Chief Executive's report

Continued progress has been demonstrated – we are committed and confident about our future >>>

Overview

Economic conditions in almost all the markets in which we operate have been depressed, making for a difficult year as a whole, with the second half being more difficult than the first. The reasons for this global downturn are well known, however, a specific impact in our case has been the very dramatic fall in the electronics sector which particularly affects our US business.

Our businesses are resilient but not immune to the prevailing economic conditions. Sales growth rates in all of our markets have been impacted. On a full year basis: reasonable growth was achieved in Europe and Japan; Asia was relatively flat; the UK experienced a moderate, and the US a significant, decline in sales. e-Commerce sales increased strongly in all our markets.

Our management strategy in these difficult times is very clear. We will not be deflected by short term economic pressures from doing what is right for the long term growth of the Group. Our businesses have enormous growth potential and we have maintained our strategic investments in them. In parallel, we have continued to manage our gross margins and the cost base to offset in part the impact of sales shortfalls. Stock has been reduced significantly whilst maintaining our exceptional service levels, and the already strong cash generation of our business was improved. Net debt was reduced by £22.5m even after a substantial increase in capital expenditure.

These external trends are cyclical, economic conditions will improve, and our views on the long term growth potential of our business model worldwide remain unchanged.

During the year, the senior management structure beneath Board level, which manages and controls the day-to-day operations of the business, was realigned to reflect the increasingly global nature of the business. The Group Executive Management Team (GEMT) was formed, whose membership consists of the Executive Directors and the Regional and Process heads. This team meets regularly to develop strategy and drive the sharing and implementation of best practice around the Group.

I will now summarise the performance of our businesses by geographic region.

UK

RS UK	2002	2001
Sales (in UK)	**£379.7m**	£412.4m
Adjusted sales (decline) growth	**(7.6)%**	2.7%
Sales (by origin)	**£393.0m**	£426.0m
Adjusted sales (decline) growth	**(7.4)%**	3.3%
Contribution	**£126.2m**	£136.2m
Contribution %	**32.1%**	32.0%

The growth demonstrated by the RS UK business in 2001 was short lived in the face of general economic difficulties and the continued pressure on the manufacturing sector. In 2002, overall sales declined by 7.4% (adjusted for trading days) to £393.0m. Growth among customers in some sectors of the economy (transport, services, etc) was insufficient to offset declines, particularly in manufacturing and telecommunications. Due to these factors and the impact of rationalisation within our customer base, the total active customer numbers also declined by 7%. UK sales in the second half declined by 10.7% (adjusted), but exited the financial year at a slightly lower rate of decline.

Despite lower sales, the UK contribution margin improved to 32.1% from 32.0% through good control of gross margin and local costs, which demonstrates effective management in difficult times. RS UK remains a highly profitable business and extremely cash generative.

We strongly believe in the growth still available to our UK business. All types of business value our services and we have customers in all Standard Industry Classification codes. Many businesses, however, have not yet become our customers. Even within the manufacturing sector, we estimate that our penetration is only 6% of our relevant market, and this declines to 1.5% in non-manufacturing. Although half our customers by number are now in non-manufacturing businesses, they generate only approximately 40% of our sales. There are also many other potential users within our current customer accounts who do not yet buy from RS. Our task is to reach more businesses and more individuals within them and convince them of the value of the RS service. Currently we are generating one thousand new customers each month.

We also aim to increase the frequency and breadth of purchase (the number of different products purchased) of our customers. Many of our customers currently purchase within a narrow range of products: they can be encouraged to broaden their use of our very wide product offer and come to rely on RS for more of their small order needs. At the end of the year the catalogue contained 132,000 products, but many customers bought only a small number of these products compared to their potential requirements from our range.

To realise our customer potential the UK business invested during the year in increasing its field sales force and undertook a major sales force development programme. Our telesales activities were increased and we have successfully introduced a new customer acquisition programme. This reduces the time it takes for new customers to increase their frequency of purchase.

Sales coverage has been intensified around each of our 13 trade counters, to increase our penetration of customers in each area. We continue to see considerable success with our Managed Stock Replenishment service from our trade counters to large customers: in this service we monitor our customers' stores for them and ensure that they have what they need when they need it. We have seen increases of around 40% in sales to participating companies. We have made the task of running their businesses easier and saved them substantial amounts of money, proving the value of using RS.

We have increased the focus of our marketing programmes on growing sectors, such as health, defence and transport. Direct mailing programmes have been very successful in stimulating customer

It's about making sure that customers have what they need when they need it, and know they can rely on us to get it for them quickly and accurately.

Debbie Moore
Nuneaton operations, RS UK

activity, and we continue to use specialogues (small catalogues) to improve the relevance of our offer to customers.

I discuss our e-Commerce activities for the Group as a whole later in this statement. Within the UK, trading over the internet at the end of the year represented over 10% of sales, up from 7% at the end of last year.

Exports from the UK to distributors and direct to overseas customers declined by 4.8% as the global economy suffered and Sterling remained strong.

Rest of Europe

RS Rest of Europe	2002	2001
Sales	**£210.7m**	£203.6m
Adjusted sales growth	**4.1%**	21.8%
Contribution	**£40.4m**	£38.5m
Contribution %	**19.2%**	18.9%

Sales in Europe grew by 4.1% (adjusted for trading days and at constant exchange rates) from £203.6m to £210.7m, which is now 28% of Group sales. Trading in the second half was more difficult than the first half and there was a small sales decline (adjusted) which persisted at the year end. Even at these more modest growth levels the success of the RS strategy (sales growth with improving contribution margins) was demonstrated and contribution margins improved by 0.3 percentage points to 19.2%. Managing the scale curve, tight cost management and improving gross margins all led to the improved contribution margin. "The Prize" potential in the Rest of Europe remains enormous when compared in relative size terms to the UK and we are following our well established strategy towards achieving this "Prize".

We are managing these markets on a more common basis and during the year a Regional General Manager was appointed for the Rest of Europe, covering businesses in France, Germany, Italy, Austria, Scandinavia, Ireland, Spain and Benelux.

The transfer of best practice between these businesses has continued with encouraging results. For example, RS Italy successfully piloted a scheme which promotes relevant or interesting products to customers as they order other products. This was successful and we were able to roll it out swiftly and efficiently to other markets. Similarly, another Italian initiative increased orderfill (the percentage of orders we can fulfil immediately from stock) by ensuring that good alternative products are offered if a product being sought is temporarily unavailable: consequently orderfill increased by about one percentage point. Again this experience has been rolled out.

We continue to exploit our very strong position in continental Europe. Our approach combines local nationals managing each business to drive growth through implementing the RS Core Business Model, together with Processes providing world-class support to drive effectiveness.

Through the year service levels in all markets improved, even though the level of stock was reduced.

Our more advanced e-Commerce capabilities developed in the UK, discussed later in this report, have now been rolled out across the Rest of Europe at a cost of over £5m.

RS Rest of Europe – sales, customers and products	Adjusted sales growth	% Increase in active customers	Number of products
France	3.3%	3%	95,000
Germany	6.7%	1%	82,000
Italy	1.1%	4%	80,000
Smaller businesses	4.7%	1%	55,000

The modest increases in customers reflected the more difficult economic conditions within these markets as the year progressed. The product offer reflects the different stages of development in each of our markets.

For much of the year Radiospares in **France** has been preparing for the first implementation of our significant systems development (as discussed in Richard Butler's report) which should go live in the second half of this year. This will subsequently be extended to all companies in Europe (including the UK). Radiospares should be the first business to generate the substantial efficiency benefits and rewards from better customer service that the improved processes and systems will support.

Growth of our businesses in **Italy** and **Germany** has driven investment in new warehouse facilities in these countries. The move to the Italian warehouse has been completed without problem, and the fit-out of the new German facility is progressing to plan. This is a major new investment situated in Bad Hersfeld, about 140km north of Frankfurt, where our current facility is located. The new building and systems in this more central location will enable us to increase our service levels and to take orders for same day despatch until later in the day than we can in our current facility.

The **smaller businesses in Europe** had differing results. Radionics in Ireland was significantly affected by a steep decline in the technology sector while Spain showed good growth throughout the year. Austria and Benelux were broadly flat for the year. Scandinavia showed growth in the year, even without the contribution of our distributor in Norway since its acquisition in September 2001. This Norwegian business has now been integrated into our Scandinavian operations. With the creation of a regional management structure for continental Europe, we will increasingly see the smaller businesses leveraging off their larger neighbours.

North America

Allied North America	2002	2001
Sales	**£110.5m**	£148.7m
Adjusted sales (decline) growth	**(27.6)%**	24.6%
Contribution	**£15.9m**	£26.4m
Contribution %	**14.4%**	17.8%

Chief Executive's report *continued*

Sales of our Allied business in the US declined by 27.6% (adjusted) to £110.5m. Allied experienced the combined effects of sharp economic slowdown and what was the worst slowdown in electronics demand since 1959 according to the Semiconductor Industry Association. The National Electronic Distributors Association reported that US distributors suffered an average year-on-year sales decline of 40% in the fourth quarter of calendar year 2001. Allied is an electronics rather than a broad range industrial distributor like the RS businesses and so was particularly impacted. Allied's customer base was much more stable, however, declining only 3%. The downturn is cyclical, as was the previous year's upturn, and we are confident that as market conditions improve Allied will return to its long term trend growth.

Allied's decline in sales was steepest around the half year. Since then the rate of decline has more than halved.

Allied's profit contribution on sales declined by 3.4 percentage points to 14.4%, despite actions on gross margins and costs. The decline in sales was almost entirely due to a fall in average order value, which also resulted in lower discounts. This, together with selective pricing adjustments, increased gross margin by over 2 percentage points.

Cost management has resulted in labour headcount being reduced by 16%, substantially all of which was part-time and contract labour. However, the extensive sales branch network and sales force have been sustained, as we believe that these provide competitive advantage. The branches give customers the personal contacts they value and ensure that we meet their service requirements better than less capable competitors. Management has not reacted to the downturn in any way which will prejudice the future long term growth potential of the business.

Different parts of the US economy had different experiences and resources have been targeted on growing segments, for example, defence, health and utilities. Over a million new potential customers have been identified who are now being targeted using various tools including direct mail and personal follow-up from the local sales offices. A number of incentive programmes were introduced to increase our penetration of growing customers, and these campaigns have produced good returns.

Allied's stock was reduced by 27.5% whilst maintaining superior customer service levels. Allied was rated number one in product availability in North America in customer surveys conducted by Electronic Buyers News, a major US trade magazine. The product offer was 125,000 at the end of the year.

e-Commerce sales have increased by 45.0% and are now 6% of total sales. "Punch-out" technology, which enables customers to build orders by "punching" through their own firewall to our website before returning to have their purchases authorised, is being used with several large national accounts who have e-Procurement software for order processing.

Japan

RS Japan	2002	2001
Sales	**£9.0m**	£8.6m
Adjusted sales growth	**15.3%**	184.8%
Contribution	**(£4.7m)**	(£6.3m)

Sales in Japan have grown by 15.3% (adjusted) to £9.0m. Losses of £4.7m were down from £6.3m last year. The low growth compared to the previous year is attributable to a rapid downturn in the Japanese economy, particularly in the electronics and manufacturing sectors. We have seen sales to some of our more established electronics customers decline because they have made a number of their engineers redundant, some of whom were our customers. However, the total number of customers served by RS Japan has grown by 15% and the average order frequency of these customers has also grown. This demonstrates that the Japanese engineer continues to value the RS service. This experience reinforces our view that the market potential remains huge.

The second half growth of 8.1% was lower than the first half, and this rate persisted to the year end.

Marketing activities have been implemented to accelerate the rate of customer acquisition and to increase the breadth of purchase of existing customers. The sales force has successfully targeted "recession proof" customers, for example, universities and government institutes.

We continue to follow our well-proven strategy of implementing the RS Core Business Model in Japan: increasing the product range through adding new technologies and increasing the number of customers and the breadth of purchase of those customers. The number of products has grown to 43,000, which is an increase of 70% since launch. The range of products has started to widen to cover electrical and mechanical products in addition to electronics, as we build up to our typical broad range industrial offer which can satisfy our customers' needs.

e-Commerce business in Japan has grown to 19% of total sales. Our more advanced internet capability, entirely in the Japanese language, was successfully launched in April 2002. A dedicated team has been created to drive sales through this exciting new e-Commerce opportunity.

To meet the potential in this market we have decided to relocate the business to a larger warehouse in a better location for serving customers. This will happen in the summer of 2002.

Given the trading backdrop and additional investments, the business is now planned to break even at the end of the 2004 financial year.

Rest of World

RS Rest of World	2002	2001
Sales	**£36.4m**	£37.0m
Adjusted sales growth	**1.0%**	17.1%
Contribution	**£0.2m**	£1.8m
Contribution %	**0.5%**	4.9%

It's about successfully replicating the Group's business model around the world; offering Japanese engineers the best way to buy their small-volume industrial product.

Jay Yamaguchi
General Manager, RS Japan

Sales in the rest of the world grew by 1.0% (adjusted) to £36.4m. The second half declined by 1.2%, but the businesses were growing again by the end of the year. Asia accounts for most of this segment.
Asia: Asia sales declined by 2.3% (adjusted) as these markets are closely linked to the US and have therefore seen very difficult economic conditions.

The Asia region is being managed on an integrated basis by a Regional General Manager. The primary focus has been to improve the sales effectiveness across the region and to transfer best practice.

Sales for the whole of **North Asia** were level (on an adjusted basis) with last year. This reflects growth in China and declines elsewhere.

Sales in China grew by 10.8% (adjusted). China held up longer in the global economic downturn, with the first signs of this downturn seen during the second half in the manufacturing centres of Southern China. Strategic investment in catalogues and fulfilment during the year amounted to £1.4m (2001: £2.5m).

Over 5,000 new customers were acquired in the year. Our Shanghai warehouse gained approval for same day despatch from the warehouse with retrospective customs clearance, so allowing us to improve considerably the service level offered in the Shanghai region. Following its entry into the World Trade Organisation, however, China has begun to place more controls on imports. Although these restrictions are not fully operational, they have caused us some disruption that we expect to continue until the new procedures are implemented consistently.

In some months, up to 30% of Chinese sales came via the internet. This was driven by particular incentive programmes, and shows the relevance of e-Commerce to all of our markets.

Hong Kong and Taiwan faced difficult trading because of the dependence of their markets on world trade levels and electronics. Our sales declined in the year.

Sales in **South Asia** declined by 7.1% (adjusted) with Singapore being particularly badly affected because of its strong links to the US economy, and the importance of electronics. In spite of this, our marketing and sales actions grew the customer base by 9% to provide a sound platform for recovery. During the year significant investment was made in systems to support future growth.

Sales in **Australasia** declined by 1.2% (adjusted). The Australian economy grew in the year, but not in the sectors where our customers are concentrated. Our efforts have been to broaden the customer base. Our smaller business in New Zealand continued to grow. The Australasian business again generated good profits.
Other Markets: Sales in our other smaller markets grew by 38.5% (adjusted), driven by particularly strong growth in South Africa.

e-Commerce

e-Commerce is a powerful way to market for the Group where we have developed clear leadership. This channel builds on existing strengths in fulfilment, content management and our relationship with customers. As well as serving existing customers we are attracting new ones and providing services not possible through other channels.

Sales over the internet represented over 8% of total Group sales at the year end. They amounted to £51.1m for the year as a whole, and grew by over 50%.

The roll-out of the Euro Internet Trading Channel (EITC) was completed during the year. Capital expenditure was £1.5m (2001: £3.6m) with development and launch costs expensed of £7.7m (2001: £4.0m). The roll-out has taken our most advanced and proven functionality (developed in the UK) to 11 European countries and all on a single platform. Each country site is in its own local language and is integrated into the local business systems so that all existing customer information remains available.

This roll-out has resulted in record levels of internet sales being achieved in all markets in which the EITC has been launched. Sales have grown by over 100% in some markets compared to the previous internet trading site, which demonstrates the value that our customers place on this new functionality. Our understanding of customer purchasing patterns is being enhanced, which will be the foundation for future marketing programmes. The power of this platform is that as new techniques are trialled and proven in one of the markets, they can then be deployed quickly to all the others.

The launch of our new PurchasingManager™ functionality in February 2002 has also been enthusiastically welcomed by customers. This is a simple to use but powerful e-Procurement package which manages customers' transactions with RS. The benefits are demonstrable control of purchasing by the purchasing professional (through setting limits for spend, approval, etc) combined with empowerment of the end-users to purchase what they need without a cumbersome paper-based approval process. The net result is a significant reduction in transaction costs and happier end-users and purchasing professionals. We expect PurchasingManager™ to be a significant revenue driver in the future.

As mentioned previously, we successfully launched the equivalent functionality of the EITC in Japan in April 2002. e-Commerce revenues in Japan were already 19% of sales in the year and so we are particularly excited about the likely impact of the new functionality. Early results are encouraging.

Summary

Our strategy remains unchanged. As a Group we have huge growth potential in the markets we serve. Even during the current economic difficulties, continued progress has been demonstrated, as has our capability for good gross margin and cost management. The very strong cash generation capability of our Group has again been demonstrated. Despite the current cyclical downturn, which we will successfully manage through, we are committed and confident about our future.

Ian Mason, Group Chief Executive