# Melrose Industries PLC

Annual Report
for the year ended 31 December 2012

Buy
Improve
Sell

Melrose

# Melrose Industries PLC

**Melrose's strategy is to acquire manufacturing businesses in sectors it understands, enhance their performance and realise significant value often within a three to five year time frame. The Company is fully committed to investing within the businesses it acquires in order to exploit their operational and strategic strengths.**

**The Group is made up of four distinct operating divisions: Energy, Lifting, Other Industrial and Elster.**

**Pictured above:**
Bridon supplied a variety of cable products for the Olympic Stadium in London; suspension cables and tension ring cables, including spiral strand cables and walkway cables, were used within the construction of the stadium roof.

**Cover pictures:** Clockwise (L–R)

- Smart meter test bench at Elster Electricity.
- High accuracy plastic measuring chambers being moulded at Elster Water, for use in both Smart and mechanical residential water meters.
- Intermittent shuttle kiln, which has a furnace temperature of approximately 1,000°C. This equipment is used in the process of manufacturing technical ceramics such as isolators. Elster's Gas Control equipment business supplied eight burners, together with burner control units and gas regulators.
- Tubular stranding machine in Bridon's new state-of-the-art manufacturing facility at Neptune Energy Park, Newcastle upon Tyne, UK. The stranding machine is used in the manufacture of steel wire strands and is equipped with the world's largest strand compaction units.
- A generator stator in the process of construction at the Brush facility in the Czech Republic.

**"Since inception less than 10 years ago Melrose has created over £2 billion of shareholder value. We are very pleased with Elster and are already one year ahead of our improvement plan, increasing margins faster than expected. Existing Melrose businesses have performed well and Elster is proving to be another great opportunity to create more value for Melrose shareholders."**

Christopher Miller
Executive Chairman

For more information about Melrose Industries PLC view our website at **www.melroseplc.net**

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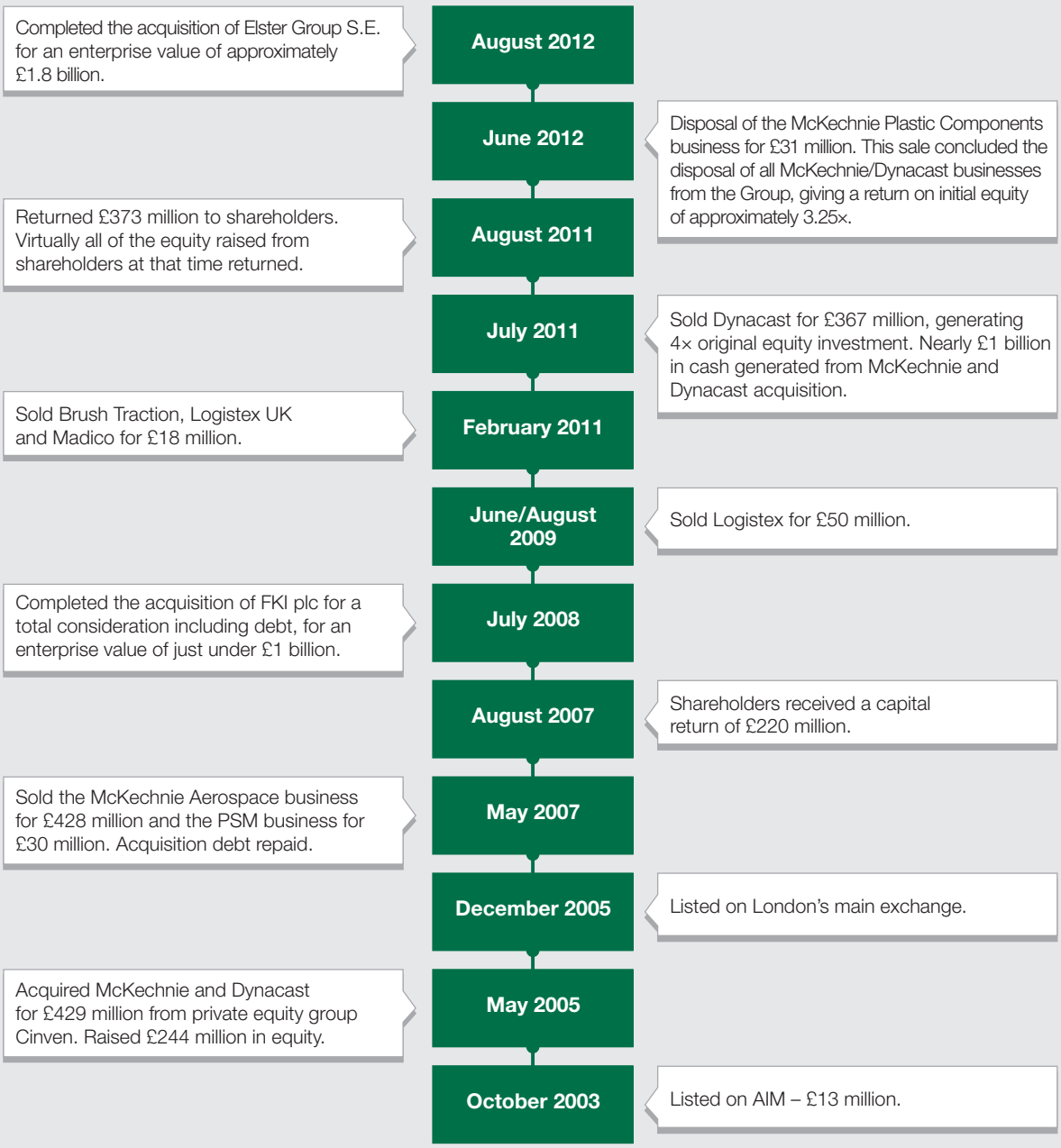
# Timeline of major events

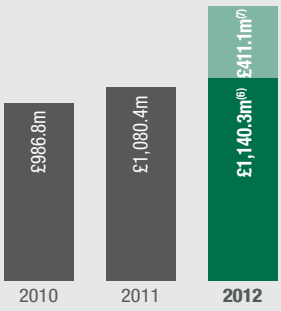
## Melrose was listed on AIM in October 2003. The timeline of key strategic events below shows how the Group has gone from strength to strength.



# Financial highlights[1]

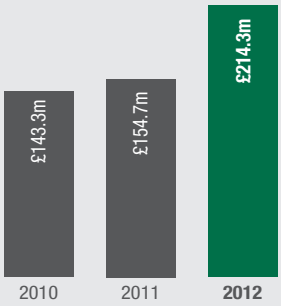
### Revenue

**£1,551.4m**



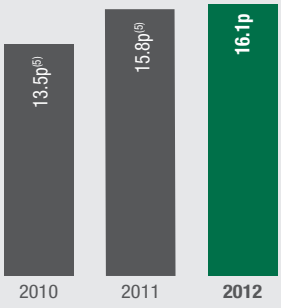

### Headline[2] profit before tax

**£214.3m**




### Headline[2] diluted earnings per share[3]

**16.1p**



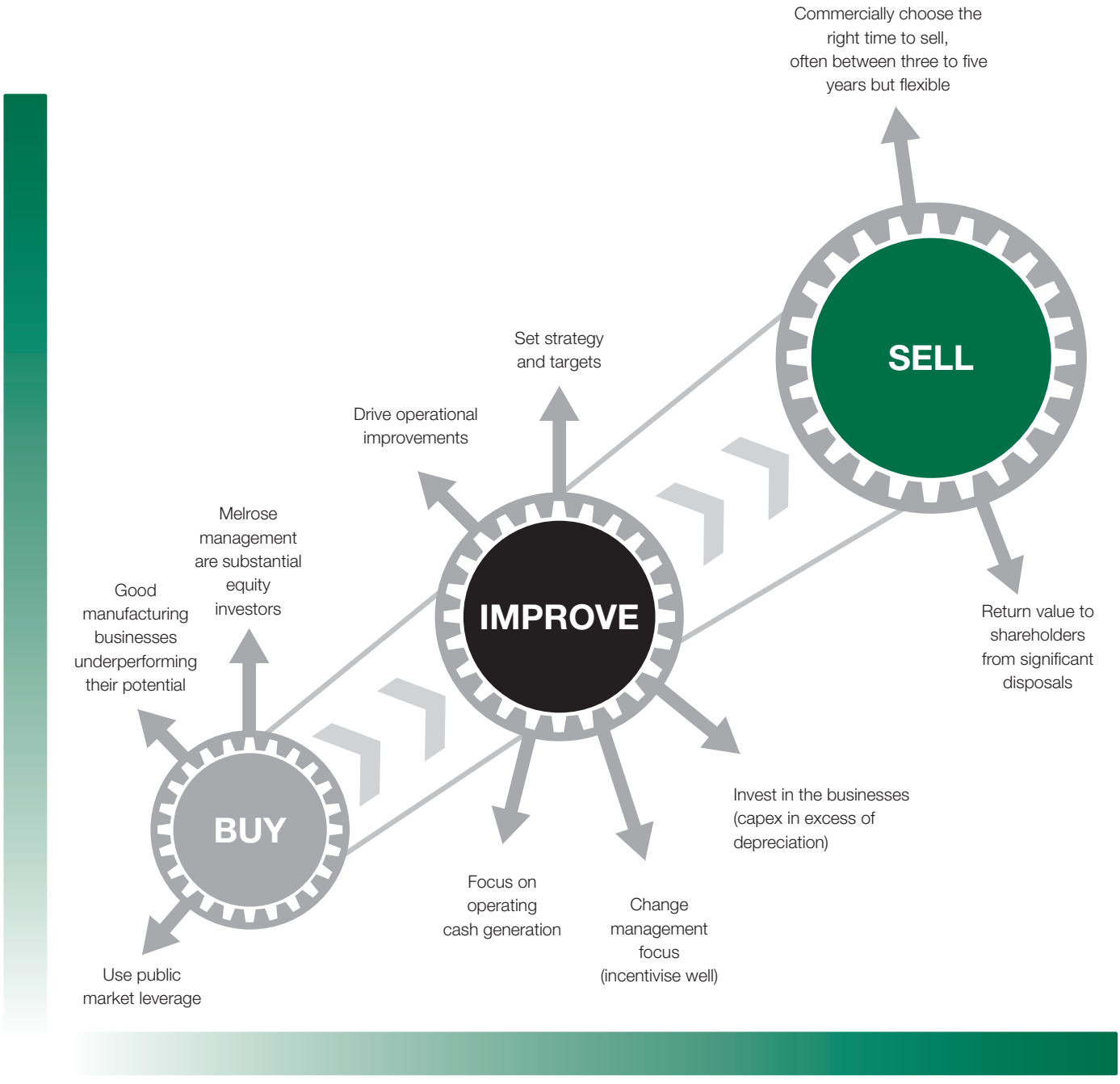

- Acquisition of Elster on 23 August 2012 for an enterprise value of £1.8 billion, improvement plan is one year ahead of schedule
- Headline[2] results
  - Revenue of £1,551.4 million (2011: £1,080.4 million)
  - Profit before tax of £214.3 million (2011: £154.7 million)
  - Melrose businesses (excluding Elster) increased revenue by 7% and operating profit by 9% at constant currency
  - Elster operating margin increased by 1.9 percentage points to 14.1%, operating profit was up 11% with revenue 2% lower, at constant currency
  - Headline[2] diluted earnings per share of 16.1p[3] (2011: 15.8p[3,5])
- Results after exceptional items and intangible asset amortisation
  - Profit after tax of £42.9 million (2011: £110.1 million)
  - Diluted earnings per share of 4.3p (2011: 12.9p)
- Net debt of £997.7 million. Net debt equal to 2.6x EBITDA[4]
- Final dividend increased by 4% to 5.0p per share (2011: 4.8p[5])
- Full year dividend of 7.6p per share (2011: 7.4p[5])
- Since inception less than 10 years ago Melrose has created over £2 billion of shareholder value

[1] Continuing operations only unless otherwise stated.
[2] Before exceptional costs, exceptional income and intangible asset amortisation.
[3] Calculated using continuing and discontinued operations, before the profit on disposal of businesses, and the diluted weighted average number of shares for the year, adjusted to remove MPC.
[4] Headline[2] operating profit before depreciation and amortisation of computer software and development costs, including Elster for eight months pre-ownership.
[5] Adjusted to include the effects of the Rights Issue.
[6] Relates to existing Melrose for the year ended 31 December 2012.
[7] Relates to Elster for the four month period from acquisition to 31 December 2012.

# The Melrose strategy

The Melrose strategy is to acquire good manufacturing businesses underperforming their potential, improve them by a mixture of investment, operational improvements and changed management focus, then commercially choose the right time to sell, often within a three to five year time frame but this is flexible. The value from significant disposals is then returned to shareholders.

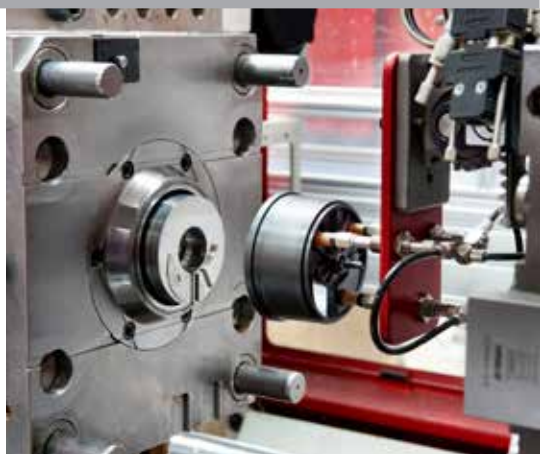
Melrose recently entered the next phase of its growth strategy via the acquisition of Elster for an enterprise value of £1.8 billion.



# Strategy in action

## Buy

- In August 2012 Melrose acquired Elster Group S.E., representing the largest acquisition in Melrose's history to date. Elster is a world leader in the provision of gas control equipment and related products, gas, electricity and water meters, networking and software solutions.
- The Elster division is split into three distinct businesses of Gas, Electricity and Water. They have manufacturing facilities throughout the world and employ nearly 7,000 people in more than 30 countries. A map showing Elster's key worldwide manufacturing locations can be seen on page 11. Since acquistion several restructuring projects have already been completed within the Elster businesses, with others currently underway.



Pictured: Manufacture of high accuracy plastic injection moulded measuring chambers take place at the Elster site in Luton, UK, which are used for both Smart and mechanical residential water meters.

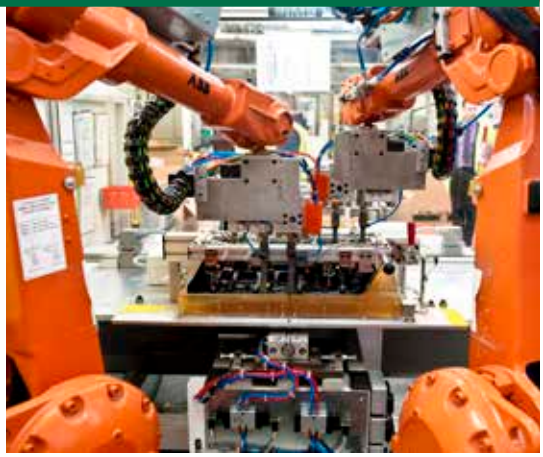
## Improve

- Melrose acquired FKI plc in July 2008, for an enterprise value of approximately £1 billion, which included Bridon, Brush, Crosby, Marelli, Truth and Harris. FKI was a major international diversified engineering group but operating under certain financial constraints.
- Since the acquisition, Melrose has identified a number of opportunities to improve these businesses, principally through an increased focus on improved profitability and cash generation.
- The Group will continue with its investment strategy in these businesses, as well as consider acquisitions and organic growth into new markets, where appropriate.

Pictured: New rope making machinery at Bridon's £20 million facility at Neptune Energy Park, Newcastle upon Tyne, UK, designed to feed wire rope cores into the stranding machine. The deep-water portside location of this new site, which opened in November 2012, will allow Bridon to use innovative loading solutions to reduce delivery timescales and order lead times for customers.

## Sell

- The sale of Dynacast and McKechnie has resulted in our initial equity investment from shareholders of £244 million increasing to cash for shareholders of nearly £800 million and thus has been highly successful.
- The most recent disposals have included McKechnie Plastic Components, sold for £30.7 million in June 2012, and the Dynacast business in July 2011 for an enterprise value of £377 million. Consistent with the Melrose strategy, the disposal of the Dynacast business provided a return of capital to shareholders of approximately £373 million in August 2011.
- Prior to this the McKechnie Aerospace business was sold for £428 million in May 2007, two years after the initial acquisition. This resulted in acquisition debt being repaid and a return of capital to shareholders of £220 million.



Pictured: Production of automotive components at McKechnie Plastic Components.

# Group operations

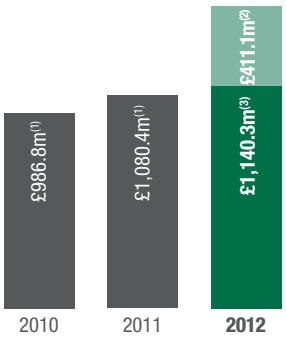
Melrose operates internationally and this has been further enhanced by the acquisition of Elster in August 2012. Elster has its key manufacturing facilities in Europe, North America and South America, together with a presence in the Far East, South Africa and Australia.

Maps showing the Group's key worldwide locations can be seen on pages 8 to 11.

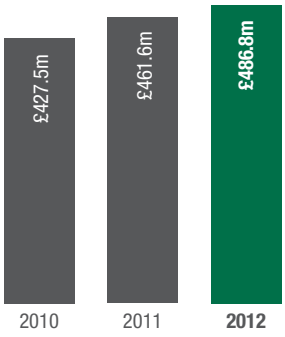
### Group Revenue

The Melrose Group is split into four distinct divisions: Energy, Lifting, Other Industrial and Elster. Revenue by division during the last three years is shown in the graphs below.

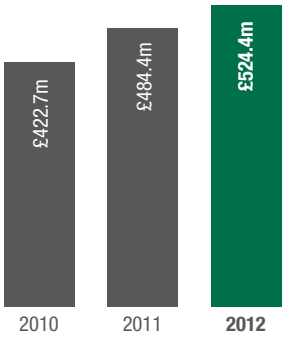
**Revenue**
**Group**
**£1,551.4m**



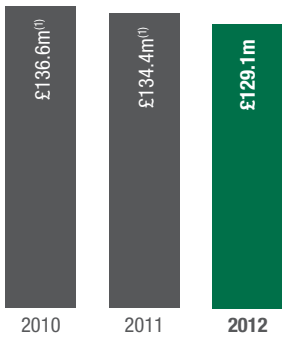

**Revenue from**
**Energy**
**£486.8m**



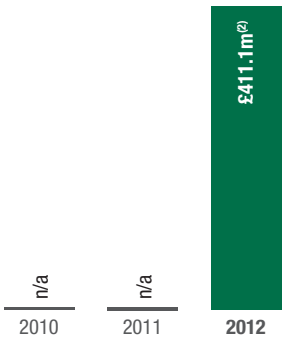

**Revenue from**
**Lifting**
**£524.4m**




**Revenue from**
**Other Industrial**
**£129.1m**




**Revenue from**
**Elster (4 months)**
**£411.1m(2)**




(1) Restated to include the results of MPC within discontinued operations.
(2) Relates to Elster for the four month period from acquisition to 31 December 2012.
(3) Relates to existing Melrose for the year ended 31 December 2012.

# Areas of operation

Pictured: Generator rotor on an 'overspeed' test within the upgrade balance tunnel at the Brush facility in the Czech Republic.

## Energy

- Brush Turbogenerators has European facilities based in the UK, the Netherlands and the Czech Republic. This business also has key manufacturing locations in the US. Hawker Siddeley Switchgear manufacture its products in South Wales, UK and also has smaller scale operations in Australia.
- Marelli has a presence in seven countries, including its key manufacturing facilities in Italy and Malaysia and international sales, service and distribution centres based in Italy, Germany, Malaysia, UK, USA and South Africa, as well as a branch in Spain.

Pictured: Bridon manufactured over 100 tonnes of stainless steel Dyform cable assemblies for the New Doha International Airport, Qatar. Bridon's products were used for a variety of structures within the airport and helped to form the sail shade design which limit the effects of the intense summer temperatures.

## Lifting

- Bridon's European manufacturing facilities are based in the UK and Germany. A total of £20 million has also recently been invested in a new state-of-the-art manufacturing facility near Newcastle upon Tyne, UK, which became operational in November 2012. Bridon also has manufacturing facilities in the US and New Zealand, as well as the Far East in Indonesia and China, plus distribution service centres in Brazil, Singapore, Hong Kong and Dubai.
- Crosby's key US manufacturing locations are based in Oklahoma, Texas and Arkansas, with a further site in Ontario, Canada. It also has facilities in Europe, principally at its factories in Belgium and the UK.
- Both Crosby and Bridon have growth opportunities within South America; sales offices, distribution and service centres and training facilities have recently been established in order to exploit these opportunities.
- Acco has facilities within the US.

Pictured: Smart electricity meters in the process of being quality assured in accordance with the Measurement Instruments Directive (MID) at Elster's site in Stafford, UK. This includes verification of the functionality of the electricity meter and communications module.

## Elster

- The Gas business operates from key manufacturing facilities in Europe and the US but also has sizeable subsidiary operations in China, Russia and Mexico. Further progress has been made in rationalising the European manufacturing footprint since the acquisition; a number of products previously manufactured in Western Europe have been transferred to the newly extended plant in Slovakia.
- The Electricity business has key production facilities located in Europe, North America and South America. Since the acquisition, actions have already been taken to streamline the US business, which includes the relocation of all remaining production at the Raleigh, US, facility to Mexico.
- Within the Water business key manufacturing sites are located within the UK, Slovakia and Brazil. Under Melrose ownership various enhancements were made to the restructuring projects that had originally been announced by Elster in 2011. These include the closure of underperforming parts of the business in Poland, Colombia and Italy, the cessation of manufacturing mechanical meters in North America and the exit from a significant number of lower margin product lines in Germany.

Pictured: A Harris BSH-30-1223 B-4 guillotine shear, purchased by a customer in Alabama, US. The equipment is used for processing miscellaneous steel scrap, pipe and selected sections of freight rail cars and ship scrap.

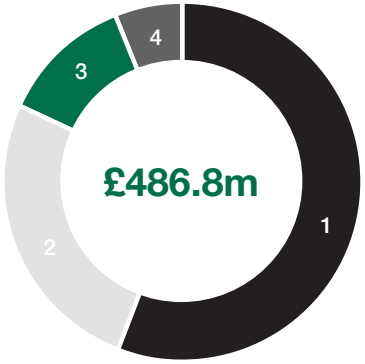
## Other Industrial

- Truth operates from its facilities based in Minnesota, US and Ontario, Canada.
- Harris is based in Georgia, US and the UK.

# Group overview

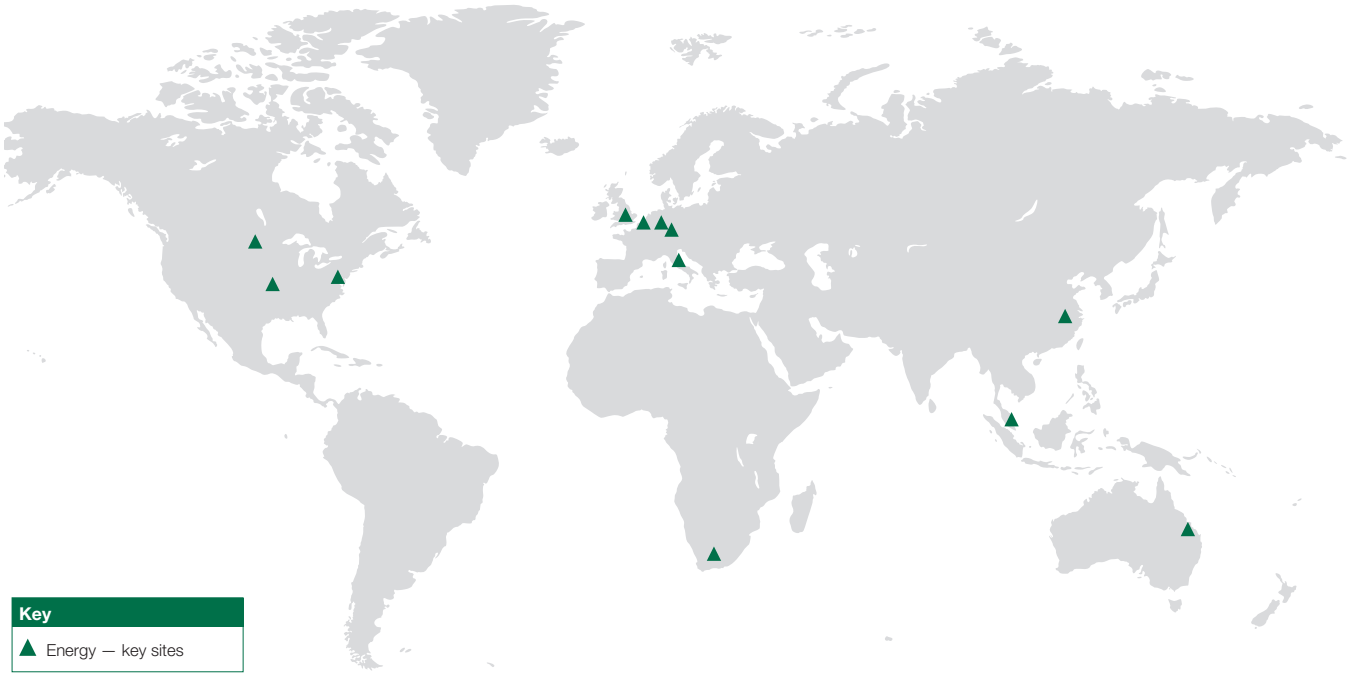
## Energy

World number one independent supplier of turbogenerators and leading supplier of other electricity generating machinery, switchgear, transformers and power infrastucture equipment. Strong aftermarket service capabilities.




**Revenue by geographical destination**
(Year ended 31 December 2012)

| | |
|---|---|
| **1** Europe | **56%** |
| **2** North America | **26%** |
| **3** Asia | **12%** |
| **4** RoW | **6%** |




### Key strengths

- Expertise to design and manufacture an extensive range of high quality, multi-pole, low, medium and high voltage generators and electric motors.
- Comprehensive and integrated aftermarket support tailored to meet customers' needs throughout operating life.
- Switchgear and transformer products in service with all UK energy supply authorities.
- Hydropower generators to produce environmentally green energy.
- Generators and electric motors for ship power.
- Strategically located around the world.

### Products

- Power generation equipment with 10 kW to 250 MW electric generators.
- Synchronous motors, induction motors, submersible and traction motors.
- Power management and excitation systems.
- Medium voltage AC and DC switchgear.
- Power and system transformers.
- Aftermarket servicing.

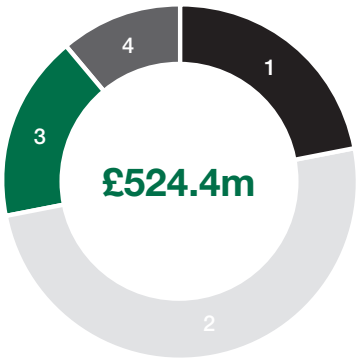
### Major customers

- Gas and steam turbine manufacturers and packagers.
- Major oil companies.
- UK distribution network operators.
- Engineering construction companies.
- Independent power producers.

To see more information on the Energy division go to pages 16 to 18, or visit our website at **www.melroseplc.net/energy.html**

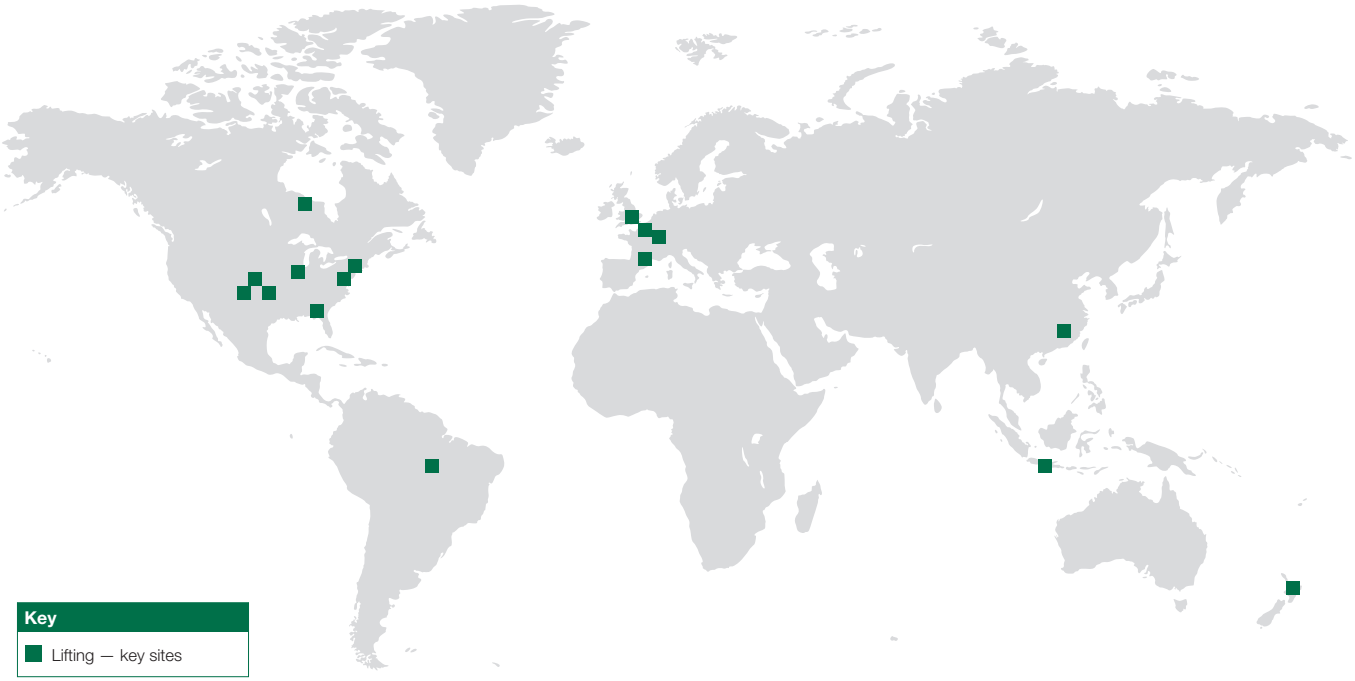
# Lifting

## Leading supplier worldwide of lifting fittings, blocks and custom engineered material handling products and top three supplier worldwide for wire and wire rope.




**Revenue by geographical destination**
(Year ended 31 December 2012)

| | |
|---|---|
| **1** Europe | **22%** |
| **2** North America | **50%** |
| **3** Asia | **17%** |
| **4** RoW | **11%** |



**Key**
Lifting — key sites

### Key strengths

- Comprehensive and competitive range of solutions in steel wire, wire and fibre rope and strand.
- Technical expertise to support customers' demanding applications, training, installation and testing.
- World's leading supplier of accessories used in lifting and material handling applications.
- Strategically located around the world with state-of-the-art facilities.

### Products

- Wire rope, fibre rope and wire.
- Hooks, shackles, blocks, sheaves, clamps and links.
- Material handling products.
- Monorail systems.
- Chain hoists.
- Industrial carts and trailers.

### Major customers

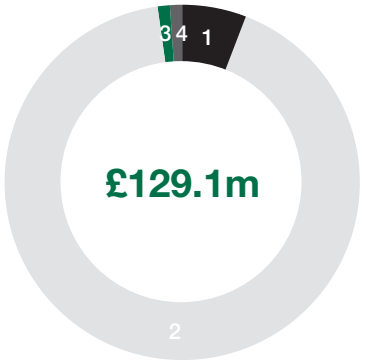
- Global crane OEMs and mining OEMs.
- Major oil companies.
- Global oil field exploration and drilling contractors.
- Construction companies.
- Lifting products distributors.

To see more information on the Lifting division go to pages 19 to 21, or visit our website at **www.melroseplc.net/lifting.html**

# Group overview continued

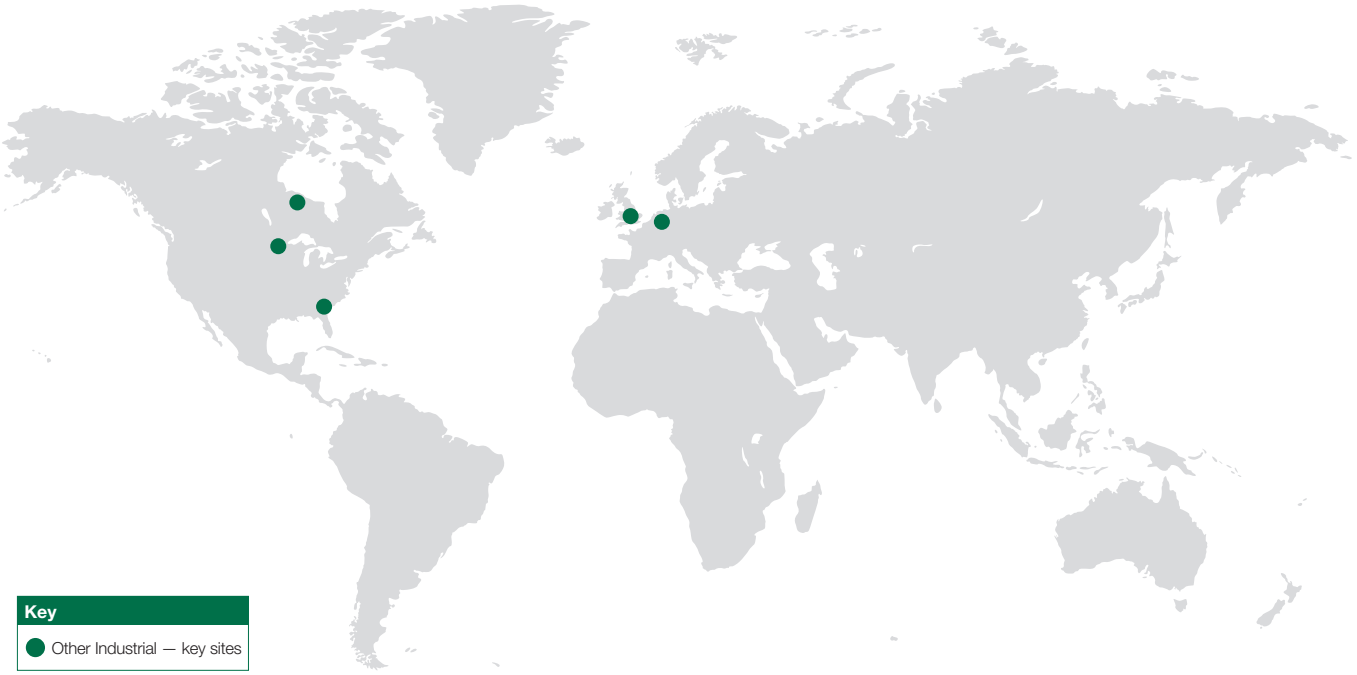
## Other Industrial

### Market leading manufacturers across the housing, construction, and scrap processing sectors.




**Revenue by geographical destination**
(Year ended 31 December 2012)

| | |
|---|---|
| **1** Europe | **6%** |
| **2** North America | **92%** |
| **3** Asia | **1%** |
| **4** RoW | **1%** |




**Key strengths**

- Market leading design, development and engineering capabilities.
- Leading innovative product development and technology choice for customers.
- Trusted long standing quality brand names.
- In-depth aftermarket service supply capabilities.

**Products**

- Window and door hardware.
- Balers, shears, waste compactors and auto shredders.
- Sealing products.

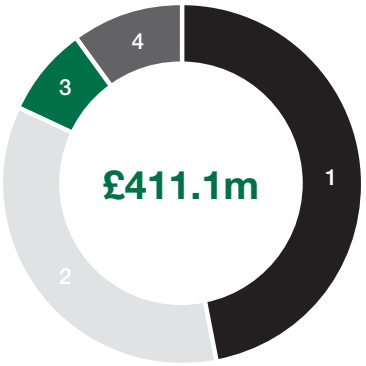
**Major customers**

- US hardware industry OEMs.
- Waste and scrap processors.

To see more information on the Other Industrial division go to pages 22 and 23, or visit our website at **www.melroseplc.net/otherindustrial.html**

# Elster

A world leading engineering business and one of the world's largest providers of gas control equipment and related communications, gas, electricity and water meters, networking and software solutions.




**Revenue by geographical destination**

(Four months ended 31 December 2012)

| | |
|---|---|
| **1** Europe | **47%** |
| **2** North America | **35%** |
| **3** Asia | **8%** |
| **4** RoW | **10%** |

## Key strengths

- Strong long-term customer relationships and strategic partnerships.
- Trusted brand name based on high accuracy, innovation and reliabilty of meters.
- Market leading position in Gas, Electricity and Water metering and measurement products.
- Number one solution provider in the field of thermo process applications.
- At the forefront of developing the next generation of Smart metering technology.
- World leader in polymer and high accuracy metering technology.
- Strategically located around the world.

## Major customers

- Customers in all segments along the gas stream.
- Major furnace and boiler OEMs, distributors and re-sellers.
- Global utilty service companies.

## Products

- Unrivalled gas regulating and metering for upstream, midstream and distribution markets.
- Best in class gas adaptive solutions for the leading boiler manufacturers.
- Broad range of gas and water mechanical meters pre-equipped for Smart metering.
- Advanced electronic meters for both residential and commercial customers.
- Innovative Smart metering solutions.
- End-to-end Smart Grid solution portfolio, from the meter all the way through to meter data management, data analytics software and standalone components.

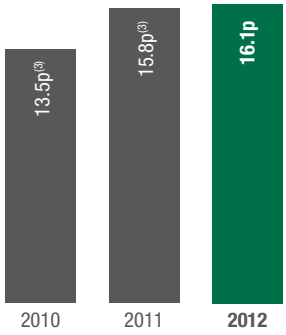
To see more information on the Elster division go to pages 24 to 26, or visit our website at **www.melroseplc.net/elster.html**

# Chairman's statement

Christopher Miller

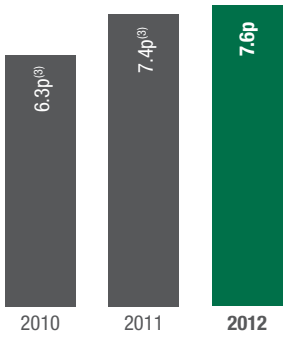
**Headline[1] diluted earnings per share[2]**

**16.1p**
**up 2%**




**Dividend per share**

**7.6p**
**up 3%**




I am pleased to report Melrose's tenth set of annual results since flotation in 2003.

This has been a busy and successful year for your Company. On 23 August we completed the acquisition of Elster Group S.E. ("Elster") for an enterprise value of £1.8 billion. The acquisition was financed by a £1.2 billion Rights Issue and a new £1.5 billion five year banking facility.

Elster is a world leader in metering products with special strength in gas meters. It has nearly 7,000 employees in more than 30 countries and turnover in the four months of our ownership in 2012 was £411.1 million. It is described in more detail in the Chief Executive's review.

It is still early in the integration process but we are already very pleased with the business and the potential for improvement over the next few years.

Shareholders' investment in Melrose, net of dividends and returns of capital since 2003, amounts to approximately £1.1 billion. Our market capitalisation, at the current share price, amounts to £3.3 billion, meaning that over £2 billion of value has been created over this period. We continue to work hard to maintain this successful track record. Our employees throughout the Group are to be thanked for their contribution to this.

## RESULTS FOR THE GROUP

These financial statements report the results for the Group for the year to 31 December 2012 and comparatives for the previous year. The results for Elster have been included from 23 August 2012.

Revenue from continuing businesses for the year was £1,551.4 million (2011: £1,080.4 million) and headline profit before tax (before exceptional costs, exceptional income and intangible asset amortisation) was £214.3 million (2011: £154.7 million). Headline diluted earnings per share ("EPS") on continuing and discontinued businesses was 16.3p (2011: 16.4p). Adjusting for the disposal of MPC, headline diluted EPS was 16.1p

[1] Before exceptional costs, exceptional income and intangible asset amortisation.
[2] Calculated using continuing and discontinued operations before the profit on disposal of businesses, adjusted to remove MPC.
[3] Restated for the effects of the Rights Issue.

"We continue to see excellent opportunities for investing in our businesses and in 2012 capital expenditure increased again to over twice depreciation within the three divisions of existing Melrose. Working capital management and cash generation remain a major focus for Melrose and 2012 was another year of good performance."

(2011: 15.8p) an increase of 2%. Diluted EPS (before exceptional costs, exceptional income and intangible asset amortisation) on continuing businesses was 4.3p (2011: 12.9p).

Further details of these results are contained in the Finance Director's review.

## DIVIDENDS

The Board intends to pay a final dividend of 5.0p per share (2011: 4.8p), which represents a 4% increase. This will be paid on 13 May 2013 to those shareholders on the register at 19 April 2013, subject to approval at the AGM on 8 May 2013. This gives a total for the year of 7.6p per share (2011: 7.4p).

These numbers and the comparatives have been affected by the Rights Issue referred to above and adjusted accordingly.

Your Board continues to pursue a progressive dividend policy.

## TRADING

2012 was another excellent year for our businesses with headline operating profit increases in all three divisions of existing Melrose. Group headline operating margins at 15.7% suffered only a small decline even allowing for the inclusion of Elster, whose margins at this stage are lower than average for the Group. Without the effect of Elster, Group operating margins in 2012 increased again.

We continue to see excellent opportunities for investing in our businesses and in 2012 capital expenditure increased again to over twice depreciation within the three divisions of existing Melrose. 2013 is likely to be another year of high investment. Net debt, after the additional debt taken on for Elster, was £997.7 million at 31 December 2012. Working capital management and cash generation remain a major focus for Melrose and 2012 was another year of good performance.

Further details on trading are included in the Chief Executive's review.

## STRATEGY AND OUTLOOK

I said last year that we were optimistic about identifying a suitable acquisition to continue the excellent growth of the Group. We firmly believe that Elster represents such an opportunity. In addition to these occasional acquisitions, however, our strategy also comprises selling existing businesses, at the appropriate time, when we believe we have achieved the bulk of improvement in performance, with subsequent related returns of capital. We are naturally fully focused on improving the performance of Elster at present but this will not deflect us from this other equally important part of our strategy.

We signalled in our Interim Management Statement in November that order books in certain of our businesses, principally the Energy division, had weakened somewhat. Although this continues to be the case we are confident of the outlook and therefore we expect further progress in 2013.

Economic recovery is not yet in sight in Europe, nor completely established in the US, but our mix of businesses with their strong positions in good end markets and opportunities for improvement gives us confidence for the future.

**Christopher Miller**
Chairman
6 March 2013

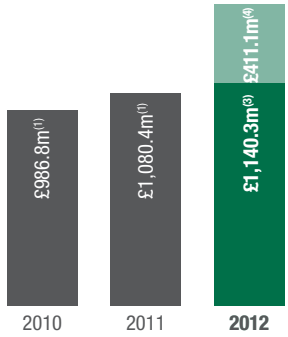
**Pictured:**
Crosby's 800 metric tonne 'Wide Body' shackles were used as part of the overall lifting system to lift a 1,250 metric tonne tower into place on the new San Francisco-Oakland Bay Bridge in the US, which is due to open later this year.

# Chief Executive's review

Simon Peckham

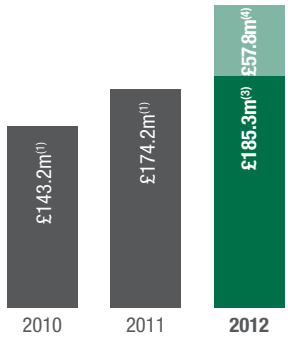
**Revenue**

**£1,551.4m**




**Headline(2) operating profit**

**£243.1m**




2012 has been a good year for Melrose with continued progress from our businesses and two important M&A events.

In June 2012, Melrose sold McKechnie Plastic Components for £30.7 million. Whilst not in itself sizeable in the context of the Group this Company was the last business acquired in the McKechnie/Dynacast acquisition made in May 2005 and thus completed the final part of our "buy, improve, sell" business model for Melrose's first acquisition. This acquisition has resulted in our initial equity investment from shareholders of £244 million increasing to cash for shareholders of nearly £800 million and thus has been highly successful.

Secondly, during 2012 we embarked on the next phase in the "buy" element of our strategy by acquiring the Elster Group for an enterprise value of £1.8 billion.

We are at the time of writing just over six months into our post-acquisition programme. Much has been achieved in that relatively short time, as is set out in this review and we would draw your attention in particular to the following key actions:

- the Gas and Electricity businesses have been reorganised into global operations;
- the old Elster Head Office has been completely restructured;
- extensive restructuring has been announced at several of the key businesses; and
- R&D expenditure has been maintained but has been far better targeted on the growth areas of the businesses.

These, and a number of other projects and opportunities, create the basis for "improving" Elster and make us confident that Elster will be a better business in the Melrose Group for the benefit of shareholders and the employees, customers and suppliers of Elster.

(1) Restated to include the MPC results within discontinued operations.
(2) Before exceptional costs, exceptional income and intangible asset amortisation.
(3) Relates to existing Melrose for the year ended 31 December 2012.
(4) Relates to Elster for the four month period from acquisition to 31 December 2012.

We would like to thank our shareholders and lending banks for their support in the Elster acquisition. It is not something we take in any way for granted. On behalf of our shareholders, I would also like to thank the employees of Elster who have welcomed and assisted in the changes that have needed to be made.

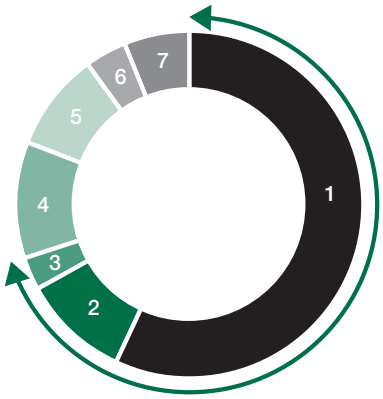
Elster is a very high quality business with strong market shares in its key markets. 2013 will be a year of substantial change and I believe these developments will enable Elster to achieve its full future potential in an exciting marketplace.

In the rest of the Group, 2012 has been a year of substantial investment. We have invested approximately £45 million this year in a number of exciting projects. The largest single project was Bridon's new factory in Newcastle upon Tyne, which opened in autumn 2012. We are confident that these investments will position our businesses well for the future and will continue to improve their value.

The Energy division had a successful year in 2012. Whilst order intake for turbogenerators in 2012 has been lower, the success in growing the aftermarket business has been very pleasing. The division has also made very good progress in the restructuring of two of the Brush subsidiaries, HMA and Hawker Siddeley Switchgear ("HSS"). The medium and long term dynamics of the marketplace are likely to be very beneficial for Brush.

Marelli has had an outstanding year. The business strategy of increasing the size of its generator products and continuing to focus on niche markets has succeeded beyond our expectations. Marelli entered the new financial year with high order books and a very strong market position.

In the Lifting division Bridon has had a good year. Revenue, profit and orders have all increased. The new factory at Newcastle upon Tyne has been delivered on time and on budget.




**Strong end markets**

**Revenue by end market**
(Year ended 31 December 2012)

| | |
|---|---|
| **1** Energy | **57%** |
| **2** Oil & Gas | **10%** |
| **3** Mining | **3%** |
| **4** Industrials | **11%** |
| **5** Water | **9%** |
| **6** Hardware | **4%** |
| **7** Other | **6%** |

**70% Energy, Oil & Gas and Mining**

"In the rest of the Group, 2012 has been a year of substantial investment. We have invested approximately £45 million this year in a number of exciting projects. We are confident that these investments will position our businesses well for the future and will continue to improve their value."

Crosby has had an outstanding year with sales and profits significantly up on 2011. We are also pleased to have invested to increase its forging capacity over the next 12-18 months and to have improved the European business by restructuring its operations. Crosby continues to grow its worldwide sales and offers exciting opportunities for future development.

In the Other Industrial division it is pleasing that the US housing market recovery appears to be well underway. This has benefited Truth in 2012 and positions it well for 2013 and beyond. Harris also performed creditably in a difficult market.

## OUTLOOK

Conditions in the overall world economy are still very hard to predict with any certainty. The US appears to be recovering subject to uncertainties about the "Fiscal Cliff" but Europe is still in a very difficult position. We are likely to see volatility in the UK caused by rapidly changing currency markets. As a result of these factors we are expecting a year in which growth may be challenging but our exposure to good markets, opportunities for improvement at Elster and the fruits of recent investment should still position us well to improve the Group's performance.

**Simon Peckham**
Chief Executive
6 March 2013

# Divisional review

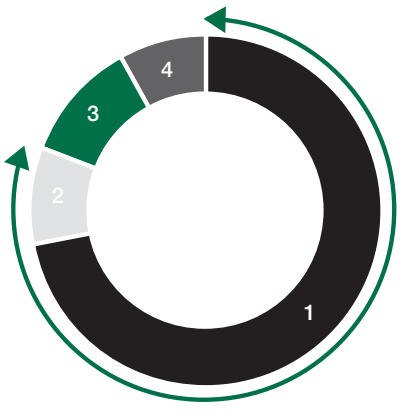
## Energy review

**Revenue**
(Year ended 31 December 2012)

**£486.8m**

**Headline[1] operating profit**
(Year ended 31 December 2012)

**£93.4m**




**Energy**

**Revenue by end market**

(Year ended 31 December 2012)

| | |
|---|---|
| 1 Energy | 72% |
| 2 Oil & Gas | 9% |
| 3 Industrials | 11% |
| 4 Other | 8% |

**81% Energy and Oil & Gas**

[1] Before exceptional costs, exceptional income and intangible asset amortisation.

Market leading manufacturers of electricity generating equipment, switchgear and transformers.

BRUSH — **www.brush.eu**

BRUSH AFTERMARKET GMS — **www.brushgms.com**

HAWKER SIDDELEY SWITCHGEAR your power in safe hands — **www.hss-ltd.com**

HGI GENERATORS — **www.hgigenerators.com**

MarelliMotori — **www.marellimotori.com**

Pictured:
The upgraded electrical coil manufacturing shop within Brush's facility in the Czech Republic, where a substantial investment has been made in changing the physical layout of the manufacturing areas. This has helped to improve product quality and reduce generator product lead times for customers.

## BRUSH

Brush Turbogenerators ("Turbogenerators") is the world's largest independent manufacturer of electricity generating equipment for the power generation, industrial, oil & gas and offshore sectors. From its four plants in the UK, Czech Republic, Netherlands and USA it designs, manufactures and services turbogenerators, principally in the 10 MW to 250 MW range, for both gas and steam turbine applications and supplies a globally diverse customer base. In addition, Brush designs and manufactures systems and power transformers under the brand name Brush Transformers ("Transformers") and also produces a wide range of indoor and outdoor medium voltage AC/DC switchgear under the Hawker Siddeley Switchgear brand name. Harrington Generators International ("HGI") is a specialist UK based small generator manufacturer supplying the construction, military, telecoms and rail sectors.

During 2012 Brush continued the trend of year on year improvement post acquisition in 2008. Revenue increased by approximately 6 per cent and this again translated to strong cash generation.

Brush

A BDAX7-193 generator going through the winding process to connect electrical coils, at the Brush Turbogenerators site at Loughborough, UK. The machine was manufactured for a floating Liquid Natural Gas project on behalf of a major exploration company.

More information about Brush is available at www.brush.eu

Orders in 2012 for new build turbogenerators in value terms were down year on year, primarily as a result of a trend during the year towards smaller turbogenerators on shorter lead-times for gas turbine aero-derivative applications. Orders for large turbogenerators, primarily for steam turbine applications, were delayed as financial closure of projects reduced due to the prevailing economic conditions. The product development strategy of increasing the product range into higher power outputs has been successful with the first sales of 187 MW air cooled turbogenerators and the first order for a 200 MW air cooled turbogenerator. These are the largest air cooled turbogenerators ever built by Brush and mark an important development for future growth.

Aftermarket orders within the turbogenerators business were up 20 per cent year on year with strong US growth, though European aftermarkets were more subdued as the utility sector in particular reduced maintenance spend.

Continued progress has been made in improving factory performance and productivity within Turbogenerators. The restructuring of the turbogenerator manufacturing plant in the Netherlands was largely carried out during the year and the full benefits of this will be seen in 2013.

HSS had a very good year with the strong order intake seen in the first half continuing throughout. Although revenue was 8 per cent down year on year, as a series of larger contracts were completed in 2011, operating margins improved significantly. This was HSS's first full year of integration as part of Brush. The full benefit of sales and marketing synergies and operational efficiencies will only be seen in 2013. The Australian division of HSS continued to perform well during the year.

Brush Transformers had a successful year, thus continuing the progress made since integration into Brush in 2010. Demand continued to recover in the third of the current 5 year OFGEM cycle and revenue finished higher than the previous year. Operating margins have improved significantly as a result of the management focus placed on the development of a new manufacturing strategy, a value engineered product line and aftermarket sales.

Despite a challenging UK market, HGI Generators had a satisfactory year, with both revenue and operating margins up against the previous year. One of the highlights of 2012 for HGI was the supply of standby power to the emergency services ahead of the London Olympics.

### Outlook

The prospects for medium and long term growth in power generation and in particular the aero-derivative gas turbine sector in which Turbogenerators has a leading position are well publicised and this, combined with the investment being made, means Brush is very well positioned for future growth. However, in the short term the trend towards smaller generators and the overall financial conditions are likely to impact sales of Brush's larger 2 pole OEM generator product during 2013. Brush should however be able to mitigate this due to continued growth in its aftermarket activities and further improved efficiencies. After a difficult 2012 due to market conditions, the prospects for the smaller 4 pole generators are more encouraging, particularly in the oil & gas and geothermal markets.

# Divisional review continued

Turbogenerators has over two thirds of its 2013 budgeted new build sales covered by orders. This is broadly consistent with the experience from previous years.

Following the encouraging increase in order intake and investment in resources through 2012, Aftermarket is well positioned for growth in 2013.

Continued capital investment and full year benefits from restructuring programmes, both at Brush facilities in the Netherlands and HSS, gives us confidence that Brush can improve further.

## MARELLI

Marelli Motori ("Marelli"), based in Italy, is one of the world's leading manufacturers of industrial electrical motors and generators with a product portfolio of motors and generators, ranging respectively from 0.12 kW to 6.4 MW and from 15 kVA to 9.0 MVA, including low, medium and high voltage. Marelli serves worldwide markets for power generation, marine, oil & gas and industrial manufacturing, through its production sites in Italy and Malaysia and further sales, service and distribution offices based in Germany, UK, Spain, USA and South Africa.

Following the increase in revenue in 2011 of around 20 per cent, a further increase of about 12.5 per cent was achieved in 2012. As in the prior year, this was mainly due to the recovery of the marine, hydroelectric and oil & gas sectors, which explains why the mix of sales continues to be focused on large and special machines, rather than smaller standard products. Order intake is currently around 19 per cent above last year and this makes Marelli's management confident of further growth for this year.

Bespoke innovative power solutions played an important role within Marelli's results. New products included customised hydroelectric generators, large cogeneration alternators for both 50 and 60 Hz usage, medium voltage marine motors and generators, together with special motors and generators for the oil & gas industries. Due to enhanced testing capabilities, customers and end users now have the opportunity to verify that products meet or exceed contractual performance. The lead times for standard products were also improved, due to the new factory layout at Marelli's Malaysian facility and the implementation of lean methodologies.

During 2012, Marelli's facility in Malaysia, which is fully dedicated to the production of standard specification machines, achieved its planned production volumes of up to 1,200 units each month. Significant capital investment has been made in Marelli's main manufacturing centre, at Arzignano, Italy; this includes a new large milling machine and a balancing machine for the increased sizes of motors and generators being manufactured. All these investments follow Marelli's strategy to focus production within its Italian facility on large and customised machines.

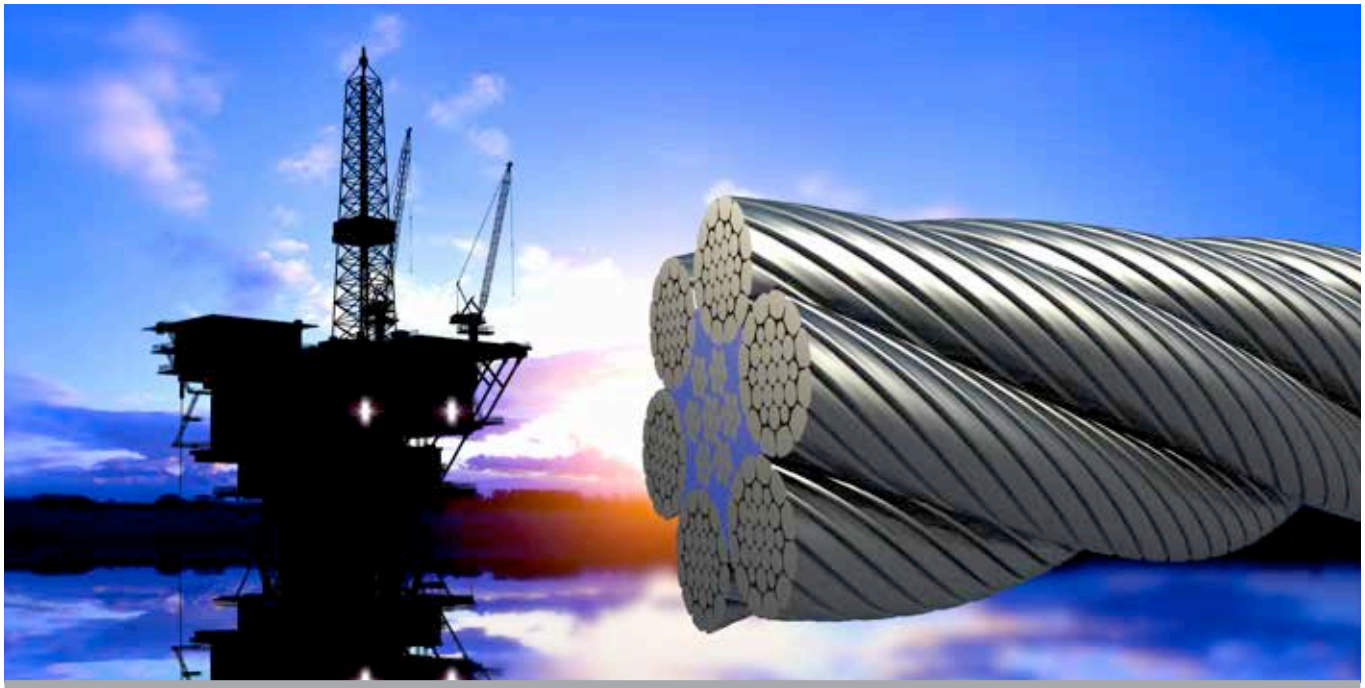
Marelli

Rotor balancing of a 900 frame size generator at Marelli's production facility in Italy. This generator was supplied by Marelli to the Pianarucci hydro power plant, Italy and has a rotor weight of 11,600kg and produces 3,300 kVA of power.

More information about Marelli is available at www.marellimotori.com

### Outlook

Marelli had a strong order book at year end, which represents 35 per cent of the projected 2013 turnover. Marelli also aims to increase its global presence worldwide through new sales offices and to concentrate its efforts in developing new products for its strategic markets of marine, hydro, cogeneration and oil & gas, which look to remain stable. The further development of exports and opportunities to grow sales with existing key customers gives us the confidence that 2013 will be another year of progress for Marelli.



# Lifting review

**Revenue**
(Year ended 31 December 2012)

**£524.4m**

**Headline[1] operating profit**
(Year ended 31 December 2012)

**£95.2m**

**Lifting**

**Revenue by end market**
(Year ended 31 December 2012)

| | |
|---|---|
| 1 Energy | 5% |
| 2 Oil & Gas | 35% |
| 3 Mining | 14% |
| 4 Industrials | 38% |
| 5 Other | 8% |

**54% Energy, Oil & Gas and Mining**

[1] Before exceptional costs, exceptional income and intangible asset amortisation.

World leading suppliers of wire, wire rope products, lifting fittings and blocks.

BRIDON **www.bridon.com**

the Crosby group **www.thecrosbygroup.com**

ACCO **www.accomhs.com**

Pictured:
Bridon supplies the Oil industry with various rope products which are at the forefront of technology. This includes the Dyform Bristar drill line rope (a cross section of which is pictured above) which has high strength strands and an engineered polymer core designed to significantly improve service life and reduce costly rig downtime.

# Divisional review continued

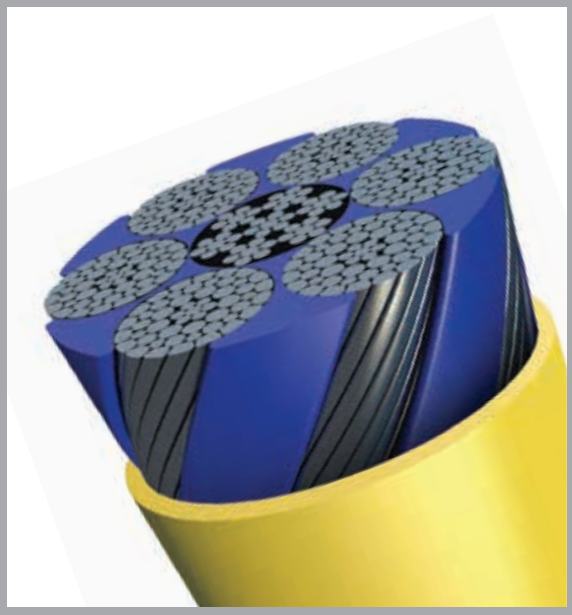
## BRIDON

Bridon designs and manufactures a comprehensive range of lifting and stabilising solutions for applications in wire rope, fibre rope, steel wire and strand. The business services global customers in the oil & gas, mining, industrial, marine and infrastructure sectors.

Bridon demonstrated further progress in trading, as revenue, operating profit, orders and margin increased when compared against the prior year. This reflects the continued strength in Bridon's core markets, as well as its focus on operational improvements. Working capital control remained strong but cash conversion was somewhat impacted by the slippage of sales of several large oil & gas projects into the last quarter of the year.

Demand for onshore oil & gas ropes was subdued in the first half, reflecting a weak drilling market due to low gas prices and poor drilling conditions in Canada. The offshore sector, by contrast, was strong, as global production companies invested in new ships and platforms. Demand was strong in the North Sea, Brazil and parts of Asia and Africa; production continued to expand in the Gulf of Mexico after a significant hiatus. In response to the growth of deep-water drilling in Latin America, Bridon opened a new facility and service centre in Macae, Brazil, in December 2012. This facility will provide wire rope and inspection services to rig operators in this fast growing oil & gas market.

Bridon



Cross section through Bridon's Zebra rope, which has a protective Optima sleeve around it. This product is used as a shovel hoist rope within the surface mining industry; the Optima sleeve design protects from external impact and abrasion, such as falling rocks and debris.

More information about Bridon is available at www.bridon.com

The expansion in exploration and drilling also offered Bridon the chance to compete for some significant contracts for bespoke anchor lines, single point mooring systems and offshore crane ropes. Among the biggest awards was the Quad project, one of the largest deep-water mooring systems for offshore production ever made. The mining market was also strong for Bridon in 2012 and Bridon continued to expand its global customer footprint, expanding sales for shovel ropes and shaft ropes in Russia, Poland, China and South Africa. In North America, sales to mining machine OEMs and specialist distributors grew over 30 per cent, despite a relatively weak US coal market and is focused on the large opportunities within this area.

The commercial construction markets in Europe and the Middle East remained subdued, while crane rope sales showed moderate growth in North America, reflecting Bridon's premier position with OEMs. Demand for crane and mining ropes continued to be solid in China, but the volatile levels of industrial production in Asia have led to variable demand for industrial ropes. Bridon's Chinese operation based in Hangzhou continued to make progress, both in domestic and local export markets.

Bridon has continued to upgrade its operations via targeted investment and through progress in programmes to drive quality, efficiency and health and safety.

In keeping with Bridon's strategy to be the global technology leader for demanding rope applications, Bridon formally opened a new factory in Newcastle upon Tyne, UK, in November 2012. The Neptune Quay facility is capable of producing the world's largest and most complex ropes and is equipped to load them directly onto vessels at the deep-water port for export. In addition, a new technology centre was built adjacent to the Doncaster production facility, providing highly advanced product design, development and testing facilities. In all, Melrose invested in excess of £20 million in the expansion and improvement of Bridon's operations and technological capabilities during the year.

Bridon developed a number of new products and completed five technology development projects during 2012. Highlights include extending the high performance Hydra product range with advanced multi-strand rope designs, to take full advantage of the new manufacturing facility at Neptune Quay. These products offer high strength ropes for offshore oil & gas market applications, such as ultra-deep abandonment and recovery with improved performance characteristics. In the surface mining market, a Tiger Blue shovel hoist rope was developed with an improved plastic extrusion coating and a proprietary anti-wear sleeve that combats bend fatigue and rock-impact damage for customers in Canada and USA. Within America, Bridon developed the Dyform 8 MAX, an improved product for active mobile industrial boom hoist crane applications, delivering improved strength, crush resistance and fatigue life. For use in structures, Bridon successfully developed a sheathed full-locked coil rope assembly that provides corrosion protection and reduces installation time in bridge applications. Longer term research projects continue to advance Bridon's technological understanding of its fibre and wire rope products, with further progress being made in rope technology, developments in materials, and non-destructive evaluation of rope condition.

### Outlook

The financial issues in the Eurozone and the ongoing negotiations around the "Fiscal Cliff" in the US have created uncertainty in a number of markets. As a result of this, some customers are cautious of making financial commitments. Despite this, Bridon expects demand for oil & gas and minerals to remain solid in 2013.

## CROSBY

Crosby is a world leader in the design, manufacture and marketing of lifting fittings, blocks and sheaves to the oil & gas, construction and mining industries, serviced primarily through a global network of value-added specialty distributors.

Following the outstanding performance achieved by Crosby during both 2010 and 2011, the business had another very successful year in 2012. Revenue for the year was up nearly 13 per cent, with operating profit up by over 20 per cent. While European and North American construction markets remained slow, this was more than offset by demand in oil & gas markets, and combined with growth in emerging markets, helped Crosby to achieve this record performance.

Crosby continued its focus on supporting its traditional worldwide distributor base by achieving record levels of training. Nearly 1,000 seminars reached over 25,000 end users of Crosby product during the year. That focus helped to reinforce the technical expertise and application knowledge that exists within Crosby and also resulted in greater market share and brand loyalty. Additionally, several new distributors were established in Asia, where Crosby continues to grow at an average of three times the overall market growth rates within these territories.

Further growth also came from several innovative new product launches. Crosby introduced its Easy-Loc® Bolt Retention System, a patented design which eliminates the need for the traditional threaded bolt, nut and cotter pin, resulting in easier and more efficient operation for the end-user, while maintaining all of the safety attributes required for demanding applications. Crosby also introduced new hoist rings designed for greater versatility in the extreme and abrasive material handling environments of subsea and saltwater applications. Lastly, the patent-pending McKissick Tubing Grab®, for use on oil rig tubing lift projects, has been designed with a quick, easy, and efficient attachment for 'well servicing' applications.

During 2012, Crosby continued to invest in its global facilities. An ongoing programme to optimise Crosby's European manufacturing footprint culminated in the announcement to close the facility in Nouzonville, France. Several production equipment moves are also ongoing, designed to create centres of excellence in forging and machining to support growth in Europe, the Middle East and Africa. Additionally, the Premier Stampings facility in the UK acquired additional land and is currently in the process of building a heat treatment facility to allow for greater flexibility and independence in its supply chain.

In Asia, Crosby's manufacturing location in Hangzhou, China, nearly doubled its sales as a result of gaining its API Q1/8C certification, which is necessary in order to manufacture monogrammed products to sell to equipment end users within the oilfield industry. By having this capability at the Chinese facility, Crosby has begun to service crane OEM customers in China with locally manufactured blocks and sheaves.

North America also enjoyed continued investment. A modernised galvanizing facility was completed during the year to increase capacity and reduce cost. Two additional forging hammers, multiple induction heaters and a state-of-the-art electric upsetter were also added to improve efficiencies, quality and throughput in the four North American facilities. However, one of the most anticipated investments will not commence production until early 2014, when Crosby plans to unveil a recently delivered 35,000lb hammer. Once operational it will be one of the largest operating in the lifting industry and allow Crosby to forge larger shackles of up to 400 tonnes, the manufacture of which would previously have been outsourced. These larger products will be used to supply the major oil companies within the offshore industry. Overall production equipment acquired during 2012 alone will, when fully operational, increase Crosby's forging capacity in North America by more than 15 per cent.

### Outlook

The outlook for Crosby in 2013 remains positive and follows three strong years of growth since 2009. Oil prices have remained high and natural gas prices have continued to edge upwards, enough to warrant additional investment by the industry. Crosby is well placed to take advantage of additional growth opportunities if these price trends continue although revenue growth is not expected to be at the same level as 2012. Crosby's unrelenting focus on continuous improvement, innovative new products and market expansion, gives the business confidence to expect another solid year of market share and performance improvement.

## ACCO

Acco, the supplier of material handling equipment including cranes, monorails, hoists, carts and trailers, performed well, with revenue increasing by over 20 per cent against the prior year. Operating profit for the year produced a return on sales of approximately 17 per cent. A move to more niche products has resulted in dramatic improvement in the results of this business.

Capital investment was also made in the business, which included a replacement conveyor system in the monorail plant, various upgrades and other equipment rebuilds, designed to increase the useful and productive life of existing equipment.

### Outlook

It will be difficult to repeat 2012 but Acco is well-positioned in its marketplace and optimism remains high for a further improvement in performance in 2013.

# Divisional review continued

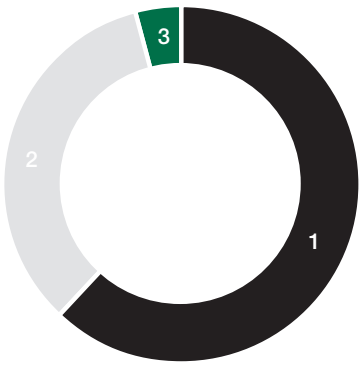
## Other Industrial review

**Revenue**
(Year ended 31 December 2012)

**£129.1m**

**Headline[1] operating profit**
(Year ended 31 December 2012)

**£17.0m**




**Other Industrial**

**Revenue by end market**
(Year ended 31 December 2012)

| | |
|---|---|
| **1** Hardware | **62%** |
| **2** Scrap Processing | **34%** |
| **3** Other | **4%** |

[1] Before exceptional costs, exceptional income and intangible asset amortisation.

Market leading manufacturers across the housing, construction, and scrap processing sectors.

TRUTH HARDWARE **www.truth.com**

Harris **www.harrisequip.com**

PRELOK® **www.prelok.com**

Pictured:
A Harris multi-purpose baler used in the non-ferrous scrap metal, recovered fibre, recovered plastics and solid waste industries. With a ram force of 137 tons, this product has been the top selling narrow box ram baler in North America for the past six years.

## TRUTH

Truth is the North American market leader in the engineering, design and manufacture of hardware products used to serve the fenestration market, which includes windows, patio doors and skylights. Truth's channel to market is through the large well known North American fenestration OEMs.

The main manufacturing facility of Truth is in Minnesota, USA, where its engineering, research and development, die casting, metal stamping, component fabrications and assembly manufacturing takes place. Truth also has a separate facility in Toronto, Canada, which serves as a competency centre for machining technology.

During the year, both revenue and operating profit increased when compared to 2011. Revenue was up by approximately 5 per cent as the North American housing market continued its recovery. Operating profit increased significantly due to a variety of factors which included a successful continuous improvement project as well as labour efficiency measures and enhanced management of the global supply chain, designed to eliminate unnecessary logistics costs.

The manufacture of Truth's product is carried out by a combination of in-house manufacturing, together with third party sourcing of lower margin product.

During the year, focus was placed on initiatives for continuous improvement, which included greater cost control, product quality, scrap reduction, inventory analysis and delivery times. Various capital investments were also made during the year, to include robotic automation in certain parts of the manufacturing process and new die casting equipment. These operational improvements and capital investments place Truth in a good position to capitalise on future market growth.

### Outlook

Truth remains confident about market growth prospects within the North American housing market during 2013. All current signs support further recovery in this market and additional sales should result in a further improvement in performance.

In addition to the positive market outlook, Truth is confident about gaining further market share as a result of widening its product portfolio. The current and future product development pipeline includes both new products and enhancements to existing products for all product categories including windows, patio doors and commercial product.

## HARRIS

Harris is a well-respected leader in the scrap and waste recycling industries, operating from two manufacturing plants in Georgia, USA. The business designs, manufactures and services a full range of size reduction equipment solutions for the scrap metal, fibre recycling and waste industries.

Harris saw revenue decrease by around 15 per cent, as demand for scrap recycling machines declined, with orders decreasing by around the same level. This contributed to a substantial fall in operating profit when compared to the prior year.

Truth

Truth's Bi-Fold hardware system allows both homeowners and businesses to take advantage of moveable glass walls that allows indoor and outdoor space to combine. The product has been engineered to take advantage of Truth's award winning Multi-Point hardware system.

More information about Truth is available at www.truth.com

During 2012, Harris continued with its strategy to further improve the quality and reliability of its existing product ranges. Engineering resources were focused on making further improvements to products launched in 2010 and 2011, such as the Centurion EHD baler, designed for the non-ferrous market and side compressor shears, designed for the ferrous market. Strategically important product launches will occur in 2013, to include equipment for both the ferrous and non-ferrous processing markets.

Harris continued to focus on key customer-facing strategies, designed to strengthen its position in the scrap and waste recycling industries. Harris further expanded its presence in Latin America to fully participate in the rapidly growing recycling industries in that region. It also made efforts to strengthen relationships with the largest scrap and waste processors, as consolidation in these industries continues. Additionally, Harris remains focused on maximising Aftermarket sales opportunities.

### Outlook

Harris expects little sales growth in 2013 due to overall market conditions. Notwithstanding this, Harris expects to further improve its internal efficiency and execute key strategies which will place the company in a stronger position going forward.

# Divisional review continued

## Elster review

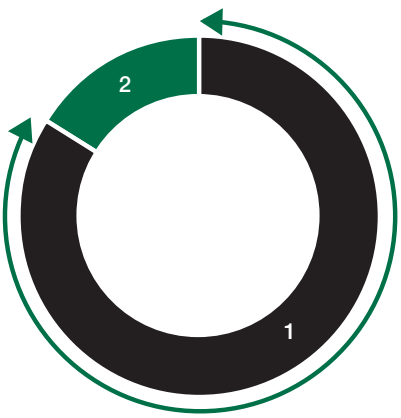
**Revenue**
(Four months[2] ended 31 December 2012)

**£411.1m**

**Headline[1] operating profit**
(Four months ended 31 December 2012)

**£57.8m**

A world leading engineering business and one of the world's largest providers of gas control equipment and related communications, gas, electricity and water meters, networking and software solutions.




**Elster**

**Revenue by end market**

(Four months ended 31 December 2012)

| | |
|---|---|
| **1** Energy | **84%** |
| **2** Water | **16%** |

**84% Energy**

elster

**www.elster.com**

[1] Before exceptional costs, exceptional income and intangible asset amortisation.
[2] Revenue stated for Elster relates only to the four month period post-acquisition. Trading within Elster is affected by seasonality so the revenue stated does not represent a true run rate for the full year.

Pictured:
Roller hearth kiln, which has a maximum temperature of 1,200°C and is used in the manufacture of fine ceramics and tiles. Elster's Gas Control equipment business supplied 150 burners, as well as automatic burner control units, solenoid valves and gear motors.

Elster Group S.E. was acquired by Melrose in August 2012 for an enterprise value of £1.8 billion. The figures given for each of the businesses are only for the four months post acquisition and are affected by seasonality. Therefore, they are not an accurate indication of a run rate for 2013.

Although it is still early days, we are very pleased with the progress that has been made so far. Restructuring projects aimed at achieving our plan for the business have either already been completed or are at least well underway. Part of this restructuring has been to reduce the number of reporting businesses from five to three; the Elster division has now been split into three distinct global businesses of Gas, Water and Electricity. Further detail about each of these businesses is given below.

## GAS

| | 2012 – 4 months post acquisition £m |
|---|---|
| Total Revenue | **236.9** |
| Headline[1] Operating Profit | **46.7** |

[1] Before exceptional costs, exceptional income and intangible asset amortisation.

Elster Gas is a world leader in the design and manufacture of gas measurement, process heat control and gas safety control equipment, supplying a global customer base in more than 130 countries. It has one of the most extensively installed utility measurement bases in the world with more than 75 million gas metering devices deployed over the last 10 years alone. Its complete range of end-to-end solutions enables customers to efficiently manage and control natural gas resources.

From its four lead plants in Europe and the USA, coupled with sizeable subsidiary operations in China, Russia and Mexico, Elster Gas supplies gas meters for both residential and commercial/industrial customers. In addition, the Elster Gas control equipment range of products is used extensively by global customers in both the upstream and midstream gas market sectors.

Despite continued delays in the anticipated roll out of Smart Gas Meters in Europe and a sluggish process heat control equipment market, particularly in China, Elster Gas full year revenues recovered in the last four months of the year to end up flat when compared to 2011. Revenue within the European market declined but this was more than offset by an increase in the US market.

Operating profit for the four month period post acquisition improved over the same period in 2011, largely as a result of operating efficiency improvements, which were implemented after the acquisition.

In the four months since acquisition many changes and initiatives have taken place in order to better position the business to exploit the projected long-term growth in its end markets.

A new unified global organisation has been created to replace the previously separate US business and disparate European operations. Clear lines of responsibility and accountability have been established and there is now a highly motivated and performance driven management team in place, working together towards a demanding set of long-term goals and objectives. At the same time a new and focused operations review process has been introduced to improve manufacturing and procurement performance.

Further progress has also been made in rationalising the European manufacturing footprint, where the production of a number of products previously manufactured in Western Europe has been transferred to the newly extended plant in Slovakia. This strategy will continue to be executed throughout 2013 and 2014.

The extensive product portfolio within Elster Gas has been reviewed and is in the process of rationalisation to eliminate low margin products. This will also enable a more focused and value driven research and development strategy to be implemented. The next few years will be key years in the roll out of Smart Gas Meters in Europe and significant work has been undertaken to ensure that the business is ready for this major opportunity.

### Outlook

Elster Gas end markets remain healthy. Order input in 2012 increased by 2 per cent against the prior year, giving a book to bill ratio of 100 per cent. When coupled with the full year effect of post-acquisition efficiency improvements and additional planned activities in the year ahead, Elster Gas should enjoy a strong performance in 2013.

Production of gas meters at the Elster facility in Osnabrück, Germany. This site was honoured with the German Global Excellence in Operations (GEO) award for 2012, due to its recognised manufacturing and assembly processes for residential and commercial gas meters.

More information about Elster is available at www.elster.com

## ELECTRICITY

| | 2012 – 4 months post acquisition £m |
|---|---|
| Total Revenue | **106.8** |
| Headline[1] Operating Profit | **12.6** |

[1] Before exceptional costs, exceptional income and intangible asset amortisation.

Elster Electricity is one of the world's largest international metering solution providers, supplying both traditional and Smart Meter equipment, including applications for residential, commercial, industrial, transmission and distribution markets.

# Divisional review continued

The product range includes distribution and control monitoring equipment, advanced Smart Metering, demand response, networking and software solutions, together with several other communication products and services. Elster Electricity has key production facilities located in Europe, North America and South America.

Revenue within Elster Electricity was impacted by the delayed roll out of Smart Metering in Europe, plus slower than expected growth in Asian markets. The North American market continued to be strong and this growth was primarily driven by Energy Axis, Elster Electricity's Smart solution for North America.

Operating profit was also affected by the delayed Smart Metering roll out in Europe. Ongoing investment in the Smart Meter product portfolio and organisational changes further impacted on the operating profit of the business.

Post-acquisition, the businesses of Elster North America and Elster International were consolidated into one Electricity business. This was done to create efficiencies and establish a highly motivated organisation, with a clear focus and responsibility. Since acquisition, actions have also already been taken to streamline the US business, via the reorganisation of certain sales, product management, research and development departments and the relocation of all remaining production at the Raleigh, US, facility to Mexico. Consolidation of the European manufacturing footprint is ongoing, which includes the development of Romanian facilities to act as a central European manufacturing and development centre, the closure of the Hungarian operation and the downsizing of some German and British operations.

During 2013, focus will be on the expected roll out of Smart Meters in Europe, which will be supported by investments in both new and existing Smart Meter product platforms and solutions; this will have a positive contribution on future revenues. Completion of the European manufacturing footprint will also continue to be a focus for the management team, together with further operational profitability improvements in North America.

### Outlook

The global electricity metering business will remain challenging in 2013 but there are strong signs it is moving in a very positive direction over the medium term. In Europe, targets are in place to roll out Smart Meters to 80 per cent of customers by 2020, and 100 per cent by 2022. This means that member states of the EU will provide a commitment to develop Smart Metering on a large scale basis, although it is inevitable that not all national governments will develop their plans at the same pace.

Further growth opportunities in Europe come from the evolution of Smart Meter functionality to grid applications, such as outage, voltage conversion, loss detection, load control and demand response. This is already a reality in North American markets and Elster Electricity will be well placed to use its experience gained from the American market.

## WATER

| | 2012 – 4 months post acquisition £m |
|---|---|
| Total Revenue | **67.4** |
| Headline[1] Operating Profit | **1.4** |

[1] Before exceptional costs, exceptional income and intangible asset amortisation.

Elster Water designs and manufactures a comprehensive range of water metering solutions, which includes high accuracy mechanical meters, fully electronic water meters and Smart metering solutions for residential, commercial and industrial sectors.

Following acquisition, a greater focus has been placed on the acceleration of various restructuring projects, profitability of sales and simplification of the business structure. It is clear that supplying certain unprofitable markets and products was adversely affecting the financial performance of this business.

Under Melrose ownership, various enhancements were made to the restructuring projects that had originally been announced by Elster in 2011. These include the closure of underperforming parts of the business in Poland, Colombia and Italy, moving from an operations to a distribution market approach. The cessation of manufacturing mechanical meters in North America and the exit from a significant number of lower margin product lines made in Germany enables a significant restructuring of operations in those markets. Although this only delivered a small operating margin improvement in 2012, these projects are expected to deliver significant benefit from 2013 onwards. In total, since acquisition, the closure and restructuring of five facilities in this business have been announced and are well underway.

The business has been successful in managing its overhead base, which contributed to the operating profit improvement during the year.

South America produced strong results, as both revenue and operating profit increased, following a market sales price recovery after a challenging 2011. Continued economic growth in the Brazilian market is helping to increase meter penetration and Elster Water continues to capture significant sales with several major customers.

New product launches in 2012 included the S150 single jet meter with improved accuracy range, HT8 and ePico hybrid AMR submeters with integrated radio communication and further extensions of the polymer bodied V200 volumetric meter range. Enhancements to the Emeris Smart Metering solutions include ERM2 route management software updates and the new Emeris WaterNet data management system, developed in conjunction with Elster Electricity.

Globally, sales of polymer bodied meters grew by over 38 per cent compared to 2011. This is an area of substantial opportunity for Elster. The award winning polymer meters are helping customers achieve their $CO_2$ reduction targets, as well as providing lead free alternatives to traditional brass and bronze products.

### Outlook

The Elster Water business will continue with its restructuring plans throughout 2013. Significant operating profit improvement will be achieved from the closure or restructuring of low operating margin businesses and the cessation of poorly performing product lines. Market conditions continue to be affected by ongoing austerity measures in several regions and competition remains strong in many segments. However, we are confident that with a revised business model for Elster Water, which will focus on its strengths and a continued emphasis on advanced metering solutions, profits within Elster Water will increase in 2013.

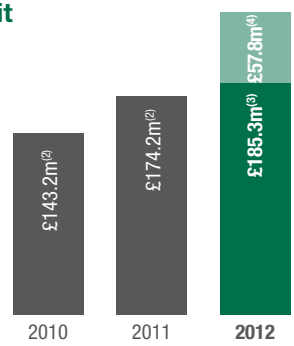
# Finance Director's review

"The year to 31 December 2012 was a significant year for Melrose with the achievement of many key events. On 23 August 2012 Melrose completed the acquisition of Elster for an enterprise value of £1.8 billion, after a successful £1.2 billion Rights Issue and a refinancing of debt."

Geoffrey Martin

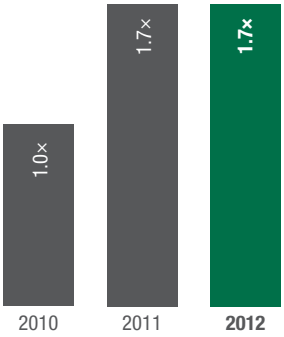
**Headline[1] operating profit**

**£243.1m**




**Net capital expenditure to depreciation**

**1.7×**




The year to 31 December 2012 was a significant year for Melrose Industries PLC ("Melrose") with the achievement of many key events. This report summarises the financial details of those events and also the financial results for the year.

### NEW GROUP HOLDING COMPANY

Following shareholder approval on 5 November 2012 a Scheme of Arrangement was sanctioned by the High Court of England and Wales on 26 November 2012, pursuant to which a new listed holding company was introduced for the Melrose Group of companies. The Scheme of Arrangement became effective on 27 November 2012 and Melrose Industries PLC became the new holding company of Melrose PLC and its subsidiaries. The subsequent reduction of share capital by this new holding company created significant distributable reserves to assist the Group to return the proceeds of future disposals to shareholders efficiently.

### ACQUISITION DURING THE YEAR

On 23 August 2012 Melrose completed the acquisition of Elster Group S.E. ("Elster") for an enterprise value of £1.8 billion. The total costs of acquiring Elster were £73 million of which £31 million related to the raising of equity, and were offset against Share premium, and £23 million related to bank facility arrangement fees, which have been included within net debt. These are being amortised over the five year life of the facility. The remaining £19 million of costs are included within exceptional items.

The acquisition and associated expenses have been funded through a combination of new debt and equity. On 1 August 2012 a 2 for 1, fully underwritten, Rights Issue was completed and subsequently 844.4 million new Melrose Ordinary Shares were issued raising £1.2 billion. This took the number of shares in issue to 1,266.6 million. The diluted weighted average number of shares in issue for 2012 was 960.7 million.

[1] Before exceptional costs, exceptional income and intangible asset amortisation.
[2] Restated to include the results of MPC within discontinued operations.
[3] Relates to existing Melrose for the year ended 31 December 2012.
[4] Relates to Elster for the four month period from acquisition to 31 December 2012.

# Finance Director's review continued

In addition a new five year facility has been agreed totalling £1.5 billion, split into a £0.5 billion multi-currency term loan and a £1.0 billion multi-currency revolving credit facility agreement. The details of this facility are included in the liquidity risk management section and refinancing section of this report.

## DISPOSAL DURING THE YEAR

On 25 June 2012 the McKechnie Plastic Components ("MPC") business, previously held within the Other Industrial division, was sold. Gross cash proceeds were £30.7 million with costs of disposal of £3.1 million. Net assets disposed were £28.2 million resulting in an accounting loss on disposal of £0.6 million. MPC contributed revenue of £73.5 million and headline operating profit of £6.6 million in the year ended 31 December 2011.

This disposal brought to a conclusion the successful investment in Dynacast and McKechnie which were acquired in May 2005 for a net equity investment of £244 million and sold for a total equity value of nearly £800 million of cash giving a return on equity of approximately 3.25 times.

## RE-FINANCING

In January 2012 the new five year committed £600 million multi-currency revolving credit facility, agreed in December 2011, was partially drawn, replacing the committed £750 million syndicated term loan and revolving credit facility which was fully repaid.

On 23 August 2012 this facility was repaid and a new £1.5 billion multi-currency bank facility was partially drawn down to accommodate the acquisition of Elster, split into a £0.5 billion term loan and a £1.0 billion multi-currency revolving credit facility agreement. This facility was signed in June 2012 and expires in June 2017. The term loan was partly used to fund the acquisition with the remaining amounts used to refinance, where necessary, the existing indebtedness of both Melrose and Elster and to finance the enlarged Group's working capital requirements.

The new facility was drawn in the Group's core currencies, namely US Dollars, Euros and Sterling, in the most suitable proportion to protect, as effectively as possible, against exchange rate volatility within the Group.

As at the year end the term loan was fully drawn and split into two tranches of £180 million and US $500 million. The revolving credit facility is split into multi-currency Sterling based tranches totalling £760 million and a €300 million tranche.

## LONG TERM INCENTIVE PLAN

On 11 April 2012, at a Melrose General Meeting, shareholders voted in favour of the early crystallisation of the previous Melrose Incentive Plan, bringing forward the maturity date from 31 May 2012 to 22 March 2012. On crystallisation the Incentive Shares were converted into 31.2 million Melrose Ordinary Shares and as a result the total number of Ordinary Shares in the Company increased from 391.0 million to 422.2 million.

At the same meeting a new five year share-based 2012 Melrose Incentive Plan was approved by shareholders which mirrors the previous Melrose Incentive Plan in most respects except that under this new plan the potential reward has been reduced from 10% to 7.5% of the increase in shareholder value creation. In addition a 5% dilution cap has been included in the new plan rules. This new plan has an end date of 31 May 2017.

The charge to headline operating profit for the 2012 Melrose Incentive Plan will be £4.0 million per annum (previous Melrose Incentive Plan: £1.8 million per annum).

## SEGMENTAL SPLIT OF DIVISIONS

As a consequence of the Elster acquisition and the disposal of MPC during 2012 the segmental split of the Group has been altered.

### Continuing operations:

The continuing operations at 31 December 2012 now consist of four divisions, namely Energy, Lifting, Other Industrial and a new Elster division containing the businesses of Gas, Electricity and Water.

### Discontinued operations:

The discontinued operations in 2012 include the results of the MPC business, previously shown within the Other Industrial division. In accordance with IFRS 5 the trading results of MPC are shown as discontinued in both years. The discontinued operations in 2011 also include the Dynacast, Brush Traction, Logistex UK, Madico and Weber Knapp businesses.

## GROUP TRADING RESULTS — CONTINUING OPERATIONS

To help understand the results of the continuing operations the term 'headline' has been used. This refers to results calculated before exceptional costs, exceptional income and intangible asset amortisation as this is considered by the Melrose Board to be the best measure of performance.

For the year ended 31 December 2012 the Group achieved revenue from continuing operations of £1,551.4 million (2011: £1,080.4 million). Headline operating profit in the year ended 31 December 2012 was £243.1 million (2011: £174.2 million) and the headline operating profit margin (defined as the percentage of headline operating profit to revenue) decreased from 16.1% in 2011 to 15.7% in 2012. Within this the existing continuing Melrose businesses increased their headline operating margin by 0.2 percentage points to 16.3% in 2012.

After exceptional costs, exceptional income and intangible asset amortisation Group operating profit was £137.1 million (2011: £110.5 million).

In accordance with IFRS 3: "Business combinations", the impact on the Group results if the acquisition had been made at the start of the year has been estimated despite the results of Elster being calculated under US GAAP for the first thirty three weeks of the year. This shows that Melrose continuing revenue would have been approximately £2,271 million and headline operating profit approximately £330 million in the year to 31 December 2012.

## TRADING RESULTS BY DIVISION - CONTINUING OPERATIONS

A split of revenue, headline operating profit and headline operating profit margin for 2012 and 2011 is as follows:

| | 2012 Revenue £m | 2012 Headline operating profit/ (loss) £m | 2012 Headline operating profit margin % | 2011 Revenue £m | 2011 Headline operating profit/ (loss) £m | 2011 Headline operating profit margin % |
|---|---|---|---|---|---|---|
| Energy | **486.8** | **93.4** | **19.2** | 461.6 | 91.1 | 19.7 |
| Lifting | **524.4** | **95.2** | **18.2** | 484.4 | 82.6 | 17.1 |
| Other Industrial | **129.1** | **17.0** | **13.2** | 134.4 | 16.5 | 12.3 |
| Elster | **411.1** | **57.8** | **14.1** | — | — | — |
| Central — corporate | **—** | **(11.8)** | **—** | — | (9.2) | — |
| Central — LTIPs[1] | **—** | **(8.5)** | **—** | — | (6.8) | — |
| **Continuing Group** | **1,551.4** | **243.1** | **15.7** | 1,080.4 | 174.2 | 16.1 |

[1] Long Term Incentive Plans.

The performance of each of the trading divisions is discussed in detail in the Chief Executive's review.

Central costs comprise £11.8 million (2011: £9.2 million) of Melrose corporate costs, which increased towards the end of the year as expected following the acquisition of Elster, and a Long Term Incentive Plan ("LTIP") accrual of £8.5 million (2011: £6.8 million). The LTIP accrual includes an amount of £0.8 million (2011: £1.8 million) in respect of the previous Melrose Incentive Plan, which matured on 22 March 2012, and an accrual of £2.7 million (2011: £nil) in respect of the new five year Melrose 2012 share-based Incentive Plan which commenced on 11 April 2012. The annual accrual for the new five year plan was calculated in accordance with IFRS 2: "Share based payments" using a standard pricing model and will be constant until the date of crystallisation.

In addition, there was a charge of £5.0 million (2011: £5.0 million) for the cash-based divisional management incentive plans. These plans are for senior operational management within the businesses and are designed to reward improvement in business performance, usually over a five year period.

## FINANCE COSTS AND INCOME

The net headline finance cost in 2012 was £28.8 million (2011: £19.5 million).

Net interest on external bank loans, overdrafts and cash balances was £21.9 million (2011: £15.6 million). Melrose uses interest rate swaps to fix the majority of the interest rate exposure on its drawn debt. Following the refinancing in January a new set of five year interest rate swaps was entered into and the existing ones were closed. Following the acquisition of Elster another layer of swaps were added to ensure the Group's interest exposure was suitably protected. More detail on these swaps is given in the finance cost risk management section of this review.

In 2012 the Group had a blended interest rate of 2.7% (2011: 3.1%).

Also included in the net headline finance cost is a £2.4 million (2011: £2.5 million) amortisation charge relating to a proportion of the arrangement costs of raising the £600 million bank facility and the new £1.5 billion bank facility, a net interest cost on pension liabilities in excess of the expected return on their assets of £3.6 million (2011: £0.3 million) and a charge for the unwinding of discounts on long term provisions of £0.9 million (2011: £1.1 million). The introduction of IAS 19 (revised) in 2013 is expected to increase the net pension charge to headline profit before tax by approximately £10 million.

## TAX

As expected, following the acquisition of Elster, the headline Income Statement tax rate increased slightly to 27% (2011: 26%). The 27% headline tax rate is expected to increase further in 2013 as a full year of 2013 Elster results are included.

The Group has chosen to reconcile the actual tax charge for the year to the weighted average tax charge, because the weighted average rate better reflects the Group's economic operating conditions. The main reason the headline rate is lower than the weighted average rate is the release of provisions previously held against potential overseas tax audits which have now been cleared.

The tax rate after exceptional items and intangible asset amortisation is 53% (2011: credit of 21%). The reasons for the high rate in the year include the non-deductibility for tax purposes of many of the exceptional costs incurred during the year, (indeed the tax credit on the exceptional costs, including intangible asset amortisation, was only 7%), and the re-evaluation of the Group's deferred tax liability on intangible assets.

The cash tax rate on headline continuing operations of 23% (2011: 15%) is again below the headline rate due to the benefit arising from the utilisation of pre-existing Melrose Group tax losses and other deferred tax assets. The rate is higher than in previous years due to the settlement of tax audits commenced prior to our ownership of FKI and the relative lack of similar deferred tax benefits being available to the Elster businesses.

The Group's current tax creditor has increased by £24 million in the year, primarily as a result of the acquisition of the Elster businesses. The net deferred tax liability has increased more significantly, by £208 million to £266 million. The net liability includes a gross deferred tax liability of £263 million in respect of brand names and customer relationships acquired with the Elster businesses.

# Finance Director's review continued

The deferred tax liability on existing intangible assets decreased during the year as a result of the normal amortisation of those assets but increased by the same amount as a result of the decision to amend their calculation to be consistent with the method used for the Elster intangible assets. The deferred tax liability in respect of intangible assets is not expected to represent a future cash tax payment and will unwind as the brand names and customer relationships are amortised.

The total amount of tax losses in the Group has increased in the year mainly due to the acquisition of Elster. The total gross tax losses within the Group are shown below:

| Tax losses | Recognised £m | Unrecognised £m | Total £m |
|---|---|---|---|
| UK | 16.1 | 170.6 | 186.7 |
| North America | 1.2 | — | 1.2 |
| Rest of World | 18.2 | 44.5 | 62.7 |
| **Total 2012** | **35.5** | **215.1** | **250.6** |
| Total 2011 | 35.0 | 166.4 | 201.4 |

## EXCEPTIONAL ITEMS

In the year ended 31 December 2012 the Group incurred exceptional operating costs of £73.9 million (2011: £40.0 million) and received exceptional income of £7.0 million (2011: £nil). In addition intangible asset amortisation of £39.1 million (2011: £23.7 million) was charged. A net tax credit on these exceptional costs, exceptional income and intangible asset amortisation, of £14.5 million (2011: £20.7 million), and an exceptional tax charge of £5.8 million (2011: credit of £38.1 million) has been taken in the year.

The table below summarises the exceptional items in 2012:

| | Total £m |
|---|---|
| **Intangible asset amortisation** | **(39.1)** |
| **Exceptional operating costs** | |
| Elster head office closures | (9.1) |
| Other restructuring costs | (45.3) |
| Acquisitions and disposals of businesses | (19.5) |
| **Total exceptional operating costs** | **(73.9)** |
| Exceptional operating income (curtailment gain on US retirement plans) | 7.0 |
| Exceptional finance costs | (16.3) |
| Net tax credit on exceptional items | 14.5 |
| Exceptional tax charge | (5.8) |
| **Total exceptional tax and tax on exceptional costs** | **8.7** |
| **Exceptional items and intangible asset amortisation (after tax)** | **(113.6)** |

Overall the net exceptional items and intangible asset amortisation, after tax, shows a net expense of £113.6 million (2011: £4.9 million).

The Elster head office closure and Elster restructuring costs, discussed further in the Chief Executive's review, will deliver significant cost savings in the future. Other restructuring costs include restructuring in the Lifting division along with the costs associated with the establishment of the new holding company. The acquisition and disposal costs primarily relate to the acquisition of Elster, along with smaller disposal activity within the Melrose Group.

In addition, £16.3 million of exceptional finance costs have been incurred which relate to the breaking of swaps on previous financing arrangements, the acceleration of the amortisation of banking fees previously capitalised and a proportion of the make whole premium charged on the repayment of Elster's Eurobond.

The exceptional operating income arises as a result of changes made to benefits in respect of Elster retirement health and life plans.

## EARNINGS PER SHARE (EPS)

In the 2011 Annual Report it was explained that the best measure of year on year growth in headline diluted EPS was by comparing the headline diluted EPS of continuing and discontinued businesses, before the profit on disposal of businesses, and using the weighted average number of shares for the year. This was because Dynacast was such a significant part of the Group and the disposal proceeds were used to buy back shares which impacted the weighted average share calculation. Excluding the Dynacast results from the 2011 EPS calculation would therefore have been misrepresentative of year on year performance. This gave a diluted headline EPS of 28.8p in 2011.

In these financial statements, in accordance with IAS 33, all EPS numbers have been restated to apply a bonus factor of 57% to reflect the impact of the Rights Issue. This restates the 28.8p discussed above to 16.4p.

Using the same measure the diluted headline EPS for 2012 was 16.3p, which shows a slight decrease year on year. However, this number has been impacted by the dilutive effect of the disposal of MPC, a relatively small business within the Group where the proceeds were not used to repurchase shares. Removing MPC from both years' calculations would result in a 2011 EPS of 15.8p and a 2012 EPS of 16.1p, showing a 2% increase year on year. In addition there has been a negative impact year on year in respect of foreign exchange movements, particularly in relation to the Euro and the Czech Koruna. Using constant currency and adjusting for MPC the diluted EPS has grown by 4% year on year.

In addition there was a period of time between issuing shares to buy Elster and actually owning Elster on 23 August 2012. If the weighted average number of shares were adjusted for this period then this would increase the 2012 EPS by an additional 0.6p. Adjusting for these factors results in underlying year on year growth of 8%.

In accordance with IAS 33, two further sets of basic and diluted EPS numbers, post exceptional items, are disclosed on the face of the Income Statement, one for continuing operations and one that also includes discontinued operations. In the year ended 31 December 2012 the diluted EPS for continuing operations was 4.3p (2011: 12.9p) and for both continuing and discontinued operations was 4.4p (2011: 33.6p). The decrease in the 2012 non-headline EPS is due to exceptional costs, primarily restructuring, acquisition and refinancing related, whereas 2011 benefited from the profit on disposal of Dynacast.

## CASH GENERATION AND MANAGEMENT

Within the existing Melrose businesses, the period of significant investment continued with a resulting net capital expenditure to depreciation ratio of these businesses being 2.1x for the year (2011: 1.7x). Consequently it is appropriate to look at the operating cash generated post working capital movements, but prior to capital expenditure, as a percentage of headline EBITDA (defined as headline operating profit before depreciation and amortisation) to gauge cash performance in the year. The percentage in 2012 for the continuing Group was 84% and indeed, within this, it was 86% for the existing Melrose businesses (2011: 90%), a good conversion considering the continued 6% growth in revenue for these businesses.

For the nineteen weeks of ownership of Elster the net capital expenditure to depreciation ratio was 0.9x and the pre capital expenditure cash conversion was 79%.

The cash generation performance in 2012 is summarised as follows:

| Movement in net debt | 2012 £m |
|---|---|
| **Opening net debt** | **(289.6)** |
| Acquired net debt with Elster | (306.3) |
| Cash flow from trading (after all costs including tax) | (1.0) |
| Increase in net debt to fund the Elster acquisition | (390.6) |
| Net cash flow from disposals (including net cash disposed) | 27.1 |
| Amounts paid to shareholders | (66.8) |
| Foreign exchange and other non-cash movements | 29.5 |
| **Closing net debt** | **(997.7)** |

The detail of the cash flow from trading and the net cash flow of acquisitions is shown below:

| Cash flow from trading (after all costs including tax) | 2012 £m |
|---|---|
| Headline operating profit | 243.1 |
| Depreciation and amortisation of computer software and development costs | 30.5 |
| Working capital movement | (44.0) |
| **Headline operating cash flow (pre capex)** | **229.6** |
| **Headline EBITDA conversion to cash (pre capex) %** | **84%** |
| Net capital expenditure | (52.9) |
| Net interest and net tax paid | (81.2) |
| Defined benefit pension contributions | (33.7) |
| Other (including discontinued operations) | (62.8) |
| **Cash outflow from trading (after all costs including tax)** | **(1.0)** |

| Increase in net debt arising from acquisitions | 2012 £m |
|---|---|
| Net proceeds on issue of shares | 1,168.1 |
| Cash payment for acquisitions (including costs) | (1,525.6) |
| Exceptional finance costs in raising and settling finance | (33.1) |
| **Increase in net debt to fund acquisitions** | **(390.6)** |

The Balance Sheet leverage (calculated as net debt divided by headline operating profit before depreciation and amortisation) was approximately 2.6x at 31 December 2012 (31 December 2011: 1.4x). This includes the results of the Elster businesses under previous ownership, adjusted to approximate the impact of the transition to IFRS and the impact of the fair value review in this period.

# Finance Director's review continued

## CAPITAL EXPENDITURE

Improving businesses by investing in capital projects is a key part of the Melrose strategy. The Group continued to authorise net capital expenditure in excess of depreciation for the existing businesses and for the Elster businesses net capital expenditure was slightly less than depreciation in the four month period of ownership whilst the Board assessed strategies for these businesses. By division, the net capital expenditure in the year was as follows:

| | Energy | Lifting | Other Industrial | Elster | Central | Total |
|---|---|---|---|---|---|---|
| Net capital expenditure £m | 10.2 | 30.0 | 3.8 | 8.0 | 0.9 | 52.9 |
| Depreciation £m | 7.5 | 9.9 | 3.4 | 9.1 | 0.6 | 30.5 |
| Net capital expenditure to depreciation ratio (full year) | 1.4x | 3.0x | 1.1x | 0.9x | 1.5x | 1.7x |
| Melrose eight year (2005-2012) average annual multiple | | | | | | 1.3x |

The net capital spend to depreciation ratio was 1.7x in 2012 (being 2.1x in existing Melrose and 0.9x in Elster), equal to the 1.7x ratio in 2011 demonstrating the continued investment phase that the Group is going through in its key businesses. The eight year Melrose average annual net capital spend remains in excess of depreciation at 1.3x.

The largest investment was made in the Bridon business (within the Lifting division) and in particular the development of a new factory on Neptune Quay in Newcastle upon Tyne to produce the largest ropes in the world. More details on this investment and others are included in the Chief Executive's review.

## FAIR VALUE EXERCISE

Following the acquisition of Elster, Melrose has undergone an extensive review of the Elster assets, liabilities and accounting policies. This, along with the change from reporting under US GAAP to reporting under IFRS and from US Dollars to Sterling, has resulted in a significant amount of fair value adjustments in the Elster businesses.

In addition to a fair value review of all the Elster assets and liabilities at the acquisition date and a review of the accounting policies, Melrose has undertaken significant actions to improve the operational and financial nature of the Elster Group. To achieve this, a number of exceptional costs have been incurred as described in the exceptional items section of this review.

## ASSETS AND LIABILITIES

The summary Melrose Group assets and liabilities are shown below:

| | **2012 £m** | 2011 £m |
|---|---|---|
| Fixed assets (including computer software and development costs) | **345.2** | 218.1 |
| Intangible assets | **1,156.3** | 334.8 |
| Goodwill | **1,836.9** | 568.5 |
| Net working capital | **218.5** | 144.8 |
| Retirement benefit obligations | **(261.3)** | (117.7) |
| Provisions | **(254.3)** | (120.6) |
| Deferred tax and current tax | **(307.1)** | (74.8) |
| Other[1] | **5.2** | (15.1) |
| **Total** | **2,739.4** | 938.0 |

(1) Includes interests in joint ventures, net derivative liabilities and, for 2011 only, a £1.1 million liability relating to the redeemable preference C shares redeemed on 30 April 2012.

These assets and liabilities are funded by:

| | **2012 £m** | 2011 £m |
|---|---|---|
| Net debt | **(997.7)** | (289.6) |
| Equity | **(1,741.7)** | (648.4) |
| **Total** | **(2,739.4)** | (938.0) |

The increase in total equity is primarily related to the Rights Issue and the increase in net debt as a result of the acquisition of Elster.

## GOODWILL, INTANGIBLE ASSETS AND IMPAIRMENT REVIEW

The total value of goodwill as at 31 December 2012 was £1,836.9 million (31 December 2011: £568.5 million) and intangible assets was £1,156.3 million (31 December 2011: £334.8 million). These items are split by division as follows:

| | Energy £m | Lifting £m | Other Industrial £m | Elster £m | Total £m |
|---|---|---|---|---|---|
| Goodwill | 244.2 | 289.7 | 18.3 | 1,284.7 | 1,836.9 |
| Intangible assets | 106.8 | 180.6 | 16.1 | 852.8 | 1,156.3 |
| Deferred tax on intangible assets | (29.6) | (50.3) | (4.5) | (262.8) | (347.2) |
| Other net assets | 81.0 | 142.9 | 25.0 | (61.5) | 187.4 |
| **Total carrying value** | **402.4** | **562.9** | **54.9** | **1,813.2** | **2,833.4** |

The goodwill and intangible assets have been tested for impairment as at 31 December 2012. The Board is comfortable that no impairment is required.

## PROVISIONS

Total provisions at 31 December 2012 were £254.3 million (31 December 2011: £120.6 million), a significant increase from the previous year. The following table details the movement in provisions in the year, the increase being virtually all related to the acquisition of Elster:

| | Total £m |
|---|---|
| At 31 December 2011 | 120.6 |
| Acquisition of businesses | 143.0 |
| Utilised — cash spend | (65.8) |
| Net charge to headline operating profit | 8.5 |
| Net charge to exceptional costs | 48.3 |
| Other (including foreign exchange) | (0.3) |
| **At 31 December 2012** | **254.3** |

Included within the cash spend on provisions in 2012 was the resolution of the litigation case involving Bridon, details of which were included in the 2011 Annual Report. On 23 May 2012, Bridon, Noble and Certex agreed a confidential settlement of the litigation and all claims have been dismissed with prejudice. The settlement sum was paid by Bridon in the year, and including legal costs and current contributions from insurers, the settlement was in line with the £25.8 million provision held at the 2011 year end.

In addition to this, the other significant cash payments against provisions have been £10.6 million in respect of reorganisation provisions originally charged through exceptional items in 2011 and £13.8 million cash spend to date against the Elster reorganisation provisions which were either inherited in the opening Balance Sheet of Elster or created through exceptional items in 2012.

Of the remaining £15.6 million cash spend on provisions during 2012, £5.3 million related to provisions previously charged through operating profit with the remaining £10.3 million relating to provisions either acquired with businesses or created through exceptional items in previous years.

The net charge to headline operating profit in 2012 in respect of provisions was £8.5 million, mostly relating to the charge of £5.0 million in respect of the divisional LTIP plans.

The other movements on provisions in the year relate to the net effect of the unwind on long term provisions, foreign exchange and the movement as a result of the disposal of MPC.

## PENSIONS

The Group has a number of defined benefit and defined contribution pension plans brought forward from 2011. In addition, Elster provides retirement benefits for most of its employees, either directly or by contributions to pension funds managed by third parties.

The acquisition of Elster has almost doubled the IAS 19 deficit in the Consolidated Balance Sheet as at 31 December 2012 with £115.2 million of the £261.3 million deficit, 44%, relating to the acquired businesses. However, unlike the incumbent FKI and McKechnie pension plans, the Elster plans are mainly unfunded with total liabilities at 31 December 2012 of £152.8 million and total assets of £37.6 million. The Elster plan liabilities acquired are much smaller than the existing Melrose funded plans.

The FKI UK Pension Plan remains the most significant pension plan in the Group. The net accounting deficit on this plan was £100.0 million at 31 December 2012 (31 December 2011: £79.4 million). This plan had assets at 31 December 2012 of £630.2 million (31 December 2011: £600.3 million) and liabilities of £730.2 million (31 December 2011: £679.7 million).

The assumptions used to calculate the IAS 19 deficit of the pension plans within the Melrose Group are considered carefully by the Board of Directors. For the FKI UK Pension Plan a male aged 65 in 2012 is expected to live for a further 22.1 years (31 December 2011: 20.3 years). This is assumed to increase by 1.4 years (6%) for a male aged 65 in 2032. A summary of the key assumptions of the UK plans are shown below:

| | **2012 Assumptions %** | 2011 Assumptions % |
|---|---|---|
| Discount rate | **4.50** | 4.90 |
| Inflation | **3.00** | 3.10 |

# Finance Director's review continued

It is noted that a 0.1 percentage point decrease in the discount rate would increase the pension liabilities on the main FKI UK Pension Plan by £14.1 million, or 2%, and a 0.1 percentage point increase to inflation would increase the liabilities on this plan by £6.8 million, or 1%. Furthermore, an increase by one year in the expected life of a 65 year old male member would increase the pension liabilities on this plan by £25.0 million, or 3%.

The FKI UK Pension Plan is closed to new members and to current members' future service.

The other UK defined benefit pension plan of significant size in the Group, namely the McKechnie UK Pension Plan, was in deficit of £8.2 million at 31 December 2012 (31 December 2011: surplus of £3.0 million). This plan had assets at 31 December 2012 of £170.8 million (31 December 2011: £157.5 million) and liabilities of £179.0 million (31 December 2011: £154.5 million).

The McKechnie UK Pension Plan is closed both to new members and current members' future service.

The long term strategy for the UK plans is to concentrate on the cash flows required to fund the liabilities as they fall due whether that is within the timescales of Melrose ownership or beyond. The Melrose Board recognise that as businesses are bought and sold eventually pension plan liabilities need to exit the Group. However, this can be done at a time which is commercially sensible.

The pension plan cash flows extend many years into the future and the ultimate objective is that the total pool of assets derived from future company contributions and the investment strategy allows each cash payment to members to be made when due. The Melrose Group made annual contributions of £18.5 million in 2012 (2011: £18.5 million) to the FKI UK Pension Plan and £4.6 million (2011: £4.6 million) to the McKechnie UK Pension Plan. In addition, in 2012, a one-off contribution of £6.0 million was made to the McKechnie UK Pension Plan following the disposal of the MPC business.

In addition, a US defined benefit plan for FKI exists. At 31 December 2012, this had assets of £198.3 million (31 December 2011: £195.2 million), liabilities of £228.4 million (31 December 2011: £228.7 million) and consequently a deficit of £30.1 million (31 December 2011: £33.5 million). This plan is closed to new members and to current members' future service.

The net deficit on the Elster acquired plans at 31 December 2012 was £115.2 million. Included in this amount is £89.6 million, 78%, relating to unfunded German defined benefit plans and early retirement programmes. The remaining plans in the Elster division are smaller in size with £19.2 million of the deficit, 17%, relating to US defined benefit and retirement healthcare and life insurance benefits.

## RISK MANAGEMENT

The financial risks the Group faces have been considered and re-evaluated following the acquisition of Elster and policies have been implemented to best deal with each risk. The most significant financial risks are considered to be liquidity risk, finance cost risk, exchange rate risk, contract and warranty risk and commodity cost risk. These are discussed in turn below.

### Liquidity risk management

The Group's net debt position at 31 December 2012 was £997.7 million compared to £289.6 million a year earlier. The increase in debt resulted from the acquisition of Elster where £390.6 million has been used, in addition to the net Rights Issue proceeds, to purchase the shares of Elster and pay acquisition costs and refinancing fees. Net debt of £306.3 million was also acquired with Elster. Subsequent to the acquisition Melrose refinanced all of the significant Elster debt facilities which consisted of a seven year 6.25% Eurobond with a principal value of €250 million which was due to mature in April 2018, in addition to a committed €450 million multi-currency revolving credit facility and a €140 million committed multi-currency guarantee facility both of which were due to mature in April 2016. On 28 November 2012 the Elster Eurobond was repaid together with the applicable redemption premium and accrued interest, resulting in a repayment including principal of €283.3 million.

The new £0.5 billion term loan is subject to mandatory repayments of 5 per cent on 30 June 2015, 30 June 2016 and 31 December 2016.

As with previous facilities the new facility has two financial covenants, a net debt to headline EBITDA (headline operating profit before depreciation and amortisation) covenant and an interest cover covenant, both of which are tested half yearly, each June and December.

The first covenant, which calculates net debt at average exchange rates during the period, is set at 3.5x at December 2012 and reduces to 3.25x at 31 December 2013 before further reducing to 3.0x at 30 June 2015. For the year ended 31 December 2012 it was approximately 2.6x (31 December 2011: 1.4x), after adjusting the first thirty three weeks of Elster EBITDA from US GAAP to IFRS and reflecting fair value adjustments, showing significant headroom compared to the covenant test. The EBITDA used in this calculation includes Elster central costs at a level prior to the actions taken following the acquisition.

The interest cover covenant remains at 4.0x throughout the life of the facility. At 31 December 2012 it was 9.1x (31 December 2011: 11.7x) which also affords comfortable headroom compared to the covenant test.

The initial drawdown of the new facility has been made in the core currencies of the Group, being US Dollars, Euro and Sterling and in proportions to protect the Group as efficiently as possible from currency fluctuations on net assets and profit.

In addition, there are a number of uncommitted overdraft, guarantee and borrowing facilities made available to the Group. These uncommitted facilities are lightly used.

Cash, deposits and marketable securities amounted to £156.5 million at 31 December 2012 (31 December 2011: £195.6 million) and are offset against gross debt of £1,154.2 million (31 December 2011: £485.2 million) to arrive at the net debt position of £997.7 million (31 December 2011: £289.6 million). The combination of this cash and the size of the new facilities allows the Directors to consider that the Group has sufficient access to liquidity for its current needs.

The Board takes careful consideration of counterparty risk with banks when deciding where to place Melrose's cash on deposit.

In accordance with the reporting requirements on going concern issued by the Financial Reporting Council the Directors acknowledge that by its very nature the economic environment causes uncertainty as to the trading outcome for 2013 and beyond. The Group has committed borrowing facilities until June 2017. In addition, the breadth of the end markets that the Melrose Group companies trade in, both by sector and geographically, gives some balance to various market and economic cycle risks. Furthermore, the Group has a consistent cash generation record, and as a consequence the Directors believe that the Group can manage its business risks successfully and accordingly the Group financial statements have been prepared on a going concern basis.

### Finance cost risk management

The Group remained in a net debt position at 31 December 2012 which significantly increased following the acquisition of Elster. The new Melrose facility carries a cost of LIBOR plus a margin which depends on the leverage which ranges from 1.40% to 2.65% and as at 31 December 2012 the margin was 2.00%.

The Group entered 2012 protecting 78% of its gross debt from exposure to changes in interest rates by holding a number of interest rate swaps to fix £380.1 million (US $546.0 million and €33.3 million) of drawn debt. Under the terms of these swaps, the Group fixed the underlying interest rate at 2.1% for US Dollars and 2.6% for the Euro, plus the bank margin which was 1.35%, through to early 2013.

In February 2012 the Group closed out these swap arrangements and replaced them with new arrangements to fix the interest rate on a proportion of the new facility drawn down on 31 January 2012. The new five year swap arrangements fixed the finance cost on US $231.0 million, £105.0 million and €42.0 million of debt. Under the terms of these swap arrangements, the Group will pay, annually in arrears, 1.0% for US Dollar swaps, 1.1% for Euro swaps and 1.1% for Sterling swaps, plus the bank margin which was 1.5% at that time. These arrangements protected approximately 70% of the Group's exposure to interest rate fluctuations for the term of the new facility.

In September 2012 the Group entered into another layer of interest rate swaps following the acquisition of Elster. The new five year swap arrangements fix the finance cost on US $329.0 million, £231.8 million and €250.0 million of drawn borrowings. Under the terms of these swap arrangements, the Group will pay, annually in arrears, 0.69% for US Dollar swaps, 0.72% for Euro swaps and 0.80% for Sterling swaps, plus the bank margin which is currently 2.00%. These swaps have also been structured to maintain the ratio of fixed interest rate cover over the five year term allowing for Group profit generation.

This fixes the interest rate cost on US $560.0 million, £336.8 million and €292.0 million of debt, 79% of gross borrowings at 31 December 2012. The weighted blended fixed finance cost are therefore 0.84% on US Dollar swaps, 0.78% on Euro swaps and 0.91% on Sterling swaps, plus the bank margin of 2.00%.

### Exchange rate risk management

The enlarged Group trades in various countries around the world and is exposed to many different foreign currencies. The Group therefore carries an exchange rate risk that can be categorised into three types as described below. The Board policy is designed to protect against the majority of the cash risks but not the non-cash risks. The most common cash risk is the transaction risk the Group takes when it invoices a sale in a different currency to the one in which its cost of sale is incurred. This is addressed by taking out forward cover against approximately 60% to 80% of the anticipated cash flows over the following twelve months, placed on a rolling quarterly basis or for 100% of each material contract. This does not eliminate the cash risk but does bring some certainty to it.

### Exchange rates used in the period

| US Dollar | Twelve month average rate | Nineteen week average rate (Elster businesses) | Closing rate |
|---|---|---|---|
| **2012** | **1.59** | **1.61** | **1.62** |
| 2011 | 1.60 | N/A | 1.55 |
| **Euro** | | | |
| **2012** | **1.23** | **1.24** | **1.23** |
| 2011 | 1.15 | N/A | 1.20 |

The effect on the key headline numbers in 2012 for the continuing Group due to the translation movement of exchange rates from 2011 to 2012 is shown below. The table illustrates the translation movement in revenue and headline operating profit if the 2011 average exchange rates had been used to calculate the 2012 results rather than the 2012 average exchange rate.

# Finance Director's review continued

| The translation difference in 2012 | £m |
|---|---|
| Revenue increase | 28.6 |
| Headline operating profit increase | 7.4 |

For reference in respect of the enlarged Group, an indication of the short term exchange rate risk, which shows both translation exchange risk and unhedged transaction exchange rate risk, is as follows:

| Sensitivity of profit to translation and unhedged transaction exchange risk | Increase in headline operating profit £m |
|---|---|
| For every 10 cent strengthening of the US Dollar against Sterling | 7.5 |
| For every 10 cent strengthening of the Euro against Sterling | 12.3 |

The long term exchange rate risk, which ignores any hedging instruments, is as follows:

| Sensitivity of profit to translation and full transaction exchange rate risk | Increase in headline operating profit £m |
|---|---|
| For every 10 cent strengthening of the US Dollar against Sterling | 10.5 |
| For every 10 cent strengthening of the Euro against Sterling | 10.9 |

No specific exchange instruments are used to protect against this translation risk because it is a non-cash risk to the Group. However, when the Group has net debt, the hedge of having a multi-currency debt facility funding these foreign currency trading units protects against some of the Balance Sheet and banking covenant translation risk.

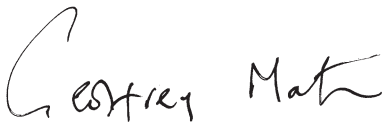
Lastly and potentially the most significant exchange risk that the Group has arises when a business that is predominantly based in a foreign currency is sold. The proceeds for those businesses may be received in a foreign currency and therefore an exchange risk might arise if foreign currency proceeds are converted back to Sterling, for instance to pay a dividend to shareholders. Protection against this risk is considered on a case-by-case basis.

### Contract and warranty risk

There are a number of contracts within the Melrose Group and these have increased significantly following the acquisition of Elster. The financial risks connected with these contracts, which include the consideration of warranty terms, duration and any other commercial or legal terms are considered carefully by Melrose before being entered into.

### Commodity cost risk management

As Melrose owns engineering businesses across various sectors the cumulative expenditure on commodities is important. The Group addresses the risk of base commodity costs increasing by, wherever possible, passing on the cost increases to customers or by having suitable purchase agreements with its suppliers which sometimes fix the price over some months into the future. On occasions, Melrose does enter into financial instruments on commodities when this is considered to be the most efficient way of protecting against movements. The acquisition of Elster increased the Group's exposure to fluctuations in market prices of commodities, especially brass, steel and aluminium. These risks are minimised through sourcing policies (including the use of multiple sources, where possible) and procurement contracts where prices are agreed for up to one year to limit exposure to price volatility.



**Geoffrey Martin**
Group Finance Director
6 March 2013

# Risks and uncertainties

Melrose operates in a wide variety of sectors and countries and is exposed to a range of risks and uncertainties from a strategic, operational, compliance, ethical and financial perspective. Detailed below are risks and uncertainties that could impact on the Company's performance. A risk management and internal controls framework is in place within the Group to ensure that such risks and uncertainties can be identified and where possible managed suitably.

| Strategic Risk | Nature of Risk | Mitigating Factors |
|---|---|---|
| Acquisition of new businesses and improvement strategies | • Discovery of unforeseen liabilities following acquisition.<br>• Value generation post acquisition does not meet expectations.<br>• Need for a greater amount of capital expenditure and working capital to grow the acquired business than originally forecast.<br>• Ability to integrate newly acquired businesses into an enlarged Group. | • Structured and focused due diligence undertaken.<br>• Focus on acquisition targets that have strong headline fundamentals - high quality products, leading market share but are underperforming their potential and ability to generate sustainable cash flows and profit growth.<br>• Hands-on role taken by Directors and other senior employees of the Group. Development of strategic plans, restructuring opportunities, capital expenditure and working capital management. |
| Disposals | • Timing of disposal of companies.<br>• Long term liabilities retained by the Group post disposal. | • Directors are experienced in judging and regularly reviewing the appropriate time in a business cycle for disposal to realise maximum value for shareholders.<br>• Each disposal is assessed on its merits, along with the extent to which indemnities, warranties and guarantees are provided. |
| **Operational Risk** | **Nature of Risk** | **Mitigating Factors** |
| Economic and political risk | • Difficult macro-economic conditions, changing pattern of global demand and political uncertainty. | • Diverse range of companies operating within the Group, within a variety of different industries and countries, which reduces macro-economic and political risks.<br>• Regular monitoring of order books and other leading indicators, to ensure the Group and each of its businesses can respond quickly to any adverse trading conditions. This includes the identification of cost reduction and efficiency measures. |
| Customers | • Concentration of customers in certain markets and/or countries around the world.<br>• Financial viability of key customers.<br>• Major customers may not buy into product concepts that are at the forefront of technology, or delay placing orders for such products.<br>• Pricing pressures from major customers and industry sectors.<br>• Operational problems at key customers leading to delays in future orders being placed and existing orders being received. | • Diverse portfolio of businesses serving different customers and markets. No reliance on any one customer, or group of customers. At a business unit level, performance could be materially affected by the loss of a key customer and regular monitoring is undertaken to reduce such risks.<br>• Active credit management and development of customer relations at a business level.<br>• Monitoring of key markets for early warning of negative commercial trends. |

# Risks and uncertainties continued

| Operational Risk | Nature of Risk | Mitigating Factors |
|---|---|---|
| Suppliers | • Over reliance on a small number of suppliers, leading to a lack of availability.<br>• Production volatility and supply chain disruption.<br>• Fluctuations in cost of raw materials. | • Diverse portfolio of suppliers. The Company is not reliant on any one supplier, or group of suppliers.<br>• Ongoing assessment of suppliers, including the monitoring of their financial viability.<br>• If commercially suitable, contract prices are agreed with raw material suppliers to reduce the effect of short term price fluctuations. Risks are further reduced by the use of escalation clauses, surcharges and price increases when negotiating contracts, together with the use of matching hedging arrangements. |
| Product quality | • Reputational risks from product quality issues.<br>• Product liabilities regarding defective products. | • Investment made available to allow for product improvements and efficient production processes.<br>• Well defined testing procedures together with suitable research and development facilities at key manufacturing locations.<br>• Maintenance of insurance policies to cover product related liabilities. |
| Production delays | • Delays in the manufacture of products due to equipment failure, fire, natural disaster, war or civil unrest and cyber attacks. | • Maintenance of insurance policies to cover certain losses and ensure recovery of production.<br>• Diverse range of companies operating in the Group, within a variety of different industries and countries. |
| Competitive markets | • Increased level of competition leading to loss of market share and/or reducing operational margins. | • Substantial investment in research and development. Funds made available for both the development of new products and to meet changing customer demands.<br>• Ongoing monitoring of competing markets and products to ensure that potential threats are identified quickly.<br>• Development of close customer relationships, understanding of customer needs and rigorous focus on costs. |
| Information technology | • Failure of IT systems leading to severe operational issues. | • Different IT systems used in each business. Regular review of IT policies and procedures within each business, to include disaster recovery planning. |
| Loss of key management | • Over reliance on small number of Directors and other senior managers, within both the Group and individual businesses.<br>• Competition to recruit and retain highly qualified management and technical personnel. | • Succession planning within the Group is co-ordinated via the Nominations Committee in conjunction with the Board and includes all Directors and senior employees.<br>• The Company recognises that, as with most businesses, particularly those operating within a technical field, it is dependent on Directors and employees with particular managerial, engineering, or technical skills. Appropriate remuneration packages and long term incentive arrangements are offered in an effort to retain such individuals. |

| Compliance and Ethical Risk | Nature of Risk | Mitigating Factors |
|---|---|---|
| Legal, regulatory and intellectual property ("IP") | • Ongoing changes to legal and/or regulatory requirements that may substantially differ from country to country.<br>• Litigation from third parties.<br>• Infringement or other inappropriate use of the Group's IP rights by a third party, leading to reputational issues and potential loss of sales.<br>• Infringement of anti-corruption and economic sanctions. | • Regular monitoring of legal and regulatory matters at both a Group and business unit level. Consultation with external advisers where necessary.<br>• Development of suitable corporate governance and compliance procedures both at a Group and business unit level.<br>• Protection of rights over trademarks, copyright, patents, designs and trade secrets, where necessary. |
| Business conduct | • Reputational risk caused by ethical breach. | • Group-wide policies are in place to ensure ethical standards are adhered to within the businesses, which include anti-bribery and whistleblowing procedures. |
| Health, safety and environmental | • Potential risk of injury or damage to employees or third parties if policies and procedures are not adhered to.<br>• Breach of legal and/or regulatory requirements. | • Strong approach to managing health and safety. Employee suggestions actively encouraged.<br>• Group-wide health and safety KPIs within the Lifting, Energy and Other Industrial divisions, designed to overlay the well established business specific KPIs. The Elster businesses will start to report under these Group health and safety KPIs during 2013. Review of health, safety and environmental matters at both Group Board meetings and business level meetings, together with the completion of risk control surveys. |
| **Financial Risk** | **Nature of Risk** | **Mitigating Factors** |
| Liquidity | • Inability of the Group to meet its financial obligations. | • Ensure the Company has adequate resources to meet its liabilities by reviewing its rolling forecasts, ensuring there is sufficient headroom within committed bank facilities to cope with market volatility. |
| Finance cost | • Material fluctuations of interest rates. | • The Company enters into a suitable amount of interest rate protection to limit this exposure. |
| Exchange rate | • Exposure to fluctuations in foreign currency values.<br>• Transaction risk when a business is acquired/ disposed and amounts paid/received in a foreign currency. | • The Company policy is to protect against the majority of foreign exchange risk which affects cash.<br>• Protection against specific transaction risks are taken by the Board on a case-by-case basis. |
| Pensions | • Pension deficit levels are affected by changes in asset values, discount rates, inflation and mortality assumptions.<br>• Higher deficit levels may increase requirement on the Group to fund the deficit. | • Each of the Group's key funded pension plans are now closed to new entrants and future service accrual. Long term funding arrangements are agreed with each of these plans and reviewed following completion of actuarial valuations. Other pension plans exist within the Group but these are largely unfunded schemes whereby funding plans are not required and benefit obligations are paid when due.<br>• Active management of pension plan assets. Further information regarding the key pension plans can be found on pages 50 and 51 of the Directors' report. |

Further details in relation to the financial risks are shown within the Finance Director's review on pages 34 to 36.

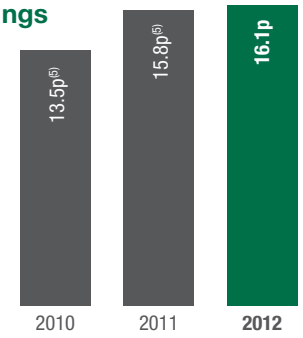
# Key performance indicators

## Financial KPIs

In order to support the Group's strategy and to monitor performance the Board use a number of financial and non-financial key performance indicators ("KPIs"). Details of a selection of the KPIs are shown below. Additional business level KPIs are also used, which are relevant to their particular circumstances.

### Headline[1] diluted earnings per share (pence)

**16.1p**




**Method of calculation**

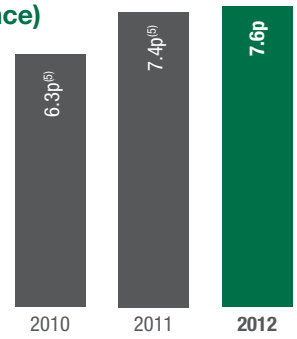
Group headline[1] profit after tax (excluding the profit on disposal of businesses) from continuing and discontinued operations (as reported in this 2012 Annual Report), excluding the results of MPC, divided by the diluted weighted average number of Ordinary Shares in issue.

**Strategic objective**

To create consistent and long term value for shareholders.

### Dividend per share (pence)

**7.6p**




**Method of calculation**

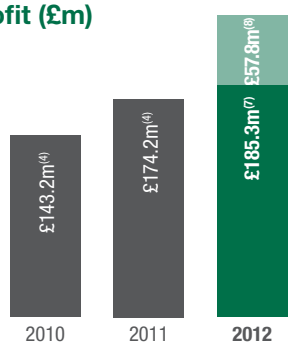
Amount declared as payable by way of dividends in terms of pence per share.

**Strategic objective**

To operate a progressive dividend policy whenever the financial position of the Company, in the opinion of the Board, justifies the payment.

### Headline[1] operating profit (£m)

**£243.1m**




**Method of calculation**

Headline[1] operating profit for the continuing Group.

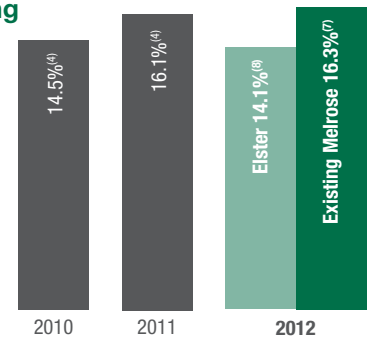
**Strategic objective**

To improve profitability of Group operations.

### Headline[1] operating profit margin (%)

**16.3%**
**(Existing Melrose)**

**14.1%**
**(Elster)**




**Method of calculation**

Headline[1] operating profit as a percentage of revenue, for the continuing Group.

**Strategic objective**

To improve profitability of Group operations.

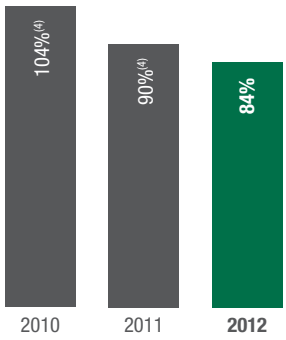
Further information in relation to the key financial performance indicators can be found within the Finance Director's review on pages 27 to 36.

[1] Before exceptional costs, exceptional income and intangible asset amortisation.
[2] Headline[1] operating profit before depreciation and amortisation of computer software and development costs.
[3] Calculated under previous banking covenants as required by banking facilities in place at that time.
[4] Restated to include the results of MPC within discontinued operations.
[5] Restated to include the effects of the 2 for 1 Rights Issue that concluded in August 2012, resulting in the issue of 844,418,024 new Ordinary Shares in the capital of Melrose PLC, raising approximately £1.2 billion in relation to the purchase of Elster.
[6] Based on 1 January 2012 to 31 December 2012 EBITDA[2] for all continuing businesses. Elster pre acquisition EBITDA[2] has been adjusted to estimate the impact of the transition to Melrose accounting policies under IFRS.
[7] Relates to existing Melrose for the year ended 31 December 2012.
[8] Relates to Elster for the four month period from acquisition to 31 December 2012.

## Financial KPIs continued

### Cash conversion (%)

**84%**




**Method of calculation**

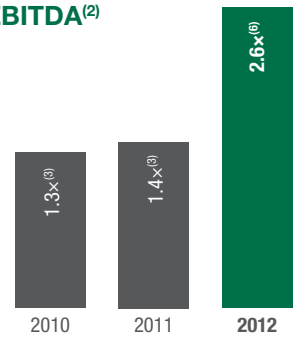
Percentage of headline[1] EBITDA[2] conversion to cash for continuing businesses, pre capital expenditure.

**Strategic objective**

To ensure businesses are suitably cash generative in order to have adequate cash reserves for the effective running of the Company and for significant capital investment where required.

### Net debt to headline[1] EBITDA[2]

**2.6×[6]**




**Method of calculation**

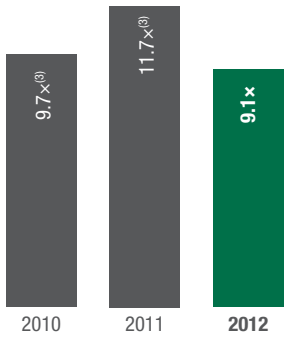
Net debt at average exchange rates divided by headline[1] EBITDA[2] for existing businesses at each year end.

**Strategic objective**

To ensure the Group has suitable amounts of debt and remains within its banking covenants.

### Interest cover

**9.1×**




**Method of calculation**

Calculated as headline[1] EBITDA[2] as a multiple of interest payable on bank loans and overdrafts for the full Group during each year.

**Strategic objective**

To ensure the Group has suitable amounts of debt and remains within its banking covenants.

## Non-financial KPIs

### Health and safety

**Method of calculation**

A variety of different health and safety KPIs are used by each of the businesses within the Group, which are specific to the exact nature of the business and its associated risks. Three overall Group KPIs are also used by the Board in relation to the Lifting, Energy and Other Industrial divisions, which are Major Accident Frequency Rate (accidents that result in an employee having more than three days off work due to a work related injury, per 200,000 working hours), Accident Frequency Rate (accidents that result in an employee having one or more days off work due to a work related injury, per 200,000 working hours to take account of both major and minor accidents) and Accident Severity Rate (average number of lost working days per work related accident).

Within Elster different health and safety KPIs are in use; during 2013 the Elster businesses will start to report under the Group's existing health and safety KPI structure.

**Strategic objective**

The Company has an objective to stop all preventable accidents.

**Performance**

During 2012, two of the KPIs improved when compared against 2011, with the other remaining constant. Further information in relation to the various health and safety initiatives undertaken by the Group's businesses during 2012 can be found within the Directors' report on page 52.

### Environmental and energy usage

**Method of calculation**

Environmental KPIs used within the Group and their method of calculation vary by business unit, which depends on the specific nature of the operation. A range of environmental measures are used, including energy consumption, $CO_2$ emissions, water consumption, water contamination and waste disposal.

**Strategic objective**

Each of the Group's businesses are committed to ensuring that their operations have a minimum adverse effect on the environment and that ongoing reductions are achieved, where practicable. Particular relevance has been placed on the reduction of energy consumption and $CO_2$ emissions.

**Performance**

Investment was provided by the Group for several environmental improvement initiatives during 2012. Details of these can be found in the Directors' report on page 53. In addition to this, the Company is currently in the process of understanding the implications of the Greenhouse Gas Emissions (Directors' Reports) Regulations 2013, which at the time of writing this report have not been finalised. The Company will be working to develop appropriate internal Group systems to ensure that over a period of time Group statistics can be collected and reported on greenhouse gas usage and future target reductions.

**Other non-financial**

Due to the diverse nature of the Group each business uses a range of its own specific non-financial KPIs, which are used to drive business performance and assist in managing risk. This helps to ensure that the KPIs used are relevant to each business and take into account specific operational and reporting requirements. Such KPIs cover operational, quality, commercial and human resource measures. Further information regarding some of the Group's recent initiatives can be found within the Directors' report on pages 49 and 50.

# Board of Directors

**Christopher Miller** Executive Chairman

Age 61, he qualified as a chartered accountant with Coopers & Lybrand, following which he was an Associate Director of Hanson plc. In September 1988 he joined the board of Wassall PLC as its Chief Executive. Between October 2000 and May 2003 he was involved in private investment activities. Mr Miller was appointed as an executive Director of Melrose on 29 May 2003.

**David Roper** Executive Vice-Chairman

Age 62, he qualified as a chartered accountant with Peat Marwick Mitchell, following which he worked in the corporate finance divisions of S.G. Warburg & Co. Limited, BZW and Dillon Read. In September 1988 he was appointed to the board of Wassall PLC and became its Deputy Chief Executive in 1993. Between October 2000 and May 2003 he was involved in private investment activities and served as a non-executive Director on the boards of two companies. Mr Roper was appointed as an executive Director of Melrose on 29 May 2003.

**Simon Peckham** Chief Executive

Age 50, he qualified as a solicitor in 1986. In 1990 he joined Wassall PLC and became an executive Director of Wassall PLC in 1999. From October 2000 until May 2003 he worked for the equity finance division of The Royal Bank of Scotland and was involved in several high profile transactions. Mr Peckham was appointed as an executive Director of Melrose on 29 May 2003.

**Geoffrey Martin** Group Finance Director

Age 45, he qualified as a chartered accountant with Coopers & Lybrand where he worked within the corporate finance and audit departments. In 1996 he joined Royal Doulton PLC and was Group Finance Director from October 2000 until June 2005 which was a period of significant restructuring for the company. Mr Martin joined Melrose on 7 July 2005 when he was appointed to the Board as Group Finance Director.

**Miles Templeman** Senior non-executive Director

Age 65, he has been a director of several consumer goods and retailing companies. He was Managing Director of Threshers Off-Licences between 1985 and 1988 and Managing Director of Whitbread Beer Company between 1990 and 2001. Mr Templeman was Chief Executive Officer of HP Bulmer Holdings PLC from January 2003 to July 2003 and non-executive Chairman of restaurant chain YO! Sushi between 2003 and 2008. He has also held a number of other non-executive directorships and was appointed as a non-executive Director of Melrose on 8 October 2003. Between October 2004 and October 2011 Mr Templeman also occupied the position of Director General of the Institute of Directors. He is currently the non-executive Chairman of Shepherd Neame, Chairman of Aspria and a non-executive Director of the Rugby Football Union.

**Perry Crosthwaite** Non-executive Director

Age 64, he has over 30 years' experience as a Director in the City of London. He was a founding Director of Henderson Crosthwaite Institutional Brokers Limited, serving on the board until its acquisition by Investec Bank in 1998. He became a Director of Investec Bank (UK) Limited and Chairman of the Investment Banking division until his retirement in 2004. Mr Crosthwaite was appointed as a non-executive Director of Melrose on 26 July 2005. He is currently Chairman of Jupiter Green Investment Trust Plc and a non-executive Director of Investec Limited and Investec Plc.

**John Grant** Non-executive Director

Age 67, Mr Grant spent his executive career in a variety of senior international roles within the automotive industry and other engineering businesses. He was Chief Executive of Ascot Plc between 1997 and 2000. Prior to that, Mr Grant was Group Finance Director of Lucas Industries Plc (subsequently LucasVarity Plc) between 1992 and 1996. He previously held several senior strategy and finance positions with Ford Motor Company in Europe and the USA. Mr Grant was appointed as a non-executive Director of Melrose on 1 August 2006. He is currently non-executive Director of MHP S.A., Pace Plc and Wolfson Microelectronics Plc.

**Justin Dowley** Non-executive Director

Age 57, he has extensive experience within the banking, investment and asset management sector and was latterly Vice Chairman of EMEA Investment Banking, a division of Nomura International plc; he was also a founder partner of Tricorn Partners, Head of Investment Banking at Merrill Lynch Europe and a Director of Morgan Grenfell. Mr Dowley was appointed as a non-executive Director of Melrose on 1 September 2011. He is also currently Chairman of Intermediate Capital Group plc, a specialist investment and asset management company and is also a director of a number of private companies including Ascot Authority (Holdings) Limited.

**Audit Committee**
John Grant (Chairman),
Perry Crosthwaite,
Justin Dowley,
Miles Templeman

During 2012 the Audit Committee met three times

**Remuneration Committee**
Perry Crosthwaite (Chairman),
Miles Templeman,
John Grant,
Justin Dowley

During 2012 the Remuneration Committee met four times

**Nomination Committee**
Miles Templeman (Chairman),
Perry Crosthwaite,
John Grant,
Justin Dowley,
Christopher Miller

During 2012 the Nomination Committee met twice

# Directors' report

The Directors of Melrose Industries PLC present their annual report and audited financial statements of the Group for the year ended 31 December 2012.

On 12 October 2012, Melrose PLC announced its intention to implement a corporate reorganisation by way of a Court-approved Scheme of Arrangement, pursuant to which a new listed holding company was to be introduced for the Melrose Group of companies. Following the approval by Melrose PLC's shareholders of the proposed Scheme of Arrangement on 5 November 2012 and, subsequently, the Court's sanction of the proposed Scheme of Arrangement on 26 November 2012, the Scheme of Arrangement became effective on 27 November 2012 and Melrose Industries PLC became the new holding company of Melrose PLC and its subsidiaries.

In this Directors' report (and also the Corporate Governance report and Remuneration report), unless explicitly stated otherwise, references to the "Company" and to "Melrose" are references to Melrose PLC up to but excluding 27 November 2012 and to Melrose Industries PLC from 27 November 2012 onwards. References to the "Board", to the "Directors" and to Board positions are references to the Board, to the Directors and to Board positions of the relevant company for those periods.

## Buy Improve Sell

Melrose has a buy, improve, sell strategy to acquire manufacturing businesses, improve performance and realise their value in the medium term. Shareholders' investment in Melrose, net of dividends and returns of capital since 2003 amounts to approximately £1.1 billion. Our market capitalisation, at the current share price, amounts to £3.3 billion, meaning that over £2 billion of value has been created over this period. Further details of each part of the strategy are shown below. Additional information is also shown on pages 4 and 5.

## Buy

Melrose aims to acquire good manufacturing businesses that, in the opinion of the Directors, are currently underperforming their potential. Businesses are targeted that have strong headline fundamentals, such as high quality products and/or a leading market share, so as to enable Melrose to generate sustainable cash flows, achieve profit growth and create value for shareholders.

The executive Directors have extensive experience of identifying and evaluating such acquisition opportunities, in both quoted and unquoted companies, within the UK and overseas. The Company funds the acquisition of such companies through a mixture of debt and equity, whilst maintaining prudent leverage levels.

In August 2012, the Company acquired Elster Group S.E. ("Elster") for an enterprise value of approximately £1.8 billion; representing the largest acquisition in Melrose's history to date. Elster is a world leader in the provision of gas control equipment and related products, gas, electricity and water meters, networking and software solutions. The purchase of Elster approximately doubled the size of the Melrose Group.

Prior to this, the most significant acquisition was that of FKI plc, in July 2008, for an enterprise value of approximately £1 billion.

## Improve

The Company is not a passive investor in the businesses that it acquires. The Directors and senior management team have a hands-on relationship with each acquired business, by working closely with their divisional senior management teams in developing the long term strategic plans of the businesses, as well as having regular input on restructuring decisions, capital expenditure and working capital management. A natural part of this process involves the disposal of non-core businesses.

The Company is fully committed to investing within the businesses it acquires in order to fully exploit their operational and strategic strengths and in 2012 capital expenditure increased to over twice depreciation in the Lifting, Energy and Other Industrial divisions.

Even though the acquisition of Elster was only completed in late August 2012, the Directors and senior management are very pleased with the progress that has been made to date. Many projects have either been completed, or are currently under way, including realigning the divisions into three global businesses of Gas, Electricity and Water and the acceleration and broadening of the existing restructuring plan. This represents the first steps in the improvement programmes for the Elster businesses. Further details can be found in the Chief Executive's review on pages 14 and 15.

The Company has a proven track record in enhancing value within the businesses it purchases, a few examples of which are shown below:

- **Dynacast**
  Melrose acquired Dynacast in May 2005 and sold this business in July 2011. During the six years of ownership, and as a result of a variety of improvement initiatives and investments made by Melrose, the equity value increased fourfold. Melrose successfully steered Dynacast through the global slowdown and cost savings made during the downturn were retained as sales recovered.

- **McKechnie Aerospace**
  Melrose acquired the McKechnie group in May 2005. Part of this purchase included the McKechnie Aerospace and aftermarkets business, which were ultimately sold in May 2007 for £428 million. During the two year period of ownership within the Group revenues grew by 35 per cent, EBITDA grew by approximately 75 per cent, with margins increasing by 6 percentage points.

- **Existing businesses**
  With regard to the current Melrose businesses that were purchased as part of the FKI transaction in July 2008, headline operating profit margins have improved from 10 per cent at acquisition, to over 16 per cent currently, with further improvements anticipated.

Further details showing the types of investment that were carried out within some of the Group's businesses during 2012 can be seen in the "Divisional reviews" section across.

## Sell

At the appropriate time, each business will be disposed of, in order to return to shareholders the value that has been created. The Directors are experienced in being able to recognise the appropriate time for disposal.

In June 2012, the McKechnie Plastic Components ("MPC") business was sold for £30.7 million which, coupled with the sale of Dynacast in 2011 and the sale of McKechnie Aerospace in 2007 represents a complete sale of the Dynacast and McKechnie businesses.

These sales have resulted in approximately £800 million in cash being returned to shareholders in comparison to their equity contribution of £244 million to the original purchase price of the businesses in 2005.

### PRINCIPAL ACTIVITIES

The Company reports according to four distinct trading divisions; Energy, Lifting, Other Industrial and Elster. Within each division, the Company's businesses operate autonomously under the supervision of Directors and senior management on a global scale, having manufacturing locations throughout the world, as shown on the world maps on pages 8 to 11. This approach has also been adopted for Elster following its acquisition in August 2012. Further details regarding the principal activities of each of the Company's businesses can be found within the Chief Executive's review on pages 14 and 15 and Divisional reviews on pages 16 to 26.

A summary of the key strengths, products and major customers of each Group business is shown within the 'Group overview' section of this Annual Report on pages 8 to 11.

### DIVISIONAL REVIEWS

The Company remains committed to investing in its various businesses and some recent examples of this can be seen below:

#### Bridon

- A new £20 million state-of-the-art manufacturing facility on the waterfront at Neptune Energy Park, Newcastle upon Tyne, UK, opened in November 2012. As a result of this investment Bridon is now capable of producing some of the world's largest and most complex ropes for loading directly onto vessels.
- Development of a new technology centre at Bridon's Doncaster factory. This is a new production, design, development and testing facility which will help to maintain Bridon's worldwide reputation for product development and quality.

#### Crosby

- The reorganisation of Crosby's manufacturing footprint in order to create centres of excellence in forging and machining products. This will also assist Crosby to grow their business in Europe, the Middle East and Africa.
- Purchase and installation of a 35,000 lb hammer which will allow Crosby to forge shackles of up to 400 tonnes, some of the largest in the world. This new machinery will go through an in-depth testing process prior to being used in production, which is estimated to be sometime during 2014.
- Completion of a modernised galvanising facility during 2012, designed to increase capacity and reduce costs.

#### Brush

- The restructuring of the generator manufacturing plant in the Netherlands.
- Further enhancements to various facilities designed to improve factory performance and productivity.
- The first full year impact of Hawker Siddeley Switchgear's ("HSS") absorption into the Turbogenerators business was realised during 2012.

#### Marelli

- Significant capital investment has been made in Marelli's Italian production facility; this includes a new milling and balancing machine and an extension and upgrade to the world class testing facility, in each case to enable it to cater for the increase in size and volume of the larger motors and generators.
- The shift of two further medium generator production lines from its Italian facility to its Malaysian production facility in order to access cost benefits and improve both flexibility and their manufacturing footprint.

#### Elster

- Each of the Elster businesses are cooperating on a joint software development initiative to address new opportunities in the data analytics markets.
- Now that we have realigned the division into three global businesses, a number of initiatives have been implemented, including:
  - Gas
    Closure and outsourcing of the die casting facility in Nebraska, US and the restructure of the Perfection business in Ohio, US and the Hauck business in Pennsylvania, US.
  - Electricity
    The relocation of the manufacturing assembly in Raleigh, US to San Luis Potosi in Mexico and the reorganisation of the Brazilian and Argentinian operations.
  - Water
    Closure of the facilities in Italy, Poland, Lampertheim in Germany and Ocala in the US.

The Company actively encourages focused ongoing research and development within each of its businesses. During 2012, investment continued in the development of new and innovative product lines in the majority of the Group's businesses, with several product launches in the pipeline. This strategy helps to ensure that each business can remain at the forefront of technological advances within defined market sectors and be able to meet specific customer demands. Some examples of the types of new products being launched within the various markets are discussed within the Divisional reviews on pages 16 to 26. During 2012, development costs totaling £1.2 million (2011: £nil) were capitalised in line with Group accounting policies.

# Directors' report continued

## FINANCIAL RESULTS

The Group's profit for the financial year attributable to Ordinary shareholders was £42.5 million (2011: £286.4 million including profit from discontinued operations of £171.7 million). In addition, there were gains attributable to non-controlling interests of £1.7 million (2011: £0.1 million).

The results of the Group are set out in detail in the financial statements on pages 71 to 75 and in the accompanying notes.

The Company is required by the Companies Act 2006 to set out in this report a fair review of the development and performance of the Group during the year, the position of the Group at the end of the year and a description of the principal risks and uncertainties facing the Group. The information that fulfils these requirements can be found within the Chief Executive's review, Divisional reviews, Finance Director's review and in this Directors' report.

Details of the main key performance and risk indicators used by the Group can be seen on pages 37 to 41.

The subsidiary undertakings principally affecting the profits or net assets of the Group in the year are listed in note 3 to the Melrose Industries PLC UK Company accounts, on page 122.

## SHAREHOLDER DIVIDEND

The Directors are pleased to recommend the payment of a final dividend of 5.0p (2011: 4.8p (adjusted to include the effects of the Rights Issue)) on 13 May 2013 to Ordinary shareholders on the register at the close of business on 19 April 2013. This dividend recommendation will be put to shareholders at the forthcoming Annual General Meeting ("AGM") of the Company, to be held on 8 May 2013. Subject to shareholder approval being obtained at the AGM for the final dividend, this will mean a full year 2012 dividend of 7.6p per share (2011: 7.4p (adjusted to include the effects of the Rights Issue)).

It is the intention of the Board to continue to pursue a progressive dividend policy, where appropriate. The Company offers a Dividend Reinvestment Plan which gives shareholders the opportunity to use their dividend payments to purchase further Melrose Industries PLC shares. Further details about the Dividend Reinvestment Plan and its terms and conditions can be found within the Investors section on the Company's website at www.melroseplc.net.

## DIRECTORS' APPOINTMENT AND POWERS

The Directors of the Company as at the date of this report, together with their biographical details, are given on pages 42 and 43. Further details regarding the executive Directors' service agreements and the non-executive Directors' letters of appointment can be found on page 64 of the Remuneration report.

The Company's Articles of Association ("Articles") give the Directors power to appoint and replace Directors. Under the terms of reference of the Nomination Committee, any appointment must be recommended by the Nomination Committee for approval by the Board. The Articles also require Directors to retire and resubmit themselves for election at the first AGM following their appointment. With effect from the 2012 AGM, the Board determined that all Directors of the Company should stand for re-election on an annual basis, in compliance with the provisions of the UK Corporate Governance Code and this requirement is now contained in the Articles.

The Directors are responsible for managing the business of the Company and exercise their powers in accordance with the Articles, directions given by special resolution and any relevant statutes. Specific powers relating to the issuing of shares and the ability of the Company to purchase its own shares are also included within the Articles and such authorities are submitted for approval by the shareholders at the AGM each year. The resolutions being proposed at the AGM on 8 May 2013 include resolutions to renew these authorities.

## DIRECTORS' INTERESTS AND REMUNERATION

Information on Directors' beneficial interests, including those of connected persons (within the meaning of section 252 of the Companies Act 2006), in the shares of Melrose is shown in the Remuneration report on page 65.

No Director had a material interest at any time during the year in any contract with the Company or any of its subsidiary undertakings, other than a service contract.

## DIRECTORS' INDEMNITIES

The Directors have the benefit of an indemnity from the Company in respect of liabilities incurred as a result of their office. This indemnity is provided under the Articles and satisfies the indemnity provisions of the Companies Act 2006.

The Group has taken out an insurance policy in respect of those liabilities for which the Directors may not be indemnified. Neither the indemnity nor the insurance provides cover in the event that a Director is proved to have acted dishonestly or fraudulently.

## DIRECTORS' RESPONSIBILITIES

The Statement of Directors' responsibilities in relation to the consolidated financial statements is set out on page 68.

## SHARE CAPITAL

During the financial year ended 31 December 2012, the following corporate actions took place which impacted on the number of Ordinary Shares in issue:

- The creation of new Ordinary Shares in the capital of Melrose PLC, following crystallisation of the 2009 Incentive Share Plan, in April 2012;
- A 2 for 1 Rights Issue that concluded in August 2012, raising approximately £1.2 billion to fund the purchase of Elster; and
- As part of the Scheme of Arrangement, which became effective on 27 November 2012, the Ordinary Shares in the capital of Melrose PLC were cancelled and shareholders were issued with the same number of new Ordinary Shares in Melrose Industries PLC, with a nominal value of 120 pence per share, so that Melrose PLC became a direct subsidiary of Melrose Industries PLC. On 29 November 2012 the nominal value of each new Ordinary Share in Melrose Industries PLC was reduced to 0.1 pence in order to create approximately £1.5 billion of distributable reserves.

Further details showing the movements in issued Ordinary Shares of Melrose Industries PLC and Melrose PLC can be seen in the table below:

| | Number of Ordinary Shares of Melrose PLC in issue as at 31 December 2011 | Ordinary Shares created as part of 2009 Incentive Share Plan crystallisation | New Ordinary Shares issued as part of 2 for 1 Rights Issue for acquisition of Elster | Scheme of Arrangement (1 Ordinary Share in Melrose Industries PLC issued for every 1 Ordinary Share in Melrose PLC and reduction in share capital) | Number of Ordinary Shares of Melrose Industries PLC in issue as at 31 December 2012 |
|---|---|---|---|---|---|
| Ordinary Shares in Melrose PLC, with a nominal value of 14/55 pence | 390,961,043 | 31,247,969 | 844,418,024 | | |
| Ordinary Shares in Melrose Industries PLC, with a nominal value of 0.1 pence | | | | 1,266,627,036 | 1,266,627,036 |

## INCENTIVE SHARES

Further details in relation to both the crystallisation of the 2009 Incentive Share Plan and the creation of options over 2012 Incentive Shares are set out on pages 63 to 65 and 67 of the Remuneration report. In summary, the 2009 Incentive Share Plan was crystallised in April 2012 and the 2009 Incentive Shares were converted into Ordinary Shares following shareholder approval at a General Meeting held on 11 April 2012. At the same time, the 2012 Incentive Share Plan was established and options were granted over 2012 Incentive Shares.

## FURTHER RIGHTS AND OBLIGATIONS ATTACHING TO SHARES

The following summary is based on the Articles of Melrose Industries PLC, which were adopted on 11 October 2012 and based on the Articles of Association of Melrose PLC at that date, with the amendments described in the Prospectus dated 12 October 2012 published in relation to the listing of Melrose Industries PLC's Ordinary Shares.

## VOTING

Only Ordinary Shares of 0.1 pence have voting rights attached. In a general meeting of the Company, subject to the provisions of the current Articles and to any special rights or restrictions as to voting attached to any other class of shares in the Company (of which there are currently none):

- on a show of hands, every member who is present (in person or by proxy) shall have one vote; and
- on a poll, every member who is present (in person or by proxy) shall have one vote for every share of which he is the holder.

If any call or other sum payable by a holder of Ordinary Shares remains unpaid, they shall not be entitled to vote at any general meeting or class meeting in respect of any shares held by them. Currently, all issued Ordinary Shares are fully paid.

## DEADLINES FOR VOTING RIGHTS

Full details of the deadlines for exercising voting rights in respect of the resolutions to be considered at the AGM to be held on 8 May 2013 are set out in the Notice of AGM, on pages 125 to 127.

## DIVIDENDS AND DISTRIBUTIONS

Subject to the provisions of the Companies Act 2006, the Company may, by ordinary resolution, declare a dividend to be paid to the holders of Ordinary Shares, but no dividend shall exceed the amount recommended by the Board. The Board may pay interim dividends and also any fixed rate dividend, whenever the financial position of the Company, in the opinion of the Board, justifies its payment. All dividends shall be apportioned and paid pro rata according to the amounts paid up on the shares.

The Board may deduct from a dividend, or other amounts payable to a person in respect of their shares, amounts due from him to the Company on account of a call or otherwise in relation to such shares.

## LIQUIDATION

Under the current Articles, if the Company is in liquidation, the liquidator may, on obtaining any sanction required by law:

- divide amongst the shareholders in kind the whole or any part of the assets of the Company; or
- vest the whole or any part of the assets in trust for the benefit of shareholders as the liquidator shall determine.

## TRANSFER OF SHARES

Subject to the Articles, any member may transfer all or any of his shares in any form which the Board may approve, and the transfer shall be executed by or on behalf of the transferor. Subject to the Articles and the requirements of any relevant investment exchange, the Board may, in its absolute discretion, refuse to register a transfer of a share which is not a fully paid share or on which the Company has a lien. The Board may also decline to register a transfer unless the transfer is: (i) in respect of only one class of shares; (ii) in favour of not more than four joint transferees or renouncees; (iii) duly stamped (if required); and (iv) delivered for registration to the registered office, or such other place as the Board may decide, accompanied by the certificate for the shares to which it relates and such other evidence as the Board may reasonably require to prove the title of the transferor.

# Directors' report continued

## SUBSTANTIAL SHAREHOLDINGS

As at 6 March 2013, the Company has been advised of the following substantial interests in the Ordinary Share capital of Melrose Industries PLC:

| Shareholder | Holding | % |
|---|---|---|
| BlackRock Inc. | 213,641,488 | 16.86 |
| Threadneedle Asset Management Ltd | 88,024,456 | 6.94 |
| Legal & General Investment Management Ltd | 72,291,307 | 5.70 |
| Aviva Investors | 56,815,045 | 4.48 |
| Scottish Widows Investment Partnership | 69,654,645 | 5.49 |
| Schroder Investment Management Ltd | 57,203,034 | 4.51 |
| Artemis Investment Management | 51,544,983 | 4.06 |

## CORPORATE GOVERNANCE

The Corporate Governance report is included as a separate report on pages 56 to 61.

## RISKS AND UNCERTAINTIES

The Group operates a variety of risk management processes designed to take into account the identification, management and mitigation of business risk, where both short term and long term considerations are monitored. A review of the effectiveness of the Company's risk management and internal control systems is carried out on a regular basis and at least annually, in accordance with the provisions of the UK Corporate Governance Code. A summary of the material strategic, operational, compliance, ethical and financial risks and uncertainties that could impact on the Group's performance is shown on pages 37 to 39. Internal control and risk management is also discussed further within the Finance Director's review on pages 27 to 36 and the Corporate Governance report on pages 56 to 61. Further accounting judgements and key sources of estimation uncertainty are included in note 3 to the consolidated financial statements. Additionally, key commercial and economic risks are covered in the Chief Executive's review on pages 14 to 26.

## SIGNIFICANT AGREEMENTS AND CHANGE OF CONTROL

With the exception of the Group's banking facilities, the 2012 Incentive Share Plan (including the options over 2012 Incentive Shares) and the divisional management long term incentive plans, there are no other agreements that would have a significant effect upon a change of control of Melrose Industries PLC on 6 March 2013.

As part of the process to acquire Elster, the Group agreed a new £1.5 billion five year multi-currency, committed, bank facility, which has substantially the same change of control provisions as the previous £600 million facility that it replaced. These provisions state that in the event of a change of control of the Company following a takeover bid, the Company and lenders under this facility are obliged to enter into negotiations to determine whether and, if so, how to continue with the facility. There is no obligation for the lenders to continue to make the facility available for more than 30 days beyond any change of control. Failure to reach agreement with parties on revised terms could require an acquirer to put in place replacement facilities.

In the event of a takeover of the Company, options over the 2012 Incentive Shares would be exercised and any 2012 Incentive Shares resulting from such exercise, or that have previously been issued, would convert into Ordinary Shares of 0.1 pence or an entitlement to a dividend paid in cash, the rate of conversion being based upon the offer price of the Company's Ordinary Shares as calculated on the date of the change of control of the Company. If part or the entire offer price is not in cash, the Remuneration Committee will determine the value of the non-cash element, having been advised by an investment bank of repute that such valuation is fair and reasonable.

## PRODUCT AND EMPLOYER'S LIABILITY CLAIMS

The Group seeks to assess its ongoing risks in relation to potential future liabilities arising from insurance claims by using external actuarial projections to measure material exposures. Historic claims experience data is used to analyse risks in relation to less significant exposures. Actuarial projections and claims history experience are regularly analysed by management and key issues, trends and statistics are also discussed at Board level.

Risks within the Group relate to potential future liabilities arising from product, industrial disease (including asbestos), employer's liability and workers' compensation claims. Provisions in relation to such risks are recognised in the Group's Balance Sheet, where appropriate. Note 30 to the consolidated financial statements provides further information with regard to contingent product liabilities.

A number of businesses have various ISO certifications, which include ISO 9001 and ISO 16949 for their quality management systems. This helps to ensure their products and processes are of a recognised quality, reducing the risk of product claims. Some businesses within the Group are also certified to international health and safety standards via ISO 18001, which helps to further ensure that risks in relation to employer's liability claims are kept to a minimum.

Within many of the Group's businesses the design and production of their products also conform with international and industry specific accreditations. For example, Crosby and Bridon products are certified to specification standards used within the Petroleum, Petrochemical and Natural Gas industries, which amongst other things involves the audit of processes, procedures and product standards by third parties.

## PAYMENTS TO SUPPLIERS

Historically, the Company has not utilised standard protocols in respect of payments to suppliers, given the international nature of the Group's operations. The Company intends to maintain this approach for the financial year ending 31 December 2013. It is the responsibility of each business to agree the exact terms and conditions of transactions with their suppliers, including as to the settlement of payments, and these arrangements are adhered to, provided that suppliers meet their contractual commitments. The Company, as a holding company, did not have any amounts owing to trade creditors at 31 December 2012.

## INTELLECTUAL PROPERTY

The Company and each of its businesses recognise the value and importance of its intellectual property ("IP") and, where appropriate, will seek to protect and enforce its rights over IP. Due to the varying types of IP rights held or licensed within the Group, each business is responsible for the management and enforcement of these on a decentralised basis through the use of external advisers and the support of the Company.

## EMPLOYMENT POLICIES

The Group recognises its responsibilities for the fair treatment of all its employees in accordance with legislation applicable to the territories within which it operates. Due to the diverse nature of the Group, businesses are required to manage their employment matters on a decentralised basis; therefore, responsibility for the adoption of employment policies and practices sits at a local business unit level. This position ensures that policies and procedures meet both site and local regulatory requirements, taking into account the size and nature of the businesses.

As part of this decentralised approach, each business is responsible for setting and measuring its own KPIs and, as such, these vary throughout the Group. However, such measurements will generally include absenteeism, punctuality, headcount and employee relations issues. Any concerns or adverse trends are responded to in a timely manner. Further, as a Group-wide policy and so far as particular disabilities permit, the Company and each of its businesses will give employees disabled during their period of employment continued employment in the same job or, if this is not practicable, a suitable alternative job.

Equal opportunities for appropriate training, career development and promotion are also available to all employees within the Group regardless of any physical disability, gender, religion, race, nationality, sexual orientation or age.

Applications for employment by disabled persons are always fully and fairly considered by the Group, taking into account job specific requirements and applicant aptitude. It is the policy of the Group that in recruitment, training, career development and promotion, the treatment of disabled persons should, as far as possible, be identical to that of other employees.

The Group regards employee training and advancement as an essential element of industrial relations. Disputes and days lost through strike action are negligible.

## EMPLOYEE INVOLVEMENT, CONSULTATION AND DEVELOPMENT

The Group attaches great importance to good labour relations, employee involvement and employee development. The nature of the Group's activities places the responsibility for employment practices with local management, in a manner appropriate to each business.

A culture of clear communication and employee consultation is inherent in the Group's businesses. Employee briefing sessions are held on a regular basis to communicate strategy, key changes, financial results, achievements and other important issues. Regular appraisals, employee surveys, notice boards, intranet sites, team meetings, suggestion boxes and newsletters are also used to communicate with employees.

Extensive training is available to all staff and is actively encouraged to ensure a high standard of skill is maintained across the Group. Cross-training programmes are also in place at a number of the Group's businesses. The importance of training extends beyond on-the-job training and also focuses on enhancing personal development. Apprenticeship programmes are in place at the majority of sites, which help to assist with succession planning in locations where there is an ageing workforce. Employees are encouraged to think in an innovative manner across the Group.

## HUMAN RESOURCE INITIATIVES

During 2012, many of the Group's businesses implemented a range of employee-related initiatives. Some of these are listed below:

- Within Bridon, several key HR improvement areas had been identified via an employee opinion survey which was carried out in 2011. During 2012, focus was placed on the areas identified within this survey, which had been conducted in partnership with the Corporate Leadership Council. The results varied by country and so during the course of 2012 a variety of different initiatives have been ongoing in the countries where Bridon has operations. For example, within Bridon America focus has been placed on internal communication and improving leadership skills. Within Bridon UK the focus has also been on internal communication initiatives and employee recognition. A second survey has been planned for 2013 in order to check progress and maintain visibility of this initiative within their worldwide operations.

- Employee 'road shows' have also been used within Bridon during 2012 to help set a strong culture of values, which are also used as a foundation during recruitment, performance management and leadership development.

- Bridon continues to place importance on its two year apprenticeship programme, which is designed to develop the rope makers, engineers and designers of the future. The practice of providing educational support enables employees at all levels to acquire enhanced skills, industry knowledge and recognised qualifications, which the business will be able to benefit from in years to come.

# Directors' report continued

Bridon

Erica Gateley, pictured above, works as a Metallurgist at Bridon's facility in Doncaster, UK. She has recently been awarded with the honour of Technician of the Year for 2012 by the Institute of Materials, Minerals and Mining. Bridon is currently sponsoring Erica to study for her engineering degree, which she is due to complete next year.

More information about Bridon is available at www.bridon.com

- During 2012, the Brush Turbogenerators business in the Czech Republic launched the first phase of their advanced employee evaluation programme. This is designed to identify both positive aspects and areas for improvement within the middle management structure of the business. Plans are being finalised to follow this initiative up with a Talent Academy in 2013, which will provide managers with practical knowledge, tailored training programmes and coaching all designed to further enhance performance and drive a culture of continuous improvement.
- Towards the end of 2012, the Brush Turbogenerators business in the UK gained its Engineering Technical Development Scheme accreditation from the Institution of Mechanical Engineers. By recognising the quality of mechanical courses offered by the Brush academy, the newly accredited training scheme will allow both students and apprentices to become registered engineering technicians upon successful completion.
- Marelli introduced several strategic HR initiatives in 2012, designed to improve flexibility within its business and enable quicker responses to market changes. As part of this approach, an organisational development project has been implemented based on a lean approach and this has led to a value stream analysis. A new organisational structure is also being evolved, together with additional staff training and employee competence mapping.
- Within parts of the Elster businesses an initiative has been established to invite both new employees and those who have particular health concerns to attend wellness sessions and health checks.

A significant number of employees are members of unions and some businesses operate works councils, both of which are used for consultation and dissemination of information, as appropriate.

The executive Directors have monthly meetings with divisional senior management and visit the sites on an ad hoc basis to communicate with the wider Group. Financial results of the Company for the half year and full year are discussed with the Group's senior management team; Group developments are communicated to the businesses as appropriate. Employee involvement in and commitment to the Group's profitability is encouraged through appropriate bonus plans.

## PENSIONS

Companies within the Group operate various defined benefit and defined contribution pension plans around the world, which it regularly reviews to reduce volatility where possible. The long term strategy for the UK pension plans is to concentrate on the cash flows required to fund the liabilities as they fall due whether that is within the timescales of Melrose ownership, or beyond. The Board recognise that as businesses are bought and sold eventually pension plan liabilities need to exit the Group. However, this can be done at a time which is commercially sensible. The table below shows the defined benefit plans that are material to the Group.

**Defined benefits pension plans material to the Group:**

| | | As at 31 December 2012 | | |
|---|---|---|---|---|
| **Name of Plan** | **Status** | **Assets £m** | **Liabilities £m** | **Number of members** |
| FKI UK Pension Plan | Closed to new members in October 2001. Closed to future service accrual on 28 February 2011. | **630.2 (2011: 600.3)** | **730.2 (2011: 679.7)** | **10,415 (2011: 10,639)** |
| McKechnie UK Pension Plan | Closed to new members in 2003. Closed to future service accrual in 2005. | **170.8 (2011: 157.5)** | **179.0 (2011: 154.5)** | **3,388[1] (2011: 3,217)** |
| FKI US Pension Plan | Closed to new members in April 2003. Closed to future service accrual in 2009. | **198.3 (2011: 195.2)** | **228.4 (2011: 228.7)** | **8,009 (2011: 8,194)** |

[1] This figure includes 276 members with benefits partially insured with Prudential which have now been identified. This explains why the number of members has increased during the year.

The FKI UK Pension Plan ("FKI UK Plan") is a UK defined benefit pension plan with FKI Limited as its principal employer. The primary liability for funding rests with the participating employers, which currently pay £20.0 million annually into the FKI UK Plan (increased from £18.5 million on 1 December 2012). The contribution levels were last formally assessed as at 31 December 2008. The Company's contribution level at that time (£18.5 million per annum) was expected to remove the funding deficit by 31 December 2022. A formal actuarial valuation of the FKI UK Plan, which will record the funding position as at 31 December 2011, is in its final stages and this has recently led to the increase in annual contributions to £20.0 million. The FKI UK Plan closed to the accrual of future benefits for existing members on 28 February 2011 and this is expected to lead to the funding deficit being removed earlier than would otherwise have been the case.

The McKechnie UK Pension Plan ("McKechnie UK Plan") is a UK defined benefit pension plan. The principal employer was changed from McKechnie Limited to McKechnie Employee Services Limited, following the sale of the MPC business in June 2012. The primary liability for funding now rests with the principal employer. The Company and Trustees reviewed the funding of the McKechnie UK Plan as part of the actuarial valuation as at 31 December 2008 and it was agreed that the participating employers would contribute £4.6 million annually into the McKechnie UK Plan. Melrose PLC guaranteed the funding of the McKechnie UK Plan on an ongoing basis. A formal actuarial valuation of the McKechnie UK Plan is currently in its latter stages of being completed, which will record the funding position as at 31 December 2011.

The FKI US Pension Plan is a defined benefit pension plan covering several of FKI's US businesses. The primary liability for funding the FKI US Pension Plan rests with the participating employers. The Company and Trustees of the plan reviewed the funding requirements of the FKI US Pension Plan, based on its 1 January 2012 actuarial valuation, and no contributions will need to be made during 2013. Unlike the UK pension plans, deferred member liabilities do not increase by inflation each year.

Elster provides retirement benefits for most of its employees, either directly or by contributions to its pension funds managed by third parties. Most Elster plans are unfunded and are not of a significant size or material nature, with the largest being an unfunded German defined benefit plan. Further reference is made to the pension plans acquired with the Elster business on page 33 of the Finance Director's review.

## HEALTH AND SAFETY

The Directors of the Company are committed to minimising the health and safety risks that each of the Group's employees are exposed to by promoting the effective use and management of business specific policies and procedures.

The Group has a policy to ensure that the Directors are made aware of any serious health and safety incidents, wherever they occur in the world, without delay to ensure that suitable investigations and corrective action can be organised. Current events and issues relating to health and safety matters are also discussed within the Group at every quarterly Board meeting of the Company.

Each of the Group's businesses use defined health and safety KPIs, which are specific to the exact nature of their business and allow for focus, analysis and improvement at local business levels, often on a location by location basis. Several of the Group's businesses already hold ISO 18001 certification, the internationally recognised assessment standard for occupational health and safety management systems. This certification includes several of the major manufacturing locations within the Group, with other sites also currently going through the accreditation process.

To supplement the business specific KPIs, Group-wide health and safety KPIs are in use. This allows the Directors to review Group statistics on a regular and consistent basis; it also ensures they have greater visibility of the key Group health and safety trends in order to help them to make decisions on where future focus should be placed.

The Group health and safety KPIs that are actively being used for the businesses of Lifting, Energy and Other Industrial divisions are: Major Accident Frequency Rate (defined as an accident that resulted in an employee having more than three days off work due to a work-related injury, per 200,000 working hours), Accident Frequency Rate (defined as an accident that resulted in an employee having at least one day off work due to a work-related injury, per 200,000 working hours) and Accident Severity Rate (which calculates the average number of lost working days per accident). Such statistics are collected quarterly on a site-by-site basis. Aggregating the three aforementioned divisions, two of these KPIs had improved during 2012, when compared to 2011, with the third KPI remaining constant. Elster uses different health and safety KPIs; during 2013 the Elster businesses will start to report under the Group's existing health and safety KPI structure.

Each business is responsible for setting its own detailed arrangements concerning health and safety policies and procedures, in accordance with local health and safety legislation. As a general rule, businesses strive to achieve best practice, in terms of what is suitable and practical for the size and nature of their operations.

# Directors' report continued

Divisional managers within each business unit have responsibilities to ensure that health and safety remains a key focus and to ensure that active procedures and monitoring systems are in place to provide substance to written policies. Detailed health and safety plans are set by businesses each year to determine annual targets and improvement initiatives.

All businesses have Health and Safety Committees ("H&S Committees"); such committees meet on a regular basis and are made up of representatives from both management and shop floor level personnel. Each of the H&S Committees has wide-ranging responsibilities which vary from business to business and include the review of reported incidents and the monitoring of incident trends. These H&S Committees are also responsible for ensuring that corrective measures are implemented when accidents occur and that all incidents, whether or not they are deemed reportable under local legislation, are given due attention.

One of the key responsibilities for these H&S Committees is to carry out regular tours of the premises in which they work, in order to ensure compliance with local policies and procedures. These tours also identify potential hazards, for which counter-measures can be identified to prevent accidents from happening. Each H&S Committee recommendation is followed up at the next committee meeting to ensure that issues are resolved. Additionally, operations are audited by the H&S Committees at least annually and reports of performance and recommended improvements are prepared and circulated to the divisional senior management teams. Divisional managers are provided with detailed health and safety reports on a frequent basis to ensure that such matters are given high visibility and that improvements are authorised and implemented quickly.

## HEALTH AND SAFETY INITIATIVES

During 2012, many of the Group's businesses implemented a range of initiatives aimed at improving health and safety performance, as part of the Group's goal of achieving zero preventable accidents. Some of these are listed below:

- Within several of the US-based businesses there has been an initiative to prevent back injuries during the course of 2012. This includes the introduction of stretching activities in both the pre-shift period and during breaks, together with the provision of suitable lifting equipment and floor mats in certain production areas designed to ease back strain. Training sessions on correct lifting techniques have also been provided to certain employees.

- At Bridon, health and safety bulletins are now issued for all significant events to prevent reoccurrences in other parts of the business. Monthly global management health and safety reviews also enable Bridon's worldwide facilities to jointly review performance and drive corrective learning. This also allows for best practice ideas to spread and this contributed to a significant reduction in worldwide lost time injuries during 2012.

- Marelli continued with the roll-out of their risk perception training programme in 2012. This has been designed to develop the capabilities of all employees to identify dangers, evaluate risks and encourage safe working processes during all stages of the production process.

- Brush have focused their attention on improving the way in which data is stored around the use of chemicals on-site, via the introduction of ichemistry software. This allows an electronic log to be created for all chemicals on-site. Suitable risk assessments can then be carried out, which are accessible by all shop floor employees to read and print out. The new system also helps to ensure compliance with COSHH legislation, as well as helping to meet ISO 9001, 14001 and 18001 standards.

- During 2013, Brush are making plans to introduce a new behavioral safety programme, designed to focus on promoting a positive health and safety culture and achieve a continued reduction in workplace accidents and occupational health illnesses.

## THE ENVIRONMENT

The Company's main impact on the environment is through its energy use and associated carbon dioxide ($CO_2$) emissions and waste. The Directors fully understand the importance of the Group's environmental responsibilities. Each of the Company's businesses are committed to ensuring that their operations have a minimum adverse effect on the environment and that ongoing reductions in both energy usage and $CO_2$ emissions are achieved, wherever practicable.

Many of the Group's businesses are developing environmental policies and procedures in line with best practice guidelines, via ongoing improvements to local processes to reduce the impact of their activities. A number of the businesses have achieved, or are currently in the process of achieving, the high standards required to obtain ISO 14001 Environmental Management Systems certification.

Although there are no standardised environmental KPIs currently used within the Group, each business understands the importance of monitoring the impact of its operations on the environment. A range of KPIs are used as environmental measures, including energy consumption, $CO_2$ emissions, water consumption, water contamination, waste disposal, solid and liquid waste generation, recycling and volatile organic compound emissions. Environmental performance is measured via the use of KPIs in order that each of the businesses can plan for ongoing reductions.

The Company is currently in the process of evaluating the potential implications of the Greenhouse Gas Emissions (Directors' Reports) Regulations 2013, which at the time of writing this report have not been finalised. The Company will be working to develop appropriate internal Group systems to ensure that over a period of time Group statistics can be collected and reported on greenhouse gas usage and future target reductions.

During the year, the Company continued to comply with the ongoing annual reporting requirements of the UK's Carbon Reduction Commitment Energy Efficiency Scheme. Each of the Group's businesses will also continue to actively look for ways to further reduce energy consumption wherever possible.

## ENVIRONMENTAL INITIATIVES

In terms of environmental initiatives that have either been completed in 2012, or are ongoing for 2013, there are a variety of examples from the Group's businesses and some of these include:

- Various initiatives have taken place at Crosby following a review of all its facilities to identify energy consumption reduction opportunities. These include the installation of a new air handling/compressor system at the Brampton location in Canada, which is substantially more efficient than the previous equipment. At the Tulsa facility in the US, flow and heat measurement systems were installed during the year to reduce the amount of gas required for heating sheaves used within the forging process. Work started in 2012 at the Texas operation to upgrade the gas furnace heating systems to induction heaters, which are estimated to be considerably more efficient and will significantly reduce the local carbon footprint at this site.

- Truth is in the process of introducing a recycled water programme at its US facility whereby water used for cooling within its die-casting process is piped into holding tanks. This recycled water is then used as part of the 'e-coat' painting system and barrel plating process. This is helping to significantly reduce water consumption within this process.

- Marelli has reduced the amount of unrecyclable waste created from its production processes at its Italian facility in Arzignano. This has been achieved via an improved waste separation process. Other improvements at this facility include the upgrade of lighting, which has not only helped to reduce electricity consumption but also improved the overall level of lighting for employees working in these areas.

- Within each of the three Elster businesses a focus has been placed on the development of Smart metering products. This provides both domestic and commercial energy consumers with the tools to understand and reduce their energy usage going forward. Elster has also played a vital role in delivering energy industry improvements by supporting the UK's Department of Energy and Climate Change to develop Smart meter standards. Elster was also a founding member of the Smart Specification Working Group, which involves key industry participants working together to create interchangeable and interoperable Smart meter networks.

- Elster's volumetric polymer water meters have a carbon footprint of approximately one-third of their old brass counter-parts and are purchased by Anglian Water for all of their new build, replacement and refurbishment projects. In March 2012, Elster announced that it had shipped its one millionth polymer bodied water meter for the European utility market to Anglian Water. Working closely with Elster has enabled Anglian Water to lower its carbon footprint throughout the supply chain.

- At the Elster facility in Stafford, UK, (which serves both the Electricity and Gas divisions) they decided to introduce the CEMARS scheme for carbon measuring and reduction towards the end of last year. CEMARS is the world's first internationally accredited greenhouse gas certification scheme to ISO 14065. They are currently working with an external consultant to acquire accreditation, which will include a five year carbon reduction plan.

## ENVIRONMENTAL LIABILITIES

The Directors seek to ensure that all environmental risks are closely managed by external environmental specialists in conjunction with internal management. The environmental laws of certain jurisdictions impose obligations to remediate contaminated sites in relation to sites both currently and previously owned by the Group.

The Company Secretary is made aware of all major environmental liabilities that may occur within any of the Group's businesses. The Board are also regularly updated on such matters. All costs incurred by the Group with regard to environmental liabilities are monitored, with provisions being made as appropriate.

## CORPORATE SOCIAL RESPONSIBILITY

Due to the heavy industrial nature of some of the Group's activities, the Directors recognise that its operations will potentially impact on a wide variety of stakeholders in terms of social, environmental and ethical matters, including employees, customers, suppliers and local communities.

Many of the Group's businesses have social and ethical policies, with responsibility for communication and implementation resting with relevant senior divisional managers. Such policies apply and extend to local laws and standards and as a minimum include equal opportunities and anti-discrimination policies.

The majority of the businesses provided community support during the year with efforts ranging from charitable donations to voluntary assistance and fund raising.

The Company is committed to continuing to invest in its businesses during its ownership, thus enhancing their reputation within the markets and communities in which they operate.

## CHARITABLE AND POLITICAL DONATIONS

The Group paid £59,000 (2011: £50,000) to charities during the year. There were no political donations made during the year (2011: £nil).

# Directors' report continued

## AUDITOR

So far as each Director is aware, there is no relevant audit information of which the auditor is unaware and the Directors have taken all the steps which they ought to have taken as Directors to make themselves aware of any relevant audit information and to establish that the Company's auditor is aware of that information. This confirmation is given and should be interpreted in accordance with the provisions of section 418 of the Companies Act 2006.

Deloitte LLP have expressed their willingness to continue in office as auditor. Accordingly, resolutions will be proposed at the AGM of the Company to reappoint Deloitte LLP as auditor of the Company and to authorise the Directors to determine their remuneration.

## GOING CONCERN

The Group's business activities, together with the factors likely to affect its future development, performance and position are set out in the Divisional reviews on pages 16 to 26. The financial position of the Group, its cash flows, liquidity position, borrowing facilities and various other financial and commercial risks are described in the Finance Director's review on pages 27 to 36. In addition, notes 19 and 24 to the consolidated financial statements include the Group's policies and processes for managing its capital, exposures to liquidity risk and financial risk management objectives, as well as details of its financial instruments and hedging strategies. Credit risk exposure is discussed in notes 16 and 24 to the consolidated financial statements.

The Group prepares regular business forecasts and monitors projected facility headroom and compliance with its banking covenants, which are reviewed by the Board. Forecasts are then adjusted for possible sensitivities which address the principal risks to which the Group is exposed, such as fluctuations in exchange rates and best estimates of the possible impact of the macroeconomic environment on the Group's underlying trading results. Consideration is then given to the potential actions available to management to mitigate the impact of one or more of the sensitivities.

Taking all this into consideration, the Group should be able to operate within the level of its current banking facilities and remain covenant compliant for the foreseeable future, being a period of at least 12 months from the date of approval of these financial statements.

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

## AGM

The AGM of the Company will be held at Barber-Surgeons' Hall, Monkwell Square, Wood Street, London, EC2Y 5BL at 11.00 am on 8 May 2013.

In accordance with the UK Corporate Governance Code and the Articles, all Directors will offer themselves for re-election at this year's AGM, as per resolutions 4 to 11 of the Notice of Meeting shown on pages 125 to 127.

Resolutions dealing with the following special business will be proposed at the AGM:

Resolution 14 will seek shareholder approval to renew the Directors' authority to allot shares or grant rights to subscribe for or convert any securities into shares pursuant to section 551 of the Companies Act 2006 (the "Section 551 authority"). The authority contained in paragraph (A) of the resolution will be limited to an aggregate nominal value representing £422,209, being approximately one-third of the Company's issued Ordinary Share capital, as at 6 March 2013.

In line with guidance issued by the Association of British Insurers, paragraph (B) of this resolution would give the Directors authority to allot shares or grant rights to subscribe for or convert any securities into shares in connection with a rights issue up to an aggregate nominal value of £844,418, representing approximately two-thirds of the Company's issued Ordinary Share capital as at 6 March 2013, as reduced by the nominal amount of any shares issued under paragraph (A) of this resolution.

The Company does not hold any treasury shares.

Resolution 15 will seek to renew the authority conferred on the Board to allot equity securities of the Company (or sell any shares which the Company may elect to hold in treasury) for cash pursuant to section 570 of the Companies Act 2006 (the "Section 570 authority") without first offering them to existing shareholders in proportion to their existing shareholdings.

The authority is limited to allotments or sales in connection with pre-emptive offers, subject to any arrangements that the Directors consider appropriate to deal with fractions and overseas requirements, and otherwise up to a maximum nominal value of £63,331, representing approximately 5 per cent of the Company's issued Ordinary Share capital as at 6 March 2013, which is in accordance with the relevant guidelines for the Company.

If approved, the Section 551 authority and the Section 570 authority will expire at the conclusion of next year's AGM or, if earlier, at the close of business on 30 June 2014. The Directors have no present intention of exercising the Section 551 authority or the Section 570 authority.

Resolution 16 will seek to renew the authority conferred on the Company to purchase its own shares pursuant to sections 693 and 701 of the Companies Act 2006. This authority is limited to an aggregate maximum number of 126,662,703 Ordinary Shares, representing 10 per cent of the Company's issued Ordinary Share capital as at 6 March 2013. This power will expire at the conclusion of next year's AGM or, if earlier, at the close of business on 30 June 2014. The maximum price which may be paid for an Ordinary Share will be an amount which is not more than 5 per cent above the average of the middle market quotation for an Ordinary Share as derived from the London Stock Exchange plc's Daily Official List for the five business days immediately preceding the day on which the Ordinary Share is purchased. The Directors have no present intention of exercising all or any of the powers conferred by this resolution and will only exercise their authority if it is in the interests of shareholders generally.

Resolution 17 will seek shareholder approval to allow the Company to continue to call general meetings (other than AGMs) on 14 clear days' notice. In accordance with the Companies (Shareholders' Rights) Regulations 2009 the notice period required for general meetings of the Company is 21 days unless shareholders approve a shorter notice period (subject to a minimum period of 14 clear days). AGMs will continue to be held on at least 21 clear days' notice.

The approval will be effective until the Company's next AGM, when it is intended that a similar resolution will be proposed. In accordance with the Companies Act 2006, the Company must make a means of electronic voting available to all shareholders for that meeting in order to be able to call a general meeting on less than 21 clear days' notice.

## RECOMMENDATIONS

The Board believes that each of the resolutions to be proposed at the AGM is in the best interests of the Company and its shareholders as a whole. Accordingly, the Directors unanimously recommend that ordinary shareholders vote in favour of all of the resolutions proposed, as they intend to do in respect of their own beneficial holdings.

## DISCLOSURES IN THE DIRECTORS' REPORT

The Corporate Governance report, Divisional reviews and Finance Director's review form part of the Directors' report.

Approved by the Board of Directors and signed on its behalf by:

**Joff Crawford**
Company Secretary
6 March 2013

# Corporate Governance report

## STATEMENT OF COMPLIANCE

The Board of Directors remains committed to maintaining the high standards of corporate governance required to ensure the Company can continue to deliver its long term strategic goals for shareholders. As part of this approach, the Board supports the principles of the 2010 UK Corporate Governance Code (the "UK Code") as it applied to the year ended 31 December 2012.

The Board is accountable to the Company's shareholders for good governance. Throughout the year ended 31 December 2012, the Company complied with the provisions of the UK Code with the exception of a specific element of Schedule A, which recommends that grants under executive share options and long term incentive plans should normally be phased rather than awarded in one block. Under the 2012 Incentive Share Plan, details of which are provided on pages 63 and 64 of the Remuneration report, entitlements to the executive Directors were awarded in one block, rather than phased. The 2012 Incentive Share Plan was recommended as being in the best interests of shareholders as a whole by the Board of Directors and was approved by shareholders in a General Meeting held on 11 April 2012. With regard to all other aspects of executive Directors' remuneration, the Company's policies fully comply with the provisions of Schedule A of the UK Code.

The statements below describe how the Company has applied the principles identified in the UK Code to the governance arrangements that have been adopted.

## THE BOARD

Members:
- Christopher Miller, Executive Chairman
- David Roper, Executive Vice-Chairman (from 9 May 2012, previously Chief Executive)
- Simon Peckham, Chief Executive (from 9 May 2012, previously Chief Operating Officer)
- Geoffrey Martin, Group Finance Director
- Miles Templeman, Senior Non-executive Director
- Perry Crosthwaite, Non-executive Director
- Justin Dowley, Non-executive Director
- John Grant, Non-executive Director

All of the above Directors were appointed to the Board of Melrose Industries PLC with effect from 8 October 2012 and all of the above Directors (save for Simon Peckham and Geoffrey Martin) resigned from the Board of Melrose PLC with effect from 27 November 2012.

## THE MAIN RESPONSIBILITIES

- effectively manage and control the Company via a formal schedule of matters reserved for its decision;
- determine and review Company strategy and policy;
- consider acquisitions, disposals and asset requests for major capital expenditure;
- review trading performance;
- ensure that adequate funding and personnel are in place;
- maintain sound internal control systems; and
- report to shareholders and give consideration to all other significant financial matters.

Board responsibilities are undertaken in conjunction with senior management, who in turn are responsible for the day-to-day conduct of the Group's operations and for reporting to the Board on items of significance and progress against objectives. The Board meets regularly during the year as well as on an ad hoc basis as required by time critical business needs. There were four scheduled Board meetings held during the year and the attendance of each of the Directors is shown on page 60. Several Board meetings were also held during the year in relation to corporate matters such as the crystallisation of the 2009 Incentive Shares and creation of the 2012 Incentive Share Plan, the acquisition of Elster Group S.E. and the Scheme of Arrangement.

## BOARD BALANCE, INDEPENDENCE AND PERFORMANCE

The Board believes that the Directors possess diverse business experience in areas complementary to the activities of the Company. Biographies of the Directors are shown on pages 42 and 43. These biographies identify any other appointments held by the Directors. The only executive Director to have held a non-executive Director appointment elsewhere during the financial year ended 31 December 2012 is Christopher Miller, who was a non-executive Director of TMO Renewables Limited. Mr Miller resigned from this position on 31 August 2012 and he was allowed to retain the remuneration he received from that appointment.

In accordance with the provisions of the UK Code, consideration has been given to the independence of all the non-executive Directors; the Board considers all the non-executive Directors to be independent. Miles Templeman was appointed as a non-executive Director of Melrose in October 2003; even though he has now served as a non-executive Director for more than nine years, the Board is of the opinion that due to his invaluable experience in financial and other corporate matters, Mr Templeman continues to maintain both his effectiveness and independence. The Board will continue to monitor this position but feel at the present time Mr Templeman continues to make an important contribution in his position as the senior independent non-executive Director.

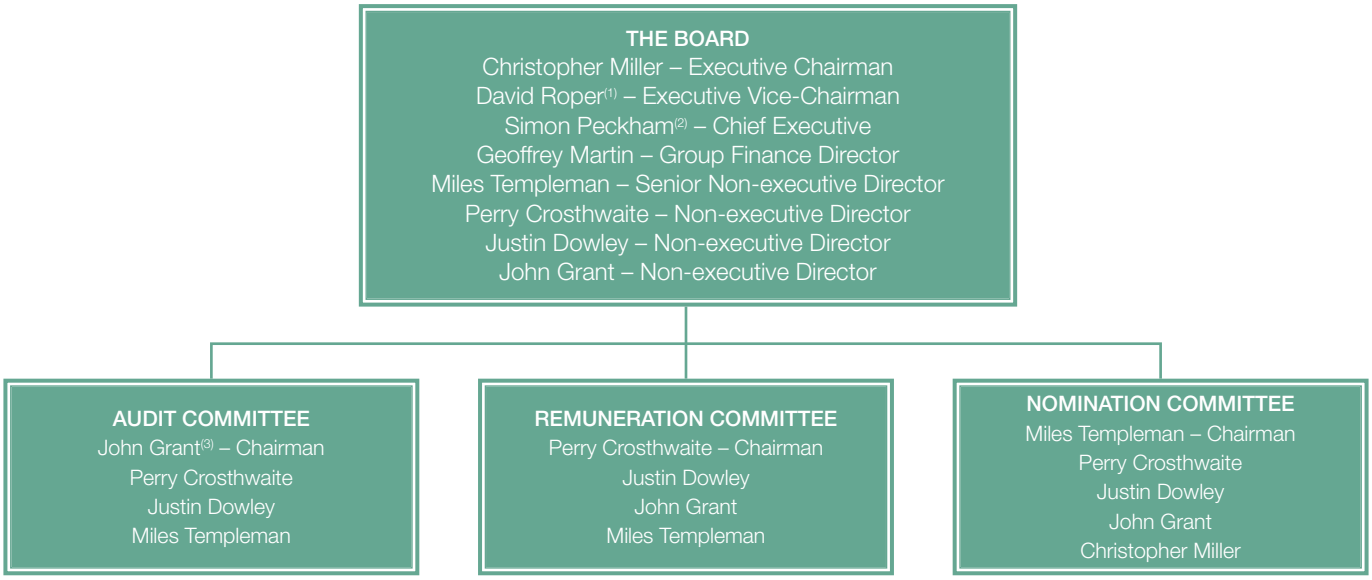
The non-executive Directors are not entitled to any bonus or shares under the 2012 Incentive Share Plan.

Performance of the Board and each Committee is evaluated annually in accordance with the UK Code. As part of the performance appraisal process both the executive and non-executive Directors are required to complete performance questionnaires on an annual basis in relation to the Board, its committees and their fellow Directors. All responses are reviewed and collated by the Company Secretary before further action is taken, as necessary. This process also helps to determine if any of the Directors have any specific training requirements.

The Chairman has held meetings with the Directors, including the senior independent non-executive Director, Miles Templeman, to discuss the performance of individual executive Directors and the Board as a whole. It was considered that the individual Directors and the Board as a whole are operating effectively. The non-executive Directors, led by Miles Templeman, the senior non-executive Director, also met during the year to discuss the performance of the Chairman and as part of this process also took account of the views of the executive Directors.

The Board is aware that within the provisions of the UK Code there is a requirement to carry out externally facilitated Board evaluations at least every three years and these will be carried out in 2013.

The Nomination Committee currently takes into account a variety of factors before recommending any new appointments to the Board including relevant skills to perform the role, experience, knowledge, ethnicity and gender. The most important priority of the Nomination Committee has been, and will continue to be, ensuring that the best candidate is selected to join the Board and this approach will remain in place going forward.




(1) David Roper became Executive Vice-Chairman with effect from 9 May 2012. Prior to this he held the position of Chief Executive.
(2) Simon Peckham became Chief Executive with effect from 9 May 2012. Prior to this he held the position of Chief Operating Officer.
(3) John Grant became Chairman of the Audit Committee on 6 March 2012. Prior to this the Chairman was Miles Templeman.

New Directors joining the Board receive a full, formal and tailored induction shortly after their appointment. Directors are advised that they have access to the advice and services of the Company Secretary, who is responsible for ensuring that Board procedures are followed and that applicable rules and regulations are complied with. The Board may seek independent legal and financial advice in the furtherance of its duties, at the Company's expense.

A pack of briefing papers and an agenda are provided to each Director in advance of each scheduled Board or standing Committee meeting. The Directors are able to seek further clarification and information on any matter from any other Director or employee of the Group whenever necessary. Decisions are taken by the Board in conjunction with the recommendations of its Committees and advice from external consultants, advisers and senior management.

## DIRECTOR TERMS AND CONDITIONS

The terms and conditions of the executive Directors' service contracts and the non-executive Directors' appointments are available for inspection at the Company's registered office. The non-executive Directors' appointment letters are also available on the Company's website, www.melroseplc.net. Executive Directors' service contracts and non-executive Directors' appointment letters will also be available to view immediately prior to and during the Company's AGM, to be held on 8 May 2013.

The service agreements of all executive Directors were novated from Melrose PLC to Melrose Industries PLC in November 2012, as part of the Scheme of Arrangement to insert a new holding company into the Group structure. All of the non-executive Directors were also issued with letters of appointment in relation to their directorships of Melrose Industries PLC as part of the Scheme of Arrangement.

## ANNUAL RE-ELECTION OF DIRECTORS

In accordance with the provisions of the UK Code, all of the Directors stood for re-election at the 2012 AGM. The Articles adopted in October 2012 require the Directors to stand for annual re-election, ensuring continued compliance with the UK Code. As such, all Directors will offer themselves for re-election at the 2013 AGM, to be held on 8 May 2013.

The Board and Nomination Committee have carefully considered the time commitments required and the contribution made by each Director. Both the Nomination Committee and the Board are of the belief that the performance of each executive and non-executive Director continues to be effective and that each Director demonstrates commitment to his role.

## CHAIRMAN, VICE-CHAIRMAN AND CHIEF EXECUTIVE

On 9 May 2012, David Roper was appointed as Executive Vice-Chairman of Melrose; Simon Peckham was appointed as Chief Executive on the same date. Christopher Miller remains in his position as Executive Chairman.

The roles of the Chairman and the Vice-Chairman are, and will remain, separate to that of the Chief Executive of the Company, in accordance with best practice and Board policy.

The Chairman, with the assistance of the Vice-Chairman, are together responsible for leadership of the Board. The Chairman sets the Board agenda and ensures that adequate time is given to the discussion of issues, particularly those of a strategic nature. Responsibility for ensuring effective communications with shareholders rests with the Chairman, Vice-Chairman and the two other executive Directors. The Chief Executive is responsible for strategic direction and decisions involving the day-to-day management of the Company.

# Corporate Governance report continued

## COMMITTEES OF THE BOARD

In accordance with the provisions of the UK Code, the Board has three standing Committees: the Audit, Remuneration and Nomination Committees. Each of these includes the four independent non-executive Directors. The duties of the Committees are set out in formal terms of reference. These are available from the Company Secretary and on the Company's website, www.melroseplc.net. The Company Secretary acts as Secretary to each of the Committees.

## AUDIT COMMITTEE

Members: John Grant, Chairman (from 6 March 2012)
Perry Crosthwaite
Justin Dowley
Miles Templeman (Chairman to 6 March 2012)

### MAIN RESPONSIBILITIES:

- review and monitor the integrity of the financial statements of the Group, including its interim accounts, the annual report, interim management and preliminary statements and any other formal announcements relating to the financial performance of the Group;
- keep under review the effectiveness of the Group's financial reporting, internal audit and controls, risk management systems and compliance controls;
- focus and challenge the consistency of accounting policies, methods used to account for significant or unusual transactions and compliance with accounting standards;
- review the Group's arrangements for its employees to raise concerns in confidence about possible wrongdoing in financial reporting, in accordance with the Company's whistleblowing policy; and
- develop, implement and monitor the Group's policy on external audit and for overseeing the objectivity and effectiveness of the auditor.

The following actions have been taken by the Audit Committee during the year ending 31 December 2012 to discharge its duties:

- review of the Annual Report and financial statements, the half-yearly financial report and the interim management statements issued in May and November 2012. As part of this review the Committee received a report from the external auditor on their audit of the Annual Report and the financial statements and review of the half-yearly report;
- considered the processes in place to generate forecasts of cash flows and accounting valuation information, including the choice and consistent use of assumptions;
- considered the output from Group-wide processes used to identify, evaluate and mitigate risk;
- reviewed the effectiveness of the Group's internal controls and disclosures made in the Annual Report and financial statements on this matter; and
- reviewed and agreed the scope of the audit work to be undertaken by the auditor.

Each member of the Audit Committee brings recent, relevant financial experience from senior executive and non-executive positions as described in their biographies on pages 42 and 43.

The Audit Committee invites the Group Finance Director, the Head of Financial Reporting and senior representatives of the external and internal auditors to attend meetings as appropriate to the business being considered. The Audit Committee has the right to invite any other Directors and/or employees to attend meetings where this is considered appropriate. In addition, the Audit Committee meets at least once per year with both the external and internal auditors, without management present.

The Audit Committee is expected to meet not less than three times a year and the Audit Committee met three times during 2012. The attendance of its members, along with the Group Finance Director, is shown in the table on page 60.

## GROUP AUDITOR

The Group's external auditor is recommended for reappointment by the Audit Committee, which also assesses the appropriateness of the scope of audit work performed and provides recommendations in respect of their remuneration and terms of engagement. The Audit Committee receives regular reports from the Group's external auditor.

The Audit Committee has a policy on the engagement of the external auditor for the supply of non-audit services. During 2012, the Audit Committee requested a detailed analysis to be carried out of the non-audit services performed for the Group over recent years by Deloitte LLP, to include an appropriate benchmarking exercise. Results of the analysis were presented to the Audit Committee who concluded that they were satisfied with the continued independence of the Group's external auditor. They also concluded that other external advisers were being retained for certain services previously undertaken by Deloitte LLP but noted that Deloitte LLP would continue to be a key provider of non-audit services to the Group where best placed to do so.

In accordance with best practice FRC guidelines, the Company policy in relation to non-audit services is kept under regular review; the policy outlines which non-audit services are pre-approved, which services require the prior approval of the Audit Committee and which services the auditor is excluded from providing.

During 2012, the main non-audit services provided by Deloitte LLP were in relation to taxation compliance, tax planning, corporate pensions advice and corporate finance (which included due diligence and reporting accountants work in respect of the acquisition of Elster and reporting accountants work for the new holding company of the Group). Further information regarding non-audit fees can be found in note 7 to the consolidated financial statements.

The Audit Committee carries out regular reviews to ensure that auditor objectivity and independence is maintained at all times. A different senior partner carries out the taxation audit of the Company compared to those working on the non-audit taxation services. With regard to due diligence services a separate team, which was independent from the audit team was used within Deloitte LLP to carry out this work. Other corporate finance services were reviewed by an independent transaction services specialist partner within the audit firm. No fees were paid to Deloitte LLP on a contingent basis. Based on these strict procedures the Audit Committee remains confident that auditor objectivity and independence has been maintained but accepts that non-audit work should be controlled to ensure that it does not compromise the auditor's position.

Deloitte LLP was appointed in 2003. At each year end, Deloitte LLP submits a letter setting out how it believes its independence and objectivity have been maintained. They are also required to rotate the audit partner responsible for the Group and subsidiary audits every five years. The Group's audit signing partner changed as part of that rotation process in 2010. There are no contractual obligations that restrict the Group's capacity to recommend a particular firm for appointment as auditor.

Following the acquisition of Elster in August 2012, Deloitte LLP were appointed as auditor of Elster Group S.E. and the vast majority of its trading entities for the year ended 31 December 2012. Deloitte LLP replaced KPMG as Group auditor and as auditors of key Elster subsidiaries. For the year ended 31 December 2012 KPMG remained as local statutory auditors with regard to the accounts of the German statutory entities and reported to Deloitte LLP for the purposes of the Group audit.

### INTERNAL AUDIT PROGRAMME

Due to the size and complexity of the Group, it is appropriate for an internal audit programme to be used within the business. BM Howarth, an external firm, provides internal audit services to the Group. A rotation programme is in place, such that every business unit will have an internal audit at least once every three years, with the largest sites being reviewed at least once every two years. The rotation programme allows divisional management's actions and responses to be followed up on a timely basis.

Following the acquisition of Elster, during 2012 BM Howarth have visited the majority of Elster sites to undertake fair value reviews and as a result have been able to risk assess the Elster businesses and bring them into the internal audit rotation programme from 2013 onwards.

The internal auditor's remit includes assessment of the effectiveness of internal control systems, compliance with the Group's Policies and Procedures Manual and a review of the businesses' Balance Sheets. A report of key findings and recommendations is presented to the Group Finance Director, Head of Financial Reporting and Group Operations Controller, followed by a meeting to discuss these key findings and resulting in action points.

BM Howarth present their key findings to the Audit Committee twice during the year. A review of the internal audit process and scope of work covered by the internal auditor is the responsibility of the Audit Committee, to ensure their objectives, level of authority and resources are appropriate for the nature of the businesses under review. A report of significant findings is presented by the internal auditor to the Committee at each meeting and implementation of recommendations by the Board are followed up at the subsequent Committee meeting.

### REMUNERATION COMMITTEE

Members: Perry Crosthwaite, Chairman
Justin Dowley
John Grant
Miles Templeman

#### MAIN RESPONSIBILITIES:

- annually review remuneration trends across the Group and obtain reliable and up-to-date information about the remuneration of Directors and senior employees in other companies;
- consider and make recommendations to the Board on the framework for the remuneration of the Company's executive Directors, the Company Secretary and other senior employees;
- ensure the executive Directors and senior employees are provided with appropriate annual incentives to encourage enhanced performance and that they are rewarded for their individual contributions to the success of the Company; and
- approve the structure of, and determine targets for, any long term incentive plans operated by the Company.

In developing its recommendations, the Committee has given due consideration to Schedule 8 of Part 15 of the Companies Act 2006.

The Remuneration Committee is expected to meet not less than twice a year and during 2012 the Remuneration Committee met four times.

The attendance of its members is shown in the table on page 60. The report to shareholders on how Directors are remunerated, together with details of individual Directors' remuneration is shown in the Remuneration report on pages 62 to 67.

### NOMINATION COMMITTEE

Members: Miles Templeman, Chairman
Perry Crosthwaite
Justin Dowley
John Grant
Christopher Miller

#### MAIN RESPONSIBILITIES:

- keep the size, structure and composition of the Board under regular review and recommend to the Board any adjustments as may be necessary from time to time;
- give full consideration to succession planning to ensure an optimum balance of executive and non-executive Directors in terms of skills, experience and diversity;
- keep under review the leadership needs of the business; and
- keep up to date and fully informed about strategic issues and commercial changes affecting the Company and the markets in which it operates.

The Nomination Committee is expected to meet not less than twice a year and during 2012 the Nomination Committee met twice. The attendance of its members is shown in the table on page 60.

The Nomination Committee uses external search consultants as appropriate.

# Corporate Governance report continued

## ATTENDANCE AT MEETINGS

The table below shows the attendance of each of the Directors at the scheduled and significant meetings of the Board and its standing Committees held during the year. The quorum necessary for the transaction of business by the Board and each of its standing Committees is two. Briefing papers and meeting agendas are provided to each Director in advance of each meeting. Decisions are taken by the Board in conjunction with the recommendations of its Committees and advice from external advisers and senior management as appropriate. The representations of any Director who is unable to attend a meeting of the Board or a standing Committee are duly considered by those Directors in attendance.

| | Board[3] | Audit[3] | Remuneration[3] | Nomination[3] |
|---|---|---|---|---|
| **Number of meetings**[1] | **4** | **3** | **4** | **2** |
| Christopher Miller | 4 | - | - | 2 |
| David Roper | 4 | - | - | - |
| Simon Peckham | 4 | - | 1[4] | - |
| Geoffrey Martin | 4 | 3[2] | - | - |
| Miles Templeman | 3 | 2 | 3 | 1 |
| Perry Crosthwaite | 3 | 2 | 3 | 1 |
| John Grant | 4 | 3 | 4 | 2 |
| Justin Dowley | 4 | 3 | 3 | 2 |

[1] In addition, ad-hoc meetings are held from time-to-time which are attended by a quorum of Directors and are convened to deal with specific items of business.
[2] Geoffrey Martin attends by invitation.
[3] All meetings relate to the Board and Committees of Melrose PLC (before the Scheme of Arrangement became effective on 27 November 2012), with the exception of one meeting for each of the Board and committees of Melrose Industries PLC that were held in December 2012.
[4] Simon Peckham attended by invitation.

## INTERNAL CONTROL AND RISK MANAGEMENT

### Objectives and policy

The objectives of the Directors and senior management are to safeguard and increase the value of the business and assets of the Group. Achievement of their objectives requires the development of policies and appropriate internal control frameworks to ensure the Group's resources are managed properly and any key risks are identified and mitigated where possible.

The Board is ultimately responsible for the Group's overall system of internal control and for reviewing its effectiveness, while the role of management is to implement the policies set by the Board in respect of risk management and controls. The Directors recognise that the systems and processes established by the Board are designed to manage, rather than eliminate, the risk of failure to achieve business objectives and cannot provide absolute assurance against material financial misstatement or loss.

The Board is committed to satisfying the internal control guidance for Directors set out in the revised version of the Turnbull Guidance on Internal Control. In accordance with this guidance, there is an ongoing process, regularly reviewed by the Directors, for identifying, evaluating, managing and mitigating (where possible) the significant risks faced by the Group. This process for reviewing the Group's internal controls is consistent with prior years and has been in place throughout the 2012 financial year and up to the date of approval of this Annual Report.

### Managing and controlling risk

The Group has policies which address a number of key business risks, including strategic, operational, compliance, ethical and financial risks. A summary of some of the strategic and operational risks and uncertainties that could impact on the Company's performance is set out on pages 37 to 39.

The Group's financial risk management objectives and policies are also described in the Finance Director's review on pages 27 to 36. Further information can also be found in the Chief Executive's review on pages 14 to 26, and the Directors' report on pages 44 to 55.

The Group operates on a de-centralised basis and the Board has established an organisational structure with clear reporting procedures, lines of responsibility and delegated authority. Divisional senior management, plant managers and financial controllers have been delegated responsibility by the Board for the establishment and implementation of detailed control systems as appropriate for their business.

An established programme of regular review is in place at the businesses and a culture of continuous improvement is encouraged by the Board through regular meetings with senior management, review of operating performance and progress against business plans. The ongoing process of review provides assurance that the control environment is operating as intended.

The Audit Committee also monitors the effectiveness of the internal control processes implemented across the Group through a review of the key findings presented by the external and internal auditors and discussions with senior management on an ad hoc basis. The Board is responsible for considering Audit Committee recommendations in respect of internal controls and risk management and ensuring implementation by management of those recommendations it deems appropriate for the business.

Following the acquisition of Elster in August 2012, the Company has been working hard to ensure the successful integration of this business into Melrose reporting and governance frameworks, in order to ensure a consistent approach is maintained throughout the Group going forward.

### Internal financial controls

The Group has a comprehensive system for assessing the effectiveness of the Group's internal financial controls, including strategic business planning and regular monitoring and reporting of financial performance. A detailed annual budget is prepared by senior management and thereafter is reviewed and formally adopted by the Board. The budget and other targets are regularly updated via a rolling forecast process and regular business review meetings are held involving senior management to assess performance. The results of these reviews are in turn reported to and discussed by the Board at each meeting. As discussed in the Audit Committee section on pages 58 and 59 of this report, BM Howarth is the Group's internal auditor and they have also recently taken internal audit responsibility for the Elster businesses.

A total of 11 businesses have been visited for the purposes of internal audits during 2012, all in the first half of the year. During the second half of 2012 the focus has been on the opening Balance Sheets of Elster and the internal auditor assisted with this process by visiting 35 sites. The Directors are pleased to report that there were no material deficiencies; the majority of the recommendations presented in the internal auditor reports have now been, or are in the process of being implemented. During 2013, the Elster businesses will be included in the internal audit visit plan and 37 businesses are planned for review this year, including 10 audits in relation to the Elster business.

The Board confirms that, from the review of internal controls, it has not determined any significant failings or weaknesses that it considers require remedial action. The Board also confirms that it has not been advised of any material weaknesses in the internal control systems that relate to financial reporting.

## WHISTLEBLOWING, ANTI-BRIBERY AND CORRUPTION POLICIES

The Company takes very seriously its responsibilities under the Bribery Act 2010 and has in place appropriate measures to ensure compliance. Following the introduction of updated internal procedures in 2011, each business within the Energy, Lifting and Other Industrial divisions is required to provide an annual confirmation to the Company that it has fully complied with the Group's anti-bribery and corruption policy. Gift, hospitality and charitable donation registers also continue to be maintained throughout the year and form part of the Group's anti-corruption procedures; no areas of concern were identified. Whilst Elster already maintain a comprehensive and robust compliance programme, during 2013 they will also start to report under the Group's existing compliance reporting procedures.

The Group's anti-bribery and corruption policy applies to all Directors, employees (whether permanent, fixed-term, or temporary), pension trustees, consultants and other business advisers, contractors, trainees, volunteers, business agents, distributors, joint venture partners, or any other person working for or performing a service on behalf of the Company, its subsidiaries and associated companies in which it has a majority interest.

Responsibility for anti-corruption policies and procedures rests with the Board of Directors. It is tasked with ensuring that adequate internal financial controls and record keeping is in place within the Group in order to minimise the risk of bribery and corruption.

As a result of the increased size of the Group following the acquisition of Elster, the Company is currently in the process of increasing its resources within the area of compliance, both at Group and business unit level, in order to ensure that continuous improvements can be made to existing policies and procedures.

The Company also operates a whistleblowing policy, as part of its anti-bribery and corruption procedures. This enables individuals to make protected disclosures to their divisional human resources manager, Company Secretary or the senior non-executive Director if they have concerns about possible improprieties in financial reporting or other malpractices within their business. Within the Elster business all employees have access to an independent whistleblowing helpline if they wish to raise any concerns about the business.

## COMMUNICATIONS WITH SHAREHOLDERS

The Company seeks to build on a mutual understanding of objectives with its institutional shareholders, via the executive Directors, through regular meetings and presentations following announcements of its annual and interim results. The non-executive Directors are available to meet institutional shareholders should there be unresolved matters they wish to bring to their attention. The views of key analysts and shareholders generally are fed back to the Board directly by individual Directors, or via the Company's brokers. This helps to ensure that all members of the Board develop an understanding of the views of major shareholders. Corporate information is available on the Company's website, www.melroseplc.net.

As part of the process to agree the early crystallisation of the 2009 Incentive Shares and creation of the 2012 Incentive Share Plan during March and April 2012, discussions took place with key institutional investors in order to ensure their views were incorporated into the process. Perry Crosthwaite, in his capacity as Chairman of the Remuneration Committee, led these discussions and acted independently from the executive Directors.

The Board welcomes the attendance of shareholders at the AGM. The number of votes cast for and against each of the resolutions proposed will be announced shortly after the AGM has concluded, via the Melrose website at www.melroseplc.net.

By order of the Board

**Joff Crawford**
Company Secretary
6 March 2013

# Remuneration report

## INTRODUCTION AND COMPLIANCE

The Directors' Remuneration report has been prepared by the Remuneration Committee and approved by the Board. It has been drawn up in accordance with relevant sections of the 2010 UK Corporate Governance Code (the "UK Code") as it applies to the year ended 31 December 2012, the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008, the Companies Act 2006 and the UK Listing Authority Listing Rules.

A resolution inviting shareholders to approve the Remuneration report will be put to the Annual General Meeting on 8 May 2013.

The Remuneration report is divided into two parts. The first part contains commentary on remuneration policy, which is not required to be audited. The second part contains details of the Directors' remuneration, which has been audited in accordance with the relevant statutory requirements.

Biographies of the Directors are shown on pages 42 and 43. These biographies identify any other significant appointments held by the Directors.

## UNAUDITED INFORMATION: REMUNERATION COMMITTEE

The Remuneration Committee is chaired by Perry Crosthwaite, an independent non-executive Director. Miles Templeman, John Grant and Justin Dowley, the other three independent non-executive Directors, complete the Committee.

The terms of reference of the Remuneration Committee are posted on the Corporate Governance section of the Company's website (www.melroseplc.net) and are also available from the Company Secretary at the registered office address. Page 59 of the Corporate Governance report sets out the functions of the Remuneration Committee.

## REMUNERATION POLICY

Remuneration packages are reviewed regularly and changes are effective from 1 January each year. The Remuneration Committee and its advisers use a number of third party remuneration surveys from which to obtain remuneration data in order to carry out benchmarking exercises.

The remuneration package for all executive Directors comprises base salary and benefits, annual bonus, long term incentive arrangements and pension contributions as described within this report. Some senior employees of the Group are also entitled to bonuses and long term incentive arrangements as noted below.

## EXECUTIVE DIRECTORS AND OTHER SENIOR EMPLOYEES

The Board establishes the remuneration policy based on the recommendations of the Remuneration Committee, having regard to best practice guidance provided by the UK Code. The remuneration policy adopted by the Company requires the package offered to any executive Director or senior employee to be sufficient to attract, retain and motivate management of a suitable quality, but not to be more than is necessary for this purpose. A significant proportion of the total remuneration package of the executive Directors is linked to both the Melrose Group and individual Director performance.

In designing the performance-related element of the total remuneration package, due regard was given to the provisions of Schedule A to the UK Code. However, the Remuneration Committee deemed it appropriate to derogate from the recommendation in Schedule A that grants under executive share options and long term incentive plans should normally be phased rather than awarded in one block. Under the 2012 Melrose Incentive Plan, details of which are provided on pages 63 and 64, entitlements of the executive Directors were awarded in one block, rather than phased. The 2012 Melrose Incentive Plan was recommended as being in the best interests of shareholders as a whole by the Board of Directors and was approved by shareholders in a General Meeting held on 11 April 2012.

## NON-EXECUTIVE DIRECTORS

The executive Directors are responsible for proposing the non-executive Directors' fees. In proposing such fees they take account of fees paid to non-executive Directors of similar sized listed companies within the Company's listing sector, as well as the time commitment and responsibility of the role. Any decisions regarding fee changes are taken by the executive Directors as a whole and non-executive Directors do not take part in discussions on their own remuneration. Non-executive Directors do not receive other taxable benefits or pension contributions from the Group.

Consistent with best practice guidance provided by the UK Code and as part of the Company's ongoing commitment to ensuring the independence of the non-executive Directors, the non-executive Directors' remuneration does not include any share options or performance-related element.

## BASE SALARY AND BENEFITS

The Remuneration Committee gives consideration to both the performance of the individual during the period of review and of current market salaries for equivalent roles based on independently sourced market information.

The salaries of all executive Directors and the senior management team are reviewed by the Remuneration Committee prior to the beginning of each year. The Remuneration Committee also consults with the Executive Chairman, Executive Vice-Chairman and the Chief Executive about its proposals for remuneration for the coming financial year. Base salaries for 2012 were reviewed in December 2011. In January 2012, each of the executive and non-executive Directors received an inflationary increase of 3 per cent. In addition, a further inflationary increase of 3 per cent was awarded in December 2012, effective from January 2013.

The executive Directors also receive a company car allowance, fuel allowance, private medical insurance, life insurance and permanent health insurance cover. Mr Martin also receives paid train travel to and from London and accommodation whilst working in London.

## ANNUAL BONUSES

Bonus scheme arrangements are in place for executive Directors and senior management and are consistent with the best practice guidance provided in Schedule A to the UK Code. The maximum bonus payable is 100 per cent of base salary. The annual bonus scheme has two components, up to 80 per cent of base salary is payable based on diluted earnings per share growth and the remaining 20

per cent is discretionary. The discretionary element is payable based on the Remuneration Committee considering a range of financial and non-financial factors including working capital management and cash generation, overhead cost control, liability management, health and safety improvements and any other factors which the Remuneration Committee consider to be relevant. The Executive Chairman does not participate in the annual bonus plan. David Roper will receive his 2012 cash bonus on a pro rata basis for the period in which he held the position of Chief Executive; he will not receive a cash bonus for the period from 9 May 2012, which is the date he became Executive Vice-Chairman.

## LONG TERM INCENTIVES

Long term incentives are granted to Directors and other senior employees in order to promote the success of the Company. The long term incentive arrangements currently in place are structured to ensure that participants are only rewarded for growth in the underlying value of the business in order to align the interests of the Directors with those of the Company's shareholders.

During 2012 the Group operated the following long term incentive plans:

- 2009 Incentive Share Plan (crystallised April 2012 with a maturity date of 22 March 2012);
- 2012 Incentive Share Plan (with effect from 23 March 2012); and
- Divisional long term incentive plans.

Further details in relation to these plans are shown below:

## 2009 INCENTIVE SHARE PLAN

Participants in the 2009 Incentive Share Plan were entitled to either a cash dividend or, at the Company's choice, a number of Ordinary Shares in Melrose PLC equal to 10 per cent of the increase in shareholder value during the period between 18 July 2007 and 31 May 2012. At a General Meeting on 11 April 2012, shareholder approval was given for the early crystallisation of the 2009 Share Incentive Plan, which resulted in an early maturity date of 22 March 2012 (the "Maturity Date"). This Maturity Date was moved forward by approximately 10 weeks to ensure that the Group could continue to explore significant acquisition opportunities, and was in a position to pursue these opportunities as they arose, whilst continuing to ensure that appropriate incentive arrangements were in place for the Company's Directors and senior management team.

During the term of the 2009 Incentive Share Plan the Directors and senior management team were successful in generating real returns for shareholders as can be seen below:

- Market capitalisation just prior to the Maturity Date was £1.65 billion against a net shareholder investment of approximately £14 million and approximately £1.5 billion of shareholder value was created;
- Headline EPS increased by 120 per cent;
- Dividends to shareholders increased by 93 per cent; and
- Total shareholder return was 197 per cent, against a return of 15 per cent for the FTSE 350.

Upon crystallisation, the Remuneration Committee determined that it would be in the Group's best interests to convert the 2009 Incentive Shares into Ordinary Shares of Melrose PLC, rather than pay a cash dividend to all participants. This decision was based on the potential cash cost and the impact on the level of distributable reserves if a cash dividend were to be paid out.

The value of the 2009 Incentive Share Plan as at 22 March 2012 was calculated as £121,367,100 (representing 10 per cent of the increase in shareholder value since 18 July 2007, as calculated in accordance with the Articles of the Company in force at the time). Participants in the 2009 Incentive Share Plan received 31,247,969 new Ordinary Shares in Melrose PLC on 12 April 2012. The table on page 65 shows the number of Ordinary Shares received in the Company by each of the Directors following crystallisation of the 2009 Incentive Share Plan.

The financial growth statistics shown above confirm that the 2009 Incentive Share Plan was very effective in incentivising the Directors and certain senior managers to deliver real value to shareholders. Therefore, upon the maturity of the 2009 Incentive Share Plan shareholder approval was sought for the creation of the 2012 Incentive Share Plan, details of which are shown below.

## 2012 INCENTIVE SHARE PLAN

The 2012 Incentive Share Plan was approved by shareholders in a General Meeting on 11 April 2012. The new plan is based on the same economic principles as the 2009 Incentive Share Plan for the period between 22 March 2012 and 31 May 2017 but is subject to the following key modifications:

- Reduction of the potential reward to 7.5 per cent of the increase in shareholder value, rather than 10 per cent as was the case for the 2009 Incentive Share Plan;
- Change to the initial invested capital calculation from the net shareholder investment to the deemed market capitalisation of the Company based on the average share price for the 40 business days up to 21 March 2012. This ensured that the increase in shareholder value prior to 21 March 2012 is fully excluded from the 2012 Incentive Share Plan;
- Creation of a dilution cap of 5 per cent of the number of Ordinary Shares in issue on 11 April 2012, plus 5 per cent of any new Ordinary Shares issued or created prior to the maturity of the 2012 Incentive Share Plan;
- Changes to the "good leaver" provisions to provide that a participant in the 2012 Incentive Share Plan retiring at normal retirement age will not be deemed to be a "good leaver" and to introduce the ability of the Remuneration Committee, at its discretion, to require "good leavers" (other than on a "good leaver's" resignation on a change of control) to transfer their unvested 2012 Incentive Shares, or a portion thereof, to an employee benefit trust or otherwise at the discretion of the Board, in order to allow for new joiners to be appropriately incentivised; and
- The executive Directors have a 68 per cent participation within the 2012 Incentive Share Plan, compared with an 87 per cent participation in the 2009 Incentive Share Plan. This has been done to recognise the growth of the team beyond Board level, which will be necessary to develop the business further. As at 31 December 2012, 95 per cent of options over 2012 Incentive Shares had been granted, meaning that the remainder can be used for the benefit of current and future employees, as may be agreed by the Remuneration Committee.

As part of the Scheme of Arrangement all options over 2012 Incentive

# Remuneration report continued

Shares in Melrose PLC were cancelled and options over 2012 Incentive Shares in Melrose Industries PLC were granted in their place based on the same terms.

As at 31 December 2012, the projected value of the 2012 Incentive Share Plan at the date of crystallisation in May 2017, using a Black Scholes option pricing model, was £60.2 million. Details of the Directors' beneficial interests in options over the 2012 Incentive Shares as at 6 March 2013 are shown in the table of Directors' shareholdings later in this report.

## DIVISIONAL LONG TERM INCENTIVE PLANS

Divisional long term incentive plans have been implemented for senior managers of certain businesses within the Group to incentivise them to create value for the Company and our shareholders. It is the intention of the Board that, depending on the amount of value created, participants in such incentive plans will receive a cash payment on the sale of their respective business. If a sale of the relevant business has not occurred within a certain period, the incentive plan will crystallise and any payment to be made to participants will be based on the increase in value of the business during this period.

## PENSION

No Director is a member of any Group pension arrangement. The executive Directors may elect to receive a Company contribution to their individual pension arrangement or a supplement to base salary in lieu of a pension arrangement. Company contributions are calculated on base salary at a level of 15 per cent per annum and are reviewed annually by the Remuneration Committee.

## SERVICE CONTRACTS

Consistent with the best practice guidance provided by the UK Code, the Company's policy is for Directors' service contracts to be terminable on a maximum of one year's notice. Directors' service contracts do not provide for pre-determined compensation in the event of termination. Any payments made would be subject to normal contractual principles, including mitigation as appropriate. The length of service for any one executive Director is not defined and is subject to the requirement for annual re-election under both the UK Code and the Company's Articles of Association. The non-executive Directors do not have service contracts but have letters of appointment for an initial period of three years, which may be renewed by mutual agreement. Generally, a non-executive Director may be appointed for one or two periods of three years after the initial three year period has expired. Miles Templeman has now been re-appointed for a fourth period of three years having originally been appointed as a non-executive Director of Melrose in October 2003; the Board considers that Mr Templeman maintains his independence in this role as described in more detail within the Corporate Governance report on page 56. The terms of appointment do not contain any contractual provisions regarding a notice period or the right to receive compensation in the event of early termination.

As part of the Scheme of Arrangement that was carried out towards the end of 2012, each of the Directors in Melrose PLC was appointed as a Director of Melrose Industries PLC, the new parent company of the Group. As part of this process the service agreements of each of the executive Directors were novated on exactly the same terms to the new parent company, with effect from when the Scheme of Arrangement became effective on 27 November 2012. Details of the executive Directors' original appointment dates and notice periods are as set out below:

| Executive Directors | Date of original appointment as an executive Director of Melrose PLC[1] | Date of appointment as an executive Director of Melrose Industries PLC | Notice period |
|---|---|---|---|
| Christopher Miller | 29 May 2003 | 8 October 2012 | 12 months |
| David Roper | 29 May 2003 | 8 October 2012 | 12 months |
| Simon Peckham | 29 May 2003 | 8 October 2012 | 12 months |
| Geoffrey Martin | 7 July 2005 | 8 October 2012 | 12 months |

[1] Service agreement novated from Melrose PLC to Melrose Industries PLC on 27 November 2012.

Each of the non-executive Directors entered into new letters of appointment with Melrose Industries PLC, with effect from when the Scheme of Arrangement became effective on 27 November 2012, which are on similar terms to their most recent letters of appointment with Melrose PLC. Details of the non-executive Directors' appointment dates and duration are shown below:

| Non-executive Directors | Date of original appointment as a non-executive Director of Melrose PLC | Date of appointment as a non-executive Director of Melrose Industries PLC | End of appointment period[1] |
|---|---|---|---|
| Miles Templeman | 8 October 2003 | 8 October 2012 | Conclusion of the 2015 AGM unless extended or renewed. |
| Perry Crosthwaite | 26 July 2005 | 8 October 2012 | Conclusion of the 2015 AGM unless extended or renewed. |
| John Grant | 1 August 2006 | 8 October 2012 | Conclusion of the 2015 AGM unless extended or renewed. |
| Justin Dowley | 1 September 2011 | 8 October 2012 | Conclusion of the 2015 AGM unless extended or renewed. |

[1] Subject also to re-election by shareholders at each AGM.

## DIRECTORS' SHAREHOLDINGS

### Ordinary Shares

The table below shows the number of shares held by each of the Directors in the Ordinary Share capital of both Melrose PLC before the Scheme of Arrangement became effective on 27 November 2012 ("Old Shares") and Melrose Industries PLC after such time ("New Shares").

None of the Directors who held office at the end of the financial year had any beneficial interest in the shares of other Group companies.

| Directors | Number of Old Shares held as at 1 January 2012 | Old Shares received on 11 April 2012 following crystallisation of the 2009 Incentive Share Plan | Old Shares sold as part of a Placing immediately following crystallisation of 2009 Incentive Share Plan | Old Shares issued pursuant to Rights Issue relating to the acquisition of Elster | Number of New Shares held as at 31 December 2012 |
|---|---|---|---|---|---|
| Christopher Miller[1] | 4,580,507 | 7,499,512 | (4,000,000) | 6,095,325 | 14,175,344 |
| David Roper | 2,276,158 | 7,499,512 | (4,200,000) | 4,008,963 | 9,584,633 |
| Simon Peckham | 1,872,124 | 7,499,512 | (3,749,756) | 4,042,188 | 9,664,068 |
| Geoffrey Martin | 659,098 | 4,687,195 | (2,577,957) | 1,990,461 | 4,758,797 |
| Miles Templeman | 313,331 | - | - | 319,012 | 632,343 |
| Perry Crosthwaite | 103,125 | - | - | 119,252 | 222,377 |
| John Grant | 145,847 | - | - | 149,970 | 295,817 |
| Justin Dowley | 138,000 | - | - | 276,000 | 414,000 |
| **Total** | **10,088,190** | **27,185,731** | **(14,527,713)** | **17,001,171** | **39,747,379** |

[1] The interest of Christopher Miller includes 4,000,000 New Shares (31 December 2011: 2,160,714 Old Shares) held by Harris & Sheldon Investments Limited, a company which is connected with Christopher Miller within the meaning of section 252 of the Companies Act 2006.

## TOTAL SHAREHOLDING RETURN

The Ordinary Shares of Melrose PLC were admitted to the Official List and to trading on the London Stock Exchange on 9 December 2005.

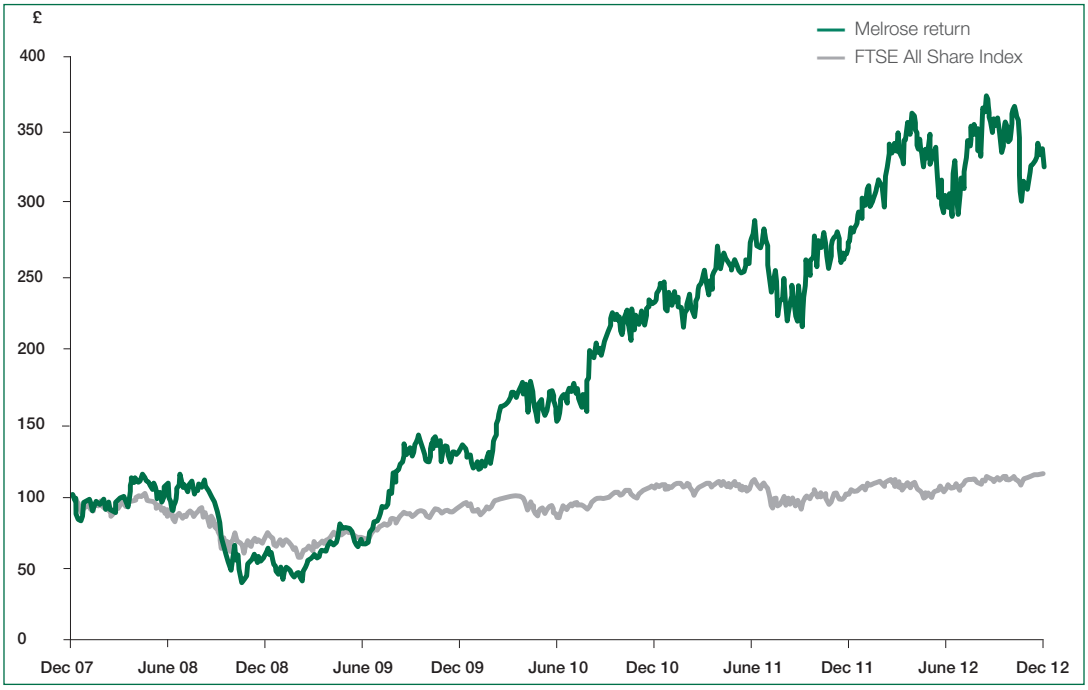
During the year ended 31 December 2012 the following corporate actions took place:

- the creation of 31,247,969 new Ordinary Shares in the capital of Melrose PLC, following crystallisation of the 2009 Incentive Share Plan, in April 2012;
- a 2 for 1 Rights Issue that concluded in August 2012, resulting in the issue of 844,418,024 new Ordinary Shares in the capital of Melrose PLC, raising approximately £1.2 billion in relation to the purchase of Elster Group S.E. The new Ordinary Shares commenced trading on the main market of the London Stock Exchange at 8.00 am on 1 August 2012. This increased the total issued share capital of Melrose PLC to 1,266,627,036 Ordinary Shares; and
- in November 2012, a Scheme of Arrangement was completed which created a new parent company, Melrose Industries PLC, in order to create approximately £1.5 billion of distributable reserves. On 27 November 2012, the Ordinary Shares in the capital of Melrose PLC were cancelled and shareholders were issued with the same number of new Ordinary Shares in Melrose Industries PLC, with a nominal value of 120 pence per share. Trading in these new Ordinary Shares commenced at 8.00 am on 27 November 2012 on the London Stock Exchange's main market for listed securities. On 29 November 2012 the nominal value of the new Ordinary Shares was reduced to 0.1 pence in order to create distributable reserves.

# Remuneration report continued

The total shareholder return graph below shows the value as at 31 December 2012 of £100 invested in the Company on 31 December 2007, compared with £100 invested in the FTSE All Share Index.

The source data for the graph below assumes that all cash returns to shareholders are reinvested in Ordinary Shares.




## AUDITED INFORMATION: DIRECTORS' REMUNERATION AND INCENTIVE SHARES

| | Emoluments during 2012 | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| **Directors** | Salaries/ fees £ | Bonus £ | Taxable benefits £ | In lieu of pension contributions £[1] | **2012 Total emoluments £** | Pension contributions £[1] | **2012 Total remuneration £** | 2011 Total remuneration £ |
| Christopher Miller[2] | 409,800 | — | 19,454 | 61,470 | **490,724** | — | **490,724** | 477,649 |
| David Roper | 409,800 | 87,424 | 19,060 | 61,470 | **577,754** | — | **577,754** | 811,152 |
| Simon Peckham | 409,800 | 262,272 | 19,338 | 17,970 | **709,380** | 43,500 | **752,880** | 811,611 |
| Geoffrey Martin | 327,900 | 209,856 | 51,069 | 11,385 | **600,210** | 37,800 | **638,010** | 686,630 |
| Miles Templeman[3] | 59,235 | — | — | — | **59,235** | — | **59,235** | 61,650 |
| Perry Crosthwaite[4] | 63,350 | — | — | — | **63,350** | — | **63,350** | 61,650 |
| John Grant[5] | 62,465 | — | — | — | **62,465** | — | **62,465** | 56,650 |
| Justin Dowley[6] | 58,350 | — | — | — | **58,350** | — | **58,350** | 18,883 |
| **Total** | **1,800,700** | **559,552** | **108,921** | **152,295** | **2,621,468** | **81,300** | **2,702,768** | **2,985,875** |

[1] Of the £233,595 attributable to pension contributions, £152,295 was paid as a supplement to base salary in lieu of pension arrangements. The balance of £81,300 was paid into the individual Directors' nominated private pension plans.
[2] Christopher Miller was a non-executive Director of TMO Renewables Limited but resigned from this position on 31 August 2012. His fees for the period from 1 January to 31 August 2012 were £12,500. This amount was retained by Christopher Miller and is therefore excluded from the table above.
[3] Miles Templeman was Chairman of the Audit Committee up to 6 March 2012 but was then replaced by John Grant. Mr Templeman received an amount of £885 in recognition of Chairmanship of the Audit Committee from 1 January 2012 to 6 March 2012.
[4] Includes £5,000 per annum in recognition of Chairmanship of the Remuneration Committee.
[5] John Grant became Chairman of the Audit Committee on 6 March 2012, in place of Miles Templeman. In recognition of Mr Grant's Chairmanship of this committee from 6 March 2012 to 31 December 2012 an amount of £4,115 was paid.
[6] Justin Dowley was appointed as a non-executive Director of the Company on 1 September 2011. He was paid £18,883 for the period from 1 September 2011 to 31 December 2011. The fee paid to Mr Dowley for the year ended 31 December 2012 relates to the full year.

## 2009 AND 2012 INCENTIVE SHARES

Details of the Directors' holdings in both the 2009 Incentive Shares (including the number of Ordinary Shares obtained by the Directors upon crystallisation) and options over 2012 Incentive Shares during the year are shown below:

| Directors | Number of 2009 Incentive Shares | Number of Ordinary Shares arising upon 2009 Incentive Share crystallisation[1] | Number of options over 2012 Incentive Shares |
|---|---|---|---|
| Christopher Miller | 12,000 | 7,499,512 | 8,500 |
| David Roper | 12,000 | 7,499,512 | 8,500 |
| Simon Peckham | 12,000 | 7,499,512 | 8,500 |
| Geoffrey Martin | 7,500 | 4,687,195 | 8,500 |
| Miles Templeman | Nil | Nil | Nil |
| Perry Crosthwaite | Nil | Nil | Nil |
| John Grant | Nil | Nil | Nil |
| Justin Dowley | Nil | Nil | Nil |

[1] The market value of each Ordinary Share received on the crystallisation date of 11 April 2012 was 406 pence. The total number of Ordinary Shares obtained by the Directors following the crystallisation on 11 April 2012 was 27,185,731, representing a market value of £110.4 million.

The report was approved by the Board on 6 March 2013 and signed on its behalf by:

**Perry Crosthwaite**
Chairman of the Remuneration Committee
6 March 2013

# Statement of Directors' responsibilities

The Directors are responsible for preparing the Annual Report and the financial statements in accordance with applicable law and regulations.

Company law requires the Directors to prepare financial statements for each financial year. Under that law the Directors are required to prepare the Group financial statements in accordance with International Financial Reporting Standards ("IFRSs") as adopted by the European Union and Article 4 of the IAS Regulation and have elected to prepare the parent Company financial statements in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards and applicable law). Under Company law the Directors must not approve the accounts unless they are satisfied that they give a true and fair view of the state of affairs of the Company and of the profit or loss of the Company for that period.

In preparing the parent Company financial statements, the Directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and accounting estimates that are reasonable and prudent;
- state whether applicable UK Accounting Standards have been followed, subject to any material departures disclosed and explained in the financial statements; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Company will continue in business.

In preparing the Group financial statements, International Accounting Standard 1 requires that Directors:

- properly select and apply accounting policies;
- present information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information;
- provide additional disclosures when compliance with the specific requirements in IFRSs are insufficient to enable users to understand the impact of particular transactions, other events and conditions on the entity's financial position and financial performance; and
- make an assessment of the Company's ability to continue as a going concern.

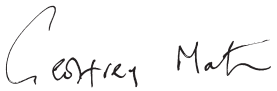
The Directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Company's transactions and disclose with reasonable accuracy at any time the financial position of the Company and enable them to ensure that the financial statements comply with the Companies Act 2006. They are also responsible for safeguarding the assets of the Company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

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

**Directors' Responsibility statement**
We confirm that to the best of our knowledge:

- the financial statements, prepared in accordance with the relevant financial reporting framework, give a true and fair view of the assets, liabilities, financial position and profit or loss of the Company and the undertakings included in the consolidation taken as a whole; and
- the Chairman's statement, Chief Executive's review, Finance Director's review and Directors' report include a fair review of the development and performance of the business and the position of the Company and the undertakings included in the consolidation taken as a whole, together with a description of the principal risks and uncertainties that they face.

By order of the Board



**Geoffery Martin**
Group Finance Director
6 March 2013

**Simon Peckham**
Chief Executive
6 March 2013

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# Independent auditor's report to the members of Melrose Industries PLC

We have audited the consolidated financial statements of Melrose Industries PLC for the year ended 31 December 2012 which comprise the consolidated Income Statement, the consolidated Statement of Comprehensive Income, the consolidated Statement of Cash Flows, the consolidated Balance Sheet, the consolidated Statement of Changes in Equity and the related notes 1 to 30. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union.

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

### Respective responsibilities of Directors and auditor

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

### Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the Group's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the Directors; and the overall presentation of the financial statements. In addition, we read all the financial and non-financial information in the annual report to identify material inconsistencies with the audited financial statements. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

### Opinion on financial statements

In our opinion the consolidated financial statements:

- give a true and fair view of the state of the Group's affairs as at 31 December 2012 and of its profit for the year then ended;
- have been properly prepared in accordance with IFRSs as adopted by the European Union; and
- have been prepared in accordance with the requirements of the Companies Act 2006 and Article 4 of the IAS Regulation.

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

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

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

We have nothing to report in respect of the following:

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

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

Under the Listing Rules we are required to review:

- the Directors' statement, contained within the Directors' report, in relation to going concern;
- the part of the Corporate Governance Statement relating to the Company's compliance with the nine provisions of the UK Corporate Governance Code specified for our review; and
- certain elements of the report to shareholders by the Board on Directors' remuneration.

### Other matter

We have reported separately on the Company financial statements of Melrose Industries PLC for the year ended 31 December 2012 and on the information in the Remuneration Report that is described as having been audited.

**Nigel Mercer, ACA (Senior Statutory Auditor)**
for and on behalf of Deloitte LLP
Chartered Accountants and Statutory Auditor
London, UK
6 March 2013

# Consolidated Income Statement

| | Notes | Year ended 31 December 2012 £m | Restated[1] year ended 31 December 2011 £m |
|---|---|---|---|
| **Continuing operations** | | | |
| Revenue | 4,5 | **1,551.4** | 1,080.4 |
| Cost of sales | | **(1,067.9)** | (749.7) |
| Gross profit | | **483.5** | 330.7 |
| Headline[2] operating expenses | | **(241.2)** | (156.5) |
| Share of results of joint ventures | 14 | **0.8** | – |
| Intangible asset amortisation | | **(39.1)** | (23.7) |
| Exceptional operating costs | 6 | **(73.9)** | (40.0) |
| Exceptional operating income | 6 | **7.0** | – |
| Total net operating expenses | 7 | **(346.4)** | (220.2) |
| Operating profit | | **137.1** | 110.5 |
| Headline[2] operating profit | 5 | **243.1** | 174.2 |
| Headline[2] finance costs | 7 | **(39.8)** | (29.5) |
| Exceptional finance costs | 6,7 | **(16.3)** | – |
| Total finance costs | 7 | **(56.1)** | (29.5) |
| Finance income | 4,7 | **11.0** | 10.0 |
| Profit before tax | | **92.0** | 91.0 |
| Headline[2] profit before tax | | **214.3** | 154.7 |
| Headline[2] tax | | **(57.8)** | (39.7) |
| Exceptional tax[3] | | **8.7** | 58.8 |
| Total tax | 8 | **(49.1)** | 19.1 |
| Profit for the year from continuing operations | | **42.9** | 110.1 |
| Headline[2] profit for the year from continuing operations | | **156.5** | 115.0 |
| **Discontinued operations** | | | |
| Profit for the year from discontinued operations | 9 | **1.3** | 176.4 |
| **Profit for the year** | | **44.2** | 286.5 |
| **Attributable to:** | | | |
| Owners of the parent | | **42.5** | 286.4 |
| Non-controlling interests | | **1.7** | 0.1 |
| | | **44.2** | 286.5 |
| **Earnings per share[4]** | | | |
| From continuing operations | | | |
| - Basic | 11 | **4.4p** | 13.8p |
| - Diluted | 11 | **4.3p** | 12.9p |
| - Headline[2] diluted | 11 | **16.1p** | 13.5p[5] |
| From continuing and discontinued operations | | | |
| - Basic | 11 | **4.5p** | 35.8p |
| - Diluted | 11 | **4.4p** | 33.6p |
| - Headline[2] diluted | 11 | **16.3p** | 16.4p |

[1] Restated to include the results of MPC within discontinued operations.
[2] Before exceptional costs, exceptional income and intangible asset amortisation.
[3] Includes exceptional tax and tax on exceptional items and intangible asset amortisation.
[4] Year ended 31 December 2011 restated for the effects of the Rights Issue (note 11).
[5] 13.5p is the restated 2011 headline[2] diluted earnings per share from continuing operations. The Board believe that 15.8p is a more appropriate measure to use for 2011 to compare against 2012 performance being the headline[2] diluted earnings per share from continuing and discontinued operations adjusted to remove the earnings (£4.8 million) of the disposed business MPC.

# Consolidated Statement of Comprehensive Income

| | Notes | Year ended 31 December 2012 £m | Year ended 31 December 2011 £m |
|---|---|---|---|
| **Profit for the year** | | **44.2** | 286.5 |
| Currency translation on net investments | 25 | **(1.2)** | (17.3) |
| Currency translation on non-controlling interests | | **0.2** | — |
| Transfer to Income Statement from equity of cumulative translation differences on disposal of foreign operations | 25 | **—** | (52.6) |
| Losses on cash flow hedges | 25 | **(6.2)** | (0.1) |
| Transfer to Income Statement on cash flow hedges | 25 | **11.9** | (5.1) |
| Actuarial loss on retirement benefit obligations | 23 | **(63.8)** | (37.1) |
| **Other comprehensive expense before tax** | | **(59.1)** | (112.2) |
| Tax relating to components of other comprehensive expense | 8 | **2.7** | 16.8 |
| **Other comprehensive expense after tax** | | **(56.4)** | (95.4) |
| **Total comprehensive (expense)/income for the year** | | **(12.2)** | 191.1 |
| **Attributable to:** | | | |
| Owners of the parent | | **(14.1)** | 191.0 |
| Non-controlling interests | | **1.9** | 0.1 |
| | | **(12.2)** | 191.1 |

# Consolidated Statement of Cash Flows

| | Notes | Year ended 31 December 2012 £m | Restated[1] year ended 31 December 2011 £m |
|---|---|---|---|
| Net cash from operating activities from continuing operations | 26 | **40.8** | 70.8 |
| Net cash from operating activities from discontinued operations | 26 | **1.7** | 20.4 |
| **Net cash from operating activities** | | **42.5** | 91.2 |
| **Investing activities** | | | |
| Disposal of businesses | 9 | **30.7** | 374.4 |
| Net cash disposed | 9 | **(1.2)** | (0.5) |
| Acquisition and disposal costs | | **(27.6)** | (3.2) |
| Purchase of property, plant and equipment | | **(52.1)** | (33.0) |
| Proceeds from disposal of property, plant and equipment | | **1.4** | 0.3 |
| Purchase of computer software | | **(2.2)** | (1.4) |
| Dividends received from joint ventures | 14 | **0.3** | — |
| Interest received | | **11.0** | 10.0 |
| Acquisition of subsidiaries | | **(1,500.4)** | — |
| Cash acquired on acquisition of Elster | 12 | **105.6** | — |
| Dividends paid to non-controlling interests | | **(0.1)** | — |
| Net cash (used in)/from investing activities from continuing operations | | **(1,434.6)** | 346.6 |
| Net cash used in investing activities from discontinued operations | 26 | **(1.8)** | (9.4) |
| **Net cash (used in)/from investing activities** | | **(1,436.4)** | 337.2 |
| **Financing activities** | | | |
| Return of capital | 10 | **(1.1)** | (372.1) |
| Repayment of borrowings[2] | | **(1,176.9)** | — |
| Net proceeds from Rights Issue | | **1,168.1** | — |
| New bank loans raised[2] | | **1,467.1** | — |
| Costs of raising and settling finance | | **(33.1)** | — |
| Dividends paid | 10 | **(65.7)** | (52.8) |
| Net cash from/(used in) financing activities from continuing operations | | **1,358.4** | (424.9) |
| Net cash used in financing activities from discontinued operations | 26 | **—** | (0.3) |
| **Net cash from/(used in) financing activities** | | **1,358.4** | (425.2) |
| **Net (decrease)/increase in cash and cash equivalents** | | **(35.5)** | 3.2 |
| Cash and cash equivalents at the beginning of the year | 26 | **195.6** | 195.7 |
| Effect of foreign exchange rate changes | 26 | **(3.6)** | (3.3) |
| **Cash and cash equivalents at the end of the year** | 17,26 | **156.5** | 195.6 |

[1] Restated to include the cash flows of MPC within discontinued operations.
[2] Relating to the repayment and drawdown of the Group facilities refinanced during the year (note 19).

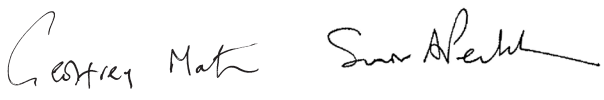
As at 31 December 2012, the Group's net debt was £997.7 million (31 December 2011: £289.6 million). A reconciliation of the movement in net debt is shown in note 26.

# Consolidated Balance Sheet

| | Notes | 31 December 2012 £m | Restated[1] 31 December 2011 £m |
|---|---|---|---|
| **Non-current assets** | | | |
| Goodwill and other intangible assets | 12 | **3,019.5** | 906.1 |
| Property, plant and equipment | 13 | **318.9** | 215.3 |
| Interests in joint ventures | 14 | **12.4** | – |
| Deferred tax assets | 21 | **145.1** | 40.4 |
| Trade and other receivables | 16 | **0.3** | 0.3 |
| | | **3,496.2** | 1,162.1 |
| **Current assets** | | | |
| Inventories | 15 | **376.1** | 205.8 |
| Trade and other receivables | 16 | **384.1** | 216.3 |
| Derivative financial assets | 24 | **3.3** | 1.7 |
| Cash and cash equivalents | 17 | **156.5** | 195.6 |
| | | **920.0** | 619.4 |
| **Total assets** | 5 | **4,416.2** | 1,781.5 |
| **Current liabilities** | | | |
| Trade and other payables | 18 | **539.4** | 276.0 |
| Interest-bearing loans and borrowings | 19 | **6.2** | 28.8 |
| Derivative financial liabilities | 24 | **7.0** | 14.1 |
| Current tax liabilities | | **41.0** | 16.9 |
| Provisions | 20 | **98.4** | 58.2 |
| | | **692.0** | 394.0 |
| **Net current assets** | | **228.0** | 225.4 |
| **Non-current liabilities** | | | |
| Trade and other payables | 18 | **2.6** | 1.6 |
| Interest-bearing loans and borrowings | 19 | **1,148.0** | 457.5 |
| Derivative financial liabilities | 24 | **3.5** | 1.6 |
| Deferred tax liabilities | 21 | **411.2** | 98.3 |
| Retirement benefit obligations | 23 | **261.3** | 117.7 |
| Provisions | 20 | **155.9** | 62.4 |
| | | **1,982.5** | 739.1 |
| **Total liabilities** | 5 | **2,674.5** | 1,133.1 |
| **Net assets** | | **1,741.7** | 648.4 |
| **Equity** | | | |
| Issued share capital | 25 | **1.3** | 494.9 |
| Share premium account | | **–** | – |
| Merger reserve | | **1,190.6** | 1,190.6 |
| Other reserves | | **(757.1)** | (874.4) |
| Capital redemption reserve | | **–** | (26.8) |
| Hedging and translation reserves | 25 | **0.3** | (2.6) |
| Retained earnings | | **1,299.5** | (133.4) |
| **Equity attributable to owners of the parent** | | **1,734.6** | 648.3 |
| Non-controlling interests | | **7.1** | 0.1 |
| **Total equity** | | **1,741.7** | 648.4 |

[1] In accordance with IFRS 3, the prior year Issued share capital, Share premium account, Merger reserve, Other reserves and Capital redemption reserve balances have been restated to reflect the nominal share capital and reserves position of the new parent company as if it had been the holding company during both periods presented. The overall impact on net equity is £nil (note 1).

The financial statements were approved and authorised for issue by the Board of Directors on 6 March 2013 and were signed on its behalf by:



**Geoffrey Martin**
Group Finance Director

**Simon Peckham**
Chief Executive

# Consolidated Statement of Changes in Equity

| Reserves | Issued share capital £m | Share premium account £m | Merger reserve £m | Other reserves £m | Capital redemption reserve £m | Hedging and translation reserves £m | Retained earnings £m | Equity attributable to owners of the parent £m | Non-controlling interests £m | Total equity £m |
|---|---|---|---|---|---|---|---|---|---|---|
| At 1 January 2011 (as previously reported) | 1.1 | 279.1 | 285.1 | — | 220.1 | 71.0 | 25.1 | 881.5 | 1.4 | 882.9 |
| Restatement for the effects of the new parent company[1] | 468.1 | (126.0) | 905.5 | (874.4) | (373.2) | — | — | — | — | — |
| At 1 January 2011 restated[1] | 469.2 | 153.1 | 1,190.6 | (874.4) | (153.1) | 71.0 | 25.1 | 881.5 | 1.4 | 882.9 |
| Profit for the year | — | — | — | — | — | — | 286.4 | 286.4 | 0.1 | 286.5 |
| Other comprehensive expense | — | — | — | — | — | (73.6) | (21.8) | (95.4) | — | (95.4) |
| Total comprehensive (expense)/ income | — | — | — | — | — | (73.6) | 264.6 | 191.0 | 0.1 | 191.1 |
| Issue of redeemable preference C shares | 372.1 | (153.1) | — | — | (220.1) | — | — | (1.1) | — | (1.1) |
| Preference C shares redeemed | (346.4) | — | — | — | 346.4 | — | — | — | — | — |
| Return of capital | — | — | — | — | — | — | (372.1) | (372.1) | — | (372.1) |
| Dividends paid | — | — | — | — | — | — | (52.8) | (52.8) | (0.2) | (53.0) |
| Credit to equity for equity-settled share-based payments | — | — | — | — | — | — | 1.8 | 1.8 | — | 1.8 |
| Disposal of non-controlling interests | — | — | — | — | — | — | — | — | (1.2) | (1.2) |
| At 31 December 2011 restated[1] | 494.9 | — | 1,190.6 | (874.4) | (26.8) | (2.6) | (133.4) | 648.3 | 0.1 | 648.4 |
| Profit for the year | — | — | — | — | — | — | 42.5 | 42.5 | 1.7 | 44.2 |
| Other comprehensive income/ (expense) | — | — | — | — | — | 2.9 | (59.5) | (56.6) | 0.2 | (56.4) |
| Total comprehensive income/ (expense) | — | — | — | — | — | 2.9 | (17.0) | (14.1) | 1.9 | (12.2) |
| Preference C shares redeemed | (25.7) | — | — | — | 26.8 | — | (1.1) | — | — | — |
| Dividends paid | — | — | — | — | — | — | (65.7) | (65.7) | (0.1) | (65.8) |
| Credit to equity for equity-settled share-based payments | — | — | — | — | — | — | 3.5 | 3.5 | — | 3.5 |
| Issue of new shares | 1,050.8 | — | — | 117.3 | — | — | — | 1,168.1 | — | 1,168.1 |
| Acquisition of Elster | — | — | — | — | — | — | — | — | 6.1 | 6.1 |
| Purchase of Elster non-controlling interests | — | — | — | — | — | — | (5.5) | (5.5) | (0.9) | (6.4) |
| Capital reduction | (1,518.7) | — | — | — | — | — | 1,518.7 | — | — | — |
| **At 31 December 2012** | **1.3** | **—** | **1,190.6** | **(757.1)** | **—** | **0.3** | **1,299.5** | **1,734.6** | **7.1** | **1,741.7** |

[1] In accordance with IFRS 3, the prior year Issued share capital, Share premium account, Merger reserve, Other reserves and Capital redemption reserve balances have been restated to reflect the nominal share capital and reserves position of the new parent company as if it had been the holding company during both periods presented. The overall impact on net equity is £nil (note 1).

# Notes to the financial statements

## 1. Corporate information

Melrose Industries PLC ("the Company") is a company incorporated in the United Kingdom under the Companies Act 2006. The address of the registered office is given on page 128. The nature of the Group's operations and its principal activities are set out in note 5 and in the Divisional review on pages 16 to 26.

Following shareholder approval on 5 November 2012, a Scheme of Arrangement was sanctioned by the High Court of England and Wales on 26 November 2012, pursuant to which a new listed company was introduced for the Melrose Group of companies. The Scheme of Arrangement became effective on 27 November 2012 and Melrose Industries PLC became the new holding company of Melrose PLC and its subsidiaries by way of a share exchange.

The Scheme of Arrangement resulting in Melrose Industries PLC becoming the new holding company for the Group has been accounted for in these consolidated financial statements as a reverse asset acquisition using the principles of reverse acquisition accounting set out in IFRS 3: "Business combinations".

As a consequence of applying reverse acquisition accounting principles, the consolidated results of Melrose Industries PLC ("the Group") for the year ended 31 December 2012 comprise the results of Melrose PLC and its subsidiaries for the year ended 31 December 2012 consolidated with those of Melrose Industries PLC from 27 November 2012. The comparative figures for the Group are those of the Group headed by Melrose PLC for the year ended 31 December 2011 except for the presentation of the Issued share capital, Share premium account, Merger reserve, Other reserves and Capital redemption reserve balances which have been restated to reflect the reserves position of the Group as if Melrose Industries PLC had been the parent company during both periods presented. On 23 January 2013, Melrose PLC changed its name to Melrose Limited.

The consolidated financial statements of the Group for the year ended 31 December 2012 were authorised in accordance with a resolution of the Directors of Melrose Industries PLC on 6 March 2013.

These financial statements are presented in pounds Sterling which is the currency of the primary economic environment in which the Company is based. Foreign operations are included in accordance with the policies set out in note 2.

The comparative information for the year ended 31 December 2011 in these financial statements has been restated to include the results and cash flows of MPC, previously disclosed within the Other Industrial segment, within discontinued operations and exclude them from continuing operations.

### 1.1 New Standards and Interpretations affecting amounts, presentation or disclosure reported in the current period

During the period, the Group adopted two amended Standards and Interpretations, neither of which significantly affected the amounts reported in these financial statements. Details of the Standards and Interpretations that were adopted are set out in section 1.2.

### 1.2 New Standards and Interpretations adopted with no significant effect on financial statements

The following new and revised Standards and Interpretations have been adopted in the current year. Their adoption has not had any significant impact on the amounts reported in these financial statements, but may impact the accounting for future transactions and arrangements.

IFRS 7 (amended): Financial instruments disclosures
IAS 12 (amended): Deferred tax – recovery of underlying assets

### 1.3 New Standards and Interpretations in issue but not yet effective

At the date of authorisation of these financial statements, the following Standards and Interpretations are in issue but not yet effective:

IAS 1 (amended): Presentation of items of other comprehensive income
IAS 32 (amended): Offsetting financial assets and financial liabilities
IAS 19 (revised): Employee benefits
IAS 27 (revised): Separate financial statements
IAS 28 (revised): Investments in associates and joint ventures
IFRS 10, IFRS 12 and IAS 27 (amended): Investment entities
IFRS 1 (amended): Government loans
IFRS 7 (amended): Disclosures – offsetting financial assets and financial liabilities
IFRS 9: Financial instruments
IFRS 10: Consolidated financial statements
IFRS 11: Joint arrangements
IFRS 12: Disclosure of interest in other entities
IFRS 13: Fair value measurement
IFRIC 20: Stripping costs in the production phase of a surface mine
Annual improvements to IFRSs (2009-2011) Cycle

## 1. Corporate information (continued)

The Directors do not anticipate that the adoption of these Standards and Interpretations will have a material impact on the Group's financial statements in the period of initial application, except as follows:

IAS 19 (revised) will impact the measurement of the various components representing movements in the defined benefit pension obligation and associated disclosures, but not the Group's total obligation. Following the adoption of IAS 19 (revised), effective from 1 January 2013, the net retirement benefit obligation in the Balance Sheet will not be impacted but the net finance and operating costs of pensions, within the Income Statement, will increase. This will reduce profit before tax for the year by approximately £10 million but will accordingly increase Other Comprehensive Income by the same amount. The net effect on Total Comprehensive Income for the year will be £nil.

## 2. Summary of significant accounting policies

### Basis of accounting

The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRSs"). The consolidated financial statements have also been prepared in accordance with IFRSs adopted for use in the European Union and therefore comply with Article 4 of the EU IAS Regulation.

The consolidated financial statements have been prepared on a historical cost basis, except for the revaluation of certain financial instruments which are recognised at fair value. Historical cost is generally based on the fair value of the consideration given in exchange for these assets. The principal accounting policies adopted are consistent with the prior year and are set out below.

### Basis of consolidation

The Group financial statements include the results of the parent undertaking and all of its subsidiary undertakings. The results of businesses acquired during the period are included from the effective date of acquisition and for those sold during the period to the effective date of disposal. Where necessary, adjustments are made to the financial statements of subsidiaries to bring the accounting policies used into line with those used by the Group. All intra-Group balances and transactions, including unrealised profits arising from intra-Group transactions, have been eliminated in full.

Non-controlling interests in subsidiaries are identified separately from the Group's equity therein. The interest of non-controlling shareholders is initially measured at the non-controlling interests proportion of the share of the fair value of the acquiree's identifiable net assets. Subsequent to acquisition, the carrying amount of non-controlling interests is the amount of those interests at initial recognition plus the non-controlling interests' share of subsequent changes in equity. Total comprehensive income is attributed to non-controlling interests even if this results in the non-controlling interests having a deficit balance.

### Going concern

The Directors have, at the time of approving the financial statements, a reasonable expectation that the Company and the Group have adequate resources to continue in operational existence for the foreseeable future. Thus they continue to adopt the going concern basis of accounting in preparing the financial statements. Further detail is contained in the Directors' statement of going concern on page 54 of the Directors' report.

### Business combinations and goodwill

The acquisition of subsidiaries is accounted for using the purchase method. The cost of acquisition is measured at the fair value of assets given, the liabilities incurred or assumed at the date of exchange of control and equity instruments issued by the Group in exchange for control of the acquiree. Control is achieved where the Company has the power to govern the financial and operating policies of an investee entity so as to obtain benefits from its activities. Costs directly attributable to business combinations are recognised as an expense in the Income Statement as incurred.

The acquired identifiable assets and liabilities are measured at their fair value at the date of acquisition except those where specific guidance is provided by IFRSs. Non-current assets and directly attributable liabilities that are classified as held for sale in accordance with IFRS 5: "Non-current assets held for sale and discontinued operations", are recognised and measured at fair value less costs to sell. Also, deferred tax assets and liabilities are recognised and measured in accordance with IAS 12: "Income taxes", liabilities and assets related to employee benefit arrangements are recognised and measured in accordance with IAS 19: "Employee benefits" and liabilities or equity instruments related to the replacement by the Group of an acquiree's share-based payments awards are measured in accordance with IFRS 2: "Share-based payments". Any excess of the cost of the acquisition over the fair values of the identifiable net assets acquired is recognised as goodwill.

If the initial accounting for a business combination is incomplete by the end of the reporting period in which the combination occurs, the Group reports provisional amounts where appropriate. Those provisional amounts are adjusted during the measurement period, or additional assets or liabilities recognised, to reflect new information obtained about facts and circumstances that existed as of the acquisition date that, if known, would have affected the amounts recognised at that date.

The measurement period is the period from the date of acquisition to the date the Group obtains complete information about facts and circumstances that existed as of the acquisition date and is subject to a maximum period of one year.

# Notes to the financial statements continued

**2. Summary of significant accounting policies (continued)**

Goodwill on acquisition is initially measured at cost being the excess of the sum of the consideration transferred, the amount of any non-controlling interest in the acquiree and the fair value of the acquirer's previously held equity interest in the acquiree over the acquirer's interest in the net fair value of the identifiable assets, liabilities and contingent liabilities. Following initial recognition, goodwill is measured at cost less any accumulated impairment losses. Goodwill is reviewed for impairment annually or more frequently if events or changes in circumstances indicate that the carrying value may be impaired.

If, after reassessment, the Group's interest in the fair value of the acquiree's identifiable net assets exceeds the sum of the consideration transferred, the amount of any non-controlling interest in the acquiree and the fair value of the acquirer's previously held equity interest in the acquiree, the excess is recognised immediately in profit or loss as a bargain purchase gain.

As at the acquisition date, any goodwill acquired is allocated to each of the cash-generating units acquired. Impairment is determined by assessing the recoverable amount of the cash-generating unit to which goodwill relates. Where the recoverable amount of the cash-generating unit is less than the carrying amount, an impairment loss is recognised in the Income Statement and is not subsequently reversed. When there is a disposal of a cash-generating unit, goodwill relating to the operation disposed of is taken into account in determining the gain or loss on disposal of that operation. The amount of goodwill allocated to a partial disposal is measured on the basis of the relative values of the operation disposed of and the operation retained.

**Joint ventures**

A joint venture is an entity which is not a subsidiary undertaking but the interest of the Group is that of a partner in a business over which the Group exercises joint control. The results, assets and liabilities of joint ventures are accounted for using the equity method of accounting.

**Revenue**

Revenue is recognised when the significant risks and rewards of ownership of goods have passed to the buyer and can be reliably measured. Revenue is measured at the fair value of the consideration received or receivable and represents amounts receivable for goods provided in the normal course of business, net of discounts, customs duties and sales taxes.

Where percentage of completion accounting is applied and where the outcome of a construction contract can be estimated reliably, revenue and costs are recognised by reference to the stage of completion of the contract activity at the Balance Sheet date. This is normally measured by the proportion that contract costs incurred for work performed to date bear to the estimated total contract costs, except where this would not be representative of the stage of completion. Variations in contract work, claims and incentive payments are included to the extent that they have been agreed with the customer.

Where the outcome of a construction contract cannot be estimated reliably, contract revenue is recognised to the extent of contract costs incurred where it is probable they will be recoverable. Contract costs are recognised as expenses in the period in which they are incurred.

When it is probable that total contract costs will exceed total contract revenue, the expected loss is recognised as an expense immediately.

Interest income is recognised when it is probable that the economic benefits will flow to the Group and the amount of revenue can be measured reliably. Interest income is accrued on a time basis, by reference to the principal outstanding and the effective interest rate applicable.

**Exceptional costs/income**

Exceptional costs/income are those costs/income of a significant and non-recurring nature or those associated with significant restructuring programmes or acquisitions or disposals.

**Operating profit**

Operating profit is stated after exceptional operating costs and income, intangible asset amortisation and the Group's share of results of joint ventures, but before finance income and finance costs.

**Borrowing costs**

Borrowing costs directly attributable to the acquisition, construction or production of qualifying assets, which are assets that necessarily take a substantial period of time to get ready for their intended use or sale, are added to the cost of those assets, until such time as the assets are substantially ready for their intended use or sale.

Investment income earned on the temporary investment of specific borrowings pending their expenditure on qualifying assets is deducted from the borrowing costs eligible for capitalisation.

All other borrowing costs are recognised in the Income Statement in the period in which they are incurred.

## 2. Summary of significant accounting policies (continued)

### Issue costs of loans

The finance cost recognised in the Income Statement in respect of the issue costs of borrowings is allocated to periods over the terms of the instrument using the effective interest rate method.

### Property, plant and equipment

Property, plant and equipment are stated at cost less accumulated depreciation and any impairment in value.

The initial cost of an asset comprises its purchase price or construction cost, and any costs directly attributable to bring the asset into operation. The purchase price or construction cost is the aggregate amount paid and the fair value of any other consideration given to acquire the asset.

Depreciation is calculated on a straight-line basis over the estimated useful life of the asset as follows:

| | |
|---|---|
| Freehold land | nil |
| Freehold buildings and long leasehold property | over expected economic life not exceeding 50 years |
| Short leasehold property | over the term of the lease |
| Plant and equipment | 3-12 years |

The estimated useful lives of property, plant and equipment are reviewed on an annual basis and, if necessary, changes in useful lives are accounted for prospectively.

The carrying values of property, plant and equipment are reviewed for impairment when events or changes in circumstances indicate that the carrying value may not be recoverable. If any such indication exists an impairment review is performed and, where the carrying values exceed the estimated recoverable amount, the assets are written down to their recoverable amount. The recoverable amount of property, plant and equipment is the greater of net selling price and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. For an asset that does not generate largely independent cash inflows, the recoverable amount is determined for the cash-generating unit to which the asset belongs.

An item of property, plant and equipment is derecognised upon disposal or when no future economic benefits are expected to arise from the continued use of the asset. Any gain or loss arising on derecognition of the asset (calculated as the difference between the net disposal proceeds or costs and the carrying amount of the item) is included in the Income Statement in the year that the item is derecognised.

### Intangible assets

Intangible assets are stated at cost less accumulated amortisation and accumulated impairment losses.

On acquisition of businesses, separately identifiable intangible assets are determined in relation to the specific circumstances of the business acquired and are valued on an appropriate basis.

Access to the use of patented technology and trade names are valued using a “relief from royalty” method which determines the net present value of future additional cash flows arising from the use of the intangible asset.

Customer relationships are valued on the basis of the net present value of the future additional cash flows arising from customer relationships with appropriate allowance for attrition of customers.

The estimated useful lives of intangible assets are:

| | |
|---|---|
| Computer software | 5 years or less |
| Patented technology | 5 years or less |
| Customer relationships | 20 years or less |
| Trade names | 20 years or less |

Computer software is initially recorded at cost. Where these assets have been acquired through a business combination, this will be the fair value allocated in the acquisition accounting. Where these have been acquired other than through a business combination, the initial cost is the aggregate amount paid and the fair value of any other consideration given to acquire the asset.

Computer software assets are amortised over their estimated useful lives on a straight-line basis.

Intangible assets are tested for impairment annually or more frequently whenever events or changes in circumstances indicate that the carrying value may not be recoverable. Impairment losses are measured on a similar basis to property, plant and equipment. Useful lives are also examined on an annual basis and adjustments, where applicable, are made on a prospective basis.

# Notes to the financial statements continued

## 2. Summary of significant accounting policies (continued)

### Research and development costs

Research costs are expensed as incurred.

Costs relating to clearly defined and identifiable development projects are capitalised when there is a technical degree of exploitation, adequacy of resources and a potential market or development possibility in the undertaking that are recognisable; and where it is the intention to produce, market or execute the project. A correlation must also exist between the costs incurred and future benefits and those costs can be measured reliably. Capitalised expenses are expensed on a straight-line basis over their useful lives of five years or less. Costs not meeting such criteria are expensed as incurred.

### Inventories

Inventories are valued at the lower of cost and net realisable value. Cost includes all direct expenditure and appropriate production overhead expenditure incurred in bringing goods to their current state under normal operating conditions. Net realisable value is based on estimated selling price less costs expected to be incurred to completion and disposal. Provisions are made for obsolescence or other expected losses where necessary.

### Trade and other receivables

Trade receivables and other receivables are measured and carried at amortised cost using the effective interest method, less any impairment. The carrying amount of other receivables is reduced by the impairment loss directly and a charge is recorded in the Income Statement. For trade receivables, the carrying amount is reduced through the use of an allowance account. Subsequent recoveries of amounts previously written off are credited against the allowance account and changes in the carrying amount of the allowance account are recognised in the Income Statement.

Trade receivables that are assessed not to be impaired individually are also assessed for impairment on a collective basis. Objective evidence of impairment for a portfolio of receivables could include the Group's past experience of collecting receipts, an increase in the number of delayed receipts in the portfolio past the average credit period, as well as observable changes in national or local economic conditions that correlate with default on receivables.

### Cash and cash equivalents

Cash and cash equivalents in the Balance Sheet comprise cash in hand and current balances with banks and similar institutions and short-term deposits which are readily convertible to cash which are subject to insignificant risks of changes in value.

For the purpose of the Consolidated Cash Flow Statement, cash and cash equivalents consist of cash and cash equivalents as defined above, net of outstanding bank overdrafts.

### Interest-bearing loans and borrowings

All loans and borrowings are initially recognised at fair value of the consideration received net of issue costs associated with the borrowings.

After initial recognition, interest-bearing loans and borrowings are subsequently measured at amortised cost using the effective interest method. Amortised cost is calculated by taking into account any issue costs, and any discount or premium on settlement.

Gains and losses are recognised in the Income Statement when the liabilities are derecognised or impaired, as well as through the amortisation process.

### Leases

Finance leases, which transfer to the Group substantially all the risks and benefits incidental to ownership of the leased item, are capitalised at the inception of the lease at the fair value 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 the finance charges and reduction of the lease liability so as to achieve a constant rate of interest on the remaining balance of the liability.

Finance charges are charged directly against income. Capitalised leased assets are depreciated over the shorter of the estimated useful life of the asset or the lease term.

Operating lease payments are recognised as an expense in the Income Statement on a straight-line basis over the lease term. Rental income from operating leases is recognised on a straight-line basis over the term of the relevant lease.

## 2. Summary of significant accounting policies (continued)

### Other financial liabilities

Other financial liabilities are initially measured at fair value, net of transaction costs. Other financial liabilities are subsequently measured at amortised cost using the effective interest method, with interest expense recognised on an effective yield basis. The effective interest method is a method of calculating the amortised cost of a financial liability and of allocating interest expense over the relevant periods. The effective interest rate is the rate that discounts estimated future cash payments throughout the expected life of the financial liability, or, where appropriate, a shorter period to the net carrying amount on initial recognition. The Group derecognises financial liabilities when the Group's obligations are discharged, cancelled or they expire.

### Derivative financial instruments and hedging

The Group uses derivative financial instruments to manage its exposure to interest rate, foreign exchange rate and commodity risks, arising from operating and financing activities. The Group does not hold or issue derivative financial instruments for trading purposes. Details of derivative financial instruments are disclosed in note 24 of the financial statements. Movements on the hedging reserve in equity are detailed in note 25.

Derivative financial instruments are recognised and stated at fair value. Their fair value is recalculated at each reporting date. The accounting treatment for the resulting gain or loss will depend on whether the derivative meets the criteria to qualify for hedge accounting.

Where derivatives do not meet the criteria to qualify for hedge accounting, any gains or losses on the revaluation to fair value at the period end are recognised immediately in the Income Statement. Where derivatives do meet the criteria to qualify for hedge accounting, recognition of any resulting gain or loss on revaluation depends on the nature of the hedge relationship and the item being hedged.

Derivative financial instruments with maturity dates of less than one year from the period end date are classified as current in the Balance Sheet.

### Hedge accounting

In order to qualify for hedge accounting, the Group is required to document from inception the relationship between the item being hedged and the hedging instrument and to show that the hedge will be highly effective on an ongoing basis. This effectiveness testing is performed at each period end to ensure that the hedge remains highly effective.

Hedge accounting is discontinued when the Group revokes the hedging relationship, the hedge instrument expires or is sold, terminated, exercised, or no longer qualifies for hedge accounting.

The Group designates certain hedging instruments as either fair value hedges, cash flow hedges, or hedges of net investments in foreign operations.

#### Fair value hedge

Derivative financial instruments are classified as fair value hedges when they hedge the Group's exposure to changes in the fair value of a recognised asset or liability. Changes in the fair value of derivatives that are designated and qualify as fair value hedges are recorded in the Income Statement immediately, together with any changes in the fair value of the hedged item that is attributable to the hedged risk.

#### Cash flow hedge

Derivative financial instruments are classified as cash flow hedges when they hedge the Group's exposure to the variability in cash flows that are either attributable to a particular risk associated with a recognised asset or liability, or a highly probable forecasted cash flow.

The effective portion of any gain or loss from revaluing the derivative financial instrument is recognised in the Statement of Comprehensive Income and accumulated in equity. The gain or loss relating to the ineffective portion is recognised immediately in the Income Statement.

Amounts previously recognised in the Statement of Comprehensive Income and accumulated in equity are recycled to the Income Statement in the periods when the hedged item is recognised in the Income Statement or the hedged relationship is discontinued. However, when the forecast transaction that is hedged results in the recognition of a non-financial asset or a non-financial liability, the gains and losses previously deferred in equity are transferred from equity and included in the initial measurement of the cost of the non-financial asset or non-financial liability.

#### Hedges of net investments in foreign operations

Derivative financial instruments are classified as net investment hedges when they hedge the Group's net investment in foreign operations. The effective element of any foreign exchange gain or loss from revaluing the derivative at a reporting period end is recognised in the Statement of Comprehensive Income. Any ineffective element is recognised immediately in the Income Statement.

Gains and losses accumulated in equity are recognised immediately in the Income Statement when the foreign operation is disposed of or the hedged relationship is discontinued.

# Notes to the financial statements continued

## 2. Summary of significant accounting policies (continued)

### Provisions

Provisions are recognised when the Group has a present obligation (legal or constructive) as a result of a past event, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation. If the effect of the time value of money is material, provisions are determined by discounting the expected future cash flows at a rate that reflects the current market assessment of the time value of money and, where appropriate, the risks specific to the liability. Where discounting is used, the increase in the provision due to the passage of time is recognised as a finance cost.

**Restructurings**

A restructuring provision is recognised when the Group has developed a detailed formal plan for the restructuring and has raised a valid expectation in those affected that it will carry out the restructuring by either starting to implement the plan or by announcing its main features to those affected by it. The measurement of a restructuring provision includes only the direct expenditures arising from the restructuring, which are those amounts that are both necessarily entailed by the restructuring and not associated with the ongoing activities of the entity.

**Warranties**

Provisions for the expected cost of warranty obligations under local sale of goods legislation are recognised at the date of sale of the relevant products, at the Directors' best estimate of the expenditure required to settle the Group's obligation.

**Onerous contracts**

Present obligations arising under onerous contracts are recognised and measured as provisions. An onerous contract is considered to exist where the Group has a contract under which the unavoidable costs of meeting the obligations under the contract exceed the economic benefits expected to be received under it.

**Environmental liabilities**

Liabilities for environmental costs are recognised when environmental assessments or clean-ups are probable and the associated costs can be reasonably estimated. Generally, the timing of these provisions coincides with the commitment to a formal plan of action. The amount recognised is the best estimate of the expenditure required. Where the liability will not be settled for a number of years, the amount recognised is the present value of the estimated future expenditure.

### Employee benefits

Wages, salaries, bonuses, social security contributions, paid annual leave and sick leave are accrued in the year in which the associated services are rendered by employees of the Group. The accounting policy for pensions and other retirement benefits is described below.

The Group also operates long term incentive plans (LTIPs) for Directors and certain employees. The expected settlement costs of these plans are expensed on a straight-line basis over the life of the plans.

### Pensions and other retirement benefits

The Group operates defined benefit pension plans and defined contribution plans, some of which require contributions to be made to administered funds separate from the Group. In some jurisdictions, funds are not administered separately from the Group but appropriate liabilities are recognised in the Balance Sheet.

For the defined benefit pension and retirement benefit plans, plan assets are measured at fair value and plan liabilities are measured on an actuarial basis, using the projected unit credit method and discounted at an interest rate equivalent to the current rate of return on a high quality corporate bond of equivalent currency and term to the plan liabilities. Any assets resulting from this calculation are limited to past service cost plus the present value of available refunds and reductions in future contributions to the plan.

The service cost of providing pension and other retirement benefits to employees for the period is charged to the Income Statement.

A charge representing the unwinding of the discount on the plan liabilities during the period is included within finance costs.

A credit representing the expected return on the plan assets during the period is included within finance costs. This credit is based on the market value of the plan assets, and expected rates of return, at the beginning of the year.

Actuarial gains and losses may result from: differences between the expected return and the actual return on plan assets; differences between the actuarial assumptions underlying the plan liabilities and actual experience during the period; or changes in the actuarial assumptions used in the valuation of the plan liabilities. Actuarial gains and losses, and taxation thereon, are recognised in full in the period in which they occur, in the Statement of Comprehensive Income.

For defined contribution plans, contributions payable are charged to the Income Statement as they fall due as an operating expense.

## 2. Summary of significant accounting policies (continued)

### Foreign currencies

The individual financial statements of each Group company are presented in the currency of the primary economic environment in which it operates (its functional currency). For the purpose of the consolidated financial statements, the results and financial position of each Group company are expressed in pounds Sterling, which is the functional currency of the Company, and the presentation currency for the consolidated financial statements.

In preparing the financial statements of the individual companies, transactions in currencies other than the entity's functional currency (foreign currencies) are recorded at the rates of exchange prevailing on the dates of the transactions. At each Balance Sheet date, monetary assets and liabilities that are denominated in foreign currencies are retranslated at the rates prevailing on the Balance Sheet date. Non-monetary items carried at fair value that are denominated in foreign currencies are translated at the rates prevailing at the date when the fair value was determined. Non-monetary items that are measured in terms of historical cost in a foreign currency are not retranslated.

Exchange differences arising on the settlement of monetary items, and on the retranslation of monetary items, are included in the Income Statement for the period. Exchange differences arising on the retranslation of non-monetary items carried at fair value are included in the Income Statement for the period except for differences arising on the retranslation of non-monetary items in respect of which gains and losses are recognised directly in equity. For such non-monetary items, any exchange component of that gain or loss is also recognised directly in equity.

For the purpose of presenting consolidated financial statements, the assets and liabilities of the Group's foreign operations are translated at exchange rates prevailing on the Balance Sheet date. Income and expense items are translated at the average exchange rates for the period, unless exchange rates fluctuate significantly during that period, in which case the exchange rates at the date of transactions are used. Exchange differences arising, if any, are recognised in the Statement of Comprehensive Income and accumulated in equity (attributed to non-controlling interests as appropriate). Such translation differences are recognised as income or as expenses in the period in which the related operation is disposed of. Any exchange differences that have previously been attributed to non-controlling interests are derecognised but they are not reclassified to the Income Statement.

Goodwill and fair value adjustments arising on the acquisition of a foreign entity are treated as assets and liabilities of the foreign entity and translated at the rate prevailing at the Balance Sheet date.

### Taxation

The tax expense is based on the taxable profits for the period and represents the sum of the tax paid or currently payable and deferred tax.

Taxable profit differs from net profit as reported in the Income Statement because it excludes items of income or expense that are taxable or deductible in other years and it further excludes items that are never taxable or deductible. The Group's liability for current tax is calculated using tax rates that have been enacted or substantively enacted by the Balance Sheet date.

Deferred tax is provided, using the liability method, on all temporary differences at the Balance Sheet date between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes.

Deferred tax liabilities are recognised for all taxable temporary differences except:

- where the deferred tax liability arises on the initial recognition of goodwill or an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss; and
- where the timing of the reversal of the temporary differences associated with investments in subsidiaries and interests in joint ventures can be controlled and it is probable that the temporary differences will not reverse in the foreseeable future.

Deferred tax assets are recognised for all deductible temporary differences, carry-forward of unused tax assets and unused tax losses, to the extent that it is probable that taxable profit will be available against which the deductible temporary differences, and carry-forward of unused tax assets and unused tax losses can be utilised except:

- where the deferred tax asset arises from the initial recognition of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss; and
- in respect of deductible temporary differences associated with investments in subsidiaries and interests in joint ventures, deferred tax assets are only recognised to the extent that it is probable that the temporary differences will reverse in the foreseeable future and taxable profit will be available against which the temporary differences can be utilised.

# Notes to the financial statements continued

### 2. Summary of significant accounting policies (continued)

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 profit will be available to allow all or part of the deferred tax asset to be utilised.

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply to the year when the asset is realised or the liability is settled, based on tax rates and tax laws that have been enacted or substantively enacted at the relevant Balance Sheet date.

Tax relating to items recognised directly in other comprehensive income is recognised in the Statement of Comprehensive Income and not in the Income Statement.

Revenues, expenses and assets are recognised net of the amount of sales tax except:

- where the sales tax incurred on a purchase of goods and services is not recoverable from the taxation authority, in which case the sales tax is recognised as part of the cost of acquisition of the asset or as part of the expense item as applicable; and
- where receivables and payables are stated with the amount of sales tax included.

The net amount of sales tax recoverable from, or payable to, the taxation authority is included as part of receivables or payables in the Balance Sheet.

#### Share-based payments

The Group has applied the requirements of IFRS 2: “Share-based payments”. The Group issues equity-settled share-based payments to certain employees. Equity-settled share-based payments are measured at fair value of the equity instrument excluding the effect of non-market based vesting conditions at the date of grant. The fair value determined at the grant date of the equity-settled share-based payments is expensed on a straight-line basis over the vesting period, based on the Group’s estimate of shares that will eventually vest and adjusted for the effect of non-market based vesting conditions.

Fair value is measured by use of the Black Scholes pricing model. The expected life used in the model has been adjusted, based on the Directors’ best estimate, for the effects of non-transferability, exercise restrictions, and behavioural considerations.

#### Government grants

Government grants are not recognised until there is reasonable assurance that the Group will comply with the conditions attaching to them and that the grants will be received.

Government grants relating to property, plant and equipment are treated as deferred income and released to profit or loss over the expected useful lives of the assets concerned.

#### Non-current assets and businesses held for sale

Non-current assets and businesses classified as held for sale are measured at the lower of carrying amount and fair value less costs to sell.

Non-current assets and businesses are classified as held for sale if their carrying amount will be recovered principally through a sale transaction rather than through continuing use. This condition is regarded as having been met only when the sale is highly probable and the asset or business is available for immediate sale in its present condition. Management must be committed to the sale which should be expected to qualify for recognition as a completed sale within one year from the date of classification.

### 3. Critical accounting judgements and key sources of estimation uncertainty

In applying the Group’s accounting policies as set out in note 2, management have made critical accounting judgements. These include the quantification of the fair value of assets and liabilities following the acquisition of Elster along with the valuation of intangible assets also acquired. In addition, the impairment of non-current assets, the quantification of provisions and the valuation of retirement benefit obligations and taxation require management judgements. Due to the inherent uncertainty involved in making assumptions and estimates, actual outcomes may differ from those assumptions and estimates. An analysis of the key sources of estimation uncertainty at the Balance Sheet date that have a significant risk of causing a material adjustment to the carrying amount of assets and liabilities within the next financial year is provided below.

#### Fair values at acquisition

Following the acquisition of Elster, management have made judgements regarding the fair value of assets and liabilities acquired particularly in relation to provisions and intangible assets. The fair value of these assets and liabilities are shown in note 12.

### 3. Critical accounting judgements and key sources of estimation uncertainty (continued)

**Intangible assets**

The valuation of intangible assets requires management to estimate the net present value of future cash flows arising from customer relationships after estimating the attrition factor relevant to the customer relationship and other factors such as access to the workforce, which are appropriate to the determination of the additional cash flows. The valuation of intangible assets in respect of brand names requires management to estimate future cash flows using a relief from royalty model.

**Impairment of non-current assets**

Goodwill and intangible assets are tested for impairment whenever events or circumstances indicate that their carrying amounts might be impaired and at least annually. Such events and circumstances include the effects of restructuring initiated by management.

To determine whether goodwill and intangible assets are impaired requires an estimation of the value in use of the cash-generating units to which goodwill and other intangible assets has been allocated. The value in use calculation requires management to estimate the future cash flows expected to arise from the cash-generating unit and a suitable discount rate in order to calculate the net present value. Such calculations require judgement relating to the appropriate discount factors and long term growth prevalent in a particular market as well as short and medium term business plans. Management draw upon experience as well as external resources in making these judgements.

The carrying amount of goodwill and other intangible assets (including computer software and development costs) at the Balance Sheet date was £3,019.5 million (31 December 2011: £906.1 million). At 31 December 2012 and 2011, the Group recognised no impairment loss in respect of these assets.

**Provisions**

The quantification of certain liabilities within provisions (environmental remediation obligations and future costs and settlements in relation to certain legal claims) have been estimated using the best information available. However, such liabilities depend on the actions of third parties and on the specific circumstances pertaining to each obligation, neither of which is controlled by the Group. Although provisions are reviewed on a regular basis and adjusted for management's best current estimates, the judgemental nature of these items means that future amounts settled may be different from those provided. Further details are set out in note 20.

**Retirement benefit obligations**

Retirement benefits are accounted for under IAS 19: "Employee benefits". For defined benefit plans, obligations are measured at discounted present value whilst plan assets are recorded at fair value. Because of changing market and economic conditions, the expenses and liabilities actually arising under the plans in the future may differ materially from the estimates made on the basis of these actuarial assumptions. Therefore, declining returns on equity markets and markets for fixed-income instruments could necessitate additional contributions to the plans in order to cover future pension obligations. Also, higher or lower withdrawal rates or longer or shorter life of participants may have an impact on the amount of pension income or expense recorded in the future.

The discount rate used to discount retirement benefit obligations to present value is derived from the yields of senior, high-quality corporate bonds at the Balance Sheet date. These generally include AA-rated securities. The discount rate is based on the market yield of a portfolio of bonds whose weighted residual maturities approximately correspond to the duration necessary to cover the entire benefit obligation.

Pension and other retirement benefits are inherently long term and future experience may differ from the actuarial assumptions used to determine the net charge for retirement benefit obligations. Note 23 to these consolidated financial statements describes the principal discount rate, earnings increase and pension retirement benefit obligation assumptions that have been used to determine the net charge for retirement benefit obligations in accordance with IAS 19. The calculation of any charge relating to retirement benefit obligations is clearly dependent on the assumptions used, which reflects the exercise of judgement. The assumptions adopted are based on prior experience, market conditions and the advice of plan actuaries.

At 31 December 2012, the Group's retirement benefit obligation deficit was £261.3 million (31 December 2011: £117.7 million). Further details on the sensitivities and assumptions are discussed in the Finance Director's review on pages 33 and 34.

**Taxation**

The Group is subject to income tax in most of the jurisdictions in which it operates. Management is required to exercise judgement in determining the Group's provision for income taxes. Management's judgement is required in estimating tax provisions where additional current tax may become payable in the future following the audit by the tax authorities of previously filed tax returns. Management's judgement is also required as to whether a deferred tax asset should be recognised based on the availability of future taxable profits. While the Group aims to ensure that the estimates recorded are accurate, the actual amounts could be different from those expected.

# Notes to the financial statements continued

## 4. Revenue

An analysis of the Group's revenue, as defined by IAS 18, is as follows:

| | Notes | Year ended 31 December 2012 £m | Restated[1] year ended 31 December 2011 £m |
|---|---|---|---|
| **Continuing operations** | | | |
| Revenue from the sale of goods | | **1,542.2** | 1,048.9 |
| Revenue recognised on long-term contracts | | **9.2** | 31.5 |
| Revenue | 5 | **1,551.4** | 1,080.4 |
| Finance income | 7 | **11.0** | 10.0 |
| Total revenue from continuing operations as defined by IAS 18 | | **1,562.4** | 1,090.4 |
| **Discontinued operations** | | | |
| Revenue from the sale of goods | | **35.9** | 250.9 |
| Revenue recognised on long-term contracts | | **—** | 0.4 |
| Revenue | 5,9 | **35.9** | 251.3 |
| Finance income | | **—** | 0.5 |
| Total revenue from discontinued operations as defined by IAS 18 | | **35.9** | 251.8 |
| **Total revenue as defined by IAS 18** | | **1,598.3** | 1,342.2 |

[1] Restated to include the results of MPC within discontinued operations.

## 5. Segment information

Segment information is presented in accordance with IFRS 8: "Operating segments" which requires operating segments to be identified on the basis of internal reports about components of the Group that are regularly reported to the Group's Board in order to allocate resources to the segments and assess their performance. The Group's reportable operating segments under IFRS 8 are as follows:

- Energy
- Lifting
- Other Industrial
- Elster (Gas, Electricity, Water)

The Energy segment incorporates the Brush and Marelli business units, specialist suppliers of energy industrial products to the global market. The Lifting segment consists of the businesses of Bridon, Crosby and Acco, serving oil & gas production, mining, petrochemical, alternative energy and general construction markets. The Other Industrial segment consists primarily of the businesses of Truth and Harris, serving the housing and steel recycling markets. During the year, Elster was acquired as detailed in note 12. This has resulted in additional Elster segments being recognised of Gas, Electricity and Water along with their associated central costs. These businesses serve residential and industrial metering and utilisation markets whilst providing related communications, networking and software solutions.

There are two central cost centres which are also separately reported to the Board:

- Central — corporate
- Central — LTIPs[1]

[1] Long Term Incentive Plans.

The Central corporate cost centre contains the Melrose Group head office costs whilst the Central LTIPs cost centre contains the costs associated with the previous Melrose Incentive Plan (crystallised on 22 March 2012), the new five year Melrose Incentive Plan (granted on 11 April 2012) and the divisional management LTIPs that are in operation across the Group.

The discontinued segment incorporates the Dynacast, Brush Traction, Logistex UK, Madico, Weber Knapp and MPC businesses in 2011 and MPC in 2012.

Transfer prices between business units are set on an arm's length basis in a manner similar to transactions with third parties.

## 5. Segment information (continued)

The Group's geographical segments are determined by the location of the Group's non-current assets and, for revenue, the location of external customers. Inter-segment sales are not material and have not been included in the analysis below.

The following tables present revenue, profit, and certain asset and liability information regarding the Group's operating segments for the year ended 31 December 2012 and the comparative period. Note 6 gives details of exceptional costs and income.

### Segment revenues and results

| | | Segment revenue from external customers | |
|---|---|---|---|
| | Notes | **Year ended 31 December 2012 £m** | Restated[1] year ended 31 December 2011 £m |
| **Continuing operations** | | | |
| Energy | | **486.8** | 461.6 |
| Lifting | | **524.4** | 484.4 |
| Other Industrial | | **129.1** | 134.4 |
| Elster[2] | | **411.1** | — |
| Total continuing operations | 4 | **1,551.4** | 1,080.4 |
| Discontinued operations | 4,9 | **35.9** | 251.3 |
| **Total revenue** | | **1,587.3** | 1,331.7 |

[1] Restated to include the revenues of MPC within discontinued operations.
[2] Elster revenue comprises: Gas £236.9 million, Electricity £106.8 million and Water £67.4 million.

| | | Segment result | |
|---|---|---|---|
| | Notes | **Year ended 31 December 2012 £m** | Restated[1] year ended 31 December 2011 £m |
| **Continuing operations** | | | |
| Energy | | **93.4** | 91.1 |
| Lifting | | **95.2** | 82.6 |
| Other Industrial | | **17.0** | 16.5 |
| Elster[2] | | **57.8** | — |
| Central — corporate | | **(11.8)** | (9.2) |
| Central — LTIPs[3] | | **(8.5)** | (6.8) |
| Headline[4] operating profit | | **243.1** | 174.2 |
| Intangible asset amortisation | | **(39.1)** | (23.7) |
| Exceptional operating costs | 6 | **(73.9)** | (40.0) |
| Exceptional operating income | 6 | **7.0** | — |
| Operating profit | | **137.1** | 110.5 |
| Finance costs — headline[4] | 7 | **(39.8)** | (29.5) |
| Finance costs — exceptional | 6,7 | **(16.3)** | — |
| Finance income | 7 | **11.0** | 10.0 |
| Profit before tax | | **92.0** | 91.0 |
| Tax | 8 | **(49.1)** | 19.1 |
| Profit for the year from discontinued operations | 9 | **1.3** | 176.4 |
| **Profit for the year** | | **44.2** | 286.5 |

[1] Restated to include the results of MPC within discontinued operations.
[2] Elster headline[4] operating profit comprises: Gas £46.7 million, Electricity £12.6 million, Water £1.4 million, and Elster central costs £2.9 million.
[3] Long Term Incentive Plans.
[4] As defined on the Income Statement.

# Notes to the financial statements continued

## 5. Segment information (continued)

| | Total assets | | Total liabilities | |
|---|---|---|---|---|
| | **31 December 2012 £m** | Restated[1] 31 December 2011 £m | **31 December 2012 £m** | Restated[1] 31 December 2011 £m |
| Energy | **630.3** | 641.0 | **227.9** | 231.6 |
| Lifting | **769.6** | 767.3 | **206.7** | 212.3 |
| Other Industrial | **78.2** | 79.1 | **23.3** | 24.8 |
| Elster[2] | **2,728.2** | — | **915.0** | — |
| Central — corporate | **209.9** | 251.7 | **1,281.3** | 632.2 |
| Central — LTIPs[3] | **—** | — | **20.3** | 15.3 |
| Total continuing operations | **4,416.2** | 1,739.1 | **2,674.5** | 1,116.2 |
| Discontinued operations | **—** | 42.4 | **—** | 16.9 |
| **Total** | **4,416.2** | 1,781.5 | **2,674.5** | 1,133.1 |

[1] Restated to include the total assets and total liabilities of MPC within discontinued operations.
[2] Elster total assets comprises: Gas £2,127.5 million, Electricity £335.6 million, Water £240.1 million and Elster central £25.0 million. Elster total liabilities comprises: Gas £594.4 million, Electricity £118.1 million, Water £154.7 million and Elster central £47.8 million.
[3] Long Term Incentive Plans.

| | Capital expenditure[1] | | Depreciation[1] | |
|---|---|---|---|---|
| | **Year ended 31 December 2012 £m** | Restated[2] year ended 31 December 2011 £m | **Year ended 31 December 2012 £m** | Restated[2] year ended 31 December 2011 £m |
| **Continuing operations** | | | | |
| Energy | **10.9** | 11.4 | **7.5** | 7.9 |
| Lifting | **30.4** | 21.3 | **9.9** | 8.8 |
| Other Industrial | **3.8** | 2.0 | **3.4** | 4.3 |
| Elster[3] | **9.0** | — | **9.1** | — |
| Central — corporate | **0.9** | — | **0.6** | 0.6 |
| Total continuing operations | **55.0** | 34.7 | **30.5** | 21.6 |
| Discontinued operations | **1.7** | 8.1 | **0.9** | 5.6 |
| **Total** | **56.7** | 42.8 | **31.4** | 27.2 |

[1] Including computer software and development costs.
[2] Restated to include the capital expenditure[1] and depreciation[1] of MPC within discontinued operations.
[3] Elster capital expenditure comprises: Gas £5.5 million, Electricity £1.5 million and Water £2.0 million. Elster depreciation comprises: Gas £5.1 million, Electricity £2.0 million and Water £2.0 million.

### Geographical information

The Group operates in various geographical areas around the world. The Group's country of domicile is the UK and the Group's revenues and non-current assets in Europe and North America are also considered to be material.

The Group's revenue from external customers and information about its segment assets (non-current assets excluding interests in joint ventures, deferred tax assets and non-current trade and other receivables) by geographical location are detailed below:

| | Revenue[1] from external customers | | Non-current assets | |
|---|---|---|---|---|
| | **Year ended 31 December 2012 £m** | Restated[2] year ended 31 December 2011 £m | **31 December 2012 £m** | Restated[2] 31 December 2011 £m |
| UK | **143.4** | 129.3 | **414.2** | 348.9 |
| Europe | **445.8** | 280.8 | **1,724.5** | 321.7 |
| North America | **651.4** | 463.2 | **1,118.4** | 422.2 |
| Other | **310.8** | 207.1 | **81.3** | 10.5 |
| Total continuing operations | **1,551.4** | 1,080.4 | **3,338.4** | 1,103.3 |
| Discontinued operations | **35.9** | 251.3 | **—** | 18.1 |
| **Total** | **1,587.3** | 1,331.7 | **3,338.4** | 1,121.4 |

[1] Revenue is presented by destination.
[2] Restated to include the revenue and non-current assets of MPC within discontinued operations.

## 6. Exceptional costs and income

| Exceptional costs | Year ended 31 December 2012 £m | Restated[1] year ended 31 December 2011 £m |
|---|---|---|
| **Continuing operations** | | |
| Restructuring costs | **(54.4)** | (15.9) |
| Acquisition, disposal and financing costs | | |
| — operating | **(19.5)** | (3.1) |
| — financing | **(16.3)** | — |
| Increase in legal provision | **—** | (21.0) |
| **Total exceptional costs** | **(90.2)** | (40.0) |
| Total exceptional costs — operating | **(73.9)** | (40.0) |
| Total exceptional costs — financing | **(16.3)** | — |
| **Total exceptional costs** | **(90.2)** | (40.0) |

[1] Restated to include the results of MPC within discontinued operations.

During 2012, the Group incurred £54.4 million (2011: £15.9 million) of costs relating to restructuring programmes, of which £52.5 million occurred in the second half of the year. These costs include £9.1 million relating to the closure of the old Elster head office along with £27.9 million of other restructuring costs occurring within several of the key Elster businesses. These include reorganising the Gas and Electricity businesses into global operations and the closure of underperforming parts of the Water business. In addition, £11.1 million of surplus leasehold property costs have been identified during the year and £6.3 million of restructuring costs have been incurred in the old Melrose businesses, in particular within the Lifting division and the corporate restructure in respect of the new holding company. The 2011 restructuring costs of £15.9 million related to programmes within the Energy and Lifting divisions.

Operating acquisition and disposal costs relate primarily to the costs incurred in acquiring Elster. In 2011, costs associated with acquisitions and disposals consisted predominantly of the expenses arising during an aborted acquisition process and the costs associated with the return of capital following the disposal of Dynacast.

Financing exceptional costs relate to the debt refinancing performed in January 2012 and subsequently in August 2012 where the amortisation of capitalised debt finance costs were accelerated and interest rate swaps were closed out early. In addition, these costs also include a proportion of the make whole premium charged upon the redemption of the Eurobond inherited on the acquisition of Elster.

The increase in the legal provision in 2011 related to a product liability claim involving Bridon. This was settled in 2012.

| Exceptional income | Year ended 31 December 2012 £m | Year ended 31 December 2011 £m |
|---|---|---|
| **Continuing operations** | | |
| Pension curtailment gain | **7.0** | — |
| **Total exceptional income** | **7.0** | — |

During 2012, a number of amendments were made to Elster retirement medical benefits and retirement life insurance benefits in the US. These removed £7.0 million of liabilities resulting in a curtailment gain on these plans.

# Notes to the financial statements continued

## 7. Revenues and expenses

| | Continuing operations | | Discontinued operations | | Total | |
|---|---|---|---|---|---|---|
| **Net operating expenses comprise:** | **Year ended 31 December 2012 £m** | Restated[1] year ended 31 December 2011 £m | **Year ended 31 December 2012 £m** | Restated[1] year ended 31 December 2011 £m | **Year ended 31 December 2012 £m** | Restated[1] year ended 31 December 2011 £m |
| Selling and distribution costs | **(113.1)** | (76.7) | **(1.5)** | (8.0) | **(114.6)** | (84.7) |
| Administration expenses | **(167.2)** | (103.5) | **(0.9)** | (14.1) | **(168.1)** | (117.6) |
| Share of results of joint ventures (note 14) | **0.8** | — | **—** | — | **0.8** | — |
| Other operating costs — exceptional (note 6) | **(73.9)** | (40.0) | **—** | (0.1) | **(73.9)** | (40.1) |
| Other operating income — exceptional (note 6) | **7.0** | — | **—** | — | **7.0** | — |
| **Total net operating expenses** | **(346.4)** | (220.2) | **(2.4)** | (22.2) | **(348.8)** | (242.4) |

[1] Restated to include the results of MPC within discontinued operations.

| | Continuing operations | | Discontinued operations | | Total | |
|---|---|---|---|---|---|---|
| **Operating profit is stated after charging:** | **Year ended 31 December 2012 £m** | Restated[1] year ended 31 December 2011 £m | **Year ended 31 December 2012 £m** | Restated[1] year ended 31 December 2011 £m | **Year ended 31 December 2012 £m** | Restated[1] year ended 31 December 2011 £m |
| Depreciation and impairment | **29.0** | 22.8 | **0.9** | 5.4 | **29.9** | 28.2 |
| Cost of inventories | **1,067.9** | 749.7 | **31.0** | 196.6 | **1,098.9** | 946.3 |
| Amortisation of other intangible assets (note 12) | **39.1** | 23.7 | **—** | 1.4 | **39.1** | 25.1 |
| Amortisation of computer software and development costs (note 12) | **2.4** | 0.6 | **—** | 0.2 | **2.4** | 0.8 |
| Operating lease expense | **10.7** | 7.7 | **0.4** | 2.9 | **11.1** | 10.6 |
| Staff costs[2] | **354.3** | 277.2 | **5.5** | 58.5 | **359.8** | 335.7 |
| Research and development costs[2] | **7.6** | 2.0 | **—** | — | **7.6** | 2.0 |
| Profit on disposal of property, plant and equipment | **(0.1)** | — | **—** | — | **(0.1)** | — |
| Impairment recognised on trade receivables | **0.8** | 0.7 | **—** | 0.1 | **0.8** | 0.8 |

[1] Restated to include the results of MPC within discontinued operations.
[2] Staff costs include £12.7 million of research and development related costs in continuing operations.

The analysis of auditor's remuneration is as follows:

| | **Year ended 31 December 2012 £m** | Year ended 31 December 2011 £m |
|---|---|---|
| Fees payable to the Company's auditor for the audit of the Company's annual accounts | **1.3** | 0.8 |
| Fees payable to the auditor for the audit of the Elster acquisition Balance Sheet | **0.4** | — |
| Fees payable to the previous auditor of Elster | **0.2** | — |
| Total fees payable for the audit of the Company's annual accounts | **1.9** | 0.8 |
| Fees payable to the Company's auditor and their associates for other audit services to the Group: | | |
| — the audit of the Company's subsidiaries pursuant to legislation | **1.5** | 0.6 |
| **Total audit fees** | **3.4** | 1.4 |

## 7. Revenues and expenses (continued)

| | Year ended 31 December 2012 £m | Year ended 31 December 2011 £m |
|---|---|---|
| Audit-related assurance services | **0.5** | 0.1 |
| Taxation compliance services | **0.2** | 0.4 |
| Other taxation advisory services | **0.3** | 0.5 |
| Corporate finance services | **1.7** | 1.7 |
| Other services | **0.2** | 0.1 |
| **Total non-audit fees** | **2.9** | 2.8 |

Fees for the audit of the Company's annual accounts represent fees payable to Deloitte LLP in respect of the audit of the Company's individual financial statements, the Group's consolidated financial statements and the audit of the acquisition Balance Sheets of Elster. Corporate finance services include due diligence and other transaction related services. Audit-related assurance services relate to the review of the half year interim statements and assurance services related to investment circulars issued for the acquisition of Elster and the new parent company.

| | Year ended 31 December 2012 £m | Restated[1] year ended 31 December 2011 £m |
|---|---|---|
| **Staff costs during the year (including executive Directors):** | | |
| Wages and salaries | **286.5** | 225.6 |
| Social security costs | **45.0** | 34.2 |
| Pension costs | | |
| — defined benefit plans | **1.2** | 0.4 |
| — defined contribution plans | **13.1** | 10.2 |
| LTIPs[2] | **8.5** | 6.8 |
| Total continuing staff costs | **354.3** | 277.2 |
| Discontinued staff costs[3] | **5.5** | 58.5 |
| **Total staff costs** | **359.8** | 335.7 |

[1] Restated to include the results of MPC within discontinued operations.
[2] Long Term Incentive Plans.
[3] Includes £nil million (2011: £0.2 million) of defined benefit pension costs and £0.1 million (2011: £0.7 million) of defined contribution pension costs.

| | Year ended 31 December 2012 Number | Restated[1] year ended 31 December 2011 Number |
|---|---|---|
| **Average monthly number of persons employed (including executive Directors)** | | |
| Energy | **3,320** | 3,341 |
| Lifting | **3,220** | 3,079 |
| Other Industrial | **1,001** | 1,076 |
| Elster[2] | **6,857** | — |
| Central — corporate | **33** | 33 |
| Total continuing operations | **14,431** | 7,529 |
| Discontinued operations | **342** | 2,478 |
| **Total average number of persons employed** | **14,773** | 10,007 |

[1] Restated to include the employees of MPC within discontinued operations.
[2] Elster average monthly number of persons employed comprises: Gas 4,017, Electricity 1,530 and Water 1,310.

# Notes to the financial statements continued

## 7. Revenues and expenses (continued)

| | Notes | Year ended 31 December 2012 £m | Restated[1] year ended 31 December 2011 £m |
|---|---|---|---|
| **Finance costs and income** | | | |
| Interest on bank loans and overdrafts | | **(32.9)** | (25.6) |
| Amortisation of costs of raising finance | | **(2.4)** | (2.5) |
| Net finance cost of pensions | | **(3.6)** | (0.3) |
| Unwind of discount on provisions | 20 | **(0.9)** | (1.1) |
| Headline[2] finance costs | | **(39.8)** | (29.5) |
| Exceptional finance costs | 6 | **(16.3)** | — |
| Total finance costs | | **(56.1)** | (29.5) |
| Finance income | 4 | **11.0** | 10.0 |
| Total continuing operations | | **(45.1)** | (19.5) |
| Discontinued operations[3] | 9 | **—** | 0.2 |
| **Total net finance costs** | | **(45.1)** | (19.3) |

[1] Restated to include the results of MPC within discontinued operations.
[2] As defined on the Income Statement.
[3] Includes £nil (2011: £0.2 million) net finance cost of pensions.

The finance cost of pensions in the continuing Group is the interest cost on benefit obligations of £51.4 million net of the expected return on plan assets of £47.8 million (2011: £52.6 million and £52.3 million respectively).

The interest cost on discontinued defined benefit obligations was £nil and the expected return on plan assets for discontinued businesses was £nil (2011: £0.2 million and £nil respectively).

## 8. Tax

| | Continuing operations | | Discontinued operations | | Total | |
|---|---|---|---|---|---|---|
| **Analysis of charge/(credit) in year:** | **Year ended 31 December 2012 £m** | Restated[1] year ended 31 December 2011 £m | **Year ended 31 December 2012 £m** | Restated[1] year ended 31 December 2011 £m | **Year ended 31 December 2012 £m** | Year ended 31 December 2011 £m |
| Current tax | **43.3** | (7.6) | **0.6** | 8.9 | **43.9** | 1.3 |
| Deferred tax (note 21) | **5.8** | (11.5) | **—** | (0.2) | **5.8** | (11.7) |
| Total income tax charge/(credit) | **49.1** | (19.1) | **0.6** | 8.7 | **49.7** | (10.4) |
| Tax charge on headline[2] profit before tax | **57.8** | 39.7 | **0.6** | 9.5 | **58.4** | 49.2 |
| Exceptional tax charge/(credit) | **5.8** | (38.1) | **—** | — | **5.8** | (38.1) |
| Tax credit on net exceptional items | **(13.1)** | (7.6) | **—** | — | **(13.1)** | (7.6) |
| Tax credit in respect of intangible asset amortisation | **(1.4)** | (13.1) | **—** | (0.8) | **(1.4)** | (13.9) |
| **Total income tax charge/(credit)** | **49.1** | (19.1) | **0.6** | 8.7 | **49.7** | (10.4) |

[1] Restated to include the results of MPC within discontinued operations.
[2] As defined on the Income Statement.

The tax charge for the year ended 31 December 2012 (credit for the year ended 31 December 2011) includes an exceptional tax charge of £5.8 million (2011: credit of £38.1 million). Of this charge, £4.2 million relates to restructuring that took place during the year and £1.6 million relates to businesses previously disposed. In 2011, a credit of £28.6 million related to the change in the Company's expectation of the outcome of overseas tax audits inherited on the acquisition of FKI and a credit of £9.5 million related to the recognition of a previously unrecognised deferred tax asset during the period that was considered to be recoverable.

## 8. Tax (continued)

The charge (2011: credit) for the year can be reconciled to the profit per the Income Statement as follows:

| | Year ended 31 December 2012 £m | Restated[1] year ended 31 December 2011 £m |
|---|---|---|
| Profit on ordinary activities before tax: | | |
| Continuing operations | **92.0** | 91.0 |
| Discontinued operations (note 9) | **2.5** | 32.7 |
| | **94.5** | 123.7 |
| Tax on profit on ordinary activities at weighted average rate 28.33% (2011: 27.62%) | **26.8** | 34.2 |
| Tax effect of: | | |
| Net permanent differences/non-deductible items | **6.9** | 1.7 |
| Change to calculation of deferred tax liability on intangible asset | **9.8** | – |
| Effect of rate change on deferred tax liability on intangible asset | **–** | (7.2) |
| Temporary differences not recognised in deferred tax | **4.4** | 0.6 |
| Tax credits, withholding taxes and other rate differences | **1.6** | 2.3 |
| Prior year tax adjustments | **(5.6)** | (3.9) |
| Exceptional tax charge/(credit) | **5.8** | (38.1) |
| **Total tax charge/(credit) for the year** | **49.7** | (10.4) |

[1] Restated to include the results of MPC within discontinued operations.

The reconciliation has been performed at a blended Group tax rate of 28.33% (2011: 27.62%) which represents the weighted average of the tax rates applying to taxable profits in the jurisdictions in which those profits arose. This blended rate has increased in 2012 following the acquisition of the Elster businesses.

In addition to the amount charged to the Income Statement, a tax credit of £2.7 million (2011: £16.8 million) has been recognised directly in the Consolidated Statement of Comprehensive Income. This represents a tax credit of £4.9 million (2011: £12.0 million) in respect of retirement benefit obligations, a tax charge of £1.6 million (2011: credit of £1.5 million) in respect of movements on cash flow hedges and a tax charge of £0.6 million (2011: credit of £3.3 million) in respect of the use of losses on items taken directly to reserves in prior years.

# Notes to the financial statements continued

## 9. Discontinued operations

### Disposal of businesses

On 25 June 2012, the Group disposed of MPC, a business acquired as part of the McKechnie acquisition in 2005, for cash consideration of £30.7 million. The costs charged during the year associated with the disposal were £3.1 million and the loss on disposal in the year was £0.6 million. There were no cumulative translation differences associated with this business to recycle upon disposal. This business was previously classified within the "Other Industrial" segment and is now shown within discontinued operations.

Financial performance of discontinued operations:

| | **Year ended 31 December 2012 £m** | Restated[1] year ended 31 December 2011 £m |
|---|---|---|
| Revenue | **35.9** | 251.3 |
| Operating costs | **(33.4)** | (217.3) |
| Headline[2] operating profit | **2.5** | 34.0 |
| Intangible asset amortisation | **–** | (1.4) |
| Exceptional items[3] | **–** | (0.1) |
| Net finance income | **–** | 0.2 |
| Profit before tax | **2.5** | 32.7 |
| Headline[2] tax | **(0.6)** | (9.5) |
| Tax on intangible asset amortisation | **–** | 0.8 |
| Profit after tax | **1.9** | 24.0 |
| Cumulative translation differences recycled on disposals | **–** | 52.6 |
| (Loss)/gain on disposal of net assets of discontinued operations | **(0.6)** | 99.8 |
| **Profit for the period from discontinued operations** | **1.3** | 176.4 |
| **Attributable to:** | | |
| Owners of the parent | **1.3** | 176.3 |
| Non-controlling interests | **–** | 0.1 |
| | **1.3** | 176.4 |

[1] Restated to include the results of MPC within discontinued operations.
[2] As defined on the Income Statement.
[3] Costs relating to the disposal of MPC incurred in 2011.

During the year, up until its sale on 25 June 2012, the MPC business contributed £35.9 million of revenue and £2.5 million of headline operating profit.

The comparative information for the year ended 31 December 2011 has been restated to exclude the results and cashflows of MPC from continuing operations and include them as discontinued operations.

Discontinued operations in 2011 also contain the results and cashflows of the Dynacast, Brush Traction, Logistex UK, Weber Knapp and Madico businesses.

## 9. Discontinued operations (continued)

The major classes of assets and liabilities disposed of with the MPC business were as follows:

| | Discontinued operations £m |
|---|---|
| Goodwill and other intangible assets | 3.8 |
| Property, plant and equipment | 15.1 |
| Inventories | 7.6 |
| Trade and other receivables | 19.8 |
| Cash and cash equivalents | 1.2 |
| Total assets disposed | 47.5 |
| Trade and other payables | 18.0 |
| Retirement benefit obligations | 0.7 |
| Tax | 0.6 |
| Total liabilities disposed | 19.3 |
| Net assets disposed | 28.2 |
| Cash consideration net of costs[1] | 27.6 |
| **Loss on disposal of businesses** | **(0.6)** |

[1] Includes £3.1 million of disposal costs.

## 10. Dividends

| | **Year ended 31 December 2012 £m** | Year ended 31 December 2011 £m |
|---|---|---|
| Final dividend for the year ended 31 December 2010 paid of 7.0p (4.0p)[1] | **–** | 34.8 |
| Interim dividend for the year ended 31 December 2011 paid of 4.6p (2.6p)[1] | **–** | 18.0 |
| Final dividend for the year ended 31 December 2011 paid of 8.4p (4.8p)[1] | **32.8** | – |
| Interim dividend for the year ended 31 December 2012 paid of 2.6p | **32.9** | – |
| | **65.7** | 52.8 |

[1] Adjusted to include the effects of the Rights Issue (note 11).

Proposed final dividend for the year ended 31 December 2012 of 5.0p per share (2011: 4.8p per share[1]) totalling £63.3 million (2011: £32.8 million).

The final dividend of 5.0p was proposed by the Board on 6 March 2013 and, in accordance with IAS 10, has not been included as a liability in these financial statements.

In addition to dividends paid, shareholders approved a £373.2 million return of capital on 8 August 2011 of which £372.1 million was paid on 19 August 2011 and £1.1 million was paid on 30 April 2012.

# Notes to the financial statements continued

## 11. Earnings per share

| Earnings attributable to owners of the parent | Year ended 31 December 2012 £m | Restated[1] year ended 31 December 2011 £m |
|---|---|---|
| Profit for the purposes of earnings per share | **42.5** | 286.4 |
| Less: profit for the year from discontinued operations (note 9) | **(1.3)** | (176.3) |
| **Earnings for basis of earnings per share from continuing operations** | **41.2** | 110.1 |
| | | |
| **Continuing operations** | | |
| Intangible asset amortisation | **39.1** | 23.7 |
| Exceptional costs (note 6) — operating | **73.9** | 40.0 |
| Exceptional income (note 6) — operating | **(7.0)** | — |
| Exceptional costs (note 6) — financing | **16.3** | — |
| Exceptional tax[2] | **(8.7)** | (58.8) |
| **Earnings for basis of headline[2] earnings per share from continuing operations** | **154.8** | 115.0 |
| | | |
| **Discontinued operations** | | |
| Profit for the period from discontinued operations (note 9) | **1.3** | 176.3 |
| Loss/(profit) on disposal of businesses | **0.6** | (152.4) |
| Intangible asset amortisation | **—** | 1.4 |
| Exceptional items (note 9) | **—** | 0.1 |
| Tax on intangible asset amortisation | **—** | (0.8) |
| **Earnings for basis of headline[2] earnings per share from continuing and discontinued operations** | **156.7** | 139.6 |

[1] Restated to include the results of MPC within discontinued operations.
[2] As defined on the Income Statement.

| | Number | Number |
|---|---|---|
| Weighted average number of Ordinary Shares for the purposes of basic earnings per share including the effects of the Rights Issue[1] (million) | **945.4** | 798.9 |
| Further shares for the purposes of diluted earnings per share[2] including the effects of the Rights Issue[1] (million) | **15.3** | 52.8 |
| Weighted average number of Ordinary Shares for the purposes of diluted earnings per share (million) | **960.7** | 851.7 |

[1] On 1 August 2012, a 2 for 1, fully underwritten, Rights Issue was completed by Melrose PLC and subsequently 844.4 million new Melrose Ordinary Shares were issued raising £1.2 billion to part fund the acquisition of Elster Group S.E.. In accordance with IAS 33, a bonus factor associated with the issue of the new share capital of 57% has been applied to the number of Ordinary Shares (including comparative periods presented) for the purpose of earnings per share calculations.
[2] Relating to the 2012 Melrose Incentive Plan and the previous Melrose Incentive Plan.

| Earnings per share | Year ended 31 December 2012 pence | Restated[1] year ended 31 December 2011 pence |
|---|---|---|
| **Basic earnings per share** | | |
| From continuing and discontinued operations | **4.5** | 35.8 |
| From continuing operations | **4.4** | 13.8 |
| From discontinued operations | **0.1** | 22.0 |
| **Diluted earnings per share** | | |
| From continuing and discontinued operations | **4.4** | 33.6 |
| From continuing operations | **4.3** | 12.9 |
| From discontinued operations | **0.1** | 20.7 |
| **Headline[2] basic earnings per share** | | |
| From continuing and discontinued operations | **16.6** | 17.5 |
| From continuing operations | **16.4** | 14.4 |
| **Headline[2] diluted earnings per share** | | |
| From continuing and discontinued operations | **16.3** | 16.4 |
| From continuing operations | **16.1** | 13.5[3] |

[1] Restated to include the results of MPC within discontinued operations and to include the effects of the Rights Issue.
[2] As defined on the Income Statement.
[3] 13.5p is the restated 2011 headline[2] diluted earnings per share from continuing operations. The Board believe that 15.8p is a more appropriate measure to use for 2011 to compare against 2012 performance being the headline[2] diluted earnings per share from continuing and discontinued operations adjusted to remove the earnings (£4.8 million) of the disposed business MPC.

## 12. Goodwill and other intangible assets

| | Goodwill £m | Other intangible assets £m | Computer software and development costs £m | Total £m |
|---|---|---|---|---|
| **Cost** | | | | |
| At 1 January 2011 | 798.1 | 454.7 | 3.0 | 1,255.8 |
| Additions | — | — | 1.6 | 1.6 |
| Disposal of businesses | (220.8) | (34.0) | (1.4) | (256.2) |
| Exchange adjustments | (8.8) | (2.4) | (0.1) | (11.3) |
| At 31 December 2011 | 568.5 | 418.3 | 3.1 | 989.9 |
| Acquisitions | 1,277.8 | 862.6 | 24.1 | 2,164.5 |
| Additions | — | — | 2.2 | 2.2 |
| Disposal of businesses | (3.2) | — | (0.6) | (3.8) |
| Exchange adjustments | (6.2) | (4.1) | 0.2 | (10.1) |
| **At 31 December 2012** | **1,836.9** | **1,276.8** | **29.0** | **3,142.7** |
| **Amortisation** | | | | |
| At 1 January 2011 | — | (73.6) | (0.6) | (74.2) |
| Charge for period | — | (25.1) | (0.8) | (25.9) |
| Disposal of businesses | — | 15.0 | 1.0 | 16.0 |
| Exchange adjustments | — | 0.2 | 0.1 | 0.3 |
| At 31 December 2011 | — | (83.5) | (0.3) | (83.8) |
| Charge for the period | — | (39.1) | (2.4) | (41.5) |
| Exchange adjustments | — | 2.1 | — | 2.1 |
| **At 31 December 2012** | **—** | **(120.5)** | **(2.7)** | **(123.2)** |
| **Net book value** | | | | |
| **At 31 December 2012** | **1,836.9** | **1,156.3** | **26.3** | **3,019.5** |
| At 31 December 2011 | 568.5 | 334.8 | 2.8 | 906.1 |
| At 1 January 2011 | 798.1 | 381.1 | 2.4 | 1,181.6 |

The net book value of other intangible assets at 31 December 2012 includes customer relationships of £836.5 million (31 December 2011: £39.0 million) and brand names of £319.8 million (31 December 2011: £295.8 million). As a result of the acquisition of Elster on 23 August 2012, other intangible assets of £862.6 million were identified.

Goodwill has been allocated to the business segments, each of which comprises several cash-generating units, as follows:

| | **31 December 2012 £m** | Restated[1] 31 December 2011 £m |
|---|---|---|
| Energy | **244.2** | 247.3 |
| Lifting | **289.7** | 298.8 |
| Other Industrial | **18.3** | 19.2 |
| Elster[2] | **1,284.7** | — |
| Discontinued | **—** | 3.2 |
| | **1,836.9** | 568.5 |

[1] Restated to include the goodwill of MPC within discontinued operations.
[2] Elster goodwill comprises: Gas £1,062.6 million, Electricity £156.7 million and Water £65.4 million.

# Notes to the financial statements continued

### 12. Goodwill and other intangible assets (continued)

The Group tests goodwill annually for impairment, or more frequently if there are indications that goodwill might be impaired.

The recoverable amounts of the cash-generating units are determined from value in use calculations. The key assumptions for the value in use calculations are those regarding the discount rates, growth rates and expected changes to selling prices and direct costs during the period. The Group estimates discount rates using pre-tax rates that reflect current market assessments of the time value of money and the risks specific to each cash-generating unit. The growth rates are based on a prudent estimate of long term industry growth forecasts. Changes in selling prices and direct costs are based on past practices and expectations of future changes in the market.

The Group prepares cash flow forecasts derived from financial budgets approved by management and extrapolates pre-tax cash flows based on estimated growth rates of 3% (2011: between 2% and 3%). This rate does not exceed the average long term growth rate for the relevant markets. The pre-tax discount rate applied is between 8% and 10% (2011: 9% and 10%) depending on the risk elements associated with each cash-generating unit. The key assumptions used in forecasting pre-tax cash flows relate to future budgeted revenue and operating margins likely to be achieved and likely rates of long-term growth by market sector. Budgeted revenue and operating margins are based on views on past performance, secured orders and orders likely to be achieved in the short to medium-term, given trends in the relevant market sector. No impairment was identified and a reasonable possible change in the assumptions applied would not result in any impairment.

### Acquisition of subsidiaries

In line with the Group's strategy to acquire good manufacturing businesses with potential for improvements, on 23 August 2012 the Group acquired 99.35% of the issued share capital and obtained control of Elster Group S.E. for cash consideration of £1,469.8 million. Subsequently a further 0.45% of the remaining 0.65% share capital was purchased on various dates in 2012 for total consideration of £6.4 million. Elster is a world leading engineering company and one of the world's largest providers of gas, electricity and water meters, gas utilisation products and related communications, networking and software solutions.

In addition, in September 2012, £24.2 million was paid in respect of deferred consideration relating to the acquisition of EnergyICT, a business acquired by Elster in 2009.

The amounts recognised in respect of the identifiable assets acquired and liabilities assumed are as set out in the table below. Fair values are provisional as at 31 December 2012 and are based on the information held to date.

| | Fair value £m |
|---|---|
| **Elster** | |
| Property, plant and equipment | 100.3 |
| Intangible assets, computer software and development costs | 886.7 |
| Derivative financial assets | 0.3 |
| Interests in joint ventures | 9.8 |
| Inventories | 176.2 |
| Trade and other receivables | 182.6 |
| Cash and cash equivalents | 105.6 |
| Trade and other payables | (356.0) |
| Provisions | (143.0) |
| Deferred tax | (206.0) |
| Retirement benefit obligation | (117.3) |
| Current tax | (29.2) |
| Interest-bearing loans and borrowings | (411.9) |
| Non-controlling interests | (4.9) |
| **Net assets** | 193.2 |
| Non-controlling interests (Elster shares) | (1.2) |
| Goodwill | 1,277.8 |
| Total consideration | 1,469.8 |
| Satisfied by: | |
| **Cash consideration** | **1,469.8** |

## 12. Goodwill and other intangible assets (continued)

Acquisition related costs (included in exceptional operating costs) amount to £19.2 million.

The fair value of the financial assets include gross trade and other receivables of £192.8 million. The best estimate at acquisition date of the contractual cash flows not to be collected are £10.2 million.

Elster contributed £411.1 million to revenue and £57.8 million to headline operating profit for the period between the date of acquisition and the Balance Sheet date.

The Elster results were prepared under US GAAP for the first thirty three weeks of the year. Adjusting to estimate the impact of the transition to Melrose accounting policies under IFRS and assuming Elster had been acquired on the first day of the financial year, Group revenues for the period would have been approximately £2,271 million and Group headline operating profit would have been approximately £330 million.

The goodwill arising on acquisition of the Elster group is attributable to the anticipated profitability and cash flows arising from the businesses acquired. None of the goodwill is expected to be deductible for income tax purposes.

Contingent liabilities of £9.5 million have been acquired in respect of warranty and legal claims and recognised within provisions. We expect that the majority of expenditure will be incurred over the next five years.

The non-controlling interests acquired are measured based on the proportion of the fair value of their net assets.

## 13. Property, plant and equipment

| | Land and buildings £m | Plant and equipment £m | Total £m |
|---|---|---|---|
| **Cost** | | | |
| At 1 January 2011 | 117.5 | 250.1 | 367.6 |
| Additions | 3.6 | 37.6 | 41.2 |
| Disposals | (0.1) | (2.1) | (2.2) |
| Disposal of businesses | (16.4) | (92.6) | (109.0) |
| Exchange adjustments | (1.7) | (2.3) | (4.0) |
| At 31 December 2011 | 102.9 | 190.7 | 293.6 |
| Acquisitions | 27.3 | 73.0 | 100.3 |
| Additions | 7.5 | 47.0 | 54.5 |
| Disposals | (0.3) | (2.6) | (2.9) |
| Disposal of businesses | (5.8) | (19.0) | (24.8) |
| Exchange adjustments | (2.0) | (4.7) | (6.7) |
| **At 31 December 2012** | **129.6** | **284.4** | **414.0** |
| **Accumulated depreciation and impairment** | | | |
| At 1 January 2011 | (10.1) | (103.8) | (113.9) |
| Charge for the period | (3.3) | (23.1) | (26.4) |
| Impairments | (1.4) | (0.4) | (1.8) |
| Disposals | 0.1 | 1.8 | 1.9 |
| Disposal of businesses | 4.7 | 56.6 | 61.3 |
| Exchange adjustments | — | 0.6 | 0.6 |
| At 31 December 2011 | (10.0) | (68.3) | (78.3) |
| Charge for the period | (3.3) | (25.7) | (29.0) |
| Impairments | — | (0.9) | (0.9) |
| Disposals | — | 1.6 | 1.6 |
| Disposal of businesses | 0.9 | 8.8 | 9.7 |
| Exchange adjustments | 0.2 | 1.6 | 1.8 |
| **At 31 December 2012** | **(12.2)** | **(82.9)** | **(95.1)** |
| **Net book value** | | | |
| **At 31 December 2012** | **117.4** | **201.5** | **318.9** |
| At 31 December 2011 | 92.9 | 122.4 | 215.3 |
| At 1 January 2011 | 107.4 | 146.3 | 253.7 |

# Notes to the financial statements continued

## 14. Interests in joint ventures

| | 31 December 2012 £m | 31 December 2011 £m |
|---|---|---|
| Aggregated amounts relating to joint ventures: | | |
| Total assets | **22.4** | 3.9 |
| Total liabilities | **(10.0)** | (4.3) |
| **Interests in joint ventures** | **12.4** | (0.4) |
| Share of joint venture revenues | **11.4** | 3.2 |
| Share of results of joint ventures | **0.8** | – |
| Dividends received from joint ventures | **(0.3)** | – |

Interests in joint ventures in 2011 were in a net liability position and were therefore recognised within current liabilities.

A list of all the significant investments in subsidiaries including the name, country of incorporation and proportion of ownership interest is given in note 3 to the Company's separate financial statements.

## 15. Inventories

| | 31 December 2012 £m | 31 December 2011 £m |
|---|---|---|
| Raw materials | **114.8** | 53.3 |
| Work in progress | **156.9** | 77.9 |
| Finished goods | **104.4** | 74.6 |
| | **376.1** | 205.8 |

The Directors consider that there is no material difference between the Balance Sheet value of inventories and their replacement cost.

## Construction contracts

| | 31 December 2012 £m | 31 December 2011 £m |
|---|---|---|
| **Contracts in progress at the Balance Sheet date:** | | |
| Amounts due from contract customers included in other receivables | **3.0** | 2.9 |
| Amounts due to contract customers included in other payables | **–** | – |
| | **3.0** | 2.9 |
| Contract costs incurred plus recognised profit less recognised losses to date | **9.4** | 19.0 |
| Less: progress billings | **(6.4)** | (16.1) |
| | **3.0** | 2.9 |

The average life of contracts is 1–2 years (31 December 2011: 1–2 years).

## 16. Trade and other receivables

| Current | 31 December 2012 £m | 31 December 2011 £m |
|---|---|---|
| Trade receivables | **334.1** | 195.9 |
| Allowance for doubtful receivables | **(12.6)** | (3.2) |
| Amounts due from joint ventures | **1.3** | — |
| Other receivables | **42.2** | 9.1 |
| Prepayments | **19.1** | 14.5 |
| | **384.1** | 216.3 |

Trade receivables are non interest-bearing. Credit terms offered to customers vary upon the country of operation but are generally between 30 and 90 days.

| Non-current | 31 December 2012 £m | 31 December 2011 £m |
|---|---|---|
| Other receivables | **0.3** | 0.3 |

An allowance has been made for estimated irrecoverable amounts made with reference to past default experience and management's assessment of creditworthiness, an analysis of which is as follows:

| | Energy £m | Lifting £m | Other Industrial[1] £m | Elster £m | Central £m | Discontinued[1] £m | Total £m |
|---|---|---|---|---|---|---|---|
| At 1 January 2011 | 2.2 | 1.1 | 0.6 | — | 0.2 | 2.5 | 6.6 |
| Disposal of businesses | — | — | — | — | — | (2.1) | (2.1) |
| Income Statement charge | 0.3 | 0.4 | — | — | — | 0.1 | 0.8 |
| Utilised | (1.0) | (0.6) | (0.1) | — | (0.1) | (0.2) | (2.0) |
| Exchange differences | (0.1) | — | — | — | — | — | (0.1) |
| At 31 December 2011 | 1.4 | 0.9 | 0.5 | — | 0.1 | 0.3 | 3.2 |
| Acquired with business | — | — | — | 10.2 | — | — | 10.2 |
| Disposal of businesses | — | — | — | — | — | (0.3) | (0.3) |
| Income Statement charge | 0.3 | 0.3 | — | 0.2 | — | — | 0.8 |
| Utilised | (0.2) | (0.1) | (0.1) | (0.9) | — | — | (1.3) |
| Exchange differences | (0.1) | (0.1) | 0.2 | — | — | — | — |
| **At 31 December 2012** | **1.4** | **1.0** | **0.6** | **9.5** | **0.1** | **—** | **12.6** |

[1] Restated to include the results of MPC within discontinued operations.

The concentration of credit risk is limited due to the large number of customers and because they are unrelated to each other. Credit control procedures are implemented to ensure that sales are only made to organisations that are willing and able to pay for them. Such procedures include the establishment and review of customer credit limits and terms. The Group does not hold any collateral or any other credit enhancements over any of its trade receivables nor does it have a legal right of offset against any amounts owed by the Group to the counterparty.

# Notes to the financial statements continued

### 16. Trade and other receivables (continued)

The ageing of impaired trade receivables past due is as follows:

| Ageing of impaired trade receivables past due | 31 December 2012 £m | 31 December 2011 £m |
|---|---|---|
| 0 – 30 days | **1.9** | 0.4 |
| 31 – 60 days | **0.4** | 0.3 |
| 60+ days | **10.3** | 2.5 |
| | **12.6** | 3.2 |

Included in the Group's trade receivables balance are overdue trade receivables with a carrying amount of £88.0 million (31 December 2011: £37.3 million) against which an appropriate provision of £12.6 million (31 December 2011: £3.2 million) is held.

The balance deemed recoverable of £75.4 million (31 December 2011: £34.1 million) is past due as follows:

| | 31 December 2012 £m | 31 December 2011 £m |
|---|---|---|
| 0 – 30 days | **58.1** | 23.3 |
| 31 – 60 days | **7.9** | 5.8 |
| 60+ days | **9.4** | 5.0 |
| | **75.4** | 34.1 |

The Directors consider that the carrying amount of trade and other receivables, including amounts not past due and not impaired, approximates to their fair value.

### 17. Cash and cash equivalents

| | 31 December 2012 £m | 31 December 2011 £m |
|---|---|---|
| Cash and cash equivalents | **156.5** | 195.6 |

Cash and cash equivalents comprises cash at bank and in hand which earns interest at floating rates based on daily bank deposit rates and short-term deposits which are made for varying periods of between one day and one month and earn interest at the respective short-term deposit rates. The carrying amount of these assets is considered to be equal to their fair value.

### 18. Trade and other payables

| Current | 31 December 2012 £m | 31 December 2011 £m |
|---|---|---|
| Trade payables | **253.4** | 144.0 |
| Other payables | **168.6** | 54.4 |
| Other taxes and social security | **16.5** | 7.4 |
| Deferred government grants | **2.4** | – |
| Accruals | **98.5** | 70.2 |
| | **539.4** | 276.0 |

Trade payables are non interest-bearing. Normal settlement terms vary by country and the average credit period taken for trade purchases is 98 days (2011: 91 days). Other payables are non interest-bearing and have an average term of approximately 60 days.

| Non-current | 31 December 2012 £m | 31 December 2011 £m |
|---|---|---|
| Other payables | **0.9** | – |
| Accruals | **1.7** | 1.6 |
| | **2.6** | 1.6 |

The Directors consider that the carrying amount of trade and other payables approximates to their fair value.

## 19. Interest-bearing loans and borrowings

This note provides information about the contractual terms of the Group's interest-bearing loans and borrowings. Details of the Group's exposure to credit, liquidity, interest rate and foreign currency risk are included in note 24.

| | Current | | Non-current | | Total | |
|---|---|---|---|---|---|---|
| | **31 December 2012 £m** | 31 December 2011 £m | **31 December 2012 £m** | 31 December 2011 £m | **31 December 2012 £m** | 31 December 2011 £m |
| **Fixed rate obligations** | | | | | | |
| Bank borrowings — Brazilian Real | **6.2** | — | **—** | — | **6.2** | — |
| | **6.2** | — | **—** | — | **6.2** | — |
| **Floating rate obligations** | | | | | | |
| Bank borrowings — US Dollar loan[1] | **—** | — | **423.3** | 390.1 | **423.3** | 390.1 |
| Bank borrowings — Euro loan[2] | **—** | — | **298.2** | 48.6 | **298.2** | 48.6 |
| Bank borrowings — Sterling loan[3] | **—** | 27.7 | **447.5** | 22.3 | **447.5** | 50.0 |
| | **—** | 27.7 | **1,169.0** | 461.0 | **1,169.0** | 488.7 |
| Redeemable preference C shares | **—** | 1.1 | **—** | — | **—** | 1.1 |
| Unamortised finance costs | **—** | — | **(21.0)** | (3.5) | **(21.0)** | (3.5) |
| **Total interest-bearing loans and borrowings** | **6.2** | 28.8 | **1,148.0** | 457.5 | **1,154.2** | 486.3 |

[1] Interest rate LIBOR +2.00%, final maturity June 2017 (31 December 2011: interest rate LIBOR +1.35%, final maturity April 2013).
[2] Interest rate EURIBOR +2.00%, final maturity June 2017 (31 December 2011: interest rate EURIBOR +1.35%, final maturity April 2013).
[3] Interest rate LIBOR +2.00%, final maturity June 2017 (31 December 2011: interest rate LIBOR +1.35%, final maturity April 2013).

From 1 January 2012 to 31 January 2012 the Group utilised a £750 million multi-currency committed facility which was due to expire on 22 April 2013. On 31 January 2012, all amounts outstanding on this facility were repaid using surplus cash in the Group at that time and by partially utilising a replacement facility, which was a £600 million committed multi-currency revolving credit facility. Subsequently, to part finance the acquisition of Elster, a new five year £1.5 billion agreement was signed on 29 June 2012, split into a £0.5 billion multi-currency term loan and a £1.0 billion multi-currency revolving credit facility. Following the successful tender offer to the shareholders of Elster this facility was part drawn on 23 August 2012 in order to repay the drawings under the aforementioned £600 million facility and pay a proportion of the consideration for the Elster shares.

In addition, the new £1.5 billion facility has been part used to refinance, where necessary, the existing indebtedness of Elster. This included a seven year Eurobond with a principal value of €250 million due to mature in April 2018, a committed €450 million multi-currency revolving credit facility and a €140 million committed multi-currency guarantee facility, both of which were due to mature in April 2016. The €450 million revolving credit facility was repaid on 28 September 2012. On 29 September 2012, the majority of the bank guarantees issued under the Elster €140 million guarantee facility were assumed under the new £1.5 billion facility. On 28 November 2012 the Elster Eurobond was repaid together with the applicable redemption premium and accrued interest, resulting in a repayment including principal of €283.3 million.

As at 31 December 2012, the new £0.5 billion term loan was fully drawn and split into two tranches of £180 million and US $500 million. The revolving credit facility is split into multi-currency Sterling based tranches totalling £760 million and a €300 million tranche, both of which were partially drawn.

Throughout the year, the Group remained compliant with all covenants under the facilities disclosed above. A number of companies have been, or continue to be, guarantors under the bank facilities disclosed herein. In addition, until Elster Group S.E. becomes a wholly owned subsidiary of Melrose Industries PLC (currently 99.8% owned) and has been converted into a German limited liability company, a pledge has been given over the shares of Elster Group S.E..

Drawdowns under the new facility bear interest at interbank rates of interest plus a margin determined by reference to the Group's performance under its debt cover covenant ratio and ranges between 1.40% and 2.65%. The margin as at 31 December 2012 was 2.00% (31 December 2011: 1.35%).

The new £0.5 billion term loan is subject to mandatory repayments of 5 per cent of the original tranches on June 2015, June 2016 and 31 December 2016.

# Notes to the financial statements continued

## 19. Interest-bearing loans and borrowings (continued)

### Maturity of financial liabilities

The maturity profile of anticipated future cash flows including interest in relation to the Group's financial liabilities, on an undiscounted basis and which, therefore, differs from both the carrying value and fair value is shown in the table below. Interest on floating rate debt is based on the relevant LIBOR curve for US Dollar and Sterling balances and the EURIBOR curve for Euro balances. Interest on hedging interest rate swaps is based on the relevant forward LIBOR curves for US Dollar and Sterling amounts and EURIBOR curve for Euro amounts and is illustrated as a net cash flow.

| | Interest-bearing loans and borrowings £m | Derivative financial liabilities £m | Other financial liabilities £m | Total financial liabilities £m |
|---|---|---|---|---|
| Within one year | 33.3 | 7.0 | 520.5 | 560.8 |
| In one to two years | 28.2 | 3.8 | 2.6 | 34.6 |
| In two to five years | 1,252.9 | (0.3) | — | 1,252.6 |
| Effect of financing rates | (160.2) | — | — | (160.2) |
| **31 December 2012** | **1,154.2** | **10.5** | **523.1** | **1,687.8** |
| Within one year | 38.7 | 14.1 | 268.6 | 321.4 |
| In one to two years | 464.2 | 1.6 | 1.6 | 467.4 |
| Effect of financing rates | (16.6) | — | — | (16.6) |
| 31 December 2011 | 486.3 | 15.7 | 270.2 | 772.2 |

## 20. Provisions

| | Surplus leasehold property costs £m | Environmental and legal costs £m | Incentive plan related £m | Warranty related costs £m | Other £m | Total £m |
|---|---|---|---|---|---|---|
| At 31 December 2011 | 19.7 | 63.7 | 15.3 | 1.1 | 20.8 | 120.6 |
| Acquisition of businesses | 5.9 | 17.4 | — | 88.4 | 31.3 | 143.0 |
| Utilised[1] | (5.1) | (32.9) | — | (4.2) | (26.3) | (68.5) |
| Arising in the year[2] | 11.1 | 0.5 | 5.0 | 5.0 | 38.6 | 60.2 |
| Unwind of discount (note 7) | 0.4 | 0.5 | — | — | — | 0.9 |
| Exchange differences | (0.5) | (1.0) | — | 0.1 | (0.5) | (1.9) |
| **At 31 December 2012** | **31.5** | **48.2** | **20.3** | **90.4** | **63.9** | **254.3** |
| Current | 7.6 | 9.8 | — | 22.7 | 58.3 | 98.4 |
| Non-current | 23.9 | 38.4 | 20.3 | 67.7 | 5.6 | 155.9 |
| | **31.5** | **48.2** | **20.3** | **90.4** | **63.9** | **254.3** |

[1] Includes £65.8 million of provisions utilised by cash and £2.7 million through headline[3] operating profit.
[2] Includes £48.3 million of provisions arising in the year through exceptional costs and £11.2 million of provisions arising in the year through headline[3] operating profit and £0.7 million arising as a result of the disposal of a subsidiary.
[3] As defined on the Income Statement.

The provision for surplus leasehold property costs represents the estimated net payments payable over the term of these leases together with any dilapidation costs. This is expected to result in cash expenditure over the next one to six years.

Environmental and legal costs provisions relate to the estimated remediation costs of pollution, soil and groundwater contamination at certain sites and estimated future costs and settlements in relation to legal claims. Due to their nature, it is not possible to predict precisely when these provisions will be utilised.

Incentive plan related provisions are in respect of long term incentive plans for divisional senior management, expected to result in cash expenditure in the next four years.

The provision for warranty related costs represents the best estimate of the expenditure required to settle the Group's obligations. Warranty terms are, on average, between one and five years.

Other provisions relate primarily to costs that will be incurred in respect of restructuring programmes and contractual obligations.

Where appropriate, provisions have been discounted using a discount rate of 3% (31 December 2011: 3%).

## 21. Deferred tax

The following are the major deferred tax assets and liabilities recognised by the Group and movements thereon during the current and prior reporting period.

| | Notes | Deferred tax assets | Deferred tax liabilities | | | |
|---|---|---|---|---|---|---|
| | | Tax losses and other assets £m | Accelerated capital allowances and other liabilities £m | Deferred tax on intangible assets £m | Total deferred tax liabilities £m | Total net deferred tax £m |
| At 1 January 2011 | | 33.0 | (12.1) | (102.8) | (114.9) | (81.9) |
| Credit/(charge) to income | 8 | 2.1 | (4.3) | 13.9 | 9.6 | 11.7 |
| Credit to other comprehensive income | | 12.0 | 1.5 | — | 1.5 | 13.5 |
| Disposal of businesses | | (6.6) | 0.2 | 4.7 | 4.9 | (1.7) |
| Exchange differences | | (0.1) | — | 0.6 | 0.6 | 0.5 |
| At 31 December 2011 | | 40.4 | (14.7) | (83.6) | (98.3) | (57.9) |
| (Charge)/credit to income | 8 | (3.0) | (4.2) | 1.4 | (2.8) | (5.8) |
| Credit/(charge) to other comprehensive income | | 4.9 | (1.6) | — | (1.6) | 3.3 |
| Acquisition of businesses | 12 | 103.8 | (43.4) | (266.4) | (309.8) | (206.0) |
| Exchange differences | | (1.0) | (0.1) | 1.4 | 1.3 | 0.3 |
| **At 31 December 2012** | | **145.1** | **(64.0)** | **(347.2)** | **(411.2)** | **(266.1)** |

As at 31 December 2012, the Group has gross unused losses of £250.6 million (31 December 2011: £201.4 million) available for offset against future profits. At 31 December 2012, a £9.1 million deferred tax asset (31 December 2011: £8.9 million) in respect of £35.5 million (31 December 2011: £35.0 million) of these gross losses has been recognised in the Balance Sheet. No asset has been recognised in respect of the remaining losses due to the divisional and geographic split of anticipated future profit streams and the effect of possible disposals in future years. The majority of these losses may be carried forward indefinitely subject to certain continuity of business requirements.

A significant part of the retirement benefit obligations recognised in the Group financial statements relates to the FKI UK Pension Plan, the McKechnie UK Pension Plan and the FKI US Pension Plan. A deferred tax asset of £18.3 million (31 December 2011: £18.4 million) has been recognised on these obligations, being the extent to which they are expected to generate tax deductions against foreseeable taxable profits. An asset of £19.5 million has also been recognised on Elster pension obligations.

The remaining asset of £98.2 million (31 December 2011: £13.1 million) relates to other temporary differences. The significant increase arises on the acquisition of Elster during the period.

As at 31 December 2012, the aggregate amount of temporary differences associated with undistributed earnings of subsidiaries for which deferred tax liabilities have not been recognised was £6.6 million (31 December 2011: £3.4 million). No liability has been recognised in respect of these differences because the Group is in a position to control the timing of the reversal of the temporary differences and it is probable that such differences will not reverse in the foreseeable future.

## 22. Share-based payments

### Melrose Incentive Plans

On 11 April 2012, at a Melrose General Meeting, shareholders voted in favour of the early crystallisation of the previous Melrose Incentive Plan, bringing forward the maturity date from 31 May 2012 to 22 March 2012. On crystallisation the Incentive Shares were converted into 31.2 million Melrose Ordinary Shares. As a result the total number of Ordinary Shares in the Company increased from 391.0 million to 422.2 million.

At the same meeting a new five year share-based 2012 Melrose Incentive Plan was approved by shareholders which mirrors the previous Melrose Incentive Plan in most respects except that under this new plan, the potential reward has been reduced from 10% to 7.5% of the increase in shareholder value creation. In addition, a 5% dilution cap has been included in the new plan rules. This new plan has an end date of 31 May 2017.

The estimated value of the 2012 Incentive Shares at 31 December 2012 was £8.6 million. Using a Black Scholes option pricing model, the projected value of this plan in over four years time, at 31 May 2017, will be £60.2 million.

# Notes to the financial statements continued

### 22. Share-based payments (continued)

The inputs into the Black Scholes model that were used to fair value the plan were as follows:

| | Valuation assumptions[1] 2012 |
|---|---|
| Weighted average share price | **£2.27** |
| Weighted average exercise price | **£2.85** |
| Expected volatility | **30.0%** |
| Expected life as at inception | **5.0yrs** |
| Risk free interest | **1.0%** |

[1] Calculated using the share price adjusted for the Rights Issue in August 2012.

Expected volatility was determined by calculating the historical volatility of the Company's share price.

The Group recognised an IFRS 2 charge of £3.5 million (2011: £1.8 million) in the year ended 31 December 2012, £2.7 million in relation to the equity-settled 2012 Melrose Incentive Plan and £0.8 million in relation to the previous Melrose Incentive Plan.

### 23. Retirement benefit obligations

Melrose holds several pension plans covering many of its employees, operating in several jurisdictions.

The most significant defined benefit pension plans are:

- The FKI UK Pension Plan which is defined benefit in type and is a funded plan where the future liabilities for members' benefits are provided for by the accumulation of assets held externally to the Group in separate trustee administered funds. The plan is closed to new members and the accrual of future benefits for existing members.
- The McKechnie UK Pension Plan which is defined benefit in type and is a funded plan (other than £4.1 million of unfunded liabilities) where the future liabilities for members' benefits are provided for by the accumulation of assets held externally to the Group in separate trustee administered funds. The plan is closed to new members and the accrual of future benefits for existing members.
- The FKI US Pension Plan which is defined benefit in type and is a funded plan where the future liabilities for members' benefits are provided for by the accumulation of assets held externally to the Group in separate trustee administered funds. The plan is closed to new members and the accrual of future benefits for existing members.

Further details of the status of the significant plans are disclosed in the Directors' report on pages 50 and 51.

Other plans include a number of funded and unfunded defined benefit arrangements across Europe, North America and the rest of the world.

During the year, a number of additional plans were acquired as part of the acquisition of the Elster division. The net deficit on the Elster acquired plans at 31 December 2012 was £115.2 million. Included in this amount is £89.6 million, 78%, relating to unfunded German defined benefit plans and early retirement programmes, designed to create an incentive, within a certain age group, to retire early. The remaining plans in the Elster division are not significant in size with £19.2 million, 17%, of the deficit, relating to US defined benefit and retirement healthcare and life insurance benefits.

The cost of the Group's defined benefit plans are determined in accordance with IAS 19 with the advice of independent professionally qualified actuaries on the basis of formal actuarial valuations using the projected unit credit method. In line with normal practice, these valuations are undertaken triennially in the UK and annually in the US.

The FKI UK and McKechnie UK Pension Plan valuations are based on the UK full actuarial valuations as of 31 December 2011 updated at 31 December 2012 by independent actuaries and the FKI US Pension Plan valuation is based on the US full actuarial valuation as of 31 December 2011 updated at 31 December 2012 by independent actuaries. The latest UK full actuarial valuations are due to be signed during March 2013.

The Group also operates unfunded retiree medical and welfare benefit plans, principally in the US.

The Group contributed £18.5 million (2011: £18.5 million) to the FKI UK Pension Plan and £4.6 million (2011: £4.6 million) to the McKechnie UK Pension Plan in the year ended 31 December 2012. The Group also contributed £6.0 million to the McKechnie UK Pension Plan following the disposal of the MPC business. Contributions to the FKI UK Pension Plan in 2013 will be £20.0 million.

In addition to this, there are a number of defined contribution plans across the Group. Contributions by continuing businesses during the year were £13.1 million (2011: £10.2 million).

## 23. Retirement benefit obligations (continued)

### Actuarial assumptions

The major weighted average assumptions used by the actuaries in calculating the Group's pension plan assets and liabilities are as set out below:

| | 31 December 2012 | | | | | |
|---|---|---|---|---|---|---|
| | **FKI UK Plan % p.a.** | **McKechnie UK Plan % p.a.** | **FKI US Plan % p.a.** | **US Plans % p.a.** | **European Plans % p.a.** | **Other plans % p.a.** |
| Rate of increase in salaries | **n/a** | **3.50**[1] | **n/a** | **4.00** | **2.75** | **3.00** |
| Rate of increase in pensions in payment | **2.90** | **3.00** | **n/a** | **n/a** | **1.90** | **n/a** |
| Discount rate | **4.50** | **4.50** | **3.90** | **3.90** | **2.90** | **3.90** |
| RPI inflation assumption | **3.00** | **3.00** | **n/a** | **n/a** | **1.90** | **2.90** |

[1] Closed to the accrual of future benefits but active members' benefits are still linked to current salaries.

| | 31 December 2011 | | | | |
|---|---|---|---|---|---|
| | FKI UK Plan % p.a. | McKechnie UK Plan % p.a. | FKI US Plan % p.a. | US Plans % p.a. | Other plans % p.a. |
| Rate of increase in salaries | n/a | 3.60[1] | n/a | n/a | n/a |
| Rate of increase in pensions in payment | 3.00 | 3.10 | n/a | n/a | n/a |
| Discount rate | 4.90 | 4.90 | 4.30 | 4.00 | 4.60 |
| RPI inflation assumption | 3.10 | 3.10 | n/a | n/a | 2.50 |

[1] Closed to the accrual of future benefits but active members' benefits are still linked to current salaries.

### Mortality

**FKI UK Pension Plan**

Mortality assumptions for the most significant plan in the Group, the FKI UK plan, as at 31 December 2012 are based on the Self Administered Pension Scheme ("SAPS") "S1" base tables with scaling factors of 110% and 105% for deferred members and pensioners respectively, which reflect the results of a mortality analysis carried out on the plan's membership. Future improvements are in line with the Continuous Mortality Investigation improvement model with a long-term rate of improvement of 1.25% p.a. for both males and females.

The assumptions are that a member currently aged 65 will live on average for a further 22.1 years if they are male and for a further 24.2 years if they are female. For a member who retires in 2032 at age 65, the assumptions are that they will live for a further 23.5 years after retirement if they are male and for a further 25.8 years after retirement if they are female.

The mortality assumptions are in line with those adopted for the triennial valuation results as at 31 December 2011.

### Sensitivities

Sensitivities around movements in the principal assumptions of the discount rate, inflation rate and mortality are discussed in the Finance Director's review on pages 33 and 34.

### Balance Sheet disclosures

The amount recognised in the Balance Sheet arising from net liabilities in respect of defined benefit plans is as follows:

| | **31 December 2012 £m** | 31 December 2011 £m | 31 December 2010 £m | 31 December 2009 £m | 31 December 2008 £m |
|---|---|---|---|---|---|
| Plan liabilities | **(1,304.6)** | (1,076.7) | (1,039.4) | (1,033.5) | (939.7) |
| Plan assets | **1,043.3** | 959.0 | 919.8 | 864.4 | 810.5 |
| Limit on pension plan surplus | **—** | — | — | — | (14.1) |
| Net liabilities | **(261.3)** | (117.7) | (119.6) | (169.1) | (143.3) |

# Notes to the financial statements continued

### 23. Retirement benefit obligations (continued)

The five year history of experience adjustments is as follows:

| | **31 December 2012 £m** | 31 December 2011 £m | 31 December 2010 £m | 31 December 2009 £m | 31 December 2008 £m |
|---|---|---|---|---|---|
| Experience adjustments on plan liabilities | **(90.1)** | (72.4) | (23.8) | (130.9) | 70.7 |
| Experience adjustments on plan assets | **26.3** | 35.3 | 37.6 | 41.0 | (78.9) |

The plan liabilities and assets at 31 December 2012 were split by plan as follows:

| | FKI UK Plan £m | McKechnie UK Plan £m | FKI US Plan £m | US Plans £m | European Plans £m | Other plans £m | **Total £m** |
|---|---|---|---|---|---|---|---|
| Plan liabilities | (730.2) | (179.0) | (228.4) | (46.4) | (111.0) | (9.6) | **(1,304.6)** |
| Plan assets | 630.2 | 170.8 | 198.3 | 26.6 | 9.7 | 7.7 | **1,043.3** |
| Net liabilities | (100.0) | (8.2) | (30.1) | (19.8) | (101.3) | (1.9) | **(261.3)** |

This amount is presented in the Balance Sheet:

| | **31 December 2012 £m** | 31 December 2011 £m | 31 December 2010 £m | 31 December 2009 £m | 31 December 2008 £m |
|---|---|---|---|---|---|
| Net liabilities | | | | | |
| — unfunded plans | **118.0** | 11.2 | 21.0 | 24.2 | 45.2 |
| — funded plans | **143.3** | 106.5 | 98.6 | 144.9 | 84.0 |
| Limit on pension plan surplus | **—** | — | — | — | 14.1 |
| | **261.3** | 117.7 | 119.6 | 169.1 | 143.3 |

Expected returns and fair value of assets:

| | Expected rates of return | | Fair value of assets | |
|---|---|---|---|---|
| | **31 December 2012 %** | 31 December 2011 % | **31 December 2012 £m** | 31 December 2011 £m |
| Equity instruments | **7.0** | 7.0 | **410.7** | 348.7 |
| Debt instruments | **3.8** | 3.8 | **534.3** | 514.2 |
| Other assets | **5.3** | 4.4 | **98.3** | 96.1 |
| Weighted average/total | **5.2** | 5.0 | **1,043.3** | 959.0 |

The expected return on plan assets at 31 December 2012 is based on market expectations at 1 January 2013 for returns on assets over the entire life of the obligation.

There is no self investment (other than in relevant tracker funds) either in the Group's own financial instruments or property or other assets used by the Group.

### 23. Retirement benefit obligations (continued)

Movements in the present value of defined benefit obligations during the year:

| | Year ended 31 December 2012 £m | Year ended 31 December 2011 £m |
|---|---|---|
| At beginning of year | **1,076.7** | 1,039.4 |
| Acquisition of business | **155.1** | — |
| Disposal of businesses | **(0.7)** | (41.1) |
| Current service cost | **1.2** | 0.6 |
| Past service cost | **(0.9)** | — |
| Interest cost | **51.4** | 52.8 |
| Actuarial losses | **90.1** | 72.4 |
| Benefits paid out of plan assets | **(49.9)** | (47.7) |
| Benefits paid out of Group assets for unfunded plans | **(1.8)** | — |
| Plan curtailments | **(7.0)** | (0.8) |
| Currency (gains)/losses | **(9.6)** | 1.1 |
| At end of year | **1,304.6** | 1,076.7 |

Movements in the fair value of plan assets during the year:

| | Year ended 31 December 2012 £m | Year ended 31 December 2011 £m |
|---|---|---|
| At beginning of year | **959.0** | 919.8 |
| Acquisition of business | **37.8** | — |
| Disposal of businesses | **—** | (30.5) |
| Expected return on assets | **47.8** | 52.3 |
| Actuarial gains | **26.3** | 35.3 |
| Contributions | **31.9** | 28.8 |
| Benefits paid out of plan assets | **(49.9)** | (47.7) |
| Currency (losses)/gains | **(9.6)** | 1.0 |
| At end of year | **1,043.3** | 959.0 |

The actual return on plan assets was a gain of £74.1 million (2011: £87.6 million).

# Notes to the financial statements continued

## 23. Retirement benefit obligations (continued)

### Income Statement disclosures

Amounts recognised in the Income Statement in respect of these defined benefit plans are as follows:

| | Year ended 31 December 2012 £m | Restated[1] year ended 31 December 2011 £m |
|---|---|---|
| **Continuing operations** | | |
| Included within headline[2] operating profit: | | |
| — current service cost | **1.2** | 0.4 |
| — past service cost | **(0.9)** | — |
| — curtailment gain | **—** | (0.8) |
| Included within net finance costs: | | |
| — interest cost | **51.4** | 52.6 |
| — expected return on assets | **(47.8)** | (52.3) |
| Included within exceptional items: | | |
| — curtailment gain | **(7.0)** | — |
| **Discontinued operations** | | |
| Included within headline[2] operating profit: | | |
| — current service cost | **—** | 0.2 |
| Included within net finance costs: | | |
| — interest cost | **—** | 0.2 |

[1] Restated to include the results of MPC within discontinued operations.
[2] As defined on the Income Statement.

### Statement of Comprehensive Income disclosures

The amount recognised in the Statement of Comprehensive Income is as follows:

| | Year ended 31 December 2012 £m | Year ended 31 December 2011 £m |
|---|---|---|
| Actuarial losses on plan liabilities | **(90.1)** | (72.4) |
| Actuarial gains on plan assets | **26.3** | 35.3 |
| | **(63.8)** | (37.1) |

The cumulative amount of actuarial gains and losses recognised in the Statement of Comprehensive Income is a total loss of £178.3 million (2011: £114.5 million).

## 24. Financial instruments and risk management

The table below sets out the Group's accounting classification of each category of financial assets and liabilities and their fair values at 31 December 2012 and 31 December 2011:

| | Energy £m | Lifting £m | Other Industrial[1] £m | Central £m | Elster £m | Discontinued[1] £m | Total £m |
|---|---|---|---|---|---|---|---|
| **31 December 2012** | | | | | | | |
| **Financial assets** | | | | | | | |
| Cash and cash equivalents | — | — | — | 156.5 | — | — | 156.5 |
| Net trade receivables | 93.0 | 78.2 | 8.3 | 0.1 | 141.9 | — | 321.5 |
| Derivative financial assets | 2.2 | 0.8 | — | 0.1 | 0.2 | — | 3.3 |
| **Financial liabilities** | | | | | | | |
| Interest-bearing loans and borrowings | — | — | — | (1,148.0) | (6.2) | — | (1,154.2) |
| Derivative financial liabilities | (1.4) | (0.7) | — | (8.2) | (0.2) | — | (10.5) |
| Other financial liabilities | (114.3) | (78.6) | (17.1) | (33.5) | (279.6) | — | (523.1) |
| 31 December 2011 | | | | | | | |
| **Financial assets** | | | | | | | |
| Cash and cash equivalents | — | — | — | 195.6 | — | — | 195.6 |
| Net trade receivables | 94.0 | 74.6 | 8.8 | 0.1 | — | 15.2 | 192.7 |
| Derivative financial assets | 0.4 | 0.9 | — | 0.4 | — | — | 1.7 |
| **Financial liabilities** | | | | | | | |
| Interest-bearing loans and borrowings | — | — | — | (486.3) | — | — | (486.3) |
| Derivative financial liabilities | (8.6) | (1.0) | (0.1) | (5.8) | — | (0.2) | (15.7) |
| Other financial liabilities | (116.8) | (83.7) | (20.1) | (33.5) | — | (16.1) | (270.2) |

[1] Restated to include the financial assets and financial liabilities of MPC within discontinued operations.

### Credit risk

The Group considers its maximum exposure to credit risk to be as follows:

| | Energy £m | Lifting £m | Other Industrial[1] £m | Central £m | Elster £m | Discontinued[1] £m | Total £m |
|---|---|---|---|---|---|---|---|
| **31 December 2012** | | | | | | | |
| **Financial assets** | | | | | | | |
| Cash and cash equivalents | — | — | — | 156.5 | — | — | 156.5 |
| Trade receivables | 93.0 | 78.2 | 8.3 | 0.1 | 141.9 | — | 321.5 |
| Derivative financial assets | 2.2 | 0.8 | — | 0.1 | 0.2 | — | 3.3 |
| 31 December 2011 | | | | | | | |
| **Financial assets** | | | | | | | |
| Cash and cash equivalents | — | — | — | 195.6 | — | — | 195.6 |
| Trade receivables | 94.0 | 74.6 | 8.8 | 0.1 | — | 15.2 | 192.7 |
| Derivative financial assets | 0.4 | 0.9 | — | 0.4 | — | — | 1.7 |

[1] Restated to include the financial assets of MPC within discontinued operations.

The Group's principal financial assets are cash and cash equivalents, trade receivables and derivative financial assets which represent the Group's maximum exposure to credit risk in relation to financial assets.

The Group's credit risk on cash and cash equivalents and derivative financial instruments is limited because the counter-parties are banks with strong credit-ratings assigned by international credit-rating agencies. The Group's credit risk is primarily attributable to its trade receivables. The amounts presented in the Consolidated Balance Sheet are net of allowances for doubtful receivables, estimated by the Group's management based on prior experience and their assessment of the current economic environment. Note 16 provides further details regarding the recovery of trade receivables.

# Notes to the financial statements continued

## 24. Financial instruments and risk management (continued)

### Capital risk

The Group manages its capital to ensure that entities in the Group will be able to continue as a going concern while maximising the return to stakeholders through the optimisation of the Group's net debt and equity balance.

The capital structure of the Group consists of net debt, which includes the borrowings disclosed in note 19, after deducting cash and cash equivalents, and equity attributable to equity holders of the parent, comprising Issued share capital, Reserves and Retained earnings as disclosed in the Consolidated Statement of Changes in Equity.

### Liquidity risk

The Group's policy for managing liquidity risk is set out in the Finance Director's review.

### Fair values

The Directors consider that the financial assets and liabilities have fair values not materially different to the carrying values.

### Foreign exchange contracts

As at 31 December 2012, the Group held foreign exchange forward contracts to mitigate expected exchange fluctuations on cash flows on sales to customers and purchases from suppliers. These instruments operate as cash flow hedges unless the amounts involved are small. The terms of the material currency pairs with total principals in excess of Sterling £1 million equivalent are as follows:

| | **31 December 2012 Selling currency millions** | **31 December 2012 Average hedged rate** | 31 December 2011 Selling currency millions | 31 December 2011 Average hedged rate |
|---|---|---|---|---|
| Sell Australian Dollar/Buy Euro | **AUD 4.7** | **EUR/AUD 1.27** | – | – |
| Sell Australian Dollar/Buy Sterling | **AUD 4.3** | **GBP/AUD 1.58** | AUD 4.3 | GBP/AUD 1.60 |
| Sell Canadian Dollar/Buy Sterling | **–** | **–** | CAD 4.3 | GBP/CAD 1.60 |
| Sell Canadian Dollar/Buy US Dollar | **CAD 1.7** | **USD/CAD 1.00** | CAD 1.9 | USD/CAD 0.99 |
| Sell Chinese Renminbi/Buy US Dollar | **–** | **–** | CNY 10.3 | USD/CNY 6.43 |
| Sell Czech Koruna/Buy US Dollar | **CZK 33.9** | **USD/CZK 20.24** | – | – |
| Sell Euro/Buy Chinese Renminbi | **–** | **–** | EUR 2.3 | EUR/CNY 8.74 |
| Sell Euro/Buy Czech Koruna | **EUR 7.1** | **EUR/CZK 25.20** | EUR 16.8 | EUR/CZK 24.59 |
| Sell Euro/Buy Mexican Peso | **EUR 4.1** | **EUR/MXN 17.01** | – | – |
| Sell Euro/Buy Polish Zloty | **EUR 1.8** | **EUR/PLZ 4.09** | – | – |
| Sell Euro/Buy Sterling | **EUR 37.4** | **GBP/EUR 1.24** | EUR 24.4 | GBP/EUR 1.15 |
| Sell Euro/Buy US Dollar | **EUR 2.7** | **EUR/USD 1.28** | EUR 2.8 | EUR/USD 1.38 |
| Sell Hong Kong Dollar/Buy Sterling | **HKD 16.9** | **GBP/HKD 12.41** | HKD 21.7 | GBP/HKD 12.11 |
| Sell Malaysian Ringgit/Buy Euro | **MYR 5.8** | **EUR/MYR 4.00** | – | – |
| Sell Malaysian Ringgit/Buy US Dollar | **MYR 5.6** | **USD/MYR 3.11** | – | – |
| Sell Norwegian Krone/Buy Euro | **–** | **–** | NOK 28.1 | EUR/NOK 7.86 |
| Sell Norwegian Krone/Buy Sterling | **NOK 92.3** | **GBP/NOK 9.30** | NOK 56.9 | GBP/NOK 9.13 |
| Sell Singapore Dollar/Buy Sterling | **SGD 2.1** | **GBP/SGD 1.98** | – | – |
| Sell South African Rand/Buy Euro | **ZAR 21.1** | **EUR/ZAR 10.60** | ZAR 34.7 | EUR/ZAR 10.51 |
| Sell South African Rand/Buy Sterling | **ZAR 29.3** | **GBP/ZAR 14.21** | – | – |
| Sell Sterling/Buy Czech Koruna | **GBP 62.1** | **GBP/CZK 30.58** | GBP 87.1 | GBP/CZK 28.55 |
| Sell Sterling/Buy Euro | **GBP 37.0** | **GBP/EUR 1.22** | GBP 35.5 | GBP/EUR 1.15 |
| Sell Sterling/Buy US Dollar | **GBP 3.1** | **GBP/USD 1.61** | GBP 1.1 | GBP/USD 1.58 |
| Sell UAE Dirham/Buy Sterling | **AED 6.8** | **GBP/AED 5.90** | – | – |
| Sell US Dollar/Buy Canadian Dollar | **USD 3.7** | **USD/CAD 1.00** | USD 4.9 | USD/CAD 0.99 |
| Sell US Dollar/Buy Chinese Renminbi | **–** | **–** | USD 1.6 | USD/CNY 6.43 |
| Sell US Dollar/Buy Czech Koruna | **–** | **–** | USD 4.2 | USD/CZK 18.50 |
| Sell US Dollar/Buy Euro | **USD 5.6** | **EUR/USD 1.22** | USD 6.4 | EUR/USD 1.38 |
| Sell US Dollar/Buy Sterling | **USD 84.5** | **GBP/USD 1.59** | USD 79.8 | GBP/USD 1.59 |

The foreign exchange contracts all mature between January 2013 and August 2014.

The fair value of the contracts at 31 December 2012 was a net asset of £0.8 million (31 December 2011: net liability of £8.3 million).

## 24. Financial instruments and risk management (continued)

### Commodity swap contracts

As at 31 December 2012, the Group held a number of copper swap contracts that were designated as cash flow hedges. These swap contracts lock the Group into fixed copper prices to protect against fluctuations in the market price of copper. The terms of the contracts are:

| Commodity swaps | Commodity | Total quantity | Maturity | Pricing (US Dollar) |
|---|---|---|---|---|
| Group pays | Copper | 130 tonnes | 4 February 2013 | 7,538 per tonne |
| Group receives | Copper | 130 tonnes | 4 February 2013 | Average LME price for the month |
| Group pays | Copper | 170 tonnes | 4 March 2013 | 7,698 per tonne |
| Group receives | Copper | 170 tonnes | 4 March 2013 | Average LME price for the month |
| Group pays | Copper | 190 tonnes | 3 April 2013 | 7,405 per tonne |
| Group receives | Copper | 190 tonnes | 3 April 2013 | Average LME price for the month |
| Group pays | Copper | 120 tonnes | 2 May 2013 | 7,395 per tonne |
| Group receives | Copper | 120 tonnes | 2 May 2013 | Average LME price for the month |
| Group pays | Copper | 80 tonnes | 4 June 2013 | 7,323 per tonne |
| Group receives | Copper | 80 tonnes | 4 June 2013 | Average LME price for the month |
| Group pays | Copper | 70 tonnes | 2 July 2013 | 7,327 per tonne |
| Group receives | Copper | 70 tonnes | 2 July 2013 | Average LME price for the month |
| Group pays | Copper | 50 tonnes | 2 August 2013 | 7,330 per tonne |
| Group receives | Copper | 50 tonnes | 2 August 2013 | Average LME price for the month |

The fair value of the contracts at 31 December 2012 was a net asset of £0.1 million (31 December 2011: £nil).

### Hedge of net investments in foreign entities

Included in interest-bearing loans at 31 December 2012 were the following amounts which were designated as hedges of net investments in the Group's subsidiaries in Europe and the USA and were being used to reduce the exposure to foreign exchange risks.

Borrowings in local currency:

| | **31 December 2012 £m** | 31 December 2011 £m |
|---|---|---|
| US Dollar | **307.8** | 390.1 |
| Euro | **281.9** | 48.6 |

### Interest rate sensitivity analysis

A one percentage point rise in market interest rates for all currencies would (decrease)/increase profit before tax by the following amounts assuming the net debt as at the Balance Sheet date was outstanding for the whole year:

| | **Year ended 31 December 2012 £m** | Year ended 31 December 2011 £m |
|---|---|---|
| Sterling | **(1.0)** | 0.4 |
| US Dollar | **(0.5)** | (0.3) |
| Euro | **(0.6)** | (0.2) |
| | **(2.1)** | (0.1) |

# Notes to the financial statements continued

### 24. Financial instruments and risk management (continued)

#### Interest rate risk management

The Group's policy for managing interest rate risk is set out in the Finance Director's review.

The Group entered 2012 protecting 78% of its gross debt from exposure to changes in interest rates by holding a number of interest rate swaps to fix £380.1 million (US $546.0 million and €33.3 million) of drawn debt. Under the terms of these swaps, the Group fixed the underlying interest rate at 2.1% for US Dollars and 2.6% for the Euro, plus the bank margin which was 1.35% at that time.

In February 2012 the Group closed out these swap arrangements and replaced them with new swap arrangements to fix the interest rate on a proportion of the new facility drawn down on 31 January 2012. The new five year swap arrangements fixed the finance cost on US $231.0 million, £105.0 million and €42.0 million of debt. Under the terms of these new swap arrangements, the Group will pay annually in arrears, 1.0% for US Dollar swaps, 1.1% for Euro swaps and 1.1% for Sterling swaps, plus the bank margin which was 1.5% at that time. This arrangement protected approximately 70% of the Group's exposure to interest rate fluctuations for the term of the new facility.

In September 2012 the Group entered into another layer of interest rate swaps following the acquisition of Elster. The new five year swap arrangements fixed the finance cost on US $329.0 million, £231.8 million and €250.0 million of drawn borrowings. Under the terms of the new swap arrangements, the Group will pay, annually in arrears, 0.69% for US Dollar swaps, 0.72% for Euro swaps and 0.80% for Sterling swaps, plus the current bank margin which is 2.00%. These swaps have also been structured to maintain the ratio of fixed interest rate cover over the five year term allowing for Group profit generation.

This fixes the interest rate cost on US $560.0 million, £336.8 million and €292.0 million of debt, 79% of gross borrowings as at 31 December 2012. The weighted blended fixed finance cost is therefore 0.84% on US Dollar swaps, 0.78% on Euro swaps and 0.91% on Sterling swaps, plus the bank margin of 2.00%.

These interest rate swaps have been designated as cash flow hedges and were highly effective throughout 2012. The fair value of the contracts at 31 December 2012 was a net liability of £8.1 million (31 December 2011: £5.7 million).

#### Foreign currency risk

The Group's policy for managing foreign currency risk is set out in the Finance Director's review on pages 35 and 36.

#### Foreign currency sensitivity analysis

Currency risks are defined by IFRS 7 as the risk that the fair value or future cash flows of a financial asset or liability will fluctuate because of changes in foreign exchange rates.

The following table details the transactional impact of hypothetical changes in foreign exchange rates on financial assets and liabilities at the Balance Sheet date, illustrating the (decrease)/increase in Group operating profit caused by a 10 cent strengthening of the US Dollar and Euro against Sterling and a 10% strengthening of the Czech Koruna against Sterling compared to the year end spot rate. The analysis assumes that all other variables, in particular other foreign currency exchange rates, remain constant. The Group operates in a range of different currencies, and those with a material impact are noted here:

| | **Year ended 31 December 2012 £m** | Year ended 31 December 2011 £m |
|---|---|---|
| US Dollar | **(0.7)** | (0.4) |
| Euro | **0.4** | 0.5 |
| Czech Koruna | **0.2** | 2.0 |

The following table details the impact of hypothetical changes in foreign exchange rates on financial assets and liabilities at the Balance Sheet date, illustrating the increase/(decrease) in Group equity caused by a 10 cent strengthening of the US Dollar and Euro against Sterling and a 10% strengthening of the Czech Koruna against Sterling. The analysis assumes that all other variables, in particular other foreign currency exchange rates, remain constant. The Group operates in a range of different currencies, and those with a material impact are noted here:

| | **31 December 2012 £m** | 31 December 2011 £m |
|---|---|---|
| US Dollar | **1.6** | (0.7) |
| Euro | **1.7** | 2.3 |
| Czech Koruna | **–** | 0.1 |

## 24. Financial instruments and risk management (continued)

In addition, the change in equity due to a 10 cent strengthening of the US Dollar and Euro against Sterling for the translation of net investment hedging instruments would be a decrease of £20.2 million (31 December 2011: £26.8 million) and £24.9 million (31 December 2011: £4.4 million) respectively. However, there would be no overall effect on equity because there would be an offset in the currency translation of the foreign operation.

### Fair value measurements recognised in the Balance Sheet

Foreign currency forward contracts are measured using quoted forward exchange rates and yield curves derived from quoted interest rates matching the maturities of the contracts.

Commodity swaps are measured using quoted forward commodity prices.

Interest rate swap contracts are measured using yield curves derived from quoted interest rates.

The fair values are shown below.

| | **31 December 2012 Current £m** | **31 December 2012 Non-current £m** | **31 December 2012 Total £m** | 31 December 2011 Current £m | 31 December 2011 Non-current £m | 31 December 2011 Total £m |
|---|---|---|---|---|---|---|
| **Derivative financial assets** | | | | | | |
| Foreign currency forward contracts | **3.2** | **—** | **3.2** | 1.6 | — | 1.6 |
| Commodity swaps | **0.1** | **—** | **0.1** | 0.1 | — | 0.1 |
| | **3.3** | **—** | **3.3** | 1.7 | — | 1.7 |
| **Derivative financial liabilities** | | | | | | |
| Foreign currency forward contracts | **(2.4)** | **—** | **(2.4)** | (8.7) | (1.2) | (9.9) |
| Commodity swaps | **—** | **—** | **—** | (0.1) | — | (0.1) |
| Interest rate swaps | **(4.6)** | **(3.5)** | **(8.1)** | (5.3) | (0.4) | (5.7) |
| | **(7.0)** | **(3.5)** | **(10.5)** | (14.1) | (1.6) | (15.7) |

The fair value of these are derived from inputs other than quoted prices that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices) and they therefore are categorised within Level 2 of the fair value hierarchy set out in IFRS 7.

## 25. Issued capital and reserves

| **Share Capital** | **31 December 2012 £m** | Restated[1] 31 December 2011 £m |
|---|---|---|
| **Allotted, called-up and fully paid** | | |
| 1,266,627,036 (31 December 2011: 390,961,043) Ordinary Shares of 0.1p each (31 December 2011: 120p each) | **1.3** | 469.1 |
| Nil (31 December 2011: 34,331,656) C Deferred Shares of 75.0p each | **—** | 25.7 |
| Nil (31 December 2011: 50,000) Incentive Shares of £1 each | **—** | 0.1 |
| | **1.3** | 494.9 |

[1] In accordance with IFRS 3, the prior year Issued share capital, Share premium account, Merger reserve, Other reserves and Capital redemption reserve balances have been restated to reflect the nominal share capital and reserves position of the new parent company as if it had been the holding company during both periods presented. The overall impact on net equity is £nil (note 1).

The rights of each class of share are described in the Directors' report.

On 12 April 2012, following approval at a General Meeting of the shareholders, the former Melrose Incentive Plan was crystallised. This resulted in the conversion of 50,000 £1 Melrose Incentive Shares into 31,247,969 Ordinary Shares of Melrose PLC.

On 30 April 2012, the remaining 34,331,656 C Deferred Shares were redeemed resulting in a £25.7 million transfer from Issued share capital into the Capital redemption reserve. In addition, the 1,392,194 C Shares were redeemed and cancelled on 30 April 2012 at a value of £1.1 million which was also transferred to the Capital redemption reserve.

On 1 August 2012 a 2 for 1, fully underwritten, Rights Issue was completed by Melrose PLC and 844,418,024 Melrose PLC Ordinary Shares were issued raising £1.2 billion to part fund the acquisition of Elster.

# Notes to the financial statements continued

### 25. Issued capital and reserves (continued)

Following the Rights Issue, the total number of 14/55p Melrose PLC Ordinary Shares in issue was 1,266,627,036.

On 27 November 2012, a Scheme of Arrangement approved by the High Court of England and Wales became effective and resulted in Melrose Industries PLC becoming the new holding company of Melrose PLC and its subsidiaries. The arrangement resulted in the issue of 1 new 120p Melrose Industries PLC Ordinary Share for each 14/55p Melrose PLC Ordinary Share. Melrose Industries PLC consequently issued 1,266,627,036 Ordinary Shares.

As explained in note 1, Ordinary Share Capital at 31 December 2011 has been restated to reflect the nominal value of the Ordinary Shares of Melrose Industries PLC at the date on which Melrose Industries PLC became the new holding company. The nominal value of each Ordinary Share in issue at 31 December 2011 has therefore been restated from 14/55p to 120p.

On 28 November 2012, the nominal value of each Ordinary Share of Melrose Industries PLC was reduced from 120p to 0.1p and resulted in a transfer of £1,518.7 million to Retained earnings.

### Own shares

The Trustee of the Melrose PLC Employee Benefit Trust ("EBT") holds no shares in Melrose Industries PLC at 31 December 2012. At 31 December 2011 the EBT held 500 Melrose Incentive Shares and 19,862 Ordinary Shares of 14/55p in Melrose PLC.

The FKI EBT holds no shares in Melrose Industries PLC at 31 December 2012. At 31 December 2011 the FKI EBT held 124,232 Ordinary Shares of 14/55p in Melrose PLC.

### Hedging and translation reserves

The hedging and translation reserve is used to record exchange differences arising from the translation of the financial statements of foreign subsidiaries. It is also used to record the foreign exchange movements of instruments designated as net investment hedges and cash flow hedges.

| Hedging and translation reserves | Hedging reserve £m | Translation reserve £m | Total £m |
|---|---|---|---|
| At 1 January 2011 | (8.6) | 79.6 | 71.0 |
| Currency translation on net investments | 0.4 | (17.7) | (17.3) |
| Losses on cash flow hedges | (0.1) | — | (0.1) |
| Taxation adjustments to equity | 1.5 | — | 1.5 |
| Transfer to Income Statement on cash flow hedges | (5.1) | — | (5.1) |
| Transfer to Income Statement on disposal of foreign operations | — | (52.6) | (52.6) |
| At 31 December 2011 | (11.9) | 9.3 | (2.6) |
| Currency translation on net investments | 0.1 | (1.3) | (1.2) |
| Losses on cash flow hedges | (6.2) | — | (6.2) |
| Taxation adjustments to equity | (1.6) | — | (1.6) |
| Transfer to Income Statement on cash flow hedges | 11.9 | — | 11.9 |
| **At 31 December 2012** | **(7.7)** | **8.0** | **0.3** |

## 26. Cash flow statement

| | Year ended 31 December 2012 £m | Restated[1] year ended 31 December 2011 £m |
|---|---|---|
| **Reconciliation of headline[2] operating profit to cash generated by continuing operations** | | |
| Headline[2] operating profit from continuing operations | **243.1** | 174.2 |
| Adjustments for: | | |
| Depreciation of property, plant and equipment | **28.1** | 21.0 |
| Amortisation of computer software and development costs | **2.4** | 0.6 |
| Restructuring costs paid and movements in other provisions | **(62.9)** | (32.2) |
| Operating cash flows before movements in working capital | **210.7** | 163.6 |
| Increase in inventories | **(3.5)** | (17.5) |
| Increase in receivables | **(7.7)** | (14.5) |
| (Decrease)/increase in payables | **(32.8)** | 13.0 |
| Cash generated by operations | **166.7** | 144.6 |
| Tax paid | **(49.4)** | (22.9) |
| Interest paid | **(42.8)** | (26.0) |
| Defined benefit pension contributions paid | **(33.7)** | (24.9) |
| **Net cash from operating activities from continuing operations** | **40.8** | 70.8 |

[1] Restated to include the results of MPC within discontinued operations.
[2] As defined on the Income Statement.

| **Cash flow from discontinued operations** | Year ended 31 December 2012 £m | Restated[1] year ended 31 December 2011 £m |
|---|---|---|
| Cash generated from discontinued operations | **1.7** | 28.1 |
| Tax paid | **—** | (3.8) |
| Defined benefit pension contributions paid | **—** | (3.9) |
| **Net cash from operating activities from discontinued operations** | **1.7** | 20.4 |
| Purchase of property, plant and equipment | **(1.8)** | (9.5) |
| Purchase of computer software | **—** | (0.2) |
| Interest received | **—** | 0.5 |
| Dividends paid to non-controlling interests | **—** | (0.2) |
| **Net cash used in investing activities from discontinued operations** | **(1.8)** | (9.4) |
| Net movement in borrowings | **—** | (0.3) |
| **Net cash used in financing activities from discontinued operations** | **—** | (0.3) |

[1] Restated to include the results of MPC within discontinued operations.

### Net debt reconciliation

| | At 31 December 2011 £m | Cash flow £m | Acquisitions £m | Disposals £m | Other non-cash movements £m | Foreign exchange difference £m | **At 31 December 2012 £m** |
|---|---|---|---|---|---|---|---|
| Cash | 195.6 | 222.4 | (285.0) | 27.1 | — | (3.6) | **156.5** |
| Debt due within one year | (27.7) | 27.8 | (6.5) | — | — | 0.2 | **(6.2)** |
| Debt due after one year | (457.5) | (318.0) | (405.4) | — | 15.6 | 17.3 | **(1,148.0)** |
| Net debt | (289.6) | (67.8) | (696.9) | 27.1 | 15.6 | 13.9 | **(997.7)** |

# Notes to the financial statements continued

## 27. Commitments and contingencies

Future total minimum rentals payable under non-cancellable operating leases were as follows:

| | 31 December 2012 £m | 31 December 2011 £m |
|---|---|---|
| Amounts payable: | | |
| Within one year | **16.3** | 7.7 |
| After one year but within five years | **33.0** | 16.8 |
| Over five years | **30.9** | 10.3 |
| | **80.2** | 34.8 |

### Capital commitments

At 31 December 2012, there were commitments of £16.8 million (31 December 2011: £18.9 million) relating to the acquisition of new plant and machinery.

## 28. Related parties

Transactions between the Company and its subsidiaries, which are related parties, have been eliminated on consolidation and are not disclosed in this note.

The Group did not enter into any significant transactions in the ordinary course of business with joint ventures during the current or prior year.

Sales to and purchases from Group companies are priced as arm's length transactions and generally are settled on 30 day terms.

### Remuneration of key management personnel

The remuneration of the Directors, who are the key management personnel of the Group, is set out below in aggregate for each of the categories specified in IAS 24: "Related party disclosures". Further information about the remuneration of individual Directors is provided in the audited part of the Directors' Remuneration report on pages 66 and 67.

| | Year ended 31 December 2012 £m | Year ended 31 December 2011 £m |
|---|---|---|
| Short-term employee benefits | **2.7** | 3.0 |
| Share-based payments | **2.5** | 1.6 |
| | **5.2** | 4.6 |

## 29. Post Balance Sheet events

There are no post Balance Sheet events which require disclosure.

## 30. Contingent liabilities

As a result of the acquisitions of the FKI and Elster businesses, certain contingent legal, environmental, warranty and tax liabilities were identified. Whilst it is difficult to reasonably estimate the ultimate outcome of these claims, the Directors' best estimate has been included in the Balance Sheet.

The Group has contingent liabilities representing guarantees and contract bonds given in the ordinary course of business on behalf of trading subsidiaries. No losses are anticipated to arise on these contingent liabilities.

# Independent auditor's report to the members of Melrose Industries PLC

We have audited the Company financial statements of Melrose Industries PLC for the period from incorporation on 8 October 2012 to 31 December 2012 which comprises the Balance Sheet and the related notes 1 to 8. The financial reporting framework that has been applied in their preparation is applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice).

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

### Respective responsibilities of Directors and auditor

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

### Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the Company's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the Directors; the overall presentation of the financial statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by us in the course of performing the audit. In addition, we read all the financial and non-financial information in the Annual Report to identify material inconsistencies with the audited financial statements. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

### Opinion on financial statements

In our opinion the Company financial statements:

- give a true and fair view of the state of the Company's affairs as at 31 December 2012;
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

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

In our opinion:

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

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

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

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

### Other matter

We have reported separately on the Group financial statements of Melrose Industries PLC for the year ended 31 December 2012.

Nigel Mercer

**Nigel Mercer, ACA (Senior Statutory Auditor)**
for and on behalf of Deloitte LLP
Chartered Accountants and Statutory Auditor
London, UK
6 March 2013

# Company Balance Sheet for Melrose Industries PLC

| | Notes | 31 December 2012 £m |
|---|---|---|
| **Fixed assets** | | |
| Investment in subsidiaries | 3 | **2,710.6** |
| | | **2,710.6** |
| **Creditors: amounts falling due within one year** | | |
| Creditors | 4 | **(0.3)** |
| **Net current liabilities** | | **(0.3)** |
| **Net assets** | | **2,710.3** |
| **Capital and reserves** | | |
| Issued share capital | 5 | **1.3** |
| Merger reserve | 6 | **1,190.6** |
| Retained earnings | 6 | **1,518.4** |
| **Shareholders' funds** | 7 | **2,710.3** |

The financial statements were approved by the Board of Directors on 6 March 2013 and were signed on its behalf by:

**Geoffrey Martin**
Group Finance Director

**Simon Peckham**
Chief Executive

Registered number: 8243706

# Notes to the Company Balance Sheet

## 1. Significant accounting policies

Melrose Industries PLC ("the Company") was incorporated on 8 October 2012 and submitted to the London Stock Exchange as the new listed holding company of Melrose PLC and its subsidiaries ("the Melrose Group") on 27 November 2012.

### Basis of accounting

The separate financial statements of the Company are presented as required by the Companies Act 2006. They have been prepared under the historical cost convention and in accordance with applicable United Kingdom Generally Accepted Accounting Practice ("UK GAAP") and law.

The principal accounting policies are summarised below. They have all been applied consistently throughout the period.

### Going concern

The Directors have, at the time of approving the financial statements, a reasonable expectation that the Company has adequate resources to continue in operational existence for the foreseeable future. Thus they continue to adopt the going concern basis of accounting in preparing the financial statements. Further detail is contained in the Directors' statement of going concern on page 54 of the Directors' report.

### Investments

Fixed asset investments in subsidiaries are shown at cost less provision for impairment.

For investments in subsidiaries acquired for consideration, including the issue of shares qualifying for merger relief, cost is measured at the fair value of the consideration paid. Any premium is ignored.

### Share-based payments

The Company has applied the requirements of FRS 20: "Share-based payments". The Company issues equity-settled share-based payments to certain employees. Equity-settled share-based payments are measured at fair value (excluding the effect of non-market based vesting conditions) at the date of grant. The fair value determined at the grant date of the equity-settled share-based payments is expensed on a straight-line basis over the vesting period, based on the Company's estimate of the shares that will eventually vest and adjusted for the effect of non-market based vesting conditions.

Fair value is measured by use of the Black Scholes pricing model. The expected life used in the model has been adjusted, based on the Directors' best estimate, for the effects of non-transferability, exercise restrictions, and behavioural considerations.

### Cash Flow Statement

The Company has taken advantage of the exemption from preparing a Cash Flow Statement under the terms of FRS 1 (revised): "Cash Flow Statements" because it prepares a consolidated Cash Flow Statement which is shown on page 73 of the Group financial statements.

### Taxation

Current tax, including UK corporation tax and foreign tax, is provided at amounts expected to be paid (or recovered) using the tax rates and laws that have been enacted or substantively enacted by the Balance Sheet date.

Deferred tax is recognised in respect of all timing differences that have originated but not reversed at the Balance Sheet date where transactions or events that result in an obligation to pay more tax in the future or a right to pay less tax in the future have occurred at the Balance Sheet date. Timing differences are differences between the Company's taxable profits and its results as stated in the financial statements that arise from the inclusion of gains and losses in tax assessments in periods different from those in which they are recognised in the financial statements.

## 2. Profit for the period

As permitted by section 408 of the Companies Act 2006 the Company has elected not to present its own Profit and Loss Account for the period. Melrose Industries PLC reported a loss for the financial period ended 31 December 2012 of £0.6 million.

The auditor's remuneration for audit services to the Company is disclosed in note 7 to the Group consolidated financial statements.

## 3. Investment in subsidiaries

| | £m |
|---|---|
| At beginning of period | – |
| Additions | 2,710.6 |
| **At 31 December 2012** | **2,710.6** |

Melrose Limited (formerly Melrose PLC) was acquired by way of a share exchange on 27 November 2012 (note 6).

The Company has investments in the following subsidiaries which principally affected the profits and net assets of the Group.

# Notes to the Company Balance Sheet continued

### 3. Investment in subsidiaries (continued)

The following subsidiary is directly owned by Melrose Industries PLC:

| Subsidiary | Country of incorporation | Principal activity | Holding % |
|---|---|---|---|
| Melrose Limited[1] | Great Britain | Holding company | 100 |

[1] Formerly Melrose PLC.

Other significant indirectly owned subsidiaries of the Group are:

| Subsidiaries | Country of incorporation | Principal activity | Equity interest % |
|---|---|---|---|
| **Energy** | | | |
| Brush Electrical Machines Limited | Great Britain | Engineering company | 100 |
| Brush HMA B.V. | Netherlands | Engineering company | 100 |
| Brush SEM s.r.o. | Czech Republic | Engineering company | 100 |
| Brush Transformers Limited | Great Britain | Engineering company | 100 |
| Harrington Generators International Limited | Great Britain | Engineering company | 100 |
| Hawker Siddeley Switchgear Limited | Great Britain | Engineering company | 100 |
| Marelli Motori SpA | Italy | Engineering company | 100 |
| Generator and Motor Services of Pennsylvania LLC | USA | Engineering company | 100 |
| **Lifting** | | | |
| Bridon-American Corporation | USA | Engineering company | 100 |
| Bridon International GmbH | Germany | Engineering company | 100 |
| Bridon International Limited | Great Britain | Engineering company | 100 |
| Bridon New Zealand Limited | New Zealand | Engineering company | 100 |
| Crosby Canada Inc | Canada | Engineering company | 100 |
| Crosby Europe N.V. | Belgium | Engineering company | 100 |
| The Crosby Group LLC | USA | Engineering company | 100 |
| **Other Industrial** | | | |
| The Harris Waste Management Group Inc | USA | Engineering company | 100 |
| Truth Hardware Corporation | USA | Engineering company | 100 |
| **Elster**[1] | | | |
| Elster Group S.E. | Germany | Holding company | 100 |
| Elster Solutions LLC | USA | Engineering company | 100 |
| Elster American Meter Company, LLC | USA | Engineering company | 100 |
| Elster GmbH | Germany | Engineering company | 100 |
| Elster Perfection Corporation | USA | Engineering company | 100 |
| Elster N.V. | Belgium | Engineering company | 100 |
| Elster Finance B.V. | Netherlands | Finance subsidiary | 100 |
| Elster Holdings Netherlands B.V. | Netherlands | Holding company | 100 |
| Elster Holdings US, Inc | USA | Holding company | 100 |
| Elster s.r.o. | Slovakia | Engineering company | 100 |
| Elster Holdings UK Limited | Great Britain | Holding company | 100 |
| **Group** | | | |
| FKI Limited | Great Britain | Holding company | 100 |
| FKI Engineering Limited | Great Britain | Holding company | 100 |
| FKI Industries Inc | USA | Holding company | 100 |
| Precision House Management Services Limited[2] | Great Britain | Management services company | 100 |

[1] Melrose Industries PLC indirectly owns 99.8% of Elster Group S.E. and its subsidiaries. Further details are disclosed in note 12 of the Group consolidated financial statements.
[2] Formerly McKechnie Management Services Limited.

## 4. Creditors

| | 31 December 2012 £m |
|---|---|
| **Amounts falling due within one year:** | |
| Amounts owed to Group undertakings | **0.3** |
| | **0.3** |

The Directors consider that amounts owed to Group undertakings approximate to their fair value.

## 5. Issued share capital

| Share Capital | 31 December 2012 £m |
|---|---|
| **Allotted, called up and fully paid** | |
| 1,266,627,036 Ordinary Shares of 0.1p each | **1.3** |
| | **1.3** |

## 6. Reserves

| | Issued share capital £m | Merger reserve £m | Retained earnings £m |
|---|---|---|---|
| At beginning of period | — | — | — |
| Issue of share capital | 1,520.0 | 1,190.6 | — |
| Capital reduction | (1,518.7) | — | 1,518.7 |
| Loss for the period | — | — | (0.6) |
| Credit to equity for equity-settled share-based payments | — | — | 0.3 |
| **At 31 December 2012** | **1.3** | **1,190.6** | **1,518.4** |

On 27 November 2012, a Scheme of Arrangement, approved by the High Court of England and Wales, became effective and resulted in Melrose Industries PLC becoming the new holding company of Melrose PLC and its subsidiaries. This resulted in the issue of 1 new 120 pence Melrose Industries PLC Ordinary Share in exchange for each 14/55 pence Melrose PLC Ordinary Share. Melrose Industries PLC consequently issued 1,266,627,036 Ordinary Shares with a total nominal value of £1,520.0 million. The market capitalisation of the Melrose Group at that date was £2,710.6 million. The difference between the market capitalisation and the total nominal value of shares issued of £1,190.6 million has been taken to the Merger reserve.

On 28 November 2012, Melrose Industries PLC received Court confirmation of the reduction in its share capital pursuant to which the nominal value of each Ordinary Share was reduced from 120 pence to 0.1 pence each. This resulted in Issued share capital decreasing by £1,518.7 million and Retained earnings increasing by an equivalent amount.

Details of share-based payments are given in note 22 to the Group consolidated financial statements.

# Notes to the Company Balance Sheet continued

## 7. Reconciliation of movements in shareholders' funds

| | £m |
|---|---|
| At beginning of period | — |
| Issue of share capital (note 6) | 2,710.6 |
| Loss for the period | (0.6) |
| Credit to equity for equity-settled share-based payments | 0.3 |
| **At 31 December 2012** | **2,710.3** |

## 8. Related party transactions

The Company has taken the exemption in FRS 8: "Related party transactions" not to disclose intercompany balances and transactions in the period with fully owned subsidiary undertakings.

# Notice of Annual General Meeting

THIS DOCUMENT IS IMPORTANT AND REQUIRES YOUR IMMEDIATE ATTENTION. IF YOU ARE IN ANY DOUBT AS TO THE ACTION YOU SHOULD TAKE, YOU SHOULD CONSULT YOUR STOCKBROKER, BANK, SOLICITOR, ACCOUNTANT, FUND MANAGER OR OTHER APPROPRIATE INDEPENDENT FINANCIAL ADVISER.

If you have sold or otherwise transferred all of your shares in Melrose Industries PLC you should send this document as soon as possible to the purchaser or transferee or to the stockbroker, bank or other agent through whom the sale or transfer was effected, for delivery to the purchaser or transferee.

Notice is given that the Annual General Meeting of the Company will be held at Barber-Surgeons' Hall, Monkwell Square, Wood Street, London, EC2Y 5BL at 11.00 am on 8 May 2013 for the following purposes. Resolutions 1 to 14 will be proposed as ordinary resolutions and resolutions 15 to 17 as special resolutions.

## Ordinary resolutions

1. To receive the Company's audited financial statements for the financial year ended 31 December 2012, together with the Directors' report and the auditor's report on those financial statements.
2. To approve the Directors' Remuneration report contained in the Company's Annual Report and financial statements for the year ended 31 December 2012.
3. To declare a final dividend of 5p per ordinary share for the year ended 31 December 2012.
4. To re-elect Mr Christopher Miller as a Director of the Company.
5. To re-elect Mr David Roper as a Director of the Company.
6. To re-elect Mr Simon Peckham as a Director of the Company.
7. To re-elect Mr Geoffrey Martin as a Director of the Company.
8. To re-elect Mr Miles Templeman as a Director of the Company.
9. To re-elect Mr Perry Crosthwaite as a Director of the Company.
10. To re-elect Mr John Grant as a Director of the Company.
11. To re-elect Mr Justin Dowley as a Director of the Company.
12. To reappoint Deloitte LLP as auditor of the Company to hold office from the conclusion of this meeting until the conclusion of the next Annual General Meeting of the Company at which accounts are laid.
13. To authorise the Directors to determine the remuneration of the auditor of the Company.
14. That, in substitution for all existing authorities, the Directors be and are generally and unconditionally authorised to exercise all the powers of the Company to allot shares in the Company or grant rights to subscribe for, or to convert any security into, shares in the Company:
    (A) up to an aggregate nominal amount of £422,209; and
    (B) comprising equity securities (as defined in section 560(1) of the Companies Act 2006 (the "Act")) up to an aggregate nominal amount of £844,418 (such amount to be reduced by the aggregate nominal amount of any allotments or grants made under paragraph (A) of this resolution) in connection with an offer by way of a rights issue:
        (i) to ordinary shareholders in proportion (as nearly as may be practicable) to their existing holdings; and
        (ii) to holders of other equity securities as required by the rights of those securities or, subject to such rights, as the Directors otherwise consider necessary,

    and so that the Directors may impose any limits or restrictions and make any arrangements which they consider necessary or appropriate to deal with treasury shares, fractional entitlements, record dates, legal, regulatory or practical problems in, or under the laws of, any territory or any other matter,

    such authorities to apply until the end of the Company's next Annual General Meeting after this resolution is passed (or, if earlier, until the close of business on 30 June 2014) but, in each case, so that the Company may make offers and enter into agreements before the authority expires which would, or might, require shares to be allotted or rights to subscribe for or convert securities into shares to be granted after the authority expires and so that the Directors may allot shares or grant rights under any such offer or agreement as if the authority had not expired.

## Special resolutions

15. That, in substitution for all existing powers and subject to the passing of resolution 14, the Directors be and are generally empowered to allot equity securities (as defined in the Act) for cash pursuant to the authority granted by resolution 14 and/or to sell ordinary shares in the capital of the Company held by the Company as treasury shares for cash in each case free of the restriction in section 561(1) of the Act, such power to be limited:

    (A) to the allotment of equity securities and sale of treasury shares for cash in connection with an offer of equity securities (but in the case of an allotment pursuant to the authority granted by paragraph (B) of resolution 14, such power shall be limited to the allotment of equity securities in connection with an offer by way of a rights issue only):
        (i) to ordinary shareholders in proportion (as nearly as may be practicable) to their existing holdings; and
        (ii) to holders of other equity securities, as required by the rights of those securities or, subject to such rights, as the Directors otherwise consider necessary,

    and so that the Directors may impose any limits or restrictions and make any arrangements which they consider necessary or appropriate to deal with treasury shares, fractional entitlements, record dates, legal, regulatory or practical problems in, or under the laws of, any territory or any other matter; and

    (B) to the allotment (otherwise than in the circumstances set out in paragraph (A) of this resolution) of equity securities pursuant to the authority granted by paragraph (A) of resolution 14 and/or the sale of treasury shares for cash up to a nominal amount of £63,331,

    such power to apply until the end of the Company's next Annual General Meeting after this resolution is passed (or, if earlier, until the close of business on 30 June 2014) but so that the Company may make offers and enter into agreements before the power expires which would, or might, require equity securities to be allotted (or treasury shares to be sold) after the power expires and so that the Directors may allot equity securities (and sell treasury shares) under any such offer or agreement as if the power had not expired.

# Notice of Annual General Meeting continued

16. That the Company be and is generally and unconditionally authorised to make one or more market purchases (within the meaning of section 693 of the Act) of ordinary shares in the capital of the Company provided that:

    (A) the maximum aggregate number of ordinary shares authorised to be purchased is 126,662,703;

    (B) the minimum price which may be paid for an ordinary share shall not be less than the nominal value of an ordinary share at the time of such purchase;

    (C) the maximum price which may be paid for an ordinary share is not more than the higher of:

        (i) 105 per cent of the average of the middle market quotation for an ordinary share as derived from the London Stock Exchange plc's Daily Official List for the five business days immediately preceding the day on which the ordinary share is purchased; and

        (ii) the higher of the price of the last independent trade and the highest current independent bid on the trading venue where the purchase is carried out,

    in each case, exclusive of expenses;

    (D) this authority will expire at the end of the next Annual General Meeting of the Company following the passing of this resolution (or, if earlier, at the close of business on 30 June 2014);

    (E) the Company may make a contract to purchase ordinary shares under this authority before expiry of the authority which will or may be executed wholly or partly after the expiry of that authority, and may make a purchase of ordinary shares in pursuance of any such contract; and

    (F) any ordinary shares purchased pursuant to this authority may either be held as treasury shares or cancelled by the Company, depending on which course of action is considered by the Directors to be in the best interests of shareholders at the time.

17. That a general meeting other than an Annual General Meeting may be called on not less than 14 clear days' notice.

**Joff Crawford**
Company Secretary
4 April 2013

Registered Office:
Precision House
Arden Road
Alcester
Warwickshire
B49 6HN

**Notes**

1. The holders of ordinary shares in the Company are entitled to attend the Annual General Meeting and are entitled to vote. A member entitled to attend and vote may appoint a proxy to exercise all or any of their rights to attend, speak and vote at a general meeting of the Company. Such a member may appoint more than one proxy, provided that each proxy is appointed to exercise the rights attached to different shares. A proxy need not be a member of the Company.

2. A form of proxy is enclosed with this notice. To be effective, a form of proxy must be completed and returned, together with any power of attorney or authority under which it is completed or a certified copy of such power or authority, so that it is received by the Company's registrars at the address specified on the form of proxy not less than 48 hours (excluding any part of a day that is not a working day) before the time for holding the meeting. Returning a completed form of proxy will not preclude a member from attending the meeting and voting in person.

3. Any person to whom this notice is sent who is a person nominated under section 146 of the Act to enjoy information rights (a "Nominated Person") may, under an agreement between him and the shareholder by whom he was nominated, have a right to be appointed (or to have someone else appointed) as a proxy for the Annual General Meeting. If a Nominated Person has no such proxy appointment right or does not wish to exercise it, he may, under any such agreement, have a right to give instructions to the shareholder as to the exercise of voting rights. The statement of the rights of shareholders in relation to the appointment of proxies in paragraphs 1 and 2 above does not apply to Nominated Persons. The rights described in paragraphs 1 and 2 can only be exercised by ordinary shareholders of the Company.

4. To be entitled to attend and vote at the Annual General Meeting (and for the purposes of the determination by the Company of the number of votes they may cast), members must be entered on the Company's register of members by 6.00 pm on 6 May 2013 (or, in the event of an adjournment, on the date which is two days before the time of the adjourned meeting). Changes to entries on the register of members after this time shall be disregarded in determining the rights of any person to attend or vote at the meeting.

5. As at 4 April 2013, the Company's issued share capital consists of 1,266,627,036 ordinary shares of 0.1p each, carrying one vote each.

6. CREST members who wish to appoint a proxy or proxies through the CREST electronic proxy appointment service may do so by using the procedures described in the CREST Manual. CREST Personal Members or other CREST sponsored members, and those CREST members who have appointed a service provider(s), should refer to their CREST sponsor or voting service provider(s), who will be able to take the appropriate action on their behalf.

7. In order for a proxy appointment or instruction made using the CREST service to be valid, the appropriate CREST message (a "CREST Proxy Instruction") must be properly authenticated in accordance with Euroclear UK & Ireland Limited's specifications, and must contain the information required for such instruction, as described in the CREST Manual (available via www.euroclear.com/CREST). The message, regardless of whether it constitutes the appointment of a proxy or is an amendment to the instruction given to a previously appointed proxy, must in order to be valid be transmitted so as to be received by the issuer's agent (ID RA19) by 11.00 am on 6 May 2013. For this purpose, the time of receipt will be taken to be the time (as determined by the time stamp applied to the message by the CREST Application Host) from which the issuer's agent is able to retrieve the message by enquiry to CREST in the manner prescribed by CREST. After this time any change of instructions to proxies appointed through CREST should be communicated to the appointee through other means.

8. CREST members and, where applicable, their CREST sponsors, or voting service providers should note that Euroclear UK & Ireland Limited does not make available special procedures in CREST for any particular message. Normal system timings and limitations will, therefore, apply in relation to the input of CREST Proxy Instructions. It is the responsibility of the CREST member concerned to take (or, if the CREST member is a CREST Personal Member, or sponsored member, or has appointed a voting service provider, to procure that his CREST sponsor or voting service provider(s) take(s)) such action as shall be necessary to ensure that a message is transmitted by means of the CREST system by any particular time. In this connection, CREST members and, where applicable, their CREST sponsors or voting system providers are referred, in particular, to those sections of the CREST Manual concerning practical limitations of the CREST system and timings.

9. The Company may treat as invalid a CREST Proxy Instruction in the circumstances set out in Regulation 35(5) (a) of the Uncertificated Securities Regulations 2001.

10. Any corporation which is a member can appoint one or more corporate representatives who may exercise on its behalf all of its powers as a member provided that they do not do so in relation to the same shares.

11. Under section 527 of the Act, members meeting the threshold requirements set out in that section have the right to require the Company to publish on a website a statement setting out any matter relating to: (i) the audit of the Company's accounts (including the auditor's report and the conduct of the audit) that are to be laid before the Annual General Meeting; or (ii) any circumstance connected with an auditor of the Company ceasing to hold office since the previous meeting at which annual accounts and reports were laid in accordance with section 437 of the Act. The Company may not require the shareholders requesting any such website publication to pay its expenses in complying with sections 527 or 528 of the Act. Where the Company is required to place a statement on a website under section 527 of the Act, it must forward the statement to the Company's auditor not later than the time when it makes the statement available on the website. The business which may be dealt with at the Annual General Meeting includes any statement that the Company has been required under section 527 of the Act to publish on a website.

12. Any member holding ordinary shares attending the meeting has the right to ask questions. The Company must answer any such questions relating to the business being dealt with at the meeting but no such answer need be given if (a) to do so would interfere unduly with the preparation for the meeting or involve the disclosure of confidential information; (b) the answer has already been given on a website in the form of an answer to a question; or (c) it is undesirable in the interests of the Company or the good order of the meeting that the question be answered.

13. A copy of this notice, and other information required by section 311A of the Act, can be found at www.melroseplc.net.

14. You may not use an electronic address provided in either this Notice of Annual General Meeting or any related documents (including the Proxy Form) to communicate with the Company for any purposes other than those expressly stated.

15. The following documents will be available for inspection at the Company's registered office during normal business hours (Saturdays, Sundays and public holidays excepted) from the date of this notice until the date of the Annual General Meeting and at the place of the Annual General Meeting for 15 minutes prior to and during the meeting:
    (A) copies of all service agreements under which Directors of the Company are employed by the Company or any subsidiaries; and
    (B) a copy of the terms of appointment of the non-executive Directors of the Company.

16. You may register your vote online by visiting Equiniti's website at www.sharevote.co.uk. In order to register your vote online, you will need to enter the Task ID, together with your Voting ID and Shareholder Reference Number which are set out on the enclosed Proxy Form. The return of the Proxy Form by post or registering your vote online will not prevent you from attending the Annual General Meeting and voting in person, should you wish. Alternatively, shareholders who have already registered with Equiniti's online portfolio service, Shareview, can appoint their proxy electronically by logging on to their portfolio at www.shareview.co.uk and then clicking on the link to vote under their Melrose Industries PLC holding details. The on-screen instructions give details on how to complete the appointment process. A proxy appointment made electronically will not be valid if sent to any address other than those provided or if received after 11.00 am on 6 May 2013.

# Company and shareholder information

As at 31 December 2012 there were 8,847 holders of Ordinary Shares in the Company. Their shareholdings are analysed as follows:

| Size of shareholding | Number of shareholders | Percentage of total number of shareholders | Number of Ordinary shareholders | Percentage of Ordinary Shares |
|---|---|---|---|---|
| 1–5,000 | 7,082 | 80.05 | 8,057,323 | 0.64 |
| 5,001–50,000 | 1,207 | 13.64 | 16,058,149 | 1.27 |
| 50,001–100,000 | 108 | 1.22 | 7,973,239 | 0.63 |
| 100,001–500,000 | 215 | 2.43 | 52,932,291 | 4.18 |
| Over 500,000 | 235 | 2.66 | 1,181,606,034 | 93.28 |
| **Total** | **8,847** | **100.00** | **1,266,627,036** | **100.00** |

## Financial calendar 2013

| | |
|---|---|
| Ex-dividend date for final dividend | 17 April 2013 |
| Record date for final dividend | 19 April 2013 |
| Annual General Meeting | 8 May 2013 |
| Payment of final dividend | 13 May 2013 |
| Announcement of interim results | August 2013 |
| Intended payment of interim dividend | November 2013 |
| Preliminary announcement of 2013 results | March 2014 |

### Directors
Christopher Miller
David Roper
Simon Peckham
Geoffrey Martin
Miles Templeman
Perry Crosthwaite
John Grant
Justin Dowley

### Company Secretary
Joff Crawford

### Head office
Leconfield House
Curzon Street
London
W1J 5JA

Tel: +44 (0) 20 7647 4500
Fax:+44 (0) 20 7647 4501
www.melroseplc.net

### Auditor
Deloitte LLP
2 New Street Square
London
EC4A 3BZ

### Registered office
Precision House
Arden Road
Alcester
Warwickshire
B49 6HN

Tel: + 44 (0) 1789 761020
Fax: + 44 (0) 1789 761057

### Registered number
08243706

### Bankers
Barclays Bank plc
BayernLB
Commerzbank AG
HSBC Bank PLC
J.P. Morgan PLC
Lloyds TSB Bank PLC
Royal Bank of Canada
The Royal Bank of Scotland plc
DBS Bank
Fifth Third Bank
ICBC
Mizuho
Santander UK PLC
Unicredit
Wells Fargo Bank International

### Legal advisers
Simpson Thacher & Bartlett LLP
CityPoint
One Ropemaker Street
London
EC2Y 9HU

### Brokers
Investec
2 Gresham Street
London
EC2V 7QP

J.P. Morgan Cazenove
25 Bank Street
London
E14 5JP

### Registrars
Equiniti
Aspect House
Spencer Road
Lancing
West Sussex
BN99 6DA

Shareholders can view up to date information about their shareholding by visiting the shareholders' website at www.shareview.co.uk.

The shareholder helpline number is 0871 384 2030 (calls cost 8p per minute plus network extras). If calling from overseas: +44 (0)121 415 7047. Lines are open 8.30 am to 5.30 pm Monday to Friday.

**Melrose Industries PLC**
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**www.melroseplc.net**

Stock code: MRO