Financial review

Our returns remain substantially higher than the Group's cost of capital >>>

Turnover, profits and earnings of continuing operations

Key figures	2002	2001
Turnover	**£759.6m**	£823.9m
Operating profit*	**£108.7m**	£130.9m
Interest	**(£3.2m)**	(£6.8m)
Profit before tax*†	**£105.5m**	£124.1m
Earnings per share*†‡	**17.3p**	20.2p
Dividend per share	**15.9p**	13.8p

Key statistics	2002	2001
Gross margin %	**51.0%**	49.1%
Operating margin %*	**14.3%**	15.9%
Return on sales %	**13.9%**	15.1%
Effective tax rate %*†‡	**29.0%**	29.3%
PBT on net assets†‡	**22.7%**	27.1%

Growth %	2002	2001
Turnover	**(7.8%)**	15.8%
Turnover – adjusted	**(7.7%)**	12.3%
Operating profit*	**(17.0%)**	10.7%
Profit before tax*†	**(15.0%)**	7.6%
Earnings per share*†‡	**(14.4%)**	6.3%
Dividend per share	**15.2%**	15.0%

*Before amortisation of goodwill
†2001: before exceptional loss on closure of Pact
‡2001: restated for the implementation of FRS19

Group turnover of continuing operations declined by 7.8% to £759.6m. Before goodwill amortisation (and exceptional charges last year) operating profit fell 17.0% to £108.7m, profit before tax fell 15.0% to £105.5m and earnings per share fell 14.4% to 17.3p. The prior year also included the Pact business for nine months before it was discontinued on 1 January 2001 and subsequently closed at an exceptional cost of £6.9m.

Exchange rate movements had a positive translation effect on our reported operating profit. At constant exchange rates, sales would have been £1.7m lower and operating profit would have been £1.0m lower, a decline of 17.7% over the prior year compared with the reported 17.0%. Adjusting sales for the number of trading days in the year and to constant exchange rates gives an underlying sales decline of the continuing operations of 7.7%.

For the continuing operations, the gross margin was 51.0%, which was up on last year. This partly reflects the lower contribution of Allied to the overall sales mix, as Allied has a lower gross margin than the RS businesses, and partly more positive management across the whole Group of all the factors that determine the gross margin.

Operating margins (before amortisation of goodwill) declined from 15.9% to 14.3% for a number of reasons. A significant factor was the lower gross profit resulting from the lower sales notwithstanding the higher gross margin percentage. The lower gross profit was not then fully offset by reductions in the cost base of the Group. Though costs have been managed down in light of the difficult trading of the past year, care has been taken not to prejudice the growth potential of the businesses when trading recovers and so costs were not driven down to the same degree as the fall in sales. The second factor, as last year, is that our higher growth businesses are our smaller businesses which have higher costs relative to sales than our larger businesses, due to scale effects. Hence, the margin decline partly reflects this change in mix of cost bases within the Group. Thirdly, our strategic investments are higher at £13.8m versus £12.8m last year: e-Commerce costs were up to £7.7m from £4.0m whilst Japan losses declined to £4.7m from £6.3m and China investment to £1.4m from £2.5m.

Overall Process costs were £69.3m, or 9.1% of sales, compared to 8.0% of sales of continuing operations last year. Before the impact of any particular project activities, these costs are anticipated to flatten and then decline as a percentage of sales over time. The largest component of these costs remained information systems, accounting for about 40% of the total, and this component is likely to increase over the next few years as the project to upgrade the Group's systems infrastructure, communications and databases incurs depreciation and costs ahead of benefits. The enterprise business systems projects cost £1.8m in the year, up from £0.1m. The development costs of e-Commerce within Processes were £5.0m, up from £1.7m last year. Conversely, given our share price development relative to the peer group, the funding of the Long Term Incentive Plan required a

charge of £0.1m in the year compared to £2.5m last year and this has benefited the Process costs. After adjusting for the project costs and the LTIP, the Process costs grew by 1.6%.

The interest charge was £3.2m compared to £6.8m last year, mainly due to lower interest rates and the reduction in net debt over the year. The tax rate of 29.0%, based on profit before tax and goodwill amortisation was marginally lower than the (restated) prior year rate of 29.3%. FRS19 (Deferred Tax) has been applied in arriving at this rate. In accordance with FRS10, the £214.8m of goodwill that arose on the acquisition of Allied is being written off over 20 years and the amortisation in the year was £11.9m. The acquisition of the business activities in Norway also led to an increase in goodwill amortisation of £0.1m during the year.

Profit before tax and after goodwill amortisation was £93.5m and the effective tax rate on this profit was 32.7%. After tax, the profit for the year amounted to £62.9m, down 11.4%.

Earnings per share before goodwill amortisation (and before exceptional items in the prior year) declined 14.4% to 17.3p from 20.2p. After goodwill amortisation (but before exceptional items in the prior year), the decline was 17.6% to 14.5p. Including the exceptional charge in the prior year the decline was 11.6%.

With the recommended final dividend of 11.0p per share, dividends rose 15.2% to 15.9p, which were covered 1.1 times by earnings before goodwill amortisation. Cash generation and the impact of strategic investments that have been expensed are also factors in considering cover. Taking the cash earnings per share (earnings per share plus depreciation) as adjusted for the after tax cost (at a rate of 29%) of the strategic investments gives a dividend cover of 1.5 times.

Cash flow and balance sheet of continuing operations

Cash flow	2002	2001
Stocks	**£29.0m**	(£8.6m)
Debtors	**£18.5m**	(£4.5m)
Creditors	**(£19.0m)**	(£1.2m)
Working capital	**£28.5m**	(£14.3m)
Capital expenditure on fixed asset additions	**(£47.2m)**	(£25.6m)
Free cash flow	**£76.3m**	£74.4m
Net debt	**(£53.0m)**	(£75.5m)

Key statistics	2002	2001
Stock turn	**2.7**	2.5
Debtors days	**50.8**	53.8
Creditors days	**33.7**	40.1

Operating cash flow of continuing operations was again healthy at £156.7m, up from £138.0m last year and representing 144.2% of operating profit (before amortisation of goodwill). Free cash flow of continuing operations for the year was £76.3m (£74.4m last year), and total free cash flow was £81.6m (£78.6m), including the cash flows from Pact.

Working capital cash inflows amounted to £28.5m compared to a £14.3m outflow last year. Cash inflow on stocks was £29.0m compared to an outflow of £8.6m last year. Whilst maintaining high service levels for customers, stock levels were tightly and effectively managed throughout the year and stock turn improved to 2.7 times from 2.5 times. Debtors recorded an inflow of £18.5m, compared with an outflow of £4.5m last year. Debtor days were 50.8, down from 53.8 last year. There was a cash outflow on creditors of £19.0m, compared to an outflow of £1.2m last year. Creditor days were 33.7, a decrease from 40.1 last year. The incidence of the Easter holidays at the year end benefited the debtors and creditors cash flows.

Capital expenditure on fixed assets additions was £47.2m, significantly higher than last year (£25.6m for continuing operations) though slightly lower than we expected earlier in the year due to rephasing. The largest expenditure in this year has been £25.2m on systems, of which £20.2m was part of the £50m enterprise business systems. This three-year investment programme will substantially improve the systems structure, data management and process design across Europe and Asia. £1.5m was also spent on e-Commerce infrastructure. Other major investments have been in the new warehouse facilities in Germany (£13.7m) and Italy (£2.8m). The combination of expenditures in the year represents a peak and the overall level is expected to be significantly lower in this year.

The closure of Pact provided a £5.3m inflow of cash during the year (2001: £4.2m). The freehold property previously occupied by Pact is subject to an offer.

Financial review *continued*

The relevant assets of our distributor in Norway were acquired on 28 September 2001 and our wholly owned business commenced trade from 1 October 2001. The acquisition cost £0.8m, all of which represented goodwill. The trading results of the new business were immaterial to the Group as a whole.

After higher tax and dividend payments of £32.9m (including Pact) and £62.7m respectively, the decrease in net debt was £22.5m or 30%, giving year end net debt of £53.0m.

Pensions

Note 7 to the Accounts indicates the effect FRS17 would have had if it had been adopted. Full adoption is required for the year ended 31 March 2004. The Group has a well-funded defined benefit scheme in the UK with much smaller defined benefit schemes in Ireland and Germany. Elsewhere the schemes are defined contribution. Under the FRS17 rules we are pleased that the defined benefit schemes showed a combined surplus of £17.6m. The last full valuation of the UK scheme was carried out as at 31 March 2001 and showed a surplus of £22.1m.

The Group has been evaluating its long term pension arrangements in the UK and is considering the introduction of a new defined contribution scheme for new employees.

Treasury

Treasury continued to operate as a centralised service centre. Its ethos remained the managed reduction of the Group's financial risks. The Treasury Committee continued to oversee any policy or procedural changes.

Treasury manages the Group's foreign currency transaction risks. These typically arise because the Group's purchases in currencies other than Sterling are much less than its receivables from catalogues with fixed prices in those currencies. Substantial hedging of net currency exposures over the catalogue lives was once again implemented in order to "shelter" forecast gross profits through the catalogue lives. In this way the impact of currency fluctuations is smoothed until selling or cost prices can be changed in light of the changed exchange rates. The hedges are enacted through forward currency contracts entered into by Group Treasury on the trading projections provided by local businesses. Note 26 to the Accounts gives a summary of the Group's hedging positions at the year end. In addition, supplier negotiations continued such that more product purchases will be made in the underlying currencies of the source, as against Sterling. This then allows increased netting of currency flows internally.

Over the course of the year, the Euro remained weak and the US Dollar strengthened. In itself this reduced our gross margins because a large part of our product supply is directly or indirectly sourced in US Dollars whilst a large part of our currency receipts are from sales in Sterling or Euros. As noted above, however, other management actions overcame this negative influence and our gross margins increased over the year.

Cash flows relating to material transactions in currencies other than the functional currency of the local business are hedged when the commitment is made.

Foreign currency translation exposures are not explicitly hedged, but local currency debt is used where economic and fiscally efficient in the financing of subsidiaries and this provides a partial hedge. Treasury guidelines are in place for reviewing the impact of translation exposures should there be any material changes. Note 26 to the Accounts summarises the financial assets and liabilities by major currencies at the year end.

The Allied acquisition in July 1999 was financed by term loans from our relationship banks and these are being paid down from trading cash flows. The financing structures of other subsidiaries continue to be reviewed for overall financial and fiscal effectiveness. Multi-country cash pooling has been successfully implemented across the Group with our banks to ensure daily netting of almost all the Group's cash flows in Sterling, US Dollar, Euro, Yen, Singapore Dollar and Hong Kong Dollar with consequent improvements in liquidity and lower interest costs.

At the year end the Group had net debt of £53.0m to give gearing of 12.9% and interest cover (before amortisation of goodwill and exceptional charges) of 33 times. The Group remains robustly financed.

It's about making sure that all our businesses use their information in the best way, to optimise our services to customers and our performance as a business.

Danny Cardew
Enterprise Business Systems, RS Singapore

Within net debt, total debt was £74.4m, of which £39.0m was denominated in US Dollars and £24.2m in Yen, whilst cash of £5.1m and short term investments of £16.3m were largely in Euro deposits. Group policy on investment management is to maximise the return on net funds subject always to the security of the principal and the liquidity of the Group. The Group has established policies to identify counterparties of suitable credit worthiness and has procedures to ensure that only these parties are used, that exposure limits are set and that these limits are not exceeded. During the year and at the year end the Group did not make use of any financial instrument for the purpose of hedging changes in interest rates. Note 26 to the Accounts provides a summary of the deposit structure of the Group at the year end.

Financial and shareholder returns

Profit before tax (and after goodwill amortisation) on net assets was 22.7%, down from 27.1% (before exceptional loss on Pact) last year. These returns remain substantially higher than the Group's cost of capital. Trading performance and the investments made to implement the Group's strategy have depressed the reported returns.

Our reduction in total shareholder return over the year was 10.3% reflecting the share price decrease between the year ends, which compared to the negative 3.2% in the Allshare index.

On 1 January 2002 Electrocomponents was reclassified from Distributors into the Business Support Services sector of the stock market, a move that we regard as beneficial to shareholders. All shareholders should benefit from the increased coverage of the Group by analysts and others that focus on this much larger sector.

Our move into the Support Services sector has meant that a significant number of investors and analysts that have not previously known the Group wish to build their understanding. This will help in broadening the market for Electrocomponents' shares. Hence, in January 2002, Electrocomponents hosted a site visit to our Nuneaton (United Kingdom) facility for investors and analysts to provide a first hand view of this major part of our fulfilment infrastructure and to learn more of our strategy. Managers of some of our major operations took part in the day and their full presentations are available on our corporate website.

Summary

Providing attractive returns for our shareholders relative to the market over the long term remains the primary goal of our strategy. In our selected markets the growth potential for our businesses is large and we believe that superior returns are available to the Group over the long term. The sales and profit performance of our main European businesses are important pointers, as is our progress in Japan and in the major Asian markets. Though Allied has had a very difficult year as a result of the electronics cycle, our experience of this business gives us confidence in its quality and in the opportunities for the Group in the North American market.

We are not distracted from pursuing our strategy by the short term trading difficulties encountered over the past year. The global economic backdrop influences the timing of the realisation of the Group's potential ("The Prize"), but does not alter our belief in its ultimate attainability. We are convinced that as our businesses realise the considerable sales potential of their markets over time, and consequently achieve the economies of scale, their profitability, absolute profits and cash generation will increase. In the larger economies our opportunities should be substantially larger than those reflected by our UK business.

We will continue to strive to make real these very attractive investment prospects.

J.L. Hewitt

Jeff Hewitt, Deputy Chairman and Group Finance Director