CEO’S REVIEW

SUSTAINABLE QUALITY COMPOUNDING

JOHNNY THOMSON
CHIEF EXECUTIVE OFFICER

Revenue in the year was up 19% to:

£1.2bn

"I am extremely pleased with our financial performance and strategic progress. I would like to thank my brilliant colleagues across the Group who do a fantastic job every single day."

EXCELLENT FINANCIAL PERFORMANCE, DELIVERED WITH DISCIPLINE

The Group has delivered another successful year, reflecting the power of our value-add propositions, our strategy, and our decentralised model. This, underpinned by the commitment of our colleagues to deliver excellent customer service, has enabled us again to deliver strong organic growth at high and growing margins.

Revenue in the year was up 19% to £1.2bn (2022: £1.0bn). Organic growth of 8% was driven by strong volumes. Acquisitions, net of a small disposal, contributed 8% to reported revenue while foreign exchange translation added a further 3%.

Our value-add customer propositions enable us to price to offset cost inflation and then selectively reinvest some of the benefits of positive operational leverage into scaling our businesses. This 'margin formula', coupled with disciplined cost control and accretive acquisitions, means that we have increased adjusted operating margin by 80 bps to a very strong 19.7% (2022: 18.9%). Our adjusted operating profit increased by 24% to £237.0m (2022: £191.2m).

Adjusted earnings per share (EPS) grew by 18%, continuing our long-term compounding track record (15% compound annual growth rate (CAGR) EPS over 15 years).

Our cash-generative business model drove free cash flow conversion of 100% (2022: 90%), benefitting from targeted inventory reduction. Together with the equity raise earlier in the year, this led to a reduction in net debt to £254.7m, reducing leverage to 0.9x at 30 September 2023 (2022: £328.9m and 1.4x). Returns on capital are a key underpin of our compounding financial model and return on average trading capital employed (ROATCE) improved by 80 bps to 18.1% (2022: 17.3%).

REVENUE DIVERSIFICATION DRIVING ORGANIC GROWTH AND INCREASING RESILIENCE

The Group's strategy is to build high-quality, scalable businesses for organic growth.

We drive organic growth in three ways: positioning behind structurally growing end markets; penetrating further into core developed geographies; and extending our product range to expand addressable markets. This strategy drives both sustainable organic growth and increased resilience. Execution of this strategy across our businesses drove organic growth of 8% in FY23, with strong trading momentum as we exit the year.

Our adjusted operating profit increased by 24% to £237.0m

24%

"The acquisition of DICSA creates a platform for our fluid power businesses in Spain and across Europe, including cross-selling opportunities."

	Revenue £m		Growth	
	FY23	FY22	Reported	Organic
Controls	**568.4**	492.8	+15%	+11%
Seals	**419.0**	331.4	+26%	+5%
Life Sciences	**212.9**	188.6	+13%	+8%
Group	**1,200.3**	1,012.8	+19%	+8%

Some examples of how our businesses are delivering organic growth are set out below, with further detail provided in the Sector Reviews on pages 24 to 35.

Positioning to take advantage of structurally growing end markets

Across the Group we have continued to drive growth through expansion in structurally growing end markets. A number of businesses in our **Controls** Sector are gaining share in aerospace, defence and energy markets as well as penetrating the wider electrification ecosystem. The acquisition of Tennessee Industrial Electronics (T.I.E.), in March gives us access to the strategically important industrial automation end market in the US. Across our **Seals** businesses, we are well positioned to benefit from US infrastructure spend and we have diversified into exciting growing markets such as water treatment and renewable energy. In **Life Sciences**, in addition to benefitting from the recovery of surgical procedures, our businesses are continuing to diversify, in particular across diagnostic areas such as molecular testing, allergy and auto-immune testing, haematology, and cancer screening.

Penetration of core developed economies

Over the last year we have made progress developing our US and European footprint. In **Controls**, for example, we continue to win market share in the German energy market delivering very strong double-digit growth.

In **Seals**, we are continuing to win share in the western and mid-west states of the US, leveraging the investment in the facility in Louisville. In the UK, R&G has enjoyed a very strong first year in the Group, building out our regional position and product offerings to drive excellent organic growth. The acquisition of Distribuidora Internacional Carmen S.A.U. (DICSA) in July creates a platform for our fluid power business in Spain and across Europe, including cross-selling opportunities with R&G. In **Life Sciences**, we now have a scaled European platform.

Product range extension

New product development forms an ongoing component of all our businesses' organic growth strategies.

- **Controls** has delivered outstanding growth from speciality adhesives, having entered that segment through the acquisition of Techsil in 2021. The acquisition of T.I.E. brings expertise in aftermarket and circular economy solutions for CNC machines and robotics.
- With the acquisition of DICSA, following last year's acquisition of R&G, **Seals** continues to diversify from its traditional strength across seals and gaskets, into wider fluid power products.
- Product development is intrinsic to our **Life Sciences** businesses. The Canadian businesses introduced new technology in the gastrointestinal and surgical segments. The European businesses introduced the single-use endoscope in the Urology segment, as well as new ultrasound technology, and new products in the lab and pharmaceutical testing environments.

COMPLEMENTARY ACQUISITIONS TO ACCELERATE GROWTH

Acquisitions can accelerate our growth strategy. We are disciplined and selective and will only consider opportunities with the following core characteristics:

- differentiated value-add customer proposition generating sustainable high gross margins;
- strong organic growth and scaling potential; and
- capable management teams we can back.

Since 30 September 2022, we have acquired 12 high-quality businesses for a total of £280m.

In March, we acquired T.I.E. for ca. £76m, entering the strategically important industrial automation end market in the US. T.I.E. is a high growth, market-leading value-add distributor of aftermarket parts and repair services for robotics and CNC machines. It differentiates through speed to market and superior technical support, driving a strong organic growth track record and high margins.

In July, we acquired DICSA for ca. £170m, establishing a platform in fluid power solutions across the European aftermarket. DICSA has significant customer value-add, based on quality product, breadth of range, technical service, and speed to market. It adds to our established positions in the US and UK, expanding our aftermarket fluid power capability and accessing key strategic markets.

Over time we will drive significant revenue and procurement synergies including cross-selling existing product from R&G through DICSA's platform into Europe; leveraging our North American Seals Aftermarket platform to accelerate DICSA's growth in the US; and delivering consolidated procurement synergies.

Both T.I.E. and DICSA are strategic platform acquisitions, well positioned for continued strong growth, and are margin and earnings accretive in the first year.

During the year, we have also completed 10 bolt-on acquisitions for £33m, at an average earnings before interest and tax (EBIT) multiple of under 5×. These will add £33m of annual revenue to the Group at accretive EBIT margins, driving ROATCE of over 20% from their first full year.

Continuing our disciplined approach to portfolio management, we disposed of the lower growth, lower margin Hawco business (fluid controls within the Controls Sector) in March for £23m.

In fragmented markets with a well-developed approach and a compelling proposition to sellers, the Group's acquisition pipeline is strong and diversified. We remain committed to disciplined investment of capital, ensuring the Group's acquisitions support our future organic growth and deliver compounding earnings growth at high returns over the long term.

Since 30 September 2022, we have acquired 12 high quality businesses for a total of £280m

£280m

SCALING THE BUSINESSES AND THE GROUP

Delivering our strategy of building high-quality businesses for sustainable organic growth requires that we scale the businesses, developing their operating models to continue to deliver great customer propositions at scale. At the same time, we are developing the Group, evolving our structures, capabilities and culture to support this growth and maintain discipline and appropriate controls.

Scaling the Businesses

We have a simple, common framework which enables our businesses to deliver their target operating models. We have a set of core competencies (value-add, supply chain, operational excellence, commercial discipline, and route to market) which underpin their model.

As well as developing core competencies, scaling our businesses requires selective investment in capability, in the form of talent, technology, and facilities. During the year, we have invested in functional leadership across a number of our businesses, creating or upgrading roles in areas such as supply chain management, operations, route to market and support functions. From a technology perspective, we have Enterprise Resource Planning (ERP) upgrade projects underway across a number of businesses, as well as automated warehouse system upgrades in some Seals and Controls businesses. In terms of facilities, we have upgrades and relocations underway in each of our three Sectors to drive efficiency and improved customer service as those businesses continue to grow.

Scaling the Group

We have continued to focus on three principles this year:

First: keep it focused. This means portfolio discipline to ensure a manageable platform for scale. Despite more than doubling in size, we have moved from 20 to 16 business units in the last four years. For example, during the year we created new scaled businesses in Life Sciences (Canada and Ireland) and Seals (Australia) by combining smaller constituent businesses to form integrated operations that are better able to service their customers at scale.

Second: lean structures with dynamic leaders. This avoids bureaucracy in the businesses and promotes alignment, agility and execution. We have very lean Central and Sector teams but require more capability and capacity as we grow. During the year we have selectively added capability in Finance, HR, Sustainability and Risk & Compliance roles. Through our development processes and programmes, alongside external appointments, we are building talent and succession across the organisation.

Third: mood - the beat of the organisation. Decentralisation doesn't mean isolation. Regular individual and collective touchpoints allow us to be agile, manage pace, and execute better. This year, we have further developed the 'Diploma Identity', strengthening leadership networks, collaboration and best practice sharing, while preserving our critical differentiated decentralised culture.

"Delivering our strategy of building high-quality businesses for sustainable organic growth requires that we scale the businesses, developing their operating models to continue to deliver great customer propositions at scale."

DELIVERING VALUE RESPONSIBLY

We are making good progress across our businesses with Delivering Value Responsibly (DVR). During the year we have hired an experienced Group Sustainability Director and submitted our net zero targets for validation to the Science Based Targets initiative (SBTi).

DVR, our framework, is focused on six core areas:

- **Colleague Engagement** increased to 80%, a very strong result particularly for a decentralised business. We have engagement plans in each of our businesses and aim to maintain engagement above 70% over the long-term.
- Workshops and listening groups are also helping to further our **Diversity, Equity & Inclusion agenda.** Over the last four years our gender diversity has improved, with women now representing 28% of our Senior Management Team (SMT) up from 20% in 2019. Our 2030 target is for women to make up 40% of our SMT.
- Potential hazard reporting and training are enhancing our **Health & Safety** culture. In 2023, our lost time incident (LTI) Rate (LTIs per 1,000 employees) was 9.5 (2022: 10.6). We target at least a 5% reduction in lost time incidents every year.
- Our businesses are stepping up engagement with their **Supply Chains**. Over 70% of key suppliers are now aligned to our Supplier Code - committing to high ethical, professional and legal standards.
- Further focus on the **Climate Action** has included energy workshops and implementing emission-reduction initiatives. We have begun to introduce solar solutions on our facilities and expect to progress this further in the coming year. Our target is to achieve net zero across our value chain by 2045, with a 50% reduction in Scope 1 & 2 emissions by 2030.
- We are making good progress in Waste Reduction, with the volume of waste sent to landfill down to 32% from 60% in the prior year.

We are also focused on the positive impact that our Group has on society and the environment by delivering innovative and life-saving healthcare solutions; playing a role in renewable energy generation; and supporting circular practices across our aftermarket businesses.

OUTLOOK

Whilst we remain mindful of the uncertain economic outlook, we are confident in the Group's prospects. Diploma has an excellent track record of compounding growth and delivering strong financial returns through the cycle. Our model is resilient, and its resilience has increased over time as we execute our strategy:

- Our revenue is resilient: ongoing diversification means we are exposed to structurally growing end segments.
- Our margins are resilient: focus on value-add solutions critical to customer needs supports pricing power.
- Our cash flow is resilient: our low capital-intensity model is highly cash-generative, underpinning a strong balance sheet.

At this stage in the year, FY24 growth is expected to be in line with our long-term financial model, albeit at higher margins:

- Volume-led organic revenue growth of ca. 5%.
- Acquisitions announced to date add ca. 6% (net) to reported revenue growth.
- Strong operating margin of ca. 19.7%.
- Free cash flow conversion of ca. 90%.

We remain focused on executing our strategy of building high-quality, scalable businesses for organic growth and are confident in our ability to deliver long-term growth at sustainably high margins.

Johnny Thomson
Chief Executive Officer