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Subject to the restrictions set out below, if you sell or transfer or have sold or otherwise transferred all of your Existing Melrose Shares (other than ex rights) held in certificated form before 8:00 a.m on 17 July 2012 (the “**ex-rights date**”), you should send this document together with the accompanying Form of Proxy and any Provisional Allotment Letter (duly renounced), if and when received, 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 transmission to the purchaser or the transferee. None of these documents should, however, be distributed, forwarded to or transmitted in or into any jurisdiction where to do so might constitute a violation of local securities laws or regulations, including but not limited to the United States and any of the Excluded Territories. If you sell or transfer or have sold or otherwise transferred only part of your holding of Existing Melrose Shares (other than ex-rights) held in certificated form before the ex-rights date, you should immediately consult the stockbroker, bank or other agent through whom the sale or transfer was effected and refer to the instructions regarding split applications in Part XII (*Terms and Conditions of the Rights Issue*) of this document and in the Provisional Allotment Letter. If you sell or transfer or have sold or otherwise transferred all or some of your Existing Melrose Shares (other than ex-rights) held in uncertificated form before the ex-rights date, a claim transaction will automatically be generated by Euroclear, which, on settlement, will transfer the appropriate number of Nil Paid Rights to the purchaser or transferee.

A copy of this document, which comprises a prospectus relating to the New Melrose Shares prepared in accordance with the Prospectus Rules made under section 73A of FSMA, has been approved by the FSA in accordance with section 87A of FSMA and has been made available to the public as required by Rule 3.2 of the Prospectus Rules.

Investors should read the whole of this document and any documents incorporated herein by reference. In particular, your attention is drawn to the factors described in the “Risk Factors” section of this document.

MELROSE PLC

(Incorporated and registered in England and Wales with registered number 4763064)

Proposed Acquisition of Elster Group SE

Proposed 2 for 1 Rights Issue of up to 844,418,024 New Melrose Shares at 142 pence per New Melrose Share to raise approximately £1.2 billion

Investec

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and Joint Underwriter*

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Barclays

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and Co-Bookrunner*

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and Co-Bookrunner*

RBC Capital Markets

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and Co-Bookrunner*

Applications will be made to the UKLA for the New Melrose Shares to be admitted to the premium segment of the Official List and to the London Stock Exchange for the New Melrose Shares to be admitted to trading on the London Stock Exchange’s main market for listed securities. It is expected that Admission will become effective, and that dealings (for normal settlement) in the New Melrose Shares (nil paid) will commence, at 8.00 a.m. on 17 July 2012.

The distribution of this document and/or the Provisional Allotment Letters and/or the transfer of the Nil Paid Rights, the Fully Paid Rights and/or the New Melrose Shares through CREST or otherwise, into jurisdictions outside the EEA may be restricted by law. Persons into whose possession these documents come should inform themselves about and observe any such restrictions. Any failure to comply with these restrictions may constitute a violation of the securities laws of any such jurisdiction. In particular, the documents should not be distributed, forwarded to or transmitted in or into the United States or any Excluded Territories under any circumstances.

The Nil Paid Rights, the Fully Paid Rights, the Provisional Allotment Letters and the New Melrose Shares are not transferable, except in accordance with, and the distribution of this document is subject to, the restrictions set out in paragraph 7 of Part XII (*Terms and Conditions of the Rights Issue*) of this document in relation to the United States and the Excluded Territories. No action has been taken by the Company, the Sponsors or the Underwriters that would permit an offer of the New Melrose Shares or rights thereto or possession or distribution of this document or any other offering or publicity material or the Provisional Allotment Letters, the Nil Paid Rights or the Fully Paid Rights in any jurisdiction where action for that purpose is required, other than in the United Kingdom.

The Nil Paid Rights, the Fully Paid Rights, the Provisional Allotment Letters and the New Melrose Shares have not been and will not be registered under the US Securities Act, or under any securities laws of any state or other jurisdiction of the United States and may not be offered, sold, taken up, exercised, resold, pledged, renounced, transferred or delivered, directly or indirectly, within the United States except pursuant to an applicable exemption from, or in a transaction not subject to the registration requirements of, the US Securities Act and in compliance with any applicable securities laws of any state or other jurisdiction of the United States. Accordingly, the Rights Issue is not being made into the United States (unless an exemption from registration under the US Securities Act is available) and no offer is being made to the public in any other Excluded Territory.

None of the Nil Paid Rights, the Fully Paid Rights, the Provisional Allotment Letters, the New Melrose Shares, this document or any other offering document has been approved or disapproved by the US Securities and Exchange Commission, any state securities commission in the United States or any US regulatory authority, nor have any of the foregoing authorities passed upon or endorsed the merits of the Rights Issue or the accuracy or adequacy of this document. Any representation to the contrary is a criminal offence in the United States.

Each of J.P. Morgan, JPMSL, Investec, Barclays, HSBC and RBC each of which is authorised and regulated in the United Kingdom by the FSA, is acting solely for Melrose and no one else in connection with the Acquisition or the Rights Issue and will not regard any other person (whether or not a recipient of this document) as a client in relation to the Acquisition or the Rights Issue and will not be responsible to anyone other than Melrose for providing the protections afforded to respective clients of J.P. Morgan, JPMSL, Investec, Barclays, HSBC and RBC or for providing advice in connection with the Acquisition or the Rights Issue or any other matter referred to in this document.

Apart from the responsibilities and liabilities, if any, which may be imposed on J.P. Morgan, JPMSL, Investec, Barclays, HSBC or RBC under FSMA or the regulatory regime established thereunder: (i) none of J.P. Morgan, JPMSL, Investec, Barclays, HSBC or RBC accepts any responsibility whatsoever and makes no warranty, express or implied, in relation to the contents of this document, including its accuracy, completeness or verification or for any other statement made or purported to be made by it, or on its behalf, in connection with Melrose, Melrose Bidco, the Nil Paid Rights, the Fully Paid Rights, the Melrose Shares, the Acquisition or the Rights Issue; and (ii) each of J.P. Morgan, JPMSL, Investec, Barclays, HSBC and RBC accordingly disclaims, to the fullest extent permitted by law, all and any liability whether arising in tort, contract or otherwise (save as referred to above) which it might otherwise have in respect of this document or any such statement.

Subject, *inter alia*, to the passing (without material amendment) of the Transaction Resolutions at the Melrose General Meeting, it is expected that Qualifying non-CREST Shareholders (subject to certain exceptions) will be sent a Provisional Allotment Letter on 16 July 2012, and that Qualifying CREST Shareholders (subject to certain exceptions) will receive a credit to their appropriate stock accounts in CREST in respect of the Nil Paid Rights to which they are entitled on 17 July 2012. The Nil Paid Rights so credited in CREST are expected to be enabled for settlement by Euroclear as soon as practicable after Admission. The Underwriters may, in accordance with applicable legal and regulatory provisions and subject to the Underwriting Agreement, engage in transactions in relation to the Nil Paid Rights, the Fully Paid Rights, the Melrose Shares and/or related instruments for their own account for the purpose of hedging their commitments under the Underwriting Agreement. Except as required by applicable law or regulation, the Underwriters do not propose to make any public disclosure in relation to such transactions.

The latest time and date for acceptance of, and payment in full for, the New Melrose Shares by holders of Nil Paid Rights is expected to be 11.00 a.m. on 31 July 2012. The procedures for delivery of the Nil Paid Rights, acceptance and payment are set out in Part XII (*Terms and Conditions of the Rights Issue*) of this document and, for Qualifying non-CREST Shareholders only, also in the Provisional Allotment Letter. Qualifying CREST Shareholders should refer to paragraph 5 of Part XII (*Terms and Conditions of the Rights Issue*) of this document.

Qualifying non-CREST Shareholders should retain this document for reference pending receipt of a Provisional Allotment Letter. Qualifying CREST Shareholders should note that they will receive no further written communication from Melrose in respect of the Rights Issue. They should accordingly retain this document for, among other things, details of the action they should take in respect of the Rights Issue. Qualifying CREST Shareholders who are CREST sponsored members should refer to their CREST sponsors regarding the action to be taken in connection with this document and the Rights Issue. Holdings of Melrose Shares in certificated and uncertificated form will be treated as separate holdings for the purpose of calculating entitlements under the Rights Issue.

This document does not constitute an offer of Nil Paid Rights, Fully Paid Rights, New Melrose Shares or Provisional Allotment Letters in the United States and no offer is being made to the public in any Excluded Territory. None of the Nil Paid Rights, the Fully Paid Rights, the New Melrose Shares or the Provisional Allotment Letters have been or will be registered under the relevant federal laws or laws of any state, province or territory of the United States (including the US Securities Act) or the Excluded Territories. This document does not constitute an offer to sell or a solicitation of an offer to buy New Melrose Shares or to take up entitlements to Nil Paid Rights in any jurisdiction in which such offer or solicitation is unlawful. The Provisional Allotment Letters, Nil Paid Rights, Fully Paid Rights and the New Melrose Shares may at the sole discretion of the Company be made available by the Company in the United States to qualified institutional buyers within the meaning of Rule 144A under the US Securities Act or accredited investors within the meaning of Rule 501(a) of Regulation D under the US Securities Act in transactions that are exempt from the registration requirements of the US Securities Act (“**Eligible US Holders**”). Any recipient of Provisional Allotment Letters, Nil Paid Rights, Fully Paid Rights or New Melrose Shares pursuant to transactions that are exempt from the registration requirements of the US Securities Act will be required to make such acknowledgements and representations to and agreements with the Company as the Company may require to establish that they are Eligible US Holders.

In addition, until 40 days after the commencement of the Rights Issue, an offer, sale or transfer of the New Melrose Shares, the Nil Paid Rights, the Fully Paid Rights or the Provisional Allotment Letters within the United States by a dealer that is participating in the Rights Issue may violate the registration requirements of the US Securities Act.

All Qualifying Shareholders with an address in, or who are located in, the United States or any of the Excluded Territories and any person (including, without limitation, a custodian, nominee, agent or trustee) who has a contractual or legal obligation to forward this document or any Provisional Allotment Letter to any jurisdiction outside the United Kingdom should read paragraph 7 of Part XII (*Terms and Conditions of the Rights Issue*) of this document.

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SUMMARY

THE FOLLOWING SUMMARY SHOULD BE READ AS AN INTRODUCTION TO THIS DOCUMENT. ANY DECISION TO INVEST IN NEW MELROSE SHARES SHOULD BE BASED ON A CONSIDERATION OF THIS DOCUMENT AS A WHOLE INCLUDING THE INFORMATION INCORPORATED BY REFERENCE INTO THIS DOCUMENT

Where a claim relating to information contained in this document is brought before a court, a plaintiff investor might, under the national legislation of the EEA States, have to bear the costs of translating this document before legal proceedings are initiated. Civil liability attaches to those persons who are responsible for this summary, including any translation of this summary, but only if this summary is misleading, inaccurate or inconsistent when read together with the other parts of this document.

1. Introduction

Today the Boards of Melrose and Elster announced that they had reached agreement on the terms of a recommended proposal whereby Melrose Bidco, a wholly owned subsidiary of Melrose, will acquire for cash the entire issued ordinary share capital of Elster. The Acquisition will be implemented principally by a US tender offer to Elster ADS Holders and Elster Shareholders at a price of \$20.50 per Elster ADS or \$82 per Elster Share (approximately \$2.3 billion, or £1.5 billion⁽¹⁾, in aggregate) which is expected to commence on or about 6 July. Elster is one of the world's largest providers of gas, electricity and water meters, gas utilisation products and related communications, networking and software solutions. The Acquisition represents a significant opportunity for Melrose to execute its strategy of acquiring specialised industrial businesses and maximising the value inherent in those businesses.

2. Summary of the Acquisition

Pursuant to the Tender Offer, which will be on the terms and subject to the conditions set out in the Tender Offer Document, Elster ADS Holders/Elster Shareholders, as the case may be, will receive:

for each Elster ADS	\$20.50 in cash
for each Elster Share	\$82 in cash

The \$20.50 per Elster ADS to be offered pursuant to the Tender Offer represents a premium of approximately 48.6 per cent. to the price of an Elster ADS on 11 June 2012, the last Business Day prior to speculation that Rembrandt was considering a sale of its Elster ADSs/Elster Shares and approximately 44.3 per cent. to the average price of an Elster ADS in the six month period ending on 11 June 2012.

The completion of the Tender Offer is conditional upon:

- the passing (without material amendment) of the Transaction Resolutions at the Melrose General Meeting;
- Admission having occurred;
- receipt of anti-trust clearances from the relevant regulatory authorities in the EU, US, Ukraine and Russia;
- there having been validly tendered (and not properly withdrawn) prior to the Tender Offer Expiration Date such number of Elster ADSs (and/or Elster Shares) that represent at least 75 per cent. of the total share capital of Elster as at the Tender Offer Expiration Date;
- the Elster Board having recommended (and having not withdrawn its recommendation for) the Tender Offer;
- there not being any judgment, order, decree or law (in the United States, the United Kingdom or in the Federal Republic of Germany) entered, enacted, promulgated, enforced or issued by any court or other governmental entity of competent jurisdiction or other legal restraint or prohibition in effect enjoining or otherwise preventing or materially delaying the making of the Tender Offer, the

(1) Based on an exchange rate of £1.00 = \$1.55 on 28 June 2012.

acceptance for payment of any Elster ADSs and/or Elster Shares, Melrose's or Melrose Bidco's full rights of ownership and voting of the Elster ADSs and/or Elster Shares or Melrose's or Melrose Bidco's ownership or operation of Elster;

- Elster not having breached or failed to perform certain obligations required to be performed by it under the Investment Agreement at or prior to the Tender Offer Expiration Date;
- the Investment Agreement not having been terminated in accordance with its terms; and
- the satisfaction or waiver of the other conditions of the Tender Offer, which are considered to be customary for a transaction of this nature.

The conditions relating to the approval of the Acquisition by Melrose Shareholders, clearance by the EU and US regulatory authorities, the Admission of the New Melrose Shares and the Investment Agreement not having been terminated will not be waived in whole or in part and the other conditions may be waived by Melrose Bidco.

3. Background to and Reasons for the Acquisition

Melrose's track record is built on the twin cores of Melrose's strategy of acquiring high quality manufacturing businesses with exposure to strong end markets which have the opportunity to be developed. The proposed acquisition of Elster fits well with this strategy.

Elster has leading positions in attractive markets

Elster has leading market positions in its core product categories: gas, the highest margin sector where Elster is number one globally, and electricity and water where Elster is in the top three globally. Elster generated revenues of \$1,869 million in 2011 and has one of the most extensively installed meter bases globally.

Further opportunities to develop Elster's business and improve efficiency

The Melrose Board believes there are further business development opportunities for Elster as well as an opportunity to improve efficiency, both of which are expected to improve Elster's financial performance.

(i) Business development opportunities

Melrose plans to support Elster's management team to grow the Elster business to its fullest potential, in accordance with a business plan to be agreed with them.

The Melrose Board believes there are two main drivers for future growth: the global growth in gas, driven in particular by new gas production and distribution coming on-line resulting in Elster's Gas division growing significantly over the medium term, and increased adoption of smart meters which offer efficiency and accuracy to customers and suppliers of gas, electricity and water.

The Melrose Board has identified a number of opportunities to invest and develop the Elster business.

(ii) Elster's previously announced reinvestment programme and listed company cost saving

In the first quarter of the 2012 financial year, the Elster Board authorised and commenced a reinvestment programme which is expected to continue to 2014. Planned actions included consolidating operations and sites, relocating certain product-lines to other Elster operations, increasing the mix of production in low-cost countries and improving the financial performance of Elster's water business.

As a company listed in the United States, Elster has significant costs related to its listing. By cancelling Elster's ADS listing, Elster's management would be able to reduce the costs associated with maintaining a listing in the United States and further enhance its focus on growth.

4. Financing the Acquisition

The Acquisition and associated expenses will be funded through a combination of new debt and new equity, approximately: \$1,816 million (£1,171 million⁽²⁾) from the total net proceeds of the fully underwritten Rights Issue and \$498 million (£321 million⁽²⁾) from the proceeds of loans under the New Facilities Agreement.

(2) Based on an exchange rate of £1.00 = \$1.55 on 28 June 2012.

5. **Financial effects of implementing the Acquisition and the Rights Issue**

The Melrose Board expects that the Acquisition will be dilutive to earnings per share in the first full financial year of ownership (2013) and will start to become accretive thereafter.⁽³⁾⁽⁴⁾ Over the medium term, the Acquisition is not expected to be dilutive to the Melrose headline⁽⁴⁾ operating margins currently being achieved.

6. **Dividend Policy**

It is the intention of the Melrose Board to maintain a progressive dividend policy going forward which will take into account the bonus element of the Rights Issue.

7. **Principal Terms of the Rights Issue**

The Company proposes to raise approximately £1.2 billion (net of commissions), by way of a fully underwritten Rights Issue of up to 844,418,024 New Melrose Shares. The Rights Issue Price of 142 pence per New Melrose Share represents a 61.5 per cent. discount to the Closing Price of 368.7 pence per Existing Melrose Share on 28 June 2012 (being the last trading day prior to the publication of this document) and a 34.7 per cent. discount to the theoretical ex-rights price of 217.6 pence per New Melrose Share calculated by reference to the Closing Price on the same day.

If a Qualifying Shareholder does not take up any of his entitlement to New Melrose Shares, his proportionate shareholding will be diluted by 66.7 per cent.

Subject to fulfilment of certain conditions, the Company proposes to offer New Melrose Shares, by way of the Rights Issue to Qualifying Shareholders on the following basis:

2 New Melrose Shares at 142 pence each for every 1 Existing Melrose Share held by Qualifying Shareholders on the Record Date.

The latest time and date for acceptance and payment in full under the Rights Issue is expected to be at 11.00 a.m. on 31 July 2012.

8. **Further details relating to the Acquisition**

8.1 *Regulatory Clearances*

The EU, US, Russian and Ukrainian competition filings will be made shortly after the publication of this document. Melrose does not expect any significant regulatory issues to arise as a result of these filings.

8.2 *Irrevocable Undertakings*

Melrose Bidco has received irrevocable undertakings to tender unconditionally (and not withdraw) Elster ADSs (or the underlying Elster Shares to which they relate) pursuant to the Tender Offer from Rembrandt and Nachtwache in respect of their entire beneficial holdings (amounting in aggregate to approximately 62.17 per cent. of the total share capital of Elster as at the day immediately prior to the date of this document) and has also received irrevocable undertakings from certain of the Elster Directors and Management Elster ADS Holders to tender (and not withdraw) their entire beneficial holdings (amounting in aggregate to approximately 62.17 per cent. of the total share capital of Elster as at the day immediately prior to the date of this document).

(3) Nothing in this document is intended to be, or is to be construed as, a profit forecast or to be interpreted to mean that earnings per Melrose Share for the current or future financial years, or those of the Enlarged Group, will necessarily match or exceed the historical earnings per Melrose Share.

(4) Before exceptional costs, exceptional income and intangible asset amortisation.

9. Key Financial Information

9.1 *The Melrose Group*

The summary financial information set out below has been extracted without material adjustment from the Audited Financial Statements for the three years ended 31 December 2011, 31 December 2010 and 31 December 2009.

	Year ended 31 December			
	2011 ⁽¹⁾	2010 ⁽¹⁾	2010	2009
	£m	£m	£m	£m
Condensed consolidated income statement				
Revenue	1,153.9	1,035.4	1,379.5	1,298.5
Gross profit	341.0	304.0	391.0	328.2
Operating profit	117.0	134.0	181.4	113.1
Headline operating profit⁽²⁾	180.8	147.0	196.9	149.7
Profit before tax	97.4	108.7	155.3	82.0
Profit for the year from continuing operations	114.8	103.7	141.3	54.7
Profit for the year from discontinued operations	171.7	37.6	—	24.6
Profit for the year	286.5	141.3	141.3	79.3
Earnings per share				
From continuing operations:				
Basic	25.2p	20.8p	28.4p	11.0p
Diluted	23.7p	19.8p	27.0p	10.8p
	As at 31 December			
	2011 ⁽¹⁾	2010 ⁽¹⁾	2010	2009
	£m	£m	£m	£m
Summary condensed consolidated balance sheet				
Non-current assets	1,162.1	1,470.2	1,470.2	1,459.6
Current assets	619.4	673.6	673.6	585.1
Total assets	1,781.5	2,143.8	2,143.8	2,044.7
Current liabilities	394.0	452.2	452.2	417.5
Non-current liabilities	739.1	808.7	808.7	863.9
Total liabilities	1,133.1	1,260.9	1,260.9	1,281.4
Net assets	648.4	882.9	882.9	763.3

(1) Excludes the results of discontinued operations (Dynacast, Brush Traction, Logistex UK, Madico and Weber Knapp).

(2) Before exceptional costs, exceptional income and intangible asset amortisation.

9.2 *The Elster Group*

The summary financial information set out below has, unless otherwise stated, been extracted without material adjustment from (i) the audited consolidated financial statements of the Elster Group for the financial years ended 31 December 2011, 31 December 2010 and 31 December 2009

and (ii) the Elster unaudited quarterly report for the first quarter ended 31 March 2012 published on 4 May 2012, each of which has been prepared in accordance with US GAAP.

CONDENSED CONSOLIDATED INCOME STATEMENT (IN THOUSANDS, EXCEPT PER SHARE DATA)	Three Months Ended 31 March	
	2012	2011
	\$ (unaudited)	\$ (unaudited)
Revenues	446,707	443,883
Gross profit	131,042	146,452
Operating income	21,226	40,693
Income before income tax	13,672	34,893
Net income	9,340	24,875
Basic income per share	0.29	0.85
Diluted income per share	0.29	0.85
SUMMARY CONDENSED CONSOLIDATED BALANCE SHEET (IN THOUSANDS)	31 March 2012	31 December 2011
	\$ (unaudited)	\$ (audited)
Total current assets	638,468	613,257
Total noncurrent assets	1,384,278	1,358,092
Total assets	2,022,746	1,971,349
Total current liabilities	500,464	453,529
Total noncurrent liabilities	780,553	799,571
Total liabilities	1,281,017	1,253,100
Total Equity	741,729	718,249

CONDENSED CONSOLIDATED INCOME STATEMENT (IN THOUSANDS, EXCEPT PER SHARE DATA)	Year ended 31 December		
	2011	2010	2009
	\$ (audited)	\$ (audited)	\$ (audited)
Revenue	1,868,975	1,759,339	1,695,122
Gross profit	606,018	550,784	503,825
Operating income	189,778	175,991	143,839
Income from continuing operations before income tax	140,468	118,870	91,693
Net income	105,381	92,038	52,344
Basic income per share	3.57	3.53	1.42
Diluted income per share	3.57	3.53	1.42

SUMMARY CONDENSED CONSOLIDATED BALANCE SHEET (IN THOUSANDS)	As at 31 December		
	2011	2010	2009
	\$ (audited)	\$ (audited)	\$ (audited)
Total current assets	613,257	767,765	616,407
Total non-current assets	1,358,092	1,396,492	1,525,035
Total assets	1,971,349	2,164,257	2,141,442
Total current liabilities	453,529	420,160	431,952
Total non-current liabilities	799,571	1,087,868	1,286,786
Total liabilities	1,253,100	1,508,028	1,718,738
Total equity	718,249	656,229	422,704

10. Current trading and prospects

10.1 *The Melrose Group*

On 9 May 2012, Melrose published its interim management statement for the period 1 January 2012 to 9 May 2012. The positive momentum experienced in Melrose's businesses on revenue and order intake during 2011 has continued into 2012. Revenue for the Melrose Group in the first four months

of 2012, at constant currency, is up 9 per cent. compared to the same period last year, and the total value of orders received in the period is 3 per cent. higher than revenue. Whilst the first quarter is historically the slowest quarter of the year, the start to 2012 has been pleasing to the Melrose Board.

The investment phase, referred to in Melrose's annual results statement for 2011, continues in Melrose's businesses with capital expenditure significantly ahead of depreciation. Current trading remains in line with plan. Since the date of the interim management statement, Melrose continues to trade in line with the Melrose Board's expectations.

10.2 *The Elster Group*

Elster's first quarter 2012 revenues were \$446.7 million, up \$2.8 million, or 0.6 per cent., over the first quarter of 2011, and up 3.3 per cent. on a constant currency basis⁽⁵⁾. Growth in Elster's water and gas segments outweighed weaker performance in the electricity segment.

Elster recorded adjusted EBITDA⁽⁶⁾ of \$63.1 million in the first quarter of 2012, up 1.4 per cent. compared to the first quarter of 2011. Adjusted EBITDA margin of 14.1 per cent. was in line with prior year results. First quarter 2012 non-GAAP net income attributable to Elster Group SE was \$27.1 million, or \$0.24 per Elster ADS compared to \$29.0 million, or \$0.26 per Elster ADS, in the first quarter of 2011. The decrease is impacted by the level of unrealised gains on interest rate swap agreements of \$6.4 million in the first quarter of 2011 compared to unrealised gains of \$1.4 million in the first quarter of 2012.

First quarter 2012 gross margin, net of charges related to the reinvestment programme, was 32.4 per cent. compared to 33.0 per cent. in the first quarter of 2011. The decrease was attributable to less favourable product mix in Elster's gas segment and to reduced volumes in Elster's electricity segment.

Since March 2012, monthly revenues have been steady and margins slightly below those in the previous quarter. The order book is at a similar level to that at the end of the first quarter and includes the large order from a North American hydro electric customer received in March 2012.

11. **Risk factors**

The following risk factors are considered by the Melrose Directors to be material:

- A significant slow down in certain industries could have a material adverse effect on the Melrose Group, the Elster Group or the Enlarged Group
- Owing to the geographical diversity of its operations, the Melrose Group the Elster Group and the Enlarged Group are subject to the risk of exchange rate fluctuations
- The Melrose Group is subject to a number of tax regimes and is subject to risks from legal proceedings and arbitrations
- Potential liability for defective products may affect the financial condition and business of the Melrose Group, the Elster Group or the Enlarged Group
- Any inability to obtain adequate supplies of component parts, raw materials and energy at favourable prices could decrease the Melrose Group, the Elster Group or the Enlarged Group's profit margins and negatively impact timely deliveries to its customers
- The utility industry worldwide is often subject to long budgeting, purchasing and regulatory review processes that can take several years to complete and can result in unpredictable capital investment cycles

(5) Constant currency rates: Calculated by translating the results from entities that have functional currencies other than US dollars into dollars using the exchange rates of the prior year.

(6) Adjusted EBITDA is a non-GAAP measure. Adjusted EBITDA margin is consolidated adjusted EBITDA as a percentage of consolidated revenue.

- The Melrose Group, the Elster Group and the Enlarged Group businesses' success and sales are dependent on the strength of their brands and reputation and are subject to customers' perceptions of those businesses and their products
- The Melrose Group may not realise the desired operational improvements benefits from the Acquisition and/or Elster may not perform in line with expectations

RISK FACTORS

A number of factors affect the operating results, financial condition and prospects of the Melrose Group and, if the Tender Offer becomes Effective, will affect the Elster Group and the Enlarged Group. This section describes the risk factors which are considered by the Melrose Directors to be material in relation to the Melrose Group and, if the Tender Offer becomes Effective, which will be material in relation to the Elster Group and the Enlarged Group. However, these should not be regarded as a complete and comprehensive statement of all potential risks and uncertainties. If the Tender Offer becomes Effective additional risks and uncertainties that are not presently known to the Melrose Directors, or which they currently deem immaterial, may also have an adverse effect on the Melrose Group's, the Elster Group's and the Enlarged Group's operating results, financial condition and prospects. In particular, if the Tender Offer becomes Effective, the Elster Group will be a significant proportion of the Enlarged Group and, therefore, (assuming the Tender Offer becomes Effective) the risks set out in Part B Risks Relating to the Elster Group and the Enlarged Group will affect the Enlarged Group because the Elster Group will represent 42 per cent. of the pro forma net assets pre-adjustments of the Enlarged Group as set out in Part VIII (Unaudited Pro Forma Information on the Enlarged Group). The information given is as of the date of this document and, except as required by the FSA, the London Stock Exchange, the Listing Rules, the Prospectus Rules, the Disclosure and Transparency Rules or any other applicable law, will not be updated.

You should consider carefully the risks and uncertainties described below, together with all other information contained in this document and the information incorporated by reference herein, before making any investment decision.

PART A: Risks relating to the Melrose Group and the Enlarged Group

1. A significant slow down in certain industries could have a material adverse effect on the Melrose Group's business or financial condition

The Melrose Group operates across a number of industries. A significant slow down in the energy, mining, oil and gas, exploration, US retail and housing, material handling, industrial and/or consumer markets could lead to a decline in the volume or demand for the Melrose Group's products and services and could have a material adverse effect on the Melrose Group's business, financial condition or results of operation. In addition, the cyclical nature of those industries could affect the financial performance of the Melrose Group from time to time.

2. Owing to the geographical diversity of its operations, the Melrose Group is subject to the risk of exchange rate fluctuations

The Melrose Group's financial condition and results of operations are reported in pounds sterling but a large proportion of its revenues are denominated in currencies other than pounds sterling, including the Euro and the US dollar. In particular, movements between the US dollar and pound sterling and the Euro and pound sterling could have a material adverse effect on the Melrose Group's results on a translational basis.

The most significant exchange risk that the Melrose Group takes arises when a division that is predominantly based in a foreign currency is sold. The proceeds for those divisions may be received in a foreign currency and therefore an exchange rate risk arises if these proceeds are converted back to pound sterling, for instance to pay a dividend to shareholders. This can lead to fluctuations in the Melrose Group's consolidated financial statements upon translation of operational results into pound sterling. There are currently no advanced plans to make any material disposals.

3. The Melrose Group is dependent on its directors

The stated strategy of the Melrose Group of "buy, improve, sell" depends on the expertise of the executive directors, each of whom significantly contribute to the Melrose Group's ability to identify, execute and manage acquisition and disposal opportunities. The retention of their services cannot be guaranteed. The loss of them could have an adverse effect on the ability Melrose Group to implement its strategy. In

addition, illness affecting them at critical stages in development may have a detrimental effect on the strategy and growth of the Melrose Group.

4. The Melrose Group is exposed to risks in relation to compliance with anti-corruption laws and regulations and economic sanction programs

Doing business on a worldwide basis requires the Melrose Group to comply with the laws and regulations of various jurisdictions. In particular, the Melrose Group's international operations are subject to anti-corruption laws and regulations, such as the U.S. Foreign Corrupt Practices Act of 1977 (the "FCPA") and the United Kingdom Bribery Act of 2010 (the "Bribery Act") (the FCPA and the Bribery Act together, the "Anti-Corruption Laws"), and economic sanction programs, including those administered by the UN, EU and OFAC and regulations set forth under the Comprehensive Iran Accountability Divestment Act (collectively, "Sanctions"). The FCPA prohibits providing anything of value to foreign officials for the purposes of obtaining or retaining business or securing any improper business advantage. The Melrose Group may, as part of its business, deal with state-owned business enterprises, the employees of which are considered foreign officials for purposes of the FCPA. The provisions of the Bribery Act extend beyond bribery of foreign public officials and are more onerous than the FCPA in a number of other respects, including jurisdiction, non-exemption of facilitation payments and penalties. Sanctions programs restrict the Melrose Group's business dealings with certain sanctioned countries.

As a result of doing business in foreign countries, the Melrose Group is exposed to a risk of violating anti-corruption laws and sanctions regulations applicable in those countries where it, its partners or agents operate. Some of the international locations in which the Melrose Group operates lack a developed legal system and have high levels of corruption. Continued expansion and worldwide operations by the Melrose Group, including in developing countries, development of joint venture relationships worldwide and the employment by it of local agents in the countries in which it operates increases the risk of violations of Anti-Corruption Laws, OFAC, or similar laws. Violations of anti-corruption laws and sanctions regulations are punishable by civil penalties, including fines, denial of export privileges, injunctions, asset seizures, debarment from government contracts (and termination of existing contracts) and revocations or restrictions of licenses, as well as criminal fines and imprisonment. In addition, any major violations could have a significant impact on the Melrose Group's reputation and consequently on its ability to win future business.

The Melrose Group has policies and procedures designed to assist its compliance with applicable laws and regulations including training of its employees to comply with such laws and regulations. While the Melrose Group has a strong culture of compliance and has adequate systems of control, it seeks to continuously improve its systems of internal controls, to remedy any weaknesses that are identified through appropriate corrective action depending on the circumstances, including additional training, improvement of internal controls and oversight, and deployment of additional resources and to take appropriate action in case of any breach of the Melrose Group's rules and procedures which might include disciplinary measures, suspensions of employees and ultimately termination of such employees. There can be no assurance, however, that policies and procedures of the Melrose Group will be followed at all times or will effectively detect and prevent violations of the applicable laws by one or more of its employees, consultants, agents or partners and, as a result, it could be subject to penalties and material adverse consequences on its business, financial condition or results of operations if it failed to prevent any such violations.

5. The Melrose Group is subject to pricing pressures from customers

The Melrose Group faces pricing pressures in certain business segments from its respective larger customers. Because of their purchasing size, the Melrose Group's larger customers can influence market participants to compete on price terms. If the Melrose Group is not able to offset pricing reductions resulting from these pressures by improved operating efficiencies and reduced expenditures, those price reductions may have an adverse impact on their respective financial results or results of operations.

6. The industries in which the Melrose Group's businesses operate are highly competitive

The industries in which the Melrose Group's businesses operate are highly competitive. Certain of the Melrose Group's businesses make products that are subject to changing technologies. The costs related to the research and development necessary to develop new technologies are significant and any reduction of the Melrose Group's research and development budget could adversely impact its competitiveness. Further, the Melrose Group may face significant competition from companies entering these industries that have greater capital resources or from companies that may develop a technological advantage over the Melrose Group either through superior production processes and/or a superior end product.

The Melrose Group's ability to compete effectively will require continuous efforts in sales and marketing, new product development and innovation, close customer relationships, understanding of customer needs and rigorous focus on cost and accountability. To ensure the products and services of the Melrose Group remain competitive, it may be required to reduce its prices for a temporary or long term period as a result of price reductions or promotional activities undertaken by its competitors. If the Melrose Group fails to make these changes its results may be adversely affected.

7. Behaviour of the competitors of the Melrose Group may adversely affect its business

Any consolidation among the competitors of the Melrose Group's businesses could enhance their product offerings and financial resources, further strengthening their competitive position and potentially reducing market share of the relevant Melrose Group business. As a result, the Melrose Group may face declining sales volumes and prices for its products and/or may be compelled to extend warranty periods or provide other gestures of goodwill to its customers.

8. The Melrose Group will be subject to the risk of major operational problems

The Melrose Group's sales will be dependent on the continued operation of its various manufacturing facilities and those of third parties that supply it, its warehousing and logistics infrastructure and its information technology systems. In particular, because the Brush sites at Loughborough, UK and Plzen, Czech Republic represent a material proportion of the Melrose Group's turnover, an operational failure at any of these sites may adversely affect the Melrose Group's business or financial condition. Operational risks include equipment failure, failure to comply with applicable regulations and standards, raw material supply disruptions, labour force shortages or work stoppages, events impeding or increasing the cost of transporting the Melrose Group's products, fires and natural disasters. There is no guarantee that the Melrose Group's insurance policies and disaster recovery plans will be sufficiently adequate to protect the Melrose Group against loss if any of the aforementioned occurs and the occurrence of major operational problems resulting from these or other events may have an adverse effect on the results and financial condition of the Melrose Group. Operational risks will be present in the Melrose Group's business. These risks include the risk of failed internal and external processes and systems (including information technology systems), human error and external events such as changes in credit terms offered by suppliers. Such events could have an impact on the results of operations of the Melrose Group during the affected period. The Melrose Group will actively assess these risks through ongoing processes embedded in its business which identify, evaluate and manage the risks faced by it.

9. Future capital requirements

The Melrose Group's stated strategy is to buy, improve and sell companies and the Melrose Directors expect that the Melrose Group will make further acquisitions which may be material in the context of the Melrose Group. While there are currently no advanced plans to make any material acquisitions (save for the Acquisition), any such acquisitions in the future may require funding by debt and equity finance. Any future equity financing (not related to the Acquisition) may dilute Melrose Shareholders' shareholdings in the Enlarged Group.

10. Any shortfall in the Melrose Group's pension schemes may require additional funding

The Melrose Group operates various pension schemes around the world with a net pension liability at 31 December 2011 of £117.7 million. The main pension scheme in the UK is the FKI UK Pension Plan,

which is a defined benefit pension scheme. The FKI UK Pension Plan was closed to new members and on 28 February 2011 it closed to current members' future service. In addition to the FKI UK Pension Plan, other pension schemes of significant size that the Melrose Group operates are the McKechnie UK Pension Plan and a US defined benefit plan for FKI. The Melrose Group monitors its pension strategy on an ongoing basis. A decline in pension asset values, different actuarial assumptions or the application of purchase accounting may result in an increase in pension liability. Decline in interest rates or the market value of the securities held by the plans, or certain other changes, could adversely affect the status of the Melrose Group's plans and affect the level and timing of required contributions. Any permanent shortfall in the Melrose Group retirement pension benefit scheme funding obligations would require additional cash funding. However, it is expected that any additional cash contributions required would be structured over a sensible period of time, such that there is no material impact on cash contributions in the next twelve months.

11. The Melrose Group is subject to risks from legal proceedings and arbitrations

Companies in the Melrose Group are involved in legal and arbitration proceedings. Such proceedings could involve substantial claims for damages relating to, for example, product liability, breach of warranty obligations, contractual penalties for late delivery or disputes over termination of contracts or could involve the payment of fines or other payments. For example, the Bridon litigation (set out in more detail at paragraph 10.1 of Part XIII (*Additional Information*) of this document) which recently settled. Certain Melrose Group companies are subject to anti-trust and competition laws in some of the markets in which they operate and may be subject to regulatory scrutiny and/or legal proceedings in these jurisdictions. The Company cannot guarantee that Melrose Group companies will succeed in defending any current or future claims, that judgments will not be rendered against them with respect to any or all current or future proceedings or that reserves set aside or to be set aside and cover taken out or to be taken out under insurance policies will be adequate to cover any such judgments. The Melrose Group could incur a charge to its earnings if its reserves prove to be inadequate in respect of any adverse judgment. The realization of any of these risks could have a material adverse effect on the business, financial condition and results of operations of the Melrose Group.

12. The Melrose Group's operations are subject to environmental, health and safety laws and regulations and non-compliance with such laws and regulations could result in substantial costs, fines, sanctions and claims

The Melrose Group operates global manufacturing, product handling and distribution facilities that are subject to a broad array of environmental laws and regulations relating to pollution, the health and safety of employees, protection of the public, protection of the environment and the storage and handling of hazardous substances and waste materials. These laws and regulations are becoming increasingly stringent. It is the policy of the Melrose Group to comply with all relevant laws and regulations. The Melrose Group actively manages these risks through regular compliance and performance improvement assessments and key performance indicators and the engagement of competent health, safety and environmental coordinators at each of its sites. However, violations of applicable laws and regulations, in particular provisions of environmental and health and safety laws, or changes in such laws and regulations (such as the imposition of more stringent standards for discharges into the environment), could result in temporary or permanent restrictions on the operations of the facilities of the Melrose Group, damages, fines, clean up costs, or other civil or criminal sanctions and/or increased costs of compliance (including capital expenditures), as well as damage to reputation. The realisation of any of these risks could have a material adverse effect on the business, financial condition and results of operations of the Melrose Group.

13. The Melrose Group is subject to a number of tax regimes

The Melrose Group operates in many countries and therefore is subject to different tax regulations. Changes in tax law could result in higher tax expense and payments. Furthermore, legislative changes could materially impact tax receivables and liabilities as well as deferred tax assets and deferred tax liabilities. In addition, the uncertain tax environment in some regions could limit the Melrose Group's ability to enforce its rights. As a globally operating organisation, the Melrose Group conducts business in countries subject

to complex tax rules, which may be interpreted in different ways. Future interpretations or developments of tax regimes may affect its tax liability, return on investments and business operations.

14. The Melrose Group could be negatively impacted if it fails to adequately protect its intellectual property rights or if third parties claim it is in violation of their intellectual property rights

The success of the Melrose Group depends, in part, on its ability to protect current and future branded products and processes through securing, enforcing and defending its intellectual property rights for example within the FKI brands. The Melrose Group relies on a combination of trademarks, copyright, patents, designs, know-how, trade secrets and contractual restrictions to establish and protect proprietary rights in its products, processes and technical data. There can be no assurance that these proprietary rights, rights in know-how and contractual provisions will be adequate to prevent the misappropriation, infringement or other unauthorised use of the intellectual property rights of the Melrose Group by third parties which could harm it. There can be no guarantees that patents will be granted with respect to patent applications for new products or processes. Further, there is no guarantee that any patents, issued or pending, will provide the Melrose Group with any competitive advantage or will not be challenged by third parties.

There is no certainty that the Melrose Group does not and will not infringe third parties' intellectual property rights. The Melrose Group may be required to defend claims of patent infringement, infringement of third party proprietary rights or breach of confidence or to take action to protect its own proprietary rights. Such proceedings could be burdensome and costly and the Melrose Group may not prevail. Any claim against the Melrose Group, even if it is without merit, may be expensive and time consuming to defend, subject the Melrose Group to damages, cause it to cease making, using or selling certain products that incorporate the disputed intellectual property, require it to redesign its products, divert management time and attention and/or require it to enter into costly licensing royalty or licensing agreements, in each case which may have an adverse effect on its business, financial condition and results of operations. Any adverse or uncertain outcome of any dispute with respect to material patents or other material proprietary rights may adversely affect the competitive position of the Melrose Group or interrupt or adversely affect the ability of the Melrose Group to carry on its business.

15. The Melrose Group businesses' success and sales are dependent on the strength of their brands and reputation and are subject to customers' perceptions of those businesses and their products

Products sold by the Melrose Group may have faults or defects or may not meet a customer's quality specification. Such faults, defects or failures to meet specification may negatively affect the market acceptance of the Melrose Group's products and their reputation and could subsequently lead to a loss of customers.

If the Melrose Group's businesses are unable to respond to changing consumer demand, those businesses' names and reputations may be impaired and customer demand for a particular category of product offering may decrease. In addition, the public image of the Melrose Group's businesses' existing and future product offering may become tarnished and create negative publicity for that business group and damage that business's brands.

Each of these factors could have a material adverse effect on the results of operations, business and financial condition of the Melrose Group.

16. Potential liability for defective products may affect the financial condition and business of the Melrose Group

Due to the nature of its operations, claims against the Melrose Group could arise from defects in material or products manufactured and/or supplied by the Melrose Group. Purchasers and third parties could make claims against Melrose Group companies, based on their delivery of defective materials or products, or for damage or loss arising from the use of these defective materials or products. If any claims of this type are determined against Melrose Group companies, and if existing insurance arrangements do not cover the liability, it could have an adverse effect on the financial performance and condition of the Melrose Group.

17. The Melrose Group has incurred and will incur substantial transaction and offer related costs in connection with the Acquisition

The Melrose Group has incurred and will incur significant transaction fees and other costs associated with completing the Acquisition, combining operations and achieving desired operational improvements. These fees and costs are substantial and include financing, financial advisory, legal and accounting fees and expenses. Additional unanticipated costs may be incurred in the integration of Elster into the Melrose Group. Although the Melrose Group expects that the realisation of other efficiencies related to the Acquisition will offset the incremental and transaction costs over time, this net benefit may not be achieved in the near term, or at all.

PART B: Risks relating to the Elster Group and the Enlarged Group

1. The sales activity of the Elster Group depends to a significant extent on general economic conditions

The Elster Group sells and distributes a significant portion of its manual-read meters and Smart Offerings for use in new construction markets and to utilities and utility contractors, and its level of sales activity in these markets depends to a significant extent on general economic conditions. The Elster Group defines its Smart Offerings as automated meter reading, or AMR, meters, advanced metering infrastructure, or AMI, meters, and other meters that are equipped with communications capabilities, communications networks and related software solutions, or Smart Grid Solutions, together with individual products, components and services for use in the Smart Grid. The Elster Group defines smart meters as meters, which are AMR or AMI enabled, are equipped with communication capabilities and may be used as components in the Smart Grid. The Smart Grid is commonly used to refer to any gas, electricity or water network that allows utilities to measure and control production, transmission and distribution more efficiently through the use of communications technology.

2. Utilities may delay installing meters and Smart Grid Solutions

Many utilities have announced plans or intentions to replace older meters with smart meters enabled for AMR or with meters enabled for AMI on a standalone basis or as components of Smart Grid solutions. However, some utilities have delayed their investments due to economic uncertainty, a reduction in the consumption of energy resources as a result of the economic downturn, difficulty in obtaining financing, limitations on their own or public financial resources or for other reasons. Utilities that are owned by municipalities or other public authorities may also face budgetary restrictions and funding constraints. Such uncertainties and funding constraints may lead some utilities to alter their budgeting and procurement priorities to focus on capital expenditures in areas other than metering, which may result in delays in the installation of meters and Smart Grid solutions.

3. The continued weakness of new construction markets poses a substantial risk to the business of the Elster Group

The new construction market in the United States has in particular been in an extended period of contraction, and the Elster Group is unable to predict when this market will return to levels approaching those seen before that weakness began. Similar contractions have occurred in the new construction markets in other countries, including in the United Kingdom and Spain. If countries where the Elster Group has significant operations continue to experience an overall contraction in new construction markets, or if these markets fail to grow, existing orders for its metering products and services may be delayed or cancelled, and new orders may not materialise. This could have a material adverse effect on the Elster Group's results of operations, business and financial condition.

4. Economic weakness and uncertainty may slow the rate of "gasification"

Economic weakness and uncertainty may slow the rate of "gasification" which the Elster Group defines as the expansion of natural gas infrastructure and distribution to include regions and customers, particularly in the Middle East, North Africa and Asia, not previously connected to the gas grid. Similarly, economic weakness has led to and may in the future lead to a decrease in demand for meters and other products that the Elster Group sells for transmission and distribution applications, as well as for gas utilization products,

which consists of process-heating equipment, such as burner-control systems for gas-fired industrial heat treatment processes, and heat-control systems for residential and commercial boilers. As a result of these developments, existing orders for products and services may be delayed or cancelled and new orders may not materialise, which could have a material adverse effect on the Elster Group's results of operations, business and financial condition.

5. Recent uncertainty in worldwide financial markets may lead customers to demand guarantees or bonds covering a larger portion of contracts with the Elster Group or require the Elster Group to maintain larger amounts of inventory

Some of the Elster Group's customers and potential customers ask it for credit and/or performance guarantees, including payment and advance payment guarantees and performance guarantees, or credit and/or performance bonds, in each case to cover portions of their potential contract volumes. They may also or alternatively ask the Elster Group to maintain a certain level of inventory. The experience of the recent uncertainty in worldwide financial markets may lead customers to demand guarantees or bonds covering a larger portion of these contracts or for the Elster Group to maintain larger amounts of inventory, while at the same time making it may be more difficult for the Elster Group to obtain favourable terms on the credit necessary to fulfil these demands. If it is unable to obtain the necessary guarantees or bonds, or maintain or finance the necessary level of inventory, the Elster Group may fail to win these contracts, which could have a material adverse effect on its business and financial condition.

6. The Elster Group's results of operations have been, and may continue to be, adversely affected by movements in exchange rates

The Elster Group's results of operations have been, and may continue to be, adversely affected by movements in exchange rates, especially among the Euro, U.S. dollar and pound sterling, but also with other currencies. Adverse currency exchange rate movements may hinder its ability to procure important materials and services from vendors and suppliers, may affect the value of its level of indebtedness, and may have a significant adverse effect on its revenues and overall financial results. Currency movements affect the Elster Group's financial statements and results of operations in various ways, including:

- As part of its consolidation each period, the Elster Group translates the balance sheet items in the financial statements of those entities in its group that have functional currencies other than the U.S. dollar into U.S. dollars at the period-end exchange rates. The translated values in respect of each entity fluctuate over time with the movement of the exchange rate for the entity's functional currency against the U.S. dollar. The Elster Group refer to this as the currency translation effect. It is not practicable to hedge against this risk and the Elster Group do not do so.
- Most of the Elster Group's entities make their purchases and sales primarily in their respective functional currencies. However, sometimes entities within the group make purchases and sales denominated in currencies other than their functional currencies. To the extent that an entity makes purchases in a currency that appreciates against its functional currency, its cost basis expressed in its functional currency will increase, or decrease, if the other currency depreciates against its functional currency. Similarly, for sales in a currency other than the entity's functional currency, its revenues will increase to the extent that the other currency appreciates against the entity's functional currency and decrease to the extent that currency depreciates against the entity's functional currency. These movements can have a material effect on the gross margin of the entity concerned and on the Elster Group's consolidated gross margin. The Elster Group refer to this as the currency transaction effect.
- After a purchase or sale is completed, the currency transaction effect continues to affect foreign currency accounts payable and accounts receivable on the books of those entities that made purchases or sales in a foreign currency. These entities are required to re-measure these balances at market exchange rates at the end of a period. In 2009, the Elster Group recognised a foreign currency gain of \$2.9 million resulting from these re-measurements; in 2010, it incurred a gain of \$2.3 million and in 2011, it recognised a loss of \$0.4 million. Through the Elster Group's group treasury function, it enters into foreign currency derivative financial products to mitigate exchange rate risks when the appropriate financial products are available on attractive terms. However, it is

often economically disadvantageous to pay the costs associated with hedging against every possible currency movement, particularly between currencies that have traditionally been rather stable, and the Elster Group will continue to be subject to this risk.

In addition, inter-company borrowings by one Elster entity to another Elster entity with a different functional currency can cause gains or losses from re-measuring the inter-company financing at changing exchange rates.

In the past, the Elster Group has experienced gains and losses from exchange rate fluctuations, including foreign exchange gains and losses from transaction risks associated with assets and liabilities denominated in foreign currencies, including inter-company financings. In 2011, the Elster Group recognised a foreign exchange gain of \$0.1 million, compared to a foreign exchange gain of \$2.9 million in 2010 and a foreign exchange gain of \$14.4 million in 2009. Although it has introduced measures to improve its ability to respond to currency exchange rate risks, these measures may prove ineffective, and recent exchange rate volatility, particularly between currency pairs that have traditionally been rather stable, may continue at high levels. As a result, the Elster Group may continue to suffer exchange rate losses, which could cause operating results to fluctuate significantly and could have a material adverse effect on its business and financial condition.

7. The Elster Group's success depends on its continued ability to identify, attract, develop and retain skilled personnel throughout the company

Competition for highly qualified management and technical personnel is intensifying as the Elster Group's industry becomes more technologically advanced. While the Elster Group has a good relationship with its management and other key employees, and while it has developed a long-term incentive compensation plan that was implemented shortly after its IPO, the Elster Group may not be able to retain key executives or other skilled personnel, or attract and retain replacements for those who may decide to leave the company. In certain strategic focus areas, such as Smart Grid technologies, the Elster Group intends to make significant investments and further develop its product portfolio. The successful development of the Elster Group's business in these strategic areas depends in part on its continued ability to hire and retain qualified and skilled personnel. The Elster Group is also dependent on the remainder of its workforce to respond effectively to customer requests, and industrial actions could negatively impact its ability to respond effectively, especially for larger, more complex rollouts that encompass a broad range of its products and services. Any such industrial actions, along with any inability to attract and retain key personnel could have a material adverse effect on its results of operations, business and financial condition.

8. The manufacturing processes for all of the Elster Group's products, especially in its gas and water segments, require a wide variety of components, raw materials and energy, including gas and electricity. The prices of components, raw materials and energy fluctuate and could negatively impact profitability

The Elster Group uses components such as brass castings, aluminium housings, sheet metal, plastics and printed circuit board assemblies and other electronics. Important raw materials include steel, resins, aluminium, brass and bronze. Prices of components, raw materials or energy may increase or become more volatile. The Elster Group recently experienced difficulties in passing on to its customers the full amount of increases in the prices of components, raw materials and energy, which has had an adverse effect on its profit margins, in particular in its water segment, and to a lesser extent, its gas segment. In many cases, especially for brass, steel and aluminium, the Elster Group seeks to manage its exposure to changing prices by executing procurement contracts for periods of up to one year with its suppliers of these materials or of components that include them. The Elster Group may pay higher prices with this approach than it otherwise would have, should market prices decline during the life of the contracts.

9. Any inability to obtain adequate supplies of component parts, raw materials and energy at favourable prices could decrease the Elster Group's profit margins and negatively impact timely deliveries to its customers

The loss of, or a substantial decrease in the availability of, products from some of the Elster Group's suppliers, or the loss of key supplier relationships for products including precision and engineered plastics and sealants and the need to find alternative sources on potentially disadvantageous terms, could lead to a reduction in its production and sales volumes and in its profit margins. Any of these events could have a material adverse effect on its business and financial condition.

10. The Elster Group will be subject to the risk of major operational problems

The Elster Group's sales will be dependent on the continued operation of its various manufacturing facilities and those of third parties that supply it, its warehousing and logistics infrastructure and its information technology systems. In particular, because Elster's sites in Raleigh, U.S., Mainz, Germany and Osnabrück, Germany represent a material proportion of the Elster Group's turnover, an operational failure at any of these sites may adversely affect the Elster Group's business or financial condition. Operational risks include equipment failure, failure to comply with applicable regulations and standards, raw material supply disruptions, labour force shortages or work stoppages, events impeding or increasing the cost of transporting the Elster Group's, fires and natural disasters. There is no guarantee that the Elster Group's insurance policies and disaster recovery plans will be sufficiently adequate to protect the Elster Group against loss if any of the aforementioned occurs and the occurrence of major operational problems resulting from these or other events may have an adverse effect on the results and financial condition of the Elster Group. Operational risks will be present in the Elster Group's business. These risks include the risk of failed internal and external processes and systems (including information technology systems), human error and external events such as changes in credit offered by suppliers. Such events could have an impact on the results of operations of the Elster Group during the affected period. The Elster Group will actively assess these risks through ongoing processes embedded in its business which identify, evaluate and manage the risks faced by it.

11. The Elster Group is exposed to risks in relation to compliance with anti-corruption laws and regulations and economic sanction programs

The Council of the European Union has adopted restrictions on trade with entities associated with certain jurisdictions, including Council Regulation (EU) No. 961/2010 of October 25, 2010 on restrictive measures against Iran, most recently updated on January 23, 2012, and Council Decision 2010/413/CFSP concerning restrictive measures against Iran, most recently amended by Council Decision 2012/35/CFSP of January 23, 2012. These sanctions regulations, which vary depending on the jurisdiction in question, apply to EU nationals worldwide, including all EU companies. While these sanctions regulations do not apply to subsidiaries of EU companies that are organised under the laws of countries outside the European Union, EU parent companies are nonetheless expected to encourage their subsidiaries to follow these regulations. The Elster Group has conducted, and continues to conduct, business with entities located in jurisdictions subject to EU sanctions regulations. If the Elster Group is found to have violated any of these restrictions, it could be subject to fines, which could have a material adverse effect on its business and reputation.

The U.S. Department of the Treasury's Office of Foreign Assets Control, or OFAC, and the Office of Export Enforcement of the U.S. Department of Commerce, or OEE, administer certain laws and regulations, or U.S. Economic Sanctions Laws, that impose restrictions upon U.S. companies and persons, or U.S. persons, and, in some contexts, foreign entities and persons, with respect to activities or transactions with certain countries, governments, entities and individuals that are the subject of U.S. Economic Sanctions Laws, or Sanctions Targets. U.S. persons are also generally prohibited from facilitating such activities or transactions. Most recently the President of the United States signed Executive Order 13590 (effective November 21, 2011). This order further expands the range of conduct that may be sanctioned by U.S. authorities and, among other things, targets exports that directly contribute to Iran's ability to develop domestic petroleum resources.

The Elster Group has engaged in business with counterparties, including government-owned or controlled counterparties, in certain countries that are Sanctions Targets, including Iran, Syria and Cuba, and it may continue to do so. However, in February 2012, the Elster Group decided to not accept any further orders from customers in Iran or with a final destination of Iran. The Elster Group will finalise deliveries under existing contracts with customers in Iran, with a total sales volume of \$8.1 million in strict compliance with applicable law and has scheduled these deliveries to be completed in the third quarter of 2012.

In the years ended 31 December 2011, 31 December 2010 and 31 December 2009, the Elster Group generated revenues from products sold to customers in Iran of \$13.0 million, \$6.8 million and \$21.8 million, respectively, which represent approximately 0.7 per cent., 0.4 per cent. and 1.3 per cent. respectively, of its total revenues for those periods. In the years ended 31 December 2011, 31 December 2010 and 31 December 2009, the Elster Group generated revenues from products sold to customers in Sanctions Targets other than Iran of \$1.6 million, \$2.9 million and \$2.6 million, respectively. The Elster Group's business with Sanctions Targets consisted mostly of the sale of electricity meters for residential and C&I use until the second quarter of 2010, after which it has ceased selling electricity meters in Iran. The Elster Group also sells gas metering and utilization products and, to a lesser extent, water meters in Sanctions Targets.

In October 2007, the Elster Group implemented enhancements to its compliance and training programmes and procedures designed to ensure that, across all its operations globally, no sales to Sanctions Targets would occur of products containing more than a de minimis level of U.S. content (or any level of U.S. content in circumstances where no U.S. content is permissible) and that U.S. persons among its employees would have no involvement in business with Sanctions Targets. Despite these enhancements and the Elster Group's other efforts designed to ensure compliance with applicable sanctions laws and embargoes, it remains possible that its products could be sold or transferred to countries, governments, entities or persons targeted by EU or U.S. sanctions in a manner that violates such sanctions. For example, despite the Elster Group's procedures, one of its businesses may miscalculate the level of U.S.-origin content in a product or transfer a U.S.-origin product to a customer that it should have known was subject to U.S. or EU sanctions. Should such sales or transfers occur, the Elster Group would bear the costs of any necessary investigative and remedial measures that may be necessary, and could be subject to fines or criminal penalties in respect of such sales or transfers.

In addition to the sanctions administered by OFAC and OEE described above, the U.S. government may impose (and has in the past imposed from time to time) restrictions and sanctions against other countries, including ones in which the Elster Group does business. In addition, the U.S. government may impose new or expanded restrictions and sanctions against existing Sanctions Targets. Any such measures targeting countries in which the Elster Group undertakes business could have a material adverse effect on business and reputation.

Certain U.S. state and municipal governments, universities and institutional investors have proposed or adopted divestment initiatives regarding investments in companies doing business with Iran and other Sanctions Targets. If the Elster Group's business activities regarding Iran or other Sanctions Targets were deemed to fall within the scope of such initiatives, then such investors holding interests in the Elster Group may sell these interests. If significant, these sales could have adverse effects on the Elster Group's business.

12. The Elster Group's industry depends substantially on governmental regulation

Historically, a key driver in its industry has been the replacement cycle of existing meters, especially the length of that cycle. Local or national regulations often determine when meters are to be replaced, and manual-read meter replacement cycles have been between five and 30 years, depending on the specific geographic market and the type and usage of the meter. Likewise, much of the impetus for the growth expected in Elster's industry arises from regulatory initiatives. Today, governments around the world are considering and, in some cases, have already begun to implement new laws and regulations to promote increased energy efficiency, slow or reverse growth in the consumption of scarce resources, reduce carbon dioxide emissions and protect the environment more generally. In particular, intensified regulatory pressure relating to energy and natural resource consumption is being driven by these and a range of additional imperatives in the United States and the European Union and in other countries, including

Australia, Brazil, Canada, China and Russia. The European Union, for example, has provided a mandatory framework for the upgrade of all gas and electricity meters to smart meters by 2022. Many of the legislative and regulatory initiatives encourage utilities to develop Smart Grid infrastructure, and some of these initiatives provide for government subsidies, grants or other incentives to utilities and other participants in their industry to promote transition to Smart Grid technologies.

If government regulations regarding the introduction of Smart Grid technologies and the related shortening of the replacement cycles for meters are delayed, revised to permit lower or different investments in metering infrastructure or terminated altogether, this could have a material adverse effect on its results of operations, business and financial condition.

In many regions, Smart Grid-related legislation or regulation is being considered, drafted or negotiated, or general legislation is in place, but awaiting implementing rules or guidance. Legislatures and governmental agencies may prolong the law- and rule-making process, subject new technology to extensive reviews or fail to implement Smart Grid-related legislation or regulation on a timely basis, if at all. For example, some of the current legislative and regulatory initiatives in the European Union have clauses that may lead to deferral or dilution to the extent the Smart Grid initiatives are deemed economically non-viable. Some of the Elster Group's utility customers have been awaiting greater clarity on the scope and implementation of these laws and regulations and the timing of, and conditions related to, the receipt of related government grants, subsidies and other incentives. This effect has caused the revenues of the Elster Group's electricity segment to decline as utilities in the United States have been deferring their upgrades of installed meter bases and infrastructure expansions. They have accordingly been deferring their commitments for the substantial upgrades of installed meter bases and infrastructure expansions that will be part of their response to Smart Grid related regulation. While awaiting the upgrades on Smart Grids, some customers have also been deferring investments in the existing meter base. These deferrals continued throughout 2011. If a significant number of utilities continue to delay their investments or opt not to participate altogether, this could lead to shortfalls in the Elster Group's sales and results of operations in the short to medium term.

The Elster Group is subject to a range of laws, regulations and ordinances in all of the jurisdictions in which it conducts business, and the Elster Group and its customers are regulated by various bodies at the supranational, national, state and local level. For example, in many U.S. states, public utility commissions regulate utilities in their states separately from other state regulators and federal agencies. The laws, regulations and ordinances to which the Elster Group is subject, and the actions and attitudes of regulators, can change from time to time. Compliance with current or future laws and regulations may increase the Elster Group's expenses if their complexity or inconsistency increases, while failure to comply could result in the imposition of significant fines, suspension of production, alteration of production processes, cessation of operations or other actions in the jurisdictions concerned, all of which could have a material adverse effect on its results of operations, business and financial condition.

The nature, scope or effect of future regulatory requirements to which the Elster Group's operations might be subject or the manner in which existing or future laws will be administered or interpreted cannot be predicted. In particular, governmental agencies and state public utility commissions may promulgate regulations that mandate or encourage the use of a particular type of technology that is not readily compatible with the technology employed in its products or may otherwise establish standards that are more favourable to its competitors. For example, in the United States, the National Institute of Standards and Technology is statutorily required to define uniform interoperability standards for the implementation of Smart Grid solutions, and the U.S. Federal Energy Regulatory Commission is required to engage in a rulemaking process to consider making these interoperability standards mandatory for interstate electricity transmission and wholesale power markets. This process may favour one company's technology over another's. If this were to happen, particularly in the larger markets in which the Elster Group sells its products, it could be forced to withdraw some of its products from the market, make substantial investments in a new technology or lose market share to competitors, all of which could have a material adverse effect on its results of operations, business and financial condition.

13. The Elster Group is subject to various governmental certification requirements and similar regulations

Many of the Elster Group's new products and much of its equipment require certifications, calibrations or regulatory approvals before they may be sold or used. In some areas, each item produced by the Elster Group must be separately calibrated or certified by a governmental agency prior to deployment. There is no certainty that any of the Elster Group's new products and equipment requiring approval will be approved in a timely manner, if at all. If certification, calibration or approval requirements become more stringent or cumbersome in the future, or differ materially on a regional or national level, the Elster Group's ability to market its products may be impaired.

In some cases, existing calibration requirements currently work to the Elster Group's benefit by driving service opportunities and meter replacement. The Elster Group's water meter products in particular are subject to ongoing calibration requirements in a number of European countries and its gas meters are generally subject to exacting safety tests. In Germany, for example, federal regulations require cold water meters to be recalibrated and repaired every six years, while hot water meters must be recalibrated and repaired every five years. German and certain U.S. state regulations also require that gas meters be tested periodically and serviced when needed. Because of the relative expense involved in repairing water and gas meters, many customers install new meters at the time national regulations call for recalibration and repair. If these national regulations were changed to extend the time for recalibration and repair, the Elster Group's sales of water and gas meters could decrease, which could have a material adverse effect on its results of operations, business and financial condition.

14. The Elster Group's communications technologies use particular radio frequencies and thus are subject to the regulation of various governmental bodies

The Elster Group's communications technologies use particular radio frequencies and thus are subject to the regulation of various governmental bodies, such as the U.S. Federal Communications Commission and corresponding regulatory institutions of various U.S. states and European countries. With respect to the United States in particular, currently very few of the Elster Group's products operate using licensed radio frequencies, but additional AMI and AMR products may operate in the United States using licensed radio frequencies in the future. To the extent that the Elster Group's products and solutions use licensed frequencies, there is a risk that there may be insufficient available licensed frequencies in some markets, that neither the Elster Group nor its customers will be able to obtain licenses where required, even if sufficient frequencies are available, and that licenses that are granted to the Elster Group or its customers may not be renewed on acceptable terms, if at all. Also, while unlicensed frequencies may currently be available for a wide variety of uses, including the Elster Group's RF mesh communications technology, the Elster Group and its customers may not be entitled to protection from interference by others who operate on frequencies close to or the same as those on which its products operate. If currently unlicensed frequencies become unacceptably crowded, or subject to restrictive rules governing their use, the Elster Group's business could suffer a material adverse effect.

15. In Europe the Elster Group is subject to data protection regulation that imposes a general regulatory framework for the collection, processing and use of personal data

Many of the Elster Group's Smart Grid and other technologies rely on the transfer of data relating to individuals and are accordingly affected by these regulations. Although the European Data Protection Directive (95/46/EC) has been implemented across the European Union, data protection laws across member states vary to a large degree, and authorities do not always apply existing laws in a consistent manner. If Elster fails to comply with such regulations it may incur costs which could have a material adverse effect on its business. While privacy issues in connection with AMR, AMI and Smart Grid solutions have been discussed within the European Union, it is unclear how regulation in connection with privacy requirements will further develop and how and to what extent it may affect technology in its industry relating to Smart Grid solutions. It may also lead to delay in other regulatory initiatives supporting the implementation of Smart Grid solutions. Elster may incur additional expenditure in order to comply with such future regulations.

Some of the Elster Group's business structures, processes or actions may infringe applicable data protection standards and as a consequence it may have to take costly and burdensome measures to change these business structures, processes or actions, and may face administrative fines or other sanctions for such infringement. The Elster Group's business and/or its reputation could suffer a material adverse effect as a result.

16. The loss of customers could have an adverse effect on the operations, business and financial condition of the Elster Group

A significant number of the Elster Group's customers purchase products under master agreements with terms ranging from one year in many cases to two to five years for larger projects. As the market moves towards large contracts in connection with Smart Grid solutions, the proportion of such contracts in the Elster Group's business is likely to increase further. Individual orders of products under these master agreements are subject to cancellation or rescheduling due to many factors that may lead the Elster Group's customers to redeploy resources. They may also cease placing orders or cancel these agreements in their entirety, in which case the Elster Group's remedies may be limited. In addition to potential changes in their views regarding the Elster Group's products, they may also take such steps in response to changes in economic conditions generally or in the public procurement or regulatory environments. Cancellation or postponement of a number of these significant contracts, or parts thereof, could have a material adverse effect on the Elster Group's results of operations, business and financial condition.

17. The Elster Group is subject to pricing pressures from customers

In an attempt to increase efficiency, some of its customers have informed the Elster Group that they are seeking to reduce the number of vendors from whom they purchase products and services, particularly as vendors, including the Elster Group, increase the breadth of the products and solutions they offer. If the Elster Group is not selected as a preferred provider in a significant number of cases, it may lose access to certain sections of the markets in which it competes or wishes to compete. Failure to maintain access to important sections of the market could have a material adverse effect on results of operations, business and financial condition. Even if the Elster Group is selected as a preferred provider, the possibility exists that increased competition will have an impact on the agreements customers are willing to enter into. As a result, the terms and conditions of agreements regarding testing, contractual penalties, bonding, warranties, performance and indemnities may be substantially more restrictive, or carry a greater risk of liability, than the terms and conditions associated with the Elster Group's standard products and services.

18. The Elster Group is reliant on the effectiveness and acceptance of its technologies

The Elster Group is exposed to the risk that new technologies, features and functionalities that it and other industry participants develop and market in connection with its manual-read meters, Smart Grid solutions and other products may not be accepted by the industry, regulators or end-users or may not meet applicable standards. This may occur as a result of technological developments or competing features or functionalities proving superior to the Elster Group's existing products, changes occurring in the regulatory landscape, including with respect to interoperability standards, perceptions that the new technologies are error-prone or present cyber-security risks or otherwise. There is a risk that competing technologies, features or functionalities will be favoured by the industry, regulators or end-users if there is not sufficient awareness of, or interest in, its innovations. For example, the advantages that Smart Grid-enabled products can provide may fail to be effective if utility customers choose not to implement corresponding technology throughout their distribution and transmission networks, or if regulators mandate or encourage the deployment of another technology. Generally, if utilities in the United States or some European countries plan to invest additional amounts for capital improvements, including meters and AMI/AMR upgrades, the utility must present the proposed capital improvement to the relevant utility regulatory commission for approval. Many of the Elster Group's utility customers are required to obtain regulatory approval to pass through the costs of products and services to their customers because of the effect it may have on utility rates for consumers. Utility regulatory commissions have decided in the past, and may decide in the future, not to permit the pass-through of such costs onto consumers and this in turn could affect the products and services that its utility customers ultimately purchase. Any delay or failure to receive this approval, due to

regulatory preference for another technology or otherwise, could reduce demand for the products the Elster Group sells to its utility customers, which could adversely affect the Elster Group's business. Market and regulatory acceptance of Smart Grid technologies varies by country and industry based on factors, such as the regulatory and business environment, environmental concerns, labour costs and other economic conditions.

The Elster Group also is exposed to the risk that consumers or other end-users will not welcome these new technologies, or view technologically advanced systems as responsible for higher utility bills, uncertainty in their relationships with their utilities, incursions on privacy or other real or perceived shortcomings. Some utilities and regulators are expressing concerns about the potential for near-term costs to customers of the installation of these new technologies. If the Elster Group's products or those of a competitor fall subject to perceptions of this nature, the resulting negative publicity for the Elster Group or for the industry generally could adversely affect the Elster Group's business.

19. Some public concern exists over the potential health risks associated with the use of radio frequency, or RF, communications in smart meters used in neighbourhoods

The Federal Communications Commission, or FCC, establishes guidelines for RF emissions for equipment used in a residence or residential setting and its devices meet the guidelines. However, these guidelines may prove to be inadequate and may change, or even if the guidelines are appropriate, public concern could impact the acceptance of its products. In such a case, the Elster Group's projects may be delayed, interrupted or terminated as a result which may have a material adverse effect on its results of operations, business or financial condition.

20. The Elster Group's industry is exposed to the risk of, and to public concern about, an increased threat of "cyber attacks" on the power grid as Smart Grid infrastructure becomes more prevalent

Smart Grid privacy and security risks have attracted attention recently, as media reports have highlighted the dangers of potential instability, blackouts and economic disruption that could result from a Smart Grid cyber attack by hackers. Any cyber attack or other security breach on any component the Elster Group or a competitor have provided, or on other similar technologies, could lead to a reduction in public acceptance of Smart Grid technologies and have a material adverse effect on the Elster Group's results of operations, business and financial condition.

21. The Elster Group faces competitive pressures from a variety of companies in each of the markets it serves

Some of the Elster Group's current or future competitors have or may have substantially greater financial, marketing, technical or manufacturing resources, and, in some cases, greater name recognition, market penetration and experience than the Elster Group does. This may also be the case with respect to Smart Grid solutions. These competitors may also be able to devote greater resources to the development, promotion and sale of their products and services.

22. The competitive environment in which the Elster Group operates has been strongly impacted by the movement towards Smart Grid solutions

While the Elster Group is increasingly focusing its business plan on the development of Smart Grid product offerings and solutions in an attempt to maintain and expand its activities and market share in this area, current or future competitors may be able to respond more quickly to new or emerging technologies and changes in customer or regulatory requirements. They may also be able to drive technological innovation and develop products that are equal in quality and performance or superior to the Elster Group's products, which could reduce the Elster Group's overall sales, require the Elster Group to invest additional funds in new technology development and put pressure on the Elster Group's market position. The Elster Group's competitors also have made or may make strategic acquisitions or establish alliances or cooperative relationships among themselves or with third parties that enhance their ability to address the needs of customers, potentially giving them a significant increase in market share at the Elster Group's expense. New entrants could include competitors from industries the Elster Group previously viewed as

distinct from its, such as the networking, telecommunications and systems integration industries. Should the Elster Group fail to compete successfully with current or future competitors, the Elster Group could experience a material adverse effect on the results of its operations, business and financial condition.

23. In the Elster Group's industry, competition based on price can be intense, particularly during periods of economic decline or stagnation

The Elster Group faces varying levels of price erosion in the markets that it serves due to a variety of factors, including existing competitors lowering their prices, competition from manufacturers in low-cost countries and new entrants using off-the-shelf products or other low-priced strategies to gain market share. In addition, the Elster Group may have a competitive cost disadvantage with its competitors who are not subject to the same legal and compliance framework as the parent company of the Elster Group will be a public company. During 2011, the Elster Group saw intense price competition, in the water segment in the Americas and some European markets, leading to price erosion for many of its products. In addition, there is a risk that low-cost providers will enter, or form alliances or cooperative relationships with the Elster Group's competitors, thereby contributing to further price erosion in the market for manual-read meter and Smart Grid solutions. The Elster Group may be unable to reorganise its operations to make them more efficient or reduce the costs of its supplies sufficiently to maintain margins on its sales in the face of intense competition. Some of the Elster Group's products and services may become commoditised and the Elster Group may have to adjust the prices of some of its products to stay competitive.

24. The Elster Group's future operating results will depend on its ability to develop and manufacture products in a cost-effective manner

The Elster Group outsources the manufacturing of some of its products and their sub-assemblies and components such as brass castings, aluminium housings, sheet metal, plastics and printed circuit board assemblies and other electronics, especially for solid state meters used by gas, electricity and water utilities to maintain focus on its core competencies and streamline its operations, as well as to minimise its manufacturing costs. Solid state meters measure gas, electricity or water using electronic devices instead of mechanical components.

The outsourcing of manufacturing capabilities reduces the day-to-day control that the Elster Group is able to exercise over the production process and could result in quality problems and increased product warranty costs. In addition, as it outsources additional production capacity, the Elster Group will retain limited internal production capacity and will rely more on third-party manufacturers to fill orders on a timely basis. While the Elster Group's strategy calls for having more than one supplier for each important product and component, it relies on a single source for some key product lines, products and components that it purchases from third-party manufacturers, such as for diaphragms for its North American residential gas meters manufactured at one of its facilities. In some cases, the Elster Group's purchases account for a material portion of some of its suppliers' respective businesses.

25. The third-party manufacturers with whom the Elster Group works often require it to provide accurate forecasts, sometimes months in advance

If the Elster Group overestimates its requirements, it may be obligated to purchase quantities of products that exceed customer demand. If the Elster Group underestimates its requirements, particularly in connection with large rollouts, it may have inadequate inventory from which to meet customer demand. From time to time, some of its suppliers may have difficulties keeping pace with the Elster Group's requirements if it increases its orders with little advance notice in response to demand for its products. While the Elster Group is seeking to give its suppliers more advance notice of its peak requirements and holding more of the affected components in inventory where possible, it may fail to do so, or may, for reasons outside its control, not have access to sufficient supplies, which may cause even longer lead times. In any case where the Elster Group must forecast its supply needs, its inability to forecast demand accurately may have a material adverse effect on its results of operations, business and financial condition.

Lead times for the components purchased from third-party manufacturers depend on a variety of factors, including the demand for each component and supplier capacity. If the Elster Group's third-party

manufacturers or any of their sub-suppliers fail to deliver quality products and services in a timely manner, or if the Elster Group's ability to source from alternative suppliers cannot be maintained or if a supplier that is dependent on the Elster Group is unable to cope with variations in the Elster Group's ordering patterns, the ensuing disruptions in its chain of supply could negatively affect its product portfolio, reputation, sales and ability to meet large orders, especially in the context of large rollouts.

In the past, the Elster Group has experienced significantly extended lead times at its suppliers that provide components used in some of its products, in particular for electronic components.

26. The natural disasters and nuclear power plant emergencies in Japan in 2011, as well as the flooding in Thailand in autumn 2011, may result in additional interruptions or long-term delays in the worldwide supply of components that manufacturers, potentially including the Elster Group's suppliers and their sub-suppliers, use in electronic components for use in many industries, including the Elster Group's.

As a result of the Thailand flooding, the Elster Group has been forced to find alternative sources for certain of its components, particularly for its North American production of water and electricity meters. The process of finding alternative sources has now been completed but the transition may be subject to delays and may result in interruptions in the production of some of its products if it is not able to successfully finalise testing of the alternative components in time and/or is not able to find suitable alternative sources of supply. While the Elster Group is not able to predict the effects, if any, on it of a longer term disruption in Japanese industry, these delays could continue well into the future and have a material adverse effect on the ability of its company and others to manufacture and ship their electronic products.

Shortages or interruptions in the supply of components or communications modules could delay shipments of the Elster Group's products or increase its production costs. This in turn could have a material adverse effect on its results of operations, business and financial condition. Any contractual penalties the Elster Group negotiates for the event that a supplier does not meet its obligations with respect to timeliness and quality may fail to mitigate the harm to the Elster Group's business caused by any such contractual breaches.

27. The utility industry worldwide is often subject to long budgeting, purchasing and regulatory review processes that can take several years to complete and can result in unpredictable capital investment cycles

The Elster Group derives most of its revenues from customers in the utility industry, either directly or through distributors and the utility industry worldwide is often subject to long budgeting, purchasing and regulatory review processes that can take several years to complete and can result in unpredictable capital investment cycles. Generally, larger contracts with utilities are granted through competitive tender processes that involve large volumes, require lengthy and complex competitive procurement processes and lead to long and unpredictable sales cycles. Utilities are under increasing economic, political and regulatory pressure to seek bids for their higher-volume purchases in as competitive a process as possible, which can further delay the time necessary to complete the tender process. In addition, in the face of increasing economic pressure, the Elster Group's customers in the utility industry may establish alliances or enter into mergers which may enhance their purchasing power and their ability to command lower prices. In some markets, utilities' ability to recover the costs of purchasing the Elster Group's products and services is also subject to lengthy and uncertain regulatory proceedings. In addition, utilities' purchasing decisions are sometimes delayed if they are considering or negotiating major transactions or changes in their businesses or operations that are unrelated to the Elster Group's products. The Elster Group's revenue development may be materially and adversely affected if these sales cycles lead to delays that it did not anticipate, for which it was unable to plan adequately or that are otherwise disadvantageous to it. This could have a material adverse effect on its results of operations, business and financial condition.

28. The Elster Group relies on its own IT systems and on IT systems provided by third parties

The Elster Group relies on its own information technology, or IT, systems to manage its business data, communications, computing needs, production and supply chain effectively and efficiently. The Elster Group's IT systems are used to conduct order entry, order fulfilment, inventory replenishment, e-commerce and other business processes. The Elster Group also relies on the IT systems provided by third parties, including, in particular, for much of its Wide Area Network and other IT infrastructure.

The Elster Group currently outsources, and in the future plans to continue to outsource, certain aspects of its technical and communication infrastructure to third parties. Should these systems not operate as intended or any third parties to whom the Elster Group outsources some of its IT services fail to deliver as expected, its ability to transact business across its international company would be significantly impaired. In addition, the Elster Group's IT systems and those it outsources are vulnerable to damage or interruption from circumstances beyond the Elster Group's control, including fire, natural disasters, power loss, hacker attacks, computer systems failure and viruses. The failure of the Elster Group's IT systems to perform as anticipated, could disrupt the Elster Group's business and could result in decreased sales, increased overhead costs, excess inventory and product shortages, causing the Elster Group's business and results of operations to suffer. In addition, unforeseen vulnerabilities in the Elster Group's security systems and policies could result in potential data misuse, resulting in damage to its reputation and an adverse effect on its business.

29. The Elster Group is subject to risks from legal proceedings and arbitrations

In the ordinary course of the Elster Group's business, it is subject to risks relating to legal proceedings. The outcomes of legal proceedings, including regulatory actions, intellectual property disputes and employee lawsuits, are inherently unpredictable. If claims are asserted against the Elster Group in the future or if it becomes subject to regulatory action or employee litigation, and if the Elster Group's opponents in these proceedings obtain judgments or awards against it or if it determines to settle any of these proceedings, the Elster Group could be required to pay substantial damages, fines and related costs. These payments may have a material adverse effect on its results of operations, business and financial condition.

The nature of the Elster Group's industry, which includes large contracts entered into with public or publicly-regulated utilities in many jurisdictions, presents greater risks of non-compliance with some forms of regulation than is the case in many other industries. These risks are accentuated by the global nature of the Elster Group's operations. The Elster Group is, in particular, exposed to the risk that its employees or agents could engage in anti-competitive behaviour or seek to influence the awarding of contracts in other impermissible ways. The Elster Group maintains a compliance infrastructure including "whistleblower" hotlines, employee education and training programmes, and due diligence on agents. Under this compliance infrastructure, the Elster Group investigates cases of potentially non-compliant behaviour and, if necessary, take specific steps to prevent such non-compliant conduct in the future. However, the Elster Group's compliance infrastructure may be insufficient to deter all misconduct. Moreover, if it becomes aware of allegations of non-compliant conduct, the Elster Group may have difficulty investigating such conduct and gathering evidence. If such cases were to arise, and misconduct were determined to have occurred, the Elster Group could be subject to fines, blacklisting and to litigation, which could have a material adverse effect on the Enlarged Group's results of operations, business and financial condition.

30. The Elster Group's operations are subject to environmental, health and safety laws and regulations and non-compliance with or liability under such laws and regulations could result in substantial costs, fines, sanctions and claims

The Elster Group operates global manufacturing, product handling and distribution facilities that are subject to a broad array of environmental laws and regulations relating to pollution, the health and safety of employees, protection of the public, protection of the environment and the storage and handling of hazardous substances and waste materials. These laws and regulations are becoming increasingly stringent. It is the policy of the Elster Group to comply with all relevant laws and regulations. The Elster Group actively manages this risk through regular compliance and performance improvement assessments and key performance indicators and the engagement of competent health, safety and environmental coordinators

at each of their sites. However, violations of applicable laws and regulations, in particular provisions of environmental and health and safety laws, could result in restrictions on the operations of the facilities of the Elster Group, damages, fines or other sanctions and/or increased costs of compliance, as well as damage to reputation. Due to the proportion of the Enlarged Group represented by the Elster Group, such effects may have a material adverse effect on the business, operations, financial condition and reputation of the Enlarged Group.

As with other companies engaged in similar activities, the Elster Group faces inherent risks of environmental liability in its manufacturing activities. For example, its former Ipsen Group furnace business has been subject to a number of claims relating to alleged asbestos exposure. Pursuant to the agreement under which it sold the Ipsen Group furnace business, the Elster Group is required to indemnify the purchaser against present or future asbestos claims notified to it by 15 August 2015, up to a maximum out-of-pocket amount for it of EUR 15 million. The agreement under which the Elster Group sold the Ipsen Group furnace business further provides that the amount of the indemnity be reduced by payments made to the purchaser under the Ipsen Group's current or pre-existing insurance policies. Claims exceeding the amount of EUR 15 million are only the subject of the indemnity if they are covered by an indemnity from the Elster Group's former owner, E.ON Ruhrgas AG. In addition, according to its due diligence conducted at the time of the disposition, Ipsen's current and pre-existing insurance coverage is in excess of the EUR 15 million amount. At the time of the disposition, 14 cases were open, and 155 new claims have been subsequently notified up to the Latest Practicable Date. Of the total claims notified, 78 have been dismissed. Additionally, there are currently three asbestos cases (filed in 1999, 2002 and 2003 by individual plaintiffs) in which Elster American Meter Company has been named as an additional defendant. All three cases have been included in the New York County Asbestos Litigation, or NYCAL, programme and are currently classified as inactive. While on the inactive docket, all discovery in these matters has been stayed until further notice.

Furthermore, the Elster Group's operations and properties are subject to U.S., European and other foreign, state and local environmental laws and regulations governing, among other things, the generation, storage, emission, discharge, transportation, treatment and disposal of hazardous materials and the clean-up of contaminated properties. Many of these environmental laws and regulations impose a form of strict joint and several liability on the current and former owners and operators of land for the presence of any hazardous waste materials on the land and require generators of waste to take remedial actions at off-site disposal locations when necessary. As such, certain parties may be found liable for such cleanup costs regardless of fault and may be required to pay for more than their fair share. For example, the U.S. Environmental Protection Agency ("EPA"), issued to one of Elster's subsidiaries in the US, Hauck Manufacturing Company, ("**Hauck**"), among many other parties, a notice of potential liability under the federal Comprehensive Environmental Response, Compensation and Liability Act of 1980, ("**CERCLA**"), in respect of hazardous substance contamination at the Gowanus Canal Superfund Site in Brooklyn, New York. A Superfund site under CERCLA is a contaminated site targeted for high priority environmental cleanup by EPA. EPA alleges that one or two former Hauck manufacturing sites near the Gowanus Canal may have discharged hazardous substances into the local sewer system that may have led into the canal. Although the EPA has yet to issue a final remedy and such remedy is not anticipated to be issued until the end of 2012, the total cost to remediate the Gowanus Canal is anticipated to be material. In addition to investigation and remediation costs, certain parties may be found liable for costs associated with assessing and restoring any natural resources damaged in connection with the release of hazardous materials, though due to the early stage of this investigation the quantum of the cost of such remedy, assessment and restoration (if applicable) is unquantifiable. In the ordinary course of its business, the Elster Group has used and may continue to use metals such as mercury and cadmium, solvents and other materials on-site that create waste, which may expose it to liability under these regulations. Any failure to comply could result in the imposition of significant fines, suspension of production, alteration of product processes, cessation of operations or other actions detrimental to the Elster Group's business.

The Elster Group's European operations may become regulated under the European Union Emissions Trading System, or ETS, which aims to reduce greenhouse gas emissions through the issuance to industrial installations of "allowances" to emit. The allowances may be traded among installations or in the open market, thereby creating an incentive for installations to reduce their emissions below their allowances

inventory and sell the excess allowances. The ETS is anticipated to become progressively more stringent over time, including by reducing the number of allowances that will be allocated by regulatory authorities to industrial installations free of cost. A number of additional international and national measures to limit industrial greenhouse gas emissions, including the Kyoto Protocol and legislation in Australia and California, are in various phases of discussion or implementation, and legislation in other countries or regions is expected to follow. These measures may result in additional requirements for us to reduce the Elster Group's direct and indirect greenhouse gas emissions and/or additional costs for it to upgrade facilities or invest in emissions allowances.

These laws and regulations have complicated requirements, which are often changed or modified and could become stricter in the future. As such, the Elster Group may incur increased costs associated with future environmental or climate change compliance, with remediation obligations or with litigation if claims are made with respect to damages resulting from its operations (including those arising under the indemnity agreement relating to our former Ipsen Group furnace business). These and any future costs associated with environmental or climate change issues currently unknown to the Elster Group could have a material adverse effect on its results of operations, business and financial condition.

31. The Elster Group is subject to a number of tax regimes

The Elster Group operates in more than 30 countries and therefore is subject to different tax regulations. Changes in tax law could result in higher tax expense and payments. Furthermore, legislative changes could materially impact tax receivables and liabilities as well as deferred tax assets and deferred tax liabilities. In addition, the uncertain tax environment in some regions could limit the Elster Group's ability to enforce its rights. As a globally operating organization, the Elster Group conducts business in countries subject to complex tax rules, which may be interpreted in different ways. Future interpretations or developments of tax regimes may affect its tax liability, return on investments and business operations. The Elster Group is regularly examined by tax authorities in various jurisdictions. In addition, the tax treatment of certain of its transactions is complex and in some cases may be subject to uncertainties and differing interpretations. If the relevant tax authorities disagree with the positions the Elster Group takes on these tax matters, it could be required to pay additional taxes in connection with these transactions.

Some of the Elster Group's subsidiaries obtained inter-company financing and record interest expense on such financing. While interest expense is generally deductible for tax purposes, the tax laws of Germany and several other countries in which the Elster Group has operations disallow the deduction of interest expenses for tax purposes either in full or in part.

Of particular relevance for the Elster Group, in Germany, for fiscal years up to and including 2007, interest expenses on loans granted, secured or guaranteed by affiliated companies may not be deductible for tax purposes due to the application of the German thin capitalization rules. Furthermore, in 2008 Germany adopted a limitation on the deductibility of interest expenses in excess of interest income, referred to as the "interest barrier rules". Subject to qualifications and exceptions contained in the interest barrier rules, German law limits the deductibility of interest expenses in excess of interest income to an amount equal to 30 per cent. of the taxpayer's earnings before interest, taxes, depreciation and amortization (EBITDA), as this earnings measure is defined in the tax law, in the respective financial year. Non-deductible interest expenses under the interest barrier rules may, subject to conditions, be carried forward to future tax years (at which time their deductibility continues to be limited by the interest barrier rules). Subsequent to the merger of its German subsidiary Elster Holdings GmbH, interest carry forwards of approximately \$27.7 million were forfeited. This did not impact its net income, as a valuation allowance was recorded against these carry forwards in the year 2009. Since 2010 the interest barrier rules apply at the level of Elster Group SE as it is the parent company of the Elster Group's fiscal unity in Germany. The interest carryforward of Elster Group SE amounted to approximately \$16.4 million as of 31 December 2011. This amount, as well as some interest expense the Elster Group may incur in the future, may not be deductible to the extent that the interest barrier rules in Germany, or similar tax rules elsewhere, apply. In Germany, this risk would be higher in periods in which the Elster Group's earnings, on the EBITDA basis described above, are low or negative. Furthermore, the interest carry forward, and certain other losses, may be forfeited on the change of control arising on the Acquisition.

To the extent the Elster Group's interest expenses are not deductible, it may incur a reduction of its existing loss carryforwards and may pay higher taxes. This could have a material adverse effect on its results of operations, business and financial condition.

32. The Elster Group could be negatively impacted if it fails to adequately protect its intellectual property rights or if third parties claim it is in violation of their intellectual property rights

The success of the Elster Group depends, in part, on its ability to protect current and future branded products and processes through securing, enforcing and defending its intellectual property rights. The Elster Group relies on a combination of trademarks, copyright, patents, designs, know-how, trade secrets and contractual restrictions to establish and protect proprietary rights in its products, processes and technical data. There can be no assurance that these proprietary rights, rights in know-how and contractual provisions will be adequate to prevent the misappropriation, infringement or other unauthorised use of the intellectual property rights of the Elster Group by third parties which could harm the Elster Group. There can be no guarantees that patents will be granted with respect to patent applications for new products or processes. The Elster Group may be required to defend claims of patent infringement, infringement of third party proprietary rights or breach of confidence or to take action to protect its own proprietary rights. An adverse or uncertain outcome of any dispute with respect to material patents or other material proprietary rights may adversely affect the competitive position of the Elster Group or interrupt or adversely affect the ability of the Elster Group to carry on its business.

The Elster Group's intellectual property rights include patents, utility models, copyrights, trade secrets, trademarks, and designs related to a range of technologies it uses in its business. The Elster Group's intellectual property is a valuable asset that helps to protect its investment in technology and software, and to supports its licensing efforts with third parties. The Elster Group depends in part on its ability to obtain and maintain ownership of and rights of use in the intellectual property related to its product and solution portfolio.

However, some of the countries in which the Elster Group operates, such as China, offer less effective intellectual property protection than is available in Europe or the United States. In jurisdictions where effective intellectual property protection is unavailable or limited, the Elster Group's intellectual property may be vulnerable to disclosure or misappropriation by employees, strategic partners, suppliers, customers and other persons. Patents may not be granted on the Elster Group's currently pending or future applications or may not be of sufficient scope or strength to provide it with meaningful protection or commercial advantage. Policing unauthorised use of its intellectual property is difficult and expensive, and the Elster Group may not be able, or may lack the resources, to prevent infringement of the Elster Group's intellectual property, particularly in countries where the laws may not protect such rights as fully as do the laws of the United States.

Competitors or others may infringe the Elster Group's intellectual property rights or successfully avoid them through alternative innovation. Moreover, patents covering technology substantially identical to that covered by intellectual property rights the Elster Group owns have in the past been, and may in the future be, granted in various jurisdictions around the world, and the Elster Group may not become immediately aware of them, which in turn, could inhibit its ability to challenge them.

To combat infringement or unauthorised use, as well as to protect existing patents from the effects of intervening ones, the Elster Group may need to litigate, which can be expensive and time-consuming. The mere existence of patent disputes can cause us reputational harm among customers and market observers and participants, in particular due to a perception that the Elster Group's ownership of its intellectual property may not be sufficiently secure. In addition, a court may decide in an infringement proceeding that an intellectual property right of the Elster Group's is not valid or is unenforceable, or may refuse to enjoin the other party from using the technology or other intellectual property right at issue on the grounds that it is non-infringing or the legal requirements for an injunction have not been met. From time to time the Elster Group is also subject to assertions that it infringes on the intellectual property rights of others.

The loss or unavailability, or threat of loss, of its intellectual property or the economic exploitation of it could have a material adverse effect on results of operations, business and financial condition. The cost of

defending against or settling intellectual property claims can be material and the existence or threat of such claims can damage the Elster Group's reputation and business.

33. The Elster Group businesses' success and sales are dependent on the strength of their brands and reputation and are subject to customers' perceptions of those businesses and their products

If an Elster Group business is unable to respond to changing consumer demand, that business's name and image may be impaired and customer demand for a particular category of product offering may decrease in the future. In addition, the public image of an Elster Group business's existing and future product offering may become tarnished and create negative publicity for that business group and damage that business' brands.

The Elster Group's customers increasingly demand access to a broad range of products and technologies and evaluate their suppliers on the basis of a number of factors, including product quality, reliability and timeliness of delivery, accuracy, new product innovation, price competitiveness, technical expertise and development capability, product design capability, manufacturing expertise, operational flexibility, customer service and overall management and so Elster must continue to develop its expertise to design, manufacture and market its products successfully. The Elster Group's success therefore depends, to a significant extent, on its development of new products and technologies and its ability to continue to meet its customers' changing requirements.

34. The Elster Group may be unable to develop or commercialise technological advances and introduce new products in a manner and to an extent sufficient for it to remain competitive within its industry

As a result, in addition to enhancing its current product and solutions portfolio, the Elster Group continually strives to offer new products and design new technologies and software solutions. This requires continued investment in product and technology development to help it maintain or increase its current market position and to allow it to respond to changing customer needs. However, the Elster Group may be unable to develop or commercialise technological advances and introduce new products in a manner and to an extent sufficient for it to remain competitive within its industry. For example, the Elster Group may, among other things, lack capacity to invest the required level of human and financial resources necessary to develop these products, commit errors or misjudgments in its planning in these areas or experience difficulties in implementing rollouts. In addition, the Elster Group may not be able to meet its product development and delivery schedules as a consequence of unforeseen problems during the design or development phases of new product and technology introductions. Some of the Elster Group's new products also require certification or regulatory approval and may not be approved in a timely manner or at all. Delays of this type, or failures to obtain regulatory approval, could negatively affect the Elster Group's reputation and relationship with its customers and lead to delayed or reduced revenues for its products.

If the Elster Group fails to enhance existing products, develop new products or keep pace with developing technology, growth opportunities could be lost or it may lose existing customers. This is especially the case for its Smart Offerings, which have experienced a rapid pace of development. In addition, the Elster Group has made commitments within some existing contracts with customers, to develop and deliver new products. If the Elster Group is unable to meet these commitments, it could be subject to contractual penalties or lose the orders altogether. Delays in product development may also lead to a need for greater investments in research, design and development. If the Elster Group encounters increased costs associated with new product development and product enhancements for which it is unable to realise sufficient revenues, the costs of the related new product development may not be recoverable. Either increased costs of or decreased revenues from newly developed products, or both, could have a material adverse effect on the Enlarged Group's results of operations, business and financial condition.

35. Potential liability for defective products may result in a loss of current customers to competitors and damage to its ability to attract new customers

Product quality and performance are a priority for the Elster Group since its products are used in various industries where precise control and measurement of gas, electricity and water are essential. The Elster

Group also focused on technological platforms and systems to facilitate the proper functioning of many of its Smart Offerings as well as more advanced manual-read meters and services it sells. The Elster Group's products and solutions will not meet performance standards if it fails to produce high-quality products that perform as their specifications demand or if the technology on which the Elster Group depends for accurate metering, data storage and secure data transmission is defective. Any delivery of substandard products, or any failure of the Elster Group's meters to record accurate data or transmit recorded data in an accurate and secure manner, even if this failure results from a failure to use its meters according to their specifications, may seriously harm the Elster Group's reputation and lead to claims, resulting both in a loss of current customers to competitors and damage to its ability to attract new customers.

As is customary in the Elster Group's industry, the Elster Group's sales agreements typically contain product warranties that generally allow post-shipment obligations and returns over a period of one year or longer, depending on the particular product and market, and may provide for liquidated damages. Some warranties provide that if certain failure rates are exceeded among a production lot of meters, all the meters in the production lot may be returned. In some cases, the length of the Elster Group's warranties and guarantees may even exceed ten years. The Elster Group has recently encountered that customers are requesting longer warranty periods, and it often needs to grant longer warranty periods in order to win business. The Elster Group may be exposed to substantial warranty claims as a result of its warranty undertakings. The Elster Group may be unable to obtain proper back-to-back coverage from its sub-suppliers. The Elster Group has experienced warranty claims in the recent past relating to some of its meters and other products. The Elster Group's accruals for warranty provisions totalled \$29.7 million as of 31 December 2011. Widespread product failures, or perceptions of such failures, may damage its market reputation, reduce its market share and cause its sales to decline. Its reputation and that of its industry may also suffer if a large or high-profile rollout, whether involving its products and solutions or those of a competitor, is impacted by serious technical or other failures.

If any of the Elster Group's products proves to be defective, it may be required to effect or participate in a recall involving those products. The Elster Group may also be the subject of lawsuits seeking damages for products alleged to be defective, including in particular product liability claims in the event that the use of its products is alleged to have resulted in injury, a risk of injury or other adverse effects. Litigation, including litigation resulting from product liability claims, can be expensive to defend and can divert the attention of management and other personnel for long periods of time, regardless of the ultimate outcome of the litigation with respect to those claims. While the Elster Group currently maintains product liability insurance coverage, such insurance may not provide adequate coverage against potential claims. A successful claim brought against the Elster Group with respect to a defective product or batches of products in excess of available insurance coverage, if the Elster Group's coverage is applicable, or a requirement to participate in a major product recall, could have a material adverse effect on its reputation, results of operations, business and financial condition.

36. The Elster Group's future financial performance and success largely depend on its ability to implement its business strategies successfully

In early 2012, the Elster Board authorised a reinvestment programme, which is intended to position it to take advantage of growth opportunities associated with global gasification trends and Smart Grid deployments in Europe, as well as further optimise operational efficiencies. The Elster Group has initiated measures that began in the first quarter of 2012 to pursue this strategy, which are expected to include adapting its manufacturing footprint to create scalable regional core production centres and driving further efficiency across its segments. Key elements include consolidating operations and sites mainly in the United States and in Europe, relocating product-lines and increasing its mix of production in low-cost countries, which are intended to result in an optimization of its cost structure. Planned actions include the closure of four major facilities and the reduction of the number of its small- and mid-sized facilities.

The expenses and capital expenditures of implementing the Elster Group's reinvestment programme may be greater than it anticipates and the implementation of its reinvestment programme may be delayed as a result of, among other things, consultations with works councils and relations with its employees generally, as well as regulatory requirements.

The Elster Group may not be able to successfully implement its reinvestment programme or its other business strategies or those to be developed by its management, and implementing these strategies may not sustain or improve, and could even harm, its results of operations in targeted sectors. The Elster Group may be unable to realise the anticipated benefits and cost reductions of its reinvestment programme or its other business strategies. The Elster Group's business strategies are based on assumptions about future demand for its current products and the new products and applications it is developing, as well as on its continuing ability to produce its products profitably.

The Elster Group's ability to implement its business strategies depends on, among other things, its ability to divest businesses or discontinue product lines on favourable terms and with minimal disruptions, finance its operations and product development activities, maintain high quality and efficient manufacturing operations, relocate and close certain manufacturing facilities with minimal disruption to its operations, respond to competitive and regulatory changes, access quality raw materials in a cost-effective and timely manner, and retain and attract highly-skilled technical, managerial, marketing and finance personnel. The details of the actions to be taken and the timing of the reinvestment programme have not yet been finalised and may differ in material ways from the strategy and plans the Elster Group has announced. In addition, the reinvestment programme or the Elster Group's other business strategies could have adverse tax implications. Any failure to develop, revise or implement its business strategies, including its reinvestment programme, in a timely and effective manner could have a material adverse effect on its results of operations, business and financial condition.

PART C: Risks relating to the Melrose Group, the Elster Group and the Enlarged Group

1. The Enlarged Group's business would be affected by the uncertainties of economic conditions

As a result of the credit crisis in Europe, in particular in Greece, Italy, Ireland, Portugal and Spain, the European Commission created the European Financial Stability Facility (the "EFSF") and the European Financial Stability Mechanism (the "EFSM") to provide funding to Eurozone countries in financial difficulties that seek such support. In March 2011, the European Council agreed on the need for Eurozone countries to establish a permanent stability mechanism, the European Stability Mechanism (the "ESM"), which will be activated by mutual agreement, to assume the role of the EFSF and the EFSM in providing external financial assistance to Eurozone countries after June 2013. Although the macroeconomic environment showed further overall improvement in the first half of 2011, the development of certain economic indicators as well as the recent turbulence in the financial markets in the second half of 2011, primarily as a result of the ongoing sovereign debt crisis in the euro-zone, still indicate a highly volatile macroeconomic environment. Future macroeconomic development is dependent upon the evolution of a number of global and local factors, such as the crisis in the credit markets, economic crises arising from sovereign debt overruns, government budget consolidation measures related thereto, reduced levels of capital expenditures, declining consumer and business confidence, increasing unemployment in certain countries, fluctuating commodity prices, bankruptcies, natural disasters, political crises and other challenges affecting the speed of sustainable macroeconomic growth. Despite these measures, concerns persist regarding the debt burden of certain Eurozone countries and their ability to meet future financial obligations, the overall stability of the Euro and the suitability of the Euro as a single currency given the diverse economic and political circumstances in individual member states. These and other concerns could lead to the re-introduction of individual currencies in one or more member states, or, in more extreme circumstances, the possible dissolution of the Euro entirely. Should the Euro dissolve entirely, the legal and contractual consequences for Euro-denominated obligations would be determined by laws in effect at such time. These potential developments, or market perceptions concerning these and related issues, could adversely affect the results of operations, business and financial condition of the Melrose Group, the Elster Group and the Enlarged Group. The Melrose Group (Europe represented 24.9 per cent. of 2011 Melrose Group continuing revenues) and the Elster Group (in the years ended 31 December 2011, 2010 and 2009, the Elster Group generated revenues from products sold to Euro-zone countries of \$604.9 million, \$521.8 million and \$538.0 million respectively, which represent approximately 32.4 per cent., 29.7 per cent. and 31.7 per cent. respectively, of its total revenues for those periods) are each exposed to European markets. In addition, as of 31 December 2011, a majority of Elster's long-term debt obligations, including the Senior Notes and EUR 45 million in drawings under its revolving credit facility, were

Euro-denominated. A continued European credit crisis, unresolved concerns over the debt burden of certain Eurozone countries and any adverse developments in relation to the Euro might therefore have a negative impact on the Melrose Group, the Elster Group and the Enlarged Group.

Numerous other factors, such as fluctuations of energy and raw material prices, as well as global political conflicts, including those in the Middle East, North Africa and other regions, continue to impact macroeconomic parameters and the international capital and credit markets. The uncertainty of economic and political conditions could have a material adverse impact on the Melrose Group, the Elster Group and the Enlarged Group's business and financial condition.

2. If the Melrose Group, the Elster Group and the Enlarged Group are not successful in adapting to conditions in the markets in which they operate, they may suffer adverse effects

In light of the latest economic developments, the level of public debt in the United States, as well as in Greece, Italy and other European countries, uncertainties with respect to the stability of the Chinese economy, and the potential impact of budget consolidation measures by governments around the world, the bases for the expectations relating to the overall economic situation and specific conditions in markets relevant to the Melrose Group, the Elster Group and the Enlarged Group are subject to considerable uncertainties. If the macroeconomic environment deteriorates and the Melrose Group, the Elster Group and the Enlarged Group are not successful in adapting their production and cost structure to subsequent changes to conditions in the markets in which they operate, they may experience adverse effects that may be material to their business, financial condition, results of operations.

PART D: Risks relating to the Acquisition

1. The Tender Offer is subject to a number of conditions which may not be satisfied or waived

The completion of the Tender Offer is subject to the satisfaction (or waiver, where applicable) of a number of conditions, including:

- the passing (without material amendment) of the Transaction Resolutions at the Melrose General Meeting;
- Admission having occurred;
- the receipt of anti-trust clearances from the relevant regulatory authorities in the EU, US, Ukraine and Russia (details of which are set out in paragraph 13 of Part I (*Information on the Acquisition and Rights Issue*));
- there having been validly tendered (and not properly withdrawn) prior to the Tender Offer Expiration Date such number of Elster ADSs (and/or Elster Shares) that represent at least 75 per cent. of the total share capital of Elster as at the Tender Offer Expiration Date;
- the Elster Board having recommended (and not having withdrawn its recommendation for) the Tender Offer;
- there not being any judgment, order, decree or law (in the United States, the United Kingdom or in the Federal Republic of Germany) entered, enacted, promulgated, enforced or issued by any court or other governmental entity of competent jurisdiction or other legal restraint or prohibition in effect enjoining or otherwise preventing or materially delaying the making of the Tender Offer, the acceptance for payment of any Elster ADSs and/or Elster Shares, Melrose's or Melrose Bidco's full rights of ownership and voting of the Elster ADSs and/or Elster Shares or Melrose's or Melrose Bidco's ownership or operation of Elster;
- Elster not having breached or failed to perform certain obligations required to be performed by it under the Investment Agreement at or prior to the Tender Offer Expiration Date;
- the Investment Agreement not having been terminated in accordance with its terms; and

- the satisfaction or waiver of the other conditions of the Tender Offer, which are considered to be customary for a transaction of this nature (set out in paragraph 13 of Part I (*Information on the Acquisition and the Rights Issue*)).

The conditions relating to the approval of the Acquisition by Melrose Shareholders, clearance by the EU and US regulatory authorities, the Admission of the New Melrose Shares and the Investment Agreement not having been terminated will not be waived in whole or in part and the other conditions may be waived by Melrose Bidco.

There is no guarantee that these (or other) conditions will be satisfied (or waived, if applicable), in which case the Tender Offer will not become Effective. The conditions are set out in more detail in Part I (*Information on the Acquisition and Rights Issue*) of this document.

2. Failure to acquire 75 per cent. of Elster may affect Melrose’s ability to complete any planned post-closing structural measures

Melrose Bidco may waive the condition regarding receipt of valid tenders representing 75 per cent. of the total share capital of Elster. However, given the irrevocable agreements to tender from Rembrandt and Nachtwache (amounting to 62.17 per cent. of the total share capital of Elster on the day immediately prior to this document), Melrose Bidco will, in any case, receive valid tenders in respect of such amount.

If the Tender Offer becomes Effective with Melrose Bidco holding less than 75 per cent. of the issued share capital of Elster, Melrose cannot be certain that it, through Melrose Bidco, will control sufficient voting rights to require Elster to undertake certain corporate actions. In particular, if Melrose Bidco holds less than 75 per cent. of the issued share capital of Elster:

- (i) Melrose Bidco may not be able to put in place a domination agreement or it may be more difficult to do so. Without a domination agreement there would be certain restrictions on the ways that Elster could be integrated into the Enlarged Group (although the majority of the Elster Board would be made up of Melrose appointees): the relationship between Melrose Bidco and Elster would have to be on an arm’s length basis, the Elster Board would be required, as is generally the case with any company with a minority shareholding, to have consideration to the interests of the shareholders generally, including the minority shareholders, and Melrose Bidco would have to compensate Elster for any losses incurred if Melrose Bidco exercised its influence to undertake a disadvantageous transaction or act; and
- (ii) Melrose Bidco will not be certain of being able to remove directors from the Elster Board. However, Melrose has received undertakings from the existing Elster Directors to resign on the Tender Offer becoming Effective (but for one director who has undertaken to resign immediately on the Melrose appointee directors being appointed to the Elster Board) so that Melrose nominated directors will obtain control of the Elster Board shortly after the Tender Offer becomes Effective.

These potential restrictions may result in certain of the structural measures identified by Melrose not being obtained or being obtained over a longer period of time.

3. If Melrose Bidco fails to acquire 95 per cent. or 90 per cent. of Elster it may not be able to proceed with Squeeze-out or Merger Squeeze-out

Following the Effective Date, Melrose intends to procure, if Melrose Bidco has acquired 95 per cent. of Elster, the passing of a resolution in relation to Squeeze-out or, if Melrose Bidco has acquired more than 90 per cent. but less than 95 per cent. of Elster, entry by Melrose Bidco into a merger agreement in relation to Merger Squeeze-out or passing of a resolution in relation to Squeeze-out (both described in further detail in Part I (*Information on the Acquisition and Rights Issue*)). If Melrose Bidco fails to acquire 95 per cent. of Elster it may not be able to effect Squeeze-out and if it does not acquire 90 per cent. of Elster it may not be able to effect Merger Squeeze-out or Squeeze-out. Following the Effective Date, Melrose intends (providing it has acquired 75 per cent. of Elster) to procure entry by Melrose Bidco into a domination agreement with Melrose Bidco as the “controlling company” and Elster as the “controlled company” so that Melrose Bidco would control the management of Elster’s business affairs. Such an agreement must ensure a recurrent cash payment as compensation to minority shareholders equal to the

amount which, on the basis of past profitability and prospective profits of Elster, could be expected to be distributed to the Elster Shareholders in the future as the average profit per Elster Share if the domination had not been entered into (described in further detail in Part I (*Information on the Acquisition and Rights Issue*)). Therefore, if Melrose Bidco is unable to undertake Merger Squeeze-out or Squeeze-out and Elster has minority shareholders, Melrose may incur additional costs in relation to the payment of this sum while such minority shareholders continue to hold Elster Shares/Elster ADSs.

4. The implementation of the Acquisition may require certain structural measures in relation to Elster

In order to effectively integrate Elster into the Enlarged Group, the adoption of certain structural measures in relation to Elster may be necessary. In particular, Melrose may procure the entry by Melrose Bidco into a domination agreement pursuant to Sec. 291 et seq. of the German Stock Corporation Act with Elster as the dominated company if, following the Tender Offer becoming Effective, Melrose Bidco holds Elster ADSs and/or Elster Shares representing at least 75 per cent. of voting rights in general meetings of Elster. Details of, and the process for entering into, a domination agreement are set out in Part I (*Information on the Acquisition and Rights Issue*) of this document. If a domination agreement between Melrose Bidco and Elster is entered into, the remaining minority Elster Shareholders would have the right to either (i) receive an annual compensation payment for the share of the profits which could be expected to be distributed to them as the average profit per Elster Share, or (ii) sell their Elster Shares to Melrose Bidco for an adequate consideration. The amounts of the annual compensation payment and the consideration will be set out in the domination agreement and may be subsequently increased by a court decision or settlement in special appraisal proceedings. The implementation of a domination agreement or other structural measures may be delayed by shareholder litigation. If a domination agreement or other structural measures cannot be implemented, there would be certain restrictions on the ways that Elster could be integrated into the Enlarged Group, although the majority of the Elster Board would be made up of Melrose appointees, the relationship between Melrose Bidco and Elster would have to be on an arm's length basis, the Elster Board would be required, as is generally the case with any company with a minority shareholding, to have consideration to the interests of shareholders generally, including the minority shareholders, and Melrose Bidco would have to compensate Elster for any losses incurred if Melrose Bidco exercised its influence to cause Elster to undertake a disadvantageous transaction or act. Any such issues may adversely affect the financial position of the Enlarged Group. However, without a domination agreement being implemented, while Melrose Bidco owns Elster ADSs and/or Elster Shares representing at least 75 per cent. of voting rights, although the Elster Board would remain independent, Melrose Bidco would have *de facto* control of Elster because Melrose Bidco would be able to pass all shareholder resolutions (including those required to appoint and remove directors of Elster) to distribute dividends, to alter the articles of association of Elster, to delist Elster and to increase the capital of Elster. Under a domination agreement, Melrose Bidco would have the additional right to instruct the Elster Board to carry out Melrose Bidco's instructions (even if such instructions are not for the benefit of Elster). However, Melrose Bidco's *de facto* ability to control Elster does not depend on this right to issue binding instructions.

5. The Enlarged Group's success will be dependent upon its ability to integrate the Elster businesses; there will be numerous challenges associated with the integration

The success of the Enlarged Group is expected in part to be dependent upon its ability to integrate Elster without any significant disruption to the business of Melrose or Elster. The Enlarged Group may encounter numerous integration challenges in connection with the Acquisition, including loss of customers, suppliers and/or employees and other challenges which are not currently foreseeable. In addition, the Enlarged Group's management and resources may be diverted away from its core business activities due to personnel being required to assist in the integration process. This integration process may take longer or prove more costly than expected, or difficulties relating to the integration, of which the Melrose Board is not yet aware, may arise. This could adversely affect the implementation of the Enlarged Group's plans, and the Enlarged Group may not be successful in addressing risks or problems encountered in connection with the integration and failure to do so may adversely affect its business or financial condition.

6. The Melrose Group may not realise the desired operational improvements from the Acquisition

The Melrose Group is targeting operational improvements from the Acquisition. Achieving the advantages of the Acquisition will depend partly on the rapid and efficient management and co-ordination of the activities of Melrose and Elster, two businesses of considerable size that functioned independently and are currently located in different countries, with geographically dispersed operations and with different business cultures and compensation structures. There is a risk that operational improvements from the Acquisition may fail to materialise, or they may be materially lower than have been estimated. In addition, the cost of funding these operational improvements may exceed expectations. Such eventualities may have a material adverse effect on the financial condition of the Enlarged Group.

7. Elster may not perform in line with expectations

If the results and cash flows generated by the combination of the operations of Elster with those of the Melrose Group are not in line with the Melrose Directors' expectations, a write-down may be required against the carrying value of the Melrose Group's investment in Elster. Such a write-down may reduce the Melrose Group's ability to generate distributable reserves and consequently affect its ability to pay dividends or return capital to shareholders.

8. An impairment of goodwill or other intangible assets would adversely affect the Melrose Group's financial condition and results of operation

Upon completion of the Acquisition, a significant portion of the difference between the purchase price, Elster's net assets at that date and the allocation of costs of the combination to the assets acquired and the liabilities assumed, will be recorded as goodwill. In addition, other intangible assets will be recorded as a result of the purchase price allocation. Under IFRS, goodwill and intangible assets with indefinite lives are not amortised but are tested for impairment annually, or more often if an event or circumstance indicates that an impairment loss may have been incurred. Other intangible assets with a finite life are amortised on a straight-line basis over their estimated useful lives and reviewed for impairment whenever there is an indication of impairment. In particular if the combination of the businesses meets with unexpected difficulties, or if the business of the Melrose Group does not develop as expected, impairment charges may be incurred in the future which could be significant and which could have an adverse effect on the Melrose Group's financial condition.

The Elster Group has significant intangible assets, long-lived assets, goodwill and deferred tax assets that are susceptible to valuation adjustments as a result of changes in various factors or conditions. The Elster Group assesses impairment of amortisable intangible and long-lived assets whenever events or changes in circumstances indicate that the carrying value may not be recoverable. In addition, many asset classes are subject to impairment consideration on a periodic basis under applicable accounting rules. Factors that could trigger an impairment of such assets include the following:

- a significant underperformance relative to historical or projected future operating results;
- significant changes in the nature of or use of the acquired assets or the strategy for its overall business;
- significant negative industry or general economic trends;
- changes in the Elster Group's organization or management reporting structure could result in additional reporting units, which may require;
- alternative methods of estimating fair values or greater aggregation or disaggregation in the Elster Group's analysis by reporting unit;
- a sustained decline in its market capitalisation below net book value; and
- the harmonisation of company trademarks throughout the Elster Group's group.

The Elster Group assesses the potential impairment of goodwill as of 31 December of each year. It also assesses the potential impairment of goodwill whenever events or changes in circumstances indicate that the carrying value may not be recoverable. Adverse changes in operations or other unforeseeable factors

could result in an impairment charge in future periods that would impact results of operations in that period.

The realisation of the Elster Group's deferred tax assets related to net operating loss carry-forwards is supported by projections of future profitability. The Elster Group provides a valuation allowance based on estimates of future taxable income in the respective taxing jurisdiction and the amount of deferred taxes that are expected to be realizable. If future taxable income is different from what is expected, the Elster Group may not be able to realise some or all of the tax benefit, which may, in turn, have a material and adverse effect on its results of operations, business and financial condition.

9. The Melrose Group will have foreign exchange risk related to the purchase price for the Acquisition

The proceeds raised by Melrose pursuant to the Rights Issue will be in pounds sterling, but the payment to selling Elster ADS Holders and/or Elster Shareholders (as the case may be) pursuant to the Tender Offer will be made in US dollars. There could be a period of several months between Admission and the payment to selling Elster ADS Holders and/or Elster Shareholders pursuant to the Tender Offer, during which time the Melrose Group will therefore be exposed to the risk of a significant appreciation in the US dollar against the pound sterling. The Melrose Group has entered, or will enter, before the completion of the Tender Offer, into a currency hedge in respect of all or substantially all of the anticipated net proceeds of the Rights Issue in order to limit its total exposure to adverse currency movements in respect of the Acquisition, although there is no guarantee that such measures will be implemented or fully effective. The Melrose Group will incur additional costs in order to secure hedging for this exchange rate risk.

10. The financial results of the Melrose Group will, as a result of the Acquisition and the resulting increased portion of assets, liabilities and earnings denominated in Euros and US dollars, be more exposed to fluctuations in the exchange rate between the pounds sterling and the Euro and/or the US dollar

The Melrose Group will present its financial statements in pounds sterling and will have a significant portion of Euro and US dollar denominated assets, liabilities and earnings as a result of the significant assets and revenues of Elster across the Eurozone and in the United States. The operational and financial results as well as the equity of the Melrose Group will therefore be more sensitive to fluctuations in the exchange rate of the pound sterling against the Euro and against the US dollar than they are currently. There has been a high degree of volatility in exchange rates since the onset of the global financial crisis and this volatility has continued with the recent EU sovereign debt crisis. A depreciation of the Euro and/or the US dollar relative to the pound sterling could have an adverse impact on the consolidated financial condition and results of operation of the Melrose Group.

PART E: Risks relating to the Rights Issue and an investment in Melrose Shares

1. Investments in listed securities and possible volatility of the price of Melrose Shares

The Melrose Shares may not be a suitable investment for all the recipients of this document. Before making a final decision, investors are advised to consult an appropriate independent investment adviser authorised under FSMA (or from another appropriately authorised financial adviser) who specialises in advising on the acquisition of shares and other securities.

Prospective investors should be aware that the value of an investment in Melrose may go down as well as up.

The market price of Melrose Shares could be volatile and subject to significant fluctuations due to a variety of factors outside the control of the Melrose Group including changes in sentiment in the market regarding the Melrose Shares (or securities similar to them), any regulatory changes affecting the Melrose Group's operations, variations in the Melrose Group's operating results, business developments of the Melrose Group or its competitors, the operating and share price performance of other companies in the industries and markets in which the Melrose Group operates, speculation about the Melrose Group's business in the press, media or the investment community, changes to the Melrose Group's profit estimates or the

publication of reports by analysts and general market conditions. Stock markets have from time to time experienced significant price and volume fluctuations that have affected the market prices for securities and which may be unrelated to the Melrose Group's operating performance, underlying asset value or prospects. The market price of the Melrose Shares may be adversely affected by any of the preceding or other factors regardless of the Melrose Group's actual results of operations and financial condition. Furthermore, the Melrose Group's operating results and prospects from time to time may be below the expectations of market analysts and investors.

2. The Rights Issue is conditional on the passing of the Transaction Resolutions but is not conditional on the Tender Offer becoming Effective

It is possible that following Admission of the New Melrose Shares, nil paid, and the Rights Issue becoming wholly unconditional, the Tender Offer may not become Effective; in particular, if any of the conditions to the Tender Offer becoming Effective are not satisfied in accordance with their terms. In this case, as the Rights Issue is not conditional upon the Tender Offer becoming Effective, the Rights Issue would still be completed and funds would be raised by the Melrose Group.

In the unlikely event that the Rights Issue proceeds but the Tender Offer does not become Effective, the Melrose Directors' current intention is that the net proceeds of the Rights Issue will be invested on a short-term basis while the Melrose Directors evaluate other acquisition opportunities and, if no acquisitions can be found on acceptable terms, the Melrose Directors will consider how best to return surplus capital to Melrose Shareholders in a timely manner. Such a return could carry fiscal costs for certain Melrose Shareholders. The Underwriters' obligations under the Underwriting Agreement are conditional (although certain of these conditions can be waived) but are unconditional from Admission.

3. An active trading market in Nil Paid Rights may not develop on the London Stock Exchange

An active trading market in the Nil Paid Rights may not develop on the London Stock Exchange during the trading period. In addition, because the trading price of the Nil Paid Rights depends on the trading price of the Melrose Shares, the Nil Paid Rights price may be volatile and subject to the same risks as noted in paragraph 1 above. The existing volatility of the Melrose Shares may also magnify the volatility of the Nil Paid Rights.

4. Melrose Shareholders who do not take up their rights in full will experience dilution in their ownership

If Melrose Shareholders do not take up the offer of New Melrose Shares under the Rights Issue their proportionate ownership and voting interests in the Melrose Group will be reduced and the percentage that their Melrose Shares will represent of the total share capital of the Melrose Group will be reduced accordingly. Even if a Melrose Shareholder elects to sell its unexercised Nil Paid Rights, or such Nil Paid Rights are sold on its behalf, the consideration it receives may not be sufficient to compensate it fully for the dilution of its percentage ownership of the Melrose Group's share capital that may be caused as a result of the Rights Issue.

5. If there is a substantial decline in the price of the Melrose Shares, the Nil Paid Rights may become worthless

The public trading market price of the Melrose Shares may decline below the subscription price for the New Melrose Shares. Should that occur after investors exercise their rights in the Rights Issue, investors will suffer an immediate unrealised loss as a result. Following the exercise of rights, such investors may be unable to sell New Melrose Shares at a price equal to or greater than the subscription price.

After Admission, any obligation of the Underwriters to subscribe for, or of the Underwriters to procure investors to subscribe for any New Melrose Shares pursuant to the terms of the Underwriting Agreement shall be incapable of termination. Melrose Shareholders who decide not to exercise their rights may also sell or transfer their Nil Paid Rights. If the public trading market price of the Melrose Shares declines below the subscription price for the New Melrose Shares, investors who have acquired any such Nil Paid Rights in the secondary market will suffer a loss as a result.

6. Any future Melrose Share issues and sales of Melrose Shares by major Melrose Shareholders may have an adverse effect on the market price of the Melrose Shares

The Melrose Group has no current plans for a subsequent offering of Melrose Shares. However, it is possible that the Melrose Group may decide to offer additional Melrose Shares in the future. An additional offering or a significant sale of Melrose Shares by any major Melrose Shareholder could have an adverse effect on the market price of the outstanding Melrose Shares.

7. The take up of Nil Paid Rights under the Rights Issue will not be available to any Melrose Shareholders with an address in, or who are located in, the United States or any other Excluded Territories in the absence of an available exemption from relevant securities laws

The take up of Nil Paid Rights under the Rights Issue will not be available to any Melrose Shareholder with an address in, or who is located in, the United States or other Excluded Territory in the absence of an available exemption from relevant securities laws. If a Qualifying Shareholder is not able to take up Rights granted in respect of Existing Melrose Shares under the Rights Issue, then it may not receive the economic benefit of such Rights because there is no assurance that the procedure in respect of Rights not taken up, described in Part XII (*Terms and Conditions of the Rights Issue*) of this document, will be successful in either selling the Nil Paid Rights or in respect of the prices obtained.

8. Investors may not receive compensation for expired and unexercised Rights

The subscription period for the New Melrose Shares being offered in the Rights Issue is expected to commence on 17 July 2012 and is expected to expire on 31 July 2012. If an investor fails to exercise its Rights prior to the end of the subscription period, then it may not receive the economic benefit of such Rights because there is no assurance that the procedure in respect of Rights not taken up, described in Part XII (*Terms and Conditions of the Rights Issue*) of this document will be successful in either selling the Nil Paid Rights, or in respect of the prices obtained.

9. The Melrose Group's ability to continue to pay dividends on the Melrose Shares will depend on the availability of distributable reserves

The Melrose Group's ability to pay dividends is limited under English company law, which limits a company to only paying dividends to the extent that it has distributable reserves available for this purpose. As a holding company, the Melrose Group's ability to pay dividends in the future is affected by a number of factors, principally its ability to receive sufficient dividends from subsidiaries and, until the EGSE Guarantee Date, restrictions in the New Facilities Agreement. The payment of dividends to the Melrose Group by its subsidiaries is, in turn, subject to restrictions, including certain regulatory requirements and the existence of sufficient distributable reserves in such subsidiaries. The ability of these subsidiaries to pay dividends and the Melrose Group's ability to receive distributions from its investments in other entities is subject to applicable local laws and regulatory requirements and other restrictions, including, but not limited to, applicable tax laws and restrictions in some of the Melrose Group's debt facilities. These laws and restrictions could limit the payment of future dividends and distributions to the Melrose Group by its subsidiaries, which could restrict the Melrose Group's ability to pay a dividend to holders of the Existing Melrose Shares or the New Melrose Shares.

10. Exchange rate fluctuations may impact the price of Melrose Shares or the value of any dividends paid

The Melrose Shares, and any dividends to be announced in respect of such shares, will be quoted in pounds sterling. An investment in Melrose Shares by an investor in a jurisdiction whose principal currency is not pounds sterling exposes the investor to foreign currency rate risk. Any depreciation of the pound sterling in relation to such foreign currency will reduce the value of the investment in the Melrose Shares in foreign currency terms and may adversely impact the value of any dividends.

11. Holders of Melrose Shares outside the United Kingdom may not be able to participate in future equity offerings

English law provides for pre-emptive rights generally to be granted to the Melrose Shareholders, unless such rights are disapplied by shareholder resolution. However, Melrose Shareholders outside the United Kingdom may not be entitled to exercise these rights. US holders of shares are customarily excluded from exercising any such pre-emption rights they may have unless a registration statement under the US Securities Act is effective with respect to those rights, or an exemption from the registration requirements or similar requirements in other jurisdictions thereunder is available. The Melrose Group has no current intention to file any such registration statement, and cannot assure prospective investors that any exemption from the registration requirements would be available to enable US or other overseas holders to exercise such pre-emption rights or, if available, that it will utilise any such exemption.

CAUTIONARY NOTE ON FORWARD LOOKING STATEMENTS

Certain statements contained in this document, including those in the parts headed “Summary”, “Risk Factors”, “Information on the Acquisition”, “Information on Elster” and “Information on Melrose”, constitute “forward-looking statements”. In some cases, these forward-looking statements can be identified by the use of forward-looking terminology, including the terms “believes”, “continues”, “estimates”, “plans”, “prepares”, “anticipates”, “expects”, “intends”, “aims”, “may”, “will” or “should” or, in each case, their negative or other variations or comparable terminology. Investors should specifically consider the factors identified in this document which could cause actual results to differ before making an investment decision. Undue reliance should not be placed on any forward-looking statements as such forward-looking statements involve known and unknown risks, uncertainties and other factors, which may cause the actual results, performance or achievements of Elster, Melrose, the Elster Group, the Melrose Group and/or the Enlarged Group, or industry results, to be materially different from any future results, performance or achievements expressed or implied by such forward-looking statements. Undue reliance should not be placed on any forward-looking statements as such forward-looking statements are based on numerous assumptions regarding Elster’s, Melrose’s, the Elster Group’s, the Melrose Group’s and/or the Enlarged Group’s present and future business strategies and the environment in which Elster, Melrose, the Elster Group, the Melrose Group and/or the Enlarged Group will operate in the future. Among the factors that could cause actual results to differ materially from those described in the forward-looking statements are the ability to combine successfully the business of Melrose and Elster and to realise expected synergies from that potential combination, changes in the global political, economic and/or business sphere, competitive, market and regulatory forces, future exchange and interest rates, changes in tax rates and future business combinations or dispositions. Such risks, uncertainties and other factors are set out more fully in the section of this document headed “Risk Factors” and include, among others: risks relating to commodity prices, risks relating to the economic conditions of the markets in which the Melrose Group and Elster Group operate, challenges in integrating the businesses of the Melrose Group and the Elster Group and risks relating to the possible volatility of the price of Melrose Shares. These forward-looking statements speak only as at the date of this document. Except as required by the FSA, the London Stock Exchange or applicable law (including as may be required by the Prospectus Rules, Listing Rules and the Disclosure and Transparency Rules), Melrose expressly disclaims any obligation or undertaking to release publicly any updates or revisions to any forward-looking statements contained in this document to reflect any change in its expectations with regard thereto or any change in events, conditions or circumstances on which any such statement is based.

Forward-looking statements contained in this document do not in any way seek to qualify the working capital statement contained in paragraph 8 of Part XIII (*Additional Information*) of this document.

EXPECTED TIMETABLE OF PRINCIPAL EVENTS⁽¹⁾

Each of the times and dates in the table below is indicative only and may be subject to change.

Announcement of the Acquisition and Rights Issue	29 June 2012
Publication of this document, posting of the Circular, the Notice of General Meeting and the Form of Proxy	29 June 2012
Tender Offer commences in the US when the Tender Offer Document is filed with the US Securities and Exchange Commission	On or about 6 July 2012
Elster to file Recommendation Statement on Schedule 14D-9, in which the Elster Board recommends acceptance of the Tender Offer ⁽²⁾	On or about 6 July 2012
Rights Issue Record Date	close of business on 12 July 2012
Latest time and date for receipt of Forms of Proxy	10.00 a.m. on 12 July 2012
Melrose General Meeting	10.00 a.m. on 16 July 2012
Despatch of Provisional Allotment Letters (to Qualifying non-CREST Shareholders only) ⁽³⁾	16 July 2012
Publication of notice in the London Gazette	17 July 2012
Existing Melrose Shares marked “ex” by the London Stock Exchange	8.00 a.m. on 17 July 2012
Dealings (for normal settlement) in New Melrose Shares, nil paid, commence on the London Stock Exchange	8.00 a.m. on 17 July 2012
Nil Paid Rights credited to stock accounts in CREST (Qualifying CREST Shareholders only) ⁽³⁾	as soon as practicable after 8.00 a.m. on 17 July 2012
Nil Paid Rights and Fully Paid Rights enabled in CREST	as soon as practicable after 8.00 a.m. on 17 July 2012
Recommended latest time for requesting withdrawal of Nil Paid Rights and Fully Paid Rights from CREST (i.e., if your Nil Paid Rights and Fully Paid Rights are in CREST and you wish to convert them to certificated form)	4.30 p.m. on 25 July 2012
Latest time for depositing renounced Provisional Allotment Letters, nil or fully paid, into CREST or for dematerialising Nil Paid Rights or Fully Paid Rights into a CREST stock account (i.e. if your Nil Paid Rights and Fully Paid Rights are represented by a Provisional Allotment Letter and you wish to convert them to uncertificated form)	3.00 p.m. on 26 July 2012
Latest time and date for splitting Provisional Allotment Letters, nil or fully paid	3.00 p.m. on 27 July 2012
Latest time and date for acceptance, payment in full and registration of renunciation of Provisional Allotment Letters	11.00 a.m. on 31 July 2012
Results of Rights Issue to be announced through a Regulatory Information Service	by 8.00 a.m. on 1 August 2012
Dealings in New Melrose Shares, fully paid, commence on the London Stock Exchange	by 8.00 a.m. on 1 August 2012

New Melrose Shares credited to CREST accounts	as soon as practicable after 8.00 a.m. on 1 August 2012
Despatch of definitive share certificates for the New Melrose Shares in certificated form	by no later than 8 August 2012
Tender Offer Expiration Date	expected to be during August 2012
Announcement of the Tender Offer results and acceptance of the Elster ADSs and/or Elster Shares tendered in the Tender Offer ⁽⁴⁾	Promptly after the Tender Offer Expiration Date

Notes:

- (1) The times and dates set out in the expected timetable of principal events above and mentioned throughout this document may be adjusted by Melrose and/or Melrose Bidco in consultation with J.P. Morgan, JPMSL, Investec, Barclays, HSBC and RBC in which event details of the new times and dates will be notified to the UKLA, the London Stock Exchange and, where appropriate, Qualifying Shareholders.
- (2) Note: Required to be filed within 10 business days after the commencement of the tender offer, but is usually filed on the same date the Tender Offer is commenced.
- (3) Subject to certain restrictions relating to Qualifying non-CREST Shareholders with registered addresses outside the EEA, details of which are set out in paragraph 7 of Part XII (*Terms and Conditions of the Rights Issue*) of this document.
- (4) Acceptance of the Elster ADSs and/or Elster Shares tendered in the Tender Offer assumes all conditions to the Tender Offer have been satisfied or waived by Melrose Bidco.

INDICATIVE SHARE CAPITAL AND RIGHTS ISSUE STATISTICS

Rights Issue Price per New Melrose Share	142 pence
Basis of Rights Issue	2 New Melrose Shares for every 1 Existing Melrose Share
Number of Melrose Shares in issue at the Latest Practicable Date ..	422,209,012
Number of New Melrose Shares to be provisionally allotted pursuant to the Rights Issue ⁽¹⁾	844,418,024
Number of Melrose Shares in issue immediately following the completion of Rights Issue ⁽¹⁾	1,266,627,036
New Melrose Shares as a percentage of the enlarged issued share capital of Melrose immediately following completion of the Rights Issue ⁽²⁾	66.7 per cent.
Estimated gross proceeds of the Rights Issue	£1,199 million
Estimated expenses of the Rights Issue and the Acquisition	£70 million
Estimated net proceeds of the Rights Issue receivable by Melrose, after deduction of estimated expenses of the Rights Issue	£1,171 million

Notes:

- (1) On the assumption that no further Melrose Shares are issued from the date of this document until completion of the Rights Issue other than the New Melrose Shares. The actual number of New Melrose Shares to be issued under the Rights Issue will be subject to rounding to eliminate fractions.
- (2) Based on the maximum number of New Melrose Shares being issued under the Rights Issue.

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PART I

INFORMATION ON THE ACQUISITION AND RIGHTS ISSUE

The selected historical financial information in relation to Melrose in this Part I (Information on the Acquisition and Rights Issue) has, unless otherwise stated, been extracted without material adjustment from the audited consolidated financial statements of the Melrose Group in the annual report and accounts of Melrose for the financial years ended 31 December 2011, 31 December 2010 and 31 December 2009, as referred to in Part VI (Historical Financial Information Relating to Melrose) of this document, each of which has been prepared in accordance with IFRS.

The selected historical financial information in relation to Elster in this Part I (Information on the Acquisition and Rights Issue) has, unless otherwise stated, been extracted without material adjustment from (i) the audited consolidated financial statements of the Elster Group for the financial years ended 31 December 2011, 31 December 2010 and 31 December 2009 and (ii) the Elster unaudited first quarter results announcement published on 4 May 2012 as referred to in Part VII (Historical Financial Information Relating to Elster) of this document, each of which has been prepared in accordance with US GAAP.

Investors should read the whole of this document and the documents incorporated herein by reference and should not just rely on the financial information set out in this Part I (Information on the Acquisition and Rights Issue).

1. Introduction

Today the Boards of Melrose and Elster announced that they had reached agreement on the terms of a recommended proposal whereby Melrose Bidco, a wholly owned subsidiary of Melrose will acquire for cash the entire issued ordinary share capital of Elster. The Acquisition will be implemented principally by way of a US tender offer to Elster ADS Holders and Elster Shareholders at a price of \$20.50 per Elster ADS or \$82 per Elster Share (as the case may be) (approximately \$2.3 billion, or £1.5 billion⁽⁷⁾, in aggregate) which will be commenced on or about 6 July. Elster is one of the world's largest providers of gas, electricity and water meters, gas utilisation products and related communications, networking and software solutions. Elster is a European public limited liability company (*Societas Europaea*) with its registered seat in Essen, Germany. Elster ADSs are traded on the NYSE (each Elster ADS represents one fourth of one Elster Share). The Acquisition represents a significant opportunity for Melrose to execute its strategy of acquiring specialised industrial businesses and maximising the value inherent in those businesses. Subject to the satisfaction or, where appropriate, waiver of the conditions of the Tender Offer, it is expected that the Tender Offer will become Effective during August 2012.

2. Reasons for the Acquisition

Melrose's track record is built on the twin cores of Melrose's strategy of acquiring high quality manufacturing businesses with exposure to strong end markets which have the opportunity to be developed. Once it has achieved its strategy it will realise value and return this to shareholders. Melrose believes that this is particularly relevant in the current economic climate. The proposed acquisition of Elster fits well with this strategy.

Melrose believes that Elster is a good manufacturing business with further potential, which serves strong end markets with attractive long term demand drivers such as growing global energy demand, energy efficiency and conservation and the replacement cycle. Moreover, Elster has good revenue visibility with an order book of approximately four months⁽⁸⁾, contracted future revenues of seven months⁽⁸⁾ and low dependence on any single customer.

Elster has leading positions in attractive markets

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.

(7) Based on an exchange rate of £1.00=\$1.55 on 28 June 2012.

(8) As of 31 March 2012.

Elster generated revenues of \$1,869 million in 2011 from providing products and solutions for use in residential, commercial and industrial end markets, as well as transmission and distribution applications, and has one of the most extensively installed meter bases in the world. Elster's products and solutions measure and control the supply of electricity, gas and water in traditional and "Smart Grid" markets in 130 countries worldwide, and in total Elster has deployed more than 200 million meters over the course of the last decade.

Elster has leading market positions in its core product categories: gas, the highest margin sector, where Elster is number one globally, and electricity and water where Elster is in the top three globally. Elster's strong incumbent position in these markets and its breadth of product and technology solutions provides the ability for Elster to generate attractive growth and returns. Furthermore it is well placed to benefit from the growth in its end markets, driven by ongoing developments and needs for improved efficiency, closer regulation, better customer service, greater functionality and energy conservation.

Further opportunities to develop Elster's business and improve efficiency

The Melrose Board believes there are further business development opportunities for Elster as well as an opportunity to improve efficiency, both of which are expected to improve Elster's financial performance. The Melrose Board believes through its experience it can assist the operational management of Elster to improve the financial performance of Elster.

(i) Business development opportunities

Melrose plans to support Elster's management team to grow the Elster business to its fullest potential, in accordance with a business plan to be agreed with the Elster management team. Melrose has a great track record of working with management teams to develop such plans and deliver top tier operational performance from its investments. The Melrose Board believes similar opportunities are available at Elster.

The Melrose Board believes there are two main drivers for future growth. The first is the global growth in gas, driven in particular by new gas production and distribution coming on-line, will result in Elster's Gas division growing significantly over the medium term. Elster's Gas division represented 57.7 per cent. of its 2011 revenues and Elster operates across the entire value chain in gas, from upstream extraction, through midstream (transmission and storage) through downstream (distribution, commercial and industrial and residential) (representing approximately three-quarters of Elster's Gas division) and finally through to the utilisation of gas in the home or industry (representing approximately one-quarter of Elster's Gas division).

In addition there is a rising level of adoption of smart meters which offer increased efficiency and accuracy to both customers and suppliers of gas, electricity and water. Elster should benefit across its gas, water and electricity product classes from the deployment of smart meters but this is expected to be a particularly strong driver of growth for the electricity business. Smart products are higher value products giving scope for accelerated revenue growth and, potentially, margin expansion. Currently the proportion of Elster's revenues derived from Smart products is 27 per cent. and the Melrose Board believes this can grow.

The Melrose Board has identified a number of opportunities to invest and develop the Elster business. These include investment in operations; investment in smart metering technology to ensure technology leadership; investment in new product development, for example polymer products in water; and investment in bolt-on acquisitions.

(ii) Elster's previously announced reinvestment programme and listed company cost saving

In the first quarter of the 2012 financial year, the Elster Board authorised a reinvestment programme which was intended to position Elster to take advantage of growth opportunities associated with global gasification trends and Smart Grid deployments in Europe, and further optimise operational improvements. Planned actions included consolidating operations and sites, mainly in North America and Europe, relocating certain product-lines to other existing Elster operations, increasing the mix of production in low-cost countries and improving the financial performance of Elster's water business unit. The planned consolidation of operations included the proposed closure of four major facilities and a reduction in the number of small- and mid-sized facilities. In addition, the programme included the consolidation of some administrative functions, particularly across finance, procurement and human

resources. The programme commenced in the first quarter of 2012 and is expected to continue through to 2014.

The total costs expected to be incurred were in the range of \$40 million to \$60 million from 2012 financial year to 2014 financial year, with \$20 million to \$35 million to be incurred in 2012 financial year. Approximately 70 per cent. of these costs were related to severance and retention costs, with the remainder relating to operation and product line transportation, relocation costs and other exit costs. Estimated recurring annual cost savings of approximately \$40 million were expected, starting in the 2014 financial year.

The Melrose Board has significant experience of successfully executing restructuring and reinvestment programmes on plan, on time and on budget and this programme has the Melrose Board's support. Consequently Melrose looks forward to working with the Elster team to maximise the efficiencies and gains to be made through this programme while potentially identifying additional areas of operational improvement.

In addition, as a company listed in the United States, Elster has significant costs related to its listing. By cancelling Elster's ADS listing in the United States and becoming a part of the Enlarged Group, Elster's management would be able to further enhance its focus on growing the business and reducing the costs associated with maintaining a listing in the United States.

3. Terms of the Acquisition

Pursuant to the Tender Offer, which will be on the terms and subject to the conditions set out in the Tender Offer Document, Elster ADS Holders/Elster Shareholders, as the case may be, will receive:

for each Elster ADS	\$20.50 in cash
for each Elster Share	\$82 in cash

Melrose Bidco's offer is for the entire issued ordinary share capital of Elster. Any Elster ADSs or Elster Shares acquired by Melrose Bidco pursuant to the Tender Offer may be cancelled (and the underlying Elster Shares withdrawn from the ADS Depository) at any time except (i) when temporary delays arise because (1) the ADS Depository and/or Elster has closed its respective transfer books; (2) the transfer of Elster Shares is blocked to permit voting at a shareholders' meeting of Elster; or (3) Elster is paying a dividend on Elster Shares, (ii) if Melrose Bidco owes money to the ADS Depository to cover (a) its fees or charges or (b) any applicable taxes and/or governmental charges payable in connection with such cancellation, or (c) when it is necessary to prohibit withdrawals in order to comply with any laws or governmental regulations that apply to ADSs or to the withdrawal of ordinary shares or other deposited securities. The Melrose Board intends to procure the cancellation of the Elster ADSs acquired by Melrose Bidco pursuant to the Tender Offer and to withdraw the underlying Elster Shares as soon as possible following the Effective Date. Following the Tender Offer becoming Effective, Melrose Bidco will have the ability to take steps to pursue a delisting of Elster ADSs from the NYSE.

If the Tender Offer becomes Effective and Melrose Bidco has received valid tenders representing less than 100 per cent. of the Elster ADSs (and/or the Elster Shares), Melrose Bidco may acquire further Elster ADSs (and/or Elster Shares) by way of (i) further offer(s) which may be required by law in connection with delisting the Elster ADSs from the NYSE, implementing a domination agreement or implementing Squeeze-out or Merger Squeeze-out at such price(s) as may be required by applicable law, and/or (ii) further offer(s) or purchases of Elster ADSs (and/or Elster Shares).

A summary of the conditions to the completion of the Tender Offer is set out in paragraph 12 below.

The proposed acquisition values the entire issued ordinary share capital of Elster at approximately \$2.3 billion (£1.5 billion⁽⁹⁾), and the \$20.50 per Elster ADS to be offered pursuant to the Tender Offer represents a premium of approximately 48.6 per cent. to the price of an Elster ADS on 11 June 2012, the last Business Day prior to speculation that Rembrandt was considering a sale of its Elster ADSs (and/or Elster Shares) and approximately 44.3 per cent. to the average price of an Elster ADS in the six month period ending on 11 June 2012.

(9) Based on an exchange rate of £1.00=\$1.55 on 28 June 2012.

Pursuant to the Tender Offer, Melrose Bidco will acquire good and unencumbered title to the Elster ADSs and Elster Shares tendered, free and clear of all liens, restrictions, charges and encumbrances and not subject to any adverse claims.

The Tender Offer Document will be filed with the SEC promptly after the date of this document with no material changes to the terms and conditions contained in the Tender Offer set out in this Part I (*Information on the Acquisition and the Rights Issue*).

The Tender Offer is conditional on, among other things, there having been validly tendered (and not properly withdrawn) prior to the Tender Offer Expiration Date, such number of Elster ADSs (and/or Elster Shares) that represent at least 75 per cent. of the total share capital of Elster as at the Tender Offer Expiration Date.

If, on the Tender Offer becoming Effective, Melrose Bidco holds less than 100 per cent. of all Elster ADSs and Elster Shares, Melrose Bidco has the ability, following the Tender Offer Expiration Date subject to applicable laws, to acquire further Elster ADSs and/or Elster Shares (at the same or at a higher or lower price per Elster ADS or Elster Share (as the case may be) than under the Tender Offer) (i) by way of an on, or off market purchase, (ii) by way of a subsequent tender offer, (iii) pursuant to an offer to minority shareholders in the course of delisting the Elster ADSs from the NYSE or concluding a domination agreement with Elster (as described below), or (iv) pursuant to an offer to minority shareholders in the course of effecting a squeeze-out (as described below).

Accordingly, even if Elster Shares and/or Elster ADSs representing less than 75 per cent. of the issued share capital of Elster are tendered to Melrose Bidco pursuant to the Tender Offer, Melrose Bidco may still purchase sufficient additional Elster ADSs and/or Elster Shares to give it ownership of 75 per cent. or more of Elster's share capital.

Following the Effective Date, if the number of Elster ADSs (and/or Elster Shares) validly tendered (and not withdrawn) is less than the threshold required to implement Merger Squeeze-out or Squeeze-out, as the Directors consider fit, Melrose intends to procure the entry by Melrose Bidco into a domination agreement with Melrose Bidco as the "controlling company" and Elster as the "controlled company". Entering into a domination agreement requires, among other things, the consent of at least 75 per cent. of shareholders voting at a general meeting of Elster. Such agreement would become effective upon registration in the commercial register of the local court in Essen, Germany. Pursuant to a domination agreement, the controlled company submits itself to the direction of the controlling company. Melrose Bidco would be authorised to issue binding orders to the Elster Board and would thereby control the management of its business affairs. A domination agreement must ensure a recurrent cash payment ("**Guaranteed Dividend**") as compensation for the minority shareholders. The amount of the Guaranteed Dividend is determined by the parties to the domination agreement and reviewed by a court-appointed expert auditor. The Guaranteed Dividend will be equal to the amount which, on the basis of the past profitability and prospective profits of Elster, could be expected to be distributed to the Elster Shareholders in the future as the average profit per Elster Share if the domination agreement had not been entered into. This calculation will be based on a determination of the value of Elster at the time of the general shareholders' meeting of Elster adopting the domination agreement. The Guaranteed Dividend would be payable annually if and to the extent the domination agreement remains effective and minority shareholders then exist. In addition, entering into a domination agreement would oblige Melrose Bidco to offer to acquire all outstanding Elster Shares belonging to minority shareholders in exchange for payment of "fair cash compensation". For the determination of "fair cash compensation," see below.

Without a domination agreement being implemented, while Melrose Bidco owns Elster ADSs and/or Elster Shares representing at least 75 per cent. of voting rights although the Elster Board would remain independent, Melrose Bidco would have *de facto* control of Elster because Melrose Bidco would be able to pass all shareholder resolutions (including those required to appoint and remove directors of Elster) to distribute dividends, to alter the articles of association of Elster, to delist Elster and to increase the capital of Elster. Under a domination agreement, Melrose Bidco would have the additional right to instruct the Elster Board to carry out Melrose Bidco's instructions (even if such instructions are not for the benefit of Elster). However, Melrose Bidco's *de facto* ability to control Elster does not depend on this right to issue binding instructions.

If, following the Effective Date, Melrose Bidco owns 95 per cent. or more of the Elster Shares, Melrose intends to procure the passing of a resolution of Elster Shareholders pursuant to Sections 327a et seq. of the German Stock Corporation Act requiring transfer of the Elster Shares held by the minority Elster Shareholders to Melrose Bidco in exchange for fair cash compensation (the “**Squeeze-out**”). The Elster Shares held by the minority Elster Shareholders will be transferred to Melrose Bidco (as the majority Elster Shareholder) upon registration in the commercial register of the local court in Essen, Germany.

In addition, if following the Effective Date, Melrose Bidco owns 90 per cent. or more of the Elster Shares, Melrose may procure the entry into a merger agreement between Elster and Melrose Bidco followed by a squeeze-out resolution of Elster Shareholders pursuant to Section 62 para. 5 of the German Transformation Act, to be adopted within a three month period after the entry into the merger agreement between Elster and Melrose Bidco. As a consequence of such squeeze-out resolution, the Elster Shares held by the minority Elster Shareholders will be transferred to Melrose Bidco in exchange for fair cash compensation (the “**Merger Squeeze-out**”). The Elster Shares held by the minority Elster Shareholders will be transferred to Melrose Bidco (as the majority Elster Shareholder) upon registration in the commercial register of the local court in Essen, Germany. The merger of Elster into Melrose Bidco will become effective immediately thereafter.

If fair cash compensation is required to be paid, it will be determined based on the value of Elster as of the date of the Elster shareholder resolution authorising the action and reviewed by an expert auditor appointed by the German court. The expert auditor would determine the value per Elster Share on a discounted earnings method based on the IDW S1 valuation standard as amended 2 April 2008. If the three-month-average price of the Elster ADSs (reflecting that one Elster ADS represents one-fourth of one Elster Share) for the three month period prior to the shareholders’ meeting deciding on the measure, insofar as such price is representative, exceeds the compensation amount determined with the discounted earnings method, then this value is to be paid as the compensation amount. The amount of fair cash compensation could be equal to the Offer Price (as adjusted to reflect that one Elster ADS represents one-fourth of one Elster Share), but could also be higher or lower.

If Melrose Bidco holds less than 75 per cent. of the total share capital of Elster, Melrose will nevertheless obtain board control of Elster shortly after completion of the Tender Offer because Melrose has entered into arrangements with Elster and the existing Elster Directors pursuant to which all except one of the existing Elster Directors will resign on the Tender Offer becoming Effective and the remaining existing Elster Director will (subject to applicable law) resign immediately on the Melrose appointee directors being appointed to the Elster Board. Pursuant to these arrangements, an application for the appointment of the Melrose appointee directors to the Elster Board will be filed with the local court of Essen by the sole remaining existing Elster Director on the day on which the Tender Offer becomes Effective (following the resignations of the other existing Elster Directors) (or the next trading day) and it is expected that these appointments will be made within five Business Days of such application. At such time, Melrose will obtain control of the Elster Board.

However, if Melrose Bidco holds less than 75 per cent. of the total share capital of Elster it may not be able to enter into a domination agreement pursuant to Sec. 291 et seq. of the German Stock Corporation Act and there would be certain restrictions on the ways that Elster could be integrated into the Enlarged Group (although the majority of the Elster Board would be made up of Melrose appointees): the relationship between Melrose Bidco and Elster would have to be on an arm’s length basis, the Elster Board would be required, as is generally the case with any company with a minority shareholding, to have consideration to the interests of the shareholders generally, including the minority shareholders, and Melrose Bidco would have to compensate Elster for any losses incurred if Melrose Bidco exercised its influence to undertake a disadvantageous transaction or act.

4. Financing of the Acquisition and Use of Proceeds

The Acquisition and associated expenses will be funded through a combination of new debt and new equity, approximately: \$1,816 million (£1,171 million⁽¹⁰⁾) from the total net proceeds of the fully underwritten Rights Issue and \$498 million (£321 million⁽¹⁰⁾) from the proceeds of loans under the term

(10) Based on an exchange rate of £1.00=\$1.55 on 28 June.

facility and the revolving credit facility under the New Facilities Agreement which has been entered into with the Company's relationship banks. The revolving credit facility will also be used (i) by Melrose to finance the Melrose Group's working capital requirements and for general corporate purposes (including refinancing existing indebtedness under the Existing Facilities Agreement or otherwise, and for financing acquisitions) and (ii) after the Effective Date (provided Elster and/or the relevant member of the Elster Group has acceded to the New Facilities Agreement as a borrower), by the Elster Group, to finance its working capital requirements and for general corporate purposes (including if required, refinancing existing indebtedness, whether under the Senior Notes, the Elster RCF or otherwise, and for financing future acquisitions). The Rights Issue has been fully underwritten on the basis set out in the Underwriting Agreement. Details of the terms of the New Facilities Agreement and the Underwriting Agreement are set out in paragraphs 11.1.2 and 11.1.1, respectively, of Part XIII (*Additional Information*) of this document.

Melrose has always looked to maintain a prudent level of gearing (calculated as net debt divided by headline operating profit before depreciation and amortisation) in order to provide it with the flexibility to invest in its businesses. Therefore, to fund the Acquisition, in addition to new debt, Melrose intends to raise new equity. The Melrose Board, taking into account, *inter alia*, the size of the fundraising relative to the current market capitalisation of Melrose and to maintain pre-emption rights of Melrose Shareholders, believes the most appropriate method to do this is by way of a rights issue.

5. Principal Terms of the Rights Issue

Melrose proposes to raise approximately £1.2 billion (net of commissions), by way of a fully underwritten Rights Issue of up to 844,418,024 New Melrose Shares. The Rights Issue Price of 142 pence per New Melrose Share, which is payable in full on acceptance by not later than 11.00 a.m on 31 July 2012, represents a 61.5 per cent. discount to the Closing Price of 368.7 pence per Existing Melrose Share on 28 June 2012 (being the last trading day prior to the publication of this document) and a 34.7 per cent. discount to the theoretical ex-rights price of 217.6 pence per New Melrose Share calculated by reference to the Closing Price on the same day. If a Qualifying Shareholder does not take up any of his entitlement to New Melrose Shares, his proportionate shareholding will be diluted by 66.7 per cent. However, if a Qualifying Shareholder takes up his Rights in full, he will, after the Rights Issue has been completed and excluding any fraction of an Ordinary Share, as nearly as practicable have the same proportionate voting rights and entitlements to dividends as he has on the Record Date.

If a Qualifying Shareholder does not subscribe for the New Melrose Shares to which he is entitled, such Shareholder can instead sell his rights to those New Melrose Shares and receive the net proceeds in cash. This is referred to as dealing in the rights "nil paid" and, subject to the fulfillment of certain conditions, dealings (for normal settlement) on the London Stock Exchange in the Nil Paid Rights are expected to commence at 8.00 a.m. on 17 July 2012. If a Qualifying Shareholder does not wish to take up his rights, he does not have to take any action and the Underwriters will use all reasonable endeavours to find investors to take up such rights at the end of the Rights Issue offer period. If the Underwriters find investors and are able to achieve a premium over the Rights Issue Price and the related expenses of procuring those investors (including any applicable brokerage and commissions and amounts in respect of VAT which, in the reasonable opinion of the Underwriters, are not recoverable), such Qualifying Shareholder will be sent a cheque for the amount of that aggregate premium above the Rights Issue Price less related expenses (including any applicable brokerage and commissions and amounts in respect of VAT which, in the reasonable opinion of the Underwriters, are not recoverable), so long as the amount in question is at least £5.

Subject to the fulfillment of, amongst others, the conditions set out below, the Company proposes to offer by way of this document, New Melrose Shares pursuant to the Rights Issue to Qualifying Shareholders on the following basis:

2 New Melrose Shares at 142 pence each for every 1 Existing Melrose Share

held by Qualifying Shareholders on the Record Date. Holdings of Existing Melrose Shares in certificated and uncertificated form will be treated as separate holdings for the purpose of calculating entitlements

under the Rights Issue. Fractional entitlements to New Melrose Shares will not be allotted and, where necessary, entitlements will be rounded down to the nearest whole number of New Melrose Shares.

The New Melrose Shares will, when issued and fully paid, rank *pari passu* in all respects with the Existing Melrose Shares, including the right to receive in full all dividends and other distributions declared, made or paid by reference to a record date after the date of their issue. Melrose Shares including the New Melrose Shares may be held in certificated or uncertificated form.

The Rights Issue is conditional upon, amongst other things:

- the passing (without material amendment) of the Transaction Resolutions at the Melrose General Meeting;
- the Underwriting Agreement having become unconditional in all respects (save for the condition relating to Admission) and not having been terminated in accordance with its terms; and
- Admission having occurred by not later than 8.00 a.m. on 17 July 2012 (or such later time and/or date as may be agreed between the Sponsors and the Company in writing).

While the Rights Issue is conditional on the Transaction Resolutions being passed it is not conditional upon the Tender Offer becoming Effective or on the New Facilities Agreement.

The Rights Issue has been fully underwritten on the basis set out in the Underwriting Agreement.

The results of the Rights Issue, including the aggregate number of New Melrose Shares issued and the aggregate amount raised, net of expenses, is expected to be announced by Melrose through a Regulatory Information Service by 8.00 a.m. on 1 August 2012.

Melrose Shareholders who hold their Melrose Shares in certificated form and who take up their rights in part or in full will receive definitive share certificates in respect of their New Melrose Shares on 8 August 2012.

Assuming the Tender Offer becomes Effective, the Rights Issue proceeds will be applied to partially satisfy the consideration to be paid to (i) Elster ADS Holders and Elster Shareholders who have tendered their Elster ADSs and/or Elster Shares (as the case may be) pursuant to the Tender Offer and (ii) Elster ADS Holders and Elster Shareholders pursuant to further purchases of Elster ADSs and/or Elster Shares (as the case may be) made following the Effective Date in connection with the Acquisition.

Having received irrevocable undertakings to tender unconditionally (and not withdraw) Elster ADSs and/or Elster Shares pursuant to the Tender Offer from Rembrandt and Nachtwache in respect of their entire beneficial holdings, and having received irrevocable undertakings from certain of the Elster Directors and Management Elster ADS Holders, to tender (and not withdraw) their entire beneficial holdings unless a Superior Offer is publicly proposed, together amounting in aggregate to approximately 64.19 per cent. of the total share capital of Elster as at the Latest Practicable Date, Melrose believes that the Tender Offer will be successful. However, Melrose Shareholders should note that while the Rights Issue is conditional on the passing of the Transaction Resolutions, it is not conditional upon the Tender Offer becoming Effective or on the New Facilities Agreement and that, subsequent to the Rights Issue becoming wholly unconditional, the Tender Offer may not become Effective. In the event that the Rights Issue settles but the Tender Offer does not become Effective, the Melrose Directors' current intention is that the net proceeds of the Rights Issue will be invested on a short-term basis while the Melrose Directors evaluate other acquisition opportunities and, if no acquisitions can be found on acceptable terms, the Melrose Directors will consider how best to return surplus capital to Melrose Shareholders in a timely manner. Such a return could carry fiscal costs for certain Melrose Shareholders and will have costs for the Company.

Applications will be made to the UKLA for the New Melrose Shares to be admitted to the premium segment of the Official List and to the London Stock Exchange for the New Melrose Shares to be admitted to trading on the main market for listed securities of the London Stock Exchange. It is expected that Admission will become effective and dealings (for normal settlement) in the New Melrose Shares will commence, nil paid, at 8.00 a.m. on 17 July 2012.

The Underwriters have agreed under the terms of the Underwriting Agreement to procure subscribers for, failing which, the Underwriters shall themselves subscribe for, the New Melrose Shares not taken up in the Rights Issue at the Rights Issue price.

Subject to, among other things, the passing of the Transaction Resolutions, it is expected that the Provisional Allotment Letters will be dispatched to Qualifying non-CREST Shareholders (other than those having an address in the United States or any Excluded Territory) on 16 July 2012, after the Melrose General Meeting.

6. Shareholder Payment Policy

Melrose paid a final dividend of 8.4 pence per Melrose Share for the financial year ended 31 December 2011 (2010: 7.0 pence).

The table below shows the amount of dividend per Melrose Share for each of the financial years ended 31 December 2011, 2010 and 2009.

	<u>2011</u>	<u>2010</u>	<u>2009</u>
Dividend per Melrose Share	13.0 pence	11.0 pence	7.7 pence

It is the intention of the Melrose Board to maintain a progressive dividend policy going forward which will take into account the bonus element of the Rights Issue. The Melrose Group's policy is to return surplus cash and business disposal proceeds to Shareholders.

7. Financial effects of implementing the Acquisition

On a *pro forma* basis and assuming that: (i) the Acquisition had become Effective on 31 December 2011 and (ii) that 100 per cent. of Elster ADS Holders and Elster Shareholders had tendered their Elster ADSs and Elster Shares (as the case may be) in full on such date to Melrose Bidco, the Enlarged Group would have had net assets of £1.8 billion at that date (based on the net assets of the Melrose Group as at 31 December 2011 and the net assets of the Elster Group as at 31 March 2012) as more fully described in Part VIII (*Unaudited Pro Forma Information on the Enlarged Group*) of this document.

The Melrose Board expects that the Acquisition will be dilutive to earnings per share in the first full financial year of ownership (2013) and will start to become accretive thereafter.⁽¹¹⁾⁽¹²⁾ Over the medium term, the Acquisition is not expected to be dilutive to the Melrose headline⁽¹²⁾ operating margins currently being achieved.

8. Melrose Shareholder approval

Due to its size, the Acquisition constitutes a Class 1 transaction for Melrose under the Listing Rules and therefore requires the approval of Melrose Shareholders. Melrose Shareholders will also be asked to approve an allotment of shares in connection with the Rights Issue and to grant certain authorities with respect to the Enlarged Share Capital following the completion of the Rights Issue. Accordingly, the Melrose General Meeting has been convened for 10.00 a.m. on 16 July 2012 at the offices of Investec. Melrose has today posted to Melrose Shareholders the Melrose Circular summarising the reasons for the Acquisition and the Rights Issue (which includes a notice convening the Melrose General Meeting). The Acquisition is conditional on, amongst other things, the Transaction Resolutions being passed (without material amendment) by Melrose Shareholders at the Melrose General Meeting.

The Melrose Directors have unanimously agreed to recommend that Melrose Shareholders vote in favour of the Resolutions, as the Melrose Directors intend to do in respect of their own beneficial holdings in Melrose representing 5.39 per cent. of the issued ordinary share capital of Melrose.

The Melrose Board is fully supportive of the Rights Issue. Each of the directors of Melrose intends, after Admission, to sell such number of Rights (nil paid) as will enable him to take up in full the balance of his

(11) Nothing in this document is intended to be, or is to be construed as, a profit forecast or to be interpreted to mean that earnings per Melrose Share for the current or future financial years, or those of the Enlarged Group, will necessarily match or exceed the historical earnings per Melrose Share.

(12) Before exceptional costs, exceptional income and intangible asset amortisation.

entitlement, other than Mr. Dowley, who intends to take up his Rights in full and Mr. Grant and Mr. Templeman, each of whom intend to take up at least such part of his entitlement to New Melrose Shares as may be funded by the sale, after Admission, of such number of Rights (nil paid) as will enable him to take up the balance of his entitlement.

9. Use of Rights Issue Proceeds

The total net proceeds of the Rights Issue will be used to fund part of the total cost of the Acquisition and related expenses, the latter of which are expected to be approximately £28 million in aggregate.

10. Elster Board recommendation and irrevocable undertakings

The Elster Board intends to recommend that Elster ADS Holders and Elster Shareholders tender their Elster ADSs and Elster Shares (as the case may be) to Melrose Bidco pursuant to the Tender Offer. The Elster Board has, subject to its fiduciary duties, there being no change in the Melrose Recommendation and no Superior Offer having been commenced, agreed to include in its Schedule 14d-9, among other things, that the Tender Offer is fair to and in the best interests of Elster and its stakeholders and it approves the Tender Offer and recommends that holders of Elster ADSs (and/or Elster Shares) tender their Elster ADSs (and/or Elster Shares) into the Tender Offer.

Melrose Bidco has received irrevocable undertakings to tender unconditionally (and not withdraw) Elster ADSs (or the underlying Elster Shares to which they relate) pursuant to the Tender Offer from Rembrandt and Nachtwache in respect of their entire beneficial holdings (amounting in aggregate to approximately 62.17 per cent. of the total share capital of Elster as at the day immediately prior to the date of this document) and has also received irrevocable undertakings from certain of the Elster Directors and Management Elster ADS Holders to tender (and not withdraw) of their entire beneficial holdings (amounting in aggregate to approximately 2.02 per cent. of the total share capital of Elster as at the day immediately prior to the date of this document) unless a Superior Offer is publicly proposed.

11. Where to find help

Further terms and conditions of the Rights Issue are set out in Part XII (*Terms and Conditions of the Rights Issue*) of this document and, where relevant, in the Provisional Allotment Letter.

12. Conditions to completion of the Tender Offer

In summary, the completion of the Tender Offer is conditional upon:

- the passing (without material amendment) of the Transaction Resolutions at the Melrose General Meeting;
- Admission having occurred;
- receipt of anti-trust clearances from the relevant regulatory authorities in the EU, US, Ukraine and Russia;
- there having been validly tendered (and not properly withdrawn) prior to the Tender Offer Expiration Date such number of Elster ADSs (and/or Elster Shares) that represent at least 75 per cent. of the total share capital of Elster as at the Tender Offer Expiration Date;
- the Elster Board having recommended (and having not withdrawn its recommendation for) the Tender Offer;
- there not being any judgment, order, decree or law (in the United States, the United Kingdom or in the Federal Republic of Germany) entered, enacted, promulgated, enforced or issued by any court or other governmental entity of competent jurisdiction or other legal restraint or prohibition in effect enjoining or otherwise preventing or materially delaying the making of the Tender Offer, the acceptance for payment of any Elster ADSs and/or Elster Shares, Melrose's or Melrose Bidco's full rights of ownership and voting of the Elster ADSs and/or Elster Shares or Melrose's or Melrose Bidco's ownership or operation of Elster;

- Elster not having breached or failed to perform certain obligations required to be performed by it under the Investment Agreement at or prior to the Tender Offer Expiration Date;
- the Investment Agreement not having been terminated in accordance with its terms; and
- the satisfaction or waiver of the other conditions of the Tender Offer, which are considered to be customary for a transaction of this nature.

The conditions relating to the approval of the Acquisition by Melrose Shareholders, clearance by the EU and US regulatory authorities, the Admission of the New Melrose Shares and the Investment Agreement not having been terminated will not be waived in whole or in part and the other conditions may be waived by Melrose Bidco.

The Tender Offer Document will be filed with the SEC promptly after the date of this document with no material changes to the terms and conditions of the Tender Offer set out above.

13. Regulatory Clearances

The EU, US, Russian and Ukrainian competition filings referred to above will be made shortly after the publication of this document. The Phase I review period for the EU filing is 25 business days and starts on the day of filing (assuming the filing is deemed complete). The waiting period for the US filing is 15 calendar days. The Russian Phase I review clearance takes approximately 30 calendar days to be granted/delivered. The Ukrainian Phase I review period is 30 calendar days which starts if, after 15 days from the date of the application, the local authority has not requested additional information (if additional information is requested, the 30 days review period will start once the filing is deemed complete by the local authority). Melrose does not expect any significant regulatory issues to arise as a result of these filings.

14. Further details of the Rights Issue

14.1 *Listing, dealings and settlement*

Applications will be made to the UKLA for the New Melrose Shares to be admitted to listing on the premium segment of the Official List and to the London Stock Exchange for the New Melrose Shares to be admitted to trading (nil and fully paid) on its main market for listed securities. It is expected that Admission will become effective and that dealings (for normal settlement) in the New Melrose Shares will commence on the London Stock Exchange, nil paid, at 8.00 a.m. on 17 July 2012 (whereupon an announcement will be made by the Company to a Regulatory Information Service).

14.2 *Overseas Shareholders*

The availability of the Nil Paid Rights, Fully Paid Rights and New Melrose Shares under the Rights Issue to persons who do not have an address in or who are not located in the UK may be affected by the laws of the jurisdiction where such persons are or have an address (although all Melrose Shareholders resident in a member state of the EEA will be entitled to participate in the Rights Issue). Such persons should inform themselves about and observe any applicable requirements. This document does not constitute an offer of Nil Paid Rights, Fully Paid Rights, New Melrose Shares or Provisional Allotment Letters in the United States or an offer to the public in any Excluded Territory. This document does not constitute an offer to sell or a solicitation of an offer to buy New Melrose Shares or to take up entitlements to Nil Paid Rights in any jurisdiction in which such offer or solicitation is unlawful. Further details in relation to Overseas Shareholders are contained at paragraph 7 of Part XII (*Terms and Conditions of the Rights Issue*) of this document.

PART II

INFORMATION ON MELROSE

The selected historical financial information and other historical financial information in relation to Melrose in this Part II (Information on Melrose) has, unless otherwise stated, been extracted without material adjustment from the audited consolidated IFRS financial statements of the Melrose Group in the annual report and accounts of Melrose for the financial years ended 31 December 2011, 31 December 2010 and 31 December 2009 as referred to in Part VI (Historical Financial Information Relating to Melrose) of this document.

Investors should read the whole of this document and the documents incorporated herein by reference and should not just rely on the financial information set out in this Part II (Information on Melrose).

1. Introduction and Business Overview

Melrose is a public limited company registered in England and Wales and was floated on AIM on 28 October 2003 with the strategy of acquiring businesses whose operational performance, in the opinion of the Melrose Directors, could be improved to create greater shareholder value. The Melrose Directors have extensive experience of identifying and evaluating acquisition opportunities, quoted and unquoted, both in the UK and overseas. During December 2005 Melrose moved onto the London Stock Exchange's main market for listed securities.

Melrose is an acquisitive company which has a track record of acquiring businesses and making the necessary changes to maximise the value inherent in those businesses to the benefit of shareholders. In May 2005 Melrose acquired two specialist engineering businesses, Dynacast and McKechnie, for an enterprise value of £429 million and in July 2008 Melrose acquired FKI plc for a total consideration of £970.4 million (including debt). During the period of its ownership, Melrose significantly improved the operational performance of these businesses. In May 2007 it completed the sale of a large part of McKechnie for £428 million (with the buyer also assuming £2.8 million of indebtedness) and in July 2011 it completed the sale of Dynacast for an enterprise value of £377 million (including £11m of pension liabilities assumed by the buyer). In August 2007 Melrose Shareholders approved a return of capital of £220 million following the McKechnie disposal (which, together with dividends already paid, equaled approximately 95 per cent. of the original capital raised from shareholders and the further capital raised to buy Dynacast and McKechnie). In August 2011 Melrose returned approximately £373 million to Melrose Shareholders following the disposal of Dynacast. Melrose's market capitalisation is approximately £1.5 billion against a net shareholder investment of £14 million (not adjusted for inflation).

2. The Melrose Group's Strategy

The Melrose Group's strategy is to acquire good industrial 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 3 to 5 year time frame (but this is flexible). The value from significant disposals is then returned to shareholders. Further details of each part of the strategy are shown below.

The Melrose Group is not a passive investor and its senior executives work closely with business managers to support the development of its subsidiaries. This includes long term strategic planning.

The Melrose Group looks for the following characteristics in an investment:

- a manufacturing company with a strong market position and high quality products; and
- a business that needs change to improve its performance through investment, refocusing or other company-specific issues.

The Melrose Group expects to challenge and be challenged as it works in tandem with management teams to improve the growth prospects of its portfolio. Management teams are given incentive arrangements that align their interests with shareholders so that they will benefit on the post acquisition value creation process.

The Melrose Group finances its acquisitions in such a way as to give it flexibility to improve its businesses. It does not saddle its businesses with high levels of debt.

The Melrose Group will seek to invest in new product developments, make bolt-on acquisitions and strengthen the senior management team to ensure the success of a portfolio company.

The expected result is an improvement in operational and financial performance, which generates an excellent return for investors. This is well illustrated by the sale of Dynacast referred to at paragraph 1 above.

3. Organisational structure and businesses

Melrose is the holding company of various principal subsidiaries listed in paragraph 7 of Part XIII (*Additional Information*) of this document and its business is conducted at the locations set out at Paragraph 6 of Part XIII (*Additional Information*). The principal businesses operated by those trading subsidiaries are discussed below.

Energy

The Melrose Group's energy businesses are market leading manufacturers of electricity generating equipment, switchgear and transformers. Energy has five business units comprising:

- Brush Turbogenerators;
- Brush Transformers;
- Marelli;
- Hawker Siddeley Switchgear; and
- Harrington Generators.

Energy services the power generation, oil and gas, utilities, industrial, marine, rail, telecommunications, construction, commercial, military, hydropower, cogeneration, and uninterrupted power supply and aftermarket sectors.

Lifting

The Melrose Group's lifting businesses are world leading suppliers of wire, wire rope products, lifting fittings and blocks. Lifting has three business units comprising:

- Bridon;
- Crosby; and
- Acco.

Lifting services the onshore and offshore oil and gas, deep shaft and surface mining, petrochemical, alternative energy, general industrial and construction markets, fishing and marine, infrastructure (for example, bridges and sports stadia) and material handling industries.

Other Industrials

Melrose's Other Industrials businesses are market leading manufacturers across the housing, construction, scrap processing and other industrial sectors. Other Industrials has three business units comprising:

- Truth;
- Harris; and
- Prelok.

Other Industrials businesses serve a diverse range of sectors, including housing, construction, retail, scrap processing, fibre recycling, consumer packaging, industrial, medical, office furniture and general engineering.

4. Selected financial information

The summary financial information set out below has been extracted without material adjustment from the audited financial statements for the year ended 31 December 2011 (under IFRS), as set out in Melrose's annual reports and accounts for 2011, the audited financial statements for the year ended 31 December 2010 (under IFRS), as set out in Melrose's annual report and accounts for 2010 and the audited financial statements for the year ended 31 December 2009 (under IFRS), as set out in Melrose's annual reports and accounts for 2009. Investors should read the whole of this document and the documents incorporated herein by reference and should not just rely on the financial information set out in this paragraph 4 of this Part II (*Information on Melrose*).

The auditors of Melrose, Deloitte LLP, issued unqualified audit opinions on Melrose's consolidated financial statements for each of the three years ended 31 December 2011, 31 December 2010 and 31 December 2009.

CONDENSED CONSOLIDATED INCOME STATEMENT UNDER IFRS (AS REPORTED)

	Year ended 31 December 2011 ⁽¹⁾	Year ended 31 December 2010 ⁽¹⁾	Year ended 31 December 2010	Year ended 31 December 2009
	£m	£m	£m	£m
Continuing operations				
Revenue	1,153.9	1,035.4	1,379.5	1,298.5
Cost of sales	(812.9)	(731.0)	(988.5)	(970.3)
Gross profit	341.0	304.0	391.0	328.2
Headline operating expenses ⁽²⁾	(160.2)	(157.0)	(193.7)	(178.9)
Share of results of joint ventures	—	(0.4)	(0.4)	0.4
Intangible asset amortisation	(23.7)	(24.1)	(26.6)	(26.7)
Exceptional costs	(40.1)	(10.3)	(10.3)	(23.9)
Exceptional income	—	21.4	21.4	14.0
Total net operating expenses	(224.0)	(170.4)	(209.6)	(215.1)
Operating profit	117.0	134.0	181.4	113.1
Headline operating profit⁽²⁾	180.8	147.0	196.9	149.7
Finance costs	(29.6)	(34.6)	(35.4)	(36.2)
Finance income	10.0	9.3	9.3	5.1
Profit before tax	97.4	108.7	155.3	82.0
Total Tax	17.4	(5.0)	(14.0)	(27.3)
Profit for the year from continuing operations . .	114.8	103.7	141.3	54.7
Profit for the year from discontinued operations .	171.7	37.6	—	24.6
Profit for the year	286.5	141.3	141.3	79.3
Attributable to:				
Owners of the parent	286.4	141.1	141.1	79.5
Non-controlling interests	0.1	0.2	0.2	(0.2)
Earnings per share				
From continuing operations				
– Basic	25.2p	20.8p	28.4p	11.0p
– Diluted	23.7p	19.8p	27.0p	10.8p
From continuing and discontinued operations				
– Basic	62.9p	28.4p	28.4p	16.0p
– Diluted	59.0p	27.0p	27.0p	15.6p
– Headline diluted ⁽²⁾	28.8p	24.1p	24.1p	16.3p

(1) Excludes the results of discontinued operations (Dynacast, Brush Traction, Logistex UK, Madico and Weber Knapp).

(2) Before exceptional costs, exceptional income and intangible asset amortisation.

SUMMARY CONDENSED CONSOLIDATED BALANCE SHEET UNDER IFRS (AS REPORTED)

	31 December 2011 ⁽¹⁾	31 December 2010 ⁽¹⁾	31 December 2010	31 December 2009
	£m	£m	£m	£m
Non-current assets	1,162.1	1,470.2	1,470.2	1,459.6
Current assets	619.4	673.6	673.6	585.1
Total assets	1,781.5	2,143.8	2,143.8	2,044.7
Current liabilities	394.0	452.2	452.2	417.5
Non-current liabilities	739.1	808.7	808.7	863.9
Total liabilities	1,133.1	1,260.9	1,260.9	1,281.4
Net assets	648.4	882.9	882.9	763.3
Equity attributable to owners of the parent	648.3	881.5	881.5	761.6
Non-controlling interests	0.1	1.4	1.4	1.7
Total equity	648.4	882.9	882.9	763.3

(1) Excludes the results of discontinued operations (Dynacast, Brush Traction, Logistex UK, Madico and Weber Knapp).

SUMMARY CONDENSED CONSOLIDATED CASH FLOW STATEMENT UNDER IFRS (AS REPORTED)

	Year ended 31 December 2011 ⁽¹⁾	Year ended 31 December 2010 ⁽¹⁾	Year ended 31 December 2010	Year ended 31 December 2009
	£m	£m	£m	£m
Net cash from operating activities	91.2	117.9	117.9	174.8
Net cash (used in)/from investing activities	337.2	(30.2)	(30.2)	28.3
Net cash used in financing activities	(425.2)	(45.4)	(45.4)	(221.5)
Net increase/(decrease) in cash and cash equivalents	3.2	42.3	42.3	(18.4)

(1) Excludes the results of discontinued operations (Dynacast, Brush Traction, Logistex UK, Madico and Weber Knapp).

5. Current trading, trends and prospects

5.1 On 9 May 2012, Melrose published its interim management statement for the period from 1 January 2012 to 9 May 2012. The following has been extracted from that statement:

Overview

The positive momentum experienced in Melrose's businesses on revenue and order intake during 2011 has continued into 2012. Revenue for the Melrose Group in the first four months of 2012, at constant currency, is up 9 per cent. compared to the same period in 2011, and the total value of orders received in the period is 3 per cent. higher than revenue. Whilst the first quarter is historically the slowest quarter of the year, the start to 2012 has been pleasing to the Melrose Board.

The investment phase, referred to in Melrose's annual results statement for 2011, continues in Melrose's businesses with capital expenditure significantly ahead of depreciation. Current trading remains in line with plan.

Energy

Brush Turbogenerators, which accounts for three quarters of Melrose's Energy division by revenue, continues to grow as planned and to perform satisfactorily. Revenue for the first four months of 2012 was up 10 per cent. on the same period in 2011, virtually all of the new build revenue planned for 2012 is now in the order book and early indications from customers are suggesting strong demand into 2013. However, due to the particular reasons noted below, margins, as expected, are slightly lower than in the same period in 2011.

The aftermarket has had a slower start to the year, but the increasing order book points to a satisfactory performance for the year.

As reported in Melrose's annual results statement for 2011, Turbogenerators' operating profit in 2011 benefited from a contract to supply some larger generators to a customer in the Slovak Republic, thereby distorting year-on-year comparisons.

The restructuring project to improve manufacturing efficiencies in the Netherlands facility is continuing to plan and this will improve the performance of the factory. The integration of Hawker Siddeley Switchgear into Turbogenerators is proceeding well and will benefit the results for 2012.

Marelli has had a good start to the year with revenue up 14 per cent. on 2011 and order intake at record levels.

Lifting

Melrose's Lifting division has had a strong start to 2012 with revenue up 11 per cent. on the same period in 2011 and the total value of orders received in the period being 8 per cent. higher than revenue. The benefits of ongoing investment and operational improvement are being reflected in an encouraging performance in margins in this division.

Crosby grew significantly in 2011 and this has continued into 2012 with revenue in the period up 23 per cent. on 2011, and order intake up 17 per cent. The strength of the US onshore oil and gas end market continues to benefit Crosby.

During the period, Melrose appointed a new CEO for the Crosby Group to continue the excellent work of the previous CEO who had been with the company for over 40 years. The new CEO will continue to focus on the international expansion of Crosby.

Bridon has an exciting year ahead. In November the new £20 million factory in Newcastle, UK is due to open. This will supply high specification rope for demanding applications for the deep water offshore oil and gas market and will be a key part of the strategy to position Bridon as the global technology leader in its field. This project remains both on time and within budget.

In addition, it is pleasing to the Melrose Board to see that Bridon continues to see recovery in its key end markets, and most encouragingly, further signs of recovery in offshore oil and gas. Whilst revenue for Bridon in this period is up only 1 per cent. on 2011, the order intake has increased 16 per cent.

The combination of Bridon and Crosby means the Lifting division has had a strong start to the year.

Other Industrial

In the first four months of 2012, revenue was 1 per cent. above the same period last year.

Truth is seeing some pockets of recovery in its end market of US housing, but it is too early to conclude anything meaningful from this.

Cashflow and Net Debt

As reported in Melrose's annual results statement for 2011, restructuring provisions of £15.9 million were charged in 2011, which are being paid in cash in 2012.

Working capital remains efficient and capital expenditure continues to be significant. At the end of April 2012, cash spent on capital projects was almost 2x depreciation which the Melrose Board believes highlights the continuation of the investment phase in the current businesses.

Cash generation remains in line with plan. Net debt is planned to increase by the end of 2012 to approximately 1.5x headline operating profit before depreciation and amortisation, with the main outflows coming in the first half of the year.

Outlook

Further progress is being made during 2012 to improve the quality and performance of Melrose's businesses and this should be particularly evident in the second half of the year.

- 5.2 Since the date of the interim management statement, Melrose continues to trade in line with the Melrose Board's expectations.
- 5.3 On 26 June 2012, Melrose announced that it had signed and completed the sale of all the issued share capital of MPC for cash consideration of £31 million.

6. Melrose breakdown of revenue

The summary financial information set out below has been extracted without material adjustment from the audited financial statements for the year ended 31 December 2011, as set out in Melrose's annual reports and accounts for 2011, the audited financial statements for the year ended 31 December 2010, as set out in Melrose's annual report and accounts for 2010, and the audited financial statements for the year ended 31 December 2009, as set out in Melrose's annual report and accounts for 2009, except for the split of Melrose's revenue by geographical area, which is taken from Melrose's annual report and accounts for 2010.

A split of Melrose's revenue by geographical area is set out below.

	Year ended 31 December 2011 ⁽¹⁾	Year ended 31 December 2010 ⁽¹⁾	Year ended 31 December 2010	Year ended 31 December 2009
	£m	£m	£m	£m
UK	195.2	156.5	199.8	201.8
Europe	287.6	294.1	416.4	364.3
North America	463.5	419.8	525.4	500.3
Other	207.6	165.0	237.9	232.1
Total	1,153.9	1,035.4	1,379.5	1,298.5

(1) Excludes the results of discontinued operations (Dynacast, Brush Traction, Logistex UK, Madico and Weber Knapp).

A split of the revenue for the continuing operations by division is set out below.

	Year ended 31 December 2011 ⁽¹⁾	Year ended 31 December 2010 ⁽¹⁾	Year ended 31 December 2010	Year ended 31 December 2009
	£m	£m	£m	£m
Energy	461.6	427.5	427.5	418.3
Lifting	484.4	422.7	422.7	419.0
Dynacast ⁽²⁾	—	—	275.7	208.7
Other Industrial	207.9	185.2	253.6	252.5
Total	1,153.9	1,035.4	1,379.5	1,298.5

(1) Excludes the results of discontinued operations (Dynacast, Brush Traction, Logistex UK, Madico and Weber Knapp).

(2) Dynacast sale completed on 19 July 2011.

7. Employees

The average number of persons employed by the Melrose Group for the year ended 31 December 2011 was 10,007 across its four divisions.

8. Pensions

The Melrose Group operates various pension schemes around the world with a net pension liability at 31 December 2011 of £117.7 million. The main pension scheme in the UK is the FKI UK Pension Plan, which is a defined benefit pension scheme. The FKI UK Pension Plan was closed to new members and on 28 February 2011 it closed to current members' future service. In addition to the FKI UK Pension Plan, other pension schemes of significant size that the Melrose Group operates are the McKechnie UK Pension Plan and a US defined benefit plan for FKI. The Melrose Group monitors its pension strategy on an ongoing basis.

PART III

INFORMATION ON ELSTER

The historical financial information in relation to Elster in this Part III (Information on Elster) has, unless otherwise stated, been extracted without material adjustment from (i) the audited consolidated financial statements of the Elster Group for the financial years ended 31 December 2011, 31 December 2010 and 31 December 2009 and (ii) the unaudited Elster quarterly report for the first quarter ended 31 March 2012 published on 4 May 2012, as referred to in Part VII (Historical Financial Information Relating to Elster) of this document, each of which has been prepared in accordance with US GAAP.

Investors should read the whole of this document and the documents incorporated herein by reference and should not just rely on the financial information set out in this Part III (Information on Elster).

1. Introduction and Overview

Elster is a European public limited liability company (*Societas Europaea*, or *SE*) with its registered seat in Essen, Germany. Its share capital amounts to EUR 28,220,041.00 and is divided into 28,220,041 Elster Shares. Elster is the ultimate parent of all Elster Group companies. ADSs representing Elster's ordinary share capital are traded on the NYSE and on the OTC (over the counter) market (*Freiverkehr*) on the stock exchanges of Berlin, Frankfurt am Main, Stuttgart and the Tradegate Exchange (each ordinary share is represented by four Elster ADSs).

2. Business Overview

Elster is one of the world's largest providers of gas, electricity and water meters, gas utilisation products and related communications, networking and software solutions. Elster's products and solutions are used to measure gas, electricity and water consumption as well as enable energy efficiency and conservation.

Elster has one of the most extensively installed meter bases in the world, with more than 200 million meters deployed over the course of the last decade. Elster sells its products and solutions in more than 130 countries across gas, electricity, water and multi-utility settings for use in the residential, commercial and industrial markets.

It is estimated (as at 2009) that Elster had the largest global market share by revenues in the gas meter market, was one of the three largest global providers in the water meter market by revenues and had the third largest share by revenues in the electricity meter market.

Elster's stated mission is to support energy and natural resource conservation with a comprehensive portfolio of innovative and trusted metering and technology solutions that help gas, electricity and water utilities as well as industrial customers to improve efficiency through accurate measurement of the consumption of energy and natural resources.

3. History

Elster traces its roots to the earliest days of the metering industry. In 1836 the American Meter Company, an early producer of gas meters in the United States, was founded in New York. In Europe, Elster's history also dates back to the nineteenth century. Elster Meters was founded in 1848 in Berlin, Germany and G. Kromschroder AG, now Elster Kromschroder, was established in 1865 in Osnabrueck.

Substantial parts of Elster's operations were later combined under the holding company Ruhrgas Industries GmbH, a German limited liability company (*Gesellschaft mit beschränkter Haftung*, or GmbH), which was a subsidiary of German Ruhrgas AG. In March 2003, E.ON AG completed its acquisition of Ruhrgas AG, including Ruhrgas Industries GmbH. On June 15, 2005, Nachtwache Acquisition GmbH, an investment vehicle indirectly owned by funds advised by CVC Capital Partners, a private equity group, entered into a share purchase agreement with E.ON Ruhrgas AG to acquire Ruhrgas Industries GmbH. The closing occurred on September 12, 2005, and Elster Group was formed.

Elster is a holding company and was originally domiciled in Luxembourg. On May 23, 2005, it had acquired 100 per cent. of the shares in former Elster Holdings GmbH (formerly known as Nachtwache Acquisition GmbH), the then intermediate holding company of Elster Group that directly and indirectly owned Elster's operating subsidiaries around the world. In early 2010, Elster moved its registered office from Luxembourg to Essen, Germany. In order to simplify its group structure, Elster Holdings GmbH was merged into Elster Group SE with effect as of July 15, 2011, and all assets and liabilities of Elster Holdings GmbH, which ceased to exist as a consequence of the merger, were transferred to Elster Group SE by means of universal succession (*Gesamtrechtsnachfolge*). The merger did not materially affect the organization and the management of Elster's company.

Since September 30, 2010, Elster ADSs have been listed on the New York Stock Exchange. One Elster ADS represents one fourth of one Elster Share.

4. Organisational structure

4.1 The principal subsidiaries of Elster as at 31 December 2011 were as follows:

<i>Name of subsidiary undertaking</i>	<i>Interest held per cent.</i>	<i>Description of undertaking</i>
Elster American Meter Company, LLC	100	Gas metering
Elster Finance B.V.	100	Finance subsidiary
Elster GmbH	100	Gas and electricity metering
Elster Holdings GmbH	100	Holding company
Elster Holdings Netherlands B.V.	100	Holding company
Elster Holdings US, Inc.	100	Holding company
Elster s.r.o.	100	Water and gas metering

4.2 Details of Administrative Board

Howard Dyer—Chairman

Mr. Howard Dyer has been the Chairman of Elster since 2005 and also served as interim CEO of Elster from March 2009 until November 2009. Mr. Dyer is also the Chairman of the Minit Group. He previously served as Chairman of New Look Group Limited, CEO of Hamleys plc, Executive Chairman and CEO of Ascot plc and a non-executive director of Asprey plc. Mr. Dyer was the CEO of the North America division and director of Williams Holdings plc. He previously worked at Alcan as the commercial director of its extrusions division in the United Kingdom and managing director of its foil division in the United Kingdom. He is certified in production engineering by Oxford Brookes University.

Marc Strobel, Deputy Chairman

Mr. Marc Strobel was elected Deputy Chairman of Elster in 2010 and is a Partner of CVC Capital Partners. He joined CVC in 2000 having previously worked at Doughty Hanson in Frankfurt and London. Before that, he was an associate at Lehman Brothers, New York and London, and an analyst at Wasserstein Perella & Co., Frankfurt. Mr. Strobel holds a degree in Business Administration from the European Business School, Oestrich-Winkel, Germany and an MBA from the Wharton School, University of Pennsylvania. In addition to his involvement in Elster and his acting as a non-executive director of Elster's parent company Rembrandt Holdings S.A., Mr. Strobel is a managing director of Gabriel Acquisitions GmbH and serves as a non-executive member on the board of Charterhouse Inuit (Luxco) S.A., companies related to investments made by funds advised by CVC in Evonik Industries and Ista International, respectively.

Simon Beresford-Wylie, Chief Executive

Mr. Simon Beresford-Wylie has been Chief Executive Officer of Elster since November 2009. Prior to joining Elster, he was the CEO of Nokia-Siemens Network and a member of the Nokia Group Executive Board. Mr. Beresford-Wylie joined the Nokia Group in 1998 and held a variety of senior leadership positions within the Nokia Group in Asia-Pacific and Europe until 2007 when Nokia-

Siemens Network was formed and he became CEO. From 1995 to 1998, he was CEO of Indian mobile network operator Modi Telstra, and prior to this was an executive with Australia's Telstra Corporation. He holds a degree from the Australian National University, and is a graduate of the Executive Development Program of Stanford University/National University of Singapore. Mr. Beresford-Wylie is also currently a non-executive director at Vitec Group plc.

Rainer Beaujean—Chief Financial Officer

Mr. Rainer Beaujean was named Elster's Chief Financial Officer and Managing Director in March 2012. Prior to that, from 2007 to 2011 he served as the CFO and member of the management board of Demag Cranes AG. Prior to Demag Cranes AG, from 2000 until 2006, Mr. Beaujean worked for the company T-Online International AG. He was the CFO of T-Online International AG for four years before being appointed CEO. Mr. Beaujean started his business career in 1995 with Deutsche Telekom AG in Bonn, Germany, working in various senior finance functions before he was appointed as CFO of T-Online International AG. Mr. Beaujean holds a degree in Business Administration (Diplom-Kaufmann) at Universität des Saarlandes (University of Saarland), Germany.

Clayton Brendish—Member of Administrative Board

Mr. Clayton Brendish, CBE, currently serves as non-executive director of BT Group PLC. He is non-executive chairman of Anite plc and SThree plc. He is also a non-executive director of Herald Investment Trust. He is a trustee of Economist Newspapers and a former trustee of the Foundation for Liver Research. Prior to his retirement in May 2001, Mr. Brendish was executive deputy chairman of CMG having joined the board when it acquired Admiral plc. He was co-founder and executive chairman of Admiral, incorporated in 1979. He also acted as an adviser to the Government on the efficiency of the Civil Service. Mr. Brendish holds degrees as Bachelor of Science and a Master of Science and received a degree as Doctor of Science—Honoris Causa from the City University of London. He holds certifications as a Chartered Engineer, Fellow of the British Computer Society and Companion of the Chartered Management Institute.

Michael Cannon—Member of Administrative Board

Mr. Michael Cannon is retired after a 35 year career in high technology companies. Mr. Cannon currently serves as a consultant to Dell Inc, where he served as President, Global Operations from February 2007 until his retirement in 2009. Prior to joining Dell, Mr. Cannon was the Chief Executive Officer of Solectron Corp, a \$12 billion electronic manufacturing services company, which he joined as CEO in 2003. From July 1996 until joining Solectron, Mr. Cannon served as the Chief Executive Officer of Maxtor Corporation, a disk drive and storage systems manufacturer. Prior to joining Maxtor, Mr. Cannon held senior management positions at IBM. Mr. Cannon studied Mechanical Engineering at Michigan State University and completed the Advanced Management Program at Harvard Business School. Mr. Cannon has served on the board of directors of Adobe Systems, a software company, since 2003.

John Delucca—Member of Administrative Board

Mr. John Delucca currently serves as a director, as chairman of the audit committee and as a member of the compensation committee of Endo Pharmaceuticals, Inc., as a director and as a member of each of the audit and governance and nominating committee of Tier Technologies, Inc., and as a director and chairman of the audit committee of ITC Deltacom. Mr. Delucca served as Executive Vice President and Chief Financial Officer of REL Consultancy Group from 2003 until 2004, Executive Vice President, Finance and Administration, and Chief Financial Officer of Coty, Inc. from 1999 to 2002 and as Senior Vice President and Treasurer of RJR Nabisco, Inc. from 1993 to 1998. Mr. Delucca also has served as Managing Director and Chief Financial Officer of Hascoe Associates; President and Chief Financial Officer of the Lexington Group; and Managing Director of The Trump Group. Mr. Delucca received a BA degree in Business Administration from Bloomfield College and an MBA from Fairleigh Dickinson University.

Gregor Hilverkus—Member of Administrative Board

Mr. Gregor Hilverkus is a Managing Director of CVC Capital Partners. He joined CVC in 2001, having previously worked as Co-Founder and CFO of the media and music company Ecapella.com GmbH in Cologne and with J.P. Morgan in Mergers & Acquisitions. Mr. Hilverkus studied Business Administration and holds a degree from the Otto Beisheim School of Management (WHU), Koblenz, Germany. In addition to his involvement in Elster and his acting as a non-executive director of Elster's parent company Rembrandt Holdings S.A., Mr. Hilverkus serves as a non-executive member of the board of Gabriel Investment S.à r.l. and Gabriel Holdings S.à r.l., companies related to the investment made by funds advised by CVC in Evonik Industries, as well as Brandlen Finance S.A., DSI Investments S.à r.l. and Tension Holding S.A., companies related to the investment made by funds advised by CVC in DSI.

Steven Koltès—Member of Administrative Board

Mr. Steven Koltès is a Managing Partner and co-founder of CVC Capital Partners and holds overall responsibility for CVC's activities in the German speaking countries. Mr. Koltès joined CVC in London in 1987, having previously headed Citicorp's Mezzanine Finance Division in London. From 1980 to 1987 he worked in Citicorp's Corporate and Investment banks in New York, Zurich and London. Mr. Koltès holds a BA degree from Middlebury College. In addition to his involvement in Elster, Mr. Koltès serves on the supervisory board of Evonik Industries AG and serves as a nonexecutive member of the board of Flint Group Holdings S.à r.l., a company related to investments made by funds advised by CVC in Flint Group.

Jill Smith—Member of Administrative Board

Ms. Jill Smith until recently served as the chairman of the board of directors and CEO of DigitalGlobe, Inc., a leading provider of satellite information products and services to commercial and government customers globally. She comes with a wealth of experience leading commercial technology companies in the internet, software and electronic publishing markets. Ms. Smith was previously president and CEO of eDial, a collaboration software company, and CEO of SRDS, L.P., a private publishing and printing company, as well as COO of Micron Electronics, Inc., a direct PC manufacturer and marketer. Additionally, Ms. Smith co-founded and led Treacy & Company, LLC, a consulting and boutique investment business. Ms. Smith's earlier professional experience includes executive positions at Sara Lee Corporation and vice president at Bain & Company. She earned a master's degree in business administration from the MIT Sloan School of Management.

5. Elster's businesses

Elster views the metering business as being divided into three levels of increasing technological sophistication:

Manual-read meters are devices that measure gas, electricity and water consumption data. They are based on mechanical technology, in which mechanical components measure the movement of gas or water, electromechanical technology, in which electricity is measured by the electromechanical movement of a disk, or solid state technology, in which gas, electricity or water is measured by electronic devices.

Automated Meter Reading, or AMR, typically enables one-way communication of periodic (monthly billing) consumption data from the meter to the utility, thereby eliminating the need to enter the consumer's premises. AMR is usually accomplished either through the use of a wireless technology such as radio frequency, or RF (which includes cellular telephony), wired telephony, or power line communications technology, or PLC, using the utility's existing power lines. Simpler AMR systems permit data to be collected through the use of "walk-by" or "drive-by" meter readings that can be made from a point close to the meter, while more advanced transmission technologies, such as cellular telephony, many power line systems and some radio frequency systems, permit meter reading to take place remotely.

Advanced Metering Infrastructure, or AMI, is a technology that allows two-way communication between the smart meter and the utility or other parties, such as the consumer, enabling measurements and functions

beyond normal monthly billing. For electricity meters, RF mesh communications technology is often used in North America, whereas PLC or general packet radio service, or GPRS, technology is preferred by most utilities in Europe. RF mesh technology uses a radio frequency communications network in which nodes within the system can act as communications paths to other nodes within the system, allowing a path around communications blockages and improving the reliability and efficiency of communications systems. For gas and water meters, RF is preferred due to its lower implementation cost. In addition to the remote, real-time collection of consumption data, AMI technology integrates interactive features, including the ability to disconnect or reconnect service, upgrade devices and deliver instructions to other devices. These smart metering systems can provide the basis for more complex commodity measurement, more advanced Smart Grid distribution measurement and control, and more consumer applications such as in-home displays and real-time pricing.

5.1 *Elster's meter, utilisation and Smart Grid Solutions*

5.1.1 *Gas*

Gas meters are used in residential, commercial and industrial settings and are installed for a number of gas infrastructure applications at various points along the gas distribution network, starting at the point of exploration and production and continuing throughout the transmission network.

Elster offers a full spectrum of gas metering and distribution products and solutions for the residential, commercial and industrial sectors. Elster's products and solutions service gas markets from the source of natural gas to consumers. Elster's gas metering products are complemented by its utilisation products, which comprise process-heating equipment, including burner-control systems for gas-fired industrial heat treatment processes, and heat-control systems for residential and commercial boilers, and by its gas distribution products, which consist of valves, risers and other gas infrastructure products.

In addition, Elster offers repair, calibration, commissioning and maintenance services as well as project engineering. Elster also offers gas pressure regulation and communication products such as low and middle pressure regulators, valves, volume converters, data loggers, flow computers, gas quality measurement, and metering and regulation stations as well as monitoring systems. These products are used predominantly in upstream and mid-stream applications.

Elster markets its gas products under recognised brands such as Elster American Meter, Elster Kromschröder, Elster Perfection and Elster Instromet. Elster's customers include gas exploration and production, gas transmission, gas distribution and general industrial companies, integrators, end-users, power plants, grid operators as well as multi-utilities.

Elster provides gas utilisation safety devices for the control and use of gas and related components and systems for the regulation of combustion processes. Elster's customers in this market include commercial boiler manufacturers, furnace builders and end-users from the metal and ceramics as well as the incineration industries. Elster's gas utilisation products consist of process-heating equipment, such as burner-control systems for gas-fired industrial heat treatment processes, and heat-control systems for residential and commercial boilers. Elster also offers products for natural and propane gas distribution systems, such as polyethylene piping products, mechanical pipe joining products and pre-fabricated meter sets that allow quick, easy and safe connections between gas mains and residential or commercial and industrial consumer premises. In 2011, 2010 and 2009, Elster's gas segment accounted for 57.7 per cent., 53.5 per cent. and 53.0 per cent. of its total revenues, respectively.

5.1.2 *Electricity*

Electricity meters are installed, in both residential, commercial and industrial settings, at the delivery point to the consumer and at various points within the electricity grid. In the electricity market, while electromechanical meters have historically been the industry standard, and these meters continue to be sold in many countries around the world, functionality requirements have recently driven many utility customers to move to solid state meters.

Elster's electricity segment offers electromechanical and solid state single-phase and polyphase meters, each of which can be equipped with AMR and AMI technology, and related products.

Elster offers numerous technologies to its electricity customers that can be adapted to the specifics of each market and the requirements of each customer, including security functions, plug & play capabilities and IP-based protocols. In addition, Elster's electricity segment offers most common communications technologies, such as RF mesh, PLC, cellular and satellite communication. In Europe, due to the unique structure of the electricity grid, Elster's focus has been generally on either PLC networks, as in Germany, France, The Netherlands and Spain, or on GPRS in several countries such as the United Kingdom and Ireland. In the North American market, Elster has primarily been focused on RF mesh (900 MHz) technology due to the high level of spectrum availability for use and the greater demand for increased functionality, such as distribution automation, which RF mesh enables.

Elster markets most of its electricity meters under the Elster name. Elster markets most of its "Smart Offerings" for electricity under the brand EnergyAxis. Elster continues to market some of its "Smart Offerings" under the EnergyICT and Coronis brands.

In 2011, 2010 and 2009 Elster's electricity segment accounted for 23.0 per cent., 24.9 per cent. and 26.3 per cent. of its revenues, respectively.

5.1.3 *Water*

Water meters are installed for a number of application areas, including water withdrawal, processing, transmission, distribution and consumption in both the residential, commercial and industrial sectors. Water conservation continues to be a concern throughout the world, and scarcity is expected to drive water meter penetration. AMI in the water metering market is currently less developed than in the electricity market.

Elster offers a full water metering product portfolio covering brass, bronze and polymer based mechanical and solid state meters (in which water is measured by mechanical or electronic devices) for residential, commercial and industrial applications. Elster's polymer meters are designed to cope with variable water qualities and are generally less expensive than brass meters.

Most of Elster's meters can be equipped with pulse or encoded output devices for easy connection to reading, billing or water management systems, and cold and warm water versions are available on most product designs. Elster offers its water meter products under brand names, such as Kent. Elster's water segment serves a global customer base primarily comprised of multi-utilities, municipal and privately owned water-only utilities. Elster also works with other systems providers to develop AMR solutions, including meters with integrated radio technology for its sub-metering products. These products enable smaller system providers to utilise Elster's technology in their solution offering.

In recent years, an increasing number of Elster's water utility customers, including in the United States, Europe and the Middle East, have been implementing AMR functionality into their networks, and Elster has been addressing this need through the combination of its meters with either its two-way offerings or third party AMR modules. Elster believes that customers will increasingly demand meters that use two-way communication. As of December 31, 2011, Elster had delivered around 5.5 million two-way communication endpoints to its water utility customers, of which over 3.1 million are fixed line enabled.

Elster's system is based on its Wavenis communications technology and enables time-based rates, remote valve actuation, on-demand consumption readings, real-time notification of leaks and tampering or backflow. This system enables intelligent two-way communication that avoids the flexibility constraints of traditional AMR, features secure and reliable transmissions.

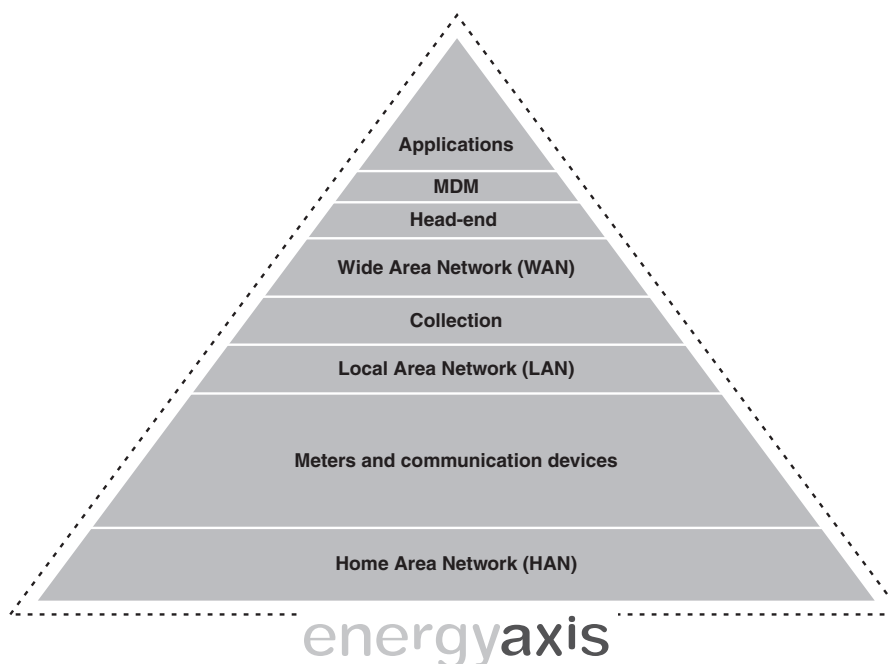
In 2011, 2010 and 2009, Elster's water segment accounted for 19.2 per cent., 21.6 per cent. and 20.8 per cent. of its total revenues, respectively.

5.2 Smart Grid Solution, Energy Axis

EnergyAxis is Elster's comprehensive portfolio of Smart Grid solutions that has applications across its gas, electricity and water segments. EnergyAxis uses an open and flexible architecture and is based on interoperable standards. It can be customised by incorporating Elster's own and third-party elements, including meters, meter and network communications technologies, customer interfaces, or head-end software, meter data management, or MDM, software and related applications. This allows Elster to tailor its Smart Grid solutions to address the specific requirements of gas, electricity and water utilities while also taking into account varying regional standards and preferences.

When an EnergyAxis system is deployed in a gas, electricity or water network, or on a multi-utility platform, it can enable distribution automation (which extends a utility's communication capabilities into the transmission and distribution grid for monitoring and control of the distribution grid), scalable demand response (which allows residential, commercial, industrial and agricultural loads to be managed to conserve or reduce peak demand), loss, theft or leakage detection, home area networking and personal consumption management. In situations where customers implement Smart Grid solutions of their own design or deploy networks based on competitor solutions, Elster also has the capability to deliver individual EnergyAxis components.

The graphic below illustrates the parts of the Smart Grid value chain covered by EnergyAxis. In addition to providing integrated EnergyAxis systems using its own or third-party components, Elster also offers a variety of individual products and components covering each link of the Smart Grid value chain for different utilities, regions and regulatory environments.



Applications: Elster's applications are designed to integrate Smart Grid solutions into a range of utility specified settings or legacy applications, using a number of open and standards-based interfaces. In addition, Elster provides or is working to develop a number of specialty applications including security management, communications scheduling, demand response and energy management, and Elster plans to continue to do so as the industry evolves. In particular, Smart Grid provides a number of new opportunities for distribution monitoring and control (for example, voltage conservation), and Elster is working closely with its customers and partners to support these opportunities.

Meter Data Management, or MDM, refers to software that provides data validation, estimation, aggregation and storage services for utilities. MDM enables detailed management of energy requirements within the Smart Grid. MDM systems generally connect to utilities' internal systems

and support detailed grid and energy management activities such as multi-tariff billing, meter reading validation and estimation, loss detection, outage management, transmission planning, demand management and customer self-service, customer prepayment and remote disconnect/reconnect. Elster's EIServer is a flexible and scalable MDM system supporting Elster's multi-utility AMI applications as well as those of third parties. It has been used in conjunction with some of our largest AMI deployments.

Head-End software: Head-end software is used to manage information flows across networks. Elster's head-end products support decision-making software at various locations, or distributed intelligence, to reduce the complexity of the communication network, including its structure, protocols, security, monitoring and maintenance, and certain specialty applications, such as MDM.

Wide Area Networks, or WANs, are communications networks that connect the utility to a variety of components, networks and systems and that commonly use public wireless technologies. Elster provides a variety of WAN communications technology options to communicate with endpoints, collection nodes, LAN Gateways and other assets in the system with internet protocol-, or IP-, based and other wired, wireless and fiber networks. These interfaces include wired and wireless (cellular) telephony, WiFi/WiMax RF, private RF, satellite communications and a broadband power line carrier.

Collection includes the infrastructure and software that enables data from different meters and meter types to be collected for use by a meter data management system within the Smart Grid. It often consists of data collection devices, which may contain embedded software that enables certain Smart Grid functionality. Elster's collection products use distributed intelligence to manage and maintain a wired or wireless Local Area Network, or LAN, as well as gather, filter and/or prepare data and process subtasks between points on the LAN and the head-end over a WAN collection.

Local Area Networks: Elster provides a variety of LAN communications technology options to reliably and cost-effectively communicate with utility endpoints. These wired and wireless interfaces include Elster's EnergyAxis 900 MHz RF mesh, Elster's RF network based on its Wavenis technology and 900/868/435 MHz bandwidths and a variety of utility specified PLC, Ethernet and RS232/485 wired communication using IP-based and other standards, including those of the Institute of Electrical and Electronics Engineers, the American National Standards Institute and the International Electrotechnical Commission, or IEC.

Meters and Communication Devices: Elster provides a broad range of meters for most applications across gas, electricity and water with and without communication devices, electronic correction or data storage functionality and service disconnect switches or valves. Elster also provides distribution automation points such as distribution transformer monitors, temperature and pressure monitors and distribution controls. Communications technologies can either be an integral part of the meter itself, or be incorporated into the device as a module. Elster has been the first to offer a hardware platform with fully integrated RF communications that can support the major North American mesh networks in Elster's REXUniversal electricity meter. Elster has designed its Apollo electricity meter to accept a variety of communications modules for its international markets in accordance with the standards of the IEC. Both of these products allow field flexibility to update or totally change communications networks, providing Elster's customers with greater flexibility. In the Smart Grid value chain, the meter typically currently accounts for more than half of the total purchase value of a complete solution.

Home Area Networks: Elster provides a variety of HAN communications technology options to extend the communications layer and interactivity into the consumer's premises or other equipment. These interfaces include a variety of wired networks, including Ethernet, M-Bus and RS242/485 and wireless networks including Elster's EnergyAxis RF mesh, Wavenis RF, ZigBee and Blueline. Elster also provides some utility-related equipment that interfaces via the HAN, such as in-home displays and load control devices.

Elster sees the Smart Grid playing a central role in the transformation of the metering industry and creating opportunities for it, despite the risk of increasing competition from traditional metering companies as well as new entrants from outside the metering business. As of December 31, 2011, Elster has delivered over 14 million of its two-way communication endpoints for metering applications, including over 9.3 million that are enabled for fixed networks. Of this total, Elster's utility customers have deployed more than 6.2 million smart meters in 101 EnergyAxis systems worldwide.

6. Selected financial information

The financial information set out below has been extracted without material adjustment from (i) Elster's consolidated financial statements for the years ended 31 December 2011, 31 December 2010 and 31 December 2009 respectively and (ii) the unaudited Elster quarterly report for the first quarter ended 31 March 2012 published on 4 May 2012, in each case, prepared in accordance with US GAAP.

The auditors of Elster, KPMG AG, issued unqualified audit opinions on Elster's consolidated financial statements for each of the years ended 31 December 2011, 31 December 2010 and 31 December 2009.

The financial information set out below does not constitute statutory accounts for any company within the meaning of section 434 of the 2006 Act.

The tables below set out Elster's consolidated income statements, balance sheets and cash flows for the periods indicated.

Elster financial information for the three month period ended 31 March 2012

This Elster historical financial information for the three month period ended 31 March 2012 has been extracted without material adjustment from Elster's unaudited quarterly report for the first quarter ended 31 March 2012 which was published on 4 May 2012. It therefore does not reflect any transactions and events that may have occurred after that date. This financial information is prepared in accordance with US GAAP.

CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME (IN THOUSANDS, EXCEPT PER SHARE DATA) (UNAUDITED)

	Three Months Ended 31 March	
	2012	2011
	\$ (unaudited)	\$ (unaudited)
Revenues	446,707	443,883
Cost of sales	– 315,665	– 297,431
Gross profit	131,042	146,452
Operating income	21,226	40,693
Total non-operating expenses	– 7,554	– 5,800
Income before income tax	13,672	34,893
Income tax expense	– 4,332	– 10,018
Net income	9,340	24,875
Net income attributable to non controlling interests	1,077	979
Net income attributable to Elster Group SE	8,263	23,896
Basic income per share	0.29	0.85
Diluted income per share	0.29	0.85

**CONSOLIDATED BALANCE SHEETS
(IN THOUSANDS)**

	31 March 2012	31 December 2011
	<u>\$</u>	<u>\$</u>
	(unaudited)	(audited)
Total current assets	638,468	613,257
Total noncurrent assets	<u>1,384,278</u>	<u>1,358,092</u>
Total assets	2,022,746	1,971,349
Total current liabilities	500,464	453,529
Total noncurrent liabilities	<u>780,553</u>	<u>799,571</u>
Total liabilities	1,281,017	1,253,100
Total equity attributable to Elster Group SE	728,115	706,036
Total equity	741,729	718,249
Total liabilities and equity	2,022,746	1,971,349

**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(IN THOUSANDS)
(UNAUDITED)**

	Three Months ended 31 March	
	<u>2012</u>	<u>2011</u>
	<u>\$</u>	<u>\$</u>
	(unaudited)	(unaudited)
Cash flows from operating activities	50,095	47,167
Net cash flow used in investing activities	– 12,735	– 10,068
Net cash flow from (used in) financing activities	– 41,127	840
Net increase (decrease) in cash and cash equivalents	<u>– 3,767</u>	<u>37,939</u>
Cash and cash equivalents at March 31	82,779	266,754

Elster financial information for the periods ended 31 December 2009, 31 December 2010 and 31 December 2011

This Elster historical financial information has been extracted without material adjustment from Form 20-Fs filed with the SEC by Elster and is prepared in accordance with US GAAP as at and for each of the three financial years ended 31 December 2009, 31 December 2010 and 31 December 2011. The auditors' reports included in those Form 20-Fs were unqualified in respect of the periods presented.

A reconciliation of net income and shareholders' equity contained in this Part III (*Information on Elster*) to net income and shareholders equity under Melrose's accounting policies under IFRS is set out in Section (B) of Part VII (*Historical Financial Information Relating to Elster*).

**CONSOLIDATED STATEMENTS OF OPERATIONS
FOR THE YEARS ENDED 31 DECEMBER
(IN THOUSANDS, EXCEPT PER SHARE AND SHARE DATA)**

	31 December 2011	31 December 2010	31 December 2009
	\$ (audited)	\$ (audited)	\$ (audited)
Revenues	1,868,975	1,759,339	1,695,122
Cost of revenues	-1,262,957	-1,208,555	-1,191,297
Gross profit	606,018	550,784	503,825
Operating income	189,778	175,991	143,839
Total non-operating expenses	-49,310	-57,121	-52,146
Income from continuing operations before income tax	140,468	118,870	91,693
Income tax expense	-33,493	-29,402	-39,349
Net income from continuing operations	106,975	89,468	52,344
Net income (loss) from discontinued operations	-1,594	2,570	0
Net income	105,381	92,038	52,344
Net income attributable to noncontrolling interests	4,502	4,779	3,456
Net income attributable to Elster Group SE	100,879	87,259	48,888
Basic income per share			
Income from continuing operations attributable to Elster Group SE	3.63	3.39	1.42
Income (loss) from discontinued operations attributable to Elster Group SE	-0.06	0.13	0.00
Net income per share attributable to Elster Group SE shareholders	3.57	3.53	1.42
Diluted income per share			
Income from continuing operations attributable to Elster Group SE	3.63	3.39	1.42
Income (loss) from discontinued operations attributable to Elster Group SE	-0.06	0.13	0.00

**CONSOLIDATED BALANCE SHEETS
AS OF 31 DECEMBER
(IN THOUSANDS, EXCEPT SHARE DATA)**

	31 December 2011	31 December 2010	31 December 2009
	<u>\$</u>	<u>\$</u>	<u>\$</u>
	(audited)	(audited)	(audited)
Total current assets	613,257	767,765	616,407
Total noncurrent assets	1,358,092	1,396,492	1,525,035
Total assets	1,971,349	2,164,257	2,141,442
Total current liabilities	453,529	420,160	431,952
Total noncurrent liabilities	799,571	1,087,868	1,286,786
Total liabilities	1,253,100	1,508,028	1,718,738
Total equity attributable to Elster Group SE	706,036	640,714	416,551
Total equity	718,249	656,229	422,704
Total liabilities and equity	1,971,349	2,164,257	2,141,442

**CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED 31 DECEMBER
(IN THOUSANDS)**

	31 December 2011	31 December 2010	31 December 2009
	<u>\$</u>	<u>\$</u>	<u>\$</u>
	(audited)	(audited)	(audited)
Cash flows from operating activities			
Net income	105,381	92,038	52,344
Net cash flow used in investing activities	- 44,109	- 27,968	- 43,043
Net cash flow from (used in) financing activities	- 281,951	25,410	- 77,431
Net increase (decrease) in cash and cash equivalents	- 134,323	138,765	- 853
Cash and cash equivalents at December 31	83,952	216,294	75,392

Unaudited reconciliation of Elster financial information to IFRS as applied by Melrose

The financial information of Elster has been prepared in accordance with US GAAP, which differs in certain material respects from the IFRS accounting policies applied by Melrose in the preparation of its financial statements for the financial years ending 31 December 2011, 31 December 2010 and 31 December 2009.

The tables below show the net profit and shareholders' equity for Elster under US GAAP and also under IFRS, which have extracted without material adjustment from Section B of Part VII (*Historical Financial Information Relating to Elster*) of this document. For full details of the reconciliation of Elster's net profit and shareholder's equity from US GAAP to IFRS, see Section B, Part VII (*Historical Financial Information Relating to Elster*) of this document.

	<u>Q1</u> <u>2012</u>	<u>2011</u>	<u>2010</u>	<u>2009</u>
	\$'m	\$'m	\$'m	\$'m
Net income under US GAAP	9.3	105.4	92.0	52.3
<i>Adjustments</i>				
A. Research and development	(0.2)	8.3	7.7	8.1
B. Pension and other employee benefits	(0.3)	(2.1)	(1.8)	(2.3)
Tax effect of above adjustments	0.1	(0.9)	(1.1)	(1.9)
Net income under IFRS	<u>8.9</u>	<u>110.7</u>	<u>96.8</u>	<u>56.2</u>
	<u>Q1</u> <u>2012</u>	<u>2011</u>	<u>2010</u>	<u>2009</u>
	\$'m	\$'m	\$'m	\$'m
Total equity under US GAAP	741.7	718.2	656.2	422.7
<i>Adjustments</i>				
A. Research and development	34.0	34.1	26.8	18.9
Tax effect of above adjustment	(9.5)	(9.5)	(7.8)	(6.0)
Foreign currency translation adjustment	(0.4)	(1.3)	(0.9)	0.3
Total equity under IFRS	<u>765.8</u>	<u>741.5</u>	<u>674.3</u>	<u>435.9</u>

7. Current trading, trends and prospects

Elster's first quarter 2012 revenues were \$446.7 million, up \$2.8 million, or 0.6 per cent., over the first quarter of 2011, and up 3.3 per cent. on a constant currency basis⁽¹³⁾. Growth in Elster's water and gas segments outweighed weaker performance in the electricity segment.

Elster recorded adjusted EBITDA⁽¹⁴⁾ of \$63.1 million in the first quarter of 2012, up 1.4 per cent. compared to the first quarter of 2011. Adjusted EBITDA margin of 14.1 per cent. was in line with prior year results. First quarter 2012 non-GAAP net income attributable to Elster Group SE was \$27.1 million, or \$0.24 per Elster ADS compared to \$29.0 million, or \$0.26 per Elster ADS, in the first quarter of 2011. The decrease is impacted by the level of unrealised gains on interest rate swap agreements of \$6.4 million in the first quarter of 2011 compared to unrealised gains of \$1.4 million in the first quarter of 2012.

First quarter 2012 gross margin, net of charges related to the reinvestment programme, was 32.4 per cent. compared to 33.0 per cent. in the first quarter of 2011. The decrease was attributable to less favourable product mix in Elster's gas segment and to reduced volumes in Elster's electricity segment.

Total operating expenses, net of charges related to the reinvestment programme, decreased by \$2.2 million, or 2.1 per cent., to \$103.6 million in the first quarter of 2012, down from \$105.8 million in the first quarter of 2011. The decrease was driven by a reduction in both general and administrative expenses and research and development investment.

(13) Constant currency rates: Calculated by translating the results from entities that have functional currencies other than US dollars into dollars using the exchange rates of the prior year.

(14) Adjusted EBITDA is a non-GAAP measure. Adjusted EBITDA margin is consolidated adjusted EBITDA as a percentage of consolidated revenue.

Gas

Gas revenues in the first quarter of 2012 of \$258.5 million reflect a 1.1 per cent. increase versus the first quarter of 2011. On a constant currency basis, revenues increased by 4.0 per cent. Segment profit⁽¹⁵⁾ of \$63.3 million was 2.3 per cent. lower compared to the first quarter of 2011 as segment profit margin⁽¹⁵⁾ decreased to 24.5 per cent. from 25.3 per cent. year-over-year.

The increase in gas segment revenues was driven by improved demand across the commercial, industrial and residential sectors for the gas utilisation product portfolio and solid metering demand across geographies. Both North America and international metering markets contributed to the growth on a constant currency basis. The segment profit decrease mainly was attributable to product mix and currency effects.

Electricity

First quarter 2012 electricity revenues were \$95.9 million, a decrease of 3.5 per cent. versus the first quarter of 2011. On a constant currency basis, revenues declined by \$1.4 million, or 1.3 per cent. Segment profit of \$2.3 million declined 37.8 per cent. compared to the first quarter of 2011. Segment profit margin declined to 2.4 per cent. from 3.7 per cent. year-over-year.

Solid Latin America and Middle East and North Africa performance was offset by slight decreases in Oceania and Europe. North America produced flat results compared to the first quarter of 2011, as several small- and mid-sized projects, which began in late 2011 and early 2012, have not yet generated significant revenues. First quarter 2012 electricity profitability primarily was impacted by lower sales volume.

Water

Water revenues in the first quarter of 2012 of \$97.8 million reflect a 1.5 per cent. increase versus the first quarter of 2011. On a constant currency basis, water revenues grew by 4.1 per cent. Water segment profit of \$8.4 million increased by 16.7 per cent. compared to the first quarter of 2011. Water segment profit margin increased to 8.6 per cent. from 7.5 per cent. year-over-year.

The increase in water segment revenues was attributable to ongoing projects in Oceania, solid Latin American results, and a slight improvement in the North American, Middle Eastern and North African markets. This was offset slightly by weakness in specific Western European markets, as utility investments for residential Smart Meter products slowed. The segment profit increase was attributable to higher revenues, favourable product mix, cost controls, and reduced raw materials pricing pressure.

Since March 2012, monthly revenues have been steady and margins slightly below those in the previous quarter. The order book is at a similar level to that at the end of the first quarter and includes the large order from a North American hydro electric customer received in March 2012.

(15) Segment profit margin is segment profit as a percentage of segment revenues. Segment profit is further defined in note 21 to the Elster consolidated financial statements set out on page 170 of this document.

8. Employees

The following table contains the numbers, functions and geographic locations of Elster's employees at the dates shown.

	As of December 31,					
	2011	per cent.	2010	per cent.	2009	per cent.
Function						
Manufacturing, assembly and operation	4,361	62.4	4,387	63.0	4,369	63.8
Sales and Marketing	882	12.6	863	12.4	834	12.2
Research & Development	656	9.4	632	9.1	561	8.2
Packaging warehousing and supply management .	417	6.0	419	6.0	436	6.4
Finance, controlling, accounting	281	4.0	289	4.2	284	4.1
Management	81	1.2	85	1.2	98	1.4
Other (IT, HR, <i>etc.</i>)	307	4.4	284	4.1	271	4.0
Total	6,985	100.0	6,959	100.0	6,853	100.0
Location						
Europe	3,709	53.1	3,710	53.3	3,686	53.8
North America	2,232	32.0	2,082	29.9	1,853	27.0
Rest of World	1,044	14.9	1,167	16.8	1,314	19.2
Total	6,985	100.0	6,959	100.0	6,853	100.0

In addition to the employee totals above, Elster also uses a number of temporary external employees in the United States and, in previous years, in South America, in connection with manufacturing activities. Elster also occasionally uses temporary employees to assist it in ordinary course office functions. Elster had 515, 395 and 367 temporary external employees as of December 31, 2011, 2010 and 2009, respectively.

As an international company operating in more than 30 countries, Elster is subject to various labour regulatory regimes. In a number of Elster's facilities, its employees are represented in works councils or labour unions. In 2011, Elster experienced one work stoppage in one of its facilities in Brazil which produces products for its water segment, affecting approximately 260 employees. The stoppage lasted four days. In 2009, Elster experienced one work stoppage in one of its facilities in France which produces products for its gas segment, affecting approximately 80 employees. Other than described above, Elster has not experienced any other material work stoppages in the last three years.

9. Pensions

Certain of the Elster Group's subsidiaries sponsor defined benefit pension plans. In addition, the Elster Group's subsidiaries in the US and Canada provide other postretirement benefits consisting of healthcare and life insurance benefits. The cost of providing these benefits is determined for each plan using the projected unit credit actuarial valuation method.

PART IV

OPERATING AND FINANCIAL REVIEW RELATING TO THE MELROSE GROUP

The operating and financial review for the year ended 31 December 2011, as set out in the annual report and accounts of Melrose for 2011, the operating and financial review for the year ended 31 December 2010, as set out in the annual report and accounts of Melrose for 2010, and the operating and financial review for the financial year ended 31 December 2009, as set out in the annual report and accounts of Melrose for 2009, are incorporated by reference into this document. The audit reports for each of the financial years ended 31 December 2011, 31 December 2010 and 31 December 2009 were unqualified. Reference should also be made to the 2011, 2010 and 2009 financial information incorporated by reference into this document: see Part VI (Historical Financial Information relating to Melrose), the Risk Factors on pages 8 to 38 of this document and the strategy section in paragraph 2 of Part II (Information on Melrose) of this document.

Investors should read the whole of this document and the documents incorporated herein by reference and should not just rely on the financial information set out in this Part IV (Operating and Financial Review Relating to the Melrose Group).

1. Cross reference list

The following list is intended to enable investors to identify easily specific items of information which have been incorporated by reference into this document.

1.1 *Operating Financial Review for the year ended 31 December 2009*

The page numbers below refer to the relevant pages of the annual report and accounts of Melrose for the financial year ended 31 December 2009:

- pages 1 to 25;
- page 28;
- pages 31 to 33;
- pages 42 to 43;
- pages 47 to 51;
- pages 58 to 59; and
- page 62.

1.2 *Operating Financial Review for the year ended 31 December 2010*

The page numbers below refer to the relevant pages of the annual report and accounts of Melrose for the financial year ended 31 December 2010:

- pages 1 to 25;
- pages 28 to 29;
- pages 31 to 34;
- pages 42 to 43;
- pages 47 to 51;
- pages 58 to 59; and
- page 62.

The page numbers below refer to the relevant pages of the annual report and accounts of Melrose for the financial year ended 31 December 2011:

- page 3;
- page 8;
- page 10;

- page 12;
- page 14;
- page 17;
- page 20;
- page 23;
- page 24;
- pages 26 to 30;
- pages 34 to 35;
- pages 58 to 59;
- pages 63 to 67;
- page 77; and
- pages 80 to 81.

1.3 ***Operating Financial Review for the year ended 31 December 2011***

The page numbers below refer to the relevant pages of the annual report and accounts of Melrose for the financial year ended 31 December 2011:

- pages 3 to 30;
- pages 34 to 35;
- page 39;
- pages 43 to 48;
- pages 58 to 59;
- pages 63 to 67;
- page 77; and
- pages 80 to 81.

PART V

CAPITAL RESOURCES

1. Capitalisation and indebtedness

The following tables show (i) the capitalisation of the Melrose Group as at 31 December 2011 and (ii) the total indebtedness and net debt of the Melrose Group as at 27 May 2012. There have been no material changes to the capitalisation figures since 31 December 2011. The figures for capitalisation have been extracted without material adjustment from Melrose's consolidated audited financial statements for the year ended 31 December 2011.

	£m
Total capitalisation and indebtedness	
Total Current debt	—
—secured	—
—unsecured	—
Total non-current debt (excluding current portion of long-term debt)	434.1
—secured	—
—unsecured	434.1
Shareholders' equity	
Share capital ⁽¹⁾	26.8
Share premium	126.0
Other reserves	629.0
Total capitalisation (as at 31 December 2011)	781.8

The following table details the net debt of the Melrose Group as at 27 May 2012:

	£m
Cash	83.8
Cash equivalents (bank deposits)	—
Liquidity	83.8
Current financial receivable	—
Current bank debt (secured and unsecured)	—
Other current financial debt (unsecured)	—
Current financial debt	—
Net current cash	83.8
Non-current bank loans (secured and unsecured)	434.1
Other non-current financial indebtedness	—
Non-current financial indebtedness	434.1
Net debt	350.3

Notes

(1) Share capital includes £25.7 million of unlisted non-cumulative redeemable preference shares of 75 pence each in the capital of Melrose which were automatically cancelled on 30 April 2012 in accordance with their terms.

Contingent liabilities and indirect debt

Melrose's Report and Accounts for the year ended 31 December 2011 contained details of product liability litigation against two Bridon companies, inherited, in part, from the FKI acquisition. On 23 May 2012, Bridon, Noble and Certex reached a consensual resolution and confidential settlement of the litigation and all claims have been dismissed with prejudice. The settlement sum to be paid by Bridon (net of current contributions from insurers but before costs) is within the provision as at 31 December 2011 (£25.8 million). Bridon is still in discussions with the remaining relevant members of its insurance programme who may be available to make further contributions up to the entire amount of the settlement paid by Bridon.

2. Funding—Melrose and the Enlarged Group

Melrose is a holding company whose principal assets are its investments in the shares of its subsidiaries. The liquidity and capital resource requirements of each subsidiary vary in the light of their own financial position and activity.

Melrose's principal source of funds is funds raised from time to time from the issue of ordinary shares and bank and other borrowings, as well as cash dividends received, and money borrowed, from its subsidiaries.

Melrose

On 22 December 2011, Melrose entered into a multi-currency revolving credit facilities agreement (the “**Existing Facilities Agreement**”) pursuant to which a multi-currency revolving credit facility (the “**Existing RCF**”) of £600 million was made available to Melrose by a consortium of banks. The Existing RCF will expire on the date which is five years after the date of the Existing Facilities Agreement. As at the Latest Practicable Date, Melrose had committed borrowing facilities under the Existing Facilities Agreement of £600 million of which £155 million, EUR 60 million and \$330 million was utilised. Other than the Existing Facilities Agreement, Melrose has no other drawn or undrawn committed banking facilities.

The Existing RCF can be used to fund the working capital requirements of the group and for its general corporate purposes. The Existing Facilities Agreement contains customary representations and warranties, financial covenants, undertakings and events of default. The undertakings include (i) an undertaking to not acquire interests in companies, businesses or undertakings if such acquisition would constitute a Class 1 transaction under the Listing Rules or the aggregate consideration for all such acquisitions during the duration of the Existing Facilities Agreement would exceed £150 million; (ii) an undertaking to ensure that financial indebtedness of members of the Melrose Group who are not obligors under the Existing Facilities Agreement, subject to certain exceptions, does not exceed £30 million at any time. There is no restriction (other than financial covenant compliance) on the ability of obligors to incur further financial indebtedness; and (iii) certain restrictions on disposal of assets (disposals in the ordinary course of trading are not subject to these restrictions).

Melrose intends to refinance the Existing Facilities Agreement on the date of initial utilisation under the New Facilities Agreement, with the proceeds of loans drawn under the New Facilities Agreement. As a result, the Existing RCF will be refinanced on or before the Effective Date, and no waiver will be required under the Existing RCF in relation to the Acquisition.

The Enlarged Group

On 29 June 2012 (the “**Signing Date**”), Melrose entered into a multi-currency term and revolving credit facilities agreement (the “**New Facilities Agreement**”) pursuant to which a USD 500 million term facility and a £180 million term facility and a EUR 300 million revolving credit facility, a £70 million revolving credit facility and a £690 million revolving credit facility will be provided to the Melrose Group (and on the Tender Offer becoming Effective, the Elster Group provided Elster and/or the relevant member of the Elster Group has acceded to the New Facilities Agreement as a borrower) by a group of lenders. Utilisation of the facilities under the New Facilities Agreement is subject to satisfaction of various customary conditions precedent. In particular, it is a condition precedent to utilisation of the facilities under the New Facilities Agreement that Melrose provide a certificate stating that Melrose Bidco has accepted for payment the Elster ADSs and Elster Shares validly tendered to it (and not properly withdrawn) and such Elster ADSs and Elster Shares represent at least 62.0 per cent. of the share capital of Elster in issue at the commencement of the Tender Offer (other than to the extent the arrangers under the New Facilities Agreement have agreed Melrose Bidco can accept a lower percentage). If the Tender Offer does not take place, Melrose's current intention is to leave the Existing Facilities Agreement in place and continue to utilise the facilities available under that agreement.

The term facilities will be available: (i) to Melrose, to partially finance the Acquisition, refinance amounts outstanding under the Existing Facilities Agreement and to refinance other indebtedness of the Melrose Group; (ii) after the Effective Date and provided Elster and/or the relevant member of the Elster Group

has acceded to the New Facilities Agreement as a borrower, to borrowers who are members of the Elster Group to refinance amounts outstanding under the Elster RCF; and (iii) for the general corporate purposes of Melrose and the Melrose Group and to pay (or refinance amounts used to pay) costs and expenses associated with the Acquisition (and the balance of the cost of acquiring any Elster Shares and/or Elster ADSs (after applying the net proceeds of the Rights Issue) not financed by loans drawn under the term facilities will be financed by loans drawn under the revolving credit facilities which are described below). The first drawdown under the term facilities must be made within eight months after the Signing Date. The term facilities cease to be available on the earlier of eight months after the Signing Date and the date that is four months after the date of the first drawdown. The aggregate outstanding amount under the term facilities are required to be reduced to (i) on the third anniversary of the Signing Date, 95 per cent. of the total term loans drawn at the end of the availability period applicable to the term facilities; (ii) on the fourth anniversary of the Signing Date, 90 per cent. of the total term loans drawn at the end of the availability period applicable to the term facilities; and (iii) on the date falling six months after the fourth anniversary of the Signing Date, 85 per cent. of the total term loans drawn at the end of the availability period applicable to the term facilities. The balance of the aggregate outstanding amounts under the term facility are required to be repaid on the date that is five years after the Signing Date.

The revolving credit facilities under the New Facilities Agreement will be available from the Signing Date until the date that is one month before the date that is five years after the Signing Date. The revolving credit facilities will be used: (i) by Melrose, to partially finance the Acquisition (including the balance of the cost of acquiring any Elster Shares or Elster ADSs (after applying the net proceeds of the Rights Issue) not financed by loans drawn under the term facilities, including pursuant to any “squeeze-out” procedure, further tender offer or market purchases) and to pay any costs and expenses in connection with the Acquisition or entry into the New Facilities Agreement; (ii) by Melrose, to finance the Melrose Group’s working capital requirements and for general corporate purposes (including refinancing existing indebtedness, whether under the Existing Facilities Agreement or otherwise, and for financing acquisitions); and (iii) after the Effective Date, by the Elster Group, provided Elster and/or the relevant member of the Elster Group has acceded to the New Facilities Agreement as a borrower, to finance its working capital requirements and for general corporate purposes (including, if required, refinancing existing indebtedness, whether under the Senior Notes, the Elster RCF or otherwise, and for financing future acquisitions). Elster Holdings US Inc. has a separate revolving credit facility of £70 million available to it for its working capital needs after it accedes to the New Facilities Agreement as a borrower.

Prior to the EGSE Guarantee Date (as defined below), Melrose is required to ensure that the aggregate of any outstanding loans under the euro denominated tranche of the revolving credit facilities do not exceed an agreed threshold (the “**RCF Drawing Limit**”) provided that the RCF Drawing Limit may be exceeded prior to the EGSE Guarantee Date as a result of the euro denominated tranche of the revolving credit facility being utilised to fund, directly or indirectly, any change of control offer, full redemption, repurchase, retirement or other acquisition of the Senior Notes or to pay associated costs and expenses or any costs and expenses incurred in connection with a waiver request or consent solicitation approved by the lenders under the New Facilities Agreement in relation to the Senior Notes.

The New Facilities Agreement contains representations and warranties, financial covenants, undertakings and events of default customary for a facilities agreement of this nature. The undertakings include (i) an undertaking to not acquire interests in companies, businesses or undertakings if (A) the aggregate consideration for all such acquisitions during the life of the New Facilities Agreement would exceed (x) £300 million (this limit will not apply if the leverage ratio at the time of a proposed acquisition (pro forma for such acquisition) is 1.50:1 or less) or (y) £150 million for such time that 75 per cent. of Elster Shares are not held by Melrose Bidco, and in all cases (B) such acquisition is not a Class 1 Transaction under the Listing Rules; (ii) an undertaking to ensure that financial indebtedness of members of the Melrose Group (and after the Effective Date, the Enlarged Group) who are not obligors under the New Facilities Agreement, subject to certain exceptions, does not exceed £75 million at any time; (iii) if Melrose Bidco does not acquire sufficient Elster ADSs and/or Elster Shares pursuant to the Tender Offer to commence “squeeze-out” proceedings under German law in respect of minority shareholders, an undertaking to exercise reasonable endeavours (taking into consideration any limitations on exercise of its influence on Elster under German law) to put in place a German law domination agreement with Elster

within 18 months of the date of initial utilisation of the term facility; (iv) an undertaking that Melrose will ensure that Elster accedes to the New Facilities Agreement as a borrower as soon as reasonably practicable and in any event no later than 25 Business Days from the date of initial drawdown and repays all amounts it has drawn under the Elster RCF and cancels the Elster RCF; and (v) a requirement to ensure that refinancing of the Senior Notes will be with either (A) the proceeds of loans under the New Facilities Agreement or (B) pari passu debt borrowed by Melrose. The financial covenants require that interest cover for the Enlarged Group remains equal to or greater than 4.0:1 and the leverage ratio for the Enlarged Group remains equal to or less than (depending on the testing period) 3.50:1 to 3.0:1 and that, until such time as Melrose Bidco acquires 75 per cent. of the total share capital of Elster, the interest cover for the Elster Group remains equal to or greater than 4.0:1 and the leverage ratio for the Elster Group remains equal to or less than (depending on the testing period) 3.25:1 to 3.0:1. Prior to the EGSE Guarantee Date, certain further restrictions apply to incurrence of financial indebtedness by the Elster Group outside of the New Facilities Agreement, the Elster RCF and the Senior Notes. Melrose has to redeem the Senior Notes by 30 April 2014 if it has not acquired 75 per cent. of the Elster Shares on or prior to that date.

Melrose and various other entities in the Melrose Group will, subject to applicable local law limitations, guarantee all amounts due under the New Facilities Agreement. After the Effective Date, the Elster Group will initially (and subject to the limitations under the Senior Notes covenants) guarantee only its own borrowings. When permitted to do so under German law, the Elster Group will, subject to limitations under the Senior Notes covenants that are applicable at such time and applicable local law limitations, guarantee the liabilities of the Melrose Group (the date on which such guarantees are granted being the “EGSE Guarantee Date”).

Melrose Bidco will grant a pledge over the Elster ADSs and Elster Shares that it acquires pursuant to the Tender Offer in favour of the lenders under the New Facilities Agreement. The New Facilities Agreement allows for the pledge to be released to allow Elster ADSs acquired by Melrose Bidco to be withdrawn from the ADS programme provided that the Elster Shares it acquires in exchange for such Elster ADSs are pledged in favour of the lenders under the New Facilities Agreement. Upon the occurrence of the EGSE Guarantee Date, any such pledge then in existence (whether over the Elster ADSs or the Elster Shares) will immediately be released.

Melrose intends to, on the date of initial utilisation under the New Facilities Agreement, repay in full all amounts then outstanding under the Existing Facilities Agreement and cancel all undrawn commitments. For further information on the Existing Facilities Agreement, please refer to the paragraph above headed “Melrose” and the Finance Director’s review in Melrose’s annual report and accounts for the financial year ended 31 December 2011 which is incorporated by reference into this document.

3. Borrowing requirements and funding structure

The Existing RCF is used (when required) to finance short-term working capital requirements. The Melrose Group’s businesses display no significant seasonality in their borrowing requirements. Committed bank facilities are made available under the Existing RCF to Melrose which draws down under them and on-lends to subsidiaries as required. Melrose can request that the commitments of lenders under the Existing RCF (up to an aggregate limit of £250 million) be made available as bilateral ancillary facilities. Overseas subsidiaries can directly avail of overdraft facilities in their jurisdictions as required. The New Facilities Agreement will provide for a revolving credit facility that can be used by Melrose and members of the Elster Group, for the purposes detailed in the description of the New Facilities Agreement at paragraph 2, above. Melrose can request that the commitments of lenders under the revolving credit facility in the New Facilities Agreement (up to an aggregate limit of £250 million) be made available as bilateral ancillary facilities.

4. Restrictions on use of capital resources

There are no notable restrictions on the use of the Melrose Group’s capital resources.

5. Treasury policies

The Melrose Group has a centralised treasury function whose primary role is to manage funding, liquidity and financial risks. Treasury is not a profit centre and does not enter into speculative transactions. The treasury policies of the Melrose Group are controlled by the Melrose Board and are subject to discussion on a regular basis, on the recommendation of the Finance Director. Whenever appropriate, the Melrose Group's treasury policy is to remit surplus cash resources to the UK companies in the Melrose Group. For further information please refer to Melrose's annual report and accounts for the financial year ended 31 December 2011 which is incorporated by reference into this document.

6. Cash flow Analysis

The selected cash flow information presented for the years ended 31 December 2011, 31 December 2010 and 31 December 2009 has been prepared in accordance with IFRS and has been extracted from the Melrose Group's audited financial statements for the years ended 31 December 2011, 31 December 2010 and 31 December 2009 respectively.

	Year ended 31 December			
	2011	2010 ⁽¹⁾	2010	2009
	£m	£m	£m	£m
Net cash from operating activities from continuing operations	74.6	72.7	117.9	176.8
Net cash from/(used in) operating activities from discontinued operations	16.6	45.2	—	(2.0)
Net cash from operating activities	91.2	117.9	117.9	174.8
Investing activities				
Disposal of businesses	374.4	(0.1)	(0.1)	49.2
Net cash disposed	(0.5)	—	—	(0.6)
Acquisition and disposal costs	(3.2)	—	—	—
Purchase of properties, plant and equipment	(37.6)	(22.9)	(29.5)	(22.9)
Proceeds on disposal of properties, plant and equipment	0.3	0.2	0.3	1.0
Purchase of computer software	(1.6)	(1.2)	(1.2)	(0.9)
Dividends received from joint ventures	—	0.3	0.3	0.2
Dividends paid to non-controlling interests	—	—	(0.2)	(0.2)
Interest received	10.0	9.3	9.3	3.8
Acquisition of subsidiary undertakings	—	(9.1)	(9.1)	—
Net cash from/(used in) in investing activities operations from continuing operations	341.8	(23.5)	(30.2)	29.6
Net cash from/(used in) investing activities operations from discontinued operations	(4.6)	(6.7)	—	(1.3)
Net cash from/(used in) investing activities	337.2	(30.2)	(30.2)	28.3
Financing activities				
Dividends paid	(52.8)	(43.8)	(43.8)	(35.6)
Return of capital	(372.1)	—	—	—
Net movement on borrowings	—	—	(0.5)	(185.8)
Repayment of obligations under finance leases	—	(1.1)	(1.1)	(0.1)
Net cash used in financing activities from continuing operations	(424.9)	(44.9)	(45.4)	(221.5)
Net cash used in financing activities from discontinued operations . . .	(0.3)	(0.5)	—	—
Net cash used in financing activities	(425.2)	(45.4)	(45.4)	(221.5)
Net increase in cash and cash equivalents	3.2	42.3	42.3	(18.4)
Cash and cash equivalents at beginning of year	195.7	147.5	147.5	167.7
Effect of foreign exchange rate changes	(3.3)	5.9	5.9	(1.8)
Cash and cash equivalents at end of year	195.6	195.7	195.7	147.5

(1) Restated to include the cash flows of Dynacast, Brush Traction, Logistex UK, Madico and Weber Knapp within discontinued operations.

7. Principal investments and acquisitions

In the financial years ended 31 December 2011, 31 December 2010 and 31 December 2010 the Melrose Group did not, and as at the Latest Practicable Date the Melrose Group does not, have any principal investments.

8. Plant, property and equipment

A description of the Melrose Group's investments in property, plant and equipment is given on pages 18 and 107 of the annual report and accounts of Melrose for the financial year ended 31 December 2011, which is incorporated into this document by reference. In addition, the Melrose Group has planned material capital expenditure of £15.8 million in relation to upgrades to certain Bridon manufacturing sites.

PART VI

HISTORICAL FINANCIAL INFORMATION RELATING TO MELROSE

1. Background

The financial statements of Melrose for the year ended 31 December 2011, as set out in the annual report and accounts of Melrose for 2011, the financial statements of Melrose for the year ended 31 December 2010, as set out in the annual report and accounts of Melrose for 2010, and the financial statements of Melrose for the financial year ended 31 December 2009, as set out in the annual report and accounts of Melrose for 2009, are incorporated by reference into this document. The audit reports for each of the financial years ended 31 December 2011, 31 December 2010 and 31 December 2009 were unqualified.

The financial statements for the financial years ended 31 December 2011, 31 December 2010 and 31 December 2009 were prepared in accordance with IFRS.

2. Cross reference list

The following list is intended to enable investors to identify easily specific items of information which have been incorporated by reference into this document.

2.1 *IFRS financial statements for the year ended 31 December 2009 and the audit report thereon*

The page numbers below refer to the relevant pages of the annual report and accounts of Melrose for the financial year ended 31 December 2009:

- consolidated income statement—page 47;
- consolidated statement of comprehensive income—page 48;
- consolidated statement of cash flows—page 49;
- consolidated balance sheet—page 50;
- consolidated statement of changes in equity—page 51;
- notes to the consolidated financial statements—pages 52 to 89;
- independent auditors' report—page 46; and
- accounting policies—pages 53 to 58.

2.2 *IFRS financial statements for the year ended 31 December 2010 and the audit report thereon*

The page numbers below refer to the relevant pages of the annual report and accounts of Melrose for the financial year ended 31 December 2010:

- consolidated income statement—page 47;
- consolidated statement of comprehensive income—page 48;
- consolidated statement of cash flows—page 49;
- consolidated balance sheet—page 50;
- consolidated statement of changes in equity—page 51;
- notes to the consolidated financial statements—pages 52 to 87;
- independent auditors' report—page 46; and
- accounting policies—pages 52 to 57.

2.3 *IFRS financial statements for the year ended 31 December 2011 and the audit report thereon*

The page numbers below refer to the relevant pages of the annual report and accounts of Melrose for the financial year ended 31 December 2011:

- consolidated income statement—page 63;
- consolidated statement of comprehensive income—page 64;
- consolidated statement of cash flows—page 65;
- consolidated balance sheet—page 66;
- consolidated statement of changes in equity—page 67;
- notes to the consolidated financial statements—pages 68 to 108;
- independent auditors' report—page 62; and
- accounting policies—pages 69 to 76.

PART VII

HISTORICAL FINANCIAL INFORMATION
RELATING TO ELSTER

Section A.1—Elster financial information for the three month period ended 31 March 2012

The Elster historical financial information for the three month period ended 31 March 2012 contained in Section A.1 of this Part VII (*Historical Financial Information Relating to Elster*) has been extracted without material adjustment from Elster's report on Form 6-K which contains the unaudited quarterly report for the first quarter ended 31 March 2012 which was filed on 4 May 2012. It therefore does not reflect any transactions and events that may have occurred after that date. This Section A.1 is prepared in accordance with US GAAP.

CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME
(IN THOUSANDS, US DOLLAR (\$), EXCEPT PER SHARE DATA)

	Three Months Ended 31 March	
	2012	2011
	\$ (unaudited)	\$ (unaudited)
Revenues	446,707	443,883
Cost of sales	- 315,665	- 297,431
Gross profit	131,042	146,452
Operating Expenses		
Selling expenses	- 46,499	- 44,112
General and administrative expenses	- 36,682	- 37,117
Research and development expenses	- 24,905	- 26,152
Other operating income (expense), net	- 1,730	1,622
Operating income	21,226	40,693
Non-Operating Expenses		
Interest expense, net	- 9,265	- 6,902
Other income, net	1,711	1,102
Total non-operating expenses	- 7,554	- 5,800
Income before income tax	13,672	34,893
Income tax expense	- 4,332	- 10,018
Net income	9,340	24,875
Net income attributable to non controlling interests	1,077	979
Net income attributable to Elster Group SE	8,263	23,896
Total other comprehensive income	13,648	21,583
Comprehensive income	22,988	46,458
Basic income per share	0.29	0.85
Diluted income per share	0.29	0.85
Weighted average shares outstanding		
Basic	28,220,041	28,220,041
Diluted	28,227,573	28,239,033

CONSOLIDATED BALANCE SHEETS
(IN THOUSANDS, US DOLLAR (\$))

	31 March 2012	31 December 2011
	\$	\$
	(unaudited)	(audited)
Assets		
Current assets		
Cash and cash equivalents	82,779	83,952
Accounts receivable (net of allowance for doubtful accounts of \$8,479 and \$8,033, respectively)	283,016	284,130
Receivables from related parties	7,004	5,900
Inventories	179,962	163,101
Prepaid expenses	9,250	6,236
Other current assets	48,066	42,625
Income tax refunds	7,303	8,121
Deferred tax assets	21,088	19,192
Total current assets	638,468	613,257
Noncurrent assets		
Property, plant and equipment, net	203,930	196,577
Other intangible assets, net	169,450	175,442
Goodwill	936,694	919,060
Other assets	58,755	52,953
Deferred tax assets	15,449	14,060
Total noncurrent assets	1,384,278	1,358,092
Total assets	2,022,746	1,971,349
Liabilities and Equity		
Current liabilities		
Pension and other long-term employee benefits, current portion	13,439	13,524
Payroll, bonuses and related accruals	60,410	55,087
Short-term debt and current portion of long-term debt	7,342	6,093
Accounts payable	213,406	203,115
Warranties, current portion	24,509	24,645
Other current liabilities	140,638	110,763
Deferred revenue	5,855	8,099
Income tax payable	27,257	25,177
Deferred tax liabilities	7,608	7,026
Total current liabilities	500,464	453,529
Noncurrent liabilities		
Pension and other long-term employee benefits, less current portion	152,869	149,630
Payroll, bonuses and related accruals	1,464	1,390
Long-term debt, less current portion	545,664	573,633
Warranties, less current portion	5,063	5,097
Other non-current liabilities	1,971	1,911
Income taxes payable	18,264	16,870
Deferred tax liabilities	55,258	51,040
Total noncurrent liabilities	780,553	799,571
Total liabilities	1,281,017	1,253,100
Equity		
Ordinary shares, €1 nominal value (47,220,041 shares authorized and 28,220,041 shares issued and outstanding as of March 31, 2012 and December 31, 2011)	36,528	36,528
Additional paid-in capital	651,945	651,453
Retained earnings	40,282	32,021
Accumulated other comprehensive loss	- 640	- 13,966
Total equity attributable to Elster Group SE	728,115	706,036
Noncontrolling interests	13,614	12,213
Total equity	741,729	718,249
Total liabilities and equity	2,022,746	1,971,349

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(IN THOUSANDS, US DOLLAR (\$))

	Three Months ended 31 March	
	2012	2011
	\$ (unaudited)	\$ (unaudited)
Cash flows from operating activities	50,095	47,167
Cash flows from investing activities		
Purchases of property, plant and equipment and intangible assets	-13,297	-10,859
Proceeds from disposals of property, plant and equipment and intangible assets	562	791
Net cash flow used in investing activities	-12,735	-10,068
Cash flows from financing activities		
Proceeds from bank borrowings	22,024	7,430
Repayment of bank borrowings	-63,135	0
Repayment of capital lease obligations	-16	-271
Dividends to noncontrolling interests	0	-6,319
Net cash flow from (used in) financing activities	-41,127	840
Net increase (decrease) in cash and cash equivalents	-3,767	37,939
Effect of exchange rate fluctuations on cash held	2,594	12,521
Cash and cash equivalents at January 1	83,952	216,294
Cash and cash equivalents at March 31	82,779	266,754
Income taxes paid	3,150	5,940
Interest paid	1,511	4,199

Notes to the Condensed Consolidated Interim Financial Statements
(in thousands of U.S. Dollar, except per share data)
(unaudited)

1. Corporate information

Elster Group SE, Essen, Germany, was originally incorporated as Gold Silver S.à r.l. on October 4, 2004 as a Luxembourg corporation to serve as a vehicle for private equity funds advised by CVC Capital Partners; it acquired the Ruhrgas Industries Group from E.ON Ruhrgas AG on September 12, 2005. After being renamed Nightwatch Investments S.à r.l. and further renamed Elster Group S.à r.l. on March 15, 2006, it was legally reorganized and became Elster Group SE, Luxembourg. Elster Group SE transferred its jurisdiction of incorporation from Luxembourg to Essen, Germany, on February 23, 2010 and is now a German corporation. The name changes and legal reorganizations were transactions under common control of the owners.

The business of Elster Group SE and its subsidiaries (hereinafter referred to as the “Company” or “Elster Group”) is the development, manufacturing and distribution of metering solutions for water, gas and electricity, as well as gas utilization and distribution products. The products and services are offered in more than 130 countries for residential, commercial and industrial customers.

2. Basis of presentation

These condensed consolidated interim financial statements are unaudited and have been prepared in accordance with accounting principles generally accepted in the United States of America (“U.S. GAAP”) to the extent applicable to interim financial statements. The condensed consolidated interim financial statements reflect all adjustments which are of a normal recurring nature that are, in the opinion of management, necessary to a fair statement of the results for the interim periods presented. Certain information and disclosures have been condensed or omitted in these condensed consolidated interim financial statements which should be read in conjunction with the audited consolidated financial statements for the year ended December 31, 2011 and accompanying notes thereto which are included in our 2011 Annual Report on Form 20-F.

Operating results and cash flows for interim periods are not indicative of the results and cash flows that may be achieved for the years ending December 31.

In December 2011 the FASB issued ASU 2011-12, “Comprehensive Income—Presentation of Comprehensive Income” (“ASU 2011-12”) which supersedes certain requirements of ASU 2011-05, “Comprehensive Income” (“ASU 2011-05”); ASU 2011-12 and 2011-05 amend the disclosure requirements for the presentation of comprehensive income in ASC 220, “Comprehensive Income”. ASU 2011-05 eliminates the option to present components of other comprehensive income (“OCI”) as part of the statement of changes in equity. Under the amended guidance, all changes in OCI are to be presented either in a single continuous statement of comprehensive income, or in two separate but consecutive financial statements. Elster has presented the changes in OCI in a single statement within the statements of operations and comprehensive income. There was no impact to the consolidated financial results as a result of the adoption of this amendment as it relates only to financial statement presentation.

Use of estimates and judgments

The preparation of the condensed consolidated financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities as well as disclosure of contingent assets and liabilities at the date of the condensed consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Significant items subject to such estimates and assumptions include the allowances for doubtful accounts and sales returns; reserves for obsolete inventory; useful lives of fixed assets and intangible assets; impairments of goodwill and long lived assets; the valuation and recognition of derivatives, deferred tax assets, and share-based compensation; and

provisions for employee benefit obligations, warranties, environmental liabilities, income tax uncertainties and other contingencies.

Estimates and underlying assumptions are reviewed on an ongoing basis.

Basis of consolidation

The accompanying condensed consolidated financial statements include the accounts of Elster Group and its subsidiaries after elimination of intercompany accounts and transactions.

The equity method of accounting is used for investments in which Elster Group can exercise significant influence over the operating and financial policies of an investee but does not have control.

Foreign currency translation

The condensed consolidated interim financial statements are presented in thousands of US dollars (“USD” or “\$”) which is the reporting currency of Elster Group, except for per share amounts.

Gains and losses from foreign currency transactions are included in other operating income (expense). The net foreign exchange gain (loss) in the three months ended March 31, 2012 and 2011 was \$-530 and \$1,518, respectively.

Derivative financial instruments

Elster Group enters into foreign currency forward contracts in order to manage currency risks arising from its forecasted and firmly committed foreign currency denominated cash flows. Elster Group enters into these contracts in order to limit future foreign exchange rate risk. Elster Group also enters into interest rate swaps to manage its interest rates on its long-term debt.

Elster Group does not enter into derivative instruments for speculative purposes.

All derivatives are measured at fair value and reported either as current assets, if the fair value is positive, or as current liabilities, if the fair value is negative, on the consolidated balance sheet. All changes in fair value of derivatives are recorded in income unless a derivative is designated as a hedging instrument.

Elster Group designates certain foreign currency forward contracts as a hedge of foreign currency denominated cash flows. The effective portion of the change in fair value of those foreign currency derivatives designated in a cash flow hedge is initially recognized in other accumulated comprehensive income and any ineffective portion is recognized in operating income; the balance recorded in other accumulated comprehensive income is subsequently recognized in income in the same period as the hedged item affects income.

Share-based payments

Elster Group has a Long-Term Incentive Plan (“LTIP”) that provides for the award of unvested American Depository Shares (“ADSs”), each of which represent one-fourth of an ordinary share, to key employees and non-employee directors. Compensation cost is based on the grant-date fair value of the awards and is recognized, net of estimated forfeitures due to termination of employment, on a straight-line basis over the requisite service period of the award and depending on the evaluation of certain performance conditions.

During the first quarter of 2012, Elster Group granted 656,895 unvested ADS awards. One half of the awards are subject to a three-year service period and a market condition measured over three years involving stock price return compared to a peer group and generally vest after four years and depending on the results of the market condition (“target stock price return” or TSR awards). The other half of the awards are subject to a three-year service period and performance condition involving earnings per share growth three years after the grant and generally vest after four years depending on the results of the performance condition (“EPS awards”). The awards are nontransferable during the vesting period and the participants are not entitled to the rights of an outstanding share, including dividend rights. There are no post-vesting restrictions on shares granted to participants. Except in limited circumstances such as

retirement or redundancy, awards will lapse without vesting if an employee leaves our company during the service period.

The grant date fair value for the 2012 EPS award was \$14.01, which was determined based on the closing price of Elster's ADSs on the grant date. The TSR award has a market condition and the company is required to estimate the results of the market condition in the grant date fair value of the award. We used a Monte Carlo model to estimate the 2012 grant date fair value of \$8.40, which is 60% of the closing price of Elster's ADSs on the grant date.

The assumptions used in the Monte Carlo model to estimate the 2012 grant date fair value for the TSR awards are as follows:

	<u>2012</u>
Grant date fair value of unvested ADS	\$8.40
Assumptions used to determine fair value	
Dividend yield	0%
Risk-free rate of return	0.45%
Expected life of awards (years)	4
Expected volatility	30.8%

The dividend yield considers the historical dividend yield paid by the company and expected dividend yield over the life of the awards. The risk-free rate is based on the U.S. Treasury yield curve in effect at the time of grant. The expected life of the award is based on the vesting period for non-vested ADS awards. Expected volatility is a proxy volatility calculated based on the average of the three-year volatility of our peers' historical share price, since the company's shares do not have an established history of trading.

The compensation cost for share-based payment awards recognized in the Statement of Operations and additional paid-in capital by period is presented below:

	<u>Three Months Ended</u> <u>March 31,</u>	
	<u>2012</u>	<u>2011</u>
	(in thousands)	
LTIP compensation cost	\$492	\$399

Warranty provisions

Elster Group offers warranties on its products. The estimated cost of warranty claims is accrued based on historical and projected product performance trends and costs. Warranty claims are reviewed in order to identify potential warranty trends. If an unusual trend is noted, an additional warranty accrual may be recorded when a failure event is probable and the cost can be reasonably estimated. Management continually evaluates the sufficiency of the warranty provision and makes adjustments when necessary.

The following table presents the change in the warranty provision for the three months ended March 31, 2012 and 2011:

	<u>Three Months Ended</u> <u>March 31,</u>	
	<u>2012</u>	<u>2011</u>
	(in thousands)	
Beginning balance	\$ 29,742	\$ 31,564
Warranties issued	2,656	1,868
Utilization	-3,105	-1,727
Changes in estimates and transfers	-345	-305
Foreign exchange fluctuation	624	1,026
Ending Balance	<u>\$ 29,572</u>	<u>\$ 32,426</u>
Thereof		
Current	24,509	24,406
Noncurrent	<u>5,063</u>	<u>8,020</u>

3. Charges, credits and other items of disclosure

Management Adjustments to Segment Profit

A total of \$20,750 has been adjusted to segment profit in the Segment Reporting footnote (Note 13) for the three months ended March 31, 2012. The management adjustments are for the reinvestment program charges of \$19,828 and Other Charges of \$922 that are described below.

Reinvestment Program Charges

In the first quarter of 2012 Elster's Administrative Board authorized a reinvestment program with planned actions that include consolidating operations and sites mainly in North America and in Europe, relocating certain product-lines to other existing Elster businesses and increasing Elster's mix of production in low-cost countries. The planned consolidation of operations includes the closure of four major facilities and the reduction in the number of our small and mid-sized facilities. In addition, the program includes the consolidation of administration structures in particular across our finance, procurement and human resources functions. Program activities started in the first quarter of 2012 and are expected to continue through 2014. Elster estimates the total cost for the program to be in the range of \$40,000 to \$60,000. The majority of the estimated cost is for involuntary employee terminations in the Water and Gas segments. In addition, the program will involve accelerated depreciation and amortization of property, plant and equipment that will not be relocated to a different site.

A summary of the reinvestment program cost by segment for the three months ended March 31, 2012 is as follows:

	<u>Gas</u>	<u>Electricity</u>	<u>Water</u>	<u>Total</u>
Employee severance	\$6,678	\$704	\$ 8,342	\$15,724
Retention bonuses	0	0	89	89
Asset impairment	0	0	148	148
Inventory write-down	0	0	658	658
Other program cost	12	148	3,049	3,209
Total reinvestment program cost	<u>\$6,690</u>	<u>\$852</u>	<u>\$12,286</u>	<u>\$19,828</u>

The employee severance cost is for involuntary terminations primarily in Europe. Elster Group recorded liabilities for termination benefits based on the applicable labor and employment laws, collective bargaining agreements or communicated policies. The severance benefits are based on estimates and subject to adjustment upon the completion of the program.

Certain employees have been offered retention bonuses that can be earned by providing service over a specified transition period; the cost for retention bonuses is expensed ratably over the required service period.

Other program cost is primarily related to the discontinuation of a specific communication product in our Water segment that was sold in North America. The cost includes an estimate to provide a number of customers with a third party replacement product due to the decision to discontinue future support and development of this specific product. The asset impairment and inventory write-down also result from exiting this product.

The charges for the reinvestment program are recognized in the following captions of the statement of operations for the three months ended March 31, 2012:

	<u>Three Months Ended March 31, 2012</u>
Cost of sales	\$13,614
Selling expenses	2,204
General and administrative expenses	2,834
Research and development expenses	1,176
Total	<u>\$19,828</u>

Elster also incurred accelerated depreciation and amortization of \$313 for the three months ended March 31, 2012 due to the reduction in remaining useful lives for certain property, plant and equipment and intangible assets associated with the reinvestment program.

The following table presents the rollforward of the reinvestment program provision for the first quarter of 2012.

	Three Months Ended March 31, 2012
Beginning balance	\$ —
Accrued	18,780
Payments made	0
Releases	0
Foreign exchange fluctuation	195
Ending balance	<u>\$18,975</u>
Thereof	
Current	\$18,975
Noncurrent	\$ —

The provision is included in the line item other current liabilities in the consolidated balance sheet.

Other Charges

In the first quarter of 2012 Elster recorded other charges of \$922, the majority of which relates to the contract fulfillment cost for the previous Chief Financial Officer who left Elster in the first quarter of 2012.

4. Earnings per share

The following table summarizes the information used to compute earnings per share for the three months ended March 31:

	Three Months Ended March 31,	
	2012	2011
<i>Numerator—Basic and Dilutive</i>		
Net income attributable to ordinary shareholders—basic and diluted	<u>\$ 8,263</u>	<u>\$ 23,896</u>
<i>Denominator—Basic and Dilutive</i>		
Basic weighted average number of ordinary shares outstanding	<u>28,220,041</u>	<u>28,220,041</u>
Effect of dilutive securities—unvested shares	7,532	18,992
Diluted weighted average number of ordinary shares outstanding	<u>28,227,573</u>	<u>28,239,033</u>

5. Inventories

Inventories consist of the following:

	March 31, 2012	December 31, 2011
	(in thousands)	
Raw materials	\$ 130,561	\$ 122,972
Work in progress	19,833	18,566
Finished goods	52,207	43,082
Total gross inventories before inventory reserves	<u>\$ 202,601</u>	<u>\$ 184,620</u>
Reserves	–22,639	–21,519
Inventories	<u>\$ 179,962</u>	<u>\$ 163,101</u>

6. Property, plant and equipment

Property, plant and equipment, including assets under capital lease, consist of the following as of March 31, 2012 and December 31, 2011:

<u>March 31, 2012</u>	<u>Cost</u>	<u>Accumulated Depreciation</u> (in thousands)	<u>Net</u>
Land	\$ 31,699	\$ 349	\$ 31,350
Buildings	60,264	22,906	37,358
Plant and machinery	212,905	118,632	94,273
Other equipment	41,591	19,625	21,966
Construction in Progress	18,983	0	18,983
Property, plant and equipment	<u>\$365,442</u>	<u>\$161,512</u>	<u>\$203,930</u>
<u>December 31, 2011</u>	<u>Cost</u>	<u>Accumulated Depreciation</u> (in thousands)	<u>Net</u>
Land	\$ 30,785	\$ 347	\$ 30,438
Buildings	58,576	21,397	37,179
Plant and machinery	200,011	110,584	89,427
Other equipment	39,360	17,519	21,841
Construction in Progress	17,692	0	17,692
Property, plant and equipment	<u>\$346,424</u>	<u>\$149,847</u>	<u>\$196,577</u>

Depreciation expense for the three months ended March 31, 2012 and 2011 was \$9,877 and \$10,158.

7. Goodwill and other intangible assets

Intangible assets consist of the following:

<u>March 31, 2012</u>	<u>Cost</u>	<u>Accumulated Amortization</u> (in thousands)	<u>Net</u>
Trade names and brands	\$ 27,518	\$ 9,233	\$ 18,285
Customer related assets	217,974	125,458	92,516
Contract-based intangible assets	60,191	51,569	8,622
Technology-related intangible assets	147,164	97,137	50,027
Other intangible assets	\$452,847	\$283,397	\$169,450
Goodwill	\$936,694	\$ —	\$936,694
<u>December 31, 2011</u>	<u>Cost</u>	<u>Accumulated Amortization</u> (in thousands)	<u>Net</u>
Trade names and brands	\$ 26,885	\$ 8,791	\$ 18,094
Customer related assets	213,896	118,016	95,880
Contract-based intangible assets	59,169	49,422	9,747
Technology-related intangible assets	143,723	92,002	51,721
Other intangible assets	\$443,673	\$268,231	\$175,442
Goodwill	\$919,060	\$ —	\$919,060

Amortization expense for the three months ended March 31, 2012 and 2011 was \$9,506 and \$10,483.

The change in goodwill balance from December 31, 2011 to March 31, 2012 is a result of changes in foreign exchange rates.

8. Pension and other long-term employee benefits

The components of net periodic benefit costs for pension benefit plans for the three months ended March 31, 2012 and 2011 are:

	Three Months Ended March 31,	
	2012	2011
German plans	(in thousands)	
Service cost	\$ 335	\$ 283
Interest cost	1,157	1,249
Amortization of net gain	– 5	– 17
Net periodic benefit cost	<u>\$1,487</u>	<u>\$1,515</u>

	Three Months Ended March 31,	
	2012	2011
Foreign plans	(in thousands)	
Service cost	\$ 124	\$ 99
Interest cost	908	963
Expected return on plan assets	– 996	– 948
Amortization of net loss	173	72
Net periodic benefit cost	<u>\$ 209</u>	<u>\$ 186</u>

The components of net periodic benefit costs for other employee benefit plans for the three months ended March 31, 2012 and 2011 are:

	Three Months Ended March 31,	
	2012	2011
German plans	(in thousands)	
Service cost	\$304	\$303
Interest cost	72	81
Net periodic benefit cost	<u>\$376</u>	<u>\$384</u>

	Three Months Ended March 31,	
	2012	2011
Foreign plans	(in thousands)	
Service cost	\$ 71	\$ 76
Interest cost	253	298
Amortization of prior service credits	– 301	– 311
Amortization of net gain	– 225	– 241
Net periodic benefit credit	<u>\$ – 202</u>	<u>\$ – 178</u>

Elster expects to pay \$3,692 in contributions to defined benefit plans in 2012. As of March 31, 2012 Elster made contributions of \$1,149.

9. Changes in Equity

Three Months Ended March 31,	2012			2011		
	Total equity attributable to Elster Group SE	Noncontrolling interests	Total equity	Total equity attributable to Elster Group SE	Noncontrolling interests	Total equity
	(in thousands)					
Beginning balance	\$706,036	\$12,213	\$718,249	\$640,714	\$15,515	\$656,229
Share-based compensation arrangement	492	0	\$ 492	399	0	\$ 399
Dividends paid to noncontrolling interests	0	0	\$ 0	0	-6,319	\$ -6,319
Changes in actuarial gains (losses) and past service costs, net of tax effect of \$154 and \$203 in 2012 and 2011 respectively	-234	0	\$ -234	-292	0	\$ -292
Foreign currency translation adjustments	13,644	324	\$ 13,968	22,412	-965	\$ 21,447
Change in fair value of cash flow hedges, net of tax effect of \$37 and \$-185 in 2012 and 2011 respectively	-86	0	\$ -86	428	0	\$ 428
Net income	8,263	1,077	\$ 9,340	23,896	979	\$ 24,875
Ending balance	<u>\$728,115</u>	<u>\$13,614</u>	<u>\$741,729</u>	<u>\$687,557</u>	<u>\$ 9,210</u>	<u>\$696,767</u>

10. Derivative financial instruments

Certain of Elster Group's subsidiaries are exposed to changes in foreign currency exchange rates in connection with future payments or balances denominated in foreign currencies. The Group has set forth in a treasury guideline that all of its operations are to use forward currency contracts to manage their currency exposures under the supervision of Elster Group's treasury department. It is the Group's policy to enter into forward contracts only to hedge currency risks arising from underlying business transactions. The contracts are either designated as a cash-flow hedging instrument or are not designated. The main currencies in which Elster Group is engaged are USD, GBP and EUR. Depending on the nominal amount of the underlying transactions, foreign currency transactions denominated in other currencies may also be managed through Elster Group treasury.

The notional amount of foreign currency forward contracts not designated for hedge accounting was \$38,449 and \$27,180 as of March 31, 2012 and December 31, 2011. The change in fair value for these contracts is recognized in operating income and amounted to a gain of \$1,166 and \$66 during the three months ended March 31, 2012 and 2011, respectively.

The notional amount of foreign currency forward contracts designated for cash flow hedge accounting was \$101,912 and \$1,732 as of March 31, 2012 and December 31, 2011. During the first quarter of 2012 and 2011 we reclassified a gain of \$116 and a loss of \$432 from other comprehensive to income due to hedged items affecting income. During the first quarter of 2012 and 2011 we recognized a gain of \$30 and a loss of \$4 in other comprehensive income for the change in fair value of foreign currency forward contracts designated for cash flow hedge accounting.

Elster Group subsidiaries, mainly in the Euro zone and in the United States of America, are also exposed to interest rate risks. Elster Group recognizes on its balance sheet a number of interest rate swap agreements that are not designated as hedging instruments. The changes in fair value are recognized within interest expenses. The aggregated notional amount of the interest rate swaps was \$497,113 and \$488,774 as of March 31, 2012 and December 31, 2011. The change in fair value of all interest rate swaps amounted to a decrease in the liability of \$1,437 and \$6,416 during the three months ended March 31, 2012 and 2011.

Embedded derivatives relate to contracts to purchase or sell non-financial assets in a foreign currency other than the currency in which the price of such assets is routinely denominated in international commerce.

The Company is also exposed to the risk that counterparties to derivative contracts will fail to meet their contractual obligations. The Company seeks to minimize this risk by entering into arrangements with counterparties with high credit ratings.

11. Fair value measurements

Fair value measurements are categorized according to a three-tier hierarchy, which prioritizes the inputs used in estimating fair values:

- (i) Level 1 is defined as observable input, such as quoted prices in active markets;
- (ii) Level 2 is defined as inputs other than quoted prices in active markets, that are directly or indirectly observable; and
- (iii) Level 3 is defined as unobservable inputs for which little or no market data exists, and therefore, requires an entity to develop its own assumptions.

The following table discloses the applicable hierarchy of estimates for the Company's derivative instruments, which are the only financial instruments measured at fair value on a recurring basis:

	Fair values as of March 31, 2012	Fair value measurements using fair value hierarchy		
		Level 1	Level 2	Level 3
(in thousands)				
Assets				
Foreign currency forward contracts	\$ 623		\$ 623	
Foreign currency forward contracts used in a cash flow hedge relationship	67		67	
Embedded derivatives	213		213	
Liabilities				
Foreign currency forward contracts	\$ 325		\$ 325	
Foreign currency forward contracts used in a cash flow hedge relationship	32		32	
Interest rate swaps	1,359		1,359	
Embedded derivatives	164		164	
(in thousands)				
	Fair values as of December 31, 2011	Fair value measurements using fair value hierarchy		
		Level 1	Level 2	Level 3
(in thousands)				
Assets				
Foreign currency forward contracts	\$ 501		\$ 501	
Embedded derivatives	654		654	
Liabilities				
Foreign currency forward contracts	\$1,379		\$1,379	
Foreign currency forward contracts used in a cash flow hedge relationship	26		26	
Interest rate swaps	2,796		2,796	
Embedded derivatives	492		492	

The fair value of interest rate swaps is calculated by discounting the future cash flows on the basis of the market interest rates applicable for the remaining term of the contract as of the balance sheet date. To determine the fair value of foreign currency forward contracts and embedded derivatives as well, the forward rate is compared to the current forward rate for the remaining term of the contract as of the balance sheet date. The result is then discounted on the basis of the market interest rate prevailing at the balance sheet date for the respective currency.

The following table presents the carrying amounts and fair values of Elster Group's financial instruments:

	March 31, 2012		December 31, 2011	
	Carrying amount	Fair value	Carrying amount	Fair value
	(in thousands)			
Cash and cash equivalents	\$ 82,779	\$ 82,779	\$ 83,952	\$ 83,952
Financial assets recognized at cost				
Account receivables (without customer contracts)	251,722	251,722	251,914	251,914
Other assets	7,904	7,904	6,909	6,909
Financial assets at fair value				
Derivatives recognized at fair value through income	836	836	1,155	1,155
Derivatives designated as hedging instruments	67	67	0	0
Financial liabilities recognized at amortized cost				
Accounts payables	213,406	213,406	203,115	203,115
Senior notes	333,899	350,791	323,474	313,582
All other debt	219,009	219,009	256,144	256,143
Other current and non current liabilities	53,194	53,194	43,330	43,330
Financial liabilities at fair value				
Derivatives recognized at fair value through income	1,848	1,848	4,667	4,667
Derivatives designated as hedging instruments	32	32	26	26

The majority of financial assets have short maturities and therefore the fair value does not significantly differ from the carrying amount.

The fair value of the Senior Notes is based on a quoted price. The other debt has variable interest rates and therefore the fair value does not significantly differ from the carrying amount.

Other current and non current liabilities include \$39,261 for the fair value of consideration outstanding from the 2009 acquisition of EnergyICT N.V., Kortrijk, Belgium. This amount is included in other current liabilities in the consolidated balance sheet and this final payment is due in the third quarter of 2012.

12. Related party disclosures

Elster Group has business relationships with subsidiaries outside the scope of consolidation and other associates that are deemed related parties.

During the three months ended March 31, 2012 and 2011, Elster Group generated revenues with related parties of \$7,229 and \$9,177. As of March 31, 2012 and December 31, 2011, the Company had receivables due from related parties of \$7,004 and \$5,900 and payables due to related parties of \$7,691 and \$3,619.

13. Segment reporting

The following tables present revenue and operating results information regarding Elster Group's operating segments for the three months ended March 31, 2012 and 2011. Segment working capital comprises those balance sheet positions which represent the operating activities of the segment.

Corporate includes activities which are not allocated to any of the operating segments, as well as the effects from consolidation.

Consolidated Statements of Operations for the three months ended	Gas		Electricity		Water	
	Mar 2012	Mar 2011	Mar 2012	Mar 2011	Mar 2012	Mar 2011
	(in thousands)					
Total revenues	\$258,470	\$255,731	\$95,909	\$99,438	\$97,776	\$96,391
thereof to external customers	258,079	255,277	92,384	95,082	96,244	93,524
thereof to other segments	391	454	3,525	4,356	1,532	2,867
Segment profit	\$ 63,250	\$ 64,817	\$ 2,298	\$ 3,681	\$ 8,372	\$ 7,183
Consolidated Balance Sheets	Mar 2012	Dec 2011	Mar 2012	Dec 2011	Mar 2012	Dec 2011
Segment working capital	\$128,178	\$118,669	\$49,432	\$61,605	\$56,843	\$52,816

Consolidated Statements of Operations for the three months ended	Total Segments		Corporate and Elimination		Consolidated Totals	
	Mar 2012	Mar 2011	Mar 2012	Mar 2011	Mar 2012	Mar 2011
	(in thousands)					
Total revenues	\$452,155	\$451,560	\$ -5,448	\$ -7,677	\$446,707	\$443,883
thereof to external customers	446,707	443,883	0	0	446,707	443,883
thereof to other segments	5,448	7,677	-5,448	-7,677	0	0
Segment profit	\$ 73,920	\$ 75,681	\$ -10,850	\$ -13,472	\$ 63,070	\$ 62,209

Management Adjustments:

Management adjustments prior to the second quarter 2011:

Foreign currency exchange effects	0	1,518
Business process reengineering and reorganisation costs	0	-835
IT project costs	0	-344

Continuing management adjustments after the second quarter 2011:

Reinvestment program cost	-19,828	0
Other management adjustments	-922	0
Previous period employee termination and exit costs	0	-112
Total Management Adjustments	-20,750	227
Depreciation and Amortization	-19,383	-20,641
Interest expense, net	-9,265	-6,902
Income tax expense	-4,332	-10,018
Net income	\$ 9,340	\$ 24,875

Consolidated Balance Sheets	Mar 2012	Dec 2011	Mar 2012	Dec 2011	Mar 2012	Dec 2011
Segment working capital	\$234,453	\$233,090	\$-6,315	\$-7,481	\$228,138	\$225,609
Accounts receivable/payable with associates					801	-2,184
Advanced payments received and deferred revenue					27,637	20,691
Current assets (other than accounts receivable and inventories)					168,486	166,026
Accounts payable					213,406	203,115
Noncurrent assets					1,384,278	1,358,092
Total assets					\$2,022,746	\$1,971,349

Decisions by the chief operating decision maker on how to allocate resources and assess performance are based on a reported measure of segment profit. The segment profit, used for purposes of such decisions,

does not include depreciation and amortization, interest and income taxes and certain adjustments identified by management. Prior to the second quarter of 2011, the adjustments identified by management were derived from the definition of Adjusted EBITDA in our old Senior Facilities Agreement (“SFA”). In connection with the refinancing that occurred in the second quarter of 2011, the SFA was terminated. As a result of the refinancing and our initial public offering in 2010, the level of indebtedness decreased significantly. Management reconsidered the transactions that warrant adjustments to determine segment profit in periods subsequent to the refinancing and has restricted such adjustments to significant non-recurring items including employee termination and exit cost activities. As a result of this change to our segment profit, items such as foreign currency exchange effects, strategy development costs, IT project cost, etc. were no longer subject to adjustment after March 31, 2011. Segment profit for the three months ended March 31 is reconciled to net income from continuing operations in the respective tables above.

Section A.2—Elster financial information for the periods ended 31 December 2009, 31 December 2010 and 31 December 2011

The Elster historical financial information contained in Section A.2 of this Part VII (*Historical Financial Information Relating to Elster*) has been extracted without material adjustment from Form-20-Fs filed with the SEC by Elster. This Section A.2 is prepared in accordance with US GAAP as at and for each of the three financial years ended 31 December 2009, 31 December 2010 and 31 December 2011. The auditors' reports included in those 20-Fs were unqualified in respect of the periods presented.

A reconciliation of net income and shareholders' equity contained in Section (A) of this Part VII (*Historical Financial Information Relating to Elster*) to net income and shareholders equity under Melrose's accounting policies under IFRS is set out in Section (B) of this Part VII (*Historical Financial Information Relating to Elster*).

A.2.1 Financial information for the financial years ended 31 December 2011, 2010 and 2009 extracted without material adjustment from Elster's Form 20-F for the period ended 31 December 2011

Report of Independent Registered Public Accounting Firm

The Administrative Board
Elster Group SE:

We have audited the accompanying consolidated balance sheets of Elster Group SE and subsidiaries (the "Company") as of December 31, 2011 and 2010, and the related consolidated statements of operations, changes in equity and comprehensive income (loss), and cash flows for each of the years in the three-year period ended December 31, 2011. We also have audited the Company's internal control over financial reporting as of December 31, 2011, based on criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company's management is responsible for these consolidated financial statements, for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying *management's annual report on internal control over financial reporting*. Our responsibility is to express an opinion on these consolidated financial statements and an opinion on the Company's internal control over financial reporting based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the consolidated financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Elster Group SE and subsidiaries as of December 31, 2011 and 2010, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2011 in conformity with U.S. generally accepted accounting principles. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2011, based on criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission.

As discussed in Note 2 to the consolidated financial statements, the Company has changed its method of accounting for revenue recognition on certain multiple-deliverable transactions in 2010 due to the adoption of Accounting Standards Update (ASU) No. 2009-13 "Multiple-Deliverable Revenue Arrangements" (ASU 2009-13) and ASU 2009-14, "Certain Revenue Arrangements that Include Software Elements".

/s/ KPMG AG
Wirtschaftsprüfungsgesellschaft

Frankfurt am Main, Germany
March 2, 2012

**CONSOLIDATED STATEMENTS OF OPERATIONS
FOR THE YEARS ENDED 31 DECEMBER
(IN THOUSANDS, US DOLLAR (\$), EXCEPT PER SHARE AND SHARE DATA)**

	For the years ended 31 December		
	2011	2010	2009
	\$ (audited)	\$ (audited)	\$ (audited)
Revenues	1,868,975	1,759,339	1,695,122
Cost of revenues	-1,262,957	-1,208,555	-1,191,297
Gross profit	606,018	550,784	503,825
Operating expenses			
Selling expenses	-180,366	-165,544	-159,419
General and administrative expenses	-136,932	-123,819	-136,997
Research and development expenses	-102,386	-87,489	-78,403
Other operating income (expense), net	3,444	2,059	14,833
Operating income	189,778	175,991	143,839
Non-operating expense			
Interest expense, net	-40,595	-57,705	-55,424
Loss on extinguishment of debt	-13,438	-2,378	0
Other income	4,723	2,962	3,278
Total non-operating expenses	-49,310	-57,121	-52,146
Income from continuing operations before income tax	140,468	118,870	91,693
Income tax expense	-33,493	-29,402	-39,349
Net income from continuing operations	106,975	89,468	52,344
Net income (loss) from discontinued operations	-1,594	2,570	0
Net income	105,381	92,038	52,344
Net income attributable to noncontrolling interests	4,502	4,779	3,456
Net income attributable to Elster Group SE	100,879	87,259	48,888
Basic income per share			
Income from continuing operations attributable to Elster Group SE	3.63	3.39	1.42
Income (loss) from discontinued operations attributable to Elster Group SE	-0.06	0.13	0.00
Net income per share attributable to Elster Group SE shareholders	3.57	3.53	1.42
Diluted income per share			
Income from continuing operations attributable to Elster Group SE	3.63	3.39	1.42
Income (loss) from discontinued operations attributable to Elster Group SE	-0.06	0.13	0.00
Net income per share attributable to Elster Group SE shareholders	3.57	3.53	1.42
Weighted average shares outstanding			
Basic	28,220,041	19,295,573	16,320,750
Diluted	28,220,041	19,299,777	16,320,750

CONSOLIDATED BALANCE SHEETS
AS OF 31 DECEMBER
(IN THOUSANDS, US DOLLAR (\$), EXCEPT SHARE DATA)

	For the years ended 31 December	
	2011	2010
	\$ (audited)	\$ (audited)
Assets		
Current assets		
Cash and cash equivalents	83,952	216,294
Accounts receivable (net of allowance for doubtful accounts of \$8,033 and \$9,732 and \$7,337, respectively)	284,130	278,217
Receivables from related parties	5,900	14,197
Inventories	163,101	154,549
Prepaid expenses	6,236	21,122
Other current assets	42,625	52,863
Income tax refunds	8,121	14,501
Deferred tax assets	19,192	16,022
Total current assets	613,257	767,765
Noncurrent assets		
Property, plant and equipment, net	196,577	202,899
Other intangible assets, net	175,442	216,406
Goodwill	919,060	936,950
Other assets	52,953	31,496
Deferred tax assets	14,060	8,741
Total noncurrent assets	1,358,092	1,396,492
Total assets	1,971,349	2,164,257
Liabilities and Equity		
Current liabilities		
Pension and other long-term employee benefits, current portion	13,524	13,486
Payroll, bonuses and related accruals	55,087	57,808
Short-term debt and current portion of long-term debt	6,093	18,010
Accounts payable	203,115	204,343
Warranties, current portion	24,645	23,403
Other current liabilities	110,763	74,514
Deferred revenue	8,099	4,039
Income tax payable	25,177	17,863
Deferred tax liabilities	7,026	6,694
Total current liabilities	453,529	420,160
Noncurrent liabilities		
Pension and other long-term employee benefits, less current portion	149,630	137,490
Payroll, bonuses and related accruals	1,390	1,326
Long-term debt, less current portion	573,633	822,447
Warranties, less current portion	5,097	8,161
Other non-current liabilities	1,911	40,505
Income taxes payable	16,870	17,271
Deferred tax liabilities	51,040	60,668
Total noncurrent liabilities	799,571	1,087,868
Total liabilities	1,253,100	1,508,028
Equity		
Preferred shares, EUR 1 nominal value (none for 31 December 2011 and 2010, 308,931,920 shares issued and outstanding as of 31 December 2009)	0	0
Ordinary shares, €1 nominal value (47,220,041 shares authorized and 28,220,041 shares issued and outstanding as of December 31, 2011, 28,220,041 and 16,320,750 shares authorized, issued and outstanding as of 31 December 2010 and 2009)	36,528	36,528
Additional paid-in capital	651,453	651,038
Retained earnings (accumulated deficit)	32,021	- 68,858
Accumulated other comprehensive income (loss)	- 13,966	22,006
Total equity attributable to Elster Group SE	706,036	640,714
Noncontrolling interests	12,213	15,515
Total equity	718,249	656,229
Total liabilities and equity	1,971,349	2,164,257

Consolidated Statements of Changes in Equity and Comprehensive Income (Loss)
(in thousands of US Dollar (\$), except for number of shares data)

	Preferred Shares		Ordinary Shares		Additional Paid-in Capital	Retained Earnings (Accumulated Deficit)	Accumulated Other Comprehensive Income (Loss)			Total Equity Attributable to Elster Group SE	Non controlling Interests	Total Equity
	Number of Shares	Amount	Number of Shares	Amount			Pensions and Other Post- Retirement Plans	Currency Translation	Derivatives			
January 1, 2009	293,217,167	\$ 410,825	16,320,750	\$20,040	\$103,382	\$ -161,641	\$ 17,448	\$ 22,120	\$ 710	\$412,884	\$ 5,933	\$418,817
Share-based compensation arrangement	0	0	0	0	-33,250	0	0	0	0	-33,250	0	-33,250
Accretion of preferred dividends	15,714,753	25,640	0	0	0	-25,640	0	0	0	0	0	0
Dividends paid	0	0	0	0	0	0	0	0	0	0	-3,048	-3,048
Comprehensive income												
Changes in actuarial gains and past service costs, net of tax effect of \$2,394	0	0	0	0	0	0	-5,215	0	0	-5,215	0	-5,215
Foreign currency translation adjustment, net of tax effect of \$-6	0	0	0	0	0	0	0	-6,046	0	-6,046	-188	-6,234
Change in fair value of cash flow hedges, net of tax effect of \$269	0	0	0	0	0	0	0	0	-710	-710	0	-710
Net income	0	0	0	0	0	48,888	0	0	0	48,888	3,456	52,344
Total comprehensive income	0	0	0	0	0	48,888	-5,215	-6,046	-710	36,917	3,268	40,185
December 31, 2009	308,931,920	\$ 436,465	16,320,750	\$20,040	\$ 70,132	\$ -138,393	\$ 12,233	\$ 16,074	\$ 0	\$416,551	\$ 6,153	\$422,704
Share-based compensation arrangement	0	0	0	0	-13,214	0	0	0	0	-13,214	0	-13,214
Accretion of preferred dividends	0	19,210	0	0	0	-19,210	0	0	0	0	0	0
Dividends paid	0	0	0	0	0	0	0	0	0	0	-831	-831
Change of noncontrolling interests	0	0	0	0	-4,759	0	0	1,631	0	-3,128	5,162	2,034
Change in scope of consolidated companies	0	0	0	0	0	1,486	0	0	0	1,486	0	1,486
Replacement of preferred shares	-308,931,920	-455,675	8,533,906	11,903	443,772	0	0	0	0	0	0	0
Capital increase, net of related costs	0	0	3,365,385	4,585	155,107	0	0	0	0	159,692	0	159,692
Comprehensive income												
Changes in actuarial gains (losses) and past service costs, net of tax effect of \$-246	0	0	0	0	0	0	-283	0	0	-283	0	-283
Foreign currency translation adjustment, net of tax effect of \$0	0	0	0	0	0	0	0	-7,064	0	-7,064	252	-6,812
Change in fair value of cash flow hedges, net of tax effect of \$257	0	0	0	0	0	0	0	0	-585	-585	0	-585
Net income	0	0	0	0	0	87,259	0	0	0	87,259	4,779	92,038
Total comprehensive income	0	0	0	0	0	87,259	-283	-7,064	-585	79,327	5,031	84,358
December 31, 2010	0	\$ 0	28,220,041	\$36,528	\$651,038	\$ -68,858	\$ 11,950	\$ 10,641	\$ -585	\$640,714	\$15,515	\$656,229
Share-based compensation arrangements	0	0	0	0	415	0	0	0	0	415	0	415
Dividends paid	0	0	0	0	0	0	0	0	0	0	-8,552	-8,552
Comprehensive income												
Changes in actuarial gains (losses) and past service costs, net of tax effect of \$6,608	0	0	0	0	0	0	-13,226	0	0	-13,226	0	-13,226
Foreign currency translation adjustment, net of tax effect of \$-1,695	0	0	0	0	0	0	0	-23,313	0	-23,313	748	-22,565
Change in fair value of cash flow hedges, net of tax effect of \$-249	0	0	0	0	0	0	0	0	567	567	0	567
Net income	0	0	0	0	0	100,879	0	0	0	100,879	4,502	105,381
Total comprehensive income	0	0	0	0	0	100,879	-13,226	-23,313	567	64,907	5,250	70,157
December 31, 2011	0	\$ 0	28,220,041	\$36,528	\$651,453	\$ 32,021	\$ -1,276	\$ -12,672	\$ -18	\$706,036	\$12,213	\$718,249

Consolidated Statements of Cash Flows
for the years ended 31 December
(in thousands, US dollars (\$))

	For the years ended 31 December		
	2011	2010	2009
	\$ (audited)	\$ (audited)	\$ (audited)
Cash flows from operating activities			
Net income	105,381	92,038	52,344
Adjustments to reconcile net income to cash from operating activities			
Depreciation, amortization and impairment losses	83,793	87,861	88,618
Loss on extinguishment of debt	13,438	2,378	0
Share-based compensation expense (credit)	415	-13,214	-33,250
Loss (gain) on sale of other long-lived assets, net	165	1,050	-2,506
Dividends from equity method investments	3,952	2,329	2,176
Changes in operating assets and liabilities			
Change in accounts receivable	-13,479	-19,595	32,419
Change in accounts payable	4,957	12,216	-14,161
Change in inventories	-13,824	-10,361	53,180
Change in other assets and liabilities	6,939	-13,379	-59,199
Cash flows from operating activities	191,737	141,323	119,621
Cash flows from investing activities			
Purchases of property, plant and equipment and intangible assets	-48,327	-42,391	-30,492
Proceeds from disposals of property, plant and equipment and intangible assets	4,218	11,938	14,838
Proceeds from shareholder loan payments	0	2,485	0
Business combinations, net of cash acquired	0	0	-27,389
Net cash flow used in investing activities	-44,109	-27,968	-43,043
Cash flows from financing activities			
Proceeds from issuance of Senior Notes	364,600	0	0
Proceeds from other bank borrowings	509,484	63,560	84,555
Payment of deferred financing cost	-20,577	0	0
Repayment of bank borrowings	-1,126,632	-184,771	-157,835
Capital increase, net of IPO costs	0	153,254	0
Repayment of capital lease obligations	-274	-1,084	-1,103
Repayment of shareholder loan	0	-6,752	0
Dividends to noncontrolling interests	-8,552	-831	-3,048
Sale of noncontrolling interest in subsidiary	0	2,034	0
Net cash flow from (used in) financing activities	-281,951	25,410	-77,431
Net increase (decrease) in cash and cash equivalents	-134,323	138,765	-853
Effect of exchange rate fluctuations on cash held	1,981	2,137	1,972
Cash and cash equivalents at January 1	216,294	75,392	74,273
Cash and cash equivalents at December 31	83,952	216,294	75,392
Income taxes paid	31,555	28,667	42,657
Interest paid	40,674	50,052	45,372

Elster Group SE
Notes to the Consolidated Financial Statements
(in thousands of US Dollar (\$), except per share data)

1. Corporate information

Elster Group SE, Essen, Germany, was originally incorporated as Gold Silver S.à r.l. on October 4, 2004 as a Luxembourg corporation to serve as a vehicle for private equity funds managed by CVC Capital Partners; it acquired the Ruhrgas Industries Group from E.ON Ruhrgas AG on September 12, 2005. After being renamed Nightwatch Investments S.à r.l. and further renamed Elster Group S.à r.l. on March 15, 2006, it was legally reorganized and became Elster Group SE, Luxembourg. Elster Group SE transferred its jurisdiction of incorporation from Luxembourg to Essen, Germany, on February 23, 2010 and is now a German corporation. The name changes and legal reorganizations were transactions under common control of the owners.

On October 5, 2010 Elster Group SE completed an initial public offering of 18,630,000 American Depository Shares, each American Depository Share representing one-fourth of an ordinary share. See Note 15—*Equity and shareholder loan* for further information regarding the initial public offering and the impact on the consolidated financial statements.

The business of Elster Group SE and its subsidiaries (hereinafter referred as the “Company” or “Elster Group”) is the development, manufacturing and distribution of metering solutions for water, gas and electricity, as well as gas utilization and distribution products. The products and services are offered in more than 130 countries for both residential and commercial and industrial customers.

2. Significant accounting policies

Basis of preparation

These consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (US GAAP). The accounting policies set out below have been consistently applied to all periods presented in these consolidated financial statements.

Basis of consolidation

The accompanying consolidated financial statements include the accounts of Elster Group and its subsidiaries after elimination of intercompany accounts and transactions.

The equity method of accounting is used for investments in which Elster Group can exercise significant influence over the operating and financial policies of an investment but does not have control.

Use of estimates and judgments

The preparation of consolidated financial statements in conformity with US GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities as well as disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Significant items subject to such estimates and assumptions include the allowances for doubtful accounts and sales returns; reserves for obsolete inventory; useful lives of fixed assets and intangible assets; impairments of goodwill and long lived assets; the valuation and recognition of derivatives, deferred tax assets, and share-based compensation; and provisions for employee benefit obligations, warranties, environmental liabilities, income tax uncertainties and other contingencies.

Estimates and underlying assumptions are reviewed on an ongoing basis.

Foreign currency translation

The consolidated financial statements are presented in thousands of US Dollars (“USD” or “\$”) which is the reporting currency of Elster Group, except for share information and per share amounts.

The assets and liabilities of Elster Group and its subsidiaries for which the functional currency is not the USD, are translated using period-end spot rates, whereas items of income and expense are translated using average exchange rates during the respective periods. Differences arising from such translation are included in accumulated other comprehensive income (loss) in shareholders' equity. Currency effects from long-term investments in foreign subsidiaries are also included in accumulated other comprehensive income (loss).

Gains and losses from foreign currency transactions are included in other operating income (expense). The net foreign exchange gain in 2011, 2010 and 2009 was \$127, \$2,933 and \$14,412, respectively.

Revenue recognition

Revenues result primarily from sales of Elster Group's products, the most significant of which are meters for electricity, gas or water. Revenues on product sales are recognized when

- persuasive evidence of an arrangement exists;
- delivery has occurred;
- the sales price is fixed or determinable; and
- collectability is reasonably assured.

Elster Group offers integrated solutions to customers, mainly utilities, by bundling certain products with services. In certain transactions, the company bundles some products, known as "smart" meters and meter reading equipment, with software and services such as software implementation, project management, consulting or maintenance support.

In September 2009, the FASB issued Accounting Standards Update (ASU) No. 2009-13 "Multiple-Deliverable Revenue Arrangements" (ASU 2009-13) which sets forth requirements that must be met for an entity to recognize revenue from the sale of a delivered item that is part of a multiple-element arrangement when other items have not yet been delivered, and ASU 2009-14, "Certain Revenue Arrangements that Include Software Elements" which addresses the accounting for revenue arrangements that contain both hardware and software elements. These ASUs which expand the scope and supersede certain guidance in ASC 605-25, "Revenue Recognition—Multiple-Element Arrangements" may be applied on a prospective basis for revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010, with earlier application permitted, or they may be applied retrospectively to all comparable periods presented. These amendments eliminate the requirement that vendor specific objective evidence (VSOE) be available for all undelivered elements when software is involved or that VSOE or third-party evidence be available in multiple-element transactions not involving software. Elster Group early adopted these accounting standards for the December 31, 2010 consolidated financial statements filed on Form 20-F with the Securities and Exchange Commission on March 10, 2011. These standards were applied prospectively as of January 1, 2010 for all new and materially modified contracts with customers that combined multiple deliverables, such as products to be delivered and services to be rendered. Under the new accounting standards for revenue recognition, the Company allocates the total consideration for all elements to each separable element based upon the estimated relative selling price of each element. The selling price for a deliverable is based on its VSOE, if available, third party evidence if VSOE is not available, or estimated selling price if neither VSOE nor third party evidence are available.

Elster Group recognizes revenue for delivered elements that have stand-alone value to the customer in accordance with its revenue recognition policies for such products or services and defers revenue for undelivered elements until delivery of an element. The amount of revenue recognized is limited to the amount that is not contingent upon future shipments of products or rendering of services or performance obligations.

Deferred revenues are reported within liabilities and recognized as revenue in the subsequent period when the applicable revenue recognition criteria are met.

As a result of this change in accounting policies for revenue recognition in 2010, revenues for the twelve months ended December 31, 2010 were approximately \$17,095 higher than revenues would have been using the previous accounting policies for revenue recognition. The increase in revenue results from shipments of products, mainly electricity meters, for contracts entered into on or after January 1, 2010 that relate to contracts with customers containing undelivered elements for which Elster Group was unable to establish VSOE under the previous standards.

Elster Group also generates revenue from projects in which the company engineers and manufactures gas utilization or metering products according to customer specifications that are accounted for by the percentage of completion method for revenue recognition. These projects are performed under customer project contracts and are referred to as customer contracts. As soon as the outcome of customer project contracts can be estimated reliably, contract revenue and expenses are recognized in profit or loss in proportion to the stage of completion of the contract. Contract revenues include the initial amount agreed in the contract (adjusted to reflect any change orders). The stage of completion is assessed by applying the percentage of contract cost incurred in relation to total estimated contract cost. When the outcome of a customer contract cannot be estimated reliably, contract revenue is recognized only to the extent of contract costs incurred that are likely to be receivable. An expected loss on a contract is recognized immediately.

All revenue is recognized net of applicable taxes such as sales tax or value-added tax.

Shipping and handling fees

Shipping and handling fees that are collected from the customers in connection with Elster Group's sales are recorded as revenue in the consolidated statement of operations. The costs incurred with respect to shipping and handling are recorded as selling expenses and were \$28,379, \$27,038 and \$24,525 in 2011, 2010 and 2009, respectively.

Advertising

Advertising costs are recorded in selling expense and are expensed as incurred. Advertising expenses were \$7,095, \$5,998 and \$5,550 in 2011, 2010 and 2009, respectively.

Income taxes

Deferred taxes are accounted for under the asset and liability method. Deferred tax assets and liabilities are recognized for future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and on tax loss and tax credit carryforwards. Deferred income tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income tax expense in the period in which the change is enacted. Deferred income tax assets are reduced by a valuation allowance to the extent that it is more likely than not that some portion or all of the deferred tax assets will not be realized. Interest and penalties on income taxes are classified as income tax expense.

The Group recognizes a tax benefit from an uncertain tax position only if it is more likely than not that the tax position will be sustained upon examination by the taxing authorities based solely on the technical merits of the position. The tax benefits recognized in the financial statements from such a position are measured based on the largest benefit that has a greater than 50 per cent. likelihood of being realized upon settlement.

Research and development costs

Research and development costs primarily include employee compensation and third party contracting fees and are expensed as incurred. Software developed by Elster to be marketed or sold is generally not capitalized due to the relatively short period of time between technological feasibility and the completion of product and software development, and the immaterial nature of these costs.

Cash and cash equivalents

Cash and cash equivalents are comprised of cash on hand, current balances on bank accounts and highly liquid, short-term deposits with an original maturity of three months or less.

Restricted cash balances pledged as collateral to financial institutions in connection with customer performance bid guarantees and other sureties were \$1,462 and \$287 as of December 31, 2011 and 2010, respectively. These balances are included in other current assets in the consolidated balance sheets.

Accounts receivable

Elster Group's accounts receivable are generally unsecured and the Company is at risk to the extent such amounts become uncollectible. Elster Group continually monitors accounts receivable balances and records an allowance for doubtful accounts at the time collection becomes questionable based on payment history or the age of the receivable. The allowance for doubtful accounts is based on the Company's specific review of outstanding receivables at period end considering Elster Group's experience. Accounts receivable are written-off against the allowance when Elster Group determines that an account or a portion thereof will not be collected.

Inventories

Inventories are valued at the lower of cost or market using the first-in, first-out method. The cost of inventories includes material, capitalized labor and overhead costs.

Property, plant and equipment

Property, plant and equipment are stated at cost, less accumulated depreciation and accumulated impairment losses. Equipment accounted for as capital leases are stated at the lesser of the original present value of minimum lease payments or the original fair value of the leased asset, less accumulated depreciation.

Depreciation is computed using the straight-line method over the estimated useful lives of the assets. The useful lives are generally as follows:

Buildings	10 to 50 years
Plant and machinery	5 to 15 years
Other equipment	3 to 12 years

Leasehold improvements are capitalized and amortized over the term of the applicable lease, including renewal periods if reasonably assured, or over the useful lives, whichever is shorter.

Cost includes expenditures that are directly attributable to the acquisition of the asset. The cost of self-constructed assets includes the cost of materials and direct labor, any other costs directly attributable to bringing the asset to a working condition for its intended use. This also includes costs of dismantling, removing the items and restoring the site on which they are located, if required.

Improvements and replacements are capitalized to the extent that they increase the useful economic life or increase the expected economic benefit of the underlying asset. Repair and maintenance costs are expensed as incurred.

Interest cost incurred on borrowings related to construction of major projects that exceed a period of three months of construction is capitalized. Capitalized interest is added to the cost of qualified assets and amortized over the estimated useful lives of the related assets.

Long-lived assets are reviewed for impairment whenever events or circumstances indicate the carrying amount of an asset or asset group may not be recoverable. Assets are grouped and evaluated for impairment at the lowest level for which there are identified cash flows that are largely independent of the cash flows of other groups of assets. The carrying value of a long-lived asset is considered impaired when the estimated undiscounted future cash flow to result from the use of the asset and its eventual disposition is less than its carrying value. The amount of the impairment loss is recognized based on the amount by

which the carrying value exceeds the fair value of the long-lived asset. Fair value is generally determined using a discounted cash flow analysis.

Business combinations

Business combinations are accounted for using the purchase method of accounting and the consolidated financial statements of Elster Group include the operations of an acquired business from the date of acquisition. Net assets of the acquired company and intangible assets that arise from contractual or legal rights, or are capable of being separated, are recorded at their fair value as of the date of acquisition.

Goodwill

Goodwill represents the excess of the aggregate purchase price over the fair value of the net assets acquired in a business combination. Elster Group performs its annual impairment test of goodwill each December 31 or more frequently whenever a triggering event occurs between the annual impairment test.

In September 2011, the FASB issued ASU 2011-08, "Testing Goodwill for Impairment" ("ASU 2011-08"), which amends the guidance in ASC 350-20, "Intangibles—Goodwill and Other—Goodwill". Under ASU 2011-08, entities have the option of performing a qualitative assessment before calculating the fair value of the reporting unit when testing goodwill for impairment. If the fair value of the reporting unit is determined, based on qualitative factors, to be more likely than not less than the carrying amount of the reporting unit, then entities are required to perform the two-step goodwill impairment test. ASU 2011-08 is effective for fiscal years beginning after December 15, 2011, with early adoption permitted. Elster Group elected to early adopt this guidance for the 2011 goodwill impairment test performed in the fourth quarter. The adoption of this guidance did not affect our consolidated financial statements.

The goodwill impairment test begins with a qualitative assessment to determine if a reporting unit's fair value is more likely than not less than the carrying amount. If the Company determines that the fair value is more likely than not less than the carrying amount, or the Company decides to bypass the qualitative assessment for a reporting unit, the goodwill is tested for impairment under the two-step valuation test. The first step of the valuation test is to estimate the fair value of the reporting unit and compare the estimated fair value to the reporting unit's carrying value. If the fair value is less than the carrying value, a second step is performed to determine the implied goodwill value by deducting the fair value of all tangible and intangible net assets of the reporting unit from the fair value of the reporting unit. If the implied fair value of the goodwill, as calculated, is less than the carrying amount of the goodwill, an impairment charge is recorded for the difference.

Other intangible assets

Separately acquired intangible assets are measured at cost. The cost of intangible assets acquired in a business combination is their estimated fair value on the date of the acquisition. Following initial recognition, intangible assets are carried at cost less accumulated amortization.

Intangible assets with indefinite useful lives are tested for impairment at least annually each December 31 and a review is performed to determine whether the indefinite life assumption continues to be appropriate. Any changes to the indefinite useful life assumption are recognized prospectively by amortizing the asset over its estimated remaining useful life. Certain trade names acquired in business combinations have been established many years ago, are being used by the Company and are expected to provide an economic benefit in the form of a competitive advantage for an indefinite period of time.

Intangible assets with finite lives are amortized over the estimated economic life using the method that best approximates their benefits (generally the straight-line-method) and are assessed for impairment whenever there is an indication that the intangible asset may be impaired. Subsequent expenditures are only capitalized when they increase the future economic benefit embodied in the specific asset to which they relate. All other expenditures, including expenditures on internally generated goodwill and trade names, are expensed as incurred.

The estimated useful lives for finite-lived intangible assets are as follows:

Customer-related intangible assets	6 to 18 years
Contract-based intangible assets and software	3 to 5 years
Technology-related intangible assets	8 to 15 years

If the estimated useful life changes the carrying value is amortized prospectively over the revised useful life.

Derivative financial instruments

Elster Group enters into foreign currency forward contracts in order to manage currency risks arising from its forecasted and firmly committed foreign currency denominated cash flows. Elster Group enters into these contracts in order to limit future foreign exchange rate risk. Elster Group also enters into interest rate swaps to limit interest rate risk on its long-term debt.

Elster Group does not enter into derivative instruments for speculative purposes.

All derivatives are measured at fair value and reported either as current assets, if the fair value is positive, or as current liabilities, if the fair value is negative, on the consolidated balance sheet. All changes in fair value of derivatives are recorded in income unless a derivative is designated as hedging instrument.

Elster Group designates certain foreign currency forward contracts as a hedge of foreign currency denominated cash flows. The effective portion of the change in fair value of those foreign currency derivatives designated in a cash flow hedge is initially recognized in other accumulated comprehensive income (loss) and the ineffective portion, if any, is recognized in operating income; the balance recorded in other accumulated comprehensive income (loss) is subsequently recognized in income in the same period as the hedged item affects income.

Leases

Lease agreements are classified as either capital or operating leases.

When substantially all of the risks and benefits of ownership have been transferred to the Company, the lease is classified as a capital lease. Assets leased under the terms of a capital lease are capitalized at the lower of the fair value of the leased asset or the present value of the minimum lease payments. Capitalized leased assets are depreciated over the shorter of the estimated useful life of the asset or the lease term, unless there is reasonable certainty that the Group will obtain ownership by the end of the lease term in which case the period of expected use is the useful life of the asset.

Rent expense on operating leases is recognized on a straight-line basis over the term of the lease including renewal terms if, at inception of the lease, renewal is reasonably assured.

Employee benefits

Defined benefit plans

Certain of Elster Group's subsidiaries sponsor defined benefit pension plans. In addition, the Group's subsidiaries in the U.S. and Canada provide other postretirement benefits consisting of healthcare and life insurance benefits. The cost of providing these benefits is determined for each plan using the projected unit credit actuarial valuation method.

The Company recognizes the funded status of its defined benefit pension and other postretirement benefit plans on its consolidated balance sheet and all actuarial gains and losses and unrecognized past service costs and credits are reflected in other comprehensive income (loss) and amortized to net periodic cost over the future periods using the corridor method.

Also, certain subsidiaries provide termination benefits under terms of applicable laws or collective bargaining agreements or they pay long term service awards to their employees which are recognized when probable and reasonably estimable.

Share-based compensation

Elster Group has a Long-Term Incentive Plan (“LTIP”) that provides for the award of unvested American Depository Shares, each of which represent one-fourth of an ordinary share, to key employees and non-employee directors. Compensation cost is based on the grant-date fair value of the awards and is recognized, net of estimated forfeitures due to termination of employment, on a straight-line basis over the requisite service period of the award and depending on the evaluation of certain performance conditions. The requisite service period is generally the vesting period stated in the award.

Rembrandt Holdings SA, Luxembourg, the immediate parent and controlling shareholder (“Rembrandt”), sponsored a Management Equity Program (“MEP”) through Nachtwache Metering Management Vermögensverwaltungs GmbH&Co. KG (“Management KG”), an entity which was controlled by Rembrandt. The MEP granted certain members of senior management of Elster Group share-based payments. The obligation of the parent related to the MEP arrangement was accounted for as a cash-settled plan and remeasured through September 30, 2010, the date of listing in connection with the initial public offering. In connection with the initial public offering, previously unvested awards under the MEP became vested and all grantees were entitled to benefits from the sale of Elster shares rather than a formula value. Accordingly, the date of the offering was the final measurement date for the MEP, aggregate compensation expense was determined based on the fair value of \$52 per ordinary share which was derived from the offering price of four American depository shares representing one ordinary share. Elster Group recognized compensation expenses for the MEP and a corresponding contribution by the parent in additional paid-in capital within equity because Elster Group did not make or fund any payments under the MEP. Neither Elster Group nor Rembrandt obtained a tax benefit from payments made to Elster Group’s executives under the terms of the MEP.

Warranty provisions

Elster Group offers warranties on its products. The estimated cost of warranty claims is accrued based on historical and projected product performance trends and costs. Warranty claims are reviewed in order to identify potential warranty trends. If an unusual trend is noted, an additional warranty accrual may be recorded when a failure event is probable and the cost can be reasonably estimated. Management continually evaluates the sufficiency of the warranty provisions and makes adjustments when necessary. The changes in the carrying amount of the warranty provision are as follows:

	<u>2011</u>	<u>2010</u>
January 1	\$ 31,564	\$ 34,762
Warranty issued	14,531	13,837
Utilizations	–10,767	–13,978
Change in estimates	–4,893	–1,826
Foreign exchange fluctuation	–693	–1,231
December 31	\$ 29,742	\$ 31,564
Thereof:		
Current	24,645	23,403
Noncurrent	5,097	8,161

The increase for change in estimates in 2011 includes a reduction in the warranty provision, due to a trend of lower claims, for a specific product in our gas segment that is no longer produced.

As of December 31, 2011, the noncurrent portion of the warranty obligations is presented as a separate line item on the balance sheet; the comparative amount was reclassified accordingly.

Earnings per share

Earnings per share is computed by dividing the net income attributable to ordinary shares by the weighted average number of ordinary shares outstanding for the period. The calculation of diluted earnings per share reflects the effect of all potentially unvested dilutive shares issued under the LTIP. None of the

unvested shares were outstanding during the periods but diluted EPS is computed on a pro forma basis. For periods prior to our initial public offering there were no potentially dilutive instruments outstanding.

All stock splits have been recognized retrospectively. The cumulative dividends on preferred shares are excluded from net income attributable to ordinary shares for periods prior to our initial public offering when preferred shares were outstanding.

Recent accounting pronouncements not yet adopted

In June 2011 the FASB issued ASU 2011-05, "Comprehensive Income" ("ASU 2011-05"), which amends the disclosure requirements for the presentation of comprehensive income in ASC 220, "Comprehensive Income". ASU 2011-05 eliminates the option to present components of other comprehensive income (OCI) as part of the statement of changes in equity. Under the amended guidance, all changes in OCI are to be presented either in a single continuous statement of comprehensive income, or in two separate but consecutive financial statements. The changes will be effective January 1, 2012 for Elster Group. There will be no impact to the consolidated financial results as the amendments relate only to changes in financial statement presentation.

3. Discontinued operations

In 2006, Elster Group sold its heat treatment business in accordance with the decision of Elster Group's management to focus on the Group's key competence as a metering solutions provider. Elster Group agreed to indemnify the buyer for certain contingent losses that originated prior to the sale of the business and recorded a liability for an expected purchase price adjustment resulting from such indemnification. In the fiscal year 2010, Elster Group obtained evidence that the issue underlying the indemnification had been resolved and released the accrued liability. The gain arising from this release of a liability for expected purchase price adjustment was recorded as income from discontinued operations in 2010.

In 2007 Elster Group also sold its furnace business and agreed to indemnify the buyer for certain contingent losses that originated prior to the sale of the business. Elster Group was notified by the buyer in the third quarter of 2011 about a contingent loss that originated prior to the sale of the business. Elster group has settled this indemnification with the buyer and recorded a liability of \$1,594. This is presented as loss from discontinued operations in 2011.

4. Business combinations

EnergyICT N.V., Kortrijk, Belgium (2009)

On October 5, 2009, Elster Group acquired a 100 per cent. interest in EnergyICT N.V., Kortrijk, Belgium ("EICT") for a total consideration of \$67,893. Cash of \$24,091 was paid upon closing and cash of \$43,802 will be paid approximately three years from the closing date. The fair value of the consideration after giving effect to discounting was \$63,603. The fair value of the consideration outstanding as of December 31, 2011 is \$37,705 and is included in other current liabilities compared to fair value outstanding of \$37,602 as of December 31, 2010 that was included in other non-current liabilities. The increase in fair value is driven by the accretion of interest which is partially offset by the change in the exchange rate between \$ and EUR. Transaction costs of \$1,733 were expensed in 2009.

EICT develops and provides advanced energy information and communications technology and Smart Grid solutions and services to utilities, energy distributors and businesses. EICT has sales offices in the United States, the United Kingdom, Germany, France, Australia and the Netherlands.

The cost of the acquisition was allocated based on estimates of fair value of the assets and liabilities acquired, and the remaining amount was assigned to goodwill, as presented in the following table:

	<u>Fair Values</u>	<u>Useful Life (Years)</u>
Current assets, including cash and cash equivalents of \$2,633	\$ 8,569	
Property, plant and equipment	486	various
Other intangible assets		
Tradenames	2,482	indefinite
Customer relationship	8,468	6
Technology-based intangible assets	5,195	6
Other noncurrent assets	145	
Deferred tax assets	1,104	
Trade payables	- 937	
Other current liabilities	- 4,684	
Deferred tax liabilities	- 5,556	
Total fair value of net assets acquired	<u>15,272</u>	
Total purchase price	\$ <u>63,603</u>	
Goodwill	\$ <u>48,331</u>	

The goodwill arising from the purchase price allocation primarily derives from the high growth rates that are expected from EICT in the future and the expectations of future growth with new customers and new technological developments. These expectations are not reflected in the value of any acquired intangible asset and therefore form part of goodwill. EICT has skilled and high qualified employees that are a key success factor in meeting the expectations; the value of the workforce is part of the goodwill. In addition, the expected synergies from combining EICT's existing business with Elster Group do not represent separate identified assets of EICT, but are part of the goodwill. Management has allocated the goodwill to the Electricity segment. Such goodwill is not deductible for tax purposes.

5. Employee termination and exit costs

Elster has restructured some of its operations, in particular the manufacturing processes of certain products. Associated with these restructuring programs were the termination of manufacturing activities and the transfer to other Elster sites or to outside manufacturing service providers. In certain cases this caused the closure of an entire Elster site. In addition, the restructuring measures included the reduction of headcount and resulted in employee termination benefit costs.

In 2011 the Water segment initiated and completed restructuring plans in Columbia to close the manufacturing site and relocate the manufacturing of water meters from Hungary to the existing site in Slovakia. The amount recognized for these restructuring plans in 2011 was \$504 and the majority of the costs were related to involuntary terminations.

The Spanish operation in the Water segment had a number of restructuring programs relating to outsourcing projects and production relocations resulting in involuntary termination benefits recognized of \$3,015 in 2010 and \$2,438 in 2009.

In 2009 the Water segment had several restructuring plans for its operations in the United Kingdom, including workforce reduction in Luton, the closure of a site in Chesterfield and outsourcing of manufacturing to Malaysia. The total amount recognized was \$511 in 2010 and \$1,516 in 2009. Additionally, the manufacturing of water meters was relocated from Russia and Poland to Slovakia in 2009 resulting in restructuring expenses of \$1,526 in 2009 primarily for inventory write downs and penalties paid to suppliers.

In 2009 the Gas segment had a restructuring plan to reduce the headcount at its Osnabrueck, Germany site. The amount recognized for involuntary termination benefits under the terms of a collective bargaining agreement were a credit of \$704 in 2010 and an expense of \$11,077 in 2009. The credit in 2010 is related to the release of a previously established reserve. The manufacturing site in Mainz, Germany was subject to a

separate restructuring plan with related expenses for involuntary termination of \$377 in 2010 and \$2,251 in 2009.

A manufacturing site of Elster's Gas segment in the United Kingdom was subject to a restructuring plan that included relocation of manufacturing operations to other Elster sites in Slovakia and Germany as well as to external contractors and the closure of that site in the United Kingdom. These restructuring measures led to involuntary termination benefits and related costs of \$448 in 2010 and \$625 in 2009.

Several other Elster subsidiaries in Italy, France, Belgium, the Netherlands, Luxembourg, Hungary, Brazil and the United States implemented restructuring measures aimed to improve operational efficiency and recorded charges of \$2,182 in 2010 and \$2,762 in 2009 for outsourcing and relocation projects.

In addition to the restructuring measures, Elster subsidiaries in Italy, Germany, France, the United Kingdom, Slovakia, Australia, South Africa, Colombia, Argentina, Brazil and the United States recognized expenses for involuntary termination benefits as a consequence of restructuring measures and capacity adjustments amounting to \$431 in 2011, \$388 in 2010 and \$3,052 in 2009.

The following summary presents employee termination and exit costs by segment:

	Gas			Electricity			Water		
	2011	2010	2009	2011	2010	2009	2011	2010	2009
Employee termination and exit costs	\$379	\$332	\$16,880	\$52	\$2,170	\$842	\$504	\$3,715	\$7,310
	Total segments			Corporate			Total		
	2011	2010	2009	2011	2010	2009	2011	2010	2009
Employee termination and exit costs	\$935	\$6,217	\$25,032	\$0	\$0	\$331	\$935	\$6,217	\$25,363

The charges for employee termination and exit activities were recognized in the following captions of the statement of operations:

	2011	2010	2009
Cost of revenues	\$617	\$3,492	\$18,847
Selling expenses	0	861	2,912
General and administrative expenses	303	1,864	2,440
Research and development expenses	15	0	1,164
Total	\$935	\$6,217	\$25,363

The following table reflects the change in the restructuring liability in 2011 and 2010:

	2011	2010
Liability at January 1,	\$ 2,223	\$ 10,768
Accrued	91	2,131
Payments made	-2,019	-8,905
Releases	0	-1,161
Foreign exchange rate change	47	-610
Liability at December 31,	\$ 342	\$ 2,223
Thereof:		
Current	342	2,223
Noncurrent	0	0

In the first quarter of 2012 Elster's Administrative Board authorized a reinvestment program with planned actions that include consolidating operations and sites mainly in North America and in Europe, relocating certain product-lines to other existing Elster businesses and increasing our mix of production in low-cost countries. The planned consolidation of operations includes the closure of four major facilities and the reduction in the number of our small and mid-sized facilities. In addition, the program includes the consolidation of administration structures in particular across our finance, procurement and human resources functions. The program is planned to begin in the first quarter of 2012 and be completed by

2014. Elster estimates future cost for the program in the range of \$40,000 to \$60,000. The majority of the estimated cost is for involuntary employee terminations in the Water and Gas segments. In addition, the program is expected to involve accelerated depreciation and amortization of property, plant and equipment that will not be relocated to a different site and estimated capital expenditures of \$35,000 through the end of 2014.

6. Interest expense, net

Interest expense, net consists of the following:

	<u>2011</u>	<u>2010</u>	<u>2009</u>
Interest income			
Interest income on bank deposits	\$ 3,058	\$ 1,741	\$ 2,467
Other	43	165	102
	<u>3,101</u>	<u>1,906</u>	<u>2,569</u>
Interest expense			
Interest on Senior Notes	15,138	0	0
Interest on all other debt	22,517	35,290	38,158
Payments (receipts) from interest rate swaps	9,107	13,189	8,713
Change in fair value of interest rate swaps	-10,070	5,016	3,824
Interest on preferred equity certificates and shareholder loan	0	280	369
Other	7,004	5,836	6,929
	<u>43,696</u>	<u>59,611</u>	<u>57,993</u>
Interest expense, net	<u>\$ 40,595</u>	<u>\$57,705</u>	<u>\$55,424</u>

Other interest expense is primarily amortization of deferred financing fees related to the issuances of debt. See note 14—*Debt* for further information regarding deferred financing fees from the refinancing in the second quarter of 2011 that resulted in the issuance of senior notes, a new revolving credit facility, and the termination of the old senior facilities agreement.

7. Income taxes

The components of income tax expense from continuing operations are as follows:

	<u>2011</u>	<u>2010</u>	<u>2009</u>
<i>Current income tax</i>			
Germany	\$ 16,348	\$ 12,543	\$ 10,339
Foreign	29,649	38,136	31,543
	<u>\$ 45,997</u>	<u>\$ 50,679</u>	<u>\$ 41,882</u>
<i>Deferred income tax</i>			
Germany	\$ -3,869	\$ -9,963	\$ -158
Foreign	-8,635	-11,314	-2,375
	<u>\$ -12,504</u>	<u>\$ -21,277</u>	<u>\$ -2,533</u>
Income tax expense from continuing operations	<u>\$ 33,493</u>	<u>\$ 29,402</u>	<u>\$ 39,349</u>

Income (loss) from continuing operations before income taxes originated in the following jurisdictions:

	<u>2011</u>	<u>2010</u>	<u>2009</u>
Germany	\$ 37,671	\$ -6,666	\$ -28,809
Foreign	102,797	125,536	120,502
	<u>\$140,468</u>	<u>\$118,870</u>	<u>\$ 91,693</u>

Total income tax expense (benefit), including the items directly recorded in equity consist of the following:

	<u>2011</u>	<u>2010</u>	<u>2009</u>
Income tax from continuing operations	\$ 33,493	\$29,402	\$ 39,349
Income tax credit recognized in other comprehensive income (loss) . . .	-4,664	-11	-2,657
Income tax recognized in additional paid-in capital	0	-6,438	0
	<u>\$ 28,829</u>	<u>\$22,953</u>	<u>\$ 36,692</u>

The income tax benefit recognized in additional paid-in capital relates to costs arising from the initial public offering since the majority of these costs are deductible under the German tax law.

Reconciliation between the expected income tax expense based on German corporate income tax rate of 15.83 per cent. to income tax expense from continuing operations reported in the consolidated statements of operations is provided in the following table:

	<u>2011</u>	<u>2010</u>	<u>2009</u>
Income from continuing operations before taxes	\$140,468	\$118,870	\$ 91,693
“Expected” income tax expense	22,236	18,817	14,515
Foreign tax rate differentials	8,733	5,614	2,995
German municipal trade tax	8,868	7,327	6,431
Tax exempt income	-2,122	-1,011	-2,636
Non deductible expenses	2,078	3,355	4,354
Tax effects arising from management equity program	0	-2,155	-5,263
Uncertain tax positions	-205	1,101	8,175
Prior year tax adjustments	-4,184	-2,735	-71
Changes in tax rate and tax law	504	-1,104	308
Changes in valuation allowances	-3,042	2,674	12,560
Tax effects from basis differences in investments in subsidiaries	905	-668	366
Tax credits	-1,889	-1,670	-3,224
Withholding tax effects	2,109	930	1,576
Others	-498	-1,073	-737
Actual income tax expense	\$ 33,493	\$ 29,402	\$ 39,349
Effective income tax rate	23.8%	24.7%	42.9%

In 2011 changes in the Company’s assessment of the recoverability of deferred tax assets attributable to tax loss carryforwards of the Spanish and Argentinean subsidiaries resulted in a reversal of valuation allowances and had a positive impact on the effective income tax rate. A significant driver of the Company’s effective income tax rate in 2010 and 2009 is attributable to the tax effects arising from share-based compensation programs, primarily the management equity program (MEP) which was sponsored by the parent (see note 16—*share-based compensation*). The parent did not obtain a deduction for such charges on its income tax return.

Deferred income tax assets and liabilities as of December 31, 2011 and 2010 consist of the following:

	2011		2010	
	Deferred Tax Asset	Deferred Tax Liability	Deferred Tax Asset	Deferred Tax Liability
Inventories	\$ 7,049	\$ 22	\$ 5,772	\$ 145
Receivables and other assets	1,903	6,937	5,501	7,901
Prepaid expenses	1,039	1,228	66	2,916
Tangible fixed assets	3,086	25,517	2,122	26,043
Other intangible assets	10,854	56,970	9,746	68,379
Goodwill	0	4,316	0	4,477
Shares in related companies	0	6,673	0	2,668
Provisions for pensions	26,670	0	22,097	0
Other liabilities	20,006	9,004	20,120	6,655
Tax loss and tax credit carryforwards	27,068	0	41,917	0
Valuation allowance on deferred tax assets	-11,822	0	-30,756	0
	\$ 85,853	\$ 110,667	\$ 76,585	\$ 119,184
Net deferred tax liabilities		\$ -24,814		\$ -42,599

No deferred tax liabilities have been recognized for the undistributed earnings of certain foreign subsidiaries that arose in 2011 and prior years that we plan to reinvest indefinitely in the foreign jurisdictions. It is not practicable to estimate the amount of deferred tax liabilities that would need to be recognized if we determined to change our plan and repatriate these undistributed foreign earnings.

In assessing the recoverability of deferred tax assets, Elster Group's management considers whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. The ultimate realization of deferred tax assets depends on the generation of future taxable income during the periods in which those temporary differences become deductible. Based on the level of historical taxable income and projections for future taxable income over the periods in which the deferred tax assets are recoverable, management believes it is more likely than not that the Company will realize the benefits of these deductible differences, net of the existing valuation allowances at December 31, 2011. The amount of the deferred tax asset considered recoverable, however, could be reduced in the near term if the Company's estimates of future taxable income during the carryforward period were reduced.

Based on the results of this assessment, valuation allowances were recorded against deferred taxes. These valuation allowances relate primarily to certain types of operating tax losses.

The amount and the expiration period of tax loss carryforwards are as follows as of December 31, 2011:

Expiration of tax loss carryforwards

Within one year	\$ 5,469
Within two years	63
Within three years	6
Within four years	65
Within five years and later	13,239
Indefinite	42,597
Total tax loss carryforwards	\$61,439

In addition to net operating loss carryforwards at federal corporate income tax level, there are German trade tax and foreign state and local income tax loss carryforwards of \$39,690 as of December 31, 2011 available to the Company. The respective tax rates vary between 2.5 per cent. and 14.2 per cent. Interest expense carryforwards of \$16,472 do not expire and can be used indefinitely.

Changes in valuation allowances comprise the following elements

<u>Valuation Allowances arising from</u>	<u>Temporary Differences</u>	<u>Tax Losses Carry-forward</u>	<u>Total</u>
As of December 31, 2008	\$ 2,105	\$ 41,631	\$ 43,736
Charged (credited) to income tax provision (benefit)	15	18,346	18,361
Reversals	-2,096	0	-2,096
Utilization / expiration of tax losses	0	-29,059	-29,059
Effect of foreign exchange fluctuation and tax rate changes	422	-387	35
As of December 31, 2009	\$ 446	\$ 30,531	\$ 30,977
Charged (credited) to income tax provision (benefit)	828	3,307	4,135
Reversals	-701	0	-701
Utilization / expiration of tax losses	0	-1,736	-1,736
Effect of foreign exchange fluctuation and tax rate changes	9	-1,928	-1,919
As of December 31, 2010	\$ 582	\$ 30,174	\$ 30,756
Charged (credited) to income tax provision (benefit)	2,072	649	2,721
Reversals	-1,772	-3,643	-5,415
Utilization / expiration of tax losses	0	-17,101	-17,101
Effect of foreign exchange fluctuation and tax rate changes	-48	909	861
As of December 31, 2011	\$ 834	\$ 10,988	\$ 11,822

A reconciliation of the beginning and ending amount of gross unrecognized tax benefits including all German corporate and trade tax as well as foreign tax jurisdictions is as follows:

	<u>2011</u>	<u>2010</u>	<u>2009</u>
Balance at the beginning of the year	\$ 47,663	\$41,786	\$23,184
Additions for tax positions taken in the current year	12,949	11,506	18,271
Reductions for tax positions taken in prior years			
Settlement	-2,919	-1,325	-130
Lapse of statute of limitation	-3,408	-3,036	0
Payments made	-386	-570	0
Effects of exchange rate changes	-310	-698	461
Balance at the end of the year	\$ 53,589	\$47,663	\$41,786

During the years ended December 31, 2011, 2010 and 2009, the Company recognized \$181, \$945, and \$205, respectively, in interest and penalties related to unrecognized tax benefits. As of December 31, 2011 and 2010, total interest and penalties related to unrecognized tax benefits accrued were \$1,757 and \$2,271 respectively.

Included in the balance of unrecognized tax benefits at December 31, 2011, 2010 and 2009, were potential benefits of \$16,957, \$17,513 and \$18,558 respectively, that if recognized, would affect the Company's effective tax rate. The Company anticipates recognizing a range of \$1,909 to \$2,561 of the total amount of unrecognized tax benefits within the next twelve months as a result of expiration of statute of limitations and tax examinations expected to be finalized within the next twelve months in several countries.

Tax years that remain subject to examination in the Group's major tax jurisdictions are:

<u>Major tax jurisdictions</u>	<u>Years Subject to Examination</u>
Germany	Subsequent to 2004
U.S. Federal	Subsequent to 2008

8. Earnings per share

The following table summarizes the information used to compute earnings per share:

	2011	2010	2009
<i>Numerator—Basic and Dilutive</i>			
Income from continuing operations attributable to Elster Group SE	\$ 102,473	\$ 84,689	\$ 48,888
Accretion of dividends on preferred shares	0	- 19,210	- 25,640
Income from continuing operations attributable to Elster Group SE—basic and dilutive	\$ 102,473	\$ 65,479	\$ 23,248
Income (loss) from discontinued operations	- 1,594	2,570	0
Net income attributable to ordinary shareholders—basic and diluted	\$ 100,879	\$ 68,049	\$ 23,248
<i>Denominator—Basic and Dilutive</i>			
Basic weighted average number of ordinary shares outstanding, adjusted for stock split	28,220,041	19,295,573	16,320,750
Diluted weighted average number of ordinary shares outstanding, adjusted for stock split	28,220,041	19,299,777	16,320,750

9. Accounts receivable

Accounts receivable consist of the following as of December 31:

	2011	2010
Open customer contracts	\$ 32,216	\$ 21,453
Trade accounts receivables	259,947	266,496
Accounts receivable before the allowance for doubtful accounts	\$292,163	\$287,949
Less allowance for doubtful accounts	- 8,033	- 9,732
Accounts receivable	\$284,130	\$278,217

The change in the allowance for doubtful accounts is as follows:

	2011	2010	2009
Balance at the beginning of the year	\$ 9,732	\$ 7,337	\$ 9,031
Additions	\$ 1,533	\$ 4,506	\$ 3,707
Utilization	- 2,933	- 2,232	- 5,732
Effects of exchange rate changes	- 299	121	331
Balance at the end of the year	\$ 8,033	\$ 9,732	\$ 7,337

Open customer contracts comprise the following:

	2011	2010
Aggregate costs incurred	\$ 176,368	\$ 163,493
Recognized profits	24,448	25,842
Recognized losses	- 65	- 424
Progress billings	- 168,535	- 167,458
Open customer contracts	\$ 32,216	\$ 21,453

Open customer contracts are open contracts accounted for using the percentage of completion as of December 31 in the table above. The majority of the open customer contracts are expected to be completed within the next twelve months.

10. Inventories

Inventories consist of the following as of December 31:

	<u>2011</u>	<u>2010</u>
Raw materials	\$ 122,972	\$ 130,456
Work in progress	18,566	17,509
Finished goods	43,082	37,307
Total gross inventories before inventory reserves	\$ 184,620	\$ 185,272
Reserves	– 21,519	– 30,723
Inventories	\$ 163,101	\$ 154,549

11. Property, plant and equipment

Property, plant and equipment, including assets under capital lease, consist of the following as of December 31:

<u>2011</u>	<u>Cost</u>	<u>Accumulated Depreciation</u>	<u>Net</u>
Land	\$ 30,785	\$ 347	\$ 30,438
Buildings	58,576	21,397	37,179
Plant and machinery	200,011	110,584	89,427
Other equipment	39,360	17,519	21,841
Construction in process	17,692	0	17,692
Property, plant and equipment	\$346,424	\$149,847	\$196,577
<u>2010</u>	<u>Cost</u>	<u>Accumulated Depreciation</u>	<u>Net</u>
Land	\$ 31,584	\$ 328	\$ 31,256
Buildings	59,139	18,183	40,956
Plant and machinery	186,301	87,282	99,019
Other equipment	32,464	10,758	21,706
Construction in process	10,621	659	9,962
Property, plant and equipment	\$320,109	\$117,210	\$202,899

Depreciation expense was \$41,607, \$40,292 and \$42,051 in 2011, 2010 and 2009, respectively. This amount includes depreciation for assets under capital lease of \$122, \$193 and \$344 in 2011, 2010 and 2009, respectively. Interest charges in the amount of \$130, \$274 and \$738 were capitalized in connection with construction projects during the years 2011, 2010 and 2009, respectively.

Impairment losses of \$2,330 and \$941 were recognized in 2010 and 2009, respectively.

Elster Group leases machinery and equipment used in manufacturing under a number of capital lease agreements. Cost of the assets under capital lease at December 31, 2011 and 2010 was \$986 and \$1,319, respectively. Accumulated depreciation at December 31, 2011 and 2010 was \$722 and \$904, respectively.

Real estate in Germany for an amount of \$6,793 as of December 31, 2011 serves as collateral for the unfunded Altersteilzeit employee benefits (see note 13).

12. Goodwill and other intangible assets

Intangible assets consist of the following as of December 31:

<u>2011</u>	<u>Cost</u>	<u>Accumulated Amortization</u>	<u>Net</u>
Trade names and brands	\$ 26,885	\$ 8,791	\$ 18,094
Customer related assets	213,896	118,016	95,880
Contract-based and other intangible assets	59,169	49,422	9,747
Technology-related intangible assets	143,723	92,002	51,721
Other intangible assets	\$443,673	\$268,231	\$175,442
Goodwill	\$919,060	\$ 0	\$919,060

<u>2010</u>	<u>Cost</u>	<u>Accumulated Amortization</u>	<u>Net</u>
Trade names and brands	\$ 27,493	\$ 8,817	\$ 18,676
Customer related assets	217,608	99,356	118,252
Contract-based and other intangible assets	56,913	43,968	12,945
Technology-related intangible assets	146,973	80,440	66,533
Other intangible assets	\$448,987	\$232,581	\$216,406
Goodwill	\$936,950	\$ 0	\$936,950

Amortization expense was \$42,186, \$45,239 and \$43,385 in 2011, 2010 and 2009, respectively.

The following presents the estimated amortization expense for intangible assets that are subject to scheduled amortization for each of the next five fiscal years:

2012	\$37,440
2013	29,168
2014	24,778
2015	19,409
2016	15,375

The carrying amount of intangible assets with an indefinite useful life, i.e. certain trade names, is \$16,079 and \$16,363 at December 31, 2011 and 2010, respectively.

Elster Group recognized impairment losses in 2009 of \$2,241 within cost of revenues for certain trade names and brands in the Gas and Water segments. The estimation of the fair value was based on discounted cash flows and involved significant unobservable inputs.

Goodwill has been allocated to the segments as follows:

	<u>Gas</u>	<u>Electricity</u>	<u>Water</u>	<u>Consolidated</u>
December 31, 2009	\$ 595,366	\$ 230,901	\$155,304	\$ 981,571
Additions	0	- 695	0	- 695
Foreign currency translation	- 31,602	- 12,324	0	- 43,926
December 31, 2010	\$ 563,764	\$ 217,882	\$155,304	\$ 936,950
Foreign currency translation	- 12,892	- 4,998	0	- 17,890
December 31, 2011	\$ 550,872	\$ 212,884	\$155,304	\$ 919,060

13. Pension and other long term employee benefits

Elster Group provides postretirement benefits for most of its employees, either directly or by contributions to pension funds managed by third parties. The benefits provided vary according to legal regulations, tax requirements and economic conditions of the countries. Certain group subsidiaries provide benefits under defined benefit pension plans. These benefits are normally based on the employees' remuneration and years of service. German pension benefit plans are unfunded. Funded defined benefit pension plans mainly

exist in the US, the UK, Canada, Australia and Belgium. These funded plans involve contributions by Elster Group to a separate pension fund that invests in accordance with the respective investment guideline and local law.

The US based subsidiaries provide postretirement healthcare and life insurance benefits. The German subsidiaries participate in an early retirement program designed to create an incentive for employees, within a certain age group, to retire early (Altersteilzeit). The measurement date for the defined benefit plans was December 31.

For defined contribution plans, the subsidiaries make contributions to pension funds managed by third parties as required by law or collective bargaining agreements or voluntarily. Total costs recognized for defined contribution pension plans in the accompanying statements of operations in 2011, 2010 and 2009 were \$32,021, \$26,003 and \$25,512 respectively.

The cost of employees' benefits under defined benefit and defined contribution plans is allocated to the functional costs appropriate to the employees in the statements of operations.

German pension plan

The components of net periodic benefit costs for German benefit plans are as follows:

<u>Net periodic benefit cost</u>	<u>Pension Benefits</u>			<u>Other Benefits</u>		
	<u>2011</u>	<u>2010</u>	<u>2009</u>	<u>2011</u>	<u>2010</u>	<u>2009</u>
Service cost	\$1,151	\$1,170	\$1,106	\$1,939	\$1,366	\$3,068
Interest cost	5,085	4,800	5,115	528	378	463
Gain on curtailments	0	0	-74	0	0	0
Amortization of net gain	-68	-122	-507	0	0	0
Net periodic benefit cost	\$6,168	\$5,848	\$5,640	\$2,467	\$1,744	\$3,531

<u>Change in Benefit Obligation</u>	<u>Pension Benefits</u>		<u>Other Benefits</u>	
	<u>2011</u>	<u>2010</u>	<u>2011</u>	<u>2010</u>
Benefit obligation at beginning of year	\$ 96,648	\$102,111	\$ 7,740	\$ 9,151
Service cost	1,151	1,170	1,939	1,366
Interest cost	5,085	4,800	528	378
Actuarial loss	9,902	522	0	0
Benefits paid	-4,981	-4,621	-2,209	-2,488
Exchange rate changes	-3,842	-7,334	-264	-667
Benefit obligation at end of year	\$103,963	\$ 96,648	\$ 7,734	\$ 7,740
Unfunded status at end of year	\$103,963	\$ 96,648	\$ 7,734	\$ 7,740

Liability consists of:

	<u>2011</u>	<u>2010</u>	<u>2011</u>	<u>2010</u>
Current liabilities	\$ 4,871	\$ 4,913	\$2,052	\$2,455
Noncurrent liabilities	\$99,092	\$91,735	\$5,682	\$5,285

The total accumulated benefit obligation for German defined benefit pension plans was \$99,528 and \$94,072 as of December 31, 2011 and 2010, respectively.

The actuarial loss impacting the projected benefit obligation was primarily due to decreases in the discount rates.

Amounts recognized for German defined benefit plans in accumulated other comprehensive income (loss) consist of the following:

	<u>2011</u>	<u>2010</u>	<u>2009</u>
Actuarial gains, net in the accumulated other comprehensive income at the beginning of year	\$ 10,443	\$11,047	\$ 17,667
Net actuarial loss reported in the period	-9,244	-482	-6,106
Amortization of actuarial gain, net	-68	-122	-507
Curtailment/Settlement	0	0	-7
Actuarial gains, net in the accumulated other comprehensive income at the end of year	\$ 1,131	\$10,443	\$ 11,047

Actuarial gains of \$21 included in accumulated other comprehensive income (loss) will be amortized into income in 2011.

The determination of discount rates for German and foreign plans is based on a yield curve constructed from a portfolio of high quality bonds rated AA or better, for which the timing and amount of cash outflows approximate the estimated payouts of the plan. Assumptions regarding future mortality are based on published statistics and mortality tables.

The weighted-average assumptions used to determine German benefit obligations as at December 31 are:

	<u>Pension Benefits</u>		<u>Other Benefits</u>	
	<u>2011</u>	<u>2010</u>	<u>2011</u>	<u>2010</u>
Discount rate	4.5%	5.1%	4.3%	4.8%
Rate of compensation increase	2.8%	2.8%	—	—

The weighted-average assumptions used to determine German net periodic benefit cost for years 2011, 2010 and 2009 are:

	<u>Pension Benefits</u>			<u>Other Benefits</u>		
	<u>2011</u>	<u>2010</u>	<u>2009</u>	<u>2011</u>	<u>2010</u>	<u>2009</u>
Discount rate	5.1%	5.3%	5.7%	4.8%	5.1%	4.9%
Rate of compensation increase	2.8%	2.8%	2.8%	—	—	—

The benefits expected to be paid for the German defined benefit plans over the next ten years are:

	<u>Pension Benefits</u>	<u>Other Benefits</u>
2012	\$ 4,871	\$2,052
2013	4,973	1,731
2014	5,241	1,479
2015	5,134	1,124
2016	5,461	1,003
Years 2017-2021	\$28,586	\$2,212

Foreign pension plans

The components of net periodic benefit costs for all foreign benefit plans are as follows:

<u>Net periodic benefit cost</u>	<u>Pension Benefits</u>			<u>Other Benefits</u>		
	<u>2011</u>	<u>2010</u>	<u>2009</u>	<u>2011</u>	<u>2010</u>	<u>2009</u>
Service cost	\$ 394	\$ 407	\$ 411	\$ 567	\$ 527	\$ 418
Interest cost	3,858	3,852	4,091	1,188	1,460	1,642
Expected return on plan assets	-3,812	-3,412	-2,967	0	0	0
Amortization of prior service credit .	0	0	0	-1,244	-1,174	-1,260
Loss (gain) on settlements or curtailments	156	0	106	0	-249	0
Amortization of net (gain) loss	201	67	105	-962	-557	-629
Net periodic benefit cost (credit) . . .	\$ 797	\$ 914	\$ 1,746	\$ -451	\$ 7	\$ 171

<u>Change in benefit obligation</u>	<u>Pension Benefits</u>		<u>Other Benefits</u>	
	<u>2011</u>	<u>2010</u>	<u>2011</u>	<u>2010</u>
Benefit obligation at beginning of year	\$ 75,120	\$ 72,267	\$ 23,970	\$ 28,377
Service cost	394	407	567	527
Interest cost	3,858	3,852	1,188	1,460
Plan participants' contributions	69	94	0	0
Actuarial loss (gain)	8,242	3,041	445	-4,262
Curtailments/Settlements	-312	0	0	-73
Benefits paid	-4,382	-3,688	-1,964	-2,076
Transfers	-25	-147	0	0
Exchange rate changes	-299	-706	-56	17
Benefit obligation at end of year	\$ 82,665	\$ 75,120	\$ 24,150	\$ 23,970

Change in plan assets

	<u>2011</u>	<u>2010</u>	<u>2011</u>	<u>2010</u>
Fair value of plan assets at beginning of year	\$52,502	\$48,210	\$ 0	\$ 0
Actual return on plan assets	3,673	4,653	0	0
Transfers	-25	-110	0	0
Employer contributions	3,692	3,376	0	0
Plan participants' contributions	69	94	0	0
Curtailments/Settlements	-312	0	0	0
Benefits paid	-4,049	-3,355	0	0
Exchange rate changes	-192	-366	0	0
Fair value of plan assets at end of year	\$55,358	\$52,502	\$ 0	\$ 0
Unfunded status at end of year	\$27,307	\$22,618	\$24,150	\$23,970

Liability consists of:

	<u>2011</u>	<u>2010</u>	<u>2011</u>	<u>2010</u>
Current liabilities	\$ 4,692	\$ 4,169	\$ 1,909	\$ 1,949
Noncurrent liabilities	\$22,615	\$18,449	\$22,241	\$22,021

The total accumulated benefit obligation for all foreign defined benefit pension plans was \$81,456 and \$74,043 as of December 31, 2011 and 2010, respectively.

Information for pension plans with an accumulated benefit obligation in excess of plan assets as of December 31:

	<u>2011</u>	<u>2010</u>
Projected benefit obligation	\$82,227	\$68,122
Accumulated benefit obligation	\$81,016	\$67,887
Fair value of plan assets	\$54,919	\$46,099

Amounts recognized for all foreign defined benefit plans in accumulated other comprehensive income consist of the following:

	<u>2011</u>	<u>2010</u>	<u>2009</u>
Actual gains, net accumulated in the other comprehensive income			
(loss) at the beginning of year	\$ 6,689	\$ 4,780	\$ 4,509
Net actuarial gain (loss) reported in the period	-8,673	2,399	668
Amortization of actuarial gain, net	-761	-490	-524
Curtailment/Settlement	156	0	127
Actuarial losses (gains), net accumulated in the other comprehensive income (loss) at the end of year	\$ -2,589	\$ 6,689	\$ 4,780
Past service credits accumulated in the other comprehensive income			
(loss) at the beginning of year	\$ 3,598	\$ 4,940	\$ 6,200
Amortization of past service credit	-1,244	-1,166	-1,260
Curtailment/Settlement	0	-176	0
Past service credit accumulated in the other comprehensive income (loss) at the end of year	\$ 2,354	\$ 3,598	\$ 4,940
Net amount recognized in accumulated other comprehensive income (loss) at the end of year	\$ -235	\$ 10,287	\$ 9,720

For foreign defined benefit plans actuarial losses of \$203 and past service credits of \$1,205 included in accumulated other comprehensive income (loss) will be amortized into income in 2012.

The weighted-average assumptions used to determine foreign benefit obligations as at December 31 are:

	<u>Pension Benefits</u>		<u>Other Benefits</u>	
	<u>2011</u>	<u>2010</u>	<u>2011</u>	<u>2010</u>
Discount rate	4.5%	5.2%	4.4%	5.2%
Rate of compensation increase	3.5%	3.4%	—	—

The weighted-average assumptions used to determine foreign net periodic benefit cost for years 2011, 2010 and 2009 are:

	<u>Pension Benefits</u>			<u>Other Benefits</u>		
	<u>2011</u>	<u>2010</u>	<u>2009</u>	<u>2011</u>	<u>2010</u>	<u>2009</u>
Discount rate	5.2%	5.6%	6.4%	5.2%	5.3%	6.5%
Expected return on plan assets	7.3%	7.1%	7.6%	—	—	—
Rate of compensation increase	3.4%	3.3%	3.4%	—	—	—

Assumed health care cost trend rates at December 31 are:

	<u>Other Benefits</u>		
	<u>2011</u>	<u>2010</u>	<u>2009</u>
Health care cost trend rate assumed for next year	9.0%	9.0%	6.9%
Rate to which the cost trend rate is assumed to decline (the ultimate trend rate)	5.0%	5.0%	5.0%
Year that the rate reaches the ultimate trend rate	2014	2014	2012

The table below shows the impact of a one percent point change in the assumed rate of health care cost:

	<u>1% increase</u>	<u>1% decrease</u>
Effect on total of service and interest cost	\$ 81	\$ - 74
Effect on postretirement benefit obligation	\$ - 1,266	\$ 1,171

The fair value of Elster Group pension plan assets as of December 31, 2011 and 2010 is measured as follows:

		Quoted Prices in Active Markets for Identical Assets	Significant Other Observable	Significant Unobservable Inputs
	Total	(Level 1)	(Level 2)	(Level 3)
2011				
Investment funds	\$53,145	\$ 15,247	\$ 37,898	\$ 0
Insurance contracts	2,213	0	2,213	0
Total assets	<u>\$55,358</u>	<u>\$ 15,247</u>	<u>\$ 40,111</u>	<u>\$ 0</u>
2010				
Investment funds	\$50,112	\$ 17,950	\$ 32,031	\$ 131
Insurance contracts	2,390	0	2,390	0
Total assets	<u>\$52,502</u>	<u>\$ 17,950</u>	<u>\$ 34,421</u>	<u>\$ 131</u>

Elster Group pension plan assets consist of investments funds and guaranteed insurance contracts managed by local trustees and fund managers in several foreign countries. Consistent with their investment strategy and local laws and regulations, the investment funds and insurance carriers invest in a diversified portfolio of equity securities (2011: 57 per cent., 2010: 60 per cent.), fixed income securities (2011: 36 per cent., 2010: 35 per cent.), real estate (2011: 1 per cent., 2010: 0 per cent.) and other assets (2011: 6 per cent., 2010: 5 per cent.).

The fair value of the investment funds classified as level 1 are based on quoted prices in active markets. The fair value of the investment funds classified as level 2 are based on the quoted prices in active markets of the underlying net assets of the investment fund. The insurance contracts have a guaranteed return on the accrued balances and future premiums plus a participation right in higher returns generated by the investments made. The fair values have been obtained from the insurance carriers.

On average, the expected rate of return is 9.0 per cent. on equity securities and 4.8 per cent. on fixed income instruments. The respective rates of return take into account country-specific conditions and are based, among other things, on interest and dividend income expected over the long term, as well as increases in the value of the portfolio after deduction of directly allocable taxes and expenses.

Elster expects to pay \$3,570 in contributions to defined benefit plans in 2012. The benefits expected to be paid over the next ten years are:

	<u>Pension Benefits</u>	<u>Other Benefits</u>
2012	\$ 4,692	\$1,909
2013	4,314	1,848
2014	4,329	1,803
2015	4,702	1,767
2016	4,528	1,681
Years 2017-2021	\$24,857	\$8,075

14. Debt

	Carrying Amount as of December 31		Annual effective Interest Rate (%)			Principal in Currency of Debt upon Issuance	Maturity
	2011	2010	2011	2010	2009		
Senior Notes	\$323,474		6.25			250,000 EUR	Apr. 15, 2018
Revolving credit facility:							
Euro-denominated	58,225		3.31				Apr. 8, 2016
USD-denominated	128,100		2.22				Apr. 8, 2016
GBP-denominated	52,667		2.66				Apr. 8, 2016
Total Revolving credit facility	\$238,992						
Other bank loans	17,152	\$ 89,181	Various	Various	Various		Various
Capital leases	108	388					
Senior facility agreement:							
Tranch B Euro-denominated		260,254	3.75	3.03	2.80	227,190 EUR	Terminated
Tranch B USD-denominated		115,137	3.03	2.30	2.29	137,076 USD	Terminated
Tranch C Euro-denominated		260,330	4.25	3.53	3.30	227,190 EUR	Terminated
Tranch C USD-denominated		115,167	3.53	2.80	2.79	137,076 USD	Terminated
Total Senior facility agreement		750,888					
Total debt	\$579,726	\$840,457					
Thereof:							
Noncurrent debt	\$573,633	\$822,447					
Current debt	\$ 6,093	\$ 18,010					

The following table presents the maturity of principal payments for debt (other than capital leases):

Debt Principal Payments

2012	\$ 6,055
2013	11,097
2014	0
2015	0
2016	238,992
Years 2017-2018	323,474
	\$579,618

In the second quarter of 2011 Elster Group refinanced all of the outstanding indebtedness under its old senior facilities agreement (“SFA”) which resulted in the principal repayment of \$866,627 and the termination of the SFA. The funds used to repay the SFA consisted of \$109,380 in available cash, \$359,131 of funds from the issuance of €250 million senior notes due in April 2018 (“Senior Notes”), and \$398,117 of funds drawn from a new multicurrency revolving credit and bank guarantee facilities agreement (“RCF”). The refinancing resulted in a \$13,438 write-off of unamortized deferred financing fees associated with the SFA that is presented as loss on extinguishment of debt in the consolidated statement of operations.

The Senior Notes have a coupon rate of 6.25 per cent. and interest is paid semi-annually. Elster Group capitalized deferred financing fees of \$8,011 for the Senior Notes issuance that will be amortized into interest expense over the seven year term.

The RCF includes a syndicate of 13 banks and consists of a €450 million multicurrency revolving credit facility and a €140 million multicurrency revolving letter of guarantee facility, each maturing in April 2016. Loans granted under the RCF bear interest at a variable rate (Euribor or Libor) plus an applicable margin. Elster Group capitalized deferred financing fees of \$12,580 for the origination of the RCF that will be amortized into interest expense over the five year term. At December 31, 2011 there was \$342,631 available capacity under the RCF credit facility.

The RCF and Senior Notes include certain affirmative and negative covenants including the incurrence of additional indebtedness, the maintenance of a maximum leverage ratio, and a minimum interest coverage ratio. Elster Group is in compliance with all debt covenants as of December 31, 2011.

In 2010 Elster Group recognized \$2,378 of incremental financing fees because of the repayments of the SFA in connection with the initial public offering (See note 15—*Equity and shareholder loan* for more information on the initial public offering). The 2011 write-off of financing fees associated with the refinancing were presented as a separate line item in the statement of operations as loss on extinguishment of debt, this comparative amount in 2010 has been reclassified accordingly.

15. Equity and shareholder loan

Initial Public Offering

On October 5, 2010 Elster Group SE completed an initial public offering of 18,630,000 American Depositary Shares (“ADSs”) at an offering price of \$13.00 per ADS, each ADS representing one-fourth of an ordinary share of Elster Group SE. A total of 4,657,500 ordinary shares were sold, of which 3,365,385 ordinary shares were issued by the Company and 1,292,115 ordinary shares were sold by Rembrandt and Management KG.

The Company received proceeds of approximately \$153,254 from the initial public offering, after deducting offering costs of \$21,746 borne by the Company. The Company primarily used the proceeds to repay \$143,915 of debt incurred under the SFA and the shareholder loan due to Management KG of \$6,752, including accreted interest.

In connection with the initial public offering, the Company and Rembrandt replaced the preferred shares held by Rembrandt with ordinary shares. As of October 1, 2010, the Company issued 8,533,906 ordinary shares to Rembrandt in exchange for all preferred shares. The aggregate value of the ordinary shares issued to Rembrandt to replace the preferred shares equaled the nominal value of all preferred shares plus accreted unpaid preferred dividends of €326,033 divided by the initial public offering price per ordinary share of \$52.00 (€38.20) which is four times the price per American depository share on the date of the initial public offering.

Other

In 2010, Elster Group sold a 25.1 per cent. noncontrolling interest in a South African subsidiary for \$2,034 in cash while retaining its controlling financial interest in that subsidiary. The transaction is accounted for as an equity transaction. As a result of the transaction, accumulated foreign currency translation losses of \$1,631 were allocated to the noncontrolling interest.

16. Share-based compensation

Long-Term Incentive Plan

Elster Group has a Long-Term Incentive Plan (“LTIP”) to provide long-term performance compensation to key employees and Managing Directors. Elster Group may grant awards up to 7,405,000 ADSs (1,851,250 ordinary shares) through September 29, 2020.

An initial grant was made to participants in connection with the initial public offering in 2010 for 674,440 non-vested ADS awards (168,610 non-vested ordinary shares). One half of the non-vested ADS awards are subjected to a service period and a market condition involving stock price return compared to a peer group and generally vest after four years and depending on the results of the market condition (“target stock price return” or TSR awards). The other half of the awards are subject to a service period and performance conditions involving earnings per share targets based on staggered performance periods from two to four years and generally vest after four years depending on the results of the performance conditions (“EPS awards”). The awards are nontransferable during the vesting period and the participants are not entitled to the rights of an outstanding share, including dividend rights. There are no post-vesting restrictions on shares granted to participants. Except in limited circumstances such as retirement or redundancy, awards

will lapse without vesting if an employee leaves our company during the vesting period. There were no awards granted in 2011.

The grant date fair value for the 2010 EPS award was \$14.15 which was determined based on the closing price of Elster's ADS on the grant date. The company is required evaluate the probability of achievement of the EPS performance conditions throughout the life of the award with adjustments recorded in earnings.

The TSR awards are considered to have a market condition for accounting purposes and the company is required to estimate the results of the market condition in the grant date fair value of the award. We used a Monte Carlo model to estimate the 2010 grant date fair value of \$8.77 which was approximately 62 per cent. of the quoted price of Elster's ADS. For these awards, the company is required to record the related compensation expense in the financial statements over the life of the awards regardless if the market condition is achieved as long as the service period is met by the participant.

The assumptions used in the Monte Carlo model to estimate the 2010 grant date fair value for the TSR awards are as follows:

	<u>2010</u>
Grant date fair value of unvested ADS	\$8.77
Assumptions used to determine fair value	
Dividend yield	0%
Risk-free rate of return	0.94%
Expected life of awards (years)	4
Expected volatility	40%

Dividend yield considers the historical dividend yield paid by the company and expected dividend yield over the life of the awards. The risk-free rate is based on the U.S. Treasury yield curve in effect at the time of grant. The expected life of the award is based on the vesting period for non-vested ADS awards. Expected volatility is a proxy volatility calculated based on the average of the 4 year volatility of our peers' historical share price volatility since the company's shares do not have an established history of trading.

A summary of the status of the company's non-vested ADS awards as of December 31, 2011, and changes during the year ended December 31, 2011, is presented below:

ADSs in thousands (represent one-fourth of an ordinary Share)	Number of ADSs	Grant Date Fair Value	
		Weighted Average	Range of Prices
Unvested ADSs at January 1, 2011	628	\$12	\$9-14
ADSs granted	0		
ADSs vested	0		
ADSs forfeited	-26	\$12	\$9-14
Non-vested ADSs at December 31, 2011	602	\$12	\$9-14

Elster Group intends to settle vested awards by issuing ordinary shares to participants.

Management Equity Program

Rembrandt Holdings SA, Luxembourg, the immediate parent and controlling shareholder ("Rembrandt"), sponsored a Management Equity Program ("MEP") through Nachtwache Metering Management Vermögensverwaltungs GmbH&Co. KG ("Management KG"), an entity which was controlled by Rembrandt. The MEP granted certain members of senior management of Elster Group share-based payments. The obligation of the parent related to the MEP arrangement was accounted for as a cash-settled plan and remeasured through September 30, 2010, the date of listing in connection with the initial public offering. In connection with the initial public offering, previously unvested awards under the MEP became vested and all grantees were entitled to benefits from the sale of Elster shares rather than a formula value. Accordingly, the date of the offering was the final measurement date for the MEP, aggregate compensation expense was determined based on the fair value of \$52 per ordinary share which was derived from the offering price of four American depositary shares representing one ordinary share.

Elster Group recognized compensation expenses for the MEP and a corresponding contribution by the parent in additional paid-in capital within equity because Elster Group did not make or fund any payments under the MEP. Neither Elster Group nor Rembrandt obtained a tax benefit from payments made to Elster Group's executives under the terms of the MEP.

Summary of Total Share Based Payment Compensation Cost Recognized in General and Administrative Expenses

A summary of the total compensation cost for all share based payment awards recognized in general and administrative expense and additional paid-in capital by year is presented below:

	<u>2011</u>	<u>2010</u>	<u>2009</u>
LTIP compensation cost	\$415	\$ 399	\$ 0
MEP compensation cost (credit)	<u>0</u>	<u>-13,613</u>	<u>-33,250</u>
Total compensation cost (credit)	\$415	\$-13,214	\$-33,250

At December 31, 2011, the company estimates a total of \$1,789 in unrecognized compensation cost that is expected to be recognized over a period of 2.8 years.

17. Derivative financial instruments

Certain of Elster Group's subsidiaries are exposed to changes in foreign currency exchange rates in connection with future payments or balances denominated in foreign currencies. The Company has set forth in a treasury guideline that all of its operations are to use foreign currency forward contracts to manage their currency exposures under the supervision of Elster Group's treasury department. It is the Company's policy to enter into forward contracts only to hedge currency risks arising from underlying business transactions. The contracts are either designated as a cash-flow hedging instrument or are not designated. The main currencies in which Elster Group is engaged are USD, GBP and EUR. Depending on the nominal amount of the underlying transactions, foreign currency transactions denominated in other currencies may also be managed through Elster Group treasury.

The notional amount of foreign currency forward contracts not designated for hedge accounting was \$27,180 and \$34,457 as of December 31, 2011 and 2010. The change in fair value for these contracts is recognized in operating income and amounted to a loss of \$526 in 2011 and a gain of \$748 and \$399 in 2010 and 2009, respectively.

The notional amount of foreign currency forward contracts designated for cash flow hedge accounting was \$1,732 and \$10,250 as of December 31, 2011 and 2010. During the year ended December 31, 2011 we reclassified a loss of \$475 from other comprehensive to income due to hedged items affecting income. For the year ended December 31, 2011 we recognized a gain of \$92 and for the year ended December 31, 2010 we recognized a loss of \$-585 in other comprehensive income for the change in fair value of foreign currency forward contracts designated for cash flow hedge accounting.

Elster Group subsidiaries, mainly in the Euro zone and in the United States of America, are also exposed to interest rate risks. Elster Group recognizes on its balance sheet a number of interest rate swap agreements that are not designated as hedging instruments. The changes in fair value are recognized within interest expenses (see Note 6). The aggregated notional amount of the interest rate swaps was \$488,774 and \$672,754 as of December 31, 2011 and 2010. The change in fair value of all interest rate swaps amounted to a decrease in the liability of \$10,070 during 2011 and an increase in the liability of \$5,016 during 2010.

In 2011 Elster Group entered into cross currency interest swap agreements as an economic hedge of an inter-company loan agreement denominated in a currency other than the lending subsidiary's functional currency. The lending subsidiary pays variable and receives fixed interest, the swaps were not designated for hedge-accounting. As such, we recorded the total change in the fair value of the swaps in income.

Embedded derivatives relate to contracts to purchase or sell non-financial assets in a foreign currency other than the currency in which the price of such assets is routinely denominated in international commerce.

The Company is also exposed to the risk that counterparties to derivative contracts will fail to meet their contractual obligations. The Company seeks to minimize this risk by entering into arrangements with counterparties with high credit ratings.

18. Fair value measurements

Fair value measurements are categorized according to a three-tier hierarchy, which prioritizes the inputs used in estimating fair values:

- (i) Level 1 is defined as observable input, such as quoted prices in active markets;
- (ii) Level 2 is defined as inputs other than quoted prices in active markets, that are directly or indirectly observable; and
- (iii) Level 3 is defined as unobservable inputs for which little or no market data exists, and therefore, requires an entity to develop its own assumptions.

The following table discloses the applicable hierarchy of estimates for the Company's derivative instruments, which are the only financial instruments measured at fair value on a recurring basis:

	Fair Value as of December 31, 2011	Fair Value Measurements using Fair Value Hierarchy		
		Level 1	Level 2	Level 3
Assets				
Foreign currency forward contracts	\$ 501		\$ 501	
Embedded derivatives	\$ 654		\$ 654	
Liabilities				
Foreign currency forward contracts	\$ 1,379		\$ 1,379	
Foreign currency forward contracts used in a cash flow hedge relationship	\$ 26		\$ 26	
Interest rate swaps	\$ 2,796		\$ 2,796	
Embedded derivatives	\$ 492		\$ 492	
	Fair Value as of December 31, 2010	Fair Value Measurements using Fair Value Hierarchy		
		Level 1	Level 2	Level 3
Assets				
Foreign currency forward contracts	\$ 247		\$ 247	
Embedded derivatives	\$ 334		\$ 334	
Liabilities				
Foreign currency forward contracts	\$ 124		\$ 124	
Foreign currency forward contracts used in a cash flow hedge relationship	\$ 608		\$ 608	
Interest rate swaps	\$12,466		\$12,466	
Embedded derivatives	\$ 533		\$ 533	

The fair value of interest rate swaps is calculated by discounting the future cash flows on the basis of the market interest rates applicable for the remaining term of the contract as of the balance sheet date. To determine the fair value of foreign currency forward contracts and embedded derivatives as well, the forward rate is compared to the current forward rate for the remaining term of the contract as of the balance sheet date. The result is then discounted on the basis of the market interest rate prevailing at the balance sheet date for the respective currency.

The following table presents the carrying amounts and fair values of Elster Group's financial instruments:

	2011		2010	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Cash and cash equivalents	\$ 83,952	\$ 83,952	\$216,294	\$216,294
Financial assets recognized at cost				
Accounts receivable (without open customer contracts)	251,914	251,914	256,765	256,765
Other assets	6,909	6,909	18,382	18,382
Financial assets at fair value				
Derivatives recognized at fair value through income	1,155	1,155	581	581
Financial liabilities recognized at amortized cost				
Accounts payable	203,115	203,115	204,343	204,343
Senior Notes	323,474	313,582	0	0
All other debt	256,144	256,143	840,068	840,068
Other current and non current liabilities	43,330	43,330	40,066	40,066
Financial liabilities at fair value				
Derivatives recognized at fair value through income	4,667	4,667	13,123	13,123
Derivatives designated as hedging instrument	26	26	608	608

The majority of financial assets have short maturities and therefore the fair value does not significantly differ from the carrying amount.

The fair value of the Senior Notes is based on a quoted price. The other debt has variable interest rates and therefore the fair value does not significantly differ from the carrying amount.

19. Commitments and contingencies

Operating lease commitments

Elster Group has operating leases for buildings, vehicles, machinery and office equipment. These leases do not have renewal options at the end of the lease term.

Future minimum lease payments under non-cancellable operating leases at December 31, 2011 are:

2012	\$5,205
2013	4,505
2014	3,597
2015	2,183
2016	1,411
More than five years	\$1,638

Expenses arising from operating leases were \$7,632, \$6,067 and \$4,941 in 2011, 2010 and 2009, respectively. The minimum lease payments for operating lease agreements during 2011, 2010 and 2009 were \$1,840, \$1,041, \$827, contingent lease payments were \$3,420, \$2,876 and \$3,844 in 2011, 2010 and 2009.

Legal claims

Various legal actions, including lawsuits for product liabilities or patent infringement, are pending or may be instituted or asserted against Elster Group's subsidiaries. Legal disputes are subject to many uncertainties. Elster Group has recorded a liability for disputes in which we determine that a loss is probable and the amount can be reasonably estimated, this amount is not material to our financial statements as of December 31, 2011. Additionally, legal contingencies that are not probable but are reasonably possible are not material to our financial statements as of December 31, 2011.

Other commitments

Elster Group had outstanding letters of credit and surety bonds of \$149,107 at December 31, 2011, including \$54,172 guarantees outstanding under the RCF guarantee facility and \$94,935 guarantees and surety bonds outstanding under other agreements.

20. Related party disclosures

Elster Group has business relationships with subsidiaries outside the scope of consolidation and other associates that are deemed related parties.

Elster Group generated revenues with related parties of \$30,659 in 2011, \$24,970 in 2010 and \$26,681 in 2009 as follows:

	<u>2011</u>	<u>2010</u>	<u>2009</u>
Revenues from equity method investments	\$25,725	\$19,955	\$21,226
Revenues from unconsolidated subsidiaries	4,934	5,015	5,455
	<u>\$30,659</u>	<u>\$24,970</u>	<u>\$26,681</u>

As of December 31, 2011 and 2010, the Company had receivables due from related parties of \$5,900 and \$14,197 and payables due to related parties of \$3,619 and \$4,794.

In 2007 Elster Group entered into agreements with the Chairman of the Administrative Board and Minit Operational Board Ltd. (Minit), a company the Chairman controls, to lease office space in London and provide various office services. These agreements were terminated in the second quarter of 2010. Expenses incurred for the agreements were \$133 in 2010 and \$1,081 in 2009.

In 2006, Elster entered into a loan agreement with Rembrandt, to fund the legal and administrative expenses Rembrandt incurs as a holding company. The loan was repaid in the fourth quarter of 2010.

21. Segment reporting

Elster Group's operating businesses are organized and managed separately according to the nature of the products and services provided. Each business offers products for different applications and markets and provides separate financial information that is evaluated regularly by the Chairman of the Board, the Chief Executive Officer and the Chief Financial Officer of Elster Group, collectively, the chief operating decision maker.

Decisions by the chief operating decision maker on how to allocate resources and assess performance are based on a reported measure of segment profit. The segment profit, used for purposes of such decisions, does not include depreciation and amortization, interest and income taxes and certain adjustments identified by management. Prior to the second quarter of 2011, the adjustments identified by management were derived from the definition of Adjusted EBITDA in the SFA. In connection with the refinancing that occurred in the second quarter, the SFA was terminated (see Note 14—*Debt*). The level of indebtedness of the company is significantly lower than in prior years as a result of the initial public offering in 2010 and the refinancing. Management reconsidered the transactions that warrant adjustments to determine segment profit in periods subsequent to the refinancing and will restrict the adjustments to significant non-recurring items including employee termination and exit costs. As a result of this change to our segment profit, items such as foreign currency exchange effects, strategy development costs, IT project cost, etc. will no longer be subject to adjustment after the first quarter of 2011.

Elster Group has identified the following reportable segments of its continuing operations:

- Gas
- Electricity
- Water

The Gas business provides products and solutions for gas metering, gas utilization and distribution. It develops, designs, manufactures and sells meters and metering solutions for residential and industrial use. These uses are mainly distinguished by the level of gas pressure and the volume to be measured. Residential gas metering products are primarily diaphragm meters and industrial meters are primarily rotary, turbine, and ultrasonic meters. All products may be combined with high-end communication solutions and gas evaluation devices. Gas utilization products include process heating equipment and heat-control systems, gas distribution products consist of valves, risers and other gas infrastructure

products. The Gas North America and Gas International operating segments are aggregated into a reportable Gas segment due to their similar economic characteristics, the similar nature of the products and production processes, the customers who buy the products and how the Company distributes the products to these customers.

The Electricity business provides electronic single-phase and polyphase meters for residential and commercial and industrial applications, and are more frequently bundled with high-end communication solutions and evaluation capabilities. The Electricity North America and Electricity International operating segments are aggregated into a reportable Electricity segment due to their similar economic characteristics, the similar nature of the products and services as well as the production processes, the customers who buy the products and how the Company distributes the products to these customers and the similar regulatory environment for electricity meters.

The Water segment provides brass and polymer based mechanical and electronic meters for residential and commercial and industrial applications, including single-jet and multi-jet flow meters or volumetric meters. For higher pressures and volumes turbine meters are used. Water meters may also be marketed in combination with high-end communication and evaluation devices.

Segment operations include transactions between segments which are treated similar to transactions to third parties. Those transactions are eliminated in the reconciliation to Elster Group consolidated balances.

Segment information

The following table presents revenue and operating results and certain balance sheet information regarding Elster Group's reporting segments for the years 2011, 2010 and 2009. While not included in the measure of segment profit reviewed by the chief operating decision maker for purposes of allocation of resources and performance assessment, information about depreciation and amortization is regularly provided. Segment working capital comprises those balance sheet positions which represent the operating activities of the segment.

Corporate includes activities which are not allocated to any of the operating segments, as well as the effects from consolidation.

	Gas			Electricity			Water		
	2011	2010	2009	2011	2010	2009	2011	2010	2009
Total revenues	\$1,079,944	\$ 943,752	\$ 899,792	\$451,784	\$451,499	\$453,089	\$369,029	\$383,928	\$355,870
thereof to external customers	1,078,960	941,426	898,071	430,427	437,713	445,050	359,588	380,200	352,001
thereof to other segments	984	2,326	1,721	21,357	13,786	8,039	9,441	3,728	3,869
Segment profit	\$ 256,351	\$ 230,228	\$ 203,958	\$ 48,227	\$ 55,935	\$ 60,424	\$ 18,609	\$ 35,439	\$ 30,418
Depreciation and amortization	-45,503	-45,638	-48,908	-23,652	-25,141	-23,286	-11,795	-11,803	-11,673
Segment working capital	\$ 118,669	\$ 121,384	\$ 110,928	\$ 61,605	\$ 49,170	\$ 76,415	\$ 52,816	\$ 61,397	\$ 48,016
Capital expenditure	\$ 31,702	\$ 17,959	\$ 14,991	\$ 7,573	\$ 10,211	\$ 9,125	\$ 8,788	\$ 8,927	\$ 7,523
Total assets	\$2,482,185	\$2,365,594	\$2,320,246	\$525,206	\$502,092	\$542,980	\$495,571	\$453,235	\$408,978

	Total Segments			Corporate and Elimination			Consolidated Totals		
	2011	2010	2009	2011	2010	2009	2011	2010	2009
Total revenues	\$1,900,757	\$1,779,179	\$1,708,751	\$ -31,782	\$ -19,840	\$ -13,629	\$1,868,975	\$1,759,339	\$1,695,122
thereof to external customers	1,868,975	1,759,339	1,695,122	0	0	0	1,868,975	1,759,339	1,695,122
thereof to other segments	31,782	19,840	13,629	-31,782	-19,840	-13,629	0	0	0
Segment profit	\$ 323,187	\$ 321,602	\$ 294,800	\$ -43,161	\$ -36,594	\$ -30,750	\$ 280,026	\$ 285,008	\$ 264,050
Management adjustments prior to the second quarter 2011:									
Foreign currency exchange effects							1,518	2,933	14,412
Business process reengineering and reorganisation costs							-835	-5,937	-16,818
IT project costs							-344	-1,884	-8,602
Strategy development costs							0	-326	-3,644
Management equity program							0	13,613	33,250
Expenses for preparation to become a public company ⁽¹⁾							0	-12,663	-22,949
Gain from sale of real estate							0	0	2,506
Effects of termination of distributor							0	-9,773	0
Other							0	-270	-316
Continuing management adjustments after the second quarter 2011:									
Employee termination and exit costs ⁽²⁾							-2,071	-6,217	-25,363
Impairment of intangible assets							0	0	-2,241
Business combination cost							0	0	-1,733
Depreciation and amortization	-80,950	-82,582	-83,867	-2,843	-2,949	-1,568	-83,793	-85,531	-85,435
Interest expense, net							-40,595	-57,705	-55,424
Loss on extinguishment of debt							-13,438	-2,378	0
Income tax expense							-33,493	-29,402	-39,349
Income from continuing operations							\$ 106,975	\$ 89,468	\$ 52,344

(1) The reconciling line item in the table above *Expenses for preparation to become a public company* includes bonuses granted in connection with the initial public offering (see Note 1 and 15) of \$5.9 million to approximately 70 employees. This amount was recognized as compensation expense in 2010.

(2) In 2011, the reconciling line item in the table above *Employee termination and exit costs* includes \$1,136 for early retirement pension costs related to a prior restructuring program in Germany. These costs are included in the pension footnote.

	Total Segments			Corporate and Elimination			Consolidated Totals		
	2011	2010	2009	2011	2010	2009	2011	2010	2009
Segment working capital	\$ 233,090	\$ 231,951	\$ 235,359	\$ -7,481	\$ -12,149	\$ -5,967	\$ 225,609	\$ 219,802	\$ 229,392
Accounts receivable/payable with associates							-2,184	-3,925	-42,949
Advanced payments received less paid							20,691	12,546	31,365
Current assets (other than accounts receivable and inventories)							166,026	334,999	202,964
Accounts payable							203,115	204,343	195,635
Noncurrent assets							1,358,092	1,396,492	1,525,035
Total assets	\$3,502,962	\$3,320,921	\$3,272,204	\$ -1,531,613	\$ -1,156,664	\$ -1,130,762	\$1,971,349	\$2,164,257	\$2,141,442
Capital expenditure	\$ 48,063	\$ 37,097	\$ 31,639	\$ 264	\$ 5,294	\$ -1,147	\$ 48,327	\$ 42,391	\$ 30,492

Geographical information

The following table presents the continuing operations' revenue and property, plant and equipment for the years 2011, 2010 and 2009.

	North America incl. Mexico			Europe			All Other Countries			Consolidated Totals		
	2011	2010	2009	2011	2010	2009	2011	2010	2009	2011	2010	2009
Total revenues . .	\$552,108	\$569,911	\$559,218	\$921,923	\$789,445	\$766,540	\$394,944	\$399,983	\$369,364	\$1,868,975	\$1,759,339	\$1,695,122
thereof United States	464,449	467,121	448,043	0	0	0	0	0	0	464,449	467,121	448,043
thereof Germany	0	0	0	294,100	238,998	256,038	0	0	0	294,100	238,998	256,038
Property, plant and equipment	\$ 55,146	\$ 58,432	\$ 63,562	\$128,921	\$128,005	\$154,320	\$ 12,510	\$ 16,462	\$ 16,361	\$ 196,577	\$ 202,899	\$ 234,243
thereof United States	55,010	58,284	63,363	0	0	0	0	0	0	55,010	58,284	63,363
thereof Germany	0	0	0	67,285	64,952	81,519	0	0	0	67,285	64,952	81,519

Sales to external customers disclosed according to geography are based on the location of the customer (destination). Disclosure of property, plant and equipment is based on the location of the asset.

A.2.2 Financial information for the financial years ended 31 December 2010, 2009 and 2008 extracted without material adjustment from Elster's Form 20-F for the period ended 31 December 2010

Report of Independent Registered Public Accounting Firm

The Administrative Board
Elster Group SE:

We have audited the accompanying consolidated balance sheets of Elster Group SE and subsidiaries (the "Company") as of December 31, 2010 and 2009, and the related consolidated statements of operations, changes in equity and comprehensive income (loss), and cash flows for each of the years in the three-year period ended December 31, 2010. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Elster Group SE and subsidiaries as of December 31, 2010 and 2009, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2010 in conformity with U.S. generally accepted accounting principles.

As discussed in Note 2 to the consolidated financial statements, the Company has changed its method of accounting for revenue recognition on certain multiple-deliverable transactions in 2010 due to the adoption of Accounting Standards Update (ASU) No. 2009-13 "Multiple-Deliverable Revenue Arrangements" (ASU 2009-13) and ASU 2009-14, "Certain Revenue Arrangements that Include Software Elements" and for business combinations in 2009.

KPMG AG
Wirtschaftsprüfungsgesellschaft

Frankfurt am Main, Germany
March 10, 2011

Consolidated Statements of Operations
for the years ended December 31,
(in thousands of US Dollar (\$), except per share and share data)

	<u>2010</u>	<u>2009</u>	<u>2008</u>
Revenues	\$ 1,759,339	\$ 1,695,122	\$ 1,904,501
Cost of revenues	-1,208,555	-1,191,297	-1,306,257
Gross profit	\$ 550,784	\$ 503,825	\$ 598,244
Operating expenses			
Selling expenses	-165,544	-159,419	-183,419
General and administrative expenses	-123,819	-136,997	-246,454
Research and development expenses	-87,489	-78,403	-70,707
Other operating income (expense), net	2,059	14,833	-39,505
Operating income	\$ 175,991	\$ 143,839	\$ 58,159
Non-operating expense			
Interest expense, net	-60,083	-55,424	-117,263
Other income, net	2,962	3,278	2,910
Total non-operating expenses	\$ -57,121	\$ -52,146	\$ -114,353
Income (loss) from continuing operations before income tax	\$ 118,870	\$ 91,693	\$ -56,194
Income tax expense	-29,402	-39,349	-30,898
Net income (loss) from continuing operations	\$ 89,468	\$ 52,344	\$ -87,092
Net income from discontinued operations	\$ 2,570	\$ —	\$ —
Net income (loss)	\$ 92,038	\$ 52,344	\$ -87,092
Net income attributable to noncontrolling interests	\$ 4,779	\$ 3,456	\$ 4,646
Net income (loss) attributable to Elster Group SE	\$ 87,259	\$ 48,888	\$ -91,738
Basic income (loss) per share			
Income (loss) from continuing operations attributable to Elster Group SE	\$ 3.39	\$ 1.42	\$ -5.68
Income from discontinued operations attributable to Elster Group SE	0.13	0.00	0.00
Net income (loss) per share attributable to Elster Group SE shareholders	\$ 3.53	\$ 1.42	\$ -5.68
Diluted income (loss) per share			
Income (loss) from continuing operations attributable to Elster Group SE	\$ 3.39	\$ 1.42	\$ -5.68
Income from discontinued operations attributable to Elster Group SE	0.13	0.00	0.00
Net income (loss) per share attributable to Elster Group SE shareholders	\$ 3.53	\$ 1.42	\$ -5.68
Weighted average shares outstanding			
Basic	19,295,573	16,320,750	16,320,750
Diluted	19,299,777	16,320,750	16,320,750

Consolidated Balance Sheets
as at December 31,
(in thousands of US Dollar (\$), except share data)

	<u>2010</u>	<u>2009</u>
Assets		
Current assets		
Cash and cash equivalents	\$ 216,294	\$ 75,392
Accounts receivable (net of allowance for doubtful accounts of \$9,732 and \$7,337, respectively)	278,217	265,652
Receivables from related parties	14,197	8,615
Inventories	154,549	147,791
Prepaid expenses	21,122	24,656
Other current assets	52,863	40,252
Income tax refunds	14,501	35,518
Deferred tax assets	16,022	18,531
Total current assets	\$ 767,765	\$ 616,407
Noncurrent assets		
Property, plant and equipment, net	202,899	234,243
Other intangible assets, net	216,406	263,844
Goodwill	936,950	981,571
Other assets	31,496	32,605
Deferred tax assets	8,741	12,772
Total noncurrent assets	\$1,396,492	\$1,525,035
Total assets	\$2,164,257	\$2,141,442
Liabilities and Equity		
Current liabilities		
Pension and other long-term employee benefits, current portion	\$ 13,486	\$ 11,306
Payroll, bonuses and related accruals	57,808	57,211
Short-term debt and current portion of long-term debt	18,010	38,969
Accounts payable	204,343	195,635
Warranties	31,564	34,762
Other current liabilities	74,514	77,236
Deferred revenue	4,039	5,823
Income tax payable	17,863	6,429
Deferred tax liabilities	6,694	4,581
Total current liabilities	\$ 428,321	\$ 431,952
Noncurrent liabilities		
Pension and other long-term employee benefits, less current portion	137,490	152,390
Payroll, bonuses and related accruals	1,326	1,318
Long-term debt, less current portion	822,447	971,400
Shareholder loan	0	6,818
Other non-current liabilities	40,505	43,355
Income taxes payable	17,271	16,885
Deferred tax liabilities	60,668	94,620
Total noncurrent liabilities	\$1,079,707	\$1,286,786
Total liabilities	\$1,508,028	\$1,718,738
Equity		
Preferred shares, €1 nominal value (none and 308,931,920 shares issued and outstanding as of December 31, 2010 and 2009)	0	436,465
Ordinary shares, €1 nominal value (28,220,041 and 16,320,750 shares authorized, issued and outstanding as of December 31, 2010 and 2009)	36,528	20,040
Additional paid-in capital	651,038	70,132
Accumulated deficit	- 68,858	- 138,393
Accumulated other comprehensive income	22,006	28,307
Total equity attributable to Elster Group SE	\$ 640,714	\$ 416,551
Noncontrolling interests	\$ 15,515	\$ 6,153
Total equity	\$ 656,229	\$ 422,704
Total liabilities and equity	\$2,164,257	\$2,141,442

Consolidated Statements of Changes in Equity and Comprehensive Income (Loss)
(in thousands of US Dollar (\$), except for number of shares data)

	Preferred shares		Ordinary shares		Additional Paid-in Capital	Accumulated Deficit	Accumulated other comprehensive income (loss)			Total Equity Attributable to Elster Group SE	Non controlling Interests	Total Equity
	Number of Shares	Amount	Number of Shares	Amount			Pensions and Other Post-Retirement	Currency Translation	Derivatives			
January 1, 2008	0	\$ —	16,320,750	\$0,040	12,682	-68,942	32,060	-31,925	0	-36,085	6,993	\$-29,092
Exchange of mandatorily-redeemable PECs for Class A shares (Note 15 and 16)	293,217,167	409,864	0	0	0	0	0	0	0	409,864	0	409,864
Share-based compensation arrangement	0	0	0	0	90,700	0	0	0	0	90,700	0	90,700
Accretion of preferred dividends	0	961	0	0	0	-961	0	0	0	0	0	0
Dividends paid	0	0	0	0	0	0	0	0	0	0	-5,359	-5,359
Change of noncontrolling interests	0	0	0	0	0	0	0	0	0	0	-1,743	-1,743
Comprehensive loss												
Changes in actuarial gains and past service costs, net of tax effect of \$8,594	0	0	0	0	0	0	-14,612	0	0	-14,612	0	-14,612
Foreign currency translation adjustment, net of tax effect of \$1,003	0	0	0	0	0	0	0	54,045	0	54,045	1,396	55,441
Change in fair value of cash flow hedges, net of tax effect of \$-269	0	0	0	0	0	0	0	0	710	710	0	710
Net loss	0	0	0	0	0	-91,738	0	0	0	-91,738	4,646	-87,092
Total comprehensive loss	0	0	0	0	0	-91,738	-14,612	54,045	710	-51,595	6,042	-45,553
December 31, 2008	293,217,167	410,825	16,320,750	20,040	103,382	-161,641	17,448	22,120	710	\$412,884	5,933	\$ 418,817
Share-based compensation arrangement	0	0	0	0	-33,250	0	0	0	0	-33,250	0	-33,250
Accretion of preferred dividends	15,714,753	25,640	0	0	0	-25,640	0	0	0	0	0	0
Dividends paid	0	0	0	0	0	0	0	0	0	0	-3,048	-3,048
Comprehensive income												
Changes in actuarial gains (losses) and past service costs, net of tax effect of \$2,394	0	0	0	0	0	0	-5,215	0	0	-5,215	0	-5,215
Foreign currency translation adjustment, net of tax effect of \$-6	0	0	0	0	0	0	0	-6,046	0	-6,046	-188	-6,234
Change in fair value of cash flow hedges, net of tax effect of \$269	0	0	0	0	0	0	0	0	-710	-710	0	-710
Net income	0	0	0	0	0	48,888	0	0	0	48,888	3,456	52,344
Total comprehensive income	0	0	0	0	0	48,888	-5,215	-6,046	-710	36,917	3,268	40,185
December 31, 2009	308,931,920	436,465	16,320,750	20,040	70,132	-138,393	12,233	16,074	0	\$416,551	6,153	\$ 422,704
Share-based compensation arrangements	0	0	0	0	-13,214	0	0	0	0	-13,214	0	-13,214
Accretion of preferred dividends	0	19,210	0	0	0	-19,210	0	0	0	0	0	0
Dividends paid	0	0	0	0	0	0	0	0	0	0	-831	-831
Change of noncontrolling interests	0	0	0	0	-4,759	0	0	1,631	0	-3,128	5,162	2,034
Change in scope of consolidated companies						1,486				1,486		1,486
Replacement of preferred shares	-308,931,920	-455,675	8,533,906	11,903	443,772			0		0		0
Capital increase, net of related costs			3,365,385	4,585	155,107	0				159,692		159,692
Comprehensive income						0						
Changes in actuarial gains (losses) and past service costs, net of tax effect of \$-246	0	0	0	0	0	0	-283	0	0	-283	0	-283
Foreign currency translation adjustment, net of tax effect of \$0	0	0	0	0	0	0	0	-7,064	0	-7,064	252	-6,812
Change in fair value of cash flow hedges, net of tax effect of \$257	0	0	0	0	0	0	0	0	-585	-585	0	-585
Net income	0	0	0	0	0	87,259	0	0	0	87,259	4,779	92,038
Total comprehensive income	0	0	0	0	0	87,259	-283	-7,064	-585	79,327	5,031	84,358
December 31, 2010	0	0	28,220,041	36,528	651,038	-68,858	11,950	10,641	-585	\$640,714	15,515	\$ 656,229

Consolidated statements of cash flows
for the years ended December 31,
(in thousands of US Dollar (\$))

	<u>2010</u>	<u>2009</u>	<u>2008</u>
Cash flows from operating activities			
Net income (loss)	\$ 92,038	\$ 52,344	\$ -87,092
Adjustments to reconcile net income (loss) to cash from operating activities			
Depreciation, amortization and impairment losses	87,861	88,618	87,380
Share-based compensation expense (credit)	-13,214	-33,250	90,700
Gain on sale of other long-lived assets, net	1,050	-2,506	-1,807
Accrued interest	1,191	2,631	26,386
Dividends from equity accounted investees, net of income in earnings	2,329	2,176	1,724
Changes in operating assets and liabilities			
Change in accounts receivable	-19,595	32,419	-29,937
Change in accounts payable	12,216	-14,161	35,435
Change in inventories	-10,361	53,180	-19,822
Change in other assets and liabilities	-12,192	-61,830	11,178
Cash flows from operating activities	\$ 141,323	\$ 119,621	\$ 114,145
Purchases of property, plant and equipment and intangible assets	-42,391	-30,492	-81,812
Proceeds from disposals of property, plant and equipment and intangible assets	11,938	14,838	3,746
Proceeds from shareholder loan payments	2,485	0	0
Business combinations, net of cash acquired	0	-27,389	-2,700
Proceeds from disposition of equity accounted investees	0	0	1,772
Net cash flow from (used in) investing activities	\$ -27,968	\$ -43,043	\$ -78,994
Cash flows from financing activities			
Proceeds from bank borrowings	63,560	84,555	130,664
Repayment of bank borrowings	-184,771	-157,835	-122,717
Capital increase, net of IPO costs	153,254	0	0
Repayment of capital lease obligations	-1,084	-1,103	-940
Repayment of shareholder loan	-6,752	0	0
Purchase of noncontrolling interests	0	0	-10,337
Dividends to noncontrolling interests	-831	-3,048	-5,359
Sale of noncontrolling interest in subsidiary	2,034	0	0
Net cash flow from (used in) financing activities	\$ 25,410	\$ -77,431	\$ -8,689
Net increase (decrease) in cash and cash equivalents	138,765	(853)	26,462
Effect of exchange rate fluctuations on cash held	2,137	1,972	-5,526
Increase of cash through change in scope of consolidation	0	0	363
Cash and cash equivalents at January 1	\$ 75,392	\$ 74,273	\$ 52,974
Cash and cash equivalents at December 31	\$ 216,294	\$ 75,392	\$ 74,273
Income taxes paid	28,667	42,657	50,577
Interest paid	50,052	45,372	74,116

Notes to the Consolidated Financial Statements
(in thousands of US Dollar, except per share data)

1. Corporate information

Elster Group SE, Essen, Germany, was originally incorporated as Gold Silver S.à r.l. on October 4, 2004 as a Luxembourg corporation to serve as a vehicle for private equity funds managed by CVC Capital Partners; it acquired the Ruhrgas Industries Group from E.ON Ruhrgas AG on September 12, 2005. After being renamed Nightwatch Investments S.à r.l. and further renamed Elster Group S.à r.l. on March 15, 2006, it was legally reorganized and became Elster Group SE, Luxembourg. Elster Group SE transferred its jurisdiction of incorporation from Luxembourg to Essen, Germany, on February 23, 2010 and is now a German corporation. The name changes and legal reorganizations were transactions under common control of the owners.

On October 5, 2010 Elster Group SE completed an initial public offering of 18,630,000 American Depository Shares, each American Depository Share representing one-fourth of an ordinary share. See Note 15—*Equity and shareholder loan* for further information regarding the initial public offering and the impact on the consolidated financial statements.

The business of Elster Group SE and its subsidiaries (hereinafter referred as the “Company” or “Elster Group”) is the development, manufacturing and distribution of metering solutions for water, gas and electricity, as well as gas utilization and distribution products. The products and services are offered in more than 130 countries for both residential and commercial and industrial customers.

2. Significant accounting policies

Basis of preparation

These consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (US GAAP). The accounting policies set out below have been consistently applied to all periods presented in these consolidated financial statements.

Basis of consolidation

The accompanying consolidated financial statements include the accounts of Elster Group SE, Essen, Germany, and its subsidiaries.

Elster Group uses the equity method of accounting for its investment in entities if it has significant influence on their operating and financial policies, but no control.

All intercompany balances and transactions have been eliminated.

Use of estimates and judgments

The preparation of consolidated financial statements in conformity with US GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities as well as disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Significant items subject to such estimates and assumptions include the allowances for doubtful accounts and sales returns; reserves for obsolete inventory; useful lives of fixed assets and intangible assets; impairments of goodwill and long lived assets; the valuation and recognition of derivatives, deferred tax assets, and share-based compensation; and provisions for employee benefit obligations, warranties, environmental liabilities, income tax uncertainties and other contingencies.

Estimates and underlying assumptions are reviewed on an ongoing basis.

Foreign currency translation

The consolidated financial statements are presented in thousands of US Dollars (“USD” or “\$”) which is the reporting currency of Elster Group, except for share information and per share amounts.

The assets and liabilities of Elster Group and its subsidiaries for which the functional currency is not the USD, are translated using period-end spot rates, whereas items of income and expense are translated using average exchange rates during the respective periods. Differences arising from such translation are included in accumulated other comprehensive income (loss) in shareholders' equity. Currency effects from long-term investments in foreign subsidiaries are also included in accumulated other comprehensive income (loss).

Gains and losses from foreign currency transactions are included in other operating income (expense). The net foreign exchange gain (loss) in 2010, 2009 and 2008 was \$2,933, \$14,412 and \$-45,153, respectively.

Revenue recognition

Revenues result primarily from sales of Elster Group's products, the most significant of which are meters for electricity, gas or water. Revenues on product sales are recognized when

- persuasive evidence of an arrangement exists;
- delivery has occurred;
- the sales price is fixed or determinable; and
- collectability is reasonably assured.

Elster Group also generates revenue from projects in which the company engineers and manufactures gas utilization or metering products according to customer specifications. These projects are performed under customer project contracts and are referred to as customer contracts. As soon as the outcome of customer project contracts can be estimated reliably, contract revenue and expenses are recognized in profit or loss in proportion to the stage of completion of the contract. Contract revenues include the initial amount agreed in the contract (adjusted to reflect any change orders). The stage of completion is assessed by applying the percentage of contract cost incurred in relation to total estimated contract cost. When the outcome of a customer contract cannot be estimated reliably, contract revenue is recognized only in that extent of contract costs incurred that are likely to be receivable. An expected loss on a contract is recognized immediately.

Elster Group offers integrated solutions to customers, mainly utilities, by bundling certain products with services. In certain transactions, the company bundles some products, known as "smart" meters, with software and services such as software implementation, project management, consulting or maintenance support.

In September 2009, the FASB issued Accounting Standards Update (ASU) No. 2009-13 "Multiple-Deliverable Revenue Arrangements" (ASU 2009-13) which sets forth requirements that must be met for an entity to recognize revenue from the sale of a delivered item that is part of a multiple-element arrangement when other items have not yet been delivered, and ASU 2009-14, "Certain Revenue Arrangements that Include Software Elements" which addresses the accounting for revenue arrangements that contain both hardware and software elements. These ASUs which expand the scope and supersede certain guidance in ASC 605-25, "Revenue Recognition—Multiple-Element Arrangements" may be applied on a prospective basis for revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010, with earlier application permitted, or they may be applied retrospectively to all comparable periods presented. These amendments eliminate the requirement that vendor specific objective evidence (VSOE) be available for all undelivered elements when software is involved or that VSOE or third-party evidence be available in multiple-element transactions not involving software. Elster Group elected to early adopt these accounting standards prospectively as of January 1, 2010 for all new and materially modified contracts with customers that combine multiple deliverables such as products to be delivered and services to be rendered and involve software. Under the new accounting standards for revenue recognition, the Company allocates the total consideration for all elements to each separable element based upon the estimated relative selling price of each element. The selling price for a deliverable is based on its VSOE, if available, third party evidence if VSOE is not available, or estimated selling price if neither VSOE nor third party evidence are available.

Elster Group recognizes revenue for delivered elements that have stand-alone value to the customer in accordance with its revenue recognition policies for such products or services and defers revenue for undelivered elements until delivery of an element. The amount of revenue recognized is limited to the amount that is not contingent upon future shipments of products or rendering of services or performance obligations.

As a result of this change in accounting policies for revenue recognition, revenues for the twelve months ended December 31, 2010 were approximately \$17,095 higher than revenues would have been using the previous accounting policies for revenue recognition. The increase in revenue results from shipments of products, mainly electricity meters, for contracts entered into on or after January 1, 2010 that relate to contracts with customers containing undelivered elements for which Elster Group was unable to establish VSOE under the previous standards.

Deferred revenues are reported within liabilities and recognized as revenue in the subsequent period when the applicable revenue recognition criteria are met.

All revenue is recognized net of applicable taxes such as sales tax or value-added tax.

Shipping and handling fees

Shipping and handling fees that are collected from the customers in connection with Elster Group's sales are recorded as revenue in the consolidated statement of operations. The costs incurred with respect to shipping and handling are recorded as selling expenses and were \$27,038, \$24,525 and \$35,617 in 2010, 2009 and 2008, respectively.

Advertising

Advertising costs are recorded in selling expense and are expensed as incurred. Advertising expenses were \$5,998, \$5,550 and \$7,711 in 2010, 2009 and 2008, respectively.

Income taxes

Deferred taxes are accounted for under the asset and liability method. Deferred tax assets and liabilities are recognized for future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and on tax loss and tax credit carryforwards. Deferred income tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income tax expense in the period in which the change is enacted. Deferred income tax assets are reduced by a valuation allowance to the extent that it is more likely than not that some portion or all of the deferred tax assets will not be realized. Interest and penalties on income taxes are classified as income tax expense.

The Group recognizes a tax benefit from an uncertain tax position only if it is more likely than not that the tax position will be sustained upon examination by the taxing authorities based solely on the technical merits of the position. The tax benefits recognized in the financial statements from such a position are measured based on the largest benefit that has a greater than 50% likelihood of being realized upon settlement.

Research and development costs

Research and development costs primarily include employee compensation and third party contracting fee and is expensed as incurred. Software developed by Elster to be marketed or sold is not capitalized, due to the relatively short period of time between technological feasibility and the completion of product and software development, and the immaterial nature of these costs, Elster generally does not capitalize product and software development expenses.

Cash and cash equivalents

Cash and cash equivalents are comprised of cash on hand, current balances on bank accounts and highly liquid, short-term deposits with an original maturity of three months or less.

Restricted cash balances pledged as collateral to financial institutions in connection with performance and bid guarantees to customers and other sureties of \$287 and \$2,756 as of December 31, 2010 and 2009, respectively, are included in other current assets in the accompanying consolidated balance sheets.

Accounts receivable

The Group's accounts receivable are generally unsecured and Elster Group is at risk to the extent such amounts become uncollectible. The Group continually monitors accounts receivable balances and records an allowance for doubtful accounts at the time collection becomes questionable based on payment history or age of the receivable. The allowance for doubtful accounts is based on the company's specific review of outstanding receivables at period end considering Elster Group's experience. Accounts receivable are written-off against the allowance when Elster Group determines that an account or a portion thereof will not be collected.

Inventories

Inventories are valued at the lower of cost or market using the first-in, first-out method. The cost of inventories includes material, capitalized labor and overhead costs.

Property, plant and equipment

Property, plant and equipment are stated at cost, less accumulated depreciation and accumulated impairment losses. Plant and equipment under capital leases are stated at the present value of minimum lease payments.

Depreciation is computed using the straight-line method over the estimated useful lives of the assets. The useful lives are generally as follows:

Buildings	10 to 50 years
Plant and machinery	5 to 15 years
Other equipment	3 to 12 years

Leasehold improvements are capitalized and amortized over the term of the applicable lease, including renewal periods if reasonably assured, or over the useful lives, whichever is shorter.

Cost includes expenditures that are directly attributable to the acquisition of the asset. The cost of self-constructed assets includes the cost of materials and direct labor, any other costs directly attributable to bringing the asset to a working condition for its intended use. This also includes costs of dismantling, removing the items and restoring the site on which they are located, if required.

Improvements and replacements are capitalized to the extent that they increase the useful economic life or increase the expected economic benefit of the underlying asset. Repair and maintenance costs are expensed as incurred.

Interest cost incurred on borrowings related to construction of major projects that exceed a period of three months of construction is capitalized. Capitalized interest is added to the cost of qualified assets and amortized over the estimated useful lives of the related assets.

Long-lived assets are reviewed for impairment whenever events or circumstances indicate the carrying amount of an asset or asset group may not be recoverable. Assets are grouped and evaluated for impairment at the lowest level for which there are identified cash flows that are largely independent of the cash flows of other groups of assets. The carrying value of a long-lived asset is considered impaired when the estimated undiscounted future cash flow to result from the use of the asset and its eventual disposition is less than its carrying value. The amount of the impairment loss is recognized based on the amount by which the carrying value exceeds the fair value of the long-lived asset. Fair value is generally determined using a discounted cash flow analysis.

Business combinations

Business combinations are accounted for using the purchase method of accounting and the consolidated financial statements of Elster Group include the operations of an acquired business from the date of acquisition. Net assets of the acquired company and intangible assets that arise from contractual or legal rights, or are capable of being separated, are recorded at their fair value as of the date of acquisition. Prior to 2009, amounts allocated to in-process research and development (IPR&D) were expensed in the period of acquisition if there was no alternative future use. Costs to complete these IPR&D are expensed as research and development expenses in the subsequent periods as incurred.

In 2009, Elster Group adopted ASC 805, “*Business Combinations*”, (ASC 805; formerly FASB Statement No. 141(Revised)) which replaces former FASB Statement No. 141. ASC 805 retains the fundamental purchase method of accounting for acquisitions, but requires a number of changes. ASC 805 requires assets acquired and liabilities assumed arising from contingencies to be recorded at fair value on the acquisition date; that IPR&D be capitalized as an intangible asset and amortized over its estimated useful life; and that acquisition-related costs are expensed as incurred. ASC 805 also requires that restructuring costs generally be expensed in periods subsequent to the acquisition date and that changes in accounting for deferred tax asset valuation allowances and acquired income tax uncertainties after the measurement period be recognized as a component of provision for taxes.

Goodwill

Goodwill represents the excess of the aggregate purchase price over the fair value of the net assets acquired in a business combination. Goodwill is reviewed for impairment at least annually.

The goodwill impairment test is a two-step test. First, the fair value of the reporting unit is compared to its carrying value. If the fair value is less than the carrying value, a second step is performed. In the second step, an implied goodwill value is determined by deducting the fair value of all tangible and intangible net assets of the reporting unit from the fair value of the reporting unit. If the implied fair value of the goodwill, as calculated, is less than the carrying amount of the goodwill, an impairment charge is recorded for the difference. Elster Group performs its annual impairment review of goodwill at December 31 and whenever a triggering event occurs between annual impairment tests.

Other intangible assets

Separately acquired intangible assets are measured at cost. The cost of intangible assets acquired in a business combination is their estimated fair value on the date of the acquisition. Following initial recognition, intangible assets are carried at cost less accumulated amortization.

Intangible assets with indefinite useful lives are tested for impairment at least annually and a review to determine whether the indefinite life assumption continues to be appropriate is performed. Any changes to the indefinite useful life assumption are recognized prospectively by amortizing the asset over its estimated remaining useful life. Certain trade names acquired in business combinations have been established many years ago, are being used by the Company and are expected to provide an economic benefit in the form of a competitive advantage for an indefinite period of time.

Intangible assets with finite lives are amortized over the estimated economic life using the method that best approximates their benefits (generally the straight-line-method) and are assessed for impairment whenever there is an indication that the intangible asset may be impaired. Subsequent expenditures are only capitalized when they increase the future economic benefit embodied in the specific asset to which they relate. All other expenditures, including expenditures on internally generated goodwill and trade names, are expensed as incurred.

The estimated useful lives for finite-lived intangible assets are as follows:

Customer-related intangible assets	6 to 18 years
Contract-based intangible assets and software	3 to 5 years
Technology-related intangible assets	8 to 15 years

If the estimated useful life changes the carrying value is amortized prospectively over the revised useful life.

Derivative financial instruments

Elster Group enters into forward foreign currency contracts in order to manage currency risks arising from its forecasted and firmly committed foreign currency denominated cash flows. Elster Group enters into these contracts in order to limit future foreign exchange rate risk. Elster Group also enters into interest rate swaps to manage its interest rates on its long-term debt.

Elster Group does not utilize derivative instruments for speculative purposes.

All derivatives are measured at fair value and reported either as current assets, if the fair value is positive, or as current liabilities, if the fair value is negative, on the consolidated balance sheet. All changes in fair value of derivatives are recorded in income unless a derivative is designated as hedging instrument.

Elster Group designates certain foreign currency forward contracts as a hedge of foreign currency denominated cash flows. The effective portion of the change in fair value of those foreign currency derivatives designated in a cash flow hedge is initially recognized in other accumulated comprehensive income (loss) and the ineffective portion is recognized in operating income; the balance recorded in other accumulated comprehensive income (loss) is subsequently recognized in income in the same period as the hedged item affects income.

Leases

Lease agreements are classified as either capital or operating leases.

When substantially all of the risks and benefits of ownership have been transferred to the Company, the lease is classified as a capital lease. Assets leased under the terms of a capital lease are capitalized at the lower of the fair value of the leased asset or the present value of the minimum lease payments. Capitalized leased assets are depreciated over the shorter of the estimated useful life of the asset or the lease term, unless there is reasonable certainty that the Group will obtain ownership by the end of the lease term in which case the period of expected use is the useful life of the asset.

Rent expense on operating leases is recognized on a straight-line basis over the term of the lease including renewal terms if, at inception of the lease, renewal is reasonably assured.

Employee benefits

Defined benefit plans

Certain of Elster Group's subsidiaries sponsor defined benefit pension plans. In addition, the Group's subsidiaries in the U.S. and Canada provide other postretirement benefits consisting of healthcare and life insurance benefits. The cost of providing these benefits is determined for each plan using the projected unit credit actuarial valuation method.

The Company recognizes the funded status of its defined benefit pension and other postretirement benefit plans on its consolidated balance sheet and all actuarial gains and losses and unrecognized past service costs and credits are reflected in other comprehensive income (loss) and amortized to net periodic cost over the future periods using the corridor method.

Also, certain subsidiaries provide termination benefits under terms of applicable laws or collective bargaining agreements or they pay long term service awards to their employees which are recognized when probable and reasonably estimable.

Share-based compensation

In connection with the initial public offering the Elster Group created a Long-Term Incentive Plan which is described more fully in Note 16 *Share-based compensation*. The Plan provides for the award of unvested American Depository Shares, each of which represent one-fourth of an ordinary share, to key employees and non-employee directors. Compensation cost is based on the grant-date fair value of the awards and is

recognized, net of estimated forfeitures due to termination of employment, on a straight-line basis over the requisite service period of the award and depending on the evaluation of certain performance conditions described in Note 16. The requisite service period is generally the vesting period stated in the award.

Rembrandt Holdings SA, Luxembourg, the immediate parent and controlling shareholder (“Rembrandt”), sponsors a Management Equity Program (“MEP”) through Nachtwache Metering Management Vermögensverwaltungs GmbH&Co. KG (“Management KG”), an entity which is controlled by Rembrandt. The MEP has granted certain members of senior management of Elster Group share-based payments.

The obligation of the parent related to the MEP arrangement was accounted for as a cash-settled plan and remeasured through September 30, 2010, the date of listing in connection with the initial public offering. In connection with the initial public offering, previously unvested awards under the MEP became vested and all grantees are entitled to benefits from the sale of Elster shares rather than a formula value. Accordingly, the date of the offering is the final measurement date for the MEP, aggregate compensation expense was determined based on the fair value of \$52 per ordinary share which was derived from the offering price of four American depositary shares representing one ordinary share.

Elster Group recognized compensation expenses for the MEP and a corresponding contribution by the parent in additional paid-in capital within equity because the Company did not make or fund any payments under the MEP.

Warranty provisions

Elster Group offers standard warranties on its products. The estimated cost of warranty claims is accrued based on historical and projected product performance trends and costs. Warranty claims are reviewed in order to identify potential warranty trends. If an unusual trend is noted, an additional warranty accrual may be recorded when a failure event is probable and the cost can be reasonably estimated. Management continually evaluates the sufficiency of the warranty provisions and makes adjustments when necessary. The changes in the carrying amount of the warranty provision are as follows:

	<u>2010</u>	<u>2009</u>
January 1	\$ 34,762	\$ 32,458
Change through business combinations	0	111
Warranty issued	13,837	13,687
Utilizations	–13,978	–10,587
Change in estimates and transfers	–1,826	–1,896
Foreign exchange fluctuation	–1,231	989
December 31	\$ 31,564	\$ 34,762
Thereof:		
Current	31,564	34,762
Noncurrent	0	0

Earnings (loss) per share

Earnings (loss) per share is computed by dividing the net income (loss) attributable to ordinary shares by the weighted average number of ordinary shares outstanding for the period. The calculation of diluted earnings (loss) per share reflects the effect of all potentially non-vested dilutive shares issued under the LTIP. None of the nonvested shares were outstanding during the period—they are unissued, notwithstanding that diluted EPS is computed on a pro forma basis. For periods prior to our initial public offering, there were no potentially dilutive instruments outstanding.

All stock splits have been recognized retrospectively. The cumulative dividends on preferred shares are excluded from net income (loss) attributable to ordinary shares for periods prior to our initial public offering when preferred shares were outstanding.

3. Discontinued operations

In 2006, Elster Group sold its LOI furnace business in accordance with the decision of Elster Group's management to focus on the Group's key competence as a metering solutions provider. Elster Group agreed to indemnify the buyer for certain contingent losses that originated prior to the sale of the business and recorded a liability for an expected purchase price adjustment resulting from such indemnification. In the fiscal year 2010, Elster Group obtained evidence that the issue underlying the indemnification had been resolved and released the accrued liability. The gain arising from this release of a liability for expected purchase price adjustment was recorded as income from discontinued operations in 2010.

4. Business combinations

EnergyICT N.V., Kortrijk, Belgium (2009)

On October 5, 2009, Elster Group acquired a 100% interest in EnergyICT N.V., Kortrijk, Belgium ("EICT"). The consideration was \$67,893 in cash: \$24,091 was paid upon closing and \$43,802 shall be paid three years after closing. The fair value of the consideration after giving effect to discounting of the amount due after three years was \$63,603. The fair value of the consideration still outstanding is \$37,602 and \$39,131 as of December 31, 2010 and 2009, respectively. The decrease in fair value is mainly driven by the change in the exchange rate between \$ and EUR. The addition of accrued interest had a converse effect. Transaction costs of \$1,733 were expensed in 2009.

EICT which develops and provides advanced energy information and communications technology and Smart Grid solutions and services to utilities, energy distributors and businesses. EICT has sales offices in the United States, the United Kingdom, Germany, France, Australia and the Netherlands.

The cost of the acquisition has been allocated based on estimates of fair value of the assets and liabilities acquired, and the remaining amount has been assigned to goodwill, as presented in the following table:

	Fair Values	Useful Life (Years)
Current assets, including cash and cash equivalents of \$2,633	\$ 8,569	
Property, plant and equipment	486	various
Other intangible assets	0	
Tradenames	2,482	indefinite
Customer relationship	8,468	6
Technology-based intangible assets	5,195	6
Other noncurrent assets	145	
Deferred tax assets	1,104	
Trade payables	- 937	
Other current liabilities	- 4,684	
Deferred tax liabilities	- 5,556	
Total fair value of net assets acquired	15,272	
Total purchase price	\$ 63,603	
Goodwill	\$ 48,331	

The goodwill arising from the purchase price allocation primarily derives from the high growth rates that are expected from EICT in the future and the expectations of future growth with new customers and new technological developments. These expectations are not reflected in the value of any acquired intangible asset and therefore form part of goodwill. EICT has skilled and high qualified employees as a key success factor in meeting the expectations; the value of the workforce is part of the goodwill. In addition, the expected synergies from combining EICT's existing business with Elster Group do not represent separate identified assets of EICT, but are part of the goodwill. Management has allocated the goodwill to the Electricity segment. Such goodwill is not deductible for tax purposes.

5. Employee termination and exit costs

Elster has restructured some of its operations, in particular the manufacturing processes of certain products. Associated with these restructuring programs were the termination of manufacturing activities and the transfer to other Elster sites or to outside manufacturing service providers. In certain cases this caused the closure of an entire Elster site. In addition, the restructuring measures included the reduction of headcount and resulted in employee termination benefit costs.

In 2010, no new restructuring programs have been initiated, but there has been a continuation of activities from previously established restructuring programs as further described below.

In 2009 the Gas segment announced a restructuring plan to reduce the headcount at its Osnabrueck, Germany site. The amount recognized for involuntary termination benefits under the terms of a collective bargaining agreement was a credit of \$704 in 2010 and an expense of \$11,077 in 2009. The credit in 2010 is related to the release of a previously established reserve. The manufacturing site in Mainz, Germany was subject to a separate restructuring plan with related expenses for involuntary termination of \$377 in 2010 and \$2,251 in 2009.

A manufacturing site of Elster's Gas segment in the United Kingdom was subject to a restructuring plan that included relocation of manufacturing operations to other Elster sites in Slovakia and Germany as well as to external contractors and the closure of that site in the United Kingdom. These restructuring measures led to involuntary termination benefits and related costs of \$448 in 2010, \$625 in 2009 and \$837 in 2008.

The Gas segment has relocated manufacturing operations between plants in the United Kingdom and closed one site which resulted in restructuring expenses of \$116 in 2009 and \$333 in 2008.

Manufacturing sites of the Water segment in Germany have been involved in a number of individual restructuring programs aimed at reducing the size of its operations, resulting in significant reduction in the number of employees. Each program was accompanied by a collective bargaining agreement negotiated with the worker's council. The amount recognized for involuntary termination benefits was \$1,346 in 2008.

In 2009 the Water segment initiated several restructuring plans for its operations in the United Kingdom, including workforce reduction in Luton, the closure of a site in Chesterfield and outsourcing of manufacturing to Malaysia. The total amount recognized was \$511 in 2010 and \$1,516 in 2009.

The Spanish operation of the Water segment has been subject to a number of restructuring programs relating to outsourcing projects and production relocations and therefore accrued involuntary termination benefits of \$3,015 in 2010, \$2,438 in 2009 and \$1,662 in 2008.

In 2009, Elster Group announced the relocation of manufacturing of water meters from Russia and Poland to Slovakia. Restructuring expenses of \$1,526 related to the relocation have been recognized in 2009, primarily for inventory write downs and penalties paid to suppliers.

Several other Elster subsidiaries in Italy, France, Belgium, the Netherlands, Luxembourg, Hungary, Brazil and the United States implemented restructuring measures aimed to improve operational efficiency and recorded charges of \$2,182 in 2010, \$2,762 in 2009 and \$919 in 2008 for outsourcing and relocation projects.

In addition to the restructuring measures, Elster subsidiaries in Italy, Germany, France, the United Kingdom, Slovakia, Australia, South Africa, Colombia, Argentina, Brazil and the United States recognized expenses for involuntary termination benefits as a consequence of restructuring measures and capacity adjustments amounting to \$388 in 2010, \$3,052 in 2009 and \$3,690 in 2008.

The following summary presents employee termination and exit costs by segment:

	Gas			Electricity			Water		
	2010	2009	2008	2010	2009	2008	2010	2009	2008
Employee termination and exit costs . .	\$332	\$16,880	\$5,803	\$2,170	\$842	\$229	\$3,715	\$7,310	\$4,425

	Total segments			Corporate			Total		
	2010	2009	2008	2010	2009	2008	2010	2009	2008
Employee termination and exit costs .	\$6,217	\$25,032	\$10,457	\$—	\$331	\$—	\$6,217	\$25,363	\$10,457

The charges for employee termination and exit activities were recognized in the following captions of the statement of operations:

	2010	2009	2008
Cost of revenues	\$3,492	\$18,847	\$ 4,800
Selling expenses	861	2,912	1,589
General and administrative expenses	1,864	2,440	3,106
Research and development expenses	0	1,164	962
	\$6,217	\$25,363	\$10,457

The following table reflects the change in the restructuring liability in 2010 and 2009:

	Liability at January 1, 2010	Accrued	Payments Made	Releases	Foreign Exchange Rate Change	Liability at December 31, 2010
Accrued liability	\$10,768	\$2,131	\$-8,905	\$-1,161	\$-610	\$2,223
Thereof:						
Current	9,884					2,223
Noncurrent	884					0

	Liability at January 1, 2009	Accrued	Payments Made	Releases	Foreign Exchange Rate Change	Liability at December 31, 2009
Accrued liability	\$2,219	\$10,104	\$-1,879	\$-217	\$541	\$10,768
Thereof:						
Current	2,096					9,884
Noncurrent	123					884

Elster Group does not expect to incur additional significant costs under the ongoing restructuring plans.

6. Interest expense, net

Interest expense, net consists of the following:

	2010	2009	2008
Interest income			
Interest income on bank deposits	\$ 1,741	\$ 2,467	\$ 2,574
Other	165	102	210
	1,906	2,569	2,784
Interest expense			
Interest on debt	35,290	38,158	77,604
Payments (receipts) from interest rate swaps	13,189	8,713	-5,839
Interest on mandatorily redeemable preferred equity certificates and shareholder loan	280	369	26,353
Change in fair value of interest rate swaps	5,016	3,824	16,770
Other	8,214	6,929	5,159
	61,989	57,993	120,047
Interest expense, net	\$60,083	\$55,424	\$117,263

Other interest expenses primarily comprise the amortization of deferred financing fees related to the senior facilities agreement. In 2010 Elster Group recognized \$2,378 incremental financing fees in other interest expense because of the repayments of the senior facility agreements.

7. Income taxes

The components of income tax expense (benefit) from continuing operations are as follows:

	<u>2010</u>	<u>2009</u>	<u>2008</u>
<i>Current income tax</i>			
Germany	\$ 12,543	\$ 10,339	\$ 9,779
Foreign	38,136	31,543	29,293
	<u>\$ 50,679</u>	<u>\$ 41,882</u>	<u>\$ 39,072</u>
<i>Deferred income tax</i>			
Germany	\$ -9,963	\$ -158	\$ -4,609
Foreign	-11,314	-2,375	-3,565
	<u>\$ -21,277</u>	<u>\$ -2,533</u>	<u>\$ -8,174</u>
Income tax expense from continuing operations	<u>\$ 29,402</u>	<u>\$ 39,349</u>	<u>\$ 30,898</u>

Income (loss) from continuing operations before income taxes originated in the following jurisdictions:

	<u>2010</u>	<u>2009</u>	<u>2008</u>
Germany	-6,666	-28,809	-82,436
Foreign	125,536	120,502	26,242
	<u>\$118,870</u>	<u>\$ 91,693</u>	<u>\$ -56,194</u>

Total income tax expense (benefit), including the items directly recorded in equity consist of the following:

	<u>2010</u>	<u>2009</u>	<u>2008</u>
Income tax from continuing operations	\$ 29,402	\$ 39,349	\$ 30,898
Income tax recognized in other comprehensive income (loss)	-11	-2,657	-9,328
Income tax recognized in additional paid-in capital	-6,438	0	0
	<u>\$ 22,953</u>	<u>\$ 36,692</u>	<u>\$ 21,570</u>

The income tax benefit recognized in additional paid-in capital relates to costs arising from the initial public offering since the majority of these costs are deductible under the German tax law.

Reconciliation between the expected income tax expense (benefit) based on German corporate income tax rates to income tax expense from continuing operations reported in the consolidated statements of operations is provided in the following table:

	<u>2010</u>	<u>2009</u>	<u>2008</u>
Income (loss) from continuing operations before taxes	<u>\$118,870</u>	<u>\$ 91,693</u>	<u>\$ -56,194</u>
“Expected” income tax expense (benefit)	18,817	14,515	-8,896
Foreign tax rate differentials	5,614	2,995	2,531
German municipal trade tax	7,327	6,431	5,065
Tax exempt income	-1,011	-2,636	-1,040
Non deductible expenses	3,355	4,354	6,484
Tax effects arising from management equity program	-2,155	-5,263	14,358
Uncertain tax positions	1,101	8,175	2,870
Prior year tax adjustments	-2,735	-71	-3,204
Changes in tax rate and tax law	-1,104	308	560
Changes in valuation allowances	2,674	12,560	11,380
Tax effects from basis differences in investments in subsidiaries	-668	366	1,361
Tax credits	-1,670	-3,224	-1,370
Withholding tax effects	930	1,576	980
Others	-1,073	-737	-181
Actual income tax expense	<u>\$ 29,402</u>	<u>\$ 39,349</u>	<u>\$ 30,898</u>
Effective income tax rate	<u>24.7%</u>	<u>42.9%</u>	<u>-55.0%</u>

A significant driver of the Company's effective income tax rate in each period presented is attributable to the tax effects arising from share-based compensation programs, primarily the management equity program (MEP) which is sponsored by the parent. The parent does not obtain a deduction for such charges on its income tax return.

Deferred income tax assets and liabilities as of December 31, 2010 and 2009 consist of the following:

	2010		2009	
	Deferred Tax Asset	Deferred Tax Liability	Deferred Tax Asset	Deferred Tax Liability
Inventories	5,772	145	6,078	371
Receivables and other assets	5,501	7,901	6,935	19,411
Prepaid expenses	66	2,916	53	1,670
Tangible fixed assets	2,122	26,043	3,555	32,433
Other intangible assets	9,746	68,379	8,778	84,690
Goodwill	0	4,477	0	4,681
Shares in related companies	0	2,668	0	3,174
Provisions for pensions	22,097	0	26,765	0
Other liabilities	20,120	6,655	35,821	16,881
Tax loss and tax credit carryforwards	41,917		38,405	
Valuation allowance on deferred tax assets	-30,756	0	-30,977	0
	\$ 76,585	\$ 119,184	\$ 95,413	\$ 163,311
Net deferred tax liabilities		\$ -42,599		\$ -67,898

No deferred tax liabilities have been recognized for the undistributed earnings of certain foreign subsidiaries that arose in 2010 and prior years that we plan to reinvest indefinitely in the foreign jurisdictions. It is not practicable to estimate the amount of unrecognized tax liabilities for these undistributed foreign earnings.

In assessing the recoverability of deferred tax assets, Elster Group's management considers whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. The ultimate realization of deferred tax assets depends on the generation of future taxable income during the periods in which those temporary differences become deductible. Based on the level of historical taxable income and projections for future taxable income over the periods in which the deferred tax assets are recoverable, management believes it is more likely than not that the Company will realize the benefits of these deductible differences, net of the existing valuation allowances as at December 31, 2010. The amount of the deferred tax asset considered recoverable, however, could be reduced in the near term if the Company's estimates of future taxable income during the carryforward period were reduced.

Based on the results of this assessment, valuation allowances were recorded against deferred taxes. These valuation allowances relate primarily to certain types of operating tax losses.

The amount and the expiration period of tax loss carryforwards are as follows as of December 31, 2010:

Expiration of tax loss carryforwards

Within one year	\$ 3,799
Within two years	3,716
Within three years	0
Within four years	0
Within five years and later	19,011
Indefinite	71,557
Total tax loss carryforwards	\$98,083

In addition to net operating loss carryforwards at federal corporate income tax level, there are German trade tax and foreign state and local income tax loss carryforwards of \$57,107 as of December 31, 2010 available to the Company. The respective tax rates vary between 1.6% and 15.0%. Interest expense carryforwards of \$41,027 do not expire and can be used indefinitely.

Changes in valuation allowances comprise the following elements:

<u>Valuation Allowances arising from</u>	<u>Temporary Differences</u>	<u>Tax Losses Carry-forward</u>	<u>Total</u>
As of December 31, 2007	\$ 1,751	\$ 40,611	\$ 42,362
Charged (credited) to income tax provision (benefit)	657	14,785	15,442
Reversals	-350	0	-350
Utilization / Expiration of tax losses	0	-3,299	-3,299
Effect of foreign exchange fluctuation and tax rate changes	47	-10,466	-10,419
As of December 31, 2008	\$ 2,105	\$ 41,631	\$ 43,736
Charged (credited) to income tax provision (benefit)	15	18,346	18,361
Reversals	-2,096	0	-2,096
Utilization / Expiration of tax losses	0	-29,059	-29,059
Effect of foreign exchange fluctuation and tax rate changes	422	-387	35
As of December 31, 2009	\$ 446	\$ 30,531	\$ 30,977
Charged (credited) to income tax provision (benefit)	828	3,307	4,135
Reversals	-701	0	-701
Utilization / Expiration of tax losses	0	-1,736	-1,736
Effect of foreign exchange fluctuation and tax rate changes	9	-1,928	-1,919
As of December 31, 2010	\$ 582	\$ 30,174	\$ 30,756

A reconciliation of the beginning and ending amount of gross unrecognized tax benefits including all German corporate and trade tax as well as foreign tax jurisdictions is as follows:

	<u>2010</u>	<u>2009</u>	<u>2008</u>
Balance at the beginning of the year	\$ 41,786	\$23,184	\$15,502
Additions for tax positions taken in the current year	11,506	18,271	8,114
Reductions for tax positions taken in prior years			
Settlement	-1,325	-130	-31
Lapse of statute of limitation	-3,036	0	0
Payments made	-570	0	0
Effects of exchange rate changes	-698	461	-401
Balance at the end of the year	\$ 47,663	\$41,786	\$23,184

During the years ended December 31, 2010, 2009 and 2008, the Company recognized \$945, \$205, and \$604, respectively, in interest and penalties related to unrecognized tax benefits. As of December 31, 2010 and 2009, total interest and penalties related to unrecognized tax benefits accrued were \$2,271 and \$1,409 respectively.

Included in the balance of unrecognized tax benefits at December 31, 2010, 2009 and 2008, were potential benefits of \$17,513, \$18,558 and \$10,127 respectively, that if recognized, would affect the Company's effective tax rate. The Company anticipates recognizing a range of \$1,834 to \$3,056 of the total amount of unrecognized tax benefits within the next twelve months as a result of expiration of statute of limitations and tax examinations expected to be finalized within the next twelve months in several countries.

Tax years that remain subject to examination in the Group's major tax jurisdictions are:

<u>Major tax jurisdictions</u>	<u>Years Subject to Examination</u>
Germany	Subsequent to 2004
U.S. Federal	Subsequent to 2005

8. Earnings (loss) per share

The following table summarizes the information used to compute earnings (loss) per share:

	<u>2010</u>	<u>2009</u>	<u>2008</u>
<i>Numerator—Basic and Dilutive</i>			
Income (loss) from continuing operations attributable to Elster Group SE	\$ 84,689	\$ 48,888	\$ -91,738
Accretion of dividends on preferred shares	-19,210	-25,640	-961
Income (loss) from continuing operations attributable to Elster Group SE—basic and dilutive	\$ 65,479	\$ 23,248	\$ -92,699
Income (loss) from discontinued operations	2,570	—	—
Net income (loss) attributable to ordinary shareholders—basic and diluted	<u>\$ 68,049</u>	<u>\$ 23,248</u>	<u>\$ -92,699</u>
<i>Denominator—Basic and Dilutive</i>			
Basic weighted average number of ordinary shares outstanding, adjusted for stock split (see note 15)	<u>19,295,573</u>	<u>16,320,750</u>	<u>16,320,750</u>
Effect of dilutive securities—unvested shares	4,204	—	—
Diluted weighted average number of ordinary shares outstanding, adjusted for stock split (see note 15)	<u>19,299,777</u>	<u>16,320,750</u>	<u>16,320,750</u>

9. Accounts receivable

Accounts receivable consist of the following as of December 31:

	<u>2010</u>	<u>2009</u>
Customer contracts	\$ 21,453	\$ 12,791
Trade accounts receivables	266,496	260,198
Accounts receivable before valuation allowance	<u>\$287,949</u>	<u>\$272,989</u>
Less valuation allowance	-9,732	-7,337
Accounts receivable	<u>\$278,217</u>	<u>\$265,652</u>

Customer contracts comprise the following:

	<u>2010</u>	<u>2009</u>
Aggregate costs incurred	\$ 163,493	\$ 95,373
Recognized profits	25,842	16,956
Recognized losses	-424	-273
Progress billings	-167,458	-99,265
Customer contracts	<u>\$ 21,453</u>	<u>\$ 12,791</u>

The customer contracts are expected to be completed within the next twelve months.

The following schedule shows the development of the valuation allowance for doubtful accounts:

	<u>2010</u>	<u>2009</u>	<u>2008</u>
Balance at the beginning of the year	\$ 7,337	\$ 9,031	\$ 7,912
Additions	\$ 4,506	\$ 3,707	\$ 3,633
Write offs	-2,232	-5,732	-1,786
Effects of exchange rate changes	121	331	-728
Balance at the end of the year	<u>\$ 9,732</u>	<u>\$ 7,337</u>	<u>\$ 9,031</u>

10. Inventories

Inventories consist of the following as of December 31:

	<u>2010</u>	<u>2009</u>
Raw materials	\$ 130,456	\$ 116,293
Work in progress	17,509	16,457
Finished goods	37,307	35,258
	<u>\$ 185,272</u>	<u>\$ 168,008</u>
Reserves	-30,723	-20,217
Inventories	<u>\$ 154,549</u>	<u>\$ 147,791</u>

Inventories of \$20,050 held by certain Elster Group's subsidiaries have been pledged as collateral in accordance with the terms of Elster Group's Senior Credit Facility. See Note 14 for further information.

11. Property, plant and equipment

Property, plant and equipment, including assets under capital lease, consist of the following as of December 31:

<u>2010</u>	<u>Cost</u>	<u>Accumulated Depreciation</u>	<u>Net</u>
Land	\$ 31,584	\$ 328	\$ 31,256
Buildings	59,139	18,183	40,956
Plant and machinery	186,301	87,282	99,019
Other equipment	32,464	10,758	21,706
Construction in process	10,621	659	9,962
Property, plant and equipment	<u>\$320,109</u>	<u>\$117,210</u>	<u>\$202,899</u>
<u>2009</u>	<u>Cost</u>	<u>Accumulated Depreciation</u>	<u>Net</u>
Land	\$ 35,678	\$ 427	\$ 35,251
Buildings	63,930	10,915	53,015
Plant and machinery	161,264	46,081	115,183
Other equipment	25,942	2,299	23,643
Construction in process	7,671	520	7,151
Property, plant and equipment	<u>\$294,485</u>	<u>\$60,242</u>	<u>\$234,243</u>

Depreciation expense, including depreciation of assets under capital lease of \$855, \$923 and \$770, was \$40,292, \$42,051 and \$42,403 in 2010, 2009 and 2008, respectively. Interest charges in the amount of \$274, \$738 and \$658 were capitalized in connection with construction projects during the years 2010, 2009 and 2008, respectively.

During the years 2010, 2009 and 2008 impairment losses were recognized amounting to \$2,330, \$941 and \$722 respectively.

Elster Group leases machinery and equipment used in manufacturing under a number of capital lease agreements. Cost of the assets under capital lease at December 31, 2010 and 2009 was \$6,063 and \$16,310 respectively. Accumulated depreciation at December 31, 2010, and 2009 was \$2,570 and \$5,727, respectively.

Real estate property with a carrying amount of \$21,473 (2009: \$24,945) serves as collateral for unfunded Altersteilzeit employee benefits in Germany (see Note 13). In addition, equipment with a carrying amount \$ 29,490 that is owned by certain subsidiaries serves as collateral in accordance with the terms of Elster Group's Senior Credit Facility. See Note 14 for further information.

12. Goodwill and other intangible assets

Intangible assets consist of the following as of December 31:

<u>2010</u>	<u>Cost</u>	<u>Accumulated Amortization</u>	<u>Net</u>
Trade names and brands	\$ 27,493	\$ 8,817	\$ 18,676
Customer related assets	217,608	99,356	118,252
Contract-based intangible assets	56,913	43,968	12,945
Technology-related intangible assets	146,973	80,440	66,533
Other intangible assets	\$448,987	\$232,581	\$216,406
Goodwill	\$936,950	\$ —	\$936,950

<u>2009</u>	<u>Cost</u>	<u>Accumulated Amortization</u>	<u>Net</u>
Trade names and brands	\$ 28,584	\$ 7,982	\$ 20,602
Customer related assets	223,071	78,667	144,404
Contract-based intangible assets	47,795	36,460	11,335
Technology-related intangible assets	161,954	74,451	87,503
Other intangible assets	\$461,404	\$197,560	\$263,844
Goodwill	\$981,571	\$ —	\$981,571

Amortization expense was \$45,239, \$43,385 and \$42,939 in 2010, 2009 and 2008, respectively.

The following presents the estimated amortization expense for intangible assets that are subject to scheduled amortization for each of the next five fiscal years:

2011	\$40,474
2012	35,685
2013	28,111
2014	23,815
2015	18,640

The carrying amount of intangible assets with an indefinite useful life, i.e. certain trade names, is \$16,363 and \$14,419 at December 31, 2010 and 2009, respectively. The estimation of the fair value is based on discounted cash flows and involves significant unobservable inputs.

The impairment losses, incurred in 2009, of \$ 2,241 were recorded in cost of revenues on certain trade names and brands of Elster Group's Gas and Water segments.

Goodwill has been allocated to the segments as follows:

	<u>Gas</u>	<u>Electricity</u>	<u>Water</u>	<u>Consolidated</u>
December 31, 2008	\$ 582,541	\$ 179,636	\$151,482	\$ 913,659
Additions	0	48,331	3,822	52,153
Foreign currency translation	12,825	2,934	0	15,759
December 31, 2009	\$ 595,366	\$ 230,901	\$155,304	\$ 981,571
Disposal of business	0	- 695	0	- 695
Foreign currency translation	- 31,602	- 12,324	0	- 43,926
December 31, 2010	\$ 563,764	\$ 217,882	\$155,304	\$ 936,950

Additions to goodwill in 2009 result from business combinations, primarily the acquisition of EICT (see Note 4).

13. Pension and other long-term employee benefits

Elster Group provides postretirement benefits for most of its employees, either directly or by contributions to pension funds managed by third parties. The benefits provided vary according to legal regulations, tax

requirements and economic conditions of the countries. Certain group subsidiaries provide benefits under defined benefit pension plans. These benefits are normally based on the employees' remuneration and years of service. German pension benefit plans are unfunded. Funded defined benefit pension plans mainly exist in the US, the UK, Canada, Australia and Belgium. These funded plans involve contributions by Elster Group to a separate pension fund that invests in accordance with the respective investment guideline and local law.

The US based subsidiaries provide postretirement healthcare and life insurance benefits. The German subsidiaries participate in an early retirement program designed to create an incentive for employees, within a certain age group, to retire early (Altersteilzeit). The measurement date for the defined benefit plans was December 31.

For defined contribution plans, the subsidiaries make contributions to pension funds managed by third parties as required by law or collective bargaining agreements or voluntarily. Total costs recognized for defined contribution pension plans in the accompanying statements of operations in 2010, 2009 and 2008 were \$26,003, \$25,512 and \$23,879 respectively.

The cost of employees' benefits under defined benefit and defined contribution plans is allocated to the functional costs appropriate to the employees in the statements of operations.

German pension plan

The components of net periodic benefit costs for German benefit plans are as follows:

<u>Net periodic benefit cost</u>	<u>Pension Benefits</u>			<u>Other Benefits</u>		
	<u>2010</u>	<u>2009</u>	<u>2008</u>	<u>2010</u>	<u>2009</u>	<u>2008</u>
Service cost	\$1,170	\$1,106	\$1,292	\$1,366	\$3,068	\$2,134
Interest cost	4,800	5,115	4,630	378	463	494
Gain on curtailments	0	-74	0	0	0	0
Amortization of net gain	-122	-507	-653	0	0	0
Net periodic benefit cost	<u>\$5,848</u>	<u>\$5,640</u>	<u>\$5,269</u>	<u>\$1,744</u>	<u>\$3,531</u>	<u>\$2,628</u>

<u>Change in Benefit Obligation</u>	<u>Pension Benefits</u>		<u>Other Benefits</u>	
	<u>2010</u>	<u>2009</u>	<u>2010</u>	<u>2009</u>
Benefit obligation at beginning of year	\$102,111	\$ 91,799	\$ 9,151	\$ 9,166
Service cost	1,170	1,106	1,366	3,068
Interest cost	4,800	5,115	378	463
Actuarial loss	522	5,879	0	0
Curtailments/Settlements	0	-67	0	0
Benefits paid	-4,621	-4,747	-2,488	-3,812
Exchange rate changes	-7,334	3,026	-667	266
Benefit obligation at end of year	<u>\$ 96,648</u>	<u>\$102,111</u>	<u>\$ 7,740</u>	<u>\$ 9,151</u>
Unfunded status at end of year	<u>\$ 96,648</u>	<u>\$102,111</u>	<u>\$ 7,740</u>	<u>\$ 9,151</u>

Liability consists of:

	<u>2010</u>	<u>2009</u>	<u>2010</u>	<u>2009</u>
Current liabilities	\$ 4,913	\$ 5,186	\$2,455	\$2,533
Noncurrent liabilities	\$91,735	\$96,925	\$5,285	\$6,618

Total accumulated benefit obligation for German defined benefit pension plans was \$ 94,072 and \$ 94,129 as of December 31, 2010 and 2009, respectively.

The actuarial loss impacting the projected benefit obligation was primarily due to decreases in the discount rates.

Amounts recognized for German defined benefit plans in accumulated other comprehensive income (loss) consist of the following:

	2010	2009	2008
Actuarial gains, net in the accumulated other comprehensive income at the beginning of year	\$11,047	\$ 17,667	\$ 19,540
Net actuarial gain (loss) reported in the period	-482	-6,106	-1,220
Amortization of actuarial gain, net	-122	-507	-653
Curtailment/Settlement	0	-7	0
Actuarial gains, net in the accumulated other comprehensive income at the end of year	<u>\$10,443</u>	<u>\$ 11,047</u>	<u>\$ 17,667</u>

Actuarial gains of \$64 included in accumulated other comprehensive income (loss) will be amortized into income in 2011.

The discount rate reflects the time value of money and the characteristics of the liability, i.e. the estimated timing of the benefit payments. Therefore the determination of discount rates is based on rates of return as of the measurement date. Assumptions regarding future mortality are based on published statistics and mortality tables.

The weighted-average assumptions used to determine German benefit obligations as at December 31 are:

	Pension benefits		Other benefits	
	2010	2009	2010	2009
Discount rate	5.1%	5.3%	4.8%	5.1%
Rate of compensation increase	2.8%	2.8%	—	—

The weighted-average assumptions used to determine German net periodic benefit cost for years 2010, 2009 and 2008 are:

	Pension Benefits			Other Benefits		
	2010	2009	2008	2010	2009	2008
Discount rate	5.3%	5.7%	5.5%	5.1%	4.9%	4.3%
Rate of compensation increase	2.8%	2.8%	2.8%	—	—	—

The benefits expected to be paid out of German defined benefit plans over the next ten years are:

	Pension Benefits	Other Benefits
2011	\$ 4,913	\$2,454
2012	5,036	1,845
2013	5,144	1,524
2014	5,468	1,328
2015	5,641	1,224
Years 2016 - 2020	\$30,743	\$4,110

Foreign pension plans

The components of net periodic benefit costs for all foreign benefit plans are as follows:

Net periodic benefit cost	Pension Benefits			Other Benefits		
	2010	2009	2008	2010	2009	2008
Service cost	\$ 407	\$ 411	\$ 365	\$ 527	\$ 418	\$ 555
Interest cost	3,852	4,091	4,262	1,460	1,642	1,751
Expected return on plan assets	-3,412	-2,967	-4,225	0	0	0
Amortization of prior service cost	0	0	-78	-1,174	-1,260	-1,176
Gain/loss on settlements or curtailments	0	106	0	-249	0	0
Amortization of net (gain) loss	67	105	-557	-557	-629	-739
Net periodic benefit cost	<u>\$ 914</u>	<u>\$ 1,746</u>	<u>\$ -233</u>	<u>\$ 7</u>	<u>\$ 171</u>	<u>\$ 391</u>

Change in benefit obligation	Pension Benefits		Other Benefits	
	2010	2009	2010	2009
Benefit obligation at beginning of year	\$ 72,267	\$ 66,913	\$ 28,377	\$ 29,124
Service cost	407	411	527	418
Interest cost	3,852	4,091	1,460	1,642
Plan participants' contributions	94	0	0	0
Actuarial loss (gain)	3,041	4,230	-4,262	-208
Curtailments/Settlements	0	-1,043	-73	0
Benefits paid	-3,688	-5,104	-2,076	-2,707
Transfers	-147	499	0	0
Exchange rate changes	-706	2,270	17	108
Benefit obligation at end of year	\$ 75,120	\$ 72,267	\$ 23,970	\$ 28,377

Change in plan assets

	2010	2009	2010	2009
Fair value of plan assets at beginning of year	\$ 48,210	\$ 39,021	\$ —	\$ —
Actual return on plan assets	4,653	7,635	—	—
Transfers	-110	487	—	—
Employer contributions	3,376	5,097	—	—
Plan participants' contributions	94	101	—	—
Curtailments/Settlements	0	-1,022	—	—
Benefits paid	-3,355	-4,756	—	—
Exchange rate changes	-366	1,647	—	—
Fair value of plan assets at end of year	\$ 52,502	\$ 48,210	\$ —	\$ —
Unfunded status at end of year	\$ 22,618	\$ 24,057	\$ 23,970	\$ 28,377

Liability consists of:

	2010	2009	2010	2009
Current liabilities	\$ 4,169	\$ 244	\$ 1,949	\$ 3,343
Noncurrent liabilities	\$ 18,449	\$ 23,813	\$ 22,021	\$ 25,034

Total accumulated benefit obligation for all foreign defined benefit pension plans was \$74,043 and \$71,119 as of December 31, 2010 and 2009, respectively.

Information for pension plans with an accumulated benefit obligation in excess of plan assets as of December 31:

	2010	2009
Projected benefit obligation	\$68,122	\$68,182
Accumulated benefit obligation	\$67,887	\$67,901
Fair value of plan assets	\$46,099	\$44,795

Amounts recognized for all foreign defined benefit plans in accumulated other comprehensive income consist of the following:

	<u>2010</u>	<u>2009</u>	<u>2008</u>
Actual gains, net accumulated in the other comprehensive income			
(loss) at the beginning of year	\$ 4,780	\$ 4,509	\$ 24,588
Net actuarial gain (loss) reported in the period	2,399	668	-18,783
Amortization of actuarial gain, net	-490	-524	-1,296
Curtailment/Settlement	0	127	0
Actuarial gains, net accumulated in the other comprehensive income			
(loss) at the end of year	<u>\$ 6,689</u>	<u>\$ 4,780</u>	<u>\$ 4,509</u>
Past service credits accumulated in the other comprehensive income			
(loss) at the beginning of year	\$ 4,940	\$ 6,200	\$ 7,454
Amortization of past service credits	-1,166	-1,260	-1,254
Curtailment/Settlement	-176	0	0
Past service credits accumulated in the other comprehensive income			
(loss) at the end of year	<u>\$ 3,598</u>	<u>\$ 4,940</u>	<u>\$ 6,200</u>
Net amount recognized in accumulated other comprehensive income			
(loss) at the end of year	<u>\$ 10,287</u>	<u>\$ 9,720</u>	<u>\$ 10,709</u>

For foreign defined benefit plans actuarial gains of \$638 and past service credits of \$1,140 included in accumulated other comprehensive income (loss) will be amortized into income in 2011.

The weighted-average assumptions used to determine foreign benefit obligations as at December 31 are:

	<u>Pension Benefits</u>		<u>Other Benefits</u>	
	<u>2010</u>	<u>2009</u>	<u>2010</u>	<u>2009</u>
Discount rate	5.2%	5.6%	5.2%	5.5%
Rate of compensation increase	3.4%	3.3%	—	—

The weighted-average assumptions used to determine foreign net periodic benefit cost for years 2010, 2009 and 2008 are:

	<u>Pension Benefits</u>			<u>Other Benefits</u>		
	<u>2010</u>	<u>2009</u>	<u>2008</u>	<u>2010</u>	<u>2009</u>	<u>2008</u>
Discount rate	5.6%	6.4%	6.2%	5.3%	6.5%	6.3%
Expected return on plan assets	7.1%	7.6%	7.3%	—	—	—
Rate of compensation increase	3.3%	3.4%	3.4%	—	—	—

Assumed health care cost trend rates at December 31 are:

	<u>Other Benefits</u>		
	<u>2010</u>	<u>2009</u>	<u>2008</u>
Health care cost trend rate assumed for next year	9.0%	6.9%	8.0%
Rate to which the cost trend rate is assumed to decline (the ultimate trend rate)	5.0%	5.0%	5.0%
Year that the rate reaches the ultimate trend rate	2014	2012	2012

The table below shows the impact of a one percent point change in the assumed rate of health care cost:

	<u>1-% increase</u>	<u>1-% decrease</u>
Effect on total of service and interest cost	\$ 354	\$ -116
Effect on postretirement benefit obligation	\$ -1,675	\$ 1,557

The fair value of Elster Group pension plan assets as of December 31, 2010 is measured as followed:

	<u>Total</u>	<u>Quoted Prices in Active (Level 1)</u>	<u>Significant Other Observable (Level 2)</u>	<u>Significant Unobservable Inputs (Level 3)</u>
Investment funds	\$50,112	\$17,950	\$32,031	\$131
Insurance contracts	2,390	—	2,390	—
Total assets	<u>\$52,502</u>	<u>\$17,950</u>	<u>\$34,421</u>	<u>\$131</u>

Elster Group pension plan assets involve investments funds and guaranteed insurance contracts managed by local trustees and fund managers in several foreign countries. Consistent with their investment strategy and local laws and regulations, the investment funds and insurance carriers invest in a diversified portfolio of equity securities (2010: 60%; 2009: 59%), fixed income securities (2010: 35%, 2009: 33%), real estate (2010: 0%, 2009: <1%) and other assets (2010: 5%, 2009: 8%).

The fair value of investment funds held by the pension plan is the quoted price of the investment or mutual fund share on the last business day of the year. The insurance contracts have a guaranteed return on the accrued balances and future premiums plus a participation right in higher returns generated by the investments made. The fair values have been obtained from the insurance carriers.

On average, the expected rate of return is 5.6% on equity securities and 8.7% on fixed income instruments. The respective rates of return take into account country-specific conditions and are based, among other things, on interest and dividend income expected over the long term, as well as increases in the value of the portfolio after deduction of directly allocable taxes and expenses.

Elster expects to pay \$2,595 in contributions to defined benefit plans in 2011. The benefits expected to be paid over the next ten years are:

	<u>Pension Benefits</u>	<u>Other Benefits</u>
2011	\$ 4,168	\$1,950
2012	4,361	1,912
2013	4,508	1,851
2014	4,351	1,806
2015	4,286	1,771
Years 2016-2020	\$24,014	\$8,411

14. Debt

	<u>Effective Interest Rate %</u>			<u>Principal in Currency of Debt</u>	<u>Maturity</u>	<u>Carrying Amount</u>	
	<u>2010</u>	<u>2009</u>	<u>2008</u>			<u>2010</u>	<u>2009</u>
Senior facility agreement, comprised of:						\$750,888	\$ 959,216
Tranche A							
Euro-denominated		2.30	4.14	40,000	Sept. 30, 2012	0	4,937
GBP-denominated		2.20	3.67	83,502	Sept. 30, 2012	0	25,718
Tranche B							
Euro-denominated	3.03	2.80	4.87	227,190	Sept. 30, 2013	260,254	327,182
USD-denominated	2.30	2.29	2.58	137,076	Sept. 30, 2013	115,137	137,093
Tranche C							
Euro-denominated	3.53	3.30	5.37	227,190	Sept. 30, 2014	260,330	327,189
USD-denominated	2.80	2.79	3.08	137,076	Sept. 30, 2014	115,167	137,097
Other bank loans	various	various	various			89,181	44,630
Capital leases						388	6,523
Total debt						\$840,457	\$1,010,369
Thereof:							
Noncurrent debt						\$822,447	\$ 971,400
Current debt						\$ 18,010	\$ 38,969

The following table presents the maturity of principal payments for debt (other than capital leases):

Debt Principal Payments

2011	\$ 17,739
2012	72,633
2013	374,848
2014	374,848
2015	0
	<u>\$840,068</u>

A syndicate of banks represented by Deutsche Bank has provided subsidiaries of Elster Group with a financing through a combination of term loans (composed of Tranche A, B and C, a revolving credit facility, an ancillary facility and a bonding facility and is hereinafter referred as “senior facility agreement” (SFA). The SFA was used to finance the Ruhrgas Industries Group acquisition (see Note 1). In accordance with the SFA, various agreements between the syndicate of banks and several Elster Group subsidiaries have been entered into under which Elster Group SE’s investments in the equity of all its significant subsidiaries and intercompany loans to such subsidiaries and all or a significant portion of those subsidiaries’ assets were pledged as collateral for payments under the SFA.

The SFA, as amended in connection with Elster Group’s initial public offering contains a number of covenants and restrictions, which are applicable for as long as any balance is outstanding or may be drawn or any commitment to provide funding is in place. The covenants are defined in the contract underlying the SFA and address Elster Group’s level of indebtedness and several other ratios. Balances outstanding under the SFA may become due in case of a change in control event as defined in the contract.

Elster Group was in compliance with the covenants as of December 31, 2010.

The company used proceeds received from its initial public offering to repay outstanding debt under the SFA of \$143,915.

As of December 31, 2010, Elster Group had unused credit lines amounting to \$127,735. There is a commitment fee of 0.63% of the amount not drawn. The credit lines are available for general corporate purposes. The credit lines may be cancelled in case of an event of default as defined in the contract including without limitation payment default, insolvency and material adverse change.

15. Equity and shareholder loans

Shareholder loans

In connection with the Ruhrgas Industries acquisition in 2005 (see Note 1), Rembrandt, the immediate parent of Elster Group, and Management KG, a subsidiary of Rembrandt, provided shareholder financing of \$335,201 in the form of mandatorily redeemable preferred equity certificates (“PECs”) which were denominated in Euro to Elster Group.

There were two classes of PECs: PEC tranche A accrued interest at 8% and PEC tranche B accrued interest at 6.8%. Their original term ended 49 years after issuance. Interest only became due and payable at the end of a calendar year if declared by the Board of Directors. Such declaration was mandatory if Elster Group was able to pay the interest after settlement of senior claims, including the senior facility agreement. Undeclared interest was cumulative.

Effective December 19, 2008, Rembrandt exchanged PECs with a total balance of \$409,864 (principal of \$329,743 plus accrued unpaid interest thereon of \$80,121) for one preferred share (Class A share). The Class A shares were not redeemable but entitled to a preferred dividend. After the exchange of the PECs by Rembrandt the only outstanding PECs were those of tranche B (\$5,457 and additionally accumulated interest of \$791) held by Management KG. On November 30, 2009, the terms and conditions of those remaining PECs held by Management KG were amended and the PECs changed to a shareholder loan that accrued interest at an annual rate of 6.8%.

The amount of interest expense charged to the consolidated statements of operations in 2010, 2009 and 2008 was \$280, \$369 and \$26,353, respectively and was included in interest expense, net (see note 6).

Recapitalization prior to initial public offering

As of December 31, 2008, the Company had 52,830 ordinary shares (Class B shares) and one preferred share (Class A share) issued and outstanding. All shares were nonredeemable, but the Class A preferred share held by Rembrandt carried an entitlement to a preferred dividend of 6.29% per annum calculated on the basis of its nominal value plus allocated premium of \$ 409,864.

In October 2009, the Company restructured its share capital by (i) reducing the nominal value of each ordinary share from € 25 to € 1 and (ii) issuing 15 million new ordinary shares to Rembrandt and Management KG in proportion to their prior ownership in Class B. The two steps of the restructuring of the ordinary shares were collectively accounted for as a stock split with retrospective application to all periods presented.

Further, the capital restructuring in October 2009 involved the conversion of the Class A share (293,217,167 preferred shares), including any accreted unpaid preferred dividends (15,714,753 preferred shares) into 308,931,920 preferred shares. The preferred shares had a nominal value of € 1 each, were nonredeemable and carried an entitlement to a preferred dividend of 5.96% per annum calculated on the basis their aggregate nominal value. The capital restructuring of the Class A share into preferred shares is presented as a stock split, but did not change the classification of the preferred shares on the consolidated balance sheet.

Initial Public Offering

On October 5, 2010 Elster Group SE completed an initial public offering of 18,630,000 American Depositary Shares (“ADSs”) at an offering price of \$13.00 per ADS, each ADS representing one-fourth of an ordinary share of Elster Group SE. A total of 4,657,500 ordinary shares were sold, of which 3,365,385 ordinary shares were issued by the Company and 1,292,115 ordinary shares were sold by Rembrandt and Management KG.

The Company received proceeds of approximately \$153,254 from the initial public offering, after deducting offering costs of \$21,746 borne by the Company. The Company primarily used the proceeds to repay \$143,915 of debt incurred under the SFA and the shareholder loan due to Management KG of \$6,752, including accreted interest.

In connection with the initial public offering, the Company and Rembrandt replaced the preferred shares held by Rembrandt with ordinary shares. As of October 1, 2010, the Company issued 8,533,906 ordinary shares to Rembrandt in exchange for all preferred shares. The aggregate value of the ordinary shares issued to Rembrandt to replace the preferred shares equals the nominal value of all preferred shares plus accreted unpaid preferred dividends of €326,033 divided by the initial public offering price per ordinary share of \$52.00 (€38.20) which is four times the price per American depository share on the date of the initial public offering.

Other

In 2010, Elster Group sold a 25.1% noncontrolling interest in a South African subsidiary for \$2,034 in cash while retaining its controlling financial interest in that subsidiary. The transaction is accounted for as an equity transaction. As a result of the transaction, accumulated foreign currency translation losses of \$ 1,631 were allocated to the noncontrolling interest.

16. Share-based compensation

Long-Term Incentive Plan

In connection with the initial public offering, the Company implemented a new Long-Term Incentive Plan (“LTIP”) to provide long-term performance compensation to key employees and Managing Directors. Elster Group SE may grant awards up to 7,405,000 ADSs (1,851,250 ordinary shares) through September 29, 2020.

An initial grant was made to participants in connection with the initial public offering for 674,440 non-vested ADS awards (168,610 non-vested ordinary shares). One half of the non-vested ADS awards are

subjected to a service period and a market condition involving stock price return compared to a peer group and generally vest after four years and depending on the results of the market condition (“target stock price return” or TSR awards). The other half of the awards are subject to a service period and performance conditions involving earnings per share targets based on staggered performance periods from two to four years and generally vest after four years depending on the results of the performance conditions (“EPS awards”). The awards are nontransferable during the vesting period and the participants are not entitled to the rights of an outstanding share, including dividend rights. There are no post-vesting restrictions on shares granted to participants. Except in limited circumstances such as retirement or redundancy, awards will lapse without vesting if an employee leaves our company during the vesting period.

The grant date fair value for the EPS award was \$14.15 which was determined based on the closing price of Elster’s ADS on the grant date. The company is required evaluate the probability of achievement of the EPS performance conditions throughout the life of the award with adjustments recorded in earnings.

The TSR awards are considered to have a market condition for accounting purposes and the company is required to estimate the results of the market condition in the grant date fair value of the award. We used a Monte Carlo model to estimate the grant date fair value of \$8.77 which was approximately 62% of the quoted price of Elster’s ADS. For these awards, the company is required to record the related compensation expense in the financial statements over the life of the awards regardless if the market condition is achieved as long as the service period is met by the participant.

The assumptions used in the Monte Carlo model to estimate the grant date fair value for the TSR awards are as follows:

	<u>2010</u>
Grant date fair value of unvested ADS	\$8.77
Assumptions used to determine fair value	
Dividend yield	0%
Risk-free rate of return	0.94%
Expected life of awards (years)	4
Expected volatility	40%

Dividend yield considers the historical dividend yield paid by the company and expected dividend yield over the life of the awards. The risk-free rate is based on the U.S. Treasury yield curve in effect at the time of grant. The expected life of the award is based on the vesting period for non-vested ADS awards. Expected volatility is a proxy volatility calculated based on the average of the 4 year volatility of our peers’ historical share price volatility since the company’s shares do not have an established history of trading.

A summary of the status of the company’s non-vested ADS awards as of December 31, 2010, and changes during the year ended December 31, 2010, is presented below:

<u>ADSs in thousands (represent one-fourth of an ordinary share)</u>	<u>Number of ADSs</u>	<u>Grant Date Fair Value</u>	
		<u>Weighted Average</u>	<u>Range of prices</u>
Non-vested ADSs at December 31,2009	0		
ADSs granted in 2010	674	\$12	\$9-14
ADSs vested in 2010	0		
ADSs forfeited in 2010	<u>-46</u>	<u>12</u>	<u>9-14</u>
Non-vested ADSs at December 31,2010	628	\$12	\$9-14

Elster Group intends to settle vested awards by issuing ordinary shares to participants.

Management Equity Program

Rembrandt Holdings SA, Luxembourg, the immediate parent and controlling shareholder (“Rembrandt”), sponsored a Management Equity Program (“MEP”) through Nachtwache Metering Management Vermögensverwaltungs GmbH&Co. KG (“Management KG”), an entity which is controlled by Rembrandt, which granted certain members of senior management of Elster Group share-based payments.

The obligation of the parent related to the MEP arrangement was accounted for as a cash-settled plan with compensation cost recognized over the two year vesting period and remeasured at the end of each reporting period based on the applicable formula price for a participant through September 30, 2010, the date of listing in connection with the initial public offering (see note 15). In connection with the initial public offering, previously unvested awards under the MEP became vested and all grantees are entitled to benefits from the sale of Elster shares rather than a formula value. Accordingly, the date of the offering is the final measurement date for the MEP, aggregate compensation expense was determined based on the fair value of \$52 per ordinary share which was derived from the offering price of four American depository shares (“ADS”) representing one ordinary share.

Elster Group recognized compensation expenses for the MEP and a corresponding contribution by the parent in additional paid-in capital within equity because the Company did not make or fund any payments under the MEP.

Neither Rembrandt nor Elster Group obtains a tax benefit from payments made to the Company’s executives under the terms of the MEP.

Summary of Total Share Based Payment Compensation Cost Recognized in General and Administrative Expenses

A summary of the total compensation cost for all share based payment awards recognized in general and administrative expense and additional paid-in capital by year is presented below:

	<u>2010</u>	<u>2009</u>	<u>2008</u>
LTIP compensation cost	\$ 399	\$ —	\$ —
MEP compensation cost (credit)	<u>– 13,613</u>	<u>– 33,250</u>	<u>90,700</u>
Total compensation cost (credit)	\$ – 13,214	\$ – 33,250	\$ 90,700

At December 31, 2010, the company estimates a total of \$5,984 in unrecognized compensation cost that is expected to be recognized over a period of 3.8 years.

17. Derivative financial instruments

Certain of Elster Group’s subsidiaries are exposed to changes in foreign currency exchange rates in connection with future payments or balances denominated in foreign currencies. The Group has set forth in a treasury guideline that all of its operations are to use forward currency contracts to manage their currency exposures under the supervision of Elster Group’s treasury department. It is the Group’s policy to enter into forward contracts only to hedge currency risks arising from underlying business transactions. The contracts are either designated as a cash-flow hedging instrument or are not designated. The main currencies in which Elster Group is engaged are USD, GBP and EUR. Depending on the nominal amount of the underlying transactions, foreign currency transactions denominated in other currencies may also be managed through Group treasury.

The notional amount of foreign exchange currency forwards not designated for hedge accounting was \$34,457 and \$8,286 of December 31, 2010 and 2009. The change in fair value of all foreign currency derivatives amounted an increases of \$748 and \$399 in 2010 and 2009 respectively and a decrease of \$–210 in 2008, respectively, and was recognized in operating income. At December 31, 2010, certain forward exchange rate contracts, with notional amount of \$10,250 were designated in a cash flow hedge. As of December 31, 2009, no foreign currency forward contracts were designated in a hedge accounting relationship.

Elster Group subsidiaries, mainly in the Euro zone and in the United States of America, are also exposed to interest rate risks; the variable interest rate exposure is predominantly represented by the senior facility agreement (see Note 14). Elster Group recognizes on its balance sheet a number of interest rate swap agreements used as economic hedges with regard to the senior credit facilities agreement. However, these interest rate swaps are not designated as hedging instruments. The changes in fair value are recognized within interest expenses (see Note 6). The aggregated notional amount of the interest rate swaps is \$672,754.

Embedded derivatives relate to contracts to purchase or sell non-financial assets in a foreign currency other than the currency in which the price of such assets is routinely denominated in international commerce.

The Company is also exposed to the risk that counterparties to derivative contracts will fail to meet their contractual obligations. The Company seeks to minimize this risk by entering into arrangements with counterparties with high credit ratings.

18. Fair value measurements

Fair value measurements are categorized according to a three-tier hierarchy, which prioritizes the inputs used in estimating fair values:

- (i) Level 1 is defined as observable input, such as quoted prices in active markets;
- (ii) Level 2 is defined as inputs other than quoted prices in active markets, that are directly or indirectly observable; and
- (iii) Level 3 is defined as unobservable inputs for which little or no market data exists, and therefore, requires an entity to develop its own assumptions.

The following table discloses the applicable hierarchy of estimates for the Company's derivative instruments, which are the only financial instruments measured at fair value on a recurring basis:

	Fair Value as of December 31, 2010	Fair Value Measurements Using Fair Value Hierarchy		
		Level 1	Level 2	Level 3
Assets				
Foreign exchange currency forward contracts	\$ 247		\$ 247	
Embedded derivatives	\$ 334		\$ 334	
Liabilities				
Foreign exchange currency forward contracts	\$ 124		\$ 124	
Foreign exchange currency forward contracts used in a cash flow hedge relationship	\$ 608		\$ 608	
Interest rate swaps	\$12,466		\$12,466	
Embedded derivatives	\$ 533		\$ 533	
	Fair Value as of December 31, 2009	Fair Value Measurements Using Fair Value Hierarchy		
		Level 1	Level 2	Level 3
Assets				
Foreign exchange currency forward contracts	\$ 196		\$ 196	
Embedded derivatives	\$ 85		\$ 85	
Liabilities				
Interest rate swaps	\$7,972		\$7,972	
Embedded derivatives	\$ 635		\$ 635	

The fair value of interest rate swaps is calculated by discounting the future cash flows on the basis of the market interest rates applicable for the remaining term of the contract as of the balance sheet date. To determine the fair value of foreign exchange currency forward contracts and embedded derivatives as well, the forward rate is compared to the current forward rate for the remaining term of the contract as of the balance sheet date. The result is then discounted on the basis of the market interest rate prevailing at the balance sheet date for the respective currency.

The following table presents the carrying amounts and fair values of Elster Group's financial instruments:

	2010		2009	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Cash and cash equivalents	\$216,294	\$216,294	\$ 75,392	\$ 75,392
Financial assets recognized at cost				
Accounts receivable (without customer contracts) . . .	256,764	256,764	252,861	252,861
Other assets	18,382	18,382	3,500	3,500
Financial assets at fair value				
Derivatives recognized at fair value through income .	581	581	281	281
Financial liabilities recognized at amortized cost				
Accounts payable	204,343	204,343	195,635	195,635
Debt	840,068	840,068	1,003,846	1,003,846
Other current and non current liabilities	40,066	40,066	49,245	49,245
Financial liabilities at fair value				
Derivatives recognized at fair value through income .	13,123	13,123	8,607	8,607
Derivatives designated as hedging instrument	608	608	0	0

Almost all financial assets have short maturities and therefore the fair value does not differ significantly from the carrying amount.

Because of the variable interest rates for the financial debt, no significant difference between fair value and net carrying amount occurred.

19. Commitments and contingencies

Capital commitments

At December 31, the Group had commitments to purchase the following property, plant and equipment assets:

	2010	2009
Buildings and leasehold	79	11
Other equipment, fixtures, furniture and office	47	923
Total capital commitments	\$126	\$934

Operating lease commitments

Elster Group has entered into leases on several motor vehicles and machinery and office equipment. These leases have mainly an average life of between two and five years with no renewal option included in the contracts. Additionally, Elster Group has entered into leases for land and buildings that have a remaining minimum term from three years to more than ten years.

Future minimum rentals payable under non-cancellable operating leases as at December 31, 2010 are:

2011	\$5,600
2012	4,788
2013	3,676
2014	2,405
2015	874
More than five years	\$3,541

Expenses arising from operating leases were \$6,067, \$4,941 and \$5,373 in 2010, 2009 and 2008, respectively. The minimum lease payments for operating lease agreements during 2010, 2009 and 2008 were \$1,041, \$827, \$1,974, contingent lease payments were \$2,876, \$3,844 and \$2,886 in 2010, 2009 and 2008.

Legal claims

Various legal actions, including lawsuits for product liabilities, are pending or may be instituted or asserted against Elster Group's subsidiaries. Legal disputes are subject to many uncertainties. However, although

their outcome cannot be predicted with certainty, potential obligations arising from these legal disputes are remote in the opinion of management.

The risk of material contingent liabilities arising from warranty costs, other claims, penalties or possible losses is remote in the opinion of the management.

20. Related party disclosures

Elster Group has business relationships with numerous subsidiaries outside the scope of consolidation and associates.

In 2010, 2009 and 2008 Elster Group generated revenues with unconsolidated subsidiaries of \$8,515, \$9,755 and \$13,396 in and revenues with equity method investees of \$19,763, \$21,213 and \$23,835. As of December 31, 2010 and 2009, the Company had receivables due from related companies of \$10,150 and \$8,615 and payables of \$439 and \$1,612 due to related parties.

In 2007, Elster entered into agreements with the Chairman of the Administrative Board and Minit Operational Board Ltd. (Minit), a company the Chairman controls to lease office space in London and provide various office services. The agreement has been terminated at the end of the second quarter of 2010. In 2010, Elster Group expensed \$133. The company has paid a total amount of approximately \$1,519 in the aggregate through termination of the lease and as of December 31, 2010 Elster Group does not have any liabilities against Minit.

In 2006, Elster entered into a loan agreement with Rembrandt, to fund the legal and administrative expenses Rembrandt incurs as a holding company. The loan was repaid in the fourth quarter of 2010. The balance outstanding as of December 31, 2009 was \$2,485. The loan was repaid in 2010.

21. Segment reporting

Elster Group's operating businesses are organized and managed separately according to the nature of the products and services provided. Each business offers products for different applications and markets and provides separate financial information that is evaluated regularly by the Chairman of the Board, the Chief Executive Officer and the Chief Financial Officer of Elster Group, collectively, the chief operating decision maker. Decisions by the chief operating decision maker on how to allocate resources and assess performance are based on a reported measure of segment profit. The segment profit, used for purposes of such decisions, does not include: depreciation and amortization, certain adjustments identified by management, interest and income taxes; and is reconciled to net income from continuing operations below.

Elster Group has identified the following reportable segments of its continuing operations:

- Gas
- Electricity
- Water

The Gas business provides products and solutions for gas metering, gas utilization and distribution. It develops, designs, manufactures and sells meters and metering solutions for residential and industrial use. These uses are mainly distinguished by the level of gas pressure and the volume to be measured. Residential gas metering products are primarily diaphragm meters and industrial meters are primarily ultrasonic, turbine and rotary meters. All products may be combined with high-end communication solutions and gas evaluation devices. Gas utilization products include process heating equipment and heating control devices, gas distribution products consist of valves, risers and other gas infrastructure products. The Gas North America and Gas Europe and Rest of World business units are aggregated into a reportable Gas segment due to their similar economic characteristics, the similar nature of the products and production processes, the customers who buy the products and how the Company distributes the products to these customers.

Products of the Electricity business comprise electromechanical and electronic single-phase and polyphase meters for residential and commercial and industrial applications, and are more frequently bundled with high-end communication solutions and evaluation capabilities. The Electricity North America and

Electricity Europe and Rest of World business units are aggregated into a reportable Electricity segment due to their similar economic characteristics, the similar nature of the products and services as well as the production processes, the customers who buy the products and how the Company distributes the products to these customers and the similar regulatory environment for electricity meters.

Water segment products are brass and polymer based mechanical and electronic meters for residential and commercial and industrial applications, including single-jet and multi-jet flow meters or volumetric meters. For higher pressures and volumes turbine meters are used. Water meters may also be marketed in combination with high-end communication and evaluation devices.

Segment operations include transactions between segments which are treated similar to transactions to third parties. Those transactions are eliminated in the reconciliation to Elster Group consolidated balances.

Segment information

The following table presents revenue and operating results and certain balance sheet information regarding Elster Group's operating segments for the years 2010, 2009 and 2008. While not included in the measure of segment profit reviewed by the chief operating decision maker for purposes of allocation of resources and performance assessment, information about depreciation and amortization is regularly provided. Segment working capital comprises those balance sheet positions which represent the operating activities of the segment.

Corporate includes activities which are not allocated to any of the operating segments, as well as the effects from consolidation.

	Gas			Electricity			Water		
	2010	2009	2008	2010	2009	2008	2010	2009	2008
Total revenues	\$ 943,752	\$ 899,792	\$1,129,383	\$451,499	\$453,089	\$404,129	\$383,928	\$355,870	\$384,032
thereof to external customers	941,426	898,071	1,127,359	437,713	445,050	395,419	380,200	352,001	381,723
thereof to other segments	2,326	1,721	2,024	13,786	8,039	8,710	3,728	3,869	2,309
Segment profit	\$ 230,228	\$ 203,958	\$ 264,111	\$ 55,935	\$ 60,424	\$ 34,952	\$ 35,439	\$ 30,418	\$ 32,276
Depreciation and amortization	-45,638	-48,908	-50,837	-25,141	-23,286	-19,817	-11,803	-11,673	-13,004
Segment working capital	\$ 121,384	\$ 110,928	\$ 135,926	\$ 49,170	\$ 76,415	\$ 61,150	\$ 61,397	\$ 48,016	\$ 65,808
Capital expenditure	\$ 17,959	\$ 14,991	\$ 31,686	\$ 10,211	\$ 9,125	\$ 35,845	\$ 8,927	\$ 7,523	\$ 13,853
Total assets	\$2,365,594	\$2,320,246	\$2,221,747	\$502,092	\$542,980	\$464,440	\$453,235	\$408,978	\$412,121

	Total Segments			Corporate and Elimination			Consolidated Totals		
	2010	2009	2008	2010	2009	2008	2010	2009	2008
Total revenues	\$1,779,179	\$1,708,751	\$1,917,544	\$ -19,840	\$ -13,629	\$ -13,043	\$1,759,339	\$1,695,122	\$1,904,501
thereof to external customers	1,759,339	1,695,122	1,904,501	0	0	0	1,759,339	1,695,122	1,904,501
thereof to other segments	19,840	13,629	13,043	-19,840	-13,629	-13,043	0	0	0
Segment profit	\$ 321,602	\$ 294,800	\$ 331,339	\$ -36,594	\$ -30,750	\$ -16,709	\$ 285,008	\$ 264,050	\$ 314,630
Foreign currency exchange effects . .							2,933	14,412	-45,153
Management equity program							13,613	33,250	-90,700
Expenses for preparation to become a public company							-12,663	-22,949	-6,969
Strategy development costs							-326	-3,644	-7,835
Employee termination and exit costs							-6,217	-25,363	-10,457
Business process reengineering and reorganisation costs							-5,937	-16,818	-3,169
IT project costs							-1,884	-8,602	-3,652
Gain (loss) from sale of real estate							0	2,506	829
Business combination cost							0	-1,733	0
Impairment of intangible assets . .							0	-2,241	-1,317
Effects of termination of distributor							-9,773	0	0
Other							-270	-316	204
Depreciation and amortization	-82,582	-83,867	-83,658	-2,949	-1,568	-1,684	-85,531	-85,435	-85,342
Interest income							1,906	2,569	2,784
Interest expense							-61,989	-57,993	-120,047
Income tax expense							-29,402	-39,349	-30,898
Income (loss) from continuing operations							\$ 89,468	\$ 52,344	\$ -87,092
Segment working capital	\$ 231,951	\$ 235,359	\$ 262,884	\$ -12,149	\$ -5,967	\$ -3,942	\$ 219,802	\$ 229,392	\$ 258,942
Accounts receivable/payable with associates							-3,925	-42,949	-4,792
Inventory held related to deferred revenue							0	0	3,389
Advanced payments received less paid .							12,546	31,365	17,461
Current assets (other than accounts receivable and inventories)							334,999	202,964	192,150
Accounts payable							204,343	195,635	199,307
Noncurrent assets							1,396,492	1,525,035	1,515,024
Total assets	\$3,320,921	\$3,272,204	\$3,098,308	\$ -1,156,664	\$ -1,130,762	\$ -916,827	\$2,164,257	\$2,141,442	\$2,181,481
Capital expenditure	\$ 37,097	\$ 31,639	\$ 81,384	\$ 5,294	\$ -1,147	\$ 428	\$ 42,391	\$ 30,492	\$ 81,812

The reconciling line item in the table above *Expenses for preparation to become a public company* includes bonuses granted in connection with the initial public offering (see Note 1 and 15) of \$5.9 million to approximately 70 employees. This amount was recognized as compensation expense in 2010.

Geographical information

The following table presents the continuing operations' revenue and long-lived assets for the years 2010, 2009 and 2008. Long-lived assets comprise tangible assets including property, plant and equipment.

	North America incl. Mexico			Europe			All Other Countries			Consolidated Totals		
	2010	2009	2008	2010	2009	2008	2010	2009	2008	2010	2009	2008
Total revenues	\$569,911	\$559,218	\$532,903	\$789,445	\$766,540	\$950,257	\$399,983	\$369,364	\$421,341	\$1,759,339	\$1,695,122	\$1,904,501
thereof United States	467,121	448,043	440,851	0	0	0	0	0	0	467,121	448,043	440,851
thereof Germany	0	0	0	238,998	256,038	308,990	0	0	0	238,998	256,038	308,990
Long-lived assets	\$ 58,432	\$ 63,562	\$ 75,639	\$128,005	\$154,320	\$164,997	\$ 16,462	\$ 16,361	\$ 14,791	\$ 202,899	\$ 234,243	\$ 255,427
thereof United States	58,284	63,363	75,414	0	0	0	0	0	0	58,284	63,363	75,414
thereof Germany	0	0	0	64,952	81,519	81,075	0	0	0	64,952	81,519	81,075

Sales to external customers disclosed according to geography are based on the location of the customer (destination). Disclosure of long-lived assets is based on the location of the asset.

Section B—Unaudited reconciliation of Elster financial information to IFRS as applied by Melrose

The financial information of Elster has been prepared in accordance with US GAAP, which differs in certain material respects from the IFRS accounting policies applied by Melrose in the preparation of its financial statements for the year ended 31 December 2011.

Elster has not previously prepared financial statements under IFRS as issued by the International Accounting Standards Board and as adopted by the European Union (EU), and accordingly in preparing the reconciliation from US GAAP to IFRS, the principles of IFRS 1 (2008), *First-time Adoption of International Financial Reporting Standards* (“IFRS 1”), have been applied with a date of transition of 1 January 2009 (“the Transition Date”). IFRS 1 generally requires that first-time adopters consistently apply all effective IFRS standards retrospectively from the date of transition.

IFRS 1 provides for certain optional exemptions and mandatory exceptions to this general principle. The following optional exemption under IFRS 1 has been applied to Elster:

- Business combinations—Elected not to apply IFRS 3 (2008), Business Combinations, retrospectively to business combinations that occurred prior to the Transition Date. Consequently, business combinations that were recognised before the Transition Date have not been restated. Any goodwill arising on such business combinations before the Transition Date was not adjusted from the carrying value previously determined under US GAAP as a result of applying this exemption.

The estimates previously made by Elster under US GAAP were not revised on transition to IFRS except where necessary to reflect any difference in accounting policies.

The impact on net income and equity of the differences between US GAAP and the IFRS accounting policies applied by Melrose are quantified and described below.

	<u>Q1</u> <u>2012</u>	<u>2011</u>	<u>2010</u>	<u>2009</u>
	\$'m	\$'m	\$'m	\$'m
Net income under US GAAP	9.3	105.4	92.0	52.3
<i>Adjustments</i>				
A. Research and development	(0.2)	8.3	7.7	8.1
B. Pension and other employee benefits	(0.3)	(2.1)	(1.8)	(2.3)
Tax effect of above adjustments	0.1	(0.9)	(1.1)	(1.9)
Net income under IFRS	<u>8.9</u>	<u>110.7</u>	<u>96.8</u>	<u>56.2</u>

	<u>Q1</u> <u>2012</u>	<u>2011</u>	<u>2010</u>	<u>2009</u>
	\$'m	\$'m	\$'m	\$'m
Equity under US GAAP	741.7	718.2	656.2	422.7
<i>Adjustments</i>				
A. Research and development	34.0	34.1	26.8	18.9
Tax effect of above adjustment	(9.5)	(9.5)	(7.8)	(6.0)
Foreign currency translation adjustment	(0.4)	(1.3)	(0.9)	0.3
Total equity under IFRS	<u>765.8</u>	<u>741.5</u>	<u>674.3</u>	<u>435.9</u>

A. Research and development

i. Capitalisation of development costs

Under US GAAP, Elster expenses all costs related to research and development activities as incurred.

Under IFRS, Melrose expenses research 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 whether 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. Costs not meeting such criteria are expensed as incurred.

As of the Transition Date an amount of \$6.5 million, net of tax, would have been capitalised in respect of development projects under Melrose's accounting policies. Adjustments have been made to capitalise, and subsequently amortise, this amount and further amounts subsequent to the Transition Date, pursuant to Melrose's accounting policies.

ii. Taxation

Under US GAAP, no deferred tax was provided for development costs because they were expensed as incurred.

Under IFRS, a taxable temporary difference arises on these capitalized development costs for which a deferred liability is recognised.

iii. Foreign currency translation

Under IFRS, a foreign currency adjustment arises in respect of development costs capitalised in respect of entities that do not use the US dollar as their functional currency.

B. Pension and other employee benefits—actuarial gains and losses and past service costs

i. Treatment of actuarial gains and losses and past service costs

Under US GAAP, Elster recognises all actuarial gains and losses in other comprehensive income (OCI) and amortises these through the income statement over future periods using the corridor method.

Under IFRS, Melrose recognises all actuarial gains and losses and past service costs in full in the period in which they occur in OCI. Such amounts are not recycled through to the income statement in future periods.

ii. Taxation

Under US GAAP, Elster has recognised the taxation effect of the amortisation of actuarial gains and losses in the income statement.

Under IFRS, Melrose has eliminated the tax effect of the amortisation of actuarial gains and losses in the income statement.

In addition to the above adjustments impacting net income, two further reclassifications representing the alignment of accounting policies, which affect line items within the income statement but do not impact overall net income, are set out below.

Finance costs associated with pension and other long term employee benefits are classified as an operating expense under Elster accounting policies. Under Melrose accounting policies, these cost items are classified as a finance expense. These expenses totalled \$1.4 million in the first quarter of 2012, \$6.8 million in the year ended 31 December 2011, \$7.1 million in the year ended 31 December 2010 and \$8.3 million in the year ended 31 December 2009.

The amortisation of purchase price allocation intangible assets are classified as an operating expense under Elster accounting policies. Under Melrose accounting policies, these cost items are classified as a non-headline operating expense. These expenses totalled \$6.7 million in the first quarter of 2012, \$30.6 million in the year ended 31 December 2011, \$33.1 million in the year ended 31 December 2010 and \$33.7 million in the year ended 31 December 2009.

The auditor's report on the reconciliation is set out at Part V (*Unaudited Reconciliation of Elster Financial Information to IFRS as Applied by Melrose*) of the Melrose Circular which is incorporated by reference into this document.

PART VIII

UNAUDITED PRO FORMA INFORMATION ON THE ENLARGED GROUP

This unaudited pro forma statement of net assets of the Enlarged Group in this Part VIII (*Unaudited Pro Forma Information on the Enlarged Group*) has been based on the net assets of Melrose Group as at 31 December 2011 and the net assets of Elster Group as at 31 March 2012 and has been prepared in accordance with Annex II of the Prospective Directive Regulation and on the basis of the notes set out below. The unaudited pro forma statement of net assets has been prepared to illustrate the effect on the consolidated net assets of the Melrose Group of the Acquisition as if the Acquisition had become Effective on 31 December 2011 and assuming that 100 per cent. of Elster ADS Holders and Elster Shareholders had tendered their Elster ADSs and Elster Shares (as the case may be) in full on such date to Melrose Bidco. As indicated above, the unaudited pro forma statement of the net assets has been prepared for illustrative purposes only and, because of its nature, the pro forma statement addresses a hypothetical situation and does not, therefore, represent the Enlarged Group's actual financial position or results following the Tender Offer becoming Effective or the Acquisition being completed.

	Historical		Adjustments					Pro forma
	As reported Melrose Group Consolidated Net Assets as at 31/12/2011	Historical Elster Group Net Assets as at 31/03/2012	Equity Issue	Acquisition	Elster Debt repayment	Acquisition finance facilities		
	(notes 1 and 7)	(notes 2 and 7)	(note 3)	(note 4)	(note 5)	(note 6)		
£ millions	£ millions	£ millions	£ millions	£ millions	£ millions	£ millions		
Non-current assets								
Goodwill and other intangible assets . . .	906.1	691.3		967.6			2,565.0	
Property, plant and equipment.	215.3	127.4					342.7	
Trade and other receivables	0.3	47.0					47.3	
Deferred tax assets	40.4	22.8					63.2	
	1,162.1	888.5	0.0	967.6	0.0	0.0	3,018.2	
Current assets								
Inventories	205.8	112.5					318.3	
Trade and other receivables	216.3	216.7					433.0	
Derivative financial asset	1.7	0.5					2.2	
Current tax asset	0.0	4.6					4.6	
Cash and short term deposits	195.6	51.8	1,171.2	(1,468.4)	(126.6)	376.4	200.0	
	619.4	386.1	1,171.2	(1,468.4)	(126.6)	376.4	958.1	
Total assets	1,781.5	1,274.6	1,171.2	(500.8)	(126.6)	376.4	3,976.3	
Current liabilities								
Trade and other payables	276.0	263.1					539.1	
Interest-bearing loans and borrowings . .	28.8	4.6			(4.6)		28.8	
Current tax liabilities	16.9	17.1					34.0	
Derivative financial instruments	14.1	1.1					15.2	
Provisions	58.2	13.9					72.1	
	394.0	299.8	0.0	0.0	(4.6)	0.0	689.2	
Net current assets	225.4	86.3	1,171.2	(1,468.4)	(122.0)	376.4	268.9	
Non-current liabilities								
Interest-bearing loans and borrowings . .	457.5	330.3			(122.0)	376.4	1,042.2	
Trade and other payables	1.6	4.7					6.3	
Non-current tax liabilities	0.0	11.4					11.4	
Deferred tax liabilities	98.3	45.2					143.5	
Retirement benefit obligations	117.7	103.9					221.6	
Derivative financial liabilities.	1.6	—					1.6	
Provisions	62.4	0.6					63.0	
	739.1	496.1	0.0	0.0	(122.0)	376.4	1,489.6	
Total liabilities	1,133.1	795.9	0.0	0.0	(126.6)	376.4	2,178.8	
Net assets	648.4	478.7	1,171.2	(500.8)	0.0	0.0	1,797.5	

- (1) The consolidated net assets of the Melrose Group have been extracted without material adjustment, from the consolidated audited financial statements of the Melrose Group for the year ended 31 December 2011 which were prepared in accordance with IFRS.
- (2) The net assets of Elster are extracted from Elster's 2012 unaudited first quarter results ended 31 March 2012 and restated under Melrose's accounting policies and are set out in the table immediately below.
- (3) Adjustments reflect funds to be raised from the Rights Issue of £1,171.2 million (gross proceeds of £1,199.1 million less expenses of £27.9 million).
- (4) The adjustment of £1,468.4m to cash represents gross cash consideration of £1,446.3m (\$2,314.0m) based on the assumption that 100 per cent. of Elster ADSs and Elster Shares are acquired for consideration per Elster ADS of \$20.50 (\$82 per Elster Share), plus estimated acquisition expenses of £22.1m. IFRS 3 (revised) requires that acquisition expenses are written off and therefore the amount of goodwill recognised has been calculated as the difference between gross cash consideration of £1,446.3m and the net assets acquired of £478.7m.
The acquisition accounting adjustments do not reflect any fair value adjustments which may ultimately be required since these cannot be accurately determined as at the date of this document. In addition, the excess of consideration over the net book value of the Elster Group's net assets has not yet been allocated between goodwill and other identifiable intangible assets.
- (5) Adjustments reflect repayment of existing Elster bank facilities as drawn down on 31 March 2012.
- (6) Adjustments reflect the drawdown of a portion of the facilities available under the New Facilities Agreement inclusive of banking fees.
- (7) No adjustment has been made to reflect the trading results of the Melrose Group since 31 December 2011 or the Elster Group since 31 March 2012.

	Historical		IFRS accounting policy adjustments		Elster group IFRS	Elster group IFRS	Melrose's IFRS classification
	As reported	Research and development	Balance sheet reclassifications	Elster group IFRS			
	Elster Group Consolidated						
	Net Assets as at 31/03/2012	(note 1)	(note 2)	(note 3)			
\$ millions—US GAAP	\$ millions	\$ millions	\$ millions	£ millions			
Non-current assets							
Goodwill	936.7			936.7	585.4	Goodwill and other intangible assets	
Other intangible assets	169.5			169.5	105.9	Goodwill and other intangible assets	
Property, plant and equipment.	203.9			203.9	127.4	Property, plant and equipment	
Other non current receivables	58.8	33.6	(17.2)	75.2	47.0	Trade and other receivables—non current	
Deferred tax assets	15.4		21.1	36.5	22.8	Deferred tax assets	
	<u>1,384.3</u>	<u>33.6</u>	<u>3.9</u>	<u>1,421.8</u>	<u>888.5</u>		
Current assets							
Inventories	180.0			180.0	112.5	Inventories	
Accounts receivable	283.0			283.0	176.9	Trade and other receivables—current	
Receivable from related parties	7.0			7.0	4.4	Trade and other receivables—current	
Prepaid expenses	9.2			9.2	5.8	Trade and other receivables—current	
Other current assets	48.1		(0.7)	47.4	29.6	Trade and other receivables—current	
Derivative financial instruments			0.7	0.7	0.5	Derivative financial instruments	
Income tax refunds	7.3			7.3	4.6	Current tax assets	
Deferred tax assets	21.1		(21.1)	0.0	0.0		
Cash and short term deposits	82.8			82.8	51.8	Cash and cash equivalents	
	<u>638.5</u>	<u>0.0</u>	<u>(21.1)</u>	<u>617.4</u>	<u>386.1</u>		
Total assets	<u>2,022.8</u>	<u>33.6</u>	<u>(17.2)</u>	<u>2,039.2</u>	<u>1,274.6</u>		
Current liabilities							
Accounts payable	213.4			213.4	133.4	Trade and other payables	
Warranties	24.5			24.5	15.3	Trade and other payables	
Payroll, bonuses and related accruals	60.4			60.4	37.8	Trade and other payables	
Other current liabilities	140.6		(23.9)	116.7	72.9	Trade and other payables	
Deferred revenue	5.9			5.9	3.7	Trade and other payables	
Short term debt	7.3			7.3	4.6	Interest bearing loans and borrowings	
Current tax liabilities	27.3			27.3	17.1	Current tax liabilities	
Pension and other employee benefits	13.4		(13.4)	0.0	0.0		
Deferred tax liabilities	7.6		(7.6)	0.0	0.0		
Derivative financial instruments			1.7	1.7	1.1	Derivative financial instruments	
Provisions			22.2	22.2	13.9	Provisions	
	<u>500.4</u>	<u>0.0</u>	<u>(21.0)</u>	<u>479.4</u>	<u>299.8</u>		
Net current assets	<u>138.1</u>	<u>0.0</u>	<u>(0.1)</u>	<u>138.0</u>	<u>86.3</u>		
Non-current liabilities							
Long term debt	545.7		(17.2)	528.5	330.3	Interest bearing loans and borrowings	
Payroll, bonuses and related accruals	1.5			1.5	0.9	Trade and other payables	
Warranties	5.1			5.1	3.2	Trade and other payables	
Other non current liabilities	2.0		(1.0)	1.0	0.6	Trade and other payables	
Income tax liabilities	18.3			18.3	11.4	Non current tax liabilities	
Deferred tax liabilities	55.2	9.5	7.6	72.3	45.2	Deferred tax liabilities	
Pension and other employee benefits	152.9		13.4	166.3	103.9	Retirement benefit obligations	
Provisions			1.0	1.0	0.6	Provisions	
	<u>780.7</u>	<u>9.5</u>	<u>3.8</u>	<u>794.0</u>	<u>496.1</u>		
Total liabilities	<u>1,281.1</u>	<u>9.5</u>	<u>(17.2)</u>	<u>1,273.4</u>	<u>795.9</u>		
Net assets	<u>741.7</u>	<u>24.1</u>	<u>0.0</u>	<u>765.8</u>	<u>478.7</u>		

- (1) The balance sheet of Elster as at 31 March 2012 has been extracted, without material adjustment, from Elster's 2012 unaudited first quarter results prepared in accordance with US GAAP included in its Form 6-K furnished with the United States Securities and Exchange Commission.
- (2) The US GAAP to IFRS adjustment in respect of the treatment of research and development expenditure and taxation are explained in Part VII (*Historical Financial Information Relating to Elster*) of this prospectus.
- (3) A number of balance sheet reclassifications have been made in order to align the balance sheet presentation of Elster under US GAAP to the balance sheet presentation of Melrose under IFRS. Specifically, Melrose does not classify any component of 'deferred taxation' or 'pension and other employee benefits' as current. Accordingly, an adjustment has been made to reclassify all current assets and current liabilities associated with these balance sheet items as non-current. Also, a \$17.2m reclassification has been made in respect of deferred banking facility fees. Under US GAAP these are recognised by Elster as an asset whereas under IFRS these deferred fees are offset against loans and other borrowings. In addition, certain balances classified by Elster as "other current liabilities", "other non current liabilities" and "other current assets" would be classified as "provisions" or "derivative financial instruments" under Melrose's accounting policies. \$22.2m of current liabilities and \$1.0m of non-current liabilities balances have therefore been reclassified to provisions and \$1.7m of current liabilities and \$0.7m of current assets have been reclassified as derivative financial instruments.
- (4) Converted at exchange rate on 31 March 2012 of 1.60USD/1GBP.

Report on Pro forma financial information



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Curzon street
London W1J 5JA

Investec Bank plc
2 Gresham Street
London EC2V 7QP

J.P. Morgan Securities Ltd.
125 London Wall
London EC2Y 5AJ

29 June 2012

Dear Sirs,

Melrose PLC (the “Company”)

We report on the pro forma financial information (the “**Pro forma financial information**”) set out in Part VIII of the prospectus (the “**Prospectus**”) published by the Company on 29 June 2012, which has been prepared on the basis described in that Part VIII, for illustrative purposes only, to provide information about how the transaction might have affected the financial information presented on the basis of the accounting policies adopted by the Company in preparing the financial statements for the year ended 31 December 2011. This report is required by Annex I item 20.2 of Commission Regulation (EC) No 809/2004 (the “**Prospectus Directive Regulation**”) and is given for the purpose of complying with those requirements and for no other purpose.

Responsibilities

It is the responsibility of the directors of the Company (the “**Directors**”) to prepare the Pro forma financial information in accordance with Annex I item 20.2 and Annex II items 1 to 6 of the Prospectus Directive Regulation.

It is our responsibility to form an opinion, in accordance with Annex I item 20.2 of the Prospectus Directive Regulation, as to the proper compilation of the Pro forma financial information and to report that opinion to you in accordance with Annex II item 7 of the Prospectus Directive Regulation.

Save for any responsibility arising under Prospectus Rule 5.5.3R (2)(f) to any person as and to the extent there provided, to the fullest extent permitted by law we do not assume any responsibility and will not accept any liability to any other person for any loss suffered by any such other person as a result of, arising out of, or in accordance with this report or our statement, required by and given solely for the purposes of complying with Annex I item 23.1 of the Prospectus Directive Regulation, consenting to its inclusion in the Prospectus.

In providing this opinion we are not updating or refreshing any reports or opinions previously made by us on any financial information used in the compilation of the Pro forma financial information, nor do we accept responsibility for such reports or opinions beyond that owed to those to whom those reports or opinions were addressed by us at the dates of their issue.

Basis of Opinion

We conducted our work in accordance with the Standards for Investment Reporting issued by the Auditing Practices Board in the United Kingdom. The work that we performed for the purpose of making this report, which involved no independent examination of any of the underlying financial information, consisted primarily of comparing the unadjusted financial information with the source documents, considering the evidence supporting the adjustments and discussing the Pro forma financial information with the Directors.

We planned and performed our work so as to obtain the information and explanations we considered necessary in order to provide us with reasonable assurance that the Pro forma financial information has been properly compiled on the basis stated and that such basis is consistent with the accounting policies of the Company.

Our work has not been carried out in accordance with auditing or other standards and practices generally accepted in jurisdictions outside the United Kingdom, including the United States of America, and accordingly should not be relied upon as if it had been carried out in accordance with those standards or practices.

Opinion

In our opinion:

- (a) the Pro forma financial information has been properly compiled on the basis stated; and
- (b) such basis is consistent with the accounting policies of the Company.

Declaration

For the purposes of Prospectus Rule 5.5.3R(2)(f) we are responsible for this report as part of the Prospectus and declare that we have taken all reasonable care to ensure that the information contained in this report is, to the best of our knowledge, in accordance with the facts and contains no omission likely to affect its import. This declaration is included in the Prospectus in compliance with Annex I item 1.2 of the Prospectus Directive Regulation.

Yours faithfully

Deloitte LLP
Chartered Accountants

Deloitte LLP is a limited liability partnership registered in England and Wales with registered number OC303675 and its registered office at 2 New Street Square, London EC4A 3BZ, United Kingdom. Deloitte LLP is the United Kingdom member firm of Deloitte Touche Tohmatsu Limited (“DTTL”), a UK private company limited by guarantee, whose member firms are legally separate and independent entities. Please see (www.deloitte.co.uk/about) for a detailed description of the legal structure of DTTL and its member firms.

Member of Deloitte Touche Tohmatsu Limited

PART IX

TAXATION CONSIDERATIONS

1. General

The comments below are of a general and non-exhaustive nature based on the Melrose Directors' understanding of current tax law and published practice in the United Kingdom, both of which are subject to change, possibly with retrospective effect. The acquisition of Melrose Shares involves a number of complex tax considerations. Changes in tax legislation in any of the countries in which the Company has assets, in the United Kingdom (or in any other country in which a subsidiary of the Company through which acquisitions are made is located), or in the United States or changes in tax treaties negotiated by those countries, could adversely affect the returns from the Company to investors or increase the tax liabilities of Qualifying Shareholders.

Melrose Shareholders who are in any doubt as to their taxation position should consult their own independent professional advisers on the potential tax consequences regarding the acquisition, holding or disposal of New Melrose Shares under the laws of their country and/or state of citizenship, domicile or residence.

2. UK taxation

The following statements are intended to apply only as a general guide to current UK tax law as applied in England and Wales and to the current published practice of HMRC (which may not be binding on HMRC). They are intended to apply only to Qualifying Shareholders who (unless the position of non-UK resident shareholders is expressly referred to) are resident and in the case of individuals ordinarily resident and domiciled in the United Kingdom for UK tax purposes (and not in any other territory), who hold their Melrose Shares directly as investments and who are the beneficial owners of their Melrose Shares and who have not acquired (or been deemed to have acquired) their Melrose Shares through any form of option arrangements or by reason of their or another person's office or employment. The statements may not apply to certain classes of shareholders such as dealers in securities or Qualifying Shareholders who are trustees or who hold their Melrose Shares through any form of investment vehicle.

Qualifying Shareholders who are in any doubt as to their tax position regarding the acquisition, ownership and disposal of the New Melrose Shares or who are subject to tax in a jurisdiction other than the United Kingdom should consult their own tax advisers.

2.1 *Taxation of chargeable gains*

2.1.1 *Rights Issue*

The issue of the New Melrose Shares by the Company to Qualifying Shareholders by way of a rights issue should constitute a reorganisation of the Company's share capital for the purposes of UK taxation of chargeable gains. Accordingly, a Qualifying Shareholder should not be treated as making a disposal, for the purposes of the taxation of chargeable gains, of all or part of part of his Existing Melrose Shares by reason of taking up all or part of his rights to New Melrose Shares. No liability to taxation on chargeable gains should arise in respect of the issue of New Melrose Shares to the extent that a Qualifying Shareholder takes up his full entitlement to New Melrose Shares.

For the purposes of the taxation of chargeable gains, if a Qualifying Shareholder takes up all or any of his rights to the New Melrose Shares his holding of Existing Melrose Shares and his New Melrose Shares should be treated as the same asset acquired at the time he acquired his Existing Melrose Shares. The amount paid for the New Melrose Shares should be added to the acquisition cost of his Existing Melrose Shares.

2.1.2 Sale of Nil Paid Rights or lapse of rights to New Melrose Shares

If a Qualifying Shareholder sells all or any of his rights to New Melrose Shares, or if he allows or is deemed to have allowed his rights to lapse and receives a cash payment in respect of them he may, depending on his circumstances (including the availability of exemptions, reliefs and/or allowable losses), incur a liability to taxation on chargeable gains or realise an allowable loss.

If the proceeds resulting from a lapse or disposal of the rights are “small” compared with the market value (on the date of lapse or disposal) of the Existing Melrose Shares and the proceeds do not exceed the total acquisition cost of the Existing Melrose Shares owned, a Qualifying Shareholder can be treated as not having made a disposal for the purposes of tax on chargeable gains and instead the proceeds can be deducted from the acquisition cost of the existing holding for the purposes of computing any chargeable gain or allowable loss on a subsequent disposal. HMRC’s current practice is that ‘small’ for these purposes means either (i) the proceeds of the disposal or lapse of rights do not exceed 5 per cent. of the market value (at the date of the disposal or lapse) of the shares in respect of which the rights arose or (ii) the amount of the proceeds is £3,000 or less, regardless of whether the 5 per cent. test is satisfied.

Where the proceeds are not “small” or the proceeds exceed the total acquisition cost of the Existing Melrose Shares owned, a part disposal is deemed to have occurred. Subject as set out below, the acquisition cost used in the calculation of any resulting gain or loss as a result of the part disposal is apportioned by reference to the proceeds receivable and the market value of the shares retained. Accordingly, the Qualifying Shareholder may, depending on his circumstances (including the availability of exemptions, reliefs and/or allowable losses) incur a liability to taxation on chargeable gains or realise an allowable loss.

In the case where the proceeds exceed the total acquisition cost of the Existing Melrose Shares owned, whether the proceeds are “small” or not, the taxpayer may, in computing its gain, elect to deduct that acquisition cost from the proceeds, reducing to nil the amount of such costs available for subsequent disposals.

2.1.3 Subsequent sale of New Melrose Shares by individuals

Following an acquisition of New Melrose Shares, a subsequent disposal of any such shares by a Qualifying Shareholder who is an individual within the charge to UK capital gains tax may, depending upon the Qualifying Shareholder’s circumstances and subject to any available exemption or relief (such as the annual exempt amount for individuals or other applicable reliefs), give rise to a chargeable gain or an allowable loss for the purposes of UK taxation of capital gains.

Individuals who are temporarily non-UK resident may, in certain circumstances, be subject to tax on their return to the United Kingdom in respect of gains realised whilst they are not resident in the United Kingdom.

2.1.4 Subsequent sale of New Melrose Shares by companies

Following an acquisition of New Melrose Shares, a subsequent disposal of any such shares by a Qualifying Shareholder who is a company within the charge to UK corporation tax may, depending upon the Qualifying Shareholder’s circumstances and subject to any available exemption or relief (such as indexation), give rise to a chargeable gain or an allowable loss for the purposes of UK corporation tax.

In calculating any such chargeable gain, companies who are Qualifying Shareholders may claim an indexation allowance in respect of the subscription monies and acquisition costs paid for their Existing Melrose Shares and New Melrose Shares. Where shares have been purchased on different dates, consideration will need to be given to the “pooling” rules to determine the correct indexed acquisition cost available to set off against the consideration

proceeds to calculate the chargeable gain arising. The indexation allowance will generally only apply from the date the shareholder became liable to make or made payment of the subscription monies. It may not be used to create or increase an allowable loss.

2.2 *Taxation of dividends*

Under current UK tax law, the Company will not be required to withhold tax at source from dividend payments it makes.

2.2.1 *Individuals*

An individual Qualifying Shareholder who is resident in the United Kingdom for tax purposes and who receives a dividend from the Company will be entitled to a tax credit which may be set off against his total income tax liability on the dividend. Such an individual Qualifying Shareholder's liability to income tax is calculated on the aggregate of the dividend and the tax credit (the "**gross dividend**") which will be regarded as the top slice of the individual's income. The tax credit will be equal to 10 per cent. of the gross dividend (i.e., the tax credit will be one-ninth of the amount of the cash dividend received).

A UK resident individual Qualifying Shareholder who is not liable to income tax in respect of the gross dividend will not be entitled to any repayment from HMRC in respect of any part of the tax credit.

A UK resident individual Qualifying Shareholder who is liable to income tax at a rate not exceeding the basic rate will be subject to income tax on the dividend at the rate of 10 per cent. of the gross dividend so that the tax credit will satisfy in full such Qualifying Shareholder's liability to income tax on the dividend. A UK resident individual Qualifying Shareholder liable to income tax at the higher rate will be subject to income tax on the gross dividend at 32.5 per cent. to the extent that such sum, when treated as the top slice of such Qualifying Shareholder's income, falls above the threshold for higher rate income tax. However, such a Qualifying Shareholder will be able to set the tax credit off against part of this liability. The effect of that set-off of the tax credit is that such a Qualifying Shareholder will have to account for additional income tax equal to 22.5 per cent. of the gross dividend (which is also equal to 25 per cent. of the cash dividend received).

A UK resident individual Qualifying Shareholder liable to income tax at the additional rate of 50 per cent. (which is proposed to be reduced to 45 per cent. from 6 April 2013) will be subject to tax on the gross dividend at the rate of 42.5 per cent. (37.5 per cent. from 6 April 2013) to the extent that such sum, when treated as the top slice of such Qualifying Shareholder's income, falls above the threshold for the additional rate of income tax. However, such a Qualifying Shareholder will be able to set the tax credit off against part of this liability. The effect of that set-off of the tax credit is that such a Qualifying Shareholder will have to account for additional income tax equal to 32.5 per cent. (27.5 per cent. from 6 April 2013) of the gross dividend, to the extent that the gross dividend falls above the threshold for the additional rate of income tax. This is equivalent to 36.1 per cent. (30.25 per cent. from 6 April 2013) of the cash dividend received.

In all circumstances, the dividend tax credit is notional only and non-refundable.

2.2.2 *Companies*

Qualifying Shareholders within the charge to UK corporation tax which are "small companies" (for the purposes of Chapter 2 of Part 9A of the Corporation Tax Act 2009 ("**CTA 2009**")) will not generally be subject to UK corporation tax on any dividend received from the Company.

Qualifying Shareholders within the charge to UK corporation tax that are not "small companies" will not be subject to UK tax on dividends received from the Company so long as the dividends fall within an exempt class under Chapter 3 of Part 9A CTA 2009 and certain conditions are met. For example, dividends paid on shares that are "ordinary shares" and are

not “redeemable” (as those terms are used in Chapter 3 of Part 9A CTA 2009) and dividends paid to a person holding less than 10 per cent. of the issued share capital of the payer (or any class of that share capital) should generally fall within an exempt class. The exemptions are not comprehensive and are subject to anti-avoidance rules. If the conditions for exemption are not or cease to be satisfied, or such a shareholder elects for an otherwise exempt dividend to be taxable, the shareholder will be subject to UK corporation tax on dividends received from the Company. Corporation tax would be charged on such dividends at the rate applicable to that company.

2.2.3 *Other UK Qualifying Shareholders*

Other Qualifying Shareholders in the UK which are not liable to UK tax on dividends, including pension funds and charities, will not be entitled to any payment from HMRC in respect of the tax credit attaching to any dividend paid by the Company.

2.3 *Stamp duty and SDRT*

2.3.1 *Rights Issue*

No stamp duty or SDRT will generally be payable on: the issue of Provisional Allotment Letters or definitive share certificates; the registration of the original holders of Provisional Allotment Letters or their renounees; the crediting of the Nil Paid Rights or Fully Paid Rights to stock accounts in CREST; or issue in un-certificated form of the New Melrose Shares.

The transfer of Nil Paid Rights or Fully Paid Rights represented by a Provisional Allotment Letter or held in CREST (other than a transfer to a depositary or clearance service or their nominees or agents) on or before the latest time for registration or renunciation or transfer, will not be liable to stamp duty but will normally be liable to SDRT at the rate of 0.5 per cent. of the actual consideration paid. In the case of transfers within CREST, any SDRT due will be collected through CREST in accordance with the CREST rules.

Where such a purchase is effected through a stockbroker or other financial intermediary, that person will normally account to HMRC for the SDRT and should indicate that this has been done in any contract note issued to the purchaser. In other cases, the acquirer of the rights to the New Melrose Shares represented by the Provisional Allotment Letters is liable to pay the SDRT and must account for it to HMRC. Any SDRT arising on the transfer of Nil Paid Rights or Fully Paid Rights held in CREST should be collected and accounted for to HMRC by CREST.

2.3.2 *Subsequent Transfers*

Stamp duty at the rate of 0.5 per cent. (rounded up to the next multiple of £5) of the amount or value of the consideration given will generally be payable on an instrument transferring New Melrose Shares. A charge to SDRT will also arise on an unconditional agreement to transfer New Melrose Shares (at the rate of 0.5 per cent. of the amount or value of the consideration payable). However, if within six years of the date of the agreement becoming unconditional, an instrument of transfer is executed pursuant to the agreement, and stamp duty is paid on that instrument, any SDRT already paid will be refunded (generally, where the tax repaid is not less than £25, with interest at the relevant prevailing rate from the date on which the payment was made until the order for repayment is issued) provided that a claim for payment is made, and any outstanding liability to SDRT will be cancelled. The liability to pay stamp duty or SDRT is generally satisfied by the purchaser or transferee. An exemption from stamp duty is available on an instrument transferring New Melrose Shares where the amount or value of the consideration is £1,000 or less, and it is certified on the instrument that the transaction effected by the instrument does not form part of a larger transaction or series of transactions for which the aggregate consideration exceeds £1,000.

Paperless transfers of New Melrose Shares within CREST are generally liable to SDRT, rather than stamp duty, at the rate of 0.5 per cent. of the amount or value of the consideration. CREST is obliged to collect SDRT on relevant transactions settled within CREST. Under the CREST system, no stamp duty or SDRT will arise on a transfer of New Melrose Shares into the system unless such a transfer is made for a consideration in money or money's worth, in which case a liability to SDRT (usually at a rate of 0.5 per cent.) will arise.

2.3.3 New Melrose Shares held through clearance services or depositary receipt schemes

Under current UK law, where New Melrose Shares are transferred (a) to, or to a nominee or agent for, a person whose business is or includes the provision of clearance services or (b) to, or to a nominee or agent for, a person whose business is or includes issuing depositary receipts, stamp duty or SDRT will generally be payable at the higher rate of 1.5 per cent. of the amount or value of the consideration payable or, in certain circumstances, the value of the New Melrose Shares (rounded up to the next multiple of £5 in the case of stamp duty). This liability for stamp duty or SDRT will strictly be accountable by the depositary or clearance service operator or their nominee, as the case may be, but will, in practice, generally be reimbursed by participants in the clearance service or depositary receipt scheme. Transfers within the clearance service, and transfers of depositary receipts, are then generally made free of SDRT or stamp duty. Clearance services may opt, provided certain conditions are satisfied, for the normal rates of stamp duty or SDRT to apply to transfers of New Melrose Shares into, and to transactions within, such services instead of the 1.5 per cent. charge generally applying to a transfer of New Melrose Shares into the clearance service and instead of the exemption from SDRT on transfers of New Melrose Shares whilst in the clearance service.

The above statements are intended only as a general guide to the current stamp duty and SDRT position. Transfers to certain categories of person are not liable to stamp duty or SDRT and others may be liable at a higher rate or may, although not primarily liable for SDRT, be required to notify and account for it.

PART X

DIRECTORS, CORPORATE GOVERNANCE AND EMPLOYEES

1. Melrose Directors

The following table sets out information relating to the Melrose Directors:

<i>Name</i>	<i>Current position in respect of Melrose</i>
Christopher Miller	<i>Executive Chairman</i>
David Roper	<i>Executive Vice-Chairman</i>
Simon Peckham	<i>Chief Executive</i>
Geoffrey Martin	<i>Group Finance Director</i>
Miles Templeman	<i>Senior Non-Executive Director</i>
Perry Crosthwaite	<i>Non-Executive Director</i>
John Grant	<i>Non-Executive Director</i>
Justin Dowley	<i>Non-Executive Director</i>

The business address of each of the Melrose Directors is Leconfield House, Curzon Street, London W1J 5JA.

1.1 Profiles of the Melrose Directors

The names, business experience and principal business activities outside the Melrose Group of the Melrose Directors, as well as the dates of their initial appointment as Melrose Directors, are set out below. The composition of the Melrose Board will not change as a result of the Acquisition.

Christopher Miller

Executive Chairman

Age 60; Mr. Miller 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. He is currently non-executive director of TMO Renewables Limited.

David Roper

Executive Vice-Chairman

Age 61; Mr. Roper 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 49; Mr. Peckham 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 44; Mr. Martin 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. During this time, he was involved in projects including raising public equity, debt refinancings and the restructuring and outsourcing of the manufacturing and supply chain. Mr Martin was appointed as an Executive Director of Melrose on 7 July 2005.

Miles Templeman

Senior Non-Executive Director

Age 64; Mr. Templeman 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 non-executive chairman of Shepherd Neame, the Kentish family brewer.

Perry Crosthwaite

Non-Executive Director

Age 63; Mr. Crosthwaite 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 66; 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 a non-executive director of MHP S.A., Pace Plc and Wolfson Microelectronics Plc.

Justin Dowley

Non-Executive Director

Aged 57; Mr. Dowley 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 at 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.

1.2 *Interests of the Melrose Directors*

As at the Latest Practicable Date, the interests (all of which are beneficial) of the Melrose Directors, their immediate families and (so far as is known to them or could with reasonable diligence be ascertained by them) persons connected (within the meaning of section 96B of FSMA) with the Melrose Directors in the issued share capital of Melrose, including: (i) those arising pursuant to transactions notified to Melrose pursuant to Disclosure and Transparency Rule 3.1.2R; or (ii) those of the connected persons of the Melrose Directors, which would, if such connected person were a Melrose Director, be required to be disclosed under (i) above, together with such interests as are expected to subsist immediately following Admission, are set out in the following table:

	Interests as at the Latest Practicable Date		Interests immediately following the Rights Issue	
	Number of Melrose Shares	Percentage of issued ordinary share capital	Number of Melrose Shares held after the Rights Issue ⁽²⁾	Percentage of ordinary Share Capital after the Rights Issue ⁽²⁾
Executive Chairman				
Christopher Miller ⁽¹⁾	8,080,019	1.9	24,240,057	1.9
Executive Vice-Chairman				
David Roper	5,575,670	1.3	16,727,010	1.3
Executive Directors:				
Simon Peckham	5,621,880	1.3	16,865,640	1.3
Geoffrey Martin	2,768,336	0.7	8,305,008	0.7
Non-Executive Directors:				
Miles Templeman	313,332	0.07	939,996	0.07
Perry Crosthwaite	103,125	0.02	309,375	0.02
John Grant	145,847	0.03	437,541	0.03
Justin Dowley	138,000	0.03	414,000	0.03

(1) The interest of Christopher Miller includes 2,160,714 Melrose Shares held by Harris & Sheldon Investments Limited, a company which is connected with Christopher Miller within the meaning of section 252 of the 2006 Act.

(2) Assuming that the Melrose Directors take up their rights in full and that the maximum number of New Melrose Shares is allotted pursuant to the Rights Issue.

Taken together, the combined percentage interest of the Melrose Directors in the issued ordinary share capital of Melrose as at the Latest Practicable Date was approximately 5.39 per cent. Taken together, the combined percentage interest in the Enlarged Share Capital of the Melrose Directors immediately following the Rights Issue will be approximately 5.39 per cent assuming that the Melrose Directors take up their rights in full.

Details of other rights over Melrose Shares held by the Melrose Directors as at the Latest Practicable Date are set out below. Those rights are not included in the interests of the Melrose Directors shown in the table above.

Directors' interests in share-based long-term incentive plans

On 11 April 2012, Melrose Shareholders approved amendments to Melrose's existing incentive share scheme which had the effect of, *inter alia*, bringing forward the crystallisation date of that incentive scheme and replacing it with a new incentive scheme, having a similar economic basis (the "**2012 Incentive Scheme**"). Participants in the 2012 Incentive Scheme have not, at the Latest Practicable Date, been issued with incentive shares in the Company but instead have been granted options over a new class of incentive shares in the Company ("**2012 Incentive Shares**"). Details of the number of options held by Melrose Directors under the 2012 Incentive Scheme are set out below. The rights and restrictions attaching to the options are set out at paragraph 2 of Part II of the shareholder circular sent to Melrose Shareholders on 23 March 2012 which is incorporated in to this document

by reference. The rights attaching to the 2012 Incentive Shares (including a description of the conversion rights) are set out at paragraph 4 of Part XIII (*Additional Information*) of this document.

	Number of options over 2012 Incentive Shares held at the Latest Practicable Date
Christopher Miller	8,500
David Roper	8,500
Simon Peckham	8,500
Geoffrey Martin	8,500
Miles Templeman	Nil
Perry Crosthwaite	Nil
John Grant	Nil
Justin Dowley	Nil

General

Save as set out above, no Melrose Director, nor any member of their respective immediate families, nor any person connected with any Melrose Director within the meaning of section 252 of the 2006 Act, has any interests (beneficial or non-beneficial) in the share capital of Melrose or any member of the Melrose Group.

Save as disclosed above, no other person involved in the Acquisition has an interest which is material to the Acquisition.

Except as set out in paragraph 12.1.2 of Part XIII (*Additional Information*), no Melrose Director has, or has had, any interest in any transaction which is or was unusual in its nature or conditions or which is or was significant to the business of Melrose and which was effected by Melrose during the current or immediately preceding financial year or which remains in any respect outstanding or unperformed.

There are no outstanding loans granted by Melrose or any member of the Melrose Group to any of the Melrose Directors, nor has any guarantee been provided by Melrose or any of its subsidiaries for their benefit save that qualifying third party indemnity provisions are in place for the benefit of Melrose Directors in relation to certain losses and liabilities which they may potentially incur to third parties in the course of their duties.

2. Remuneration of the Melrose Directors

Set out below is information on the current employment and remuneration arrangements for the Melrose Directors and the arrangements in place during the year ended 31 December 2011.

2.1 Directors' Service Agreements and Letters of Appointment

Details of the terms of each executive Melrose Director's service agreement are set out below:

<u>Name</u>	<u>Date of Initial Appointment⁽¹⁾</u>	<u>Salary per annum (£)</u>	<u>Leave (days)⁽²⁾</u>	<u>Benefits on Termination</u>	<u>Notice Period</u>	<u>Confidentiality Obligations</u>
Christopher Miller	29 May 2003	409,800	25	None other than payment in lieu of untaken holiday entitlement	12 months	During and after employment
David Roper	29 May 2003	409,800	25	None other than payment in lieu of untaken holiday entitlement	12 months	During and after employment
Simon Peckham	29 May 2003	409,800	25	None other than payment in lieu of untaken holiday entitlement	12 months	During and after employment
Geoffrey Martin	7 July 2005	327,900	25	None other than payment in lieu of untaken holiday entitlement	12 months	During and after employment

(1) Each of the executive directors was re-appointed at the 2012 AGM and will stand for re-appointment at the 2013 AGM.

(2) In addition to bank and public holidays.

<u>Name</u>	<u>Date of initial appointment⁽¹⁾</u>	<u>Non-executive fee per annum (£)</u>	<u>Expenses</u>	<u>Confidentiality Obligations</u>	<u>Termination Provisions</u>
Miles Templeman	8 October 2003 ⁽²⁾	58,350 (to be reviewed annually)	Reimbursement of travel, hotel and other incidental expenses incurred in the course of duties	Confidentiality undertaking without limitation in time	Without notice and/or compensation if removed from office by shareholders in general meeting
Perry Crosthwaite	26 July 2005 ⁽³⁾	63,350 (to be reviewed annually)	Reimbursement of travel, hotel and other incidental expenses incurred in the course of duties	Confidentiality undertaking without limitation in time	Without notice and/or compensation if removed from office by shareholders in general meeting
John Grant	1 August 2006 ⁽⁴⁾	63,350 (to be reviewed annually)	Reimbursement of travel, hotel and other incidental expenses incurred in the course of duties	Confidentiality undertaking without limitation in time	Without notice and/or compensation if removed from office by shareholders in general meeting
Justin Dowley	1 September 2011 ⁽⁵⁾	58,350 (to be reviewed annually)	Reimbursement of travel, hotel and other incidental expenses incurred in the course of duties	Confidentiality undertaking without limitation in time	Without notice and/or compensation if removed from office by shareholders in general meeting

(1) All of the non-executive Directors will stand for re-appointment at the 2013 AGM.

(2) Miles Templeman has been a non-executive Director of Melrose since 8 October 2003 and was re-appointed as non-executive Director on 28 October 2006 and again on 28 October 2009 and again on 9 May 2012 and the end of his appointment is 27 October 2012.

(3) Perry Crosthwaite has been a non-executive Director of Melrose since 26 July 2005 was re-appointed as non-executive Director on 25 July 2008 and again on 25 July 2011 and again on 9 May 2012. The end of his appointment is 24 July 2014.

(4) John Grant has been a non-executive Director of Melrose since 1 August 2006 and was re-appointed as non-executive Director on 1 August 2009 and again on 9 May 2012. The end of his appointment is 31 July 2012.

(5) Justin Dowley was appointed as a non-executive Director of Melrose on 1 September 2011 and again on 9 May 2012. The end of his appointment is 31 August 2014.

Save as set out above, there are no existing or proposed service agreements between any Melrose Director and any member of the Melrose Group providing for benefits upon termination of employment.

In the financial year ended 31 December 2011, the amount of remuneration paid (including any contingent or deferred compensation) and benefits in kind granted to each of the Melrose Directors by the Melrose Group for services in all capacities to the Melrose Group were as follows:

	Basic salary and fees	Bonus	Taxable benefits	In lieu of pension contributions	Pension contributions ⁽¹⁾	Total
	(£)	(£)	(£)	(£)	(£)	(£)
Christopher Miller ⁽²⁾	397,850	—	20,121	59,678	—	477,649
David Roper	397,850	334,194	19,430	59,678	—	811,152
Simon Peckham	397,850	334,194	19,891	16,176	43,500	811,611
Geoffrey Martin	318,300	267,372	53,217	9,941	37,800	686,630
Miles Templeman ⁽³⁾	61,650	—	—	—	—	61,650
Perry Crosthwaite ⁽⁴⁾	61,650	—	—	—	—	61,650
John Grant	56,650	—	—	—	—	56,650
Justin Dowley ⁽⁵⁾	18,883	—	—	—	—	18,883

- (1) Of the £226,773 attributable to pension contributions, £145,473 was paid as a supplement to basic salary in lieu of pension arrangements. The balance of £81,300 was paid into the individual Director's nominated private pension schemes. No other amount is set aside to provide pension, retirement or similar benefits to Melrose Directors.
- (2) Christopher Miller is a non-executive director of TMO Renewables Limited. His fees for the year were £27,472. This amount is retained by Christopher Miller and therefore excluded from the table above.
- (3) Includes £5,000 per annum in recognition of chairmanship of the Audit and Nomination Committees.
- (4) Includes £5,000 per annum in recognition of chairmanship of the Remuneration Committee.
- (5) Justin Dowley was appointed as a non-executive Director of Melrose on 1 September 2011.

2.2 Pension arrangements of the Executive Directors of Melrose

No Melrose Director is a member of any Melrose Group pension arrangement. The Executive Melrose Directors may elect to receive a contribution by Melrose to their individual pension arrangements, or a supplement to basic salary in lieu of a pension arrangement. Contributions by Melrose are calculated on base salary only.

3. Corporate governance

The Board is accountable to the Company's shareholders for good governance. With the exception set out immediately below, the Company complies with all the provisions of the UK Corporate Governance Code and with all the requirements of the Disclosure and Transparency Rules on audit committees and corporate governance statements.

Schedule A of the UK Corporate Governance Code recommends that grants under executive share option and the long term incentive schemes should normally be phased rather than awarded in one block. Under the 2012 Incentive Scheme, further details of which are set out in paragraph 1.2 of this Part X (*Directors, Corporate Governance and Employees*), entitlements to be paid are to be awarded in one block. The proposals relating to the 2012 Incentive Scheme were approved by Melrose Shareholders and an explanation of the proposed payment is included in the circular to shareholders dated 23 March 2012 which is incorporated in to this document by reference.

The statements below describe how the Company has applied the principles identified in the UK Corporate Governance Code and Disclosure and Transparency Rules.

3.1 The Melrose Board

The Melrose Board meets regularly during the year as well as on an ad-hoc basis as required by time critical business needs. The Melrose Board is responsible to shareholders for the effective and proper management and control of the Company and has a formal schedule of matters reserved for its decisions. Its primary roles are to determine and review Company strategy and policy, consider

acquisitions and disposals, assess requests for major capital expenditure, review trading performance, ensure that adequate funding and personnel are in place, maintain sound internal control systems and to 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 Melrose Group's operations and for reporting to the Melrose Board on items of significance and progress against objectives. There were four scheduled Board meetings held during 2011.

As at 31 December 2011, the Melrose Board comprised eight members being the Executive Chairman, Mr. Christopher Miller, three other Executive Directors and four non-executive Directors. The four Executive Directors, Mr. Christopher Miller, Chairman, Mr. David Roper, Chief Executive Officer, Mr. Simon Peckham, Chief Operating Officer and Mr. Geoffrey Martin, Group Finance Director, and three of the four non-executive Directors, Mr. Miles Templeman, Mr. Perry Crosthwaite and Mr. John Grant, served throughout the year. Mr. Justin Dowley was appointed as a non-executive Director of the Company on 1 September 2011. On 9 May 2012, Simon Peckham, took over as Chief Executive of the Company. David Roper, whom he succeeded as Chief Executive, became Executive Vice-Chairman with effect from the same date. The terms and conditions of the non-executive Directors' appointments and the Executive Directors' service contracts are set out in paragraph 2.1 of this Part X (*Directors, Corporate Governance and Employees*).

The Melrose Board believes that the Melrose Directors possess diverse business experience in areas complementary to the activities of the Company. Biographies of the Melrose Directors are set out in paragraph 1.1 of this Part X (*Directors, Corporate Governance and Employees*). These biographies identify any other appointments held by the Melrose Directors. The only Executive Director to hold non-executive director appointments elsewhere is Mr. Christopher Miller, who is a non-executive director of TMO Renewables Limited and is allowed to retain the remuneration he receives from that appointment.

In accordance with the provisions of the UK Corporate Governance Code, consideration has been given to the independence of all the non-executive Directors and the Melrose Board considers all the non-executive Directors to be independent. The non-executive Directors are not entitled to any bonus or shares under the 2012 Incentive Share Scheme. Performance of the Melrose Board and each committee is evaluated annually.

With effect from 31 December 2011 and notwithstanding the Articles, the Melrose Board determined that all Directors of Melrose would stand for election or re-election at the 2012 Annual General Meeting and annually thereafter, in compliance with the provisions of the UK Corporate Governance Code. Prior to this, one third of Melrose's Directors were subject to retirement by rotation with a requirement to then offer themselves for re-election. It is the policy of the Melrose Board that non-executive Melrose Directors are appointed for an initial term of three years, following which their appointment will be reviewed.

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

Performance of the Melrose Board and each Committee is evaluated annually. The Chairman has held meetings with the Melrose Directors, including the senior independent non-executive Director, Mr. Miles Templeman, to discuss the performance of individual Executive Directors and the Melrose Board as a whole. It was considered that the individual Directors and the Melrose Board as a whole were operating effectively. The non-executive Directors, led by Miles Templeman, the Senior non-executive Director, are responsible for the performance evaluation of the Chairman and as part of this process also take into account the views of the Executive Directors. Directors determine whether there are any training requirements, by completing an evaluation questionnaire during the year that is designed to identify any failures in the performance of the Melrose Board and each of its Committees. The findings of the 2011 evaluations were reviewed by the Company Secretary and feedback was provided to the Melrose Board.

The Melrose Board is currently considering the impact on the performance evaluation process with respect to the new requirement under the UK Corporate Governance Code to carry out externally facilitated performance evaluations at least every three years. As at the date of this document, the Company has not yet carried out an external evaluation of its Directors' performance.

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

All Directors receive a formal and tailored induction shortly after their appointment. Directors are advised that they have access to the advice and services of the Company Secretary, Garry Barnes, who is responsible for ensuring that Board procedures are followed and that applicable rules and regulations are complied with. The Melrose Board may seek independent legal and financial advice in the furtherance of their 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 Melrose 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 Melrose Board in conjunction with the recommendations of its Committees and advice from external consultants, advisors and senior management.

3.2 *Chairman and Chief Executive*

The roles of the Chairman and Chief Executive of the Company are, and will remain, separate and distinct from one another in accordance with best practice and Board policy.

The Chairman alone is responsible for the leadership of the Melrose Board and for ensuring effective communication with shareholders together with the other Executive Directors. The Chief Executive is responsible for strategic direction and decisions involving the day-to-day management of the Company. These respective responsibilities are set out in writing and have been approved by the Melrose Board, who consider that the respective roles and responsibilities are clearly understood by both individuals and by the Melrose Board as a whole.

3.3 *Committees of the Melrose Board*

In accordance with the provisions of the UK Corporate Governance Code, the Melrose Board has three standing committees: the Audit, Nomination and Remuneration Committees (the "Committees"), each of which include the four independent non-executive Melrose Directors. The duties of the Committees are set out in formal terms of reference. These are available from the Company Secretary and on the Melrose Group's website: (www.melroseplc.net). Membership of the Committees is shown below. The Company Secretary acts as Secretary to each of the Committees.

3.4 *Audit Committee*

The Audit Committee currently comprises the four independent non-executive Melrose Directors, Mr. Miles Templeman, Mr. Perry Crosthwaite, Mr. John Grant and Mr. Justin Dowley. Mr. John Grant is the Chairman of the Audit Committee, replacing Mr Miles Templeman with effect from 6 March 2012.

Each member of the Audit Committee brings relevant financial experience from senior executive and non-executive positions as described in their biographies at paragraph 1.1 of this Part X (*Directors, Corporate Governance and Employees*).

The Audit Committee reviews and monitors the integrity of the financial statements of the Melrose 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 Melrose Group; keeps under review the effectiveness of the Melrose Group's financial reporting, internal controls, risk management systems and compliance controls; focuses and challenges the

consistency of accounting policies, methods used to account for significant or unusual transactions and compliance with accounting standards; reviews the Melrose Group's arrangements for its employees to raise concerns in confidence about possible wrongdoing in financial reporting, in accordance with the Melrose Group's whistleblowing policy; and develops, implements and monitors the Melrose Group's policy on external audit and for overseeing the objectivity and effectiveness of the auditor.

The Audit Committee invites the Melrose 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 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 2011.

External Auditor

The Melrose Group's external auditor is recommended for reappointment by the Audit Committee who also assess 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 Melrose Group's external auditor. The Audit Committee has a policy on the engagement of the external auditor for the supply of non-audit services. In accordance with best practice FRC guidelines, which apply from 30 April 2011 onwards, the Melrose Group's 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 2011, the main non-audit services provided by Deloitte were in relation to taxation compliance, tax planning, corporate finance (which included work carried out around the sale of Dynacast and the aborted purchase of Charter International plc) and UK pensions.

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 Melrose Group compared to those partners working on the non-audit taxation services. A separate team, which was independent from the audit team, was used within Deloitte to carry out work in relation to corporate finance services. The non-audit work provided on pensions was performed either by a different senior partner to those involved in audit work, or by independent actuaries who have no links with Deloitte. 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 was appointed in 2003. At each year end Deloitte submits a letter setting out how it believes its independence and objectivity have been maintained. Deloitte is also required to rotate the audit partner responsible for the Melrose Group and subsidiary audits every five years. The Melrose Group's audit signing partner changed as part of that rotation process in 2010. There are no contractual obligations that restrict the Melrose Group's capacity to recommend a particular firm for appointment as auditor.

Internal Audit

Due to the size and complexity of the Melrose 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 Melrose 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 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. During the year ended 31 December 2011, BM Howarth also carried out an Audit of the Group's central head office functions.

The internal auditors' remit includes assessment of the effectiveness of internal control systems, compliance with the Melrose 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 Melrose Group Finance Director, Head of Financial Reporting and Melrose Group Operations Controller, followed by a meeting to discuss key findings and resulting action points. 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 Audit Committee at each meeting and implementation of recommendations by the Melrose Board is followed up at the subsequent Audit Committee meeting.

3.5 *Remuneration Committee*

The Remuneration Committee currently comprises the four independent non-executive Directors, Mr. Miles Templeman, Mr. Perry Crosthwaite, Mr. John Grant and Mr. Justin Dowley. Mr. Perry Crosthwaite chairs the Committee.

The function of the Remuneration Committee is to annually review remuneration trends across the Melrose 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 Melrose Board on the framework for the remuneration of the Company's Executive Directors, Company Secretary and other senior employees; ensure that remuneration of 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 Remuneration Committee gives due consideration to Schedule 8 of Part 15 of the 2006 Act. The Remuneration Committee is expected to meet not less than twice a year and during 2011 the Remuneration Committee met twice.

3.6 *Nomination Committee*

The Nomination Committee currently comprises Mr. Christopher Miller and the four independent non-executive Melrose Directors, Mr. Miles Templeman, Mr. Perry Crosthwaite, Mr. John Grant and Mr. Justin Dowley. Mr. Miles Templeman is the Chairman of the Nomination Committee.

The Nomination Committee keeps the size, structure and composition of the Melrose Board under regular review and recommends to the Melrose Board any adjustments as may be necessary from time to time; gives full consideration to succession planning to ensure an optimum balance of executive and non-executive Directors in terms of skills, experience and diversity; keeps under review the leadership needs of the business; and keeps up-to-date and fully informed about strategic issues and commercial changes affecting the Melrose Group and the market in which it operates. The Nomination Committee uses external search consultants as appropriate.

The Nomination Committee is expected to meet not less than twice a year and during 2011 the Nomination Committee met three times.

4. Employees

4.1 *Melrose Group*

The average number of persons employed by the Melrose Group for the years ended 31 December 2011, 31 December 2010 and 31 December 2009 is set out below:

Number of employees (including Directors)	Average number of employees		
	Year ended 31 December 2011	Year ended 31 December 2010 ⁽¹⁾	Year ended 31 December 2009 ⁽¹⁾
Continuing Operations			
Energy	3,341	3,277	3,558
Lifting	3,079	2,917	2,886
Other Industrial	1,670	1,650	1,638
Corporate	33	33	29
Continuing operations total	8,123	7,877	8,111
Discontinued operations			
Dynacast ⁽²⁾	1,743 ⁽²⁾	2,647	2,141
Other ⁽²⁾	141 ⁽²⁾	650	2,250
Total	10,007	11,174	12,502

(1) Restated to show Dynacast and other disposed businesses within discontinued operations.

(2) Represented to separate the employee numbers for discontinued operations between the Dynacast business and other disposed businesses.

As at 25 June 2012, immediately following the sale of MPC, the Melrose Group employed 7,579 persons (excluding the Melrose Directors).

4.2 *Elster Group*

The number of persons employed by the Elster Group as at 31 December 2011, 31 December 2010 and 31 December 2009 are set out below:

Function	Year ended 31 December 2011	As at 31 December 2010	As at 31 December 2009
Manufacturing, assembly and operation	4,361	4,387	4,369
Sales and Marketing	882	863	834
Research and Development	656	632	561
Packaging warehousing and supply management	417	419	436
Finance, controlling, accounting	281	289	284
Management	81	85	98
Other (IT, HR, etc.)	307	284	271
Total	6,985	6,959	6,853
Location			
Europe	3,709	3,710	3,686
North America	2,232	2,082	1,853
Rest of World	1,044	1,167	1,314

5. Directors' confirmations

5.1 During the last five years, and save as expressly set out in paragraph 5.2 below, no Melrose Director has:

- (a) been convicted in relation to a fraudulent offence;
- (b) been associated with any bankruptcy, receivership or liquidation while acting in the capacity of a member of the administrative, management or supervisory body or senior management of any company;

- (c) been subject to any official public incrimination and/or sanction by statutory or regulatory authorities (including designated professional bodies);
- (d) been disqualified by a court from acting as a member of the administrative, management or supervisory bodies of any issuer or from acting in the management or conduct of the affairs of any issuer;
- (e) been a partner in a partnership which, while he was a partner or within 12 months of his ceasing to be a partner, was put into compulsory liquidation or administration or which entered into any partnership or voluntary arrangement, or had a receiver appointed over any partnership asset;
- (f) had a receiver appointed with respect to any assets belonging to him; or
- (g) has been a director of a company which has been placed in receivership, compulsory liquidation, creditors' voluntary liquidation or administration or which entered into any company voluntary arrangement or any composition or arrangement with its creditors generally or any class of creditors, at any time during which he was a director of that company or within 12 months after his ceasing to be a director.

5.2 As set out in paragraph 7 of this Part X (*Directors, Corporate Governance and Employees*), John Grant previously held the office of Director of (i) Hasgo Group Limited (“**Hasgo**”); (ii) MCT Mitchell Cotts Limited (a wholly-owned subsidiary of Hasgo) (“**MCT**”); and (iii) WDS Components Limited (a wholly-owned subsidiary of Hasgo) (“**WDS**”). MCT and WDS were put into administration on 11 May 2009 whilst John Grant held the office of Director. Hasgo was put into creditors' voluntary liquidation on 5 October 2009 whilst John Grant held the office of Director.

6. Conflicts of interest

In respect of any Melrose Director, there are no actual or potential conflicts of interests between any duties he has to the Company or the Melrose Group, either in respect of the Acquisition or otherwise, and the private interests and/or other duties they may also have.

No Melrose Director has or has had any interest in the Acquisition which is or was unusual in its nature or conditions or which is or was significant to the business of the Melrose Group and which was effected by Melrose during the current or immediately preceding financial year or during an earlier financial year and which remains in any respect outstanding or unperformed.

No Melrose Director has, or had during the year ended 31 December 2011, a material interest in any significant contract with Melrose or any Member of the Melrose Group.

None of the Melrose Directors was selected to be a Melrose Director pursuant to any arrangement or understanding with any major customer, supplier or other person having a business connection with the Melrose Group.

There are no family relationships between any of the Melrose Directors.

7. Directorships and partnerships

Save as set out below, no Melrose Director has held any directorships of any company, other than in relation to companies in the Melrose Group, or been a partner in a partnership at any time in the five years prior to the date of this document.

Director	Current appointments	Former appointments
Christopher Miller	TMO Renewables Limited Gordon House Investor LLP	
David Roper	—	Alkaline S.A.
Simon Peckham	—	
Geoffrey Martin	—	—
Miles Templeman	Shepherd Neame Limited Cell Drinks Limited The Institute for the Management of Sport and Physical Activity Rugby Football Union	Miles Templeman Consultancy Limited Start Talking Ideas Limited Young Enterprise YO! Sushi Group Limited The Director Publications Limited Enterprise United Kingdom Enterprise Insight Trading Limited
Perry Crosthwaite	Jupiter Green Investment Trust PLC Investec Plc Investec Limited Investec Bank Plc Nordoff-Robbins Music Therapy 606 Club LLP	CIDA Foundation Toluna Group Limited
John Grant	MHP S.A Pace Plc Surion Energy Limited Wolfson Microelectronics Plc Eclipse Film Partnership No. 5 LLP Second Northern Film Partnership The Magenta Film Partnership	Floform Limited Floform USA Inc. Floform Pension Trust Limited Gas Turbine Efficiency Limited Hasgo Group Limited International Motor Sports Limited MCT Mitchell Cotts Limited MCT Pension Trust Limited The Royal Automobile Club Limited The Royal Automobile Club Motor Sports Association Limited Trottrak Plc Trottrak (Property) Limited WDS Components Limited WDS Pension Trust Limited
Justin Dowley	Intermediate Capital Group plc Ascot Authority (Holdings) Limited Tillmouth & Tweed Salmon Fishings LLP Burnham Overy Boathouse Limited Independent Port Handling Limited MCC Overseas Limited Callerheugh Limited L.J and E.L Dowley Farming Partnership New Schools Network Old Bailey 2005 LLP	Tricorn Partners LLP Bridgewell Group Limited Tricorn Corporate Member Limited

PART XI

SOME QUESTIONS AND ANSWERS ON THE RIGHTS ISSUE

The questions and answers set out in this Part XI (*Some Questions and Answers on the Rights Issue*) are intended to be generic guidance only and, as such, you should also read Part XII (*Terms and Conditions of the Rights Issue*) of this document for full details of what action you should take. If you are in any doubt about the action to be taken, you are recommended to seek immediately your own personal financial advice from your stockbroker, bank manager, solicitor, accountant, fund manager or other appropriate independent financial adviser duly authorised under FSMA if you are in the United Kingdom, or if you are not, from another appropriately authorised financial adviser.

Melrose Shares can be held in certificated form (that is, represented by a share certificate) or in uncertificated form (that is, through CREST). Accordingly, these questions and answers are split into four sections:

- Section 1 (*General*);
- Section 2 (*Melrose Shares in certificated form*) answers questions you may have in respect of the procedures for Qualifying Shareholders who hold their Melrose Shares in certificated form;
- Section 3 (*Melrose Shares in CREST*) answers questions you may have in respect of the equivalent procedures for Qualifying Shareholders who hold their Melrose Shares in CREST; and
- Section 4 (*Further procedures for Melrose Shares whether in certificated form or in CREST*) answers some detailed questions about your rights and the actions you may need to take and is applicable to Melrose Shares whether held in certificated form or in CREST.

If you do not know whether your Melrose Shares are in certificated or uncertificated form, please call the Shareholder Helpline between 8.30 a.m. and 5.30 p.m. Monday to Friday (except UK public holidays) on 0871 384 2778 (from within the UK) and +44 121 415 0128 (from outside the UK). Calls to the Shareholder Helpline cost 8 pence per minute from a BT landline, excluding VAT. Other network providers' costs may vary. Calls to the Shareholder Helpline from outside the UK will be charged at the applicable international rates. Different charges may apply to calls from mobile telephones and calls may be recorded and randomly monitored for security and training purposes. For legal reasons, the Shareholder Helpline will be unable to give advice on the merits of the Rights Issue or to provide financial, tax or investment advice.

1. General

1.1 What is a rights issue?

A rights issue is one way for companies to raise money. Companies do this by issuing shares for cash and giving their existing shareholders a right of first refusal to buy these shares in proportion to their existing shareholdings. For example, a 1 for 4 rights issue generally means that a shareholder is entitled to buy one new ordinary share for every four ordinary shares currently held. This Rights Issue is 2 for 1; that is, an offer of 2 New Melrose Shares for every 1 Existing Melrose Share held at the close of business on 12 July 2012 (the “**Record Date**”).

New ordinary shares are typically offered in a rights issue at a discount to the current share price. Because of this discount, the right to buy the new ordinary shares is potentially valuable. In this Rights Issue, the Rights Issue Price of 142 pence per New Melrose Share represents a 61.5 per cent. discount to the Closing Price of 368.7 pence per Existing Melrose Share on 28 June (being the last trading day prior to the publication of this document) and a 34.7 per cent. discount to the theoretical ex-rights price of 217.6 pence per New Melrose Share calculated by reference to the Closing Price on the same day.

If you do not want to buy the New Melrose Shares to which you are entitled, you can instead sell your rights to those shares and receive the net proceeds in cash. This is referred to as dealing “nil paid”.

If you do not wish to take up your rights, you do not have to take any action and the Underwriters will use all reasonable endeavours to find investors to take up your rights at the end of the Rights Issue offer period. If the Underwriters find investors and are able to achieve a premium over the Rights Issue Price

and the related expenses of procuring those investors (including any applicable brokerage and commissions and amounts in respect of VAT which, in the reasonable opinion of the Unerwriters, are not recoverable), you will be sent a cheque for the amount of that aggregate premium above the Rights Issue Price less related expenses (including any applicable brokerage and commissions and amounts in respect of VAT which, in the reasonable opinion of the Unerwriters, are not recoverable), so long as the amount in question is at least £5.

1.2 What happens next?

The Company has called a general meeting to be held at the offices of Investec, 2 Gresham Street, London EC2V 7QP at 10.00 a.m. on 16 July 2012. If you are a Melrose Shareholder please see the Notice of General Meeting contained in the Circular. As you will see from the contents of the Notice of General Meeting, the Melrose Directors are seeking shareholder approval for the Acquisition and the Rights Issue.

2. MELROSE SHARES IN CERTIFICATED FORM

2.1 How do I know if I am eligible to participate in the Rights Issue?

If you receive a Provisional Allotment Letter then you should be eligible to participate in the Rights Issue (as long as you have not sold all of your Melrose Shares before 8.00 a.m. on 17 July 2012 (the time when the Existing Melrose Shares are expected to be marked “ex-rights” by the London Stock Exchange), in which case you will need to follow the instructions on the front page of this document).

However, if you receive a Provisional Allotment Letter and you have an address in, or are located in a country other than the United Kingdom you must satisfy yourself as to the full observance of the applicable laws of such territory including obtaining any requisite governmental or other consents, observing any other requisite formalities and paying any issue, transfer or other taxes due in such territories. Receipt of the Prospectus or a Provisional Allotment Letter does not constitute an offer in those jurisdictions in which it would be illegal to make an offer. Overseas Shareholders should refer to paragraph 7 of Part XII (*Terms and Conditions of the Rights Issue*) of this document for further details.

If you do not receive a Provisional Allotment Letter, and you do not hold your shares in CREST, this probably means you are not eligible to acquire any New Melrose Shares. However, see question 2.4 below.

2.2 What are my options and what should I do with the Provisional Allotment Letter?

The Provisional Allotment Letter shows:

- (a) In Box 1: how many Melrose Shares you held at the close of business on the Record Date;
- (b) In Box 2: how many New Melrose Shares you are entitled to buy pursuant to the Rights Issue; and
- (c) In Box 3: how much you need to pay if you want to take up your rights in full.
- (i) If you want to take up your rights in full

If you want to take up in full your rights to subscribe for the New Melrose Shares to which you are entitled, all you need to do is send the Provisional Allotment Letter, together with your cheque or banker’s draft for the full amount shown in Box 3, payable to “Equiniti Limited re Melrose PLC Rights Issue” and crossed “A/C payee only”, by post or by hand (during normal business hours only) to the address shown on page 1 of the Provisional Allotment Letter so as to arrive before 11.00 a.m. on 31 July 2012. You can use the reply-paid envelope which will be provided with the Provisional Allotment Letter within the United Kingdom. Please allow sufficient time for delivery. Paragraphs 4.2 and 4.4 of Part XII (*Terms and Conditions of the Rights Issue*) of this document set out in full instructions on how to accept and pay for your New Melrose Shares. These instructions are also set out in the Prospectus and the Provisional Allotment Letter. You will be required to pay in full for all the rights you take up. A definitive share certificate will be sent to you for the New

Melrose Shares you acquire and it is expected that such certificate(s) will be despatched to you by 8 August 2012.

You will only need your Provisional Allotment Letter to be returned to you if you want to deal in your Fully Paid Rights.

(ii) If you do not want to take up your rights at all

If you do not want to take up any of your rights, you do not need to do anything. If you do not return your Provisional Allotment Letter by 11.00 a.m. on 31 July 2012, the Company has made arrangements under which the Underwriters will use all reasonable endeavours to find investors to take up your rights by 4.30 p.m. on the second dealing day after the last date for acceptance of the Rights Issue. If the Underwriters find investors and are able to achieve a premium over the Rights Issue Price and the related expenses of procuring those investors (including any applicable brokerage and commissions and amounts in respect of VAT which are not recoverable), you will be sent a cheque for the amount of that aggregate premium above the Rights Issue Price less related expenses (including any applicable brokerage and commissions and amounts in respect of VAT which are not recoverable), so long as the amount in question is at least £5. Cheques are expected to be despatched by 8 August 2012 and will be sent to your address as it appears on the Register (or to the first named holder if you hold Existing Melrose Shares jointly).

(iii) If you want to take up some but not all of your rights

If you want to take up some but not all of your rights and wish to sell some or all of those you do not want to take up, you should first apply for split Provisional Allotment Letters by completing Form X on page 4 of the Provisional Allotment Letter and then return it by post or by hand (during normal business hours only) to Equiniti at Aspect House, Spencer Road, Lancing, West Sussex BN99 6DA so as to be received by 3.00 p.m. on 27 July 2012, the last time and date for splitting Provisional Allotment Letters, together with a covering letter stating the number of split Provisional Allotment Letters required and the number of Nil Paid Rights or Fully Paid Rights to be comprised in each split Provisional Allotment Letter. You can use the reply-paid envelope which will be provided with the Provisional Allotment Letter within the United Kingdom. Please allow sufficient time for delivery. You should then deliver the split Provisional Allotment Letter representing the right to New Melrose Shares you wish to accept together with your cheque or banker's draft to Equiniti so as to be received by 11.00 a.m. on 31 July 2012, the last time and date for acceptance and payment in full.

Alternatively, if you want only to take up some of your rights (and do not wish to sell some or all of those you do not want to take up), you should complete Form X on page 4 of the Provisional Allotment Letter and return it by post or by hand (during normal business hours only) to Equiniti at Aspect House, Spencer Road, Lancing, West Sussex BN99 6DA together with a covering letter confirming the number of New Melrose Shares you wish to take up and a cheque or banker's draft for the appropriate amount. In this case the Provisional Allotment Letter and cheque must be received by Equiniti by 11.00 a.m. on 31 July 2012, the last time and date for payment. You can use the reply-paid envelope which will be provided with the Provisional Allotment Letter within the United Kingdom. Please allow sufficient time for delivery. Further details relating to payment and acceptance are set out in paragraphs 4.2 and 4.4 of Part XII (*Terms and Conditions of the Rights Issue*) of this document.

(iv) If you want to sell all of your rights

If you want to sell all of your rights you should complete and sign Form X on page 4 of the Provisional Allotment Letter (if it is not already marked "Original Duly Renounced") and pass the entire letter to your stockbroker, bank manager or other appropriate financial adviser or to the transferee (provided that they are not in the United States or any of the Excluded Territories).

Please note that your ability to sell your rights is dependent on the demand for such rights and that the price for the Nil Paid Rights will fluctuate.

The latest time and date for selling all of your rights is 11.00 a.m. on 31 July 2012. Please ensure, however, that you allow enough time so as to enable the person acquiring your rights to take all necessary steps in connection with taking up the entitlement prior to 11.00 a.m. on 31 July 2012.

2.3 How do I transfer my rights into the CREST system?

If you are a Qualifying non-CREST Shareholder, but are also a CREST member and want your New Melrose Shares to be in uncertificated form, you should complete Form X and the CREST Deposit Form (both on page 4 of the Provisional Allotment Letter), and ensure they are delivered to the CREST courier and sorting service to be received by 3.00 p.m. on 26 July 2012 at the latest. CREST sponsored members should arrange for their CREST sponsors to do this.

If you have transferred your rights into CREST, you should refer to paragraph 5.2 of Part XII (*Terms and Conditions of the Rights Issue*) of this document for details on how to pay for the New Melrose Shares.

2.4 What if I do not receive a Provisional Allotment Letter?

If you do not receive a Provisional Allotment Letter and you do not hold your Melrose Shares in CREST, this probably means that you are not eligible to participate in the Rights Issue. Some Qualifying Shareholders, however, will not receive a Provisional Allotment Letter but may still be able to participate in the Rights Issue, namely:

- (a) Qualifying CREST Shareholders who held their Existing Melrose Shares in uncertificated form on 1 February 2012 and who have converted them to certificated form;
- (b) Qualifying non-CREST Shareholders who bought Melrose Shares before 8.00 a.m. on 17 July 2012 but were not registered as the holders of those Melrose Shares at the close of business on 12 July 2012 (please see question 2.5 below); and
- (c) certain Overseas Shareholders (please see question 4.7 below).

If you are unsure as to whether you should receive a Provisional Allotment Letter please contact the Shareholder Helpline between 8.30 a.m. and 5.30 p.m. Monday to Friday (except UK public holidays) on 0871 384 2778 (from within the UK) and +44 121 415 0128 (from outside the UK). Calls to the Shareholder Helpline cost 8 pence per minute from a BT landline, excluding VAT. Other network providers' costs may vary. Calls to the Shareholder Helpline from outside the UK will be charged at the applicable international rates. Different charges may apply to calls from mobile telephones and calls may be recorded and randomly monitored for security and training purposes. For legal reasons, the Shareholder Helpline will be unable to give advice on the merits of the Rights Issue or to provide financial, tax or investment advice.

2.5 If I buy Melrose Shares before 8.00 a.m. on 17 July 2012 (the date the New Melrose Shares start trading ex-rights) will I be eligible to participate in the Rights Issue?

If you buy Melrose Shares before 8.00 a.m. on 17 July 2012 (the date the New Melrose Shares start trading ex-rights (that is, without the right to participate in the Rights Issue, referred to as the ex-rights date)) but are not registered as the holder of those Melrose Shares on the Record Date you may still be eligible to participate in the Rights Issue. If you are in any doubt, please consult your stockbroker, bank or other appropriate financial adviser, or whoever arranged your share purchase, to ensure you claim your entitlement.

You will not be entitled to Nil Paid Rights in respect of any Melrose Shares acquired on or after the ex-rights date.

2.6 What should I do if I sell or have sold or transferred all or some of the Melrose Shares shown in Box 1 of the Provisional Allotment Letter before the ex-rights date?

If you sell or have sold or transferred all of your Melrose Shares before the ex-rights date, you should complete Form X on page 4 of the Provisional Allotment Letter and send the entire

Provisional Allotment Letter together with this document to the stockbroker, bank or other appropriate financial adviser through whom you made the sale or transfer.

If you sell or have sold or transferred only some of your holding of Melrose Shares before the ex-rights date, you will need to complete Form X on page 4 of the Provisional Allotment Letter and consult the stockbroker, bank or other appropriate financial adviser through whom you made the sale or transfer before taking any action with regard to the balance of rights due to you.

2.7 How many New Melrose Shares will I be entitled to acquire?

Box 2 on page 1 of the Provisional Allotment Letter shows the number of New Melrose Shares you will be entitled to buy if you are a Qualifying non-CREST Shareholder. You will be entitled to 2 New Melrose Shares for every 1 Existing Melrose Share held on the Record Date. All Qualifying non-CREST Shareholders (other than certain Overseas Shareholders) will be sent a Provisional Allotment Letter after the Melrose General Meeting has approved the Transaction Resolutions.

2.8 What should I do if I think my holding of Melrose Shares (as shown in Box 1 on page 1 of the Provisional Allotment Letter) is incorrect?

If you are concerned about the figure in Box 1, please call the Shareholder Helpline between 8.30 a.m. and 5.30 p.m. Monday to Friday (except UK public holidays) on 0871 384 2778 (from within the UK) and +44 121 415 0128 (from outside the UK). Calls to the Shareholder Helpline cost 8 pence per minute from a BT landline, excluding VAT. Other network providers' costs may vary. Calls to the Shareholder Helpline from outside the UK will be charged at the applicable international rates. Different charges may apply to calls from mobile telephones and calls may be recorded and randomly monitored for security and training purposes. For legal reasons, the Shareholder Helpline will be unable to give advice on the merits of the Rights Issue or to provide financial, tax or investment advice.

2.9 If I take up my rights, when will I receive my New Melrose Share certificate?

If you take up your rights under the Rights Issue, share certificates for the New Melrose Shares are expected to be posted by 8 August 2012.

3. MELROSE SHARES IN CREST

3.1 How do I know if I am eligible to participate in the Rights Issue?

If you are a Qualifying CREST Shareholder (save as mentioned below), and on the assumption that the Rights Issue proceeds as planned, your CREST stock account will be credited with your entitlement to Nil Paid Rights on 17 July 2012. The stock account to be credited will be the account under the participant ID and member account ID that apply to your Melrose Shares on the Record Date. The Nil Paid Rights and the Fully Paid Rights are expected to be enabled as soon as practicable after 8.00 a.m. on 17 July 2012. If you are a CREST sponsored member, you should consult your CREST sponsor if you wish to check that your account has been credited with your entitlement to Nil Paid Rights. The CREST stock accounts of Overseas Shareholders with an address in the United States or any of the Excluded Territories will not be credited with Nil Paid Rights. Overseas Shareholders should refer to paragraph 7 of Part XII (*Terms and Conditions of the Rights Issue*) of this document.

3.2 How do I take up my rights using CREST?

If you are a Qualifying CREST Shareholder, you should refer to paragraph 5 of Part XII (*Terms and Conditions of the Rights Issue*) of this document for details on how to take up and pay for your rights.

If you are a CREST member you should ensure that a Many-to-Many (“MTM”) instruction has been inputted and has settled by 11.00 a.m. on 31 July 2012 in order to make a valid acceptance. If your Melrose Shares are held by a nominee or you are a CREST sponsored member you should speak directly to the agent who looks after your stock or your CREST sponsor (as appropriate) who will be

able to help you. If you have further questions, particularly of a technical nature regarding acceptance through CREST, you should call the CREST Service Desk on 0845 964 5648 (+44 845 964 5648 if you are calling from outside the United Kingdom).

3.3 If I buy Melrose Shares before 8.00 a.m. on 17 July 2012 (the date that the Melrose Shares start trading ex-rights) will I be eligible to participate in the Rights Issue?

If you buy Melrose Shares before 8.00 a.m. on 17 July 2012, but are not registered as the holder of those Melrose Shares on the Record Date, you may still be eligible to participate in the Rights Issue. Euroclear will raise claims in the normal manner in respect of your purchase and your Nil Paid Rights will be credited to your stock account(s) on settlement of those claims.

You will not be entitled to Nil Paid Rights in respect of any further Melrose Shares acquired on or after the ex-rights date.

3.4 What should I do if I sell or transfer all or some of my Melrose Shares before 8.00 a.m. on 17 July 2012 (the ex-rights date)?

You do not have to take any action except, where you sell or transfer all of your Melrose Shares before the ex-rights date, to send this document to the purchaser or transferee or to the stockbroker, bank or other financial adviser through whom you made the sale or transfer. A claim transaction in respect of that sale or transfer will automatically be generated by Euroclear which, on settlement, will transfer the appropriate number of Nil Paid Rights to the purchaser or transferee.

3.5 How many New Melrose Shares am I entitled to acquire?

Your stock account will be credited with Nil Paid Rights in respect of the number of New Melrose Shares which you are entitled to acquire. You will be entitled to acquire 2 New Melrose Shares for every 1 Existing Melrose Share you hold at the close of business on 12 July 2012, the Record Date. You can also view the claim transactions in respect of purchases/sales effected after this date, but before the ex-rights date. If you are a CREST sponsored member, you should consult your CREST sponsor.

3.6 What should I do if I think my holding of Melrose Shares is incorrect?

If you buy or sell Melrose Shares between the date of this document and 8.00 a.m. on 17 July 2012, your transaction may not be entered on the register of members before the Record Date and you should consult the stockbroker, bank or other appropriate financial adviser through whom you made the sale, purchase or transfer before taking any other action. If you are concerned about the number of Nil Paid Rights with which your stock account has been credited, please call the Shareholder Helpline between 8.30 a.m. and 5.30 p.m. Monday to Friday (except UK public holidays) on 0871 384 2778 (from within the UK) and +44 121 415 0128 (from outside the UK). Calls to the Shareholder Helpline cost 8 pence per minute from a BT landline, excluding VAT. Other network providers' costs may vary. Calls to the Shareholder Helpline from outside the UK will be charged at the applicable international rates. Different charges may apply to calls from mobile telephones and calls may be recorded and randomly monitored for security and training purposes. For legal reasons, the Shareholder Helpline will be unable to give advice on the merits of the Rights Issue or to provide financial, tax or investment advice.

3.7 If I take up my rights, when will New Melrose Shares be credited to my CREST stock account(s)?

If you take up your rights under the Rights Issue, it is expected that New Melrose Shares will be credited to the CREST stock account in which you hold your Fully Paid Rights on 1 August 2012.

4. FURTHER PROCEDURES FOR MELROSE SHARES WHETHER IN CERTIFICATED FORM OR IN CREST

4.1 What happens if the number of Melrose Shares I hold is not exactly divisible? Am I entitled to fractions of New Melrose Shares?

Your entitlement to New Melrose Shares will be calculated on the Record Date (other than in the case of those who bought Melrose Shares after the Record Date but before the ex-rights date who are eligible to participate in the Rights Issue). If the result is not a whole number, your entitlement will be rounded down to the nearest whole number of New Melrose Shares, meaning that you will not receive a New Melrose Share in respect of the fractional entitlement.

4.2 Will I be taxed if I take up or sell my rights or if my rights are sold on my behalf?

If you are resident in the United Kingdom for tax purposes, you should not have to pay UK tax when you take up your right to receive New Melrose Shares, although the Rights Issue will affect the amount of UK tax you may pay when you sell your Melrose Shares. However, you may be subject to capital gains tax on any proceeds you receive from the sale of your rights.

Further information for certain Qualifying Shareholders is contained in Part IX (*Taxation Considerations*) of the Prospectus. Qualifying Shareholders who are in any doubt as to their tax position should consult their professional advisers as soon as possible. Please note that the Shareholder Helpline is unable to advise on any taxation issues.

4.3 I understand that there is a period when there is trading in the Nil Paid Rights. What does this mean?

If you do not want to buy the New Melrose Shares being offered to you under the Rights Issue and you are a Melrose Shareholder, you can instead sell or transfer your Nil Paid Rights to those New Melrose Shares and receive the net proceeds of the sale or transfer in cash. This is referred to as dealing “nil paid”. During the nil paid trading period (between 8.00 a.m. on 17 July 2012 and 11.00 a.m. on 31 July 2012), subject to demand and market conditions, persons can buy and sell the Nil Paid Rights. Please note that your ability to sell your rights is dependent on demand for such rights and that the price of the Nil Paid Rights will fluctuate.

If you wish to sell or transfer all or some of your Nil Paid Rights and you hold your Melrose Shares in certificated form, you will need to complete Form X, the form of renunciation, on page 4 of the Provisional Allotment Letter and send it to the stockbroker, bank or other agent through or by whom the sale or transfer was effected, to be forwarded to the purchaser or transferee.

If you buy Nil Paid Rights, you are buying an entitlement to take up the New Melrose Shares, subject to your paying for them in accordance with the terms of the Rights Issue. Any seller of Nil Paid Rights who holds his Melrose Shares in certificated form will need to forward to you his Provisional Allotment Letter (with Form X completed) for you to complete and return, with your cheque, by 11.00 a.m. on 31 July 2012, in accordance with the instructions in the Provisional Allotment Letter.

If you are a CREST member or CREST sponsored member and have received a Provisional Allotment Letter and you wish to hold your Nil Paid Rights in uncertificated form in CREST, then you should send the Provisional Allotment Letter with Form X and the CREST Deposit Form on page 4 of the Provisional Allotment Letter completed (in the case of a CREST member) to the CREST courier and sorting service or (in the case of a CREST sponsored member) to your CREST sponsor by 3.00 p.m. on 26 July 2012 at the latest.

Qualifying CREST Shareholders and, subject to dematerialisation of their Nil Paid Rights as set out in the Provisional Allotment Letter, Qualifying non-CREST Shareholders who are CREST members or CREST sponsored members can transfer Nil Paid Rights, in whole or in part, by means of CREST in the same manner as any other security that is admitted to CREST. Please consult your CREST sponsor or stockbroker, bank or other appropriate financial adviser, or whoever arranged your share purchase, for details.

4.4 **What if I want to sell the New Melrose Shares for which I have paid?**

If you are a Qualifying non-CREST Shareholder, provided the New Melrose Shares have been paid for and you have requested the return of the receipted Provisional Allotment Letter, you can transfer the Fully Paid Rights by completing Form X, the form of renunciation, on page 4 of the receipted Provisional Allotment Letter in accordance with the instructions set out on page 3 of the Provisional Allotment Letter until 11.00 a.m. on 31 July 2012.

After that time, you will be able to sell your New Melrose Shares in the normal way. However, the share certificate relating to your New Melrose Shares is expected to be despatched to you only by 8 August 2012. Pending despatch of such share certificate, valid instruments of transfer will be certified by Equiniti against the register.

If you hold your New Melrose Shares and/or rights in CREST, you may transfer them in the same manner as any other security that is admitted to CREST. Please consult your stockbroker, bank or other appropriate financial adviser, or whoever arranged your share purchase, for details.

4.5 **What if I do nothing?**

If you do not want to take up any of your rights, you do not need to do anything. If you do not take up your rights, the number of Melrose Shares you hold in the Company will stay the same, but the proportion of the total number of Melrose Shares that you will hold will be lower than that held currently. If you do not return your Provisional Allotment Letter by 11.00 a.m. on 31 July 2012, the Company has made arrangements under which the Underwriters will use all reasonable endeavours to find investors to take up your rights by 2.00 p.m. on the second dealing day after the last date for acceptance of the Rights Issue. If the Underwriters find investors and are able to achieve a premium over the Rights Issue Price and the related expenses of procuring those investors (including any applicable brokerage and commissions and amounts in respect of VAT which are not recoverable), you will be sent a cheque for the amount of that aggregate premium above the Rights Issue Price less related expenses (including any applicable brokerage and commissions and amounts in respect of VAT which are not recoverable), so long as the amount in question is at least £5. Cheques are expected to be despatched by 8 August 2012 and will be sent to your address as it appears on Register (or to the first named holder if you hold Existing Melrose Shares jointly).

4.6 **Do I need to comply with the Money Laundering Regulations (as set out in paragraph 5.3 of Part XII (*Terms and Conditions of the Rights Issue*) of this document)?**

If you are a Qualifying non-CREST Shareholder, you do not need to follow these procedures if the value of the New Melrose Shares you are subscribing for is less than EUR 15,000 (approximately £12,500) or if you pay for them by a cheque drawn on an account in your own name and that account is one which is held with an EU or UK regulated bank or building society. If you are a Qualifying CREST Shareholder, you will not generally need to comply with the Money Laundering Regulations unless you apply to take up all or some of your entitlement to Nil Paid Rights as agent for one or more persons and you are not an EU or UK regulated financial institution.

Qualifying non-CREST Shareholders and Qualifying CREST Shareholders should refer to paragraphs 4.5 and 5.3 respectively of Part XII (*Terms and Conditions of the Rights Issue*) of this document for a fuller description of the requirements of the Money Laundering Regulations.

4.7 **What should I do if I live outside the United Kingdom?**

Your ability to take up rights to New Melrose Shares may be affected by the laws of the country in which you live or are located and you should take professional advice about any formalities you need to observe. Melrose Shareholders who have a registered address or are located outside the United Kingdom should refer to paragraph 7 of Part XII (*Terms and Conditions of the Rights Issue*) of this document.

4.8 Will the Rights Issue affect the dividends Melrose pays?

All issued New Melrose Shares will be eligible for the next dividend due. It is the intention of the Melrose Board to maintain a progressive dividend policy going forward which will take into account the bonus element of the Rights Issue.

4.9 What do I do if I have any further queries about the Rights Issue or the action I should take?

If you have any other questions, please telephone the Shareholder Helpline between 8.30 a.m. and 5.30 p.m. Monday to Friday (except UK public holidays) on 0871 384 2778 (from within the UK) and +44 121 415 0128 (from outside the UK). Calls to the Shareholder Helpline cost 8 pence per minute from a BT landline, excluding VAT. Other network providers' costs may vary. Calls to the Shareholder Helpline from outside the UK will be charged at the applicable international rates. Different charges may apply to calls from mobile telephones and calls may be recorded and randomly monitored for security and training purposes. For legal reasons, the Shareholder Helpline will be unable to give advice on the merits of the Rights Issue or to provide financial, tax or investment advice. However, the staff can explain the options available to you, which forms you need to fill in and how to fill them in correctly.

Your attention is drawn to the terms and conditions of the Rights Issue in Part XII (*Terms and Conditions of the Rights Issue*) of this document which are set out herein for information purposes only and (in the case of Qualifying non-CREST Shareholders) in the Provisional Allotment Letter.

PART XII

TERMS AND CONDITIONS OF THE RIGHTS ISSUE

1. Details of the Rights Issue

The Company proposes to raise approximately £1.2 billion (gross) by way of a fully underwritten Rights Issue.

The Rights Issue Price of 142 pence represents a 61.5 per cent. discount to the Closing Price of an Existing Melrose Share of 368.7 pence on 28 June 2012 (being the last trading day prior to the publication of this document) and a 34.7 per cent. discount to the theoretical ex-rights price of 217.6 pence per New Melrose Share calculated by reference to the Closing Price on the same day.

Assuming the Tender Offer becomes Effective, the net proceeds of the Rights Issue will be applied to partially satisfy the consideration to be paid to Elster ADS Holders and Elster Shareholders who have tendered their Elster ADSs and/or Elster Shares (as the case may be) made following the Effective Date in connection with the Acquisition.

While the Rights Issue is conditional on the Transaction Resolutions being passed it is not itself conditional upon the Tender Offer becoming Effective or on the New Facilities Agreement. In the event that the Rights Issue settles but the Tender Offer does not become Effective, the Melrose Directors' current intention is that the net proceeds of the Rights Issue will be invested on a short-term basis while the Melrose Directors evaluate other acquisition opportunities and, if no acquisitions can be found on acceptable terms, the Melrose Directors will consider how best to return surplus capital to Melrose Shareholders in a timely manner. Such a return could carry fiscal costs for certain Melrose Shareholders and will have costs for the Company.

The Underwriters' obligations under the Underwriting Agreement are conditional (although, with certain exceptions, these conditions can be waived) but are unconditional from Admission.

2. Terms and Conditions

Subject to the fulfilment of the conditions set out below, the New Melrose Shares are, pursuant to this document, offered for subscription by way of rights issue to Qualifying Shareholders on the following basis and otherwise on the terms and conditions set out in this document (and, in the case of Qualifying Non-CREST Shareholders, the Provisional Allotment Letter):

2 New Melrose Shares at 142 pence per New Melrose Share for every 1 Existing Melrose Share

held and registered in their name on the Record Date.

Holdings of Existing Melrose Shares in certificated and uncertificated form will be treated as separate holdings for the purpose of calculating entitlements under the Rights Issue. New Melrose Shares representing fractional entitlements will not be provisionally allotted to Qualifying Shareholders and, where necessary, entitlements to New Melrose Shares will be rounded down to the nearest whole number. Aggregated fractions will not be allotted to Qualifying Shareholders but will be sold in the market for the benefit of the Company pursuant to the authorities granted to the Melrose Directors at the annual general meeting of the Company held on 9 May 2012.

Qualifying Shareholders who do not take up their entitlements to New Melrose Shares will have their proportionate ordinary shareholdings in the Company diluted by approximately 66.7 per cent. Qualifying Shareholders who take up their rights in full will, as nearly as practicable, have the same proportionate voting and distribution rights as held by them on the Record Date.

The attention of Qualifying Shareholders and any person (including, without limitation, custodians, nominees, agents and trustees) who has a contractual or other legal obligation to forward this document and, in the case of Qualifying non-CREST Shareholders, the Provisional Allotment Letter, into a jurisdiction other than the United Kingdom is drawn to paragraphs 7 and 8 of this Part XII (*Terms and Conditions of the Rights Issue*). In particular, subject to the provisions of paragraph 7 of this Part XII (*Terms*

and Conditions of the Rights Issue), Qualifying Shareholders with addresses in the United States or any of the Excluded Territories will not be sent this document and Overseas Shareholders with an address in the United States or any of the Excluded Territories will not be sent any Provisional Allotment Letters and will not have their CREST stock accounts credited with Nil Paid Rights or Fully Paid Rights.

The New Melrose Shares will be issued pursuant to the authority to be granted under the Rights Issue Resolution being proposed at the Melrose General Meeting. When issued and fully paid, the New Melrose Shares will rank *pari passu* in all respects with the Existing Melrose Shares, including the right to all future dividends or other distributions made, paid or declared after the date of their issue.

Applications will be made to the UKLA for the New Melrose Shares to be admitted to listing on the premium segment of the Official List and to the London Stock Exchange for the New Melrose Shares to be admitted to trading (nil paid and fully paid) on its main market for listed securities. It is expected that Admission will become effective and that dealings (for normal settlement) in the New Melrose Shares will commence on the London Stock Exchange, nil paid, at 8.00 a.m. on 17 July 2012 (whereupon an announcement will be made by the Company to a Regulatory Information Service).

The Existing Melrose Shares are already admitted to CREST. The New Melrose Shares and the Existing Melrose Shares are in registered form and can be held in certificated or uncertificated form via CREST.

The Rights Issue has been fully underwritten by the Underwriters in accordance with the terms of the Underwriting Agreement and is conditional, *inter alia*, upon:

- (a) the passing without amendment (or with such amendments as the Sponsors and the Company may agree in writing) of the Transaction Resolutions at the Melrose General Meeting;
- (b) the Tender Offer not having been withdrawn or terminated prior to Admission; and
- (c) Admission having occurred by not later than 8.00 a.m. on 17 July 2012 (or such later time and/or date as may be agreed between the Sponsors and the Company in writing).

Subject, *inter alia*, to the passing (without material amendment) of the Transaction Resolutions, it is intended that Provisional Allotment Letters in respect of the New Melrose Shares will be despatched on 16 July 2012 to Qualifying non-CREST Shareholders (other than Qualifying Shareholders who have a registered address in the United States or any of the Excluded Territories) at their own risk. Provisional Allotment Letters constitute temporary documents of title.

Applications will be made for the Nil Paid Rights, the Fully Paid Rights and the New Melrose Shares to be admitted to CREST. Euroclear requires the Company to confirm to it that certain conditions (imposed by the CREST Manual) are satisfied before Euroclear will admit any security to CREST. It is expected that these conditions will be satisfied on Admission in respect of the Nil Paid Rights and Fully Paid Rights. As soon as practicable after Admission, the Company will confirm this to Euroclear.

Save as provided in this Part XII (*Terms and Conditions of the Rights Issue*) and subject to, *inter alia*, the conditions above being satisfied, it is expected that:

- (a) Provisional Allotment Letters in respect of Nil Paid Rights will be despatched to Qualifying non-CREST Shareholders (other than Qualifying non-CREST Shareholders who have a registered address in the United States or any of the Excluded Territories) on 16 July 2012;
- (b) the Registrar will instruct Euroclear to credit the appropriate stock accounts of Qualifying CREST Shareholders (other than Qualifying CREST Shareholders with registered addresses in the United States or any of the Excluded Territories) with such Qualifying CREST Shareholders' entitlements to Nil Paid Rights, as soon as practicable after 8.00 a.m. on 17 July 2012;
- (c) the Nil Paid Rights and the Fully Paid Rights will be enabled for settlement in CREST by Euroclear as soon as practicable after the Company has confirmed to Euroclear that all the conditions for admission of such rights to CREST have been satisfied which is expected to be by 8.00 a.m. on 17 July 2012;

- (d) New Melrose Shares will be credited to the appropriate stock accounts of relevant Qualifying CREST Shareholders (or their renounees) who validly take up their rights as soon as practicable after 8.00 a.m. on 1 August 2012; and
- (e) share certificates for the New Melrose Shares to be held in certificated form will be despatched by no later than 8 August 2012 to relevant Qualifying non-CREST Shareholders (or their renounees) who validly take up their rights, at their own risk.

This document constitutes the offer of New Melrose Shares to Qualifying CREST Shareholders (other than those with registered addresses in, or who are located in, the United States or any of the Excluded Territories), such offer being on the terms and conditions set out in this document (and, in the case of Qualifying non-CREST Shareholders, the Provisional Allotment Letter).

The offer of New Melrose Shares pursuant to the Rights Issue is not being made by means of this document into the United States or to the public in any of the Excluded Territories. Pursuant to the 2006 Act, the offer of New Melrose Shares to Qualifying Shareholders who: (i) have no registered address in and are not located in an EEA State; and (ii) who have not provided the Company with an address in an EEA State for the serving of notices will be made through a notice in the London Gazette, details of which are provided in paragraph 7.4 of this Part XII (*Terms and Conditions of the Rights Issue*) which notice will not constitute an offer to sell, or a solicitation of an offer to buy, in the United States or in any Excluded Territory.

Qualifying Shareholders taking up their rights by completing a Provisional Allotment Letter or by sending an MTM instruction to Euroclear will be deemed to have given the representations and warranties set out in paragraph 8 below of this Part XII (*Terms and Conditions of the Rights Issue*), unless such requirement is waived by the Company.

All documents and cheques posted to, by, from or on behalf of Qualifying Shareholders and/or their transferees or renounees (or their agents, as appropriate) will be posted at their own risk.

If the Rights Issue is delayed so that Provisional Allotment Letters cannot be despatched on 16 July 2012, the section of this document entitled “*Expected Timetable of Principal Events*” will be adjusted accordingly and the revised dates will be set out in the Provisional Allotment Letters and announced through a Regulatory Information Service. All references in this Part XII (*Terms and Conditions of the Rights Issue*) should be read as being subject to this adjustment.

The attention of Overseas Shareholders is drawn to paragraph 7 of this Part XII (*Terms and Conditions of the Rights Issue*).

3. Action to be Taken

The action to be taken in respect of New Melrose Shares depends on whether, at the relevant time, the Nil Paid Rights or Fully Paid Rights in respect of which action is to be taken are in certificated form (that is, are represented by Provisional Allotment Letters) or in uncertificated form (that is, are in CREST).

If you are a Qualifying non-CREST Shareholder and are not located in and do not have a registered address in the United States or any of the Excluded Territories, please refer to paragraphs 4, 6, 7.3 and 8 to 14 (inclusive) of this Part XII (*Terms and Conditions of the Rights Issue*).

If you hold your Existing Melrose Shares in CREST and are not located in and do not have a registered address in the United States or any of the Excluded Territories, please refer to paragraphs 5, 6, 7.3 and 8 to 14 (inclusive) of this Part XII (*Terms and Conditions of the Rights Issue*) and to the CREST Manual for further information on the CREST procedures referred to below.

If you are a a Qualifying non-CREST Shareholder or Qualifying CREST Shareholder located in or with a registered address in the United States or any of the Excluded Territories, please refer to paragraph 7 of this Part XII (*Terms and Conditions of the Rights Issue*).

CREST sponsored members should refer to their CREST sponsors, as only their CREST sponsors will be able to take the necessary actions specified below to take up the entitlements or otherwise to deal with the Nil Paid Rights or Fully Paid Rights of CREST sponsored members.

All enquiries in relation to the Provisional Allotment Letters should be addressed to the Shareholder Helpline on 0871 384 2778 (from inside the United Kingdom) or +44 121 415 0128 (from outside the United Kingdom) between 8.30 a.m. and 5.30 p.m. on any Business Day. Calls to the Shareholder Helpline cost 8 pence per minute from a BT landline, excluding VAT. Other network providers' costs may vary. Calls to the Shareholder Helpline from outside the UK will be charged at the applicable international rates. Different charges may apply to calls from mobile telephones and calls may be recorded and randomly monitored for security and training purposes. For legal reasons, the Shareholder Helpline will be unable to give advice on the merits of the Rights Issue or to provide financial, tax or investment advice.

4. Action to be taken by Qualifying non-CREST Shareholders in relation to Nil Paid Rights represented by Provisional Allotment Letters

4.1 General

Subject to the passing of the Transaction Resolutions at the Melrose General Meeting, it is the intention of the Company that the Provisional Allotment Letters will be despatched to Qualifying non-CREST Shareholders (other than Qualifying non-CREST Shareholders with addresses in the United States or any of the Excluded Territories) on 16 July 2012.

The Provisional Allotment Letter will set out:

- (a) the holding of Existing Melrose Shares on which a Qualifying non-CREST Shareholder's entitlement to New Melrose Shares has been based;
- (b) the aggregate number (and cost) of New Melrose Shares provisionally allotted to such Qualifying non-CREST Shareholder;
- (c) the procedures to be followed if a Qualifying non-CREST Shareholder wishes to dispose of all or part of his entitlement or to convert all or part of his entitlement into uncertificated form; and
- (d) instructions regarding acceptance and payment, consolidation, splitting and registration of renunciation.

On the basis that Provisional Allotment Letters are posted on 16 July 2012 and that dealings (for normal settlement) commence at 8.00 a.m. on 17 July 2012, the latest time and date for acceptance and payment in full will be 11.00 a.m. on 31 July 2012.

4.2 Procedure for acceptance and payment

- (a) Qualifying non-CREST Shareholders who wish to accept in full

Holders of Provisional Allotment Letters who wish to take up all of their Nil Paid Rights must return the Provisional Allotment Letter in accordance with the instructions thereon, together with a cheque or banker's draft, made payable to "Equiniti Limited re Melrose PLC Rights Issue", and crossed "A/C payee only" for the full amount payable on acceptance, in accordance with the instructions printed on the Provisional Allotment Letter, by post or by hand (during normal business hours) to the Receiving Agent at Equiniti, Aspect House, Spencer Road, Lancing, West Sussex BN99 6DA, so as to be received as soon as possible and, in any event, not later than 11.00 a.m. on 31 July 2012. A reply-paid envelope will be enclosed with the Provisional Allotment Letter for use within the United Kingdom only. If you post your Provisional Allotment Letter, it is recommended that you allow sufficient time for delivery. Please note that payments via CHAPS, BACS or electronic transfer will not be accepted.

- (b) Qualifying non-CREST Shareholders who do not wish to take up their Rights at all

Holders of Provisional Allotment Letters who do not wish to take up their Rights at all do not need to do anything. If Qualifying non-CREST Shareholders do not return the Provisional Allotment Letter by 11.00 a.m. on 31 July 2012, the Company has made arrangements under which the Underwriters will use all reasonable endeavours to find investors to take up such Rights. If they do find investors and are able to achieve a premium over the Rights Issue Price and the related

expenses of procuring those investors (including any applicable brokerage and commissions and amounts in respect of VAT which are not recoverable), Qualifying non-CREST Shareholders so entitled will be sent a cheque for the amount of that aggregate premium, so long as the amount in question is at least £5.

(c) Qualifying non-CREST Shareholders who wish to accept in part

Holders of Provisional Allotment Letters who wish to take up some but not all of their Rights should refer to paragraph 4.8 of this Part XII (*Terms and Conditions of the Rights Issue*).

4.3 *Discretion as to validity of acceptances*

If payment is not received in full by 11.00 a.m. on 31 July 2012, the provisional allotment will be deemed to have been declined and will lapse. However, the Company may, but shall not be obliged to, treat as valid: (a) Provisional Allotment Letters and accompanying remittances for the full amount due that are received through the post not later than 8.00 a.m. on 1 August 2012 (the cover bearing a legible postmark not later than 11.00 a.m. on 31 July 2012); and (b) acceptances in respect of which a remittance is received prior to 11.00 a.m. on 31 July 2012 from an authorised person (as defined in section 31(2) of FSMA) specifying the number of New Melrose Shares to be acquired and undertaking to lodge the relevant Provisional Allotment Letter, duly completed, in due course.

The Company may also (in its absolute discretion) treat a Provisional Allotment Letter as valid and binding on the person(s) by whom or on whose behalf it is lodged even if it is not completed in accordance with the relevant instructions or is not accompanied by a valid power of attorney (where required).

4.4 *Payments*

All payments must be made in pounds sterling by cheque or banker's draft made payable to "Equiniti Limited re Melrose PLC Rights Issue", and crossed "A/C payee only". Third-party cheques may not be accepted. Such payments will be held by the Receiving Agent to the order of the Company. Cheques or banker's drafts must be drawn on an account at a branch (which must be in the United Kingdom, the Channel Islands or the Isle of Man) of a bank or building society which is either a settlement member of the Cheque and Credit Clearing Company Limited or the CHAPS Clearing Company Limited or which has arranged for its cheques and banker's drafts to be cleared through facilities provided by either of these companies. Such cheques and banker's drafts must bear the appropriate sorting code in the top right-hand corner. Neither post-dated cheques nor payments via CHAPS, BACS or electronic transfer will be accepted.

If payment is made by a building society cheque (not being drawn on account of the applicant) or a bankers' draft, the building society or bank must endorse on the cheque or draft the applicant's name and the number of an account held in the applicant's name at the building society or bank, such endorsement being validated by a stamp and an authorised signature.

Cheques and banker's drafts will be presented for payment on receipt. No interest will be allowed on payments made before they are due and any interest on such payments ultimately will accrue for the benefit of the Company. It is a term of the Rights Issue that cheques shall be honoured on first presentation, and the Company may elect to treat as invalid any acceptances in respect of which cheques are not so honoured. If New Melrose Shares have already been issued to Qualifying non-CREST Shareholders prior to any payment not being so honoured or such Qualifying non-CREST Shareholders' acceptances being treated as invalid, the Company may (in its absolute discretion as to manner, timing and terms) make arrangements for the sale of such New Melrose Shares on behalf of those Qualifying non-CREST Shareholders and hold the proceeds of sale (net of the Company's reasonable estimate of any loss that they have suffered as a result of the acceptance being treated as invalid and of the expenses of sale including, without limitation, any SDRT payable on the transfer of such New Melrose Shares, and of all amounts payable by such Qualifying non-CREST Shareholders pursuant to the provisions of this Part XII (*Terms and Conditions of the Rights Issue*) in respect of the acquisition of such New Melrose Shares) on behalf of such Qualifying

Shareholders. None of the Company, the Underwriters or any other person shall be responsible for, or have any liability for, any loss, expenses or damage suffered by such Qualifying non-CREST Shareholders as a result.

4.5 *Money Laundering Regulations*

It is a term of the Rights Issue that, to ensure compliance with the Money Laundering Regulations, the Receiving Agent may require, at its absolute discretion, verification of the identity of the beneficial owner by whom or on whose behalf the Provisional Allotment Letter is lodged with payment (which requirements are referred to in this paragraph 4.5 as “**verification of identity requirements**”). If an application is made by a UK regulated broker or intermediary acting as agent and which is itself subject to the Money Laundering Regulations, any verification of identity requirements are the responsibility of such broker or intermediary and not of the Receiving Agent. In such case, the lodging agent’s stamp should be inserted on the Provisional Allotment Letter.

The person lodging the Provisional Allotment Letter with payment (the “**applicant**”), including any person who appears to the Receiving Agent to be acting on behalf of some other person, shall thereby be deemed to agree to provide the Receiving Agent with such information and other evidence as the Receiving Agent may require to satisfy the verification of identity requirements. The Receiving Agent may make a search using a credit reference agency for the purpose of confirming such identity where deemed necessary. A record of such search will be retained.

If the Receiving Agent determines that the verification of identity requirements apply to any applicant or application, the relevant New Melrose Shares (notwithstanding any other term of the Rights Issue) will not be issued to the relevant applicant unless and until the verification of identity requirements have been satisfied in respect of that applicant or application. The Receiving Agent is entitled, in its absolute discretion, to determine whether the verification of identity requirements apply to any applicant or application and whether such requirements have been satisfied, and none of the Receiving Agent, the Company or the Underwriters will be liable to any person for any loss or damage suffered or incurred (or alleged), directly or indirectly, as a result of the exercise of such discretion.

If the verification of identity requirements apply, failure to provide the necessary evidence of identity within a reasonable time may result in delays and potential rejection of an application. If, within a reasonable period of time following a request for verification of identity, the Receiving Agent has not received evidence satisfactory to it as aforesaid, the Company may, in its absolute discretion, treat the relevant application as invalid, in which event, the application moneys will be returned (at the applicant’s risk) without interest to the account of the bank or building society on which the relevant cheque or banker’s draft was drawn.

The verification of identity requirements will not usually apply for UK purposes if:

- (a) the applicant is a regulated UK broker or intermediary acting as agent and is itself subject to the Money Laundering Regulations; or
- (b) the applicant is an organization required to comply with the EU Money Laundering Directive (No. 91/308/EEC) as amended by Directive 2001/97/EC and 2005/60/EC; or
- (c) the applicant is a company whose securities are listed on a regulated market subject to specified disclosure obligations; or
- (d) the applicant (not being an applicant who delivers his/her application in person) makes payment through an account in the name of such applicant with a credit institution which is subject to the Money Laundering Regulations or with a credit institution situated in a non-EEA State which imposes requirements equivalent to those laid down in that directive; or
- (e) the aggregate subscription price for the relevant New Melrose Shares is less than EUR 15,000 (approximately £12,500).

Where the verification of identity requirements apply, please note the following as this will assist in satisfying the requirements. Satisfaction of these requirements may be facilitated in the following ways:

- (i) payments must be made by cheque or banker's draft in pounds sterling drawn on a branch in the UK of a bank or building society and bear a UK bank sort code number in the top right hand corner. Cheques, which must be drawn on the personal account of the individual investor where they have sole or joint title to the funds, should be made payable to "Equiniti Limited re Melrose PLC Rights Issue". Third-party cheques may not be accepted except for building society cheques or banker's drafts where the building society or bank has confirmed the name of the account holder by stamping or endorsing the building society cheque/banker's draft to such effect. The account name should be the same as that shown on the Provisional Allotment Letter; or
- (ii) if the Provisional Allotment Letter is lodged with payment by an agent which is an organization of the kind referred to in paragraph (i) above or which is subject to anti-money laundering regulations in a country which is a member of the Financial Action Task Force (the non-EU members of which are Argentina, Australia, Brazil, Canada, members of the Gulf Co-operation Council (being Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and the United Arab Emirates), Hong Kong, Iceland, Japan, Mexico, New Zealand, Norway, the Russian Federation, Singapore, South Africa, Switzerland, Turkey and the United States), the agent should provide written confirmation that it has that status with the Provisional Allotment Letter(s) and written assurances that it has obtained and recorded evidence of the identity of the person for whom it acts and that it will on demand make such evidence available to the Receiving Agent and/or any relevant regulatory or investigatory authority; or
- (iii) if a Provisional Allotment Letter is lodged by hand by the applicant in person, he should ensure that he has with him evidence of identity bearing his photograph (for example, his passport) and evidence of his address.

To confirm the acceptability of any written assurance referred to in paragraph (ii) above, or in any other case, the applicant should contact the Receiving Agent between 8.30 a.m. and 5.30 p.m. Monday to Friday (except UK public holidays). The telephone number of the Receiving Agent is 0871 384 2778 (or +44 121 415 0128 from outside of the United Kingdom). Calls to this number cost 8 pence per minute from a BT landline, excluding VAT. Other network providers' costs may vary.

4.6 *Dealings in Nil Paid Rights*

Subject to the fulfilment of the conditions set out in paragraph 2 of this Part XII (*Terms and Conditions of the Rights Issue*), dealings (for normal settlement) on the London Stock Exchange in the Nil Paid Rights are expected to commence at 8.00 a.m. on 17 July 2012. A transfer of Nil Paid Rights can be made by renunciation of the Provisional Allotment Letter in accordance with the instructions printed on it and delivery of the Provisional Allotment Letter to the transferee, up to the latest time for acceptance and payment in full stated in the Provisional Allotment Letter, which is 11.00 a.m. on 31 July 2012.

4.7 *Dealings in Fully Paid Rights*

After acceptance of the provisional allotment and payment in full in accordance with the provisions set out in this document and (in the case of Qualifying non-CREST Shareholders) in the Provisional Allotment Letter, the Fully Paid Rights may be transferred by renunciation of the relevant Provisional Allotment Letter and lodging of the same, by post or by hand (during normal business hours only) to the Receiving Agent at Aspect House, Spencer Road, Lancing, West Sussex BN99 6DA, so as to be received not later than 11.00 a.m. on 31 July 2012. Thereafter, the New Melrose Shares will be registered and transferable in the usual way or, if they have been issued in or converted into uncertificated form, in electronic form under the CREST system.

4.8 *Renunciation and splitting of Provisional Allotment Letters*

The Provisional Allotment Letters are fully renounceable (save as required by the laws of certain overseas jurisdictions) and may be split by no later than 3.00 p.m. on 27 July 2012 nil paid and fully paid.

Qualifying non-CREST Shareholders who wish to transfer all of their Nil Paid Rights or, after acceptance of the provisional allotment and payment in full, Fully Paid Rights comprised in a Provisional Allotment Letter may (save as required by the laws of certain overseas jurisdictions) renounce such allotment by completing and signing Form X on page 4 of the Provisional Allotment Letter (if it is not already marked “Original Duly Renounced”) and passing the entire Provisional Allotment Letter to their stockbroker or bank or other appropriate financial adviser or to the transferee. Once a Provisional Allotment Letter has been so renounced, it will become a negotiable instrument in bearer form and the Nil Paid Rights or Fully Paid Rights (as appropriate) comprised in such letter may be transferred by delivery of such letter to the transferee. The latest time and date for registration of renunciation of Provisional Allotment Letters is 11.00 a.m. on 31 July 2012 and after such date the New Melrose Shares will be in registered form, transferable by written instrument of transfer in the usual common form or, if they have been issued in or converted into uncertificated form, in electronic form under the CREST system. Qualifying non-CREST Shareholders should note that fully paid Provisional Allotment Letters will not be returned to Qualifying non-CREST Shareholders unless their return is requested, by completing the appropriate box on the Provisional Allotment Letter.

If a holder of a Provisional Allotment Letter wishes to have only some of the New Melrose Shares registered in his name and to transfer the remainder, or wishes to transfer all the Nil Paid Rights, or (if appropriate) Fully Paid Rights but to different persons, he may have the Provisional Allotment Letter split, for which purpose he must sign and date Form X on page 4 of the Provisional Allotment Letter. The Provisional Allotment Letter must then be delivered by post or by hand (during normal business hours only) to the appropriate address as set out in paragraph 4.7 of this Part XII (*Terms and Conditions of the Rights Issue*) by no later than 3.00 p.m. on 27 July 2012, to be cancelled and exchanged for the split Provisional Allotment Letters required. The number of split Provisional Allotment Letters required and the number of Nil Paid Rights or (as appropriate) Fully Paid Rights to be comprised in each split Provisional Allotment Letter should be stated in an accompanying letter. Form X on page 4 of split Provisional Allotment Letters will be marked “Original Duly Renounced” before issue. The holder of the split Provisional Allotment Letters should then follow the instructions in the preceding paragraphs in relation to transferring the Nil Paid Rights or (if appropriate) Fully Paid Rights represented by each of the Provisional Allotment Letters. The Company reserves the right to refuse to register any renunciation in favour of any person in respect of which the Company believes such renunciation may violate applicable legal or regulatory requirements including (without limitation) any renunciation in the name of any person with an address outside the United Kingdom.

4.9 *Registration in the names of Qualifying Shareholders*

A Qualifying non-CREST Shareholder who wishes to have all his entitlement to New Melrose Shares registered in his name must accept and make payment for such allotment prior to the latest time for acceptance and payment in full, which is 11.00 a.m. on 31 July 2012, in accordance with the provisions set out in the Provisional Allotment Letter and this document, but need take no further action. A share certificate shall be sent to such Melrose Shareholder by post not later than 8 August 2012.

4.10 *Registration in the names of persons other than Qualifying Shareholders originally entitled*

A renounee who wishes to have the New Melrose Shares comprised in a Provisional Allotment Letter registered in his name, or his agent’s name, must complete Form Y on page 4 (unless the renounee is a CREST member who wishes to hold such shares in uncertificated form, in which case the CREST Deposit Form must be completed—as set out in paragraph 4.11 of this Part XII (*Terms and Conditions of the Rights Issue*)) of the Provisional Allotment Letter and lodge the entire letter

when fully paid by post or by hand (during normal business hours only) with the Receiving Agent at the appropriate address as set out in paragraph 4.7 of this Part XII (*Terms and Conditions of the Rights Issue*) not later than the latest time for registration of renunciation which is 11.00 a.m. on 31 July 2012. Registration cannot be effected unless and until the New Melrose Shares comprised in a Provisional Allotment Letter are fully paid.

4.11 *Deposit of Nil Paid Rights or Fully Paid Rights into CREST*

The Nil Paid Rights or Fully Paid Rights represented by a Provisional Allotment Letter may be converted into uncertificated form, that is deposited into CREST (whether such conversion arises as a result of a renunciation of those rights or otherwise). Similarly, Nil Paid Rights or Fully Paid Rights held in CREST may be converted into certificated form, that is withdrawn from CREST. Subject as provided in the next paragraph or in the Provisional Allotment Letter, normal CREST procedures and timings apply in relation to any such conversion. You are recommended to refer to the CREST Manual for details of such procedures.

The procedure for depositing the Nil Paid Rights or Fully Paid Rights represented by a Provisional Allotment Letter into CREST, whether such rights are to be converted into uncertificated form in the name(s) of the person(s) whose name(s) and address(es) appear on page 1 of the Provisional Allotment Letter or in the name of a person or persons to whom the Provisional Allotment Letter has been renounced, is as follows: Form X and the CREST Deposit Form (both set out on page 4 of the Provisional Allotment Letter) will need to be completed and the Provisional Allotment Letter deposited with the CREST Courier and Sorting Service (the "CCSS"); in addition, the normal CREST Stock Deposit procedures will need to be carried out, except that: (a) it will not be necessary to complete and lodge a separate CREST Transfer Form (prescribed under the Stock Transfer Act 1963) with the CCSS; and (b) only the whole of the Nil Paid Rights or Fully Paid Rights represented by the Provisional Allotment Letter may be deposited into CREST. If you wish to deposit only some of the Nil Paid Rights or Fully Paid Rights represented by the Provisional Allotment Letter into CREST, you must first apply for split Provisional Allotment Letters. If the rights represented by more than one Provisional Allotment Letter are to be deposited, the CREST Deposit Form on each Provisional Allotment Letter must be completed and deposited. A Consolidation Listing Form (as defined in the CREST Regulations) must not be used.

A holder of the Nil Paid Rights (or, if appropriate Fully Paid Rights) represented by a Provisional Allotment Letter who is proposing to convert those rights into uncertificated form (whether following a renunciation of such rights or otherwise) is recommended to ensure that the conversion procedures are implemented in sufficient time to enable the person holding or acquiring the Nil Paid Rights or Fully Paid Rights in CREST following the conversion to take all necessary steps in connection with taking up the entitlement prior to 11.00 a.m. on 31 July 2012. In particular, having regard to processing times in CREST and on the part of the Receiving Agent, the latest recommended time for depositing a renounced Provisional Allotment Letter (with Form X and the CREST Deposit Form on page 4 of the Provisional Allotment Letter duly completed) with the CCSS (to enable the person acquiring the Nil Paid Rights or Fully Paid Rights in CREST as a result of the conversion to take all necessary steps in connection with taking up the entitlement prior to 11.00 a.m. on 31 July 2012) is 3.00 p.m. on 26 July 2012.

CREST sponsored members should contact their CREST sponsor as only their CREST sponsor will be able to take the necessary action to take up their entitlement or otherwise to deal with the Nil Paid Rights or Fully Paid Rights of the CREST sponsored member.

4.12 *Issue of share certificates in respect of New Melrose Shares*

Definitive share certificates in respect of the New Melrose Shares to be held in certificated form are expected to be despatched by post by no later than 8 August 2012 at the risk of the person(s) entitled to them, to accepting Qualifying non-CREST Shareholders and renounees or their agents or, in the case of joint holdings, to the first-named Melrose Shareholder at their registered address (unless lodging agent details have been completed on page 4 of the Provisional Allotment Letter). After despatch of definitive share certificates, Provisional Allotment Letters will cease to be valid for any

purpose whatsoever. Pending despatch of definitive share certificates and the inscription of the member in the Company's register of members, instruments of transfer of the New Melrose Shares will be certified by the Registrar against the lodgement of fully paid Provisional Allotment Letters and/or, in the case of renunciations, against the Provisional Allotment Letters held by the Registrar.

5. Action to be taken by Qualifying CREST Shareholders in relation to Nil Paid Rights in CREST

5.1 General

Subject as provided in paragraph 7 of this Part XII (*Terms and Conditions of the Rights Issue*) in relation to certain Overseas Shareholders, each Qualifying CREST Shareholder is expected to receive a credit to his CREST stock account of his entitlement to Nil Paid Rights as soon as practicable after 8.00 a.m. on 17 July 2012. The CREST stock account to be credited will be an account under the participant ID and member account ID that apply to the Existing Melrose Shares held at the close of business on the Record Date by the Qualifying CREST Shareholder in respect of which the Nil Paid Rights are provisionally allotted.

The Nil Paid Rights will constitute a separate security and can accordingly be transferred, in whole or in part, by means of CREST in the same manner as any other security that is admitted to CREST.

If for any reason it is impracticable to credit the stock accounts of Qualifying CREST Shareholders or to enable the Nil Paid Rights by 8.00 a.m. on 17 July 2012, Provisional Allotment Letters shall, unless the Company decides otherwise, be sent out in substitution for the Nil Paid Rights which have not been so credited or enabled and the expected timetable as set out in this document may be adjusted as appropriate. References to dates and times in this document should be read as subject to any such adjustment. The Company will make an appropriate announcement to a Regulatory Information Service giving details of the revised dates but Qualifying CREST Shareholders may not receive any further written communication.

CREST members who wish to take up all or part of, or otherwise to transfer all or part of, their Rights held by them in CREST, should refer to the CREST Manual for further information on the CREST procedures referred to below. If you are a CREST sponsored member, you should consult your CREST sponsor if you wish to take up your entitlement as only your CREST sponsor will be able to take the necessary action to take up your entitlements or otherwise deal with your Nil Paid Rights or Fully Paid Rights.

5.2 Procedure for acceptance and payment

(a) MTM instructions

CREST members who wish to take up all or part of their entitlement in respect of Nil Paid Rights in CREST must send (or, if they are CREST sponsored members, procure that their CREST sponsor sends) an MTM instruction to Euroclear which, on its settlement, will have the following effect:

- (i) the crediting of a stock account of the Receiving Agent under the participant ID and member account ID specified below, with the number of Nil Paid Rights to be taken up;
- (ii) the creation of a settlement bank payment obligation (as this term is defined in the CREST Manual), in accordance with the RTGS payment mechanism (as this term is defined in the CREST Manual), in favour of the RTGS settlement bank (as this term is defined in the CREST Manual) of the Receiving Agent in pounds sterling, in respect of the full amount payable on acceptance in respect of the Nil Paid Rights referred to in sub-paragraph (i) above; and
- (iii) the crediting of a stock account of the accepting CREST member (being an account under the same participant ID and member account ID as the account from which the Nil Paid Rights are to be debited on settlement of the MTM instruction) of the corresponding number of Fully Paid Rights to which the CREST member is entitled on taking up his Nil Paid Rights referred to in sub-paragraph (i) above.

(b) Contents of MTM instructions

The MTM instruction must be properly authenticated in accordance with Euroclear's specifications and must contain, in addition to the other information that is required for settlement in CREST, the following details:

- (i) the number of Nil Paid Rights to which the acceptance relates;
- (ii) the participant ID of the accepting CREST member;
- (iii) the member account ID of the accepting CREST member from which the Nil Paid Rights are to be debited;
- (iv) the participant ID of the Receiving Agent, in its capacity as a CREST receiving agent. This is 2RA22;
- (v) the member account ID of the Receiving Agent, in its capacity as a CREST receiving agent. This is RA103601;
- (vi) the number of Fully Paid Rights that the CREST member is expecting to receive on settlement of the MTM instruction. This must be the same as the number of Nil Paid Rights to which the acceptance relates;
- (vii) the amount payable by means of the CREST assured payment arrangements on settlement of the MTM instruction. This must be the full amount payable on acceptance in respect of the number of Nil Paid Rights to which the acceptance relates;
- (viii) the intended settlement date (which must be on or before 11.00 a.m. on 31 July 2012);
- (ix) the Nil Paid Rights ISIN. This is GB00B8GRB070;
- (x) the Fully Paid Rights ISIN. This is GB00B8GLZ411;
- (xi) the Corporate Action Number (as this term is defined in the CREST Manual) to the Rights Issue. This will be available by viewing the relevant corporate action details in CREST;
- (xii) contact name and telephone numbers in the shared notes field; and
- (xiii) a priority of at least 80.

(c) Valid acceptance

An MTM instruction complying with each of the requirements as to authentication and contents set out in sub-paragraph (c) of this paragraph 5.2 will constitute a valid acceptance where either:

- (i) the MTM instruction settles by not later than 11.00 a.m. on 31 July 2012; or
- (ii) at the discretion of the Company: (A) the MTM instruction is received by Euroclear by not later than 11.00 a.m. on 31 July 2012; and (B) the number of Nil Paid Rights inserted in the MTM instruction is credited to the CREST stock member account of the accepting CREST member specified in the MTM instruction at 11.00 a.m. on 31 July 2012; and (C) the relevant MTM instruction settles by 2.00 p.m. on 31 July 2012 (or such later date as the Company has determined).

An MTM instruction will be treated as having been received by Euroclear for these purposes at the time at which the instruction is processed by the Network Provider's Communications Host (as this term is defined in the CREST Manual) at Euroclear of the network provider used by the CREST member (or by the CREST sponsored member's CREST sponsor). This will be conclusively determined by the input time stamp applied to the MTM instruction by the Network Provider's Communications Host.

(d) Representations, warranties and undertakings of CREST members

A CREST member, or CREST sponsored member who makes a valid acceptance in accordance with this paragraph 5.2, represents, warrants and undertakes to the Company and

the Underwriters that he/she has taken (or procured to be taken), and will take (or will procure to be taken), whatever action is required to be taken by him/her or by his/her CREST sponsor (as appropriate) to ensure that the MTM instruction concerned is capable of settlement at 11.00 a.m. on 31 July 2012 and remains capable of settlement at all times after that until 2.00 p.m. on 31 July 2012 (or until such later time and date as the Company may determine). In particular, the CREST member or CREST sponsored member represents, warrants and undertakes that at 11.00 a.m. on 31 July 2012 and at all times thereafter until 2.00 p.m. on 31 July 2012 (or until such later time and date as the Company may determine) there will be sufficient Headroom within the Cap (as those terms are defined in the CREST Manual) in respect of the cash memorandum account to be debited with the amount payable on acceptance to permit the MTM instruction to settle. CREST sponsored members should contact their CREST sponsor if they are in any doubt.

If there is insufficient Headroom within the Cap in respect of the cash memorandum account of a CREST member or CREST sponsored member for such amount to be debited or the CREST member's or CREST sponsored member's acceptance is otherwise treated as invalid and New Melrose Shares have already been allotted to such CREST member or CREST sponsored member, the Company may (in its absolute discretion as to manner, timing and terms) make arrangements for the sale of such shares on behalf of that CREST member or CREST sponsored member and hold the proceeds of sale (net of the Company's reasonable estimate of any loss that it has suffered as a result of the acceptance being treated as invalid and of the expenses of sale, and of all amounts payable by the CREST member or CREST sponsored member pursuant to the provisions of this Part XII (*Terms and Conditions of the Rights Issue*) in respect of the acquisition of such shares) on behalf of such CREST member or CREST sponsored member. None of the Company or the Underwriters or any other person shall be responsible for, or have any liability for, any loss, expenses or damage suffered by such CREST member or CREST sponsored member as a result.

(e) CREST procedures and timings

CREST members and CREST sponsors (on behalf of CREST sponsored members) should note that Euroclear does not make available special procedures in CREST for any particular corporate action. Normal system timings and limitations will therefore apply in relation to the input of an MTM instruction and its settlement in connection with the Rights Issue. It is the responsibility of the CREST member concerned to take (or, if a CREST sponsored member, to procure that his CREST sponsor takes) the action necessary to ensure that a valid acceptance is received as stated above by 11.00 a.m. on 31 July 2012. In this connection, CREST members and (where applicable) CREST sponsors are referred in particular to those sections of the CREST Manual concerning the practical limitations of the CREST system and timings.

(f) CREST member's undertaking to pay

A CREST member or CREST sponsored member who makes a valid acceptance in accordance with the procedures set out in this paragraph 5.2: (a) undertakes to pay to the Company, or to procure the payment to the Company of, the amount payable in pounds sterling on acceptance in accordance with the above procedures or in such other manner as the Company may require (it being acknowledged that, where payment is made by means of the RTGS payment mechanism (as defined in the CREST Manual), the creation of a RTGS settlement bank (as this term is defined in the CREST Manual) payment obligation in pounds sterling in favour of the Receiving Agent's RTGS settlement bank, in accordance with the RTGS payment mechanism, shall, to the extent of the obligation so created, discharge in full the obligation of the CREST member (or CREST sponsored member) to pay the amount payable on acceptance); and (b) requests that the Fully Paid Rights and/or New Melrose Shares to which they will become entitled be issued to them on the terms set out in this document and subject to the Articles. If the payment obligations of the relevant CREST

member in relation to such New Melrose Shares are not discharged in full and such New Melrose Shares have already been issued to the CREST member or CREST sponsored member, the Company may (in its absolute discretion as to the manner, timing and terms) make arrangements for the sale of such shares on behalf of that CREST member or CREST sponsored member and hold the proceeds of sale (net of expenses, and all amounts payable by the CREST member or CREST sponsored member pursuant to the provisions of this Part XII (*Terms and Conditions of the Rights Issue*) in respect of the acquisition of such shares) or an amount equal to the original payment of the CREST member or CREST sponsored member (whichever is lower) on trust for such CREST member or CREST sponsored member. In these circumstances, none of the Underwriters or the Company shall be responsible for, or have any liability for, any losses, expenses or damages arising as a result.

- (g) Discretion as to rejection and validity of acceptances

The Company may following consultation with the Underwriter:

- (i) reject any acceptance constituted by an MTM instruction, which is otherwise valid, in the event of breach of any of the representations, warranties and undertakings set out or referred to in this paragraph 5.2. Where an acceptance is made as described in this paragraph 5.2 which is otherwise valid, and the MTM instruction concerned fails to settle by 2.00 p.m. on 31 July 2012 (or by such later time and date as the Company may determine), the Company shall be entitled to assume, for the purposes of its right to reject an acceptance as described in this paragraph 5.2, that there has been a breach of the representations, warranties and undertakings set out or referred to in this paragraph 5.2 unless the Company is aware of any reason outside the control of the CREST member or CREST sponsor (as appropriate) concerned for the MTM instruction to settle;
- (ii) treat as valid (and binding on the CREST member or CREST sponsored member concerned) an acceptance which does not comply in all respects with the requirements as to validity set out or referred to in this paragraph 5.2;
- (iii) accept an alternative properly authenticated dematerialised instruction from a CREST member or (where applicable) a CREST sponsor as constituting a valid acceptance in substitution for, or in addition to, an MTM instruction and subject to such further terms and conditions as the Company may determine;
- (iv) treat a properly authenticated dematerialised instruction (the “first instruction”) as not constituting a valid acceptance if, at the time at which the Receiving Agent receives a properly authenticated dematerialised instruction giving details of the first instruction, either the Company or the Receiving Agent has received actual notice from Euroclear of any of the matters specified in CREST Regulation 35(5)(a) in relation to the first instruction. These matters include notice that any information contained in the first instruction was incorrect or notice of lack of authority to send the first instruction; and
- (v) accept an alternative instruction or notification from a CREST member or (where applicable) a CREST sponsor, or extend the time for acceptance and/or settlement of an MTM instruction or any alternative instruction or notification, if, for reasons or due to circumstances outside the control of any CREST member or CREST sponsored member or (where applicable) CREST sponsor, the CREST member or CREST sponsored member is unable validly to take up all or part of his/her Nil Paid Rights by means of the above procedures. In normal circumstances, this discretion is only likely to be exercised in the event of any interruption, failure or breakdown of CREST (or of any part of CREST) or on the part of facilities and/or systems operated by the Receiving Agent in connection with CREST.

5.3 *Money Laundering Regulations*

If you hold your Nil Paid Rights in CREST and apply to take up all or part of your entitlement as agent for one or more persons and you are not a UK or EU regulated person or institution (for example, a bank, a broker or another UK financial institution), then, irrespective of the value of the

application, the Receiving Agent is required to take reasonable measures to establish the identity of the person or persons on whose behalf you are making the application. You must therefore contact the Receiving Agent before sending any MTM instruction or other instruction so that appropriate measures may be taken.

Submission of an MTM instruction which constitutes, or which may on its settlement constitute, a valid acceptance as described above constitutes a warranty and undertaking by the applicant to provide promptly to the Receiving Agent any information the Receiving Agent may specify as being required for the purposes of the Money Laundering Regulations or FSMA. Pending the provision of evidence satisfactory to the Receiving Agent as to identity, the Receiving Agent, having consulted with the Company, may take, or omit to take, such action as it may determine to prevent or delay settlement of the MTM instruction. If satisfactory evidence of identity has not been provided within a reasonable time, the Receiving Agent will not permit the MTM instruction concerned to proceed to settlement; but without prejudice to the right of the Company and/or to take proceedings to recover any loss suffered by it/them as a result of failure by the applicant to provide satisfactory evidence.

5.4 *Dealings in Nil Paid Rights*

Subject to the passing of the Transaction Resolutions at the Melrose General Meeting and the Rights Issue otherwise becoming unconditional, dealings (for normal settlement) in the Nil Paid Rights on the London Stock Exchange are expected to commence at 8.00 a.m. on 17 July 2012. Dealings in Nil Paid Rights can be made by means of CREST in the same manner as any other security that is admitted to CREST. The Nil Paid Rights are expected to be disabled in CREST after the close of CREST business on 31 July 2012.

5.5 *Dealings in Fully Paid Rights*

After acceptance and payment in full in accordance with the provisions set out in this document and (where appropriate) the Provisional Allotment Letter, the Fully Paid Rights may be transferred (in whole or in part) by means of CREST in the same manner as any other security that is admitted to CREST. The last time for settlement of any transfer of Fully Paid Rights in CREST is expected to be 11.00 a.m. on 31 July 2012.

The Fully Paid Rights are expected to be disabled in CREST after the close of CREST business on 31 July 2012. After 31 July 2012, the New Melrose Shares will be registered in the name(s) of the person(s) entitled to them in the Company's register of members and will be transferable in the usual way.

5.6 *Withdrawal of Nil Paid Rights or Fully Paid Rights from CREST*

Nil Paid Rights or Fully Paid Rights held in CREST may be converted into certificated form, that is withdrawn from CREST. Normal CREST procedures (including timings) apply in relation to any such conversion.

The recommended latest time for receipt by Euroclear of a properly authenticated dematerialised instruction requesting withdrawal of Nil Paid Rights or, if appropriate, Fully Paid Rights from CREST is 4.30 p.m. on 25 July 2012, so as to enable the person acquiring or (as appropriate) holding the Nil Paid Rights or, if appropriate, Fully Paid Rights, following the conversion to take all necessary steps in connection with taking up the entitlement prior to 11.00 a.m. on 31 July 2012. You are recommended to refer to the CREST Manual for details of such procedures.

5.7 *Issue of New Melrose Shares in CREST*

New Melrose Shares will be issued in uncertificated form to those persons registered as holding Fully Paid Rights in CREST at the close of business on the date on which the Fully Paid Rights are disabled. The Receiving Agent will instruct Euroclear to credit the appropriate stock accounts of those persons (under the same participant ID and member account ID that applied to the Fully Paid

Rights held by those persons) with their entitlements to New Melrose Shares with effect from the next Business Day (expected to be 1 August 2012).

5.8 *Right to allot/issue in certificated form*

Despite any other provision of this document, the Company reserves the right to allot and to issue any Nil Paid Rights, Fully Paid Rights or New Melrose Shares in certificated form. In normal circumstances, this right is only likely to be exercised in the event of an interruption, failure or breakdown of CREST (or of any part of CREST) or of a part of the facilities and/or systems operated by the Receiving Agent in connection with CREST.

6. **Procedure in respect of Rights not taken up**

If an entitlement to New Melrose Shares is not validly taken up in accordance with the procedure laid down for acceptance and payment, then that provisional allotment will be deemed to have been declined and will lapse. The Underwriters will use all reasonable endeavours to procure, by not later than 2.00 p.m. on the second Business Day after the last date for acceptance of the Rights Issue, subscribers for as many as possible of those New Melrose Shares not taken up if a price not less than the Rights Issue Price plus the expenses of procuring such subscribers (including any applicable brokerage and commissions and amounts in respect of VAT which are not recoverable) can be obtained.

Notwithstanding the above, the Underwriters may cease to endeavour to procure any such subscribers if, in their reasonable opinion, it is unlikely that any such subscribers can be so procured at such a price by such time. If and to the extent that subscribers cannot be procured on the basis outlined above, the relevant New Melrose Shares will be subscribed for by the Underwriters as principal pursuant to the Underwriting Agreement or by the sub-underwriters (if any) procured by the Underwriters, in each case, at the Rights Issue Price on the terms and subject to the conditions of the Underwriting Agreement.

Any premium over the aggregate of the Rights Issue Price and the expenses of procuring subscribers (including any applicable brokerage and commissions and amounts in respect of VAT which are not recoverable) shall be paid (subject as provided in this paragraph 6):

- (i) where the provisional allotment was, at the time of its lapsing, represented by a Provisional Allotment Letter, to the person whose name and address appeared on page 1 of the Provisional Allotment Letter;
- (ii) where the Nil Paid Rights were, at the time they lapsed, in uncertificated form, to the person registered as the holder of those Nil Paid Rights at the time of their disablement in CREST; and
- (iii) to the extent not provided above, where an entitlement to New Melrose Shares was not taken up by an Overseas Shareholder, to that Overseas Shareholder.

New Melrose Shares for which subscribers are procured on this basis will be re-allotted to such subscribers and the aggregate of any premiums (being the amount paid by such subscribers after deducting the price at which the New Melrose Shares are offered pursuant to the Rights Issue and the expenses of procuring such subscribers including any applicable brokerage and commissions and amounts in respect of VAT which are not recoverable tax), if any, will be paid (without interest) to those persons entitled (as referred to above) *pro rata* to the entitlements not taken up, save that no payment will be made of amounts of less than £5, which amounts will be aggregated and ultimately paid to the Company. Cheques for the amounts due will be sent in pounds sterling, by first class post, at the risk of the person(s) entitled, to their registered addresses (the registered address of the first named in the case of joint holders), provided that where any entitlement concerned was held in CREST, the amount due will, unless the Company (in its absolute discretion) otherwise determines, be satisfied by the Company procuring the creation of an assured payment obligation in favour of the relevant CREST member's (or CREST sponsored member's) RTGS settlement bank in respect of the cash amount concerned in accordance with the RTGS payment mechanism.

Any transactions undertaken pursuant to this paragraph 6 shall be deemed to have been undertaken at the request of the persons who did not take up their entitlements and none of the Company, the Underwriters nor any other person procuring subscribers shall be responsible for any loss or damage (whether actual or

alleged) arising from the terms of or timing of any such acquisition, any decision not to endeavour to procure subscribers or the failure to procure subscribers on the basis described above.

Melrose Shareholders will not be entitled to apply for New Melrose Shares in excess of their entitlement.

7. Overseas Shareholders and selling and transfer restrictions

7.1 General

The offer of Nil Paid Rights, Fully Paid Rights, Provisional Allotment Letters and/or New Melrose Shares pursuant to the Rights Issue and the distribution of this document or any other document relating to the Rights Issue (including the Provisional Allotment Letter) to persons located in or who have a registered address in a jurisdiction other than the United Kingdom, may be affected by the laws of the relevant jurisdiction. Those persons should consult their professional advisers as to whether they require any governmental or other consents or need to observe any other formalities to enable them to take up their rights. It is the responsibility of all persons (including, without limitation, custodians, nominees, agents and trustees) outside the United Kingdom receiving this document and/or a Provisional Allotment Letter and/or a credit of Nil Paid Rights to a stock account in CREST and wishing to accept the offer of New Melrose Shares to satisfy themselves as to full observance of the laws of the relevant territory, including obtaining all necessary governmental or other consents which may be required, observing all other requisite formalities needing to be observed and paying any issue, transfer or other taxes due in such territory. The comments set out in this paragraph 7 are intended as a general guide only and any Qualifying Shareholder who is in any doubt as to his position should consult his professional adviser without delay.

This paragraph 7 sets out the restrictions applicable to Qualifying Shareholders who have registered addresses outside the United Kingdom, who are located in countries other than the United Kingdom, or who are persons (including, without limitation, custodians, nominees, agents and trustees) who have a contractual or legal obligation to forward this document to a jurisdiction outside the United Kingdom or who hold Existing Melrose Shares for the account or benefit of any such person.

As legally required, New Melrose Shares will be provisionally allotted (nil paid) to all Qualifying Shareholders, including all Qualifying Shareholders with registered addresses in, or who are located in, the United States or any of the Excluded Territories. However, Provisional Allotment Letters have not been, and will not be, sent to, and Nil Paid Rights will not be credited to CREST accounts of, any Qualifying Shareholders with addresses in the United States or any of the Excluded Territories, or to their agents or intermediaries, except where the Company and the Underwriters are satisfied that such action would not result in the contravention of any registration or other legal requirement in such jurisdiction.

Receipt of this document and/or a Provisional Allotment Letter or the crediting of Nil Paid Rights to a stock account in CREST will not constitute an offer in or into the United States or an Excluded Territory and, in those circumstances, this document and/or a Provisional Allotment Letter must be treated as sent for information only and should not be copied or redistributed. No person receiving a copy of this document and/or a Provisional Allotment Letter and/or receiving a credit of Nil Paid Rights to a stock account in CREST with a registered address or who is located in any territory that is not an EEA state may treat the same as constituting an invitation or offer to him, nor should he in any event use the Provisional Allotment Letter or deal with Nil Paid Rights or Fully Paid Rights in CREST unless, in the relevant territory, such an invitation or offer could lawfully be made to him and the Provisional Allotment Letter or Nil Paid Rights or Fully Paid Rights in CREST could lawfully be used or dealt with without contravention of any unfulfilled registration or other legal or regulatory requirements.

Accordingly, persons (including, without limitation, custodians, nominees, agents and trustees) receiving a copy of this document and/or a Provisional Allotment Letter or whose stock account in CREST is credited with Nil Paid Rights or Fully Paid Rights should not, in connection with the Rights Issue, distribute or send the same, or transfer Nil Paid Rights or Fully Paid Rights to any person, in or into, the United States or an Excluded Territory. If a Provisional Allotment Letter or

credit of Nil Paid Rights or Fully Paid Rights in CREST is received by any person with a registered address or who is located in the United States or any Excluded Territory or by their agent or nominee in any such territory, he may only seek to take up the rights referred to in the Provisional Allotment Letter or in this document or renounce the Provisional Allotment Letter or transfer the Nil Paid Rights or Fully Paid Rights in CREST to the extent that the Company determines that such actions would not violate applicable legal or regulatory requirements. Any person (including, without limitation, custodians, nominees and trustees) who does forward this document or a Provisional Allotment Letter into any such territories (whether under contractual or legal obligation or otherwise) should draw the recipient's attention to the contents of this paragraph 7.

Subject to this paragraph 7, any person (including, without limitation, custodians, nominees, agents and trustees) outside the United Kingdom wishing to take up his rights under the Rights Issue (or to do so on behalf of someone else) must satisfy himself as to full observance of the applicable laws of any relevant territory including obtaining any requisite governmental or other consents, observing any other requisite formalities and paying any issue, transfer or other taxes due in such territories. The comments set out in this paragraph 7 are intended as a general guide only and any Qualifying Shareholder who is in doubt as to his position should consult his own independent professional adviser without delay.

The Company may treat as invalid any acceptance or purported acceptance of the offer of Nil Paid Rights, Fully Paid Rights, Provisional Allotment Letters or New Melrose Shares which appears to the Company or the Receiving Agent or their respective agents to have been executed, effected or despatched in a manner which may involve a breach of the laws or regulations of any jurisdiction or if it believes or they believe that the same may violate applicable legal or regulatory requirements or if, in the case of a Provisional Allotment Letter, it provides for an address for delivery of the definitive share certificates for New Melrose Shares, or, in the case of a credit of New Melrose Shares in CREST, the Qualifying CREST Shareholder's registered address is in the United States or an Excluded Territory, or if the Company believes or its agents believe that the same may violate applicable legal or regulatory requirements.

Despite any other provisions of this document or the Provisional Allotment Letter, the Company reserves the right to permit any Qualifying Shareholder to take up his rights if the Company in its sole and absolute discretion is satisfied that the transaction in question is exempt from or not subject to the legislation or regulations giving rise to the restriction in question. If the Company is so satisfied, the Company will arrange for the relevant Qualifying Shareholder to be sent a Provisional Allotment Letter if he is a Qualifying non-CREST Shareholder or, if he is a Qualifying CREST Shareholder, arrange for Nil Paid Rights to be credited to the relevant CREST stock account.

Those Qualifying Shareholders who wish, and are permitted, to take up their entitlements should note that payments must be made as described in paragraphs 4.2 and 4.4 in relation to Qualifying non-CREST Shareholders and paragraph 5.2 in relation to Qualifying CREST Shareholders of this Part XII (*Terms and Conditions of the Rights Issue*).

The Underwriters will procure subscribers for Rights Issue Shares not taken up in the Rights Issue only outside the US and in reliance on Regulation S of the US Securities Act.

The provisions of paragraph 6 of this Part XII (*Terms and Conditions of the Rights Issue*) will apply generally to Overseas Shareholders who are unable to take up New Melrose Shares provisionally allotted to them.

7.2 *Offering and transfer restrictions relating to the United States*

None of the New Melrose Shares, the Nil Paid Rights, the Fully Paid Rights and the Provisional Allotment Letters have been or will be registered under the US Securities Act or under any other relevant federal securities laws or the securities laws of any state or other jurisdiction of the United States and may not be offered, sold, taken up, exercised, resold, pledged, renounced, transferred or delivered, directly or indirectly, in or into the United States at any time without registration or an applicable exemption from or in a transaction not subject to the registration requirements of the US Securities Act and in compliance with state securities laws.

Neither this document nor a Provisional Allotment Letter will be sent to, and no Nil Paid Rights will be credited to a stock account in CREST with a bank or financial institution of, any Qualifying Shareholder with an address in, or who is resident in, the United States and must not be transferred to any such Qualifying Shareholder unless such a person satisfies the Company that a relevant exemption from the US Securities Act is available. The Provisional Allotment Letters, Nil Paid Rights, Fully Paid Rights and New Melrose Shares may at the sole discretion of the Company be made available in the United States to qualified institutional buyers within the meaning of Rule 144A under the US Securities Act or accredited investors within the meaning of Rule 501(a) of Regulation D under the US Securities Act (“**Eligible US Holders**”). The Provisional Allotment Letter, Nil Paid Rights, Fully Paid Rights and New Melrose Shares are subject to certain restrictions on transfer within the United States, as set out below.

Any recipient of Provisional Allotment Letters, Nil Paid Rights, Fully Paid Rights or New Melrose Shares pursuant to transactions that are exempt from the registration requirements of the US Securities Act will be required to make such acknowledgements and representations to and agreements with the Company as the Company may require to establish that they are Eligible US Holders.

Provisional Allotment Letters or renunciations thereof sent from or post-marked in the United States will be deemed to be invalid. Any person in the United States who obtains a copy of this document or a Provisional Allotment Letter and who is not an Eligible US Holder is required to disregard them.

Accordingly:

- (a) the Company reserves the right to treat as invalid any Provisional Allotment Letter (or renunciation thereof) that appears to the Company or its agents to have been executed in or despatched from the United States, or that provides an address in the United States, from the acceptance or renunciation of the Rights Issue, or which does not make the warranty set out in the Provisional Allotment Letter to the effect that the person accepting and/or renouncing the Provisional Allotment is not otherwise located in the United States, and is not acquiring the Nil Paid Rights, Fully Paid Rights or New Melrose Shares with a view to the offer, sale, resale, transfer, delivery or distribution, directly or indirectly, of any such Nil Paid Rights, Fully Paid Rights or the New Melrose Shares in the United States or where the Company believes acceptance of such Provisional Allotment Letter may infringe applicable legal or regulatory requirements;
- (b) the Company will not be bound to offer any New Melrose Shares, Nil Paid Rights, Fully Paid Rights or Provisional Allotment Letter to any person with an address in, or who is otherwise located in, the United States in whose favour a Provisional Allotment Letter or any Nil Paid Rights, Fully Paid Rights or New Melrose Shares may be transferred or renounced; and
- (c) the Company reserves the right to reject any MTM instruction sent by or on behalf of any CREST Member with a registered address in, or who is located in, the United States in respect of Nil Paid Rights.

The provisions set out in paragraph 6 above, will apply to the rights of Qualifying Shareholders with registered addresses in the United States or who are located or located in the United States unless they take up their rights pursuant to a relevant exemption from the registration requirements of the US Securities Act, having satisfied the Company that they are an Eligible US Holder (as discussed above).

In addition, until 40 days after the commencement of the Rights Issue, an offer, sale or transfer of the New Melrose Shares, the Nil Paid Rights, the Fully Paid Rights or the Provisional Allotment Letters within the United States by a dealer that is participating in the Rights Issue may violate the registration requirements of the US Securities Act.

7.3 *Other overseas territories*

(a) General

Provisional Allotment Letters will be posted to Qualifying non-CREST Shareholders (other than Qualifying Shareholders with registered addresses in the United States or any of the Excluded Territories) and Nil Paid Rights will be credited to the CREST stock accounts of Qualifying CREST Shareholders with registered addresses in any country other than the United States or an Excluded Territory. No offer of or invitation to subscribe for New Melrose Shares is being made by virtue of this document or the Provisional Allotment Letters into any of the United States or Excluded Territories. Qualifying Shareholders may, subject to the laws of their relevant jurisdiction, accept their rights under the Rights Issue in accordance with the instructions set out in this document and, in the case of Qualifying non-CREST Shareholders only, the Provisional Allotment Letters.

Qualifying Shareholders who have registered addresses in or who are located in countries other than the United Kingdom should consult their appropriate professional advisers as to whether they require any governmental or other consents or need to observe any other formalities to enable them to take up their Nil Paid Rights or to acquire Fully Paid Rights or New Melrose Shares. If you are in any doubt as to your eligibility to accept the offer of New Melrose Shares or to deal with Nil Paid Rights or Fully Paid Rights, you should contact your appropriate professional adviser immediately.

(b) EEA States (other than the United Kingdom)

In relation to the EEA States (except for the United Kingdom) that have implemented the Prospectus Directive (each, a “**relevant member state**”), with effect from and including the date on which the Prospectus Directive was implemented in that relevant member state (the “**relevant implementation date**”), no New Melrose Shares, Nil Paid Rights or Fully Paid Rights have been offered or will be offered pursuant to the Rights Issue to the public in that relevant member state prior to the publication of a prospectus in relation to the New Melrose Shares, Nil Paid Rights and Fully Paid Rights which has been approved by the competent authority in that relevant member state or, where appropriate, approved in another relevant member state and notified to the competent authority in the relevant member state, all in accordance with the Prospectus Directive, except that with effect from and including the relevant implementation date, offers of New Melrose Shares, Nil Paid Rights or Fully Paid Rights may be made to the public in that relevant member state at any time under the following exemptions under the Prospectus Directive, if they are implemented in that relevant member state:

- (a) to any legal entity which is a qualified investor, as defined in the Prospectus Directive;
- (b) to fewer than 100, or if the relevant member state has implemented the relevant provisions of the PD Amending Directive, 150 natural or legal persons (other than qualified investors as defined in the Prospectus Directive) in such relevant member states; or
- (c) in any other circumstances falling within Article 3(2) of the Prospectus Directive,

provided that no such offer of New Melrose Shares, Nil Paid Rights or Fully Paid Rights shall result in a requirement for the publication by the Company, the Sponsors or the Underwriters of a prospectus pursuant to Article 3 of the Prospectus Directive.

For this purpose, the expression “an offer of any New Melrose Shares, Nil Paid Rights or Fully Paid Rights to the public” in relation to any New Melrose Shares, Nil Paid Rights and Fully Paid Rights in any relevant member state means the communication in any form and by any means of sufficient information on the terms of the Rights Issue and any New Melrose Shares, Nil Paid Rights and Fully Paid Rights to be offered so as to enable an investor to decide to acquire any New Melrose Shares, Nil Paid Rights or Fully Paid Rights, as the same may be varied in that relevant member state by any measure implementing the Prospectus Directive in that relevant member state.

7.4 *Gazette notice*

In accordance with section 562(3) of the 2006 Act, the offer by way of Rights to Qualifying Shareholders who have no registered address in an EEA State and who have not given to the Company an address in an EEA State for the serving of notices, will (subject to the other conditions of the Rights Issue) be made by the Company causing a notice to be published in the London Gazette on 17 July 2012 stating where copies of this document and the Provisional Allotment Letters may be obtained or inspected on personal application by or on behalf of such Qualifying Shareholders.

However, in order to facilitate acceptance of the offer made to such Qualifying Shareholders by virtue of such publication, Provisional Allotment Letters will also be posted to Qualifying Shareholders who are Overseas Shareholders (other than to those with addresses in the United States or any of the Excluded Territories). Such Melrose Shareholders, if it is lawful to do so, may accept the offer by way of Rights either by returning the Provisional Allotment Letter posted to them in accordance with the instructions set out therein or, subject to surrendering the original Provisional Allotment Letter posted to them, by obtaining a copy thereof from the place stated in the notice and returning it in accordance with the instructions set out therein. Similarly, Nil Paid Rights are expected to be credited to stock accounts in CREST of Qualifying CREST Shareholders who are Overseas Shareholders (other than those with addresses in the United States or any of the Excluded Territories).

8. Additional representations and warranties

8.1 *Qualifying non-CREST Shareholders*

Any person accepting and/or renouncing a Provisional Allotment Letter or requesting registration of the New Melrose Shares comprised therein represents and warrants to the Company and the Underwriters that, except where proof has been provided to the Company's and the Underwriters' satisfaction that such person's use of the Provisional Allotment Letter will not result in the contravention of any applicable legal requirement in any jurisdiction:

- (a) such person is not located in, and is not accepting and/or renouncing the Provisional Allotment Letter from within the United States or any other Excluded Territory;
- (b) such person is not in any territory in which it is unlawful to make or accept an offer to subscribe for New Melrose Shares or to use the Provisional Allotment Letter in any manner in which such person has used or will use it;
- (c) such person is not acting on a non discretionary basis for a person located within the United States or any other Excluded Territory or any territory referred to in (b) above at the time the instruction to accept or renounce was given, and such person is not accepting for the account of any person who is located within the United States; and
- (d) such person is not acquiring New Melrose Shares with a view to the offer, sale, resale, transfer, delivery or distribution, directly or indirectly, of any such New Melrose Shares into the United States or any other Excluded Territory or any territory referred to in (b) above.

The Company may treat as invalid any acceptance or purported acceptance of the allotment of New Melrose Shares comprised in, or renunciation or purported renunciation of, a Provisional Allotment Letter in the circumstances set out in paragraph 4.8 of this Part XII (*Terms and Conditions of the Rights Issue*), or if it purports to exclude the warranty required by this paragraph.

8.2 *Qualifying CREST Shareholders*

A Qualifying CREST Shareholder who makes a valid acceptance in accordance with the procedure set out in paragraph 5 of this Part XII (*Terms and Conditions of the Rights Issue*) represents and warrants to the Company and the Underwriters that, except where proof has been provided to the

Company's and the Underwriters' satisfaction that such person's acceptance will not result in the contravention of any applicable legal requirement in any jurisdiction:

- (a) he is not within the United States or any of the Excluded Territories;
- (b) he is not in any territory in which it is unlawful to make or accept an offer to acquire or subscribe for Nil Paid Rights, Fully Paid Rights or New Melrose Shares;
- (c) he is not acting on a non-discretionary basis for a person located within the United States or any Excluded Territory or any territory referred to in (b) above at the time the instruction to accept was given, and such person is not accepting for the account of any person who is located within the United States; and
- (d) he is not acquiring Nil Paid Rights, Fully Paid Rights or New Melrose Shares with a view to the offer, sale, resale, transfer, delivery or distribution, directly or indirectly, of any such Nil Paid Rights, Fully Paid Rights or New Melrose Shares into the United States or any Excluded Territory or any territory referred to in (b) above.

The Company may treat as invalid any MTM instruction which: (a) appears to the Company to have been despatched from the United States or an Excluded Territory or otherwise in a manner which may involve a breach of the laws of any jurisdiction or they or their agents believe may violate any applicable legal or regulatory requirement; or (b) purports to exclude the warranty required by this paragraph.

8.3 *Waiver*

The provisions of paragraphs 7 and 8 of this Part XII (*Terms and Conditions of the Rights Issue*), and of any other terms of the Rights Issue relating to Qualifying Shareholders with registered addresses in, or who are located in, the United States or any of the Excluded Territories may be waived, varied or modified as regards specific Qualifying Shareholder(s) or on a general basis by the Company in its absolute discretion. Subject to this, the provisions of this paragraph 8.3 which refer to Qualifying Shareholders shall include references to the person or persons executing a Provisional Allotment Letter and, in the event of more than one person executing a Provisional Allotment Letter, the provisions of this paragraph 8.3 shall apply jointly to each of them.

8.4 *Payment*

All payments must be made in the manner set out in paragraphs 4.4 and 5.2 of this Part XII (*Terms and Conditions of the Rights Issue*) (as applicable).

9. **Taxation**

Information on taxation in the United Kingdom with regard to the Rights Issue is set out in Part IX (*Taxation Considerations*) of this document. The information contained in Part IX (*Taxation Consideration*) is intended only as a general guide to the current tax position in the United Kingdom and Qualifying Shareholders should consult their own tax advisers regarding the tax treatment of the Rights Issue in light of their own circumstances. Melrose Shareholders who are in any doubt as to their tax position or who are subject to tax in any other jurisdiction should consult an appropriate professional adviser immediately.

10. **Withdrawal rights**

Qualifying Shareholders wishing to exercise statutory withdrawal rights pursuant to section 87(Q)(4) of FSMA after the issue by the Company of a prospectus supplementing this document must do so by lodging a written notice of withdrawal, which must include the full name and address of the person wishing to exercise statutory withdrawal rights and, if such person is a CREST member, the participant ID and the member account ID of such CREST member with the Receiving Agent by post or by hand (during normal business hours only) at Corporate Actions, Equiniti at Aspect House, Spencer Road, Lancing, West Sussex BN99 6DA, so as to be received no later than two Business Days after the date on which a supplementary prospectus is published. Notice of withdrawal given by any other means or which is deposited with or received by the Receiving Agent after expiry of such period will not constitute a valid withdrawal. The

Company shall treat as valid any notice of withdrawal received through the post which bears a legible postmark on its envelope dated not later than the date falling two Business Days after the date on which such supplementary prospectus was published. The Company will not permit the exercise of withdrawal rights after payment by the relevant person for New Melrose Shares in full and the issue of such New Melrose Shares to such person becoming unconditional, save as required by statute.

Following the valid exercise of statutory withdrawal rights, application moneys will be returned by post to relevant Qualifying Shareholders at their own risk and without interest to the address set out in the Provisional Allotment Letter and/or the Receiving Agent will refund the amount paid by a Qualifying CREST Shareholder by way of a CREST payment, without interest, as applicable within 14 days of such exercise of statutory withdrawal rights. Interest earned on such moneys will be retained for the benefit of the Company. The provisions of this paragraph 10 are without prejudice to the statutory rights of Qualifying Shareholders. In such event Shareholders are advised to seek independent legal advice.

11. Times and dates

The Company shall, at its discretion and after consultation with its financial and legal advisers, be entitled to amend the dates that Provisional Allotment Letters are despatched or dealings in Nil Paid Rights commence and amend or extend the latest date for acceptance under the Rights Issue and all related dates set out in this document and in such circumstances shall announce such amendment via a Regulatory Information Service and notify the UKLA and, if appropriate, Melrose Shareholders.

12. ISIN

The ISIN for the New Melrose Shares will be the same as for the Existing Melrose Shares being GB00B464F978. The ISIN for the Nil Paid Rights will be GB00B8GRB070 and the Fully Paid Rights GB00B8GLZ411.

13. Dilution

If a Qualifying Shareholder does not take up the offer of New Melrose Shares in whole or in part, such Qualifying Shareholder's holding will be diluted by approximately 66.7 per cent.

14. Governing law

The terms and conditions of the Rights Issue as set out in this document and the Provisional Allotment Letter and any non-contractual obligations relating thereto shall be governed by, and construed in accordance with, the laws of England and Wales. The New Melrose Shares will be created pursuant to the Articles and under the 2006 Act.

15. Jurisdiction

The courts of England and Wales are to have exclusive jurisdiction to settle any dispute which may arise out of or in connection with the Rights Issue, this document and the Provisional Allotment Letter (where appropriate). By accepting rights under the Rights Issue in accordance with the instructions set out in this document and, in the case of Qualifying non-CREST Shareholders only, the Provisional Allotment Letter, Qualifying Shareholders irrevocably submit to the jurisdiction of the courts of England and Wales and waive any objection to proceedings in any such court on the ground of venue or on the ground that proceedings have been brought in an inconvenient forum.

PART XIII

ADDITIONAL INFORMATION

1. RESPONSIBILITY

- 1.1 The Company and the Melrose Directors, whose names appear at paragraph 1 of Part X (*Directors, Corporate Governance and Employees*) of this document, accept responsibility for the information contained in this document. To the best of the knowledge of the Company and the Melrose Directors (having taken all reasonable care to ensure that such is the case), the information contained in this document is in accordance with the facts and contains no omission that is likely to affect its import.
- 1.2 Deloitte, whose registered address is at 2 New Street Square, London EC4A 3BZ, accepts responsibility for (i) its report on pro forma financial information set out in Part VIII (*Unaudited Pro Forma Information on the Enlarged Group*) of this document and (ii) its report on the reconciliation of financial information as incorporated by reference into this document. To the best of the knowledge of Deloitte (having taken all reasonable care to ensure that such is the case) the information contained in such reports is in accordance with the facts and contains no omissions likely to affect its import.

2. CORPORATE HISTORY

- 2.1 Melrose was incorporated in England and Wales on 13 May 2003 under the 1985 Act as a public company limited by shares with registration number 4763064 and with the name Wheelmark PLC.
- 2.2 The Company's name was changed from Wheelmark PLC to Melrose PLC on 1 October 2003.
- 2.3 The liability of the members of the Company is limited.
- 2.4 The Company is domiciled in the United Kingdom and its registered office is at Precision House, Arden Road, Alcester, Warwickshire B49 6HN. The Company's principal place of business is at Leconfield House, Curzon Street, London W1J 5JA (tel. no. +44 (0)20 7647 4500).
- 2.5 On 10 October 2003, the Company was granted a certificate under section 117 of the 1985 Act entitling it to commence business.
- 2.6 On 28 October 2003, the Melrose Shares were admitted to trading on AIM.
- 2.7 On 9 December 2005, the Melrose Shares were admitted to the Official List of the UKLA and to trading on the London Stock Exchange's main market for listed securities.

3. SHARE CAPITAL

- 3.1 The following table sets out the issued share capital of Melrose as at the date of this document:

Class	£	Number	Nominal Value
Ordinary	1,074,713.85	422,209,012	¹⁴ / ₅₅ pence

- 3.2 The following table sets out the issued share capital of Melrose immediately following Admission⁽¹⁾:

Class	£	Number	Nominal Value
Ordinary	3,224,141.55	1,266,627,036	¹⁴ / ₅₅ pence

(1) Assuming that no rounding down is necessary to resolve fractional entitlements.

The Melrose Board has granted 47,875 options in respect of 2012 Incentive Shares (including 34,000 to Melrose Directors as set out at paragraph 1.2 to Part X (*Directors, Corporate Governance and Employees*) of this document). The terms of such options are set out at paragraph 2.2 (*Details of options to subscribe for 2012 Incentive Shares*) of Part II (*Details of the Proposals*) of the shareholder circular sent to Melrose Shareholders on 23 March 2012 which is incorporated into this document by reference.

3.3 As at 1 January 2009, the issued share capital of the Company was 497,586,779 ordinary shares of 0.2 pence and 50,000 2007 Incentive Shares of £1 each (“**2007 Incentive Shares**”), each of which was fully paid up. The issued share capital of the Company has changed since 1 January 2009 as follows:

3.3.1 On 14 May 2009:

- (a) the Company purchased 50,000 fully paid 2007 Incentive Shares pursuant to the terms of a share purchase contract (the terms of which were set out in a circular to shareholders on 15 April 2009); and
- (b) upon the purchase of the 2007 Incentive Shares each 2007 Incentive Share was cancelled and the Company’s issued share capital was diminished by the nominal value of those shares (but the purchase did not reduce the amount of the Company’s authorised share capital) and each 2007 Incentive Share was reclassified as a 2009 Incentive Share of £1 each (the “**2009 Incentive Shares**”), having the rights and restrictions set out in the Articles adopted on the same date.

3.3.2 On 8 August 2011:

- (a) the Melrose Directors capitalised a sum of £220,061,595.75 then standing to the credit of the Company’s capital redemption reserve and a sum of £153,128,488.50 then standing to the credit of the Company’s share premium account and applied the aggregate of such sums in paying up in full 497,586,779 C Shares and the Melrose Directors allotted and issued such C Shares credited as fully paid up, in an aggregate nominal amount of £373,190,084.25, to the holders of the then existing ordinary shares of 0.2 pence each in the capital of the Company (the “**Existing Ordinary Shares**”) on the basis of one C Share for each Existing Ordinary Share held and recorded on the Register at 6.00 p.m. on 8 August 2011;
- (b) the Melrose Directors allotted and issued 3 ordinary shares of 0.2 pence in the capital of the Company so as to avoid having a fraction of an ordinary share outstanding following the share capital consolidation described in paragraph 3.3.2(c) below;
- (c) in respect of each holding of Existing Ordinary Shares as shown on the Register at 6.15 p.m. on 8 August 2011 each issued Existing Ordinary Share was sub-divided into eleven shares of $\frac{1}{55}$ pence and forthwith upon such sub-division, every fourteen shares of $\frac{1}{55}$ pence resulting from such sub-division were consolidated into one Melrose Share of $\frac{14}{55}$ pence (no member was entitled to a fraction of a Melrose Share) and all fractional entitlements arising out of the consolidation were aggregated into Melrose Shares (up to such number as resulted in a whole number of Melrose Shares) and the whole number of Melrose Shares so arising were sold and the net proceeds of sale were paid in due proportion (rounded down to the nearest penny) to those shareholders who would otherwise have been entitled to such fractional entitlements, save that individual amounts not exceeding £1 and any such rounding were retained by the Company and donated to charities chosen by the Melrose Board; and
- (d) the Company adopted new Articles containing the rights and restrictions attaching to the C Shares allotted pursuant to the resolution described at paragraph 3.3.2(a) above and the Melrose Shares resulting from the sub-division and consolidation described at paragraph 3.3.2(c) above.

3.3.3 On 16 August 2011, 461,862,929 C Shares were redeemed and immediately cancelled and the remaining 35,723,850 C Shares were redeemed on 30 April, 2012 and immediately cancelled.

3.3.4 On 11 April 2012:

- (a) each issued 2009 Incentive Share was sub-divided and re-designated into 392 Melrose Shares (with no holder of such shares being entitled to the fraction of a 2009 Incentive Share arising as a result of such sub-division and re-designation) and each

such fraction was aggregated and re-designated into one deferred share of £109¹¹/₁₁ (the “**Deferred Share**”) which was registered in the name of the Company Secretary;

- (b) the Company purchased the Deferred Share pursuant to the terms of a contract dated 22 March 2012 entered into between the Company and the Company Secretary relating to such purchase and under which the consideration was one penny;
- (c) upon its purchase by the Company, the Deferred Share was cancelled and the amount of the Company’s issued share capital was diminished accordingly; and
- (d) the Melrose Directors:
 - (i) capitalised a sum of £29,649.38 standing to the credit of the Company’s capital redemption reserve and applied such sum in paying up in full 11,647,969 Melrose Shares; and
 - (ii) allotted and issued such Melrose Shares to those persons who had previously been holders of 2009 Incentive Shares (as further described in the shareholder circular dated 23 March 2012).

3.3.5 On 22 March 2012, the Melrose Board conditionally granted 47,500 options in respect of the 2012 Incentive Shares to certain Melrose Directors and other key personnel, and on 12 March 2012 this grant became unconditional in all respects. On 26 March 2012 the Melrose Board granted a further 375 options in respect of 2012 Incentive Shares.

3.4 Set out below in a description of the resolutions, authorisations and approvals by virtue of which the New Melrose Shares will be created and/or issued:

3.4.1 By ordinary resolutions to be proposed at the Melrose General Meeting:

- (a) subject to and conditional on the passing of resolution 1 set out in the Notice of General Meeting, and in accordance with Article 10 of the Articles, in addition and without prejudice to all existing authorities conferred on the Melrose Directors, the Melrose Directors be generally and unconditionally authorised for the purposes of section 551 of the 2006 Act to exercise all the powers of the Company to allot ordinary shares in the Company or grant rights to subscribe for or to convert any securities into ordinary shares in the Company up to an aggregate nominal amount of £2,149,427.70, provided that:
 - (i) such authority to expire (unless previously renewed, varied or revoked by the Company in general meeting) 15 months after the Melrose General Meeting or, if earlier, at the conclusion of the next annual general meeting of the Company following the Melrose General Meeting; and
 - (ii) the Company may before the expiry of the authority make an offer or agreement which would or might require shares in the Company to be allotted or rights to subscribe for or to convert any security into shares in the Company to be granted after such expiry and the Melrose Directors may allot such shares or grant such rights in pursuance of that offer or agreement as if the authority conferred by the resolution had not expired.
- (b) subject to and conditional on Admission, in addition to the authorities granted pursuant to resolution 2 set out in the Notice of General Meeting but in substitution for the authority granted pursuant to resolution 13 passed at the 2012 AGM, the Melrose Directors be generally and unconditionally authorised pursuant to section 551 of the 2006 Act 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:
 - (i) up to an aggregate nominal amount of £1,074,713.85; and

- (ii) comprising equity securities (as defined in section 560(1) of the 2006 Act) up to an aggregate nominal amount of £2,149,427.70 (such amount to be reduced by the aggregate nominal amount of any allotments or grants made under the authority described at paragraph (i) above in connection with an offer by way of a rights issue:
 - a. to holders of ordinary shares in proportion (as nearly as may be practicable) to their existing holdings; and
 - b. to holders of other equity securities as required by the rights of those securities or, subject to such rights, as the Melrose Directors otherwise consider necessary, and so that the Melrose 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,

provided that such authorities will expire (unless previously renewed, varied or revoked by the Company in general meeting) 15 months after the Melrose General Meeting or, if earlier, at the conclusion of the next annual general meeting of the Company following the Melrose General Meeting but in each case, the Company may before the expiry of the authority make offers or agreements which would or might require shares of the Company to be allotted, or rights to subscribe for or to convert securities into shares in the Company to be granted, after such expiry and the Melrose Directors may allot such shares or grant such rights in pursuance of any such offer or agreement as if the authority conferred by the resolution had not expired.

3.4.2 By special resolutions to be proposed at the Melrose General Meeting:

- (a) in substitution for the authority granted pursuant to resolution 14 passed at the 2012 AGM, and subject to and conditional on Admission and the passing of resolution 3 set out in the Notice of General Meeting (“**Resolution 3**”), the Melrose Directors be generally empowered to allot equity securities for cash pursuant to the authority conferred by Resolution 3 and/or to sell ordinary shares held by the Company as treasury shares for cash, in each case free of the restriction in section 561(1) of the 2006 Act, such power to be limited:

- (i) 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 3, such power will be limited to the allotment of equity securities in connection with an offer by way of a rights issue only):
 - a. to holders of Melrose Shares in proportion (as nearly as may be practicable) to their existing holdings; and
 - b. to holders of other equity securities, as required by the rights of those securities or, subject to such rights, as the Melrose Directors otherwise consider necessary,

and so that the Melrose 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

- (ii) to the allotment (otherwise than in the circumstances set out in paragraph (i) of equity securities pursuant to the authority granted by

paragraph (A) of Resolution 3 and/or the sale of treasury shares for cash up to a nominal amount of £161,207.08,

provided that such power will expire (unless previously renewed, varied or revoked by the Company in general meeting) 15 months after the Melrose General Meeting or, if earlier, at the conclusion of the next annual general meeting of the Company following the Melrose General Meeting, provided that the Company may before such expiry make an offer or agreement which would or might require equity securities to be allotted (and/or treasury shares to be sold) after such expiry and the Melrose Directors may allot equity securities (and/or sell treasury shares) in pursuance of such offer or agreement as if the power conferred had not expired; and

- (b) in substitution for the authority granted pursuant to resolution 15 passed at the 2012 AGM, and subject to and conditional on Admission, the Company be generally and unconditionally authorised to make one or more market purchases (within the meaning of section 693 of the 2006 Act) of Melrose Shares provided that:
- (i) the maximum aggregate number of Melrose Shares authorised to be purchased is 126,662,703 (representing 10 per cent. of the issued ordinary share capital immediately following Admission);
 - (ii) the minimum price which may be paid for a Melrose Share shall be not less than the nominal value of a Melrose Share at the time of such purchase;
 - (iii) the maximum price which may be paid for a Melrose Share shall be not more than the higher of:
 - a. 105 per cent. of the average of the middle market quotation for a Melrose Share as derived from SEDOL for the five business days immediately preceding the day on which the Melrose Share is purchased which amount shall be exclusive of expenses; and
 - b. 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;
 - (iv) the authority will expire (unless previously renewed, varied or revoked by the Company in general meeting) 15 months after the Melrose General Meeting or, if earlier, at the conclusion of the next annual general meeting of the Company following the Melrose General Meeting;
 - (v) the Company may make a contract to purchase Melrose Shares under the 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 Melrose Shares in pursuance of any such contract; and
 - (vi) any Melrose Shares purchased pursuant to the authority may either be held as treasury shares or cancelled by the Company, depending on which course of action is considered by the Melrose Directors to be in the best interests of shareholders at the time.

- 3.5 The Company remains subject to the continuing obligations of the Listing Rules published by the FSA with regard to the issue of securities for cash.
- 3.6 As at the date of this document, the Company does not hold any Melrose Shares in treasury.
- 3.7 The principal legislation under which the Company operates and pursuant to which the Existing Melrose Shares have been, and the New Melrose Shares will be, created is the Companies Acts and regulations made under the Companies Acts. The Existing Melrose Shares are, and the New Melrose Shares will be, denominated in pounds sterling. The ISIN of the Melrose Shares is GB00B464F978 and the SEDOL number is B464F97. The New Melrose Shares will be in registered form and are capable of being held in either (i) certificated form; or (ii) uncertificated form, and title to such shares may be transferred by means of a relevant system (as defined in the CREST Regulations).

4. ARTICLES OF ASSOCIATION

The following is a summary of the rights and restrictions attaching to the Melrose Shares and the 2012 Incentive Shares which are more fully set out in the Articles. The New Melrose Shares will have the same rights and restrictions attached to them as the Existing Melrose Shares.

4.1 *Share Capital*

The share capital of Melrose at the date of this document is divided into Melrose Shares and unissued 2012 Incentive Shares which carry the respective rights and privileges and are subject to the respective provisions and restrictions set out in the Articles.

4.2 *Voting rights*

4.2.1 Subject to any special rights or restrictions as to voting attached to any class of shares by or in accordance with the Articles, at a general meeting every Melrose Shareholder present in person or by proxy has on a show of hands one vote and every Melrose Shareholder present in person or by proxy has on a poll one vote for every share of which he is the holder. In the case of joint holders, the vote of the person whose name stands first in the register of members and who tenders a vote is accepted to the exclusion of any votes tendered by any other joint holders.

4.2.2 The holders of 2012 Incentive Shares have the right to receive notice of and attend any general meeting of Melrose but do not have the right to vote thereat.

4.3 *Dividends*

4.3.1 Subject to the Articles and the 2006 Act, Melrose may by ordinary resolution declare a dividend to be paid to the Melrose Shareholders according to their respective rights and interests, but no dividend may exceed the amount recommended by the Melrose Board. The Melrose Board may declare and pay such interim dividends as appear to it to be justified by the profits of Melrose available for distribution.

4.3.2 The 2012 Incentive Shares do not confer a right to be paid a dividend save as set out in paragraph 4.5 below.

4.3.3 Except as otherwise provided by the rights attached to shares, a dividend shall be declared and paid according to the amounts paid up on the shares in respect of which the dividend is declared and paid, but no amount paid up on a share in advance of a call may be treated for these purposes as paid up on the share. Dividends shall be apportioned and paid proportionately to the amounts paid up on the shares during any portion or portions of the period in respect of which the dividend is paid.

4.3.4 Except as otherwise provided by the rights attached to shares, dividends may be declared or paid in any currency and, with the prior authority of an ordinary resolution of Melrose,

payment of a dividend may be satisfied wholly or in part by the distribution of assets in specie.

- 4.3.5 A dividend unclaimed for a period of 12 years from the date it was declared or became due for payment is forfeited and ceases to remain owing by the Company.

4.4 *Return of Capital*

- 4.4.1 On a voluntary winding up of Melrose the liquidator may, on obtaining any sanction required by law, divide among the members in kind the whole or any part of the assets of Melrose, whether or not the assets consist of property of one kind or of different kinds and vest the whole or any part of the assets in trustees upon such trusts for the benefit of the members. For such purpose the liquidator may set the value he deems fair on a class or classes of property, and may determine on the basis of that valuation and in accordance with the then existing rights of members how the division is to be carried out between members or classes of members. The liquidator may not, however, distribute to a member without his consent an asset to which there is attached a liability or potential liability for the owner.
- 4.4.2 On a return of capital on winding up (but not otherwise), the holders of 2012 Incentive Shares shall be entitled to participate in Melrose's assets available for distribution in accordance with paragraph 4.5.14 below.

4.5 *Further rights attaching to 2012 Incentive Shares*

- 4.5.1 (a) The holders of the 2012 Incentive Shares shall, not later than 20 business days after the trigger date, be paid a dividend which shall be equal to such amount per 2012 Incentive Share (the "**Dividend Amount**") as equals the Conversion Number (as determined in accordance with paragraph 4.5.3 for the trigger date, except that if the Conversion Number is a fraction it shall not be rounded up) multiplied by SP (as determined in accordance with paragraph 4.5.3). To the extent that a dividend is paid in respect of 2012 Incentive Shares in accordance with this paragraph 4.5.1(a), those shares shall, with effect from the payment date, be re-designated (and in any event shall have the same rights (and no other rights)) as non-voting deferred shares, having the rights set out in paragraph 4.5.11.
- (b) Prior to the trigger date, the remuneration committee of the Melrose Board may in its absolute discretion determine that the Dividend Amount to be paid on the 2012 Incentive Shares should be reduced in whole or in part. If the Dividend Amount is reduced in whole, the 2012 Incentive Shares shall be converted in accordance with the remaining provisions of this paragraph 4.5. If the Dividend Amount is reduced in part the 2012 Incentive Shares shall be converted in accordance with the remaining provisions of this paragraph 4.5 save that the Conversion Number shall be reduced to reflect the amount of the dividend per share to be paid. The Company shall serve a notice on the holders of such 2012 Incentive Shares (a "**conversion notice**") informing such holders of the determination by the remuneration committee of the Melrose Board and such notice shall be served within five business days of such determination.
- (c) If the Company is unable (for whatever reason) to pay the full amount of the dividend which is due as provided for in paragraph 4.5.1(a) or paragraph 4.5.1(b) or if the Company decides not to pay such a dividend or if the remuneration committee of the Melrose Board determines in accordance with paragraph 4.5.1(b) that the 2012 Incentive Shares should be converted but the Company fails to convert the 2012 Incentive Shares in accordance with paragraph 4.5.1(b) and the remaining provisions of this paragraph 4.5, then the Company shall procure that such 2012 Incentive Shares shall be purchased, not later than 25 business days after the trigger date, by an employee benefit trust nominated by the Company for consideration per 2012 Incentive Share equal to the Dividend Amount (as defined in paragraph 4.5.1(a)),

failing which the Company shall redeem such 2012 Incentive Shares, not later than 25 business days after the trigger date, for a redemption payment per 2012 Incentive Share equal to the Dividend Amount (the Dividend Amount, in each case, to be reduced by the amount of any dividend actually paid on the 2012 Incentive Shares in accordance with paragraph 4.5.1(b)).

- 4.5.2 If a conversion notice is served in accordance with paragraph 4.5.1(b), or pursuant to paragraph 4.5.13 or paragraph 4.5.14, on conversion each 2012 Incentive Share shall convert into such number of fully paid ordinary shares as equals the Conversion Number (save where a dividend has been paid on the 2012 Incentive Shares in accordance with paragraph 4.5.1(b) in which case the Conversion Number shall be reduced to reflect the amount of any dividend per share actually paid).
- 4.5.3 Subject to paragraph 4.5.7 and paragraph 4.5.13 and subject always to adjustment in accordance with paragraph 4.5.15 and/or paragraph 4.5.16, the “**Conversion Number**” equals:

$$\frac{7.5}{100} \times \frac{[(SP \times N) - IC] \times \frac{1}{SP}}{NBS}$$

Where:

- N = the number of ordinary shares in issue on the relevant trigger date
- NBS = 50,000
- SP = the price certified by Investec Investment Banking (or other brokers for the time being of the Company) to be the average closing middle market quotation (in pounds sterling) of an ordinary share in the capital of the Company as derived from the Daily Official List for the 40 business days prior to the trigger date
- IC = the invested capital relating to the ordinary shares (in pounds sterling), being the sum of the Indexed Capital for each month in which there is either an Ordinary Share Cost or a Return from (and including), if Resolution 1 proposed at the general meeting of the Company held on 11 April 2012 is passed, March 2012 or, if such resolution is not passed, May 2012 up to (and including) the month in which the relevant trigger date for the 2012 Incentive Shares occurs (and for these purposes the Ordinary Share Cost for March 2012 or May 2012, as the case may be, shall be the deemed market capitalisation of the Company as at, if Resolution 1 proposed at the general meeting of the Company held on 11 April 2012 is passed, 21 March 2012, or, if such resolution is not passed, 30 May 2012 based on the average closing middle market quotation (in pounds sterling) of an ordinary share in the capital of the Company as derived from the Daily Official List for the 40 business days up to and including the relevant date).

and where:

- (i) the “**Indexed Capital**” for a month means the Net Capital for that month multiplied by the relevant Index Adjustment for the period from the commencement of that month until the commencement of the month in which the trigger date falls
- (ii) the “**Net Capital**” for a month means the Ordinary Share Cost in that month or the Returns in that month or, in the event that there is both, the net amount of Ordinary Share Cost minus Returns, and which for the avoidance of doubt may be zero or a negative number
- (iii) “**Ordinary Share Cost**” means the total amount (in pounds sterling) paid up (as to nominal value and any premium) on any allotment of ordinary shares in the period, provided that

(I) if any part of such amount paid up on any ordinary share is paid up otherwise than in cash the amount paid up on that share shall be deemed to be the price certified by Investec Investment Banking (or other broker for the time being of the Company) to be the average closing middle market quotation (in pounds sterling) of an ordinary share as derived from the Daily Official List for the 10 business days from and including the date on which the new ordinary shares are admitted to trading, and (II) if any ordinary shares shall be allotted credited as fully paid by way of capitalisation of profits or reserves the amount paid up on such shares shall be excluded from the calculation of Ordinary Share Cost

(iv) “**Returns**” means the sum of any dividends or distributions of any kind paid or made on or in respect of the ordinary shares, including (I) a purchase of any of the Company’s own shares (whether or not out of the proceeds of any fresh issue of shares or out of unrealised profits), (II) a reduction of share capital by paying off paid up share capital, and (III) any other returns of capital in the period, whether in cash or otherwise and however described, excluding:

(a) any issue of shares credited as fully paid to shareholders by way of capitalisation of profits or reserves which is to be, or may at the election of the shareholders be, issued instead of the whole or any part of a cash dividend which the shareholders concerned would or could otherwise have received; and

(b) any issue of shares credited as fully paid to the shareholders (or as they may direct) by way of capitalisation of profits or reserves (including any share premium account or capital redemption reserve)

(v) “**Index Adjustment**” =

$$\left(\left(\frac{RPI_2}{RPI_1} \right)^{\frac{12}{t}} + 0.02 \right)^{\frac{t}{12}}$$

Where:

RPI₁ is the RPI for the month immediately preceding the start of the period referred to in (i) above (rounded to one decimal place)

RPI₂ is the RPI for the month immediately preceding the end of the period referred to in (i) above (or, if that has not been published by the close of business on the trigger date, then the RPI for the latest month for which the RPI has been published) (rounded to one decimal place)

“t” is the number of months between the two months used to determine RPI₁ and RPI₂ (and for the avoidance of doubt, there are 12 months between the same months in consecutive years)

“**RPI**” means the UK Retail Prices Index (all items) published by the Office for National Statistics (or any successor Government department) (January 1987 = 100) or any index which may replace the RPI, as selected by the remuneration committee of the Melrose Board

references to a month are to a calendar month.

For the avoidance of doubt, where “IC” is a negative number the formula in this paragraph 4.5.3 shall continue to be applicable.

In the event that the calculation in this paragraph 4.5.3 results in a Conversion Number being less than one, the Conversion Number for the purposes of these paragraphs shall be one.

The Conversion Number multiplied by NBS shall not exceed the sum of (i) 5 per cent. of the aggregate number of ordinary shares in issue on, if Resolution 1 proposed at the general meeting of the Company on 11 April 2012 is passed, 22 March 2012 or, if such resolution is not passed, 31 May 2012, plus (ii) 5 per cent. of any additional ordinary shares issued or created after the relevant date (the “Cap”).

- 4.5.4 In this paragraph 4.5, the “**trigger date**” is (except where paragraph 4.5.13 or paragraph 4.5.14 applies) 31 May 2017. If, however, the Company’s annual accounts for its preceding financial period (or where applicable a summary financial statement derived from the annual accounts) have (or has) not been published by 31 March 2017, the trigger date is 2 months after the date on which the annual accounts (or where applicable the summary financial statement) are (or is) so published. If the Company shall change its accounting reference date from 31 December, there shall be substituted for the said 31 May 2017 the date which is five months after the new accounting date. Other than pursuant to paragraph 4.5.13 and paragraph 4.5.14 the trigger date as calculated in accordance with this paragraph 4.5.4 shall not be prior to 31 May 2017.
- 4.5.5 The ordinary shares to which a holder is entitled on conversion shall not rank for any dividends or other distributions paid or made on ordinary shares prior to the relevant trigger date but shall rank for any paid or made thereafter, and subject thereto they shall rank pari passu in all respects and form one class with the ordinary shares then in issue.
- 4.5.6 If a conversion notice is served in accordance with paragraph 4.5.1(b), within 20 business days after the trigger date (the “**conversion date**”), the Melrose Board shall convert the 2012 Incentive Shares into the ordinary shares and deferred shares (if any) arising on conversion and, as soon as reasonably practicable thereafter, shall issue to the holders of such ordinary shares without charge certificates for the ordinary shares and deferred shares (if any). In the meantime, transfers of ordinary shares shall be certified against the register.
- 4.5.7 Except for the purposes of paragraph 4.5.1(a), where the Conversion Number is a fraction, the Conversion Number shall be rounded up to the nearest whole number provided that where a holder of 2012 Incentive Shares converts more than one 2012 Incentive Share at the same time, then for the purposes of determining the number of ordinary shares to which a holder is entitled and whether (and if so what) fraction of an ordinary share arises, the number of ordinary shares arising on the conversion of 2012 Incentive Shares by any one holder shall first be aggregated.
- 4.5.8 Where a block admission arrangement is in place with a relevant investment exchange, the Company will use its best endeavours to procure that the aggregate Conversion Number of ordinary shares shall, upon conversion, be admitted to the relevant investment exchange. Where a block admission arrangement is not in place or is insufficient to deal with the aggregate Conversion Number, the Company will apply for admission to the relevant investment exchange for that number of ordinary shares for which there are insufficient ordinary shares available under a block admission arrangement to satisfy the aggregate Conversion Number. The Company shall prepare and use its best endeavours to issue any listing particulars and other documents that may be required to be issued in respect of any ordinary shares arising on conversion pursuant to the rules of any relevant investment exchange.
- 4.5.9 The Melrose Board may in its absolute discretion from time to time decide the manner in which 2012 Incentive Shares are to be converted, subject to the provisions of the Articles and the Act, and for the avoidance of doubt may decide to effect conversion of 2012 Incentive Shares partly in one manner and partly in another.
- 4.5.10 Without prejudice to paragraph 4.5.9, the Melrose Board may, pursuant to the authority given by the adoption of the Articles and without the requirement for any further resolution of the Company or of the holders of any class of shares, elect to effect conversion, in whole or in part, by sub-division, in which case each 2012 Incentive Share to be converted shall,

pursuant to the authority granted by the adoption of the Articles, be sub-divided and re-designated into:

- (i) such number of ordinary shares of the same nominal amount as the ordinary shares of the Company at such time as the Melrose Board determines, equal to (or no greater than) the Conversion Number; and
- (ii) a non-voting deferred share with a nominal value equal to the balance of such share, having the rights set out in paragraph 4.5.11 (a “**deferred share**” and, together, the “**deferred shares**”).

4.5.11 The deferred shares shall not confer the right to be paid a dividend or to receive notice of or to attend or vote at a general meeting. On a winding-up, after the distribution of the first £10 billion of the assets in accordance with paragraph 4.4.2, the holders of the deferred shares (if any) shall be entitled to receive an amount equal to the nominal value of such deferred shares pro rata to their respective holdings. The deferred shares shall not, save as referred to in this paragraph 4.5.11, be transferable. Conversion of a 2012 Incentive Share is deemed to confer irrevocable authority on the Melrose Board at any time to do all or any of the following without obtaining the sanction of the holder of any or all of the deferred shares:

- (i) to appoint a person to execute on behalf of each holder of deferred shares an instrument of transfer for or an agreement to transfer (or both) all or some of the deferred shares, without making a payment to the holder, to such person as the Melrose Board may decide, as custodian;
- (ii) to purchase all or some of the deferred shares (subject to the provisions of the Act) for a price of 1 pence for all the deferred shares purchased, without obtaining the sanction of the holder;
- (iii) for the purposes of any such purchase, to appoint any person to execute on behalf of the holder of deferred shares a contract for the sale to the Company of any such deferred shares by him or her; and
- (iv) to cancel all or any of the same so purchased in accordance with the Act.

Pending the transfer or purchase the Company may retain the certificates for the deferred shares.

4.5.12 Without prejudice to paragraph 4.5.9, and notwithstanding the provisions of the Articles, the Melrose Board may without the requirement for any further resolution of the Company or of the holders of any class of shares, (I) elect to effect conversion, in whole or in part, by way of the capitalisation of profits or reserves (including a share premium account, capital redemption reserve and profit and loss account), whether or not available for distribution, (II) appropriate the sum to be capitalised to any one or more holders of 2012 Incentive Shares and whether or not in proportion to the nominal amounts of shares held by them, and apply that sum on such holders’ behalf in or towards paying up in full unissued ordinary shares of a nominal amount equal to that sum, and to allot the shares to such holders or as they may direct. Immediately upon such allotment, the 2012 Incentive Shares to be converted at any one time and held by such holder shall, if conversion is effected in whole pursuant to this paragraph 4.5.12, pursuant to the authority given by the adoption of the Articles and without the requirement for any further resolution of the Company, be re-designated as non-voting deferred shares having the rights set out in paragraph 4.5.11.

4.5.13 If, prior to the payment of the dividend provided for in paragraph 4.5.1(a) and paragraph 4.5.1(b), the conversion of the 2012 Incentive Shares into ordinary shares pursuant to paragraph 4.5.1(b) or the purchase or redemption of the 2012 Incentive Shares pursuant to paragraph 4.5.1(c), as the case may be, the Company becomes aware that, as a result of an offer made to all holders of ordinary shares (or all holders of ordinary shares other than the offeror and any associates of the offeror, as defined in section 988 of the Act)

to acquire all or some of the ordinary shares (including any such offer implemented by way of a court approved scheme of arrangement under Part 26 of the Act) the right to cast more than 50 per cent. of the votes that may ordinarily be cast on a poll at a general meeting has or will become vested in the offeror and those associates, the Company shall give notice to all holders of 2012 Incentive Shares forthwith upon it becoming so aware. Subject to paragraph 4.7.3, the 2012 Incentive Shares shall convert on the third day following the date of the notice in accordance with this paragraph 4.5 except that for such purposes the “trigger date” shall be the date of, but immediately prior to, the change of control of the Company (the “**Change of Control**”) and “SP” shall be the offer price as calculated on the date of the Change of Control. In the event that part or all of the offer price is not in cash, the remuneration committee shall determine the value of the non-cash element, having been advised by an investment bank of repute that such valuation is fair and reasonable. For the avoidance of doubt, any offer so made (including any offer implemented by way of a court approved scheme of arrangement under Part 26 of the Act) which results in the Company being controlled by a new company (“**New Company**”) in which at least 90 per cent. of the shares in the New Company are held by substantially the same persons who immediately before the offer was made were shareholders in the Company shall not constitute a Change of Control of the Company and no “trigger date” shall be deemed to have occurred provided that the 2012 Incentive Shares have been exchanged or are exchangeable for new incentive shares in the New Company on substantially the same terms as the 2012 Incentive Shares.

- 4.5.14 If, prior to the payment of the dividend provided for in paragraph 4.5.1(a) and paragraph 4.5.1(b), the conversion of the 2012 Incentive Shares into ordinary shares pursuant to paragraph 4.5.1(b) or the purchase or redemption of the 2012 Incentive Shares pursuant to paragraph 4.5.1(c), as the case may be, either (I) a resolution for voluntary winding-up of the Company is passed or (II) a winding-up order is made by the court in relation to the Company, subject to paragraph 4.7.3, the 2012 Incentive Shares shall be treated as if they had converted in accordance with this paragraph 4.5 on the date of, and with effect immediately prior to, the resolution for the voluntary winding-up of the Company being passed or the date of the winding-up order being made, as the case may be (in either case, the “**operative date**”) except that for such purposes the “trigger date” shall be the operative date. In that event, the holder thereof shall be entitled to be paid, in satisfaction of the amount due in respect of his 2012 Incentive Shares, a sum equal to the amount to which he would have been entitled on a return of capital on a winding-up if he had been the holder of the ordinary shares to which he would have become entitled on such conversion.
- 4.5.15 If a doubt or dispute arises concerning the calculation of the Conversion Number or any component part of the formulae for calculating the Conversion Number, the Melrose Board shall refer the matter to the auditors and their certificate as to such calculation shall be conclusive and binding on all concerned.
- 4.5.16 In the event that any provision (or combination of provisions) in this paragraph 4.5 or any future change to the capital structure of the Company produces, or is likely to produce, a Conversion Number which appears to the remuneration committee to be an anomalous result or there shall be quantified material information known to the remuneration committee in relation to the current financial position of the Company that is not in the public domain that would, in the reasonable opinion of the remuneration committee, produce an anomalous result if such information were in the public domain, the remuneration committee may make such adjustments to the method of calculating the Conversion Number as it considers appropriate to ensure that conversion is fair and reasonable, and as an investment bank of repute shall have confirmed in writing to be fair and reasonable so far as the ordinary shareholders are concerned.

4.6. *Permitted Transfer of 2012 Incentive Shares*

- 4.6.1 Subject to paragraph 4.6.2, the holders of the 2012 Incentive Shares may not transfer, charge, encumber, grant any option over or otherwise dispose of any 2012 Incentive Share or any interest therein.
- 4.6.2 A holder of a 2012 Incentive Share may at any time transfer a 2012 Incentive Share:
- (a) with the prior written consent of the Melrose Board (and where such consent is given in relation to a transfer to the trustees of a trust of which the only beneficiaries (and the only people capable of being beneficiaries) are the holder of the 2012 Incentive Shares who established the trust and who is transferring the relevant shares; and/or his spouse; and/or his lineal descendants by blood or adoption, such transferees being “**permitted transferees**”); or
 - (b) when required by paragraph 4.6.3 or paragraph 4.7.2.
- 4.6.3 If a transferee of any shares under paragraph 4.6.2 shall at any time cease to be a permitted transferee in relation to the original holder of the relevant 2012 Incentive Shares (the “**relevant shares**”), it shall be the duty of the trustees and/or the person holding the relevant shares to notify the board in writing that such event has occurred and the trustees and/or the person shall be bound to execute a stock transfer form and to do such other things as may be necessary to transfer the relevant shares at the price per share (if any) for which they were acquired, to the original holder (who shall be bound to acquire the relevant shares) and, if they or he fails to do so, the directors may authorise any director to execute any stock transfer form and to do such other things as may be necessary or desirable to transfer the relevant shares on behalf of the trustees and/or the person holding the relevant shares pursuant to this paragraph 4.6.3.
- 4.6.4 The Melrose Board may require from any person lodging a share transfer such information and evidence as the Melrose Board thinks fit regarding any matter which they may reasonably deem relevant for the purposes of paragraph 4.6.2 and may refuse to register the relevant transfer until they have received information and evidence satisfactory to them.

4.7 *Compulsory transfer or conversion*

If the holder of any 2012 Incentive Shares or the original holder of any 2012 Incentive Shares transferred pursuant to paragraph 4.6, if an employee of the Company or any of its subsidiary undertakings, ceases to be an employee, if a director of the Company, ceases to be a director, and if an employee and director, ceases to be both, in each case other than by reason of death, permanent ill health, permanent disability, his resignation in connection with a Change of Control, or the termination of his employment or directorship by the Company without cause, he shall be deemed to be a “**bad leaver**”.

If the holder of any 2012 Incentive Shares or the original holder of any 2012 Incentive Shares transferred pursuant to paragraph 4.6, if an employee of the Company or any of its subsidiary undertakings, ceases to be an employee, if a director of the Company, ceases to be a director, and if an employee and director, ceases to be both, and such person is not a bad leaver, he shall be deemed to be a “**good leaver**”.

- 4.7.1 Unless the remuneration committee shall in its absolute discretion determine otherwise, if the holder of any 2012 Incentive Shares or the original holder of any 2012 Incentive Shares transferred pursuant to paragraph 4.6 becomes a bad leaver then the provisions of paragraph 4.7.1 to paragraph 4.7.3 shall apply in respect of:
- (a) the bad leaver; and
 - (b) any permitted transferee of such bad leaver and any subsequent transferee of such shares
- (together the “**compulsory transferors**”).

- 4.7.2 Each 2012 Incentive Share held by the compulsory transferors shall within the period of 20 business days following the bad leaver ceasing to be an employee or director, be transferred to the trustees of an employee share ownership plan trust, or such person as the Melrose Board may direct, at a price per share equal to the lower of the nominal value per 2012 Incentive Share and the closing middle market quotation of an ordinary share in the capital of the Company as derived from the Daily Official List on the business day prior to the transfer, and the compulsory transferors shall be bound to execute a stock transfer form and to do such other things as may be necessary to transfer the relevant shares and if they fail to do so, the directors may authorise any director to execute any stock transfer form and to do such other things as may be necessary or desirable to transfer the relevant shares on behalf of the compulsory transferors.
- 4.7.3 Following a cessation of employment or directorship causing this paragraph 4.7 to apply to particular 2012 Incentive Shares, those 2012 Incentive Shares may not be transferred pursuant to paragraph 4.6.2(a). In the event of a Change of Control between the date of cessation of employment or directorship and the relevant transfer date in paragraph 4.7.2, those 2012 Incentive Shares shall convert in accordance with paragraph 4.5.13 except that each such 2012 Incentive Share shall convert into one fully paid ordinary share and one fully paid deferred share with a nominal value equal to the balance of the nominal value of the 2012 Incentive Share (the “**bad leaver conversion rate**”). In the event of either (I) a resolution for a voluntary winding-up of the Company being passed or (II) a winding-up order being made by the court in relation to the Company, in either case between the date of cessation of employment or directorship and the relevant transfer date in paragraph 4.7.2, those 2012 Incentive Shares shall convert in accordance with paragraph 4.5.14 except that each such 2012 Incentive Share will convert in accordance with the bad leaver conversion rate.
- 4.7.4 Save in circumstances where a holder of 2012 Incentive Shares becomes a good leaver as a result of his resignation in connection with a Change of Control, the remuneration committee may, in its absolute discretion, require that a good leaver and any person to whom such good leaver has transferred 2012 Incentive Shares pursuant to paragraph 4.6 and any subsequent transferee of such shares shall be deemed to be a compulsory transferor and that the provisions of paragraph 4.7.2 shall apply to such good leaver or transferee as the case may be, in respect of some or all of the Unvested Portion of the 2012 Incentive Shares held by such good leaver, as they apply to a bad leaver.

Any determination by the remuneration committee in accordance with paragraph 4.7.4 shall be notified to such good leaver within three months of such person becoming a good leaver.

For the purposes of this paragraph 4.7.4, “**Unvested Portion**” shall mean the product of (i) the number of full calendar months remaining from the date on which a holder of 2012 Incentive Shares becomes a good leaver up to 31 May 2017 divided by 62 if Resolution 1 proposed at the general meeting of the Company on 11 April 2012 is passed, or 60 if such resolution is not passed and (ii) the total number of 2012 Incentive Shares held by such good leaver; rounded up to the nearest whole number of 2012 Incentive Shares; save that, in the case of a good leaver who becomes entitled to become a holder of 2012 Incentive Shares more than six weeks after this paragraph 4.7 takes effect the Unvested Portion shall be the total number of 2012 Incentive Shares held by such good leaver.

4.8. ***Restrictions***

If 2012 Incentive Shares remain capable of being converted into ordinary shares, the Company shall not, except with the consent in writing of the holders of at least three-fourths of the nominal amount of the 2012 Incentive Shares then in issue or with the sanction of a special resolution passed at a separate meeting of the holders of the 2012 Incentive Shares then in issue validly held in accordance with the provisions of the Articles (I) create, allot or issue any further 2012 Incentive

Shares in the capital of the Company; or (II) pass a resolution varying any of the special rights attached to the 2012 Incentive Shares.

4.9 *Transfer of Shares*

4.9.1 Shares issued by Melrose in certificated form may be transferred by an instrument of transfer in writing in any usual form, or in such other form as the Melrose Board may approve. The instrument of transfer shall be executed by or on behalf of the transferor and, in the case of a transfer of a share that is not fully paid, by or on behalf of the transferee.

4.9.2 In exceptional circumstances, approved by any relevant investment exchange, the Melrose Board may refuse to register the transfer of certificated shares provided that such refusal would not disturb the market in those shares. Subject to the requirements of any relevant investment exchange, the Melrose Board may, in its absolute discretion refuse to register any transfer of a certificated share which is not fully paid or the transfer of a certificated share on which Melrose has a lien. Subject to the requirements of any relevant investment exchange, the Melrose Board may also, in its absolute discretion, refuse to register the transfer of a certificated share or a renunciation of a renounceable letter of allotment unless:

- (a) it is only in respect of one class of shares;
- (b) it is in favour of a single transferee or renounee or not more than four joint transferees or renounees;
- (c) it is duly stamped (if required); and
- (d) it is delivered for registration to the registered office or such other place as the Melrose Board may decide, accompanied by the certificate for the shares to which it relates (except where the shares are transferred by a recognised financial institution and no certificates have been issued for them or in the case of a renunciation) and such other evidence as the Melrose Board may reasonably require to prove title of the transferor or the person renouncing and due execution by him of the transfer or renunciation.

If the Melrose Board refuses to register the transfer of a certificated share it shall, as soon as reasonably practicable, send notice of such refusal to the transferee together with its reasons for the refusal.

4.9.3 Shares issued by Melrose in uncertificated form may be transferred in accordance with the CREST Regulations. The Melrose Directors may refuse to register a transfer of a share in uncertificated form in any case where Melrose is entitled to refuse (or is expected from the requirement) under the CREST Regulations to register the transfer.

4.10 *Changes in Capital and Purchase of Own Shares*

4.10.1 Melrose may at any time by way of ordinary resolution:

- (a) consolidate and divide all or any of its share capital into shares of a larger amount;
- (b) subject to the 2006 Act, subdivide all or part of its share capital into shares of a smaller amount and may determine that the shares resulting from the sub-division have amongst themselves such preferred, deferred or other special rights or advantages or be subject to any such restrictions as Melrose has power to attach to unissued or new shares;
- (c) cancel any shares which, at the date of the ordinary resolution, have not been taken or agreed to be taken by any person and diminish the amount of its share capital by the amount of the shares so cancelled; and
- (d) increase its share capital.

4.10.2 Subject to the 2006 Act and to the rights attached to existing shares, Melrose may:

- (a) subject to the requirements of any relevant investment exchange, purchase, or agree to purchase in the future, its own shares; and
- (b) by special resolution, reduce its share capital, capital redemption reserve, share premium account or other undistributable reserve in any way.

4.11 *Variation of Rights*

Subject to the 2006 Act, all or any of the rights for the time being attached to any class of shares may be varied or abrogated either with the consent in writing of the holders of at least three-fourths in nominal amount of the issued shares of that class or with the sanction of a special resolution passed at a separate meeting of the holders of the issued shares of that class validly held in accordance with the Articles. The rights attached to a class of shares are not, unless otherwise expressly provided for in the rights attaching to those shares, deemed to be varied by the creation, allotment or issue of further shares ranking *pari passu* with or subsequent to them or by the purchase or redemption by Melrose of its own shares in accordance with the 2006 Act and the Articles.

4.12 *Constitution of the Melrose Board*

There is no age limit for directors. The directors must not, unless otherwise determined by an ordinary resolution of Melrose, be less than two. A director need not be a member of Melrose.

4.13 *Directors' remuneration, pensions and benefits*

4.13.1 The directors shall be paid such aggregate amount of fees for their services as directors as the Melrose Board decides (or such other aggregate amount as Melrose may by ordinary resolution decide). The aggregate fees shall be divided among the directors in such proportions as the Melrose Board decides or, if no decision is made, equally. Subject to the 2006 Act, the requirements of any relevant investment exchange and the Articles, the Melrose Board may arrange for part of a fee payable to a director to be provided in the form of fully-paid shares in the capital of Melrose.

4.13.2 The Melrose Directors are entitled to be repaid all reasonable travelling, hotel and other expenses properly incurred by them in the performance of their duties as directors including expenses incurred in attending meetings of the Melrose Board or of Committees of the Melrose Board or general meetings or separate meetings of the holders of a class of shares of Melrose.

4.13.3 In addition, the Melrose Board may decide to pay a director who, at the request of the Melrose Board, goes or resides abroad, makes a special journey or performs a special service on behalf of Melrose, such reasonable additional remuneration (whether by way of salary or otherwise) and expenses as the Melrose Board may decide.

4.13.4 The salary or other remuneration of a director appointed to hold employment or executive office in accordance with the Articles may be a fixed sum of money, or wholly or in part governed by business done or profits made, or as otherwise decided by the Melrose Board, and may be in addition to or instead of a fee payable to him for his services as director pursuant to the Articles.

4.13.5 The Melrose Board may exercise all the powers of Melrose to provide pensions or other retirement or superannuation benefits and to provide death or disability benefits or other allowances or gratuities to a person who is or has at any time been a director of:

- (a) Melrose or any company which is or was a subsidiary undertaking of Melrose;
- (b) any company allied to or associated with Melrose or a subsidiary undertaking of Melrose; or

- (c) a predecessor in business of Melrose or of a subsidiary undertaking of Melrose, or any member of his family or his dependants. For this purpose the Melrose Board may establish, maintain, subscribe and contribute to any scheme, trust or fund and pay premiums.

4.14 *Directors' retirement*

At each annual general meeting of Melrose one-third of the directors who are subject to retirement by rotation, or if their number is not three or a multiple of three, the number nearest to but not less than one third, shall retire from office provided that if there are fewer than three directors who are subject to retirement by rotation, one shall retire from office. If any one or more directors were last appointed or reappointed three years or more prior to the meeting or were last appointed or reappointed at the third immediately preceding annual general meeting, he or they shall retire from office and shall be counted in obtaining the number required to retire at the meeting. All retiring directors shall be eligible for reappointment.

4.15 *Directors' interests in contracts*

Subject to the 2006 Act and provided he has disclosed to the Melrose Board the nature and extent of any direct or indirect interest of his, a director, notwithstanding his office:

- 4.15.1 may enter into or otherwise be interested in a contract, arrangement, transaction or proposal with Melrose or in which Melrose is otherwise interested either in connection with his tenure of an office or place of profit or as seller, buyer or otherwise;
- 4.15.2 may hold another office with Melrose (except that of auditor or auditor of a subsidiary of Melrose) in conjunction with the office of director and may act by himself or through his firm in a professional capacity to Melrose, and in that case on such terms as to remuneration and otherwise as the Melrose Board may decide either in addition to or instead of the remuneration described in paragraph 4.9 above;
- 4.15.3 may be a director or other officer of, or employed by, or a party to a contract, transaction, arrangement or proposal with or otherwise interested in, a company promoted by Melrose or in which Melrose is otherwise interested or as regards which Melrose has a power of appointment; and
- 4.15.4 is not liable to account to Melrose for a profit, remuneration or other benefit realised by such contract, arrangement, transaction, proposal, office or employment and no such contract, arrangement, transaction or proposal is avoided on the grounds of any such interest or benefit.

4.16 *Restrictions on voting by directors*

4.16.1 A director may not vote or be counted in the quorum in respect of any contract, arrangement, transaction or proposal to which Melrose is or is to be a party and in which he has an interest which is, to his knowledge, a material interest (otherwise than by virtue of his interest in shares or debentures or other securities of or otherwise in or through Melrose). Notwithstanding the above, a director shall be entitled to vote on:

- (a) the giving of a guarantee, security or indemnity in respect of money lent or obligations incurred by him or by any other person at the request of, or for the benefit of, Melrose or any of its subsidiary undertakings;
- (b) the giving of a guarantee, security or indemnity in respect of a debt or obligation of Melrose or any of its subsidiary undertakings for which he himself has assumed responsibility under a guarantee or indemnity or by the giving of security;
- (c) any contract, arrangement, transaction or proposal concerning an offer of shares, debentures or other securities of Melrose or any of its subsidiary undertakings for subscription or purchase in respect of which he is or may be entitled to participate as

a holder of any such securities or in the underwriting or sub-underwriting of which he is to participate;

- (d) any contract, an arrangement, transaction or proposal to which Melrose is or is to be a party concerning another company (including a subsidiary undertaking of Melrose) in which he is interested (directly or indirectly) if he does not to his knowledge hold an interest in shares (within the meaning of sections 820 to 825 of the 2006 Act) representing one per cent. or more of any class of the equity share capital of such company or of the voting rights of that company;
- (e) any contract, arrangement, transaction or proposal for the benefit of employees of Melrose or any of its subsidiary undertakings which does not award him a privilege or benefit not generally awarded to the employees to whom it relates; and
- (f) any contract, arrangement, transaction or proposal concerning the purchase or maintenance of an insurance policy under which he may benefit.

4.16.2 A director shall not vote or be counted in the quorum at a meeting of the directors or committee meeting in respect of any resolution concerning his own appointment (including fixing and varying the terms of his appointment or its termination), as the holder of any office or place of profit with Melrose or any other company in which Melrose is interested.

4.17 *Borrowing powers*

The Melrose Board may exercise all the powers of Melrose to borrow money and to mortgage or charge all or part of the undertaking, property and assets (present or future) and uncalled capital of Melrose and, subject to the 2006 Act and all other relevant legislation, to issue debentures and other securities whether outright or as collateral security for a debt, liability or obligation of Melrose or a third party. There is no limit on the amount of borrowings.

4.18 *Disclosure*

Where there is a default in supplying information required by a notice served under section 793 of the 2006 Act, the Articles provide for voting and related rights to be restricted in relation to the relevant shares and, where the relevant shares represent 0.25 per cent. or more in nominal value of the issued shares of the relevant class, the right to receive dividends to be withheld.

4.19 *General Meetings*

The Melrose Board may call general meetings whenever it thinks fit and immediately on receipt of a requisition of members pursuant to the 2006 Act.

Unless consent to short notice is obtained in accordance with the provisions of the 2006 Act, an annual general meeting shall be called by at least 21 clear days' notice. All other general meetings shall be called by at least 14 clear days' notice. A notice of meeting shall be given to each member of the Company (other than any who, under the Articles or the terms of an allotment or issue of shares, is not entitled to receive notice), to the Melrose Directors and to the Company's auditors.

No business shall be transacted at any general meeting unless a quorum is present. Two "qualifying persons" present and entitled to vote shall be a quorum, where "qualifying persons" includes proxies and corporate representatives. The absence of a quorum does not prevent appointment of a chairman in accordance with the Articles, which shall not be treated as part of the business of the meeting.

The Melrose Board may make any arrangement and impose any restriction it considers appropriate to ensure the security of a meeting of the Company including, without limitation, the searching of a person attending the meeting and the restriction of the items of personal property that may be taken into a meeting. A director or the secretary of the Company may refuse entry to a meeting to any person who refuses to comply with any such arrangements and eject from a meeting any person who causes the proceedings to become disorderly.

Each director shall be entitled to attend and speak at a general meeting and at a separate meeting of the holders of a class of shares or debentures in the Company, whether or not he is a member. The chairman may invite any person to attend and speak at any general meeting of the Company where he considers that this will assist in the deliberations of the meeting.

At a general meeting, a resolution put to the vote of the meeting shall be decided on a show of hands unless (before or on the declaration of the result of the show of hands), a poll is demanded by the chairman of the meeting; or not less than five members present in person or by proxy and entitled to vote at the meeting; or a member or members present in person or by proxy and representing in aggregate not less than one-tenth of the total voting rights of all the members having the right to vote at the meeting; or a member or members present in person or by proxy holding shares conferring a right to vote at the meeting, being shares on which an aggregate sum has been paid up equal to not less than one-tenth of the total sum paid up on all the shares conferring that right. Members present by proxy shall have the right to speak and to vote on a show of hands.

On a poll votes may be given in person or by proxy and a member entitled to more than one vote need not, if he votes, use all his votes or cast all the votes he uses in the same way. A person appointed to act as a proxy need not be a member of the Company. Members may appoint more than one proxy, provided that each proxy is appointed to exercise the rights attached to different shares.

A company which is a member of the Company may, by resolution of its directors or other governing body, authorise one or more persons to act as its representative at a meeting of the Company or at a separate meeting of the holders of a class of shares. The person so authorised is entitled to exercise on behalf of the company which he represents (in respect of that part of the company's holding of shares to which the authorisation relates) those powers that the company could exercise if it were an individual member. The company is for the purposes of the Articles deemed to be present in person at a meeting if a representative is present. Such representative may be required to produce a certified copy of the resolution of authorisation before permitting him to exercise his powers.

The above is a summary only of certain provisions of the Articles. Copies of the Articles are available for inspection in the manner specified in paragraph 16 below.

5. MAJOR INTERESTS IN SHARES

5.1 So far as the Company is aware, as at the Latest Practicable Date the following persons (other than the Melrose Directors) hold voting rights, whether direct or indirect (and/or holdings, whether direct or indirect, of certain financial instruments which give the holder an unconditional right or a right exercisable in his sole discretion to acquire), in respect of three per cent. or more of the ordinary issued share capital of the Company:

Shareholder	Number of Existing Melrose Shares	Approximate percentage of existing issued share capital	Number of Ordinary Shares following Rights Issue ⁽¹⁾	Approximate percentage of issued share capital following Rights Issue ⁽¹⁾
BlackRock, Inc.	47,823,838	11.33	143,471,514	11.33
Ameriprise Financial, Inc.	31,065,172	7.36	93,195,516	7.36
Standard Life Investments Ltd.	27,163,618	6.43	81,490,854	6.43
Artemis Investment Management LLP . . .	25,701,112	6.09	77,103,336	6.09
Lloyds Banking Group plc	23,577,665	5.58	70,732,995	5.58
Ignis Investment Services Limited	19,725,217	4.67	59,175,651	4.67
Aviva Plc and its subsidiaries	19,996,176	4.74	59,988,528	4.74
Legal and General Investment Management Ltd.	16,576,989	3.93	49,730,967	3.93
F&C Asset Management Plc	14,728,830	3.49	44,186,490	3.49

(1) Assuming each major Melrose Shareholder takes up its rights to New Melrose Shares in full and the maximum number of New Melrose Shares are issued.

5.2 As at the Latest Practicable Date, save as set out in this Part XIII (*Additional Information*), the Company is not aware of any person who holds voting rights, whether direct or indirect (and/or

holdings, whether direct or indirect, of certain financial instruments which give the holder an unconditional right or a right exercisable in his sole discretion to acquire), three per cent. or more of the ordinary issued share capital of the Company.

- 5.3 None of the Melrose Shareholders referred to in paragraph 5.1 above has now, or will following the Rights Issue have different voting rights from any other holder of Melrose Shares in respect of any Melrose Shares held by them.
- 5.4 As at the Latest Practicable Date, the Company is not aware of any person or persons who directly or indirectly, acting jointly with others or acting alone, exercised or could exercise control over the Company.

6. PROPERTY

The following properties are the principal properties occupied by the Melrose Group:

UK Location	Division	Tenure	Use
Leconfield House, Curzon Street, London W1J 5JA	Group	Leasehold	Offices
Precision House, Arden Road, Alcester, Warwickshire B49 6HN	Group	Leasehold	Offices
Greenhill Industrial Estate, Coltswood Road, Coatbridge, North Lanarkshire ML5 2AG	Bridon Group	Freehold	Manufacturing
Carr Hill, Doncaster, South Yorkshire DN4 8DG	Bridon Group	Freehold	Manufacturing
ICON Building Firstpoint Balby Carr Bank, Doncaster, South Yorkshire DN4 5JQ	Bridon Group	Leasehold	Offices
Willington Quay, Wallsend, Tyne and Wear NE28 6TT	Bridon Group	Part Freehold/ Part Leasehold	Manufacturing
PO Box 18, Falcon Works, Nottingham Road, Loughbrough, Leicestershire LE11 1EX	Brush Turbogenerators	Freehold	Manufacturing
PO Box 20, Nottingham Road, Loughbrough, Leicestershire LE11 1HN	Brush Turbogenerators	Freehold	Manufacturing
Ravenstor Road, Wirksworth, Derbyshire DE4 4FY	Brush Turbogenerators	Leasehold	Manufacturing
Newport Road, Blackwood, Gwent NP12 2XH	Switchgear	Leasehold	Manufacturing
Station Street, Cradley Heath, West Midlands B64 6AJ	Crosby	Freehold	Manufacturing
Europe Location	Division	Tenure	Use
Leuvensebaan 51, Putte, B-2580, Belgium	Crosby	Freehold	Manufacturing
Edvarda Beneše 39/564, Plzen, Czech Republic, 301 00.	Brush Turbogenerators	Freehold	Manufacturing
27 rue des 3 Obus, Nouzonville, 08700, France	Crosby	Freehold	Manufacturing
Mageburger street 14a, Gelsenkirchen, Germany 45881	Bridon Group	Freehold	Manufacturing
Heliswannenweg 50, Elze, Germany, 31008	Marelli	Freehold	Warehouse
Via Sabbionara 1, Arzignano, Italy, 36071	Marelli	Freehold	Manufacturing
Ringdijk, 390B, Ridderkerk, Netherland, 2983GS, The Netherlands	Brush Turbogenerators	Freehold	Manufacturing
Celsiusstraat 51, Ede, Netherland, 67163Z, The Netherlands	Crosby	Freehold	Manufacturing

Asia			
Location	Division	Tenure	Use
Loyang Offshore Supply Base (SOPS Way), Box No: 5064, 25 Loyang Crescent, Singapore 508988	Bridon Group	Leasehold	Warehouse
Jl. Raya Bekasi Km.43 Cibitung, Bekasi, Indonesia, 17520	Bridon Group	Freehold	Manufacturing
Lot PT Nos 5038 and 5941, Jalan Teluk Datuk 28/40, Off Persiaran Sepang, Seksyen 28, 40400 Alam, Selangor Darul Ehsan, Malaysia	Marelli	Leasehold	Manufacturing
57 Yonghau Street, Xiachebg District, Hangzhou City, ZheJiang Province, 310022, China	Bridon Group	Leasehold	Manufacturing
North America			
Location	Division	Tenure	Use
76 ACCO Drive, PO Box 792, York, PA, 17405, USA	Acco	Leasehold	Manufacturing
280 New Commerce Blvd. Wilkes-Barre, PA, 18706 (corporate and wiremill)	Bridon Group	Freehold	Manufacturing
101 Stevens Lane, Exeter, PA, 18643, USA	Bridon Group	Freehold	Manufacturing
340 Jekyll Road, Baxley, GA, 31513, USA	Harris	Freehold	Manufacturing
315 West 12th Ave. Cordele, GA, 31010, USA	Harris	Freehold	Manufacturing
2801 Dawson Rd., Tulsa, Oklahoma, 74110 (Main Address), USA	Crosby	Freehold	Manufacturing
900 Fisher Rd. Longview, Texas, 75606, USA	Crosby	Freehold	Manufacturing
700 West Bridge Street, Owatonna, MN, 55060, USA	Truth	Freehold	Manufacturing
601 Braddock Ave, Turtle Creek, PA 15145, USA	Brush Turbogenerators	Leasehold	Manufacturing
145 Heart Lake Road, Brampton, Ontario, L6W 3K3 BLDG 1, Canada	Crosby	Freehold	Manufacturing
Middle East			
Location	Division	Tenure	Use
PO Box 44903, Falcon Towers, Al Nasr St, M-41 Plot 87-A4, ICAD, Abu Dhabi, UAE	Brush Turbogenerators	Leasehold (land) Freehold (buildings)	Manufacturing
Australasia			
Location	Division	Tenure	Use
2 Frawley Avenue, Narangba Brisbane, Queensland, 4504, Australia	Switchgear	Leasehold	Manufacturing
Cookes: 6-10 Greenmount Drive, East Tamaki, Auckland, New Zealand	Bridon Group	Leasehold	Manufacturing

7. SUBSIDIARIES

- 7.1 The Company is the holding company of the Melrose Group. The Melrose Group's stated strategy is to acquire companies and businesses whose operational performance the Melrose Directors believe can be improved to create shareholder value. Further details are set out in paragraph 2 of Part II (*Information on Melrose*).

- 7.2 The significant subsidiary undertakings of Melrose are set out in the table below. The proportion of share capital indicated in each of these companies is directly or indirectly owned by Melrose. The issued share capital of each company is fully paid.

Name of subsidiary	Incorporated and registered in	Proportion of share capital owned by Melrose (per cent.)
Energy		
Brush Electrical Machines Limited	Great Britain	100
Brush HMA B.V.	Netherlands	100
Brush SEM s.r.o.	Czech Republic	100
Brush Transformers Limited	Great Britain	100
Harrington Generators International Limited	Great Britain	100
Hawker Siddeley Switchgear Limited	Great Britain	100
Marelli Motori SpA	Italy	100
Generator & Motor Services of Pennsylvania LLC	USA	100
Lifting		
Bridon-American Corporation	USA	100
Bridon International GmbH	Germany	100
Bridon International Limited	Great Britain	100
Bridon New Zealand Limited	New Zealand	100
Crosby Europe N.V.	Belgium	100
The Crosby Group LLC	USA	100
Other Industrial		
McKechnie Specialist Products Limited	Great Britain	100
The Harris Waste Management Group Inc	USA	100
Truth Hardware Corporation	USA	100
Group		
FKI Engineering Limited	Great Britain	100
Crosby Canada Inc (formerly FKI Industries Canada Limited)	Canada	100
FKI Industries Inc	USA	100
McKechnie Management Services Limited	Great Britain	100
FKI Limited (formerly FKI plc)	Great Britain	100
Melrose Overseas Holdings Limited	Great Britain	100
Melrose UK Holdings Limited	Great Britain	100
McKechnie Holdings (UK) Limited	Great Britain	100
Eachairn Aerospace Holdings Limited	Great Britain	100
McKechnie EP Holdings Limited	Great Britain	100
Melrose North America Inc	USA	100
Melrose PFG Company Number 1 Limited	Great Britain	100

- 7.3 Set out below are details of undertakings in which Melrose has a direct or indirect participating interest and where that participating interest generates at least 10 per cent. of the consolidated net profit of the Melrose Group:

Name of subsidiary	Incorporated and registered in	Principal activity	Proportion of share capital owned by Melrose (per cent.)
Brush Electrical Machines Limited	Great Britain	Engineering Company	100
Brush SEM s.r.o.	Czech Republic	Engineering Company	100
Bridon International Limited	Great Britain	Engineering Company	100
The Crosby Group LLC	USA	Engineering Company	100

There are no undertakings in the Melrose Group that individually own net assets that exceed 10 per cent. of the net assets of the Melrose Group.

8. WORKING CAPITAL

The Company is of the opinion that, taking into account the bank facilities available to it, the Melrose Group has sufficient working capital for its present requirements, that is, for at least the 12 months following the date of publication of this document.

9. SIGNIFICANT CHANGE

- 9.1 There has been no significant change in the financial or trading position of the Melrose Group since 31 December 2011, being the date to which the last audited consolidated annual accounts of the Melrose Group were prepared.
- 9.2 There has been no significant change in the financial or trading position of the Elster Group since 31 March 2012, being the date to which the last unaudited interim results for the Elster Group were prepared.

10. LITIGATION

10.1 *Melrose Group*

Melrose's Report and Accounts for the year ended 31 December 2011 contained details of product liability litigation against two Bridon companies, inherited, in part, from the FKI acquisition. On 23 May 2012, Bridon, Noble and Certex reached a consensual resolution and confidential settlement of the litigation and all claims have been dismissed with prejudice. The settlement sum to be paid by Bridon (net of current contributions from insurers but before costs) is within the provision as at 31 December 2011 (£25.8 million). Bridon is still in discussions with the remaining relevant members of its insurance programme who may be available to make further contributions up to the entire amount of the settlement paid by Bridon.

Save as stated above, there are no governmental, legal or arbitration proceedings (including any such proceedings which are pending or threatened of which the Company is aware) during the 12 months immediately preceding the date of this document), which may have, or have had, in the recent past a significant effect on the Company and/or any member of the Melrose Group's financial position or profitability.

10.2 *Elster Group*

Elster's former Ipsen furnace business has been subject to a number of claims relating to alleged asbestos exposure. Pursuant to the agreement under which Elster sold its Ipsen furnace business, Elster is required to indemnify the purchaser against present or future asbestos claims noticed to Elster by 15 August 2015, up to a maximum out-of-pocket amount for Elster of EUR 15 million. The agreement under which Elster sold its Ipsen furnace business further provides that the amount of the indemnity be reduced by payments made to the purchaser under Ipsen's current or pre-existing insurance policies.

Claims exceeding the amount of EUR 15 million are only subject of the indemnity if they are covered by an indemnity from Elster's former owner, E.ON Ruhrgas AG. In addition, Ipsen's current and pre-existing insurance coverage is in excess of the EUR 15 million amount. As a consequence, Elster does not believe that these cases will have a material adverse effect on its financial condition. At the time of the disposition, 14 cases were open, and 155 new claims have been subsequently notified up to the Latest Practicable Date. Of the total claims notified, 78 have been dismissed.

In addition, there are currently three asbestos cases (filed in 1999, 2002 and 2003 by individual plaintiffs) in which Elster American Meter Company has been named as an additional defendant. As is common in asbestos related cases, the plaintiffs have not quantified their respective claims and, as such, the value of these claims is not quantifiable. All three cases have been included in the New York County Asbestos Litigation, or NYCAL, programme and are currently classified as inactive. While on the inactive docket, all discovery in these matters has been stayed until further notice.

The U.S. Environmental Protection Agency, or EPA, issued to one of Elster's subsidiaries in the U.S., Hauck Manufacturing Company ("Hauck"), among many other parties, a notice of potential liability under the federal Comprehensive Environmental Response, Compensation and Liability Act of 1980 ("CERCLA"), in respect of hazardous substance contamination at the Gowanus Canal Superfund Site in Brooklyn, New York. EPA invited potentially responsible parties ("PRPs"), including Hauck, to a briefing in March 2012 to hear EPA's technical findings, potential remediation plan and legal enforcement approach.

Previously, in March 2010, EPA added the 1.8 mile Gowanus Canal to its National Priorities List of Superfund sites under CERCLA, which are contaminated sites targeted for high priority environmental cleanup by EPA. In December 2011, EPA issued a draft remedial investigation/feasibility study that reviewed various approaches to conduct a cleanup of the contaminated canal sediments. EPA plans to propose a cleanup remedy for the site during 2012 and to select the final remedy by the end of 2012. Although the EPA has yet to issue a final remedy, and such remedy is not anticipated to be issued until the end of 2012, the total cost to remediate the Gowanus Canal is anticipated to be material. In addition to investigation and remediation costs, certain parties may be found liable for costs associated with assessing and restoring any natural resources damaged in connection with the release of hazardous materials, though due to the early stage of this investigation, the quantum of the cost of such remedy, assessment and restoration (if applicable) is unquantifiable.

CERCLA and similar state statutes could impose strict, joint and several liability for investigation and remediation costs upon owners and operators of contaminated property and generators of hazardous substances that were sent to a contaminated property. EPA alleges that one or two former Hauck manufacturing sites near the Gowanus Canal may have discharged hazardous substances into the local sewer system that may have led into the canal before they ceased operations in 1964. However, the notice of potential liability is not a formal legal determination of liability and does not mean that EPA expects Hauck to perform or fund any work related to the site at this time. Hauck denies it discharged hazardous substances into the canal and intends to avail itself of all appropriate legal defenses. At this early stage of the proceedings, we are unable to predict whether or not Hauck could be exposed to liability. We understand that EPA has entered into a consent order with City of New York and National Grid as PRPs to conduct certain investigation work at the canal, has issued notices of potential liability to many other PRPs, and is engaged in an ongoing search for additional PRPs.

Save as stated above, there are no governmental, legal or arbitration proceedings (including any such proceedings which are pending or threatened of which the Company is aware) during the 12 months immediately preceding the date of this document), which may have, or have had, in the recent past a significant effect on Elster and/or any member of the Elster Group's financial position or profitability.

11. MATERIAL CONTRACTS

11.1 *Melrose Group*

The following are all of the contracts, not being contracts entered into in the ordinary course of business, which: (i) are or may be material to the Melrose Group, and have been entered into by Melrose and/or a member of the Melrose Group within the two years immediately preceding the date of this document; or (ii) (regardless of when entered into) contain provisions under which a member of the Melrose Group has an obligation or entitlement which is or may be material to the Melrose Group, as at the date of this document:

11.1.1 *Underwriting Agreement*

On 29 June 2012, Melrose entered into the Underwriting Agreement with the Underwriters pursuant to which the Underwriters have agreed to fully underwrite the Rights Issue. Pursuant to the Underwriting Agreement, the Underwriters will (severally) use all reasonable endeavours to procure subscribers in the market for any New Melrose Shares not

validly accepted (or not treated as validly accepted) under the Rights Issue at a price not less than the Rights Issue Price plus the Underwriters' expenses in procuring such subscribers and, failing this, the Underwriters have agreed to subscribe themselves (or procure subscribers) for any outstanding New Melrose Shares at the Rights Issue Price.

In consideration of such underwriting, Melrose has agreed to pay (together with any VAT): (i) to the Underwriters a commission of 2.0342 per cent. of the aggregate value at the Rights Issue Price of the New Melrose Shares; plus (ii) to the Sponsors, a distribution fee of 0.25 per cent. of the aggregate value at the Rights Issue Price of the New Melrose Shares; plus (iii) to the Sponsors, a commission of 0.375 per cent. of the aggregate value at the Rights Issue Price of the number of New Melrose Shares for which sub-underwriters (prior to the Announcement) have provided firm written commitments to the Underwriters to sub-underwrite and which exceed 50 per cent. of the total number of New Melrose Shares.

Melrose has given representations, warranties and undertakings to the Underwriters customary for such agreements regarding, amongst other things, the accuracy of the information contained in this document. Melrose has also provided an indemnity to the Underwriters and each person acting for or on behalf of them in connection with the services rendered or duties performed by any such indemnified person in connection with the Rights Issue, the Tender Offer, Admission, the arrangements contemplated by this document, the Announcement and the Melrose Circular. In addition, Melrose has agreed to perform certain obligations relating to the implementation of the Rights Issue.

The obligations of the Underwriters under the Underwriting Agreement are subject to certain conditions including Admission having occurred by not later than 8.00 a.m. on 17 July 2012 (or such later time and/or date as may be agreed between the Sponsors and the Company in writing) and the Tender Offer not having been withdrawn or terminated prior to Admission.

The Underwriting Agreement provides that if a condition is not fulfilled before 8:00 a.m. on the date of Admission, or the parties agree in writing that a condition has become incapable of being fulfilled before 8:00 a.m. on the date of Admission, the Underwriting Agreement will terminate immediately.

The Sponsors (acting jointly but not severally) may by notice to Melrose (to be received prior to Admission) terminate the Underwriting Agreement in limited circumstances.

11.1.2 *New Facilities Agreement*

On the Signing Date, Melrose entered into the New Facilities Agreement pursuant to which a USD 500 million term facility and a £180 million term facility and a EUR 300 million revolving credit facility, a £70 million revolving credit facility and a £690 million revolving credit facility will be provided to the Melrose Group (and on the Tender Offer becoming Effective, the Elster Group provided Elster and/or the relevant member of the Elster Group has acceded to the New Facilities Agreement as a borrower) by a group of lenders. Utilisation of the facilities under the New Facilities Agreement is subject to satisfaction of various customary conditions precedent. In particular, it is a condition precedent to utilisation of the facilities under the New Facilities Agreement that Melrose provide a certificate stating that Melrose Bidco has accepted for payment the Elster ADSs and Elster Shares validly tendered to it (and not properly withdrawn) and such Elster ADSs and Elster Shares represent at least 62.0 per cent. of the share capital of Elster in issue at the commencement of the Tender Offer (other than to the extent the arrangers under the New Facilities Agreement have agreed Melrose Bidco can accept a lower percentage). If the Tender Offer does not take place, Melrose's current intention is to leave the Existing Facilities Agreement in place and continue to utilise the facilities available under that agreement.

The term facilities will be available: (i) to Melrose to partially finance the Acquisition, refinance amounts outstanding under the Existing Facilities Agreement and to refinance

other indebtedness of the Melrose Group; (ii) after the Effective Date and provided Elster and/or the relevant member of the Elster Group has acceded to the New Facilities Agreement as a borrower, to borrowers who are members of the Elster Group to refinance amounts outstanding under the Elster RCF; and (iii) for the general corporate purposes of Melrose and the Melrose Group and to pay (or refinance amounts used to pay) associated costs and expenses associated with the Acquisition (and the balance of the cost of acquiring any Elster Shares and/or Elster ADSs (after applying the net proceeds of the Rights Issue) not financed by loans drawn under the term facilities, will be financed by the revolving credit facilities which are described below). The first drawdown under the term facilities must be made within eight months of the Signing Date. The term facilities cease to be available on the earlier of eight months after the Signing Date and the date that is four months after the date of first drawdown. The aggregate outstanding amount under the term facilities are required to be reduced to (i) on the third anniversary of the Signing Date, 95 per cent. of the total term loans drawn at the end of the availability period applicable to the term facilities; (ii) on the fourth anniversary of the Signing Date, 90 per cent. of the total term loans drawn at the end of the availability period applicable to the term facilities; and (iii) on the date falling 6 months after the fourth anniversary of the Signing Date, 85 per cent. of the total term loans drawn at the end of the availability period applicable to the term facilities. The balance of the aggregate outstanding amounts under the term facility are required to be repaid on the date that is five years after the Signing Date.

The revolving credit facilities under the New Facilities Agreement will be available from the Signing Date until the date that is one month before the date that is five years after the Signing Date. The revolving credit facilities will be used by (i) Melrose, to partially finance the Acquisition (including the balance of the cost of acquiring any Elster Shares or Elster ADSs (after applying the net proceeds of the Rights Issue) not financed by loans drawn under the term facility, including pursuant to any “squeeze-out” procedure, further tender offer or market purchases) and to pay any costs and expenses in connection with the Acquisition or entry into the New Facilities Agreement; (ii) Melrose, to finance the Melrose Group’s working capital requirements and for general corporate purposes (including refinancing existing indebtedness, whether under the Existing Facilities Agreement or otherwise, and for financing acquisitions); and (iii) after the Effective Date, the Elster Group, provided Elster and/or the relevant member of the Elster Group has acceded to the New Facilities Agreement as a borrower to finance its working capital requirements and for general corporate purposes (including, if required, refinancing existing indebtedness, whether under the Senior Notes, the Elster RCF or otherwise, and for financing future acquisitions). Elster Holdings US Inc has a separate revolving credit facility of £70 million available to it for its working capital needs after it accedes to the New Facilities Agreement as a borrower.

Prior to the EGSE Guarantee Date, Melrose is required to ensure that the aggregate of any outstanding loans under the euro denominated tranche of the revolving credit facilities do not exceed the RCF Drawing Limit provided that the RCF Drawing Limit may be exceeded prior to the EGSE Guarantee Date as a result of the euro denominated tranche of the revolving credit facility being utilised to fund, directly or indirectly, any change of control offer, any full redemption, repurchase, retirement or other acquisition of the Senior Notes or to pay associated costs and expenses or any costs and expenses incurred in connection with a waiver request or consent solicitation approved by the lenders under the New Facilities Agreement in relation to the Senior Notes.

The New Facilities Agreement contains representations and warranties, financial covenants, undertakings and events of default customary for a facilities agreement of this nature. The undertakings include (i) an undertaking to not acquire interests in companies, businesses or undertakings if (A) the aggregate consideration for all such acquisitions during the life of the New Facilities Agreement would exceed (x) £300 million (this limit will not apply if the leverage ratio at the time of a proposed acquisition (pro forma for such acquisition) is 1.50:1

or less) or (y) £150 million for such time that 75 per cent. of Elster Shares are not held by Melrose Bidco, and in all cases (B) such acquisition is not a Class 1 Transaction under the Listing Rules; (ii) an undertaking to ensure that financial indebtedness of members of the Melrose Group (and after the Effective Date, the Enlarged Group) who are not obligors under the New Facilities Agreement, subject to certain exceptions, does not exceed £75 million at any time; (iii) if Melrose Bidco does not acquire sufficient Elster ADSs and/or Elster Shares pursuant to the Tender Offer to commence “squeeze-out” proceedings under German law in respect of minority shareholders, an undertaking to exercise reasonable endeavours (taking into consideration any limitations on exercise of its influence on Elster under German law) to put in place a German law domination agreement with Elster within 18 months of the date of initial utilisation of the term facility; (iv) an undertaking that Melrose will ensure that Elster accedes to the New Facilities Agreement as a borrower as soon as reasonably practicable and in any event no later than 25 Business Days from the date of initial drawdown and repays all amounts it has drawn under the Elster RCF and cancels the Elster RCF; and (v) a requirement to ensure that refinancing of the Senior Notes will be with either (A) the proceeds of loans under the New Facilities Agreement or (B) pari passu debt borrowed by Melrose. The financial covenants require that interest cover for the Enlarged Group remains equal to or greater than 4.0:1 and the leverage ratio for the Enlarged Group remains equal to or less than (depending on the testing period) 3.50:1 to 3.0:1 and that, until such time as Melrose Bidco acquire 75 per cent. of the total share capital of Elster, the interest cover for the Elster Group remains equal to or greater than 4.0:1 and the leverage ratio for the Elster Group remains equal to or less than (depending on the testing period) 3.25:1 or 3.0:1. Prior to the EGSE Guarantee Date, certain further restrictions apply to incurrence of financial indebtedness by the Elster Group outside of the New Facilities Agreement, the Elster RCF and the Senior Notes. Melrose has to redeem the Senior Notes by 30 April 2014 if it has not acquired 75 per cent. of the Elster Shares on or prior to that date.

Melrose and various other entities in the Melrose Group will, subject to applicable local law limitations, guarantee all amounts due under the New Facilities Agreement. After the Effective Date, the Elster Group will initially (and subject to the limitations under the Senior Notes covenants) guarantee only its own borrowings. When permitted to do so under German law, the Elster Group will, subject to limitations under the Senior Notes covenants that are applicable at such time and applicable local law limitations, guarantee the liabilities of the Melrose Group.

Melrose Bidco will grant a pledge over the Elster ADSs and Elster Shares that it acquires pursuant to the Tender Offer in favour of the lenders under the New Facilities Agreement. The New Facilities Agreement allows for the pledge to be released to allow Elster ADSs acquired by Melrose Bidco to be withdrawn from the ADS programme. Should Melrose Bidco withdraw the Elster ADSs that it acquires pursuant to the Tender Offer from the ADS programme prior to the EGSE Guarantee Date, it will need to grant a pledge in favour of the lenders under the New Facilities Agreement over the Elster Shares it acquires in exchange for such Elster ADSs. Upon the occurrence of the EGSE Guarantee Date, any such pledge then in existence (whether over the Elster ADSs or the Elster Shares) will immediately be released.

Melrose intends to, on the date of initial utilisation under the New Facilities Agreement, repay in full all amounts then outstanding under the Existing Facilities Agreement and cancel all undrawn commitments. For further information on the Existing Facilities Agreement please refer to paragraph 2 of Part V (*Capital Resources*) of this document and the Finance Director’s review in Melrose’s annual report and accounts for the financial year ended 31 December 2011 which is incorporated by reference into this document.

11.1.3 *Investment Agreement*

On 29 June 2012 Melrose, Melrose Bidco and Elster entered into the Investment Agreement pursuant to which Elster has given certain undertakings to cooperate with the Company to implement the Tender Offer and Melrose and Melrose Bidco have given certain undertakings to Elster concerning, among other things, their conduct in connection with the Tender Offer and their commitments and intentions in connection with the continuation of the business of the Elster Group after the Effective Date. The parties have also agreed, so far as is legally practicable, to use all reasonable commercial efforts to effect the Tender Offer and complete the transaction contemplated by the Investment Agreement.

Melrose has agreed that as promptly as reasonably practicable following the date of the Investment Agreement (and in any case by 5.30 p.m. (New York City time) on 13 July 2012) that Melrose Bidco will commence the Tender Offer and file the Tender Offer Document and associated documentation with the SEC (the key terms of which are set out in paragraph 12 of Part I (*Information on the Acquisition and the Rights Issue*) of this document) and that the terms and conditions of the Tender Offer will be consistent with the terms and conditions set out in the Investment Agreement, unless otherwise approved by Elster. Melrose may waive any of the Tender Offer conditions, save for antitrust clearances under the Hart-Scott Rodino Antitrust Improvements Act 1976 and the European Commission.

The Melrose Board has, subject to the Elster Board including in its Schedule 14D-9 that in its opinion the Tender Offer is fair to and in the interests of Elster and its stakeholders, including its shareholders, employees and customers, approving the transaction and recommending that Elster ADS Holders and/or Elster Shareholders accept the Tender Offer and tender their Elster ADSs and/or Elster Shares into the Tender Offer (the “**Elster Recommendation**”) and no intervening events occurring, agreed to include a statement in the Melrose Circular that it believes the Tender Offer is in the best interests of Melrose Shareholders as a whole and recommending that Melrose Shareholders vote in favour of the Transaction Resolutions (the “**Melrose Recommendation**”).

Each party has agreed not to make any public statement which could reasonably be considered to be (i) contrary to the Elster Recommendation or the Melrose Recommendation (as the case may be), the Tender Offer or the Rights Issue or (ii) recommending that its shareholders take or consider taking any action that could prevent, delay or adversely affect the Tender Offer and/or the Rights Issue.

The Elster Recommendation and the filing/dissemination of the Schedule 14D-9 by Elster is subject to the Tender Offer having commenced on the terms and conditions set out in the Investment Agreement, no Superior Offer having been publicly proposed, no intervening event having occurred that prevents the Elster Board from supporting and recommending the Tender Offer (in accordance with fiduciary duties) and there being no change in the Melrose Recommendation. As long as such requirements remain fulfilled, the Elster Board will not withdraw, qualify or adversely modify the Elster Recommendation (or their intention to make it) and shall not recommend (or agree to recommend) a Competing Elster Proposal.

It is confirmed in the Investment Agreement that Elster will be required to accede as a borrower to the New Facilities Agreement as soon as reasonably practicable after the Tender Offer Expiration Date. Melrose will ensure that funds up to a maximum of EUR 350 million are made available on a certain funds basis to Elster when Elster accedes as a borrower to the New Facilities Agreement and that Elster will have access to a EUR 350 million revolving credit facility. Melrose represents in the Investment Agreement that Elster will not be liable for the payment of any arrangement fees under or in connection with the New Facilities Agreement. It is further confirmed in the Investment Agreement that the New Facilities Agreement will not provide for any guarantees, grant of security, indemnities or other credit support from Elster and/or any other member of the Elster Group for any borrowings of Melrose or any other member of the Melrose Group which would result in a

breach of the obligation of Elster to fully comply with Sections 57, 71a of the Stock Corporation Act.

Pursuant to the Investment Agreement the parties have agreed to cooperate and make the necessary filings required by each party to obtain clearances of the Acquisition. The withdrawal of any such filing (other than with the Russian Federal Antimonopoly Service and the Ukrainian Anti-Monopoly Committee) by Melrose or Elster is subject to the prior written consent of the other party.

Elster has confirmed that as of the date of the Investment Agreement neither it nor any member of the Elster Group is under any obligation to enter into or implement a Competing Elster Transaction and that so far as it is aware none of its directors, employees, advisers or agents is in discussions (or has not terminated any discussions) with any third party which could reasonably be expected to result in a Competing Elster Proposal.

Elster has also undertaken, subject to the Elster Board's fiduciary duties, that neither it nor any member of its Group (nor its directors, employees, advisers or agents) will directly or indirectly solicit, encourage, initiate or otherwise seek to procure any Competing Elster Proposal or proposal or approach in relation thereto or to enter into any communications or discussions with a view to soliciting any Competing Elster Proposal or proposal or approach in relation thereto or permit any third party any access to the Elster Group in relation to a Competing Elster Proposal. Subject to any pre-existing confidentiality obligations, Elster has undertaken that it will notify Melrose without undue delay, if it or any member of its Group (or its directors, employees, advisers or agents) receives a proposal or approach from a third party (or a revised proposal or renewed contact from a third party that has been party to such a proposal or any approach prior to the date of the Investment Agreement) in relation to any Competing Elster Proposal, will notify Melrose within two calendar days whether it intends to further pursue such proposal or approach and it will keep Melrose informed on a weekly basis as to the progress of such proposal or approach.

Elster has also agreed that, prior to the earlier of the resignation of the current members of the Elster Board and the Investment Agreement terminating, Elster will, and will use reasonable best efforts to procure that the members of the Elster Group will, subject to fiduciary duties, continue to operate their respective businesses in the ordinary and usual course and consistent with past practice in all material respects.

The parties have agreed that as long as a domination agreement is not in place the Elster Board (the majority of which will be made up of Melrose appointees following the Tender Offer becoming Effective) shall continue independently to conduct the business operations of Elster and Melrose will not instruct the Elster Board to take any actions which would not be in the best interests of the Elster Group. Melrose intends to work with the Elster Board to implement the restructuring and reinvestment program previously authorised by the Elster Board. Pursuant to the Investment Agreement, other than those changes already planned by the Elster Board, Melrose and Melrose Bidco shall not cause Elster, for a period of two years from the Tender Offer Expiration Date, to:

- (i) change the location of the corporate seat and head office of Elster in Essen;
- (ii) change the corporate seats or locations of Elster's significant subsidiaries;
- (iii) change the use of the assets and future obligations;
- (iv) sell or otherwise dispose of substantial assets of the Elster Group, including the research and development facilities;
- (v) break-up the Elster Group by selling or otherwise disposing of Elster's core segments (i.e. gas, electricity, water and Smart grid); or
- (vi) merge or otherwise combine businesses of the Elster Group with businesses of the Melrose Group.

Following a possible delisting of Elster, Melrose may cause the Elster Group to discontinue certain central service functions of the Elster Group and has agreed that:

- (i) if any employees are affected by any discontinuation of central service functions, such employees shall be offered an equivalent position in the Elster Group, to the extent such position is available and the employee is suited for the position;
- (ii) up to EUR 2,000,000 shall be paid in aggregate to current employees who have a base salary of up to EUR 100,000 per annum and who become unemployed as a result of the discontinuation of central service functions (but have not accepted an equivalent position within the Elster Group), each being entitled to their annual gross basic salary plus any statutory entitlements until such monies are exhausted; and
- (iii) Melrose shall compensate the Elster Group for any such payments made to employees who become unemployed as a result of the discontinuation of central service functions.

Melrose intends to support Elster to capitalise on its brand and further enhance brand awareness and has no intention to change the brand strategy of Elster or its corporate name.

Pursuant to the Investment Agreement, each of the Elster Directors will resign from the Elster Board and any other Elster Group companies on or shortly after the Tender Offer Expiration Date.

Elster irrevocably confirms in the Investment Agreement its plans relating to the effect of the implementation of the Tender Offer on the long term incentive plan for certain members of Elster management.

The Investment Agreement has a fixed term of two years but may be terminated in certain circumstances. The Investment Agreement may be terminated by mutual written consent of the parties, by either party if the Effective Date has not occurred on or prior to 25 October 2012, or if the acceptance for payment of the Elster ADSs and/or Elster Shares by Melrose Bidco is prohibited by law.

The Investment Agreement may be terminated by Elster if (i) there is a change to the Melrose Recommendation, (ii) the Transaction Resolutions are not passed on or prior to 9 August 2012 (or such other date as may be agreed by the parties) or (iii) Melrose or Melrose Bidco has not submitted all antitrust and competition filings to the relevant antitrust authorities on or prior to 31 July 2012, or (iv) Melrose or Melrose Bidco becomes insolvent (or suffers an equivalent event), unless in the case of (ii) or (iii) above Melrose is able to demonstrate within ten business days to the satisfaction of Elster that there is a reasonable prospect of a full remedy prior to 25 October 2012.

The Investment Agreement may be terminated by Melrose if (subject to certain exceptions):

- (i) Elster or any of the Elster Directors fails to file and disseminate its recommendation statement on Schedule 14D-9 in connection with the Tender Offer (including the Elster Recommendation);
- (ii) Elster or any of the Elster Directors withdraws, qualifies or adversely modifies the Elster Recommendation or recommends (or agrees or resolves to recommend) a Competing Elster Transaction;
- (iii) Elster becomes insolvent (or suffers an equivalent event);
- (iv) prior to the Tender Offer Expiration Date, any change or changes shall have occurred in Elster's or its subsidiaries' business, properties, assets, liabilities, capitalization, shareholders' equity, financial condition, operations, results of operations or prospects that has had or could reasonably be expected to have a material and adverse effect on Elster or its subsidiaries, taken as a whole (an "Elster MAC") and has not been cured by 24 October 2012;

- (v) prior to the Tender Offer Expiration Date, Elster or any member of the Elster Group fails to operate its respective business in the ordinary and usual course and consistent with past practice and such failure (or combination of such failures) result, or would reasonably be expected to result, in (i) a reduction in Elster's EBITDA of at least EUR 75 million or (ii) a material adverse effect in excess of EUR 125 million on Elster's net assets (each a "**Relevant Ordinary Course Breach**") and together the "**Relevant Ordinary Course Breaches**"), and such Relevant Ordinary Course Breach has not been cured by 24 October 2012;
- (vi) Elster or any of its significant subsidiaries takes any of the following actions until the Tender Offer Expiration Date (each a "**Relevant Action**" and together the "**Relevant Actions**") and such Relevant Action has not been cured by 24 October 2012:
 - (a) any acquisition or disposal or grant of any right or option in respect of any assets, in each case (i) not being in the ordinary and usual course of trading on arm's length terms or (ii) not being an immaterial merger/acquisition transaction having a value not exceeding EUR 5 million in the aggregate (provided there is a material adverse effect on the Elster Group as a whole);
 - (b) discontinuing or ceasing to operate all or any material part of its business (provided there is a material adverse effect on the Elster Group as a whole);
 - (c) any proposal or recommendation to Elster's shareholders to declare, authorise, make or pay a dividend (in cash or in specie) or other distribution of a similar nature or taxed in the same way as a dividend or any reduction of capital (other than lawfully made by any member of the Elster Group to another member of the Elster Group, as the case may be);
 - (d) other than pursuant to the exercise of options and/or satisfaction of awards under established employee schemes or plans, any creation, allotment or issue of, or any grant of any option over or other right to subscribe for or otherwise acquire, any share or securities of Elster, or securities convertible or exchangeable into any of the foregoing, or any alteration or amendment to the terms or rules of any share scheme or plan;
 - (e) any acquisition, reduction, redemption or purchase by a member of the Elster Group of Elster Shares other than in the ordinary and usual course of business in connection with the long-term incentive plan in accordance with the existing share buy back program carried out under the stock purchase plan engagement agreement dated 6 March 2012 between Elster and Merrill Lynch, Pierce, Fenner & Smith Incorporated;
 - (f) any proposal or recommendation to Elster's shareholders to alter any of the provisions of the Articles of Association or relevant incorporation documents or adopting or passing or proposal of further regulations or resolutions inconsistent therewith;
 - (g) any amendments to the terms and conditions of employment (including remuneration and benefits) of any member of the Elster Board or the managing directors of Elster (other than as otherwise agreed in the Investment Agreement);
 - (h) any payments of any kind not provided for in the respective employment or service agreements or any applicable incentive program (including the long term incentive plan), in each case as in effect as of the date hereof, to any member of the Elster Board or the managing directors of Elster;
 - (i) any payments of any kind exceeding an aggregate amount of EUR 2 million not provided for in the respective employment or service agreements or any applicable incentive program (including the long term incentive plan), in each

case as in effect as of the date hereof, to the employees of any member of the Elster Group other than in the ordinary and usual course of business;

- (j) any proposal or recommendation to Elster Shareholders to appoint new members of the Elster Board (other than as otherwise agreed in the Investment Agreement);
- (k) any appointment of new managing directors of Elster (other than as otherwise agreed in the Investment Agreement);
- (l) any amendment to the deposit agreement among Elster, Deutsche Bank Trust Company Americas and the holders and beneficial owners of Elster ADSs; and
- (m) entry into of any agreement or the assumption of any obligation (in each case, whether conditional or otherwise) to do any of the foregoing.

Melrose may not terminate the Investment Agreement in respect of a Relevant Action if:

- (i) the Relevant Action is required in relation to the implementation of the restructuring and reinvestment program authorised by the Elster Board on 21 February 2012;
- (ii) the Relevant Action is required to respond to information requests from Elster Group employees regarding the discontinuation of service functions;
- (iii) the Relevant Action has been approved by the Elster Board and was disclosed to Melrose prior to the date of the Investment Agreement;
- (iv) the Relevant Action is required for the completion or performance of any obligations undertaken pursuant to any contract entered into prior to the date of the Investment Agreement without having been approved by the Elster Board;
- (v) the Relevant Action is required to be done by the Investment Agreement or in order to implement the Tender Offer in accordance with the terms of the Investment Agreement;
- (vi) Melrose has either given its prior written consent to the Relevant Action or has unreasonably withheld or delayed such consent or Elster has taken the Relevant Action at the written request of Melrose;
- (vii) the Relevant Action is required by a court order or applicable laws (other than compliance of the Elster Board with its fiduciary duties under German law, in particular the duty of care and loyalty under Section 93 of the Stock Corporation Act).

11.1.4 *Melrose Cost Cover Agreement*

On 31 May 2012, Melrose entered into a cost cover agreement with Elster (the “**Cost Cover Agreement**”) pursuant to which Melrose agreed to reimburse Elster: (i) a lump sum amount of EUR 55,000 for internal costs; and (ii) up to EUR 145,000 for reasonable external costs and expenses (in particular costs of professional advisors) incurred in connection with the general due diligence process in relation to the Acquisition and the preparation of this document.

11.1.5 *Indemnity Agreement*

On 29 June 2012, Melrose entered into an indemnity agreement (the “**Indemnity Agreement**”) with Elster, pursuant to which Melrose agrees to indemnify and hold harmless, subject to certain exceptions, Elster and any of its directors, officers and employees from any and all damages and reasonable expenses arising from: (i) confidential information disclosed by Elster to Melrose; and (ii) any other assistance provided by Elster to Melrose, in each case in connection with the Rights Issue and the Tender Offer. The aggregate liability of

Melrose under the Indemnity Agreement is limited to £24 million less any liability under the Cost Cover Agreement.

11.1.6 *Elster Non-Solicitation Agreement*

On 6 June 2012 Melrose entered into non son-solicitation agreement with Elster (the “**Non-Solicitation Agreement**”) with Elster. Pursuant to such agreement, Elster has undertaken not to directly or indirectly solicit, invite the submission of any proposal, indication of interest or offer of any kind from any person other than Melrose and Melrose was made aware of discussions between Elster and certain third parties that were ongoing at the time of entry into the Non-Solicitation Agreement.

Elster has also undertaken that if it responds to any unsolicited enquiries (including revised proposal or renewed contact from a third party that has been party to such a proposal or any approach prior to the date of the Non-Solicitation Agreement) it will inform Melrose of the enquiry and whether it intends to respond to such enquiry and will keep Melrose informed as to the progress of such approach.

11.1.7 *Rembrandt Lock-out Agreement*

On 14 June 2012, Melrose entered into a lock-out agreement (the “**Rembrandt Lock-Out Agreement**”) with Rembrandt and Nachtwache (Nachtwache and Rembrandt, together, the “**Sellers**”), pursuant to which each Seller represents that no member of its group, nor any of their respective directors, officers, duly authorized representatives, advisers, agents or employees is directly or indirectly in discussion or negotiation with any person in connection with a Competing Elster Transaction nor is any such person under any obligation to enter into or implement a Competing Elster Transaction. This representation is deemed to be repeated on each day from the date of the Rembrandt Lock-Out Agreement until 6 July 2012 (the “**Lock-Out Period**”).

Lock-Out

During the Lock-Out Period, the Sellers may not and must ensure that no member of its group nor any of its or their directors, officers, employees, representatives, members, partners or advisers will directly or indirectly:

- (i) support (in its capacity as an Elster Shareholder) a sale of all or a material portion of Elster’s assets;
- (ii) support (in its capacity as an Elster Shareholder) any increase in the share capital of Elster or the issuance of Elster Shares to third parties;
- (iii) solicit, encourage, initiate, facilitate, enter into or be involved in any discussion or negotiation with any person in connection with any Competing Elster Transaction or otherwise seek to procure any Competing Elster Transaction;
- (iv) enter into an agreement or arrangement with any person in connection with a Competing Elster Transaction; or
- (v) make available to any person any non-publicly available information relating to or in connection with a Competing Elster Transaction.

Break Fee

Under the Rembrandt Lock-Out Agreement, the Sellers agree to pay a break fee (the “**Break Fee**”) to Melrose in the event that Melrose launches the Tender Offer for all outstanding Elster ADSs and Elster Shares at a price not less than \$20.50 per Elster ADS (\$82 per Elster Share), but before the expiration date of the Tender Offer, a public tender offer in respect of a Competing Elster Transaction is announced (the “**Competing Offer**”) and the Tender Offer subsequently expires or is terminated without Melrose having accepted

for payment validly tendered and not properly withdrawn Elster ADSs and Elster Shares and the Competing Offer or any subsequent public tender offer in respect of a Competing Elster Transaction is announced before the expiration or termination of a previously announced Competing Elster Transaction (and within 12 months of the commencement of the Tender Offer) which is accepted by the Sellers.

The Break Fee covers all external fees, costs and expenses actually incurred by Melrose after 5 April 2012 and payable in connection with the Tender Offer and the associated debt and equity fund raising, notwithstanding the Tender Offer expiring, being terminated or being withdrawn, including all costs and expenses that Melrose has agreed to pay or reimburse to Elster, subject to the Break Fee in no event exceeding a maximum amount of £50,000,000.

11.1.8 *Irrevocable Undertakings to Tender*

On 29 June 2012, Melrose entered into a tender agreement (the “**Shareholders Tender Agreement**”) with Rembrandt and Nachtwache (Nachtwache and Rembrandt, together, the “**Shareholders**”), pursuant to which the Shareholders agree to validly tender (and not withdraw) all of their Elster Shares and/or Elster ADSs at least ten trading days prior to the Tender Offer Expiration Date, unless the Tender Offer lapses or is withdrawn.

Under the Shareholders Tender Agreement, Melrose gives certain limited representations and warranties to the Shareholders and the Shareholders each give certain limited representations and warranties to Melrose, including that the Shareholders each own the number of Elster Shares and/or Elster ADSs set out in the Shareholders Tender Agreement. During the term of the Shareholders Tender Agreement, each Shareholder may not: (i) sell or offer to sell any of its Elster Shares and/or Elster ADSs, save as pursuant to the Tender Offer; or (ii) grant any proxy, power of attorney or authority that could be reasonably expected to prevent or impede the Tender Offer.

On 29 June 2012, Melrose entered into a tender agreement (each, a “**Management Tender Agreement**”) with certain of the Elster Directors who hold Elster ADSs (and/or Elster Shares) and Management Elster ADS Holders (each, a “**Manager**”), pursuant to which each Manager agrees to validly tender (and not withdraw) all of his Elster Shares and/or Elster ADSs prior to the Tender Offer Expiration Date, unless the Tender Offer lapses or is withdrawn or if a Superior Offer is publicly proposed. Each Manager has also agreed to sell his Elster ADSs/Elster Shares to Melrose Bidco in certain circumstances prior to 24 October 2012 after the Elster ADSs/Elster Shares have been accepted for payment by Melrose Bidco under the Tender Offer provided that no Superior Offer remains.

Under each Management Tender Agreement, Melrose gives certain limited representations and warranties to each Manager and each Manager gives certain limited representations and warranties to Melrose, including that he owns the number of Elster Shares and/or Elster ADSs set out in the relevant Management Tender Agreement. During the term of each Management Tender Agreement, each Manager may not: (i) sell or offer to sell any of his Elster Shares and/or Elster ADSs, save as pursuant to the Tender Offer; or (ii) grant any proxy, power of attorney or authority that could be reasonably expected to prevent or impede the Tender Offer.

11.1.9 *Agreement for the disposal of Dynacast*

On 5 June 2011, Melrose and its subsidiaries, Melrose Overseas Holdings Limited and Melrose UK 4 Limited (formerly known as Dynacast Investments Limited) (Melrose, Melrose Overseas Holdings Limited and Melrose UK 4 Limited, collectively being the “**Dynacast Sellers**”) entered into a share purchase agreement with Dynacast International Inc. (formerly known as KDI Holdings Inc.) (the “**Dynacast Buyer**”), a company formed by a consortium of financial investors and managed by Kenner & Company, Inc. Under the terms of this agreement the Dynacast Sellers agreed to dispose of Dynacast by way of the sale of the entire issued share capitals of the Dynacast Companies for

a cash consideration of US\$590 million. In addition, the Dynacast Buyer indirectly assumed approximately US\$17 million of pension liabilities accruing to certain entities within Dynacast.

The Dynacast Sellers and the Dynacast Buyer each gave certain representations and warranties customary for this type of transaction. The Dynacast Sellers also gave the Dynacast Purchaser an indemnity in respect of certain tax liabilities relating to Dynacast.

11.2 *Elster Group*

The following are all of the contracts, not being contracts entered into in the ordinary course of business, which: (i) are or may be material to the Elster Group, and have been entered into by Elster and/or a member of the Elster Group within the two years immediately preceding the date of this document; or (ii) (regardless of when entered into) contain provisions under which a member of the Elster Group has an obligation or entitlement which is or may be material to the Elster Group, as at the date of this document:

11.2.1 *Elster RCF and Senior Notes*

The Elster Revolving Credit Facility (the “**Elster RCF**”), was entered into by Elster in April 2011 and comprises a multicurrency revolving credit facility in a maximum aggregate amount of EUR 450 million and a multicurrency revolving letter of guarantee facility in a maximum aggregate amount of EUR 140 million, each maturing in April 2016. Also in April 2011, Elster placed EUR 250 million of senior unsecured notes due 2018 with a coupon of 6.25 per cent. per annum (the “**Senior Notes**”) with institutional investors. The Senior Notes were issued by Elster Finance B.V., a wholly owned finance subsidiary of Elster, and guaranteed by Elster and certain of its subsidiaries.

Melrose has arranged sufficient facilities under the New Facilities Agreement to enable Elster, if required, to prepay amounts outstanding under the Elster RCF and the Senior Notes on the Tender Offer becoming Effective.

11.2.2 *Elster Shareholder Indemnification Agreement*

In May 2011, the German Federal Court of Justice ruled that the assumption of prospectus liability by a German stock corporation in a secondary offering of its securities constitutes an unlawful repayment of capital to the extent that the economic benefit received by the selling shareholder is not offset by the granting of adequate compensation by the selling shareholder. Under the court’s decision, an unlawful repayment of capital may only be avoided by the selling shareholder agreeing to reimburse the issuer for all costs incurred by it, and to indemnify the issuer for any liabilities assumed by it, in connection with the secondary offering.

On 1 April 2011, Elster entered into an intercompany agreement with Rembrandt (the “**Intercompany Agreement**”) in connection with the April 2011 secondary public offering of Elster ADSs by Rembrandt (the “**April 2011 Offering**”). Under the Intercompany Agreement, in consideration for Elster’s undertaking to comply with its obligations under the underwriting agreement relating to the April 2011 Offering, Rembrandt agreed to reimburse Elster for all costs incurred by Elster in connection with the April 2011 Offering (including legal fees and accountants’ fees) and to indemnify Elster for all liabilities assumed by it in connection with the April 2011 Offering, including liability under U.S. federal securities laws.

On 20 March 2012, Elster entered into an indemnification and cost reimbursement agreement with Rembrandt (the “**Indemnification and Reimbursement Agreement**”) in connection with the initial public offering of Elster ADSs in October 2010 (the “**IPO**”), the April 2011 Offering, and any additional offerings from time to time under a shelf registration statement (together with the April 2011 Offering and the IPO, the “**Offerings**”). The Indemnification and Reimbursement Agreement superseded and replaced the Intercompany

Agreement. Under the Indemnification and Reimbursement Agreement, Rembrandt agreed to reimburse Elster for all costs incurred or to be incurred by Elster in connection with the Offerings (including legal fees and accountants' fees) and to indemnify Elster for all liabilities assumed by it in connection with the Offerings. The indemnity and cost reimbursement obligations in relation to each of the Offerings terminates on the third anniversary of the relevant Offering (save to the extent claims have been raised by a third party in relation to the relevant Offering prior to such date).

12. RELATED PARTY TRANSACTIONS

12.1 *Melrose Group*

12.1.1 Save as disclosed below and in the financial information set out in the related party transactions note 28 to the financial statements of Melrose for the financial years ended 31 December 2011, 31 December 2010 and 31 December 2009, which are incorporated by reference into this document, neither Melrose nor the Melrose Group entered into any material transactions with related parties during the financial years ended 31 December 2011, 31 December 2010 and 31 December 2009 or during the period between 1 January 2012 and the Latest Practicable Date.

12.1.2 On 12 April 2012, Melrose sub-divided and re-designated each of the 50,000 2009 Incentive Shares (held by certain directors and other key managers of Melrose) into 392 Melrose Shares and simultaneously capitalised £29,649.38 standing to the credit of its capital redemption reserve and applied such sum to paying up in full 11,647,969 Melrose Shares which were allotted and issued to those persons who had been holders of 2009 Incentive Shares, *pro rata* to their holding of such shares (the “**Incentive Share Reset**”). Certain amendments to Melrose’s articles of association were implemented to give effect to the Incentive Share Reset and to set out the rights of the 2012 Incentive Shares. On 22 March 2012, the Melrose Board conditionally granted 47,500 options in respect of the 2012 Incentive Shares to certain Melrose Directors and other key personnel, and on 12 April 2012 this grant became unconditional in all respects. At a general meeting of Melrose dated 11 April 2012, Melrose Shareholders approved by way of special resolution the Incentive Share Reset (including, *inter alia*, the amendments to Melrose’s articles of association referred to above). As at the Latest Practicable Date the Melrose Board has granted 47,875 options in respect of 2012 Incentive Shares.

13. CONSENTS

13.1 Deloitte, whose registered office is at 2 New Street Square, London EC4A 3BZ, is a member of the Institute of Chartered Accountants in England and Wales and has given and has not withdrawn its written consent to the inclusion of (i) its report on pro forma financial information set out in Part VIII (*Unaudited Pro Forma Information on the Enlarged Group*) of this document; and (ii) its report on reconciliation as incorporated by reference into this document, and the references to its reports and its name in the form and context in which they are included and has authorised the contents of the part of this document which comprises its reports for the purposes of Prospectus Rule 5.5.3(2)(f).

13.2 Investec has given and has not withdrawn its written consent to the inclusion in this document of its name and the references thereto in the form and context in which it appears.

13.3 J.P. Morgan has given and has not withdrawn its written consent to the inclusion in this document of its name and the references thereto in the form and context in which it appears.

13.4 JPMSL has given and has not withdrawn its written consent to the inclusion in this document of its name and the references thereto in the form and context in which it appears.

13.5 Barclays has given and has not withdrawn its written consent to the inclusion in this document of its name and the references thereto in the form and context in which it appears.

- 13.6 HSBC has given and has not withdrawn its written consent to the inclusion in this document of its name and the references thereto in the form and context in which it appears.
- 13.7 RBC has given and has not withdrawn its written consent to the inclusion in this document of its name and the references thereto in the form and context in which it appears.

14. SOURCES AND BASES OF SELECTED FINANCIAL INFORMATION

14.1 Unless otherwise stated below:

- (a) financial information relating to Melrose has been extracted (without material adjustment) from the audited annual report and accounts for Melrose for the years ended 31 December 2011, 31 December 2010 and 31 December 2009;
- (b) financial information relating to Elster has been extracted (without material adjustment) from (i) the audited consolidated financial statements of the Elster Group for the financial years ended 31 December 2011, 31 December 2010 and 31 December 2009 and (ii) the Elster unaudited first quarter results announcement published on 4 May 2012.

14.2 As at the close of business on the Latest Practicable Date, Melrose had in issue 422,209,012 ordinary shares of $\frac{14}{55}$ pence each. The ISIN for Melrose Shares is GB00B464F978.

15. GENERAL

- 15.1 The financial information concerning the Melrose Group contained in this document does not constitute statutory accounts within the meaning of section 434 of the 2006 Act. Full individual accounts of the Company and each of its subsidiary undertakings for each financial year to which the financial information relates and on which the auditors gave unqualified reports have been delivered to the Registrar of Companies. The consolidated financial statements of the Company in respect of the three years ended 31 December 2011, 31 December 2010 and 31 December 2009 were reported on by Deloitte, a member of the Institute of Chartered Accountants for England and Wales, the auditors of the Company within the meaning of section 434 of the 2006 Act.
- 15.2 The total costs, charges and expenses payable by the Company in connection with the Rights Issue and the Acquisition are estimated to be approximately £70 million (exclusive of VAT).

16. FORECASTS AND PROJECTIONS

Elster's outstanding earnings per ADS guidance

Financial projections for Elster's 2012 earnings per ADS have been disclosed by Elster management in the press release announcing its unaudited 2011 fourth quarter and full year results (the "**Financial Projections**"). The Financial Projections do not reflect the Melrose Directors' view of Elster's prospects and financial performance nor the prospects and financial performance of the Enlarged Group.

The Melrose Directors do not believe that the Financial Projections need to be included in this document, as the Financial Projections would no longer be valid under Melrose's ownership, as the earnings of Elster would differ as a result of (i) changes of strategic direction and changes to the financial and operational management of Elster under Melrose's ownership, such as cost efficiencies as a result of its ability to delist Elster, investment in operations and technology (in particular smart metering), further emphasis on product development and new business development opportunities; (ii) change to the functional currency of Elster to Euros from US\$; and (iii) the fact that Melrose reports under IFRS and Elster reports under US GAAP which is specifically expected to affect research and development cost recognition and pension accounting.

Neither Melrose nor any Melrose Director was involved in the preparation and review of the Financial Projections. The Melrose Directors believe that the assumptions underpinning the 2012 earnings per ADS would differ materially under Melrose's ownership. None of Melrose, the Melrose Directors or their respective advisers accept responsibility for the accuracy, reasonableness, validity or completeness of the Financial Projections or the estimates and assumptions that underlie them.

The Financial Projections were not intended for publication by Melrose and should not be regarded as forecasts of profits by Melrose or any of the Melrose Directors and accordingly have not been prepared to the standard required in producing a profit forecast in the context of the Acquisition. Melrose Shareholders should not rely upon any of the financial projections in making any decision about New Melrose Shares or in deciding whether or not to approve the Acquisition.

Disclosure in the Tender Offer Document

Melrose is required to file a Tender Offer Statement on Schedule TO upon the commencement of the Tender Offer, the contents of which are governed by the U.S. federal securities laws, including the SEC's rules and regulations promulgated thereunder, which require that material information about the tender offer be included in such Tender Offer Statement on Schedule TO.

Melrose has been informed by Elster that their Recommendation Statement on Schedule 14d-9 in response to the Tender Offer which is expected to be filed with the SEC at the same time as the Tender Offer Statement on Schedule TO is filed with the SEC will contain the financial projections provided to Melrose and financial projections provided to three institutions giving fairness opinions on the transaction. Elster's Recommendation Statement on Schedule 14d-9 will therefore contain certain financial projections of Elster for the years ending 31 December 2012, 2013, 2014, 2015, 2016 and 2017 (the "5 Year Plan"). Melrose understands that Elster will be disclaiming the 5 Year Plan in their Recommendation Statement on Schedule 14d-9 and ask its shareholders not to rely on such 5 Year Plan.

The SEC has often taken the position that financial projections provided by a seller to a buyer during due diligence is material information that should be disclosed to the seller's shareholders. As a result of these rules and regulations and the SEC's position on these matters, most issuers and their counsel have determined that summary disclosure of projections received during diligence should be included in the Tender Offer Statement on Schedule TO to ensure compliance with the U.S. federal securities laws and regulations and the SEC's position with respect to such laws and regulations.

For the reasons set out above and to comply with U.S securities laws and regulations, the Tender Offer Statement on Schedule TO will include financial projections provided by Elster to Melrose for 2012 and 2013 and additional financial projections provided by Elster to the three institutions giving fairness opinions on the transaction which will be set out in the Recommendation Statement on Schedule 14d-9 and which were subsequently disclosed to Melrose which contain certain profit forecasts for the purposes of the Listing Rules.

The 5 Year Plan does not reflect the Melrose Directors' view of Elster's prospects and financial performance, nor the prospects and financial performance of the Enlarged Group and Melrose has not relied on them. The Melrose Directors do not believe that the financial projections included in the 5 Year Plan need to be included in this document, as the 5 Year Plan would no longer be valid under Melrose's ownership as the financial position of Elster would differ as a result of (i) changes of strategic direction and changes to the financial and operational management of Elster under Melrose's ownership such as cost efficiencies as a result of its ability to delist Elster, investment in operations and technology (in particular smart metering), further emphasis on product development and new business development opportunities; (ii) change to the functional currency of Elster to Euros from US\$; and (iii) the fact that Melrose reports under IFRS and Elster reports under US GAAP which is specifically expected to affect research and development cost recognition and pension accounting.

The 5 Year Plan, which was prepared by Elster for internal management purposes only, was not prepared with a view to public disclosure or compliance with the published guidelines of the SEC regarding projections or forecasts. The 5 Year Plan was not intended for publication in the UK and should not be regarded as a forecast of profits by Elster or Melrose and accordingly have not been prepared or reviewed to a standard to which published projections would be prepared and reviewed in the UK.

The 5 Year Plan is a medium term forecast which can only be seen as high level guidance, as it is not possible to forecast the business' performance over such a period with accuracy. The 5 Year Plan of Elster is not current, and has not been prepared using assumptions that have been approved by Melrose. Melrose intends to review the 5 Year Plan with Elster management following the Acquisition, in particular the

assumptions underlying the business plan and Melrose expects that the business plan will change as a result of such review.

Accordingly, Elster's 5 year Financial Projections have not been included in this document and none of Melrose, the Melrose Directors or their respective advisers or any other party accepts responsibility for accuracy, reasonableness, validity or completeness of these projections or the estimates and assumptions that underlie them. Melrose Shareholders should not rely on any of the Elster financial projections in making any decision about investment in Melrose or Elster or in deciding whether or not to approve the Acquisition.

17. DOCUMENTS FOR INSPECTION

Copies of the following documents will be available for inspection during normal business hours on any weekday (Saturday, Sundays and public holidays excepted) at (i) the registered office of the Company (being Precision House, Arden Road, Alcester, Warwickshire B49 6HN) and (ii) the offices of Simpson Thacher & Bartlett LLP (being CityPoint, One Ropemaker Street, London EC2Y 9HU) from the date of this document (other than the Tender Offer Document, which shall be available for inspection from the date that it is filed with the SEC (which will be promptly after the date of this document and in any event within 10 New York City business days of the date of this document with no material changes to the terms and conditions of the Tender Offer as set out in Part I (*Information on the Acquisition and Rights Issue*) of this document) up to and including the date of Admission:

- (a) the Articles;
- (b) the report by Deloitte set out in Part VIII (*Unaudited Pro Forma Information on the Enlarged Group*) of this document;
- (c) The audited consolidated accounts of the Melrose Group for the three financial years ended 31 December 2011, 31 December 2010 and 31 December 2009;
- (d) the audited consolidated accounts of the Elster Group for the three financial years ended 31 December 2011, 31 December 2010 and 31 December 2009 and the unaudited financial information of the Elster Group for the three month period ended 31 March 2012;
- (e) the Melrose Circular and the Form of Proxy;
- (f) the consent letters referred to at paragraph 13 above;
- (g) the Cost Cover Agreement;
- (h) the Investment Agreement;
- (i) the Tender Offer Document;
- (j) the Indemnity Agreement;
- (k) the Non-Solicitation Agreement;
- (l) the Rembrandt Lock-Out Agreement;
- (m) the Shareholders Tender Agreement;
- (n) the Management Tender Agreements;
- (o) the New Facilities Agreement; and
- (p) this document.

The Melrose Circular and this document and the information incorporated by reference into this document (as set out on page 280 under the heading "*Melrose information incorporated by reference*") may also be viewed via the National Storage Mechanism.

18. ANNOUNCEMENT ON RESULTS OF THE RIGHTS ISSUE

Melrose will make an announcement(s) to a Regulatory Information Service giving details of the results of the Rights Issue.

Dated: 29 June 2012

DEFINITIONS

The following definitions apply throughout this document unless the context otherwise requires:

“1985 Act”	the Companies Act 1985, as amended;
“2006 Act”	the Companies Act 2006, as amended and for the time being in force;
“2007 Incentive Shares”	has the meaning given to such term at paragraph 3.3 of Part XIII (<i>Additional Information</i>) of this document;
“2009 Incentive Shares”	has the meaning given to such term at paragraph 3.3.1(b) of Part XIII (<i>Additional Information</i>) of this document;
“2012 AGM”	the annual general meeting of Melrose held on 9 May 2012;
“2012 Incentive Scheme”	has the meaning given to such term at paragraph 1.2 of Part X (<i>Directors, Corporate Governance and Employees</i>) of this document;
“2012 Incentive Shares”	has the meaning given to such term at paragraph 1.2 of Part X (<i>Directors, Corporate Governance and Employees</i>) of this document;
“5 Year Plan”	has the meaning given to such term at paragraph 16 of Part XIII (<i>Additional Information</i>);
“Acquisition”	the acquisition of the Elster Shares and/or Elster ADSs by way of (i) the Tender Offer, and, following the Effective Date, (ii) any further offer or offers required to be made by applicable law, arising from or in connection with steps taken by the Company to delist the Elster ADSs from the NYSE, to implement a domination agreement with Elster or to implement a Squeeze-out or a Merger Squeeze-out; and/or (iii) any further tender offer or purchases of Elster ADSs and/or Elster Shares by Melrose Bidco;
“Admission”	the proposed admission of the New Melrose Shares by the FSA (in its capacity as the UKLA) to listing on the premium segment of the Official List and by the London Stock Exchange to trading nil paid on the main market of the London Stock Exchange;
“ADS”	an American Depository Share;
“ADS Depository”	the depository established pursuant to a deposit agreement dated 29 September 2010 between, among others, Elster and Deutsche Trust Company Americas;
“AIM”	AIM, a market operated by the London Stock Exchange;
“Announcement”	the announcement made by Melrose on 29 June 2012 in relation to the Acquisition;
“Articles”	the articles of association of Melrose as amended from time to time;
“Anti-Corruption Laws”	has the meaning given to such term at paragraph 4 of Part A of the section of this document headed “Risk Factors”;
“April 2011 Offering”	has the meaning given to such term at paragraph 11.1.2 of Part XIII (<i>Additional Information</i>) of this document;
“Audit Committee”	the Audit Committee of the Melrose Board;

“Audited Financial Statements”	the audited financial statements for the year ended 31 December 2011 (under IFRS), as set out in Melrose’s annual report and accounts for 2011, the audited financial statements for the year ended 31 December 2010 (under IFRS), as set out in Melrose’s annual report and accounts for 2010 and the audited financial statements for the year ended 31 December 2009 (under IFRS), as set out in Melrose’s annual report and accounts for 2009;
“Australia”	the Commonwealth of Australia and its dependent territories;
“BACS”	the UK BACS system for the electronic processing of financial transactions;
“Barclays”	Barclays Bank PLC;
“Board(s)”	the Melrose Board and/or the Elster Board (as the case may be);
“Break Fee”	has the meaning given to such term at paragraph 11.1.7 of Part XIII (<i>Additional Information</i>) of this document;
“Bribery Act”	has the meaning given to such term at paragraph 4 of Part A of the section of this document headed “Risk Factors”;
“Business Day”	a day (other than a Saturday or Sunday or public holiday) on which banks are open for business in London other than solely for trading and settlement in Euro;
“Canada”	Canada, its provinces and territories and all areas subject to its jurisdiction or any political subdivision thereof;
“CERCLA”	has the meaning given to such term at risk factor B31 of the section of this document headed “Risk Factors”;
“certificated” or “in certificated”	in relation to a share or other security, a share or other security title form to which is recorded in the relevant register of the share or other security as being held in certificated form (that is, not in CREST);
“CHAPS”	the UK Clearing House Automated Payment System for the same-day processing of pound sterling and Euro fund transfers;
“Closing Price”	the closing middle market price of a relevant share as derived from SEDOL on any particular day;
“Committees”	the Audit, Nomination and Remuneration Committees of the Melrose Board as described at paragraph 3.3 of Part X (<i>Directors, Corporate Governance and Employees</i>) of this document;
“Companies Acts”	the Companies Act 1985 and the Companies Act 2006;
“Company” or “Melrose”	Melrose PLC;

“Competing Elster Proposal”	means any inquiry, proposal or offer relating to, or that could reasonably be expected to lead to, a merger or business combination, liquidation or other transaction involving any third party: (i) in respect of or for all or a significant proportion (being 30 per cent. or more when aggregated with shares already held by such third party and any person acting in concert with that third party) of the share capital or voting rights of Elster; or (ii) in respect of or for all or a significant proportion (being 25 per cent. or more) of the Elster Group’s undertaking, business, revenues, profits; or (iii) the consideration for which exceeds 25 per cent. of Elster’s market capitalisation, in each case howsoever it is proposed that such transaction be implemented (and whether or not subject to any (pre-) conditions);
“Competing Elster Transaction”	any enquiry, proposal or offer relating to, or that could reasonably be expected to lead to, a sale, transfer, assignment, pledge, mortgage, hypothecation, grant of options over, or other disposition of the Elster Shares and/or Elster ADSs or any of them held directly or indirectly by Rembrandt and Nachtwache or any other transaction in relation to any such Elster Shares and/or Elster ADSs involving any third party;
“Competing Offer”	has the meaning given to such term at paragraph 11.1.7 of Part XIII (<i>Additional Information</i>) of this document;
“conversion notice”	has the meaning given to such term at paragraph 4.5.1b of Part XIII (<i>Additional Information</i>) of this document;
“Cost Cover Agreement”	has the meaning given to such term at paragraph 11.1.4 of Part XIII (<i>Additional Information</i>) of this document;
“CREST”	the relevant system (as defined in the CREST Regulations) in respect of which Euroclear is the operator (as defined in the CREST Regulations);
“CREST courier and sorting service” or “CCSS”	the CREST courier and sorting service operated by Euroclear to facilitate, <i>inter alia</i> , the deposit and withdrawal of securities;
“CREST Deposit Form”	the form used to deposit securities into the CREST system in the United Kingdom;
“CREST Manual”	the rules governing the operation of CREST, consisting of the CREST Reference Manual, CREST International Manual, CREST Central Counterparty Service Manual, CREST rules, Registrars Service Standards, Settlement Discipline Rules, CCSS Operations Manual, Daily Timetable, CREST Application Procedure and CREST Glossary of Terms (all as defined in the CREST Glossary of Terms promulgated by Euroclear on 15 July 1996, as amended);
“CREST member”	a person who has been admitted by Euroclear as a system-member (as defined in the CREST Regulations);
“CREST Regulations”	the Uncertificated Securities Regulations 2001 (SI 2001 No. 01/378), as amended;
“C Share”	non-cumulative redeemable preference shares of 75 pence each issued by the Company to shareholders to facilitate the Return of Capital;
“CTA 2009”	has the meaning given to such term at paragraph 2.2.2 of Part IX (<i>Taxation Considerations</i>) of this document;

“Deferred Share”	has the meaning given to such term at paragraph 3.3.4(a) of Part XIII (<i>Additional Information</i>) of this document;
“Deloitte”	Deloitte LLP, auditors to Melrose and reporting accountants;
“Disclosure and Transparency Rules”	the Disclosure and Transparency Rules as published by the FSA;
“Dividend Amount”	has the meaning given to such term at paragraph 4.5.1(a) of Part XIII (<i>Additional Information</i>) of this document;
“Dynacast”	the Dynacast business comprising the Dynacast Companies and their respective subsidiaries and subsidiary undertakings;
“Dynacast Buyer”	has the meaning given to such term at paragraph 11.1.9 of Part XIII (<i>Additional Information</i>) of this document;
“Dynacast Companies”	Dynacast (UK) Limited; Dynacast Beteiligungs und Verwaltungs GmbH (formerly known as Melrose Beteiligungs und Verwaltungs GmbH); Dynacast Parent Spanish Holding Company S.L. (formerly known as Melrose Spain S.L.); US 1 LLC (formerly known as Melrose US 1 LLC); and Dynacast Singapore Holdings Pte Ltd (formerly known as Melrose Singapore Holdings Pte Ltd);
“Dynacast Sellers”	has the meaning given to such term at paragraph 11.1.9 of Part XIII (<i>Additional Information</i>) of this document;
“EBITDA”	earnings before interest, tax, depreciation and amortisation;
“EEA”	the European Economic Area;
“EEA States”	the member states of the European Economic Area;
“Effective”	acceptance and payment by Melrose Bidco in respect of the Elster ADSs and Elster Shares validly tendered pursuant to the Tender Offer (and not properly withdrawn) following the satisfaction or waiver of the conditions to the Tender Offer;
“Effective Date”	the date on which the Tender Offer becomes Effective;
“EFSF”	has the meaning given to such term at paragraph 1 of Part C of the section of this document headed “Risk Factors”;
“EFSM”	has the meaning given to such term at paragraph 1 of Part C of the section of this document headed “Risk Factors”;
“EGSE Guarantee Date”	has the meaning given to such term at paragraph 2 of Part V (<i>Capital Resources</i>) of this document;
“Eligible US Holders”	has the meaning given to such term at paragraph 7.2 of Part XII (<i>Terms and Conditions of the Rights Issue</i>) of this document;
“Elster”	Elster Group SE, a German <i>Societas Europaea</i> registered in the commercial register of the local court of Essen, Germany, under HRB number 22030;
“Elster ADS”	an ADS representing one fourth of one Elster Share;
“Elster ADS Holder”	a holder of Elster ADSs;
“Elster Board”	the administrative board of Elster;
“Elster Directors”	the members of the Elster Board;
“Elster Group”	Elster, its subsidiaries and subsidiary undertakings;
“Elster MAC”	has the meaning given to such term at paragraph 11.1.3 of Part XIII (<i>Additional Information</i>) of this document;
“Elster RCF”	has the meaning given to such term at paragraph 11.2.1 of Part XIII (<i>Additional Information</i>) of this document;

“Elster Recommendation”	has the meaning given to such term at paragraph 11.1.3 of Part XIII (<i>Additional Information</i>) of this document;
“Elster Shareholders”	holders of Elster Shares;
“Elster Share(s)”	the ordinary registered shares with a nominal value of EUR 1 each in the share capital of Elster;
“Enlarged Group”	the Melrose Group following the acquisition of the Elster Group;
“Enlarged Share Capital”	the issued ordinary share capital of Melrose as it is expected to be following the issue of the New Melrose Shares;
“EPA”	has the meaning given to such term at paragraph 30 of Part B of the section of this document headed “Risk Factors”;
“ESM”	has the meaning given to such term at paragraph 1 of Part C of the section of this document headed “Risk Factors”;
“EU”	the member states of the European Union;
“Euroclear”	Euroclear UK & Ireland Limited, the operator of CREST;
“ex-rights date”	the date on which the holders of Existing Melrose Shares cease to have a right to participate in the Rights Issue (being 8.00 a.m. on 17 July 2012);
“Exchange Act”	the United States Securities Exchange Act of 1934, as amended;
“Excluded Territories”	Australia, Canada, Japan and South Africa and any other jurisdictions where the extension and availability of the Rights Issue would breach any applicable law;
“Executive Director”	an executive director of Melrose;
“Existing Facilities Agreement”	has the meaning given to such term at paragraph 2 of Part V (<i>Capital Resources</i>) of this document;
“Existing Melrose Shares”	the ordinary shares of $\frac{14}{55}$ pence each in the capital of Melrose in issue immediately prior to the Rights Issue;
“Existing Ordinary Share”	has the meaning given to such term at paragraph 3.3.2(a) of Part XIII (<i>Additional Information</i>) of this document;
“Existing RCF”	has the meaning given to such term at paragraph 2 of Part V (<i>Capital Resources</i>) of this document;
“FCPA”	has the meaning given to such term at paragraph 4 of Part A of the section of this document headed “Risk Factors”;
“Financial Projections”	has the meaning given to such term at paragraph 16 of Part XIII (<i>Additional Information</i>) of this document;
“Form of Proxy”	the form of proxy for use at the Melrose General Meeting;
“FSA”	the United Kingdom Financial Services Authority;
“FSMA”	the Financial Services and Markets Act 2000, as amended from time to time;
“Fully Paid Rights”	rights to acquire the New Melrose Shares, fully paid;
“Guaranteed Dividend”	has the meaning given to such term at paragraph 3 of Part I (<i>Information on the Acquisition and Rights Issue</i>) of this document;
“Hauck”	has the meaning given to such term at paragraph 30 of Part B of the section of this document headed “Risk Factors”;
“HM Revenue & Customs” or “HMRC”	HM Revenue & Customs, the UK tax authority;

“HSBC”	HSBC Bank PLC;
“IFRS”	International Financial Reporting Standards as adopted for use in the European Union;
“IFRS 1”	has the meaning given to such term at Section B of Part VII (<i>Historical Financial Information Relating to Elster</i>) of this document;
“Incentive Share Reset”	has the meaning given to such term at paragraph 12.1.2 of Part XIII (<i>Additional Information</i>) of this document;
“Indemnification and Reimbursement Agreement”	has the meaning given to such term at paragraph 11.2.2 of Part XIII (<i>Additional Information</i>) of this document;
“Indemnity Agreement”	has the meaning given to such term at paragraph 11.1.5 of Part XIII (<i>Additional Information</i>) of this document;
“Intercompany Agreement”	has the meaning given to such term at paragraph 11.2.2 of Part XIII (<i>Additional Information</i>) of this document;
“International Securities Identification Number” or “ISIN”	the international code for a listed security;
“Investec”	Investec Bank plc;
“Investment Agreement”	the investment agreement between Melrose, Melrose Bidco and Elster dated 29 June 2012, as more fully described at paragraph 11.1.3 of Part XIII (<i>Additional Information</i>) of this document;
“IPO”	has the meaning given to such term at paragraph 11.2.2 of Part XIII (<i>Additional Information</i>) of this document;
“Japan”	Japan, its cities, prefectures, territories and possessions;
“J.P. Morgan”	J.P. Morgan Limited;
“J.P. Morgan Cazenove”	both J.P. Morgan and JPMSL;
“JPMSL”	J.P. Morgan Securities Ltd.;
“KPMG”	KPMG AG Wirtschaftsprüfungsgesellschaft, The Squire, Am Flughafen 60549 Frankfurt am Main;
“Latest Practicable Date”	27 June 2012 (being the latest practicable date prior to the publication of this document);
“Listing Rules”	the listing rules made by the FSA under section 73A of FSMA;
“Lock-out Period”	has the meaning given to such term at paragraph 11.1.7 of Part XIII (<i>Additional Information</i>) of this document;
“London Gazette”	the official newspaper of the Crown;
“London Stock Exchange”	the London Stock Exchange plc or its successor;
“Manager”	has the meaning given to such term at paragraph 11.1.8 of Part XIII (<i>Additional Information</i>) of this document;
“Management Elster ADS Holders”	certain members of Elster’s management (other than the Elster Directors) who hold Elster ADS (and/or Elster Shares);
“Management Tender Agreement”	has the meaning given to such term at paragraph 11.1.8 of Part XIII (<i>Additional Information</i>) of this document;
“Melrose Bidco”	Mintford AG, an indirectly wholly owned Melrose subsidiary;
“Melrose Board”	the board of directors of Melrose;

“Melrose Circular”	the circular to be sent to Melrose Shareholders on or about the date hereof in connection with the Acquisition and the Rights Issue;
“Melrose Directors”	the directors of Melrose;
“Melrose General Meeting”	the general meeting of Melrose to be held on 16 July 2012 to vote on the Resolutions;
“Melrose Group”	Melrose, its subsidiaries and subsidiary undertakings from time to time;
“Melrose Recommendation”	has the meaning given to such term at paragraph 11.1.3 of Part XIII (<i>Additional Information</i>) of this document;
“Melrose Shareholders”	holders of Melrose Shares;
“Melrose Shares” or “Ordinary Shares”	ordinary shares of 14/55 pence each in the capital of Melrose;
“McKechnie”	the group of businesses acquired by Melrose in May 2005 which, at that time, included the MPC, MVC, Aerospace Aftermarket, Aerospace OEM and PSM businesses (some of which have now been sold);
“Merger Squeeze-out”	has the meaning given to such term at paragraph 3 of Part I (<i>Information on the Acquisition and Rights Issue</i>) of this document;
“Money Laundering Regulations”	the Money Laundering Regulations (SI 2007 No. 2157), as amended;
“MPC”	McKechnie Plastic Components;
“MTM”	a many-to-many instruction in CREST;
“Nachwache”	Nachwache Reserve GmbH;
“National Storage Mechanism”	the document publication facility made available by the FSA at (www.hemscott.com/nsm.do);
“New Melrose Shares”	the ordinary shares of 14/55 pence each proposed to be issued by Melrose pursuant to the Rights Issue;
“New Facilities Agreement”	has the meaning given to such term at paragraph 2 of Part V (<i>Capital Resources</i>) of this document;
“Nil Paid Rights”	New Melrose Shares in nil paid form provisionally allotted to Qualifying Shareholders pursuant to the Rights Issue;
“Noble”	Noble Drilling Services Inc.;
“Nomination Committee”	the nomination committee of the Melrose Board;
“Non-Solicitation Agreement”	has the meaning given to such term at paragraph 11.1.6 of Part XIII (<i>Additional Information</i>) of this document;
“Notice of General Meeting”	the notice of Melrose General Meeting which forms part of the Melrose Circular;
“NYSE”	The New York Stock Exchange;
“Offerings”	has the meaning given to such term at paragraph 11.2.2 of Part XIII (<i>Additional Information</i>) of this document;
“Official List”	the official list of the UKLA;
“Overseas Shareholders”	Qualifying Shareholders who have a registered address in or are located in jurisdictions other than the United Kingdom;
“pence”, “£” and “pound sterling”	the lawful currency of the United Kingdom;

“Prospectus” or “this document”	this document dated 29 June 2012, comprising a prospectus relating to the Company and the listing of the New Melrose Shares on the premium segment of the Official List (together with any supplements or amendments thereto);
“Prospectus Directive”	Directive 2003/71/EC (as amended from time to time, including by Directive 2010/73/EC (the “ PD Amending Directive ”) to the extent implemented in the relevant EEA State) and includes any relevant implementing measures in each EEA State that has implemented Directive 2003/71/EC;
“Prospectus Rules”	the rules for the purposes of Part VI of FSMA in relation to offers of securities to the public and the admission of securities to trading on a regulated market;
“Provisional Allotment Letter(s)” or “PAL(s)”	the renounceable provisional allotment letters relating to the Rights Issue to be issued to Qualifying non-CREST Shareholders other than certain Overseas Shareholders as described in Part XII (<i>Terms and Conditions of the Rights Issue</i>) of this document;
“Qualified Institutional Buyer”	has the meaning given to such term in Rule 144A under the US Securities Act;
“Qualifying Shareholders”	Melrose Shareholders on the Register at the Record Date;
“Qualifying CREST Shareholders”	Qualifying Shareholders whose Melrose Shares are in uncertificated form;
“Qualifying non-CREST Shareholders”	Qualifying Shareholders whose Melrose Shares are in certificated form;
“RBC”	RBC Europe Limited (operating under the name RBC Capital Markets);
“RCF Drawing Limit”	has the meaning given to such term at paragraph 2 of Part V (<i>Capital Resources</i>) of this document;
“Receiving Agent” or “Equiniti”	Equiniti Limited;
“Record Date”	close of business on 12 July 2012;
“Register”	the Company’s statutory register of members;
“Registrar”	Equiniti, or any other registrar appointed by the Company from time to time;
“Regulatory Information Service”	one of the regulatory information services authorised by the UKLA to receive, process, and disseminate regulatory information from listed companies;
“Relevant Action” and “Relevant Actions”	have the meanings given to such terms at paragraph 11.1.3 of Part XIII (<i>Additional Information</i>) of this document;
“Relevant Ordinary Course Breach” and “Relevant Ordinary Course Breaches”	have the meanings given to such terms at paragraph 11.1.3 of Part XIII (<i>Additional Information</i>) of this document;
“Rembrandt”	Rembrandt Holdings S.A;
“Rembrandt Lock Out Agreement”	the agreement between Melrose and Rembrandt dated 14 June 2012 as described at paragraph 11.1.7 of Part XIII (<i>Additional Information</i>) of this document;
“Remuneration Committee”	the remuneration committee of the Melrose Board;
“Resolutions”	the resolutions numbered 1 to 5 set out in the Notice of General Meeting;

“Return of Capital”	the return of approximately £373.2 million of capital by Melrose to Melrose Shareholders by way of a capital reorganisation and C share scheme approved by Melrose Shareholders at a general meeting of the Company on 8 August 2011;
“Rights”	the Nil Paid Rights and/or the Fully Paid Rights;
“Rights Issue”	the proposed issue of the New Melrose Shares to Qualifying Shareholders by way of Rights on the terms and subject to the conditions set out in this document and, in the case of Qualifying non-CREST Shareholders only, the Provisional Allotment Letters;
“Rights Issue Price”	142 pence per New Melrose Share;
“Sanctions”	has the meaning given to such term at paragraph 4 of Part A of the section of this document headed “Risk Factors”;
“SDRT”	stamp duty reserve tax;
“SEC”	the US Securities and Exchange Commission;
“SEDOL”	the London Stock Exchange Daily Official List of share identifiers;
“Senior Notes”	has the meaning given to such term at paragraph 11.2.1 of Part XIII (<i>Additional Information</i>) of this document;
“Settlement Date”	is the date for settlement of the Underwriters’ payment obligations to Melrose pursuant to the Underwriting Agreement;
“Shareholder Helpline”	the helpline set up for Melrose Shareholders which will advise Melrose Shareholders how to complete the Provisional Allotment Letter (if they are Qualifying non-CREST Shareholders) and answer certain questions about the Rights Issue: 0871 384 2778 (from inside the United Kingdom) or +44 121 415 0128 (from outside the United Kingdom) between 8.30 a.m. and 5.30 p.m. on any Business Day (calls to this number cost 8 pence per minute from a BT landline, excluding VAT. Other network providers’ costs may vary.);
“Shareholders”	has the meaning given to such term at paragraph 11.1.8 of Part XIII (<i>Additional Information</i>) of this document;
“Shareholders Tender Agreement”	has the meaning given to such term at paragraph 11.1.8 of Part XIII (<i>Additional Information</i>) of this document;
“Signing Date”	has the meaning given to such term at paragraph 2 of Part (V) (<i>Capital Resources</i>) of this document;
“Sponsors”	together JPMSL and Investec;
“Squeeze-out”	has the meaning given to such term at paragraph 3 of Part I (<i>Information on the Acquisition and Rights Issue</i>) of this document;

“Superior Offer”	means a competing tender offer (within the meaning of Rule 14d-2 under the Exchange Act) for all Elster ADSs of Elster which the Elster Board, acting reasonably and in good faith, determines in reliance on outside legal and financial advice is more favourable to Elster and all stakeholders, including the shareholders, employees and customers of Elster than the Tender Offer, taking into account, without limitation, the matters in relation to the Tender Offer referred to in paragraph 11.1.3 of Part XIII (<i>Additional Information</i>) of this document, any post-completion consequences, and all of the terms and conditions of the competing tender offer including its conditionality, the likelihood of its completion in accordance with its terms and the likely timing of the transaction;
“Tender Offer”	the offer by Melrose Bidco to purchase all of the issued and outstanding Elster ADSs (and the underlying Elster Shares to which they relate), at a purchase price of \$20.50 per Elster ADS (\$82 per Elster Share) in cash on the terms and subject to the conditions to be set out in the Tender Offer Document;
“Tender Offer Commencement Date”	the date the Tender Offer Document is filed with the SEC and mailed to Elster ADS Holders and Elster Shareholders, expected to be on or about 6 July 2012;
“Tender Offer Document”	a Tender Offer Statement on Schedule TO (including the Offer to Purchase contained therein) and the related Letter of Transmittal, which will be filed with the SEC and mailed to Elster ADS Holders and Elster Shareholders on the Tender Offer Commencement Date containing and setting out the terms and conditions of the Tender Offer;
“Tender Offer Expiration Date”	the 20 th business day (calculated as set forth in Rule 14d-1(g) under the Exchange Act) from the Tender Offer Commencement Date or such subsequent date to which the expiration of the Tender Offer is extended pursuant to and in accordance with the terms of the Tender Offer Document;
“Transition Date”	has the meaning given to such term at Section B of Part VII (<i>Historical Financial Information Relating to Elster</i>) of this document;
“Transaction Resolutions”	the resolutions numbered 1 and 2 set out in the Notice of General Meeting;
“UK” or “United Kingdom”	the United Kingdom of Great Britain and Northern Ireland;
“UK Corporate Governance Code”	the combined code on corporate governance issued by the Financial Reporting Council in the United Kingdom from time to time;
“UKLA”	the FSA in its capacity as the competent authority for the purposes of Part VI of FSMA;
“uncertificated” or “in uncertificated form”	a share or other security title to which is recorded in the relevant register of the share or security as being held in uncertificated form, in CREST, and title to which, by virtue of the CREST Regulations may be transferred by means of CREST;
“Underwriters”	JPMSL, Investec, Barclays, HSBC and RBC;
“Underwriting Agreement”	the agreement dated 29 June 2012 between Melrose and the Underwriters pursuant to which the Underwriters have conditionally agreed to underwrite the Rights Issue, a summary of which is contained in Part I (<i>Information on the Acquisition and Rights Issue</i>) of this document;

“US” or “United States” or “United States of America”	the United States of America (including the states of the United States and the District of Columbia), its possessions and territories and all areas subject to its jurisdiction;
“US GAAP”	generally accepted accounting principles in the United States;
“US Securities Act”	the US Securities Act of 1933, as amended, and the rules and regulations promulgated thereunder;
“US\$”, “US dollars” or “\$”	the lawful currency of the United States; and
“VAT”	(i) within the EU, any tax imposed by any member state in conformity with the directive of the council of the European Union on the common system of value added tax (2006/112/ EC), and (ii) outside the EU, any tax corresponding to, or substantially similar to, the common system of value added tax referred to in paragraph (i) of this definition.

All references to legislation in this document are to the legislation of England and Wales unless the contrary is indicated. Any reference to any provision of any legislation shall include any amendment, modification, re-enactment or extension thereof.

For the purpose of this document, “subsidiary” and “subsidiary undertaking” have the meanings given by the 2006 Act.

Words importing the singular shall include the plural and vice versa, and words importing the masculine gender shall include the feminine or neutral gender.

DOCUMENTS INCORPORATED BY REFERENCE

The following documentation, which was sent to Melrose Shareholders or Elster Shareholders (as applicable) at the relevant time and/or is available for inspection in accordance with paragraph 17 of Part XIII (*Additional Information*), contains information which is relevant to the Acquisition:

1. Melrose's Annual Report and Accounts for the financial years ended 31 December 2011, 2010 and 2009

These reports and accounts contain the audited consolidated historical financial statements of Melrose for the financial years ended 31 December 2011, 31 December 2010 and 31 December 2009 and the audit Annex I, reports in respect of each year.

2. Information incorporated by reference

The table below sets out the documents which are incorporated by reference into this document, to ensure that Melrose Shareholders and others are aware of all information which, according to the particular nature of the Company and of the New Melrose Shares, is necessary to enable Melrose Shareholders and

others to make an informed assessment of the assets and liabilities, financial position, profit and losses and prospects of the Company and of the rights attaching to the New Melrose Shares:

<u>Information incorporated by reference into this document</u>	<u>Location of incorporation in this document</u>	<u>Page number(s) in this document</u>
Melrose's Annual Report and Accounts 2011 including Melrose's financial statements for the year ended 31 December 2011, the notes and the auditors' report thereon and the Finance Director's review (pages 23-30 and 62-108)	Part VI (<i>Historical Financial Information Relating to Melrose</i>)	83-84
Melrose's Annual Report and Accounts 2010 including Melrose's financial statements for the year ended 31 December 2010, the notes and the auditors' report thereon (pages 46-87).	Part VI (<i>Historical Financial Information Relating to Melrose</i>)	83-84
Melrose's Annual Report and Accounts 2009 including Melrose's financial statements for the year ended 31 December 2009, the notes and the auditors' report thereon (pages 46-89).	Part VI (<i>Historical Financial Information Relating to Melrose</i>)	83-84
Melrose's operating and financial review for the year ended 31 December 2011	Part IV (<i>Operating and Financial Review Relating to the Melrose Group</i>)	75-76
Melrose's operating and financial review for the year ended 31 December 2010	Part IV (<i>Operating and Financial Review Relating to the Melrose Group</i>)	75-76
Melrose's operating and financial review for the year ended 31 December 2009	Part IV (<i>Operating and Financial Review Relating to the Melrose Group</i>)	75-76
Divisional review for the year ended 2011 (page 18)	Part V (<i>Capital Resources</i>)	77-82
Deloitte auditors' report on reconciliation from Part V (<i>Unaudited Reconciliation of Elster Financial Information to IFRS as Applied by Melrose</i>) of the Circular	Part VII (<i>Historical Financial Information Relating to Elster</i>)	85-175
Paragraph 2.2 (<i>Details of options to subscribe for 2012 Incentive Shares</i>) of Part II (<i>Details of the Proposals</i>) from the shareholder circular sent by Melrose to Melrose Shareholders on 23 March 2012	Part X (<i>Directors, Corporate Governance and Employees</i>)	186-198

To the extent that any document or information incorporated by reference or attached to this document itself incorporates any information by reference, either expressly or impliedly, such information will not form part of this document for the purposes of the Prospectus Rules, except where such information or documents are stated within this document as specifically being incorporated by reference or where this document is specifically defined as including such information.

Any statement contained in a document which is deemed to be incorporated by reference into this document shall be deemed to be modified or superseded for the purpose of this document to the extent that a statement contained in this document (or in a later document which is incorporated by reference into this document) modifies or supersedes such earlier statement (whether expressly, by implication or otherwise). Any statement so modified or superseded shall not be deemed, except as so modified or superseded, to constitute a part of this document.

Where certain parts only of a document have been incorporated by reference into this document, the other parts of those documents which have not been expressly stated to be incorporated are either not relevant to investors or are covered elsewhere in this document.

The information incorporated by reference is available for inspection (in respect of (i) and (ii) during normal business hours on any weekday (Saturday, Sundays and public holidays excepted)) (i) at the registered office of Melrose (being Precision House, Arden Road, Alcester, B49 6HN), (ii) at the offices of Simpson Thacher LLP (being CityPoint, One Ropemaker Street, London EC2Y 9HU), (iii) at the Melrose Group's website (www.melroseplc.net) and (iv) via the National Storage Mechanism.

