

Chief Executive's report

Overview

Despite the continuation of tough economic conditions throughout the year, the second half of the year saw an improvement in trading.

Over the past year regional sales performance has reflected some of these initiatives: strong sales growth was achieved in Japan, despite a very weak economy; Europe and Asia had modest growth rates, though with the second half better than the first; North America had a small decline in sales for the year as a whole but grew in the second half; and the sales decline of our UK business lessened as the year progressed. e-Commerce sales accelerated in all our major markets.

We believe firmly in the growth potential of all our businesses, and have continued to invest in them, particularly in sales and marketing, e-Commerce, Japan, warehouse facilities and information systems. We have continued to improve our gross margins, and have managed the cost base effectively, although there is a limit to the pressure we can place on costs without adversely impacting future growth. Stock has been reduced while maintaining our excellent service levels, and our cash generation has remained very positive. Net debt has consequently been reduced. Capital expenditure peaked last year and has reduced to £31.3m this year.

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

UK

RS UK	2003	2002
Sales (by destination)	£353.7m	£379.7m
Adjusted sales decline	(7.2)%	(7.6)%
Sales (by origin)	£366.9m	£393.0m
Adjusted sales decline	(7.0)%	(7.4)%
Contribution	£119.1m	£126.2m
Contribution %	32.5%	32.1%

RS UK had a sales decline of 7.0% (adjusted for trading days) to £366.9m, reflecting the continuing weakness of the manufacturing sector. UK sales in the second half declined by 4.7% (adjusted), and exited the year at a lower rate of decline. The UK business is firmly focused on returning to growth by broadening its customer base. Record numbers of new customers have been acquired in the more buoyant service sectors, offsetting losses in manufacturing through customers losing their jobs. Over the year the UK thereby maintained overall customer numbers. Sales to customers in the manufacturing sectors consequently declined most, but still accounted for over half of our total sales.

During the year we closed a specialised activity serving the troubled telecommunications and related sectors. The one-off costs of this withdrawal amounted to about £2.4m, of which £0.9m has been charged against RS UK contribution and £1.5m, related to stock, property and systems, against Process costs.

There are many initiatives in place to regain sales growth. We have increased the size of the sales force and the number of catalogues distributed to customers in the second half. Part of this additional investment is being directed to sectors where RS has traditionally been under-represented. These include the publicly funded sectors, including health. Currently, due to our historic sales and marketing focus, RS sells to only a fifth of all hospitals, but where we do have customers we have observed similar purchasing dynamics to customers in manufacturing. Also, a six month pilot demonstrated that hospitals buy across our entire product range, which reflects our experience in other service sectors.

Customer contact is ever more important and so the size of each sales territory has been reduced, and more sales people



Ian Mason
Group Chief Executive

recruited, which allows more time for customer acquisition and development activities. Although we have contracts in place with large organisations which have many end-users, our experience indicates that the key to obtaining value from such contracts is in accessing and serving the end-users themselves. In addition we opened two new trade counters in South Wales and Aberdeen, and rolled out our successful Managed Stock Replenishment programme, run from the trade counters, which manages customers' inventory requirements.

Increased targeting and distribution of the catalogue among potential customers has enhanced the visibility of our offer and of the value we bring. This should increase the pace of growth in the business as maintenance and development engineers across all sectors of the economy see and understand the relevance of our services. Our "nursery" programme is designed to ensure that once new customers have bought from us they increase their order frequency more quickly, and purchase more broadly across our product range. Our product range increased 2% over the year to 135,000.

e-Commerce continued its very strong performance, growing year on year at 45%, and now accounts for around 15% of sales, up from 10%. This success is driven by innovative improvements in functionality that focus on reducing our customers' costs. Success has been achieved across all sectors of the economy.

Despite lower sales and the investments made in the year, the UK contribution margin improved to 32.5% from 32.1% through continued active management of gross margin and control over local costs. Our RS UK business remains highly cash generative.

Exports from the UK to third party distributors and direct to overseas customers were flat against last year.

Rest of Europe

RS Rest of Europe	2003	2002
Sales	£224.3m	£210.7m
Adjusted sales growth	1.5%	4.1%
Contribution	£44.1m	£40.4m
Contribution %	19.7%	19.2%

Sales in Europe grew by 1.5% (adjusted for trading days and at constant exchange rates) to £224.3m, which is 30.2% of Group sales. Trading conditions in both halves were similar, though growth was slightly better in the second half. During the year we invested heavily in the region with capital expenditure on warehouses and systems. The contribution is stated after disruption costs of about £1.5m resulting from the relocation of our German warehouse. Excluding these one-off costs, the contribution margin would have been higher at 20.3%.

These results demonstrate our strategy in action (sales growth with improving contribution margins), even in difficult economic conditions. This improvement in contribution margin has again come through a combination of higher gross margin and tight management of costs. The higher gross margin reflects close attention to all elements of gross margin, not just our cost prices and selling prices: for example, we have reduced sales credits by reducing errors in customer product selection and order fulfilment. Through such actions we are also improving customer service.

Europe, excluding the United Kingdom, is managed on a regional basis to ensure greater cohesion between the businesses and to transfer best practice, in particular in selling and marketing activities.

This year was the first full year of trading in Rest of Europe from our higher functionality websites, and this has delivered excellent results. e-Commerce sales have more than doubled in the year to about 10% of total sales, and exited the year at over 12% of sales.

We believe firmly in the growth potential of all our businesses, and have continued to invest in them

Chief Executive's report (continued)

RS Rest of Europe – sales, customers and products	Adjusted sales growth (decline)	Increase in customers	Number of products
France	0.0%	1%	93,000
Germany	1.6%	0%	84,000
Italy	(0.2)%	2%	75,000
Smaller businesses	5.6%	2%	55,000

The performance of the larger businesses reflected the depressed economic conditions. Each of the businesses is pursuing initiatives to grow sales, without assuming any improvement in the economic backdrop.

In France, Germany and Italy there was also a lot of internal activity during the year.

The European systems project will be implemented first in June 2003 in **France**. During the year considerable time and effort has been spent by the French management team on ensuring that the implementation goes according to plan. Equally, attention is being focused on making sure that the substantial efficiency benefits and rewards from better customer service will be realised.

The relocation to the new warehouse in **Germany** was completed over the Christmas 2002 break. In the coming year our customers will experience enhanced service from this purpose-built facility. It is situated close to all major carrier hubs and will give us the ability to provide higher service levels (including later order cut-off) to support our growth in Germany and also in nearby countries.

RS Italy moved to a larger warehouse and offices last year and can now accommodate significant growth. Following extensive customer research, Italy changed the frequency of its catalogue from semi-annual to annual in September 2002, and at the same time increased the number of catalogues circulated by 40%. Though overall catalogue costs have been reduced, further investment was made in more responsive, shorter term marketing initiatives.

The **smaller businesses** had differing results. Spain continued to grow at a high rate throughout the year and moved to a larger warehouse facility. Elsewhere, Austria grew well, Scandinavia and Benelux grew, but more slowly than last year, whilst our business in Ireland returned to growth.

Despite the economic difficulties we have continued to invest in the future growth potential of our European businesses. These businesses are in an excellent position to return to strong sales growth when the upturn comes, with higher levels of contribution.

North America

Allied North America	2003	2002
Sales	£103.4m	£110.5m
Adjusted sales decline	(0.4)%	(27.6)%
Contribution	£14.4m	£15.9m
Contribution %	13.9%	14.4%

Sales of our Allied business in North America declined slightly (adjusted) to £103.4m. Allied returned to growth in the second half of the year at 4.3% growth year on year, and exited the year at a slightly higher rate. We believe that we have taken sales from the many small, local businesses that face increasing service and supply difficulties during the electronics cycle. Allied's customer base was flat over the year.

Gross margins of about 40% were similar to last year. The national sales-office branch network was maintained, while further front-end investments resulted in a planned increase in costs. For example, the catalogue underwent a number of improvements in May 2002 with the launch of the first colour edition, featuring a new buyers' guide and enhancements in layout and indexing. Customer service in the local sales branches is being improved by better staff training and will be further enhanced by the implementation of a new quote system, which



In 2003, Allied Electronics
in North America celebrates
75 years of excellent
service

in the pilot led to a substantial increase in bookings. An initiative to extend the product portfolio with maintenance-related products new to the Allied offer is under way. As a result, Allied's contribution on sales declined by 0.5 percentage points to 13.9%.

Sales over the internet improved again, to 7% of total sales.

Allied celebrates its 75th anniversary in 2003 and is in a strong position to continue its historical sales and profit successes in the future.

Japan

RS Japan	2003	2002
Sales	£11.3m	£9.0m
Adjusted sales growth	31.6%	15.3%
Contribution	(£3.3m)	(£4.7m)

Sales growth in Japan accelerated to 31.6% (adjusted), giving sales of £11.3m. The second half growth rate was 35.6%. This strong performance came in spite of the weak Japanese economy. The growth in the year was driven by the new e-Commerce functionality introduced in April 2002. The website is entirely in Japanese and is supported by dedicated local staff. Several major customers, particularly in the public sector, have been using the advanced buy-side functionality of the site and have found it a valuable tool in retaining control over purchasing while saving administrative costs. Since the launch of the new functionality, sales through e-Commerce have run at about one third of total sales, almost double the level of a year ago.

The product offer has been broadened, with the number of products increasing by 6% to 46,000. Health and safety, mechanical and electrical products are now offered in addition to electronics, as we build to the usual broad-range RS offer. This has also helped broaden the customer base, which grew by 12%, and the breadth of purchase of existing customers, so increasing average order frequency.

Customer-facing activities have been further strengthened with additional resource in sales and customer service. The success of RS in Japan and the value that Japanese engineers place on the RS service demonstrate the transferability and fundamental high value of the RS business model. Our view that the market potential is huge is reinforced by this year's results.

Losses of £3.3m were down from £4.7m last year despite the costs of moving the warehouse in August 2002 and launching the new internet capability in April 2002. We anticipate that the business will reach break-even on a month-by-month basis during the coming year.

Rest of World

RS Rest of World	2003	2002
Sales	£37.8m	£36.4m
Adjusted sales growth	5.7%	1.0%
Contribution	£2.4m	£0.2m
Contribution %	6.3%	0.5%

Sales in Rest of World grew by 5.7% (adjusted) to £37.8m. The second half grew slightly faster at 6.5%, and the businesses exited the year at a similar rate. Asia accounts for most of the sales in this segment.

Asia

Asia sales grew by 2.7% (adjusted), returning to growth in the second half of the year.

Sales in **North Asia** were down 0.7%, reflecting growth in China, but declines in Hong Kong and Taiwan.

Sales in China grew by 5.2% (adjusted), despite sales in the first half being adversely affected by the Chinese government putting in place new product safety compliance requirements on many categories of imports. Close co-operation with the authorities and our suppliers enabled us to mitigate the impact in the second half,



Our **European network** has got stronger. In 2003 we added new warehouses in Germany and Spain to our facilities in Corby, Nuneaton, Beauvais (France), Milan, Gmünd (Austria), Copenhagen, and Dublin

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though many products remained unavailable for sale. Second half growth was 11.5%. The April 2003 Chinese catalogue of 26,500 products is 100% compliant with the new requirements.

Hong Kong and Taiwan faced continuing difficult markets because of their dependence on world trade and electronics.

Sales in **South Asia** increased by 4.1% (adjusted), a sharp reversal of last year's 7.1% decline, as customers were acquired in the more buoyant sectors of the economies. The new enterprise business system being developed for Asia was implemented first in South Asia in March 2003 and is operating well.

Sales in **Australasia** increased by 4.7% (adjusted), so recovering from last year's small decline. The trade counter network in Australia was particularly effective, with improved promotions and layouts.

Other Markets

Sales in our other markets grew by 30.4% (adjusted), driven once more by impressively strong growth in South Africa.

e-Commerce

Sales over the internet were about 11% of total Group sales for the year and exited the year at about 13%. Sales were £79.3m, a growth of 55%. After extensive analysis, we now believe that a significant proportion of these sales is incremental, ranging from around 20% to 50% depending on the market.

The development costs of e-Commerce expensed in the year were just over £5m, similar to last year, and included the further development of the European Internet Trading Channel, its extension to Japan and the finalisation of PurchasingManager™.

The PurchasingManager™ programme was launched last year. This effective and adaptable e-Procurement package has been well received by customers and is in active use in 150 organisations across six countries. Our sales through this programme now match those through

third party e-Procurement packages, which we continue to support through our punch-out capability.

Importantly, we are also now in a position to launch new products on our websites before they appear in our catalogues, so that our customers always have access to the latest products.

Further developments continue to be worked on, including e-Invoicing and additional roll-outs.

Summary

Our strategy to realise the huge growth potential in the markets we serve has remained firm. Investments have continued to be made in support of this strategy. Operationally, we have again demonstrated good gross margin, cost and cash management. Despite the difficult trading of recent years we remain committed and confident about our future.



Ian Mason, Group Chief Executive



RS UK achieved a remarkable
 “treble” in the year: **ISO 14001**
 Environmental Management,
OHSAS 18001 Health & Safety
 Management Standards and
ISO 9001 Quality Management
 Standard accreditations