Diploma PLC
Annual Report and Accounts 2008

Diploma PLC Annual Report and Accounts 2008

DIPLOMA PLC

Section 1
Group Overview

Section 2
Business Review
Other Regulatory Statements

Section 3
Financial Statements

Financial Highlights

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

Year ended 30 September	2008 £m	2007 £m	
Revenue	172.3	140.7	+22%
Operating profit*	27.3	22.1	+24%
Operating margin*	15.8%	15.7%	
Adjusted profit before tax*†	27.5	23.3	+18%
Profit before tax	21.8	22.3	-2%
Free cash flow	18.0	13.2	+36%

	Pence	Pence	
Adjusted earnings per share*†‡	16.4	14.0	+17%
Basic earnings per share ‡	11.8	12.7	-7%
Total dividends per share ‡	7.5	5.4	+39%
Free cash flow per share ‡	15.9	11.7	+36%

* Before amortisation of acquisition intangible assets
† Before fair value remeasurements
‡ Comparative numbers restated to adjust for the impact of the January 2008 bonus issue

Note: Diploma PLC uses alternative performance measures as key financial indicators to assess the underlying performance of the Group. These include adjusted profit before tax, adjusted earnings per share and free cash flow. The narrative on pages 2 to 45 is based on these alternative measures and an explanation is set out in note 2 to the consolidated financial statements.

What makes us different

Our stable revenue growth is achieved through the focus on essential products and services funded by customers' operating, rather than capital budgets

Read more: page 8

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

Read more: page 10

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

Read more: page 12

Over five years, we have delivered profit growth of 21% p.a. through a combination of steady organic growth and carefully selected, value enhancing acquisitions

Read more: page 14

An ungeared balance sheet and strong cash flow have funded this growth strategy while providing healthy dividends

Read more: page 16

Chairman's Statement

Another year of strong earnings growth and strong free cash flow demonstrates the resilience of the Group

The Diploma Group continued to make strong progress during 2008, against a background of a weakening economic environment. The acquisitions completed towards the end of the previous year contributed to another year of double digit growth in earnings and strong cash flow. Organic growth was also achieved in challenging markets; on a comparable and constant currency basis, the underlying growth in both revenue and operating profit was a creditable 3%. These positive results again highlight the ability of the Group to achieve stable growth and attractive margins by focusing on markets where the demand is funded by operating budgets which are less impacted by economic cycles than capital budgets.

Results

In 2008, Group revenue increased by 22% to £172.3m (2007: £140.7m) and operating profit, before the amortisation of acquisition intangible assets, increased by 24% to £27.3m (2007: £22.1m). Operating margins remained stable at 15.8% (2007: 15.7%) despite a number of investments in new growth initiatives during the year.

The results benefited from currency gains to revenue (£4.8m) and operating profits (£1.0m) on translation of the results of the overseas businesses, as UK sterling continued to weaken against the major currencies during the year. Net finance income reduced by £1.0m to £0.2m (2007: £1.2m) following the substantial investment in acquisitions at the end of the previous year.

Adjusted profit before tax increased by 18% to £27.5m (2007: £23.3m); IFRS profit before tax was £21.8m (2007: £22.3m) reflecting the impact of amortisation of acquisition intangible assets and fair value remeasurements of future obligations to acquire minority interests. Adjusted earnings per share increased by 17% to 16.4p (2007: 14.0p) and basic earnings per share were 11.8p (2007: 12.7p).

The underlying strength of the Group is demonstrated by another year of strong cash flow generation. Free cash flow increased by 36% to £18.0m (2007: £13.2m) benefiting from tight control of working capital and lower capital expenditure of £1.9m (2007: £2.2m). Expenditure on acquisitions during 2008 was more modest than last year at £7.9m (2007: £31.6m). After returning £6.9m in 2008 (2007: £5.4m) to shareholders in the form of dividends, cash funds at 30 September 2008 increased by £3.3m to £15.7m (2007: £12.4m).

Dividends

In the Interim Report, the Board indicated that in light of the increased scale of the Group's activities and the continuing strong free cash flow it had decided to target dividend cover towards 2.0, based on adjusted earnings per share. The Directors are therefore recommending a significant increase in the final dividend for 2008 of 1.4p to 5.0p (2007: 3.6p). This increases the total dividend payment for the year by 39% to 7.5p (2007: 5.4p).

The increased final dividend will be paid on 21 January 2009 to shareholders on the Register on 28 November 2008. The Board intends to continue with its policy of growing dividends in line with adjusted earnings per share, whilst applying the balance of the cash flow to strengthen the Group's businesses.

Financial and Human Resources

The Group ends the year in a strong financial position and with the resources in place to tackle the challenges ahead. We have cash funds of £15.7m, working capital facilities of £5.0m and committed bank facilities of £20.0m. This strong balance sheet provides a secure platform to progress our strategy.

Our human resources are equally strong. The energy and commitment of our people is a critical factor in the success of our Group and are particularly important in the current uncertain environment. On behalf of the Board, I would like to thank our employees for their commitment and efforts during

this year. I am confident of their ability to respond to the new challenges in the coming year, as we will inevitably have to face tougher trading conditions.

Outlook

The Board remains committed to growing the Group through a combination of organic growth and by acquisition. The Group has a strong balance sheet, committed bank facilities and businesses that consistently generate strong cash flows each year.

In the current uncertain market and economic conditions, the Group draws strength from its focus on essential products and services, funded by customers' operating rather than capital budgets. Margins are sustained by the service levels provided and operating costs are, to a large extent, variable. Cash flow remains strong through tight management of working capital.

As price expectations of potential target companies become more realistic there should be good opportunities to make value-enhancing acquisitions. With acquisition opportunities adding to modest organic growth, the Board is confident of making further progress in the year.

John Rennocks
Chairman

17 November 2008

Adjusted PBT (£m)

Year	Adjusted PBT (£m)
2004	13.1
2005	17.2
2006	20.4
2007	23.3
2008	27.5

Adjusted EPS (pence)

Year	Adjusted EPS (pence)
2004	8.2
2005	10.7
2006	12.6
2007	14.0
2008	16.4

Chief Executive's Review

The Group continues to execute its strategy and deliver against Key Performance Indicators

The Group comprises a number of high quality, specialised businesses supplying technical products and services. The common characteristics of these businesses are:

- Stable revenue growth, achieved through a focus on essential products and services, funded by customers' operating rather than capital budgets.

- Attractive margins, sustained through the quality of customer service, the depth of technical support and value adding activities.

- Strong committed management teams in the operating businesses, executing well formulated development strategies.

Over five years, the Group has grown revenues by 17% p.a. and operating profits, before amortisation of acquisition intangible assets, by 23% p.a., broadly half through organic growth and half through acquisitions. An ungeared balance sheet and strong cashflow have funded this growth strategy, while providing healthy and progressive dividends.

Strategic Developments

The Group's strategic objective is to build more substantial, broader based businesses in its chosen sectors through a combination of organic growth and acquisition. Further progress was made in the year in executing this strategy in each of the three sectors.

Life Sciences

The strategy in this sector has been to broaden the customer and geographic scope to reduce dependence on Life Science Research activities in the UK. The acquisition last year of AMT in Canada and its subsequent strong growth this year, has significantly advanced our position in Clinical markets. The earlier acquisition of CBISS, also provided impetus to the further growth in the year of the Environmental business. In 2008, the Canadian Healthcare businesses have grown substantially to account for ca. 50% of revenues and the Environmental business for ca. 25% of revenues. Life Sciences research accounted for the balance of 25%, which compares with 80% five years ago.

The broadening of sector activities has also introduced greater stability to revenues. Multi-year customer contracts for consumables and service now underpin some 60% of sector revenues and long term distribution agreements are in place to secure quality manufacturer branded products. The smaller acquisitions of Hitek in February 2008 and Meditech in Canada (acquired after the year end) have opened up further growth opportunities in related market segments.

Seals

The core business in this sector is the next day delivery of seals and seal kits used in the repair and maintenance of heavy mobile machinery. Through a combination of acquisitions and investment in broadening the product range and customer base, the sector businesses have established a leading position in the Seals Aftermarket in North America. The Aftermarket focus has ensured relatively stable revenue growth and the increased scale has secured attractive margins.

Significant growth potential remains in the core business in North America, but initiatives are also in process to extend the scope of the business into industrial OEMs and to expand internationally. The acquisition last year of M Seals contributed in both dimensions; this year it has achieved significant growth in Sweden and China and generally in the wind turbine industry. The acquisition of Snijders Engineering in the Netherlands in June 2008 was a further important step in the development of an Aftermarket Seals business in Europe.

Controls

The strategy in the Controls sector is to focus on more specialised, technology driven segments of the market that have been more buoyant than the broader industrial economies in which they operate. The core businesses in this sector have established strong positions in supplying into industries including Aerospace, Military & Marine, Motorsport, Automotive Diagnostics and Medical Equipment.

The acquisition last year of Cabletec, has expanded the products offered by adding a range of manufactured products including bonding leads which this year achieved EN4199 and Airbus ASNE approvals. Advances were also made this year in establishing stronger positions in the Power Generation and Rail industries. In Motorsport, a new satellite operation was established in North Carolina to focus on the US Nascar series and further advances were made in Asian markets. With 90% of sector revenues still generated in the UK and Germany, further opportunities to expand the geographic scope are being pursued.

Key Performance Indicators

The principal metrics used in measuring Group performance over the longer term are growth in adjusted earnings per share ("EPS") and total shareholder return ("TSR"). Adjusted EPS has grown by an average of 21% p.a. over the last five years; over the same period TSR has grown by 113% p.a. compared with growth of 64% in the FTSE 250 index, as shown on page 41 of this Report.

The Group also uses four financial key performance indicators ("KPIs") as measures in incentive programmes at Group and operating business levels. Performance against these KPIs is summarised below, with more detailed definitions and year by year data, set out within the Business Review on page 23.

Adjusted Profit Before Tax ("PBT")

In 2008, the Group's adjusted PBT increased by 18% to £27.5m (2007: £23.3m). This continued the growth trend over the last five years, during which period adjusted PBT has grown at an average rate of 21% p.a. This has been under-pinned by an average 23% p.a. growth in operating profit, before finance income.

Operating Margin

Over the last five years, the Group's operating margin has increased steadily from ca. 12% to the current year level of 15.8% (2007: 15.7%). Gross margins have on average remained very stable in each of the Group's sectors. At the same time, acquisitions and organic growth have added scale to each of the Group's businesses; the resulting operational leverage underpins the improvement in operating margins.

Free Cash Flow

The Group is strongly cash generative. Over the last five years, the Group has generated a robust free cash flow averaging £12.2m p.a. representing 87% of average adjusted profit after tax. In 2008, this trend continued with free cash flow increasing by 43% to £18.0m (2007: £12.6m), representing 92% of adjusted profit after tax. This performance is before accounting for the one-off proceeds from the phased sales of surplus land in Stamford, which have generated an additional £20.4m since 2003.

Return on Trading Capital Employed

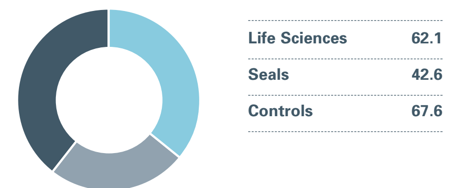
Return on Trading Capital Employed ("ROTCE") is a measure of the return that the Group makes on the total resources invested in the businesses. It is calculated as operating profit as a percentage of trading capital employed, including all goodwill and acquired intangible assets. A pre-tax threshold of 20% has been set for ROTCE which is broadly consistent with the Group's post tax IRR measure of 13% for capital project appraisal. In each of the last five years, ROTCE has remained above 20%; in 2008, the impact of the recently acquired businesses has resulted in this measure reducing to 21.0% (2007: 24.2%), but still comfortably above the threshold of 20%.

Bruce Thompson
Chief Executive Officer

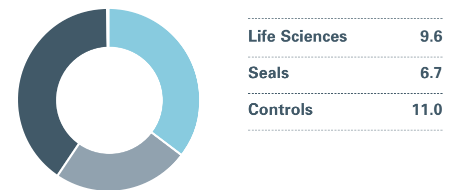
17 November 2008

Life Sciences | Seals | Controls

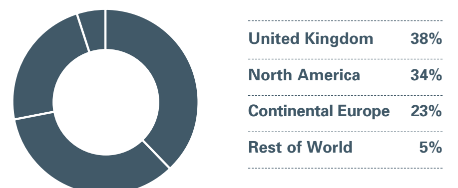
Revenue by Sector (£m)



Operating Profit by Sector (£m)



Revenue by destination



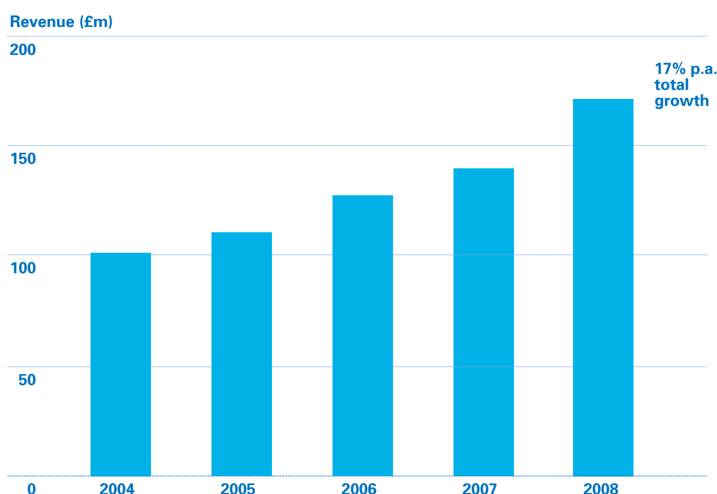
Stable Revenue Growth

We aim to achieve stable revenue growth by focusing on markets where the demand is funded by operating budgets which are less impacted by economic cycles than capital budgets. A high proportion of our revenues are generated from consumable products and service contracts and in many cases the products will be used in repair, maintenance and refurbishment applications, rather than original equipment manufacture.

Where public sector funding or regulation is involved, year on year changes in funding may also be less dramatic. This has proved to be the case in recent years in Healthcare, Rail, Power Generation, Defence and Environmental industries which have been relatively insulated from economic cycles.

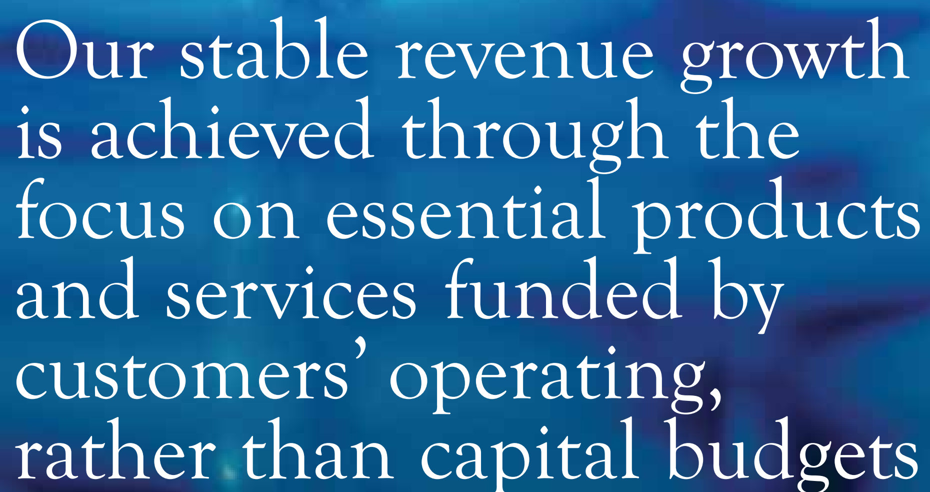
Our businesses also gain protection through offering specialised products and services, often used in technically demanding applications. This defends against customers quickly switching business to achieve better pricing when markets turn down. Markets such as Aerospace, Motorsport and Medical equipment, have proved to be more buoyant than the general industrial economy.

Five Year Revenue Growth



Our objective is to grow organically at a rate higher than GDP growth – the target is ca. 5% p.a. over the economic cycle.

Acquisitions contribute to the higher growth rates achieved – average of 17% p.a. over five years.


Our stable revenue growth
is achieved through the
focus on essential products
and services funded by
customers' operating,
rather than capital budgets

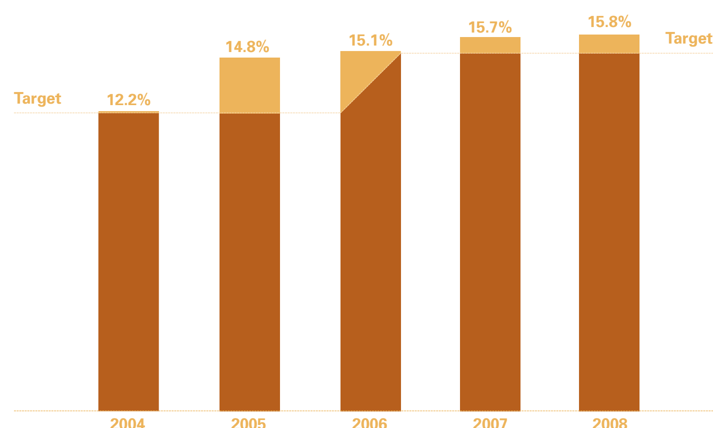
Attractive Margins

Our attractive margins are sustained over time by providing a range of services to our customers which they value and are therefore prepared to pay a premium for. Such services fall broadly into three categories – customer service, technical support and value adding activities.

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

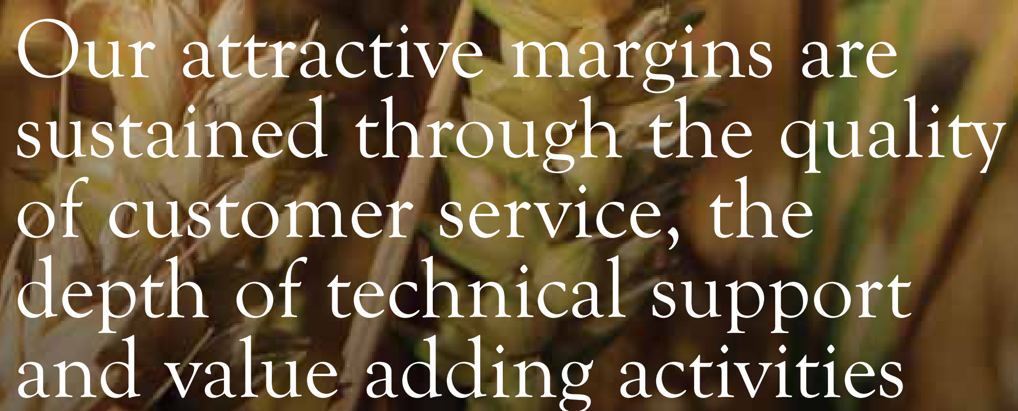
If real value is not provided, margins will erode over time. The evidence that we are delivering value lies in our gross margins which in specific product/market segments are very stable over time. Movements in gross margin principally arise due to changes in the mix of business or short term currency movements.

Operating Margin (%)



Operating margin is the ratio of adjusted operating profit to revenues.

Scale economies and investment have raised the sustainable level and the target has increased from 12% to 15%.


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

Strong Committed Management

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

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

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

The total cadre of ca. 50 senior managers in the operating businesses, demonstrate a good blend of energy, ambition and experience. The average age of these managers is 44 and they have an average length of service within their companies of 10 years. Key statistics for the broader workforce are summarised below.

Key Employee Statistics

	Number of employees	Males as % of total	Average length of service (yrs)	Average staff turnover	Sick days lost per person
30 September 2008	**976**	**64%**	**5.5**	**20.4%**	**3.3**
30 September 2007	926	63%	5.3	21.0%	2.9

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

Value Enhancing Acquisitions

To complement our organic growth strategy, we make selective acquisitions to accelerate growth and take us into new but related markets. Prospective acquisitions should be sales and marketing led with strong customer relationships and a secure supply of quality, differentiated products. They should have capable management, and the potential for profitable growth and cash generation.

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

The Group's robust balance sheet, supported by strong and consistent operating cash flow, give us the resources to support an active acquisition strategy.

Acquisition Overview

	2004	2005	2006	2007	2008
Life Sciences	**Somagen**		**CBISS**	**AMT**	**Hitek** **Meditech**
Seals		**HKX**		**M Seals**	**Snijders Engineering**
Controls				**Cabletec**	

Over five years, we have delivered profit growth of 21% p.a. through a combination of steady organic growth and carefully selected, value enhancing acquisitions

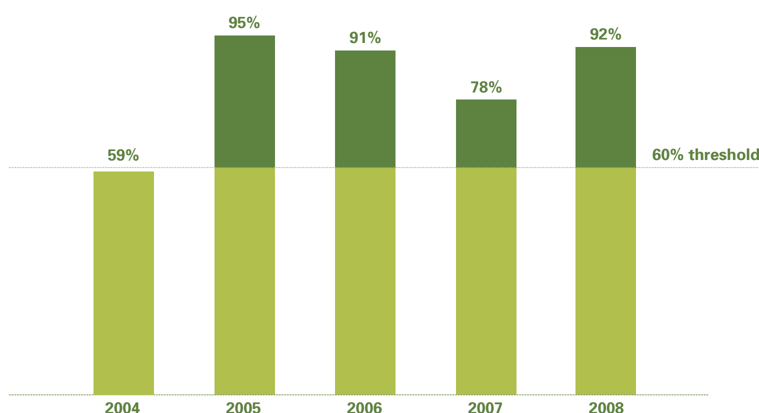
Strong Cash Flow

Our operating businesses are strongly cash generative. Once the businesses have achieved a certain critical mass, they can generally increase revenues without a significant increase in working capital. Our businesses are not particularly capital intensive, with the principal fixed assets being IT systems, office and warehouse facilities. Significant investments are made periodically in IT system up-grades and facility expansions, but annual capital expenditure would typically be lower than the depreciation charge over the business cycle.

Our threshold for conversion of adjusted profit after tax into free cash flow is 60%, but over the last five years we have achieved an average conversion rate well in excess of 80%. In recent years, this strong cash flow from the operating businesses has been supplemented by the phased sale of certain surplus land in Stamford, generating additional funds of ca. £20m over a five year period.

The total cash flow, after dividend payments and acquisitions, has left us with a strong, ungeared balance sheet.
This provides the financial resources to fund our growth strategy, while providing healthy and progressive dividend payments.

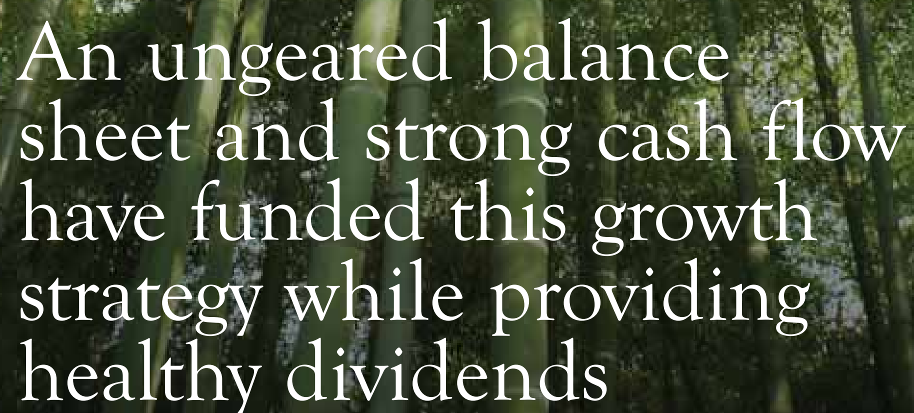
Free cash flow* (% of adjusted PAT)



***Excludes Stamford land proceeds**

Free cash flow is after tax, but before dividends and acquisitions. Proceeds from the sale of surplus land in Stamford have been excluded.

The target is to convert a minimum 60% of adjusted profit after tax (“PAT”) to free cash flow.


An ungeared balance
sheet and strong cash flow
have funded this growth
strategy while providing
healthy dividends

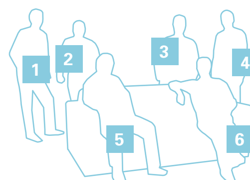
Directors and Advisors

Our experienced Board focuses on strategy, financial control and risk management.

* Member of the Remuneration Committee
† Member of the Audit Committee
‡ Member of the Nomination Committee

1. I Henderson (52)
Chief Operating Officer
Joined the Board as a Director in 1998. He was previously a Director of Glenchewton plc and ANC Holdings Limited.

2. NP Lingwood ACA (49)
Group Finance Director and Company Secretary
Joined the Company in June 2001 and appointed Group Finance Director on 3 July 2001. Prior to joining Diploma, he was Group Financial Controller of Unigate PLC, having previously qualified with Price Waterhouse, London.



3. BM Thompson (53)
Chief Executive Officer
Joined the Board in 1994 and appointed Chief Executive Officer in 1996. He started his career in the automotive industry, first as a design engineer and then in marketing. Prior to joining Diploma, he was Director of Arthur D Little Inc's Technology Management Practice in the United States.

4. IM Grice (55) *†‡
Non-Executive
Joined the Board in January 2007. He is Chairman of Pims Group Limited and a non-Executive Director of John Graham Holdings Limited. He was Group Chief Executive of Alfred McAlpine plc until February 2008.

5. JL Rennocks FCA (63) *†‡
Non-Executive Chairman
Joined the Board in July 2002. He is Chairman of Nestor Healthcare plc and Intelligent Energy plc, Deputy Chairman of Inmarsat plc and a non-Executive Director of Babcock International Group plc. He has previously been Executive Director Finance at Corus Group Plc and Finance Director of PowerGen Plc and Smith & Nephew plc.

6. JW Matthews FCA (64) *†‡
Non-Executive
Joined the Board in 2003. He is Chairman of Regus Group plc and a non-Executive Director of Minerva plc and SDL plc. He has previously been Chairman of Crest Nicholson plc and was a Managing Director of County NatWest and Deputy Chairman/Deputy Chief Executive of Beazer plc.

Investment Bankers:
Lazard
50 Stratton Street
London W1J 8LL

Corporate Stockbrokers:
Panmure Gordon & Co
Moorgate Hall, 155 Moorgate
London EC2N 6XB

Solicitors:
Ashurst
Broadwalk House
5 Appold Street
London EC2A 2HA

Auditors:
Deloitte and Touche LLP
Stonecutter Court
1 Stonecutter Street
London EC4A 4TR

Bankers:
Royal Bank of Scotland
62-63 Threadneedle Street
London EC2R 8LA

Section 2
Regulatory Statements

Business Review

Strategy and Performance 21
Sector Review: Life Sciences 24
Sector Review: Seals 26
Sector Review: Controls 28
Finance Review 30
Risk and Uncertainties 32
Corporate and Social Responsibility 35

Other Regulatory Statements

Directors' Report 36
Corporate Governance 37
Remuneration Report 41

Strategy and Performance

Group Strategy

The Group comprises a number of high quality, specialised businesses supplying technical products and services and operating in the three broad industry sectors of Life Sciences, Seals and Controls. The businesses aim to achieve stable revenue growth through the focus on essential products and services funded by customers' operating, rather than capital budgets. Attractive margins are sustained through the quality of customer service, depth of technical support and value adding activities. The Group's strategic objective is to build more substantial, broader based businesses in the chosen sectors through a combination of organic growth and acquisition.

There are a number of core themes which underpin the strategies of the Group and its operating businesses:

Focus on growth market segments
Our businesses are encouraged not to settle for growth at the sector average or to be driven unquestioningly by business cycles. The challenge is to identify and focus on the more attractive market segments where more rapid or consistent growth is achievable. This can be achieved by either organic growth initiatives, or acquisition, or a combination of both.

In Life Sciences, growth in the original core Research market in the UK has slowed as the major Pharmaceutical and Biotechnology companies have restructured their laboratory operations and focused on cost control. In response we have developed new businesses in the growing Environmental and Clinical markets and have broadened the geographic scope. In 2008, the Canadian Healthcare and Environmental businesses together contributed ca. 75% of sector revenues and more than 60% of revenues were generated outside the UK.

In Seals, the businesses have been traditionally focused on North America and on the Aftermarket . With a series of organic investments and acquisitions, we have extended the business into a broader range of international markets and into industrial OEMs. The acquisition of M Seals in 2007 and Snijders Engineering in 2008 and the investments in Europe and China have continued this process. In 2008, 40% of sector revenues were generated in international markets outside North America and industrial OEMs now account for ca. 25% of sector revenues.

In Controls, the businesses have achieved stronger growth than the general industrial economies in which they operate, by focusing on more buoyant markets including Defence, Aerospace, Motorsport, Rail, Power and Medical Equipment. The acquisition of Cabletec has further extended the sector activities in the Aerospace and Rail markets.

Strong customer relationships underpinned by full service offering
Sales and marketing are the main drivers for each of the businesses. With a background in specialised distribution it is natural to start with the needs of key customers and then to design the business models to respond to these requirements in terms of products, service offerings and operational responsiveness.

A key priority for our businesses is to build strong customer relationships within our selected product and market segments. Such customer relationships are made more robust and resilient through our delivery of a full service offering. Such services fall broadly into three categories – customer service, technical support and value added activities.

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

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

As an example of the strength of customer relationships and following the acquisition of AMT, ca. 60% of sector revenues in Life Sciences are generated from multi-year customer contracts for consumables and services.

Core Strategic Themes

Focus on growth market segments

Strong customer relationships underpinned by full service offering

Secure supply of quality differentiated products

Motivated and committed management teams

Efficient and responsive operations and information systems

Carefully selected acquisitions to accelerate growth

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

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

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

The strong performance by AMT in 2008, exemplifies the power of strong proprietary products supplied on an exclusive basis. By contrast, the a1-group has improved competitiveness by developing its own range of containment products which are now manufactured by reliable sub-contractors. Finally, Cabletec has had success by developing its own manufactured products.

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

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

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

The ca. 50 managers, who together make up the senior management cadre in the operating businesses, demonstrate a good blend of energy, ambition and experience. The average age of these managers is 44 and they have an average length of service within their companies of ten years.

Efficient and responsive operations and information systems
We continue to make substantial investments in infrastructure and systems to give high levels of customer service, responsiveness and operational efficiency. This is an important element of the value added by the Group when transforming small owner-managed companies into more substantial broader based businesses.

Ongoing investment programmes ensure that our principal businesses are operating from purpose built or newly expanded facilities designed for efficient operations and with the scale to support significant future growth.

Similarly in the area of information systems, regular investment ensures that the businesses are supported by integrated IT systems designed to give strong functionality and efficiency and capable of supporting growth. Over the past five years, an average of £0.6m p.a. has been invested in improving the Group's information systems; in 2008, investment of £0.6m was made in IT systems.

Carefully selected acquisitions to accelerate growth
To complement our organic growth strategy, we make selective acquisitions to accelerate growth and take us into new, but related markets. The Group's ungeared balance sheet, supported by strong and consistent operating cash flow, give us the resources to support an active acquisition programme.

We have clear criteria which guide our pro-active acquisition programme and are derived from the strategic themes above. Prospective acquisitions should be sales and marketing led with strong customer relationships and a secure supply of quality, differentiated products. They should have capable management, and the potential for profitable growth and cash generation.

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

Three acquisitions were completed in August 2007 for a total maximum consideration of ca. £30m and these have all contributed significantly to growth in 2008. The two acquisitions completed in 2008 for £3.9m, Hitek and Snijders Engineering, were smaller but both open up new growth opportunities within their respective sectors.

Key Performance Indicators

The success of the Group strategy in the longer term is measured in financial terms by the growth in the two key measures of adjusted earnings per share ("EPS") and total shareholder return ("TSR"). These are the principal quantitative measures used in the incentive compensation programmes for the Executive Directors.

To assess the performance of the Group at a more detailed level, we use four financial key performance indicators ("KPIs") as described below. These measures are defined in note 2 to the consolidated financial statements. As well as being used to measure the performance at Group level, the financial KPIs drill down through the organisation and are used as the principal quantitative elements in the short and long term incentive programmes for senior management of the operating businesses. Non-financial KPIs are also used in each of the businesses, but these are tailored to the particular requirements and characteristics of each business.

Adjusted PBT

The growth in adjusted profit before tax ("PBT") is a key measure of the underlying performance of the Group over time. Adjusted PBT removes the distorting influence of the costs of restructuring or rationalisation of operations, the profit or loss on sale of properties, the amortisation and impairment of acquisition intangible assets and fair value remeasurements. Within the operating businesses, profit growth is measured in terms of operating profit, before finance income and amortisation of acquisition intangible assets.

The Group's adjusted PBT has grown at an average rate of 21% p.a. over the last five years. This has been underpinned by an average 23% p.a. growth in operating profit, as defined above.

Operating margin

Operating margin represents operating profit, before amortisation of acquisition intangible assets, divided by revenue. It is an important measure to the Group as it monitors the success of the businesses in achieving superior margins by offering strongly differentiated products and services, as well as by running their operations efficiently.

Over the last five years, the Group operating margin has steadily increased from ca.12% to 15.8% in 2008.

A number of the acquisitions made in recent years have had a positive impact on Group average margins. The most important driver, however, has been the operational leverage gained as the businesses have increased in scale, leading to increased revenues without a proportionate increase in operating costs. This effect has been most visible in the Seals sector businesses in North America where major investments have been made in the IT infrastructure and the warehousing operations to support the increasing scale and scope.

Free cash flow

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

Over the last five years, the Group has generated a robust free cash flow averaging £15.4m p.a.; these figures have been boosted by a total of £20.4m received since 2003 from the sale of three phases of the Stamford land. Removing the Stamford land sale proceeds, free cash flow has still been an average of £12.2m p.a. representing 87% of average adjusted profit after tax over the same period.

Return on trading capital employed

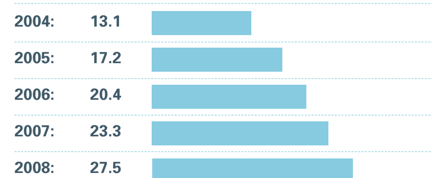
Return on trading capital employed ("ROTCE") represents operating profit, before amortisation of aquisition intangible assets, as a percentage of trading capital employed ("TCE"), defined as net assets less net cash and non-operating assets and liabilities.

At the Group level, TCE, as defined in note 2 of the consolidated financial statements, includes the total cash invested in acquisitions, including all gross goodwill and acquired intangible assets, both capitalised and written off in previous years. Over the last five years, ROTCE has remained consistently above 20.0%.

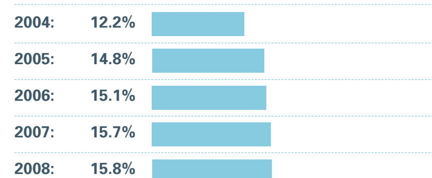
At the operating business level, goodwill and acquired intangible assets are excluded from TCE so that management is judged more narrowly on the return achieved on capital invested in fixed assets and working capital. This is because the operating business management may not have been directly involved in the price negotiations for acquisitions completed within their sectors.

Key Performance Indicators

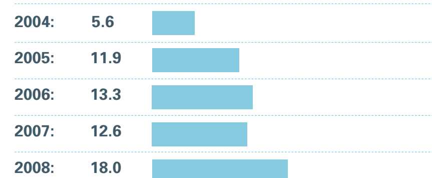
Adjusted PBT (£m)



Operating Margin

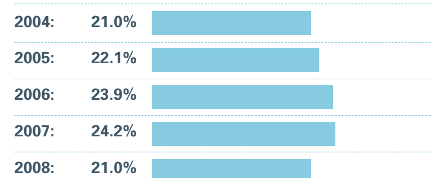


Free Cash Flow* (£m)



*excluding sale of Stamford land

ROTCE



Sector Review: Life Sciences

Sector Definition and Scope

The Life Sciences sector businesses supply a range of consumables, instrumentation and related services to clinical, research and environmental applications.

The Canadian Healthcare businesses are **Somagen**, based in Edmonton, Alberta, and **AMT**, based in Kitchener, Ontario. Somagen supplies a range of consumables and instruments used in the diagnostic testing of blood, tissue and other samples in the 500-600 hospital pathology laboratories across Canada. AMT supplies specialty electrosurgery and endoscopy equipment and consumables for use in the operating rooms and endoscopy suites of the same Canadian hospitals. A large proportion of the revenues for both Somagen and AMT come from multi-year customer contracts with hospitals and buying groups.

Anachem, based in Luton, is a supplier of pipettes, tips and laboratory automation products to the Life Sciences Research market in the UK and Eire. Key customers are the major Pharmaceutical and Biotechnology companies, Research Institutions and Universities. The products are supported by a comprehensive range of maintenance, calibration and validation services.

The **a1-envirosciences group** (“the a1-group”) is a supplier to Environmental testing laboratories and to Health & Safety engineers. a1-envirotech supplies a range of specialised instruments for detecting and measuring specific elements in liquids, solids and gases. a1-safetech supplies gas detection devices, as well as a range of containment enclosures for potent powder handling. CBISS supplies equipment and services for the monitoring and control of environmental emissions. The UK operations of the a1-group are located in Luton and Tranmere. In Continental Europe, the group has locations in Dusseldorf in Germany and Basel in Switzerland.

Market Drivers

Somagen and AMT supply into the Canadian Healthcare sector, which is mostly public sector funded. The principal demand driver is therefore the level of healthcare spending by the Canadian Government.

C$bn	2004	2005	2006	2007	Growth % p.a
Public sector health expenditure in Canada	92.6	99.1	105.7	113.0	6.8%

Over many years, healthcare expenditure has grown steadily in the range 6-7% p.a. with annual variations mostly dependant on the periodic additional tranches of funding provided by individual provinces. Other factors which may influence the demand for Somagen and AMT products and services are:

- Proportion of total healthcare budgets allocated to diagnostic testing and to surgical procedures.
- Emergence of new tests driven by focus on specific diseases or allergies.
- Increased use of electrosurgical and endoscopic products in hospitals.

The market for Anachem’s Life Science Research products is driven principally by the level of private and public sector funds allocated to research to identify the causes of disease and to develop new drugs or therapies.

£m	2004	2005	2006	2007	Growth % p.a
UK Government expenditure on medical research[1]	471	475	574	609	9.2%
Pharmaceutical R&D expenditure in the UK[2]	3,239	3,379	3,949	n/a	10.6%

Sources:
(1) HM Treasury
(2) The Office of National Statistics

In recent years, publicly funded research in the medical field has grown by an average of 9% p.a. boosted by a particularly large reported increase in 2006. Growth was slower in 2007 and is likely to moderate further in 2008 and 2009.

In pharmaceutical companies, research activity was relatively flat over the period 2000 to 2005 as the companies pursued cost control initiatives and rationalised research and development activities in the UK. There was a strong reported increase of 17% in 2006 Pharmaceutical R&D expenditure in the UK. More recent data will be required to confirm whether this level of expenditure has been sustained.

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

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

The market for Environmental Monitoring and Instrumentation (EMI) in the UK has been estimated by a 2006 DTI/ CEED study to be ca. £190m with an annual growth rate through to 2015 projected at ca. 3% p.a.

Sector Performance

The Life Science businesses increased revenues in 2008 by 39% to £62.1m (2007: £44.7m). Sector revenues benefited from both an excellent first full year contribution from AMT and from the strong appreciation of the Canadian dollar against UK sterling. On a comparable and constant currency basis, sector revenues showed underlying organic growth of 7%.

Operating profits increased by 45% to £9.6m (2007: £6.6m) with operating margins increasing to 15.5% (2007: 14.8%). The UK businesses experienced pressure on margins from the appreciation of the euro against UK sterling, restructuring costs and the installation of new IT systems. The strong combined performance of the Canadian businesses however, more than offset these margin pressures.

Capital expenditure in the sector was £1.1m, including £0.6m invested in field equipment for placement by the Canadian businesses. The balance was invested in IT upgrades in the two UK businesses and on refurbishing calibration equipment in Anachem. Free cash flow before tax of £9.7m was generated in the sector (2007: £5.2m).

Somagen achieved good growth in the sale of Consumables, Reagents and Services (“CRS”) from the core suppliers which account for ca. 70% of revenues. Success was achieved in converting key customers to newer technology instruments such as Sebia’s Capillarys system, Phadia’s Immunocap 250 allergy system, Sakura’s new automation products and Tosoh’s new G8 instruments. These new instrument placements will secure multi-year CRS contracts with key customers.

In recent years, Somagen has suffered from the effects of supplier consolidation with the acquisition of suppliers including DSL, Biosite and Blackhawk. In current market conditions such acquisition activity has slowed and Somagen has been successful in adding new suppliers including Trek, Meridian, BBI-Seracare and Biolytical. Overall however, Somagen's revenues reduced slightly in the year as the growth in core product lines and new supplier introductions were not sufficient to fully offset the supplier losses.

AMT in its first full year as part of the Group, delivered an exceptional performance with growth in excess of 30% compared with the prior year comparable period. The two principal business streams, AMT Electrosurgery and AMT Endoscopy, both contributed strongly to this performance.

AMT Electrosurgery continued its penetration of the major hospitals, signing up multi-year contracts for the supply of its core proprietary products including smoke evacuation, reuseable grounding pads and specialty electrodes. AMT has long term, exclusive distribution rights in Canada for these products which are strongly differentiated and patent protected. Success was also achieved by focusing product specialists on increasing sales of other specialty products in a broader range of surgical applications.

AMT Endoscopy concentrates on sales to Gastro-Intestinal ("GI") and Endoscopy units which are run separately within hospitals, with different product requirements and purchasing processes. AMT has focused on a small number of proprietary products supplied on an exclusive basis, including Argon Plasma Coagulation ("APC") and flexible endoscopic instruments. Having established strong relationships with customers, AMT is again sourcing new innovative products to broaden the product offering and take a greater share of customer contract requirements.

Overall, there was a modest increase in revenues for **Anachem**, with pipettes and tips continuing to make progress and a good first year contribution from the Hitek calibration services business, offsetting a further decline in the sales of instrumentation products.

Operationally, it was a year of significant change for Anachem, with the business being formally separated from the a1-group at the beginning of the year and new IT systems being implemented concurrently. This caused some disruption and higher operating costs for a period, although the systems have now successfully bedded down and action has been taken to reduce the legacy overhead costs. The new ERP system has significantly enhanced the company's marketing capabilities, with the e-commerce sales content increasing steadily in the final quarter of the year. The company is now leaner and in a stronger position to compete, although the strength of the euro and the US dollar, relative to UK sterling, will continue to impact margins.

The **a1-group** increased revenues by 12%, with strong sales in Continental Europe compensating for weaker performance in the UK. Sales of analysers in Germany increased strongly once again as the operation took full advantage of strong customer demand, new product introductions and competitor weakness. Sales of sulphur and nitrogen analysers to the chemical and petrochemical sector were particularly strong and a new range of industry-leading AOX analysers, which measure the levels of halogens in waste water, also made significant gains.

Further progress was made with the enclosure products, with sales moving ahead strongly in Switzerland, France, Germany and Ireland. The year saw a major change in the design and manufacture of these products and the new generation of enclosures was launched at the key industry trade exhibition, Analytica. The early response has been very positive with two major OEMs already committed to adopting new designs for the containment of their instruments and significant interest from laboratory health and safety professionals. Switzerland continued to make progress with specialist stainless steel enclosures and the business was successful in achieving initial sales into the French pharmaceutical sector.

Sales of emissions monitoring equipment and services in the UK were broadly flat, with margins generally lower as the project mix moved to larger, more complex installations. Order levels slowed in the second half of the year as less Energy from Waste incinerators entered the construction phase. The demand for alternative electricity generation is high but local planning resistance has slowed project approval. Planning applications are now being switched to focus on Biomass incinerators and on adding capacity to already existing sites.

Revenue	£62.1m	2007: £44.7m
Operating Profit*	£9.6m	2007: £6.6m
Operating Margin*	15.5%	2007: 14.8%
Free Cash Flow (before tax)	£9.7m	2007: £5.2m
Trading Capital Employed	£47.0m	2007: £41.4m
ROTCE	20.6%	2007: 22.6%

* Before amortisation of acquisition intangible assets

Customers

Clinical	51%
Industrial & environmental	23%
Life Science research	26%

Geography

Canada	49%
United Kingdom and Eire	39%
Continental Europe	10%
Rest of World	2%

Products

Consumables	59%
Service	14%
Instrumentation	27%

Sector Review: Seals

Sector Definition and Scope

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

The **Hercules Fluid Power Group** comprises Hercules Sealing Products ("Hercules"), Bulldog Hydraulic & Gaskets ("Bulldog") and HKX. The core Hercules business based in Clearwater, Florida provides a next day delivery service throughout the US, for seals, seal kits and cylinders used in a range of heavy mobile machinery applications. Hercules in Canada offers the same range of products from its two branch operations located in the provinces of Ontario and Quebec.

Bulldog supplies a range of gasket and seal kits for heavy duty diesel engines, transmissions and hydraulic cylinders used in off road and marine applications. Bulldog is based in Reno, Nevada, but more than 75% of sales are to international customers outside the US.

HKX is based near Seattle, Washington State and supplies hydraulic kits used in the installation of attachments on excavators. HKX's colour coded kit systems with 'lego-logic' instructions, substantially reduce the time and engineering expertise required to install attachments.

Outside North America, Hercules has centred its European operations on the newly acquired Snijders Engineering business in the Netherlands. Hercules also has a Representative Office in Tianjin, close to Beijing in China.

Fluid Power Equipment ("FPE") is based in the UK, with operations in Darlington and Doncaster, and supplies a range of seals, seal kits, cylinder parts and sealants to ram repairers, mobile and heavy plant operators, mechanical handling and process control companies.

M Seals is a specialised distributor of O rings, moulded parts, PTFE products and shaft seals. Products range from the finest precision seals for hearing aids to large heavy duty seals for wind power mills. M Seals has operations in Espergaerde in Denmark and Halmstad in Sweden.

Market Drivers

The core business, representing ca. 50% of sector revenues, is the next day delivery of sealing products to the mobile machinery Aftermarket in North America. Hercules and Bulldog supply into a broad range of applications in heavy construction, logging, mining, agriculture, material handling (lift trucks, fork lifts and dump trucks) and refuse collection.

These businesses are focused on the Aftermarket, with the main customers being machinery and cylinder repair shops, engine and transmission re-builders and tractor parts distributors. Products are generally used in the repair and maintenance of equipment after it has completed its initial warranty period or lease term, or has been sold on in the pre-used market.

The principal market drivers are the growth in the general industrial economies and in particular heavy construction, although the Aftermarket focus means that the businesses are relatively insulated from the extremes of the economic and business cycles.

	2004	2005	2006	2007	Growth % p.a.
US real GDP growth[1]	+3.6%	+3.1%	+2.9%	+2.2%	3.0%
Annual US construction spending $billion[2]	1,023	1,132	1,192	1,161	4.4%
US mobile hydraulic shipments $million[3]	2,223	2,724	2,766	2,626	6.3%

Sources:
(1) Organisation for Economic Co-operation and Development (OECD)
(2) US Census Bureau
(3) National Fluid Power Association

Hercules and Bulldog benefited from the strong US economy from mid 2003 to mid 2006. Into 2007 and 2008, the residential construction sector declined due to overbuilding of homes and the sub-prime mortgage crisis. Demand in the heavy construction sector remained more resilient with continued state and local government funding for major road-building and infrastructure programmes.

In Canada, economic growth has been fuelled principally by the expansion of the Oil and Gas industry in Alberta. This growth has slowed significantly in 2008 with drilling activity much reduced.

The HKX business is driven more strongly by new equipment sales. HKX attachment kits are sold mostly with new excavators, where demand declined significantly in 2007 and further in 2008. Sales growth for HKX in 2009 will continue to rely on penetration into new accounts and increased penetration of attachment kits.

In the UK, FPE supplies principally to ram (hydraulic cylinder) repairers who serve a broad range of industrial users including construction, agriculture and material handling. Growth has remained sluggish in these sectors in recent years and this is forecast to continue as the UK economy enters recession.

M Seals supplies to industrial OEMs in Denmark, Sweden and China. Since applications are quite specialised (for example wind turbines), sales growth is dependent on the success of M Seals' customers in both domestic and export markets.

Sector Performance

The Seals businesses made further advances in 2008 and increased revenues by 18% to £42.6m (2007: £36.0m), benefiting from the first full year contribution from M Seals. On a comparable and constant currency basis, sector revenues showed underlying organic growth of 3%.

Operating profits increased by 16% to £6.7m (2007: £5.8m) with operating margins slightly decreasing to 15.7% (2007: 16.1%). The reduced operating margins reflected investments of £0.4m made in establishing new operations in Europe and China and one-off costs incurred in the closure of the Edmonton branch office.

Capital expenditure in the sector totalled £0.5m, including an initial investment in a new warehouse automation system in Hercules and seal assembly machinery at M Seals. Free cash flow before tax of £6.5m was generated in the year (2007: £5.6m.

The **Hercules Fluid Power Group** achieved revenue growth of 2% in challenging economic conditions by successfully adapting its approach to focus on new products, more buoyant market segments and international expansion.

In the US domestic market, the core distribution operations demonstrated their strength and resilience by maintaining sales broadly at prior year levels.

The development of new seals and seal kits continued, with over 1,400 Hercules and Bulldog products added during the year. Focus was also re-directed to more buoyant segments by developing, for example, a range of customised kits for the mining industry.

The challenging market conditions were used to exert further pressure on competitors through selective aggressive pricing. In parallel, however, the policy to "out-service" competitors continued and protected overall margins. Order fill rates remained high and on-time delivery targets were maintained throughout the year. The recently introduced Seals-on-Demand service, where small runs of non-stocked seals are cut to customers' requirements within 48 hours, also delivered strong growth in 2008.

Sales of HKX's attachment kits for excavators fell only marginally, which was a commendable result in a period when the sales of new heavy mobile equipment in the US fell by an estimated 15-20%. A focussed sales plan was successful in developing both new customers and achieving greater penetration in existing, but underdeveloped accounts. Several of the targeted dealers have now been converted to using attachment kits either as their first choice, or to supplement their existing arrangements. The maintenance of technical leadership in attachment kits continued to be a prime objective and 50 new kits were introduced to the market.

In Canada, sales increased against the prior year, with new products, customer-specific kits and further penetration of existing accounts all contributing to the result. In Western Canada, sales fell as drilling activity in the Alberta oil patch reduced substantially and the sales and operational resources were realigned to give a greater concentration on the other western provinces. In September, the Edmonton branch was closed to fit with this new approach.

International sales outside North America grew strongly across all product categories. Sales of the core seal and cylinder ranges maintained momentum and significant gains were made in many South American countries, the Middle East and Turkey. A new initiative to test the potential of the previously untapped markets of South East Asia, India and Eastern Europe, produced overall growth in excess of 10%. The first steps into international markets for the attachment kit range were also made in the year. The initial focus was on South America and the Middle East where Hercules' existing agent and dealer networks are strongest. The early market responses have been positive and initial orders have been received from several dealers in the Middle East.

The acquisition of Snijders Engineering, a small seals distributor based in the Netherlands, was completed in June 2008. This acquisition, although small, is an important step in the development of the Hercules aftermarket seal brand in mainland Europe. A General Manager of Hercules Europe has been appointed, further key employees added and new premises selected. Multilingual seal and seal kit catalogues have been developed which will contain over 12,000 items designed specifically for the mobile machine models used most frequently in central Europe. The initial development work is close to completion and the launch in the Netherlands and Belgium will begin in early 2009.

In the UK, **FPE** achieved 14% growth with a strong first half performance which benefited from an additional contribution from a small seals business acquired in March 2007. In the second half of the year, growth was more modest as economic and market conditions deteriorated. As in the US, a focus on alternative products (eg metal parts for cylinders), added value services (eg Seals-on-Demand) and exports combined to deliver a creditable result.

M Seals completed its first full year in the Seals group by delivering good growth on a like-for-like basis. Sales growth was modest in the Danish industrial customer base, but the more recently established Swedish operation grew strongly as customers became aware of M Seals' engineering and service capabilities and began to award new projects to the company. During the year, M Seals consolidated its position as a significant supplier of specialised seals to the wind power turbine sector and these seals now account for almost 10% of total sales. M Seals includes the two leading European wind power manufacturers as customers and further prototype work is underway for potential customers in China and India.

Although its core strengths lie in the supply of products to OEMs, M Seals has also adopted the Hercules range of aftermarket, hydraulic seals. A Danish catalogue has been designed and a new web-based offering is close to completion. M Seals will launch these products during 2009.

Revenue	£42.6m	2007: £36.0m
Operating Profit*	£6.7m	2007: £5.8m
Operating Margin*	15.7%	2007: 16.1%
Free Cash Flow (before tax)	£6.5m	2007: £5.6m
Trading Capital Employed	£30.1m	2007: £26.0m
ROTCE	22.2%	2007: 29.3%

* Before amortisation of acquisition intangible assets

Customers

Heavy construction	56%
Lift trucks & fork lifts	5%
Dump trucks & refuse collection	6%
Industrial and other	33%

Geography

North America	60%
Europe	23%
Rest of World	17%

Products

Seals & seal kits	71%
Gaskets	7%
Cylinders & components	9%
Attachment kits	13%

Sector Review: Controls

Sector Definition and Scope

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

The **IS-Group** has its principal operations in Swindon, UK from where IS-Rayfast supplies high performance wiring and interconnect products for use in a range of technically demanding applications including Aerospace, Military & Marine, Rail and Electronics. Cabletec, based in Weston-super-Mare, UK, distributes similar products, but in addition supplies a range of manufactured products, including flexible braided products and multi-core cables.

IS-Motorsport and Clarendon supply wiring, harness components and fasteners into the Motorsport sector, supplying most of the Formula 1 teams, as well as other series in the UK, US and Continental Europe. The UK operations are located in Swindon and Leicester, with satellite operations in the US in Indianapolis and Mooresville. The IS-Group has also established a representative office in Beijing, with an initial focus on the Chinese commercial aerospace repair and aftermarket sector.

Sommer and **Filcon** supply a range of high performance wiring and connectors to customers in a range of high technology industries including Defence, Aerospace, Automotive Diagnostics and Medical equipment. A range of value adding activities enhances the customer offering, including connector assembly, marking of protective sleeves and prototype quantities of customised multi-core cables. Sommer and Filcon have operations in Stuttgart, Munich and Frankfurt in Germany and Ely in the UK.

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

Market Drivers

With over 90% of sector sales in the UK and Germany and a wide range of product applications, the underlying market drivers are the growth of the UK and German industrial economies:

	2004	2005	2006	2007	Growth % p.a
UK real GDP growth [1]	+3.3%	+1.8%	+2.8%	+3.1%	2.7%
UK manufacturing index [2]	102.2	102.0	103.8	104.5	0.8%
German real GDP growth [1]	+0.6%	+1.0%	+3.1%	+2.6%	1.8%

Sources:
(1) Organisation for Economic Co-operation and Development (OECD)
(2) The Office of National Statistics

Over the period 2004 – 2007, real GDP in the UK has grown at an average rate of ca. 2.7% p.a. but manufacturing has remained relatively flat. This trend has broadly continued in 2008, with recessionary concerns building as the year progressed. Over the same period, the German economy has grown at an average rate of 1.8% p.a. After a period of modest recovery in 2006 and 2007, mainly driven by export performance, growth has slowed in 2008.

While strongly influenced by the UK and German economies, the Controls sector businesses have focused on more specialised, technology driven market segments. The IS-Group, Sommer and Filcon have all benefited in particular from the more buoyant market conditions in the defence and aerospace sectors:

	2004	2005	2006	2007	Growth % p.a
German Defence capital budget €billion [1]	4.5	4.6	6.0	6.4	13.1%
UK Defence capital budget £billion [2]	6.0	6.7	6.7	7.0	5.4%
Commercial Aerospace market growth [3]	+11.4%	+5.0%	+5.0%	+4.9%	6.5%

Sources:
(1) NATO; Federal Ministry of Defence – Germany.
(2) UK Government's Expenditure Plans 2007/8
(3) Boeing and Airbus market outlook publications – revenue passenger kilometres

The combined Defence capital budgets in the UK and Germany have grown at an average of ca. 8% p.a. Filcon in particular has positioned itself well to supply major programmes. The IS-Group and Sommer focus more on repair, refurbishment and upgrade programmes as well as supplying to Tier 2 electronics suppliers. They typically only supply to OEMs and the Tier 1 suppliers when ex-stock availability and responsiveness are important.

In the commercial aerospace sector, again IS-Group, Sommer and Filcon have benefited from the buoyancy in the overall market. The market has shown strong growth since 2003 and this continued in 2008. Both Boeing and Airbus are still projecting longer term growth of ca. 5% p.a. in revenue passenger kilometres.

Other specialised, technically driven markets including Motorsport, Medical, Rail and Power have remained buoyant and have shown stronger growth than the general industrial economies.

Sector Performance

The Controls businesses increased revenues in 2008 by 13% to £67.6m (2007: £60.0m). The first full year contribution from Cabletec and the stronger euro relative to UK sterling, boosted the overall sector performance. On a comparable and constant currency basis, sector revenues decreased by 1%, against a strong prior year comparative.

The focus on more buoyant, technically driven sectors in the UK and Germany delivered good underlying growth for the IS-Group and Sommer. These growth elements only partially offset the impact of reduced project business at Filcon and continued challenging market conditions for Hawco.

Sector operating profits increased by 13% to £11.0m (2007: £9.7m) with operating margins broadly unchanged at 16.3% (2007: 16.2%).

A significant IT upgrade at Sommer and Filcon was successfully completed during the year and this project accounted for the majority of the £0.3m invested in the sector during 2008. Free cash flow before tax of £10.7m was generated in the sector (2007: £9.9m).

The **IS-Group** delivered another year of very solid growth across all market sectors and in all geographic regions; although with a stronger first half than second half. Sales to the Aerospace market were buoyant, with a solid level of background business and several good sized projects providing further incremental business.

The Ground Defence and Military Marine sectors also recorded sales close to prior year levels, although the frequency of requests to supply products for Urgent Operational Requirements has fallen back from the peaks of the past three years.

In the Motorsport sector, the IS-Group increased its penetration of the core Formula 1 racing teams in Europe and consolidated its position as the prime supplier of harness components and high performance fasteners. A partnership arrangement to support the Japanese teams involved in the top flights of motorcycle racing, brought further export gains during the year. In the US, Motorsport sales continued to grow and a new satellite operation was opened in February 2008 at the heart of the NASCAR racing series in Mooresville, North Carolina.

Sales to the wider industrial market showed steady growth with sales to the Power generation industry moving ahead strongly. There was also further growth in exports of the core harness component products, primarily to mainland Europe.

Cabletec made a solid start in its first year as part of the IS-Group. During the year, Cabletec became one of the first companies to gain the newly introduced EN4199 aerospace approval for its manufactured bonding leads and the prestigious Airbus approval standard (ASNE) was also awarded. Operationally, sales responsibilities have been clearly defined and the purchasing and accounting functions of Cabletec have been merged within the IS-Group.

In Germany, **Sommer** delivered solid sales growth with most of its traditional harness manufacturing customers showing consistently positive demand throughout the year, across a range of sectors. Civil aerospace sales remained buoyant with regular demand from manufacturers such as Eurocopter and Euroavionics.

Military sales were also strong and harness components were supplied to a range of German military programmes including the Leopard II tank and the Fuhrungs Information System, used in military land vehicles. Further progress was also made in the development of highly specialised connectors and backshells for use on the solar panels of satellites, with a new design delivered to EADS-Astrium just prior to the year end.

The Medical sector maintained a consistently high level of demand and Sommer benefited from its location in Baden-Wurttemberg, a region which has one of the highest concentrations of medical equipment manufacturers in the world. The company is well positioned to supply this sector with its range of highly specialised medical grade wires and tubings.

Filcon experienced lower sales to the major projects which had contributed to the strong prior year performance. These included the Eurofighter Tranche 2 project and the first phase of the Transrapid railway line extension in Shanghai, both of which peaked in the prior year. Filcon will be well placed to make further sales to future project phases, although it is unlikely that the exceptional 2007 levels will be repeated for these projects.

Filcon continued to service many other important German military programmes, including the Tornado upgrade and the Tiger and NH90 helicopters, as well as consolidating its position as a key supplier to MTU, which supplies engines to many military vehicle programmes throughout the world. There were also successes in supplying a customised Motorsport connector, introduced last year and now supplied to BMW and other leading customers. Key initiatives were also developed to increase the level of non-project, background business to partly moderate the peaks and troughs created by large projects.

The market conditions for **Hawco** in the UK remained challenging, with competitive and pricing pressures bearing down on UK manufacturing. Against this background, management worked hard to mitigate these adverse factors. Sales to the key refrigeration OEM accounts held up relatively well and new product introductions included a range of low energy LED lights designed for food counter displays.

Hawco has also rationalised its range of thermal control products and focussed on a smaller number of high quality manufacturing partners who are willing to support the company and grant exclusive sales rights, rather than appoint multiple distributors. This strategy has shown some early success and Hawco was recently appointed as the European Master Distributor for two important US suppliers. While Hawco still faces many challenges in an unhelpful market, the company is lean, focused on quality and service and is in a good position to compete for business in 2009.

Revenue	**£67.6m**	2007: £60.0m
Operating Profit*	**£11.0m**	2007: £9.7m
Operating Margin*	**16.3%**	2007: 16.2%
Free Cash Flow (before tax)	**£10.7m**	2007: £9.9m
Trading Capital Employed	**£27.3m**	2007: £26.3m
ROTCE	**40.3%**	2007: 46.0%

* Before amortisation of acquisition intangible assets

Customers

Aerospace & defence	30%
Motorsport	14%
Medical & scientific	4%
Electronics & other	35%
Heating, cooling & refrigeration	17%

Geography

United Kingdom and Eire	55%
Continental Europe	41%
Rest of World	4%

Products

Wire & cable	45%
Connectors	27%
Control components	16%
Refrigeration & a/c equipment	12%

Finance Review

Results for the Year

Revenue and operating profit, before amortisation of acquisition intangible assets, increased by 22% and 24% to £172.3m and £27.3m, respectively. Operating margins, before amortisation of acquisition intangible assets, improved marginally to 15.8% (2007: 15.7%). An increase in Life Sciences' margins offset a small decrease in Seals' margins, while Controls' margins remained broadly unchanged.

The results benefited from a substantial contribution to revenue and operating profit from the businesses acquired in August last year and from currency gains on the translation of the results of the overseas businesses. On an underlying basis, revenues and operating profits, before amortisation of acquisition intangible assets, increased by ca. 3%; this is after adjusting on a comparable basis for the contribution of last year's acquisitions, this year's acquisitions and for the currency benefits to revenue and operating profit of £4.8m and £1.0m, respectively.

Adjusted profit before tax (which is a defined alternative performance measure, as discussed below) increased 18.0% to £27.5m (2007: £23.3m), after net finance income, excluding fair value remeasurements, of £0.2m (2007: £1.2m); the reduction in finance income reflected the significant investment made in acquiring new businesses towards the end of the previous year. Adjusted earnings per share increased 17.1% to 16.4p compared with 14.0p last year.

IFRS profit before tax, which is after amortisation of acquisition intangible assets of £2.7m (2007: £1.0m) and fair value remeasurements of £3.0m (2007: £Nil), was £21.8m (2007: £22.3m) and IFRS basic earnings per share were 11.8p (2007: 12.7p).

Taxation

The Group's adjusted effective tax charge represented 29.1% (2007: 30.4%) of adjusted profit before tax. This reduction is principally due to the lowering of tax rates in the United Kingdom, Canada and Germany; however this benefit was partly offset by the impact from a larger proportion of the Group's operating profits being earned this year in territories which have higher tax rates than the United Kingdom.

Free Cash Flow and Cash Funds

The Group continues to be strongly cash generative. The Group's free cash flow, which is before expenditure on dividends and business combinations, increased by £4.8m to £18.0m; this represents 92.3% of adjusted profit after tax (2007: 77.8%).

Operating cash flow increased by £5.8m to £28.8m. On a constant currency basis, there was a £1.3m (2007: £1.1m) increase in working capital to £28.6m of which £0.4m was accounted for by stock purchased in advance of known price increases. At 30 September 2008, Group working capital remained unchanged at 16.6% of annual revenue and has consistently remained below 17.0% in each of the last three years.

Group tax payments were £8.2m (2007: £8.0m) and benefited from the recently acquired businesses remaining on an annual tax payment basis during the year; however this will lead to higher tax payments in 2009, as these businesses move to quarterly payments. The Group's Employee Benefit Trust also took advantage of a weaker share price during the year to acquire a further 528,760 shares in the Company at a cost of £0.9m (2007: £1.3m).

Capital expenditure of £1.9m (2007: £2.2m) represented 76% of annual depreciation. Expenditure in 2008 included £0.7m investment in tooling and warehouse equipment and £0.6m on acquiring field equipment for lease in the Life Science businesses; the balance was spent on completing prior year IT projects and on small upgrades to the general IT infrastructure across the Group.

After spending £7.9m on the acquisition of businesses, including minority interests, as described below, the Group's cash funds increased by £3.3m to £15.7m at 30 September 2008 (2007: £12.4m). The Group also has a £20m committed revolving bank facility which expires in November 2010, together with £5m of working capital facilities. None of these facilities were utilised at 30 September 2008.

Acquisitions and Minority Interests

During the year the Group acquired two small businesses in support of broadening its Life Science and Seals businesses for £3.9m, in aggregate; a further £3.7m was paid to the minority shareholders in Somagen on exercise of options to acquire 11.8% of the outstanding share capital in that business. Deferred consideration of £0.3m was paid to the vendors of Cabletec, which was acquired last year, and a further £1.1m of deferred consideration will also be payable after the year end (in December 2008) to the vendors of AMT, which was acquired in August 2007.

At 30 September 2008 the Group has an aggregate liability, estimated at £11.2m, (2007: £11.8m) which is payable between 1 October 2009 and 31 December 2012, to the vendors of AMT, Somagen and M Seals who retain minority interests in the share capital of these businesses. This liability arises under put/call options entered into at the time of acquisition and is based on the Directors' estimate of the likely Earnings Before Interest and Tax ("EBIT") of these businesses, which will form the basis of the valuation of the minority shareholding on exercise of the option. Based on the strong performance of these businesses during the year, the Directors have reassessed the potential liability at 30 September 2008 to acquire the remaining outstanding minority interests. This has led to a charge of £2.3m being made in the consolidated Income Statement. An analysis of the movement in this liability is set out in note 19 to the consolidated financial statements.

Land at Stamford

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

Acquisition Intangible Assets and Goodwill

There were no additions to acquisition intangible assets in 2008; however goodwill increased by £6.2m net, on a constant currency basis, to £51.6m reflecting the amount paid for the acquisitions during the year, in excess of the value of the net tangible assets. This goodwill largely comprises the value in each of these businesses relating to both the product know-how held by the employees and to the prospects for sales growth in the future from both new customers and new products.

The Directors have carried out an impairment review of the total Group goodwill of £51.6m held at 30 September 2008 and are satisfied that none of this goodwill has been impaired.

Pensions

Pension benefits to employees are provided through defined contribution schemes at an aggregate cost in 2008 of £0.8m (2007: £0.7m). In addition, in the UK the Group retains a small number of legacy defined benefit pension schemes which are closed to future accrual. At 30 September 2008 the accounting deficit in these defined benefit schemes had increased marginally to £1.7m (2007: £1.6m). While the market value of the underlying assets in the schemes had fallen by £2.3m to £12.5m, the margin between the rate used to discount the liabilities and the assumed inflation rate had increased on the previous year by 0.8% to 3.2%. This increase, together with the Group's cash contributions of £0.2m, led to a reduction in the gross pension liability of £2.2m to £14.2m (2007: £16.4m)

There were no new formal actuarial valuations of the Group's principal schemes carried out during the year and therefore the ongoing funding level of the PLC and Anachem legacy schemes remained unchanged at 96% and 91%, respectively.

The aggregate deficit in the defined benefit schemes, net of deferred tax, at 30 September 2008 was £1.2m (2007: £1.1m) which equates to 1.1% of total shareholders' equity.

Capitalisation and Dividends

At 30 September 2008, the number of shares in issue were 113.2m, of which 1.3m are held by the Company's employee share plan. During the year the Company undertook a bonus issue of four new ordinary shares for each ordinary share held by shareholders; this resulted in the issue of 90.6m new ordinary shares and represented the capitalisation of £4.6m of the Company's reserves. Shareholders' funds, which represents the Group's total capital, increased by £17.4m to £108.1m due to the effect of exchange rate movements, gains on cash flow hedges and the purchase of minority interests, as well as earnings retained for the year.

The Group's trading capital employed, which is defined in note 2 to the consolidated financial statements, increased at 30 September 2008 by £13.0m to £104.5m (2007: £91.5m), of which £70.2m (2007: £62.8m) was accounted for by goodwill and acquisition intangible assets. The Group return on trading capital employed decreased to 21.0% (2007: 24.2%) at 30 September 2008. This reflects in part the impact of the acquisitions completed in late 2007 and in part the increase in overseas trading capital at 30 September 2008, resulting from the weakening in UK sterling.

During 2008, £6.9m (2007: £5.4m) was returned to shareholders in the form of ordinary dividends. In May 2008 the Board announced that that it intended to move dividend cover towards 2.0 times, based on adjusted earnings per share. The Board's distribution policy and its overall financial strategy is to strike a balance between the interests of shareholders and the interests of the business, whilst maintaining a strong balance sheet.

Measuring Financial Performance

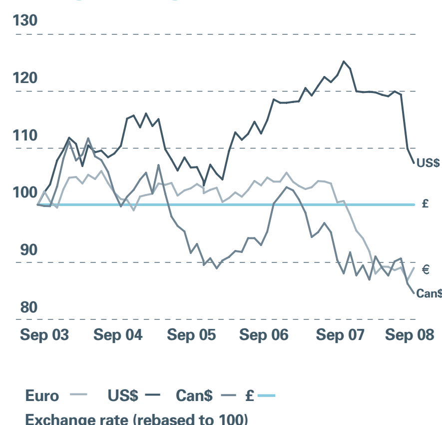
The Board uses specific measures when assessing the performance of the Group and these are referred to throughout this Annual Report in the discussion of the performance of the businesses. These measures are not defined in IFRS, but are used by the Board to assess the underlying operational performance of the Group and its businesses. As such the Board believes these performance measures are important and should be considered alongside the IFRS measures. The alternative performance measures, which have been used in this Annual Report, are described in note 2 to the consolidated financial statements.

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

International Financial Reporting Standards (IFRS)

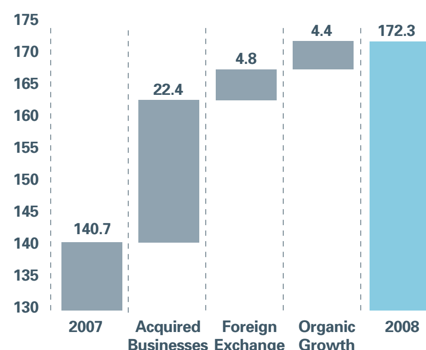
The Group's consolidated financial statements have been prepared in accordance with IFRS. This year the Group has adopted *IFRS 7, Financial Instruments: Disclosures*, which requires additional disclosures in respect of financial instruments. These additional disclosures are given within the section on Risks and Uncertainties on page 33 and in note 18 to the consolidated financial statements. The Group has not been required to adopt any other new accounting standards during the year which have had a significant impact on the consolidated financial statements.

Rolling Exchange Rates



Euro — US$ — Can$ — £ —
Exchange rate (rebased to 100)

Revenue (£m)



Risks and Uncertainties

Risk Management Process

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

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

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

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

Strategic Risks

Downturn in major markets

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

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

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

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

Loss of key supplier(s)

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

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

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

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

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

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

Loss of major customer(s)

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

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

The nature of the Group's businesses, however, ensures that there is not a high level of dependence on any individual customers. No one customer represents more than 5% of sector revenue or more than 2% of Group revenue.

Technological change

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

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

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

Product liability

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

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

However, if a legal claim is made it will typically draw in our business as a party to the claim and the business may be exposed to legal costs and potentially damages if the claim succeeds and the supplier fails to meet its liabilities for whatever reason. To mitigate this risk, the Group has established Group-wide product liability insurance which provides worldwide umbrella insurance cover of £10m (ca.US$20m) in all sectors.

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

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

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

Operational Risks

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

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

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

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

- Back-up power generator.
- Materials on hand to secure the facility.
- Communications re-route to other branches or interim location.
- IT recovery plan using back up server in separate location.
- Regular building inspection and weather monitoring.
- Plans to drop-ship product from suppliers where needed.

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

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

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

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

Financial Risks

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

Foreign currency risk
Foreign currency risk is the risk that changes in currency rates will affect the Group's results. The Group operates internationally and is exposed to foreign exchange risk arising from various currency exposures, primarily with respect to the US dollar, the euro and the Canadian dollar (translational exposure). During the year ended 30 September 2008, ca. 50% of the Group's sales and operating profits were earned in currencies other than UK sterling.

In comparison to the prior year, the net effect of currency translation was to increase turnover by £4.8m and to increase operating profit by £1.0m. It is estimated that a strengthening of UK sterling by 10% against all the currencies in which the Group does business, would reduce operating profit, before amortisation of

Risks and Uncertainties continued

acquisition intangible assets and tax, by approximately £2.0m (7.3%) (2007: £1.4m (6.3%)) due to currency translation.

The Group has certain investments in foreign operations whose net assets are also exposed to foreign currency translation risk. Currency exposure arising from the net assets of the Group's foreign operations are not hedged. At 30 September 2008, the Group's non-UK sterling trading capital employed in overseas businesses was £75.0m, which represented 72% of the Group's trading capital employed. It is estimated that a strengthening of UK sterling of 10% against all the non-sterling capital employed would reduce shareholders' funds by £6.9m (2007: £5.4m).

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

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

Details of average exchange rates, used in the translation of overseas earnings, and of year end exchange rates, used in the translation of overseas balance sheets, for the principal currencies used by the Group, are shown in note 26 to the consolidated financial statements.

Liquidity risk

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

The Group is highly cash generative and uses monthly cash flow forecasts to monitor cash requirements and to optimise its return on investments. Typically the Group ensures that it has sufficient cash on hand to meet foreseeable operational expenses, but it maintains a £5m overdraft facility on which interest is payable at UK Base Rate plus 100 bps. The Group also has an undrawn committed £20m revolving bank facility which expires in November 2010. Interest on this facility is payable at 80 bps over LIBOR.

Interest rate risk

Interest rate risk is the risk that changes in interest rates will affect the Group's results. The Group's interest rate risk arises primarily from its cash funds. An analysis of the currency and interest rate profile of the Group's funds is shown in note 17 to the consolidated financial statements. The Group manages its interest-bearing funds in a manner designed to maximise interest income, while at the same time minimising any risk to these funds. Surplus funds are deposited with commercial banks that meet the credit criteria approved by the Board, for periods of between one to six months at rates that are generally fixed by reference to the relevant UK Base Rate, or equivalent rates. The Group does not undertake any hedging activity of interest rates.

It is estimated that a reduction of 1% in interest rates would reduce the Group's profit before tax by a maximum of £0.1m (2007: £0.1m)

Credit risk

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

Trade receivable exposures are managed locally in the operating units where they arise and credit limits are set as deemed appropriate for the customer. The Group is exposed to customers ranging from government backed agencies and large private wholesalers to small privately owned businesses and the underlying local economic risks vary throughout the world.

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

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

Capital risk management

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

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

Accounting Risks

Inventory obsolescence

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

Fraud and theft

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

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

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

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

Corporate and Social Responsibility

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

Employment

Building and developing the skills, competencies, motivation and teamwork of employees is recognised by the Board as being key to achieving the Group's business objectives. The stability and commitment of the employees is demonstrated by the average length of service being 5.5 years (2007: 5.3 years). In addition the number of working days lost to sickness continues to remain less than 4% a year. These measures remain consistent across each of the Group's sectors.

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

Both employment policy and practice in the Group are based on non-discrimination and equal opportunities. Ability and aptitude are the determining factors in the selection, training, career development and promotion of all employees. The Group remains supportive of the employment and advancement of disabled persons. Applications for employment by disabled persons are always fully considered, bearing in mind the respective aptitudes and abilities of the applicants concerned. If an employee is, or becomes disabled during their period of employment, the Group will, if necessary and to the extent possible, adapt the work environment to enable the employee to continue in their current position or retrain the employee for duties suited to their abilities following disablement. At 30 September 2008 the Group's employees included ten who were disabled and three who were on long term sick leave.

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

Health and Safety

The Group places a great deal of importance on the provision of clean, healthy and safe working conditions. In addition to compliance with all local regulations, the Group promotes working practices which protect the health and safety of its employees. Health and Safety matters are kept under regular review by local management who report on such matters to the Chief Operating Officer. During 2008, 41 employees (2007: 48) were reported as having suffered minor injuries at work; none of these injuries resulted in absence from work for more than three days. One employee (2007: one) suffered a serious injury which resulted in his absence from work for three months.

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

Environmental

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

Relationships with suppliers, customers and other stakeholders

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

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

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

Suppliers are, in that way, made aware of these terms. Group companies seek to abide by these payment terms when they are satisfied that the supplier has provided the goods or services in accordance with the agreed terms and conditions. At 30 September 2008 the amount of trade creditors shown in the Group balance sheet represents 48 days (2007: 47 days) of average purchases.

Community impact and involvement

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

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

The Group made donations for charitable purposes during the year which amounted to £20,452 (2007: £15,285). No political donations were made.

Directors' Report

For the year ended 30 September 2008

The Directors present their report and the audited financial statements for the year ended 30 September 2008.

Principal Activities

The principal activity of the Group is the supply of specialised technical products and services. A description and review of the activities of the Group during the financial year and an indication of future developments is set out in the Business Review on pages 21 to 35; the Business Review incorporates the requirements of the Companies Act.

Results and Dividends

The profit for the financial year attributable to shareholders was £13.3m (2007: £14.3m). The Directors recommend a final dividend of 5.0p per ordinary share (2007: 3.6p), to be paid, if approved, on 21 January 2009. This, together with the interim dividend of 2.5p per ordinary share paid on 18 June 2008, amounts to 7.5p for the year (2007: 5.4p).

Share Capital

On 21 January 2008 the Company undertook a bonus issue of four new ordinary shares of 5 pence each for each ordinary share held by shareholders of the Company. The bonus issue resulted in the issue of 90,591,644 new ordinary shares, representing the capitalisation of £4.4m of the Company's retained earnings, together with £0.2m which was held in the capital redemption reserve. The current issued share capital comprises 113,239,555 ordinary share of 5p each with an aggregate nominal value of £5.7m. As a consequence of this bonus issue, the comparative earnings and dividends per share included in this Annual Report have been restated.

Substantial Shareholdings

At 14 November 2008 the Company had been notified, pursuant to the Financial Service Authority's Disclosure and Transparency Rules, of the following notifiable voting rights in its ordinary share capital:

	Percentage of ordinary share capital
F&C Asset Management plc	9.19
Insight Investments Limited	5.52
Lincoln Vale European Partners Master Fund LP	5.05
Fidelity International	5.00
Legal & General Investment Management Limited	4.74
Newton Investment Management Limited	4.39
Slater Investments Limited	3.57
IG International Management Limited	3.20
UBS Global Asset Management Life Limited	3.00

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

Directors

The persons currently serving as Directors of the Company are shown on pages 18 and 19. JL Rennocks and BM Thompson retire from the Board by rotation at the Annual General Meeting on 14 January 2009 and being eligible, offer themselves for re-election. The Directors' beneficial interests in the Company's ordinary share capital at 30 September 2008 are set out in the Remuneration Report on page 45.

Directors' and Officers' Liability Insurance and Indemnity

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

Other Statutory Information

An explanation of the Company's policy on matters relating to Employment, Health and Safety, Environmental and its relationship with suppliers, customers and other stakeholders is set out within the Business Review on page 35 of the Annual Report. The Group's use of financial instruments is discussed on page 33.

New Articles of Association

It is intended that a special resolution for adoption of new Articles of Association of the Company, will be put to shareholders at the Annual General Meeting.

Company law has undergone substantial change since January 2007 when the staged implementation of the Companies Act 2006 (the "2006 Act") commenced. The Articles of Association of the Company in their current form contain certain provisions that no longer fully reflect both legislation and best practice and accordingly the Board considers it prudent to replace the Company's existing Articles of Association with new Articles that take account of those developments (the "New Articles").

A summary of the material changes brought about by the proposed adoption of the New Articles is set out in an Appendix to the Notice of Annual General Meeting. Other changes, which are of a minor, technical or of a clarifying nature have not been noted in the Appendix.

Further amendments to the New Articles may be required in the coming years as a result of the implementation of the 2006 Act. The 2006 Act represents a major reform of UK companies' legislation and is being brought into force in stages, with full implementation scheduled by October 2009. At this year's Annual General Meeting the Company proposes to adopt provisions which reflect changes in the law brought about by the 2006 Act in respect of, among other things, electronic communications, notice periods for meetings, proxy voting and directors' conflicts of interest. Over the course of the next year the Company intends to conduct a further review of the New Articles in order to identify any additional amendments that might be necessary following the full implementation of the 2006 Act by October 2009. It is the Board's intention that any further amendments will be put to shareholders at the 2010 AGM.

A copy of the new Articles of Association will be on display at the Registered Office of the Company during normal business hours on any week day, up to and including the date of the Annual General Meeting, and at that meeting.

Annual General Meeting

The Annual General Meeting will be held at midday on 14 January 2009 in the Brewers' Hall, Aldermanbury Square, London EC2V 7HR.

The Special Business of the meeting includes a resolution to adopt new Articles of Association of the Company, as described above, and to seek authority to allot shares and the disapplication of pre-emption rights. The Company will also be seeking authority to make market purchases of shares in the Company up to a maximum of 10% of the Company's shares. Further detail of all these proposals will be set out in the Notice of the Annual General Meeting which is a separate document which will be sent to all shareholders.

Independent Auditors

The previous auditors, PricewaterhouseCoopers LLP resigned as auditors to the Company on 22 September 2008, following an audit tender process. Deloitte & Touche LLP were subsequently appointed to fill the casual vacancy arising on resignation of the previous auditors. A resolution to appoint Deloitte & Touche LLP as auditors and to authorise the Directors to determine their remuneration will be proposed at the forthcoming Annual General Meeting of the Company.

By order of the Board
NP Lingwood
Company Secretary

17 November 2008

Corporate Governance

Compliance Statement

The Board recognises the importance of high standards of corporate governance throughout the Group. The Board is accountable to the Company's shareholders for good governance and this statement sets out how the principles set out in the FRC Combined Code on Corporate Governance ("the Code"), issued in June 2006, are applied by the Company. The Board confirms that the Company has complied with all of the Provisions set out in Section 1 of the Code, throughout the year.

Directors

The Board

The Board comprises three non-Executive Directors, including the Chairman, and three Executive Directors, providing a wide range of skills and experience. The biographical details of the Board members are set out on pages 18 and 19. The Board has six scheduled meetings each year and meets more frequently as required. It met on six occasions during the year under review.

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

	Board	Audit Committee	Remuneration Committee	Nomination Committee
Number of meetings during the year	6	8	4	1
Non-Executive Directors:				
JL Rennocks				
(Chairman)	6	8	4	1
JW Matthews	6	8	4	1
IM Grice	6	8	4	1
Executive Directors*:				
BM Thompson	6			
I Henderson	6			
NP Lingwood	6			

*The Executive Directors attend all the meetings of the Audit Committee; BM Thompson also attended the meetings of the Nomination and Remuneration Committees during the year.

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

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

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

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

Chairman and Chief Executive

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

Board Balance and Independence

The non-Executive Directors are appointed for specified terms, the details of their respective appointments being as set out in the Remuneration Report on page 43. Non-Executive Directors are required to inform the Board of any changes to their other appointments.

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

There are three standing Committees of the Board to which various matters are delegated. Membership of the Committees is set out on page 19 and terms of reference are available on request and are set out on the Company's website. In order to ensure that undue reliance is not placed on particular individuals, the Board has decided that all its independent non-Executive Directors should serve on all Committees. The Board regularly reviews the chairmanship of its Committees.

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

Appointments to the Board

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

Corporate Governance continued

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

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

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

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

The Nomination Committee met once during the year under review.

Information and Professional Development

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

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

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

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

Performance Evaluation

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

Re-election

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

Remuneration

The Board has established a Remuneration Committee consisting exclusively of independent non-Executive Directors. The application of corporate governance principles in relation to the Directors' remuneration is described in the Remuneration Report on page 41.

Accountability and Audit

Financial Reporting

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

In this context, reference should be made to the Statement of Directors' Responsibilities on page 47, which includes a statement in compliance with the Code regarding the Group's status as a going concern, and to the Reports of the Auditors on pages 77 and 78, which includes a statement by the auditors about their reporting responsibilities.

Internal Control

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

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

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

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

The risks and uncertainties which are currently judged to have the largest potential impact on the Group's long term performance are set out in the Business Review on pages 21 to 35.

During 2008 the Group maintained its programme of internal audit reviews at most of its businesses using experienced resources from within the Group finance department. The Audit Committee keeps under review the need for an independent internal audit function in the Group. The Audit Committee believes that the Group's system of internal control is appropriate for a group of the size and nature of Diploma PLC and the Audit Committee's current view is that a separate independent internal audit function is not necessary.

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

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

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

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

The Committee normally meets at least five times a year, but met eight times during the year under review in order to undertake a review of the audit engagement (described further below). The external auditors and the Executive Directors generally attend Audit Committee meetings. In addition, the Committee periodically meets the external auditors without the Executive Directors present.

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

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

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

As noted above, one of the primary responsibilities of the Audit Committee is to make recommendations to the Board in relation to the appointment, reappointment and removal of the external auditors.

Following the completion of the 2007 Annual Report, the Committee decided that it was appropriate to review the audit engagement; the incumbent firm having been auditors to the Group for a period in excess of ten years.

The Committee invited each of the "Big 4" audit firms (including the incumbent firm) to propose for the audit of the Group; the Committee felt that because of the many different geographies in which the Group operates, it was appropriate to limit the process to these four audit firms.

As part of the tender process, each firm was given access to two of the Group's larger businesses, as well as to the Executive Directors and senior financial management at the Group's corporate head office. Each firm also met separately with the Chairman of the Audit Committee and the Chairman of the Company. Each firm was asked to submit an audit tender document to the Committee which set out their proposed audit scope, methodology and team. They were also invited to make a presentation to the Committee, at which the Executive Directors were also present.

A number of factors were taken into account by the Committee in assessing the competing audit proposals, including:

- Clarity – the methodology to be used in providing the external audit service and other services had to be clearly articulated in the proposal.
- Understanding – the proposal had to demonstrate that the issues that might be of relevance to the audit of the Company had been understood and factored into the proposal as appropriate.
- Value for money – the proposal had to represent, in overall terms, an effective and cost efficient external audit service.

Based on these factors, the Committee recommended to the Board the appointment of Deloitte & Touche LLP as auditors to the Company and the Group for the year ended 30 September 2008.

Corporate Governance continued

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

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

Taxation services are not provided by the auditors; a separate firm is retained to provide tax advice, including any assistance with tax compliance matters generally.

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

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

Communications with Shareholders

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

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

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

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

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

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

Remuneration Report

This Report is presented to shareholders by the Board and provides information on Directors' remuneration. This Report complies with the Directors' Remuneration Report Regulations 2002 and also sets out how the principles of the FRC Combined Code on Corporate Governance ("the Code") issued in June 2006 relating to Directors' remuneration are applied.

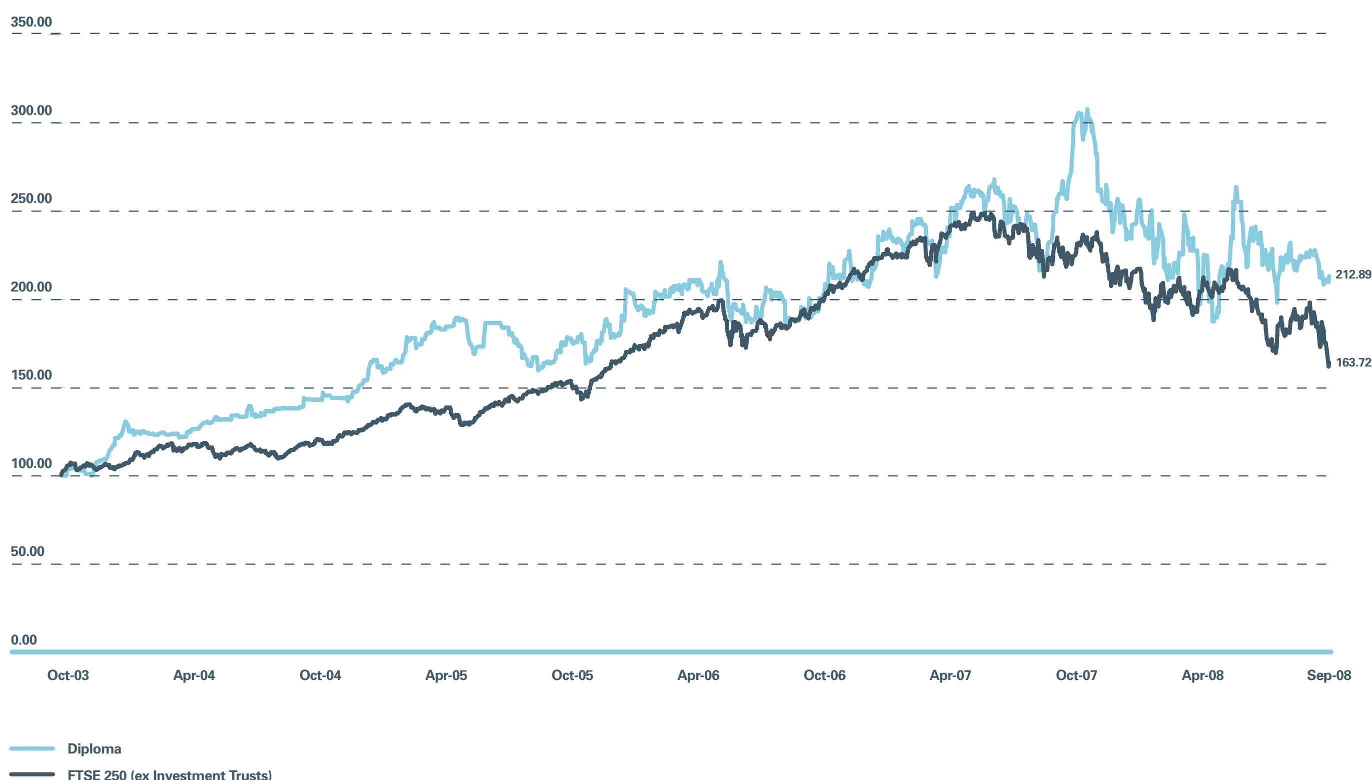
A resolution will be put to shareholders at the Annual General Meeting on 14 January 2009, inviting them to consider and approve this Report.

Performance

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

The graph below shows the total shareholder return for a holding of the Company's ordinary shares for the five financial years to 30 September 2008. This is compared to the total shareholder return for a hypothetical holding in the FTSE mid-250 index (excluding investment trusts). This was chosen as the Remuneration Committee ("the Committee") believes it is the most appropriate index to which the Company's performance can be compared and it is the index which is used for the purposes of the Long Term Incentive Plan.

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



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

	Diploma	FTSE mid-250
September 2003	100	100
September 2008	213	164
	+113%	+64%

Remuneration Report continued

Remuneration Committee

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

The Committee met on four occasions during the year.

The Committee received advice from Towers Perrin in July 2008 on matters relating to Directors' Remuneration. The advice was summarised in a report which was based on an analysis of disclosed data for ten comparative PLCs and covered, for the Executive Directors:

- basic salaries and annual bonuses;
- structure of the Long Term Incentive Plan ("LTIP");
- potential introduction of a Co-Investment Plan; and
- pension contributions.

In addition, the report made observations on the level of fees for the Chairman and non-Executive Directors. The Committee took the report's findings into account in establishing remuneration policies for the 2009 financial year.

Following the report from Towers Perrin during the year, the Committee is satisfied that the current share incentive scheme, including grant levels and performance conditions, remains appropriate to the Company's current circumstances and prospects.

Remuneration Policy

This Remuneration Report sets out the Company's policy on Directors' remuneration for 2008 and, so far as practicable, for subsequent years. In framing this policy the Committee has given full consideration to the provisions of the Code.

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

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

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

The Committee considers that a successful remuneration policy needs to be sufficiently flexible to take account of future changes in the Company's business environment and in remuneration practice. Any changes in policy for years after 2008 will be described in future Remuneration Reports. Any statements in this Report in relation to remuneration policy for years after 2008 should be considered in this context.

Components of Remuneration

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

Salary and Benefits

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

The value of non-salary benefits for Executive Directors is included in the table of remuneration on page 44 and comprises life and health insurance and cash payments in lieu of a car. The value of these benefits is not pensionable, but is assessable to tax.

Short Term Incentives

The Company operates an annual performance related cash bonus scheme for Executive Directors. The maximum bonus payment under this scheme in 2008 is 100% of basic salary for the Chief Executive Officer and 70% for other Executive Directors. On target bonus is 60% for the Chief Executive Officer and 40% for other Executive Directors. The bonus for the Chief Executive Officer is wholly dependent on the financial performance of the Group; the bonus for the other Executive Directors is 80% based on the financial performance of the Group with the remaining 20% subject to achievement of specified personal objectives.

Long Term Incentive Plan ("LTIP")

The Company operates a Long Term Incentive Plan ("LTIP") for Executive Directors. In line with current best practice, the LTIP provides for annual grants to Executive Directors.

Under the LTIP, Executive Directors are awarded rights to acquire ordinary shares. Each award made under the LTIP is subject to performance conditions which will determine how many, if any, of the shares under the award the participant is entitled to receive after the three year performance period. The value of awards which can be made in any year to a participant will normally be equal to 100% of basic salary. This limit can be increased to a maximum of 200% in the case of a participant who within the previous 12 months joined the Group or received a significant promotion.

In any ten-year period, the number of shares which may be issued or placed under option under any executive share plan established by the Company, may not exceed 5% of the issued ordinary share capital of the Company from time to time. In any ten-year period the number of shares which may be issued or placed under option, under any all-employee share plan established by the Company, may not exceed 10% of the issued ordinary share capital of the Company, from time to time.

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

The first performance condition is that the average annual compound growth in the Company's earnings per share ("EPS") over the three consecutive financial years, following the year prior to the grant, must exceed the annual compound growth rate in the UK Retail Price Index (RPI) plus 3% per annum, over the same period. At this level of performance, 30% of the award relating to EPS performance would vest. Full vesting of the award relating to EPS performance requires that the Company's average annual compound growth in EPS exceeds the compound growth in RPI plus 5% per annum over the period. Between these two points, an increasing proportion of vesting occurs at RPI plus

3.5%, RPI plus 4% and RPI plus 4.5%. For the purposes of this condition, EPS will comprise adjusted EPS as defined in note 2 to the consolidated financial statements. The definition of adjusted EPS remains consistent with the definition of EPS approved by the Remuneration Committee in previous years.

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

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

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

Subsisting awards may vest before their vesting date in the event of a change of control of the Company, in accordance with the rules of the LTIP.

Benefits under the LTIP are not pensionable.

Awards under this LTIP have been made annually by the Remuneration Committee to BM Thompson, I Henderson and NP Lingwood, the last award being made on 17 December 2007. Following the end of the relevant performance period, the number of shares over which an award vests is determined and a participant may then exercise the award on payment of £1 at any time within ten years of the date of grant. The performance period for the awards granted on 7 January 2004, 29 November 2004 and 2 December 2005 ended on 30 September 2006, 2007 and 2008, respectively. The number of shares over which the 2005 awards have vested at 30 September 2008 are set out on page 44. The outstanding awards will vest on 30 September 2009 and 2010 respectively, subject to the performance conditions set out above, measured over three year performance periods ending on 30 September 2009 and 2010.

Pension Arrangements

The Executive Directors receive pension contributions from the Company which are paid into money-purchase schemes. No Directors are members of the Group's defined benefit schemes. The pension contributions are 20.0% (2007: 20.0%) of base remuneration, excluding bonuses.

Relative Performance of Remuneration Elements

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

Service Contracts – Executive Directors

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

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

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

Non-Executive Directors

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

The non-Executive Directors do not have contracts of service, but are appointed pursuant to letters of appointment. Such appointments are for a one year term and the Company's policy is for re-appointment to be on an annual basis. Non-Executive Directors are not eligible to participate in any incentive plan or Company pension arrangement and are not entitled to any payment in compensation for any early termination of their appointment. They are due for re-appointment to the Board on the following dates:

	Date of Re-appointment	Renewal
IM Grice	24 January 2009	Annual
JW Matthews	24 July 2009	Annual
JL Rennocks	11 July 2009	Annual

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

During the year ended 30 September 2008 the non-Executive Directors received a base fee of £30,000 per annum (2007: £30,000). The Chairman, who is a non-Executive Director, received a salary and fees of £60,000 per annum (2007: £60,000) for his services during the year ended 30 September 2008.

Remuneration Report continued

Total Remuneration of the Directors

The total remuneration of the Directors for the year ended 30 September 2008 is set out below.

	Fixed emoluments Salary & fees £000	Other benefits £000	Performance based bonus £000	2008 Total £000	2007 Total £000
IM Grice	30	–	–	30	21
I Henderson	197	11	120	328	323
NP Lingwood	197	12	120	329	324
JW Matthews	30	–	–	30	30
JL Rennocks	60	–	–	60	60
Lord Stewartby	–	–	–	–	8
BM Thompson	329	14	288	631	619
	843	37	528	1,408	1,385

Note
1. IM Grice was appointed to the Board on 24 January 2007; Lord Stewartby retired from the Board on 10 January 2007.

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

	2008 £000	2007 £000
BM Thompson	66	62
I Henderson	39	37
NP Lingwood	39	37
	144	136

Long Term Incentive Plan

On 17 December 2007 Executive Directors received a share award with a face value of one times salary as set out below. On 30 September 2008 the performance period relating to the award made on 2 December 2005 ended and the LTIP awards vested and became exercisable by each of the Directors, as set out below.

	LTIP shares held at 30 Sept 2007 Number	LTIP shares awarded during the year ended 30 Sept 2008 Number	LTIP shares vested on 30 Sept 2008 (note 1) Number	LTIP shares lapsed on 30 Sept 2008 Number	Share price on date of award	Vesting date	Total LTIP shares held at 30 Sept 2008 Number
BM Thompson							
2 December 2005	212,830	–	188,099	24,731	137.2p	30 Sept 2008	–
22 December 2006	191,925	–	–	–	161.6p	30 Sept 2009	191,925
17 December 2007	–	178,225	–	–	184.6p	30 Sept 2010	178,225
I Henderson							
2 December 2005	127,550	–	112,729	14,821	137.2p	30 Sept 2008	–
22 December 2006	115,155	–	–	–	161.6p	30 Sept 2009	115,115
17 December 2007	–	106,715	–	–	184.6p	30 Sept 2010	106,715
NP Lingwood							
2 December 2005	127,550	–	112,729	14,821	137.2p	30 Sept 2008	–
22 December 2006	115,155	–	–	–	161.6p	30 Sept 2009	115,115
17 December 2007	–	106,715	–	–	184.6p	30 Sept 2010	106,715

Note:
1. The awards which vested on 30 September 2008 were calculated in accordance with the performance conditions described on pages 42 and 43. The awards may be exercised at any time before 2 December 2015 on payment of £1. In aggregate 88.4% of the total LTIP award granted on 2 December 2005 vested unconditionally and became exercisable.
   - Under the first performance condition, the average annual compound growth rate in the Company's adjusted EPS (as defined on page 52) over the three year period ended 30 September 2008 was 15.3% pa; this compares with an annual compound growth rate in RPI +5% over the same period of 7.9% pa. Accordingly 100% of the shares relating to this award (representing 50% of the total award) vested unconditionally.
   - Under the second performance condition, the Company's TSR grew 29.0% over the three year period ended 30 September 2008; this growth gave the Company a ranking of 54 in the comparator group and put the Company in the 67 percentile. The median TSR was 1.8% and the lower threshold of the upper quartile was 45.3%. Accordingly 77% of the shares relating to this part of the award vested unconditionally.

Directors' Shareholdings

	Ordinary shares of 5p each		
	At 17 November 2008 Number	At 30 September 2008 Number	At 1 October 2007 Number
IM Grice	20,000	20,000	15,000
I Henderson	421,875	421,875	305,000
NP Lingwood	195,875	195,875	125,000
JW Matthews	–	–	–
JL Rennocks	214,766	214,766	50,000
BM Thompson	1,026,940	1,026,940	878,810

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

As described above, following the vesting of the LTIP awards the Executive Directors are able to exercise their vested awards to acquire ordinary shares of 5p each in the Company for an aggregate consideration of £1. The underlying shares are held by the Diploma Employee Benefit Trust and are transferred to the participant on exercise. Whilst ordinary shares are held within the Diploma Employee Benefit Trust, the voting rights in respect of those shares are exercisable by the trustees in accordance with their fiduciary duties. At 30 September 2007 and 2008 the number of shares which are the subject of vested LTIP awards and are held by each Director were as follows:

	Vested LTIP awards				Share price		Amount	
	At 30 Sept 2007 Number	Exercised during 2008 Number	Vested during 2008 Number	At 30 Sept 2008 Number	At 30 Sept 2007	At 30 Sept 2008	At 30 Sept 2007 £	At 30 Sept 2008 £
BM Thompson	118,125	(118,125)	188,099	188,099	220.6p	152.5p	260,584	286,851
I Henderson	70,875	(70,875)	112,729	112,729	220.6p	152.5p	156,350	171,912
NP Lingwood	70,875	(70,875)	112,729	112,729	220.6p	152.5p	156,350	171,912

Note:
1. On 26 November 2007, each participant exercised their option to acquire shares which had vested at 30 September 2007, for consideration of £1. The share price at the date of exercise was 176.0p.
2. The share price during the year to 30 September 2008 ranged from 136.0p to 228.0p

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

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

IM Grice
Chairman of the Remuneration Committee

17 November 2008

Section 3
Financial Statements

Consolidated Income Statement 48

Consolidated Balance Sheet 49

Consolidated Statement of Recognised Income and Expense 50

Consolidated Cash Flow Statement 51

Notes to the Consolidated Financial Statements 52

Group Accounting Policies 69

Parent Company Balance Sheet 75

Notes to the Parent Company Financial Statements 76

Independent Auditors' Reports 77

Principal Subsidiaries 79

Financial Calendar and Shareholder Information 79

Five Year Record 80

Statement of Directors' Responsibilities for the Financial Statements

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

Company law requires the directors to prepare Group and Parent Company financial statements for each financial year. Under that law the Directors are required to prepare Group financial statements in accordance with IFRSs as adopted by the European Union ("EU") and have elected to prepare the Parent Company financial statements in accordance with UK Accounting Standards.

The Group financial statements are required by law and IFRSs as adopted by the EU, to present fairly the financial position and the performance of the Group; the Companies Act 1985 provides in relation to such financial statements, that references in the relevant part of that Act to financial statements giving a true and fair view, are references to their achieving a fair presentation.

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

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

The Directors are responsible for keeping proper accounting records that disclose with reasonable accuracy at any time the financial position of the Parent Company and enable them to ensure that its financial statements comply with the Companies Act 1985. They have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Group and to prevent and detect fraud and other irregularities.

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

Each of the Directors confirms that so far as he is aware, there is no relevant audit information of which the Company's auditors are unaware and that he has taken all steps that he ought to have taken as a director in order to make himself aware of any relevant audit information and to establish that the Company's auditors are aware of that information.

The Directors are satisfied that the Group has adequate resources to meet its operational needs for the foreseeable future and accordingly, they continue to adopt the going concern basis in preparing the financial statements.

Directors' responsibility statement

The Directors confirm that to the best of their knowledge:

- The Group consolidated financial statements, prepared in accordance with IFRSs as adopted by the EU, and the Parent Company financial statements, prepared in accordance with UK Accounting Standards, give a true and fair view of the assets, liabilities, financial position and profit or loss of the Group and Parent Company and the undertakings included in the consolidation taken as a whole: and
- the Annual Report includes a fair review of the development and performance of the business and the position of the issuer 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.

By order of the Board

BM Thompson
Chief Executive Officer

NP Lingwood
Group Finance Director

17 November 2008

Consolidated Income Statement

For the year ended 30 September 2008

	Note	2008 £m	2007 £m
Revenue	3,4	**172.3**	140.7
Cost of sales		**(110.0)**	(90.1)
Gross profit		**62.3**	50.6
Distribution costs		**(4.8)**	(4.2)
Administration costs		**(32.9)**	(25.3)
Operating profit, before amortisation of acquisition intangible assets	3,4	**27.3**	22.1
Amortisation of acquisition intangible assets	11	**(2.7)**	(1.0)
Operating profit	3	**24.6**	21.1
Finance (expense)/income, net	6	**(2.8)**	1.2
Profit before tax		**21.8**	22.3
Tax expense	7	**(7.4)**	(7.5)
Profit for the year		**14.4**	14.8
Attributable to:			
Shareholders of the Company		**13.3**	14.3
Minority interests	20	**1.1**	0.5
		14.4	14.8
Earnings per share			
Basic and diluted earnings	9	**11.8p**	12.7p

All activities, both in the current and previous year, relate to continuing operations.

Alternative Performance Measures (note 2)

	Note	2008 £m	2007 £m
Profit before tax		**21.8**	22.3
Add: Amortisation of acquisition intangible assets	11	**2.7**	1.0
Fair value remeasurements	6	**3.0**	–
Adjusted profit before tax		**27.5**	23.3
Adjusted earnings per share	9	**16.4p**	14.0p

The notes on pages 52 to 74 form part of these financial statements.

Consolidated Balance Sheet

As at 30 September 2008

	Note	2008 £m	2007 £m
Non-current assets			
Goodwill	10	**51.6**	42.7
Acquisition intangible assets	11	**18.6**	20.1
Other intangible assets	11	**1.2**	1.0
Property, plant and equipment	12	**11.6**	11.7
Deferred tax assets	13	**1.3**	1.5
		84.3	77.0
Current assets			
Inventories	14	**31.5**	27.4
Trade and other receivables	15	**26.7**	26.0
Cash and cash equivalents	17	**15.7**	12.4
		73.9	65.8
Current liabilities			
Trade and other payables	16	**(26.3)**	(27.1)
Current tax liabilities		**(3.3)**	(3.0)
Other liabilities	19	**(1.1)**	(4.8)
		(30.7)	(34.9)
Net current assets		**43.2**	30.9
Total assets less current liabilities		**127.5**	107.9
Non-current liabilities			
Retirement benefit obligations	23	**(1.7)**	(1.6)
Other liabilities	19	**(11.2)**	(8.7)
Deferred tax liabilities	13	**(4.6)**	(5.1)
Net assets		**110.0**	92.5
Equity			
Share capital		**5.7**	1.1
Capital redemption reserve		**–**	0.2
Translation reserve		**8.0**	0.6
Hedging reserve		**0.7**	(0.6)
Retained earnings		**93.7**	89.4
Total shareholders' equity		**108.1**	90.7
Minority interests	20	**1.9**	1.8
Total equity		**110.0**	92.5

The consolidated financial statements were approved by the Board of Directors on 17 November 2008 and signed on its behalf by:

BM Thompson **Chief Executive Officer**
NP Lingwood **Group Finance Director**

The notes on pages 52 to 74 form part of these financial statements.

Consolidated Statement of Recognised Income and Expense

For the year ended 30 September 2008

	Note	2008 £m	2007 £m
Exchange rate adjustments on foreign currency net investments		**7.4**	(0.1)
Gains/(losses) on fair value of cash flow hedges		**1.3**	(0.6)
Actuarial (losses)/gains on defined benefit pension schemes	23	**(0.5)**	2.7
Deferred tax on items recognised in equity	13	**(0.3)**	(0.6)
Net income recognised directly in equity for the year		**7.9**	1.4
Profit for the year		**14.4**	14.8
Total recognised income and expense for the year		**22.3**	16.2
Attributable to:			
Shareholders of the Company		**21.1**	15.8
Minority interests		**1.2**	0.4
		22.3	16.2

Other changes in shareholders' equity

	Note	Share capital £m	Capital redemption reserve £m	Translation reserve £m	Hedging reserve £m	Retained earnings £m	Total £m
At 1 October 2006		1.1	0.2	0.7	–	90.9	92.9
Total recognised income and expense for the year attributable to shareholders		–	–	(0.1)	(0.6)	16.5	15.8
Share-based payments	5	–	–	–	–	0.5	0.5
Purchase of own shares		–	–	–	–	(1.3)	(1.3)
Future purchases of minority interests	19	–	–	–	–	(11.8)	(11.8)
Dividends	8	–	–	–	–	(5.4)	(5.4)
At 30 September 2007		1.1	0.2	0.6	(0.6)	89.4	90.7
Total recognised income and expense for the year attributable to shareholders		–	–	7.4	1.3	12.4	21.1
Bonus issue of shares		4.6	(0.2)	–	–	(4.4)	–
Share-based payments	5	–	–	–	–	0.5	0.5
Purchase of own shares		–	–	–	–	(0.9)	(0.9)
Future purchases of minority interests	19	–	–	–	–	3.6	3.6
Dividends	8	–	–	–	–	(6.9)	(6.9)
At 30 September 2008		**5.7**	**–**	**8.0**	**0.7**	**93.7**	**108.1**

The notes on pages 52 to 74 form part of these financial statements.

Consolidated Cash Flow Statement

For the year ended 30 September 2008

	Note	2008 £m	2007 £m
Cash flows from operating activities			
Cash flow from operations	22	**28.8**	23.0
Finance income received, net		**–**	1.1
Tax paid		**(8.2)**	(8.0)
Net cash from operating activities		**20.6**	16.1
Cash flows from investing activities			
Acquisition of subsidiaries (net of cash acquired)	21	**(7.6)**	(31.1)
Deferred consideration paid	19	**(0.3)**	(0.5)
Proceeds from the sale of property, plant and equipment		**0.2**	0.6
Purchase of property, plant and equipment	12	**(1.6)**	(1.6)
Purchase of other intangible assets	11	**(0.3)**	(0.6)
Net cash used in investing activities		**(9.6)**	(33.2)
Cash flows from financing activities			
Dividends paid to shareholders	8	**(6.9)**	(5.4)
Dividends paid to minority interests	20	**(0.9)**	(0.3)
Purchase of own shares		**(0.9)**	(1.3)
Net cash used in financing activities		**(8.7)**	(7.0)
Net increase/(decrease) in cash and cash equivalents		**2.3**	(24.1)
Cash and cash equivalents at beginning of year		**12.4**	36.7
Effect of exchange rates on cash and cash equivalents		**1.0**	(0.2)
Cash and cash equivalents at end of year	17	**15.7**	12.4

Alternative Performance Measures (note 2)

	2008 £m	2007 £m
Net increase/(decrease) in cash and cash equivalents	**2.3**	(24.1)
Add: Dividends paid to shareholders	**6.9**	5.4
Dividends paid to minority interests	**0.9**	0.3
Acquisition of subsidiaries (net of cash acquired)	**7.6**	31.1
Deferred consideration paid	**0.3**	0.5
Free cash flow	**18.0**	13.2

The notes on pages 52 to 74 form part of these financial statements.

Notes to the Consolidated Financial Statements

For the year ended 30 September 2008

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 17 November 2008. These statements are presented in UK sterling, with all values rounded to the nearest one hundred thousand, except where otherwise indicated.

The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS"), as adopted by the European Union, and in accordance with the Companies Act 1985, as applicable to companies reporting under IFRS. The financial statements of the Parent company, Diploma PLC, have been prepared in accordance with "UK GAAP", and are set out in a separate section of the Annual Report on pages 75 to 76.

2. Alternative Performance Measures

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

2.1 Adjusted profit before tax

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

2.2 Adjusted earnings per share

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

2.3 Free cash flow

On the face 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, but before expenditure on business combinations and dividends paid to both minority shareholders and the Company's shareholders. The Directors believe that free cash flow gives an important measure of the cash flow of the Group, available for future investment.

2.4 Trading capital employed

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

3. Business Segment Analysis

For management reporting purposes, the Group is organised into three main business segments, Life Sciences, Seals and Controls. These segments form the basis of the primary reporting format disclosures below. The principal activities of each of these segments is described in the Business Review on pages 21 to 35. Segment revenue represents revenue from external customers; there is no inter-segment revenue. Segment results, assets and liabilities include items directly attributable to a segment, as well as those that can be allocated on a reasonable basis.

	Life Sciences		Seals		Controls		Total	
	2008 £m	2007 £m	2008 £m	2007 £m	2008 £m	2007 £m	2008 £m	2007 £m
Revenue – continuing operations	**61.2**	44.7	**42.6**	36.0	**67.6**	60.0	**171.4**	140.7
– acquisitions	**0.9**	–	**–**	–	**–**	–	**0.9**	–
Revenue	**62.1**	44.7	**42.6**	36.0	**67.6**	60.0	**172.3**	140.7
Segment operating profit – continuing operations	**9.3**	6.6	**6.7**	5.8	**11.0**	9.7	**27.0**	22.1
– acquisitions	**0.3**	–	**–**	–	**–**	–	**0.3**	–
Segment operating profit	**9.6**	6.6	**6.7**	5.8	**11.0**	9.7	**27.3**	22.1
Amortisation of acquisition intangible assets	**(1.5)**	(0.6)	**(0.8)**	(0.3)	**(0.4)**	(0.1)	**(2.7)**	(1.0)
Operating profit	**8.1**	6.0	**5.9**	5.5	**10.6**	9.6	**24.6**	21.1

3. Business Segment Analysis (continued)

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

	Life Sciences		Seals		Controls		Total	
	2008 £m	2007 £m	2008 £m	2007 £m	2008 £m	2007 £m	2008 £m	2007 £m
Operating assets	**21.5**	20.8	**22.0**	18.4	**24.5**	23.8	**68.0**	63.0
Goodwill	**30.6**	23.4	**8.9**	7.4	**12.1**	11.9	**51.6**	42.7
Acquisition intangible assets	**11.4**	12.4	**5.3**	5.4	**1.9**	2.3	**18.6**	20.1
	63.5	56.6	**36.2**	31.2	**38.5**	38.0	**138.2**	125.8
Unallocated assets:								
– Deferred tax assets							**1.3**	1.5
– Cash and cash equivalents							**15.7**	12.4
– Corporate assets							**3.0**	3.1
Total assets							**158.2**	142.8
Operating liabilities	**(12.4)**	(11.3)	**(4.9)**	(4.1)	**(10.5)**	(11.1)	**(27.8)**	(26.5)
Unallocated liabilities:								
– Deferred tax liabilities							**(4.6)**	(5.1)
– Retirement benefit obligations							**(1.7)**	(1.6)
– Future purchases of minority interests							**(11.2)**	(11.8)
– Corporate liabilities							**(2.9)**	(5.3)
Total liabilities							**(48.2)**	(50.3)
Net assets							**110.0**	92.5

Other segment information

	Life Sciences 2008 £m	Life Sciences 2007 £m	Seals 2008 £m	Seals 2007 £m	Controls 2008 £m	Controls 2007 £m	Total 2008 £m	Total 2007 £m
Capital expenditure	**1.1**	1.3	**0.5**	0.5	**0.3**	0.4	**1.9**	2.2
Depreciation (including software)	**1.3**	0.9	**0.7**	0.6	**0.5**	0.3	**2.5**	1.8

Alternative Performance Measures (note 2)

	Life Sciences		Seals		Controls		Total	
	2008 £m	2007 £m	2008 £m	2007 £m	2008 £m	2007 £m	2008 £m	2007 £m
Net assets							**110.0**	92.5
Add/(less):								
– Deferred tax, net							**3.3**	3.6
– Retirement benefit obligations							**1.7**	1.6
– Future purchases of minority interests							**11.2**	11.8
– Cash and cash equivalents							**(15.7)**	(12.4)
– Adjustment to goodwill	**(4.1)**	(3.9)	**(1.2)**	(1.1)	**(0.7)**	(0.6)	**(6.0)**	(5.6)
Group trading capital employed							**104.5**	91.5
Corporate (assets)/liabilities, net							**(0.1)**	2.2
Segment trading capital employed	**47.0**	41.4	**30.1**	26.0	**27.3**	26.3	**104.4**	93.7

Notes to the Consolidated Financial Statements

For the year ended 30 September 2008

4. Geographic Segment Analysis by Origin

	Revenue		Operating profit*		Gross assets		Trading capital employed		Capital expenditure	
	2008 £m	2007 £m	2008 £m	2007 £m	2008 £m	2007 £m	2008 £m	2007 £m	2008 £m	2007 £m
United Kingdom	**73.8**	66.6	**8.6**	8.8	**51.2**	55.8	**29.5**	26.6	**0.7**	1.2
Rest of Europe	**33.7**	25.1	**5.7**	4.3	**26.8**	22.5	**20.7**	16.4	**0.3**	0.3
North America	**64.8**	49.0	**13.0**	9.0	**80.2**	64.5	**54.3**	48.5	**0.9**	0.7
	172.3	140.7	**27.3**	22.1	**158.2**	142.8	**104.5**	91.5	**1.9**	2.2

*before amortisation of acquisition intangible assets

5. Group Employee Costs

The key management of the Group are the Executive Directors who have authority and responsibility for planning and controlling all significant activities of the Group. The Directors' emoluments and interests in shares of the Company are given in the Remuneration Report on pages 41 to 45. The charge for share-based payments of £0.5m relate to the Group's share schemes, described in the Remuneration Report. The fair value of services provided as consideration for part of the grant of the LTIP awards has been based on a predicted future value model and was £0.2m (2007: £0.2m).

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

	2008 £m	2007 £m
Wages and salaries	**30.3**	24.0
Social security costs	**2.8**	2.4
Pension costs – defined contribution	**0.8**	0.7
Share-based payments	**0.5**	0.5
	34.4	27.6

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

	2008 Number	2007 Number
Life Sciences	**344**	293
Seals	**360**	326
Controls	**254**	202
Corporate	**9**	9
Number of employees – average	**967**	830
Number of employees – year end	**976**	926

6. Finance (Expense)/Income, net

	2008 £m	2007 £m
Finance income		
– interest receivable on short term deposits	**0.3**	1.1
– net finance income from defined benefit pension scheme (note 23)	**0.2**	0.1
	0.5	1.2
Finance expense		
– interest payable on bank borrowings	**(0.3)**	–
– fair value remeasurement of put options (note 19)	**(3.0)**	–
	(3.3)	–
Net finance (expense)/income	**(2.8)**	1.2

The fair value remeasurement of £3.0m includes £0.7m which relates to the unwinding of the discount on the liability for future purchases of minority interests.

7. Taxation

	2008 £m	2007 £m
Current tax		
The tax charge is based on the profit for the year and comprises:		
UK corporation tax	**3.0**	2.8
Overseas tax	**5.4**	4.0
	8.4	6.8
Adjustments in respect of prior year:		
UK corporation tax	**(0.4)**	–
Overseas tax	**0.2**	–
	(0.2)	–
Total current tax	**8.2**	6.8
Deferred tax		
The deferred tax (credit)/charge based on the origination and reversal of timing differences comprises:		
United Kingdom	**(0.3)**	0.2
Overseas	**(0.5)**	0.5
Total deferred tax	**(0.8)**	0.7
Total tax on profit for the year	**7.4**	7.5

Factors affecting the tax charge for the year:

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

	2008 £m	2007 £m
Profit before tax	**21.8**	22.3
Tax on profit at UK effective corporation tax rate of 29% (2007: 30%)	**6.3**	6.7
Effects of:		
Higher tax rates on overseas earnings	**0.7**	0.8
Adjustments to tax charge in respect of previous periods	**(0.2)**	–
Fair value remeasurements	**0.9**	–
Other permanent differences	**(0.3)**	–
Total tax on profit for the year	**7.4**	7.5

The Group earns its profits in the UK and overseas. The standard rate for UK corporation tax is currently 28%; however the effective tax rate for UK corporation tax in respect of the year ended 30 September 2008 was 29% and this rate has been used for tax on profit in the above reconciliation. The Group's overseas tax rates are higher than those in the UK, primarily because the profits earned in North America are taxed at standard rates varying from 32% to 38%.

Notes to the Consolidated Financial Statements

For the year ended 30 September 2008

8. Dividends

	2008 pence per share	2007 pence per share	2008 £m	2007 £m
Interim dividend, paid in June	**2.5**	1.8	**2.8**	3.4
Final dividend of the prior year, paid in January	**3.6**	3.0	**4.1**	2.0
	6.1	4.8	**6.9**	5.4

The Directors have proposed a final dividend in respect of the current year of 5.0p (2007: 3.6p) which will be paid in January 2009, subject to approval of shareholders at the Annual General Meeting on 14 January 2009. The total dividend for the current year, subject to approval of the final dividend, will be 7.5p (2007: 5.4p).

Shares held by the Diploma Employee Benefit Trust are not eligible for dividends.

A reconciliation of the movement in share capital is set out in note (d), of the Parent Company financial statements on page 76.

9. Earnings Per Share

Basic and diluted earnings per share

Basic and diluted earnings per ordinary 5p share are calculated on the basis of the weighted average number of ordinary shares in issue during the year of 112,237,586 (2007: 112,473,930) and the profit for the year attributable to shareholders of £13.3m (2007: £14.3m). There were no potentially dilutive shares. The comparative number of shares in issue has been restated to reflect the bonus issue of shares on 21 January 2008.

Adjusted earnings per share

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

	2008 pence per share	2007 pence per share	2008 £m	2007 £m
Profit before tax			**21.8**	22.3
Tax expense			**(7.4)**	(7.5)
Minority interests			**(1.1)**	(0.5)
Earnings for the year attributable to shareholders of the Company	**11.8**	12.7	**13.3**	14.3
Amortisation of acquisition intangible assets	**2.4**	0.9	**2.7**	1.0
Fair value remeasurements	**2.7**	–	**3.0**	–
Tax effects on goodwill, acquisition intangible assets and fair value remeasurements	**(0.5)**	0.4	**(0.6)**	0.4
Adjusted earnings	**16.4**	14.0	**18.4**	15.7

10. Goodwill

	Life Sciences £m	Seals £m	Controls £m	Total £m
At 1 October 2006	13.8	4.7	9.5	28.0
Acquisitions	9.0	2.9	2.3	14.2
Exchange adjustments	0.6	(0.2)	0.1	0.5
At 30 September 2007	23.4	7.4	11.9	42.7
Acquisitions (note 21)	5.8	0.8	–	6.6
Adjustments to prior year goodwill	(0.2)	–	(0.2)	(0.4)
Exchange adjustments	1.6	0.7	0.4	2.7
At 30 September 2008	**30.6**	**8.9**	**12.1**	**51.6**

10. Goodwill (continued)

Goodwill of £6.6m, which arose on acquisitions completed during the year, is described further in the Business Review on page 30.

The Directors have carried out an impairment review of goodwill held at 30 September 2008 and are satisfied that goodwill has not been impaired. The key assumptions used for the value in use calculations are those regarding the discount rates and growth rates. The discount rates used were ca. 16% (2007: ca. 14%), which are pre-tax rates that reflect the current market assessments of the time value of money and the risks specific to the asset. An increase in the discount rates of up to 3% would be unlikely to lead to an impairment in the carrying value of goodwill. The growth rates are broadly based on a prudent estimate of industry forecasts. Changes in selling prices and direct costs are based on past practices and expectations of future changes in the market and inflation.

The cash flow forecasts are derived from the most recent budgets approved by management for the next financial year and are extrapolated thereafter using a growth rate of between 0% and 3%, depending on the relevant market in which the business operates.

11. Acquisition and Other Intangible Assets

	Acquisition intangible assets £m	Other intangible assets £m	Total £m
Cost			
At 1 October 2006	2.3	0.9	3.2
Additions	–	0.6	0.6
Acquisitions	18.7	–	18.7
Exchange adjustments	0.4	–	0.4
At 30 September 2007	21.4	1.5	22.9
Additions	–	0.3	0.3
Disposals	–	(0.2)	(0.2)
Exchange adjustments	1.4	0.7	2.1
At 30 September 2008	**22.8**	**2.3**	**25.1**
Amortisation			
At 1 October 2006	0.3	0.3	0.6
Charge for the year	1.0	0.2	1.2
At 30 September 2007	1.3	0.5	1.8
Charge for the year	2.7	0.3	3.0
Disposals	–	(0.1)	(0.1)
Exchange adjustments	0.2	0.4	0.6
At 30 September 2008	**4.2**	**1.1**	**5.3**
Net book value			
At 30 September 2008	**18.6**	**1.2**	**19.8**
At 30 September 2007	20.1	1.0	21.1

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

	Net book value £m	Economic life
Customer relationships	10.1	5-15 years
Supplier relationships	7.7	7-10 years
Databases	0.8	5-7 years
	18.6	

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

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

Notes to the Consolidated Financial Statements

For the year ended 30 September 2008

12. Property, Plant and Equipment

	Freehold properties £m	Leasehold properties £m	Plant & equipment £m	Total £m
Cost				
At 1 October 2006	7.3	0.7	10.8	18.8
Additions	–	0.1	1.5	1.6
Acquisitions	1.1	–	1.5	2.6
Disposals	–	(0.1)	(1.2)	(1.3)
Exchange adjustments	–	–	(0.3)	(0.3)
At 30 September 2007	8.4	0.7	12.3	21.4
Additions	–	0.2	1.4	1.6
Acquisitions (note 20)	–	–	0.1	0.1
Disposals	(0.1)	–	(0.9)	(1.0)
Exchange adjustments	0.1	0.1	1.2	1.4
At 30 September 2008	**8.4**	**1.0**	**14.1**	**23.5**
Depreciation				
At 1 October 2006	1.6	0.2	7.5	9.3
Charge for the year	0.1	0.1	1.4	1.6
Disposals	–	(0.1)	(1.0)	(1.1)
Exchange adjustments	–	–	(0.1)	(0.1)
At 30 September 2007	1.7	0.2	7.8	9.7
Charge for the year	0.2	0.1	1.9	2.2
Disposals	(0.1)	–	(0.6)	(0.7)
Exchange adjustments	–	0.2	0.5	0.7
At 30 September 2008	**1.8**	**0.5**	**9.6**	**11.9**
Net book value				
At 30 September 2008	**6.6**	**0.5**	**4.5**	**11.6**
At 30 September 2007	6.7	0.5	4.5	11.7

Land included above, but not depreciated, is £2.0m (2007: £2.0m). Capital commitments contracted, but not provided, were £Nil (2007: £Nil).

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

13. Deferred Tax

The movement on deferred tax is as follows:

	2008 £m	2007 £m
At 1 October	**(3.6)**	3.4
Credit/(charge) for the year	**0.8**	(0.7)
Acquisitions (note 21)	**0.1**	(5.6)
Accounted for in equity	**(0.3)**	(0.6)
Exchange adjustments	**(0.3)**	(0.1)
At 30 September	**(3.3)**	(3.6)

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

	Assets		Liabilities		Net	
	2008 £m	2007 £m	2008 £m	2007 £m	2008 £m	2007 £m
Property, plant and equipment	**0.2**	0.2	**(0.5)**	(0.6)	**(0.3)**	(0.4)
Goodwill and intangible assets	**0.3**	0.4	**(5.1)**	(5.6)	**(4.8)**	(5.2)
Retirement benefit obligations	**0.5**	0.5	**–**	–	**0.5**	0.5
Inventories	**0.7**	0.5	**–**	–	**0.7**	0.5
Share-based payments	**0.1**	0.2	**–**	–	**0.1**	0.2
Other temporary differences	**0.5**	0.8	**–**	–	**0.5**	0.8
	2.3	2.6	**(5.6)**	(6.2)	**(3.3)**	(3.6)
Set off of deferred tax	**(1.0)**	(1.1)	**1.0**	1.1	**–**	–
	1.3	1.5	**(4.6)**	(5.1)	**(3.3)**	(3.6)

No deferred tax has been provided for unremitted earnings of overseas Group companies as the Group controls the dividend policies of its subsidiaries. Unremitted earnings may be liable to overseas and/or UK taxation (after allowing for double taxation relief) if they were to be distributed as dividends. The aggregate amount for which deferred tax liabilities have not been recognised in respect of unremitted earnings was £1.0m (2007: £0.5m).

14. Inventories

	2008 £m	2007 £m
Finished goods and goods held for resale	**31.5**	27.4

Inventories are stated net of impairment provisions of £3.5m (2007: £3.1m).

15. Trade and Other Receivables

	2008 £m	2007 £m
Trade receivables	**24.9**	25.0
Less: Impairment provision	**(0.6)**	(0.6)
	24.3	24.4
Other receivables	**1.0**	0.5
Prepayments and accrued income	**1.4**	1.1
	26.7	26.0

Notes to the Consolidated Financial Statements

For the year ended 30 September 2008

15. Trade and Other Receivables (continued)

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

	2008 £m	2007 £m
Sterling	**11.0**	12.0
US Dollars	**4.5**	3.6
Canadian Dollars	**4.3**	4.4
Euro	**3.7**	4.0
Other	**1.4**	1.0
	24.9	25.0

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

	2008 £m	2007 £m
Not past due	**19.8**	18.8
Past due, but not impaired	**4.5**	5.6
Past due, but impaired	**0.6**	0.6
	24.9	25.0

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

	2008 £m	2007 £m
Up to one month past due	**3.0**	3.8
Between one and two months past due	**0.8**	1.3
Between two and four months past due	**0.5**	0.3
Over four months past due	**0.2**	0.2
	4.5	5.6

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

	2008 £m	2007 £m
At 1 October	**0.6**	0.7
Charged against profit, net	**–**	–
Utilised by write off	**–**	(0.1)
Acquired business	**–**	–
	0.6	0.6

16. Trade and Other Payables

	2008 £m	2007 £m
Trade payables	**15.2**	14.6
Other payables	**1.0**	2.2
Other taxes and social security	**1.7**	1.8
Accruals and deferred income	**8.4**	8.5
	26.3	27.1

16. Trade and Other Payables (continued)

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

	2008 £m	2007 £m
Sterling	**5.4**	5.9
US Dollars	**5.0**	3.3
Canadian Dollars	**0.7**	0.3
Euro	**3.8**	4.7
Other	**0.3**	0.4
	15.2	14.6

17. Cash and Cash Equivalents

	Sterling £m	US$ £m	Can$ £m	Euro £m	2008 Total £m	Sterling £m	US$ £m	Can$ £m	Euro £m	2007 Total £m
Cash at bank	**0.5**	**1.3**	**0.5**	**1.4**	**3.7**	1.8	2.5	2.1	2.1	8.5
Short term deposits	**1.0**	**4.0**	**6.2**	**0.8**	**12.0**	2.5	0.5	0.4	0.5	3.9
	1.5	**5.3**	**6.7**	**2.2**	**15.7**	4.3	3.0	2.5	2.6	12.4

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

18. Financial Instruments

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

The principal financial risks to which the Group is exposed are those of credit, liquidity, foreign currency and interest rate. An explanation of each of these risks, how the Group manages these risks and an analysis of sensitivities is set out on page 33 within Risks and Uncertainties.

Further analyses of these risks are included in the consolidated financial statements as follows:

a) Credit risk

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

	Carrying amount 2008 £m	Carrying amount 2007 £m
Trade receivables	**24.3**	24.4
Other receivables	**1.0**	0.5
Cash and cash equivalents	**15.7**	12.4
	41.0	37.3

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

Notes to the Consolidated Financial Statements

For the year ended 30 September 2008

18. Financial Instruments (continued)

b) Liquidity risk

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

	Carrying amount 2008 £m	Carrying amount 2007 £m
Trade payables	**15.2**	14.6
Other payables	**1.0**	2.2
Other liabilities	**12.3**	13.5
	28.5	30.3

The maturities of the undiscounted financial liabilities are as follows:

	2008 £m	2007 £m
Less than one year	**17.3**	20.4
One-two years	**2.1**	1.2
Two-five years	**12.2**	11.6
	31.6	33.2
Less: Discount	**(3.1)**	(2.9)
	28.5	30.3

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

c) Currency risk

The Group holds forward foreign exchange contracts to hedge forecast transactional exposure of certain of the Group's businesses to movements in the US dollar and euro. These forward foreign exchange contracts are classified as cash flow hedges and are stated at fair value. The net fair value of forward foreign exchange contracts used as hedges at 30 September 2008 was a £0.2m asset (2007: £1.1m liability).

d) Interest rate risk

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

In February 2008, the Group drew down £2.4m from its revolving bank facility of £20.0m to finance a small acquisition. The loan was repaid in full in September 2008. The weighted average of the interest paid on the loan, which was by reference to LIBOR, was 6.3%.

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

e) Fair values

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

- Derivatives
  Forward exchange contracts are valued at year end spot rates adjusted for the forward points to the contract's value date, and gains and losses taken to equity. No contract's value date is greater than 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 notional amount is deemed to reflect the fair value.
- Other liabilities
  The carrying amount represents a discounted value of the expected liability which is deemed to reflect the fair value.

19. Other Liabilities

	2008 £m	2007 £m
Future purchases of minority interests	**11.2**	11.8
Deferred consideration	**1.1**	1.7
At 30 September	**12.3**	13.5
Analysed as:		
Due within one year	**1.1**	4.8
Due after one year	**11.2**	8.7

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

	2008 £m	2007 £m
At 1 October	**11.8**	–
(Released)/charged to retained earnings	**(3.6)**	11.8
Unwinding of discount	**0.7**	–
Fair value remeasurements	**2.3**	–
At 30 September	**11.2**	11.8

The Group retains put/call options to acquire the outstanding minority shareholdings in Somagen, AMT and M Seals, which are exercisable between 1 October 2009 and 31 December 2012. Following the acquisition on 3 March 2008 of 11.8% of the ordinary share capital of Somagen Diagnostics Inc. from the minority shareholders, the liability of £3.6m recognised in the consolidated financial statements at 30 September 2007 has been released to retained earnings.

At 30 September 2008, the estimate of the financial liability to acquire the outstanding minority shareholdings was reassessed by the Directors, based on their current estimate of the future performance of the businesses and to reflect foreign exchange rates at 30 September 2008. This led to a remeasurement of the fair value of these put options and the liability was increased by £2.3m by a charge to the consolidated Income Statement.

Deferred consideration of £1.1m is payable to the vendors of AMT, based on the performance of the AMT business in the year ended 30 September 2008. Deferred consideration of £0.3m was paid on 10 April 2008 to the vendors of Cabletec Interconnect Components Systems Limited ("Cabletec") in final settlement of their performance payment; unearned deferred consideration of £0.2m was released against goodwill.

20. Minority Interests

	£m
At 1 October 2006	1.6
Acquisitions	0.1
Share of profit for the year	0.5
Accounted for in equity	(0.1)
Dividends paid	(0.3)
At 30 September 2007	1.8
Acquisition of minority interest (note 21)	(0.3)
Share of profit for the year	1.1
Accounted for in equity	0.1
Dividends paid	(0.9)
Exchange adjustments	0.1
At 30 September 2008	**1.9**

Notes to the Consolidated Financial Statements

For the year ended 30 September 2008

21. Acquisitions

On 5 February 2008, the Group acquired 100% of Hitek Group Limited ("Hitek"), a supplier of calibration services in the United Kingdom. The consideration, net of cash acquired and acquisition expenses, was £2.5m. On 17 June 2008, the Group acquired 100% of Snijders Engineering BV ("Snijders"), a supplier of hydraulic seals in the Netherlands. The consideration, net of cash acquired and acquisition expenses, was £1.4m (€1.8m).

On 3 March 2008, the Group acquired 11.8% of the ordinary share capital of Somagen Diagnostics Inc ("Somagen") for £3.7m (C$7.3m) from the minority shareholders of Somagen, pursuant to put/call option agreements entered into at the time of the original acquisition in July 2004. The Group now owns 91.8% of the issued share capital of Somagen.

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

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

	Book value £m	Fair value £m
Property, plant and equipment	0.1	0.1
Deferred tax	–	0.1
Inventories	0.8	0.5
Trade and other receivables	0.2	0.2
Trade and other payables	(0.1)	(0.2)
	1.0	0.7
Minority's share of net assets		0.3
Net assets acquired by Group		1.0
Goodwill arising on acquisitions completed during the year		6.6
		7.6
Satisfied by:		
Cash paid		7.4
Cash acquired		(0.1)
Expenses of acquisition		0.3
Total consideration		**7.6**

From the date of acquisition to 30 September 2008, these acquired businesses contributed £0.9m to revenue and £0.3m to operating profit. If the acquisition of the acquired businesses had been made at the beginning of the financial year, the acquired businesses would have contributed £1.8m to revenue and £0.4m to profit after tax. Profit after tax should not be viewed as indicative of the results of these acquired operations that would have occurred, if these acquisitions had been made at the beginning of the year.

22. Reconciliation of Cash Flow from Operations

	2008 £m	2007 £m
Profit for the year	**14.4**	14.8
Depreciation/amortisation of tangible and other intangible assets	**2.5**	1.8
Amortisation of acquisition intangible assets	**2.7**	1.0
Share-based payments expense	**0.5**	0.5
Finance expense/(income)	**2.8**	(1.2)
Tax expense	**7.4**	7.5
Operating cash flow before changes in working capital	**30.3**	24.4
Increase in inventories	**(1.5)**	(0.2)
Decrease/(increase) in trade and other receivables	**0.9**	(1.2)
(Decrease)/increase in trade and other payables	**(0.7)**	0.3
Cash paid into defined benefit schemes	**(0.2)**	(0.3)
Cash flow from operations	**28.8**	23.0

23. Retirement Benefit Obligations

The Group maintains several defined benefit schemes, all of which are closed to future accrual and the assets of the schemes are held in separate trustee administered funds. The schemes are funded in accordance with rates recommended by independent qualified actuaries on the basis of triennial or shorter period reviews using the projected unit method.

The two principal defined benefit schemes ("the schemes") are the Diploma Holdings PLC Permanent Staff Pension and Assurance Scheme ("the PLC Scheme") and the Anachem Limited Retirement Benefits Scheme ("the Anachem Scheme").

Pension deficit included in the balance sheet:

	2008 £m	2007 £m
Market value of schemes' assets		
Equities	**9.5**	11.7
Bonds	**3.0**	3.1
Cash	**–**	–
	12.5	14.8
Present value of schemes' liabilities	**(14.2)**	(16.4)
At 30 September	**(1.7)**	(1.6)

Amounts credited to the income statement in respect of defined benefit schemes:

	2008 £m	2007 £m
Charged to operating profit	–	–
Interest cost	**(0.9)**	(0.9)
Expected return on schemes' assets	**1.1**	1.0
Credited to finance income (note 6)	**0.2**	0.1
	0.2	0.1

Amounts recognised in the consolidated statement of recognised income and expense ("SORIE"):

	2008 £m	2007 £m
Experience adjustments on schemes' assets	**(3.4)**	0.3
Changes in assumptions on schemes' liabilities	**3.0**	2.3
Experience adjustments on schemes' liabilities	**(0.1)**	0.1
	(0.5)	2.7

Analysis of movement in the pension deficit:

	2008 £m	2007 £m
At 1 October	**1.6**	4.7
Amounts credited to profit and loss account	**(0.2)**	(0.1)
Contributions paid by employer	**(0.2)**	(0.3)
Actuarial loss/(gain)	**0.5**	(2.7)
At 30 September	**1.7**	1.6

Notes to the Consolidated Financial Statements

For the year ended 30 September 2008

23. Retirement Benefit Obligations (continued)

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

	2008 £m	2007 £m
At 1 October	**16.4**	18.0
Interest cost	**0.9**	0.9
Actuarial loss/(gain)	**0.1**	(0.1)
Gain on changes in assumptions	**(3.0)**	(2.3)
Benefits paid	**(0.2)**	(0.1)
At 30 September	**14.2**	16.4

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

	2008 £m	2007 £m
At 1 October	**14.8**	13.3
Expected return on assets	**1.1**	1.0
Actuarial (loss)/gain	**(3.4)**	0.3
Contributions paid by employer	**0.2**	0.3
Benefits paid	**(0.2)**	(0.1)
At 30 September	**12.5**	14.8

Principal actuarial assumptions for the schemes at balance sheet dates:

	2008	2007	2006
Inflation rate	**3.8%**	3.4%	3.0%
Expected rate of pension increases	**3.8%**	3.4%	3.0%
Discount rate	**7.0%**	5.8%	5.0%
Number of years a current pensioner is expected to live beyond age 65			
• Men	**21.9**	21.9	20.5
• Women	**24.8**	24.8	23.4
Expected return on schemes' assets			
Analysed as:			
Equities	**8.0%**	8.0%	8.0%
Bonds	**5.5%**	5.5%	4.6%
Cash	**4.5%**	5.0%	4.0%

23. Retirement Benefit Obligations (continued)

Demographic assumptions:

Basic mortality table used:	100% of PMA92/PFA92
Year the mortality table was published:	1999
Allowance for future improvements in longevity:	Year of birth projections, with medium cohort improvements with adjustments to reflect expected scheme experience
Allowance made for members to take a cash lump sum on retirement	Members are assumed to take 100% (in PLC) and 50% (in Anachem) of their maximum cash sum (based on current commutation factors)

Sensitivities:
Sensitivity of 2008 pension liabilities to changes in assumptions are as follows:

		Impact on pension liabilities	
Assumption	Assumption	Estimated increase %	Estimated increase £m
Discount rate	Decrease by 0.5%	9.6	1.4
Expected rate of pension increase	Increase by 0.5%	4.2	0.6
Life expectancy	Increase by 1 year	1.2	0.2

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

	PLC	Anachem
Date of last formal funding valuation	6 April 2006	5 April 2007
Deficit	£317,000	£839,000
Funding level	96%	91%
Funding approach	Assumes that schemes' assets will outperform Government bonds by 2.34% pa pre-retirement and 0.24% pa post-retirement	Assumes that schemes' assets will outperform Government bonds by 2.35% pa pre-retirement and NIL% pa post-retirement
Lump sum contributions per annum to remove the deficit	£42,000	£120,000
Period over which the deficit is expected to be removed	6 April 2007 – 5 April 2016	1 October 2007 – 30 September 2017
Expected contributions during FY2009	£42,000	£120,000
Current investment strategy	80% Equities/20% Bonds	85% Equities/15% Bonds
Number of deferred members at date of actuarial valuation	152	187

Notes to the Consolidated Financial Statements

For the year ended 30 September 2008

23. Retirement Benefit Obligations (continued)

History of experience gains and losses

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

	2008	2007	2006	2005	2004
Experience adjustments arising on schemes' assets:					
Amount (£m)	**(3.4)**	0.3	0.6	1.1	0.3
% of schemes' assets	**27%**	2%	5%	9%	3%
Changes in assumptions arising on present value of schemes' liabilities:					
Amount (£m)	**3.0**	2.3	(0.6)	–	0.3
% of present value of schemes' liabilities	**21%**	14%	3%	–	2%
Experience adjustments arising on present value of schemes' liabilities:					
Amount (£m)	**(0.1)**	0.1	(0.6)	(1.7)	0.3
% of present value of schemes' liabilities	**1%**	1%	3%	11%	2%
Present value of schemes' liabilities	**(14.2)**	(16.4)	(18.0)	(16.1)	(13.9)
Market value of schemes' assets	**12.5**	14.8	13.3	11.7	9.8
Deficit	**(1.7)**	(1.6)	(4.7)	(4.4)	(4.1)

24. Commitments

At 30 September 2008 the Group has total lease payments under non-cancellable operating leases as follows:

	Land and Buildings 2008 £m	2007 £m
Lease payments due:		
Within one year	**1.1**	1.0
Within two to five years	**2.3**	2.5
After five years	**0.3**	0.3
Total payable at 30 September	**3.7**	3.8

Operating lease payments made in respect of land and buildings during the year were £1.1m (2007: £0.8m).

25. Audit Fees

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

	2008 £'m	2007 £'m
Fees payable to the auditors for the audit of:		
– the Company's annual report	**0.1**	0.1
– the Company's subsidiaries, pursuant to legislation	**0.1**	0.2
Total audit fees	**0.2**	0.3

There were no other fees paid to the Group's auditors.

26. Exchange Rates

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

	Average 2008	Average 2007	Closing 2008	Closing 2007
US Dollar	**1.97**	1.98	**1.78**	2.04
Canadian Dollar	**1.99**	2.18	**1.90**	2.02
Euro	**1.31**	1.48	**1.27**	1.43

27. Subsequent Event

On 5 November 2008, the Group acquired a small medical diagnostic company in Canada, Meditech Istisharat Canada Inc. ("Meditech") for maximum consideration of £1.5m (C$2.9m), including expenses.

Group Accounting Policies

The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") as endorsed by the European Union, and in accordance with the Companies Act 1985, as applicable to companies reporting under IFRS. The accounting policies set out below have been consistently applied in 2008 and the comparative period. There has been no material impact on the Group's consolidated financial statements in 2008 from the issue of IFRS, or interpretations to existing Standards, during the year. The Group has adopted *IFRS 7, Financial Instruments: Disclosures* at 30 September 2008, however this relates only to additional disclosures in respect of financial instruments, which are included in this Annual Report.

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.

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

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

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

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

(a) Defined contribution pension plans
Contributions to the Group's defined contribution schemes are recognised as an employee benefit expense when they fall due.

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

(i) Within profit before tax:

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

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

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

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

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

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

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

Group Accounting Policies continued

1.5 Foreign currencies

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

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

(i) Foreign currency monetary items are retranslated at the rates prevailing at the balance sheet date. Exchange differences arising on the settlement or retranslation of monetary items are recognised in the income statement;

(ii) Non-monetary items measured at historical cost in a foreign currency are not retranslated; and

(iii) Non-monetary items measured at fair value in a foreign currency are retranslated using the exchange rates at the date the fair value was determined. Where a gain or loss on non-monetary items is recognised directly in equity, any exchange component of that gain or loss is also recognised directly in equity and conversely, where a gain or loss on a non-monetary item is recognised in the income statement, any exchange component of that gain or loss is also recognised in the income statement.

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

(i) Assets and liabilities are translated using exchange rates prevailing at the balance sheet date;

(ii) Income and expense items are translated at average exchange rates for the year, except where the use of such an average rate does not approximate the exchange rate at the date of the transaction, in which case the transaction rate is used; and

(iii) All resulting exchange differences are recognised in translation reserves as a separate component of equity; these cumulative exchange differences are recognised in the income statement in the period in which the foreign operation is disposed of.

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

1.6 Taxation

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

Current tax is based on taxable profit for the year, which differs from profit before taxation as reported in the income statement. Taxable profit excludes items of income and expense that are taxable (or deductible) in other years and also excludes items that are never taxable or deductible. The Group's liability for current tax, including UK corporation tax and overseas tax, is calculated using rates that have been enacted or substantively enacted at the balance sheet date.

Deferred tax is accounted for using the balance sheet liability method. Deferred tax is recognised on differences between the carrying amounts of assets and liabilities in the financial statements and the corresponding tax bases used in the computation of taxable profit. Deferred tax liabilities are generally recognised for all taxable temporary differences and deferred tax assets are recognised to the extent that it is probable that taxable profits will be available against which deductible temporary differences can be utilised. Temporary differences arise primarily from the recognition of the deficit on the Group's defined benefit pension schemes, the difference between accelerated capital allowances and depreciation and for short term timing differences where a provision held against receivables or stock is not deductible for taxation purposes. However, deferred tax assets and liabilities are not recognised if the temporary difference arises from goodwill or from the initial recognition (other that 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. If these earnings were remitted, it is unlikely there would be any significant impact on the tax charge or liability.

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

1.7 Property, plant and equipment

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

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

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

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

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

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

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

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

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

(d) Goodwill – business combinations
Goodwill arising on the acquisition of a subsidiary represents the excess of the aggregate of the fair value of the consideration over the aggregate fair value of the identifiable intangible and tangible assets, net of the aggregate fair value of the liabilities (including contingencies of businesses acquired at the date of acquisition), and net of any costs directly attributable to the business combination. Goodwill is initially recognised as an asset at cost and is subsequently measured at cost less any accumulated impairment losses. Impairment testing is carried out annually or more frequently if events or changes in circumstances indicate that the carrying value may be impaired.

Goodwill on acquisitions after 30 September 2004 is not amortised and goodwill arising on acquisitions before the date of transition to IFRS (which is 1 October 2004), is not amortised after that date. Goodwill existing at the date of transition to IFRS has been retained at the previous UK GAAP amounts, as the Group has elected not to restate business combinations that occurred before the date of transition to IFRS.

1.9 Impairment of tangible and intangible assets
An impairment loss is recognised to the extent that the carrying amount of an asset or cash generating unit exceeds its recoverable amount.

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

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

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

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

(b) Impairment of other tangible and intangible assets
At each balance sheet date, the Group reviews the carrying amount of its tangible and intangible assets to determine whether there is

Group Accounting Policies continued

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

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

1.10 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.

1.11 Financial instruments

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

(a) Trade receivables

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

(b) Trade payables

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

(c) Cash and cash equivalents

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

(d) Put options held by minority interests

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

(e) Derivative financial instruments and hedge accounting

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

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

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

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

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

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

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

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

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

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

1.15 Share capital
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.

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.

1.16 Accounting standards, interpretations and amendments to published standards not yet effective
Certain new standards, amendments and interpretations to existing standards have been published that are mandatory for the Group's accounting periods beginning on or after 1 October 2008 or later periods, but which the Group has not early adopted. The new standards which are expected to be relevant to the Group's operations are as follows:

IFRS 8 Operating Segments (effective from 1 October 2009)
This IFRS specifies how an entity should report information about its operating segments in its financial statements.

IFRS 3 Business Combinations (Revised) (effective from 1 October 2009)
This revised standard relates to accounting for acquisitions.

Amendment to IAS 1 Presentation of Financial Statements (effective from 1 October 2009)
This amendment requires information in financial statements to be aggregated on the basis of shared characteristics and introduces a statement of comprehensive income.

IFRIC 13 Customer Loyalty Programmes (effective from 1 October 2008)
IFRIC 13 addresses accounting by entities that grant loyalty award credits to customers who buy other goods or services.

IFRIC 14 The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction (effective from 1 October 2009)
IFRIC 14 addresses the accounting by entities where the present value of cash contributions to a defined pension scheme exceed the IAS 19 deficit.

Management is currently assessing the impact of these IFRS, interpretations and amendments on the Group's consolidated financial statements.

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

2.1 Goodwill impairment
The Directors use their judgement to determine the extent to which goodwill has a value that will benefit the performance of the Group over future periods. To assist in making this judgement, the Directors undertake an assessment, at least annually, of the carrying value of the Group's capitalised goodwill, using discounted cash flow forecasts to derive the "value in use" to the Group of the capitalised goodwill.

Group Accounting Policies continued

This calculation is usually based on projecting future cash flows over a five year period and using a terminal value to incorporate expectations of growth thereafter. A discount factor is applied to obtain a current value ("value in use"). The "fair value less costs to sell" of an asset is used if this results in an amount in excess of "value in use".

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

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

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

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

Details of these assumptions, which are based on advice from the Group's actuaries, are set out in note 23.

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

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

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

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

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

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

Parent Company Balance Sheet

As at 30 September 2008

	Note	2008 £m	2007 £m
Fixed assets			
Investments	c	**70.2**	70.2
Creditors: amounts falling due within one year			
Amounts owed to subsidiary undertakings		**(43.0)**	(44.8)
Total assets less current liabilities		**27.2**	25.4
Capital and reserves			
Called up equity share capital	d	**5.7**	1.1
Capital redemption reserve		**–**	0.2
Profit and loss account		**21.5**	24.1
		27.2	25.4

The financial statements were approved by the Board of Directors on 17 November 2008 and signed on its behalf by:

BM Thompson **Chief Executive Officer**
NP Lingwood **Group Finance Director**

The notes on page 76 form part of these financial statements.

Reconciliation of Movements in Shareholders' Funds

for the year ended 30 September 2008

	Share capital £m	Capital redemption reserve £m	Profit and loss account £m	Total £m
At 1 October 2007	1.1	0.2	24.1	25.4
Retained profit for the year	–	–	2.2	2.2
Bonus issue of shares	4.6	(0.2)	(4.4)	–
Purchase of own shares, net	–	–	(0.4)	(0.4)
At 30 September 2008	**5.7**	**–**	**21.5**	**27.2**

Notes to the Parent Company Financial Statements

a) Accounting Policies

a.1 Basis of accounting

These financial statements have been prepared under the historical cost convention in accordance with the Companies Act 1985 and applicable UK accounting standards. A summary of the accounting policies of the Parent company ("the Company") is set out below. As permitted by section 230 of the Companies Act 1985, no separate profit and loss account is presented for the Company.

a.2 Investments and dividends

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

a.3 Employment Benefit Trust and Employee Share Schemes

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

b) Directors' Remuneration

No emoluments are paid directly by the Company; information on the Directors' remuneration and interests in the share capital of the Company are set out in the Remuneration Report on pages 41 to 45.

c) Investments

	£m
Shares in Group undertakings	
At 30 September 2008 and 1 October 2007	**70.2**

Details of the principal subsidiaries are set out on page 79.

d) Share Capital

	2008 Number	2007 Number	2008 £m	2007 £m
Authorised ordinary shares of 5p each				
At 1 October	**35,000,000**	35,000,000	**1.7**	1.7
Increase in authorised ordinary shares	**100,000,000**	–	**5.0**	–
At 30 September	**135,000,000**	35,000,000	**6.7**	1.7
Allotted, issued and fully paid ordinary shares of 5p each				
At 1 October	**22,647,911**	22,647,911	**1.1**	1.1
Bonus issue	**90,591,644**	–	**4.6**	–
At 30 September	**113,239,555**	22,647,911	**5.7**	1.1

On 21 January 2008 the Company undertook a bonus issue of four new ordinary shares of 5 pence for each ordinary share held by shareholders of the Company. The bonus issue resulted in the issue of 90,591,644 new ordinary shares, representing the capitalisation of £4.4m of the Company's retained earnings, together with the £0.2m which was held in the capital redemption reserve.

As a consequence of this bonus issue, the comparative earnings and dividends per share included in this Annual Report have been restated.

During the year, the Diploma Employee Benefit Trust purchased a further 528,760 ordinary shares in the Company for an aggregate amount of £0.9m. These shares were acquired in connection with potential awards under the Group's share incentive plans. Pursuant to these plans, during the year 259,875 shares were transferred from the Trust to participants in connection with vesting of awards under the Long Term Incentive Plan. In accordance with UITF 38, the purchase cost of own shares has been deducted from shareholders' funds.

At 30 September 2008 the Trust held 1,281,820 (2007: 1,012,935) ordinary shares in the Company representing 1.1% of the called up share capital. The market value of the shares at 30 September 2008 was £2.0m (2007: £2.2m).

Independent Auditors' Reports

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

We have audited the Group financial statements of Diploma PLC for the year ended 30 September 2008 which comprise the consolidated income statement, the consolidated balance sheet, the consolidated cash flow statement, the consolidated statement of recognised income and expense, the Group Accounting Policies and the related notes 1 to 27. These Group financial statements have been prepared under the accounting policies set out therein. We have also audited the information in the Directors' Remuneration Report that is described as having been audited.

We have reported separately on the Parent company financial statements of Diploma PLC for the year ended 30 September 2008.

This report is made solely to the Company's members, as a body, in accordance with section 235 of the Companies Act 1985. Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditors' report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's members as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of directors and auditors

The Directors' responsibilities for preparing the Annual Report, the Directors' Remuneration Report and the Group financial statements in accordance with applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union are set out in the Statement of Directors' Responsibilities.

Our responsibility is to audit the Group financial statements and the part of the Directors' Remuneration Report to be audited in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland).

We report to you our opinion as to whether the Group financial statements give a true and fair view and whether the Group financial statements have been properly prepared in accordance with the Companies Act 1985 and Article 4 of the IAS Regulation and whether the part of the Directors' Remuneration Report described as being audited has been properly prepared in accordance with the Companies Act 1985. We also report to you whether in our opinion the information given in the Directors' Report is consistent with the Group financial statements. The information given in the Directors' Report includes that specific information presented in the Business Review that is cross referred from the Principal Activities section of the Directors' Report. In addition we report to you if, in our opinion, we have not received all the information and explanations we require for our audit, or if information specified by law regarding Director's remuneration and other transactions is not disclosed.

We review whether the Corporate Governance Statement reflects the Company's compliance with the nine provisions of the 2006 Combined Code specified for our review by the Listing Rules of the Financial Services Authority, and we report if it does not. We are not required to consider whether the Board's statements on internal control cover all risks and controls, or form an opinion on the effectiveness of the Group's corporate governance procedures or its risk and control procedures.

We read other information contained in the Annual Report and consider whether it is consistent with the audited Group financial statements. The other information comprises only the Directors' Report, the Financial Highlights, the Chairman's Statement, the Business Review and the Corporate Governance Statement. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the Group financial statements. Our responsibilities do not extend to any further information outside of the Annual Report.

Basis of audit opinion

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the Group financial statements. It also includes an assessment of the significant estimates and judgements made by the Directors in the preparation of the Group financial statements, and of whether the accounting policies are appropriate to the Group's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the Group financial statements are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the Group financial statements.

Opinion

In our opinion:

- the Group financial statements give a true and fair view, in accordance with IFRSs as adopted by the European Union, of the state of the Group's affairs as at 30 September 2008 and of its profit for the year then ended;
- the Group financial statements have been properly prepared in accordance with the Companies Act 1985 and Article 4 of the IAS Regulation;
- the part of the Directors' Remuneration Report described as having been audited has been properly prepared in accordance with the Companies Act 1985; and
- the information given in the Directors' Report is consistent with the Group financial statements.

Deloitte & Touche LLP
Chartered Accountants and Registered Auditors
London
17 November 2008

Independent Auditors' Reports continued

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

We have audited the Parent company financial statements of Diploma PLC for the year ended 30 September 2008 which comprise the Parent company balance sheet, the reconciliation of movement in shareholders' funds and the related notes. These Parent company financial statements have been prepared under the accounting policies set out therein. We have also audited the information in the Directors' Remuneration Report that is described as having been audited.

We have reported separately on the Group financial statements of Diploma PLC for the year ended 30 September 2008.

This report is made solely to the Company's members, as a body, in accordance with section 235 of the Companies Act 1985. Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditors' report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's members as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of directors and auditors

The Directors' responsibilities for preparing the Annual Report, the Directors' Remuneration Report and the Parent company financial statements in accordance with applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice) are set out in the Statement of Directors' Responsibilities.

Our responsibility is to audit the Parent company financial statements and the part of the Directors' Remuneration Report to be audited in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland).

We report to you our opinion as to whether the Parent company financial statements give a true and fair view and whether the Parent company financial statements have been properly prepared in accordance with the Companies Act 1985. We also report to you whether in our opinion the information given in the Directors' Report is consistent with the Parent company financial statements. The information given in the Directors' Report includes that specific information presented in the Business Review that is cross referred from the Principal Activities section of the Directors' Report. In addition we report to you if, in our opinion, the Company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding Directors' remuneration and other transactions is not disclosed.

We read other information contained in the Annual Report and consider whether it is consistent with the audited Parent company financial statements. The other information comprises only the Directors' Report, the Financial Highlights, the unaudited part of the Directors' Remuneration Report, the Chairman's Statement and the Business Review. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the Parent company financial statements. Our responsibilities do not extend to any further information outside of the Annual Report.

Basis of audit opinion

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the Parent company financial statements and the part of the Directors' Remuneration Report to be audited. It also includes an assessment of the significant estimates and judgements made by the Directors in the preparation of the Parent company financial statements, and of whether the accounting policies are appropriate to the Company's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the Parent company financial statements and the part of the Directors' Remuneration Report to be audited are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the Parent company financial statements and the part of the Directors' Remuneration Report to be audited.

Opinion

In our opinion:

- the Parent company financial statements give a true and fair view, in accordance with United Kingdom Generally Accepted Accounting Practice, of the state of the Company's affairs as at 30 September 2008 and its profit for the year then ended;
- the Parent company financial statements have been properly prepared in accordance with the Companies Act 1985; and
- the information given in the Directors' Report is consistent with the Parent company financial statements.

Deloitte & Touche LLP
Chartered Accountants and Registered Auditors
London
17 November 2008

Principal Subsidiaries

	Group percentage of equity capital	Country of incorporation or registration
Life Sciences		
Anachem Limited	100%	England
Hitek Limited	100%	England
a1-Envirosciences Limited	100%	England
a1-technologies GmbH	100%	Germany
a1-safetech AG	100%	Switzerland
Somagen Diagnostics Inc	91.8%	Canada
AMT Vantage Holdings Inc	75%	Canada
Seals		
Hercules Sealing Products Inc	100%	USA
HKX Inc	100%	USA
Hercules Europe BV (formerly Snijders Engineering BV)	100%	Netherlands
M Seals A/S	90%	Denmark
FPE Limited	100%	England
Controls		
IS Rayfast Limited	100%	England
IS Motorport Inc	100%	USA
Clarendon Engineering Supplies Limited	100%	England
Cabletec Interconnect Components Systems Limited	100%	England
Sommer GmbH	100%	Germany
Filcon GmbH	100%	Germany
HA Wainwright (Group) Limited	100%	England
Other Companies		
Diploma Holdings PLC	100%	England
Diploma Holdings Inc	100%	USA

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

Financial Calendar and Shareholder Information

Announcements (provisional dates)

Interim Management Statement released	14 January 2009
Interim results announced	11 May 2009
Interim Management statement released	4 August 2009
Preliminary results announced	16 November 2009
Annual Report posted to shareholders	27 November 2009
Annual General Meeting	13 January 2010
Dividends (provisional dates)	
Interim announced	11 May 2009
Paid	17 June 2009
Final announced	16 November 2009
Paid (if approved)	20 January 2010

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

Share Registrar – Computershare Investor Services PLC: The Company's Registrar is Computershare Investor Services PLC, PO Box 82, The Pavilions, Bridgwater Road, Bristol BS99 7NH. Telephone: 0870 7020010.

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

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

Web site: Diploma's web site is www.diplomaplc.com

Five Year Record

	IFRS 2008 £m	IFRS 2007 £m	IFRS 2006 £m	IFRS 2005 £m	UKGAAP 2004 £m
Revenue	**172.3**	140.7	128.2	111.3	100.5
Operating profit	**27.3**	22.1	19.4	16.5	12.3
Finance income	**0.2**	1.2	1.0	0.7	0.8
Adjusted profit before tax	**27.5**	23.3	20.4	17.2	13.1
Amortisation of acquisition intangibles and goodwill	**(2.7)**	(1.0)	(0.3)	–	(0.8)
Property profits and restructuring costs, net	**–**	–	11.1	–	3.1
Fair value remeasurements	**(3.0)**	–	–	–	–
Profit before tax	**21.8**	22.3	31.2	17.2	15.4
Taxation	**(7.4)**	(7.5)	(7.0)	(5.0)	(3.3)
Profit after tax	**14.4**	14.8	24.2	12.2	12.1
Capital structure					
Equity shareholders' funds	**108.1**	90.7	92.9	75.4	64.0
Minority interest	**1.9**	1.8	1.6	1.7	1.3
Add/(less): cash and cash equivalents	**(15.7)**	(12.4)	(36.7)	(25.7)	(17.9)
retirement benefit obligations	**1.7**	1.6	4.7	4.4	–
future purchases of minority interests	**11.2**	11.8	–	–	–
deferred tax, net	**3.3**	3.6	(3.4)	(3.1)	–
adjustment to goodwill in respect of deferred tax	**(6.0)**	(5.6)	–	–	–
Trading capital employed	**104.5**	91.5	59.1	52.7	47.4
Net increase/(decrease) in cash	**2.3**	(24.1)	11.3	7.5	(11.3)
Add: dividends paid	**7.8**	5.7	5.0	4.1	3.6
acquisition of businesses	**7.9**	31.6	8.0	0.3	17.3
Free cash flow	**18.0**	13.2	24.3	11.9	9.6
Per ordinary share (pence)					
Basic earnings	**11.8**	12.7	21.1	10.5	10.5
Adjusted earnings	**16.4**	14.0	12.6	10.7	8.2
Dividends	**7.5**	5.4	4.6	4.0	3.4
Equity shareholders' funds	**95**	80	82	67	57
Dividend cover	**2.2**	2.6	2.7	2.7	2.4
Ratios	**%**	%	%	%	%
Return on trading capital employed	**21.0**	24.2	23.9	22.1	21.0
Operating margin	**15.8**	15.7	15.1	14.8	12.2

Notes
1 The consolidated financial statements have been prepared in accordance with IFRS except for 2004, which has not been restated in accordance with IFRS.
2 Equity shareholders' funds represent share capital and reserves.
3 Cash and cash equivalents includes cash at bank and short term deposits less bank overdrafts.
4 Return on trading capital employed represents operating profit, before amortisation of acquisition intangible assets, as a percentage of trading capital employed (as adjusted for the effect of the timing of major acquisitions and disposals). Trading capital employed is calculated as defined in note 2 to the consolidated financial statements.
5 Adjusted earnings per share is calculated in accordance with note 9 to the consolidated financial statements.
6 Equity shareholders' funds per share have been calculated by dividing equity shareholders' funds by the number of ordinary shares in issue at the year end.
7 Dividend cover is calculated on adjusted earnings as defined in note 2 to the financial statements.
8 On 21 January 2008 the Company undertook a bonus issue of four new ordinary shares of 5 pence each for each ordinary share held by shareholders of the Company. The comparative amounts stated above have been restated to reflect this bonus issue.

www.diplomaplc.com

Design www.energydesignstudio.com Production Imprima De Bussy Limited 020 7105 0300

Diploma PLC

12 Charterhouse Square
London EC1M 6AX

Telephone: +44 (0)20 7549 5700
Facsimile: +44 (0)20 7549 5715

www.diplomaplc.com