DOWTY ROTOL

CONFIDENTIAL TO DOWTY ROTOL EMPLOYEES

STOP PRESS

The 1988/89 Results

(Financial Year April 1988 to March 1989)

Sales	—	**£138.7 million**	**Average Capital Employed**	—	**£ 94.0 million**
Trading Profit	—	**£ 18.1 million**	**Return on Capital Employed**	—	**19.3%**

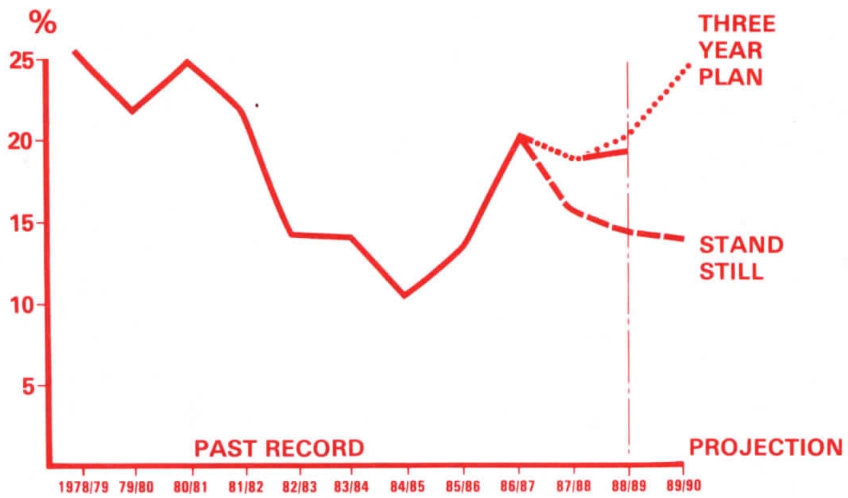
Sales last year reached a record level and were £9 million above our forecast mainly due to the increased customer demand for original equipment.

Trading Profit also increased last year but the increase was not as steep as the increase in sales. Two particular problems which we faced were the continued pressure from our customers to reduce prices and an increase in our warranty costs.

Average Capital Employed is the amount of money invested in our business in land, buildings, plant, machinery, stocks and work-in-progress. The figure shown is the average throughout the year and in fact our capital employed peaked at £97 million during the year then fell back as a result of the efforts put into reducing stocks and receivables.

Return on Capital Employed is our trading profit divided by the average capital employed. Last year's result was above our forecast of 18.1% and this means that there will be a payment through the payroll, to all eligible employees of £130 from our profit sharing scheme. This will be paid once our results have been audited.

Return on Capital Employed Record



The graph above shows our historical return on capital employed (solid line) up to and including 1988/89. The — — — — line shows the standstill level i.e. what would have happened if we had not taken steps to improve 2 years ago.

The • • • • line shows our three year plan targets.

Whilst we have made significant improvements above the standstill level, and beat our forecast last year, we fell short of our 3 year plan target.

The Three Year Plan

In April 1987 we set ourselves a 3 year plan with the aim of becoming better than our international competitors in terms of price, financial capabilities, and performance. We set a target of 25% ROCE and aimed to reach 24% by 1989/90.

Detailed below is an assessment of our performance in the first two years of the plan in our targeted improvement areas.

Non People Costs

In the first year of the plan we reduced our day to day running costs (excluding wages) by £400,000 and last year we made a further saving of £450,000. This is a good achievement but we can still do more to reduce waste and improve energy conservation.

We also need to concentrate on improving our purchasing. Last year we spent over £50 million on materials and other bought out items. A small percentage reduction in this area would help to boost our profits. This is not solely a task for the Buying Department but involves other parts of the company as well. Some of the actions we can take are:-

* **Design for ease of subcontract manufacture**
* **Avoid creating monopoly suppliers**
* **Give purchasing enough time to evaluate alternatives**
* **Collaborate with other Group companies to improve purchasing power**

Manning Levels

Our target was to reduce manning levels by 300 people over three years without redundancies. In the first 2 years of the plan the number of employees has reduced by 260 and so we are well on the way to achieving our target.

Capital Employed

As well as improving our return on capital employed by increasing our profits we can also reduce the amount of capital we employ.

However, we still need to invest in new plant and equipment and last year we invested a further £9 million on new plant and tooling.

We have managed to reduce the value of our stocks and work-in-progress through the introduction of MRP and there will be opportunities to make further improvements as the system is developed and linked to other computer systems in the company.

Another element which makes up our capital employed is receivables. This is the money owed to us by our customers for goods we have already delivered. We want to keep this item as low as possible to give us more cash to invest in our business. Whilst we did reduce our receivables last year it still takes, on average, 77 days for our customers to pay their bills and we need to focus more effort on further improvements in this area.

Prospects For 1989/90

Our sales forecast for 1989/90 is £149 million. We are forecasting a return on capital employed of 22.2% which is below our three year plan target of 24% and reflects the fact that the aerospace industry has become more competitive.

The particular problems which face us in the year ahead are:-

Price Increases

Our increases on A320 and several other large contracts will be only 3%. On our business as a whole we will not be getting an average of more than 4% to 4½%.

Interest Rates

High interest rates keep up the value of the pound and make it harder to sell our products in dollars. The dollars we get paid convert to less pounds and we effectively get a price reduction. This applies to 30% of our business.

Warranties

The high warranty costs we faced last year will be repeated in 1989/90.

Profit Sharing Scheme (1989/90)

Despite the problems we face it is possible for us to beat our forecast. The Board of Directors have decided to introduce a profit sharing scheme for 1989/90 based upon the principle of making lump sum payments for performance above our forecast return on capital employed. The rules of eligibility are the same as for last year's scheme.

Return On Capital Employed	Payment Per Employee
22%	—
23%	£150
24%	£300
25%	£450
26%	£600
27%	£750

Some of the ways we can all contribute to improving profitability are shown below:-

* **Questioning What We Do**
* **Improving Working Methods**
* **Improving Communications**
* **Improving Teamwork**
* **Improving Quality**
* **Improving Commercial Awareness**

Beyond The Three Year Plan

In the last two years we have made major improvements in our overall performance and we have been successful in winning new business.

However, we cannot afford to be complacent. To win new orders we have had to accept prices which mean we must further reduce our costs if we are to make an acceptable profit. On A330/340 it will take us until the end of the century to recover the money we have invested in this programme.

The performance of our competitors has also improved and our original target of 25% return on capital employed is no longer an acceptable long term goal. If we are to safeguard our future we need to set our sights higher and aim for more ambitious targets.

Airbus A330/340 main landing gear mock-up

Conclusion

* **We have made significant improvements in the first two years of the plan**
* **The performance of our competitors has also improved**
* **Prices for new orders mean we must make further cost reductions**
* **By working together we can achieve our targets**
* **In the longer term we need to set our sights higher**

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.