanding minority shareholdings, as described below and £27.0m (2017: £23.7m) on paying dividends to both Company and minority shareholders.

ACQUISITIONS COMPLETED DURING THE YEAR

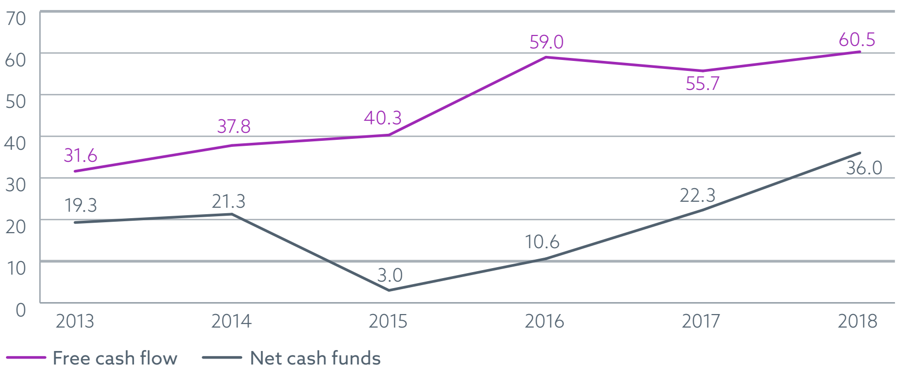
The Group invested £18.1m on acquiring new businesses this year and paid a further £0.3m of deferred consideration on businesses acquired in prior years. The continuing favourable economic markets in the US and Continental Europe this year contributed again to a much tougher environment to persuade potential vendors to dispose of their companies. However there were tentative signs towards the end of the year that, having enjoyed several years of stronger trading and with uncertainty about the future direction of global economies, some of these vendors were returning to the M&A market.

In August 2018 the Group completed the acquisition of FS Cables, based in St Albans, UK, for £16.9m on a debt/cash free basis. FS Cables is a leading supplier of specialist cable products to installers, end-users and wholesalers for a range of industries. The business complements the Group's existing Cablecraft business acquired in 2016, which supplies cable accessory products used to identify, secure and protect electrical cables. A further £1.2m was spent in October 2017 to acquire Coast, a small specialty fastener distributor based in California, US.

These acquisitions added £9.1m to the Group's acquired intangible assets, which represents the valuation of customer and supplier relationships that will be amortised over periods ranging from five to ten years. At 30 September 2018, the carrying value of the Group's acquired intangible assets was £53.6m and there was a £9.3m charge this year to amortise these assets.

Goodwill at 30 September 2018 was £128.5m and included £5.7m relating to those businesses acquired during the year (including fair value 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. It was confirmed that there was significant headroom on the valuation of this goodwill, compared with the carrying value of goodwill at the year end.

FREE CASH FLOW AND NET CASH FUNDS (£m)



Shortly after the year end, the IS-Group acquired Gremtek, a supplier of own-branded protective sleeving products based in France for £7.4m. This business will be integrated into the IS-Group to support their expansion into European markets.

LIABILITIES TO MINORITY SHAREHOLDERS

The Group's liability to purchase outstanding minority shareholdings at 30 September 2018 reduced to £4.5m (2017: £6.1m) following the purchase of the outstanding 10% minority shareholding in TPD for £2.0m.

The minority shareholdings outstanding at 30 September 2018 relate to a 10% interest held in both M Seals and Kentek. The options are exercisable in the next financial year.

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. A charge of £0.4m (2017: £1.0m) has been included in finance expense to reflect in part a slightly higher expected cost of purchasing these minority interests and in part the unwinding of the discount on the liability.

The Group also has a small liability at 30 September 2018 for deferred consideration of up to £1.1m (2017: £0.5m), which represents the Directors' best estimate of the amount likely to be paid to the vendors of businesses purchased during the year, based on the expected performance of these businesses during the measurement period. During the year, £0.3m was paid as deferred consideration relating to the acquisition of Ascome and Edco in previous years and £0.2m, which was no longer required, 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 used 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 that 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 2018, the Group ROATCE remained comfortably ahead of our 20% benchmark and improved to 24.5% (2017: 24.0%), which reflects the strong increase in adjusted operating profit this year. Adjusted trading capital employed is defined in notes 2 and 3 to the consolidated financial statements.

The Group continues to maintain a strong balance sheet with cash funds of £36.0m at 30 September 2018, compared with £22.3m last year. Surplus cash funds are generally repatriated to the UK, unless they are required locally to meet certain commitments, including acquisitions.

The Group also maintains a three year revolving multi-currency credit facility that expires on 1 June 2020, but has an option to extend the facility up to 1 June 2022. The facility comprises a £30m committed facility with an accordion option that allows the Group to increase the commitment up to a maximum of £60m of borrowings. These facilities have 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 2018 of £3.1m (2017: £2.8m).

The Group maintains a small legacy closed defined benefit pension scheme in the UK. A formal triennial funding valuation of this scheme was carried out as at 30 September 2016 and reported a funding deficit of £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. Since the valuation date, bond yields have increased to 2.9% and investment returns have been strong, which has led to a lower funding deficit. This deficit is being funded by cash contributions of £0.5m (2017: £0.4m) paid by the Company to the scheme. This contribution rate increases annually on 1 October by 2% with the objective of eliminating the deficit within ten years.

During the year, the scheme trustees, with the support of the Company, completed a buy-in of the pensioner liabilities existing at 1 September 2018. The buy-in was completed on 28 September 2018 with Just Retirement Limited for a premium of £13.0m, which was funded by the scheme, utilising substantial investment gains realised on the scheme's growth assets.

A recent decision by the High Court has confirmed that pension schemes will be required to equalise GMPs accrued between 1990 and 1997, between men and women. The UK scheme has not yet equalised GMPs, although as only ca. 25% of the members were contracted out of SERPS prior to 1997, the impact is unlikely to be material to the schemes existing liabilities.

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 (2017: £0.2m).

Both the UK defined benefit scheme and the Kubo contribution scheme are accounted for in accordance with IAS19 (Revised). At 30 September 2018 the aggregate accounting pension deficit in these two schemes increased slightly by £0.6m to £10.5m with a reduction of the deficit in the Swiss scheme being more than offset by an increase in the UK scheme deficit. The larger deficit in the UK scheme is because the buy-in premium was larger than the valuation of the corresponding liabilities; the Swiss scheme benefited from a higher discount rate, which led to a reduction in the scheme deficit. The gross aggregate pension liability in respect of these two schemes at 30 September 2018 decreased by £0.4m to £49.1m, which is funded by £38.6m of assets.

POTENTIAL IMPACT OF BREXIT

At an operational level, the impact on the Group's businesses from the current uncertainty over the process and timing of the UK's exit from the European Union is not expected to be significant in terms of the Group's overall profitability. UK based revenues account for only 26% of the Group's overall revenues and the UK businesses, as well as those based in Continental Europe, are substantially "in country" industrial suppliers of goods with limited cross border sales activity.

The Group's financial results may be impacted by macroeconomic instability arising from a delayed or disruptive exit from the European Union, such as a depressed UK economy or a substantial depreciation in UK sterling. In such a scenario, there may be a reduction in the Group's UK revenues and operating profits, although Group net assets would benefit from translating the results of the Group's overseas businesses into UK sterling. It is also likely that a depreciation in UK sterling would lead to stronger inflation in supplier costs for the Group's UK based businesses, which would need to be managed robustly to maintain gross margins.

The Board will continue to monitor closely developments in the Brexit plans on its UK businesses. A prolonged disruption at the UK's borders has the potential to impact the supply chain of the Group's UK businesses; however the businesses maintain a strong depth of inventories and have begun to build inventory levels of their faster moving product lines which would mitigate the impact on their activities from a significant disruption in cross border trade between the UK and Continental Europe.