DOWTY ROTOL

CONFIDENTIAL TO DOWTY ROTOL EMPLOYEES

STOP PRESS

As you know, presentations have recently been made to all employees about the Company's results for the last financial year and our plans for the future. In this newsletter we have summarised the main points contained in the presentations.

The Board of Directors believe that communication of information to all employees is very important. For this reason we have arranged for the publication of last year's results much earlier than in the past and we intend to continue with this policy in the future.

The 1986/87 Results

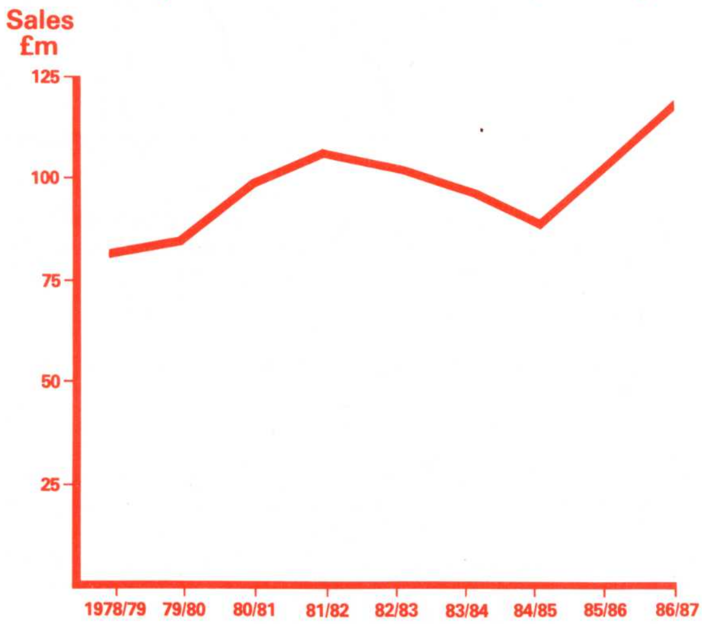
The figures below show the results we achieved in the financial year April 1986 to March 1987.

Sales	—	**£114 million**
Trading Profit	—	**£13.6 million**
Average Capital Employed	—	**£75.1 million**
Return on Capital Employed	—	**18.1%**

Sales

Graph 1 shows a comparison of our sales last year with the sales we have achieved since 1978/79. The figures are shown at 1987 price levels and therefore take account of inflation.

Graph 1 — Sales Record (1987 £)

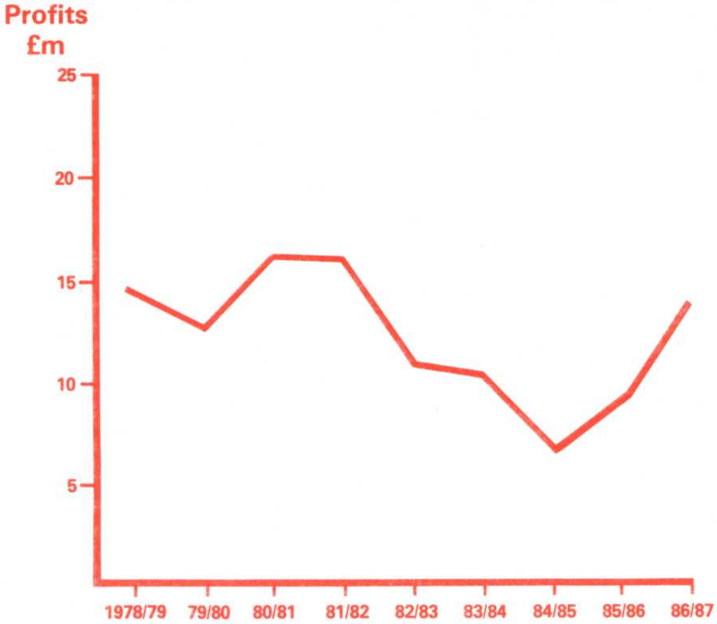


Our sales started to decline between 1981/82 and 1984/85 in line with the general recession in the aircraft industry. In the last two years sales have increased and in 1986/87 reached a record high of £114 million. This was due to higher sales of AV8B and Tornado and the start of the F50, F100 and A320 programmes.

Profit

Graph 2 shows our trading profit since 1978/79 with the figures again adjusted to take account of inflation. Out of our trading profit we have to pay interest on the money we have borrowed and government taxes.

Graph 2 — Profits Record (1987 £)



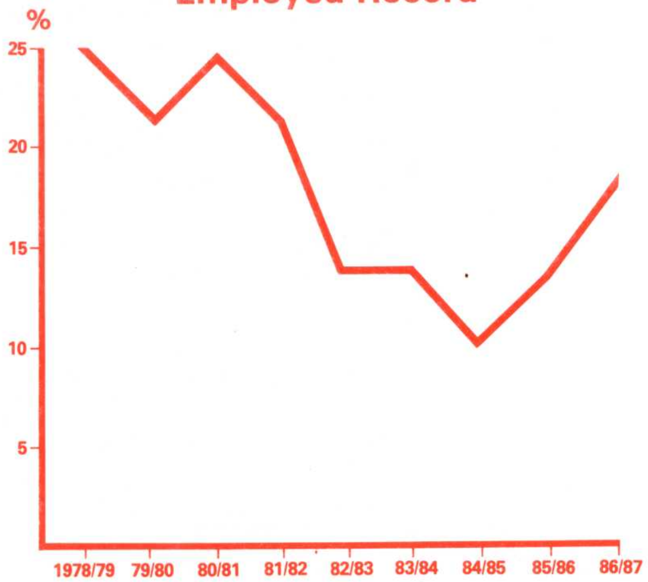
Between 1981/82 and 1984/5 our profits fell by 58%. During the same period our sales dropped by 16% but the number of employees fell by only 10%. The reason for this was that the Company spent a lot of money on the development of new projects and retained employees and their skills in order to secure the future.

In the last two years our profits have started to improve. The increase last year was assisted by certain one-off items that will not happen again. These included price increases from the M.O.D. relating to previous years sales and extra development funds for the A320 project paid for by the customer.

Return On Capital Employed

The amount of profit we make in "pound notes" is not a very good measure of how well we are performing because it does not take any account of how much money is used to produce the profit. The best measure of our performance and the way others judge us is our return on capital employed. The return is our trading profit. The capital employed is the amount of money being used by our business for such things as land, buildings, plant, machinery, stocks, and work-in-progress.

Graph 3 — Return on Capital Employed Record



Last year we made £13.6 million trading profit. Our average capital employed was £75.1 million. Therefore our return on capital employed was

$$\frac{£13.6 \text{ million}}{£75.1 \text{ million}} \times 100 = 18.1\%$$

Graph 3 shows how last years performance compared with previous years.

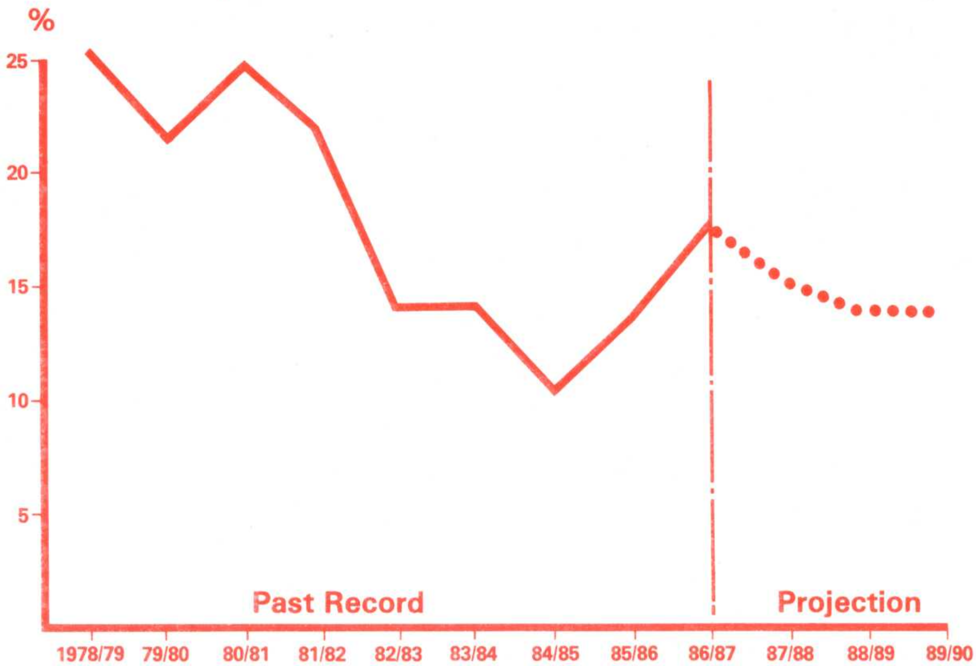
The last two years have shown a considerable improvement but we are still not back to the levels we achieved in 1981/82 and before.

It is very important to produce a good return on capital employed in order to be able to obtain funds to invest in our business. Dowty Rotol is currently investing £18 million pounds a year in plant, equipment, buildings, tooling and the development of new projects.

Prospects For The Future

We want Dowty Rotol to be a successful business that can compete with the best throughout the world and provide long-term security for the Company and its employees.
Graph 4 shows our best assessment of what will happen in the next three years to our return on capital employed if we carry on as we are.

Graph 4 — The 'Stand Still' R.O.C.E.



Far from the upward trend continuing we predict that our return on capital will start to fall and then remain at around 15%. This is well below the level which we must produce to secure the amount of investment we need to safeguard the future.

Why is it that the upward trend in the last two years will not continue?

There are several reasons. We do not predict any dramatic increase in our sales in the next few years. The amount of capital we employ is increasing and will reach £95 million by the end of March 1988. This is because of the amount of money we need to spend in order to develop new projects and the investment we need to make in buildings, plant and stock levels on projects we have recently won.

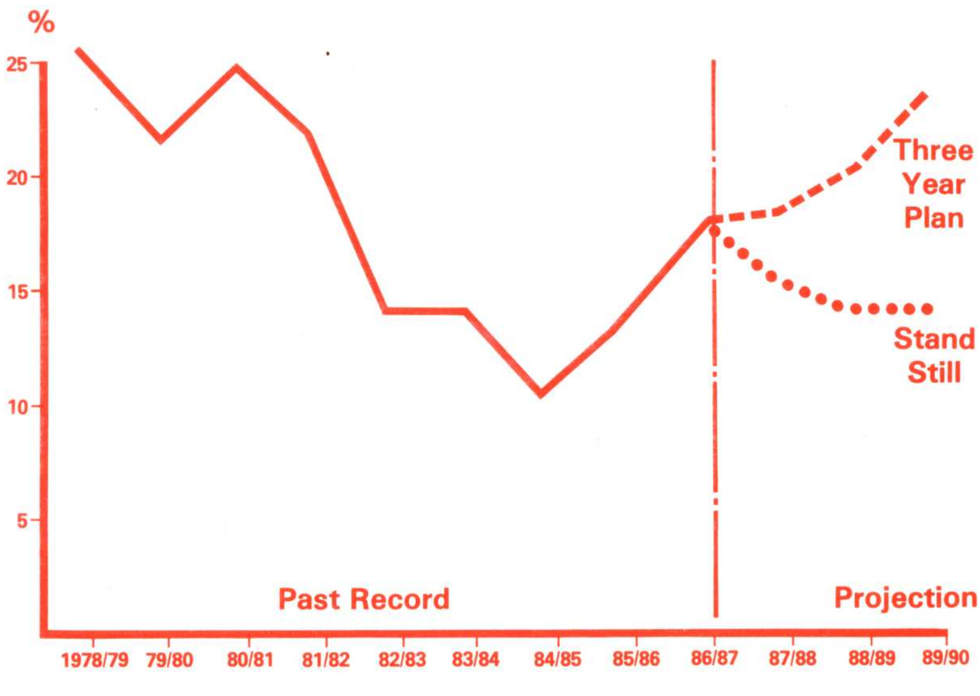
In addition to this there will be a reduction in some profitable contracts, which will be replaced by less profitable programmes. The fact is that it is becoming more and more difficult, with the increase in international competition, to obtain business which produces the same profit levels as in the past.

OUR TARGET — 25% RETURN ON CAPITAL EMPLOYED

We are aiming to increase our return on capital employed to 25%. In three years time we aim to reach 24% with an ongoing rate of 25% thereafter.

In graph 5 the broken line shows our targets over the next three years. The dotted line is what will happen if we carry on as we are.

Graph 5 — The Alternative Approaches — R.O.C.E.



Why do we need to reach this target?

• It will enable us to obtain the funds which we need to continue investing in the future of our business. The major long term projects we are interested in are the A320, GE Prop Fan, EFA, Boeing 7J7 and A330/A340. To successfully compete for these projects we have to be able to generate funds for new plant and equipment and pay for development costs.

• A strong company earning good profits is much less vulnerable to outside influences such as market shocks and downturns.

• A healthy profitable company is able to provide secure long-term employment.

It needs to be stressed that we are not attempting to reach an impossible target. We are simply trying to get back to where we were before the recession. Many other companies already achieve in excess of 25% return on capital employed.

The Way Forward

To reach our target we need to improve our efficiency and the way we operate in the following three ways.

Non-People Costs

We need to improve the way we control what we spend. We should also make sure that we look for greater value for money when we spend the Company's money. We can also eliminate waste by reducing scrap and rectification and improving energy conservation etc.

Manning Levels

We intend to reduce manning levels by 300 over the next two to three years.

This can be achieved without redundancies.

If we replace only half of those who leave over the next three years due to retirement and other reasons, we shall achieve this target.

How can we manage with less people:-

- **By removing inessential tasks and duplication of effort**
- **By working more effectively**
- **By greater flexibility**
- **By better training to improve the skill levels of employees**

Capital Employed

We do **not** want to reduce our capital employed by investing less in the Company. However we can reduce the amount of stocks and work-in-progress by:—

- **Better manufacturing planning**
- **Removing buffer stocks**
- **Improving supplier reliability**

Conclusion

- Last year's results were good but we need to do better in the future.
- Our target of 25% Return On Capital Employed will provide greater job security for the future.
- We need to ensure that we are better than the international competition.
- We can achieve the improvements we need without redundancies.
- We can reach our target.

If you have a question you would like to ask as a result of this newsletter or a presentation you attended please complete the enclosed slip and send it to the Personnel Department.