Financial review

Results

Turnover, profits and earnings

Key figures	2003	2002
Turnover	**£743.7m**	£759.6m
Operating profit*	**£102.1m**	£108.7m
Interest	**(£1.2m)**	(£3.2m)
Profit before tax*	**£100.9m**	£105.5m
Profit before tax	**£89.6m**	£93.5m
Earnings per share*	**16.5p**	17.3p
Earnings per share	**13.9p**	14.5p
Dividend per share	**17.0p**	15.9p

Key statistics	2003	2002
Gross margin %	**52.7%**	51.0%
Operating margin %*	**13.7%**	14.3%
Return on sales %*	**13.6%**	13.9%
Effective tax rate %*	**29.0%**	29.0%
PBT on net assets	**23.1%**	22.7%

Growth %	2003	2002
Turnover	**(2.1%)**	(7.8%)
Turnover – adjusted	**(2.6%)**	(7.7%)
Operating profit*	**(6.1%)**	(17.0%)
Profit before tax*	**(4.4%)**	(15.0%)
Earnings per share*	**(4.6%)**	(14.4%)
Dividend per share	**6.9%**	15.2%

*Before amortisation of goodwill

Group turnover declined by 2.1% (reported) to £743.7m. Before goodwill amortisation, operating profit fell 6.1% to £102.1m, profit before tax fell 4.4% to £100.9m and earnings per share fell 4.6% to 16.5p. After goodwill amortisation, earnings per share fell 4.1% to 13.9p.

The withdrawal from the specialist telecommunications supply activity in the United Kingdom announced at the half year depressed the year's sales and profits: this year sales were £4.1m compared to £7.9m last year, whilst the one-time withdrawal costs within operating profit were £2.4m, £0.4m less than anticipated.

Exchange rate movements had no material effect on our reported sales, but a positive effect on our reported operating profit. At constant (last year) exchange rates, sales would have been £0.1m higher and operating profit would have been £0.7m lower, a decline of 6.8% compared with the reported 6.1%. Adjusting sales for the number of trading days in the year as well as exchange rates gives an underlying sales decline of 2.6%.

The gross margin was 52.7%, which was up 1.7 percentage points on last year. In the first half the increase against the first half of last year was 2.5 percentage points to 52.6%, in the second half the increase was 0.9 percentage point to 52.8%. The substantial improvement reflects more active management of all the factors that determine the gross margin: selling prices and cost prices, product mix, column and customer discounts, sales credits and delivery charges. Small movements in each area have contributed to the overall increase. We believe that more progress is possible on each of the factors to increase gross margins further whilst improving customer service and supporting sales growth.

Operating margins (before amortisation of goodwill) declined to 13.7% from 14.3% for a number of reasons. First, the withdrawal costs of £2.4m noted above accounted for half the decline. Second, the warehouse relocation costs of £1.5m in Germany. Adjusting for these "one-off" costs, the operating margin would have been flat. Additionally, there were the increased costs of the European/Asian enterprise systems project of £2.7m. The increase in gross margin was largely offset by the profit impact of the lower sales and by increased selling and marketing costs.

Process costs were £74.6m or 10.0% of sales, compared to £69.3m and 9.1% respectively last year. Before the impact of projects, these costs are anticipated to flatten and then decline as a percentage of sales over time. In the year the European/Asian enterprise business systems project cost included in Process costs was £4.5m, up from £1.8m. We estimate that about 80% of the required capital expenditures for these projects have now been incurred. In the coming

Jeff Hewitt
Deputy Chairman and Group Finance Director

year the first implementation of the European project will take place and this will trigger higher depreciation charges. As the project rolls out, we anticipate that these charges will peak at £10m per year during the next two to three years, with approximately £5m arising next year. The development costs of e-Commerce within Processes were £5.1m, similar to last year. Within Processes, the withdrawal costs noted above were £1.5m. After adjusting for projects and withdrawal costs, Process costs grew by 1.6%.

"Strategic investments" have previously been identified where costs have been substantial and have been incurred ahead of sales. Investments in Japan, e-Commerce and China have in past years been so categorised. Japan losses are now much reduced, whilst the profits on incremental sales from e-Commerce are now significant and China is close to break-even. Hence "strategic investment" costs now just reflect Japan losses of £3.3m.

The interest charge of £1.2m was £2.0m lower than last year, mainly due to lower interest rates over the year. The tax rate of 29%, based on profit before tax and goodwill amortisation was the same as last year. In accordance with FRS 10, the £214.8m of goodwill that arose on the acquisition of Allied is being written off over 20 years. Taken together with the goodwill amortisation on another small prior year acquisition, the total goodwill amortisation in the year was £11.3m.

Profit before tax and after goodwill amortisation was £89.6m and the effective tax rate on this profit was 32.7%. After tax, the profit for the year amounted to £60.3m, down 4.1%.

Earnings per share before goodwill amortisation declined 4.6% to 16.5p from 17.3p; after goodwill amortisation the decline was 4.1% to 13.9p.

With the recommended final dividend of 11.75p per share, dividends rose 6.9% to 17.0p, which were not fully covered by earnings, as discussed in the Chairman's statement.

Cash flow and balance sheet

Cash flow	2003	2002*
Stocks	**£2.7m**	£29.0m
Debtors	**(£0.2m)**	£18.5m
Creditors	**£9.9m**	(£19.0m)
Working capital	**£12.4m**	£28.5m
Capital expenditure on fixed asset additions, including fixed asset accruals	**(£31.3m)**	(£47.2m)
Free cash flow	**£68.2m**	£76.3m
Net debt	**(£46.9m)**	(£53.0m)

Key statistics	2003	2002
Stock turn	**2.6**	2.7
Trade debtors days	**49.4**	50.8
Trade creditors days	**38.7**	33.7

*Excluding cash flows from Discontinued Operations

Operating cash flow remained very strong at £133.6m though down from £156.7m last year as stock levels, though lower, did not reduce as much as in last year. The operating cash flow was 131% of operating profit (before amortisation of goodwill).

Working capital cash inflows amounted to £12.4m compared to £28.5m last year. The main difference was the inflow on stocks of £2.7m compared to £29.0m last year. Whilst maintaining high service levels for customers, stock levels were again tightly and effectively managed throughout the year with the stock turn slightly down to 2.6x from 2.7x. Debtors recorded an outflow of £0.2m, compared to an inflow of £18.5m last year: trade debtor days were 49.4, down from 50.8 last year, reflecting tight credit management. The cash inflow on creditors of £9.9m reversed an outflow of £19.0m last year: trade creditor days were 38.7, five days higher than last year.

Capital expenditure on fixed assets additions (including accruals) was £31.3m, significantly lower than the £47.2m spent last year as the spending peak on information systems and warehouses has passed

We are investors in our businesses for the long term. The economic backdrop does not change our view on the Group's potential

Financial review (continued)

and this trend is expected to continue: capital expenditures in the coming year are estimated to be about £20m. The largest expenditure in this year has been £22.9m on information systems, of which £12.5m was part of the multi-year spend of over £50m on enterprise business systems.

After lower interest and tax payments of £1.2m and £31.5m respectively, free cash flow for the year remained robust at £68.2m, though down from £76.3m (of continuing operations) last year. The outflow on dividends was £70.6m, up from £62.7m last year. Exchange rate movements benefited net debt by £8.0m to give an overall decrease in net debt of £6.1m to £46.9m.

Gearing declined to 12.1% from 12.9% last year and interest cover (before amortisation of goodwill) increased to 85x from 34x.

Pensions

SSAP 24 remains the accounting standard applied to pensions as described in note 6 to the Accounts. The last full valuation of the UK defined benefit scheme was carried out as at 31 March 2001 and showed a surplus of £22.1m. The next triennial valuation is due as at 31 March 2004. However, approximate funding updates are carried out each year and as at 31 March 2002 the surplus had reduced to £11.1m. The results of the review at 31 March 2003 are not yet finalised, but the position will have deteriorated further, with the scheme now in deficit. Relative to many UK pension schemes, however, the statutory minimum funding position of the scheme remains good with a Minimum Funding Ratio estimated at between 120% and 125% as at 31 March 2003. The cost of the scheme in the year was £3.9m up from £3.6m last year, reflecting an increase in payroll. However, if current equity and bond values persist these costs will increase significantly after the next valuation. The Company will therefore consider during the year whether it might be appropriate to increase contributions.

After an evaluation of its long term pension arrangements in the UK, the defined benefit scheme was closed to new entrants as of 1 April 2003 with a new defined contribution scheme introduced for new employees.

Note 6 also indicates the effects FRS 17 (the proposed new UK pension accounting standard whose introduction has now been deferred) would have had if it had been adopted as our accounting standard. The relevant schemes in the Group are the UK defined benefit scheme and the much smaller defined benefit schemes in Ireland and Germany. Elsewhere the schemes are defined contribution. Under the FRS 17 rules the defined benefit schemes showed a combined deficit of £30.1m (net of deferred tax) compared to a surplus of £12.5m at the end of last year. Under FRS 17 the charge to profits arising from these schemes would have been £5.4m.

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 are 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 25 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

We now have **more catalogues** and **more salesmen** reaching **more customers**

flows internally. The Group is evaluating the potential effect of International Financial Reporting Standard 39 on its future currency hedging policies.

Over the course of the year, the Euro strengthened and the US Dollar weakened. In itself this increased 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.

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. This was particularly so of the US Dollar over the year as a large part of the debt of the Group is in US Dollars arising from the acquisition of Allied and the exchange rate movements relating to this debt offset the impact on underlying assets. Treasury guidelines are in place for reviewing the impact of translation exposures should there be any material changes. Note 25 to the Accounts summarises the financial assets and liabilities by major currencies at the year end.

Multi-country cash pooling has been now been fully implemented across the Group with our banks to ensure daily netting of almost all the Group's cash flows in all currencies with consequent improvements in liquidity and reduced interest costs.

At the year end the Group had net debt of £46.9m. Total debt was £73.6m, including £30.8m denominated in US Dollars, £28.7m in Yen and £14.1m in other currencies. Financial assets comprised short term investments of £23.8m and cash of £2.9m, which were largely in Euro deposits. The net interest charge was therefore low relative to net debt. 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 25 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 23.1%, up from 22.7% last year. These returns remain substantially higher than the Group's cost of capital.

Our total shareholder return over the year was down by 43.3%, driven by the share price decrease between the year ends, compared to the 29.8% reduction in the Allshare index. Providing attractive returns for our shareholders relative to the market over the long term remains the primary goal of our strategy.

Summary

We have continued to invest to implement our strategy despite the difficult trading conditions. We are investors in our businesses for the long term. Although the economic backdrop influences the time that will be required to realise the Group's potential, it does not change our view on its desirability or attainability. The characteristics of "The Prize" – high sales growth, good and improving profitability and excellent cash flow – make for a very attractive outlook.

Jeff Hewitt, Deputy Chairman and Group Finance Director